PRESERVING STATE CORPORATE GOVERNANCE LAW IN CHAPTER 11: MAXIMIZING VALUE THROUGH TRADITIONAL FIDUCIARIES

JOHN WM. ("JACK") BUTLER, JR.
CHRIS L. DICKERSON
STEPHEN S. NEUMAN*

INTRODUCTION

In designing chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code"),[1] Congress made a considered judgment,[2] upon the occurrence of a company filing for protection under chapter 11, to leave both the operation of the company's business and control of the chapter 11 case, in most instances, in the hands of state law fiduciaries operating as debtors-in-possession.[3] Absent the demonstrated failure of traditional state law fiduciaries, through fraud or gross mismanagement, Congress understood that business enterprise value would be maximized if traditional state law fiduciaries operated the debtor's business and controlled the chapter 11 cases under the Bankruptcy Code as opposed to the former federal trustee model embodied in chapter X of the Bankruptcy Act that the Bankruptcy Code superseded.[4]

Empowering state law fiduciaries to manage a chapter 11 case enables those fiduciaries to maintain normalized business relationships with stakeholders and make the scores of complex business judgments necessary to navigate a complex business from the filing of a petition for relief through the confirmation of a plan of reorganization. Congress deftly avoided the "fox in the henhouse" trap by (a) anointing court-appointed statutory committees with, effectively, "co-fiduciary" status, (b) delegating broad oversight to the court and the U.S. Trustee and (c) giving standing to every party-in-interest in a chapter 11 case to be heard on all out-

---

* Messrs. Butler and Dickerson are partners and Mr. Neuman is an associate in the corporate restructuring practice at Skadden, Arps, Slate, Meagher & Flom LLP.

1 *See generally* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

2 For a review of the debate that ensued over who should control the debtor's case, see Robert J. Berdan & Bruce G. Arnold, *Displacing the Debtor in Possession: The Requisites for and Advantages of the Appointment of a Trustee in Chapter 11 Proceedings*, 67 MARQ. L. REV. 457, 460–69 (1984).

3 *See* 11 U.S.C. § 1107(a) (2006) (providing trustees power as debtors-in-possession); *see also* Christopher W. Frost, *Running the Asylum: Governance Problems in Bankruptcy Reorganizations*, 34 ARIZ. L. REV. 89, 135 (1992) (discussing Congress's decision to leave operation of business with debtor-in-possession); Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1, 9–10 (1989) ("[I]n Chapter 11, the statutory premise directs that, unless ordered otherwise, the debtor continues in possession after filing and the DIP operates in the 'ordinary course of business' [without] need for prior court approval.").

4 In 1938 Congress enacted the Chandler Act, which adopted chapters X and XI. *See* Clifford J. White III & Walter W. Theus, Jr., *Chapter 11 Trustees and Examiners After BAPCPA*, 80 AM. BANKR. L.J. 289, 293 (2006) ("Despite the major differences between chapters X and XI, the Bankruptcy Act did not establish a clear line for the eligibility of debtors under each chapter.").

of-the-ordinary-course business transactions.[5] This adherence to state law notions of corporate governance and fiduciary duties,[6] overlaid with these additional checks and balances, has proven to be sufficiently flexible to respond to material changes affecting reorganization practice over the last three decades. The current model has demonstrated flexibility to accommodate the proliferation of distressed investing and claims trading, radical changes in the composition of secured lending syndicates including their dominance by hedge funds and other non-traditional investors, evolution in the composition of statutory committees, and constantly changing capital structures fueled by complex financial products.

Whether to maintain the current design has been the subject of a great deal of ongoing commentary and criticism. While numerous proposals have been offered to abandon or modify the state law fiduciary model,[7] Congress made fundamentally the right judgment when it entrusted state law fiduciaries with primary control over the direction of chapter 11 cases.[8] A debtor's incumbent directors and officers bring to bear experience and institutional knowledge, which would be squandered if they were automatically replaced at the commencement of each chapter 11 proceedings as had been the case under chapter X of the Bankruptcy Act. Moreover, the current

---

[5] *See* 28 U.S.C. § 586(a)(3) (2006) (stating U.S. trustee supervises "the administration of cases and trustees in cases under chapter 7, 11, 12, 13, or 15 of title 11"); Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 AM. BANKR. L.J. 431, 449 (1995) (discussing purpose of statutory committee).

[6] *See* Davis v. Yageo Corp., 481 F.3d 661, 679 (9th Cir. 2007) ("[S]tate corporate governance law, not federal bankruptcy law, governs the duties of a corporate fiduciary."); D.J. (Jan) Baker, John Wm. (Jack) Butler, Jr. & Mark A. McDermott, *Corporate Governance of Troubled Companies and the Role of Restructuring Counsel*, 63 BUS. LAW. 855, 858 (2008) ("[W]hen a corporation becomes insolvent, the nature of the duties of loyalty and care and the requirements of the business judgment rule are the same."). For an extended discussion of the role of state law fiduciary duties in the context of a reorganization, see generally, Baker et al., *supra*.

[7] *See generally* Edwards S. Adams, *Governance in Chapter 11 Reorganizations: Reducing Costs, Improving Results*, 73 B.U. L. REV. 581 (1993) (proposing reorganization approach aimed at reducing bankruptcy costs); Frost, *supra* note 3, at 118 (asserting fiduciary duties and judicial devices to replace management are inadequate to keep business decisions in check); Yaad Rotem, *Contemplating a Corporate Governance Model for Bankruptcy Reorganizations: Lessons from Canada*, 3 VA. L. & BUS. REV. 125 (2008) (advocating a Canadian hybrid approach in which a judge-appointed "Monitor" oversees business activities alongside incumbent managers).

[8] *See* Miller, *supra* note 5, at 445–46 (1995) (expressing approval of Congress's adoption of debtor-in-possession concept). A number of influential and well-respected commentators and scholars continue to advocate for major reforms to the United States system to align it with the principles of traditionally European bankruptcy systems. *See, e.g.*, James J. White, Comment, *Harvey's Silence*, 69 AM. BANKR. L.J. 467, 477–78 (1995) (proposing adoption of French reorganization regime). It is ironic that at the same time these arguments are being made here in the United States, many foreign jurisdictions are adopting reorganization systems that, in many respects, mirror the chapter 11 model. *See* Stephen J. Lubben, *Business Liquidation*, 81 AM. BANKR. L.J. 65, 84 (2007) ("In recent years many nations have rushed to adopt corporate reorganization systems inspired by chapter 11."); Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 199–200 (2004) ("As countries in Europe move towards a reorganizational model similar to the Chapter 11 debtor-in-possession concept, the United States may be moving in the opposite direction.").

system is one of checks and balances. It is sufficiently adversarial such that relevant issues are brought to light, but the system also fosters consensus whenever possible. The consensual outcomes that the state law fiduciary model encourages tend to be efficient and cost-effective. When necessary, however, the bankruptcy judge is available to adjudicate disputes. Because of these benefits, and the flexibility that the bankruptcy judge retains to make adjustments in appropriate circumstances, state law fiduciaries should continue to control their chapter 11 cases in most instances.[9]

I. GOVERNANCE UNDER THE PRE-1978 SYSTEM

The current system, in which state law fiduciaries remain in control of a debtor's restructuring process, was not always in place. Prior to the enactment of the Bankruptcy Code in 1978, there were multiple reorganization chapters under the Bankruptcy Act. Under chapter X of the Bankruptcy Act, an independent trustee was automatically appointed in almost every case.[10] The trustee under chapter X was charged with the duty of operating the debtor's business and was also the

[9] *See, e.g.*, H.R. REP. NO. 95-595, at 231–34 (1977) (discussing benefits and flexibility of chapter 11); Nimmer & Feinberg, *surpa* note 3, at 30 (1989) (discussing "flexible results tailored by the acts, choices and negotiation of the parties" that are facilitated by chapter 11 governance structure). This article is, in a sense, a follow-up to a debate that transpired fifteen years ago in 1995 between Harvey Miller and Jim White. *Compare* Miller, *supra* note 5 *with* White, *supra* note 8. That debate, at least in part, considered the extent to which chapter 11 should be completely abandoned. Here, for purposes of this article which is more narrowly focused on competing corporate governance models in chapter 11 reorganization cases, the premise is that the structure of chapter 11 should be preserved, but the question is who should run the chapter 11 case. For all of the reasons laid out herein, the authors believe that state law fiduciaries should continue to do so, which they freely acknowledge represents their "practitioners" disagreement with some of the conclusions in Professor White's piece. In particular, the authors take exception with Professor White's proposal to enact a statute that "encourages liquidation." White, *supra*, at 479. His proposal fails to take into account the deleterious effects imposed by liquidations, including the loss of jobs and adverse impact on communities. *See, e.g.*, *In re* Lehman Bros. Holdings, Inc., 415 B.R. 77, 82 (S.D.N.Y. 2009) (noting that the bankruptcy court stated that the consequences of a liquidation "could prove to be truly disastrous and the harm to the debtor, its estates, the customers, creditors, generally, the national economy and the global economy could prove to be incalculable") (internal quotations omitted); *In re* General Motors Corp., 407 B.R. 463, 474 (Bankr. S.D.N.Y. 2009) (stating that a liquidation would be "a disastrous result for GM's creditors, its employees, the suppliers who depend on GM for their own existence, and the communities in which GM operates"). The fact that European nations are eschewing their traditional preference for a liquidation model in favor of a United States-style system that favors reorganization represents an empirical rebuttal to at least some of Professor White's arguments. What the authors and Professor White do agree on completely is that speedy reorganizations are preferable and that unreasonable delays in reorganization cases often result in excessive costs and "event" risks that are nearly always antithetical to the creation and augmentation of business enterprise value. *See* White, *supra*, at 473.

[10] *See* H.R. REP. NO. 95-595, at 232 (1977) (noting chapter X mandates "appointment of a trustee in every case"); *see also* Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416, 435 (1972) (Douglas, J., dissenting) (discussing essential role of disinterested trustee in chapter X proceedings); White & Theus, *supra* note 4, at 292 ("In a reorganization under chapter X, the district court was required to appoint 'on its own initiative' a disinterested trustee if the corporation's liquidated, non-contingent, debts exceeded $250,000.").

"prime agent" in formulating a plan.[11] Generally a debtor's officers were ousted and its board of directors was rendered impotent. The Securities and Exchange Commission was charged with a major oversight and statutory role in the administration of a corporate reorganization case as well as the formulation and confirmation of a chapter X plan.[12]

Conversely, under chapter XI of the Bankruptcy Act, "the debtor [*i.e.*, the state law fiduciaries] generally remained in possession of its property and had all of the rights and powers of a trustee, subject to such limitations as the court might impose."[13] At least in part as a result of a trustee being automatically appointed under chapter X, whereas the state law fiduciaries operating as a debtor-in-possession could remain in control under chapter XI, chapter XI was used much more frequently than chapter X.[14]

Various problems with the pre-1978 system compelled Congress to institute reforms. Congress worried that one of the problems with the pre-1978 Bankruptcy Act was that "debtors too often wait[ed] too long to seek bankruptcy relief."[15] Another concern was that a system that too often led to the appointment of a trustee "would exacerbate that problem, to the detriment of both debtors and their creditors."[16] Outcomes in chapter X, which led to the automatic appointment of a trustee, were also of concern since they produced a plan of reorganization that was successfully confirmed and consummated in only one out of every five cases.[17]

As a result of these and other concerns, Congress, in 1978, combined chapters X and XI and created a single reorganization chapter (chapter 11) "that is

---

[11] *See* H.R. REP. NO. 95-595, at 235 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6194 ("[T]he trustee is the prime agent in formulating a plan under chapter X, and in operating the business of the debtor and managing the case.").

[12] *See* H.R. REP. NO. 95-595, at 225, *reprinted in* 1978 U.S.C.C.A.N. at 6185 (indicating, after hearing on plan, SEC develops advisory report for creditors informing them of evaluation and contents of plan).

[13] White & Theus, *supra* note 4, at 292 & n.15 (citing Bankruptcy Act § 342 (repealed 1978)).

[14] *See* H.R. REP. NO. 95-595, at 222, *reprinted in* 1978 U.S.C.C.A.N. at 6182 ("Less than ten percent of all business reorganization cases are under chapter X. Chapter XI is the much more popular procedure, even though what can be done under chapter XI is less than under chapter X.") (footnote omitted); *see also* Douglas E. Deutsch, *Ensuring Proper Bankruptcy Solicitation: Evaluating Bankruptcy Law, the First Amendment, the Code of Ethics, and Securities Law in Bankruptcy Solicitation Cases*, 11 AM. BANKR. INST. L. REV., 213, 217–18 (2003) (noting one reason debtors chose to use chapter XI over chapter X was to maintain possession and operation of business); White & Theus, *supra* note 4, at 293 ("The use of chapter XI to the near exclusion of chapter X continued unabated through the 1960s. For that reason, reorganization trustees were quite rare.").

[15] *See* H.R. REP. NO. 95-595, at 233–34, *reprinted in* 1978 U.S.C.C.A.N. at 6193; *see also In re* Johns-Mansville Corp., 36 B.R. 727, 736 (Bankr. S.D.N.Y. 1984) (explaining that one goal of Code was to ensure that debtors did not wait until last minute to file).

[16] *See* H.R. REP. No. 95-595, at 234, *reprinted in* 1978 U.S.C.C.A.N. at 6193.

[17] *See* H.R. REP. No. 95-595, at 223, *reprinted in* 1978 U.S.C.C.A.N. at 6183 ("Chapter X has become an unworkable procedure, and chapter XI is inadequate to fill the void."); *see also* Dan J. Schulman, *Business Reorganizations Under Proposed Senate Bill 540*, 3 J. BANKR. L. & PRAC. 265, 269 & n.21 (1994) (citing 124 CONG. REC. S17, 419 (daily ed. Oct. 6, 1978)) (noting chapter X reorganizations were successful only 21% of time).

fundamentally grounded in the presumption that pre-bankruptcy management will continue to operate the business following the filing of a petition for relief."[18]

II. STATE LAW FIDUCIARIES, OPERATING AS A DEBTOR-IN-POSSESSION, ARE THE LEAD PARTICIPANTS IN CHAPTER 11 CASES

Chapter 11 of the Bankruptcy Code continued the basic framework set forth in chapter XI of the Bankruptcy Act, whereby the state law fiduciary becomes the debtor-in-possession and plays the prominent role in reorganization proceedings. The Bankruptcy Code empowers debtors-in-possession with various powers but also provides for myriad oversights as a check on those powers.

A. State Law Fiduciaries Have Various Powers to Operate the Debtor's Business and Control the Reorganization Process

Chapter 11 authorizes a debtor's state law fiduciaries to run the debtor's business as debtors-in-possession.[19] The legislative history of section 1107 demonstrates that Congress intended for debtors-in-possession to have broad powers and administrative duties:

> This section places a debtor-in-possession in the shoes of a trustee in every way. The debtor is given the rights and powers of a chapter 11 trustee. He is required to perform the functions and duties of a chapter 11 trustee (except the investigative duties). He is also subject to any limitations on a chapter 11 trustee, and to such other limitations and conditions as the court prescribes.[20]

Certain of the debtor-in-possession's powers and duties are particularly important. For instance, subject to court approval, the debtor-in-possession has the

---

[18] Berdan & Arnold, *supra* note 2, at 458. *See generally* 11 U.S.C. § 1107(a) (2006) (vesting debtor-in-possession with all powers of trustee); 11 U.S.C. § 1108 (2006) (stating trustee may operate debtor's business).

[19] *See* 11 U.S.C. §§ 1107, 1108. Section 1108 of the Bankruptcy Code authorizes the trustee to operate the debtor's business. Under section 1107, the debtor-in-possession, with certain exceptions, "shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee." Thus, the interplay between sections 1107 and 1108 dictates that the debtor-in-possession can run the debtor's business. *See generally In re* Curlew Valley Assocs., 14 B.R. 506, 509–11 (Bankr. D. Utah 1981) (explaining Code allows debtor to stay in possession of and run debtor's business).

[20] H.R. REP. NO. 95-595, at 404 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6360; *see* Maurice Sporting Goods, Inc. v. Maxway Corp., 27 F.3d 980, 983 (*In re* Maxway Corp.) (4th Cir. 1994) (citing legislative intent and purpose of section 1107 in support of proposition that "[s]ection 1107 confers upon a debtor-in-possession the power and authority of a chapter 11 trustee."); *In re* Ala. State Fair Auth., 232 B.R. 252, 263 (Bankr. N.D. Ala. 1999) (stating court will read section 1107 broadly to include trustee and debtor-in-possession duties).

power to decide whether to obtain financing, sell assets, and continue operations.[21] The Bankruptcy Code also empowers debtors-in-possession to sell assets outside the ordinary course of business after meeting certain requirements;[22] to appoint other persons to perform functions for the estate; and to sue (or be sued) in the same manner as a trustee under section 323.[23] In addition, the debtor-in-possession has "the duty to protect and preserve the assets" and "to prosecute the case in an expeditious manner."[24] Another benefit that the Bankruptcy Code bestows upon debtors-in-possession is a period during which the debtor has the exclusive right to file a plan of reorganization. With certain limitations, "only the debtor may file a plan until after 120 days after the date of the order for relief" under chapter 11.[25] Exclusivity is an important power because it "is perceived to encourage rehabilitation by empowering the debtor to control its own destiny . . . . [it] can be seen as the debtor's chip in the reorganization game."[26]

Each of the powers and duties that the Bankruptcy Code bestows upon debtors-in-possession must be viewed through the lens of applicable state law notions of fiduciary duty. That is, as a debtor's directors and officers guide the company through the chapter 11 process, those directors and officers are at all times bound by the duties they owe to the debtor's stakeholders. At the same time, precisely because the state law fiduciary is operating as a debtor-in-possession in a chapter 11 reorganization case, Congress imposed upon state law fiduciaries the oversight and transparency of the bankruptcy court, the statutory committees, the U.S. Trustee and other parties-in-interest – each of which is permitted by statute at any time to seek to curtail the powers of, or even to seek to replace, the debtor-in-possession.

---

[21] *See* 11 U.S.C. § 1108 (2006) (stating trustee may operate debtor's business); *see also* John T. Roache, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133, 141 & n.94 (1993) (citing 11 U.S.C. §§ 363, 364, 1108) (noting debtor-in-possession's powers and authority).

[22] *See* 11 U.S.C. § 363(b)(1) (2006) (providing debtor-in-possession may act out of "ordinary course of business" "after notice and a hearing," with exceptions); *see also* Fulton State Bank v. Schipper (*In re* Schipper), 933 F.2d 513, 515 (7th Cir. 1991) (listing statutory and common law criteria debtor-in-possession must meet); Inst'l. Creditors of Cont'l Air Lines, Inc. v. Cont'l Air Lines, Inc. (*In re* Cont'l Air Lines, Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986) (adding need for "articulated business justification" for acting beyond parameters of "ordinary course of business").

[23] Roache, *supra* note 21, at 141 (enumerating powers and abilities of debtor-in-possession); *see also* 11 U.S.C. § 323 (stating trustee "has capacity to sue and be sued"); U.S. Brass & Copper Co. v. Caplan (*In re* Century Brass Prods., Inc.), 22 F.3d 37, 39 (2d Cir. 1994) (noting that a debtor-in-possession is given same power as trustee).

[24] Roache, *supra* note 21, at 141–42 (including duties debtor-in-possession must perform); *see also In re* Nautilus of N.M., Inc., 83 B.R. 784, 789 (Bankr. D.N.M. 1988) (stating debtor-in-possession has fiduciary duty to protect assets); *In re* Van Brunt, 46 B.R. 29, 30 (Bankr. W.D. Wis. 1984) (providing that the debtor-in-possession is a fiduciary of its creditors and is obligated to prosecute the case "expeditious[ly]").

[25] 11 U.S.C. § 1121(b) (2006).

[26] Karen Gross & Patricia Redmond, *In Defense of Debtor Exclusivity: Assessing Four of the 1994 Amendments to the Bankruptcy Code*, 69 AM. BANKR. L.J. 287, 291 (1995); *see In re* Sharon Steel Corp., 78 B.R. 762, 764 (Bankr. W.D. Pa. 1987) ("[Section 1121] was designed to strike a balance between the rights and obligations of a debtor-in-possession and its creditors."); *see also* Nimmer & Feinberg, *supra* note 3, at 67 ("The power to propose a reorganization plan is an important element of business governance and control.").

B. The Bankruptcy Code's Structure Provides for Meaningful Oversight

While chapter 11 entrusts debtors-in-possession with myriad powers, it also contains various mechanisms to balance the debtor-in-possession's power and ensure that there is vigorous oversight. It is important to remember that these checks supplement the protections that are already in place as a result of the expanded state law fiduciary duties that debtors' directors and officers owe to their stakeholders.

The Bankruptcy Code creates a creditors' committee to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan."[27] The creditors' committee plays an important role in monitoring the power of the debtor-in-possession, and that role is consistent with Congress's intent in creating mandatory creditors' committees. The legislative history of section 1103(c) reveals that creditors' committees were designed, in part, to "provide supervision of the debtor-in-possession and of the trustee."[28] The Bankruptcy Code also contemplates the creation of additional statutory committees. Moreover, even if no statutory committees (besides the creditors' committee) are officially appointed, parties may nevertheless form ad hoc committees that can be heard on any issue in a chapter 11 case (assuming that they comply with various disclosure and reporting obligations).[29]

The Bankruptcy Code requires debtors to inform creditors' committees about their corporate affairs to enable the committees to effectively monitor the debtor-in-possession.[30] Debtors-in-possession are also required to furnish the creditors' committee with information upon request.[31] As one court noted regarding the debtor's duty to ensure that creditors' committees were fully informed, "[t]he structure of the Code (and its implementing rules) is designed to assure that creditors, the court and court-appointed representatives will have ready and early access to correct information about the corporate debtor's affairs."[32] The Bankruptcy Code's imposition upon debtors-in-possession of "an affirmative duty to both

---

[27] 11 U.S.C. § 1103(c)(2).

[28] H.R. REP. NO. 95-595, at 401 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6357.

[29] *Compare* 11 U.S.C. § 1102(a)(2) (discussing when an equity committee can be formed) *with* Michael DeMarino, *Rule 2019: The Debtor's New Weapon*, 42 J. MARSHALL L. REV. 165, 185 (2008) (mentioning existence of ad hoc committees, which are not fiduciaries).

[30] *See* 11 U.S.C. § 521(a)(1) (2006) (enumerating debtor's disclosure responsibilities).

[31] *See id.* at § 704(a)(7); *In re* Refco Inc., 336 B.R. 187, 193 (Bankr. S.D.N.Y. 2006) (acknowledging importance of maintaining and informing committee); *see also In re* UNR Indus. Inc., 42 B.R. 99, 101 (Bankr. N.D. Ill. 1984) ("Debtors have a corresponding obligation, within reasonable limits, to provide the Committee with the information it requests.").

[32] *In re* Muy Bueno Corp., 257 B.R. 843, 848 (Bankr. W.D. Tex. 2001).

voluntarily disclose and to cooperate"[33] creates an important check on a debtor-in-possession's power because, as the Supreme Court has noted, "'[s]unlight is said to be the best of disinfectants; electric light the most efficient policeman.'"[34] By requiring debtors to disclose and cooperate, the Bankruptcy Code ensures that creditors' committees can identify issues and resolve them either consensually with the debtor or through an adjudication of contested matters and adversary proceedings by the bankruptcy judge.

Under the state law fiduciary model, creditors' committees have an important role to play in monitoring debtors-in-possession and functioning, in effect, as "co-fiduciaries." Nevertheless, creditors' committees, at times, fail to fulfill effectively the role that Congress envisioned for them when it designed the system.[35] For example, at times creditors' committees are not sufficiently engaged with the issues of a chapter 11 case and thus are unable to perform the monitoring function for which they were designed. The enhanced roles and powers of the bankruptcy judge and the United States Trustee promulgated by Congress in amendments to the Bankruptcy Code since its enactment in 1978 mitigate, if not eliminate, problems with the occasional inattentive statutory committee and their absence altogether in some smaller chapter 11 cases.

The Bankruptcy Code also created the U.S. Trustee and tasked it with, among other duties, supervising debtors-in-possession.[36] The U.S. Trustee is authorized to "raise and may appear and be heard on any issue in any case or proceeding."[37] The U.S. Trustee often raises issues regarding debtors' first-day pleadings, plans of reorganization and other issues of significance in a chapter 11 case. As a result, debtors tend to solicit the U.S. Trustee's input on major actions in advance. This is especially true at the preliminary stage of a chapter 11 case, when stakeholders are not yet fully engaged. Thereafter the U.S. Trustee generally, and appropriately,

---

[33] *Id*. (citing 11 U.S.C. §§ 343, 521(a)(1), (3)); *see also* Burnes v. Pemco Aeroplex, Inc., 291 F.3d 1282, 1286 (11th Cir. 2002) (stating that "[a] debtor seeking shelter under the bankruptcy laws" has duty to notify bankruptcy court of all its assets); *In re* Matthews, 154 B.R. 673, 678 (Bankr. W.D. Tex. 1993) ("'[B]oth law and equity require that the Debtor-in-Possession voluntarily and willingly disclose . . . his financial affairs.'") (quoting *In re* Baumgartner, 57 B.R. 513, 516 (Bankr. N.D. Ohio 1986)).

[34] *See* Buckley v. Valeo, 424 U.S. 1, 67 & n.80 (1976) (quoting LOUIS BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 62 (1933)); Michael D. Sousa, *Making Sense of the Bramble-Filled Thicket: The "Insured vs. Insured" Exclusion in the Bankruptcy Context*, 23 EMORY BANKR. DEV. J. 365, 432 (2007) (noting the powers of creditors' committee to check powers of debtor-in-possession).

[35] *See* Anne M. Burr, *The Unproposed Solution to Chapter 11 Reform: Assessing Management Responsibility for Business Failures*, 25 CAL. W. INT'L L.J. 113, 137 n. 210 (1994) (discussing elements contributing to ineffectiveness of creditors' committees); *see also* Miller, *supra* note 5, at 450–51 (listing reasons why creditors' committee is not completely effective).

[36] *See* 28 U.S.C. § 586(a)(3) (2006) (listing means by which United States Trustee may supervise administration of cases); *In re* Texasoil Enters. Inc., 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) ("Debtors in possession are subject to supervision by the United States [T]rustee."); *In re* Darmstadt Corp., 164 B.R. 465, 466 (D. Del. 1994) (stating United States Trustee has obligation to "supervise the administration of bankruptcy cases").

[37] 11 U.S.C. § 307. It should be noted, however, that the U.S. Trustee "may not file a plan pursuant to 1121(c)." *Id.*

defers to the positions asserted by proactive stakeholders that participate and assert themselves in more advanced stages of chapter 11 cases. Debtors also file monthly operating reports with the U.S. Trustee, thereby providing extensive transparency with respect to their affairs.[38] Because of the U.S. Trustee's role and its ability to raise issues before the court, it, too, serves to monitor debtors-in-possessions' compliance with their state law fiduciary duties.

Bankruptcy courts can also appoint committees in addition to the creditors' committee.[39] The Bankruptcy Code states that, "[o]n request of a party in interest the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders," providing yet another monitor of the activities of the debtor-in-possession.[40] While courts consider a number of factors in determining whether or not to appoint additional committees, in general, assuring adequacy of representation is the most important consideration; the size of the case alone is not determinative.[41] These other statutory committees, like creditors' committees, both monitor debtors-in-possessions' compliance with their state law fiduciary duties and ensure that all parties in a case have their interests protected.

Apart from statutory committees, any party-in-interest, including "a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may [rise] and be heard on any issue" in a chapter

---

[38] *See, e.g.*, Richard F. Broude et al., *The Judge's Role in Insolvency Proceedings: The View From the Bench; The View From the Bar*, 10 AM. BANKR. INST. L. REV. 511, 549 (2002) ("[M]onthly operating reports are required of the debtors and they are filed with the court and sent to the United States Trustee."); Thompson E. Carlson & Jennifer Frasier Hayes, *The Small Business Provisions of the 2005 Bankruptcy Amendments*, 79 AM. BANKR. L.J. 645, 686–87 (2005) (explaining that the U.S. Trustee's role is expanded to include "explain[ing] the debtor's obligations to file monthly operating reports"); Dexter K. Case & Jennifer R. Alderfer, *BAPCPA and the New Provisions Relating to Small Businesses*, 15 WIDENER L.J. 585, 592–93 (2006) (including debtor's obligation to file monthly reporting reports among United States Trustee's "increased monitoring responsibilities").

[39] *See* 11 U.S.C. § 1102(a)(2) ("[T]he court may order the appointment of additional committees . . . if [it is] necessary to assure adequate representation . . . ."); *see also In re* Enron Corp., 279 B.R. 671, 684 (Bankr. S.D.N.Y. 2002) ("There is no indication, upon review of the plain language of the statute, that the court is constrained in making such a determination."), *aff'd sub nom.* Mirant Ams. Energy Mktg., L.P. v. Official Comm. of Unsecured Creditors of Enron Corp., No. 02 Civ. 6274 (GBD), 2003 WL 22327118 (S.D.N.Y. Oct. 10, 2003); *In re* McLean Indus., Inc., 70 B.R. 852, 857–58 (Bankr. S.D.N.Y. 1987) ("Congress expressly retained in the bankruptcy courts the ability to decide *de novo* the question of whether additional committees are necessary to assure adequate representation.").

[40] 11 U.S.C. § 1102(a)(2) (2006); *see, e.g.*, *In re* Curlew Valley Assocs., 14 B.R. 506, 510 (Bankr. D. Utah 1981) (emphasizing court's authority over debtors-in-possession).

[41] *See* § 1102(a)(2) (permitting court to order appointment of additional committee "to assure adequate representation"); *In re* Enron Corp., 279 B.R. at 684 ("The court, however, is instructed by 11 U.S.C. § 1102(a)(2) that it is to appoint an additional committee to *assure adequate representation*.") (emphasis in original); *see also In re* Wilnor Drilling, Inc., 29 B.R. 727, 731 (S.D. Ill. 1982) (granting SEC motion for separate committee of investors to assure adequate representation and protection of investors' interests).

11 case.[42] Parties will also often form "ad hoc" committees, which can themselves rise and be heard on an issue in a chapter 11 case.[43] As one court explained, "[c]reditors' committees and even individual creditors may also police the actions of a debtor-in-possession."[44] This ensures that virtually any stakeholder can have its concerns raised before the bankruptcy court.

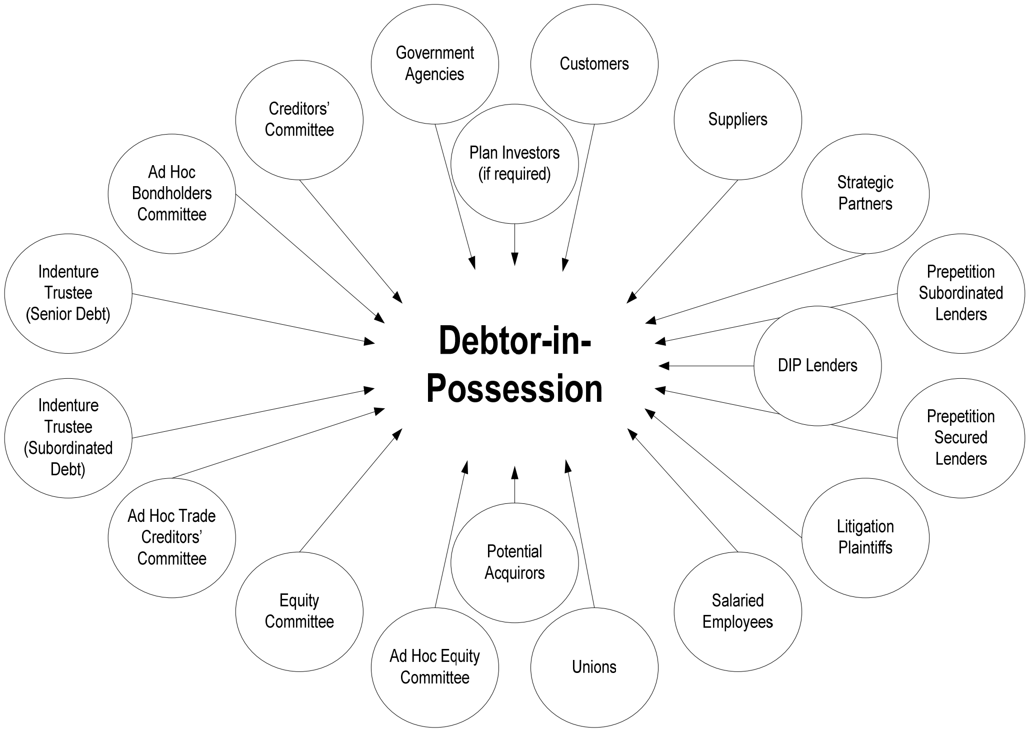
The figure below illustrates many of the entities that may be stakeholders in a debtor's chapter 11 case.

---

[42] 11 U.S.C. § 1109(b); *see, e.g., In re* Overmyer, 30 B.R. 123, 125 (Bankr. S.D.N.Y. 1983) ("[W]here the trustee or debtor-in-possession has already initiated an adversary proceeding, the creditors' committee has an absolute right to intervene as a party in interest under Code § 1109(b).").

[43] *See* § 1109(b); James M. Shea, Jr., *Who is at the Table? Interpreting Disclosure Requirements for Ad Hoc Groups of Institutional Investors Under Federal Rule of Bankruptcy Procedure 2019,* 76 FORDHAM L. REV. 2561, 2616 (2008) (stating ad hoc group does have standing by virtue of creditor status); *see also* Evan D. Flaschen & Kurt A. Mayr, *Bankruptcy Rule 2019 and the Unwarranted Attack on Hedge Funds,* AM. BANKR. INST. J., Sept. 2007, at 16 (defining ad hoc committee as informal mechanism allowing for parties with similar interests to consolidate actions).

[44] *In re* Texasoil Enters. Inc., 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003).



Importantly, the bankruptcy judge also oversees state law fiduciaries acting as a debtor-in-possession through the confluence of sections 105, 704(a)(7) and 1109(b) of the Bankruptcy Code. Section 105 empowers the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code,[45] section 704(a)(7) obligates debtors to furnish information[46] and section 1109(b) allows parties-in-interest to rise and be heard on any issue in a chapter 11 case.[47] Those Bankruptcy Code sections empower the debtors' stakeholders and ensure that the system is sufficiently adversarial, without

[45] 11 U.S.C. § 105(a) (2006); *see, e.g.*, Morgan v. Goldman (*In re* Morgan), 573 F.3d 615, 626 (8th Cir. 2009) (noting section 105 expressly grants bankruptcy courts authority to take actions required to carry out Bankruptcy Code provisions); Mitan v. Duval (*In re* Mitan), 573 F.3d 237, 244 (6th Cir. 2009) (cautioning that section 105 gives bankruptcy courts authority, but "such power is constrained by the provisions of the Bankruptcy Code").

[46] 11 U.S.C. § 704(a)(7) ("The trustee shall . . . furnish such information concerning the estate and the estate's administration as is requested by a party in interest . . . ."); *In re* Heritage Med. Assocs., 362 B.R. 235, 238 (Bankr. E.D.N.C. 2007) (stating section 704(a)(7) allows trustee to provide estate-related information); *In re* Refco Inc., 336 B.R. 187, 192 (Bankr. S.D.N.Y. 2006) (commenting that under section 704(a)(7), trustee is required to furnish information upon request).

[47] 11 U.S.C. § 1109(b) ("A party in interest . . . may raise and may appear and be heard on any issue in a case under this chapter."); Biltmore Assocs., LLC v. Twin City Fire Ins. Co., 572 F.3d 663, 674 n.41 (9th Cir. 2009) ("A creditor can demand that the debtor-in-possession bring an action on its behalf. If the debtor-in-possession refuses, the creditor 'may appear and be heard' on the issue in the bankruptcy proceeding.").

being extensively or presumptively adversarial. Because of the interplay among sections 105, 704(a)(7) and 1109(b), issues that are important to parties-in-interest will be ferreted out and addressed. Often, and most preferably, parties resolve issues consensually, which promotes both efficiency and cost-effectiveness. When parties are unable to reach agreement on a given issue, however, the bankruptcy judge is there to render a determination. Of course, the bankruptcy judge's looming presence alone often enhances parties' ability to forge consensus.

While section 1109(b) enables parties-in-interest to bring matters before the bankruptcy judge, the bankruptcy judge can also raise matters on her own. Section 105(a) states that

> [n]o provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.[48]

The bankruptcy judge's powers—to adjudicate issues brought by the debtor's stakeholders and to raise issues on her own—provide both a meaningful check upon the debtor-in-possession's power and important protections to creditors and other parties-in-interest. The bankruptcy judge monitors the debtor-in-possession in other ways as well, including by attaching limitations and conditions on the debtor-in-possession's discretion[49] and restricting the debtor-in-possession's ability to engage in activities (e.g., asset sales) that occur outside the ordinary course of business.[50]

Furthermore, section 105(d) empowers the bankruptcy judge to hold status conferences and to issue orders at such conferences prescribing such limitations and conditions as the judge deems appropriate to ensure that the case is handled expeditiously and economically.[51] A bankruptcy judge can also monitor the state law fiduciary through the use of alternative dispute resolution.[52] The power to

---

[48] 11 U.S.C. § 105(a).

[49] *See* 11 U.S.C. § 1107(a) ("Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor-in-possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter."); *see also* Roache, *supra* note 21, at 142 & nn. 101, 106–12 (noting court's right of intervention, including determining who should act on behalf of debtor-in-possession).

[50] *See, e.g.*, 11 U.S.C. § 363(c)(1) (2006) (granting power to trustee to enter debtor's business into certain transactions "in the ordinary course of business"); *see* A. Mechele Dickerson, *Privatizing Ethics in Corporate Reorganizations*, 93 MINN. L. REV. 875, 897 (2009) (discussing section 363).

[51] 11 U.S.C. § 105(d); Richard I. Aaron, *Hooray for Gibberish! A Glossary of Bankruptcy Slang for the Occasional Practitioner or Bewildered Judge*, 3 DEPAUL BUS. & COM. L.J. 141, 167 n. 85 (2005) ("Bankruptcy Code § 105(d) specifies powers of case management for the bankruptcy judge."); Novica Petrovski, *The Bankruptcy Code, Section 1121: Exclusivity Reloaded*, 11 AM. BANKR. INST. L. REV. 451, 517 (2003) (discussing section 105(d)).

[52] *See* Ralph R. Mabey, Charles J. Tabb & Ira S. Dizengoff, *Expanding the Reach of Alternative Dispute Resolution in Bankruptcy: The Legal and Practical Bases for the Use of Mediation and the Other Forms of*

appoint mediators and arbitrators to resolve disputes between the parties is another power the bankruptcy court possesses to oversee the management of a chapter 11 case.

Bankruptcy judges are often most effective when they provide guidance and adopt a proactive posture in terms of case management and oversight. The most skilled bankruptcy judges are able to assume these functions without undue or cumbersome interference with the inevitable compromises that must be forged between the debtor and its stakeholders. In short, a bankruptcy judge functions most effectively when she provides guidance and keeps a case on track to avoid undue delay and event risk but refrains from becoming intimately involved in the administration of the chapter 11 case before her as was routine under the former Act.

The Bankruptcy Code also limits the debtor-in-possession's power by limiting the period of exclusivity. While section 1121 grants debtors a period of 120 days during which the debtor has the exclusive right to file a plan,[53] thereafter, if no extension for cause has been granted, any party in interest may file a plan.[54] Moreover, before 2005, judges could have extended a debtor's exclusivity rights indefinitely; now, however, the outer limit is eighteen months.[55] The time limit that the Bankruptcy Code places upon debtor exclusivity recognizes that creditors have a stake in the debtor's business and ensures that debtors' powers are not without limits.

Another check on the state law fiduciary is the fact that a bankruptcy judge can appoint an examiner "to conduct such an investigation of the debtor as is appropriate."[56] Section 1104(c) sets forth two grounds for the appointment of an examiner. On request of a party-in-interest or the U.S. Trustee, the court shall order the appointment of an examiner if "such appointment is in the interests of creditors, any equity security holders, and other interests of the estate," or if "the debtor's

---

ADR, 46 S.C. L. REV. 1259, 1265–66 (1995) (summarizing use of alternative dispute resolution by bankruptcy courts); Miller, *supra* note 5, at 436–37 (1995) (discussing use of alternative dispute resolution concurrently with section 105(a)); *see also* Hon. Stephen A. Stripp, *An Analysis of the Role of the Bankruptcy Judge and the Use of Judicial Time*, 23 SETON HALL L. REV. 1329, 1378 (1993) (describing bankruptcy courts' use of alternative dispute resolution).

[53] 11 U.S.C. § 1121(b); Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603, 631 (2005) (explaining plan exclusivity); *supra* notes 25–26 and accompanying text.

[54] 11 U.S.C. § 1121(c)(2); Petrovski, *supra* note 51, at 494 (explaining section 1121(c)); Shannon R. Oehlke Lieke, Comment, *Will Congress's Proposed "Cap" on Extensions to the Debtor's Exclusivity Period in Chapter 11 Solve the Problem of Creditor Preclusion from the Plan Negotiation Process?*, 43 S. TEX. L. REV. 1289, 1296 (2002) (discussing filing reorganization plan under chapter 11).

[55] 11 U.S.C. § 1121(d)(2)(A) (2006) (indicating 120-day extension period in provision cannot exceed eighteen months after relief is ordered); *see also* Carlson & Hayes, *supra* note 38, at 683 (noting that a chapter 11 debtor's "exclusive period for filing a plan can be extended to no longer than eighteen months after the order for relief under Chapter 11 . . . .").

[56] 11 U.S.C. § 1104(c); *e.g., In re* Gliatech, Inc., 305 B.R. 832, 835 (Bankr. N.D. Ohio 2004) ("[T]he court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate . . . .").

fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000."[57] In the view of many, however, the use of examiners is overdone.[58] Section 1104 contains the word "shall," and thus some argue that the appointment of an examiner is mandatory if a party-in-interest requests one and the debtor's debts exceed $5 million.[59] With the exception of extraordinary circumstances where public policy warrants an unusual amount of transparency or the offering of independent review, the imposition of an examiner often causes more harm than good. Like many of a bankruptcy judge's powers, the power to appoint an examiner—and the debtor-in-possession's awareness of that power—is often more effective and salutary than its actual use.

The language of section 1104 demonstrates that Congress intended the examiner to function in an investigatory role. The examiner's role is

> 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.[60]

While the appointment of an examiner imposes significant oversight on the debtor, it does not strip the debtor-in-possession of its authority to run the business, nor does it limit the debtor-in-possession's right to exclusivity with respect to proposing a chapter 11 plan.

In sum, the presumptive governance approach in chapter 11 is that the state law fiduciaries, operating as a debtor-in-possession, remain in control of both the business and the direction of a chapter 11 case. Nevertheless, the structure of chapter 11 creates checks to augment the protection that creditors and other stakeholders enjoy as a result of the state law fiduciary obligations that the debtor's directors and officers owe.

---

[57] 11 U.S.C. § 1104(c); *see, e.g.*, Walton v. Cornerstone Ministries Invs., Inc., 398 B.R. 77, 78 (N.D. Ga. 2008) (explaining need to balance interests of creditors, estate ,and equity holders before allowing appointment); *In re* Collins & Aikman Corp., 368 B.R. 623, 626 (Bankr. E.D. Mich. 2007) (applying section 1104(c)'s debt threshold).

[58] *See* Morgenstern v. Revco D.S., Inc. (*In re* Revco D.S., Inc.), 898 F.2d 498, 501 (6th Cir. 1990) (describing debtor's argument that appointment of examiner could unnecessarily delay trial); *In re* Keene Corp., 164 B.R. 844, 856 (Bankr. S.D.N.Y. 1994) (highlighting committee's argument that motion for examiner was made solely for "purposes of delay"); *In re* Rutenberg, 158 B.R. 230, 233 (Bankr. M.D. Fla. 1993) (positing court granting motion to appoint examiner will "further delay" chapter 11 proceeding).

[59] *See infra*, notes 104—06; *see also* Escoe v. Zerbst, 295 U.S. 490, 493 (1935) (stating "shall" in statute is "language of command"); White & Theus, *supra* note 4, at 303–04 ("While there has been a split of authority on the issue, the better reasoned decisions give effect to the mandatory 'shall' and the legislative history and direct the appointment of an examiner where the proponent of the appointment establishes that the debt threshold is met.").

[60] 11 U.S.C. § 1104(c) (2006).

III. THE BANKRUPTCY JUDGE MAINTAINS FLEXIBILITY TO DIVEST THE DEBTOR-IN-POSSESSION OF CONTROL OF THE CHAPTER 11 CASE

While the chapter 11 governance model invests state law fiduciaries with the authority to continue to operate the debtor's business and generally control the conduct of the debtor's chapter 11 case, there are also mechanisms whereby, if the circumstances warrant, state law fiduciaries can be removed entirely from the process. That is, Congress established multiple procedures through which state law fiduciaries can have their control over the chapter 11 case examined, limited or even eliminated. Congress left the state law fiduciaries in control, but it also recognized that there must be a way to divest the dishonest or grossly incompetent debtor-in-possession of control.[61]

First, section 1112(b) states that, for cause, the bankruptcy court can dismiss a chapter 11 case or convert it to a case under chapter 7.[62] Bankruptcy judges have considerable discretion to determine what constitutes "cause" under section 1112(b).[63] If the case is converted to chapter 7, a chapter 7 trustee is appointed. The appointment of a chapter 7 trustee deprives the state law fiduciaries of control over the chapter 11 case.[64]

In addition to dismissing the case or converting it to chapter 7, a bankruptcy judge has the power to strip state law fiduciaries of control over the case by appointing a trustee.[65] If a trustee is appointed "she usually takes over for the [debtor-in-possession] completely and becomes primarily responsible for operating

---

[61] Berdan & Arnold, *supra* note 2, at 458. For an interesting discussion about enforcing corporate fiduciary duties in bankruptcy, see Kelli A. Alces, *Enforcing Corporate Fiduciary Duties in Bankruptcy*, 56 U. KAN. L. REV. 83, 95 (2007) (citing CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY 63 (1997)), in which the author generally agrees with our view that bankruptcy remedies and procedures, particularly the appointment of a chapter 11 trustee where circumstances warrant, should be the first resort where there are serious grievances with current management about gross mismanagement or breach of fiduciary duty.

[62] 11 U.S.C. § 1112(b)(1); *see also* Richter v. Klein/Ray Broad. (*In re* Klein/Ray Broad.), 100 B.R. 509, 511 (B.A.P. 9th Cir. 1987) (recognizing court's ability to convert to chapter 7).

[63] *See In re* Gonic Realty Trust, 909 F.2d 624, 626 (1st Cir. 1990) ("[I]n determining 'cause' for dismissal the court may consider other factors as they arise and use its powers to reach appropriate results in individual cases."); *see also* Mich. Nat'l Bank v. Charfoos (*In re* Charfoos), 979 F.2d 390, 392 (6th Cir. 1992) (emphasizing bad faith may serve as ground for dismissal although it is not expressly mentioned under section 1112(b)); H.R. REP. NO. 95-595, at 406 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6362 ("The list is not exhaustive. The court will be able to consider other factors as they arise, and to use its equitable powers to reach an appropriate result in individual cases.").

[64] *See* 11 U.S.C. §§ 701–704 (providing circumstances for appointment of chapter 7 trustee and its duties thereafter); *see also* Silverman v. Tracar, S.A. (*In re* Am. Preferred Prescription, Inc.), 255 F.3d 87, 91 (2d Cir. 2001).

[65] *See* 11 U.S.C. § 1104(a)(1)–(2) (2006) (providing court, after notice and hearing, may order appointment of trustee "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management" or "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate").

the debtor and for negotiating and composing a plan of reorganization."[66] Indeed, "[t]he threat of removal represents an extreme form of direct control."[67] Congress intended bankruptcy judges to have significant flexibility in deciding whether to appoint a trustee:

> The policy that has been followed generally . . . has been flexibility, in place of the absolute rules now contained in chapter X, and determination of the needs of each case on the facts of the case. The current state of reorganization situations suggests that the same need for flexibility and case-by-case determination exists in the development of the standard for the appointment of a trustee.[68]

By providing bankruptcy judges with flexibility in deciding whether to appoint a trustee, the chapter 11 procedures represent a compromise between those who wanted a trustee to be appointed in every case and those who wanted the debtor-in-possession to have unfettered control.[69]

In sum, Congress made a conscious choice to entrust state law fiduciaries, acting as debtors-in-possession, in the first instance, with control over the direction of chapter 11 cases. The state law fiduciaries' control, however, is by no means unfettered. It is governed principally by traditional state law notions of corporate governance and fiduciary duty augmented by Congressionally imposed oversight and mechanisms by which the debtor-in-possession can be totally stripped of its control over the case if circumstances warrant.

The figure below illustrates the fabric of the current corporate governance model in the chapter 11 reorganization process.

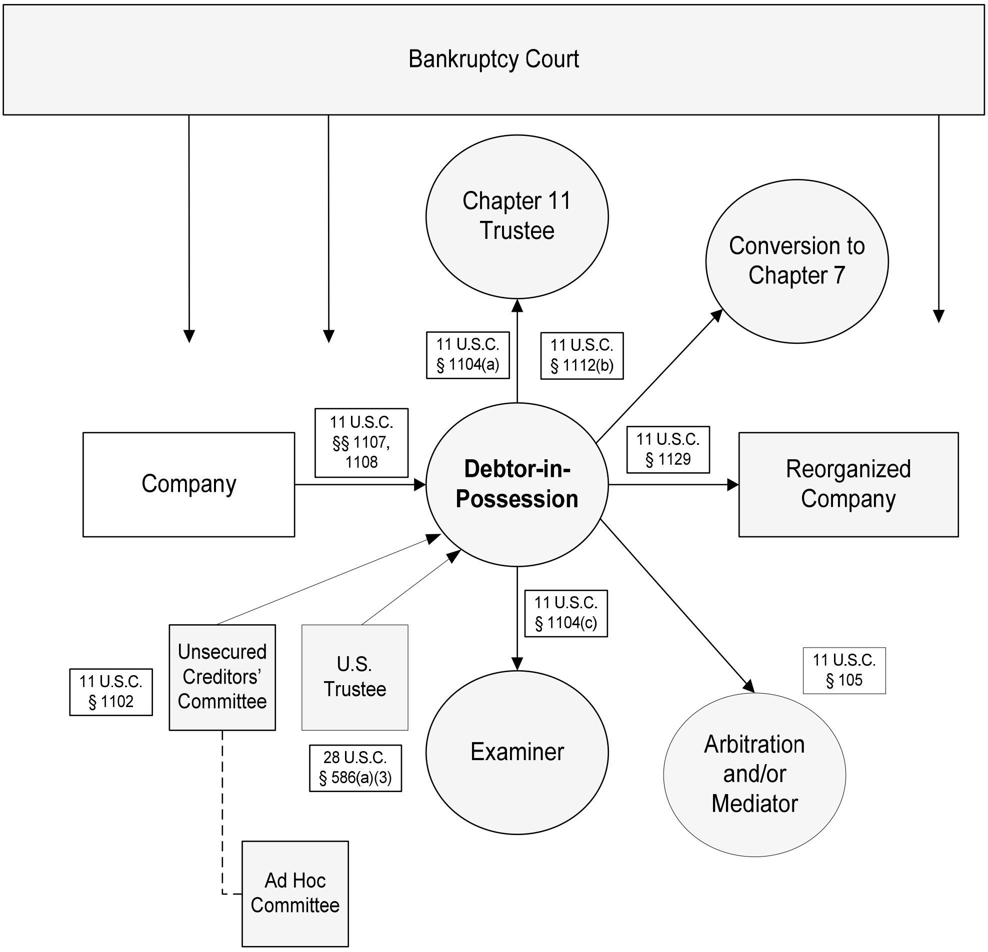
---

[66] Alces, *supra* note 61, at 96; *see also* Jeffery A. Deller, *Examining the Examiner: Waiver of the Attorney-Client Privilege and the Outer Limits of an Examiner's Powers in Bankruptcy*, 43 DUQ. L. REV. 187, 193–94 (2005) (observing powers and duties of trustee to be "quite vast" and include: fiduciary duties to creditors, duty to investigate financial affairs of debtor, duty to maximize value of bankruptcy estate, power to sue to recover from fraudulent or preferential transfers, power to run debtor's business, and power to use, sell, or lease property of debtor's estate).

[67] Nimmer & Feinberg, *supra* note 3, at 54–55 (discussing how "basic management structure of Chapter 11" would be compromised if any party in interest can force debtor-in-possession's removal).

[68] H.R. REP. NO. 95-595, at 233 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6193.

[69] *See* Walter W. Theus Jr., *Who's Responsible Here? "Responsible Persons" in Chapter 11 Cases,* AM. BANKR. INST. J., May 2008, at 12, 12 (acknowledging Code's flexibility reflects compromise between legislators who favored appointment of trustees in all cases involving public companies and those who believed debtors should control reorganization).



IV. CONTINUUM OF ALTERNATIVE SYSTEMS

Despite the flexibility and viability of the current state law fiduciary duties model, some commentators have proposed abandoning the model and imposing a federal trustee or a court-appointed manager.

A. *The Federal Trustee Model*

One option for addressing the concerns of those who believe that state law fiduciaries should not control the direction of chapter 11 cases would be to revert to the chapter X paradigm of automatically appointing a federal trustee to displace management upon the commencement of every case. Those who oppose enabling existing management to exert control argue that the same management team that led the company into financial distress should not be allowed to run the company's affairs or control the direction of the reorganization process.[70] Moreover, some argue that insolvency alters the incentives of ownership such that owners' incentives are misaligned with those of creditors.[71] Ordinarily the management of a solvent company owes duties exclusively to the corporation and its shareholders.[72] Therefore, some worry that the managers may not be able to reorient their viewpoint in light of the expanded list of entities to whom they owe fiduciary duties in bankruptcy.[73]

---

[70] *See* A. Mechele Dickerson, *The Many Faces of Chapter 11: A Reply To Professor Baird*, 12 AM. BANKR. INST. L. REV. 109, 135 (2004) (positing "there should be a rebuttable presumption that the directors of insolvent firms are unfit for board service and that they should be disqualified from future board service"); Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 WIS. L. REV. 729, 732 n.11 (1993) (noting that owner-managers may steer company in "directions that are not in economic interests of the company"). *But see* Ziad Raymond Azar, *Bankruptcy Policy: An Empirical Investigation of 50 Jurisdictions Worldwide*, 82 AM. BANKR. L.J. 407, 431 (2008) (emphasizing "[m]anagement should not be displaced upon filing reorganization").

[71] *See* LoPucki, *supra* note 70, at 733 ("Because the[] [management] retain[s] the benefits of risk taking without suffering a corresponding share of the losses, it may be in their interests that the company take risks not justified by the expected returns to the company."); *see also In re* Pilgrim's Pride Corp., 401 B.R. 229, 237 (Bankr. N.D. Tex. 2009) (noting executives may focus on self-serving interests rather than interests of estate when devising compensation packages for chapter 11); *In re* KenDavis Indus. Int'l, 91 B.R. 742, 765 (Bankr. N.D. Tex. 1988) (highlighting document submitted into evidence that was written by owner-manager of bankrupt company which read "[a]s Barb continues to repeat and everyone agrees there is no shareholder equity—so we've got nothing to [lose]. The banks have it all on the line now—not us.").

[72] *See* Baker, Butler & McDermott, *supra* note 6, at 856 & n.5 (explaining such duty owed by directors are "exclusively to the corporation and its shareholders") (citing Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986)); *see also* ASARCO LLC v. Americas Mining Corp, 396 B.R. 278, 395 (Bankr. S.D. Tex. 2008) ("As a general rule, a director owes a fiduciary duty only to its corporation and its shareholders (not its creditors)."); MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 501 A.2d 1239, 1247 (Del. Ch. 1985) ("[T]he directors have the right, even the duty, to adopt defensive measures to defeat a takeover attempt which is perceived as being contrary to the best interests of the corporation and its shareholders.").

[73] *See* Baker, Butler & McDermott, *supra* note 6, at 858 ("When a corporation becomes insolvent, the directors' and officers' fiduciary duties expand and extend to the firm and its 'entire community of interests,' including creditors."); *see also* Bd. of Trs. of Teamsters Local 863 Pensions Fund v. Foodtown, Inc., 296 F.3d 164, 173 (3d Cir. 2002) (explaining insolvency of corporation triggers fiduciary duty owed by directors to corporation's creditors); Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485, 1489–91, 1523 (1993) (observing some courts take a "'community of interest'" while other courts opine that shareholders switch places with creditors).

B. Hybrid Models

Other commentators advocate creating hybrid models for use in the corporate reorganization process. One scholar suggests creating a bifurcated governance process.[74] Under his approach, a trustee would be appointed immediately upon the bankruptcy filing; however, the trustee would serve alongside incumbent management.[75] This scholar theorizes that "[t]he fundamental task of the independent trustee would be to decide if a liquidation or reorganization of the corporation is the proper course of action. Pre-petition management . . . would continue [to run the company's day-to-day operations]."[76]

Another scholar suggests a hybrid governance model in which a trustee would be appointed and, rather than displacing existing management, would take a seat—with a veto power—on the company's board of directors.[77]

Yet a third proposal is to adopt the Canadian model, in which a monitor is appointed.[78] In the Canadian system the monitor is not intended to manage the firm on a daily basis but rather to report to the court and the creditors and serve as a set of "'eyes and ears.'"[79] The Canadian monitor serves other functions as well, including (1) exploring the firm's options for asset redeployment, (2) submitting recommendations regarding the distribution of dividends and (3) taking a position on legal issues pending before the bankruptcy judge.[80]

---

[74] Adams, *supra* note 7, at 621.

[75] *Id.*; *see* Karen M. Gebbia-Pinetti, *Small Business Reorganization and the SABRE Proposals*, 7 FORDHAM J. CORP. & FIN. L. 253, 287–90 (2002) (contextualizing Adams' model as one "designed to enhance the effectiveness . . . or fill the gap" where debtor's management is ineffective); Rotem, *supra* note 7, at 129 (noting Adams' model vests daily business decisions with the debtor's incumbent management while "'bankruptcy decisions,' meaning decisions on whether to reorganize or liquidate, are to be made by a court-appointed [trustee]").

[76] Adams, *supra* note 7, at 621—22.

[77] David Hahn, *Concentrated Ownership and Control of Corporate Reorganisations*, 4 J. CORP. L. STUD. 117, 147–49 (2004) (advocating greater trustee power over business management decision-making); *see* Rotem, *supra* note 7, at 129 (summarizing Professor Hahn's "bifurcated co-determination governance regime" where incumbent management "share control of the firm and issue all decisions together, with the trustee enjoying a veto power over all decisions made by the firm's board of directors").

[78] *See, e.g.*, Rotem, *supra* note 7, at 130 (noting courts' monitor appointment power is "perhaps unique to Canada"); Douglas I. Knowles, *To Liquidate or Restructure Under the CCAA? The Monitor's Conflicting Duties*, ANNUAL REV. INSOLVENCY L. 95, 102 (2006) (summarizing appointed monitors' powers as court officers); *see also* JANIS SARRA, CREDITOR RIGHTS AND THE PUBLIC INTEREST: RESTRUCTURING INSOLVENT CORPORATIONS 26 (2003) (stating practice of appointing monitors in bankruptcy reorganizations became mandatory since 1997 statutory amendments).

[79] Rotem, *supra* note 7, at 144–45 (explaining monitors function in Canadian insolvency system); *see also* Edward T. Canuel, *United States-Canadian Insolvencies: Reviewing Conflicting Legal Mechanisms, Challenges and Opportunities for Cross-Border Cooperation*, 4 J. INT'L BUS. & L. 8, 11 (2005) (noting appointed monitors "oversee the company's financial affairs and report upon any deterioration in such affairs during the stay period").

[80] Rotem, *supra* note 7, at 145–46 (discussing various functions and benefits of Canadian Monitor Model).

C. *Third Party Chief Restructuring Officer Model*

Some, in particular those in the turnaround management and creditor communities, argue for a more robust and systematic use of independent, third-party chief restructuring officers ("CROs"). Employing turnaround professionals as CROs has become common in recent years. Often creditors insist that companies install third-party CROs in the midst of a dire financial situation. "As part of the process by which creditors historically have required, or influenced troubled companies to 'voluntarily' retain turnaround professionals to assist in the restructuring process, creditors are now directing such companies to retain turnaround professionals as CROs rather than as consultants."[81] Those who strongly advocate the increased use of CROs contend that CROs "can devise an objective strategic plan to guide a financially troubled company back to solvency while allowing existing managers to focus on the firm's day-to-day operations."[82]

Without question, there are instances where retaining a certified turnaround professional such as a CRO makes sense for a company that expects to file or has filed a chapter 11 petition. However, because CROs are often engaged at the request of a particular creditor, serious conflict-of-interest questions can arise. As one commentator put it, CROs "are predisposed to favor only one entity involved in the debtor's chapter 11 reorganization: the creditor who was responsible for getting them hired."[83] Another issue associated with the increased use of CROs is that some are not employed by the debtor-in-possession but rather serve as independent consultants. This raises the concern of whether the CRO owes fiduciary duties and, if so, to whom. As one commentator stated, CROs "typically have limited liability and may have a right to be indemnified for their actions, yet have no clear duties to either the debtor or any creditor other than the one who may have insisted that they be hired."[84] While there are legitimate concerns about more systematically using third-party CROs, the authors believe that CROs often make important, value-added

---

[81] Mark V. Bossi, *Are CROs More Powerful than Turnaround Consultants? Creditors Drive Trend Toward New Title*, J. CORP. RENEWAL (Oct. 1, 2006), *available at* www.turnaround.org/Publications/Articles.aspx?objectID=6588.

[82] Dickerson, *supra* note 50, at 920; *see also* Anthony Horvat, *Defining the Role of the CRO: The Strategic and Tactical Benefits of a Seasoned Professional*, AM. BANKR. INST. J., Sept. 2005, 46, 46 (stating CRO "brings the major benefit of insulating the CEO and the management team from many of the pressures of the reorganization process so they can focus on the important job of running the company on a day-to-day basis"); James H.M. Sprayregen et al., *Chapter 11: Not Perfect, But Better Than The Alternatives*, 14 J. BANKR. L. & PRAC. 6 Art. 1, 24–25 (2005) (arguing CROs are able to "tailor their roles from case to case" rather than a "'one size fits all'" approach).

[83] Dickerson, *supra* note 50, at 919; *see also In re* The Colad Group, Inc., 324 B.R. 208, 215 (Bankr. W.D.N.Y. 2005) (noting proposed consultant, selected by debtor, was based on secured creditor's recommendation); Richard E. Mikels & Charles W. Azano, *"The More Things Change . . .": Reflections on 34 Years of Practice*, AM. BANKR. INST. J., Oct. 2006, at 22, 70 (noting lenders often require employment of CRO and that it is "more beneficial for creditors than for the debtor to have in place managers with less allegiance to shareholders and other management").

[84] Dickerson, *supra* note 50, at 928.

contributions to reorganization cases. This assumes, however, that the CRO, whether appointed from within the ranks of management or selected from a group of certified turnaround professionals, is integrated into the management team and reports to, and is accountable to, the state law fiduciaries operating as the debtor-in-possession.

V. THE CURRENT SYSTEM SHOULD BE PRESERVED

The purpose of chapter 11 is to foster effective reorganizations. The current system promotes the goal of enabling effective reorganizations by allowing the debtor's directors and officers, who owe expanded state law fiduciary duties to the company's stakeholders, to remain in control of a chapter 11 case. Congress determined that enabling existing state law fiduciaries to remain in control during the pendency of chapter 11 proceedings improves the chances of a successful reorganization and decreases the probability of a liquidation. The legislative history of chapter 11 states Congress's belief that "a debtor continu[ing] in possession may lead to a greater likelihood of success in the reorganization."[85]

The current state law fiduciaries model has various benefits. First, all parties-in-interest are protected both by the structure of the Bankruptcy Code[86] and by debtors-in-possession owing fiduciary duties to their stakeholders pursuant to state law. The "debtor-in-possession is a fiduciary of the creditors and, as a result, has an obligation to refrain 'from acting in a manner which could damage the estate, or hinder a successful reorganization.'"[87] In point of fact, the debtor-in-possession owes fiduciary obligations to equity owners, secured creditors and unsecured creditors.[88] As the Supreme Court stated, if a debtor remains in possession—that is, if a trustee is not appointed—the debtor's directors bear essentially the same fiduciary obligation to creditors and shareholders as would the trustee for a debtor out of possession. Indeed, the willingness of courts to leave debtors in possession "is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee."[89]

---

[85] H.R. REP. NO. 95-595, at 233 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6192.

[86] *See supra* Part III.B. *See generally* 11 U.S.C. § 1103(c)(2) (2006) (appointing creditors' committee to monitor debtor-in-possession); 28 U.S.C. § 586(a)(3) (authorizing U.S. Trustee to supervise debtor-in-possession); 11 U.S.C. § 1102(a)(2) (granting U.S. Trustee authority to appoint additional committees to oversee debtor-in-possession).

[87] Petit v. New Eng. Mortgage Servs., 182 B.R. 64, 69 (D. Me. 1995) (quoting *In re* Ionosphere Clubs, Inc., 113 B.R. 164, 169 (Bankr. S.D.N.Y. 1990)).

[88] *See, e.g.*, *In re* B & W Tractor Co., 38 B.R. 613, 614 (Bankr. E.D.N.C. 1984) (stating debtor-in-possession has powers of trustee and "is acting for the benefit of the debtor, its owners, and its creditors"); *In re* Humphreys Pest Control Franchises, Inc., 40 B.R. 174, 176 n.5 (Bankr. E.D. Pa. 1984) (noting debtor-in-possession, acting as trustee, "owes a fiduciary obligation to all creditors"); *In re* Harms, 10 B.R. 817, 822 (Bankr. D. Colo. 1981) (asserting debtor-in-possession is vested with rights and powers of trustee and thus owes fiduciary duties to creditors).

[89] Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) (quoting Wolf v. Weinstein, 372 U.S. 633, 651 (1963)).

Accordingly the state law fiduciaries have an obligation to "focus on maximizing the value of the enterprise, rather than on attempting to maximize recoveries for any one particular constituency."[90] The state law fiduciaries' expanded duties help ensure that all parties' interests are protected.

Moreover the debtor's directors and officers have a familiarity with the business, which is an asset that generally benefits all interested parties in a chapter 11 reorganization. As the legislative history of section 1108 states, "very often the creditors will be benefited by continuation of the debtor-in-possession, both because the expense of a trustee will not be required, and the debtor, who is familiar with his business, will be better able to operate it during the reorganization case."[91] One court explained that the strong presumption against appointing a trustee "finds its basis in the debtor-in-possession's usual familiarity with the business it had already been managing at the time of the bankruptcy filing, often making it the best party to conduct operations during the reorganization."[92] The debtors' directors and officers often have established relationships with key suppliers or creditors, and those relationships are beneficial as the company seeks to reorganize.[93] Furthermore, immediately replacing management with a trustee would dramatically increase the costs of conducting a reorganization because the trustee would have to familiarize herself with the business before she could turn to the details of the reorganization.[94] In short, replacing directors and officers with a trustee is more disruptive to the company than simply allowing the state law fiduciaries to remain in control.[95] At best, such a replacement is inefficient, at worst it is value destructive.

---

[90] Baker, Butler & McDermott, *supra* note 6, at 858; *see also* Yellowhouse Mach. Co. v. Mack (*In re* Hughes), 704 F.2d 820, 822 (5th Cir. 1983) (noting debtor-in-possession must "promote the common good of *all* of an estate's creditors" and fulfill duties of trustee); *In re* Mushroom Transp. Co., 366 B.R. 414, 453 (Bankr. E.D. Pa. 2007) ("[A] debtor-in-possession performs the same functions as a trustee in a reorganization . . . [and] therefore, . . . must fulfill the duties of a trustee . . . [including] . . . the duty to maximize the value of the estate.") (citations omitted).

[91] Baker, Butler & McDermott, *supra* note 6, at 858–61 (suggesting creditors are benefited by corporate management taking part in rehabilitation process); *see also In re* Sharon Steel Corp., 871 F.2d 1217, 1226 (3d Cir. 1989); *In re* V. Savino Oil & Heating Co., 99 B.R. 518, 524 (Bankr. E.D.N.Y. 1989) ("[C]urrent management is generally best suited to orchestrate the process of rehabilitation for the benefit of creditors and other interests of the estate.").

[92] *In re* Marvel Entm't Group, Inc., 140 F.3d 463, 471 (3d Cir. 1998).

[93] *See* Alces, *supra* note 61, at 96; *see also In re* Intercat, Inc., 247 B.R. 911, 924 (Bankr. S.D. Ga. 2000) (suggesting debtor's management is "heart and soul" of company and "[c]ustomer recognition of and loyalty" to debtor's management is key ingredient of successful company).

[94] *See* H.R. REP. NO. 95-595, at 233, *reprinted in* 1978 U.S.C.C.A.N. at 6192 ("A trustee frequently has to take time to familiarize himself with the business before the reorganization can get under way."); *see also* David A. Skeel, Jr., *Markets, Courts, and the Brave New World of Bankruptcy Theory*, 1993 WIS. L. REV. 465, 517 & n.188 (1993) (detailing problems caused to reorganization process by appointing trustee); *cf. In re* Sharon Steel Corp., 871 F.2d at 1226 (acknowledging replacing management with trustee would increase expense).

[95] *See* H.R. REP. NO. 95-595, at 233 (1978), *reprinted in* 1978 U.S.C.C.A.N. at 6192 (theorizing that leaving management in control leads to "greater likelihood of success in the reorganization" than if corporation was placed in hands of trustee); Frost, *supra* note 3, at 139 (citing reduction in disruption of business as "chief purpose" for allowing management to retain control during bankruptcy).

To be sure, there are instances where a company's need to file a chapter 11 case is the result of managerial malfeasance. However, Congress contemplated such situations, and thus the Bankruptcy Code already empowers the bankruptcy court to appoint a trustee when necessary. In a great many instances, however, companies endure financial distress as a result of external circumstances that are outside the control of management.[96] Also, even if a company is forced to file a chapter 11 case because of fraud, dishonesty or mismanagement, "very frequently the fraudulent management will have been ousted shortly before the filing of the reorganization case, and the new management, very capable of running the business, should not be ousted by a trustee because of the sins of the former management."[97]

Another benefit of the system that makes state law fiduciaries the lead players in the chapter 11 case is that it eliminates concerns that companies will avoid filing for chapter 11 because of concerns that directors and officers will be displaced. Congress, when considering amending the pre-1978 Bankruptcy Act, noted that "a standard for the appointment of a trustee . . . that led to too frequent appointment would prevent debtors from seeking relief under the reorganization chapter and would leave the chapter largely unused except in extreme cases."[98] A system that divested directors and officers of control of the company automatically upon filing could discourage companies from availing themselves of the benefits of chapter 11.

Returning to the former system that automatically appoints a trustee when a company files would lead to the very problems Congress sought to mitigate when it enacted the Bankruptcy Code. If companies delay filing chapter 11 petitions because of concerns that management will be removed, fewer companies may be able to reorganize successfully. This, in turn, would undermine the very purpose of chapter 11 (to foster reorganizations) and lead to more liquidations. The current system, which leaves companies in control of their reorganizations, maximizes efficiency and leads to larger distributions for creditors:

> One cannot overemphasize the advantages of speed and simplicity to both creditors and debtors. Chapter XI allows a debtor to negotiate a plan outside of court and, having reached a settlement of each class of creditors, permits the debtor to bind all unsecured creditors to the terms of the arrangement. From the perspective of creditors, early confirmation of a plan of arrangement generally

[96] *See* H.R. REP. NO. 95-595, at 233 (1978), *reprinted in* 1978 U.S.C.C.A.N. at 6192 ("[T]he need for reorganization of a public company today often results from simple business reverses, not from any fraud, dishonesty, or gross mismanagement on the part of the debtor's management."); Nimmer & Feinberg, *supra* note 3, at 24 (1989) (opining underlying causes of bankruptcy filings are often "circumstantial and reflect conditions not ineptly created by management"); *see also* Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007) ("The principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.'") (quoting Grogan v. Garner, 498 U.S. 279, 286–87 (1991)).

[97] H.R. REP. NO. 95-595, at 233 (1978), *reprinted in* 1978 U.S.C.C.A.N. at 6192–93.

[98] H.R. REP. NO. 95-595, at 233 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6193.

> reduces administrative expenses which have priority over the claims of unsecured creditors; second, permits creditors to receive prompt distributions on their claims with respect to which interest does not accrue after the filing date; and third, increases the ultimate recovery on creditor claims by minimizing the adverse effect on the business which often accompanies efforts to operate an enterprise under the protection of the Bankruptcy Act.[99]

Creditors often prefer current management to remain in control of the chapter 11 proceedings.[100] Creditors express this preference by (a) accepting a company's decision to seek to reorganize under chapter 11 rather than liquidate under chapter 7 and (b) exercising voluntary restraint from seeking to curtail the powers of the debtor-in-possession or the appointment of an examiner or chapter 11 trustee, which they (and other stakeholders) are otherwise freely able to pursue during the pendency of a chapter 11 case.[101] Therefore, the current system, which minimizes disincentives for filing chapter 11 petitions, accedes to the wishes of both debtors and their stakeholders.

The current model promotes flexibility by creating a presumptive system (state law fiduciaries in control) but then empowering bankruptcy judges to scale back the debtor-in-possession's autonomy to a degree necessary based upon the details of the individual case. The bankruptcy judge has discretion to circumscribe a debtor-in-possession's powers under section 1107, appoint a monitor, appoint a chapter 11 trustee, convert the case to chapter 7 or dismiss the case outright.[102] The panoply of options available to bankruptcy judges ensures that existing management's experience and know-how can be utilized in most instances, but, when appropriate, fraud, dishonesty or gross mismanagement can be excised.

---

[99] Schulman, *supra* note 17 at 269–70 & n.23 (quoting 124 CONG. REC. S17, 418 (daily ed. Oct. 6, 1978)). *reprinted in* 3 COLLIER ON BANKRUPTCY app. at X-38).

[100] *See* Peter F. Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 CASE W. RES. L. REV. 301, 322 (1982) ("[P]arties in interest usually will not request a trustee under chapter 11.").

[101] *See* 11 U.S.C. § 1104(a) (2009) ("At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest . . . the court shall order the appointment of a trustee . . . ."); Coogan, *supra* note 100, at 322 (noting creditor "preference for a debtor-in-possession is indicated by their preference for chapter 11"); *see also* Deller, *supra* note 66, at 188 ("It is widely recognized that the appointment of a trustee or examiner in a Chapter 11 bankruptcy is an extremely rare event.").

[102] *See, e.g.*, *In re* Gonic Realty Trust, 909 F.2d 624, 626 (1st Cir. 1990) (holding that a bankruptcy judge "determining 'cause' for dismissal [or conversion] may consider other factors as they arise and use its powers to reach appropriate results in individual cases"); Schuster v. Dragone, 266 B.R. 268, 271–72 (D. Conn. 2001) (discussing bankruptcy court's discretion in appointing trustee); *In re* G-I Holdings Inc., 295 B.R. 502, 507 (D. N.J. 2003) ("decision to appoint a trustee must be made on a case-by-case basis" and "falls within the court's discretion").

Shortly before this article was presented at the American Bankruptcy Institute's 2009 Legislative Symposium,[103] a bankruptcy judge in the Southern District of New York underscored the importance of maintaining flexibility. In *In re Lyondell Chemical Co.*, the Official Committee of Unsecured Creditors asked Judge Robert Gerber to appoint an examiner pursuant to 11 U.S.C. § 1104(c).[104] Because section 1104(c) obligates a judge to appoint a chapter 11 examiner upon a party-in-interest's request if the debtor's unsecured debt exceeds $5 million,[105] Judge Gerber granted the motion.[106] In so doing, however, Judge Gerber criticized the mandatory examiner law as "terrible bankruptcy policy" and said that judges should have discretion to decide when an examiner is necessary.[107] Judge Gerber's comments highlight the problems inherent in a one-size-fits-all approach and militate in favor of a system where the bankruptcy judge can tailor solutions to address individual cases. The provision for the mandatory appointment of an examiner notwithstanding, the current system generally provides the bankruptcy judge with the flexibility necessary to ensure the most efficient outcomes on a case-by-case basis. In our view, such flexibility should be encouraged and broadened, not restricted.

Automatically appointing a chapter 11 trustee in every case would eviscerate the flexibility that exists in the current model and is simply unworkable: "[T]he cost, the learning curve and the impact this would have on a debtor's willingness to use Chapter 11 as a source of debt relief, makes the routine appointment of a trustee disfunctional [sic]."[108]

The recent reorganization of Delphi Corporation after four years at the epicenter of the distressed capital markets and restructuring of the automotive industry also

---

[103] The symposium, which was entitled "Chapter 11 at the Crossroads: Does Reorganization Need Reform? A Symposium on the Past, Present and Future of U.S. Corporate Restructuring," took place at the Georgetown University Law Center on November 16-17, 2009.

[104] Motion of the Official Comm. of Unsecured Creditors for Appointment of an Exam'r Pursuant to Section 1104(c) of the Bankruptcy Code at 1, *In re* Lyondell Chem. Co., No. 09-10023, (Bankr. S.D.N.Y. Oct. 2, 2009).

[105] 11 U.S.C. § 1104(c) (2009) ("[O]n request of a party in interest . . . the court shall order the appointment of an examiner . . . if . . . the debtor's fixed, liquidated, [and] unsecured debts . . . exceed $5,000,000.").

[106] *See* Order Directing the Appointment of an Examiner & Specifying Scope of Examiner's Investigation & Duties Pursuant to Sections 1104(c) and 1106(b) of the Bankruptcy Code, *In re* Lyondell Chem. Co., No. 09-10023, 2009 WL 1767591 (Bankr. S.D.N.Y. June 10, 2009) (granting motion of Official Committee of Unsecured Creditors and ordering examiner to be appointed); *see also* Posting of David McLaughlin to Bankruptcy Beat, http://blogs.wsj.com/ bankruptcy/2009/10/27/bankruptcy-judge-to-congress-change-examiner-law/ (Oct. 27, 2009, 13:04 EST) (explaining Judge Gerber ordered examiner to investigate conflicts of interest but criticized examiner statute).

[107] *See* McLaughlin, *supra* note 106 (stating Judge Gerber was opposed to mandatory appointment and asked Congress to change law).

[108] Nimmer & Feinberg, *surpa* note 3, at 10–11 (indicating it would be nonsensical to bring in trustee as neutral third party and it would be better to let control remain with debtor who has knowledge of business).

illustrates the utility of state law fiduciaries operating as debtors-in-possession.[109] When Delphi filed its chapter 11 cases in 2005, it was the largest U.S. auto-related bankruptcy and the then-largest reorganization case ever for a manufacturing company.[110] Delphi was prepared to close on its confirmed plan of reorganization in early 2008 but was forced to suspend the plan closing when a group of investors walked away from a multi-billion dollar equity investment.[111] The debtors-in-possession then developed other strategic alternatives to the confirmed plan while obtaining the consent of required DIP lenders to continue to use the company's $3.4 billion DIP loan beyond its December 2008 maturity.[112] In April, 2009, immediately before Chrysler and General Motors commenced their chapter 11 cases, Delphi's principal economic stakeholders informed the company that they would not provide continued interim or long-term financial support and urged the company to liquidate.[113] Instead, the state law fiduciaries, acting as debtors-in-possession, determined that pursuing modifications to the confirmed plan of reorganization would maximize value for the company's stakeholders. Ultimately, Delphi forged a consensus among its stakeholders and won approval of a modified reorganization plan, which was substantially consummated in October, 2009.[114] Delphi's completed plan of reorganization marks one of the few successful chapter 11 reorganizations that has occurred during the current distressed markets cycle. It would not have occurred but for the determination and perseverance of the state law fiduciaries to maximize value for all stakeholders as well as the ultimate support of its key economic stakeholders. Delphi's core businesses are now part of a private company owned by a group of investors and are managed by the core management team that

---

[109] In the interests of full disclosure, one of the authors and the authors' law firm acted as Delphi's lead restructuring counsel in its chapter 11 reorganization cases.

[110] *See* Daniel Keating, *Harsh Realities and Silver Linings for Retirees*, 15 AM. BANKR. INST. L. REV. 437, 462 (2007) (noting car-parts manufacturer Delphi filed for chapter 11 bankruptcy); *see also* Stephen J. Lubben, *Credit Derivatives and the Future of Chapter 11*, 81 AM. BANKR. L.J. 405, 416 (2007) (explaining economic backdrop leading to Delphi filing for chapter 11); Roundtable Discussion, *American Bankruptcy Institute Media Teleconference to Examine the Future of Automotive Sector Distress*, 17 AM. BANKR. INST. L. REV. 105, 106 (2009) (indicating that decreased demands for GM, Ford, and Chrysler caused Delphi and other tier one suppliers to file for chapter 11).

[111] *See* Corinne Ball, *Unaddressed Issues Scuttle Delphi Bankruptcy Plan, Distressed Mergers & Acquisitions*, N.Y. L.J., Apr. 24, 2008, at 5 (indicating equity investor, Appaloosa, walked away from Delphi's chapter 11 plan).

[112] *See* Press Release, Delphi Corp., Delphi Receives Court Approval on DIP Accommodation Agreement (Dec. 1, 2008) (noting court extended DIP loan until June 30, 2009).

[113] *See generally* Jewel Gopwani, *Delphi Must Act Fast on GM Deal: Supplier Risks Loss of Loans, Liquidation*, DETROIT FREE PRESS, Apr. 17, 2009, at A11.

[114] *See* DPH Holdings Co. Home Page, http://www.dphholdingsdocket.com (last visited March 4, 2010) ("On October 6, 2009, Delphi substantially consummated its First Amended Joint Plan of Reorganization . . . ."). While the modified plan did not provide for material distributions to unsecured creditors and cancelled the claims and interests of more junior classes, the modified plan did provide for the satisfaction of the DIP loan, the payment of administrative claims and contingent recoveries to unsecured creditors.

filed the 2005 reorganization cases.[115] The go-forward business has more than 100,000 employees and operates in 270 locations in 32 countries.[116] Moreover, Delphi's non-core businesses, which employ tens of thousands of additional employees, were divested successfully as going concerns.[117]

No system works perfectly in all instances. However, chapter 11 strikes an important and delicate balance. The system enables directors and officers—bound by expanded fiduciary duties to the company's stakeholders—to remain in place and thereby takes advantage of those managers' experience and expertise. However, the system contains vigorous oversights to buttress state law fiduciary duties and ensure that all parties' interests are fairly and adequately represented. Finally, the system provides the flexibility necessary to ensure that managers who have committed fraud or gross mismanagement are unable to remain in place. This balance increases the likelihood of achieving efficient and cost-effective resolutions, and ultimately maximizes companies' ability to reorganize effectively.

CONCLUSION

The system for reorganizations that Congress created under chapter 11 maximizes flexibility by eschewing a one-size-fits-all-approach. The system enables existing state law fiduciaries, operating as debtors-in-possession, to control the direction of their chapter 11 case, but it imposes meaningful oversight by the creditors' committee, other statutory committees, individual creditors, the U.S. Trustee and the bankruptcy judge to ensure that, to the greatest extent possible, all parties' interests are protected. In addition, the Bankruptcy Code is flexible such that, in appropriate instances, the bankruptcy court has the power to circumscribe a debtor-in-possession's authority (by appointing an examiner) or to remove the debtor-in-possession altogether (by dismissing the case, converting it to chapter 7 or appointing a chapter 11 trustee). The current model has demonstrated flexibility to accommodate the proliferation of distressed investing and claims trading, radical changes in the composition of secured lending syndicates including their dominance

---

[115] *See id.* ("Delphi has now become a private company following the acquisition of substantially all of its global core businesses by a group of private investors.").

[116] *See* Matt Andrejczak & Jim Jelter, *Delphi Emerges from Four-Year Bankruptcy*, MARKETWATCH, Oct. 6, 2009, http://www.marketwatch.com/story/car-parts-maker-delphi-emerges-from-bankruptcy-2009-10-06 (noting Delphi still employs 100,000).

[117] *See* DPH Holdings Corp. Home Page, *supra* note 114 ("The former debtors' non-core steering business and certain US manufacturing plants have been acquired by an affiliate of General Motors Company."). *See also* Order Approving Modifications Under 11 U.S.C. § 1127(b) to (I) First Amended Joint Plan of Reorganization of Delphi Corp. & Certain Affiliates, Debtors & Debtors-In-Possession, as Modified and (II) Confirmation Order (Docket No. 18707), *In re* Delphi Corp., No. 05-44481, (Bankr. S.D.N.Y. July 30, 2009); Order (A)(I) Approving Modifications to Debtors' First Amended Plan of Reorganization (as Modified) & Related Disclosures & Voting Procedures & (II) Setting Final Hearing Date to Consider Modifications to Confirmed First Amended Plan of Reorganization & (B) Setting Administrative Expense Claims Bar Date & Alternative Transaction Hearing Date ("Modification Procedures Order") (Docket No. 17032), *In re* Delphi Corp., No. 05-44481 (Bankr. S.D.N.Y. June 16, 2009).

by hedge funds and other non-traditional investors, evolution in the composition of statutory committees, and constantly changing capital structures fueled by complex financial products. While no system is perfect, the authors believe that the current model, which adopts as its cornerstone traditional notions of state law corporate governance and fiduciary duty, remains vastly superior to the alternatives.