APPOINTMENT OF INDEPENDENT DIRECTORS ON THE EVE OF BANKRUPTCY: WHY THE GROWING TREND?

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When a company becomes financially distressed, management often faces difficult questions and tough choices. One question is whether to bring in new personnel to help navigate the situation. The answer, with rising frequency, is a "yes." In recent years, distressed companies have become increasingly likely to appoint particular individuals or groups of individuals, previously unaffiliated with the company, to act as chief restructuring officers and/or independent directors. Chief restructuring officers are frequently hired in distressed situations to provide current management with additional expertise. Indeed, the company's secured creditor may require it in a default scenario as a condition to a restructuring or forbearance. Additionally, struggling corporations may turn to special committees of "independent" or "outside" directors to help make difficult decisions, particularly when the existing directors are conflicted.

While good corporate governance dictates using "independent directors" in a variety of circumstances, in an insolvency context, corporations frequently use "independent directors" when heading into a bankruptcy as a means to avoid the appointment of an examiner or a trustee or where the company expects future transactions will be under intense creditor scrutiny. This article first surveys the relevant principles of Delaware corporate law relating to fiduciary duties, as well as the impact of special committees on the corresponding burdens of proof when fiduciary breaches are alleged. It then discusses recent situations where companies, prior to or at the time of bankruptcy, have appointed independent directors, the incentives for doing so and the implications of those decisions.

I. FIDUCIARY DUTIES OF DIRECTORS

A foundational principal of Delaware corporate law is the separation of control and ownership, under which corporations are managed not by their shareholders, but instead by a board of directors elected by the shareholders.[1] The board of directors typically defines the corporation's business policies and objectives, manages its affairs, appoints and oversees corporate officers and makes decisions regarding significant corporate undertakings and transactions.[2] While directors are responsible for managing the corporation, the company's officers and other management make the day to day decisions on behalf of the corporation, such as hiring employees and executing contracts within the ordinary course of business.[3] Case law establishes that both directors and officers have a fiduciary responsibility to carry out their duties for the benefit of the corporation and its shareholders.[4]

The directors of a corporation are required under Delaware law to manage the business for the benefit of its shareholders.[5] In carrying out their responsibilities, situations arise where, in hindsight, the directors are viewed as acting in their own self-interest or as lacking independence. To "check" this potential for abuse, courts in Delaware and elsewhere have established two basic fiduciary duties to which all directors are beholden: (1) the Duty of Care and (2) the Duty of Loyalty.[6] These duties run from the directors and the officers to the company and its shareholders.[7] Should they fail to meet that standard, case law provides for the possibility of either a direct claim asserted by the shareholders against the directors, or a derivative claim asserted by the shareholders or other constituents against the directors, on behalf of the corporation.[8] While the resolution of fiduciary claims is usually highly contextual and fact-sensitive, courts in Delaware often point to the utilization of independent directors as a factor cutting against fiduciary liability with respect to particular corporate actions.

a. <u>The Business Judgment Rule, Entire Fairness & Enhanced Scrutiny</u>

The business judgment rule is a fundamental tenet of Delaware corporate law under which the decisions of a corporation's directors are afforded strong deference. Judicially established, the business judgment rule presumes that such decisions "have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation."[9] A court will not substitute its judgment for that of the board if the decisions in question were rooted in a rational business purpose.[10] The rule is designed to protect the broad statutory discretion granted corporate directors, and courts accordingly will not second-guess board decisions absent proof the directors failed to exercise a minimum level of care in reaching the decision.[11] The business judgment rule thus protects directors from personal liability for the simple exercise of poor judgment, which in turn maintains the desirability of corporate management positions and allows companies to better attract talented people to manage their affairs.[12] In short, if the board acts in an informed and rational manner calculated to benefit the company's shareholders, the business judgment rule should apply.

The presumption established by the business judgment rule sets a high bar for plaintiffs to overcome. For this reason, early stages of litigation often center on the rule's applicability, namely whether the directors should be entitled to its protections or whether a less deferential standard should apply. Delaware courts have established a framework for making this determination, under which the burden of proof falls on the plaintiff to rebut at least one element of the business judgment rule.[13] To render the presumption in favor of management inapplicable, the plaintiff must show: (1) the directors did not in fact make a decision; (2) the challenged decision was uninformed; (3) the directors were neither disinterested nor independent; or (4) the directors were grossly negligent.[14] Upon the rebuttal of any element, the standard of review shifts to the far less deferential "entire fairness" standard, under which the burden of proof generally shifts to the defendants to demonstrate the entire fairness of the transaction.[15]

Entire fairness review is triggered by a rebuttal of the business judgment rule, especially where a corporation enters into a "conflict" or "insider" transaction – meaning a transaction in which any director is affiliated with the counter-party to the transaction or in which a director or controlling shareholder stands on both sides of the deal.[16] In that context, the defendants will typically bear the burden of proof to demonstrate the transaction's entire fairness.

Courts in Delaware have established two ways, however, in which defendant directors can shift the burden of proof back to the plaintiff to prove a *lack of fairness* – by obtaining the formal approval of a properly functioning committee of independent directors or an informed majority of minority shareholders.[17] In either case, the inquiry is a far more searching one than the business judgment rule provides for, and courts will scrutinize the underlying facts to determine if the action taken was "fair" or not. When the entire fairness standard applies, the party with the burden of proof must prove the transaction was (or in the case of the plaintiff, was not) "entirely fair" to the corporation, as demonstrated by proof of "both fair dealing and fair price" or a lack thereof.[18]

Under an entire fairness inquiry, fair dealing and fair price are separate factors to be examined, although Delaware courts have suggested that evidence of fair or unfair price is the "preponderant consideration."[19] Regarding the fair dealing requirement, Delaware courts have looked to whether the directors approving the transaction had adequate time to consider and respond to the issue/transaction at hand, whether the process was characterized by good-faith negotiations and whether there was evidence of coercion.[20] Additionally, courts inquire whether the board possessed and considered all material information concerning the transaction in making its decision.[21]

As part of the "fair price" inquiry, courts applying the entire fairness standard in the context of a sale, acquisition or merger will evaluate the sufficiency of the purchase price underlying the transaction. Fair price need not be the highest price available, but it must be a price a reasonable seller under the circumstances could reasonably accept.[22] Courts may consider, among other things, market and asset values, earnings and comparable transactions.[23] While the specifics of the entire fairness inquiry naturally depend on the type of transaction in question, a board's need to demonstrate a lack of harm to the corporation through proof of fair price and fair dealing is critical.[24]

While the business judgment rule and entire fairness standard mark the least and most onerous levels of review, respectively, that Delaware courts apply to corporate transactions, an intermediate standard of review known as "enhanced scrutiny" exists as well.[25] Enhanced scrutiny analysis applies in limited situations, typically involving the approval of a sale transaction that results in a change of control or a board's defensive action against a takeover bid.

Established in *Unocal v. Mesa Petroleum Co.*,[26] enhanced scrutiny is triggered when identifiable situations arise in which potential conflicts of interest might undermine the decisions of even independent directors.[27] Under an enhanced scrutiny analysis, the burden of proof initially rests with the defendant directors to demonstrate that their motivations were proper and reasonably related to their legitimate objective.[28] The directors will only be entitled to the protections of the business judgment rule after they are found to have satisfied that "threshold" inquiry.[29]

In *Unocal*, the Delaware Supreme Court examined the response of a target board to a hostile takeover in which the board conducted a self-tender at a significantly higher price than what the hostile bidder had offered to the shareholders. The Court found that enhanced scrutiny, rather than the business judgment rule, was the proper standard of review because of the inherent conflict of interests in the use of takeover defenses, namely the purchase of shares with corporate funds.[30] Applying enhanced scrutiny, the Court held the board was obligated to show reasonable grounds for believing the hostile bid posed a "danger to corporate policy and effectiveness," but that this burden could be carried through a showing of good faith and a reasonable investigation. Moreover, the Court noted that the approval of a board consisting of a majority of independent directors would "materially enhance" the board's showing of reasonableness.[31]

Because the Court found the board, based on its investigation, had a reasonable and rational belief that the terms of the bidder's tender offer were inadequate and coercive, it held the enhanced scrutiny standard was satisfied and the board's actions would thus be judged instead under the business judgment rule.[32] As stated by Justice Holland of the Delaware Supreme Court in a 2008 lecture for the Institute of Law and Economics at the University of Pennsylvania Law School, *Unocal*'s significance was two-fold. First, it introduced the concept of enhanced scrutiny, and second, it emphasized the presence of independent directors as "guardians of the board's decision-making process."[33]

Since *Unocal*, other Delaware decisions have expanded the applicability of the enhanced scrutiny standard. The most well-known of these subsequent decisions was the 1986 case *Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*[34] In *Revlon*, the court extended the enhanced scrutiny application to the sale of a corporation, also in connection with an offer from a hostile bidder. The court held that once the board authorized the negotiation of the sale and the company's break-up thus became "inevitable," the duty of the board switched from preserving the company as a corporate entity to maximizing the value of the sale for the company's shareholders.[35] As such, the court found a "lock-up" agreement by the board to sell certain company assets to a third party at a price below market value, essentially "ending an active auction," was an impermissible violation of the duty of loyalty because it was motivated to protect the company's noteholders (who had threatened litigation in the face of declining value of their notes), rather than to maximize value to the shareholders in the sale context.[36] In the years since *Revlon*, enhanced scrutiny has been further extended to other situations involving company sales in which a board's decision appears to be influenced by considerations other than the best interests of the business or the shareholders.[37]

b. Duty of Care

The duty of care obligates directors to make decisions on an "informed basis."[38] Given the level of deference afforded directors under the business judgment rule, board members will not be held in violation of the duty of care unless a plaintiff can demonstrate the actions taken were done so with gross negligence.[39] Although what constitutes gross negligence is fact-specific, generally courts will not find directors in breach of their duty of care unless the members of the board "collectively have failed to inform themselves fully and in a deliberate manner before voting" on a significant corporate transaction.[40] In the well-documented case of *Smith v. Van Gorkom*, the Delaware Supreme Court held that a corporation's directors breached their duty of care by approving a merger agreement during the course of a two-hour meeting without reviewing the agreement itself or evaluating the sufficiency of the purchase price.[41] The court rejected the argument that the collective experience and sophistication of the board members rendered the decision inherently reasonable and well-informed, and found the directors should have exercised greater diligence before submitting the proposal to the company's shareholders.[42]

In light of *Van Gorkom* and its progeny, one commentator has suggested that, to meet their duty of care, directors should consider all relevant information, take their time in making an evaluation and implement monitoring systems to detect regulatory and legal failures within the business.[43] Additionally, in many instances, the board frequently retains and consults with professionals or experts.[44] The DGCL provides directors may reasonably rely on expert advice and guidance as long as their reliance on the information in question is in good faith.[45] That said, this does not obviate the need for directors to do their own homework. Regardless of whether experts are consulted, the inquiry remains the same: did the board adequately inform itself of all relevant information before making a decision? If not, the directors will lose the protections of the business judgment rule and the transaction will instead be evaluated under the aforementioned entire fairness standard.[46]

c. Duty of Loyalty

While a duty of care analysis is implicated by the board's objective failure to do its homework, duty of loyalty issues typically arise when a director's decision-making is compromised by an undisclosed conflict of interest or when a director acts in bad faith.[47] A formal duty of loyalty dates back to *Guth v. Loft*, in which the Delaware Supreme Court established that corporate directors and officers may not use their positions of confidence and trust to further their own private interests.[48] Courts have since reasoned that because corporations have perpetual existence[49] and the equity capital of their shareholders is thus permanent, directors must take actions aimed to achieve the greatest long-term value of the corporation not for their own benefit, but for the benefit of those who provided such capital.[50]

The duty of loyalty requires directors to act at all times in furtherance of the best interests of the corporation and its shareholders, regardless of any personal or disparate interests they might hold.[51] To comport with the duty of loyalty, a corporation's directors must have a good faith belief that the actions being taken are those most likely to benefit the corporation.[52] One way for directors to demonstrate this good faith – or at least the absence of bad faith – is to simply avoid making decisions when they are likely to suffer from an actual or perceived conflict of interest. Judicial decisions since the 1980s have suggested that tasking independent directors with such decisions can be a persuasive, if not conclusive, means of protecting directors from duty of loyalty liability.

In 1983, in *Weinberger v. UOP, Inc.*, the Delaware Supreme Court held that directors who sat on the board of both a parent company and its subsidiary when the parent eliminated the subsidiary's minority shareholders through a cash-out merger violated their duty of loyalty, in large part because they prepared the feasibility study concluding that the transaction would be a "good investment."[53] Notably, the decision included a "now famous footnote" (footnote 7), stating "the result here could have been entirely different if [the subsidiary] had appointed an independent negotiating committee of its outside directors to deal with [the parent] at arm's length."[54] As noted by Justice Holland, Delaware courts since *Weinberger* have echoed this principle.[55]

d. <u>Fiduciary Duties in LLCs and Partnerships</u>

Much of the reason for the wealth of statutory and case law respecting corporate governance issues is that corporations were the dominant business form for many years. Over the past two decades, however, the limited liability company ("*LLC*") has become vastly more popular.[56] LLCs provide the same limited liability protections as corporations, but offer potentially more favorable tax treatment for their members than corporate shareholders receive.[57] Additionally, corporate shareholders typically purchase their shares subject to non-negotiable terms and conditions, while LLC membership interests may be negotiated and individualized in accordance with the governing operating agreement.[58]

The Delaware Limited Liability Company Act (the "*LLC Act*") explicitly provides that LLC operating agreements may be drafted to eliminate all liability for breaches of fiduciary duties, other than those constituting a "bad faith violation of the implied contractual covenant of good faith and fair dealing."[59] Based on freedom of contract principles, the rights and privileges of the members of an LLC – as well as the protections to which they are entitled – are typically established in the applicable operating agreement to which all members and any managers are bound.[60] Cases interpreting the LLC Act have followed its plain language, holding that when express, the language of the operating agreement will control.

In the 2009 case *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, the Delaware Chancery Court noted "[t]he Delaware LLC Act gives members of an LLC wide latitude to order their relationships, including the flexibility to limit or eliminate fiduciary duties."[61] In that case, the court denied the defendant's motion to dismiss a fiduciary breach claim because the operating agreement contained two apparently contradictory provisions, one section stating the members had the same duties and obligations to one another as provided for in the Delaware LLC Act, and the other disclaiming all duties outside of those imposed by the operating agreement. Applying the principle that (absent a contrary provision in the operating agreement) LLC managers owe traditional fiduciary duties to the members, the court found because the elimination of fiduciary duties was not "plain and unambiguous," such duties would be deemed applicable.[62] However, this holding has been interpreted as at odds with the Delaware Chancery Court's decision one year earlier, in which Chancellor Chandler stated, "[i]n the context of limited liability companies, which are creatures not of the state but of contract, those duties or obligations must be found in the LLC Agreement or some other contract."[63]

While the uncertainty persisted in subsequent decisions, the Delaware legislature clarified the situation in August 2013.[64] Eleven words were added to Section 18-1104 of the

LLC Act, which now reads "[i]n any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity related to fiduciary duties and the law merchant, shall govern."[65] While case law citing the revised section remains sparse, since the amendment it appears that in the absence of contrary language in the LLC Agreement, default fiduciary duties apply to LLC managers.[66]

Another recent case, although outside of Delaware, has addressed whether – in the bankruptcy context – the management of a debtor partnership owes fiduciary duties to a debtor's estate even in the face of an operating agreement disclaiming such duties. In *In re Houston Regional Sports Network, L.P.*,[67] an involuntary chapter 11 petition was filed against Houston Regional Sports Network, L.P. (the "*Debtor*") by four of its creditors, all Comcast affiliates. The Debtor limited partnership was comprised of three limited partners, the Houston Astros (the "*Astros*"), the Houston Rockets and Houston SportsNet Holdings, LLC, and a general partner, Houston Regional Sports Network, LLC (the "*General Partner*"). Four directors sat on the General Partner's board of directors (the "*Houston Board*"), each of whom - under the operating agreement – was required to consent to any voluntary chapter 11 filing by the Debtor.

When the involuntary petition was filed, the Astros moved to dismiss the petition for bad faith and futility.[68] The Astros argued that under Section 1112(b)(4)(A) of the Code, any plan of reorganization required the Astros' consent and that the Astros could vote in their own interest because they did not owe any fiduciary duty to the partnership under the operating agreement. Accordingly, the Astros asserted that as limited partners of the Debtor, they would veto any plan of reorganization and subsequent business deals, even if profitable.[69]

In considering the Astros' argument, the court acknowledged that the "[Debtor] was created in a manner to disclaim any fiduciary responsibilities by the partners."[70] The court then explained that in a chapter 11 proceeding with no trustee, the estate's fiduciary duties lie with the directors of the debtor-in-possession.[71] The court rejected the argument that the partnership was a "bankruptcy remote structure that absolves its director's fiduciary responsibilities."[72] Noting that the Houston Board owed fiduciary duties to the Debtor, the court found that the board members would breach those duties if they adhered to a blanket policy under which they would veto *any* reorganization proposal.[73] The court refused to hold the reorganization futile based on the exercise of a power that the Astros did not even have under the law.[74]

The *Houston Regional Sports Network* decision suggests that the management of partnerships and LLCs, once a bankruptcy proceeding is initiated, may not be able to rely on provisions in operating and partnership agreements that disclaim fiduciary duties.

e. Fiduciary Duties in Insolvency

When a business becomes insolvent, the directors' obligations to act in accordance with the duties of care and loyalty continue. Should they fail to do so, the same remedies apply.[75] At the same time however, insolvency triggers a potential expansion of interested parties, as the board of an insolvent company becomes beholden to act in the best interests of all stakeholders.[76] In establishing this concept, Delaware courts have explained when directors of an insolvent company breach their fiduciary duties, causing a diminution in the value of the business, the "principle constituency injured" by such conduct is the company's creditors.[77] Therefore, if an insolvent company's board fails to maximize value for its creditors – even if it is acting for the benefit of the shareholders – the directors may face potential liability.

That said, in *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla* ("*Gheewalla*"), the Delaware Supreme Court struck a victory for directors in affirming the Chancery Court's holding that creditors of an insolvent corporation only have standing to bring derivative, but not direct claims, against a board or its members.[78] For a creditor to achieve standing to assert breach of fiduciary duty claims against the directors, creditors must thus assert the directors breached their duty owed to the corporation, rather than to the creditors themselves.[79] The Supreme Court agreed with the Chancery Court's assessment that creditors have existing protections – through negotiated agreements, fraudulent conveyance and bankruptcy law, and security instruments – which render direct claims unnecessary in light of the potential cost to economic efficiency.[80] The court noted concern that the potential for creditors to bring direct claims could undermine the corporation's important ability to negotiate these claims in good faith, thus handicapping struggling companies from working to find solutions to their problems.[81] Moreover, Justice Holland pointed to the need for clarity and certainty in the landscape, and reasoned that recognizing a "new right" for creditors to bring direct claims for breach of fiduciary duty would inevitably conflict directors between acting in the best interests of the corporation as a whole and the best interests of the creditors.[82]

II. Independent Directors & Special Committees

a. Background

As discussed in Part I, Delaware case law over the past three decades has emphasized the importance of the utilization of "independent directors" as a matter of good corporate governance.[83] An independent director of a corporation is a non-employee, non-management director who derives no income from his or her position outside of customary director fees.[84] Independent directors are appointed by the company's current board of directors and are typically appointed in small groups as "special" committees, who act and make their decisions as a body. The use of a special, independent committee is a long-standing tool to ensure the decisions in question are – from an objective standpoint – sound choices calculated to benefit the company.[85] Although Delaware law does not mandate the use of special committees, the DGCL expressly allows for their formation.[86]

Special committees are often formed for a particular purpose and the responsibilities of the individual committee-members thus depend on the stated purpose.[87] Corporate governance in Delaware has seen the formation of two broad classes of committees, transactional committees and special litigation committees.[88] Transactional committees are often more specifically described as negotiation committees, and may be tasked with negotiating corporate transactions and evaluating their impact on the company. These committees are typically appointed when a controlling shareholder is a party to the transaction in question or when existing board members have a conflict of interest that would render them potentially unable to conduct good faith negotiations on behalf of the company.[89]

Litigation committees are formed to conduct investigations as to possible wrongdoing by the corporation or its directors, and in turn to provide a recommendation on whether a cause of action is available to parties who have allegedly suffered harm.[90] In this way, independent directors who serve on litigation committees perform similar functions to those of bankruptcy examiners.[91]

Legally, the appointment of a special committee to evaluate and approve a transaction provides two major benefits: (1) in non-conflict situations it makes the business judgment rule more likely to apply, particularly if used in conjunction with a shareholder vote, and (2) when the entire fairness standard applies, it may shift the burden of proof to the plaintiff to prove the transaction's lack of fairness.[92] Regardless of which standard applies, the appointment of independent directors is a strategic mechanism to ensure that if a transaction is challenged, the burden of proof will rest with the plaintiffs to establish a breach of fiduciary duty.[93]

b. <u>Independence Alone May Not Be Enough</u>

In conflict situations, however, the use of a special committee alone does not automatically shift the burden to the plaintiffs. The committee, in addition to being independent, must be "well functioning" – meaning it must have actual bargaining power and the real ability to decide whether to accept or reject the terms of an offer.[94] Even if the board is entirely independent, decisions regarding conflict transactions must not be made without properly considering available alternatives and following a thorough evaluative procedure, or the burden of proof will remain with the defendant directors.[95]

In *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*[96] ("*Southern Peru*"), the Delaware Chancery Court found the defendant corporation, a mining company listed on the New York Stock Exchange, and its directors liable for breaching their fiduciary duty of loyalty in connection with the acquisition of a Mexican mining company at an unfairly high price.[97] Despite the fact that a special committee of independent directors had been formed to evaluate the proposal, the committee's failure to "negotiate" the transaction and consider alternatives caused the burden of proof to remain with the defendants.[98] The court additionally held that regardless of the burden-shift, the merger was fundamentally unfair as evidenced by the fact the corporation paid significantly more for the acquisition than the acquired company was worth.[99] In light of the *Southern Peru* decision that independent directors must not only review the transaction, but must conduct a searching evaluation, it becomes even more important for companies to hire savvy and sophisticated professionals who can properly make these assessments.

Since *Southern Peru*, the Delaware Court of Chancery has continued to require more from independent directors than simply their "independence." In *In re Puda Coal*, the court refused to dismiss an action for breach of fiduciary duty against independent directors who resigned after their investigation into conduct by the company's CEO was halted.[100] Puda Coal Inc. was a Delaware corporation created through a merger with a Chinese company which had most of its assets in China. The plaintiff shareholders alleged that the CEO of the company stole corporate assets through a series of unauthorized transfers, but the independent directors failed to discover the theft for eighteen months. Upon finally discovering the alleged theft, the independent directors attempted to investigate the situation, but their efforts were "stonewalled."[101] Then, instead of making further efforts to investigate or protect the company from the CEO, the independent directors resigned. The Court of Chancery found their decision to resign at that time, leaving the company under sole control of someone they subjectively believed to have committed a major corporate theft, akin to "run[ning] away," which Chancellor Strine characterized as a "Monty Python response."[102] The court additionally suggested the decision to leave at that stage might be, in itself, a breach of fiduciary duty, and denied the motion to dismiss partly on that basis.[103]

Comments from the *Puda* court suggest that independent directors could face possible liability for failing to adequately monitor the business, even absent the decision to resign.[104] Placing weight on the fact that the assets were situated in China, the court commented that directors "better have [their] physical body in China an awful lot" and "better have the language skills to navigate the environment in which the company is operating."[105] In this case, the independent directors in question – only one of whom spoke Chinese – failed to demonstrate sufficient engagement in the company's affairs to warrant a dismissal of the complaint.[106] The lessons from *In re Puda Coal* are thus two-fold. First, independent directors must be fully active and aware of developments in the business they have been hired to oversee, even if the company's assets are located abroad. Second, in the face of potential wrongdoing – and particularly when the alleged wrongdoer remains in control of the company – independent directors may not simply "run away" and expect to wash their hands of the situation.[107] Instead, the independent directors may need to pursue legal action, or at least monitor the situation to ensure future wrong-doing is avoided.[108] Just how far an independent director must go to protect the company will likely be a fact-sensitive inquiry.

c. **Standards for Independence**

When a director's (or a committee's) independence is challenged, the party challenging the transaction bears the burden of proof to demonstrate a lack of independence.[109] However, the standard as to whether an individual is an "independent director" largely depends on the situation and its context. The New York Stock Exchange ("*NYSE*"), for example, requires listed companies to have a majority of independent directors and mandates the establishment of entirely independent compensation and nominating committees.[110] As to what constitutes independence under its requirements, the NYSE requires a listed company's board of directors to determine that the "director has no material relationship with the listed company," either as a partner, shareholder or officer.[111] The NYSE also imposes additional independence requirements for members of compensation committees, namely that the board "must consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management."[112]

Rendering clarity in the landscape even more elusive, NASDAQ listing rules – while imposing the same NYSE requirement that a majority of the board members of a listed company be independent – employs its own criteria for independence. For purposes of compliance with NASDAQ listing rules, an independent director is a person "other than an Executive Officer or employee of the Company or any other individual having a relationship which, in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director."[113]

Furthermore, a separate standard arises under Sarbanes-Oxley for independence of public company audit committee members. Sarbanes-Oxley directs the SEC to require *each* member of an audit committee to be independent. The SEC accordingly has established standards for independence under the Securities Exchange Act of 1934 (the "*Exchange Act*").[114] While the Exchange Act does not specifically define the term "independent director," it provides that in order to be considered independent for audit committee purposes, a director may not accept consulting fees, advisory fees or other compensation from the company.[115]

All that said, the richest interpretation and analysis of independence standards can be found in Delaware case law. The Delaware Court of Chancery has held that to be considered independent, directors must not themselves be dominated or controlled by any party with an interest in the transaction.[116] For example, the court found directors of a corporation lacking independence when the corporation's controlling shareholder was an entity controlled by an individual who controlled other businesses through which the directors received significant employment compensation.[117] On the other hand, a simple friendship between a director and an interested party has been held insufficient on its own to establish the director's lack of independence.[118] In reaching these decisions, Delaware courts have rejected the application of bright-line rules and instead have evaluated the specifics of any alleged conflicts in light of factual circumstances.

Finally, the "strictest test" for independence was established in 2003, also under Delaware case law's contextual approach.[119] In *In re Oracle Corp.*, the Delaware Chancery Court held that to be considered independent, a director must be free from any personal interest or relationship rendering him or her incapable of acting with the best interests of the corporation in mind.[120] In that case, a corporation's shareholders brought fiduciary breach claims in connection with the sale of the company's stock by certain directors alleged to have traded on the basis of material, non-public information.[121] After the action was initiated, the company established a two-director special litigation committee to investigate the trades in question. When the special committee found no breach under the facts and moved to terminate the litigation, the court denied the motion because questions of material fact as to the special committee members' independence remained.[122] Because both special committee members were professors at Stanford University – as was one of the defendants – and because other defendants had made sizable contributions to Stanford, questions remained about the committee's impartiality and independence.[123] As then-Vice Chancellor Strine noted, a director may be "compromised" by virtue of being "beholden to an interested person," even in the absence of any financial connection between them.[124]

d. **Independent Directors for Insolvent Corporations**

Many of the reasons companies have traditionally leaned on the guidance of independent directors are equally applicable in the context of an impending bankruptcy. First and foremost, companies heading toward insolvency may need greater experience in the restructuring area.

More specifically, the appointment of independent directors immediately before bankruptcy could be a sign the board of directors is concerned about potential conflicts of interest with respect to strategic decisions to be made in the bankruptcy.[125] For example, the Debtor may intend to pursue an action the board would like to see "validated" by an independent party – whether it be a particular course of action or the submission of a general restructuring plan. Employing an outside director to exercise independent judgment as to corporate transactions in bankruptcy may not only provide additional guidance to a suffering business, but can make the decision-making process seem right in the eyes of stakeholders and ultimately, the court.

Recent cases have used the appointment of independent directors for the purpose of conducting investigations as to the corporation's past conduct.[126] By launching investigations through an outside director, the corporation avoids the inevitable conflict of interest that would arise if the existing board were tasked with investigating its own prior conduct. It also demonstrates to the company's shareholders that the business is willing to honestly assess management's prior actions. Strategically, a corporation that appoints independent directors may have a better chance of pre-empting an argument for the appointment of an examiner or a trustee, or of quashing a creditor's committee request for standing to file suit against the board for a breach of the duty of loyalty.[127]

e. **Examples**

1. Cengage Learning, Inc.

In 2013, one of the largest textbook publishers in the United States, Connecticut-based Cengage Learning, Inc. ("*Cengage*") filed a voluntary chapter 11 petition in the Eastern District of New York. Only six years after a private equity group led by Apax Partners LLP ("*Apax*") acquired the company for $7.75 billion, Cengage was faced with a 22 percent decline in revenues and insufficient liquidity to pay off its obligations.[128] Hoping a new emphasis on product innovation and cost-cutting would make the company a viable market player again, Cengage filed for bankruptcy to restructure its balance sheet and reduce its $5.8 billion debt level.[129] Prior to the filing however, Apax purchased over $1 billion of Cengage debt.[130] Months later, Cengage engaged Richard Feintuch – a former Wachtell, Lipton, Rosen & Katz partner and director of PGT, Inc. – as an independent director to aid in analyzing potential restructuring alternatives for the company. When advised as to the pre-petition debt purchases by Apax, Feintuch decided to investigate whether Cengage might be able to assert breach of fiduciary duty claims against Apax or any Cengage directors.[131]

In the course of his investigation, Cengage granted Feintuch the authority to assess, in his sole discretion, whether valid claims against Apax existed, and if so, whether to prosecute them.[132] To aid in the investigation, Feintuch hired an outside law firm, Wilkie, Farr & Gallagher, to serve as his independent counsel and to prepare a detailed report of findings (the "*Wilkie Report*") for his review. Clearly troubled by Feintuch's role, the official committee of unsecured creditors filed a motion requesting the court to terminate, or in the alternative suspend, his investigation.[133] The creditors' committee alleged the Feintuch investigation was too limited in scope and that it would compromise the committee's ability to conduct its own investigation. The committee requested that the court suspend the investigation until the board provided more information regarding its evaluatory process and until the committee completed a separate investigation of its own.[134] After lengthy discussions, an agreement was reached to allow the Feintuch investigation to continue. Upon reviewing the Wilkie Report, however, Feintuch concluded that Cengage likely had no viable claim against either Apax or any director and it would thus not be in the best interests of the company to bring an action related thereto.[135]

2. <u>Edison Mission</u>

In similar fashion, Edison Mission ("*Edison*"), a prominent California-based energy development firm and holding company, filed a voluntary chapter 11 petition in the Northern District of Illinois in December 2012. Edison hired Kirkland and Ellis as its independent restructuring counsel, who recommended the appointment of independent directors to "make decisions on topics for which [certain] directors might have a conflict."[136] Edison then engaged two independent directors – Frederic Brace and Hugh Sawyer – to provide advice and leadership for the business and to serve as the sole members of its newly formed special committees – an investigation committee and a compensation committee.[137] Both Brace and Sawyer were "experienced restructuring professionals" chosen on the basis of their qualifications and experience in previous chapter 11 cases.[138]

In the years leading up to the bankruptcy, Edison's parent company – Edison International – received a number of significant distributions from Edison, drawing the ire of Edison and its creditors. In 2012, just months before the bankruptcy, Edison International withdrew $183 million from Edison and terminated a tax-sharing agreement between the two entities.[139] Edison and its unsecured creditors' committee asserted that Edison International's conduct was the exercise of "abusive domination and control" over the soon-to-be bankrupt Edison, calculated to drain Edison's value for the benefit of its parent.[140] The creditors' committee alleged that since its founding, Edison had operated as nothing more than a "controlled division" of Edison International. Specifically, it compared the relationship between Edison and its parent to a minor league baseball team in a major league team's farm system, in which Edison was used simply as a "training ground" for employees to gain experience without jeopardizing Edison International.[141] As members of the investigation committee, Brace and Sawyer were charged with investigating such allegations and deciding whether claims should be brought.[142]

In their role as members of the compensation committee, Brace and Sawyer made decisions on executive compensation and bonuses for corporate management and other key employees. In this capacity, they formulated a plan to distribute a total of up to $7.5 million in bonuses to Edison employees, including $6.4 million in incentives for insiders and $1.1 million in retention payments for non-insider employees.[143] Brace testified that insider employees would receive "no guaranteed payouts" and payouts for such insiders would be tied to "actual, future operational and other transactional results."[144] Over the U.S. Trustee's objection, Judge Jacqueline Cox of the U.S. Bankruptcy Court in Chicago, IL allowed the payments to insiders as proper incentive payments under the Bankruptcy Code.[145] This result should be instructive for other distressed companies – the use of an independent special committee to make and execute restructuring plans can increase the likelihood courts will uphold the actions taken.

3. WorldCom, Inc.

The use of independent directors in high-profile bankruptcy cases is nothing new. In what at the time was the largest bankruptcy ever, Houston-based WorldCom, Inc. ("*WorldCom*") filed for chapter 11 bankruptcy in 2002 with $107 billion in assets. Prior to the bankruptcy, WorldCom had initiated a series of acquisitions – including the 1998 purchase of MCI Communications Corporation – establishing it as the second-largest United States long-distance telecom company. However, as a result of changes in the telecom industry and the exposure of a massive accounting fraud by certain executives, WorldCom found itself unable to pay its debts as they came due.[146] On June 26, 2002, the Securities and Exchange Commission ("*SEC*") initiated a lawsuit against WorldCom and less than one month later, WorldCom filed its bankruptcy petition in the Southern District of New York.[147] Soon after, the WorldCom board formed a special investigative committee of independent directors to conduct an investigation of substantial accounting irregularities. The independent directors selected by the board included Nicholas Katzenbach, former United States Attorney General and general counsel of IBM, and Dennis Beresford, an accounting professor at the University of Georgia who had previously served as chairman of the Financial Accounting Standards Board.[148]

On March 31, 2003, the independent investigative committee released its Report of Investigation (the "*WorldCom Report*") summarizing its findings regarding the accounting fraud. The Report stated that to avoid redundancies, the investigation was coordinated with a separate investigation by Richard Thornburgh, the examiner appointed by the bankruptcy court.[149] While Thornburgh's investigation addressed relationships between WorldCom and its outside financial analysts, the company's merger and acquisition activities and the role of WorldCom management in securities offerings, the independent committee focused on the existence of false or unsupported accounting entries allegedly made to help WorldCom achieve certain financial results.[150]

The Report presented detailed findings that high-ranking people at WorldCom deliberately engaged in certain practices to artificially inflate revenues.[151] The Report also criticized the board as "so passive and reliant on [management] that it had little opportunity to learn of the fraud."[152] Furthermore, the Report suggested the board's authorization of a bonus plan rewarding short-term revenue growth may have incentivized the wrongful conduct in question.[153]

All in all, the WorldCom Report painted a picture of a distressed company whose top-level management elected to fraudulently conceal its losses and whose outside auditors were woefully deficient in detecting substantial accounting irregularities. Those in position to put an end to the fraud either failed to detect it or failed to blow the whistle, which in conjunction with a poor system of internal controls led to what remains one of the largest bankruptcies of all time. WorldCom is thus an example of why companies should involve independent professionals in decision-making processes, particularly when the business is struggling.[154]

4. <u>Station Casinos, Inc.</u>

In *In re Station Casinos Inc.*, Station Casinos, Inc. ("*SCI*"), a hotel/casino operator, filed for chapter 11 protection in 2009 in the face of significant debt and a rapid decline in revenues. Just two years earlier, SCI had completed a going-private transaction which left 24.1% of the company in the hands of SCI's parent company and 75.9% with an investment group owned by affiliates of the debtors' and outside investors.[155] In connection with taking the company private, SCI's Board had formed a special committee of independent directors to evaluate any offers or proposals for business combinations or sales. The special committee – after two and a half months of negotiation – agreed to a transaction price of $90 per share plus dividends, eight dollars per share higher than the initial offer received.[156] On the basis of the committee's recommendation, the board approved the private sale. According to the SCI disclosure statement, the transaction left the company "highly, but not unreasonably, leveraged," which, in conjunction with a global economic recession, SCI was unable to withstand.[157] Faced with the need to restructure its business, SCI filed a voluntary chapter 11 petition in the District of Nevada.

As part of its restructuring, SCI once again formed a special committee – this time a litigation committee to investigate potential fraudulent conveyance and related claims in connection with the debt incurred in taking the company private. The litigation committee consisted of three members, an independent member of the SCI board and two independent members (with restructuring expertise) with no prior connections to SCI.[158] The committee hired its own independent attorneys and financial advisor to assist with its investigation. Ultimately, the committee found no evidence of fraud or improper conduct by any parties in connection with the company's going-private transaction, and thus recommended that no action be taken in connection therewith.[159]

After nearly nine months in chapter 11, SCI adopted a new strategy to initiate a § 363 sale to a purchasing entity owned in part by SCI's controlling shareholders.[160] In doing so, SCI grouped its assets into two separate groups of casinos, its Las Vegas properties (the "Propco" properties) and its other properties (the "Opco" properties). To the ire of its creditors, SCI only included the Opco properties in the § 363 sale, while the Propco properties and certain intellectual property were transferred to the same purchasing entity *outside* of the auction process. SCI created a special committee of independent directors to oversee the $772 million sale and to evaluate the offer as well as any rival buyout proposals.[161] The sale eventually was consummated and the debtor's controlling shareholders continued to operate all of the casinos.[162]

In response, Boyd Gaming ("*Boyd*"), a major competitor of the Debtors' in the Las Vegas casino market who was not selected as the stalking-horse bidder, withdrew from the § 363 auction and objected to the bidding process.[163] According to Boyd, the auction process was rigged in favor of SCI's owners and the separation of the Propco properties from the Opco properties would create a windfall for Propco while leaving Opco as a "shell" that would need to be rebuilt.[164] Other creditor groups and independent lenders also protested, alleging that the sale process did not provide sufficient opportunity for outside purchasers to make bids because the Opco assets were not sufficiently marketed and the timeframe for interested purchasers to conduct due diligence (30 days) was insufficient.[165]

Upon review of the sale procedure, the court held that because the proposed sale was to a company owned in part by insiders, the transaction should be evaluated under the entire fairness standard.[166] In examining the transaction under the heightened standard, the court found the stalking-horse bid to be a fair and reasonable reflection of the company's value, selected only after "vigorous competition" between the winning bid and other bidders.[167] The court additionally pointed to the presence of independent directors in overseeing the auction as a factor supporting its conclusion that the Debtors had satisfied their burden of proving the fairness of the transaction.[168]

The Station Casinos bankruptcy exemplifies the various roles independent directors may be tasked with in connection with a single bankruptcy. Additionally, it evidences how courts may look to the presence of independent directors not only as a factor supporting the business judgment rule's application, but alternatively as a factor supporting a factual finding on behalf of the debtor even under a heightened scrutiny analysis.

III. BANKRUPTCY EXAMINERS

a. Background and Purpose

The issue of independent oversight in the bankruptcy context extends beyond the appointment of independent directors. A controversial issue in large chapter 11 bankruptcies is whether the court is obliged to appoint an independent examiner to oversee an investigation. An examiner is a private individual appointed by the United States Trustee ("*UST*") in a chapter 11 case to investigate and report on potentially wrongful prepetition conduct.[169] In 1978, Congress created examiners to provide "special protection for the large cases having great public interest", and like certain independent directors, examiners have played a key investigative role in a number of significant bankruptcies.[170] Unlike trustees, examiners – typically bankruptcy attorneys or other professionals with experience in restructuring or forensic accounting– do not take over for the Debtor, but rather perform their investigative duties while the Debtor remains in control of its own business.[171]

An examiner brings objectivity and impartiality to the administration of the bankruptcy estate. The theory is that oversight by a "disinterested" party brings a fresh set of eyes less likely to suffer from conflicts of interest or ongoing errors in judgment.[172] But examiner investigations are notoriously expensive, which has led to debate as to whether their appointment is worth the time and cost it necessarily entails.[173] This debate is fueled by the fact that examiner investigations may be duplicative of prior or ongoing investigations by creditor's committees or special committees of independent directors.

Additional points of contention arise because the United States Bankruptcy Code (the "*Code*") is unclear on whether courts have discretion to refuse his or her appointment.[174] Section 1104(c)(2) of the Code provides in part "on request of a party in interest . . . the court *shall* order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate . . . if such appointment is in the . . . interests of the estate; or the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5 million."[175] While "shall" suggests a court order appointing an examiner would be mandatory, the "as is appropriate" language has been read as a qualifier undermining that conclusion. In 1990, the Sixth Circuit – the first circuit court to address the issue – held that the word "shall" must be read without qualification and thus required the court to appoint an examiner.[176] The court noted the discretion of the bankruptcy court applies in its ability to direct the examiner's investigation once-appointed, rather than in the decision to appoint the examiner in the first place.[177]

Other courts, however, have rallied against the "mandatory" appointment interpretation, pointing to the massive costs associated therewith and reasoning examiner requests may be nothing more than a "litigation or negotiating ploy."[178] In the 2012 case *In re Residential Capital, LLC*, the United States Bankruptcy Court for the Southern District of New York explicitly disagreed with the Sixth Circuit, holding that even if the provisions of 1104(c)(2) are satisfied, the appointment of an examiner is not mandatory.[179] In reaching his conclusion, Judge Glenn examined the legislative history of 1104(c), citing language providing that to render appointment mandatory, the protection of an examiner "must be needed."[180] On the facts however, the court found sufficient evidence that an examiner would be necessary and beneficial to the administration of the case, thus mandating appointment.[181]

b. AgFeed Industries, Inc.

In the recent Delaware bankruptcy case of hog producer AgFeed Industries, Inc., the company had suffered substantial losses in China between 2008 and 2011 stemming from alleged fraud by its Chinese management.[182] The UST filed a motion asserting the need for an examiner to ensure the proper administration of the chapter 11 process. In its motion, the UST argued that despite the debtor's formation of a special committee, reliable financial reports for the years in question were never produced, and an examiner would assist in this process and properly identify any potential colorable claims against bad actors within the company.[183]

In response, the Debtors – joined by both the official committees of equity holders and unsecured creditors – asserted that the examiner would waste millions of dollars investigating what was already investigated in 2011 by its special committee, particularly in light of the UST's failure to allege any deficiency or lack of completeness in the prior investigation.[184] The Debtors' objection additionally alleged that the appointment of an examiner would risk derailing a $50 million sale of the company's Chinese assets. In support of this assertion, the Debtors referenced a provision in the stock purchase agreement allowing the potential buyer to terminate the deal if a bankruptcy examiner was appointed.[185]

Upon review, Judge Brendan L. Shannon, noted he had numerous questions regarding the examiner's effect on the process, and admitted he was wrestling with "the utility of the exercise."[186] At a hearing on September 30, 2013, Judge Shannon sided with the Debtors, placing significant weight on the objections from the committees of creditors and equity holders. While he did not rule out the possibility an examiner could be appointed later in the case, Judge Shannon deferred to the parties' arguments that an examiner appointment could undermine the sale process, and stated he would "leave to another day" the question of whether the appointment of an examiner would be proper.[187]

c. New Century Financial Corporation

A bankruptcy examiner's assessment does not in itself establish substantive liability, but may illuminate questionable or wrongful conduct that creditors can point to in court.[188] In the highly-publicized bankruptcy of California-based New Century Financial Corporation ("*New*

Century"), a bankruptcy examiner was appointed by the Delaware bankruptcy court to investigate potential fraud within the company and accounting failures by the company's auditor, KPMG. New Century was engaged in a booming business as a subprime mortgage lender, but when the recession in 2007 caused many of its borrowers to default, the company was forced to file for chapter 11.[189] Shortly thereafter, the UST moved to appoint a chapter 11 trustee, or in the alternative, an examiner. Choosing to leave New Century to manage its own affairs, the court did not appoint a chapter 11 trustee, but appointed Michael Missal as examiner to investigate a number of misstated financial statements.

Missal eventually produced a report largely focusing on the failures of KPMG to discover the financial mismanagement, but additionally noting New Century's failure to cooperate with the investigation. For example, Missal's report stated the Debtor "unreasonably withheld" thousands of relevant documents.[190] As to New Century, the report concluded the bankruptcy estates had viable causes of action against New Century executives to recover bonuses and other compensation awarded based on financial criteria which later turned out to be false. Although Missal did not find intentional manipulation by New Century with respect to its earnings, the report noted the company "had a brazen obsession with increasing loan originations, without due regard to the risks associated with that business strategy."[191]

Regarding New Century's auditors, Missal found KMPG had "contributed to certain of these accounting and financial reporting deficiencies" by allowing them to continue.[192] The result of these failures was, among other things, a reported profit of $63.5 million in the third quarter of 2006, when the company had actually suffered a loss. The report concluded that on that basis, as well as other misstatements, the estate might be able to pursue claims against KPMG for professional negligence and negligent misrepresentation.[193] At the end of the day, a class action and SEC enforcement suit were brought against New Century and KPMG, both of which settled for substantial sums.[194]

IV. CONCLUSION

Independence is a key concept in corporate governance as applied to healthy and struggling companies alike. In the best of times, qualified independent personnel should be consulted with respect to major transactions to ensure the contemplated actions are taken in an effort to benefit the corporation's shareholders, as well as to demonstrate the board's objectivity and good faith. From a litigation standpoint, when corporations assign decision-making to independent, unbiased professionals, they are more likely to receive the protections of the business judgment rule. When the business judgment rule is unavailable, as where there is a conflict of interest, the presence of properly functioning independent directors can shift the burden of proof to the plaintiff to demonstrate lack of fairness, thus making it less likely the court will set the transaction aside.

When a business begins to erode, depending on the circumstances, the use of independent directors can become even more important. Independent directors brought in during insolvency or on the brink of bankruptcy can indicate a commitment by the company's board to investigate any prior wrongdoing and to continue managing the company for the benefit of the stakeholders. Upon an actual bankruptcy filing, independent directors remain instrumental both to explore and negotiate possible restructuring options and to investigate questionable conduct for which the estate may pursue a claim.

In some instances, the role of the independent director may be supplemented by the bankruptcy examiner. The appointment of the examiner, while more controversial than the use of independent directors, is further evidence of the degree of independence courts expect businesses to exercise when they restructure. Regardless of title, or mechanics, the conclusion remains the same – the *proper* use of independent professionals can provide a company with fresh perspectives and added expertise to help make complicated decisions. Additionally, when a business utilizes independent directors, it signals to stakeholders that their interests are being protected and increases the likelihood that courts, to the extent possible, will allow the company to continue to manage its own affairs.

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[1] *See, e.g.*, 8 Del. C. § 141(a) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors."); Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998).

[2] *See, e.g.*, L. Johnson & D. Millon, Recalling Why Corporate Officers are Fiduciaries, 46 Wm. & Mary L. Rev. 1597, 1607 (2005) ("Simply put, stockholders elect directors who, by statute, exercise, or authorize others to exercise, all corporate powers and manage, or direct others in the management of, the business and affairs of the corporation . . . Acting on behalf of the corporation, the board of directors appoints and sets the compensation of senior officers, delegates managerial responsibilities to those officers, and monitors and evaluates the managerial performance of officers.").

[3] *See id.* at 1601 (noting officers manage daily corporate operations while director monitoring is more remote).

[4] *See*, *e.g.*, In re US Digital, Inc., 443 B.R. 22, 40-41 (Bankr. D. Del. 2011) ("The legal responsibility of managing the business of a corporation for the benefit of its shareholders rests with the board of directors. Accordingly, the Delaware Supreme Court has long recognized that fiduciary duties are imposed on directors and officers of a Delaware corporation.").

[5] *See* In re Trados Inc. S'holder Litig., 73 A.3d 17, 36 (Del. Ch. 2013); eBay Domestic Hldgs., Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010); *accord* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) ("The directors of Delaware corporations have the legal responsibility to manage the business of a corporation for the benefit of its shareholder[ ] owners."); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

[6] For many years, Delaware courts referred to a "triad" of fiduciary duties: due care, loyalty, and good faith. However, in 2006, the Delaware Supreme Court established that the duty to act in good faith was a "subsidiary element" of the duty of loyalty, rather than an independent fiduciary duty. *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("[A]lthough good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty.").

[7] While this article refers to Delaware corporate law, it is important to recognize that fiduciary principles in other states may differ. *See* F. Lipman & L. Keith Lipman, Corporate Governance: Best Practices, 27 (2006) ("In many states other than Delaware, fiduciary duties are owed only to the organization and not to its equity holders. In addition, approximately 40 states (excluding Delaware) permit directors to consider the interest of constituencies other than equity holders in complying with their fiduciary duties.").

[8] *See* Z. Olson, Direct or Derivative: Does it Matter After Gentile v. Rossette? Journal of Corporation Law, 33 J. Corp. L. 595, 598 (2008) (defining a derivative claim as "a claim belonging to the corporation, which an individual or group of individuals brings on behalf of the corporation" and contrasting it to a direct claim, defined as "a claim belonging to an individual (or class of individuals) that is appropriately brought by that individual (or class) on his or her (or their) own behalf.") In a derivative suit, any recovery goes to the corporation while in a direct suit, the recovery goes directly to the shareholders. *See id.*

[9] Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987); *see also* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), *overruled on other grounds* 965 A.2d 695 (Del. 2009).

[10] *See, e.g.,* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

[11] *See* In re Los Angeles Dodgers LLC, 457 B.R. 308, 313 (D. Del. 2011).

[12] *See* Gagliardi v. Trifoods Intnt'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996) (explaining that unlike shareholders, directors see no financial upside from entering into high-risk transactions on behalf of the corporation). Because directors receive no direct benefit from a risky transaction, absent the business judgment rule there would be no incentive for a board to take any actions other than the most risk-averse business decisions. *Id.*

[13] *See* In re Trados Inc. S'holder Litig., 73 A.3d 17, 43 (Del. Ch. 2013) ("Unless one of [the business judgment rule's] elements is rebutted, 'the court merely looks to see whether the business decision made was rational in the sense of being one logical approach to advancing the corporation's objectives.'"(citation omitted)).

[14] *See* In re Los Angeles Dodgers LLC, 457 B.R. at 313.

[15] *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361-62 (Del. 1993) (stating the purpose of the entire fairness standard is to shift the burden of proof from the plaintiff to the defendant directors).

[16] *See id.*; Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994) (applying entire fairness standard in context of interested merger); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness.").

[17] *See* Kahn, 638 A.2d at 1117 (explaining although the initial burden under entire fairness rests with the party on both sides of the transaction, there are two situations which will cause the burden on the issue of fairness to shift to the party challenging the transaction).

[18] *See* Cede 634 A.2d at 361-62; In re Los Angeles Dodgers LLC, 457 B.R. at 313.

[19] *See, e.g.*, Weinberger, 457 A.2d at 711.

[20] *See id.*; *see also* Kahn, 638 A.2d at 1121.

[21] *See* In re Emerging Commc'ns, Inc. S'Holder Litig., 2004 Del. Ch. LEXIS 70, at *129 (Del. Ch. May 3, 2004).

[22] *See, e.g.*, Cede, 634 A.2d at 361 (stating when the issue involves the sale of a company, the directors must show that the offered price was the "highest value reasonably available under the circumstances.").

[23] *See, e.g.*, Weinberger, 457 A.2d at 711.

[24] *See* R.R. Donnelley, Fiduciary Duties and Other Responsibilities of Corporate Directors and Officers, 5th Ed., at 34.

[25] *See* In re Trados Inc. S'holder Litig., 73 A.3d 17, 43 (Del. Ch. 2013) ("Enhanced scrutiny is Delaware's intermediate standard of review.").

[26] 493 A.2d 946 (Del. 1985).

[27] In re Trados Inc. S'holder Litig., 73 A.3d at 43.

[28] *See id.* (citing Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 810 (Del. Ch. 2007)).

[29] *See* Unocal, 493 A.2d at 954 ("Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.").

[30] *See id.* (citing Bennett v. Propp, 187 A.2d 405, 409 (Del. 1962)).

[31] *Id.* at 955.

[32] *Id.* at 958.

[33] R. Holland, Delaware Directors' Fiduciary Duties: The Focus on Loyalty, Distinguished Jurist Lecture, U. Penn. Law School, Inst. for Law & Econ., at 686 (Nov. 11, 2008).

[34] *See* 506 A.2d 173 (Del. 1986).

[35] *See id.* at 182 ("The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.").

[36] *See id.* at 175-76, 182.

[37] C. Furlow, Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware, 2009 Utah L. Rev. 1061, 1089-90 (2009). *See also* Paramount Commc'ns v. QVC Network, 637 A.2d 34 (Del. 1993); In re Topps Co. S'holders Litig., 926 A.2d 58 (Del. Ch. 2007).

[38] *See, e.g.*, In re US Digital, Inc., 443 B.R. 22, 41 (Bankr. D. Del. 2011).

[39] *See id.*

[40] *See id.; see also* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 366-68 (Del. 1993) (describing standard for violation of duty of care).

[41] *See* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), *overruled on other grounds* 965 A.2d 695 (Del. 2009).

[42] *See id.* at 873, 880.

[43] *See* Donnelley, *supra* note 24, at 16-17.

[44] *See id.*

[45] 8 Del. C. § 141(e).

[46] In practice, however, directors in Delaware can benefit from the protection afforded by Section 102(b)(7) of the DCGL, which allows corporations to eliminate, in their certificate of incorporation, director liability for duty of care breaches. 8 Del. C. § 102(b)(7).

[47] *See* Donnelley, *supra* note 24, at 22.

[48] *See* 5 A.2d 503, 510 (Del. 1939); *see also* Schoon v. Smith, 953 A.2d 196, 206 (Del. 2008).

[49] *See* 8 Del. C. § 102(b)(5).

[50] *See* In re Trados Inc. S'holder Litig., 73 A.3d 17, 37 (Del. Ch. 2013).

[51] *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361-62 (Del. 1993) (noting "classical" examples of director self-interest, including when a director appears on both sides of a transaction or is benefited from a transaction while shareholders are not).

[52] *See, e.g.,* Guttman v. Huang, 823 A.2d 492, 508 n.34 (Del. Ch. 2003) ("A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest.").

[53] 457 A.2d 701, 705 (Del. 1983).

[54] *Id.* at 715, n.7 (Del. 1983); Holland, *supra* note 33, at 685 (characterizing footnote 7 in Weinberger as "famous").

[55] Holland, *supra* note 33, at 685 ("For the last twenty-five years, the Delaware courts have emphasized the importance of independent directors in safeguarding the interests of shareholders by preserving the integrity of the corporate governance process.").

[56] *See* M. Steele, Freedom of Contract and Default Contractual Duties in Delaware Limited Partnerships and Limited Liability Companies, 46 Am. Bus. L.J. 221, 222 (2009) ("As evidence of the Delaware limited liability company's (LLC) prowess, the Delaware Secretary of State reports that nearly 112,000 new LLCs were formed in 2007, compared to just 43,000 new formations in 2001."); *see also* N. Sciotto, Opt-In vs. Opt-Out: Settling the Debate Over Default Fiduciary Duties in Delaware LLCs, 37 Del. J. Corp. L. 531 (2012) (noting LLCs are the nation's most popular business form).

[57] *See* M. Harner & J. Marincic, The Naked Fiduciary, 54 Ariz. L. Rev. 879, 886-87 (2012).

[58] *See* Steele, *supra* note 56, at 222.

[59] 6 Del. C. § 18-1101(e) ("A limited liability company agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement; provided, that a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.").

[60] *See* Sciotto, *supra* note 56, at 537 (explaining LLCs are contractual entities and LLC agreements are the "cornerstone" to their operation (citing Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 291 (Del. 1999))).

[61] Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC, No. 3658-VCS, 2009 WL 1124451, *8 (Del. Ch. Apr. 20, 2009).

[62] *Id.* (applying the principle that when multiple contractual provisions are ambiguous, the defendants will only be entitled to dismissal under Rule 12(b)(6) if the interpretation upon which the defendant's theory of dismissal rests is the "only reasonable construction as a matter of law" (citation omitted)).

[63] Fisk Ventures, LLC v. Segal, No. 3017-CC, 2008 WL 1961156, *8 (Del. Ch. May 7, 2008). As noted in an article by former Chief Justice Myron T. Steele, however, the statement in Segal is somewhat ambiguous because it speaks of "duty" as a general concept, rather than referencing "fiduciary" duties in particular. *See* Steele, *supra* note 56, at 230.

[64] T. Kearns, Delaware LLC Statute Amendment Regarding Default Fiduciary Duty, Olshan Law (Oct. 11, 2013).

[65] 6 Del. C. § 18-1104. While the prior version of the statute stated rules of law and equity would apply to all cases "not provided for," the 2013 version added the phrase "including the rules of law and equity related to fiduciary duties." D. Batey, Stoel Rives LLP, Uncertainty over Delaware LLC Fiduciary Duties to be Clarified, LLC Law Monitor (Apr. 16, 2013).

[66] *See* Kearns, *supra* note 64; Batey, *supra* note 65.

[67] No. 13-35998 (Bankr. S.D. Tex., February 12, 2014).

[68] *See id.* at 1.

[69] *See id.* at 17-18.

[70] *See id.* at 17.

[71] *See id.* at 21 ("In a chapter 11 case in which no trustee is appointed, the fiduciary duties to the Estate rest with a debtor-in-possession's directors.").

[72] *Id.*

[73] *See id.* at 20. In footnote 3, the court explains that the parties had not fully briefed the fiduciary responsibility issue, and that although it "strongly believe[d]" that the directors had fiduciary duties as of the entry for relief, the court was "not reaching a final conclusion" on that issue. *Id.* at 20, n. 3.

[74] *See id.* at 24 ("The court is unaware of any case law that would support a dismissal of futility that is engineered by the party seeking the dismissal.").

[75] *See, e.g.*, Davis Polk & Wardwell, The Fiduciary Duties of Directors of Troubled U.S. Companies: Emerging Clarity, Chap. 2 (2008) ("The [Delaware court] decisions stress that in all situations – including insolvency – the duty of directors is always to direct the affairs of the corporation so as to maximise its value for the benefit of its stakeholders.").

[76] *See* Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 787-89 (Del. Ch. 1992) (interpreting other cases as having established that "it is the fact of insolvency which causes the duty to creditors arise." (citation omitted)).

[77] Production Resources Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 792 (Del. Ch. 2004).

[78] *See generally* 930 A.2d 92 (Del. 2007).

[79] *See id.* at 103 ("[W]e hold that individual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation.").

[80] *See id.* at 100-01.

[81] *See id.*

[82] *See id.* at 103.

[83] The DGCL refers to "interested directors" but not "independent directors." *See, e.g.*, 8 Del. C. § 144 (discussing "interested directors"). Although the concepts are related, "independent" in this context has a broader meaning than "interested." While a director is interested in a given transaction if (s)he stands to derive financial benefit unavailable to other shareholders, independence goes beyond mere financial interest and involves a more comprehensive analysis of whether the director is in some way connected to an interested individual or is influenced by personal or extraneous considerations in his or her decision-making. *See* Holland, *supra* note 33, at 687.

[84] *See* Selectica, Inc. v. Versata Enter., Inc., No. 4241-VCN, 2010 WL 703062, at *13 (Del. Ch. Feb. 26, 2010), *aff'd*, 5 A.3d 586 (Del. 2010).

[85] *See, e.g.*, G. Varallo, W. McErlean & R. Silberglied, From Kahn to Carlton: Recent Developments in Special Committee Practice, 53 Bus. Law 397 (1998) (noting since the 1982 decision of Weinberger v. UOP, Inc., special committees have commonly been used in corporate transactions in which conflicts of interests are implicated).

[86] 8 Del. C. § 141(c)(1) ("The board of directors may. . . designate 1 or more committees, each committee to consist of 1 or more of the directors of the corporation.").

[87] *See* Lipman, *supra* note 7 (describing a number of reasons for which special committees are typically formed, including – among others – conducting investigations involving directors, considering whether to terminate an action brought by shareholders in the name of the corporation and considering transactions in which existing board members have adverse interests to the corporation).

[88] *See* Varallo, McErlean & Silberglied, *supra* note 77, at 397.

[89] *See id.* at 397-98 (describing transactional committees).

[90] *See id.*

[91] For a discussion of bankruptcy examiners, *see infra* notes 161-185 and accompanying text.

[92] *Compare* Oberly v. Kirby, 592 A.2d 445, 466 (Del. 1991) (noting the approval by a disinterested committee of directors may cause a transaction to be evaluated under the business judgment rule) *with* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994) (stating that mergers with controlling shareholders will be evaluated under entire fairness review, but describing situations in which the burden may shift from the defendant to plaintiff to prove the unfairness of the transaction).

[93] *See* Lipman, *supra* note 7, at 94 (explaining that "the proper creation and operation of [an independent committee] can shift the burden of proof to the plaintiff complaining about such decisions or recommendations and assist in protecting directors from personal liability").

[94] *See, e.g.,* In re First Boston, Inc. S'holder Litig., No. 10338, 1990 Del. Ch. LEXIS 74 (June 7, 1990).

[95] *See, e.g.,* Rabkin v. Olin Corp., No. 7547, 1990 WL 47648, at *861-62 (Del. Ch. Apr. 17, 1990), *aff'd* 586 A.2d 1202 (Del. 1990) ("The mere existence of an independent special committee . . . does not itself shift the burden. At least two factors are required. First, the majority shareholder must not dictate the terms of the merger. (citation omitted). Second, the special committee must have real bargaining power that it can exercise with the majority shareholder on an arms length basis.").

[96] 52 A.3d 761 (Del. Ch. 2011).

[97] *See id.* at 819.

[98] *See id.* at 769, 774 (noting that the board resolution establishing the special committee did not give the committee the express power to negotiate, nor to consider other alternatives). "Instead of [acting like a third-party negotiator], the Special Committee was 'comforted' by the fact that they could . . . justify paying more for Minera than they originally thought they should." *See id.*

[99] *See id.* at 797.

[100] *See* In re Puda Coal, Inc. S'holders Litig., C.A. No. 6476–CS, 15–17, Feb. 6, 2013 (TRANSCRIPT).

[101] *See* D. Katz & L. McIntosh, Can You Resign From the Board of a Troubled Company?, The CLS Blue Sky Blog, May 23, 2013.

[102] In re Puda Coal, Inc. S'holders Litig., at 23 (TRANSCRIPT).

[103] *See id.* ("If these directors are going to eventually testify that at the time they quit they believed that the chief executive officer of the company had stolen the assets out from under the company, and they did not cause the company to sue or do anything, but they simply quit, I'm not sure that that's a decision that itself is not a breach of fiduciary duty.").

[104] *See id.*

[105] *Id.* at 17-18.

[106] *See id.* at 11, 17-19.

[107] *See id.* at 23.

[108] *See id.* ("[T]here are some situations in which running away does not immunize you. It in fact involves a breach of fiduciary duty. And I think the extreme circumstances here might well constitute one.").

[109] *See, e.g.,* In re Maxxam, Inc. / Federated Dev. S'holder Litig., 659 A.2d 760, 773 (Del. Ch. 1995).

[110] New York Stock Exchange, Listed Company Manual § 303A (2013) ("Listed companies must have a majority of independent directors."); *see also* J. Farano, How Much is Too Much? Director Equity Ownership and its Role in the Independence Assessment, 38 Seton Hall L. Rev. 753, 759 (2008).

[111] New York Stock Exchange, Listed Company Manual § 303A (2013).

[112] New York Stock Exchange, Listed Company Manual § 303A (2013) (stating the factors a board must consider include, but are not limited to, the source of the director's compensation and whether the director is affiliated with the listed company or its subsidiaries).

[113] NASDAQ, Equity Rules § 5605 (2013). The NASDAQ equity rules additionally delineate seven classifications of persons who will not be considered independent under its listing standards, including a director who was employed by the company in question at any time within the past three years.

[114] *See* Farano, *supra* note 102, at 756 ("Consistent with the SEC's charge to prevent market fraud perpetrated through inaccurate corporate disclosures, Sarbanes-Oxley directs the SEC to require audit committees to be composed solely of independent directors to oversee the audit of those disclosures.").

[115] 15 U.S.C. § 78j-1(m).

[116] *See, e.g.,* In re Maxxam, Inc. / Federated Dev. S'holder Litig., 659 A.2d 760, 773 (Del. Ch. 1995).

[117] *See id.*

[118] *See, e.g.,* Orman v. Cullman, 794 A.2d 5 (Del. Ch. 2002).

[119] *See* Lipman, *supra* note 7, at 98.

[120] *See* In re Oracle Corp Derivative Litig., 824 A.2d 917, 920 (Del. Ch. 2003).

[121] *See id.* at 920.

[122] *See id.*; s*ee also* Lipman, *supra* note 7 at 98-99 (discussing Oracle).

[123] *See* Oracle, 824 A.2d at 942 ("Using the contextual approach I have described, I conclude that the [special litigation committee] has not met its burden to show the absence of a material factual question about its independence. I find this to be the case because the ties among the [special litigation committee], the [defendants], and Stanford are so substantial that they cause reasonable doubt about the [special litigation committee's] ability to impartially consider whether the [defendants] should face suit.").

[124] *See id.* at 938-39. *See also* Lipman, *supra* note 7, at 98 (explaining that under the Oracle approach, especially in the special litigation committee context, courts will "closely scrutinize relationships between special committee members and the directors whose conduct they may be called on to review.").

[125] *See, e.g.,* In re Edison Mission Energy, Docket No. 1090, Notice of Debtors' Objection to Creditors' Committee's Motion for Standing (Bankr. N.D.IL. Aug. 14, 2013) (noting that after retaining restructuring counsel, the Debtors' board elected independent directors to make decisions that the existing directors could not make for conflict reasons).

[126] *See, e.g.,* S. Bishop, Cengage Looks to Continue Exploring Apax Debt Buy, Law360, July 24, 2013.

[127] *See, e.g.,* *See* J. Santo, US Trustee Wants Ch. 11 Examiner Appointed in AgFeed Case, Law360, September 16, 2013. In In re AgFeed USA LLC, the debtor company asserted that a previous investigation by its special committee rendered the subsequent appointment of an examiner unnecessary. *See id.*

[128] *See* M. Schwartz, Cengage May Declare Bankruptcy, Library Journal, May 14, 2013.

[129] *See id.*; *see also* Cengage Learning, Cengage Learning Reaches Agreement with Lenders to Restructure Balance Sheet and Strengthen Financial Position, Press Release, July 2, 2013.

[130] M. Spector & E. Glazer, Buyout Firm Gathers Cengage Debt, Wall Street Journal, April 26, 2013.

[131] *See* In re Cengage Learning, Inc., Docket No. 181, Declaration of Richard D. Feintuch in Support of Debtors' Objection to Motion of the Official Committee of Unsecured Creditors For an Order Terminating or, in the Alternative, Suspending the Debtors' Prepetition Investigation into Certain Conduct of Apax Partners, L.P. and its Affiliates (Bankr. E.D.N.Y. July 30, 2013).

[132] *See* In re Cengage Learning, Inc., Docket No. 180, Debtors' Objection to Motion of the Official Committee of Unsecured Creditors for an Order Terminating or, in the Alternative, Suspending the Debtors' Prepetition Investigation into Certain Conduct of Apax Partners, L.P. and its Affiliates (Bankr. E.D.N.Y. July 30, 2013).

[133] *See* In re Cengage Learning, Inc., Docket No. 164, Motion of the Official Committee of Unsecured Creditors for an Order Terminating or, in the Alternative, Suspending the Debtors' Prepetition Investigation into Certain Conduct of Apax Partners, L.P. and its Affiliates (Bankr. E.D.N.Y. July 26, 2013).

[134] *See id.*

[135] *See* In re Cengage Learning, Inc., Docket No. 553, Disclosure Statement for Debtors' Joint Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code, 41-42 (Bankr. E.D.N.Y. Oct. 3, 2013).

[136] *See* In re Edison Mission Energy, Docket No. 1090, Notice of Debtors' Objection to Creditors' Committee's Motion for Standing, par. 14. (Bankr. N.D.IL. Aug. 14, 2013).

[137] Edison Mission Energy, Form 10-K/A, Item 10, Dec. 31, 2012.

[138] *See* In re Edison Mission Energy, Docket No. 1090, par. 14. Prior to his appointment at Edison, Frederic Brace was the Chief Restructuring Officer and Chief Financial Officer of UAL Corporation, the parent of United Air Lines, Inc., and had guided UAL through a very successful chapter 11. Hugh Sawyer was appointed on the basis of over 30 years of experience as a director or officer in complex chapter 11 restructurings, including Spiegel, Inc. and Allied Systems Holdings Inc. *See id.* at par. 15-16.

[139] *See* J. Palank, UPDATE: Edison Mission Creditors Seek Standing to Sue Parent, ADVFN, August 1, 2013.

[140] *See id.*

[141] *Id.*

[142] *See* In re Edison Mission Energy, Docket No. 1090.

[143] *See* J. Palank, Judge Approves Edison Mission's $7.5 Million Employee Bonus Plan, Nasdaq, November 6, 2013.

[144] In re Edison Mission Energy, Docket No. 1404, Declaration of Frederic I. Brace in Support of Debtors' Reply to the United States Trustee's Objection to the Debtors' Motion to Approve (I) Entry into Plan Sponsor Agreement, (II) Sponsor Protections, and (III) Related Relief, par. 12 (Bankr. N.D.IL. Oct. 24, 2013).

[145] *See* In re Edison Mission Energy, Docket No. 1561, Order Approving Exit Plan (Bankr. N.D.IL. Nov. 6, 2013).

[146] L. Beltran, Worldcom Files Largest Bankruptcy Ever, CNN Money, July 22, 2002.

[147] *See* Report of Investigation by the Special Investigative Committee of the Board of Directors of WorldCom, Inc. ("WorldCom Report"), 2 (Mar. 31, 2003).

[148] *See* Beltran, *supra* note 138.

[149] *See* WorldCom Report. at 3.

[150] *See id.* at 3-4.

[151] *See id.* at 5-8. WorldCom's improper accounting occurred in two different ways: reduction of reported line costs and exaggeration of reported revenues. *See id.* at 9.

[152] *Id.* at 7.

[153] *See id.*

[154] In another developing situation, Energy Future Holding Corporation (formerly, TXU corporation) has been struggling with financial issues, although it has not yet filed for bankruptcy. In 2006, the company appointed four independent directors to bring new expertise to the company and to increase transparency in its decision-making. *See* TXU Annual Report, 2006. More recently, a report surfaced that in 2013 the company added two new directors, at least one of whom was purportedly independent, prior to the board's vote on making a significant interest payment. Commenting on the situation, Erik Gordon, a professor at the University of Michigan's Ross School of Business, stated "[y]ou want independent directors to sign off on those decisions. You don't want the decisions to be attacked as being self-interested rather than for the benefit of the company and its creditors." *See* B. Jinks & R. Bravo, Energy Future Said to Add New Directors as Vote on Default Nears, Bloomberg, Oct. 29, 2013.

[155] Station Casinos, Inc., Form 8-K, Item 9.01, Exhibit 2.1, Disclosure Statement to Accompany First Amended Joint Chapter 11 Plan of Reorganization for Station Casinos, Inc. and Its Affiliated Debtors, at 29 ("Station Casinos Disclosure Statement") (July 28, 2010).

[156] *See id.*

[157] *See id.* at 35.

[158] *See id.*

[159] *See id.* at 41.

[160] D. Carragher, Sales to Insiders: Are they Entirely Fair?, American Bankruptcy Institute Journal, Vol. XXIX, No. 9, November 2010.

[161] *See* Associated Press, Station Casinos Gets 4.7 Billion Dollar Buyout Offer, Fox News, December 4, 2006.

[162] *See* Carragher, *supra* note 152, at 1 (describing situation as one in which "the controlling shareholders managed to preserve the enterprise's going-concern value and repurchase the assets for their own benefit at a fraction of the company's debts").

[163] *See id.*

[164] *See* S. Green, Boyd Gaming Objects to Station Casinos Reorganization Plan, Las Vegas Sun, Apr. 22, 2010.

[165] *See id.* (quoting independent lenders' comment "the process makes no sense: It's like selling KFC without the Colonel's secret recipe, or selling Coke without the formula, because the seller fails to capture the full value of the enterprise and the buyer acquires a business crippled without its competitive advantage"). *See also* Carragher, *supra* note 152, at 2.

[166] *See* Carragher, *supra* note 152, at 2.

[167] *See id.*

[168] *See id.*

[169] *See* J. Lipson, Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies, 84 Am. Bankr. L.J. 1, 2 (2010).

[170] *See id.*

[171] *See* In re Big Rivers Elec. Corp., 355 F.3d 415, 422 (6th Cir. 2004). *See also* S. Lubben, Dynegy Bankruptcy Examiner Finds Fraudulent Transfer, New York Times, Mar. 9, 2012 (noting examiner, Susheel Kirpalani, was a "well-respected bankruptcy lawyer"); F. Norris, Market Place; Almost Everyone Is Faulted In Interco Bankruptcy Case, New York Times, Oct. 25, 1991 (discussing Interco bankruptcy in which examiner was head of Kelley Drye & Warren bankruptcy practice).

[172] *See* In re Big Rivers, 355 F.3d at 429-30 (discussing requirement that examiners be disinterested).

[173] *See, e.g.,* Lipson, *supra* note 161, at 53 (comparing costs and benefits of bankruptcy examiners and noting such costs may be "significant").

[174] *See id.* at 14 (noting courts have "struggled to understand whether Congress really meant that examiners should be appointed if requested in any reasonably large case, regardless of cost or need.").

[175] 11 U.S.C. § 1104(c), in full, provides:

(c) If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if – (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

[176] *See* In re Revco D.S., Inc., 898 F.2d 498, 499 (6th Cir. 1990) (holding language of 11 U.S.C. § 1104(c) mandated examiner's appointment).

[177] *See id.* at 501.

[178] *See* Lipson, *supra* note 161.

[179] *See* In re Residential Capital, LLC, 474 B.R. 112, 121 (S.D. N.Y. 2012) (holding although Section 1104(c) expresses a Congressional *preference* for the appointment of a bankruptcy examiner when the requisite factors are met, courts may deny the request when the evidence establishes that under the facts and circumstances of the case, an examiner is not necessary).

[180] *See id.* at 1120-21.

[181] *See id.* at 1122 (explaining why, under the facts of the case, the appointment of an examiner was required). Judge Glenn noted no trustee had been appointed, no plan had been confirmed, the Debtors owed over $5 million in fixed debts, and that there was no dispute as to the fact that an investigation of the Debtor's conduct was appropriate. *See id.*

[182] *See* M. Chiappardi, AgFeed Says Ch. 11 Examiner Could Derail $50M China Deal, Law360, September 25, 2013.

[183] *See* J. Santo, US Trustee Wants Ch. 11 Examiner Appointed in AgFeed Case, Law360, September 16, 2013.

[184] *See* Chiappardi, *supra* note 174.

[185] *See id.*

[186] *See* J. Santo, AgFeed Judge Must Appoint Ch. 11 Examiner, Trustee Argues, Law360, September 30, 2013.

[187] *See* J. Santo, AgFeed Judge Nixes Bid for Ch. 11 Examiner to Probe Fraud, Law360, October 1, 2013.

[188] *See* A. Johnson, Examiner Finds Rocky Relationship Between Ally, Rescap, Wall Street Journal, June 26, 2013 ("Examiners' reports aren't binding on the bankruptcy court, though creditors could use details to support arguments in the future.").

[189] *See* B. Keoun & S. Church, New Century, Biggest Subprime Casualty, Goes Bankrupt, Bloomberg, Apr. 2, 2007.

[190] *See* Final Report of Michael J. Missal, Bankruptcy Court Examiner, pg. 18 (Feb. 29, 2008).

[191] *See* K. LaCroix, New Century Examiner's Report Faults KPMG, Company Officials, The D&O Diary, March 27, 2008.

[192] *Id.*

[193] *See id.* KPMG vigorously contested the report's conclusions. According to Kathleen Fitzgerald, the KPMG spokesperson at the time, "[t]he examiner . . . prepared an advocacy piece, which has many one-sided statements and significant omissions." *See* F. McKenna, The Bankruptcy Examiner's Report: Shining a Bright Light on Auditor Failure, Forbes, Nov. 1, 2010.

[194] *See* K. LaCroix, First-Filed Subprime Securities Suit Settles for $125 Million, The D&O Diary, Aug. 3, 2008. Of the total settlement amount, $65,077,088 was assigned to former New Century directors and officers, $44,650,000 to KPMG, and $15,000,000 to parties who underwrote the offering. *See id.*