UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE:	.	Chapter 11
	.	Case No. 20-10927(MFW)
PACE INDUSTRIES, LLC, et al,	.	
	.	824 Market Street
	.	Wilmington, Delaware 19801
Debtors.	.	
. . . .	.	Tuesday, May 5, 2020

TRANSCRIPT OF TELEPHONIC HEARING ON
MACQUARIE SEPTA (US) I, LLC'S MOTION FOR AN ORDER DISMISSING THE CHAPTER 11 CASES OF KPI IMMEDIATE HOLDINGS, INC., AND ITS DIRECT AND INDIRECT SUBSIDIARIES
BEFORE THE HONORABLE MARY F. WALRATH
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

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OFFICE OF THE U.S. TRUSTEE

(Appearances Continued)

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1 (Proceedings commence at 10:30 a.m.)

2 THE OPERATOR: And Her Honor has joined us.

3 THE COURT: Excuse me?

4 THE OPERATOR: Yes, Your Honor. My name is Cynthia
5 with CourtCall. I will assist you on the 10:30 calendar. We
6 do have your court clerk standing by --

7 THE COURT: Thank you.

8 THE OPERATORS: And your court deputy is in a
9 listen-only mode.

10 THE COURT: Thank you.

11 (Pause in proceedings)

12 THE COURT: Who is that?

13 (No verbal response)

14 THE COURT: Okay.

15 THE OPERATOR: Your law clerk Brandon has an un-
16 muted line, and James and Laurie have listen-only lines,
17 muted lines.

18 THE COURT: All right. Thank you.

19 THE OPERATOR: And Your Honor, just to keep you
20 updated on the time, I do show we're three minutes away from
21 the start of the calendar. Your judicial assistant Cathy has
22 joined us; she's in a listen-only mode, as well. And counsel
23 is still checking in.

24 THE COURT: All right. Yeah, I'm waiting for one
25 more person on June [sic], which is the U.S. Trustee's

1 Office.

2 THE OPERATOR: Okay.

3 THE COURT: Thank you.

4 THE OPERATOR: And Your Honor, we show we're one

5 minute away from the start of the calendar. Was there

6 someone in particular you were waiting on before we get

7 underway?

8 THE COURT: Yeah, we're waiting for the United

9 States Trustee's Office, David Buchbinder, who --

10 THE OPERATOR: Okay. And Mr. Buchbinder has

11 checked in.

12 THE COURT: On CourtCall.

13 THE OPERATOR: That is correct, yes.

14 THE COURT: All right. Well, let's start then and

15 I'll -- I thought he was going to be on Zoom, but --

16 THE OPERATOR: He has checked in --

17 THE COURT: -- let's just go ahead.

18 THE OPERATOR: -- through CourtCall. Yeah, he has

19 checked in on court -- through CourtCall, Your Honor.

20 THE COURT: All right. Well, maybe he's just going

21 to not speak then -- not be on Zoom. All right. You can

22 open up the line then. Thank you.

23 THE OPERATOR: Okay. What I'm going to do then is

24 I'm going to step away and start a record line, and then I

25 will come back to let you know that counsel is live. Okay?

1 Please stand by.
2 THE COURT: All right. Thank you.
3 THE OPERATOR: And Your Honor, counsel is live.
4 THE COURT: All right. Thank you.
5 Good morning. And thank you to everybody who's
6 participating, both on CourtCall and by Zoom.
7 Before we get started, I want to give my wishes to
8 everybody that everybody is still safe and handling the
9 pandemic appropriately. And I want to thank counsel who are
10 appearing on Zoom for getting out of their exercise gear and
11 getting in business attire. And I want to just assure you
12 that I'm using the headphones, so that I can hear the
13 arguments that will be made today without interruption.
14 So, with that said, we are here on the motion to
15 dismiss filed by Macquarie. And I'll turn it over, I guess,
16 to you, Mr. Krause. Are you going to present the argument?
17 (No verbal response)
18 THE COURT: Can everybody hear me?
19 MR. BOWDEN: Your Honor, it's Mr. Bowden at Ashby &
20 Geddes. I can hear you without any trouble whatsoever.
21 MR. KRAUSE: Judge, this is Jeffrey Krause. The
22 screen says your speaker is muted.
23 THE COURT: Yeah, the -- you all should be on
24 CourtCall, rather than speaking through Zoom, because we need
25 to record this. Are you all connected to CourtCall?

1 MR. CHENEY: Your Honor, this is Alex Cheney. Are
2 we supposed to dial in through CourtCall, as well?
3 THE COURT: Yes.
4 MR. BOWDEN: Yes.
5 THE COURT: Yes.
6 MR. CHENEY: (Indiscernible) thank you.
7 THE COURT: Yes.
8 MR. MORTON: Your Honor, this is Edmon Morton --
9 THE COURT: All right. I'll give the parties a
10 minute --
11 MR. MORTON: -- (indiscernible)
12 THE COURT: I'll give the parties a moment to do
13 that.
14 MR. MORTON: Yes. Thank you, Your Honor. This is
15 Ed Morton. I was going to suggest that same thing, if we can
16 just take a moment and let Mr. Krause and Mr. Cheney dial in
17 to CourtCall, so that the audio can work in that regard.
18 Thank you.
19 THE COURT: All right.
20 MR. MORTON: And Your Honor, one other thing, I
21 will just -- I'll just observe for the record while we're
22 waiting is that we also had scheduled today final
23 consideration of our NOL trading restriction motion. We were
24 able to present that on CNO and Your Honor has entered that
25 order.

1 The final thing I'll note is, I think, for purposes
2 of today, as you've surmised from Zoom, Alexander Cheney from
3 Willkie, Farr & Gallagher will be arguing our objection on
4 behalf of the debtors. And so I just -- you've already
5 entered a pro hac vice order for him. I just wanted to kind
6 of introduce him for purposes of the record today and not to
7 break up the flow of the hearing as we get to our portion of
8 the hearing.
9 THE COURT: All right. Thank you.
10 All right. Let me see. If those who are on Zoom
11 can give me a thumbs up if they are connected to CourtCall,
12 or when they get connected to CourtCall. If those on Zoom
13 can give me a thumbs up when they're connected to CourtCall.
14 (Pause in proceedings)
15 MR. BOWDEN: Your Honor, it's Mr. Bowden from
16 Macquarie. I'll send Mr. Krause an email now, in the event
17 he's having difficulty hearing you, to let him know to give
18 you the thumbs up when he's connected.
19 THE COURT: Okay.
20 MR. MORTON: And I'm doing the same thing for Mr.
21 Cheney. Your Honor, this is Ed Morton.
22 THE COURT: Okay. I got a thumbs up from Mr.
23 Cheney.
24 MR. MORTON: His quicker with his dialing fingers
25 than I am with my typing fingers.

1 (Pause in proceedings)

2 MR. HARRIS: Your Honor, it's Adam Harris from
3 Schulte Roth. Mr. Gussman, who's on the Zoom, may not have
4 independently set up a separate dial-in line through
5 CourtCall, so it may take him a minute to get through on
6 that.

7 MR. GUSSMAN: Your Honor, I have been able to join.
8 This is Bill Gussman from Schulte.

9 MR. HARRIS: Oh, hey, Bill. Great.

10 MR. GUSSMAN: I am now on.

11 MR. LANDIS: Your Honor, Adam Landis is here. I am
12 Delaware counsel, along with Mr. Harris and Mr. Gussman. We
13 did get them set up. I am on CourtCall. We filed a joinder
14 on behalf of TCW Asset Management, to the debtor's opposition
15 to Macquarie's motion to dismiss. Mr. Gussman will handle
16 it, handle the argument, and I'm going to remain on mute,
17 largely on CourtCall.

18 THE COURT: Okay.

19 MR. LANDIS: And Mr. Gussman has -- we moved his
20 admission pro hac vice, which Your Honor has entered.

21 THE COURT: I already have that. Is Mr. Krause on
22 CourtCall?

23 MR. BOWDEN: Your Honor, it's Mr. Bowden. I
24 understand that Mr. Krause is attempting to dial in through
25 CourtCall now, so, hopefully --

1 THE COURT: Okay.

2 MR. BOWDEN: -- he will be with us momentarily. I

3 apologize for the inconvenience.

4 THE COURT: How about Mr. Swett, on behalf of Bank

5 of Montreal, is he on CourtCall?

6 MR. SWETT: Thank you, Your Honor. I'm on both.

7 THE COURT: Okay. I don't know that Mr. Buchbinder

8 is. He is on. Okay.

9 THE OPERATOR: And Your Honor, Mr. Krause has

10 connected.

11 THE COURT: Okay. Good. We finally have everybody

12 on CourtCall, as well as those who are arguing on Zoom.

13 So, again, let's start. This is the Pace

14 Industries hearing, and this is the hearing on Macquarie's

15 motion to dismiss the case. I'm having some feedback on the

16 talking, so I hope everybody can hear me.

17 UNIDENTIFIED: We can hear you.

18 THE COURT: I'll ask that the --

19 UNIDENTIFIED: Yes, Your Honor. You're --

20 THE COURT: Put the --

21 UNIDENTIFIED: You're fine on our end.

22 THE COURT: Cynthia, could you mute all the lines,

23 except Mr. Krause, Mr. Cheney, Mr. Buchbinder, Mr. Gussman,

24 and Mr. Swett. And I'll ask them to not talk over each

25 other.

1 THE OPERATOR: Very good.
2 THE COURT: Thank you.
3 All right. I guess it's Mr. Krause. I'll turn it
4 over to you.
5 MR. KRAUSE: Thank you, Your Honor. Good morning.
6 Jeffrey Krause of Gibson Dunn on behalf of Macquarie Septa,
7 the preferred shareholders and movant.
8 Macquarie is not a creditor in this case; it's a
9 preferred shareholder. The Series A preferred shareholders
10 invested $37 million and, at the time, negotiated provisions
11 in the certificate, including Section 6.1.3, that limited the
12 authority of the board to file Chapter 11 cases. The board
13 ultimately decided that it was not bound by those limitations
14 and filed the Chapter 11 petitions without the consent of the
15 Series A preferred shareholders. None of that is disputed.
16 That means the questions that the motion to dismiss
17 presents for the Court are whether public policy somehow
18 voids a provision that limits what shareholders can consent
19 to. Does the consent alone make Macquarie a minority
20 shareholder, despite authority directly to the contrary and
21 no authority that says that it does? Can this Court exercise
22 jurisdiction, even though the petitions were not authorized?
23 And finally, does the fact that the secured lenders have
24 threatened to file an involuntary petition if the Court
25 recognizes the lack of authority of the directors and the

1 lack of jurisdiction of the Court because of that lack of
2 authority; does that somehow imbue the directors with
3 authority they do not have?
4 Your Honor, this is not the first case to deal with
5 these issues. We cited multiple cases in our motion that say
6 that an equity holders, as distinguished from a creditor, can
7 retain authority in the certificate to consent to the filing
8 of a bankruptcy proceeding? Franchise Services of North
9 America, Global Shipping, NNN 123 North Wacker all hold that
10 a shareholders or member of a limited liability company can
11 retain the authority to make the decision whether or not a
12 bankruptcy proceed should be filed.
13 These are consistent with Delaware Courts that have
14 said that the parties have freedom of contract in deciding on
15 the terms of the articles of incorporation and the
16 certificates. Indeed, the Jones case, Your Honor, which the
17 debtors tried to distinguish, specifically said Delaware
18 Courts -- or excuse me -- Delaware's corporate statute is
19 widely regarded as the most flexible in the nation. And it
20 stated the purpose of Section 141, to allow -- which allows
21 limitations in the articles on what the directors can do is:
22 "-- to permit (absent some conflict with Delaware
23 public policy) certificate provisions to withdraw
24 authority from the board."
25 There's no question this is permissible under

1 Delaware law. There's no question it's been permitted by the
2 Bankruptcy Courts that have addressed the issue.
3 The debtor cites multiple cases in an effort to
4 say, well, there are some cases that have held that the
5 articles or the certificate cannot limit the power of the
6 board to file a voluntary bankruptcy petition. All of those
7 cases are easily distinguishable.
8 Quad-C, which is one of the cases they rely on,
9 there was actual a super majority vote of the shareholders to
10 file the petition. The question was all of the stock had
11 been validly issued. And the Court said it didn't need to
12 get into that, the shareholders had voted for the filing.
13 In American Globus, one of the shareholders had
14 ignored the requirement of unanimity for the board to act --
15 or for the shareholders to act when it liquidated the
16 company, closed the doors, and paid itself preferences. The
17 other shareholder filed a bankruptcy petition. And the
18 shareholder who had completely disregarded the unanimity
19 provision said, oh, now the unanimity provisions apply, and
20 the Court said it couldn't have it both ways.
21 Intervention and Lake Michigan, which they rely on,
22 are the classic "give the creditor a golden share."
23 Intervention, the creditor paid one dollar for one membership
24 interest out of 22 million. In Lake Michigan, the membership
25 interest actually didn't have any economic interest; no right

1 in profits, no right in losses. These are the only cases the
2 debtor has been able to cite for the proposition that a
3 limitation on the powers of the board in the certificate is
4 not binding. Those cases involved creditors seeking a golden
5 shares, as the Court in the Fifth Circuit held in Franchise
6 Services of North America.

7 So, Your Honor, we respectfully submit that there
8 is no case authority supporting the debtors' proposition that
9 there's a limitation on the ability of shareholders,
10 sophisticated parties investing millions of dollars, to agree
11 in the certificate on the power of the board to file a
12 proceeding.

13 So the next question I'd like to address is: Does
14 that power, in and of itself, make a minority shareholder a
15 controlling minority shareholder who is a fiduciary. Your
16 Honor, we've cited Delaware Chancery Court cases that say it
17 does not. Franchise Services Company of North America, on
18 almost identical facts, says it does not.

19 And the debtors cite one case for the proposition
20 maybe it does, which is the Basho case. But they completely
21 ignore what the Court in Basho actually said. I think there
22 are two quotes from the Basho opinion that demonstrate how
23 far the debtors have gone in their attempt to void a
24 provision that is valid under Delaware law.

25 The first, the Court said, and I quote:

1 "A blocking right, standing alone, is highly
2 unlikely to support either a finding or reasonable
3 inference of control."
4 And Your Honor, the Court went on to say -- and
5 this is pretty remarkable -- the Court didn't want anyone to
6 read the Basho opinion in exactly the way the debtors ask you
7 to read the opinion now. The Court said:
8 "Lest readers fear that this decision heightened
9 risk for venture capital firms who exercise their
10 consent rights, I reiterate, a finding of control
11 requires a fact-specific analysis of multiple
12 factors. If preferred shareholder only had
13 exercised its consent right, that fact alone would
14 not have supported a finding of control."
15 So, Your Honor, in this case, like in Franchise
16 Services of North America, the fact that the board filed
17 without getting Macquarie's consent demonstrates beyond any
18 argument Macquarie didn't control the board. That's what
19 makes a minority shareholders a minority controlling
20 shareholder and imposed fiduciary duties.
21 Your Honor, the next issue I would like to address
22 is the debtors' argument that it's not really jurisdictional.
23 Even if the people who purported to file the bankruptcy
24 proceeding didn't have authority to file the bankruptcy
25 proceeding, this Court can keep the case because the debtor

1 really needs relief. Your Honor, the Supreme Court has said
2 that is not true. The Supreme Court said, in Price v.
3 Gurney, if the Court concludes that the people who filed the
4 petition did not have authority, it has no alternative, it
5 must dismiss the case.
6 They say that Price v. Gurney didn't deal with a --
7 in their footnote, they quote "invalid blocking rights."
8 That is a circular argument. They're saying the rights are
9 invalid; therefore, they're invalid; therefore, they have
10 authority. The problem for the debtors is that all of the
11 case law actually dealing with the issue says that the rights
12 are valid. So, if they are valid blocking rights or consent
13 rights, the debtor had no authority to file. Price v.
14 Gurney, Franchise Services of North America say the Court has
15 no alternative to -- but to dismiss the case.
16 Your Honor, the debtors say but we really need
17 Chapter 11. Separate and apart from whether or not that's
18 true -- because many of the things the debtors and the
19 secured lenders propose to do in the plan, the debtors and
20 the secured lenders could do outside of the case -- they're
21 un-impairing other unsecured creditors. They're
22 restructuring the secured debt, which they could do out of
23 court. The one thing they're doing that they couldn't do out
24 of court is wiping out the interests of my client for no
25 consideration, without providing it with any opportunity to

1 participate in the process. But with respect to all of the
2 other things they're doing, they could do those things out of
3 court. So maybe they don't really need Chapter 11.
4 But the Supreme Court addressed that issue, too.
5 In Price v. Gurney, the debtor said -- or the petitioning
6 party said we really need this proceeding to benefit all
7 parties. And the Supreme Court said:
8 "Respondents may have a meritorious case for
9 relief. On that, we intimate no opinion. But if
10 they are to be allowed to put their corporation
11 into bankruptcy, they must present credentials to
12 the Bankruptcy Court showing their authority."
13 The debtors have not done that. The board did not
14 have authority. The Supreme Court and the Fifth Circuit have
15 both said dismissal is mandatory.
16 Your Honor, the lenders then say, well, there's no
17 point in dismissing the case because, if you dismiss the
18 voluntary, we'll just file an involuntary. Well, Your Honor,
19 I don't know if they will or they will not file an
20 involuntary. I know they (indiscernible) against the
21 ultimate parent because it's not an obligor under the pre-
22 petition loan documents and it's giving releases to
23 shareholders and insiders under the plan. I don't know if
24 they will. They haven't. And the issues that an involuntary
25 might present are not before the Court today.

1 But Your Honor, an involuntary would present
2 issues:
3 Are the debtors generally paying their debts as
4 they come due? The plan is providing for unimpairment of all
5 the unsecured creditors.
6 If the debtors are not generally paying their debts
7 as they come due, are the guarantee claims against multiple
8 of the debtors not contingent?
9 Are the claims that are secured by all of the
10 assets of the debtors indisputably unsecured up to at least a
11 certain dollar amount? And the secured lenders try and get
12 around that requirement by saying, well, we'll just waive
13 $15,000 of our collateral. The secured lenders in Taburna
14 tried that, and the Court dismissed the case as having been
15 filed improperly.
16 And the secured lenders seem to say the directors
17 will collude with us to actually consent to the entry of an
18 order for relief, once we file the involuntary petition. And
19 Your Honor, that's exactly what Global Shipping said is a bad
20 faith filing.
21 So those issues aren't before the Court. They
22 haven't filed the involuntary petition. But an involuntary
23 petition is not an automatic slam dunk there would be in
24 order for relief. If they filed that petition, the Court and
25 the parties would have to deal with the issues that petition

1 raises. They haven't filed that petition. The petition
2 that's been filed is a voluntary petition, approved only by
3 the directors who, under the certificate, clearly had no
4 authority to file the petition. And the Supreme Court has
5 said, if the Court finds that those who purport to act on
6 behalf of the corporation have not been granted authority by
7 local law to institute the proceedings, it has no
8 alternative, no alternative but to dismiss the petition.
9 So, Your Honor, we respectfully request that the
10 Court grant the motion to dismiss. And I'm happy to answer
11 any questions the Court has or to respond to counsel. I'm
12 not quite used to the telephonic and Zoom appearances, but
13 I'm happy to answer any questions the Court may have.
14 THE COURT: I have none at this time. So I'll turn
15 it over to -- who wants to go first? Mr. Cheney.
16 MR. CHENEY: (indiscernible) Your Honor. Can you
17 hear me?
18 THE COURT: I can.
19 MR. CHENEY: Great. Good morning, Your Honor.
20 Alex Cheney from Willkie, Farr & Gallagher on behalf of the
21 debtors.
22 I want to start by focusing on why it is Macquarie
23 says it's refusing to consent to these bankruptcy proceedings
24 because I think that's critical to the Court's analysis.
25 First, it says it has certain objections to the

1 prepackaged plan. That's easy to address. The Court can
2 address any objections Macquarie has to the plan at
3 confirmation.
4 Second, it says that it wants a seat at the table,
5 that it wants to be involved in deciding the future for the
6 company, or that it wants to be involved in the process, but
7 it hasn't submitted any evidence that it's been shut out of
8 that process. And in fact, Macquarie does not want a seat at
9 the table. It doesn't even identify any other viable options
10 for the debtors. Instead, it wants ultimate authority to
11 decide whether the company can file for bankruptcy. And it
12 says that the interests of the company are totally
13 irrelevant.
14 So what we (indiscernible) is a company that's out
15 of money, that's unable to pay its debts. The company has
16 been forced to close facilities and terminate a substantial
17 portion of its (indiscernible)
18 THE COURT: I think you've been cut off. Is
19 CourtCall on?
20 THE OPERATOR: Yes, Your Honor. This is CourtCall.
21 Mr. Cheney does have an active line, but I'm not hearing him.
22 THE COURT: Yeah. Mr. Cheney, can you speak a
23 little bit? And let's see what the issue is.
24 MR. CHENEY: Yeah. Can you hear me?
25 THE COURT: Yes.

1 MR. CHENEY: Oh (indiscernible)
2 THE COURT: Maybe closer.
3 MR. CHENEY: Thank you, Your Honor.
4 So what we have here is a company that's out of
5 money, it's unable to pay its debts. The company has been
6 forced to close facilities and terminate a substantial
7 portion of its workforce as a result of the pandemic. We
8 have fiduciaries, the directors of the company, who have
9 determined that these cases are in the company's best
10 interests. And we have a minority shareholder who claims
11 that none of that matters.
12 And we make the point in our papers, Your Honor,
13 that Macquarie is doing this just to gain leverage in
14 negotiations with the debtors' lenders, and it does not
15 dispute that. More to the point, Macquarie is threatening to
16 force a foreclosure, so that it can try to get something in
17 negotiations that it would not get under the Bankruptcy Code
18 or in a foreclosure action. Allowing Macquarie to abuse its
19 consent right in this fashion is contrary to Delaware law and
20 federal public policy.
21 Now I'll start with Delaware law, Your Honor.
22 Macquarie says that there's no question that this blocking
23 right is permitted. That's not actually the case. As far as
24 we know, no Delaware State Court has even addressed the
25 legality of this kind of blocking right in this contest.

1 This is a matter of first impression.
2 And while the DTCL [sic] is flexible, we do think
3 that Delaware Courts would put some limits on exercising this
4 kind of blocking right in this context. And we see that in
5 the Basho case. The Basho Court explained that Delaware law
6 imposes fiduciary obligations on minority shareholders when
7 they can control a particular transaction.
8 Now Macquarie argues that consent rights alone do
9 not create fiduciary obligations. While that may be true in
10 the context of a typical corporate transaction, the decision
11 of whether or not to file for bankruptcy is not a typical
12 transaction. That decision is often a last resort. And
13 having a blocking right in that context gives the shareholder
14 an extraordinary level of control over the company.
15 And the Basho case made clear that that context
16 matters. In that case, the blocking right gave the
17 shareholder the ability to cut off the company's access to
18 capital. And the Court said that, typically, this right
19 alone would be indicative of control if the company had
20 multiple sources of capital. But the Basho company was not
21 in that situation. It was a cash-burning company and it was
22 light on assets. And I want to quote what the Court said
23 here because I think it's very important. It said, quote:
24 "For a company like Basho, the parties that control
25 its access to cash sit on the company's lifeline,

1 with the ability to turn it on or off. When cash
2 is like oxygen, self-interested steps to choke off
3 the air supply provide a strong indicator of
4 control."
5 And that's at Page 29.
6 Now, for a company like Pace, Chapter 11 is the
7 company's lifeline. And Macquarie says it alone can cut it
8 off. That level of control renders Macquarie a fiduciary,
9 with the obligation to consider the company's best interests.
10 In any event, Your Honor, the Court need not decide
11 this matter of first impression under Delaware law because,
12 even if Macquarie is not a fiduciary, the outcome is the
13 same. And that is because federal public policy does not
14 permit Macquarie to exercise its blocking right in the way
15 it's doing here. And we know this from the Intervention
16 Energy and Lake Michigan cases.
17 The Intervention Energy case is the only decision
18 from this Court addressing these types of blocking rights.
19 And what the Court found problematic about the blocking right
20 in that case were a list of things:
21 One, the blocking right was obtained by contract;
22 Two, it gave single minority shareholder the
23 ultimate authority to file for bankruptcy;
24 And, three, the shareholder had no obligation to
25 consider the company's best interests.

1 Those same facts exist here. Now it is true that
2 the shareholder in that case was also a lender. But that was
3 just one factor in the Court's analysis.
4 And Macquarie has not cited any authority -- and
5 we're not aware of any -- saying that these public policy
6 concerns that are raised by blocking rights in this context
7 are only implicated when a lender exercising the blocking
8 right. That would be an extraordinarily narrow reading of
9 the important public policies ensuring that companies have
10 access to bankruptcy relief when needed.
11 So what the Court must do here is determine whether
12 Macquarie's exercise of its blocking right conflicts with the
13 company's constitutional right to seek bankruptcy relief.
14 Under the circumstances of this case, Your Honor, it does
15 conflict; and it's, therefore, void. It cuts off the
16 company's right to seek bankruptcy relief completely.
17 Again, Macquarie does not dispute the company needs
18 bankruptcy relief. It does not identify any other viable
19 options for these companies. And Macquarie does not dispute
20 that it is trying to block these cases, so that it can gain
21 leverage in negotiations with lenders, or that a dismissal
22 will harm the debtors.
23 As the Intervention Energy and Lake Michigan cases
24 tell us, this kind of self-interested exercise of a blocking
25 right at the expense of the debtor offends public policy.

1 And the reason for that is simple, Your Honor. Unless the
2 parties who are deciding whether or not the company will file
3 for bankruptcy are compelled to consider the company's best
4 interests, there is nothing protecting the company's
5 constitutional right to seek bankruptcy relief. Otherwise,
6 the right really becomes subject to the whim and interests of
7 a third party, who may not care if the company is driven into
8 the ground.
9 Now Macquarie relies heavily on the Fifth Circuit's
10 decision in the Franchise Services case. And I'll make three
11 points about that case, Your Honor:
12 First, the Court's holding regarding the
13 lender/shareholder distinction is actually quite limited. It
14 held that a blocking right held by a shareholder is not void
15 just because the shareholder is also a lender. That's not at
16 issue here.
17 And on the issue of whether the shareholder must
18 consider the interests of the company, with all due respect
19 to the Fifth Circuit, we think the Court got it wrong. It --
20 the Court's decision is not consistent with Delaware law, as
21 stated in Basho, or with federal public policy, as stated in
22 this Court's decision in Intervention Energy or in the Lake
23 Michigan case.
24 And finally, what the fifth -- the Fifth Circuit
25 said that, even if this exercise of a blocking right

1 constituted a breach of fiduciary duty, the proper remedy is
2 a state law claim, not denial of the motion to dismiss. But
3 I think that really misconstrues what the Court's rule is
4 here.
5 The Court is not searching for the appropriate
6 remedy for a state law breach of fiduciary duty claim. It's
7 determining whether or not the exercise of the blocking right
8 in this context comports with public policy. And if the
9 shareholders completely disregards the company's interests in
10 exercising this blocking right and disregards that exercising
11 its blocking right is going to harm the company when the
12 company has no other options, we submit that is -- that does
13 offend federal public policy, Your Honor.
14 Now Mr. Krause mentioned the Quad-C and American
15 Globus cases, Your Honor, and tried to distinguish those.
16 Your Honor, what those cases tell us is that courts do have
17 the discretion to overlook defects in authorization for
18 filings when it's supported by law or equity, as is the case
19 here.
20 And Mr. Krause also discussed the Price v. Gurney
21 case. Your Honor, that really has very little application
22 here. It has nothing to do with federal public policy
23 concerns or consent rights. In that case, a shareholder
24 tried to commence a Chapter 10 case, which it's not permitted
25 to do under the Bankruptcy Code; and the Court found that,

1 therefore, it had -- the Bankruptcy Court had no jurisdiction
2 over that matter.
3 Now, finally, Your Honor, the debtors are going to
4 end up in Chapter 11 one way or another. Dismissing this
5 case will not benefit Macquarie and keeping the cases will
6 not prejudice Macquarie. It can raise any objections to the
7 plan that it has at confirmation. But dismissal will
8 prejudice everyone. And for what, so that Macquarie can come
9 back and object to the plan? There is no good reason to
10 force the debtors and the stakeholders to go through that
11 process.
12 And unless Your Honor has any other questions -- or
13 has any questions, that completes my presentation.
14 THE COURT: No, I don't. Thank you.
15 MR. CHENEY: Thanks.
16 THE COURT: Who wants to go next? Mr. Gussman?
17 MR. GUSSMAN: Your Honor, this is -- yeah, this is
18 Bill Gussman from Schulte, Roth & Zabel, Your Honor, on
19 behalf of TCW, and I'll be brief.
20 I'm going to just address the involuntary petition
21 piece that Mr. Krause touched on. As we -- as the Court
22 knows, we filed the declaration of Suzanne Grasso of TCW, in
23 which she states that, if this case is dismissed, the pre-
24 petition noteholders will file an involuntary petition.
25 Macquarie's argument on this point is that this

1 fact is irrelevant. Your Honor, it is not irrelevant.
2 Context and reality, quite simply, are important and real.
3 And Macquarie would like the Court to ignore reality and the
4 consequences of dismissal of this bankruptcy case, and that
5 would be inappropriate here.
6 First of all, Your Honor, the very fact that the
7 noteholders would file an involuntary underscores the fact
8 that this company really needs to be in bankruptcy. Mr.
9 Cheney touched on a number of those reasons in his papers and
10 in his presentation, so I won't belabor that. But preserving
11 value, protecting creditors, protecting employees, that
12 requires bankruptcy process here. In this -- in the
13 proceedings presently before the Court, the general unsecured
14 claims will be paid in full. Macquarie wants to take us in a
15 different direction that would harm everybody.
16 And not only does Macquarie want to force the
17 noteholders to file the involuntary petition, they, as you
18 heard today and at -- it's foreshadowed in their papers, they
19 promise to oppose it. Obviously, today is not the time to
20 argue the involuntary petition. I don't want to do that, but
21 Mr. Krause touched on the five issues that he raised in his
22 reply, and I want very, very quickly to touch on all five
23 because, frankly, there will be no basis to oppose the
24 involuntary.
25 I think there is no doubt, based on the facts in

1 the first-day declarations and what Mr. Cheney went over,
2 that the company is unable to generally pay their debts as
3 they become due. That is a totality of the circumstances
4 test, as Your Honor knows.
5 Second, Mr. Krause raises the issue in the papers
6 about whether we would have the ability to file an
7 involuntary against KPI Holdings, LLC. We expressly carve
8 that out in our papers; that's not an issue, we would not be
9 able to do that. But there are plenty of other debtors here
10 at issue.
11 Third, and very importantly -- and I think that Mr.
12 Krause touched on -- referenced the Taburna case in
13 connection with the issue of whether the noteholders would be
14 able to waive their secured claims with respect to an amount
15 -- the statutory amount to gain eligibility to file an
16 involuntary. And he suggests that Taburna says that they
17 can't do that, that that would be a bad faith way of getting
18 around the requirements under 303(b). That is not the case.
19 First of all, that is not what Taburna holds. It's
20 a Southern District case, it does not hold that. That is one
21 of many, many factors in a very different case that that
22 court considered in dismissing that bankruptcy case. That
23 was a CDO case [sic]. There was no operating company. The
24 noteholders purchased the notes to get around the governance
25 provisions within the notes, a very different case.

1 Furthermore, he overlooks case law that is directly
2 on point. For example, in In Re East-West Associates, 106
3 B.R. 767, another case in the Southern District of New York,
4 quote -- the quote said -- and I quote -- and it couldn't be
5 more on point:
6 "A secured creditor may waive all or part of its
7 secured claim to become an eligible unsecured
8 petitioning creditor under Section 303(b)."
9 I've never heard a more directly on point statement
10 in a decision, and it's directly contrary to the position
11 that Mr. Krause is taking.
12 Fourth, Your Honor, he references in the papers the
13 notion that some of the debtors are merely guarantors, and
14 whether or not the noteholders would have non-contingent
15 claims. That will not be an issue with all the defaults
16 here. Those claims are clearly not contingent any longer.
17 And then, finally, and I think most tellingly, he
18 raises this issue of collusion or conspiracy or bad faith,
19 that somehow Ms. Grasso's declaration suggests there's been
20 some wrongdoing. He completely mischaracterizes what her
21 affidavit says, indicating that she stated that the debtors
22 would immediately consent to the involuntary petitions and
23 orchestrate the same Chapter 11 process. That quote is not
24 what she said. She simply said that they would work together
25 with the debtors. That's the spirit of cooperation and good

1 faith, Your Honor, that is actually necessary to benefit this
2 company and its stakeholders.
3 What we would be left here, Your Honor, if we had
4 to go the involuntary route -- which we would --
5 unfortunately, would be a vortex of litigation. And that is
6 something that we should, obviously, avoid. Those are my
7 comments, Your Honor.
8 THE COURT: All right. Thank you.
9 Mr. Swett?
10 MR. SWETT: Thank you, Your Honor. It's Brian
11 Swett from McGuireWoods on behalf of the Bank of Montreal,
12 which is the ABL agent, pre-petition and under the DIP.
13 I have nothing substantive to add to the
14 presentations made by Mr. Cheney and Mr. Gussman. We've
15 joined in their papers with a reservation with respect to the
16 involuntary, and we join in their arguments here this
17 morning. Thank you, Your Honor.
18 THE COURT: All right. Thank you.
19 Mr. Buchbinder, do you have anything that you would
20 like to add from the U.S. Trustee?
21 (No verbal response)
22 THE COURT: I'm getting a no signal.
23 Mr. Krause, do you want to respond to any of the
24 opposition arguments?
25 MR. KRAUSE: Yes, Your Honor, if I could. I'll try

1 and be relatively brief.
2 I want to start with the last arguments, relating
3 to the involuntary petition. And Mr. Gussman said that, in
4 Taburna, the creditors who were filing the petition were
5 waiving part of their debt -- and I think I got this right --
6 to get around governance in the corporate documents. That's
7 exactly what the secured lenders and the debtor are talking
8 about doing here.
9 With respect to the question of does the consent
10 right, in and of itself, give rise to a fiduciary duty, the
11 only case applying Delaware law that the debtor has cited is
12 Basho. Basho -- and the Court specifically said there are
13 multiple other reasons why there's a breach of fiduciary duty
14 here, including other conduct and intimidation and actions by
15 the creditor who -- or the shareholder, who also had approval
16 rights. The Court specifically said the approval rights, in
17 and of themselves, the consent rights did not give rise to a
18 fiduciary duty.
19 And Your Honor, that is not unique to Basho or to
20 bankruptcy cases. Delaware Courts have, on multiple
21 occasions, held that consent rights over critical issues
22 relating to a debtor do not make a minority shareholder a
23 controlling shareholder. We cited Superior Vision and
24 another Chancery Court case in our materials. And the
25 debtors have not cited one single case where a non-creditor

1 shareholder was deprived of contractually negotiated consent
2 rights, upon which they relied when they invested millions of
3 dollars, that were negotiated among sophisticated parties.
4 Now there are two other matters that I think are
5 important, Your Honor. One is counsel talked about the
6 directors and that they are fiduciaries trying to do the
7 right thing. Well, Your Honor, the directors in this case
8 are not unconflicted. The directors negotiated for personal
9 releases, personal releases by the companies, including the
10 ultimate parent company against whom the secured lenders say
11 they couldn't file an involuntary. So, if that entity is not
12 in bankruptcy, it can't grant releases. So, even if we went
13 down the involuntary path, the directors could not get the
14 releases they negotiated for in the plan from the ultimate
15 parent company.
16 Some of the directors will benefit from
17 compensation. All of the directors will get exculpated from
18 doing what they knew they had the right to do in filing the
19 involuntary petition. All of them will have broad
20 indemnifications assumed that might not otherwise be assumed.
21 So, Your Honor, the members of the board who made the
22 decision to ignore the provision in the certificate had
23 personal motivations and personal conflicts.
24 That is why preferred shareholders negotiate for
25 provisions in the certificate to give them approval rights

1 because they recognize that board members are not always
2 objective, are sometimes interested in doing what is in their
3 own personal best interests, as the board members did here.
4 Your Honor, with respect to the question of whether
5 Macquarie Septa has a better plan for the debtor, I come back
6 to the fact that most of the things that the debtor is doing
7 in connection with the bankruptcy case it doesn't need a
8 bankruptcy to do, in cooperation with its secured lenders.
9 Now counsel for the secured lenders said it needs
10 the bankruptcy process to preserve value. At no point has
11 anybody for the debtors or the secured lenders explained why
12 they could not preserve the same value they're proposing to
13 preserve in a proceeding by cooperating together out of the
14 proceeding. We don't know what that will look like because
15 Macquarie has been excluded from the process, despite the
16 fact that its consent right is intended to give it a right to
17 be heard in connection with the process.
18 Your Honor, counsel for the secured lenders ticked
19 through multiple issues that would have to be addressed by
20 the Court if the involuntary petition were filed, including
21 arguments about which of two cases govern in the bad faith
22 context. Those issues are not before the Court.
23 And counsel said, Judge, you have to look at
24 reality. Okay. What's the reality? The reality is the
25 debtor filed an unauthorized voluntary petition. The reality

1 is the secured lenders didn't believe filing an involuntary
2 petition was a no-brainer and would just go forward, and
3 didn't file an involuntary petition. So the Court is not,
4 today, being asked to rule on the five issues that we've
5 listed that might come up in the context of an involuntary
6 petition because the reality is nobody filed an involuntary
7 petition.
8 Your Honor, there is no case holding that a
9 blocking authority held by someone who is not a secured
10 lender is void. As we pointed out in our brief and in our --
11 I repeated in the opening argument, in Lake Michigan, the
12 equity interest had literally no value, no profit rights, no
13 loss obligations. And it was granted to a secured creditor
14 in the context of a forbearance agreement to allow it to
15 foreclose if the forbearance agreement expired.
16 The same dynamic is true in connection with -- I
17 apologize -- the only Delaware case that counsel cited, where
18 the member paid one dollar for an LLC interest to enable it
19 to foreclose on its secured debt. Franchise Services of
20 North America says both cases turn on the fact that the
21 blocking right was granted to a creditor who was primarily a
22 creditor.
23 No case says that a true shareholder, who is only a
24 shareholder, cannot negotiate as a condition to putting in
25 millions of dollars -- in this case, north of $37 million --

1 as a preferred equity to have a consent right. This Court
2 would be making new law if you said an equity holder who is
3 not a creditor cannot exercise consent rights they negotiated
4 for in the underlying certificate. It would be contrary to
5 Delaware law. There is no federal case that holds that. And
6 we respectfully submit, Your Honor, that's because there is
7 no public policy that prohibits the entity from vesting the
8 authority to make a decision whether or not to file in the
9 preferred shareholders, as opposed to in the board.
10 And we respectfully request that the Court do what
11 the Supreme Court said it must do, if it concludes the
12 petition was not authorized, which is to dismiss the case.
13 THE COURT: All right. Thank you.
14 Any final comments from anybody before I rule?
15 MR. CHENEY: Your Honor, can I make two quick final
16 comments in response --
17 THE COURT: Yes.
18 MR. CHENEY: -- to Mr. Krause? Thank you, Your
19 Honor.
20 First, Mr. Krause mentioned the allegations of
21 director conflicts. The only allegations of conflicts here
22 relate to the details of the plan and have nothing to do with
23 the decision to file for bankruptcy. Those are separate
24 issues.
25 And two, were the case -- were the motion to be

1 denied, that would not be contrary to any controlling
2 authority. There is no case law saying that shareholders may
3 always exercise blocking rights and the exercise of these
4 kinds of blocking rights is always consistent with federal
5 public policy, and that the Court should disregard that out-
6 of-the-money shareholders are trying to hold a company
7 hostage in order to gain something in out-of-court
8 negotiations. Thank you, Your Honor.
9 THE COURT: All right. Well, let me make my ruling
10 then. I do recognize that there is no case directly on
11 point, holding that a blocking right by a shareholder who is
12 not a creditor is void as contrary to federal public policy
13 that favors the constitutional right to file bankruptcy. But
14 I think that, based on the facts of this case, I am prepared
15 to be the first court to do so, and therefore conclude that
16 the motion to dismiss must be denied.
17 And I think it's important to talk about the
18 context of this case. There is no contest that the debtor
19 needs a bankruptcy. It was in financial straights even
20 before COVID-19 hit. With COVID-19, its plants have been
21 closed and most of its employees have been furloughed. Even
22 as states reopen, the resumption of operations will not
23 happen overnight, and they will require additional liquidity.
24 At the time the debtor filed -- debtors filed bankruptcy, it
25 had less than 150,000 in liquidity.

1 There is also no contest that, in the current
2 context, the bankruptcy case will benefit most stakeholders.
3 There is a prepack. The lenders have agreed to the payment
4 of all other creditors in full, if the plan is confirmed.
5 The debtor and lenders contend that they can make a case for
6 cramming down the shareholders, who will be wiped out in that
7 plan. I am not prepared to deal with any of that today, and
8 I don't think it is necessary. But I think it is clear that
9 a lack of access to the Bankruptcy Code and the Bankruptcy
10 Courts would violate the federal public policy, again, to
11 allow a debtor to file bankruptcy.
12 The provision in the charter of one of the debtors
13 that bars the filing by that debtor and all its subsidiaries
14 I believe violates public policy and is void as it is
15 exercised by a minority shareholder. Numerous courts have
16 held that all persons -- which, by definition, include
17 corporations -- have a constitutional right to avail
18 themselves of a right to file a bankruptcy, to negotiate with
19 their creditors and other stakeholders. And the Courts have
20 held that any restriction of that constitutional right is
21 against federal public policy.
22 And I think Judge Walsh, in the TWA case, said it
23 best. He noted that Bankruptcy Court are loathe to enforce
24 any waiver of rights granted under the Bankruptcy Code
25 because such a waiver violates public policy, and that it

1 purports to bind the debtor-in-possession to a course of
2 action without regard to the impact in the bankruptcy estate,
3 other parties with a legitimate interest in the process, or
4 the debtor-in-possession's fiduciary duty to the estate.
5 And Macquarie argues that the above cases that hold
6 that federal public policy precludes the blocking of the
7 filing of a bankruptcy are distinguishable because they
8 involved creditors who acquired an equity interest only to
9 block the bankruptcy filing, and therefore protect their
10 interests as creditors, not as equity. And the Fifth
11 Circuit, in Franchise Services, did, in fact, say that, and
12 said that that was a distinguishing factor.
13 But I must respectfully decline to follow that
14 case. I see no reason to conclude that a minority
15 shareholder has any more right to block a bankruptcy -- the
16 constitutional right to file a bankruptcy by a corporation
17 than a creditor does. Federal public policy allows any
18 entity to file for bankruptcy, and it is the same regardless
19 of who is seeking to block that filing.
20 But I think that the Fifth Circuit and the Basho
21 case, particularly, inform my decision. I do believe that,
22 under Delaware state law, contrary to the Fifth Circuit's
23 interpretation of that law, would and does find that a
24 blocking right, such as exercised in the circumstances of
25 this case, would create a fiduciary duty on the part of the

1 shareholder; a fiduciary duty that, with the debtor in the
2 zone of insolvency, is owed not only to other shareholders,
3 but to all creditors.
4 Basho particularly noted that the circumstances of
5 the case control. And while the Basho felt, in that case,
6 that a blocking right alone was not enough to find such a
7 fiduciary duty, I think that, on the circumstances of this
8 case, the additional facts do support that such a blocking
9 right does create a fiduciary duty. And those include,
10 again, the debtors are clearly in the zone of insolvency.
11 They do not have the liquidity, in the absence of the DIP
12 loan, to pay their debts as they come due. And their
13 operations have been severely disrupted by the COVID
14 pandemic.
15 The proposed plan of reorganization, again, or any
16 other plan that could be negotiated in the bankruptcy case,
17 would offer a better prospect than leaving the company
18 outside of bankruptcy. It is hard to contemplate an
19 alternative to the bankruptcy proceeding, and Macquarie has
20 not suggested any; any viable one, anyway. There appears to
21 be no benefit to a dismissal of this case for any party,
22 other than perhaps Macquarie, and giving it negotiating
23 rights.
24 And I think that, whether or not the person or
25 entity blocking access to the Bankruptcy Courts is a creditor

1 or a shareholder, federal public policy does require that the
2 Court consider what is in the best interest of all, and does
3 consider whether the party seeking to block it has a
4 fiduciary duty that it appears it is not fulfilling by not
5 specifically -- and Macquarie has said clearly it is not
6 considering the rights of others in its decision to file the
7 motion to dismiss.

8 So, accordingly, I will deny the motion to dismiss.
9 I do not think that I am precluded from proceeding with the
10 case. Consequently, I'll look for a form of order to be
11 presented by counsel.

12 And I think we have nothing else today then?

13 (No verbal response)

14 THE COURT: All right.

15 UNIDENTIFIED: Thank you, Your Honor.

16 THE COURT: We'll stand adjourned. And thank you
17 to the parties.

18 COUNSEL: Thank you. Thank you, Your Honor. Thank
19 you, Your Honor.

20 (Proceedings concluded at 11:27 a.m.)

21 *****

1 CERTIFICATION

2 I certify that the foregoing is a correct
3 transcript from the electronic sound recording of the
4 proceedings in the above-entitled matter to the best of my
5 knowledge and ability.

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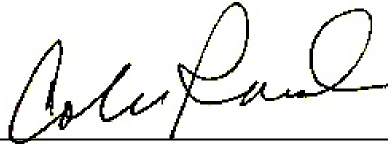

11 ______________________________ May 6, 2020

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