Dated: May 07, 2020
The following is ORDERED:

Jennie D. Latta
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re	
WILLIAM H. THOMAS, JR.,	Case No. 16-27850-L
Debtor.	Chapter 11

ORDER GRANTING "CHAPTER 11 TRUSTEE'S EMERGENCY MOTION FOR AN ORDER (I) COMPELLING (A) FINANCIAL INSTITUTIONS HOLDING ACCOUNTS IN THE NAME OF TI PROPRETIES, LLC TO RECOGNIZE THE TRUSTEE AS THE SOLE AUTHORIZED REPRESENTATIVE OF TI PROPERTIES, LLC WITH RESPECT TO ALL TI PROPERTIES LLC'S ACCOUNTS AND (B) THE DEBTOR AND ALL INDIVIDUALS HOLDING RECORDS OF TI PROPERTIES, LLC TO PROVIDE TO THE TRUSTEE ALL FINANCIAL RECORDS OF TI PROPERTIES, LLC AND (II) ENJOINING ANY ACTIVITY THAT IS CALCULATED TO INTERFERE WITH THE TRUSTEE'S CONTROL OVER TI PROPERTIES, LLC" [DKT. NO. 945]

The motion of Michael E. Collins, Chapter 11 Trustee (the "Trustee"), filed April 2, 2020 [Dkt. No. 945], came before the court for hearing on April 30, 2020. The Trustee seeks an order (I) compelling (A) financial institutions holding accounts in the name of TI Properties, LLC ("TI Properties") to recognize him as the sole authorized representative of TI Properties with respect to the financial accounts of TI Properties and (B) the Debtor and all individuals holding records of TI Properties to provide them to the Trustee and (II) enjoining any activity that is calculated to

interfere with the Trustee's control over TI Properties [the "Emergency Motion"]. The Trustee asked that the motion be heard on an emergency basis. It was originally scheduled for hearing on April 23, 2020, but the hearing was continued to April 30 to accommodate counsel for Lynn Schadt Thomas ("Ms. Thomas"). The Debtor filed a motion asking that the hearing be continued to May 21, 2020, which was denied. *See Order Denying Request for Continuance*, entered April 15, 2020. [Dkt. No. 990]. Ms. Thomas filed a response and objection to the Emergency Motion on April 16, 2020 (the "Response"). [Dkt. No. 994]. Attached to the Response was a copy of the Operating Agreement of TI Properties, which the parties stipulated to be authentic. On April 16, the Debtor filed an Amendment to his Schedule C in an attempt to exempt his interests in various limited liability companies under Tennessee law.[1] [Dkt. No. 996]. The Debtor also filed a "Motion to Dismiss"[2] the Emergency Motion. [Dkt. No. 997]. The Trustee filed a reply on April 27, 2020, [Dkt. No. 1024], and Ms. Thomas filed a Surreply on April 28, 2020, without leave of court. [Dkt. No. 1026].

At issue in the Emergency Motion and the responses to it is the question of a trustee in bankruptcy's governance rights with respect to a limited liability company wholly owned by a debtor before the commencement of a voluntary bankruptcy case. The Trustee argues that by virtue of the filing of the bankruptcy petition and his appointment as Trustee, he holds both the financial rights and governance rights that make up the membership interest in TI Properties. Ms. Thomas argues that the Trustee holds only the financial rights but not the governance rights.

[1] The Debtor was domiciled in Florida when his original petition was filed. The Trustee had not yet filed an objection to the amended Schedule C at the time of the hearing but did note in his Reply that the Debtor is not entitled to claim exemptions under Tennessee law. The court expresses no opinion at this time concerning the Debtor's attempt to exempt the governance rights that form part of the membership interest in TI Properties, LLC.

[2] The appropriate response to a motion is a response rather than a motion to dismiss.

The Debtor insists that the filing of his bankruptcy petition did not constitute a transfer of his governance rights under Tennessee law. The parties agreed at the beginning of the hearing that the issues before the court are legal issues; there are no disputed issues of fact.

UNDISPUTED FACTS

This case was commenced by the filing of a voluntary petition under Chapter 11 of the Bankruptcy Code on June 2, 2016, in the United States Bankruptcy Court for the Northern District of Florida.

The case was transferred to this court on August 29, 2016. The case was assigned to Bankruptcy Judge David S. Kennedy.

On January 18, 2019, Judge Kennedy granted the motion of Clear Channel Outdoors, Inc., seeking appointment of a Chapter 11 trustee. Michael E. Collins was appointed Trustee pursuant to the recommendation of the United States Trustee on January 24, 2019.

On January 14, 2020, this case was transferred to the undersigned bankruptcy judge.

The Debtor is the sole member of TI Properties, LLC, a limited liability company organized under the laws of the state of Tennessee.

TI Properties is not a debtor in bankruptcy.

ANALYSIS

As preliminary matters, Ms. Thomas asserts that the Trustee lacks standing to bring the Emergency Motion and that this court lacks subject matter jurisdiction over TI Properties, which is a nondebtor, and its assets, which are not property of the bankruptcy estate. Conversely, the Trustee argues that Ms. Thomas lacks standing to object to the Emergency Motion. The resolution of these issues goes to the heart of the substantive question raised in the Emergency Motion, i.e., the governance rights of a trustee in bankruptcy with respect to a limited liability company solely

owned by the debtor. The resolution of this issue turns on the interaction between the Bankruptcy Code and the Tennessee Revised Limited Liability Act (the "Tennessee Revised Act"), Tennessee Code Annotated section 48-249-101, et seq. *See Butner v. United States,* 440 U.S. 48 (1979) (property interests, created and defined by state law, will be honored unless a specific bankruptcy provision or policy requires a different result). Upon the filing of a petition in bankruptcy, an estate is created consisting of all the legal and equitable interests of the debtor in property as of the commencement of the case. 11 U.S.C. § 541(a)(1).

The Tennessee Revised Limited Liability Act

Under Tennessee law, a membership interest in a limited liability is personal property. TENN. CODE ANN. § 48-249-502(a). The term "membership interest" means a member's interest in a limited liability company, which consists of the member's financial rights and governance rights. TENN. CODE ANN. § 48-249-102(22). The term "financial rights" means a member's or holder's rights to:

> (A) Share in profits and losses, as provided in § 48-249-304;
>
> (B) Share in and receive distributions, as provided in § 48-249-305;
>
> (C) Receive liquidation distributions, as provided in § 48-249-620; and
>
> (D) Transfer the financial rights described in subdivisions (11)(A)-(C), as provided in § 48-249-507.

TENN. CODE ANN. § 48-249-102(11). The term "governance rights" means "a member's right to vote on one (1) or more matters, all of a member's other rights as a member in the LLC under the LLC documents or this chapter, other than financial rights, and the right to transfer the voting and other rights described in this subdivision." TENN. CODE ANN. § 48-249-102(13). The term "holder of financial rights" or "holder" means "a person, other than a member, owning any financial rights in an LLC." TENN. CODE ANN. § 48-249-102(14). The holder of financial rights may acquire its

financial rights either by transfer of ownership from a member or other holder, or directly from the company. The financial rights of a member or holder may be transferred unless restricted by the LLC documents, by a written resolution adopted by all the members, or by a written agreement among, or other written action by, all the members. TENN. CODE ANN. § 48-249-507(a) and (c).

The Tennessee Revised Act provides the following rights to transferees of financial rights in an LLC:

> A transfer of the financial rights of a member or a holder of financial rights entitles the transferee to receive, to the extent transferred, only the share of profits and losses and the distributions to which the transferor would otherwise be entitled, together with the right to transfer further the financial rights so transferred. **A transfer of the financial rights of a member or a holder of financial rights does not dissolve the LLC and does not entitle or empower the transferee to become a member, to cause a dissolution, or to exercise any governance rights.** Any attempt by the transferee to become a member, cause a dissolution or exercise any governance rights shall be null and void.

TENN. CODE ANN. § 48-249-507(b) (emphasis added).

The Tennessee Revised Act provides that a membership interest terminates, however, upon the filing of a petition in bankruptcy by the member. TENN. CODE ANN. § 48-249-503(a)(7)(A). When a member's interest terminates (except as the result of an event specified in § 48-249-503(a)(8)), the member loses all governance rights except the right to wind up the affairs of the limited liability company in the event that the business of the limited liability company is discontinued. TENN. CODE ANN. § 48-249-505(a)(2). If the existence and business of the company are continued, however, "the member whose membership interest has terminated loses all governance rights and will be considered merely a holder of the financial rights owned before the termination of the membership interest, other than any financial rights transferred by the member in connection with the termination of the membership interest." TENN. CODE ANN. § 48-249-505(a)(1).

It would seem that under the Tennessee Revised Act, it is contemplated that in the case of a multi-member limited liability company, the bankruptcy of one member results in termination of the member's membership interest, with the result that the trustee in bankruptcy becomes the holder of the financial rights of the debtor. The governance rights of the debtor are lost, and therefore, not available to the trustee in bankruptcy, unless the business of the limited liability company is discontinued. In that event, the Tennessee Revised Act contemplates the retention by the member, and thus the passing to the trustee, of limited governance rights necessary to wind up the affairs of the company. *See, e.g., In re Albright*, 291 B.R. 538, n.7 (Bankr. D. Colo. 2003) ("Where a single member files bankruptcy while the other members of a multi-member LLC do not, and where the non-debtor members do not consent to a substitute member status for a member interest transferee, the bankruptcy estate is only entitled to receive the share of profits or other compensation by way of income and the return of the contributions to which that member would otherwise be entitled.").

Even if this reading is correct, this case presents the question of governance rights when the sole member of a single-member limited liability company files a petition in bankruptcy. The Tennessee Revised Act appears to limit a trustee in bankruptcy to the exercise of only those governance rights needed to wind up the affairs of the limited liability company reserved to a member whose membership interest is terminated. The Tennessee Revised Act does not address the governance rights of a single-member limited liability company when the membership interest terminates as the result of the filing of a bankruptcy petition but the trustee in bankruptcy desires to continue the business of the LLC for the benefit of creditors of the bankruptcy estate.

Preemption of the Tennessee Revised Act's Membership Termination Provision

In what appears to be a question of first impression under the Tennessee Revised Act, the Trustee argues that the Tennessee Revised Act's attempt to terminate a member's membership interest upon the filing of a bankruptcy petition is an *ipso facto* clause made inapplicable by the Bankruptcy Code, which states:

> [A]n interest of the debtor in property becomes property of the estate under [section 541](a)(1), (a)(2), or (a)(5) … notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law … that is conditioned on the … commencement of a case under … title [11], or on the appointment of or taking possession by a trustee in a case under this title … and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

11 U.S.C. § 541(c)(1)(B). The Trustee thus argues that in the event of the bankruptcy of a member of an LLC, the debtor's membership interest, consisting of both his financial rights and governance rights, becomes property of the bankruptcy estate by virtue of section 541(a)(1) of the Bankruptcy Code. The Tennessee Revised Act's attempt to prevent this result, he argues, is invalid. Remarkably, Ms. Thomas agrees that section 541(c)(1)(B) preempts the Tennessee Code's termination of a member's membership interest upon the filing of a bankruptcy petition. Response of Ms. Thomas, Dkt. No. 994, p. 17, fn. 6 ("The automatic dissociation of a member upon the filing of a bankruptcy petition would be preempted by 11 U.S.C. § 541(c)(1)(B)."). Ms. Thomas, however, interprets the effect of that preemption differently than the Trustee.

Section 541(c) was promulgated to "invalidate restrictions on the transfer of property of the debtor, in order that all the interests of the debtor in property will become property of the estate." H.R. REP. NO. 95-595, at 368–69 (1977). The Tennessee Revised Act defines "membership interest" to include both financial rights and governance rights and further specifies that the membership interest, not merely the financial rights, of a member are personal property.

As personal property, a debtor's membership interest, not merely his financial rights, become property of his bankruptcy estate upon the filing of a bankruptcy petition pursuant to the broad sweep of section 541(a)(1). The Tennessee Revised Act's attempt to separate a member's financial rights from his or her governance rights upon the filing of a bankruptcy petition does appear to run afoul of section 541(c)(1)(B) because it is a provision in nonbankruptcy law that is conditioned upon the commencement of a case under title 11 that effects a modification or forfeiture of the debtor's rights.[3]

As explained by Chief Judge David S. Kennedy of this district, "[*i*]*pso facto* means 'by the fact itself,' and *ipso facto* clauses in agreements specify the consequences that arise by the fact of a bankruptcy filing itself and not by normal operation of the agreement." *In re Denman,* 513 B.R. 720, 727 (Bankr. W.D. Tenn. 2014), citing BLACK'S LAW DICTIONARY 846 (8th ed. 2004). In *Denman,* Judge Kennedy held that section 541(c)(1)(B) invalidated a section of an operating agreement that triggered an option for members to purchase the membership interest of another member upon the filing of a bankruptcy petition. In a similar case construing Arizona law, the Bankruptcy Appellate Panel for the Ninth Circuit held that all of debtors' contractual rights and interest in a limited liability company became property of their estate under section 541(a)(1) by operation of law when they filed their petition, and further, that section 541(c)(1)(A) overrides both contract and state law restrictions on the transfers or assignment of debtors' interest. *Fursman v. Ulrich (In re First Protection),* 440 B.R. 821, 830 (B.A.P. 9th Cir. 2010). Likewise, the Maryland bankruptcy court held invalid a provision of the Maryland Code that provides that a person ceases to be a member of a limited liability company upon the filing of a voluntary petition

[3] It is worth noting that this conclusion does not depend on the status of TI Properties as a single-member LLC. It would seem that section 541(c)(1)(B) would prevent the termination of the membership interest of a member in a multi-member LLC as well, but that issue is not before the court.

in bankruptcy. *In re Jundanian,* 2012 WL 1098544, at *5 (Bankr. D. Md. 2012) (Section 541(c)(1) overrides both the *ipso facto* provision in Md. Code Ann., Corps. & Ass'ns., § 4A–606(3)(ii) and the restriction on transfer provision in the Operating Agreement). *See In re Warner,* 480 B.R. 641, 655-66 (Bankr. N.D. W.Va. 2012) (Section 541(c)(1)(B) invalidates provision of an operating agreement that triggered dissolution of a limited liability company upon the filing of a bankruptcy petition by a member).

Ms. Thomas argues that the result of the preemption of section 48-249-503(a)(7)(A) of the Tennessee Revised Act by section 541(c)(1)(B) of the Bankruptcy Code is that a member is not dissociated as the result of filing a bankruptcy petition. Rather, she says, upon the filing of a petition in bankruptcy, the rights that make up a member's membership interest are severed. Ms. Thomas asserts that sections 48-249-508(d)[4] and 509[5] of the Tennessee Revised Act prevent creditors from reaching the governance rights of a membership interest, and thus that the trustee in bankruptcy becomes a mere holder of financial rights, while the debtor retains his membership interest with its governance rights. She argues that as the result of the filing of a bankruptcy

[4] Tennessee Code Annotated section 48-249-508(d) provides:

> The pledge of, or granting of a security interest, lien or other encumbrance in or against all or any portion of the membership interest of a member, is not a transfer of ownership and shall not cause the member to cease to be a member, or to cease to have the power to exercise any rights or powers of a member. The foreclosure of such a pledge, security interest, lien or other encumbrance shall have the effect of the transfer of the financial rights derived from such membership interest and is subject to § 48-249-507(b).

[5] Tennessee Code Annotated section 48-249-509 provides:

> On application to a court of competent jurisdiction by any judgment creditor of a member or holder of financial rights, the court may charge such person's financial rights with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of a transferee of such person's financial rights under § 48-249-507. This section does not deprive any member, holder or transferee of financial rights of the benefit of any exemption laws applicable to the membership interest or financial rights. This section is the sole and exclusive remedy of a judgment creditor with respect to the judgment debtor's membership interest or financial rights.

petition, the trustee holds the rights and powers of a hypothetical judicial lien creditor pursuant to the operation of Code section 544(a)(1), and has charging rights with respect to a debtor's financial rights, but no more.

Ms. Thomas points to no provision of the Tennessee Revised Act that supports her position that a membership interest is severed upon the filing of a bankruptcy petition. To the contrary, the Tennessee Revised Act states that the interest is terminated and specifies the results of termination. Unlike Ms. Thomas, the Act does not speak in terms of "dissociation." Section 48-249-508(d) of the Tennessee Revised Act does not apply to the filing of a petition in bankruptcy, but rather to the consensual "pledge of, or granting of a security interest, lien or other encumbrance in or against all or any portion of the membership interest of a member." In that event, the Tennessee Revised Act says, the transfer is "not a transfer of ownership and shall not cause the member to cease to be a member." The Tennessee Revised Act further specifies that the foreclosure of pledge, security interest, lien, or other encumbrance results in a transfer of the financial rights derived from a membership interest. Section 48-249-509 of the Tennessee Revised Act is equally inapplicable to the filing of a petition in bankruptcy. It concerns the rights of a successful litigant who obtains an involuntary lien upon a member's membership interest. When a member's membership interest or holder's financial rights are charged by a court of competent jurisdiction, the judgment creditor has only the rights of a transferee of the judgment debtor's financial rights. These arguments fail to address the effect of a voluntary petition in bankruptcy upon a debtor-member's membership interest.

Ms. Thomas further asserts that particular provisions of the TI Properties' Operating Agreement prevent the Trustee from obtaining the governance rights that were part of the Debtor's membership interest prior to the filing of his bankruptcy petition. She asserts that when section

48-249-503(b)(1)[6] of the Tennessee Revised Act is read together with section 10.3 of the TI Properties' Operating Agreement, the result is that the Debtor is prohibited from withdrawing as the member of the LLC. This, she says, negates the Tennessee Revised Act's *ipso facto* provision with the result that the Debtor remains Chief Manager and Secretary of TI Properties.

Ms. Thomas argues on the basis of *Northwest Wholesale, Inc. v. Pac Organic Fruit, LLC*, 357 P.3d 650 (Wash. 2015), that allowing the Trustee to exercise the Debtor's governance rights would fail to recognize the separateness of the limited liability company and ignore law governing the company. In *Northwest Wholesale*, the trustee in bankruptcy for one member of a limited liability company attempted to bring a derivative action on behalf of the company against the other member and his related companies. A Washington statute, since repealed,[7] dissociated a member

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[6] Tennessee Code Annotated section 48-249-503(b)(1) provides:

> Except as otherwise provided in subdivision (b)(2), and subject to § 48-249-504, a member has the power and right to terminate such member's membership interest at any time, including, without limitation, upon withdrawal by express will under subdivision (a)(1). A provision in the LLC documents that negates any right of a member to terminate the member's membership interest shall also automatically negate the corresponding power of the member to terminate the member's membership interest, unless the corresponding power of the member to terminate the member's membership interest is expressly reserved. Any attempted termination of a member's membership interest as to which the power to terminate has been negated shall be null and void.

[7] Washington Revised Code Annotated section 25.15.130(1)(d)(ii) (West 2015) (repealed) provided:

> (1) A person ceases to be a member of a limited liability company, and the person or its successor in interest attains the status of an assignee as set forth in R.C.W. 25.15.250(2), upon the occurrence of one or more of the following events:
> ....
> (d) Unless otherwise provided in the limited liability company agreement, or with the written consent of all other members at the time, the member ... (ii) files a voluntary petition in bankruptcy.

Further, Washington Revised Code Annotated sections 25.15.250(1) and (2)(a) (West 2015) (repealed) provided:

> "The assignee of a member's limited liability company interest shall have no right to participate in the management of the business and affairs of a limited liability company," and "[a]n assignment entitles the assignee to share in such profits and losses, to receive

upon the filing of a voluntary petition in bankruptcy with the result that the former member held only the rights of an assignee, i.e., the right to share in profits, but not in management. The trial court held that the former member relinquished his membership upon filing his bankruptcy petition. The former member filed a motion for reconsideration, arguing for the first time that federal bankruptcy law preempted the Washington statute in question. The motion for reconsideration was denied, and that decision was affirmed by the intermediate appellate court. The Washington Supreme Court affirmed, noting the strong presumption against preemption. It relied in substantial part upon the decision of the Court of Appeals for the Ninth Circuit, *In re Farmers Markets, Inc.,* 792 F.2d 1400 (9th Cir. 1986), in which the court said that a debtor's interest in a liquor license was limited by state laws that restricted transfer. The Washington court interpreted this to mean that the bankruptcy estate would receive only the interest of an assignee rather than a member because of the Washington statute's dissociation of a member upon the filing of a bankruptcy petition. It found that the Washington statute was not preempted by section 541(c)(1)(A) of the Bankruptcy Code because the estate received the debtor's entire interest as defined by state law. Significantly, of course, the debtor's interest under the Washington statute was limited *as a result of* the filing of a bankruptcy petition rather than for all purposes as in the case of the liquor license at issue in *Farmers Markets*. Whether or not the Washington Supreme Court reached the correct interpretation of the Bankruptcy Code's impact on the former Washington statute, the case is clearly distinguishable from this case. The Tennessee statute provides for the termination of the membership interest upon the filing of a bankruptcy petition,

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such distributions, and to receive such allocation of income, gain, loss, deduction, or credit or similar item to which the assignor was entitled, to the extent assigned."

Quoted in *Northwest Wholesale,* 357 P.3d at 655 and fn. 8.

not for dissociation of the member. The Tennessee statute clearly violates section 541(c)(1)(A) of the Bankruptcy Code, as Ms. Thomas admits.

Ms. Thomas's argument is also similar to the argument advanced in *In re B & M Land and Livestock, LLC,* in which the member of a sole-member limited liability company filed a bankruptcy petition on behalf of the company even though she was herself a debtor under Chapter 7. 498 B.R. 262 (Bankr. D. Nev. 2013). The United States trustee filed a motion to dismiss the petition on the basis that the member was not authorized to file the petition. In granting the motion, the court noted: "In obtaining the debtor's rights, the trustee is not a mere assignee, but steps into a debtor's shoes as to all rights, including the rights to control a single-member LLC." *Id.* at 266. Similar to Ms. Thomas, the member in *B & M Land* argued that the trustee in bankruptcy held no more rights than a judgment creditor who had executed upon one partner's partnership interest. The court explained:

> State law does not control the administration of property interests that are part of the bankruptcy estate. Further, the rights addressed in *Weddell* are analogous to the economic benefit that one would receive by executing on a partnership and receiving the economic benefit accruing to a partner. This is distinguished from the rights that a trustee requires to administer the estate or that an estate acquires under § 541. *In re Blixseth*, 484 B.R. at 369 (9th Cir. BAP 2012) (distinguishing *Weddell* and holding that a bankruptcy trustee had additional rights and remedies not available to the judgment creditor). *Blixseth* makes clear that the trustee's set of powers is broader than and encompasses that of the judgment creditor. *Weddell* both addresses a different set of rights than are applicable here and is trumped by the priority given to the Bankruptcy Code.

In re B & M Land and Livestock, LLC, 498 B.R. at 268 (Bankr. D. Nev. 2013), discussing *Weddell v. H2O*, 271 P.3d 743 (Nev. 2012). Mr. Thomas's membership interest became property of his bankruptcy estate by virtue of section 541(a), not by the exercise of the avoidance powers granted to the trustee in bankruptcy under section 544(a) of the Bankruptcy Code. The Trustee, as

representative of the estate, holds the membership interest in its entirety. He is not limited to the rights of a holder of financial rights under the Tennessee Code.

The Trustee counters that as a result of the preemption of section 541(c)(1)(A), the membership interest was not terminated or severed upon the filing of the Debtor's bankruptcy petition. Rather, the Debtor's membership interest remains intact and became property of his bankruptcy estate pursuant to the broad reach of section 541(a)(1). In support of this result, the Trustee points out that section 48-249-508(b)(2) of the Tennessee Revised Act provides that, "[w]ith respect to a single-member LLC, the single member may freely transfer governance rights or membership interests, or both, in the LLC to any other person at any time." The Trustee argues that this is precisely what the Debtor did when he filed a voluntary petition in bankruptcy.

The Trustee is correct. Upon the filing of his bankruptcy petition, all the Debtor's interests in property, both legal and equitable, became property of his bankruptcy estate. The Tennessee Revised Act defines the membership interest of a member in an LLC as personal property. As such, it became property of the bankruptcy estate upon the filing of the bankruptcy petition. The Tennessee Revised Act attempts to prevent this result by providing for the "termination" of a membership interest upon the filing of a petition in bankruptcy by a member. This result is preempted, however, by section 541(c)(1)(B) of the Bankruptcy Code.

Governance Rights are Not Excluded from the Estate by Section 541(b)(1)

As an alternative to or augmentation of her argument that the filing of a petition in bankruptcy severs a member's financial rights from his or her governance rights, Ms. Thomas argues that the Debtor's governance rights are excluded from his estate by the exception provided at section 541(b)(1) of the Bankruptcy Code, which excludes from property of the estate "any power that the debtor may exercise solely for the benefit of an entity other than the debtor."

11 U.S.C. § 541(b)(1). Ms. Thomas argues that the governance rights that were part of the Debtor's membership interest before the filing of his bankruptcy petition constitute just such a power because they can be exercised solely for the benefit of the limited liability company. Response of Ms. Thomas, Dkt. No. 994, pp. 20-21, ¶ 54. She argues that "Governance rights are powers that a member must exercise for the benefit of the limited liability company." *Id*. This is incorrect. TI Properties is a member-managed LLC. *See Operating Agreement of TI Properties, LLC*, Response of Ms. Thomas, Dkt. No. 994, Ex. A, ¶ 5. The only duties the Tennessee Revised Act imposes upon members of a member-managed LLC are duties of loyalty and care, and these are owed "to a member-managed LLC and the LLC's other members and holders." TENN. CODE ANN. § 48-249-403(a).[8] Moreover, subsection (e) of section 403 permits a member to act in his

[8] Tennessee Code Annotated section 48-249-403 provides, in pertinent part:

> 48-249-403. General standards of conduct for members, managers, directors and officers.
>
> (a) Member-managed LLC. The only fiduciary duties a member owes to a member-managed LLC and the LLC's other members and holders are the duty of loyalty and the duty of care imposed by subsections (b) and (c).' A holder of financial rights owes no duties to the LLC, or to the other members or holders, solely by reason of being a holder of financial rights.
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> (b) Duty of loyalty. A member's duty of loyalty to a member-managed LLC and the LLC's other members and holders of financial rights is limited to the following:
> (1) To account to the LLC and to hold as trustee for it any property, profit or benefit derived by the member in the conduct or winding up of the LLC's business, or derived from a use by the member of the LLC's property, including the appropriation of any opportunity of the LLC;
> (2) Subject to § 48-249-404, to refrain from dealing with the LLC in the conduct or winding up of the LLC's business as, or on behalf of, a person having an interest adverse to the LLC; and
> (3) To refrain from competing with the LLC in the conduct of the LLC's business before the termination of the LLC.
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> (c) Duty of care. A member's duty of care to a member-managed LLC, and the LLC's other members and holders of financial rights in the conduct of and winding up of the LLC's business, is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law.

own interest.[9] She refers to the powers of the Debtor as Chief Manager and Secretary of TI Properties. The Trustee responds that these powers are exercised not only for the benefit of TI Properties but also for the benefit of the Debtor himself.

It is important to distinguish the governance rights that are part of the membership interest from the operational management of the business of the LLC. These are legally distinct under the Tennessee Revised Act, which provides three possibilities for management of an LLC: member management, manager management, and director management. TENN. CODE ANN. § 48-249-401.[10] Managers and directors, for example, are chosen by the vote of a majority of the members

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> (d) Good faith and fair dealing. A member shall discharge the member's duties to a member-managed LLC and its other members and holders of financial rights under this chapter or under the LLC documents, and shall exercise any rights with respect to the LLC consistently with the obligation of good faith and fair dealing.

[9] Tennessee Code Annotated section 48-249-403(e) provides:

> A member of a member-managed LLC does not violate a duty or obligation under this chapter or under the LLC documents, merely because the member's conduct also furthers the member's own interest.

[10] Tennessee Code Annotated section 48-249-401 provides in pertinent part:

> (a) MEMBER-MANAGED LLC. In a member-managed LLC:
> (1) Each member has equal rights in the management and conduct of the LLC's business; and
> (2) Except as otherwise provided in subsection (e) or (f), any matter relating to the business of the LLC shall be decided by a majority vote of the members.
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> (b) MANAGER-MANAGED LLC. In a manager-managed LLC:
> (1) Each manager has equal rights in the management and conduct of the LLC's business;
> (2) Except as otherwise provided in subsection (e) or (f), any matter relating to the business of the LLC shall be exclusively decided by the manager, or, if there is more than one (1) manager, by a majority vote of the managers; and
> (3) A manager:
> (A) Shall be designated, appointed, elected, removed, or replaced by a majority vote of the members;
> (B) Holds office until a successor has been designated, appointed or elected and qualified, unless the manager sooner resigns or is removed; and
> (C) Need not be a member of the LLC.

and need not be members themselves. TENN. CODE ANN. § 48-249-401(b) and (c). In a member-managed LLC, on the other hand, each member has equal rights in the management and conduct of the LLC's business, and, with few exceptions, the business of the LLC is decided by a majority vote of the members. TENN. CODE ANN. § 48-249-401(a). The TI Properties' Operating Agreement specifies that the sole member shall serve as Chief Manager and Secretary so long as he is the sole member. Operating Agreement, Dkt. No. 994, Ex. A, ¶ 5. Thus, although legally distinct, the governance rights of the member and the operational management in the case of TI Properties are held by the same person.

The only powers that Ms. Thomas may rely on in support of her claim that governance rights are excluded from property of the bankruptcy estate by virtue of section 541(b)(1) are those that belong to the member as member – i.e., voting rights, all membership rights other than financial rights, and the right to transfer the voting and other rights included within governance rights. *See* TENN. CODE ANN. § 48-249-102(12). Voting rights are not a power generally contemplated in section 541(b)(1). The reach of section 541(b)(1) was described by one bankruptcy judge as follows:

> Section 541(b) is derived from § 70a(3) of the former bankruptcy act. The latter provided that the trustee was vested "with powers which he [the bankrupt] might have exercised for his own benefit, but not those which he might have exercised solely for some other persons." 5 Alan N. Resnick & Henry J. Sommer, Collier on

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(c) DIRECTOR-MANAGED LLC. In a director-managed LLC:
(1) All LLC powers shall be exercised under the authority of, and the business and affairs of the LLC shall be managed under the direction of, its board of directors;
(2) Except as otherwise provided in subsection (e) or (f), any matter relating to the business of the LLC shall be exclusively decided by the director, or, if there is more than one (1) director, by a majority vote of the directors; and
(3) A director:
(A) Shall be designated, appointed, elected, removed, or replaced by a majority vote of the members;
(B) Holds office until a successor has been designated, appointed or elected and qualified, unless the director sooner resigns or is removed; and
(C) Need not be a member of the LLC.

> Bankruptcy ¶ 541.19, at 541-93 (15th ed. rev. 2004) ("Collier"). The classic example of an excluded power is the debtor's power of appointment under a will that prohibits the appointment to the debtor or his estate. 1 [David G. Epstein, Bankruptcy] § 2-8, at 48; *see* 5 Collier ¶ 541.19, at 541-94. On the other hand, if the debtor can exercise the power of appointment for his own benefit, the power vests in the estate notwithstanding § 541(b)(1). Charles Jordan Tabb, The Law of Bankruptcy § 5.9, at 303 (1997).

Buchwald v. Di Lido Beach Resort, Ltd. (In re McCann, Inc.), 318 B.R. 276, 286 (Bankr. S.D. N.Y. 2004). The governance rights included in a member's membership interest are not similar to such a power. They are exercised by the member as he or she sees fit and in his or her own interest. They include, for example, the right of a member to vote for himself as manager of a manager-managed LLC. Ms. Thomas has pointed to no governance rights under the Tennessee Revised Act that must be exercised exclusively for someone other than the member.

To summarize, upon the filing of the Debtor's bankruptcy petition, his membership interest in TI Properties became property of his bankruptcy estate notwithstanding the attempt by the Tennessee Revised Act to prevent that result. The Debtor's membership interest included both financial rights and governance rights. Upon the appointment of the Trustee, the right to exercise the governance rights for the benefit of the estate passed to the Trustee. Because TI Properties is a member-managed LLC, upon the appointment of the Trustee, the right to manage the LLC passed to the Trustee. This conclusion is consistent with the reported decisions concerned with governance of a single-member limited liability company when the sole member files a bankruptcy petition. "[T]he trustee in bankruptcy [or debtor in possession] is the only person who can assure that management rights are exercised for the benefit of the estate and its creditors." *Hagemeyer v. Peachy Adventures, LLC (In re Neal),* 2013 WL 12108275, at *3 (Bankr. W.D. Tenn. Feb. 5, 2013). *See also In re Modanlo,* 412 B.R. 715 (Bankr. D. Md. 2006), *aff'd* 266 Fed. Appx. 272 (4th Cir. 2008) (Under Delaware law, the Chapter 11 trustee possesses both the economic and

governance rights to participate in the management of a limited liability company that debtor enjoyed prior to his bankruptcy filing); *In re First Protection, Inc.*, 440 B.R. at 830 (Debtors' contractual rights and interest in a limited liability company became property of their estate under § 541(a)(1) by operation of law when they filed their petition); *Fresno Rock Taco, LLC v. Nat'l Sur. Corp*, 2013 WL 5276132, at *18 (E.D. Cal. Sept 17, 2013) (Bankruptcy trustee was entitled to step into the shoes of the debtor and obtain 100 percent management control of the LLC through the filing of the sole member's chapter 7 bankruptcy petition); *In re B & M Land & Livestock, LLC,* 498 B.R. at 267 (Trustee for sole member obtains governance rights with respect to limited liability company upon filing of bankruptcy petition by member); *In re Neal,* 2013 WL 12108275, at *3 (Bankr. W.D. Tenn. Feb. 5, 2013); *In re Ellis,* 2011 WL 5147551, at *3 (Bankr. S.D. Ind. Oct. 27, 2011) (Debtor held all of his membership interests—both economic and noneconomic—when he filed his chapter 7 case and those interests became property of the estate); *Klingerman v. ExecuCorp, LLC (In re Klingerman)*, 388 B.R. 677, 679 (Bankr. E.D. N.C. 2008) ("Section 541(c) provides that *all* of the debtor's interest passes to the estate *notwithstanding* applicable nonbankruptcy law that effects a modification or termination of the debtor's interest upon the commencement of a bankruptcy case."); *In re Albright,* 291 B.R. at 540 (Sole member of Colorado limited liability company effectively assigned her entire membership interest in the LLC to Chapter 7 estate upon filing of bankruptcy petition, and trustee obtained all of her rights, including right to control management of the LLC). Ms. Thomas has pointed to no reported bankruptcy decision that reached the opposite result.

As a result, the Trustee is well within his rights to ask the court to direct the Debtor (and all other persons) to cooperate with his administration of the Debtor's membership interest in TI Properties, LLC (and all other membership interests owned by the Debtor in single-member

limited liability companies) and to enjoin the Debtor (and all other persons) from interfering in his exercise of his rights and responsibilities with respect to those membership interests.

Ms. Thomas seems to fear that the Trustee will not respect the separateness of the business and assets of TI Properties. She notes several times that TI Properties is not in bankruptcy and that its assets are not property of the Debtor's bankruptcy estate. Ms. Thomas is correct. The Trustee may not ignore the separateness of TI Properties. Its assets are not property of the Debtor's bankruptcy estate. It has its own assets and liabilities. What is property of the bankruptcy estate, however, is the Debtor's membership interest, including both its financial rights and its governance rights. As the estate holds the only membership interest, the Trustee, acting on behalf of the estate, has the right to manage the company pursuant to the Operating Agreement. He must, of course, do so in full compliance with the Operating Agreement, including the duties of loyalty and care imposed by the Tennessee Revised Act.

The court will address each of the remaining arguments raised by Ms. Thomas, the Debtor, and the Trustee in turn.

Trustee Standing

Ms. Thomas asserts that the Trustee lacks standing to bring the Emergency Motion because he is the holder of the financial rights only with respect to TI Properties. As has been shown above, Ms. Thomas is incorrect. The Trustee, as representative of the estate, holds the Debtor's membership interest in TI Properties, including both financial rights and governance rights. The membership interest is property of the bankruptcy estate. The Trustee has standing to bring the motion to clarify and enforce the estate's interest in that asset.

Ms. Thomas's Standing

The Trustee argues that Ms. Thomas lacks standing to respond to the Emergency Motion. Although he acknowledges that Ms. Thomas is a creditor of the bankruptcy estate, he asserts that this fact alone is insufficient to confer standing to contest every issue in a Chapter 11 case. Section 1109(b) permits parties in interest, including creditors, to appear and be heard on any issue in a case under Chapter 11. Although the Trustee raises some interesting arguments with respect to the limits of the right to appear and be heard, the court is satisfied that Ms. Thomas may be heard in connection with the Emergency Motion where there are no disputed issues of fact, and the court has found the briefs and argument of counsel for Ms. Thomas helpful in considering the issues raised by the Emergency Motion.

Jurisdiction

Ms. Thomas argues that the court is without subject matter jurisdiction "over the internal affairs of TI Properties, who [sic] is a nondebtor, and its company assets, which are not property of the estate." Response of Ms. Thomas, Dkt. No. 994, p. 2. Ms. Thomas argues that the "proceeding" is therefore neither "core nor noncore." *Id.* The Trustee responds that his motion does not ask the court to exercise jurisdiction over TI Properties or over assets of TI Properties. Rather, it asks the court's assistance to enable the Trustee to exercise his statutory duties. In his Reply, the Trustee characterizes the motion as seeking a comfort order to allow him to exercise his right to administer the estate of the Debtor in the ordinary course pursuant to 11 U.S.C. § 363(c) or, in the alternative, to use, sell, or lease property of the estate other than in the ordinary course under section 363(b). Reply of Trustee, Dkt. No. 1024.

Jurisdiction over a contested matter arising under the Bankruptcy Code lies with the district court. 28 U.S.C. § 1334(b). Pursuant to authority granted to the district courts at 28 U.S.C.

§ 157(a), the district court for the Western District of Tennessee has referred to the bankruptcy judges of this district all cases arising under title 11 and all proceedings arising under title 11 or arising in or related to a case under title 11. *In re Jurisdiction and Proceedings Under the Bankruptcy Amendments Act of 1984*, Misc. No. 81-30 (W.D. Tenn. July 10, 1984). Matters concerning the administration of the bankruptcy estate and orders concerning the use or lease of property are core proceedings arising under the Bankruptcy Code. *See* 28 U.S.C. § 157(b)(2)(A) and (M). The bankruptcy court has authority to enter an order determining the rights of the Trustee vis à vis the Debtor's membership interest in a limited liability company subject only to appellate review.

TI Properties is Not Dissolved

Ms. Thomas correctly notes that TI Properties was not dissolved upon the filing of the Debtor's bankruptcy petition, citing Tennessee Code Annotated section 48-249-601(b), which provides:

> The termination, dissociation, death, incapacity, withdrawal, retirement, resignation, expulsion, bankruptcy or dissolution of any member, or the occurrence of any other event that terminates the membership interest of any member, shall not cause the LLC to be dissolved or its affairs to be wound up, and upon the occurrence of any such event, the LLC shall be continued without dissolution.

The filing of a bankruptcy petition by the sole member of a limited liability company does not, by itself, dissolve the company. It does, however, result in the transfer of the membership interest of the debtor, including both his financial rights and governance rights, to the estate. The trustee must exercise the governance rights included in the membership interest to promote the best interest of creditors and the estate.

No Violation of the Uniformity Principle

Ms. Thomas argues that the Trustee's distinction between the treatment of multi-member and single-member limited liability companies in bankruptcy violates the uniformity principle of the United States Constitution with respect to bankruptcies. U.S. CONST. art. I, § 8, cl. 4 ("Congress shall have power … to establish … uniform Laws on the subject of Bankruptcies throughout the United States."). The court's conclusion that section 541(c)(1)(B) invalidates the Tennessee Revised Act's *ipso facto* clause does not depend upon the status of TI Properties as a single-member limited liability company. The attempt by the Tennessee Revised Act to terminate the membership interest of *any* member of a limited liability company who files a petition in bankruptcy is invalid. The court expresses no opinion concerning the result of that preemption in a multi-member limited liability company, but the court need not address Ms. Thomas's uniformity argument.

An Adversary Proceeding is Unnecessary (at this time)

Ms. Thomas argues that the Trustee's motion should have been brought in the form of an adversary proceeding. Ms. Thomas notes that an injunction and other equitable relief must be brought by adversary proceeding under Federal Rule of Bankruptcy Procedure 7001(7) and that a proceeding to recover property or to determine an interest in property must be brought by adversary proceeding under Federal Rule of Bankruptcy Procedure 7001(1), (2). Ms. Thomas also notes that a proceeding to obtain a declaratory judgment concerning these and other matters must be brought by adversary proceeding pursuant to Federal Rule of Bankruptcy Procedure 7001(9).

The Trustee responds that the motion asks instead for approval of the Trustee's use of property of the estate pursuant to enforcement of his rights as chapter 11 trustee.

In fact, of course, the Emergency Motion is directed to one person – Mr. Thomas. The Trustee seeks the court's assistance in obtaining the cooperation of Mr. Thomas in the administration of the assets of the estate. Mr. Thomas, as the Debtor, is already before the court. It is not necessary for the Trustee to file an adversary complaint to obtain jurisdiction over Mr. Thomas. The due process rights of Mr. Thomas are fully protected. Mr. Thomas did file an objection to the Emergency Motion and did participate in the hearing on the motion. He did not raise any legal issues not already raised by Ms. Thomas. No purpose would be served by compelling the Trustee to refile the Emergency Motion as an adversary proceeding naming the Debtor as the sole defendant.

The Debtor and persons in his employ can and will be compelled to cooperate with the Trustee in his administration of the estate and to turn over the banking and other records of TI Properties necessary for the Trustee to administer the membership interest which belongs to the estate. The Trustee recognizes that TI Properties has its own creditors and he must respect their rights. The court hopes that after receiving this opinion, the Debtor will cooperate with the Trustee in his efforts to maximize the value of the estate. If, instead, the Trustee finds it necessary, for example, to open new financial accounts for TI Properties with himself as signatory, he may do so.

Waiver, Laches, and Estoppel Do Not Apply

Ms. Thomas, as an alternative, argues that the defenses of waiver, laches, and estoppel apply in this case. The court disagrees. Ms. Thomas asserts that the Trustee has chosen to "sit on his hands" since appointed in January 2019, and therefore has waived any right to control TI Properties and is bound by the doctrines of laches and estoppel. "Under Tennessee law, 'waiver is the voluntary relinquishment of a known right and is established by express declarations or acts

manifesting an intent not to claim the right.'" *Patton v. Bearden*, 8 F.3d 343, 346 (6th Cir. 1993). Next, "[t]he defense of laches, in its most basic terms, provides that equity will not intervene on behalf of one who has delayed unreasonably in pursuing his rights." *Dennis Joslin Co., LLC v. Johnson*, 138 S.W.3d 197, 200 (Tenn. Ct. App. 2003) (internal quotation omitted). "However, delay, by itself, is not sufficient to invoke the doctrine of laches." The delay must prejudice the party seeking to employ laches as a defense. *Grand Valley Lakes Prop. Owners Ass'n, Inc. v. Burrow*, 376 S.W.3d 66, 83 (Tenn. Ct. App. 2011). Last, in Tennessee, "[t]he party seeking to invoke the equitable estoppel must have acted to his detriment in reliance upon the statements or conduct of the party against whom it is to be enforced." *Patton*, 8 F.3d at 346 (quoting *Bokor v. Holder*, 722 S.W.2d 676, 680 (Tenn. Ct. App. 1986)).

Ms. Thomas argues that the defenses of waiver, laches, and estoppel are applicable here because since his appointment 16 months ago, the Trustee has allowed the chief manager to continue to operate TI Properties without ever notifying the manager, creditors, and other interested parties of his intent to assert a right to control TI Properties or the separate assets of TI Properties. She has not suggested any evidence, however, that the Trustee has made an express declaration or manifestation of his intent to forfeit or abandon the right to control TI Properties as required to establish voluntary waiver under Tennessee and bankruptcy law. The Bankruptcy Code is clear about the process a trustee must follow to abandon property of the estate. *See* 11 U.S.C. § 554. Neither has Ms. Thomas pointed to evidence in the record or otherwise supporting the argument that the Trustee may not assume control of TI Properties under the doctrine of laches because his delay in asserting his right to do so is so unreasonable that it prejudices interested parties. After the Trustee was appointed on January 26, 2019, the Debtor filed an appeal of the order granting the motion to appoint a Chapter 11 trustee (Dkt. No. 526), and related orders, as

well as various other orders issued by the bankruptcy court, Tennessee state courts, and U.S. district court including a district court order which held that some or all of the Tennessee Billboard Act is unconstitutional, thereby delaying all proceedings until November 2019. It cannot be said that any delay by the Trustee in asserting his right to control TI Properties was unreasonable or that he "sat on his hands." Finally, there is nothing to suggest that Ms. Thomas (who does not appear to be a creditor of TI Properties), the Debtor, or other interested parties have acted to their detriment or been prejudiced by any statements or inaction by the Trustee.

CONCLUSION

Based upon the foregoing, the Emergency Motion is **GRANTED**. The membership interest of TI Properties, LLC, including both financial rights and governance rights, became property of the bankruptcy estate upon the filing of the Debtor's bankruptcy petition. Upon appointment of Michael E. Collins as trustee in bankruptcy, he became the sole person who may exercise those rights for the benefit of the estate. As such, pursuant to the Operating Agreement of TI Properties, LLC, he is also charged with management of the business of TI Properties, LLC.

Therefore, **IT IS ORDERED**:

1. All financial institutions holding accounts in the name of TI Properties, LLC shall recognize the Trustee as the sole authorized representative of TI Properties with respect to the financial accounts for which TI Properties is account holder and the Trustee shall have full authority to make changes to the accounts, execute new signature cards, close accounts, and take any other action that TI Properties would be authorized to take as account holder.
2. The Debtor and all individuals in possession of financial records pertaining to TI Properties shall turn over such records where and when requested by the Trustee.

cc: Debtor (pro se)
Chapter 11 Trustee
Attorney for Chapter 11 Trustee
Ms. Lynn Schadt Thomas
Attorney for Lynn Schadt Thomas
United States Trustee
Attorney for United States Trustee
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