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THE RISE OF BANKRUPTCY DIRECTORS AND THE EVOLUTION OF CORPORATE GOVERNANCE IN CHAPTER 11

The growing use of "bankruptcy directors" has emerged as a notable development in chapter 11 practice, particularly in sponsor-controlled restructurings. These directors — often restructuring professionals appointed shortly before a bankruptcy filing — are frequently tasked with negotiating restructuring transactions, evaluating insider claims, and managing conflicts involving controlling shareholders. Proponents argue that bankruptcy directors enhance board expertise and help address governance conflicts that arise when financially distressed companies are controlled by private equity sponsors or other insiders. Critics contend that the practice can shift investigative authority away from unsecured creditors' committees, which traditionally serve as the principal watchdog for creditor interests in chapter 11 cases. Drawing on recent empirical research and several prominent restructurings — including Cengage Learning, Nine West, Payless Shoes, and Neiman Marcus — this article examines how bankruptcy directors operate in practice and how their role affects the balance of power between debtor boards and creditor committees. The article concludes that while bankruptcy directors may improve governance in some circumstances, their growing prevalence raises important questions about transparency, independence, and the appropriate allocation of investigative authority in chapter 11 proceedings.

By Stephen B. Selbst *

INTRODUCTION

Chapter 11 is constantly changing. Amendments to the Bankruptcy Code often codify developments in practice rather than drive them. Congress's enactment of section 524(g) of the Bankruptcy Code was a codification of the lawyers' structure, not a legislative innovation.[1] It was lawyers and the late Judge Burton Lifland who created the trust structure for the benefit of asbestos victims.[2] Although the drafters of the Bankruptcy Code assumed that the goal of a successful chapter 11 case was confirmation of a plan of reorganization and continuation of the debtor's business, beginning in the 1980s sales of a debtor's business became the dominant form of industrial reorganization.

It is therefore unsurprising that corporate governance in chapter 11 has evolved as well. The increasing use of "bankruptcy directors" reflects that evolution. Their use adheres to the form of traditional corporate governance but often departs from it in operation. These directors, typically restructuring professionals such as former investment bankers, restructuring advisors, or attorneys, are appointed to the debtor's board shortly before or after the commencement of chapter 11 proceedings.

[1] 11 U.S.C. § 524(g).

[2] DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 131–59 (2001).

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