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## THE ZONE OF SAFETY: HOW TO BE AN ACTIVE AND CONFIDENT DIRECTOR DURING FINANCIAL DISTRESS

*In this article the author lays out 11 points for directors in restructuring corporations to consider. If adopted, these can establish boundary lines for what the author calls a “zone of safety” in which directors can be active and engaged for the benefit of the corporation and its stakeholders without fear of liability.*

By Andrew G. Dietderich \*

A few recent corporate chapter 11 cases have drawn public and Congressional attention to corporate behavior in bankruptcy. And yet, much conventional advice to corporate directors about their fiduciary duties in circumstances of financial distress remains out-of-date. Delaware law and market conventions have both changed significantly over the past years. Today, the rules of the road for directors are clearer than they have been in the past. Directors can continue to be actively involved in the oversight of the corporation during a restructuring, confidently approving even risky transactions, without fear of liability, so long as they are aware of current law and take specific precautions. Indeed, active and engaged directors are the most effective way for a corporation to avoid criticism during a reorganization. This memorandum dispels some old myths about the “Zone of Insolvency” and suggests practical steps to replace it with a modern “Zone of

Safety,” within which directors can defend and preserve corporate value with confidence.

The topic of director fiduciary duties is perhaps the most important one in restructuring law today. The American system of reorganizing corporations as going concerns depends upon a management, overseen by the board, that is in the best position to decide what to do when a firm cannot pay its debts. This is not intuitive, and other countries take a different approach. Nevertheless, our American restructuring process remains solidly board-centered. When restructuring is done right, the boardroom — not the courtroom — is the first and primary venue where the fate of the corporation is determined. When the various classes of creditors have confidence in the board process, it is easier to find consensus on a restructuring path — even when some creditors initially disagree. When the court has confidence in the board process, the standard of review

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