Companies faced with impending financial distress frequently seek assistance from crisis management firms. Rather than serve as a long-term employee, the turnaround manager becomes a senior officer of the distressed company for the restructuring or reorganization process.

Clearly creditors are more sophisticated and in control of the reorganization process than in 1978.¹ Many cash collateral agreements now include remedial rights as well as interim payment requirements and as a result, place restrictions, often significant ones, on the borrower, forcing asset sales and otherwise exerting indirect control over the business activities and operations of the borrower, including appointment of a chief restructuring officer. Not surprisingly, it is the lenders, not the borrowers, that have experience with turnaround firms. The lenders often suggest that a borrower retain a turnaround manager, sometimes requiring the retention of such expertise in connection with a pre-petition waiver of covenants or extension of additional credit.

Some commentators have questioned whether this potential for business referral from lenders creates an inherent conflict for the turnaround manager.² Indeed some courts have recognized that there is potential for abuse in the hiring of advisors and others who offer their professional services to beleaguered debtors.³ Moreover, these same commentators have inquired whether that relationship influences the outcome to one supported by the lenders, most often a sale.⁴

Rather than focus on outcome, the conflict analysis should focus on the frame of reference for decision-making by the crisis manager and the process for implementing such decisions. Such analysis has three phases: (i) the protections of the retention procedures for crisis managers in Chapter 11; (ii) the requirements of state and bankruptcy law for key decisions; and (iii) the level of participation by lenders, bondholders, other creditors and equity prior to implementation of such decisions.

I. Retention Procedures

A. Section 327 retention:

Turnaround managers and their firms still must be retained under the Bankruptcy Code once a company has filed its bankruptcy petition.⁵ Initially turnaround management firms were viewed as “professional persons” that should be retained under Section 327(a) which mandates that they are disinterested and do not hold or represent an interest adverse to the estate.⁶ Disclosure requirements for retention extend to all “connections” to the debtor, its creditors and their professionals.⁷ The sanction for not complying with Section 327 is serious. Under Section 328(c) the court may deny compensation for services and reimbursement of expenses of a professional person if, at any time during such professional’s employment, the person is not disinterested or represents or holds an interest adverse to the interest of the estate with respect to the subject matter of the employment.

Possibly conflicting loyalties or potential conflicts should not cause a competent professional to be disqualified. In In re Allegheny International Inc., one of the debtors retained a special advisor under Section 327(a) over the objection of the equity committee, which unsuccessfully argued that a conflict existed because the funding source for the plan made its funding contingent upon the same advisor becoming an executive of the reorganized debtor. Holding that the possibility of a conflict was insufficient, the court stated that “the possibility that [the advisor] may eventually play a managerial role in an as-yet speculative reorganization plan does not mean that [the advisor] would fall prey to conflicting loyalties while employed under the special advisor agreement, or that his interest would be materially adverse to those of the estate, creditors or equity security holders.”⁸

B. Section 363 retention:

More recently crisis management
retentions have proceeded under Section 363 following a retention protocol (the “Retention Protocol”) which emerged from a settlement with the United States Trustee in two Delaware Chapter 11 cases. Each debtor in In re Safety-Kleen Corporation10 and In re Harnischfeger Industries, Inc.,10 requested a retention of one firm as restructuring consultants, crisis managers and bankruptcy consultants. In each case, principals of the professional firm had served as officers or directors under contracts between the firm and the debtor which provided that the firm be compensated for the services provided by its principals. The United States trustee objected and sought the disqualification of the firm, as well as the surrender and disallowance of fees, based on the firm’s alleged failure to be disinterested due to its pre-petition service as officers. Ultimately, the firm agreed that it would not act in more than one capacity in one bankruptcy case; and once retained, it may not switch to a different retention capacity. The retention protocol applies to firms acting as: (i) crisis manager retained under Section 363; (ii) financial advisor retained under Section 327; (iii) claims agent/claims administrator appointed pursuant to 28 U.S.C. §156(c) and any applicable local rules; and (iv) investor/acquiror. Under the retention protocol, engagements for interim executive officers,11 whether pre- or post-petition, are subject to retention as crisis manager under Section 363; and engagements as a financial advisor are subject to retention under Section 327. Persons serving as executive officers will be retained in such positions upon the express approval of an independent board of directors whose members are performing their duties and obligations as required under applicable law. They will act under the direction, control and guidance of the board and will serve at the board’s pleasure. In addition, the retention application under Section 363 must contain the same disclosure required for retention under Section 327, including “any connection, relationship or affiliation with secured creditors, postpetition lenders, significant unsecured lenders, equity holders, current or former officers and directors, prospective buyers, or investors … and any pre-petition role as officer, director, employee or consultant … “

A retention under Section 363(b) remains subject to court approval after notice and a hearing. All interested parties have the right to object to the retention and to be heard. The judge evaluating a Section 363(b) application must expressly find from the evidence presented at the hearing that a good business reason exists to grant such application.12

Retention under Section 363 is used outside Delaware. For example, in In re Enron Corp., Stephen Forbes Cooper, LLC (“SF Cooper LLC”) was retained under Section 363 as an independent contractor to provide management services. SF Cooper LLC provided Stephen Cooper and up to the full-time equivalent of 15 additional individuals to work for the debtors. Stephen Cooper was to be employed as Enron’s Acting Chief Executive Officer and Chief Restructuring Officer, authorized to make decisions with respect to all aspects of Enron’s management and operations, subject to appropriate governance by the board of directors. Indeed, retention under Section 363 has been used when there was no active board. A reorganization committee of creditors and the chief restructuring officer are in charge of the company’s reorganization in In re Metropolitan Mortgage & Securities Co., Inc.13

Even though lenders may be a continued source of business for crisis managers, there are more than adequate safeguards against any alleged inherent conflict.14

II. Decision Making

A. State law:

As a corporate officer, the crisis manager has certain fiduciary duties which are determined by state law, generally including duties of care and loyalty that, absent insolvency, are owed to the corporation and its shareholders. As a general matter, decisions made by disinterested directors that are reasonably informed and acting in good faith and in the honest belief that the action taken is in the best interest of the corporation, are entitled to the protection of the business judgment rule. Once a company becomes insolvent,15 the fiduciary duties of officers and directors (including chief restructuring officers) may shift to creditors. Some courts have even held that officers and directors may owe fiduciary duties to creditors when the company is not yet insolvent but is “in the vicinity of insolvency.”16 Hence, under applicable state law, chief restructuring officers may be responsible to creditors and equity.

Given the practical recognition that insolvency is often not a bright line, rather than a shift in duties, enlightened boards should focus on maximizing the value of the company for the benefit of potentially multiple constituencies. Rather than holding boards of insolvent companies to the strict quasi-trustee standard of Pepper v. Litton,17 courts are moving to recognize that boards of financially troubled corporations, including crisis managers, can and should retain the protection of the business judgment rule to facilitate business reorganization.18

B. Court approval of key decisions:

Pursuant to Section 363(b), any use, sale or lease of property of the estate outside the ordinary course of business of the debtor may only take place with court approval after notice and a hearing. Hence, in addition to the continuing court oversight of crisis
managers, a party in interest has a right to be heard on their key decisions. There may be a question, however, about the two core decisions: a sale of the business and proposing a Chapter 11 plan. Technically the debtor controls the decision to sell, just as exclusivity gives the debtor control of the plan. In some cases, one may argue that court oversight is too little, too late. For instance, a financing or cash collateral agreement, which by its terms expressly requires asset sales, or indirectly requires asset sales through limiting cash available to operate, may make the business decision to sell the enterprise somewhat illusory, leaving the court to review the sale process and confirm the “highest and best” offer. Similarly, in many instances, the sale process is well under way before a motion to approve the sale is filed. The motion may follow circulation of offering memoranda to potential buyers, submission of indications of interest and selection of a stalking horse. Although creditors have succeeded in blocking sales, it is rare. Similarly, in deciding when to propose a plan of reorganization and what to include in the plan, the debtor retains substantial control as long as the debtor’s right to exclusivity is maintained. Judicial review awaits confirmation, by which time the plan and momentum of the reorganization may be unstoppable. This phenomenon is sometimes analogical to trying to stop a speeding train.

III. Various Interests

Should there be less deference to a debtor’s exclusivity and a decision to sell the enterprise if there is a chief restructuring officer? The answer should be “no.” Not all cases in which a crisis manager is retained end in a sale of the enterprise and cash payments to the lenders. Chapter 11 cases are dynamic. Cases are no longer confined to a secured lender and creditors’ committee being active and well represented. Creditor claims change hands. Distress investors may purchase bonds or bank debt with a view to a controlling equity interest in the reorganized debtor, thus changing the objectives of a traditional lender to those associated with an investor.

The crisis manager must work towards solution with the original lenders, bondholders who purchased their notes at par, as well as distressed investors who purchased bank debt, bonds and/or trade claims at a discount. These, at times, competing interests may require a crisis manager to reach a resolution involving a reorganization plan, as opposed to a sale. Indeed, depending on the going concern value of the debtor, a crisis manager may be best positioned to obtain a recovery for equity.

Even though lenders may be a continued source of business for crisis managers, the protections against influence arising from the continuing oversight of court- retained professionals, the frame of reference for decision making under state and bankruptcy law, as well as the multiple opportunities for creditor activism and intercreditor conflict, are more than adequate safeguards against any alleged conflict inherent in crisis management.


2. Under Delaware law the economic relationship of the individual director to the proponent of the transaction may be relevant to the analysis of “disinterestedness” and thus whether certain decisions are protected by the business judgment rule. See Brehm v. Eisner, 746 A.2d 244 (Del. 2000). See also Miller and Waisman, supra note 1.


4. See Miller and Waisman, supra note 1.

5. Pursuant to 11 U.S.C. §1107(a), a debtor in possession has all the rights of the trustee, with the exception of the right to compensation under §330.

6. The majority of the courts have held that a lack of disinterestedness results in automatic disqualification. See, e.g. In re Middleton Arms L.P., 934 F.2d 723, 725 (6th Cir. 1991); Pierce v. Aetna Life Ins. Co. (In re Pierce), 809 F.2d

1356, 1362 (8th Cir. 1987); In re Consol. Bancshares Inc., 785 F.2d 1249, 1256 n.6 (5th Cir. 1986); In re Enviroynde Indus. Inc., 150 B.R. 1008 (Bankr. N.D. Ill. 1993); In re Am. Printers & Lithographers Inc., 148 B.R. 862, 864 (Bankr. N.D. Ill. 1992). However, some courts have decided that a bankruptcy judge can make a case-by-case analysis and look at the totality of the circumstances. See In re Martin, 817 F.2d 175, 180-83 (1st Cir. 1987); In re O’Connor, 52 B.R. 892, 899 (Bankr. W.D. Okla. 1985).


11. Executive officers include, without limitation, chief executive officer, president, chief operating officer, Treasurer, chief financial officer, chief restructuring officer, chief information officer and any other officers having similar roles, power or authority, as well as any other officers provided for in the company’s bylaws.


14. A company is insolvent when the sum of its debts exceeds the fair value of its property. See 11 U.S.C. §101(32); Briden v. Foley, 776 F.2d 379, 382 (1st Cir. 1985).


