

DIRECTORS' DUTIES IN THE ZONE OF INSOLVENCY

11:15 AM

Julia Darlow, University of Michigan

Andrew Kramer, UBS Securities LLC

Keith Marchiando, formerly with DURA Automotive

Judy O'Neill, Foley & Lardner LLP

Michael P. Richman, Foley & Lardner LLP



JULIA DARLOW
REGENT
UNIVERSITY OF MICHIGAN

Julia Donovan Darlow was elected to an eight year term on the Board of Regents of the University of Michigan in Michigan's statewide general election in November, 2006. She serves on the Board's Personnel, Compensation and Governance Committee. Previously, she practiced law for 33 years with Dickinson Wright PLLC in Detroit, where she focused on international and domestic business transactions and corporate governance, and for two years with Varnum, Riddering, Schmidt & Howlett LLP in Novi, where she focused on nonprofit organizations.

During 2001-2005 Julia served as a director of Internet Corporation, which underwent Chapter 11 reorganization. She chaired Internet's corporate governance committee.

Among various leadership positions she has held, Julia was president of the State Bar of Michigan (the first woman elected to this position), board chair of Hutzel Women's Hospital, a member of the executive committee and board of the Detroit Medical Center, a founding board member of several nonprofit institutions serving women and girls, and a director of several manufacturing companies. She served on the Michigan Bilateral Trade Team for Germany, the Michigan State Officers' Compensation Commission, and the International Women's Forum Global Affairs Committee. She has taught at Wayne State University Law School and was the Reporter for the Michigan Nonprofit Corporation Act. Her current positions include the Michigan Opera Theatre Board of Directors and the Detroit Bar Foundation Board of Trustees.

Julia received her B.A. degree from Vassar College and her J.D. degree from Wayne State University Law School.



ANDREW KRAMER
MANAGING DIRECTOR
UBS SECURITIES LLC

Andy Kramer is a Managing Director in UBS's Financial Sponsors and Leveraged Finance Group in New York. He focuses on Leveraged Finance for the Transportation and Telecommunications industries and is senior member of the firm's Restructuring Group. Prior to joining UBS, Mr. Kramer was a Senior Vice President of Credit Suisse First Boston focusing on Restructurings. Prior to that, Mr. Kramer was an investment banker at Donaldson, Lufkin & Jenrette. Since 1993, Mr. Kramer has had significant experience working with companies and related parties in distressed situations across a variety of industries including travel and leisure, transportation, telecom, paper and forest products, steel, automotive and other general industrial sectors. Mr. Kramer also has significant leveraged finance, M&A, equity and other transaction experience. Mr. Kramer holds an MBA from Columbia University and a BA from Brown University.



KEITH MARCHIANDO
FORMER CHIEF FINANCIAL
OFFICER
DURA AUTOMOTIVE
SYSTEMS, INC.

Keith R. Marchiando joined DURA Automotive Systems, Inc. in 2003. In his role as Chief Financial Officer, Marchiando oversaw DURA's global financial activities, including accounting, tax, treasury, internal audit, financial analysis, strategic planning, forecasting and business reporting processes. He also led the company's business development activities and focuses on reducing debt and increasing shareholder value. Mr. Marchiando was a leader in the company's transition into Chapter 11 and worked closely with the company's financial and legal advisors in that process.

Prior to being named CFO, Marchiando served as DURA's vice president and corporate controller. Before joining DURA, Marchiando spent six years with the Dow Chemical Company and was instrumental in the formation of Dow Automotive, where he held the position of global finance director.

He began his career at Ford Motor Company in 1990, where he held finance positions of increasing responsibility in manufacturing, purchasing and product development.

Marchiando is a member of the Original Equipment Suppliers Association (OESA) where he participates on the organizations' CFO Council. He also is a member of the Economic Club of Detroit and serves on the Board of Directors of Variety, The Children's Charity, in Southfield, Michigan.

Marchiando holds a master of business administration from the Tepper School of Management at Carnegie Mellon University (Pittsburgh, Pa.), and a bachelor of science in Business and Economics from Lehigh University (Bethlehem, Pa). He is a member of Beta Gamma Sigma, the honorary academic society for business and economics.



JUDY A. O'NEILL
PARTNER
FOLEY & LARDNER LLP

Judy A. O'Neill is a partner with Foley and is vice chair and leader of strategic development of the firm's national Business Reorganizations Practice. She is experienced in bankruptcy, insolvency, reorganization, commercial transactions and corporate law and business transactions, specializing in issues arising under the Bankruptcy Code. She has represented clients in all aspects of debt restructurings, including representation of purchasers and sellers in acquisitions, troubled public and private companies in bankruptcy and out-of-court proceedings, unsecured creditors committees, and secured lenders in bankruptcy and out of court restructurings.

Ms. O'Neill received her law degree from University of Michigan Law School in 1980 with high honors, and her undergraduate degree from Michigan State University in 1976, *magna cum laude*.

Ms. O'Neill is a member of the American Board of Certification; was inducted into the American College of Bankruptcy Fellows in 2002; is a life member of the National Registry of *Who's Who*, 2001 edition; and has been listed in *The Best Lawyers in America*®, for more than the past decade. She is also listed in *Who's Who Legal USA: Insolvency & Restructuring 2006*, and *Who's Who in American Law*, 2000 edition. She was selected by *Crain's Detroit Business* as one of the "100 Most Influential Women in Michigan," March 2002. She is included in the *Guide to the World's Insolvency and Restructuring Lawyers*, 2003 and 2006. Ms. O'Neill is also recognized in the list of 2006 "Super Lawyers" by *Law & Politics Media, Inc.* for her work in bankruptcy, creditor and debtor rights, and will appear in the Top 50 Female Michigan "Super Lawyers" list.



MICHAEL P. RICHMAN
PARTNER
FOLEY & LARDNER LLP

Michael P. Richman is a partner with Foley & Lardner LLP and chair of the Business Reorganizations Practice. He handles bankruptcy, restructurings and creditors' rights litigation, with primary emphasis upon the representation of secured and unsecured creditors, bank groups, creditors' committees and other parties of interest in contested and litigated bankruptcy cases, out-of-court workouts and civil suits.

Mr. Richman earned his J.D. from Columbia University Law School (1979) where he was a Harlan Fiske Stone Scholar and was awarded the David M. Berger Memorial Award in honor of Prof. Wolfgang Friedman (International Law). He was also the managing editor of the *Columbia Journal of Transnational Law*. He graduated from Vassar College (A.B., 1975) where he was awarded general honors and departmental honors in political science. Mr. Richman spent a year of his undergraduate study abroad attending the London School of Economics and Political Science.

Mr. Richman is chairman of the board for the American Bankruptcy Institute and is a past president as well as a member of both the management and executive committees and board of directors. He was recently named a 2006 New York "Super Lawyer" in a survey of his peers by *Law & Politics Media, Inc.* He is also profiled in *Who's Who in American Law*, and *Who's Who in America: Finance and Industry* and was named one of 12 "Outstanding Restructuring Lawyers - 2004" by *Turnarounds & Workouts*.

Mr. Richman is a contributing editor to the *American Bankruptcy Institute Journal* and a columnist for a periodic opinion column in the *Daily Bankruptcy Review*.

THE SIXTH ANNUAL NATIONAL DIRECTORS INSTITUTE

Directors' Duties in the Zone of Insolvency

Julia Darlow, University of Michigan

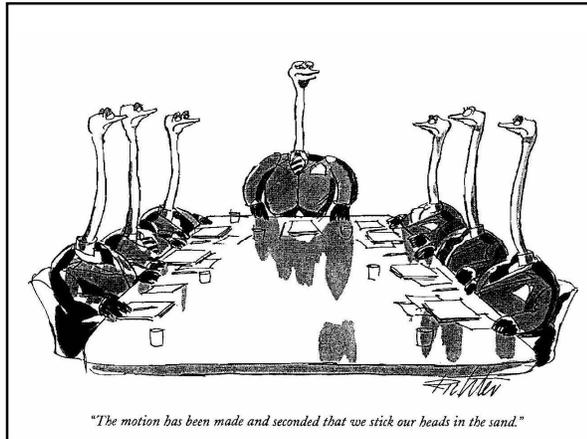
Andrew Kramer, UBS Securities LLC

Keith Marchiando, formerly with DURA Automotive

Judy A. O'Neill, Foley & Lardner LLP

Michael P. Richman, Foley & Lardner LLP

©2007 Foley & Lardner LLP • All rights reserved. This document is not intended to constitute an offer of legal services. It is not intended to constitute an offer of legal services. It is not intended to constitute an offer of legal services. It is not intended to constitute an offer of legal services.



General Duties of the Board

- The Board owes a fiduciary duty to the stockholders of the corporation.
- There are three parts to a Board's fiduciary duty:
 - The duty of care requires that a director act in "good faith" and with the care an ordinary, prudent person in a like position would exercise under similar circumstances.
 - The duty of loyalty requires that a director put the interest of an insolvent corporation and its stockholders/creditors above his or her own personal interests.
 - The duty of good faith requires that a director not make "ostrich like" decisions that demonstrate a deliberate indifference to a potential risk of harm to the corporation.

THE SIXTH ANNUAL NATIONAL DIRECTORS INSTITUTE

When Does a Corporation Enter the Zone of Insolvency?

There is no bright line test to determine when a company has entered the zone of insolvency. There are two types of tests that have been used:

- Financial Tests (balance sheet test, cash flow test, unreasonably small capital test)
- Legal Tests (foreseeability of insolvency test)

Financial Tests

- Balance Sheet Test: whether the value of the assets or the enterprise value of the corporation exceeds the liabilities.
- Cash Flow Test: whether the corporation has sufficient cash flow to meet its fixed financial obligations as they become due.
- Unreasonably Small Capital Test: whether the company has sufficient capital to obtain or support financing for future operations.

Legal Tests

- Under the legal test, a corporation is in the zone of insolvency when its financial conditions makes insolvency reasonably foreseeable.
- A corporation is also in the zone of insolvency if its officers believed it to be insolvent.
- A corporation may also be in the zone of insolvency if there is substantial risk that creditors will not be paid.

THE SIXTH ANNUAL NATIONAL DIRECTORS INSTITUTE

How Do Duties Change Once a Corporation Enters the Zone?

- Some courts have held that when a company enters the zone of insolvency, the directors' duties expand to include creditors of the corporation, in addition to the shareholders and the corporation itself.
- Other courts have compared directors to trustees administering the assets of the corporation for the benefit of creditors.
- In either scenario, directors of the insolvent corporation must maximize the value of the assets for payment of creditors.

How to Satisfy Fiduciary Duties During the Zone of Insolvency

- Stay informed of and verify all factors that are relevant to any of the corporation's major transactions.
- Seek the advice of reliable and objective third party professionals, including accountants, financial advisors, and attorneys, in order to be sure that all material transactions are in the best interest of the shareholders and creditors.
- Supervise, monitor and manage the general accounting and financial affairs of the company.
- Consider all options to preserve value.

What Not to Do When a Corporation is in the Zone of Insolvency

- Do not prefer shareholders to creditors. Upon entry into the vicinity of insolvency, directors may not make decisions that benefit shareholders at the expense of creditors.
- Do not harm creditors. Directors may not divert or dissipate assets necessary to satisfy their claims. Subjecting assets to unwarranted claims is a way of diverting them from legitimate corporate uses.

THE SIXTH ANNUAL NATIONAL DIRECTORS INSTITUTE

Breaches of Fiduciary Duty

- The following are some examples of what might constitute breaches of fiduciary duty while a corporation is insolvent or in the zone of insolvency:
 - Self-dealing or insider preferences (when a director receives a greater percentage of his or her debt than general creditors);
 - Failure to minimize losses (corporate waste);
 - Failure to maximize corporation's long-term wealth-creating capacity (unduly risking assets necessary to pay creditors' claims); and
 - Decision-making without reasonably adequate information.

Business Judgment Rule

- Under the business judgment rule, a board of directors' business decision will be respected by the courts if the decision was made
 - on a fully informed basis,
 - without self-interest,
 - in good faith, and
 - in the honest belief that the decision was in the best interests of the corporation and its stockholders/creditors.
- In certain circumstances (e.g., a transaction that contemplates a change of control), a board's duties may be heightened, in order to ensure that it is obtaining the best transaction that is reasonably available.

Deepening Insolvency: What is It?

- Courts have recently begun to recognize a new theory of liability, coined "deepening insolvency."
- Under this new theory, liability is imposed for fraudulently or even negligently, prolonging the life of a corporation, and increasing the corporation's debt and exposure to creditors.
- In general, prolonging an insolvent corporation's life alone is not enough to sustain liability.
- Instead, the party must wrongfully prolong the insolvent corporation's life, by engaging in fraud, recklessness, or negligence.

THE SIXTH ANNUAL NATIONAL DIRECTORS INSTITUTE

Potential Targets of Deepening Insolvency Action

- Directors and Officers
- Accountants
- Financial Advisors
- Attorneys
- Third Party Lenders
- Controlling Shareholder(s)

Examples of Deepening Insolvency

- Directors used fraudulent financial statements to increase capital and shareholder investments, deepening the company's insolvency and causing bankruptcy.
- Parent company and directors continued to operate an insolvent company by fraudulently concealing the company's insolvency.
- Negligent preparation of financial statements which caused the corporation to incur unmanageable debts and file for bankruptcy.
- Negligent preparation of valuation reports which induced the corporation to continue to make corporate acquisitions and borrow additional funds, which resulted in financial deterioration.

Pushback to Deepening Insolvency

- Recently, some courts have begun to discredit the theory of deepening insolvency.
- For example, one court has held that an allegation of negligence is insufficient to form the basis of a deepening insolvency claim.
- Instead, it has been suggested that only fraudulent conduct will suffice to support a deepening insolvency claim.
- Other courts have even held that a deepening insolvency claim, by itself, cannot stand as an independent cause of cause of action.

THE SIXTH ANNUAL NATIONAL DIRECTORS INSTITUTE

Final Thoughts

- In order to satisfy its fiduciary obligations during the zone of insolvency and the bankruptcy process, the Board must:
 - stay informed of and verify the factors of all major transactions;
 - seek objective advice from third party professionals;
 - properly supervise the corporation's accounting and financial affairs; and
 - consider all options to preserve value.

Directors' Duties in the Zone of Insolvency

Julia Darlow, University of Michigan

Andrew Kramer, UBS Securities LLC

Keith Marchiando, formerly with DURA Automotive

Judy A. O'Neill, Foley & Lardner LLP

Michael P. Richman, Foley & Lardner LLP

©2007 Foley & Lardner LLP. All rights reserved. This report is not intended to constitute an offer of securities or any other financial product. It is not a recommendation, offer, or solicitation of any financial product. It is not a contract. It is not a guarantee. It is not a statement of fact. It is not a statement of opinion. It is not a statement of intent. It is not a statement of belief. It is not a statement of knowledge. It is not a statement of information. It is not a statement of any kind. It is not a statement of any nature. It is not a statement of any description. It is not a statement of any character. It is not a statement of any quality. It is not a statement of any quantity. It is not a statement of any value. It is not a statement of any price. It is not a statement of any cost. It is not a statement of any benefit. It is not a statement of any risk. It is not a statement of any return. It is not a statement of any yield. It is not a statement of any interest. It is not a statement of any dividend. It is not a statement of any income. It is not a statement of any profit. It is not a statement of any loss. It is not a statement of any gain. It is not a statement of any expense. It is not a statement of any liability. It is not a statement of any asset. It is not a statement of any net worth. It is not a statement of any balance sheet. It is not a statement of any income statement. It is not a statement of any cash flow statement. It is not a statement of any other financial statement. It is not a statement of any other financial information. It is not a statement of any other financial data. It is not a statement of any other financial facts. It is not a statement of any other financial figures. It is not a statement of any other financial statistics. It is not a statement of any other financial trends. It is not a statement of any other financial patterns. It is not a statement of any other financial behaviors. It is not a statement of any other financial habits. It is not a statement of any other financial preferences. It is not a statement of any other financial choices. It is not a statement of any other financial decisions. It is not a statement of any other financial actions. It is not a statement of any other financial inactions. It is not a statement of any other financial omissions. It is not a statement of any other financial commissions. It is not a statement of any other financial offenses. It is not a statement of any other financial crimes. It is not a statement of any other financial violations. It is not a statement of any other financial breaches. It is not a statement of any other financial infractions. It is not a statement of any other financial misdemeanors. It is not a statement of any other financial felonies. It is not a statement of any other financial crimes. It is not a statement of any other financial offenses. It is not a statement of any other financial violations. It is not a statement of any other financial breaches. It is not a statement of any other financial infractions. It is not a statement of any other financial misdemeanors. It is not a statement of any other financial felonies.
