Taking Corporate Bankruptcy Fiduciary Duties Seriously

Stephen J. Lubben**

The board's fiduciary duties are the bedrock of corporate law. Bankruptcy trustees also owe fiduciary duties to the "bankruptcy estate." But corporations in bankruptcy rarely worry about fiduciary duties, even those corporations in chapter 11 reorganization cases, when the company is supposed to act as if it were the bankruptcy trustee.

At the same time, modern chapter 11 is increasingly seen as "problematic." Opportunism runs unchecked. This Article argues that these two points are directly connected: the underdevelopment of a corporate debtor's fiduciary duties enables the abuses seen in modern chapter 11.

I thus use this Article to frame bankruptcy-specific corporate fiduciary duties and then identify several common instances in which the debtor-corporation's board must act to meet those duties. This Article is the first to analyze the debtor's fiduciary duties from a perspective that integrates the literature on chapter 11 corporate governance and broader corporate bankruptcy policy considerations. While the articles identifying problems with modern chapter 11 are legion, those offering solutions are rare.

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INTRODUCTION

Fiduciary duties are the bedrock of corporate law. It is axiomatic that a corporation's directors are fiduciaries, owing duties of loyalty and care to the corporation's shareholders.[1] Such fiduciary duties have substantial bite and play the central role in ensuring that companies are managed in shareholders' interests.[2]

When a company files for bankruptcy, however, the situation is different. In theory, the corporate directors continue owing fiduciary duties (albeit to creditors as well as shareholders), and the corporate debtor itself owes the duties of a trustee,[3] but in practice fiduciary duties have little purchase in bankruptcy. This Article argues that the lack of meaningful fiduciary duties for directors in bankruptcy is responsible for a range of deleterious effects on the modern corporate bankruptcy system. In short, without fiduciary duties, corporate bankruptcy is broken.

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Most large American corporations file bankruptcy under chapter 11, the reorganization provision of the Bankruptcy Code, under which debtors remain "in possession" of their bankruptcy estate.[4] That is, no trustee is ever appointed.[5] Chapter 11

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1. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 745 (Del. Ch. 2005) ("The fiduciary duties owed by directors of a Delaware corporation are the duties of due care and loyalty."), *aff'd*, 906 A.2d 27 (Del. 2006); *see* Cynthia A. Williams, *Fiduciary Duties and Corporate Climate Responsibility*, 74 VAND. L. REV. 1875, 1887 (2021) (restating the general fiduciary duties that officers and directors owe).

2. Tom C.W. Lin, *Executive Private Misconduct*, 88 GEO. WASH. L. REV. 327, 353 (2020); William J. Moon, *Delaware's New Competition*, 114 NW. U. L. REV. 1403, 1448 (2020).

3. *See* Daniel B. Bogart, *Liability of Directors of Chapter 11 Debtors in Possession: "Don't Look Back—Something May Be Gaining on You*,*"* 68 AM. BANKR. L.J. 155, 185 (1994) ("The Code does not specifically describe the content of the fiduciary obligations imposed upon the DIP or the trustee in chapter 11. As a result, courts have developed a federal common law of fiduciary obligations to govern the behavior of the trustee and, derivatively, the DIP.").

4. The estate, while ostensibly distinct from the debtor itself, is a somewhat abstract concept in chapter 11, largely as a result of the lack of a trustee.

5. Kathleen G. Noonan, Jonathan C. Lipson & William H. Simon, *Reforming Institutions: The Judicial Function in Bankruptcy and Public Law Litigation*, 94 IND. L.J. 545, 548–49 (2019).

debtors in possession (DIPs)[6] owe fiduciary duties to the bankruptcy estate, just like trustees.[7] Plain statements of this principle are legion.[8]

The duty is frequently stated, yet rarely applied. Indeed, it is hard to find many examples of DIP fiduciary duties in action. Who can enforce the duty to the estate, and what form might that enforcement take?[9] What does the duty comprise, when is it simply instructive or hopeful, and when does it have "teeth?"[10] How do these bankruptcy-triggered duties relate to the duties of management under state corporate law?[11] And most plainly, what does the duty require of the DIP's board?[12] None of these fundamental points have been satisfactorily established.

That is, the DIP's chapter 11 fiduciary duties loom wraith-like around corporate restructuring—noted but rarely seen. This stands in contrast to corporate law, where the board's fiduciary duties are highly specified.

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6. 11 U.S.C. § 1101(1) (defining "debtor in possession" as the debtor); *see* 11 U.S.C. § 1107(a) (stating that the trustee in a bankruptcy case must perform all the functions required by the code); *In re* Americana Expressways, Inc., 133 F.3d 752, 756 (10th Cir. 1997) ("In all essential respects a debtor in possession in a Chapter 11 bankruptcy proceeding is subject to the same responsibilities as a trustee.").

7. Harvey R. Miller, *Corporate Governance in Chapter 11: The Fiduciary Relationship Between Directors and Stockholders of Solvent and Insolvent Corporations*, 23 SETON HALL L. REV. 1467, 1488 (1993) ("A chapter 11 debtor clearly has fiduciary duties to the involved constituents, including secured creditors, senior and junior unsecured creditors, and stockholders."); *In re* United Healthcare Sys., Inc., 200 F.3d 170, 177 n.9 (3d Cir. 1999) ("United Healthcare, as a debtor-in-possession, is a fiduciary for its estate and for its creditors."); Brent Expls., Inc. v. Karst Enters., Inc. (*In re* Brent Expls., Inc.), 31 B.R. 745, 752 (Bankr. D. Colo. 1983) ("[A]t the filing of the bankruptcy petition the debtor becomes a new entity, the debtor-in-possession with its own rights and duties. . . . This second entity has a fiduciary duty to the estate."). Given that most chapter 11 debtors are business entities, it might be more precise to say that the DIP's board owes fiduciary duties to the DIP's estate. JLM, Inc. v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 25 (B.A.P. 2d Cir. 1997) ("Both management and its counsel have fiduciary duties to an estate in bankruptcy.").

8. *E.g.*, JKJ Chevrolet, Inc. v. Reynolds & Reynolds Co. (*In re* JKJ Chevrolet, Inc.), 26 F.3d 481, 485 (4th Cir. 1994) (holding that trustees and DIPs "both owe fiduciary duties to the creditors of the estate"); *In re* Microwave Prods. of Am., Inc., 102 B.R. 666, 672 (Bankr. W.D. Tenn. 1989) (stating that a "debtor as a representative of the estate is a fiduciary to the entire creditor body, the equity shareholders, and the management, officers, and directors of the debtor" and is bound by the "duty of loyalty and care"); Juliet M. Moringiello, *Dispossessing Resident Voice: Municipal Receiverships and the Public Trust*, 53 U. MICH. J.L. REFORM 733, 738 (2020); Michelle M. Harner, *The Search for an Unbiased Fiduciary in Corporate Reorganizations*, 86 NOTRE DAME L. REV. 469, 486 (2011); Daniel B. Bogart, *Unexpected Gifts of Chapter 11: The Breach of a Director's Duty of Loyalty Following Plan Confirmation and the Postconfirmation Jurisdiction of Bankruptcy Courts*, 72 AM. BANKR. L.J. 303, 307 (1998); John T. Roache, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133, 144.

9. As others have noted, the state law corporate system does not cleanly interface with chapter 11 in this regard. *E.g.*, Kelli A. Alces, *Enforcing Corporate Fiduciary Duties in Bankruptcy*, 56 U. KAN. L. REV. 83, 95 (2007).

10. A. Mechele Dickerson, *Privatizing Ethics in Corporate Reorganizations*, 93 MINN. L. REV. 875, 894 (2009).

11. Alessandra Zanardo, *Fiduciary Duties of Directors of Insolvent Corporations: A Comparative Perspective*, 93 CHI.-KENT L. REV. 867, 883 (2018); Dennis F. Dunne, *The* Revlon *Duties and the Sale of Companies in Chapter 11*, 52 BUS. LAW. 1333, 1339 (1997).

12. *See* Brook E. Gotberg, *Relational Preferences in Chapter 11 Proceedings*, 71 OKLA. L. REV. 1013, 1018 (2019) ("The DIP's fiduciary duty to maximize the estate certainly suggests a duty to maximize preference recoveries pursuant to a cost-benefit analysis, although there is no clear direction on how costs and benefits should be measured.").

At the same time, modern chapter 11 is increasingly seen as "problematic."[13] Aggressive forum shopping,[14] extreme deference to insider deals,[15] and excessive speed have moved chapter 11 into a realm where powerful insiders always win.[16] Ellias and Stark call it "hardball."[17] LoPucki calls it "lawless."[18] Dick summarizes the development of modern, ultra-aggressive restructuring "as a normative failure in the . . . capital markets that will likely continue and grow worse over time."[19]

The proponents of these deals pick and choose which parts of chapter 11 they want to follow, using what is useful and ignoring those pieces that might lead to more balance or transparency.[20] As one noted commentator recently summarized, "proponents of bankruptcy à la carte (including financial institutions, hedge funds, private-equity funds, and their restructuring professionals) misappropriate value meant for a more diffuse group of stakeholders and capture it for themselves."[21]

This Article argues that these two issues are closely related: the underdevelopment of the DIP's fiduciary duties enables the abuses seen in modern chapter 11. I thus use this Article to frame those bankruptcy-specific fiduciary duties and then identify several common instances in which the DIP's board must act to meet those duties. The first Part synthesizes the prior literature, which the second Part uses as a springboard for a novel argument that directly links more active DIP boards to the current abuses that plague chapter 11.[22] That is, rather than abstractly stating that a DIP's board must follow the duties of care and loyalty, I identify specific steps that the board should contemplate to meet its duties.

This Article argues, for example, that the DIP's board should approach a takeover—whether by a pre-bankruptcy lender or by a group of funds that has acquired a majority position in the "fulcrum security"—just as it would outside of bankruptcy. Just as a "normal" corporation sometimes has an obligation to slow down a hostile bid to maximize value for shareholders, a DIP's board should consider objecting to credit bids,[23] or rejecting

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13. Jonathan C. Lipson, *The Shadow Bankruptcy System*, 89 B.U. L. REV. 1609, 1686 (2009); Adam J. Levitin, Purdue*'s Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. 1079, 1079 (2022); *see also* Jay Lawrence Westbrook, *Chapter 11 Under Duress*, 37 EMORY BANKR. DEVS. J. 551, 555 (2021).

14. Adam J. Levitin, *Judge Shopping in Chapter 11 Bankruptcy*, 2023 U. ILL. L. REV. 351, 354 (2023).

15. Stephen J. Lubben, *Holdout Panic*, 96 AM. BANKR. L.J. 1, 2 (2022).

16. Lynn M. LoPucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L.J. 247, 249 (2022).

17. Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745, 748 (2020).

18. LoPucki, *supra* note 16.

19. Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333, 1378 (2021).

20. Vincent S.J. Buccola, *Unwritten Law and the Odd Ones Out*, 131 YALE L.J. 1559, 1559 (2022) (reviewing DOUGLAS G. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS (2022)) (arguing reorganizers have "mastered the art of ignoring or interpreting away 'written law' inconsistent with their core commitments" accounting for "a variety of persistent norms and tensions of reorganization practice not attributable to statute or judicial precedent").

21. Melissa B. Jacoby, *Shocking Business Bankruptcy Law*, 131 YALE L.J.F. 409, 411 (2021).

22. For an overview of the creditor fiduciary duty literature, see generally Zanardo, *supra* note 11.

23. *See* Alan N. Resnick, *Denying Secured Creditors the Right to Credit Bid in Chapter 11 Cases and the Risk of Undervaluation*, 63 HASTINGS L.J. 323, 333 (2012) ("In general, a court may deny the right to credit bid if such denial is in the interest of furthering a policy advanced by the Bankruptcy Code, such as when credit bidding would chill the bidding process or would otherwise hinder the reorganization process.").

overly aggressive milestones,[24] or quick sales, even in situations where the debtor's management agreed to these pre-bankruptcy. That is, the DIP's board may often have a duty to reconsider what it did as a state-law board.

Of course, once it became clear that boards are adopting such a proactive approach to chapter 11, it would have knock-on effects on pre-bankruptcy negotiations. I argue that is a good thing to the extent it reduces the pressure on boards to agree to onerous deals on the eve of filing. And in bankruptcy, the expectation that boards will actively attempt to maximize the value of the estate—for *all* stakeholders—will move chapter 11 back toward a point of balance, which has been missing for at least a decade.[25]

This Article is thus the first to analyze the DIP's fiduciary duties from a perspective that integrates the literature on DIP corporate governance and broader corporate bankruptcy policy considerations. While the articles identifying problems with modern chapter 11 are legion, those offering solutions are rare.

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Part I sets forth a brief review of the current state of chapter 11. Restructuring support agreements, prepacks that are in and out of bankruptcy in less than 24 hours, and aggressive venue (and judge) shopping are all features of modern chapter 11. Restructuring support agreements (or RSAs) are particularly troublesome, inasmuch as they often seem to allow parties to "waive" key parts of the Bankruptcy Code. For example, some recent RSAs seem to be designed to evade the rule that all creditors within a class receive equal treatment.[26]

Part II of this Article then frames the DIP's fiduciary duties by reference to the comparable duties under Delaware corporate law. I argue that the DIP's duties are at least as wide-ranging as those, and the Delaware duties offer the advantage of extensive judicial explication. But the application of those duties is also an issue in chapter 11—and too often the issues of how the duties are applied, who can enforce them, and how the duties relate to the bankruptcy-specific remedial provisions of chapter 11 are neglected. For example, because Delaware law routinely immunizes directors from liability for breaching the duty of care, should chapter 11 do the same? These application issues are just as important as the framing of the fiduciary duties themselves.

Once the duties of a DIP's board are established, Part III of the Article then looks to how these duties could address the tribulations of modern chapter 11. As noted at the outset, the core of the DIP's fiduciary duties is the simple requirement that the board actively work to maximize the value of the estate. That means that the board may not negotiate a deal to sell the debtor-firm to the senior lenders simply because such a deal is "easy," and likewise it means that maximizing the returns to bondholders or those senior lenders is inconsistent with maximizing estate value as a whole. In short, the board must actively consider and reconsider all possible options in chapter 11.

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24. Typically the case milestones are set forth in either the proposed DIP loan or, more recently, the terms of a restructuring support agreement (RSA). I discuss both in further detail in the body of this Article.

25. *See generally* Stephen J. Lubben, *Fairness and Flexibility: Understanding Corporate Bankruptcy's Arc*, 23 U. PA. J. BUS. L. 132 (2020) (arguing that the modern chapter 11 has emphasized flexibility in big bankruptcy cases to the detriment of fairness).

26. The most notorious example is *In re* Peabody Energy Corp., 933 F.3d 918, 923 (8th Cir. 2019), where the court seem to be willfully blind to what was going on.

And indeed, I ultimately conclude that if we take a DIP's fiduciary duties seriously, it could open a new, more dynamic role for boards in chapter 11 cases. In doing so, chapter 11 might well heal itself and preserve its continued utility in the American economy.

I. THE PROBLEMS WITH MODERN CHAPTER 11

Large corporations in theory can file for bankruptcy under either chapter 7 or chapter 11, but most file under chapter 11.[27] In chapter 7, the debtor's assets are all placed under the control of an independent, court-appointed trustee who liquidates the company and distributes the liquidation proceeds according to a fixed statutory order of distribution.[28] Chapter 11 is different. As two leading commentators have summarized:

> In Chapter 11, the corporation's management operates its business under court supervision, filing various reports and appearing regularly in court. The procedure's goal is the adoption of a reorganization plan by a vote of the creditors organized by classes to reflect differing legal and economic interests. Creditors and other stakeholders get notice of important issues, legal and economic, and have an opportunity to object to whatever has been proposed. Shareholders are recognized as stakeholders in bankruptcy reorganization and fairly often emerge from the reorganization with an interest in the corporation, although frequently one of small value. The company's business is managed by existing management, which exercises the powers of the Debtor in Possession (DIP) . . . . The supervising court is a specialized bankruptcy court within the structure of the federal district courts and exercises an exclusive federal jurisdiction over bankruptcy matters. Most cases are handled by members of a highly specialized bar.[29]

Following its enactment in 1978, and for at least the following decade, chapter 11 was both widely used and heavily criticized. According to critics, chapter 11 was too debtor-friendly and too slow:

> Chapter 11 seemed to give too much control to the debtor's managers, enabling them to stiff-arm creditors and drag out the bankruptcy cases for inordinate periods of time. Managers were playing with creditors' money, and large cases often lasted several years or more.
>
> The worst offender was Eastern Airlines . . . . Although it was clear to just about everyone that Eastern should be sold, Eastern's CEO Frank Lorenzo postponed the inevitable for several years as Eastern's value deteriorated. In the

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27. *See Here's a List of 154 Bankruptcies in the Retail Apocalypse—and Why They Failed*, CBINSIGHTS (Apr. 26, 2023), https://www.cbinsights.com/research/retail-apocalypse-timeline-infographic [https://perma.cc/6XZZ-VXE9] (listing major corporations filing for bankruptcy, the majority filing under chapter 11).

28. 11 U.S.C. §§ 701–84.

29. Henry T. C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1347 (2007) (footnotes omitted).

> end, Eastern's assets were liquidated at a fraction of what they had been worth at the outset of the bankruptcy case.[30]

Beginning in the mid-1990s, the balance of power began to shift. Secured creditors learned how to use their power under the Bankruptcy Code—especially once enhanced by a friendly amendment of UCC article 9.[31] Among other things, these lenders used their power to compel a quick sale of the debtor's assets under section 363 before consideration of a plan.[32] Reorganization plans, voted on by creditors, are the traditional form of restructuring; when an asset sale under section 363 precedes a plan, the plan simply allocates the cash received in that sale to creditors.[33]

That is, the debtor is turned into a corporate box of cash. As a result, the protections that the Bankruptcy Code incorporates into the plan confirmation process—voting, classification, and various other rules—have far more salience if the debtor has effectively left the stage via an early asset sale. While this trend began in the mid-1990s, and was noticed by bankruptcy academics a few years later, it burst into the mainstream with the use of such sales in leading financial crisis era cases like General Motors, Chrysler, and Lehman Brothers.[34]

And then chapter 11 began to morph yet again. In the decade following Lehman, and again after the onset of COVID-19, interest rates dropped to near zero, and firms' capital structures became quite intricate.[35] Layer upon layer of cheap debt has multiplied the stakeholders in a distressed company, to the point that bankruptcy courts likely dread the prospect of unwinding it all in a traditional chapter 11 case.

Lucky for them, they rarely have to in large modern chapter 11 cases. The bulk of modern, big-debtor chapter 11 is ultimately not governed by the Bankruptcy Code or the bankruptcy judge but, instead, by the terms of a restructuring support agreement (RSA) negotiated by the parties.[36] As a consequence of agreeing to an RSA, the debtor and key

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30. David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 920–21 (2003) (footnotes omitted).

31. As a result of widely adopted 2001 amendments to UCC Article 9, it is now relatively easy for a group of lenders to obtain a comprehensive security interest in all of the debtor's assets. *See, e.g.*, Sally McDonald Henry, *The $1.5 Billion General Motors Recalls at the Dangerous Intersection of Chapter 11, Article 9, and TARP*, 85 U. CIN. L. REV. 131, 142–43 (2017); Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 923 (2014); Jonathan C. Lipson, *The Secret Life of Priority: Corporate Reorganization After* Jevic, 93 WASH. L. REV. 631, 686 (2018).

32. Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 156–57 (2005).

33. *Id.*

34. Jacoby & Janger, *supra* note 31, at 878–89; *see also* Andrew B. Dawson, *Selling Out*, 41 CARDOZO L. REV. 2521, 2535 (2020) (discussing Chrysler and General Motors's "quick sale" bankruptcy cases during the Great Recession).

35. *See generally* SARAH PATERSON, CORPORATE REORGANIZATION LAW AND FORCES OF CHANGE 62 (2020).

36. *See* Edward J. Janger & Adam J. Levitin, *Badges of Opportunism: Principles for Policing Restructuring Support Agreements*, 13 BROOK. J. CORP. FIN. & COM. L. 169, 170–71 (2018) ("[R]estructuring support agreements ('RSAs')—contractual agreements among creditors, and sometimes the debtor, to support restructuring plans that have certain agreed-upon characteristics. RSAs potentially offer a salutary bridge between the efficiencies of a quick sale and the procedural protections of a plan, but they also pose a potential avenue for abuse of the bankruptcy process.").

institutional creditors agree to support a future reorganization plan so long as it significantly adheres to what was specified in the RSA.[37]

In a variety of ways, such an agreement can be used to impose a plan that does not comply with the terms of chapter 11.[38] In many cases the RSA itself is apparently unproblematic, but it binds parties to a package of other deals—including DIP loans, terms sheets for a plan, and post-bankruptcy financing arrangements—that favor some stakeholders over other stakeholders.[39] It is the terms of these ancillary agreements, and the binding effect of the RSA, that are truly pernicious.[40]

Take, for example, the recent chapter 11 case of Chilean carrier LATAM Airlines, where the debtor entered into an RSA that included the outline of a plan and arrangement for the debtor's post-bankruptcy financing.[41] As part of the latter, the debtor selected a group of creditors to "backstop" its convertible debt and equity offering under the plan.[42] These creditors would receive $734 million in cash for buying any securities that went unpurchased under the plan.[43] The general unsecured creditors (who were not allowed to participate in the backstop) argued that the real goal was to make a large side payment (or bribe) to the backstopping creditors who held veto power over the plan.[44]

RSAs frequently benefit those with "a seat at the table," at the expense of other estate stakeholders. For example, the debtor typically agrees to pay the consenting creditors' professional fees and may design the DIP loan (or the exit loan) with input from these same creditors. As a result, these select creditors are in a commanding position to provide new financing, which is typically quite profitable. In general, an RSA can be used to give those with power—holding either 2/3 of class debt (or at just over 1/3 of the same class) and, thus, exercising a latent veto power[45]—extra return despite the requirement in section 1123 of the Bankruptcy Code, that a plan "provide the same treatment for each claim or interest of a particular class."[46]

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37. *Id.*

38. *Cf.* Pamela Foohey, Jevic*'s Promise: Procedural Justice in Chapter 11*, 93 WASH. L. REV. ONLINE 128, 136 (2018) (describing the implications for procedural justice and corporate reorganization that arose in *Czyzewski v. Jevic*).

39. Bruce Grohsgal, *The Alteration of Ex Ante Agreements by the Bankruptcy Code*, 95 AM. BANKR. L.J. 713, 735 (2021) ("Chapter 11 debtors and their senior creditors increasingly entered into these agreements to achieve a speedy and successful exit from bankruptcy. They cared less about how much of the reorganized firm they gave away in the process, so long as the amount was within the range of what the bankruptcy judge would approve.").

40. Although the true binding effect of the RSA is debatable, as discussed *infra* Part III.

41. *In re* LATAM Airlines Grp. S.A., No. 20-11254, 2022 WL 2206829, at *1, *3 (Bankr. S.D.N.Y. June 18, 2022).

42. *Id.* at *4.

43. *Id.*

44. Andrew Scurria & Akiko Matsuda, *Latam Airlines Defends Fees for Capital Raise to Ease Bankruptcy Exit*, WALL ST. J. (Feb. 11, 2022), https://www.wsj.com/articles/latam-airlines-defends-fees-for-capital-raise-to-ease-bankruptcy-exit-11644628597 (on file with the *Journal of Corporation Law*).

45. 11 U.S.C. § 1126(c) ("A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount . . . .").

46. 11 U.S.C. § 1123(a)(4).

Why would bankruptcy courts accept such a deal? RSAs are presented as tidy, consensual resolutions to what could otherwise easily become an extremely chaotic case.[47] Moreover, it is hard for an outsider—like the court—to tell whether the debtor is really in cahoots with a select group of creditors or if the objecting parties simply want to create leverage for their own benefit.

And certain low-level stakeholders—like employees and trade creditors—often make out quite well under the RSA-driven deals, which regularly provide for payment in full of creditors that are too scattered to bother negotiating with. On the other hand, we can safely assume that this advantageous treatment is solely a function of where the plan proponents' interests lie; any benefit to small stakeholders is purely accidental, and it is unclear that these benefits will survive in a changing chapter 11 (and broader economic) environment. Similarly, while RSAs are often unveiled with outlandishly large majorities in favor, that enthusiastic support is often the result of a highly coercive negotiation process pre-petition.[48] In short, courts can only be content with many of the deals if they pay no attention to the man behind the curtain.[49]

All of which comes within a broader restructuring context in which out-of-court workouts are increasingly aggressive with regard to their treatment of small investors, and debtors in general are looking for new ways to twist their debt agreements.[50] Chapter 11 of recent vintage are further tainted by aggressive venue (and judge) shopping and cases that proceed too quickly to involve anything that resembles due process.

II. DIP FIDUCIARY DUTIES

It is widely acknowledged that DIPs are fiduciaries, but to whom they are fiduciaries, who can enforce these duties, and what these duties entail is often left rather vague.[51] Developing the DIP's duties in the abstract quickly becomes unwieldy, so this Part begins first with a review of the fiduciary duties of solvent and insolvent corporations outside of bankruptcy, which provides a starting point to then understand the bankruptcy-specific DIP duties. The first set of duties are creatures of state law, whereas the DIP's duties are triggered only upon filing a federal bankruptcy petition.[52]

47. Douglas G. Baird, *Bankruptcy's Quiet Revolution*, 91 AM. BANKR. L.J. 593, 593 (2017) ("A new device—the restructuring support agreement—has transformed the plan-formation process over the last few years. It lacks any basis in the Bankruptcy Code.").

48. Oscar Couwenberg & Stephen J. Lubben, *Private Benefits Without Control? Modern Chapter 11 and the Market for Corporate Control*, 13 BROOK. J. CORP. FIN. & COM. L. 145, 166 (2018).

49. *See* THE WIZARD OF OZ (Metro-Goldwyn-Mayer 1939) (referring to The Wizard, unable to maintain his charade).

50. *See* Lubben, *supra* note 15, at 1 (stating the changes in restructuring situations).

51. *See* SEC v. Chenery Corp., 318 U.S. 80, 85–86 (1943) (discussing the unclarity around who is considered a fiduciary and when duties arise).

52. Hu & Westbrook, *supra* note 29, at 1331.

A. Corporate Fiduciary Duties

A corporation is a discrete legal entity that achieves its ends through the acts of agents,[53] and the board of the corporation "can be said to personify the corporate principal."[54] Broadly stated, a corporation's board of directors is responsible for managing the affairs of the corporation,[55] although a realistic account would also acknowledge the key role played by the chief executive.[56]

According to the traditional corporate law and finance literature, managers maximize shareholder value, optimize corporate investment, and generally invest in positive net present value projects.[57] These academic principles only partially align with real-world decision-making, where the individuals who hold these positions tend not to be profit-maximizing asocial psychopaths. There is also a chance that they are either (unreasonably) self-serving or incompetent, and the law guards against this by holding managers to a fiduciary standard.[58]

Under Delaware corporate law,[59] directors (and officers) of a corporation owe the corporation:

1. a duty of care, requiring a director to be reasonably informed and to exercise the level of care of an ordinarily prudent person under the circumstances;[60] and

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53. *See In re* Elsinghorst Bros. Co., 180 B.R. 52, 53 (Bankr. W.D.N.Y. 1995) (noting that the corporation itself is a distinct legal person); *cf.* Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y REV. 265, 270–71 (1998) (stating that principal and agent relations complicate the analysis of a corporation as a single entity).

54. STEPHEN M. BAINBRIDGE, AGENCY, PARTNERSHIPS & LLCS 37 (3d ed. 2019).

55. Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) ("The business and affairs of a corporation . . . shall be managed by or under the direction of a board of directors . . . ." (emphasis omitted) (quoting DEL. CODE ANN. tit. 8, § 141 (1983)); *accord* MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR ASS'N 2023) ("[A]ll corporate powers shall be exercised by or under the authority of the board of directors, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of the board of directors.").

56. Afra Afsharipour, *Women and M&A*, 12 U.C. IRVINE L. REV. 359, 367 (2022) (noting how senior executives (specifying CEOs) "dominate decision-making").

57. The "Shareholder Wealth Maximization" debate has raged for years, and scholars consistently reevaluate the extent of this unclear standard. *See, e.g.*, Stephen M. Bainbridge, *Why We Should Keep Teaching* Dodge v. Ford Motor Co., 48 J. CORP. L. 77, 78–79 (2022) ("The time has thus seemed propitious to many legal scholars to revisit the law of corporate purpose."); Robert T. Miller, *Delaware Law Requires Directors to Manage the Corporation for the Benefit of Its Stockholders and the Absurdity of Denying It: Reflections on Professor Bainbridge's* Why We Should Keep Teaching Dodge v. Ford Motor Co., 48 J. CORP. L. DIGIT. 32, 32–33 (2023) ("The law is . . . clear on [the duty of management to maximize shareholder wealth] . . . . This makes the scholarly articles misstating Delaware law on this fundamental issue entirely incomprehensible.").

58. Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 CALIF. L. REV. 1097, 1106 (2020) ("A core problem—if not *the* core problem—of the corporate form is the agency problem: that is, shareholders own the corporation, but delegate day-to-day running of their corporation to hired managers.").

59. *Accord* MODEL BUS. CORP. ACT §§ 8.30, 8.31 (2023).

60. Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963) ("[D]irectors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances.").

2. a duty of loyalty, requiring a director to act in the interests of the corporation (and not in her own interest) which includes a duty of good faith.[61]

If a plaintiff (typically a shareholder) alleges in detail that a director made a patently uninformed decision or approved a self-interested transaction, the courts will apply the "entire fairness" test.[62] The director must then prove that the price and the process leading to the disputed transaction were fair to the corporation and its stockholders.[63]

All other allegations will be dismissed out of hand, under the broad presumption that directors are doing their job correctly—typically shorthanded as the "business judgment rule."[64] Even borderline cases can be subject to the business judgment rule if approved by a fully informed, uncoerced vote of the disinterested stockholders.[65]

Delaware law also allows a corporation to exculpate its directors (and recently officers too) from monetary liability for a breach of the duty of care, and claims that are subject to exculpation also will be dismissed before trial.[66] In short, under Delaware law, the only damage claims that are viable in litigation are those involving either an undisclosed breach of loyalty[67] or an extreme breach of the duty of care—so extreme that it violates the director's good faith obligations.[68]

Traditionally, transactions involving a controlling shareholder on both sides—archetypally involving the buyout of the minority stub—are also analyzed under the entire fairness standard.[69] The thinking is that such transactions are comparable to situations where a corporation enters a transaction with an officer or director: the controlling shareholder lacks the normal shareholder incentives to maximize price, and the minority shareholder may lack good alternatives.[70]

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61. For example, a failure to ensure that reliable information and reporting systems are in place to detect misconduct could give rise to a claim for breach of the duty of care and the obligation of good faith. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996); Stone v. Ritter, 911 A.2d 362 (Del. 2006).

62. *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1204 (Del. Ch. 1995).

63. Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983); *In re* Dole Food Co., S'holder Litig., No. 8703, 2015 WL 5052214, at *45 (Del. Ch. Aug. 27, 2015).

64. As the Delaware Court of Chancery explained:

> [W]hether a judge or jury considering the matter . . . believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational," provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in . . . good faith. . . .

In re Caremark, 698 A.2d at 967 (emphasis omitted).

65. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015) (expanding upon the already existent statutory "safe harbors"); Lawrence A. Cunningham, *Ask the Smart Money: Shareholder Votes by a "Majority of the Quality Shareholders*,*"* 55 U.C. DAVIS L. REV. 1019, 1041 (2021) (expanding on how the duty of loyalty is not covered by the business judgment rule).

66. *In re* USG S'holder Litig., C.A. No. 2018-0602, 2020 WL 5126671, at *2 (Del. Ch. Aug. 31, 2020); Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 950–51 (2012).

67. Disclosed conflicts of interests can be overcome by an approval of disinterested board members or shareholders. Salladay v. Lev, No. 2019-0048, 2020 WL 954032, at *8 (Del. Ch. Feb. 27, 2020).

68. Bridgeport Holdings, Inc. v. Boyer (*In re* Bridgeport Holdings, Inc.), 388 B.R. 548, 569–72 (Bankr. D. Del. 2008).

69. *In re* GGP, Inc. S'holder Litig., No. 2018-0267, 2021 WL 2102326, at *13 (Del. Ch. May 25, 2021).

70. *In re* Tesla Motors, Inc. S'holder Litig., No. 12711, 2020 WL 553902, at *4–7 (Del. Ch. Feb. 4, 2020).

More recently, the Delaware courts have approved a transactional framework that allows for the application of the business judgment rule to such controlling shareholder deals by synthetically creating something like arm's length bargaining. Specifically, when a controlling stockholder transaction is conditioned—before the start of negotiations—on *both* the approval of an independent, adequately empowered special board committee (that meets its own duty of care) and the uncoerced, informed vote of a majority of the minority stockholders, that transaction, once consummated, is entitled to business judgment rule review.[71] If such transactional planning is not possible, for whatever reason, the old rule of "entire fairness" will apply.[72]

When reviewing certain transactions—such as the imposition of defensive measures (e.g., a poison pill), a "cash out" of shareholders, or the sale of control—the business judgment rule will only apply after the court applies "intermediate scrutiny" to the transaction.[73] That is, there is a kind of preliminary review before the customary framework applies, and that first-stage review can itself take one of two forms: *Revlon* or *Unocal*.[74]

The *Revlon* rule involves "enhanced scrutiny" in "final stage" transactions, such as a cash sale, a break-up, or a sale to a controlling shareholder.[75] In the limited situations where *Revlon* applies, directors have a duty to maximize return to shareholders (and presumably creditors when the company is insolvent, as discussed below).[76] The "paradigmatic context for a good *Revlon* claim . . . is when a supine board under the sway of an overweening CEO bent on a certain direction, tilts the sales process for reasons inimical to the stockholders' desire for the best price."[77]

Notably, several states have enacted constituency statutes that arguably counter *Revlon*'s specific focus on shareholders (or creditors), perhaps making it easier for boards to pass intermediate review.[78] That is, *Revlon* is not uniformly the law of all American corporations.

The *Unocal* rule, the other intermediate standard, establishes a reasonableness test when a board implements defensive measures in response to a perceived threat to corporate

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71. Flood v. Synutra Int'l, Inc., 195 A.3d 754, 763 (Del. 2018); Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014).

72. *Kahn*, 88 A.3d at 644.

73. *In re* Williams Cos. S'holder Litig., No. 2020-0707 (Del. Ch. Feb. 26, 2021).

74. Dan Awrey, Blanaid Clarke & Sean J. Griffith, *Resolving the Crisis in U.S. Merger Regulation: A Transatlantic Alternative to the Perpetual Litigation Machine*, 35 YALE J. ON REGUL. 1, 9 (2018).

75. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986); *see also* Afsharipour, *supra* note 56, at 372 (discussing role of directors during M&A proceedings).

76. Matthew D. Cain et al., *Does* Revlon *Matter? An Empirical and Theoretical Study*, 108 CALIF. L. REV. 1683, 1689–90 (2020) ("*Revlon* duties are triggered by a 'change of control,' which principally includes an acquisition of target shares for cash, as in *Revlon* itself, or—in the case of a stock-for-stock acquisition—an acquisition in which diffusely held public equity is exchanged for shares of a company in which there is a controlling shareholder." (footnote omitted)); *see* Mary Siegel, *The Illusion of Enhanced Review of Board Actions*, 15 U. PA. J. BUS. L. 599, 611 (2013) (discussing the Delaware Supreme Court's disfavor toward covenants).

77. *In re* Toys "R" Us, Inc. S'holders Litig., 877 A.2d 975, 1002 (Del. Ch. 2005).

78. *E.g.*, CONN. GEN. STAT. § 33-756(d) (2015); 15 PA. CONS. STAT. § 515(a) (2023); *see also* Russell C. Silberglied, *Can a Lower Bid for a Debtor's Assets Be Approved as "Better" Because It Saves More Jobs than the Higher Bid?*, 76 BUS. LAW. 817, 828 (2021) (discussing how states changed their corporate statutes in response to *Revlon*). In these jurisdictions, a *Revlon* claim might become a good faith claim.

policy,[79] to guard against the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."[80]

Directors owe fiduciary duties to the corporation itself—rather than any particular constituent thereof.[81] But because in normal times the duties can only be enforced by shareholders, there is a tendency to think of the directors as representing the shareholders.[82] However, if the corporation is insolvent, the duties can also be enforced by creditors, which underlines that the focus of the duties are on the firm.[83] As two leading scholars noted several years ago, "a public corporation is a team of people who enter into a complex

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79. Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946 (Del. 1985). Katie Clemmons, *Dissecting* Revlon*: Severing the Standard of Conduct from the Standard of Review in Post-Closing Litigation*, 73 VAND. L. REV. 267, 277 (2020).

80. Huff Energy Fund, L.P. v. Gershen, No. CV 11116, 2016 WL 5462958, at *14 (Del. Ch. Sept. 29, 2016); *accord* Iman Anabtawi, *The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence*, 43 DEL. J. CORP. L. 161, 172–73 (2019).

81. *See* Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155, 192 (Del. Ch. 2014) (stating that the creditor plaintiff could not rebut the business judgment rule merely by arguing that the directors took an excessively risky course of action, so long as it was designed to benefit the corporation as a whole, including creditors); Friedman v. Wellspring Cap. Mgmt., LLC (*In re* SportCo Holdings, Inc.), No. 19-11299, 2021 WL 4823513, at *6 (Bankr. D. Del. Oct. 14, 2021) ("Under Delaware law, corporate officers and directors owe the corporations they serve duties of care and loyalty . . . ."). Courts are frequently imprecise on this point. Andrew S. Gold, *Dynamic Fiduciary Duties*, 34 CARDOZO L. REV. 491, 493 (2012) ("Courts regularly state that directors' fiduciary duties are owed to both shareholders and the corporation. Yet it has long been recognized that shareholders and corporations can have divergent interests." (footnote omitted)).

82. Thus, many courts have held that directors owe no duties to creditors of solvent corporations—but that does not necessarily mean directors owe duties directly to shareholders either. *See, e.g.*, United States v. Jolly, 102 F.3d 46, 48–49 (2d Cir. 1996) (corporate president acquired loans to the corporation through fraud and plead guilty to mail fraud); Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504 (S.D.N.Y. 1989) (bondholders brought an action against corporation to recover for loss of value of the bonds following leveraged buyout); Simons v. Cogan, 549 A.2d 300, 303–04 (Del. 1988) (holding issuing corporation owed no fiduciary duty to debenture holders; restrictive provisions of indenture agreement precluded claim for breach of indenture; and holder's complaint failed to plead facts constituting actionable fraud); Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del. Ch. 1986) (bondholder sought to enjoin consummation of exchange offer and consent solicitation made by corporation to holders of long-term debt).

83. N. Am. Cath. Edu. Programming Found. Inc v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) ("When a corporation is *insolvent*, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value."); s*ee also* Ben Franklin Retail Stores, Inc. v. Kendig (*In re* Ben Franklin Retail Stores, Inc.), 225 B.R. 646, 653 (Bankr. N.D. Ill. 1998) (holding Delaware companies liable in bankruptcy proceedings); *In re* O.P.M. Leasing Servs., Inc., 28 B.R. 740, 760–61 (Bankr. S.D.N.Y. 1983). The Delaware court's decision that the duties are owed "to the corporation," avoids the many problematic questions that courts and commentators wrestled with in the 1980s and 90s, including: (i) what is the scope and nature of such duties?; (ii) do directors of insolvent corporations continue to owe fiduciary duties to shareholders and other constituencies?; and (iii) at what point in time, and to what extent, do directors of a financially-distressed corporation owe fiduciary duties to creditors of the corporation? *See generally* Laura Lin, *Shift of Fiduciary Duty upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485 (1993) (discussing conflicts of interest between shareholders and creditors)*; see also* Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganizations*, 83 COLUM. L. REV. 527, 583 (1983) (discussing bankruptcy in the context of shareholders).

agreement to work together for their mutual gain."[84] It is that collective unit that is protected by the duties, rather than any single actor therein.[85]

The Delaware courts, and courts generally, have generally assumed that the directors' fiduciary duties are purely internal—that is, the duties that are normally enforced by the shareholders, typically through the mechanism of a derivative suit, are the only duties the directors owe.[86] That is, there is an unexamined premise in this case law that state *corporate* law is the sole source of director duties.

But even if the *directors* owe no other fiduciary duties, these courts fail to consider whether the firm *itself* might owe similar fiduciary duties arising out of the credit relationship. These would typically be a matter of New York law, which governs most debt instruments issued in the United States.[87] That is, might an insolvent firm owe fiduciaries duties under New York law to its creditors that mirror the core corporate law (director) fiduciaries duties under Delaware law?

Because the potential New York duties would be breached by the directors acting on behalf of the corporation—the firm itself being quite inanimate—it would be quite easy to conflate these two formally distinct sets of duties.[88] Moreover, plaintiff's counsel would have to clearly distinguish which set of duties was being invoked in any particular claim.

Assuming these difficulties of understanding can be overcome, it would presumably be for the New York courts, and not the Delaware courts, to develop the creditor duties, even if the directors of Delaware corporations would largely be responsible for the corporation's adherence to them.[89] At present, this remains an unexplored nook in the pre-bankruptcy law of financial distress.

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84. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 278 (1999).

85. *Id.* at 293–94 ("[C]ase law makes clear that directors owe their fiduciary duties primarily *to the corporation itself*. Although this duty to 'the corporation' can perhaps be interpreted to mean a duty exclusively to the shareholders of the corporation, we agree with those who argue directors should be viewed as owing fiduciary duties to the corporation as a separate legal entity, apart from any duties they might also owe to shareholders." (footnote omitted)); *see also* Lisa M. Fairfax, *Just Say Yes? The Fiduciary Duty Implications of Directorial Acquiescence*, 106 IOWA L. REV. 1315, 1345–46 (2021) ("Of course, directors have a duty to the corporation and its shareholders. However, case law is clear that such a duty does not require directors to accede to the demands of shareholders. Instead, directors can take actions to protect the corporate enterprise against shareholders, including a majority of shareholders.").

86. Prod. Res. Grp., LLC. v. NCT Grp., Inc., 863 A.2d 772, 776, 793 (Del. Ch. 2004) (stating that "[c]laims of this type are classically derivative, in the sense that they involve an injury to the corporation as an entity and any harm to the stockholders and creditors is purely derivative of the direct financial harm to the corporation itself," and that "the later fact of insolvency does not transform the nature of the claim; it simply changes the class of those eligible to press the claim derivatively, by expanding it to include creditors").

87. Stephen J. Lubben, *Protecting Ma and Pa: Bond Workouts and the Trust Indenture Act in the 21st Century*, 44 CARDOZO L. REV. 81, 113 n.161 (2022).

88. *See* Kirschner v. Large S'holders (*In re* Tribune Co. Fraudulent Conv. Litig.), 10 F.4th 147, 160–61 (2d Cir. 2021) (explaining the differences between duties owed in a tribunal).

89. *Cf.* N.Y. Credit Men's Adjustment Bureau v. Weiss, 110 N.E.2d 397, 398 (1953) ("If the corporation was insolvent at that time it is clear that defendants, as officers and directors thereof, were to be considered as though trustees of the property for the corporate creditor-beneficiaries.").

B. Fiduciary Duties in Bankruptcy

Upon filing a bankruptcy petition, an estate is created. This estate is comprised of all of the debtor's property "wherever located and by whomever held."[90] Under chapter 11, "the trustee may operate the debtor's business,"[91] while at the same time the debtor-firm becomes the debtor-in-possession or DIP, and assumes the rights and duties of a trustee.[92] As explained by Congress at the time of the Bankruptcy Code's enactment:

> This section [§ 1107(a)] 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 [it?] 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.[93]

The debtor-firm thus has a fiduciary obligation to protect the estate, and operate the debtor's business within the estate, for the benefit of all who have an interest therein.[94] The debtor as an entity remains a creation of state law, but it undertakes new obligations that are functions of federal law—a situation that results in the debtor and its management wearing more than its fair share of hats.

Operationally, it is the debtor's officers and directors who will ensure the debtor's compliance with that fiduciary obligation,[95] and thus courts tend to speak in terms of the managers having this trustee-like duty.[96] More precisely, it might be said that the officers and directors have a duty to the DIP to ensure that the debtor-firm complies with its own duties to the estate.[97]

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90. 11 U.S.C. § 541(a).

91. 11 U.S.C. § 1108.

92. 11 U.S.C. § 1107(a); *see also* 11 U.S.C. § 1101(1) (defining "debtor in possession").

93. S. REP. NO. 95-989, at 116 (1978); *accord* Wolf v. Weinstein, 372 U.S. 633, 649 (1963) ("[S]o long as the Debtor remains in possession, it is clear that the corporation bears essentially the same fiduciary obligation to the creditors as does the trustee for the Debtor out of possession.").

94. Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 462 (6th Cir. 1982) ("The principles governing the liability of a bankruptcy trustee are applicable to a debtor in possession."); *see also* John A. E. Pottow, *Fiduciary Principles in Bankruptcy and Insolvency*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 205, 205 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019).

95. *Wolf*, 372 U.S. at 649–50 ("[I]n practice these fiduciary responsibilities fall not upon the inanimate corporation, but upon the officers and managing employees who must conduct the Debtor's affairs under the surveillance of the court.").

96. *See, e.g.*, Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) ("[I]f a debtor remains in possession . . . the debtor's directors bear essentially the same fiduciary obligation to creditors and shareholders as would the trustee for a debtor out of possession."); *In re* Intermagnetics Am., Inc., 926 F.2d 912, 917 (9th Cir. 1991) ("Officers of a debtor-in-possession are officers of the court because of their responsibility to act in the best interests of the estate as a whole and the accompanying fiduciary duties.").

97. *In re* Frankel, 77 B.R. 401, 404 (Bankr. W.D.N.Y. 1987). While professionals are beyond the scope of this paper, courts have long held that debtor professionals owe duties to both the estate and their client. *In re* Arlan's Dep't Stores, Inc., 615 F.2d 925, 934 (2d Cir. 1979); *see also In re* Taxman Clothing Co., 49 F.3d 310, 314 (7th Cir. 1995) (holding that a lawyer, hired as a trustee, has a fiduciary duty to the estate); *In re* Perez, 30 F.3d 1209, 1219 (9th Cir. 1994) (stating that "[c]ounsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually" but that counsel "must always take his directions from his client"); *but see* Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434 (D. Utah 1998) (holding that counsel does not have a fiduciary duty while the debtor-in-possession does).

The debtor's duty is rooted in the Bankruptcy Code, particularly section 1107(a).[98] While the board's duty is a creation of federal common law,[99] tracking state law without necessarily slavishly following it, reinforced by the threat of appointment of a trustee under section 1104 if the directors fail to keep the debtor-firm on track.[100] The DIP-entity's duty is therefore a unique construction: under state law, only officers and directors have duties, not the entity itself (subject to the previous observation about the undeveloped state of New York debtor-creditor law), whereas, under bankruptcy, the DIP as trustee undertakes such duties as guardian of the bankruptcy estate.

A violation of duty by officers is likely to reflect not only a violation of duty by the board because the board has a duty to supervise the officers,[101] but also a violation by the DIP itself, acting through its agents (the officers and directors).[102]

Similarly, if we think of the board's duties as the first-stage duties and the firm's duties as the second-stage duties, the tendency to collapse the two duties into one becomes logical. In short, there are likely few cases in which the second-stage duties of the firm could be violated without a violation by the directors in the first stage. Nevertheless, as with the duties outside of bankruptcy, a host of conundrums can be avoided by resisting the urge to discount the distinction between the debtor-firm and the individuals who serve on that firm's board.[103] And there may be situations where the board has collectively violated its duties, thus triggering a violation by the DIP, but each individual director's violation is comparatively minor. That is, a DIP might violate its bankruptcy duties through the collective weight of the officers' or directors' "mere" negligence.[104]

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98. 11 U.S.C. § 1107(a) ("[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.").

99. *In re* Signature Apparel Grp. LLC, 577 B.R. 54, 96–97 (Bankr. S.D.N.Y. 2017) (finding that debtor's controlling member "owed a fiduciary duty of loyalty arising under federal law as a principal of the debtor in possession"); *see also In re* Evangeline Refining Co., 890 F.2d 1312, 1322–23 (5th Cir. 1989) (noting that those who perform duties in administration of the estate are officers of the court); *cf.* Nancy B. Rapoport, *Using General Counsel to Set the Tone for Work in Large Chapter 11 Cases*, 88 FORDHAM L. REV. 1727, 1733 (2020) (discussing the impact of general counsel's values).

100. *See* Alces, *supra* note 9, at 144 (discussing the role of state law remedies within federal bankruptcy cases).

101. *Cf.* Hanson Tr. PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 274–75 (2d Cir. 1986) (explaining that outside of bankruptcy, "[d]irectors may be liable to shareholders for failing reasonably to obtain material information or to make a reasonable inquiry into material matters").

102. As one court summarized:

> [A] principal of a corporation in Chapter 11 does not have the right to so engage in self-dealing that profiteers on his own pre-petition connivance or misfeasance or that interferes with the efforts to liquidate or reorganize the Debtor-in-Possession. His fiduciary duty is not just that of a corporate officer or director, it is the duty of high trust imposed on the "representative of the estate" pursuant to 11 U.S.C. § 323(a), 11 U.S.C. § 1101(a), and Rule 9001(5), of the Rules of Bankruptcy Procedure.

In re Albion Disposal, Inc., 152 B.R. 794, 801–02 (Bankr. W.D.N.Y. 1993).

103. *See generally* Elizabeth Pollman, *The Supreme Court and the Pro-Business Paradox*, 135 HARV. L. REV. 220 (2021) (exploring the problems that result from the failure to distinguish between the participants in a corporate enterprise).

104. *Cf.* Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 138 (2010) (discussing the role of the independent director to check inside directors).

In addition, we should underline that the debtor's duties are owed to the bankruptcy estate, not to any particular constituency of that estate.[105] Clearly, those constituents have claims and interests in the estate, of varying priority, but the debtor's obligation is to the pie as a whole rather than to any particular slice (or crumb).

Some commentators have identified two different specifications of the DIP's fiduciary duties: one corporate-based version and one trust-based version.[106] The first simply states that the debtor's obligation is to protect and conserve property for the benefit of the various estate stakeholders.[107] Sometimes this version of the duty is stated somewhat more ambitiously—that the debtor has a duty to maximize the value of the estate.[108]

Growing the size of the estate is properly distinct from increasing return to creditors—there are non-creditor stakeholders in the estate, be they employees or shareholders—but there is undoubtedly a tendency to conflate the two objectives. But if a debtor faces two paths, each of which will provide the same return to unsecured creditors, with one presenting less dislocation to employees, the fiduciary duty as I conceive of it would require the DIP to take the second path. Of course, rarely will the assortment of paths come labeled quite so plainly.

The trust-based version ties into the statutory basis for the DIP's fiduciary duties, which are statutorily connected to the duties of chapter 7 trustees.[109] It is notable, however, that most of the cases that apply a trust version of the DIP's duties involve fact patterns where the officers or directors are themselves operating under a clear conflict of interest.[110] These cases could instead be reconceptualized as situations where violations of the director's duties (the first stage) inexorably lead to suspicion that the DIP is also violating its (second stage) duties. In short, obvious violation of the board's duties may well lead to a more probing review of the DIP's actions, not unlike the situations where the "entire fairness" standard is invoked under state corporate law.

The DIP, as an entity, owes a fiduciary duty to the estate, a duty that we might root in the common law of agency, namely that the DIP must act with appropriate care and diligence in pursuing the estate's interests.[111] Agency law seems most apt here in that the DIP is standing in for an agent (the trustee), while the concerns that shape corporate

105. *In re* Microwave Prods. of Am., Inc., 102 B.R. 666, 671 (Bankr. W.D. Tenn. 1989) ("Because the DIP's fiduciary obligation is to the estate, and not to one group, the DIP must act to benefit the estate as a whole."); *see also* CFTC v. Weintraub, 471 U.S. 343, 355 (1985) ("[T]he fiduciary duty of the trustee runs to shareholders as well as to creditors.").

106. C.R. Bowles, Jr. & Nancy B. Rapoport, *Has the DIP's Attorney Become the Ultimate Creditors' Lawyer in Bankruptcy Reorganization Cases?*, 5 AM. BANKR. INST. L. REV. 47, 55–56 (1997).

107. *In re* Sillerman, 605 B.R. 631, 648 (Bankr. S.D.N.Y. 2019).

108. *In re* Martin, 91 F.3d 389, 396 (3d Cir. 1996); *accord* Lin, *supra* note 83, at 1497–98; *but see* Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 785 (1993) ("The existence of potentially huge distributional effects from the investment policies pursued by management casts doubt on management's ability to remain unbiased while determining what course of action will maximize the estate.").

109. John T. Roache, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133, 134.

110. *See, e.g.*, *In re* Performance Nutrition, Inc., 239 B.R. 93, 111–12 (Bankr. N.D. Tex. 1999); *In re* Gen. Homes Corp., 199 B.R. 148, 151–52 (S.D. Tex. 1996); *In re* Main Line Motors, Inc., 9 B.R. 782, 784 (Bankr. E.D. Pa. 1981).

111. *In re* Brook Valley VII, Joint Venture, 496 F.3d 892, 900 (8th Cir. 2007) ("Debtors in possession and those who control them owe fiduciary duties to the bankruptcy estate.").

fiduciary duties, such as desires to encourage service by "top people," are decidedly less relevant in a context where the DIP's role is not open to alternative parties.

The DIP's fiduciary obligations to the estate are actually performed by the board and agents appointed by the board (officers). Internally, the relationship between the DIP and these real parties is governed by state corporate law. But what of their roles in facilitating the DIP's duties to the estate?

Here, courts have tended to look to corporate law but have, then, struggled with the reality that corporate law varies a good deal from state to state. For example, as noted under the *Revlon* rule, Delaware requires the board to maximize the return to shareholders (and perhaps creditors when the firm is insolvent) whenever selling for cash.[112] But in other jurisdictions, like Maryland or New Jersey, constituency statutes largely override the *Revlon* rule, replacing it with the general question of whether the board (outside of bankruptcy) has acted in good faith.[113]

It seems inappropriate that a DIP's board should have different chapter 11 duties based on the state of incorporation. That is, what right does state law have to intrude on such an essential aspect of (federal) chapter 11 procedure? There is also no good reason why the DIP-board's obligations should be limited by exculpation provisions, such as Delaware's section 102(b)(7),[114] given that the trustee (and the DIP itself) could never obtain such protection.[115]

More appropriate might be to approach board decisions in bankruptcy (regarding central bankruptcy matters) under a kind of common law of corporations. That is, unconflicted board decisions on routine matters should be given deference, subject to judicial scrutiny only upon a showing of gross negligence.

Officers, as corporate agents, should be subject to agency law—even if the debtor is incorporated in those jurisdictions that include at least some officers in the director's statutory framework.

In the context of managerial competence, the DIP's duties and the directors' own duties to the DIP functionally collapse into a single obligation of care on the part of the directors. The DIP can exercise no more or less care than the board that controls it.[116]

But the DIP could also violate its fiduciary duty when the directors are conflicted.[117] Stated otherwise, a director's disloyalty could result in the DIP violating its fiduciary duty to the estate.[118] For example, a conflicted director might direct the sale of the debtor's assets in a way that diminishes the return to the estate, such as by accepting side payments from a bidder or selling the assets to a bidder that the director has an interest in.[119]

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112. *Supra* note 75–77 and accompanying text.

113. *Supra* note 78 and accompanying text.

114. Del. Code. Ann. tit. 8, § 102(b)(7) (2023).

115. Other states have even broader limitations on fiduciary duty claims, which underlines the importance of developing a distinct, chapter 11 jurisprudence in this context. Kobi Kastiel & Yaron Nili, *The Corporate Governance Gap*, 131 YALE L.J. 782, 820 (2022).

116. *In re* McConville, 110 F.3d 47, 50 (9th Cir. 1997).

117. *In re* L.S. Good & Co., 8 B.R. 312, 315 (Bankr. N.D.W. Va. 1980).

118. *See In re* Colorado-Ute Elec. Ass'n, 120 B.R. 164, 176 (Bankr. D. Colo. 1990) (holding the appointment of a trustee proper when the bankruptcy court could not envision a way for current management to resolve conflicts).

119. *In re* Hampton Hotel Invs., L.P., 270 B.R. 346, 352–53 (Bankr. S.D.N.Y. 2001).

That is, while the DIP's duty is singular, the debtor could violate it because of multifarious violations by its decision-makers.

That said, in many instances such breaches will be preempted in bankruptcy before they ever occur.[120] While corporate law enforces fiduciary duties primarily through ex post litigation, chapter 11 enforces the DIP's fiduciary duty through a combination of such litigation and, more importantly, ex ante court oversight.[121] This oversight will thwart most of the duty-breaching decisions—"let's invest the estate's cash in bitcoin!"—that would have to be litigated ex post under state law.[122]

Ex post fiduciary duty litigation in bankruptcy is largely limited to the situation where there has been a dual failure: the DIP has breached its duty in both a substantive decision and, in the procedural decision to not seek court approval, when such approval was required. A related category of litigation might result from the DIP's breach of its duty because of its officer or director's lack of candor. That is, court approval is sought, but without disclosure of circumstances that would have led the court to review the DIP's actions under the more exacting—entire fairness or trustee-like—standard of review.[123]

Note that under this conception of bankruptcy fiduciary duties, the estate might have claims against the DIP, while the DIP might have claims against its board, directors, or officers. In both forms, the claims are restitution for lost estate value and, as such, do not fall into the traditional pre-petition or post-petition (administrative) bankruptcy dichotomy.[124] It could not be otherwise, for if breach of duty claims were administrative claims, a pre-bankruptcy creditor would never bring such a claim for fear of self-subordination. And characterizing fiduciary duty claims as administrative would likewise

120. *See* Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154, 1164 (2022) ("[D]ebtors are constrained in how they operate during a Chapter 11 case, and must seek court approval before making decisions outside of the ordinary course of business."); Oscar Couwenberg & Stephen J. Lubben, *Good Old Chapter 11 in a Pre-Insolvency World: The Growth of Global Reorganization Options*, 46 N.C. J. INT'L L. 353, 361 (2021) (discussing the formality and publicity of chapter 11 bankruptcy).

121. *E.g.*, 11 U.S.C. §§ 327, 363–65, 1113–14, 1129 (providing the mechanisms for ex ante oversight in chapter 11 proceedings). Professor LoPucki argues that "the bankruptcy system provides the only form of governance practical in the circumstances: a benevolent dictatorship of the board as fiduciary and the bankruptcy judge as referee." Lynn M. LoPucki, *The Myth of the Residual Owner*, 82 WASH. U. L.Q. 1341, 1369 (2004).

122. Martin J. Bienenstock, *Conflicts Between Management and the Debtor in Possession's Fiduciary Duties*, 61 U. CIN. L. REV. 543, 564 (1992) ("One of the most potent protections against a trustee or management acting contrary to creditors' interests is the requirement that most significant actions be taken only after notice and hearing.").

123. *See In re* Marvel Ent. Grp., Inc., 140 F.3d 463, 474 (3d Cir. 1998) ("When the chapter 11 petition was filed in this case, the debtor-in-possession assumed the same fiduciary duties as would an appointed trustee . . . . These obligations include '[o]pen, honest and straightforward disclosure to the Court and creditors.'" (alteration in original) (quoting *In re* V. Savino Oil & Heating Co., Inc., 99 B.R. 518, 526 (Bankr. E.D.N.Y. 1989))).

124. Section 503(b) administrative expenses include the post-petition "actual, necessary costs and expenses of preserving the estate," including allowed fees of professionals such as attorneys and accountants, certain taxes and fines, and certain creditor or indenture trustee expenses that result in a benefit to the estate. 11 U.S.C. § 503(b). These claims generally must be paid in full—11 USC §§ 507(a)(2), 1129(a)(9)(A)—while pre-petition (pre-bankruptcy) claims are subject to partial payment under a chapter 11 plan. *See* 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, 604–05 (2005) (finding claims are not subject to administrative proceedings).

place such claims in competition with the claims of third-party victims of estate torts under the *Reading Co. v. Brown* line of cases.[125]

Under the terms of the Bankruptcy Code, it would seem that the DIP's fiduciary duty is enforceable, when necessary, by any "party in interest" to the case—a class that potentially sweeps much broader than the "shareholders and sometimes creditors" standard of state law.[126] The question of whether or not the DIP has violated its fiduciary duties might also be investigated by an examiner, a tool unavailable to plaintiff's attorneys in state court.[127]

* * *

In summary, the DIP, as an entity, owes a fiduciary duty to the estate that is rooted in agency law: a "duty to protect and conserve property in its possession" for the benefit of those with stakes in the estate.[128] Confusion often results from the parallel fiduciary duties that officers and directors owe to the estate while in their role as officers of the court.[129] If a director, or the full board, breaches its duty, that will often result in the DIP breaching its duty as well, since state corporate law created the DIP "as a separate legal person and places the board of directors at the heart of its decision-making structure and vests it with the authority to manage the affairs of the corporation."[130] Chapter 11 then utilizes that structure while imposing a distinct set of fiduciary obligations, as I have outlined above.

Claims arising out of the pre-bankruptcy fiduciary duties to the corporation, whether enforced by creditors or shareholders, will typically become property of the estate, enforceable by the DIP,[131] or perhaps other players in the chapter 11 process.[132] Once triggered, the bankruptcy duties preempt the state-law duties for as long as the bankruptcy estate exists.[133]

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125. Reading Co. v. Brown, 391 U.S. 471, 484 (1968). Under *Reading*, which dates from before the current Bankruptcy Code but remains in force, the Court held that damages resulting from a trustee's negligence result in an administrative claim, even though such claims may not strictly benefit the estate.

126. 11 U.S.C. § 1109; *see also* 11 U.S.C. § 105(a) ("No 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.").

127. John Wm. ("Jack") Butler, Jr., Chris L. Dickerson & Stephen S. Neuman, *Preserving State Corporate Governance Law in Chapter 11: Maximizing Value Through Traditional Fiduciaries*, 18 AM. BANKR. INST. L. REV. 337, 349 (2010). Although it should be noted that examiners rarely investigate post-bankruptcy acts.

128. *In re* Marvel Ent. Grp., 140 F.3d 463, 474 (3d Cir. 1998).

129. *Cf.* Brown v. Gerdes, 321 U.S. 178, 182 (1944) (explaining the dueling duties attorneys representing bankruptcy estates owe to debtors and to those administering the reorganization).

130. Pollman, *supra* note 103, at 254.

131. *See* Mitchell Excavators, Inc. v. Mitchell, 734 F.2d 129, 131 (2d Cir. 1984) ("Under 11 U.S.C. § 541, the rights of action of the debtor pass to the estate created by the commencement of the bankruptcy proceeding, not directly to the trustee. Those rights, however, are still normally vindicated by the trustee.").

132. Off. Comm. Of Unsecured Creditors *ex rel.* Cybergenics Corp. v. Chinery, 330 F.3d 548, 568 (3d Cir. 2003) (en banc) ("[T]he ability to confer derivative standing upon creditors' committees is a straightforward application of bankruptcy courts' equitable powers.").

133. *See* U.S. CONST. art. VI, cl. 2 ("[T]he Laws of the United States . . . shall be the supreme Law of the Land,"); *id.* art. I, § 8, cl. 4 ("The Congress shall have Power . . . [t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."). Or we might simply say that anything that complies with the bankruptcy duties per se complies with the state law duties of the directors and leave it at that.

It must be conceded that while the duties owed by the DIP, its officers, and its directors have a long history as a federal common law gloss upon the statutory DIP concept, such is subject to question given the current Supreme Court's marked hostility to judicial lawmaking.[134] On the other hand, the DIP duties are clear extensions of the trustee concept, which has a long history of court oversight.[135] Moreover, the debtor in possession is a core bankruptcy concept, rooted in Congress's powers under the Bankruptcy Clause, the development of which cannot be outsourced to state legislators.[136] Further, the uniformity demanded by the clause cannot be achieved in an environment where the debtor might shift between various state law rules.

For example, under Delaware law, an LLC can waive all fiduciary duties, and some debtors (especially those owned by private equity firms) have been known to convert to LLCs on the eve of bankruptcy.[137] But there is no reason why the DIP should be free of the fiduciary duties that a trustee otherwise owes under the Bankruptcy Code.[138]

III. AN APPLIED ACCOUNT OF DIP FIDUCIARY DUTIES

The general theme of this Part is that DIP boards need to become far more active during chapter 11 cases. That is, the board's duties to manage the DIP—and thus ensure that the DIP meets its duties to the bankruptcy estate—do not end with the signing of an RSA pre-petition and the filing of the bankruptcy case.

Rather, I argue that the board only fulfills its duties after the estate is finally settled. Until that occurs, the board must constantly reevaluate the choices it made previously and consider whether those choices still represent the best possible outcome for the estate. Most importantly, the board must consider if the debtor-firm's negotiating position has changed since taking on the status of debtor-in-possession. That is, the deal—that was agreed to under state law before bankruptcy—may not look as attractive now that the debtor has the benefit of plan exclusivity, the ability to reject contracts, cramdown a reorganization plan, and the other exceptional powers that come with being a chapter 11 debtor.

In the remainder of this Part, I sketch out three distinct moves that a debtor might make in furtherance of a more active realization of the DIP's fiduciary duties. Many of these moves can be facilitated by a more "fiduciary minded" approach by bankruptcy courts.[139] That work could in turn be facilitated by amendments to the Federal Rules of Bankruptcy Procedure, which might set up these issues for consideration by courts—and in doing so, help alert all of the relevant parties to their duties.

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134. *See* Lubben, *supra* note 87, at 136.

135. Wolf v. Weinstein, 372 U.S. 633, 641 (1963) (stating that decisions relating to the compensations of trustees are an "embodiment of 'ancient equity rules governing the conduct of trustees . . . .'").

136. Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1203 (9th Cir. 2005) (finding that state laws that give debtors a discharge of their debt are preempted by federal bankruptcy law, even if they are "compatible with (or even identical to) the federal discharge statute").

137. DEL. CODE ANN. tit. 6, § 18-1101 (2013).

138. The Bankruptcy Court in *Houston Regional Sports Network, L.P.* followed a similar approach, holding that waivers of state law fiduciary duties did not apply to similar bankruptcy duties. *In re* Houston Reg'l Sports Network, L.P., 505 B.R. 468, 481 (Bankr. S.D. Tex. 2014).

139. *See* Simon, *supra* note 120, at 1206 (explaining how bankruptcy judges can curb bankruptcy grifters by implementing specific criteria for approving or rejecting plans containing channeling injunctions and non-debtor releases).

A. *Reject the RSA*

As noted, many chapter 11 cases today enter bankruptcy with an RSA, under which the debtor agrees to follow a path set forth in that agreement. Not only does the RSA bind the debtor, but it also binds the debtor's creditors to a specific deal, frustrating further negotiations. But as a prepetition contract, the estate is not bound by the RSA until it is assumed under section 365 of the Bankruptcy Code.[140]

Many debtors nevertheless proceed as though the RSA is binding, even though the agreement is never assumed. Courts similarly never seem to question the debtor's decision to make a gift to some of its creditors—for example, by paying RSA signatories' professional fees. The DIP should have some obligation to explain how adhering to a non-binding contract is consistent with the exercise of its fiduciary duties. And what if the RSA deal is not the best deal for the estate but, rather, the most readily available deal pre-petition?

As noted, most RSAs are never assumed or rejected by the debtor. That is, the debtor retains a kind of one-way option regarding the deal in the RSA, even without invoking the traditional "fiduciary out" contained therein. If it remains a good deal, the debtor should continue to adhere to the RSA, but the debtor's board should verify that point shortly after the chapter 11 case is commenced.

If the deal no longer looks attractive, the debtor should exercise its power under section 365 to reject (breach) the RSA.[141] And indeed, in all cases, the debtor should contemplate using the threat of rejection to negotiate a better deal, even when that deal is still with the original creditors.[142] Both the debtor and its creditors might be better served by wiping the slate clean and reopening plan negotiations.

Most centrally, the board should consider whether the aggressive timeline and milestones contained in most modern RSAs are still consistent with the duty to get the best possible return for the estate. *Hertz*, one of the most prominent bankruptcy cases of the COVID age,[143] provides a good example of why a more open, transparent exercise of the DIP's fiduciary duties might be warranted.

Hertz filed a post-petition Plan Support Agreement (i.e., a post-petition RSA) that reflected a deal with a series of key creditors. The agreement called for a quick pre-plan sale of the company, and the debtor heartily resisted all efforts to slow down the process—even to the point of rejecting a late bid from the eventual auction winners. The auction winners ultimately provided enough value to pay all creditors in full while also providing a nice return for equity.[144]

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140. 11 U.S.C. § 365(a).

141. *See id.* ("[T]he trustee . . . may assume or reject any executory contract or unexpired lease of the debtor."). By doing so, the debtor will arguably also release the creditors from the deal, given that they will no longer have an obligation to perform upon the debtor's breach.

142. It is sometimes suggested that because RSAs include a "specific performance" clause, rejection (and the payment of breach damages as a prepetition claim) is unavailable. But courts routinely find similar clauses—like arbitration provisions—unenforceable in bankruptcy. *See* 11 U.S.C. § 365(g) ("[T]he rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease.").

143. *In re* Hertz Corp., 637 B.R. 781 (Bankr. D. Del. 2021).

144. *Hertz Selects $6 Billion Bid from Knighthead, Certares and Apollo to Fund Chapter 11 Exit*, CISION PR NEWSWIRE (May 12, 2021), https://www.prnewswire.com/news-releases/hertz-selects-6-billion-bid-from-knighthead-certares-and-apollo-to-fund-chapter-11-exit-301290040.html [https://perma.cc/UP5Z-7SEZ].

While it seems that the Hertz board eventually "came around," the board's initial conviction that the first deal was the only viable deal seems all too familiar and all too common. Undoubtedly, there ought to be a bit more scrutiny of debtors' predictable assertions that "time is of the essence"—and a showing of "why"—to justify jamming a case through chapter 11 at extreme speed. That is, not only should the debtor's board demonstrate its exercise of duty, including by thoughtful consideration of the option to reject the RSA and the ancillary agreements thereunder, but the court should provide a check on such exercise of the board's duties.

To be sure, some DIP boards might already be doing this. But the key point is the importance of documenting these efforts in a manner that can be illustrated to the estate stakeholders.[145] Both a more proactive board, and court oversight, are clearly needed.

B. Renegotiate the DIP Loan

Throughout the twenty-first century, scholars have noted that providing post-petition financing (called a DIP loan) to a chapter 11 debtor gives lenders tremendous power.[146] According to the conventional story, pre-bankruptcy secured lenders frequently position themselves to have all-encompassing liens on the debtor's assets. Once in bankruptcy, the DIP has little choice but to turn to those same pre-bankruptcy lenders for a DIP loan, because the lenders are well entrenched. Given the lack of alternatives, the pre-bankruptcy lenders can dictate terms to the debtor, and then control the chapter 11 case.[147]

While this account is fine as far as it goes, it does neglect the complete abandonment of section 364(d) in modern chapter 11 practice. This provision allows the estate to obtain financing "secured by a senior or equal lien on property of the estate that is subject to a lien."[148] That is, it allows the "priming"—or subordination—of existing secured lenders. In theory, this should allow a debtor to obtain a DIP loan senior to its existing (pre-bankruptcy) lending facility. But that never happens. Instead, the pre-bankruptcy lender becomes the post-bankruptcy lender, and the old loan is "rolled" (refinanced) into the new loan.[149]

One common explanation for 364(d)'s neglect is often shorthanded as "nobody wants a priming fight on the first day of case." That is, the debtor has enough going on when it files for bankruptcy, so why invite contentious and time-consuming litigation against the existing lenders when financing is needed immediately?

Perhaps more central to the point is that the debtor can have little hope of winning such litigation, given the courts' crabbed reading of the requirement that any priming be accompanied by the provision of "adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be

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145. *Cf. In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021) (discussing the evidentiary burden for pleading a claim against a corporation's officers and noting how much evidence is required to successfully litigate the claim).

146. *See* Kenneth Ayotte & Jared A. Ellias, *Bankruptcy Process for Sale*, 39 YALE J. ON REGUL. 1, 1 (2022) (noting that debtor in possession loans give creditors significant control in the chapter 11 process).

147. *See* Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 859 (2004) (discussing the control that post-bankruptcy lenders exert on creditors).

148. 11 U.S.C. § 364(d)(1).

149. David Griffiths, *Roll-up, Roll-up, Read All About It!*, WEIL RESTRUCTURING (Oct. 6, 2010), https://restructuring.weil.com/dip-financing/roll-up-roll-up-read-all-about-it [https://perma.cc/RD3B-DNG9].

granted."[150] Courts rarely find anything besides an "equity cushion"—that is, unencumbered collateral value—to be sufficient to provide adequate protection. And modern capital structures rarely leave unencumbered collateral lying around in the months before bankruptcy.[151]

A more generous view of what constitutes adequate protection would be a key step toward a more competitive DIP loan market. As many have noted, this might begin by examining what precisely the lenders' "interest" in the estate's property actually entails.[152] Certainly, to the extent that a DIP loan preserves or even enhances the "going concern" value of the debtor and thus the pre-bankruptcy lenders' collateral, it might be argued that the new loan itself provides ample protection to those prior lenders.

But judicial reconsideration of the scope of section 364(d) will only arise if the DIP's board is willing to entertain funding from outside DIP lenders. Technically, section 364 already requires some marketing of the loan, inasmuch as the court may only approve the more senior forms of DIP loans upon finding that ordinary credit is unavailable.[153] But that says little about the DIP's choice of lenders, which I instead submit is a function of the DIP's fiduciary duties. That is, the DIP can favor the pre-bankruptcy lender only when doing so is consistent with its fiduciary duties to the estate.

Most large debtors report that they attempt to meet their fiduciary obligations pre-petition but that such efforts almost inevitably fail. For example, in the declaration supporting Pier 1 Imports, Inc.'s motion to approve its DIP loan, the debtor's financial advisor reported that:

> After conducting diligence, four (4) parties provided preliminary proposals for debtor-in-possession financing. The other parties informed me that they were either unwilling or unable to provide the financing requested by the Debtors due to a variety of reasons, including because some of these parties' assessment that, in light of the Debtors' prepetition lenders' incumbency position, as well as the particular composition of the prepetition lender group, it would be challenging to provide a financing on similar or better economic terms than the Prepetition DIP ABL Parties' proposal.[154]

In short, "we tried, but the prepetition lenders were better."

What is rarely seen, however, is an attempt to reengage with potential alternative lenders after the petition date. Early in the case, the court typically approves a DIP loan on an interim basis, with final approval only coming later, upon the formation of a creditors committee and potential discovery by objectors.[155]

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150. 11 U.S.C. § 364(d)(1)(B).

151. Frederick Tung, *Financing Failure: Bankruptcy Lending, Credit Market Conditions, and the Financial Crisis*, 37 YALE J. ON REGUL. 651, 658 (2020).

152. Edward J. Janger, *The Logic and Limits of Liens*, 2015 U. ILL. L. REV. 589, 605–06 (2015).

153. *E.g.*, 11 U.S.C. § 364(d)(1)(A) (providing that the court may authorize the incurring of debts secured by a senior loan only if "the trustee is unable to obtain such credit otherwise").

154. Declaration of Durc Savini in Support of the Debtors' Motion for Entry of Interim and Final Orders at 6, *In re* Pier 1 Imports, Inc., 615 B.R. 196 (Bankr. E.D. Va. 2020) (No. 20-30805).

155. FED. R. BANKR. P. 4001(c)(2) ("The court may commence a final hearing on a motion for authority to obtain credit no earlier than 14 days after service of the motion. If the motion so requests, the court may conduct a hearing before such 14-day period expires, but the court may authorize the obtaining of credit only to the extent necessary to avoid immediate and irreparable harm to the estate pending a final hearing.").

During this interregnum, the debtor's board, in furtherance of its fiduciary obligations, should re-market the loan. At this point in the case, the terms of a "stalking horse" loan are fully public, and potential lenders can plainly see what they are negotiating against. Even a loan with the same economic terms but relaxed case targets (or "milestones") would represent a real gain for estate stakeholders, especially those who will face the first losses in a truncated chapter 11 process.[156] Given the undoubted importance of DIP loans—and the covenants contained therein—to modern chapter 11, a second round of loan marketing seems central to the fulfillment of the board's fiduciary obligations.

C. *Resist the Loan-to-Own*

Under the Bankruptcy Code, a pre-petition secured lender is normally entitled to use its loan as currency in an auction sale of the debtor. Specifically, under section 363(k), "such [lender] may offset such claim against the purchase price of such property."[157]

The right to "credit bid" the loan is subject to the proviso "unless the court for cause orders otherwise."[158] While the power to prohibit credit bidding is seldom used, I submit that the DIP's board might have a fiduciary obligation to object to credit bidding on occasion.

Outside of bankruptcy, it has been recognized that the board has an obligation to resist a below-value takeover by a controlling shareholder.[159] This resistance most often takes the form of an obligation to adopt a "poison pill" or take other steps to compel the payment of top dollar.[160] Only by strongly negotiating against such a takeover will the board (and the controlling shareholder) obtain the benefits of the deferential business judgment rule.

Upon bankruptcy, a prepetition secured lender is in a position like a controlling shareholder. The ability to credit bid in an auction—especially when the lender is substantially undersecured and the credit bid is worth more than the liquidation value of the loan—gives the lender the ability to block the debtor-firm's other options. And the lender can signal its ability to exercise that power in a way that discourages other participants in the auction sale.

The DIP's board, on the other hand, has a duty to grow the value of the estate for all stakeholders in the context of a 363 sale, which in many respects is quite similar to a cash

156. Pier 1's DIP loan included eight specific "milestones" for the case, including a requirement that the debtor file a sale motion on the first day of the case. *See generally* Disclosure Statement for the Amended Joint Chapter 11 Plan of Pier 1 Imports, Inc. and Its Debtor Affiliates at 113–14, *In re* Pier 1 Imports, Inc., 615 B.R. 196 (Bankr. E.D. Va 2020).

157. 11 U.SC. § 363(k) (discussing the sale of property that is under a lien).

158. *Id.*

159. *See In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397(Del. Ch. 2020) (detailing the obligations of the board against the controlling shareholders during takeovers).

160. *See id.* at 415 ("A controller making a tender offer does not have an inalienable right to usurp or restrict the authority of the subsidiary board of directors. . . . A subsidiary board, acting directly or through a special committee, can deploy a rights plan legitimately against a controller's tender offer, just as against a third-party tender offer, to provide the subsidiary with time to respond, negotiate, and develop alternatives. The fact that the subsidiary's alternatives may be limited as a practical matter does not require that the controller be given a veto over the board decision-making process."). *Cf.* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113 (Del. 1994) ("The Independent's Committee's own legal counsel . . . suggested that the Independent Committee should review alternatives to a cash-out merger with Alcatel, including a 'white knight' third party acquiror, a repurchase of Alcatel's shares, or the adoption of a shareholder rights plan.").

out of the shareholders outside of bankruptcy. When the lender's credit bid would have a detrimental effect on the DIP's ability to meet that duty, the board has an obligation to explain to the court that some "cause" exists to limit non-cash bids.

But what if the debtor (pre-bankruptcy) signed on to a sale agreement with the lender, that contemplates the lender acting as the stalking horse bidder through its credit bid? Once again, we return to the DIP's fiduciary duties: an agreement to sell the company in derogation of the board's duties is unenforceable.[161]

D. Other Considerations

Lurking in the background of this analysis is the question of "how far" to take all this. Many will view bankruptcy as a "*Revlon*-like" situation, where financial interests come to the fore. That would suggest that the DIP's board may not prioritize (non-creditor) employee interests ahead of bondholders or shareholders.[162]

On the other hand, it is important to remember that *Revlon* is not actually the law in many States, and while Delaware is undoubtedly the single most important corporate law jurisdiction, there is no necessary reason why federal bankruptcy law should follow its lead in this area. New York, for example, provides that:

> In taking action, including . . . action which may involve or relate to a change . . . in the control of the corporation, a director shall be entitled to consider . . . (1) both the long-term and the short-term interests of the corporation and its shareholders and (2) the effects that the corporation's actions may have in the short-term or in the long-term upon [other corporate stakeholders].[163]

Even the first clause—which permits the consideration of the "long-term and the short-term interests of the corporation"—might suggest an approach to federal bankruptcy law that is roomier than a pure *Revlon*-inspired duty.[164] Indeed, in maximizing the estate, which is often stated as the board's duty in chapter 11, we might consider whether that means turning the debt into cash immediately, or whether chapter 11 has its focus more on enterprise value.[165]

If the latter, *Revlon*'s focus on return to shareholders might be misplaced, inasmuch as it suggests a chapter 7 liquidation of the debtor more than a reorganization.[166]

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161. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 39, 51 (Del. 1994) (holding that "a contract [that] purports to require a board to act or not act [so] as to limit the exercise of fiduciary duties . . . is invalid and unenforceable"); *see also* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 938 (Del. 2003) ("The directors of a Delaware corporation have a continuing obligation to discharge their fiduciary responsibilities, as future circumstances develop, after a merger agreement is announced."). Given that a pre-petition contract is liable to be rejected (or breached) in any event, the real question in chapter 11 is whether or not the frustrated bidder has a viable pre-petition claim for breach damages.

162. *See* Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3315 (2013) (suggesting that the DIP's board may not prioritize employee interests ahead of bondholders or shareholders).

163. N.Y. BUS. CORP. LAW § 717(b).

164. Even *Revlon* in Delaware may not be as strict as originally thought. Zachary J. Gubler, *What's the Deal with* Revlon*?*, 96 IND. L.J. 429, 445 (2021); Charles R. Korsmo, *Delaware's Retreat from Judicial Scrutiny of Mergers*, 10 U.C. IRVINE L. REV. 55, 70 (2019).

165. *Cf.* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1051–54 (1982).

166. *See In re* Bear Creek Trail, LLC, 35 F.4th 1277, 1280 (10th Cir. 2022).

Reorganization is about saving the company, and it seems appropriate that the focus should be broader than merely the balance sheet. Indeed, the realization of going concern value depends on the continued cooperation of those non-balance sheet stakeholders, and it seems natural that their contributions should not be ignored in the reorganization.

We should also acknowledge the effect that "forum shopping" will have on my proposed reforms.[167] At present, a large corporate debtor has a choice of where to file its case: state of incorporation, location of corporate headquarters, or where the case of an affiliate is already pending.[168] Many courts will accept chapter 11 cases with but the slenderest of connections to the district.[169] If one jurisdiction begins to enforce the board's fiduciary duties, as I have suggested, other jurisdictions might become attractive for their lack of such enforcement. That is, only with a reduction in forum shopping can the reforms I suggest really take hold.

Finally, there is a practical question of how to enforce the duties that have been developed in this paper. Modern chapter 11 plans routinely contain exculpation clauses that release officers and directors from any liability for their acts during the case. The regular approval of such provisions—which have been far less controversial than the better-known "third party" releases—undermines the enforcement of the DIP's fiduciary duties. As such, perhaps fiduciary duty claims should routinely survive confirmation—at least when creditors make a colorable showing of potential liability.[170] Of course, the possibility of post-confirmation suit would definitely change board behavior.

CONCLUSION

Chapter 11 has become a rough and tumble place in recent years. Whether that is a serious problem is certainly subject to debate, but I have argued that the DIP (and their boards) can use their existing tools to engage in the new dynamics of chapter 11 while that reality exists.

The key challenge will be getting the first debtor to utilize the powers I have described. The risks of being the "first" in this context are sizable, and many boards will likely prefer to take the "safe" course. In that respect, perhaps the DIP boards will only begin to fully flex their powers as fiduciaries if and when they see that there are consequences to taking the easy way out. That is, DIP board liability may have to come before increased DIP board activity.

The Delaware Supreme Court ruling in the *Smith v. Van Gorkom* case stands out as an inflection point for boards' roles in M&A transactions.[171] Before 1985, courts were

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167. *See* Samir D. Parikh, *Bankruptcy Tourism and the European Union's Corporate Restructuring Quandary: The Cathedral in Another Light*, 42 U. PA. J. INT'L L. 205, 212 (2020) (mentioning statistical data with regards to companies indulging in U.S. forum shopping over periods of time); *see generally* Andy Dietderich, *"Confessions" of a Forum-Shopper* (pt. 1), 40 AM. BANKR. INST. J. 28, 52 (2021).

168. 28 U.S.C. § 1408.

169. Adam Levitin, *A Discussion on Credit, Finance, and Bankruptcy: Borders Improper Bankruptcy Venue*, CREDIT SLIPS (Feb. 28, 2011), https://www.creditslips.org/creditslips/2011/02/borders-improper-bankruptcy-venue.html [https://perma.cc/AUR6-EC5M].

170. Becky Yerak, *Oklahoma's Schusterman Family Faces Trial over Oil Company's Bankruptcy*, WALL ST. J. (Aug. 8, 2022), https://www.wsj.com/articles/oklahomas-schusterman-family-faces-trial-over-oil-companys-bankruptcy-11660001576 (on file with the *Journal of Corporation Law*).

171. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

reluctant to hold boards liable for a breach of their fiduciary duty of care if the directors acted in good faith, in the best interest of the corporation, and its decisions were not tainted by fraud, illegality, or loyalty violations.[172] But in *Van Gorkom,* the court found that the board had breached its fiduciary duties simply by failing to engage in active scrutiny of the deal at hand.[173] Chapter 11 is waiting for its *Van Gorkom* moment.

172. *Id.*; *see also* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2609–10 (2021) (indicating that scandals about how passive boards discharged their duties led to a revisiting of the board's functions in the 1970s).

173. *Van Gorkom*, 488 A.2d at 47.