Fiduciary Duties in Chapter 11

Richard G. Mason
Outline for American Bankruptcy Institute
17th Annual New York City Conference
May 14, 2015

Wachtell, Lipton, Rosen & Katz
Board of Directors is fiduciary for all stakeholders

- Responsible for maximizing value of estate
- Must navigate potentially competing interests of:
  - secured creditors
  - unsecured creditors
  - equity holders
  - other interested parties (e.g., unions, customers, regulators)
Fiduciary Duties in Chapter 11

Board decisions are reviewed under same standards as outside Chapter 11

• Business judgment
• Entire fairness

But in Chapter 11 the Board’s decisions might be subject to oversight in areas in which, outside of bankruptcy, no court is involved

• Compensation (severance and retention)
• Settlements (9019 review)
• Releases

And the scrutiny can be far more intense and less deferential

• Bankruptcy Court is forum for “real-time” review
• Decisions can be challenged by:
  △ economic stakeholders (ad hoc committees)
  △ official committees (co-fiduciaries)
  △ government officials (United States Trustee)
Fiduciary Duties in Chapter 11

Potential liability for directors is usually low
  • Bankruptcy Court reviews and approves/disapproves non-ordinary course action before it is taken
  • Directors usually released/exculpated in plan of reorganization for post-petition conduct

But directors must nevertheless be diligent in overseeing the debtor
  • Reputation
  • Minimize or avoid public second-guessing of decisions
  • Potential litigation if debtor collapses (Chapter 7 trustee)
Fiduciary Duties in Chapter 11

Three areas in which fiduciary issues can arise

- Appointment of equity committee
- Restructuring Support Agreement
- Conflicts between or among subsidiary-debtors and debtor-parent
Fiduciary Duties in Chapter 11

Appointment of equity committee

- Not warranted if Debtor is “hopelessly insolvent.”
  - △ How and when measured?
  - △ Does this mean Board no longer has fiduciary duty to shareholders?
- Board can “adequately represent” shareholders.
  - △ True in every case?
  - △ Does this put Board in conflict with creditors?
Fiduciary Duties in Chapter 11

Restructuring Support Agreement (RSA)

• Binds creditors but not Debtor (fiduciary-out)
• Creditors often require Debtor to assume RSA
• Forces a mini-trial on plan of reorganization (Plan)
• What is the standard for scrutinizing Board decision to enter into RSA? Good faith? Business judgment? Entire fairness?
Fiduciary Duties in Chapter 11

What if estates have claims against each other?

- Examples: tax claims; allocation of corporate overhead; intercompany loans/advances
- Who analyzes claims and determines whether to bring or settle them? Disinterested directors?
- What about Plan/strategy that affects subsidiaries differently?