

Examining the Role of Independent Directors in Chapter 11 UTLAW CLE

41st Annual Jay L. Westbrook Conference
November 17-18, 2022
Austin, Texas

Norton Rose Fulbright US LLP



1

Moderator:

The Honorable E. Lee Morris
United States Bankruptcy Court, Northern District of Texas,
Fort Worth, TX

Panelists:

David Dunn
Principal
Province, Inc., Stamford, CT

Ryan Manns
Co-Head, Financial Restructuring & Insolvency
Norton Rose Fulbright, Dallas, TX

2

Introduction: Appointment of independent directors in financially distressed situations

- Important tool to consider: the appointment of unaffiliated individuals with expertise in navigating distressed situations to act as independent directors.
- Charged with analyzing management's decisions and authorizing major transactions or investigations; particularly useful when the company expects its actions to come under greater scrutiny by its creditors.
- A company's lenders may also demand the appointment of an independent director as part of a forbearance agreement or in connection with providing funding for a comprehensive restructuring.

3



3

What are the benefits of appointing an independent director?

- Can help bolster relationships and credibility with key creditors and other important constituents.
- Independent evaluation/insulation of non-ordinary course transactions (e.g., asset sales, new employee compensation programs, new financing arrangements or modifications to these arrangements). See e.g. 11 U.S.C. § 363(b)(1).
- These may include “insider” transactions subject to heightened scrutiny.

4



4

What are the benefits of appointing an independent director? (cont.)

- Prepetition board of directors' decisions are protected by the business judgment rule so long as the board is well-informed and acts in the company's best interest.¹
- Post-petition decisions of management are protected by the business judgment rule so long as there is an articulated business justification.²
- Because an independent director has not previously been involved in a company's business affairs, his or her decisions are not influenced by the self-interests of existing stakeholders and therefore are more likely entitled to deference under the business judgment rule.³

1. *Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 746-47 (Del. Ch. 2005) (directors of a corporation enjoy a presumption that in "making a business decision the directors of a corporation acted on an informed basis and in the honest belief that the action taken was in the best interest of the company.")

2. *Institutional Creditors of Continental Airlines, Inc. v. Continental Airlines, Inc.*, 780 F.2d 1223, 1226 (5th Cir. 1986); *Committee of Equity Security Holders v. Lionel Corp.*, 722 F.2d 1063, 1070-71 (2d Cir. 1983).

5 3. E.g., *Friedman v. Dolan*, 2015 WL 4040806 (Del. Ch. June 30, 2015). If a conflict of interest exists, the decision will be held to the heightened "entire fairness standard. *In re LATAM Airlines Group, S.A.*, 620 B.R. 722, 769 (Bankr. S.D.N.Y. 2020).



5

Rise of Independent Directors

The use of independent directors in bankruptcy cases has increased from 3.7% in 2004 to 48.3% in 2019.³

Potential Reasons:

- The Sarbanes-Oxley Act of 2002 (15 U.S.C. §§ 7201-7266) and related listing rules tightened independence standards and required public corporations to staff their boards and committees with independent directors.
- Institutional investors emphasize board independence.
- A means to avoid regulations and preserve corporate autonomy.
- Court deference to board decisions made by independent directors.

3. Jared A. Ellias, Ehud Kamar, and Kobi Kastiel, *The Rise of Bankruptcy Directors*, Forthcoming 95 *Southern California Law Review* (2022).

6



6

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](https://utcle.org/elibrary)

Title search: Examining the Role of Independent Directors in Chapter 11s

First appeared as part of the conference materials for the 41st Annual Jay L. Westbrook Bankruptcy Conference session "Examining the Role of Independent Directors in Chapter 11s"