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Bankruptcy-Remote Structures Tested in First Brands Group Cases

By Martin E. Beeler and Julia Philips Roth*

In this article, the authors explain that the outcome of the challenges to the "bankruptcy-remote" governance provisions in the chapter 11 cases of First Brands Group, LLC, and its affiliated debtors could require a fresh look at existing practice.

In structured transactions, participants are often cautioned that "bankruptcy remote" does not mean "bankruptcy proof." The chapter 11 cases of First Brands Group, LLC, and its affiliated debtors illustrate that principle. The First Brands Group debtors include several special purpose vehicles formed to implement "off-balance sheet" inventory financing programs and structured as bankruptcy-remote entities (BREs). Secured lenders to three of these BREs have filed motions to dismiss those three cases, asserting they were filed in contravention of the BRE debtors' bankruptcy-remote governance provisions, which required the consent of a "qualified independent manager" to authorize a bankruptcy filing.

Because the structures and contract provisions at issue in these disputes are common, the outcome of the challenges to the BRE filings could require a fresh look at existing practice.

BANKRUPTCY-REMOTE ENTITIES

BREs are commonly used in structured finance and asset-based lending transactions to isolate specific assets—such as inventory, receivables, real estate, or intellectual property—from the credit risk of a broader enterprise. The entities are typically organized with corporate governance and contractual features intended to reduce the likelihood they enter bankruptcy through a voluntary or involuntary filing or substantive consolidation with affiliated entities. BRE governance documents typically include:

- Restrictions on the BRE's purpose that permit only a narrow set of actions aligned with its financing function (e.g., purchasing, holding, and monetizing inventory) to minimize the risk unanticipated creditors could file an involuntary petition or assert claims outside the negotiated financing structure.
- Separateness covenants to protect the BRE against substantive consolidation risk by requiring the BRE to operate with meaningful indepen-

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dence from its affiliates (e.g., maintaining its own books, records, and accounts, observing corporate formalities, engaging in affiliate dealings on an arm's-length basis).

- Appointment of an "independent manager" or "independent director" whose consent is required to approve any "material action," including a bankruptcy filing, as protection against the risk that the parent or equity sponsor could initiate bankruptcy strategically to the detriment of the BRE's lenders.

While these features are intended to enhance predictability for a BRE's lenders, the First Brands Group filings and ensuing disputes demonstrate that the effectiveness of these limitations is not guaranteed.

FIRST BRANDS GROUP AND THE BRE DEBTORS

First Brands Group is a global manufacturer and distributor of aftermarket automotive parts, operating through a diversified portfolio of automotive parts brands. Prior to filing, the business relied heavily on various "off-balance sheet" inventory financing arrangements. These arrangements were implemented through BREs formed to purchase semi-complete inventory or raw material from its affiliates, utilize that inventory as a borrowing base to obtain secured loans, finish the inventory, and sell the completed inventory back to its affiliates or to third parties.

Among the more than 100 affiliated First Brands Group entities that filed voluntary chapter 11 petitions in September 2025 are three BREs (the BRE Debtors): Broad Street Financial, LLC (Broad Street, the borrower under a $45 million "off-balance sheet" asset-based revolving credit facility; and Carnaby Inventory II, LLC and Carnaby Inventory III, LLC (together, Carnaby Inventory), borrowers under $60 million and $100 million "off-balance sheet" asset-based revolving credit facilities, respectively.

The governance provisions of the BRE Debtors required their respective independent managers to be associated with a "nationally recognized provider" of such services and to "consider only the interest of the [BRE], including its respective creditors"—i.e., not the interest of other members of the BRE's group—in making decisions. The operating agreements further required the unanimous written consent of both the manager and the independent manager to amend the independent manager qualifications or obligations.

It is worth noting the larger context in which the disputes regarding the BRE Debtors' filings occur. Creditors of First Brands Group have made allegations of extensive financing irregularities, including with respect to the enterprise's factoring arrangements and the "off-balance sheet" inventory financing transactions.

In light of these irregularities and potential fraud, dishonesty, or criminal activity in the prepetition management of First Brands Group, the court ordered the appointment of an examiner to investigate and evaluate First Brands Group's prepetition factoring transactions, as well as transfers and transactions related to the inventory financing arrangements.

THE MOTIONS TO DISMISS THE BRE CASES

According to allegations by the Broad Street and Carnaby Inventory secured lenders, (collectively, the Lenders), on the eve of bankruptcy, First Brands Group removed the Broad Street and Carnaby Inventory independent managers and installed new managers, who also served as managers on the parent companies' boards. The Lenders allege these new managers, who then approved the BRE Debtors' bankruptcy filings shortly after their appointment, were not associated with a "nationally recognized" service provider such as CT Corporation, Corporation Service Company, National Registered Agents, Inc., Wilmington Trust Company, or Stewart Management Company.

The Lenders moved to dismiss the chapter 11 cases of the BRE Debtors on the grounds that the filings were unauthorized under applicable nonbankruptcy law, the filings were made in bad faith, and dismissal would be in the best interest of the creditors.

Authority to File

State law determines who has authority to initiate a voluntary bankruptcy case on behalf of a corporate debtor. Here, because the BRE Debtors are Delaware limited liability companies, Delaware law dictates that their respective operating agreements govern authority to file for bankruptcy, and Delaware LLC law provides broad flexibility with respect to the relevant provisions of such agreements.

As a result of the eleventh-hour governance changes described above, the Lenders allege that independent manager consent for the bankruptcy filings either was not obtained or was obtained from individuals who did not satisfy contractual independence and qualification requirements. In the absence of proper corporate authorization, dismissal is mandatory.

Bad Faith/Best Interest of Creditors

The Lenders additionally contend that, even if the cases were properly authorized, they should be dismissed as "bad faith" filings under the "for cause" provision of Section 1112(b) or in the "best interest of the creditors" under Section 305, because the cases allegedly lack any legitimate purpose and prejudice the interests of the BRE Debtors' stakeholders. In support of these

arguments, the Lenders emphasize that, because the BRE Debtors have no material creditors (other than the Lenders), the resolution of each entity's debts constitutes a "two-party dispute" that could be more efficiently resolved in a different forum. The Lenders maintain continuation of the chapter 11 cases would benefit only the BRE Debtors' affiliates, not the BRE Debtors themselves or the Lenders. The Lenders argue these factors weigh heavily in favor of mandatory dismissal based on bad faith, or discretionary dismissal to serve the best interest of the creditors.

RESPONSES TO MOTIONS TO DISMISS BRE CASES

The debtors and certain stakeholders, including the Official Committee of Unsecured Creditors, oppose dismissal of the BRE Debtors' cases. The debtors contend that the operating agreements were properly amended prepetition via unanimous written consents of the managers and the pre-amendment independent managers to remove the requirement that an independent manager be associated with a "nationally recognized provider." Accordingly, they claim the managers who authorized the filings were properly appointed under the applicable amended LLC agreements. In response to the Lenders' bad faith filing allegations, the opposing parties argue that the BRE Debtors' bankruptcy cases are not "two-party disputes" with the Lenders because the BRE Debtors are operationally integrated into the First Brands Group enterprise and chapter 11 protection is necessary to preserve value and resolve complex collateral disputes. This last point could impact any court decision, because the widespread financial irregularities and potential difficulty separating the assets and liabilities of the BRE Debtors from the rest of the First Brands Group could militate in favor of keeping the BRE Debtors in bankruptcy.

CASE LAW ON BRE FILING AUTHORITY

Few courts have addressed challenges to BRE filing authority. When doing so, the courts have emphasized substance over form in interpreting the applicable governance provisions and fiduciary obligations of decision-makers and have reached different results depending on the language of the entities' governance documents.

The leading case is *General Growth Properties, Inc.*[1] *General Growth*, like First Brands Group, involved an eleventh-hour removal of independent directors, and the court rejected lender arguments that individual property-level BRE filings were improper. The court held that each debtor had a valid bankruptcy purpose and separateness covenants did not preclude chapter 11 relief where the

[1] General Growth Properties, Inc., 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

boards acted consistently with their fiduciary duties. The *General Growth* court explained that the independent directors were entitled under Delaware law to consider the interests of the entire debtor group, not only the individual BRE debtors, when exercising their fiduciary duties. In response to the *General Growth* decision, BRE governance provisions now tend to specify that independent managers may consider *only* the interests of the BRE and its creditors in connection with material actions, such as a bankruptcy filing. As noted above, the BRE Debtors' operating agreements reflect this trend.

Recently, provisions designed to protect against the *General Growth* outcome were tested in *In re 301 W. North Avenue, LLC*.[2] In that case, the court confirmed that post-*General Growth* limitations on an independent manager's ability to consider the larger enterprise do not violate public policy so long as the provisions do not eliminate the BRE's ability to file altogether. The *301 W. North Ave.* court drew a distinction between operating agreement provisions that clearly delineate and respect a director's fiduciary duties (which are enforceable), and provisions that effectively nullify the right to file bankruptcy (which are unenforceable).

WHY THIS MATTERS

These disputes highlight uncertainty around the effectiveness of standard independent manager and director provisions in BRE governance documents. For lenders, the cases underscore the importance of careful drafting, monitoring, and enforcement of governance protections designed to preserve bankruptcy-remote structures. The cases also highlight that, as a practical matter, it simply may be impossible to prevent a bankruptcy filing if a borrower aggressively interprets governance provisions and is willing to litigate proper corporate authorization and allegations of bad faith filing once the BRE is in bankruptcy. Similarly, for sponsors and borrowers, the litigation illustrates the risk that, even if a BRE is filed, last-minute governance actions may invite heightened judicial scrutiny and delay or complicate an enterprise's broader restructuring strategy.

WHAT TO WATCH

As the First Brands Group cases progress, market participants should monitor how the court evaluates the timing and substance of independent manager appointments, the degree of operational integration between BREs

[2] In re 301 W. North Avenue, LLC, 666 B.R. 583 (Bankr. N.D. Ill. 2025).

and the broader enterprise, and whether alleged defects in filing authority warrant dismissal or lesser remedies.[3]

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[3] After this article was written, but before publication, the BRE Debtors reached settlements with all of the Lenders. The Broad Street secured lenders agreed to abate their motion to dismiss in connection with an agreed cash collateral stipulation with the Debtors, and the Carnaby Inventory secured lenders agreed to withdraw their motion to dismiss without prejudice in connection with a stipulation lifting the automatic stay to permit the secured lenders to enforce their rights against their collateral.

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