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INDUSTRIAL PRACTICE / CEO & BOARD PRACTICE

# Filling the empty table

The seven attributes of best-in-class directors for post-bankruptcy boards

Companies emerging from a US Chapter 11 bankruptcy filing face many daunting tasks, perhaps none more consequential than assembling the leadership team—starting with a new slate of directors who are fully prepared and equipped to provide best-in-class oversight. The process of filling an empty table is different from replacing individual directors; these post-bankruptcy boards pose a heightened demand for specific skill sets and personal attributes, transformational leadership, and the creation of a winning culture from scratch. Based on our work for bondholders, creditors, and advisors, we have identified seven essential attributes for directors of companies emerging from bankruptcy. While this article focuses on the natural resources industry, the lessons are broadly applicable across sectors.

The cyclical nature of the natural resources industry is currently forcing companies into bankruptcy with increasing frequency. Largely precipitated by the downturn in global commodity prices, the number of US companies at highest risk of defaulting on their debt is nearing a peak not seen since the height of the financial crisis of 2008–09. The first wave of bankruptcies has already hit the US oil and gas industry, with some 67 of these firms filing for bankruptcy in 2015—a whopping 379% increase over the previous year.<sup>1</sup> Another, larger

wave is building. Many of these bankruptcies are filed as a pre-packaged Chapter 11, meaning that the company continues operations with reduced debt and new ownership under a more expedited approval process. Bondholders in this situation face an unusual challenge: recruiting seasoned, best-in-class directors who must hit the ground running in overseeing the operational and organizational restructuring of the company. Faced with an urgently time-sensitive process, the individuals assembling a board slate often must do so in a matter of weeks. Indeed, new boards are increasingly put in place to improve the odds of the bankruptcy judge approving and expediting the reorganization plan.

In the post-Sarbanes world of heightened corporate governance (especially in the shadow of black-swan events such as the credit crisis and the BP oil spill), the need for experienced risk managers on boards has already been elevated. For post-bankruptcy companies, seeking a fresh start in this “new normal”—one of vigorous oversight, tremendous commodity volatility, and constant macroeconomic uncertainty—requires a group of directors who bring robust skill sets and clear heads. Unlike typical board recruitment, which often focuses on a particular niche skill or experience as part of a succession or expansion, creating a post-bankruptcy board requires bondholders to identify an entire cohort of directors. This unique need means that post-bankruptcy companies are somewhat akin to mature start-ups; the directors must provide the necessary knowledge, functional expertise, and governance capability—all while building a new boardroom culture that balances independence and teamwork.

Our experience in this area has led us to identify seven essential attributes and behavioral characteristics of board directors who are the best fit for companies seeking transformation and renewed corporate performance. While it is unlikely that every board member will check every box, each of these elements should be present to some extent in one or several individuals.

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<sup>1</sup> Matt Egan, “U.S. oil bankruptcies spike 379%,” *CNN Money*, February 11, 2016, [money.cnn.com](http://money.cnn.com).



## ONE: AN OWNER-ORIENTED MIND-SET

Serving on a post-bankruptcy board is a valuable opportunity. Many candidates are drawn in by the enormous potential equity upside and high return on investment once the company, with an improved capital structure, is operating more efficiently and profitably. The right candidate for the job comes with a mind-set in line with the new owners themselves—and is not primarily concerned with his or her own piece of the pie.

While every board director serves at the pleasure of shareholders, the director of a post-bankruptcy company has an even more elevated sense of responsibility to the company's new owners. In the natural resources sector, owners are typically first-lien bondholders of potentially attractive long-term assets (for example, energy services and equipment, oil and gas hydrocarbons, or mineral resources). Directors at post-bankruptcy companies have far fewer masters to serve, as the number of bondholders is typically smaller than at a company operating under normal conditions. But these owners have taken on the responsibility of what still may be a leveraged balance

sheet or challenged business and, hence, considerable risk—which is why their first priority must be to secure board members who share their perspective.

We recently partnered with bondholders of a bankrupt global energy services company that was laser-focused on assembling a board with an owner-oriented perspective. In one case, a leading candidate (by pedigree and industry background) focused much of his interview on what was in it for himself. He wanted equity ownership in the company—and though he was qualified to serve, the danger was that his service would come at the expense of others. By contrast, those who rose to the top of the short list put themselves in the shoes of the owners from an oversight perspective. They were more concerned for the bondholders than for themselves, and they connected with the company on an intellectual level. With an owner-oriented mind-set, they presented themselves as intently engaged in the operations of the business instead of viewing the opportunity as another seat to add to their board resume.

“There is no delight,” wrote Seneca, “in owning anything unshared.” The Roman philosopher was speaking of life, but he could have been speaking of corporate responsibility and governance in the 21st century.

## TWO: TRANSFORMATIVE THINKING

Not every board member is going to have a background in change management, but a certain comfort level with operational transformation is needed in an individual looking to fill a board seat at a post-bankruptcy company. Although these enterprises may have been resurrected with a new debt structure, they cannot achieve sustainability without implementing commercial and operational changes to overcome an extremely challenging macroeconomic environment. Bondholders and creditors must carefully consider their post-bankruptcy narrative and seek transformational leadership, not only from management teams but also in how the directors contribute to the dialogue and support difficult but necessary changes.

Several common issues plague reorganizations, including complex capital structures and shortened, court-mandated timelines. The result is that leadership may overlook fundamental business issues in the face of pressing capital concerns. “The common characterization, ‘good company/bad balance sheet,’ is a flawed one—it’s never just a ‘bad balance sheet’ that causes failure,” said Robert J. Duffy of FTI Consulting in a recent interview with *Financier Worldwide* magazine. “Operating deterioration is ultimately what causes a capital structure to become inappropriate or unsustainable.”<sup>2</sup> As such, prospective directors must not only be seasoned financial experts able to dissect complex balance-sheet issues; they must also have the proven operational and commercial expertise to pursue transformation.

A top candidate for the chairman role of a post-bankruptcy, multibillion dollar energy company distinguished himself during his interview through his deep operational understanding of the assets as well as his distinctive and informed point of view of how they should be managed in a downturn. With an almost activist perspective, he asked piercing questions about the company’s approach to procurement, safety, and operational excellence as well as whether or not the company had begun formal transformation programs

in these areas (as many of the company’s peers had done). While he inquired about the future capital structure, he was more curious about the operational structure, the capability of the management team, and how the group planned to drive change.

## THREE: WELL-ROUNDED CORPORATE EXPERIENCE

In traditional board recruitment, the goal is often to replace the specific skills and knowledge (such as finance, sales, operations, or cybersecurity) of departing board members. However, a post-bankruptcy board often has many more players involved in its creation, including creditor committees, the bondholders, and bankruptcy lawyers representing the debtholders. Given these numerous interests as well as the nature of the challenges facing post-bankruptcy companies, the board must be stocked with well-rounded corporate experience. While some directors may bring specialty skill sets, they should be able to build on broader corporate experience to weigh in on all matters strategic, operational, and commercial. Moreover, post-bankruptcy boards are typically smaller in size than other boards, and they thus require a broader set of skills from each director.

In one case, we worked with a restructured company to recruit a slate of generalists with broad skills and diverse industry backgrounds. The audit committee chairman, for example, was more than an auditor—he was the former CFO of a major independent refiner. He had managed substantial dealings with this industry sector and had exceptional knowledge of capital markets. He had also been a key member of a leadership team transforming a company, and he understood strategically where our client’s customers were headed. The board slate was rounded out by just a few directors with highly specific skills—for example, a retired audit partner with experience dealing with similarly challenging situations.

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<sup>2</sup> Fraser Tennant, “New beginnings: Life as a Chapter 11 emerged entity,” *Financier Worldwide*, June 2015, [financierworldwide.com](http://financierworldwide.com).

## FOUR: COMMITMENT

Active participation and attendance for any board are essential, but directors of post-bankruptcy boards must be prepared to “roll up their sleeves,” dig in, and contribute far more time beyond the typical board calendar. This is particularly true in the first year, when numerous financial, operational, and transactional decisions may need to be reached under tight deadlines.

Since a post-bankruptcy company is starting from scratch, it will have a series of complex issues to address from day one. High-functioning companies often have boards that operate on the basis of “noses in, fingers out,” meaning they probe and provide advice but let management manage. In a post-bankruptcy environment, however, the board must be more hands on. This is especially true in strategy development, guidance on operational issues and asset deployment, and, of course, succession planning. Typically, the most important function of a board is to hire and fire the CEO, but for a post-bankruptcy company, directors will quickly discover that they have much more responsibility. In addition to formal board meetings, a newly reemerged entity requires many special meetings and in-depth engagement with management.

A post-bankruptcy company should proceed with caution when considering a candidate who already serves on more than three corporate boards. In one recent engagement, several candidates quickly opted out once they understood the unusual demands for board leadership and engagement. For many would-be board members, serving on more than two corporate boards with the addition of a post-bankruptcy board is most likely the cap.

In another recent engagement, we focused more on capacity and capability to serve and less on long-standing corporate governance experience on numerous boards. In fact, a willingness to bring on directors with no prior public board experience can be a key recruiting lever for the post-bankruptcy company. Many candidates will be successful on the basis of their prior professional services or corporate roles, which provided them substantial experience with governance and boards.

## FIVE: OPTIMISM

“In the business world,” Warren Buffett once said, “the rearview mirror is always clearer than the windshield.” Bankruptcy carries a negative stigma (though it has diminished as more companies have been successfully restructured over the years), but the bondholders, creditors, advisors, and, especially, the new directors must be looking through the windshield instead of dwelling on the problems that took the company to bankruptcy. If the assets are attractive and the strategy sound, the company will recover; its partners will want to partner again, candidates will find job postings attractive, and customers will return.

To read about a company that successfully emerged from bankruptcy through a winning mind-set, see “Culture: The fuel that rocketed Dynegy back into the power elite,” on [heidrick.com](http://heidrick.com).

To convey this optimism, board directors and management must construct a post-bankruptcy narrative that the right actions have been taken and the business will thrive. Of course, this new narrative will take time to disseminate and turn into a reality, but that does not detract from the importance of optimism in shaping the perception and future of the company.

One candidate in a recent post-bankruptcy board slate for a global oil field driller came to the interview table armed with a global utilization model that suggested a potential long-term demand for the company’s most attractive assets. Instead of being waylaid by the company’s past, he brought a perspective focused on future opportunities and where the company should invest long term.

On another post-bankruptcy board build-out for a logistics provider to the oil and gas industry, a former partner from a major international consultancy emerged as a front-runner partly thanks to his experience—operationally and strategically—with major transportation providers through their respective bankruptcies or transformations. This unique knowledge base gave this director a more granular understanding of the strategic decisions for which the board needed to provide oversight—insights that he used to steer his colleagues to focus on the future of the business rather than strictly on current financial performance.

## SIX: FRUGALITY

Compared with boards of companies operating under normal conditions, post-bankruptcy boards face heightened responsibility for holding management accountable for managing operating costs and allocating capital. The debt owners in a bankruptcy are understandably focused on frugality—and as such, board members must be responsible stewards of the company's balance sheet in every way. A fiscally conservative perspective ensures that the director will provide prudent oversight of projects, ventures, and corporate initiatives—as well as personal expenses and expectations.

As the late Yogi Berra once opined, “You can observe a lot by watching.” Owners interviewing prospective board members should probe about the candidates' former corporate stewardship as well as observe their personal values and fiscal mentality.

Take, for example, a director candidate in the mix on a recent post-bankruptcy board slate. Throughout the interview process, he expected white-glove treatment, from first-class air travel to a luxury hotel stay. Another prospect, meanwhile, submitted receipts for coach fare, a three-star hotel, and a couple of cabs. Which candidate do you think resonated more with the bondholders? Of course, frugality alone doesn't qualify someone for board service; the second candidate also came to the interview table with an analysis of the elevated general and administrative costs as well as executive compensation compared with the company's peers.

As further evidence of this thrifty mentality, the second candidate became a director and asked to have a working lunch with the CEO of the business. Instead of arranging for a quick sandwich, the CEO reserved a table at a fine French restaurant that served a five-course meal. This director got a firsthand taste of what might have contributed to the fiscal irresponsibility of this company prior to its Chapter 11 filing a year earlier, and the experience underscored his unique qualification to serve on a post-bankruptcy board.

By contrast, a newly placed CEO at a distressed energy company took a different approach. To set the right tone, he immediately subleased the high-end office space the company had in a major metropolitan market and moved the company to the equivalent of office space over a strip mall—a move that sent a strong, positive signal to current and prospective investors alike.

## SEVEN: COLLEGIALLY—AND FIERCE INDEPENDENCE

Corporate and board cultures happen by either default or design. As our colleagues at Senn Delaney (the culture-shaping unit of Heidrick & Struggles) argue, “Smart leaders help shape their company's culture—instead of allowing the culture to shape the company.”<sup>3</sup>

This may be even truer in filling the post-bankruptcy board table. In most cases, bankrupt companies failed not only because of highly leveraged balance sheets but also because their culture developed by default, without much care and consideration. Board cultures, like company cultures, require careful design made up of the behavior, contributions, and leadership styles of their members.

Needless to say, as a consensus body, board cultures should be highly collegial and collaborative and built upon a solid foundation of trust. Board members must work well with all parties, including fellow directors, bondholders, and management. In particular, post-bankruptcy boards must be composed of directors who are exceedingly independent and willing to ask

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<sup>3</sup> Larry Senn, “The four principles of culture change,” August 18, 2015, [heidrick.com](http://heidrick.com).

tough questions. The ideal cultural dynamic in a post-bankruptcy environment must therefore include mutual respect, trust, and candor—and all three are related.

Failing to nurture a culture of candor can have serious consequences. Indeed, among the many factors contributing to BP's 2010 oil spill in the Gulf was a poor safety culture fueled by a lack of trust.<sup>4</sup> When companies lack candor and trust, employees often hesitate to put problems on the table for leadership to address.

Post-bankruptcy boards, in our experience, have a unique opportunity to change these dynamics and put the company on a much different course. It all starts in the boardroom. When team members have mutual respect, it begets trust, and trusts begets candor, with directors sharing information more quickly and reducing the risk of directors falling into cliques on the board. And when they all have the same information, they then can challenge one another's conclusions objectively. Our experience suggests that the highest-performing post-bankruptcy companies have extremely contentious boards that regard dissent as an obligation and that treat no subject as off-limits.

Filling the empty table in the boardroom requires a high standard of assessment and selection. First, it calls for a thorough, methodical perspective in assembling corporate overseers with the right competencies to drive corporate renewal and shareholder value. Such individuals possess an owner-oriented mind-set, transformative thinking, and well-rounded corporate experience. Second, it requires a thoughtful consideration of the individuals' personal and behavioral characteristics—commitment, optimism, frugality, collegiality, and independence—to create and foster the ideal boardroom culture to harness the change. Bondholders, who have assumed great risk, should settle for nothing less.

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<sup>4</sup> Deepwater Horizon Study Group, *Final Report on the Investigation of the Macondo Well Blowout*, March 1, 2011, [ccrm.berkeley.edu](http://ccrm.berkeley.edu).

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