Business Law Update

Fall 2020

Business Perspectives

Looking Ahead

By Frank D. Chaiken, Practice Group Leader, Corporate Transactions & Securities

One of our great sages, Yogi Berra, supposedly said, "It's tough to make predictions, especially about the future." Then again, he also supposedly said, "I never said most of the things I said." However, assuming he did, he was right. In his inimitable way, the Bronx Bomber put his finger on one of the timeless truths.

In this edition of the *Business Law Update*:

- Tony Kuhel and Will Henry imagine what the M&A process may look like in 10 years' time (which will be here before we know it)
- Branwen Buckley and Nick Pullen cover the fast-developing field of transactional risk insurance
- Lindsay Karas Stencel outlines recent regulatory developments affecting investments in startup ventures
- Corby Baumann, David Forsh and Matthew Kerschner discuss a new judicial decision on the rights and potential fiduciary obligations of company shareholders in the bankruptcy context, with major implications for debtor/creditor relations going forward

Typically, we do not have a theme for each issue of this newsletter. Nonetheless, this collection of topics put me in mind of Berra's dictum about the unknowability of the future.

In 2008, *The New York Times* published a commentary by the late financial consultant and historian Peter Bernstein, quite near the end of his long career, entitled "What Happens if We're Wrong?" In that article Bernstein (quoting another author) asserts that "risk" means that more things can happen than will happen.

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For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

Bernstein continues:

> That is a fancy way of saying we don't know what will happen, but it is a useful formulation when we take up the task of risk management. If more things can happen than will happen, we can devise probabilities of possible outcomes, but – and this is a big 'but' – we will never know in advance the true range of outcomes we may face.

Bernstein was a prolific and thoughtful writer on the subject of risk. For anyone interested, his popular book *Against the Gods: The Remarkable Story of Risk* is worth the effort.

These days it seems that so many of the things that *can* happen actually *are* happening.

Business lawyers deal in risk all the time. In fact, if I had to pick two words that define what I work on most days, they would be "risk" and "justice."

Risk is what we help our clients manage on the front end of a transaction. Lawyers and the contracts we draw up for clients in a sense are the repository of everything that can go wrong in a deal, with clauses built up over time layer by layer based on experience. For example, from now on, the word "pandemic" will appear in most lawyers' standard contract clauses to be certain that an occurrence such as the COVID-19 pandemic is accounted for in the future. If you ever wanted to complain to your lawyer about why the contracts are so many pages, and getting longer all the time, there's your reason. Lawyers' creative imaginations for doom and gloom scenarios know no bounds.

All this comes at a price. Negotiating a detailed contract of a hundred pages or more certainly is more involved than one handwritten on the back of a dinner napkin. Another wise person once said that if the price were right, they would be happy to sign a blank dinner napkin to get the deal done. As with most things in life, one usually finds the happy medium. Other techniques for risk management include due diligence, insurance, escrows, liens and a variety of other legal instruments and techniques. In the end it is a matter of cost/benefit analysis, the amounts at stake, and differing levels of risk tolerance. As lawyers, one of the key elements of our client service approach is understanding each client's particular risk approach and expectations, so that we can align and tailor our work accordingly.

The other element—justice—at least in the context of business law—means assuring that one actually gets the benefit of the carefully crafted bargain. I will leave that as a topic for a later date.

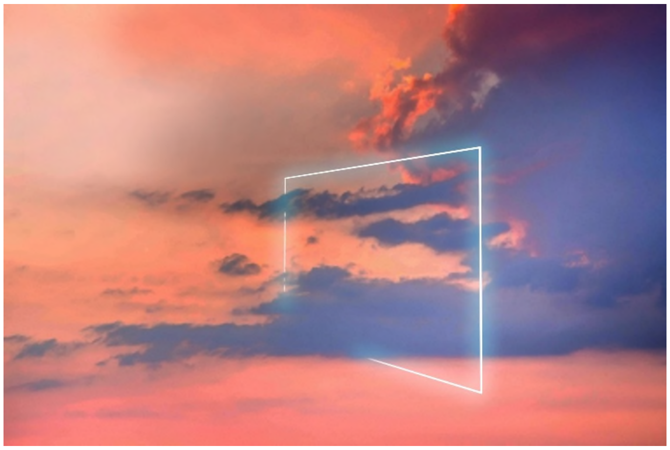
I hope you all are keeping well and enjoy this current issue of the *Business Law Update*.

Frank Chaiken leads the firm's highly regarded Corporate Transactions & Securities practice, which comprises more than 100 professionals who represent clients of all sizes across virtually every industry. If you have questions or would like to share your thoughts, please contact Frank at 312.998.4249 or Frank.Chaiken@ThompsonHine.com.

Mergers and Acquisitions

Back to the Future: What Will M&A Be Like in 2030?

By William M. Henry and Tony Kuhel



One of the nice things about writing an article that projects M&A—or really anything—10 years out into the future is that it's very easy to admit we'll be wrong about a lot of things. Nonetheless, it's an impossibly hard task, and as such, we limit ourselves to roughly 1,000 words on the subject. So, with that admission out of the way, let's be courageous and proceed with a few M&A-related predictions.

Volume – We can't predict this one, since we don't know if there'll be a recession or a bull market or some other material factor (pandemic or cyberattack, the latter of which is likely). How many deals get done in 2030 is, as at any time, a function of where we're at in the economic cycle and the presence of those unpredictable external factors. However, if history is any indication, we do think that it's unlikely a 10-year bull run will occur again.

Effects of Technology – The effects of technology have already started manifesting themselves (beyond the advent of email and virtual elimination of the fax machine), but will become predominant in three important ways: speed, routinization and buyer/seller differentiation. First, as to deal speed, software that has been developed in recent years—including diligence software that can review and summarize thousands of contracts in, remarkably, minutes—will first become the gold standard, then the default standard in M&A transactions, possibly well before 2030. As such, while diligence used to take anywhere from 30 to 120 days on average, the diligence—and thus, the transaction—period, will be significantly accelerated. We think also that software will extend to drafting of purchase agreements and other ancillary documents as programs will be developed (and we imagine is underway) allowing lawyers to simply "drop in" standard representations, warranties and covenants, possibly based on precedent from other similar recent transactions completed by each party. This technology will allow buyers and sellers to quickly identify issues particular to the current transaction and avoid multiple turns of documents to resolve points that are probably (certainly) not important in the minds of the clients. Second, and related, because of technology, routinization will occur that will remove a lot of emotionality from the negotiating process, as software will determine (1) when diligence is satisfactorily complete (informed initially with assistance of lawyerly judgment, but less so over time) and (2) eventually, if the purchase agreement balances risk sufficiently between the parties. Further, legal risk will additionally be reduced and instead, most of the transactional risk will not be on breaches of representations and warranties, but on accuracy of financial diligence (though we expect technology will soon pervade those areas, too). Third, buyers and sellers will be more meaningfully (far more than now) differentiated in the market on how regularly and successfully they use technology. Buyers that don't use diligence software will do transactions much more slowly than those who do, and will as a result commonly lose out. Likewise, sellers that don't use technology to sort through their files will be passed over in favor of sellers that do.

Industry Specificity – We think, as has been increasingly the case with infrastructure funds and specialized hedge funds, the concept of "industry verticals" will proliferate in the coming decade. Private equity funds will increasingly specialize in popular industries—which increasingly are health care and technology—and thereafter will fragment further, into sub-specialties like telemedicine, nanotechnology and other sub-specialties yet to be developed. Strategic acquirers will in turn focus more on deals that may have historically been considered "out of scope" with respect to their current businesses in the interest of expanding their business operations into the next burgeoning industry and taking advantage of popular verticals.

Lack of Effective Regulation – As we have started seeing in certain spheres—antitrust, health care, cryptocurrency and privacy—technology is developing at a rate that is beginning to exceed our ability to understand, and therefore regulate it. (We analogize it to our kids figuring out iPads faster than we do.) It will not be for lack of trying as (and in part depending upon electoral outcomes) it is likely governments will try their best to add regulations and oversight, but will find it impossible to effectively enforce those regulations in the face of rapid changes (and growth) in technology. As such, while we don't think technology will be a total wild west by 2030, we think that trend will continue as growth in artificial intelligence (AI), automation and nanotechnology (to name a few) continues to burgeon. Companies like Facebook, Amazon, Apple, Netflix and Google (colloquially known as FAANG) will lead this charge and other similarly situated companies will follow. From an M&A perspective, that means that while technology used to be a barrier to entry to deals (and to certain bidders), it will be less intimidating because as technology outpaces these regulations, regulatory risk inherent in these types of transactions will decrease as a relative matter. Additionally, on the antitrust side, as regulatory risk decreases, market consolidation will likely increase via large acquirers doing a bunch of smaller, mid-market deals. (In the legal industry, we have seen this trend of consolidation occur meaningfully since the great recession and it will continue.)

Role of Lawyers – So if technology is going to speed up and automate certain elements of deals, if deals become increasingly specialized and if companies are all going to end up getting owned by FAANG, where does that leave your trusty M&A lawyers? Well, while we won't make a Keynesian prediction that we'll all be working 20 hours a week and substituting our working time for leisure (we'll save that for a 2050 article), M&A lawyers will play three increasingly critical roles as we navigate the next 3,500 days: first, they will introduce, manage and translate technology for clients, especially those that are dubious that technology can manage meaningful phases of transactions. While AI can, for example, prepare a diligence chart, lawyers will need to confirm the chart's accuracy (at least initially) and translate significant findings to the client in non-legal jargon. Second, technology will not (again, at least in the short- and medium-term) replace judgment and strategic thinking, and lawyers that can differentiate themselves by simply not "relying on technology" to do their jobs will be at a premium, especially among more senior attorneys. For instance, while it is likely that programs will in the near-term be able to draft and revise significant portions of a purchase agreement, lawyers will need to interpret nuances in key provisions, advise clients on the pros and cons of the various flavors of these provisions being proposed by the other side, and engage in original drafting of hotly contested provisions (earn-outs, working capital and indemnity in particular) with a greater focus than ever before. Third, while the regulatory space will, as noted, become increasingly hard to manage, it won't be for lack of trying that regulators will try to impose regulations that are confusing and come down hard (make an example of!) certain clients. Therefore, M&A lawyers will need to issue-spot key areas of regulatory differentiation and highlight those to clients, connecting clients to relevant specialists as appropriate. In this area, we have already seen a booming increase in interest in data privacy and information security regulation, which was almost an afterthought in many an M&A transaction as recently as the mid-2010s.

The future is fundamentally the consequence of a continuum—and as such, many of the predictions we've made here are, in a sense, merely continuations of what we have seen. That part is almost a truism. The harder part is to appreciate just how quickly these trends will accelerate in the next 10 years, but it's going to be an amazing ride.

Please contact Will Henry or Tony Kuhel with any questions.

How Has COVID-19 Shaped the Transactional Insurance Markets?

By Branwen Buckley and Nick Pullen

Leading up to the global shutdown due to the novel coronavirus in the first quarter of 2020, the market for representation and warranty (R&W) insurance for M&A transactions was booming, with R&W insurers offering lower premiums and fewer exclusions than ever before due to strong competition in the insurance markets. However, the unprecedented economic impact of COVID-19 has forced insurers to re-think their approach to the R&W M&A market. Although the long-term impact of COVID-19 is not yet known, insurers have already begun to implement changes in coverage in order to limit their exposure to pandemic-related risk, while also looking to offer new insurance products aimed at emerging risk areas related to COVID-19. The increase in the volume of transactions involving distressed businesses has also resulted in a renewed focus on the use of R&W insurance and similar transactional insurance products in the distressed M&A space.

How Has COVID-19 Changed the R&W Policy?

COVID-19 Exclusions. In an attempt to mitigate their direct exposure to the fallout from COVID-19, insurance carriers have begun to regularly incorporate COVID-19-specific exclusions into R&W policies and nearly all indications of interest now have some form of proposed exclusion for these types of exposures. COVID-19 exclusions will often initially be quite broad and may specifically look to exclude any business interruption or any other loss arising out of, resulting from or to the extent it is increased by the presence of COVID-19.

When presented with a broad COVID-19 exclusion, M&A lawyers representing an insured party should be careful to try and narrow the language of the exclusion as much as possible. Otherwise, the insured party may be surprised after the fact by the insurer's ability to argue that a wide range of claims are not covered by the policy, even claims that may seem only tangentially related to COVID-19. A properly narrowed COVID-19 exclusion, however, would leave the client bearing only the risk associated with specifically identified aspects of the acquired business that have been directly impacted by COVID-19 (for example, supply chain issues, relationships with customers or labor matters).

Fortunately for insureds, as insurers have begun to become more comfortable doing business in a post-COVID-19 market, many insurers have demonstrated an increasing willingness to reduce the scope of the exclusion and, in limited cases, do away with it entirely. At least one market-leading insurer has largely opted out of such negotiations by replacing its initial broad exclusion with a much more limited exclusion focused primarily on losses related to the target's liability for exposing individuals to COVID-19. However, we note that this change to a more limited standard exclusion occurred in the context of a substantial premium increase implemented by the insurer.

Due Diligence Process. Transaction parties can expect increased scrutiny on any business areas susceptible to the likelihood of COVID-19-related disruptions and lack of adequate diligence in any of these areas will certainly result in specific policy exclusions and/or the insistence on a broad COVID-19 exclusion in the R&W policy. M&A lawyers will want to discuss any known impacts of COVID-19 on the target's business as well as any areas that have been identified as posing potential risks, including the magnitude of these matters, on the target's business. Beyond the relevancy of these matters to negotiations regarding any COVID-19 exclusion from the policy, the R&W insurers are likely to specifically ask about these issues during the course of any underwriting discussions and the transaction parties will also need to understand these issues in order to allocate risk associated with any final policy exclusions as between the buyer and seller(s).

Pricing. During the first quarter of 2020, premium rates for R&W insurance were at historic lows. There was some expectation at that time within the R&W market that the premium rates for R&W policies would eventually increase due to the inevitable rise in claims (and, in fact, this has turned out to be the case with the insurer noted above, whose premium increase was largely driven by its volume of historical claims). However, for the most part, premium rates have remained stable throughout the pandemic. This is most likely attributable to fewer M&A deals closing, which has increased competition among the insurance carriers over the remaining successful transactions, and it is anticipated that premium prices may eventually increase if there continues to be an upswing in R&W claims, especially as M&A deal volume returns to the levels that were seen prior to the impact of the pandemic.

PPP Loan Insurance

Entirely new insurance products have also emerged in the wake of the pandemic. Pursuant to the Coronavirus Aid, Relief, and Economic Security Act and subsequent legislation, the U.S. government instituted the Paycheck Protection Program (PPP), which enabled businesses to apply for loans to keep their workers on the payroll. Under the PPP, these loans would be forgiven by the Small Business Administration (SBA), so long as all employee retention criteria are met, and the funds are used for eligible expenses. At the time of the loan application, businesses are required to make certain certifications, one of which certifies that the economic uncertainty makes the loan necessary to support the ongoing operations of the loan recipient, which is known as the Necessity Certification. If a borrower is deemed to have falsified the Necessity Certification, the borrower can face steep fines and penalties. Additionally, in order to qualify for a PPP loan, a business may not have more than 500 employees, including all affiliates; however, the actual number of employees may be difficult for some businesses to ascertain, given the complex affiliation rules that apply. In response to these risks, certain insurance carriers are offering an insurance policy that will cover the risk that a business was ineligible to receive a PPP loan at the time it was granted, namely that the Necessity Certification was inaccurate when made, as well as certifications as to employee counts, taking into account the affiliation rules. The current premium rates for this type of policy have been approximately 4-5% of the policy amount plus a $30,000 underwriting fee and a $200,000 retention.

Distressed M&A

As expected, the pandemic and related market shutdown has led to an increased volume of distressed M&A deals, which is a trend that is widely expected to continue throughout the fall of 2020. Traditionally, R&W insurance was not likely to be used in distressed M&A transactions, but recently both insurers and M&A practitioners have begun to look more closely at the potential of obtaining R&W insurance and related transactional insurance products, such as successor liability insurance, in distressed M&A deals. Although the benefits of a R&W insurance policy (or another insurance product) will vary depending on the type of distressed transaction and the specific risks associated with the insured's business, these insurance products may offer buyers a solution to the issue of limited or non-existent post-closing recourse in distressed M&A transactions due to concerns regarding the creditworthiness of the sellers or the limitations associated with liquidation, receivership or sales conducted as part of bankruptcy process. This ability to obtain insurance may support the sellers' (or creditors') desire to maximize sale proceeds. As we see more distressed M&A deals close, we anticipate that there will be an increased use of transactional insurance products and an increased demand on insurers to offer products that address the unique issues raised by these types of transactions.

Please contact Branwen Buckley or Nick Pullen with any questions.

Venture Capital

Turning the Heat Back on in Venture Capital Investing
By Lindsay Karas Stencel

For nearly a decade, the Bank Holding Company Act (BHCA), specifically, the Volcker Rule, severely limited banks and banking entities' ability to invest in venture capital funds, effectively eliminating those entities' ability to invest in the very types of businesses that the BHCA originally sought to promote – small businesses, regional businesses and startups, which served to create jobs and spur innovation. The Volcker Rule, implemented following the Great Recession, sought to curtail the ability of banks to invest in perceived high-risk assets and classes of investment, like alternative investment vehicles. While the Volcker Rule never specifically called out venture capital funds as included in the Rule's definition of a "covered fund," the practical application of the Rule treated hedge funds, private equity funds and venture funds alike, permitting investments under the BHCA only in the instance of a statutory exclusion made pursuant to various implementing regulations, which were often punitively expensive or time-consuming for smaller venture capital fund managers, making them nearly impossible to implement in reality.

The unintended consequence of wrapping venture capital into this "covered fund" definition was to curtail investment by banks in earlier, smaller and often more localized venture capital funds that traditionally relied on institutional investors, such as banks and bank entities, to serve as larger limited partners in those funds, which not only increased the flow of capital to the region in which they were investing in those funds, but often attracted additional sources of investment capital for those venture funds. This resulted in many regions of the United States having difficulties raising early or smaller-sized venture funds, as the cost of seeking a permitted statutory exclusion, such as a Small Business Investment Company license, was often too burdensome, time-consuming and costly for smaller organizations. As a result, a chilling of venture capital investment in smaller, regional venture capital funds was occurring outside of the large venture capital hubs of New York and Palo Alto, which in turn, led to a strain on capital access for startups and small businesses outside of those hubs. The end result was reduced innovation and limited new industry development across the country.

On June 25, 2020, however, banks were informed that as of October 2020, they may reenter the realm of venture capital investing for funds meeting certain reduced requirements. In an unusual collective action taken by five federal agencies (Federal Reserve System, Department of the Treasury, Federal Deposit Insurance Corporation, Commodity Futures Trading Commission and the Securities and Exchange Commission (the "Five Agencies")), a new exclusion to the previously limiting "covered funds" definition was created for "qualifying venture capital funds." The new qualifying venture capital fund definition excludes funds that are defined in Rule 203(l)-1 and funds that do not engage in any activity that would constitute proprietary trading as if they were banking entities, meaning, most traditional venture capital firms will once again be eligible for bank investment.

The Five Agencies concluded that by permitting banks and bank entities to invest in qualifying venture capital funds, banks and bank entities could once again serve as foundational investors to support capital formation, job creation and economic development, particularly for small businesses and startups in regions outside of the major investment hubs. They surmised that the broader financial system would be improved if more capital was permitted to flow to small businesses and innovation. As such, beginning in October 2020, venture capital will again see banks and banking entities as potential investors, opening up new sources of capital, and turning the heat back on for innovation, economic development and new job creation across the previously chilled regions of the country.

The final changes to the Volcker Rule are slated for finalization and implementation on October 1, 2020.

Please contact Lindsay Karas Stencel with any questions.

Bankruptcy

Minority Shareholders Beware: Consent Rights May Trigger Fiduciary Duties

By David S. Forsh, Corby J. Baumann and Matthew Kerschner

Is a minority shareholder with consent rights over major corporate actions subject to fiduciary duties in exercising such rights? The Delaware bankruptcy court overseeing the pending Pace Industries bankruptcy case recently ruled that a minority shareholder with a consent right over a voluntary bankruptcy filing by the company was a controlling shareholder under Delaware law with associated fiduciary duties. This is the first such ruling and an adverse development for minority investor protections even outside of the bankruptcy context.

Constraints on Business Entities. Companies can have great flexibility under state law in determining their valid purposes and the scope of authority for directors or managers. Constraining that authority to tailor corporate governance or risk allocation can be in the best interests of the company or its owners under various circumstances.

Bankruptcy remote financing may be the most common example of such an arrangement. In these transactions, a special purpose entity is established as the borrower to operate under strict constraints with assets segregated from its affiliates. Lenders benefit from this structure through an improved borrower credit profile and a lower risk of bankruptcy, while borrowers benefit from significantly improved financing terms and availability. In addition, as companies look to raise capital from strategic partners and sophisticated investors, including through joint ventures, preferred stock investments, issuances of convertible or mezzanine debt, or private investment in public equity (PIPE) transactions, constraints on company actions that are considered fundamental to the operation of the business or the underlying investment are often bargained for and received by investors entering into a transaction with a non-controlled entity. These rights can take many forms but typically involve some combination of share classification, director or manager designations, supermajority or unanimous voting requirements for directors or managers, and explicit consent requirements for major corporate actions such as amendments to charter documents, capital raises, acquisitions, asset sales, or bankruptcy.

While the transaction structures may vary, approval rights (also referred to as consent rights, blocking rights or minority protective provisions) are included in the company's organizational documents or a shareholders' agreement in order to specifically limit the powers otherwise exercisable by the directors or managers of the company. This provides the investor with highly valuable or essential protections that are otherwise not available without majority ownership or actual control, and can benefit the company by attracting a wider pool of potential investors and improved funding terms.

Voluntary Bankruptcies & Consent Rights. As consent rights have become more commonplace, so have disputes over the validity of consent rights that restrict voluntary bankruptcy filings. On one hand, it is axiomatic that any eligible person may commence a voluntary bankruptcy case and that agreements by companies with creditors not to file for bankruptcy are not enforceable on public policy grounds. However, it is also axiomatic that the commencement of a voluntary bankruptcy case – as with any other corporate action – must be validly authorized, as determined by the charter documents and applicable state law.

There have been few decisions to date analyzing consent rights over voluntary bankruptcies. In general, such rights have not been enforced when held by creditors or by parties primarily motivated as creditors, but have been enforced when held by equity holders without creditor motivations. Notably, the only circuit court opinion on the issue held that federal public policy did not prevent a bona fide shareholder from exercising its blocking right over a voluntary bankruptcy petition even when the shareholder was also a creditor. *In re Franchise Servs. of N. Am., Inc.*, 891 F.3d 198 (5th Cir. 2018). After that decision, parties could have been reasonably confident that the charter document rights of equity owners acting in that capacity would be enforced. After all, if federal public policies do not void the blocking right of a shareholder who is also a creditor, surely federal public policies do not void the blocking right of a shareholder who is not a creditor.

The recent *Pace Industries* ruling is a significant setback for any such expectation. There, a minority shareholder of a Delaware corporation moved to dismiss the corporate bankruptcy that had been filed without its consent as required by the certificate of incorporation. The debtors objected, claiming that the blocking right was void on public policy grounds and that the shareholder was breaching its fiduciary duties by withholding its consent. In an oral ruling, the bankruptcy court denied the shareholder's motion, holding that the consent right was void on federal public policy grounds for interfering with the company's right to file bankruptcy and also that the minority shareholder would be a "controlling shareholder" with attendant fiduciary duties under Delaware law in exercising its consent right. Hearing Transcript, *In re Pace Industries, LLC, et al.*, No. 20-10927 (MFW), Docket No. 148 (Bankr. D. Del. May 5, 2020).

Fiduciary Duties & Controlling Minority Shareholders. Fiduciary duties are imposed on directors due to the "separation of legal control from beneficial ownership. Equitable principles act in those circumstances to protect those who are not in a position to protect themselves." *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998). Such concerns are not applicable for equity holders, and many LLC and LP statutes expressly authorize elimination of such duties. Even where such duties have not been expressly eliminated, shareholders are generally free to act in their own self-interest without fiduciary duties except for majority owners or others who control the company. Under some circumstances, "contractual rights, coupled with a significant equity position and other factors, will support the finding that a particular shareholder is, indeed, a 'controlling shareholder,' especially if those contractual rights are used to induce or to coerce the board of directors to approve (or refrain from approving) certain actions." *Superior Vision Servs. v. ReliaStar Life Ins. Co.*, No. 1668-N, 2006 Del. Ch. LEXIS 160 at *20 (Del. Ch. Aug. 25, 2006). For example, such circumstances were found in *Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs, LLC*, No. 11802-VCL, 2018 Del. Ch. LEXIS 222 (Del. Ch. Jul. 6, 2018), *aff'd*, 221 A.3d 100 (Del. 2019), where the minority shareholder exercised actual control by deliberately manipulating a blocking right to be on both sides of the transaction at issue. However, establishing actual control is a steep burden; courts have declined to find that a minority shareholder becomes a controlling shareholder with fiduciary duties by exercising its consent rights absent egregious circumstances such as those in *Basho*. The *Pace Industries* ruling runs counter to that orthodoxy, on the reasoning that the minority shareholder "controls" the corporation by its consent right and thereby has fiduciary duties.

While the *Pace Industries* ruling noted the debtors' financial constraints, the lack of viable alternatives offered by the minority shareholder, and the benefits of proceeding with the debtors' preferred course of action, similar arguments may be made for many other significant corporate decisions and transactions. It is not clear how such circumstances result in fiduciary duties without other action by the minority shareholder and the ruling does not provide guidance for evaluating when a minority shareholder may be deemed to have "control." While *Pace Industries* may have limited precedential impact as a bench ruling, and as a decision concerning the fiduciary duties for a corporation rather than for an entity where fiduciary duties have been validly eliminated under state law, its reasoning is potentially broadly applicable in a broad range of circumstances extending outside of bankruptcy. Minority investors with consent rights are left to wonder whether their specifically negotiated rights will be enforceable and whether they will be deemed to be controlling shareholders with fiduciary duties.

Future Battlegrounds. Borrowers, lenders and investors will continue exploring the substantial flexibility provided by state statutes to implement organizational structures providing the desired risk and governance characteristics. As this occurs, parties will continue testing the ability to enforce consent rights and otherwise restrict voluntary bankruptcy filings, and courts will continue to develop and apply the competing policies at issue.

Any such attempts should begin with the valid elimination or limitation under state law of fiduciary obligations for the person to make or consent to the relevant decision. Consent rights should be provided for in the applicable charter documents and not merely in a shareholders' agreement, in order to preserve the ultra vires argument rather than merely a breach of contract and specific performance issue.

To the extent possible, investors should seek to preserve or create direct claims against company officers, directors, other owners and lenders as to the validity and enforceability of the applicable consent rights, and damages for any breach.

Parties should be aware that consent rights are more likely to be upheld outside of bankruptcy court and in particular jurisdictions. Parties seeking to enforce consent rights may benefit from seeking declaratory relief on short notice in state or federal courts if it appears that such rights will not be honored by the company or by declining to consent to final adjudication by bankruptcy courts. In addition, charter documents could be drafted to include a provision requiring any voluntary bankruptcy to be commenced in (or outside of) a specific venue, or that disputes relating to that provision could be brought only in (or outside of) a specific venue. Alternatively, such a provision could refer all disputes relating to the exercise of a consent right to arbitration. While such provisions have yet to be tested, the validity of forum selection clauses in organizational documents have been approved in other contexts.

Conclusion. Borrowers, lenders and investors will continue to explore the substantial flexibility provided by state statutes to develop organizational structures with the desired risk allocations and corporate governance characteristics for mutual benefit. When considering performance or recoveries under various scenarios, parties should be aware that consent rights may be unenforceable in certain situations and mindful of the risk of becoming subject to fiduciary duties.

Please contact David Forsh, Corby Baumann or Matthew Kerschner with any questions.