Thought Leadership

Director Liability to Creditors: The Changing Landscape

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For an insolvent corporation or a corporation approaching the so-called "zone of insolvency," the courts have considered the directors to have fiduciary duties to the corporate creditors. Certain recent judicial decisions have been somewhat more director-friendly with respect to director duties to corporate creditors. This discussion summarizes directors' duties to the corporation (for the solvent corporation) and to the creditors (for the insolvent corporations). This discussion considers the impact of recent judicial precedent on corporate directors, on debtor corporations, and on corporate creditors. And, this discussion provides insights to all parties involved in an insolvency situation: the corporation officers and directors, the corporation shareholders, the various creditors, and the financial advisers and valuation analysts.

Introduction

Over the past few decades, creditors of insolvent and nearly insolvent corporations have enjoyed an expanded opportunity to enforce a director's or officer's corporate fiduciary duties. That opportunity expansion was the result of judicial decisions finding that the directors of insolvent or nearly insolvent corporations owe the same fiduciary duties to creditors as the directors of solvent corporations owe to shareholders.

Judicial attitudes seem to be changing, as various courts have re-grounded their decisions on fundamental principles of corporate law. Accordingly, these courts have limited or eliminated the opportunity for creditors to sue directors. This shift in judicial attitude requires those affected to evaluate the changing landscape for potential opportunities and potential pitfalls.

First, this discussion traces the recent history of creditor-based claims and the more recent restrictions of such claims. Second, this discussion traces the development of the state of corporation law in this area, from expansive creditor-friendly decisions, to recent, narrow holdings limiting creditor rights.[1]

This discussion outlines a director's or officer's duties owed to a solvent corporation. Also, the discussion provides a broad overview of how directors and officers came to be held accountable to creditors of an insolvent or nearly insolvent corporation. In addition, this discussion addresses the state of the law today by examining recent judicial decisions that have drastically scaled back the protections afforded to creditors of insolvent or nearly insolvent companies.

Finally, this discussion provides legal insights for those parties most affected by these changes: directors and officers, creditors, shareholders, and financial professionals.

Director's Duties to Creditors—A Legal Overview

Director Duties and Liability in a Financially Sound Corporation

As managers of the corporation, corporate directors and officers[2] owe the following two fiduciary duties to both the corporation and the corporation's shareholders:

1. the "duty of care"
2. the "duty of loyalty"

The duty of care requires directors of a corporation to act in good faith, with due care and diligence in managing the affairs of the corporation. This duty is most often implicated in situations in which:

1. a director makes a questionable business decision without first being properly informed, or
2. a director makes a questionable payment to an employee or other organization.

The duty of loyalty requires that the directors of a corporation put the corporation's interests above their own. This duty is implicated in three types of transactions.

First, a director may breach the duty of loyalty by participating in a transaction on behalf of the company in which he or a family member has a personal interest.

Second, a director may breach this duty by usurping a corporate opportunity. That occurs when the director personally takes advantage of a business opportunity that the corporation would have profited from, had it been informed of the opportunity.

Third, a director may breach the fiduciary duty of loyalty by unfairly competing with the corporation, through a transaction or use of corporate information.

Many states, including Delaware, allow a corporation to limit a director's personal liability for breach of fiduciary duties through exculpatory language in the articles or certificate of incorporation.[3]

These potential limitations, however, are not all encompassing. While a corporation may limit or eliminate its directors' duties of care, the duty of loyalty cannot be limited or eliminated. Moreover, a corporation can not protect its directors from their own intentional misconduct through statutory flexibility or otherwise.

A director that breaches a fiduciary duty and causes economic damages must answer personally to the corporation and its shareholders. Procedurally, two mechanisms exist for pursuing recovery for a breach of fiduciary duty.

First, either a shareholder or the corporation may bring a direct suit against the breaching director.[4] Second, a shareholder may bring a derivative suit against the director on the corporation's behalf. The two types of suit are conceptually distinct, have different legal requirements, and yield different results.

In a direct suit by a shareholder, the shareholder claims that the director's breach directly harmed the individual shareholder as opposed to the corporation as a whole. For example, a shareholder may directly sue a director for failing to issue a deserved dividend or improperly restricting the shareholder's right to vote.

In both of these instances, the shareholder alleges that it was his or her rights—not the corporation's—that were injured. As a result, any recovery inures to the benefit of the offended shareholder.

On the other hand, a shareholder who brings a derivative action claims that a director breached a fiduciary duty owed to the corporation, that the breach damaged the corporation and that directors must compensate the corporation for the damage. A shareholder's standing, or right to bring the lawsuit, derives from his or her ownership of shares in the corporation. Because the shareholder is bringing the suit on the corporation's behalf, any recovery from the director benefits the corporation and not the shareholder personally.

A derivative action would be appropriate in a situation in which the shareholder alleges that the directors made a particular decision with inadequate information or with insufficient advice. Similarly, a shareholder derivative action would be appropriate in the instance of a director who encouraged the board of directors to enter into a transaction that personally benefited the director without disclosing that personal benefit.

Under both mechanisms, a shareholder's right to enforce those fiduciary duties is a result of the position of trust that exists between the directors and the corporation.

The value of a shareholder's interest in the corporation is directly affected by the directors' actions. As a result, shareholders shoulder the risk of those decisions. It is that relationship that gives rise to directors' personal liability to shareholders.

Creditors do not, however, stand in the same legal or practical relationship to a corporation or its directors. Creditors have contracts, leases, or commercial law rights that protect them in their dealings with corporations.

As a result, creditors of solvent corporations have neither direct nor indirect claims against directors for breaches of fiduciary duties. When a business becomes insolvent, or enters the "zone of insolvency,"[5] the relationship between a creditor, on the one hand, and a corporation and its directors, on the other hand, changes.

The History of a Director's Fiduciary Duties to Creditors

When a corporation becomes insolvent, the shareholders' interests in the corporation arguably become worthless. Shareholders may be paid dividends only after all creditors have been paid. Essentially, the creditors' interests take a priority position to shareholders' interests upon insolvency.

When that happens, the directors' decisions no longer affect the value of the shareholders' interests. Rather, they affect a creditor's ability to recover under its contract or tort claim.

As stated by one court, "anything the managers do to increase or decrease shareholder equity is primarily to the benefit or detriment of the creditors, rather than shareholders, until the corporation regains solvency."[6] As a result, when a corporation becomes insolvent, the law extends the fiduciary duties normally owed only to shareholders to creditors.

The concept of fiduciary duties to creditors of insolvent corporations is not new; it finds its roots in the "trust fund doctrine," dating back to the 1800s.[7] The doctrine was created out of necessity prior to modern bankruptcy laws.

Since then, its theories have applied as the basis for holding directors liable to creditors of an insolvent corporation. Applying the doctrine, once a corporation becomes insolvent, its directors effectively become trustees, holding the corporate assets "in trust" for the benefit of creditors.[8]

Insolvency Defined

Before delving deeper into the history and rationale behind expanding the beneficiaries of fiduciary duties of directors of insolvent corporations, it may be helpful to explore what it means from a legal perspective for a corporation to be "insolvent."

Currently, the law recognizes two types of insolvency, "equitable insolvency," and "balance-sheet insolvency." It is important to understand both standards. This is because fiduciary duties to creditors are triggered when a corporation is deemed insolvent under either type.

Equitable insolvency is the more basic, commonsense standard. Equitable insolvency occurs when a corporation is unable to meet its obligations as they become due in the ordinary course of business.[9] Basically, a corporation is equitably insolvent when it cannot pay its bills.

Balance-sheet insolvency is slightly more sophisticated, at least in an accounting sense. Balance-sheet insolvency occurs when a corporation's assets fall behind its liabilities with no reasonable prospect of righting themselves.[10] In legal circles the balance sheet insolvency test is also known as "bankruptcy insolvency." This is because it is the definition embraced by the bankruptcy code.[11]

This bankruptcy-based insolvency test known to many lawyers, accountants, and forensic analysts, essentially compares the fair value of all of debtor's assets with the face, or stated, value of debtor's liabilities on the relevant date. And, it is different from equity tests that focus on debtor's current ability to pay debts as they become due.[12]

The Expansion of Director Liability into the "Zone of Insolvency"

As indicated above, it is important to be aware of the point in time at which a corporation becomes

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insolvent. That is because it is at that point that directors owe fiduciary duties to creditors as opposed to shareholders. This trigger point has been blurred in recent years.

What began as duties owed only to creditors of insolvent corporations has expanded to allow creditors of corporations nearing, or on the brink of, insolvency to assert claims. Some courts have even suggested that such fiduciary duties arise even earlier: that they arise when a corporation is in the "vicinity of insolvency"[13] or when insolvency is "reasonably foreseeable."[14]

The expansion to creditors of the benefits of directors' fiduciary duties is almost always linked to the 1991 decision of the Delaware Chancery Court in *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp*.[15]

In *Credit Lyonnais*, a dispute arose following a leveraged buyout of the corporation in question—that is, MGM. Following the buyout, MGM was forced into bankruptcy by its creditors. MGM was able to emerge from chapter 11 through substantial financing by Credit Lyonnais Bank Nederland ("Credit Lyonnais Bank").

As part of the financing, the corporate governance agreement provided that control would be returned to the MGM controlling shareholder upon the repayment of a certain amount of the newly issued debt.

Following the MGM emergence from bankruptcy, the controlling shareholder urged the corporation to begin paying down its debt. The board, concerned with the overall financial circumstances of the company, refused. During this time, MGM was teetering on the edge of insolvency.

The case was brought before the court by MGM's major lender Credit Lyonnais Bank against the principal defendant, Giancarlo Paretti ("Paretti"), considered to be the "indirect controlling shareholder" of MGM.[16] Both sides claimed that the other breached the corporate governance agreement. Paretti contended that the fiduciary duties owed to him were breached.

The court ultimately determined that there was no breach of fiduciary duties. After finding that the board's actions were reasonable, the court explained, "[the directors] were appropriately mindful of the potential differing interests between the corporation and its 98 percent shareholder.

At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise."[17] The corporate enterprise includes creditors and shareholders alike.

In a footnote to the judicial decision, Chancellor Allen posed a hypothetical:

> [i]n managing the business affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both efficient and fair) course to follow for the corporation may diverge from the choice that stockholders would make if given the opportunity to act.[18]

It is clear from this language as well as from the context in which it was written that the court was not determining that directors must take creditors' interests into account or that creditors' interest are paramount or exclusive. Rather, the court opined that directors *could* take creditors' interests into account. Nevertheless, the language was enough to open the door for courts to expand director liability to creditors within the vicinity of insolvency.[19]

Credit Lyonnais also failed to define the "vicinity of insolvency," leaving room for further interpretation—and confusion. Many courts following *Credit Lyonnais* have pointed out that the difficulty in defining the "zone of insolvency" is in no small part based on how difficult it is to determine the point when a corporation is insolvent.[20] Other courts have cemented the Credit Lyonnais creditor protections.

In *Production Resources Group, L.L.C. v. NCT Group, Inc.*, the court recognized that creditors of insolvent corporations have standing to bring derivative claims against directors for breach of fiduciary duties.[21]

In an insolvent corporation, this right is based on the premise that, at all times of solvency or insolvency, claims for breach of a fiduciary duty belong to the corporation itself. But when a corporation is insolvent, creditors are provided with an action for the indirect harm caused by the corporation's diminishing overall value.[22]

While adding some clarity to the creditor protection puzzle, *Production Resources* left open the possibility that creditors have the right to assert a claim directly against a director (the first of the two mechanisms discussed earlier in this discussion).[23]

The court skirted the issue on the basis that only a derivative action was alleged, leaving the issue for another court to decide.[24]

Nearly fifteen years after *Credit Lyonnais*, the Delaware Supreme Court offered some guidance in *National American Catholic Educational Programming Foundation, Inc. v. Gheewalla*.[25]

The *Gheewalla* decision clarified the duties that are owed by directors of corporations operating in the zone of insolvency. And, this decision scaled back the broad protections afforded to creditors by various courts after *Credit Lyonnais*.

In *Gheewalla*, the North American Catholic Education Programming Foundation (NACEPF), a creditor of Clearwire Holdings, Inc. ("Clearwire") asserted a direct, not a derivative, claim against the Clearwire directors.[27]

Covering its bases, NACEPF alleged that the directors breached duties owed directly to NACEPF (as opposed to duties owed to the corporation itself), while Clearwire was either insolvent or in the zone of insolvency.[28]

In a decision that ran against the growing current of cases, the *Gheewalla* court held that creditors of a Delaware corporation that is insolvent or operating in the zone of insolvency have no legal right, as a matter of law, to assert direct claims against directors for a breach of fiduciary duty.[29] The economic impact of this holding is significant.

In a derivative action, any money damages from the lawsuit are awarded to the corporation. This is because the lawsuit is brought on behalf of the corporation, while in a direct action by a shareholder (or creditor), the recovery flows directly to the shareholder (or creditor).

Therefore, under *Gheewalla*, individual creditors may no longer individually benefit from the recovery. Rather, any damages would be split among the corporation's creditors.

In addition to narrowing creditor protections, the court defined the scope of duties owed when operating in the zone of insolvency. The court stated that the focus of Delaware directors should not change, "directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners."[30]

Accordingly, while a clear definition "zone of insolvency" remains elusive in the law, under the *Gheewalla* decision, corporate directors' still owe duties primarily to the corporation and its shareholders, not corporate creditors.

State of the Law Today—Beyond *Gheewalla*

Gheewalla was the first Delaware decision to recognize that *Credit Lyonnais* decision and its successors may have gone too far in expanding the liability of directors. Since, *Gheewalla*, other jurisdictions have followed suit, suggesting that such liability is more limited.

The following discussion summarizes two recent judicial decisions that have further limited creditor protections.

Berg & Berg Enterprises

In the case of *Berg & Berg Enterprises, LLC v. Boyle*,[31] a California court of appeals recently determined for the first time since the *Credit Lyonnais* decision whether California would follow suit in affording creditors broad fiduciary duty protections.

The *Berg* decision involved the failure of Pluris, a company against which Berg held the largest creditors claim. The company's directors had opted to effect an assignment for the benefit of creditors. Mr. Berg attempted to force the company to pursue a bankruptcy, contending that a bankruptcy would allow the company to realize value on its significant tax losses.

When his effort failed, Berg sued the directors. Berg alleged that Pluris was insolvent, that the directors owed a broad duty to creditors, and that by failing to pursue a bankruptcy (and preserve the benefit of the tax losses) the directors had breached their duties.

Through a series of earlier decisions, the direct versus indirect claim procedural issue had been resolved: the claims Berg asserted were derivative, not direct. Accordingly, the issue before the court was whether or not, under California law, directors of a company that is insolvent or near insolvency owe broad fiduciary duties to creditors.

And in resolving that issue, the court had to consider whether creditors' protections should be expanded beyond the "trust fund" rule that had traditionally protected creditors.

A number of earlier California cases had applied, in insolvency situations, the trust fund doctrine. Under that doctrine, "all of the assets of a corporation, immediately upon becoming insolvent, become a trust fund for the benefit of all creditors."[32]

Directors are liable if they diverted assets of the corporation for the benefit of insiders or preferred creditors. Moreover, application of the doctrine requires "that directors have engaged in conduct that directed, dissipated or unduly risked corporate

assets that might otherwise have been used to [pay creditors]."[33]

Confronted with the choice between the more limited liability of earlier law or the more expansive duties and liabilities of the Credit Lyonnais line of cases, the court opted for a more limited approach. "[U]nder. . . California law, there is no broad, paramount fiduciary duty of due care or loyalty that directors of an insolvent corporation owe the corporation's creditors solely because of a state of insolvency. . . ."[34]

CML V, LLC v. Bax

Most recently, in *CML V, LLC v. Bax*,[35] the Delaware Chancery Court faced the issue of whether a creditor of an insolvent limited liability company (LLC) has standing to maintain a derivative action against an LLC's board of directors.

JetDirect Aviation Holdings, LLC, ("JetDirect") was a private jet management and charter company. It became highly leveraged after an aggressive expansion effort. During the expansion process, the JetDirect board of directors (the "Board") was notified by more than one auditor that the company had serious internal accounting deficiencies.

These reported deficiencies worsened after a change in the JetDirect billing system. As a result, the Board received financial data often 16 weeks out of date.

Subsequent to the initiation of its expansion effort and its financial reporting challenges, JetDirect received a $34 million loan from CML V, LLC ("CML"). The Board then approved four major acquisitions, despite its lack of current information regarding the company's financials. JetDirect then defaulted on its CML loan. Within six months of the default, it was clear that JetDirect was insolvent.

In an effort to improve cash flow, the Board began liquidating some of the JetDirect holdings and, according to CML, as part of this liquidation, certain Board members engaged in self-dealing by selling assets to entities they controlled without full disclosure.

CML, as a creditor of JetDirect, asserted derivative claims for breach of the fiduciary duties of care and loyalty against certain Board members. In their defense, the Board member defendants asserted that CML lacked standing to sue derivatively under Delaware's Limited Liability Company Act (the "LLC Act").

After noting that creditors of insolvent Delaware corporations have a right to maintain a derivative action, the court turned to the question of whether creditors of a limited liability company enjoy a similar right. It began its analysis with the language of the statute.

Under the "Right to Bring" section of the LLC Act:

> A member or an assignee of a limited liability company interest may bring an action in the Court of Chancery in the right of a limited of a limited liability company to recover a judgment in its favor if managers or members with authority to do so have refused to bring the action or if an effort to cause those managers or members to bring the action is not likely to succeed.[36]

Under, the "Proper Plaintiff" section of the LLC Act, "the plaintiff *must* be a member or an assignee of a limited liability company. . . ."[37] In other words, under the language of the Delaware LLC Act, a derivative action against a director of a limited liability company must be brought by a member or an assignee of the limited liability company.

Neither creditors nor a right by creditors to assert derivative claims is mentioned anywhere. Moreover, as the court noted, the language is limiting: it uses "must" rather than "may." The latter term would have suggested a different result.

Moreover, the court was unpersuaded by the CML arguments that limiting the rights of creditors of a limited liability company would create an inappropriate and unfair distinction between creditors of a corporation and creditors of a limited liability company.

According to the court, the underpinnings of corporate law and the LLC Act are different and "courts should be wary of uncritically importing requirements of [corporate law] into the [LLC] contexts."[38] Creditors are free to contract with a limited liability company regarding their rights. It is not the court's job to add protections the creditors did not contract for or the legislature did not provide.

The *CML* case further stems what had appeared to be a steady movement towards the expansion of creditor rights against directors of business entities. At least in Delaware, directors of a limited liability company do not have any duties to creditors beyond what may be set forth by agreement. Their actions should be guided by what is best for the company and its members.

Summary and Conclusion

What does the evolving trend of creditors' rights mean for directors and officers, business owners, creditors, and financial advisers?

After the 1991 decision by the Delaware Chancery Court in *Credit Lyonnais*, a number of courts began viewing the relationship between directors and creditors differently. While no court suggested that directors of a solvent business needed to take account of creditors' interests, many held that directors of an insolvent corporation had to consider, in the decision-making process, the interests of creditors primarily, if not exclusively.

Other courts went further. These other courts held that the fiduciary duties of directors extended to creditors when a business entered the zone of insolvency.

Recent decisions by various courts have placed some limits on creditors' rights and, in the process, relieved some of the risks faced by directors. *Gheewalla* made clear that any claims that creditors have is derivative, not direct. *Berg*, in turn, reveals that courts that face the issue for the first time are not prepared to simply adopt wholecloth the decisions and reasoning of earlier courts.

Finally, in *CML*, the Delaware Chancery Court refused to apply decisions under corporate law to cases involving limited liability companies, at least when in the face of a contradictory statute.

As a result, directors of a limited liability company in Delaware do not currently face liability from breach of fiduciary duty claims—direct or derivative—from creditors. Overall, the trend of cases indicate that the tides have turned, and modern courts do not appear as eager to afford creditors protections beyond what they have bargained for on their own accord.

Insights for Directors and Officers

Notwithstanding the recent limitations that courts have imposed on creditor claims against directors, significant risks continue to exist. First, directors owe fiduciary duties to the company; they must continue to meet those duties, and failure to do so could result in liability. Second, the decisions discussed in this discussion are by a variety of courts and do not, at least not yet, represent the general state of the law. In other words, other courts may reach different conclusions, resulting in different outcomes.

Likewise, the unpredictability of the current economic climate opens directors up to additional scrutiny from shareholders and creditors alike. At the first signs of insolvency, directors should seek advice from counsel prior to making what could be considered risky or unreasonable financial decisions, especially in a "turn-around" situation.

Moreover, if a board is uncertain of the signs of insolvency or perceived signs of insolvency, retaining independent counsel for the board, rather than solely relying on the company's in-house counsel, may provide additional clarity in decision-making.

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Directors should also take affirmative steps to protect themselves from personal liability. Directors can bargain for additional defenses against shareholders and creditors through exculpatory clauses. They should also insist upon adequate (and funded) directors and officers liability insurance (commonly referred to as D&O).

Many states now allow exculpatory clauses in corporate charters, which shield directors from personal liability in certain instances, by eliminating or limiting fiduciary duties owed. Nonetheless, directors should remain cautious, as these clauses do not offer comprehensive protection.

For example, Delaware corporate law allows exculpatory clauses that eliminate a director's duty of care, but corporations are prohibited from eliminating a director's duty of loyalty.[39]

This discussion highlights important recent decisions, as well as provides historical background, leaving directors and officers with an overview of the evolution of the jurisprudence that may affect decision-making for a financially troubled company.

Insights for Creditors

Creditors, like directors, should stay informed of recent judicial developments regarding creditor protections. More importantly, creditors should be aware of the corporate structure of the entity with which they are doing business, in order to fully understand what protections creditors may or may not be afforded.

In the wake of the *CML* decision, and the resulting elimination of creditor claims against directors of a limited liability company, creditors need to rely on other tools when dealing with LLCs or corporations that are insolvent or operating in the zone of insolvency.

These tools are best considered on the front end of the relationship. For example, a creditor of a Delaware LLC may want to consider reviewing the LLC charter to determine what contractual protections, if any, are afforded to the LLC creditors.

Likewise, when negotiating a contract with a corporation or an LLC, creditors should seek legal counsel to ensure that contractual protections for the creditor are maximized. Taking such steps can ensure that a creditor has the appropriate protections provided under state law.[40]

Insights for Shareholders and LLC Members

The recent move by some courts away from strong creditor protections would suggest that shareholder interests may be entitled to greater considerations than previously thought. As the court in *Credit Lyonnais* first suggested, directors must act consistent with their duties to shareholders, but may take into account the interests of, among others, creditors.

What appears to be a proper reading of *Credit Lyonnais* and its recent progeny is that directors, when confronted with an insolvency situation, can—and perhaps should—take into account creditors' interests, but should not ignore shareholders interests.

For LLC members, the fact that creditors cannot pursue breach of fiduciary duty claims against directors means that members are (or remain) the sole beneficiaries of such duties. If directors take creditor interests into account, it is quite possible that members may have claims against the directors for doing so.

Insights for Financial Professionals

With the point of insolvency remaining a relevant guidepost as to how directors, officers and even creditors of companies should act, financial professionals need to keep a close watch on what exactly constitutes insolvency in various contexts. The case law suggests that a financial professional evaluate significant signs of financial trouble, and do so in a time frame appropriate to the situation.

Moreover, forensic analysts and valuation professionals providing solvency opinions retrospectively should be aware of the recent judicial decisions that may make "zone of insolvency" or the process of nearing insolvency relevant.

For financial professionals, this foregoing discussion illuminates the need for conscientious financial professionals and up-to date accounting procedures and policies, in an uncertain economy.

Notes:

1. This discussion focuses, for the most part, on Delaware case law. The analysis may be applicable to the law of other states or instructive for analytical purposes. This discussion addresses certain state law remedies of creditors. Once in bankruptcy court, creditors have an additional venue to enforce their rights, in the form of an adversary proceeding.
2. For years, courts in Delaware and elsewhere, implied that officers owed the same fiduciary duties as directors. The Supreme Court of Delaware explicitly held this in *Gantler v. Stephens*. 965 A.2d 695, 709 (Del. 2009) ("Corporate officers owe fiduciary duties that are identical to those owed by corporate directors."). Accordingly, while this discussion speaks to director issues, all of the concepts discussed would equally apply to officers.
3. See DEL. CODE ANN. tit. 8, § 102(b)(7) (2010).
4. A corporation may directly sue one or more of its own directors or officers to enforce the fiduciary duties it is owed. It is the directors who are charged with managing and acting for the company. It is unusual for a corporation to take the initiative in pursuing a breach of a fiduciary duty claim, because they would effectively be suing themselves. Consequently, it is much more common to see fiduciary duties enforced through shareholder derivative actions. *In re Ferro Corp. Derivative Litig*., 511 F.3d 611 (6th Cir. 2008).
5. See *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, 1991 WL 277613 (Del. Ch. 1991).
6. *In re Ben Franklin Retail Stores, Inc.*, 225 B.R. 646, 653 n.13 (Bankr. N.D. Ill. 1998).
7. See *Wood v. Dummer*, 30 F.Cas. 435, No. 17944 (C.C.D. Me. 1824).
8. See generally, *In re Mortgageamerica Corp.*, 714 F.2d 1266, 1269 (5th Cir. 1983) (discussing the history of the trust fund doctrine and the basis for its creation); see also, Robert B. Millner, *What Does it Mean for Directors of Financially Troubled Corporations to Have Fiduciary Duties to Creditors?*, 9 J. BANKR. L. & PRAC. 201 (2000) (hereinafter "Millner").
9. *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92, 98 (Del. 2007).
10. *Gheewalla*, 930 A.2d at 98; See also 11 U.S.C. §101 (32) (U.S. Bankruptcy Code also relies on the balance sheet test).
11. See 11 U.S.C. § 101(32).
12. *In re Winstar Communications, Inc.*, 348 B.R. 234 (Bankr. D. Del. 2005).
13. *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, 1991 WL 277613, at *34 (Del. Ch. 1991).
14. *In re Healthco International Inc.*, 208 B.R. 288, 302 (Bankr. D. Mass. 1997) (court did not establish a firm rule and this is not widely adopted).

15. *Credit Lyonnais*, 1991 WL 277613 (Del. Ch. 1991).
16. Millner, at 9.
17. *Credit Lyonnais*, 1991 WL 277613, at *34.
18. Id. at n. 55 ("The possibility of insolvency can do curious things to incentives, exposing creditors to risks of opportunistic behavior and creating complexities for directors.").
19. After *Credit Lyonnais*, many courts adopted, and expanded upon, its thinking and rationale requiring directors to consider the interest of creditors in their decision making. See e.g., *Weaver v. Kellog*, 216 B.R. 563 (Bankr. S.D. Tex. 1997); *Blackmore Partners, L.P., v. Link Energy LLC*, 2005 WL 2709639 (Del Ch. Oct. 14, 2005); *Bren v. Capital Realty Group Senior Housing, Inc.*, 2004 WL 5366107 (Del. Ch. 2004); *Adlerstein v. Wertheimer*, 2002 WL 205684 (Del. Ch. 2002).
20. See *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772 (Del Ch. 2004).
21. Id. at 776.
22. Id.
23. Id. (the court was "not prepared to rule out" the possibility of a limited direct claim); see also, *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007).
24. *Production Resources*, 863 A.2d at 776.
25. See *Gheewalla*, 930 A.2d 92 (Del. 2007).
26. *Gheewalla*, 930 A.2d at 93-94.
27. Id.
28. Id.
29. *Gheewalla*, 930 A.2d at 94. Since *Gheewalla*, other jurisdictions have had similar holdings. See *In re Amcast Indus. Corp. v. Baker*, 365 B.R. 91, 110 (Bankr. S.D. Ohio. 2009) (Applying Ohio law, "a director has no distinct legal obligation directly to creditors, separate from the corporate entity as a whole, even when a corporation has reached the point of insolvency. The court concludes that while a company operates outside a pending dissolution, receivership, bankruptcy, or similar formal insolvency proceeding, the directors' fiduciary obligations remain to the corporation and its shareholders and they are under no obligation to treat the corporate assets as a "trust" that must be liquidated on behalf of creditors. The court concurs with the analysis in PHD, Inc. that the explicit language of Ohio Rev. Code § 1701.59(E) forecloses any claim against a director for breach of a fiduciary duty directly to creditors upon insolvency.").
30. Id. at 101.
31. *Berg & Berg Enterprises, LLC v. Boyle*, 178 Cal. App.4th 1020 (Cal. Ct. App. 2009).
32. *Berg*, 178 Cal.App.4th at 1040 (citing *CarrAmerica Realty Corp. v. Nvidia Corp.*, C05-00428JW, 2006 WL 2868979, *5 (N.D. Cal. Sept. 29, 2006)).
33. *Berg*, 178 Cal.App.4th at 1041.
34. Id.
35. *CML V, LLC v. Bax*, 6 A.3d 238 (Del. Ch. 2010).
36. DEL. CODE ANN. tit. 18 § 1001 (2010).
37. DEL. CODE ANN. tit. 18 § 1002 (2010) (emphasis added) ("In a derivative action, the plaintiff must be a member or an assignee of a limited liability company interest at the time of bringing the action and: (1) At the time of the transaction of which the plaintiff complains; or (2) The plaintiff's status as a member or an assignee of a limited liability company interest had devolved upon the plaintiff by operation of law or pursuant to the terms of a limited liability company agreement from a person who was a member or an assignee of a limited liability company interest at the time of the transaction.") Id.
38. *CML*, 6 A.2d at 249-50, citing *Twin Bridges Ltd. P'ship v. Draper*, 2007 WL 2744609, at *19 (Del. Ch. Sept. 14, 2007) (discussing limited partnership).
39. DEL. CODE ANN. tit. 18 § 102(b)(7) (2010).
40. As noted previously, this discussion addresses certain state law remedies of creditors. Once in bankruptcy court, creditors have an additional venue to enforce their rights, in the form of an adversary proceeding.

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