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RECOGNIZING AND FULFILLING FIDUCIARY DUTIES IN THE BANKRUPTCY ZONE

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TABLE OF CONTENTS

Page

I. FIDUCIARY DUTIES OF DIRECTORS AND OFFICERS 1

- A. Fiduciary Duties Owed By Directors Of Solvent Corporations 1
  - 1. Directors Owe Fiduciary Duties to the Corporation and Its Shareholders 1
  - 2. Directors Owe a Duty of Care and a Duty of Loyalty 2
    - a. The Duty of Care 2
    - b. The Duty of Loyalty 2
    - c. The Business Judgment Rule 3
- B. Fiduciary Duties Owed By Directors Of Insolvent Corporations 4
  - 1. When Directors Owe Expanded Fiduciary Duties to Creditors 4
  - 2. A Director's Expanded Fiduciary Duties Arise at Insolvency 5
- C. Fiduciary Duties Owed By Officers 6
- D. Fiduciary Duties Of Directors And Officers In Chapter 11 6
- E. Potential Liabilities Associated With Breaches Of Fiduciary Duty 7
  - 1. Liability for Deepening Insolvency 7
    - a. Deepening Insolvency as Independent Cause of Action 7
    - b. Deepening Insolvency as Measure of Damages 9
  - 2. Liability for Fraudulent Transfers 10
    - a. Bridgeport Holdings Inc. Liquidating Trust v. Boyer (In re Bridgeport Holdings, Inc.) 10
    - b. ASARCO LLC v. Americas Mining Corporation 10
  - 3. Miscellaneous Liability Issues 13
- F. Safeguards For Directors And Officers 14

II. FIDUCIARY DUTIES OF OFFICIAL COMMITTEES IN CHAPTER 11 15

III. FIDUCIARY DUTIES OF TRUSTEES IN CHAPTER 7 16

- A. The Fiduciary Obligations Of A Chapter 7 Trustee 16
- B. Beneficiaries Of The Chapter 7 Trustee's Fiduciary Duties 17
- C. Consequences Of Chapter 7 Trustee Violating His Of Her Fiduciary Duties 18

This paper analyses Delaware law and (where applicable) Texas law, focusing on three areas affecting fiduciary duties in the insolvency and bankruptcy context: (i) the fiduciary duties of directors and officers, including what duties are owed, and to whom, in both solvent and insolvent corporations (including those in chapter 11); (2) the fiduciary duties impacting official committees in chapter 11 cases; and (3) the fiduciary duties of bankruptcy trustees.[1]

I. FIDUCIARY DUTIES OF DIRECTORS AND OFFICERS

A. Fiduciary Duties Owed By Directors Of Solvent Corporations

1. Directors Owe Fiduciary Duties to the Corporation and Its Shareholders

Directors of solvent corporations owe fiduciary duties to the corporation and its shareholders. *See Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, 545 A.2d 1171, 1174 (Del. 1988); *Revlon v. MacAndrews & Forbes Holdings Inc.*, 506 A.2d 173, 179 (Del. 1986). Directors of solvent corporations do not owe fiduciary duties to constituencies other than the corporation and its shareholders, including creditors. *See Simons v. Cogan*, 549 A.2d 300, 304 (Del. 1988); *Katz v. Oak Indus.*, 508 A.2d 873, 879 (Del. Ch. 1986). Indeed, directors that prefer constituencies other than the corporation and its shareholders may be in violation of their fiduciary duties. *See Revlon*, 606 A.2d at 173 (where board breached duty of loyalty in preferring noteholder interests over shareholders). These maxims were recently reconfirmed by the Delaware Supreme Court in *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, where the court summarized the duties of directors of solvent corporations as follows:

> It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders. While shareholders rely on directors acting as fiduciaries to protect their interests, creditors are afforded protection through contractual agreements, fraud and fraudulent conveyance law, implied covenants of good faith and fair dealing, bankruptcy law, general commercial law and other sources of creditor rights. Delaware courts have traditionally been reluctant to expand existing fiduciary duties. Accordingly, 'the general rule is that directors do not owe creditors duties beyond the relevant contractual terms.'

930 A.2d 92, 99 (Del. 2007). Because a director's fiduciary duties are to the corporation and its shareholders, those shareholders, as "the ultimate beneficiaries of the corporation's growth and increased value[,]" have standing to bring derivative claims for any breach of those duties on behalf of the corporation. *Id.* at 101; *Mims v. Fail (In re Vartec Telecom, Inc.)*, Adv. No. 06-03506, 2007 WL 2872283, *3 (Bankr. N.D.Tex. Sept. 24, 2007).

[1] This paper was prepared solely for the University of Texas School of Law 2008 Jay L. Westbrook Bankruptcy Conference and should in no way be relied upon or construed as legal advice. For specific information on particular factual situations, the opinion of legal counsel should be sought.

2. Directors Owe a Duty of Care and a Duty of Loyalty

Directors of solvent corporations owe the corporation and shareholders a duty of care and a duty of loyalty.

a. The Duty of Care

The duty of care, governed either by judicial decision or statute, requires that the director discharge his or her duties in good faith and with the degree of care "which ordinarily careful and prudent men would use in similar circumstances," and in a manner reasonably believed to be in the best interests of the corporation. *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963); *see also Meyers v. Moody*, 693 F.2d 1196, 1209 (5th Cir. 1982) (Texas law requires directors to exercise "that degree of care which a person of ordinary prudence would exercise under the same or similar circumstances"); *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000).

In exercising their duty of care, directors should take reasonable steps to assure themselves that they have the relevant information required to take, or refrain from taking, corporate action -- and that they devote sufficient *time* to the consideration of such information. *Brehm*, 746 A.2d at 259. Although directors are not required to be intimately involved in routine daily business operations, the board must implement adequate processes to assure that appropriate information will come to the board's attention in a timely manner as a matter of ordinary operations, so that the board may satisfy its responsibility. *See In re Caremark Int'l Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996). Without such a system, the board, in theory, may be found liable for breach of the fiduciary duty of care. However, as stated in *Caremark*:

> [O]nly a sustained or systematic failure of the board to exercise oversight -- such as an utter failure to attempt to assure a reasonable information and reporting system [exists] -- will establish the lack of good faith that is a necessary condition to liability. Such a test of liability -- lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight -- is quite high.

Id. at 971; s*ee also Cantor v. Perelman*, 235 F. Supp. 2d 377, 389 (D. Del. 2002); *Stone v. Ritter*, 911 A.2d 362, 368-69 (Del. 2006).

b. The Duty of Loyalty

The duty of loyalty obligates directors to act in the best interests of, and deal fairly with, the corporation and its shareholders. *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361-62 (Del. 1993); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983). Thus, directors must refrain from self-dealing, usurping corporate opportunities or taking acts that would permit the director to receive improper personal benefits or injure the corporation or the shareholders. *See In re Performance Nutrition, Inc.*, 239 B.R. 93, 111-12 (Bankr. N.D. Tex. 1999); *Stone*, 911 A.2d at 362; *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939). Typically, duty-of-oyalty issues arise in the context of directors' appearing on both sides of a transaction or in self-dealing situations, directors deriving an improper benefit in a transaction, bad faith by a director, or intentional dereliction of a director's duty.

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