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INTRODUCTION

A company's descent into bankruptcy may result from one or more troubling factors. Often the failing enterprise has adopted a poor business model, been led by deficient management, or labored under an unworkable capital structure. More often than not, a business failure is also accompanied by a less-than-ideal corporate governance structure within the organization. The failure to adopt an effective corporate governance model often leads to a sterile, inactive board of directors and may hasten a firm's demise. Conversely, proper corporate governance may prevent a business's slide into Chapter 11. Indeed, several studies have demonstrated a strong relationship

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between corporate performance and effective corporate governance.[1] Board independence and equity ownership, along with the mantras of good governance, can create an environment in which management is effectively monitored and bankruptcy generally is avoided.

But what happens when an organization does fail? Traditionally, the focus in Chapter 11 restructurings has been on financial and managerial reform, largely ignoring equally important issues of firm governance. Attention to governance concerns, however, can greatly benefit firms emerging from bankruptcy. In reorganization, a failed firm stands at a critical juncture at which it must take a course of action that will ensure its successful revival. This course of action must include the restructuring of its corporate governance structure to incorporate, inter alia, both the election of independent outside directors and the use of equity ownership to incentivize these directors to effectively monitor management. In order to promote the firm's sound future, the debtor must undertake both this corporate restructuring and the traditional financial and managerial restructuring that occurs during Chapter 11.

Business leaders within the firm, institutional investors, and even bankruptcy judges can influence and encourage a firm's decision to reform its governance structure. Indeed, many institutional investors currently demand the placement of independent, outside directors on the board prior to any infusion of additional capital. Bankruptcy judges must utilize the feasibility requirement to inquire into the firm's efforts at corporate governance reform, while the debtor company must create the kind of vital board that is crucial to its future survival and success. Whether on the road to or from bankruptcy, firms will benefit from adopting an effective corporate governance structure. The adoption of an independent board and an equity ownership plan, as urged by governance theorists, is an essential means of ensuring the firm's successful emergence from reorganization, future survival, and performance.

Part I of this Article provides a general background to corporate governance norms and the concepts of independence and equity ownership. This part also explores the relationship between these mechanisms, effective governance, and corporate success. Part II

1. *See* Sanjai Bhagat, Dennis C. Carey & Charles M. Elson, *Director Ownership, Corporate Performance, and Management Turnover*, 54 BUS. LAW. 885, 917 (1999); Paul W. MacAvoy & Ira M. Millstein, *The Active Board of Directors and Performance of the Large Publicly Traded Corporation*, 98 COLUM. L. REV. 1283, 1317-18 (1998). For a compilation of studies and scholarship related to this topic, see generally D. JEANNE PATTERSON, CONFERENCE BOARD, REP. NO. 1276-00-RR, THE LINK BETWEEN CORPORATE GOVERNANCE AND PERFORMANCE (2000).

briefly discusses the traditional Chapter 11 bankruptcy model, which has focused on managerial and financial restructuring. After this review, the case is made for the inclusion of corporate governance reform as part of the overall effort to revitalize the corporation. In Part III, these concepts are applied to the reorganization of the Loewen Group, in which several corporate governance reforms were implemented as part of the firm's emergence from Chapter 11. The Article concludes with a call for a reassessment of the role of corporate governance reform during Chapter 11 reorganization.

I. CORPORATE GOVERNANCE PREBANKRUPTCY

In the wake of Enron, Adelphia, Tyco, Worldcom, and other corporate debacles, the importance of sound corporate governance principles and their consistent application has become increasingly apparent. Active monitoring of corporate executives by boards of directors, in order to prevent mismanagement and malfeasance, is an essential means of repairing the damage done to market valuations and market integrity by recent scandals, as well as preventing their recurrence.[2]

Modern corporate governance theory advocates the use of equity ownership and independence as mechanisms to motivate and enable the board of directors to monitor the management of the corporation actively. Although in theory the board was designed to be an active management-monitoring intermediary and a fiduciary of the shareholders, in reality boards often diverge from this ideal.[3] For much of the last century, the board of directors was commonly viewed as an unimportant, almost ancillary body composed of management retainees who had little sense of accountability to shareholders.[4] Some

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2. Not only are corporate governance rules of paramount importance in ensuring the integrity of the corporate system in the United States, but tbey also have a profound influence on corporate governance worldwide and serve as a model for new legislation in emerging markets. *See* Gérard Hertig, *Corporate Governance in the United States as Seen from Europe*, 1998 COLUM. BUS. L. REV. 27, 28 (1998).

3. Charles M. Elson & Robert B. Thompson, *Van Gorkom's Legacy: The Limits of Judieially Enforced Constraints and the Promise of Proprietary Incentives*, 50 S.M.U. L. REV. 127 (2002); D. Gordon Smith, *Corporate Governance and Managerial Incompetence: Lessons from Kmart*, 74 N.C. L. REV. 1037, 1057-58 (1996) (citing ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 112-16 (rev. ed. 1968)); Charles M. Elson, *The Duty of Care, Compensation, and Stock Ownership*, 63 U. CIN. L. REV. 649 (1995) [hereinafter *The Duty of Care*]; Charles M. Elson, *Executive Overcompensation—A Board-Based Solution*, 34 B.C. L. REV. 937 (1993).

4. *See* Robert W. Hamilton, *Corporate Governance in America 1950-2000: Major Changes but Uncertain Benefits*, 25 IOWA J. CORP. L. 349, 352 (2000).

even referred to directors as the parsley on the corporate fish. An interesting anecdote illustrating the validity of this traditional view involved the Penn Central Railroad bankruptcy in the early 1970s. One commentator reported that the Penn Central board of directors only learned of the company's bankruptcy reorganization filing from newspaper accounts, as the decision to file was made exclusively by management.[5]

As the modern corporate environment evolved, however, commentators perceived that new mechanisms were needed to govern public corporations in order to encourage both management effectiveness and accountability to shareholders.[6] Importantly, commentators and shareholders began to view the board of directors as a tool to combat inactive, inefficient, and self-dealing management.[7] Moreover, as the prevailing political, financial, and corporate environment underwent drastic changes, so too did the normative precepts of solid corporate governance. For example, as the hostile takeover boom of the 1980s altered the landscape of corporate culture, courts and legislatures felt pressured to adopt new restraints on corporate action.[8] In the wake of this unprecedented activity, the traditional principles of corporate governance underwent a similar substantial revision.[9] More recently, legal and business commentators have called for more fundamental corporate governance reform. These commentators, including one of the authors of this Article, have focused primarily on the independence of directors and long-term director equity ownership. This approach has become central to modern corporate governance theory, and the persistent need for its application not only prebankruptcy, but more importantly, in Chapter 11 corporate restructurings is the central focus of this Article.

In many of America's largest corporations, management is supervised by a board of directors who are largely appointed by

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5. *See id.*

6. *See, e.g.*, Lawrence E. Mitchell, *Private Law, Public Interest? The ALI Principles of Corporate Governance*, 61 GEO. WASH. L. REV. 871, 872-73 (1993).

7. In particular, this response was provoked hy management's insulation from the market for corporate control. Along with staggered boards and other takeover defenses, poison-pill provisions were adopted hy several boards in the 1980s. To substitute for the discipline of the market, shareholders and corporate law turned to board composition, compensation, and independence as means to ensure alignment of managerial and ownership interests. *See* sources cited *supra* note 3.

8. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). Although the corporate governance reforms adopted here were chiefly internal in nature, they represented a dramatic departure from traditional norms.

9. *See, e.g.*, Mitchell, *supra* note 6, at 872-73 (noting that "[e]very generation seems to have its corporate law debate, and ours is no exception").

management.[10] This highly undesirable situation—in which board members owe their positions to executive largesse—creates an environment in which corporate directors have little incentive to monitor management but great reason to acquiesce to any management initiative. The resulting passivity, commonly referred to as "management capture,"[11] eliminates spirited bargaining and oversight from the director/management relationship due to both board composition and incentive. Not only does this problem precipitate the oft-discussed management overcompensation dilemma,[12] but, more generally, it leads to a complete lack of effective management monitoring and results in poor corporate performance. The outside directors must consider management initiatives, not from the perspective of one engaged by and beholden to management, but from the viewpoint of the stockholders whose interests they represent and to whom they are legally responsible.

Although board passivity is commonly criticized as being at odds with principles of sound corporate governance, there is little agreement with respect to a viable solution. The modern judicial response to the passivity problem is exemplified in the oft-cited Delaware Supreme Court decision in *Smith v. Van Gorkom*.[13] The *Van Gorkom* court ostensibly sought to put teeth in the traditional duty of care imposed on directors. In doing so, the court focused on the board's decisionmaking process itself, holding that the defendant board was underinformed when it approved the sale of the company after a two-hour meeting; the board was not entitled to rely upon the deferential business judgment rule as a protection from liability. While the court did not specify detailed procedures whereby a board may avail itself of business judgment rule protection, the defendant board's decisionmaking process instantly became a paradigm of improper board action. *Van Gorkom* thus resulted in heightened emphasis on board procedure and process. While *Van Gorkom* remains good law, it is doubtful that the decision had a positive effect on the perennial problem of board passivity.[14] The *Van Gorkom* decision created an

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10. *See* ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 178 (2nd ed. 2001) (noting a 1991 study which found that 82% of board vacancies were filled as a result of recommendations by the CEO).

11. *See* MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION 139-48 (1976).

12. *See, e.g.*, *The Duty of Care*, *supra* note 3, at 654-67.

13. 488 A.2d at 893.

14. *See, e.g.*, Elson, *supra* note 3, at 689 (questioning the effectiveness of the decision while arguing instead for incentive-based changes to internal board structure: "[A]s a well-known parable suggests, it is not the stick that compels acceptable behavior, but the carrot as incentive. The *Van Gorkom* enhanced duty of care functions as an ineffective 'stick'; we must replace it with

even greater emphasis on form over substance. The real solution to the board passivity problem involves stimulating effective board oversight from within the boardroom itself. Good corporate governance requires attention to structural incentives for director accountability—for example, installing independent directors and equity-based director compensation.

Reliance on truly independent directors is central to modern corporate governance theory outside of bankruptcy. The board's role is to monitor management for the benefit of shareholders. Effective monitoring is nearly impossible if the monitor does not possess objectivity—objectivity that is best fostered through a strong, independent board of directors. Active monitoring also promotes greater management accountability and performance. The salient point here is simple: To promote effective conduct, management must be accountable to someone. This accountability does not materialize unless there is a vigilant intermediary independent of the examined party. Independence thus promotes the kind of board objectivity necessary to properly review management, and this objectivity in turn promotes thoughtful and careful decisionmaking by management.

Modern corporate governance theory has emphasized the need for directors to hold an equity stake in the corporation. While independence promotes objectivity, the board also must have an incentive to exercise that objectivity effectively. Granting board members equity ownership in the corporation may help achieve this goal. When management appoints the board, and directors have no stake in the enterprise other than their board seats, there is simply no personal pecuniary incentive to engage in the active monitoring of management. As directors shirk their duty to monitor management actively, stockholder interests are left unprotected. The most effective way to incentivize directors to address their responsibilities from the perspective of the shareholders, to whom they are responsible, is to make them stockholders as well. By becoming equityholders, the outside directors assume a personal stake in the success or failure of the enterprise. When directors are active equity participants, they have an incentive to monitor management's performance more effectively, since poor monitoring may have a direct negative impact upon their personal financial interests.

Of course, where stock ownership is insubstantial when compared to the other private benefits associated with being a

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a carrot."). Note that since the *Van Gorkom* decision, shareholders have been allowed to exculpate directors for duty of care violations. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001); *see, e.g.*, Emerald Partners v. Berlin, 787 A.2d 85, 90-91 (Del. 2001).

director, the motivational impact is bound to be minimal. For example, in many large public corporations, outside directors do have a nominal equity stake in the company, but receive far more substantial compensation in the form of annual fees, which often exceed $90,000, in exchange for attendance at a few board meetings per annum.[15] Such a compensation system, of course, is wholly inadequate to promote the kind of personal incentive necessary to create an active board. To have any sort of favorable impact on director behavior, the amount of stock that each director holds must be substantial. Therefore, to align director and shareholder interests and promote effective monitoring, director fees should be paid primarily in restricted company stock.

It is important to note that while equity ownership provides the incentive to monitor, it alone does not provide the proper objectivity to foster effective oversight. Independence creates this objectivity, and that is why modern governance theory demands both equity ownership and independence. Independent directors without equity ownership may be objective, but they have little incentive to engage in active oversight. Equity ownership provides the incentive to exercise objective oversight. On the other hand, equityholding directors who are not independent may have the proper incentive but lack the necessary objectivity. Independence and equity ownership, acting in tandem, are the keys to effective corporate governance.

Sound corporate governance principles, such as independence of corporate directors, are not only important in theory. Empirical evidence has borne out their importance and effect on companies' performance as well. For example, Ira Millstein, the noted corporate governance lawyer, and Professor Paul MacAvoy of the Yale University School of Management conducted an extensive study in 1998 that found substantial correlation between active, independent boards and superior corporate performance.[16] Similarly, a 1999 study conducted by one of the authors of this Article revealed a relation between director stock ownership and "heightened corporate performance."[17] Another commentator has noted that "[b]oard ownership has ushered in a new era of management accountability."[18]

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15. *See* Pearl Meyer, *Board Stock Ownership: More, and More Again*, DIRECTORS & BOARDS, Winter 1998, at 55-56 (stating that the approach to director pay has changed dramatically over the last several years).

16. *See* MacAvoy & Millstein, *supra* note 1, at 1317-18; *see also* PATTERSON, *supra* note 1.

17. R. Franklin Balotti, Charles M. Elson & J. Travis Laster, *Equity Ownership and the Duty of Care: Convergence, Revolution, or Evolution?*, 55 BUS. LAW. 661, 671-77 (2000); *see also* Bhagat et al., *supra* note 1, at 917.

18. Meyer, *supra* note 15, at 55-56 ("Bringing directors into an ownership position has stymied the inertia suffered by many boards, whose responsibility it is to hold management

Given the theoretical and empirical importance of independence and equity ownership, most commentators and investors have supported the call for sound corporate governance prior to bankruptcy. No one, however, has seen the restructuring that occurs during Chapter 11 reorganization as an exceptional opportunity to implement needed corporate governance reforms. In combination with financial and managerial restructuring, these reforms are an indispensable element of the "fresh start" the corporation desires.

II. CORPORATE GOVERNANCE POSTBANKRUPTCY

When a corporation becomes unable to pay its debts as they become due, bankruptcy law provides relief. The debtor company may "restructure" its debt and make other amendments to its capital and operating structure while temporarily shielded from the demands of creditors. The traditional bankruptcy reorganization has focused primarily on business and financial restructuring, but has ignored the equally important considerations of corporate governance reform.[19] Reforms designed to increase the equity ownership and independence of the board are vital to the directors' ability to monitor and ensure corporate success.

A. The Existing Model: Financial and Managerial Restructuring

The first recurring theme in Chapter 11 reorganization—financial restructuring—is of primary interest to bankruptcy attorneys and the bankruptcy court. This theme involves an apportionment of economic interests in the estate between creditors and shareholders, and the plan must be confirmed by a bankruptcy court.[20] This negotiated process is the province of

focused on the well-being of shareholders and the corporation's other stakeholders . . . . Directors, with their own investment on the line, are found to be more vigilant—more pro-active in meeting potential problems head-on before trouble arises and snowballs.").

19. For example, one commentator observes that there has been a debate among scholars as to whether reorganizing corporations should be governed chiefly for the benefit of shareholders or creditors. *See* Lynn M. Lopucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 767 (1993) (discussing corporate governance in the context of management versus shareholder power during a reorganization). Hence, the traditional corporate bankruptcy dialogue has focused on issues extraneous to the principles of corporate governance discussed above. *Id.*

20. *See, e.g.*, *id.* at 677-79.

creditors' committees, cramdown, and the formal "plan of reorganization."[21]

Supplementing the financial restructuring, the debtor's business plan concentrates on restoring the company to financial health, not through debt restructuring, but through managerial decisions aimed at producing a more efficient business entity.[22] For example, a new business plan may call for the abandonment or sale of unprofitable subsidiaries or firm components or a reduction in expenses.[23] Though in many situations the debtor's former management remains in office postfiling, management's power over the creation of the new business plan for the debtor corporation is checked by creditors and institutional investors.[24] What *is* lacking from the traditional Chapter 11 reorganization is any serious attention to the principles of sound corporate governance.

B. Updating the Model: Corporate Governance Restructuring

In addition to the financial and managerial modifications that the debtor undertakes, special—indeed, utmost—consideration should be given to the restructuring of the firm's corporate governance model. While defects in the monitoring function may not have been the sole factor in the debtor's decline, there is little doubt that flaws in a firm's board structure precipitate poor financial and managerial performance. Given this causal link between monitoring and operational outcomes prebankruptcy, serious consideration should be given to reforming the corporate governance structure of the firm *post*-bankruptcy. The plan of reorganization should include reforms designed to augment both the independence and the equity ownership of the board.

This corporate governance restructuring is necessary to the realization of the debtor's "fresh start."[25] The debtor endeavors to right

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21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. This "fresh start" should not be confused with the individual debtor's "fresh start" under the Bankruptcy Code. *See* DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 62 (3d ed. 2001). In Chapter 11, future earnings of the corporation may be available to existing debtors, while in a noncorporate bankruptcy, there is no such availability. The reference to "fresh start" here is intended to refer to the ability of an otherwise profitable enterprise to receive the protection of the Code in order to emerge from an unworkable financial capital structure. Regardless of the technical differences, in bankruptcy the corporation is able to reevaluate and alter not only its financial structure but also its operational and corporate governance design.

itself through a series of reforms. Traditionally, these reforms have included adjustments to the firm's financial and managerial models. A proper governance structure translates into better monitoring, improved managerial accountability, and enhanced performance long-term.

Historically, the board of directors has been vested with the responsibility of monitoring management for the benefit of the firm's residual owners, i.e., its stockholders. The separation of ownership and control through the corporate form creates the potential for agency costs. Agency costs include the detrimental effects of opportunistic action by management and the expenditure of time and resources required to address this problem.[26] Of the several mechanisms that owners of the firm may utilize to reduce agency costs, oversight by the board of directors stands as the primary bulwark against managerial indiscretion.[27] When the board fails to monitor effectively, disaster results—executive enrichment and corporate failure ensue. To curb managerial opportunism and protect against disastrous corporate performance, a firm must implement a corporate governance model capable of effectively monitoring the enterprise's operations.

This monitoring is especially relevant in the bankruptcy context. As noted above, empirical studies have demonstrated an intimate relationship between sound corporate governance and superior financial and operational results.[28] Arguably, the nexus between monitoring and performance becomes most relevant at the time a corporation attempts to reemerge from bankruptcy. To effectuate the contemplated financial and managerial reforms, a corporation relies upon the efficacy and integrity of its management and its ability to carry out the monitoring function.

Modern corporate governance theory emphasizes two major factors that make the board an effective, active monitor: independence and equity ownership.[29] As discussed in Part I, equity ownership gives individual directors the incentive to monitor, while independence from management makes this monitoring possible. Equity ownership

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26. JAMES D. COX ET AL., CORPORATIONS § 2.5 (1997).

27. *Id.* § 10.2. The expense of the board of directors is itself a component of agency costs. In theory, at least, the marginal benefit of this monitoring mechanism exceeds its cost. The result is a net decrease in agency costs. Other direct and indirect mechanisms available to stockholders include audited financial reports, the certificate of incorporation, contractual obligations, government regulation, external capital-market constraints, the specter of bankruptcy, and a reduction in free cash flows.

28. *See supra* note 1.

29. *See generally* Elson, *supra* note 3, at 690-96.

facilitates the alignment of the directors' interests with those of the shareholders. Linking the fortunes of the directors and the shareholders motivates the board to closely monitor the management of the enterprise. Upon emergence from Chapter 11, this alignment can ensure that the directors share the same interests as the new equity investors. Often a restructuring will require a substantial injection of capital in the form of additional equity. These investors, who often take a substantial gamble on the renewal of the enterprise, are not far removed from the dangers of corporate mismanagement. It is therefore not surprising that several large, activist institutional investors have demanded governance reforms as a condition precedent to substantial reinvestment in the restructured business.

The equity stake of individual board members must reflect certain attributes to ensure properly guided monitoring. An essential characteristic is the long-term nature of the investment. Short-term gains are driven by shortsighted strategy. To emerge from bankruptcy successfully, the business must be able to focus on its long-term horizon. Board members who have an incentive to monitor the stockholders' investment over an extended time period will ensure that management develops a corresponding strategy. In addition to their stock being subject to resale restrictions, board members should be required to personally invest in the corporate stock. This personal investment, when combined with director compensation in the form of stock, will motivate corporate monitors to ensure that management is responsive to shareholder interests.

Equity ownership is a necessary, but not complete, promoter of proper corporate monitoring. In addition to having a substantial stake in the enterprise, the board must be independent from the management team that is subject to its oversight. Independence requires the severance of board members' economic ties to management and the company (with the exception of the equity stake itself). For oversight to be meaningful, it cannot be overridden by the clouded and biased judgment of self-interested behavior. Similarly, the majority of the board cannot be deeply involved in the day-to-day operational decisions that it is supposed to objectively review, challenge, and sometimes reverse. The directors overseeing management action also must be appropriately dispersed among the committees of the board and reasonably versed in financial reporting methods. Finally, the outside directors should have some knowledge of the business they are attempting to monitor and guide.

Several means exist to create an effective board governance structure. These reforms, which can be implemented during the Chapter 11 transition, include:

- a substantial majority of independent outsiders on the board; and its audit, compensation, nominating, and governance committees solely comprised of independent directors;
- predominantly equity-based director compensation;
- substantial long-term equity commitment to the company by each outside director;
- annual election of the board;
- selection of board members based on industry expertise and financial literacy; and
- restriction on the number of additional boards on which the directors can serve.

These reforms can ensure the viability of the monitoring function and can result in the long-term financial and operational health of the enterprise that reemerges from Chapter 11.

Who should be charged with the responsibility of implementing these reforms? First and foremost, the board of directors that operates during the reorganization process can plan to make these changes. Additionally, institutional investors and creditors, through the "power of the purse," can make activist demands of the board and of senior management. By linking new infusions of cash with corporate governance concessions, these investors can protect their interests. Senior management, through its own influence over the board, can also encourage the adoption of board equity ownership and the nomination of independent outside directors. Finally, bankruptcy judges may also intervene to promote the establishment of new monitoring mechanisms. Through the feasibility requirement, the bankruptcy court is charged with a sua sponte review of the debtor's ability to successfully continue operations postconfirmation.[30] Judges may use this power to ensure that time and attention is directed not just to the allocation of assets and capital, but also to the continued ability of the firm to prosper and avoid future bankruptcy filings.

In the bankruptcy context, detached oversight can ensure that management pursues the effective strategies necessary to the firm's successful revival. An active board can both prevent the mismanagement that led to bankruptcy and ensure the rehabilitation

30. *See* Hon. Leif M. Clark, *Taking Feasibility Seriously*, 1997 AM. BANKR. INST. J. 192 (1997).

of the enterprise. With an independent board overseeing its actions, management will be spurred to thoughtful and reflective decision-making. Management becomes *accountable* to an intermediary that represents shareholder interests. Without this accountability, management may adopt strategies similar to those that led to the firm's decline. In contrast, a watchful, objective monitor can ensure that management is properly considering its business and investment decisions and encouraging successful reemergence.

III. APPLICATION: THE LOEWEN BANKRUPTCY

The experience of the Loewen Group provides a rich illustration of the importance of proper corporate governance both pre- and postbankruptcy. Prebankruptcy, Loewen's board of directors seemingly lacked significant independence from management. Loewen executed a poor business strategy and subsequently filed for bankruptcy protection, which was arguably, at least in part, the result of the board's ineffective monitoring of management. Once in bankruptcy, in addition to its financial and managerial restructuring, the Alderwoods Group (the successor corporation) adopted a series of corporate governance reforms designed to both rehabilitate the business and prevent recurrence of its precipitous decline.

The Loewen Group, organized under the laws of British Columbia, was a major player in the market for funeral homes and cemeteries.[31] In 1998, Loewen owned and operated over 1,115 funeral homes and 427 cemeteries throughout North America.[32] Loewen made funeral, cemetery, and cremation arrangements, and provided various other funeral services. Loewen also offered cemetery and life-insurance products, the latter of which primarily served to finance its preneed funeral services.

The business expanded quickly through a series of acquisitions in the late 1980s and throughout the 1990s.[33] To finance several of these acquisitions, the firm acceded to a highly leveraged capital structure. In addition to the strain created by this significant debt load, the firm suffered from negative cash flow associated with its preneed funeral service operations. Finally, a series of substantial lawsuits dealt the funeral home and cemetery provider a "death blow" in the mid-1990s. Consequently, Loewen filed a petition for creditor

31. THE LOEWEN GROUP, INC., SCHEDULE 14A PROXY STATEMENT (Apr. 9, 1998).
32. THE LOEWEN GROUP, INC., FORM 10-K (Dec. 31, 1998)
33. THE LOEWEN GROUP, INC., DISCLOSURE STATEMENT (Sept. 10, 2001).

protection on June 1, 1999. The plan of reorganization was confirmed by the U.S. Bankruptcy Court for the District of Delaware in late 2001, and the firm emerged under the new moniker Alderwoods Group, Inc. From its decline to its rebirth, Loewen Group underwent substantial restructuring, including a series of corporate governance reforms.

A. Prebankruptcy

Prior to bankruptcy, the Loewen board lacked substantial independence from management. Insiders and directors who by modern governance standards lacked sufficient independence dominated the board. As of 1998, four of the fourteen members were Loewen employees, while four of the remaining ten members had relationships with the company that raised independence concerns.[34] Each director in the latter group had some financial tie to the company. Outstanding examples of the composition of the board included an ex-legislator who was the member of five other boards, two clergymen, and a real estate company head—who held less than five hundred shares of stock and missed several board meetings.

Raising questions of effective board oversight, management boasted a number of now-controversial perquisites, including use of a corporate yacht and aircraft, substantial executive loans, and generous golden parachutes. Takeover threats were avoided through the use of a staggered board and poison pill.[35] Two directors with independence issues held spots on the four-person audit committee and similarly sized corporate governance committee. In short, the monitoring mechanism could most properly be termed problematic.

34. The board of directors included the President and Chief Executive Officer, the Executive Vice President of Operations, the Senior Vice President of Finance and Chief Financial Officer, and the Chairman of the Board of a wholly owned international subsidiary. THE LOEWEN GROUP, INC., *supra* note 31. Furthermore, several members of the board henefited from related transactions with either Loewen or one of its subsidiaries. *Id.* Such arrangements included fees for consulting services, presentations to management, leases for chapel premises, and underwriting services. Included in this analysis were three nominees to the board. *Id.*

35. THE LOEWEN GROUP, INC., *supra* note 32. Takeover defenses frustrate the market for corporate control, which, if left unfettered, can produce efficiency gains for management. Insulation of the board can have a deleterious effect on the positive incentives produced by this market.

B. Postbankruptcy

Once in bankruptcy, Loewen committed to implementing several corporate governance reforms.[36] All of the reforms were initiated by the new chairman of the board with the strong support of the institutional investor creditors. The new Alderwoods board consists of nine members. A substantial majority of the new board is completely independent of management and was selected on the basis of a professional search process.[37] These outside board members were chosen for the various monitoring skills they brought to the table. The group includes a Canadian investment manager, a retired insurance executive, a retired consumer-products executive with substantial marketing experience, a retired international accounting firm partner with significant audit experience, an investment banker, a valuation/reorganization expert, and a corporate governance legal academic.[38] None of these outside directors has any form of consulting or financial arrangement with the reorganized company or its subsidiaries.

Going forward, it will be incumbent upon the newly composed board to adopt the corporate governance guidelines that were envisioned during Chapter 11. The annually elected board is currently compensated with stock options, a retainer, and meeting fees that may be paid entirely in company stock. With such a high number of outside directors on the board, the owners of Alderwoods can be assured that the firm's audit, compensation, and corporate governance committees will be populated by truly independent members.

The key to a company's long-term success is an independent board with long-term equity ownership. As discussed earlier, independence gives directors objectivity in monitoring, while equity ownership provides the incentive to exercise this function. The Alderwoods board was constructed with this principle in mind. In the end, this corporate governance restructuring, along with the other financial and managerial reforms carried out in the bankruptcy process, gives the company the best chance for long-term survival and success. Corporate governance reform was an integral part of the Loewen bankruptcy process and promises to play an important part in the continuing corporate structure of Alderwoods and numerous other companies that emerge from bankruptcy.

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36. ALDERWOODS GROUP, INC., FORM 10-K (Mar. 28, 2002); THE LOEWEN GROUP, INC., *supra* note 33.

37. Only two of the nine directors are currently listed as executive officers of Alderwoods.

38. The academic noted is one of the authors of this Article.

CONCLUSION

The historic functions of the board of directors were to hire and fire management and to monitor the company for the benefit of shareholders. This situation created a classic agency problem: Who is monitoring the monitors? To solve this problem, modern corporate governance emphasizes two central factors to make the board an effective, active monitor: independence and equity ownership. These mechanisms become especially important in the bankruptcy context. As a firm reorganizes its financial and business structure, it should also attach importance to corporate governance restructuring. The implementation of corporate governance reforms can ensure the successful reemergence of the debtor and avoid the mismanagement that preceded the bankruptcy in the first place. While it is too early to tell if today's large failing corporations will implement meaningful corporate governance reforms similar to those implemented by Loewen as part of Chapter 11 restructuring, both empirical evidence and common business sense suggest that they would be well advised to do so. Such reform should help ensure a healthy reemergence from the throes of bankruptcy and foster the development of a viable and reformed corporation.