FTI CONSULTING

Navigating Today's Environment

The Directors' and Officers' Guide to Restructuring

SECOND EDITION

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AMERICAN BANKRUPTCY INSTITUTE

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Despite their many well-known challenges, companies in restructuring have a rare luxury: to completely reconceptualize and reinvent their board of directors, breathing new life and energy where it is often desperately needed. Our extensive experience working on the most prominent restructuring-related board builds since the outbreak of the COVID-19 pandemic has highlighted just how stark the contrast between these assignments and conventional board recruitments can be. Whereas the usual "board refresh" can take years, with new board members added only incrementally and occasionally, a company emerging from a reorganization or bankruptcy has a unique chance to reshape its board in one fell swoop to reflect its strategic direction, while also responding to both the challenges and opportunities of the reorganized company.

This was an opportunity that presented itself to many companies in 2020 and 2021. The pandemic led to an intense wave of bankruptcies, especially in the first several months, and particularly in sectors imperiled by the sudden and extensive deceleration in economic activity (e.g., travel, hospitality, retail and rental cars). In other sectors (e.g., energy exploration and production and offshore drilling), the negative impact of decreased demand pushed already weakened companies into insolvency.

For companies facing these circumstances, the board refresh can serve as a central element of rethinking their future. We have seen how creditor-shareholders can create significant value by seizing this opportunity and asking the right question at the outset — *What is our newly defined future and strategic plan and whom do we want guiding us there?* — and then building their board accordingly. In this chapter, we examine how creditor-shareholders can take advantage of this unique situation to create a board of directors that can drive success into the future.

Considerations in a board refresh

Corporate boards of directors are normally stable organizations; year-over-year changes are usually minimal, occurring most typically when directors reach retirement age. Bankruptcy is one of the only scenarios in which boards can be aggressively reinvented, usually from scratch. The stakeholders remaking the company following its emergence from the restructuring — typically pre-petition creditors and new money investors — have an opportunity to look at both board composition and company governance at a fundamental level.

The board is a critical component of a company's transformation from its previous identity as an overleveraged laggard to a newly recapitalized and reinvigorated organization. This calls for directors who are specialists in areas central to supporting the strategic course the new owners have charted for the company, and who have both the expertise and time needed to devote to the board.

Recruiting strong directors is difficult for any board, and there are distinct challenges for companies that have endured the public perception of a costly and often contentious bankruptcy process. But before even considering the issue of whom to recruit, there is usually an initial hurdle to surmount: finding a way to shift the focus of the creditor group (which typically selects the new directors) away from the narrow interests of each party to a broader focus that will serve the post-emergence company's interests in both the immediate and longer terms.

With that in mind, there are several fundamentals at play when constructing a new board:

— **Defining the capabilities needed to drive the change agenda:** First is identifying the characteristics of the independent directors who can carry the company forward. These are usually senior executives with both relevant industry experience and contextual expertise in companies undergoing meaningful transformation. In our broad work on non-distressed boards since the beginning of the COVID-19 pandemic, we have seen companies skewing toward experienced directors for open slots — executives who have been through crises and can provide expertise on how to navigate them — rather than up-and-comers. For companies emerging from a restructuring, particularly those where management turnover appears likely, this holds even more true. Conversely, we find that most companies emerging from restructuring are open to adding first-time directors to their boards; in these situations, the occasional "rookie" with specific and relevant expertise may be a strong fit alongside a fully refreshed slate of experienced directors.

— **Adding diversity:** Another advantage is the ability to add diversity to boards in a rapid manner, particularly in situations where regulations or best practices for public companies demand it. Our experience is unambiguous: assembling a diverse board, both demographically and cognitively, is among the most critical priorities expressed by our clients on both regular board recruitments and post-reorganization board builds. But our clients' ability to achieve this objective is dramatically higher in the latter.

— **Interim management candidates:** Many creditor-shareholders will be looking for possible management candidates should they decide that new leadership is needed. In a conventional board search, capacity to take a management position is seldom a factor in a director's candidacy. The owners of post-reorganization companies are almost always at least considering the possibility of replacing certain members of the management team. In refreshing a board, many of our clients explicitly seek a few director candidates who have the leadership depth and credibility to step into a leadership role — at least on an interim basis — if needed.

A blueprint for building a board

Our decades of experience as trusted advisors to organizations looking to enhance their boards as well as our knowledge of the restructuring process and players have given us a unique opportunity to work with companies who have to completely remake their boards of directors. Looking across many of these engagements, we have developed best practices that create a reliable blueprint for building a board.

Start with strategy

Building a new board needs to begin with a thoughtful, detailed process and upfront planning before the outreach to director candidates begins. Regardless of the specifics of the situation, the foundation of this process is a thorough understanding of the future strategy of the company. In distressed situations, the new directors will be crucial to helping regain credibility with key investors, customers and other stakeholders (e.g., regulators).

In these situations, understanding the strategy enables the next logical step: determining the combination of skills, backgrounds and knowledge needed on the board to evaluate and propel the strategy, and to assess the management team's progress in executing that strategy according to plan.

Secure board leaders

Board leadership is always an important consideration to ensure the company gets off to a strong start, and this is even more crucial when constructing a new board. A strong nonexecutive chairman can be a key player in helping the board assess the strength and suitability of management for the restructured business and ensuring that early milestones set out during the restructuring are met. A nonexecutive chairman also serves as an independent voice to stakeholders.

That said, whether to recruit a nonexecutive chairman as an "anchor director" at the outset of the board-build project is a common discussion point, and there is no single path to making this determination given the many considerations at play. For example, for one of our clients rebuilding its board, filling the chairman position was the priority. The owners sought someone who could give the company credibility with other board candidates, help develop the governance strategy and play an integral role in filling the board with the right people. Other companies consider the board's skills first; they simply want the best people, and then select the leader after putting together the right team. Ultimately, client preferences vary, and the individual situation will dictate the optimal approach.

Create a matrix of desired board skills

Given the complex strategic, operational, financial and legal aspects of restructuring, there is a need for directors with significant financial acumen and industry-specific knowledge, as well as those who have the bandwidth to dedicate to the board's work. A common fallacy is to believe that the company's restructuring is behind it at emergence; experienced directors understand that the post-emergence board inherits oversight of a damaged company — to varying degrees, of course — when its directors take office.

We have found it essential to identify the targeted capabilities of the board at the outset, and we often employ the use of a skills matrix to ensure that the board possesses the diverse range of attributes typically sought. Each square of the matrix reflects a "must have" or "nice to have" skill or experience found in a single director, and setting out these *individual* capabilities side-by-side facilitates a visual comparison of the *overall* capabilities of the board taken as a whole. These attributes include prior board experience, industry expertise, specific board committee experience (audit or compensation, for example) or specialized expertise in areas such as international trade, marketing, technology, compliance, human capital transformation or mergers & acquisitions ("M&A"). The matrix also illustrates demographic data, such as age, race and gender. Once the parameters of the matrix are developed, each candidate can be mapped onto it, with the objective of ensuring that every priority requirement is met when recruiting directors.

Matrices and priorities will, of course, vary depending on the nature of the business, its strategy and current situation. For example, in a company whose bankruptcy was precipitated by sector-specific overcapacity, future consolidation may be inevitable. In these circumstances, it may be invaluable for the board to have one or more directors with extensive M&A and capital allocation experience to ensure that the board can effectively evaluate a wide range of potential strategic alternatives following the company's emergence.

An important category in the matrix is diversity. Rather than being considered as an end in itself, diversity is increasingly viewed as an underlying dimension or criterion when potential directors are sought for skills or experience. Most companies today recognize the value of diverse perspectives on the board — in terms of age, gender, race, ethnicity, geography and academic background, among other factors. Diversity of thought expands the board's potential range of views on issues, options and solutions and this diversity (both demographic and cognitive) is increasingly acknowledged to be an indispensable feature of robust board discussions and deliberations.

Committee requirements are also a factor. In addition to the audit committee, the board needs knowledgeable independent directors to lead and serve as members of the compensation and nomination and governance committees. For a compensation committee chair, the desired background might include a public company CEO with significant board experience, someone who has previously served as a compensation committee chair, or others with HR transformation or compensation expertise. The nominating committee chair should be a board governance expert with a thorough understanding of best practices and evolving trends in corporate governance.

Consider the board culture and organization

A successful board not only brings together varied experiences, expertise and perspectives — it also works well together. The best boards know why they have been recruited and what is expected of them, both individually and collectively.

Teamwork is critical to the effective working of a board. Creditor-shareholders leading the search committee will be able to develop a feel for a candidate's fit for the desired culture in their interviews with a prospective director. Candidates should have an informed and contemporary view on governance, neither diminishing its importance nor allowing compliance to overshadow the board's broader role in strategy and succession planning. The best directors are willing to make tough decisions and to be accountable for results while simultaneously being open to dissenting perspectives from other board members and maintaining a helpful posture as a "team player." They are able to question, discuss, listen, express an opinion and articulate differences in a constructive way.

This is particularly true as a new shareholder group creates a new board from scratch, without the benefit of past context, culture, or relationships. Many new boards start the culture-building process by having directors regularly meet — virtually or in person (say, over dinner) — before each board meeting. Informal dinners or similar social gatherings allow directors to bond before they begin to work as a group. Many "pre-meet" as a way to familiarize themselves with the important business issues or governance-related topics facing their company, so they are prepared for the first formal board meeting, when they must begin to deal with live board issues in real time.

Of course, not every board has the luxury of time prior to emergence to gradually acclimate directors — particularly when the governance picture is left to the late stages of a restructuring transaction. Many of our clients simply need a top team as quickly as possible. But, when possible, creating cohesion among directors early pays dividends down the road as the board tackles the organization's toughest issues under time pressure.

Understand special considerations for different scenarios

Just as no two restructurings are alike and there is never one simple reason for why the company was forced to restructure, when it comes to finding the "right board" every company will be facing different historical contexts, constraints and industry (and intercreditor) dynamics. Our clients invariably tailor their boards to respond to their specific challenges, which are as diverse as the themes that prevailed during the reorganization.

In some situations, the right choice may not be the intuitive candidate with the most industry or operational expertise, but rather someone who may have experience in a completely different sector but possesses highly relevant skills. For example, we recently worked on a board build for a company that needed a top-down transformation at all levels of the company after its emergence; this client group ensured that one of its seats went to an HR expert who had led transformational culture change following a highly visible reputational problem. This skill set was identified early and was prioritized during the recruitment, and that board member is currently driving the beginning of the company's transformation in the C-suite.

Another common scenario is a fragmented creditor group where intercreditor factions have formed and the high temperature of contentious negotiations elsewhere in the case bleeds into the board selection process. Naturally skeptical of their fellow creditors following difficult zero-sum negotiations, certain creditors reflexively take rigid positions that can be counterproductive, particularly at the outset. For example, they voice inflexible views on the categories of the target matrix, or strong skepticism regarding a fellow creditor's candidate nomination (fearing that another creditor is advocating for "their" director). We frequently find ourselves working to diffuse these tensions and continually focusing the conversation on the candidate's objective capabilities. Our experience has taught us that frequent reiteration of the potential contributions of a given candidate usually focuses our clients on their shared values and objectives, and that insurmountable differences of opinion on specific candidates during the interview process are quite rare.

Board refresh: getting the ball rolling

The inescapable reality of complex restructurings is that there are many simultaneous topics that require energy and attention, and selecting board directors is merely one of them. Clients who engage us on a post-restructuring board build often have little time; they need a top-quality board, and they need it fast.

In the best-case scenario, however, board composition and governance should receive attention as early in a restructuring as possible. What kind of board leadership is best for our company? What committees will be established at the outset? What skills, expertise and culture do we want in our boardroom to help push our newly restructured company to success? The sooner these questions are answered, the more effective the board of directors will become.

While there is no single formula for success, with a measured approach — and by making boardroom best practice a central part of the rebuilding strategy from the beginning — companies emerging from restructurings can find the board leadership needed to move forward and thrive, and shareholders who seize this opportunity can create outsized value from their investments.

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