

Motion to Dismiss
Standing of Creditor
Prepetition Waiver of Bankruptcy Protection
11 U.S.C. § 1109(b)
11 U.S.C. § 1112(b)

In re Bay Club Partners-472, LLC, Case No. 14-30394-rld11

05/06/2014 RLD

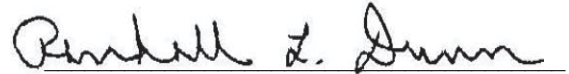
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The secured creditor moved to dismiss the debtor's chapter 11 bankruptcy case for cause under § 1112(b) on the grounds that (1) the debtor's operating agreement prohibited it from filing for bankruptcy protection and (2) the debtor's manager was not authorized to file for bankruptcy protection without the affirmative vote of 100% of the LLC members. A member owner in the debtor joined in the secured creditor's motion to dismiss. The debtor challenged the secured creditor's motion to dismiss on the grounds that (1) the secured creditor lacked standing to prosecute the motion to dismiss and (2) the provisions in the operating agreement prohibiting the debtor from filing for bankruptcy were inconsistent with Oregon limited liability law and were unenforceable as contrary to public policy.

Following an evidentiary hearing, the bankruptcy court found that the secured creditor had standing to prosecute its motion to dismiss, both under § 1109(b) and under Fondiller v. Robertson (In re Fondiller), 707 F.2d 441 (9th Cir. 1983), which held that a party has standing to appear and be heard if it was directly and adversely affected pecuniarily by the bankruptcy case. The bankruptcy court also found that the provisions in the operating agreement prohibiting the debtor from filing for bankruptcy were unenforceable because they violated public policy as determined under prevailing Ninth Circuit authority. The bankruptcy court further determined that the operating agreement authorized the debtor's manager to initiate the chapter 11 bankruptcy filing on the debtor's behalf. The bankruptcy court therefore denied the secured creditor's motion to dismiss.

P14-4(10)

Below is an Opinion of the Court.



RANDALL L. DUNN
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:) Bankruptcy Case
BAY CLUB PARTNERS-472, LLC,) No. 14-30394-rld11
Debtor.) MEMORANDUM OPINION

On March 6, 2014, secured creditor Legg Mason Real Estate CDO I, Ltd. ("Legg Mason") filed a motion to dismiss, Docket No. 59 ("Motion to Dismiss"), the debtor Bay Club Partners-472, LLC's ("Bay Club") chapter 11 case for cause pursuant to § 1112(b).¹ Legg Mason argued that Bay Club's LLC operating agreement prohibited it from filing for bankruptcy protection, and Bay Club's Manager further was not authorized to file for bankruptcy protection without the affirmative votes of 100% of the LLC members. Trail Ranch Partners, LLC ("Trail Ranch"), a 20% member owner in Bay Club, joined in the Motion to Dismiss, Docket No. 62.

¹ Unless otherwise indicated, all chapter and section references are to the federal Bankruptcy Code, 11 U.S.C. §§ 101-1532; all "Rule" references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037; and all "Civil Rule" references are to the Federal Rules of Civil Procedure.

1 Trail Ranch's joinder initially was filed by Mr. Leonard Brown, its
2 Managing Member ("Mr. Brown"), but ultimately, Trail Ranch filed a
3 joinder motion by counsel, Docket No. 130. Bay Club filed an opposition
4 to the Motion to Dismiss, Docket No. 127.

5 I held the final evidentiary hearing ("Hearing") on the Motion
6 to Dismiss on April 23, 2014. After admitting exhibits and hearing
7 testimony and argument, I took the matter under submission. Since the
8 Hearing, I have reviewed the Motion to Dismiss and all supporting and
9 opposing documents. I further have reviewed all admitted exhibits and my
10 notes from the hearing. I have considered carefully the evidence and
11 arguments presented. I also have taken judicial notice of all relevant
12 entries on the docket of Bay Club's chapter 11 case for the purpose of
13 ascertaining facts not reasonably in dispute. Federal Rule of Evidence
14 201; In re Butts, 350 B.R. 12, 14 n.1 (Bankr. E.D. Pa. 2006). In
15 addition I have reviewed relevant legal authorities, both as cited to me
16 by the parties and as located through my own research.

17 Based on that consideration and review, I will deny the Motion
18 to Dismiss for the reasons stated in this Memorandum Opinion. Following
19 are my findings of fact and conclusions of law under Civil Rule 52(a),
20 applicable with respect to this contested matter under Rules 7052 and
21 9014.

22 I. Relevant Facts

23 Bay Club was formed as an Oregon limited liability company in
24 2005 to acquire, renovate and operate a large apartment complex in Mesa,
25 Arizona (the "Property"). On or about November 15, 2005, Legg Mason's
26 predecessor in interest loaned Bay Club \$23,600,000 (the "Loan"),

1 evidenced by a promissory note ("Note"), to acquire the Property.

2 Repayment of the Loan is secured by a deed of trust on the Property.

3 The Loan terms were modified four times, ultimately resulting
4 in the principal balance of the Note being increased to \$24,000,000 and
5 the maturity date being extended to March 1, 2014. However, by early
6 2014, negotiations for further forbearance and modifications with
7 respect to the Loan between Bay Club and Legg Mason apparently broke
8 down. On January 17, 2014, Bay Club received a notice of default on the
9 Loan obligation from Legg Mason, and Legg Mason offset against the Loan
10 debt Bay Club's reserve accounts for taxes, insurance and capital
11 expenses for the Property in an amount totaling \$345,006.68. See
12 Disclosure Statement, Docket No. 116, p.12.

13 Bay Club filed its chapter 11 petition on January 28, 2014.
14 The petition was signed by Mr. David Butler ("Mr. Butler") on behalf of
15 Bay Club Management, LLC as Bay Club's Manager. See Exhibit E, p.3. A
16 Written Consent and Resolutions of Bay Club members ("Consent
17 Resolution"), dated January 21, 2014, was prepared to document
18 authorization of Bay Club's chapter 11 filing. See Exhibit 8. The
19 Consent Resolution was signed in behalf of three of Bay Club's four
20 members, representing 80% of Bay Club's member ownership interests.
21 However, the evidentiary record is clear that no representative of Trail
22 Ranch signed the Consent Resolution, even though Mr. Brown was repeatedly
23 asked to do so. In fact, Trail Ranch opposed Bay Club's bankruptcy
24 filing. See Exhibit 7.

25 Oregon limited liability companies ("LLC's") are governed by
26 Oregon Revised Statutes ("ORS") Chapter 63. ORS § 63.130 recognizes two

1 types of management arrangements for LLC's: 1) management by the members
2 (ORS § 63.130(1)); and 2) management by a manager (ORS § 63.130(2)). Bay
3 Club is a manager-managed LLC. See Exhibit A, p.2, section 4.1. In a
4 manager-managed LLC, ORS 63.130(2)(b) provides, with exceptions that do
5 not apply in the circumstances before me, that "any matter relating to
6 the business of the limited liability company may be exclusively decided
7 by the manager"

8 Bay Club has a Limited Liability Company Operating Agreement
9 ("Operating Agreement") that provides for the management of its business
10 affairs, as authorized by ORS § 63.057. See Exhibits A and 2. Under
11 Section 4.1 of the Operating Agreement, entitled "Management," the
12 Manager

13 shall have the sole and exclusive authority to manage
14 the Company and to make any contracts, enter into any
15 transactions, and make and obtain any commitments on
16 behalf of the Company to conduct or further the
17 Company's business. The affirmative consent
18 (regardless of whether written, oral, or by course of
19 conduct) of the Manager shall constitute the sole
20 requisite consent for purposes of any provision of
21 this Agreement or the Act, excepting only the
22 dissolution of the Company which shall require the
23 consent of a majority in interest of the Members. All
24 other decisions concerning the business affairs of the
25 Company shall be made by the Manager. The Manager
26 shall have the power to bind the Company as provided
in this Article. The act of the Manager, regardless
of whether such action is for the purpose of
apparently carrying on in the usual way the business
or affairs at the Company, including the exercise of
authority indicated in this Article, shall bind the
Company and no person dealing with the Company shall
have any obligation to inquire into the power or
authority of the Manager acting on behalf of the
Company. . . .

25 However, in spite of the breadth of the Manager's authority to manage the
26 business affairs of Bay Club, as set forth in Section 4.1 of the

1 Operating Agreement, significant restrictions on Bay Club's business and
2 operating decisions are imposed in Article XI of the Operating Agreement,
3 entitled "Special Purpose Entity Restrictions."

4 Section 11.1, entitled "Negative Covenants with Respect to
5 Indebtedness, Operations and Fundamental Changes of Company," provides a
6 preamble to specific restrictions and states as follows:

7 The Company intends to borrow money with which to
8 acquire the Property, and to pledge the Property and
9 related assets as security therefor. Until such time
as the indebtedness secured by that pledge is paid in
full, the Company:

10 Thereafter, Section 11.1.24 of the Operating Agreement sets forth the
11 restrictions of particular relevance to the Motion to Dismiss:

12 [Bay Club] shall not institute proceedings to be
13 adjudicated bankrupt or insolvent; or consent to the
14 institution of bankruptcy or insolvency proceedings
15 against it; or file a petition seeking, or consent to,
16 reorganization or relief under any applicable federal
17 or state law relating to bankruptcy; or consent to the
18 appointment of a receiver, liquidator, assignee,
trustee, sequestrator (or other similar official) of
the Company or a substantial part of the Company's
property; or make any assignment for the benefit of
creditors; or admit in writing its inability to pay
its debts generally as they become due; or take any
action in furtherance of any such action.

19 Although representatives of all members of Bay Club at the time
20 signed the Operating Agreement (see Exhibits A and 2, p.17), no testimony
21 or evidence was introduced that the members or their representatives
22 discussed the restrictive provisions of Article XI on or before the date
23 that they signed the Operating Agreement. Mr. Dean Alterman, who served
24 as counsel to Bay Club with respect to its organization and prepared the
25 Operating Agreement, testified that the restrictive provisions of Article
26 XI of the Operating Agreement were included at the request of Legg Mason.

1 or inadequate authorization for a bankruptcy filing. See, e.g., In re
2 Orchard at Hansen Park, LLC, 347 B.R. 822 (Bankr. N.D. Tex. 2006); In re
3 A-K Enters., Inc., 111 B.R. 149 (Bankr. N.D. Ohio 1990); In re Giggles
4 Rest., Inc., 103 B.R. 549 (Bankr. D.N.J. 1989).

5 In the Ninth Circuit, Fondiller v. Robertson (In re Fondiller),
6 707 F.2d 441, 442 (9th Cir. 1983), states the classic standard as to
7 standing with respect to bankruptcy matters: Only those persons or
8 entities "who are directly and adversely affected pecuniarily" by a
9 bankruptcy proceeding have standing to appear and be heard.

10 In this case, Legg Mason has a direct pecuniary interest in
11 whether Bay Club can proceed to attempt to confirm a plan in chapter 11.
12 Legg Mason is the primary, if not the only, secured creditor in the case.
13 The total of all other debts, of all types, scheduled by Bay Club is
14 dwarfed by the unpaid Loan debt. See Summary of Schedules, Docket No.
15 39. Bay Club's bankruptcy filing was precipitated by Legg Mason's notice
16 of default and the impending maturity date of the Loan obligation. In
17 these circumstances, it is no surprise that in its plan of
18 reorganization, Bay Club seeks to lower the interest rate and extend the
19 maturity date of the Loan debt. See Plan of Reorganization, Docket No.
20 115, p.8. Legg Mason has a pecuniary interest that inevitably will be
21 adversely impacted by Bay Club's bankruptcy filing. In spite of its
22 clear self interest, I conclude that Legg Mason has standing to prosecute
23 the Motion to Dismiss, based on the straightforward provisions of
24 § 1109(b) and the pecuniary interest test of the Fondiller decision.

25 Even if I did not conclude that Legg Mason had standing, in any
26 event, Trail Ranch has standing to prosecute its "me, too" motion to

1 dismiss as a member of Bay Club. Accordingly, I will proceed to consider
2 the merits of the Motion to Dismiss.

3 III. Prepetition Waivers of Bankruptcy Protection are
4 Contrary to Public Policy

5 Much of the parties' argument at the Hearing focused on whether
6 the restrictions in Article XI of the Operating Agreement, particularly
7 the provisions of Section 11.1.24 prohibiting Bay Club from initiating a
8 bankruptcy case, were consistent with Oregon LLC law. However, my
9 ultimate conclusion is that the disposition of this matter is governed by
10 federal law.

11 The Ninth Circuit has been very clear that a debtor's
12 prepetition waiver of the right to file a bankruptcy case is
13 unenforceable because it is a violation of public policy.

14 It is against public policy for a debtor to waive the
15 prepetition protection of the Bankruptcy Code. Hayhoe
16 v. Cole, 226 B.R. 647, 651-54 (9th Cir. B.A.P. 1998).
17 This prohibition of prepetition waiver has to be the
18 law; otherwise, astute creditors would require their
19 debtors to waive.

20 Bank of China v. Huang (In re Huang), 275 F.3d 1173, 1177 (9th Cir.
21 2002). Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe
22 Insulation Co.), 671 F.3d 1011, 1026 (9th Cir. 2012) (same); Wank v.
23 Gordon (In re Wank), 505 B.R. 878, 887-88 (9th Cir. BAP 2014).

24 No evidence or argument was presented to the effect that Legg
25 Mason insisted on a bankruptcy waiver in its Loan agreements. What the
26 evidence established in this case is more cleverly insidious. Legg Mason
requested that the bankruptcy waiver of Section 11.1.24 of the Operating
Agreement be included with its requests for other restrictive covenants

1 in Article XI, and the bankruptcy waiver provision apparently was
2 included in the Operating Agreement without discussion among the members.
3 The purpose of the bankruptcy waiver provision to prevent a bankruptcy
4 filing while any amount was owed on the Loan debt is clear from the
5 provision of Section 11.1 of the Operating Agreement that the restrictive
6 covenants of Article XI would only be effective "[u]ntil such time as the
7 [Loan] indebtedness secured by that pledge is paid in full." That the
8 members of Bay Club signed the Operating Agreement among themselves
9 rather than acquiescing in the bankruptcy waiver provision in a Loan
10 agreement with Legg Mason is a distinction without a meaningful
11 difference. The bankruptcy waiver in Section 11.1.24 of the Operating
12 Agreement is no less the maneuver of an "astute creditor" to preclude Bay
13 Club from availing itself of the protections of the Bankruptcy Code
14 prepetition, and it is unenforceable as such, as a matter of public
15 policy.

16 IV. Bay Club's Chapter 11 Filing was Properly
17 Authorized by the Manager

18 With my conclusion that the bankruptcy waiver provision of
19 Section 11.1.24 of the Operating Agreement is not enforceable, the
20 question as to whether Bay Club's chapter 11 filing was properly
21 authorized refocuses on the authority of its Manager under Section 4.1 of
22 the Operating Agreement.

23 Section 4.1 authorizes the Manager to take any actions to
24 further Bay Club's business interests, both in and outside of the
25 ordinary course. Bay Club did go to the trouble of trying to obtain
26 agreement of all of its members to its chapter 11 filing and requested

