

Fiduciary Duties of Directors of Financially Troubled Corporations

by Sherri D. Way

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This article discusses a recent case that addresses whether and to what extent the interests of creditors must be considered in decision-making for nearly insolvent corporations, providing much-needed guidance for those steering corporations through troubled times.

A number of courts have grappled with issues pertaining to the fiduciary duties of corporate directors and officers to the creditors of financially distressed corporations. In November 2004, the Delaware Chancery Court again addressed the issue in *Production Resources Group, L.L.C. v. NCT Group, Inc.*¹ *Production Resources* provides directors and their counselors with much-needed guidance for steering corporations through troubled times.

The recently retired Chief Justice of the Delaware Supreme Court, Norman E. Veasey, noted the challenging nature of issues involving whether and to what extent corporate directors must consider the interests of creditors when a corporation is in the vicinity of insolvency.² Colorado courts have yet to publish a decision expressly addressing fiduciary duties of corporate directors to creditors of nearly insolvent entities. However, inasmuch as Delaware law often influences decisions on corporate fiduciary duty in Colorado, as in other jurisdictions, Colorado practitioners may benefit from that jurisdiction's seasoned review of this challenging area.

This article is intended to provide practitioners with a basic understanding of what fiduciary duties may be owed by corporate directors of corporations that either are insolvent or approaching insolvency. It reviews the *Production Resources* case, where the court conducts a robust discussion of whether: (1) direc-

tors must consider the interests of creditors in making decisions for nearly-insolvent corporations; (2) exculpatory provisions typically included in the debtor's articles of incorporation will insulate the directors of insolvent corporations from creditors' claims; (3) the business judgment rule will apply to decisions made; and (4) various claims made by creditors are generally derivative or direct.

Fiduciary Duties to Creditors: Background

The nature of the fiduciary duties owed by directors to a corporation's creditors, whether the corporation is solvent or insolvent, is generally established. Absent special circumstances, directors typically do not owe duties to creditors of a solvent corporation beyond the relevant contractual terms.³ However, when a corporation becomes insolvent, directors become subject to fiduciary obligations to creditors.⁴ Moreover, under Colorado law, if a corporation is insolvent, its directors are deemed to be trustees for the corporation and its creditors.⁵

Approximately twelve years ago, the Delaware Court of Chancery first addressed the murky area of the fiduciary duties owed by directors of a Delaware corporation to its creditors when the corporation is in the tenuous "zone" or "vicinity" of insolvency. In *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*,⁶ the dispute arose in the

context of a leveraged buyout of MGM-Pathé Communications Co. ("MGM"). In an opinion authored by then-Chancellor William T. Allen, the court determined that the corporation had begun to falter financially almost immediately after consummation of the buyout transaction.

In a now well-known footnote—footnote 55—the Chancellor remarked that the specter of insolvency can do "curious things to incentives" and that creditors could be exposed to "risks of opportunistic behavior."⁷ To demonstrate, the court constructed a detailed example of how the interests of a corporation's stockholders might differ from those of its creditors. It posed a hypothetical where a corporation with an equity value of \$3.55 million and \$12 million owing to bondholders had a \$51 million judgment (its only asset) currently being appealed by a solvent entity. This judgment had an expected value on appeal of \$15.55 million, and an offer to settle was available at \$12.5 million.⁸

In this circumstance, preferences of creditors would differ considerably from those of the stockholders. The court speculated that creditors likely would favor a settlement offer of anything above \$12.5 million. However, stockholders probably would oppose anything at or approximating that amount, because they would receive substantially no benefit. In fact, it was surmised that stockholders might even oppose a settlement at \$17.5 million.⁹

The court rationalized that if the corporation's "community of interests" was considered, a settlement offer should be accepted if it were available at \$15.55 million or above.¹⁰ Under this hypothetical, the court indicated that if the directors were to consider only the interests of the corporation's stockholders, the above result would not be reached. Thus, the court remarked that

[i]n managing the business affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.¹¹ (*Emphasis added.*)

Concluding that MGM's chief executive officer was "appropriately mindful" of the potential differing interests between the corporation and its 98 percent stockholder, the court recited that "[a]t 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."¹²

Defining the "Zone" or "Vicinity" of Insolvency

There currently exists no universally accepted test for determining whether a corporation is operating in the "zone" or "vicinity" of insolvency. However, Delaware courts expressly have eschewed the theory that the zone of insolvency commences with the initiation of a proceeding in bankruptcy. Instead, they have opted for a determination based on whether the corporation is "insolvent in fact."¹³ Two tests have been used to determine insolvency issues: the balance sheet test and the equitable (cash flow) test.¹⁴

Balance Sheet Test

In the "balance sheet" test, courts address whether a corporation's liabilities exceed the reasonable market value, or "fair value," of its assets.¹⁵ In applying the balance sheet test, courts must consider how fair value will be determined under the applicable circumstances. For example, whether a corporation's assets are valued on a going-concern basis or a liquidation basis can produce significantly different results. Citing *In re MFS/Sun Life Trust-High Yield Series*,¹⁶ the court in *Joy Recovery Technology Corp. v. Chang*¹⁷ remarked that, as a general rule, fair market value (that is, the value a willing buyer would pay for the assets as a going concern) should be used to value assets "unless a company is on its deathbed."¹⁸

Even assuming the position articulated in *Joy Recovery* were to be adopted as the general rule in other jurisdictions, a number of additional factors must be considered in arriving at fair value. These likely would include methods of discounting and adjustments to income—both of which make the determination of when a corporation is insolvent, or in the zone of insolvency, a difficult and uncertain proposition. Moreover, the Delaware Court of Chancery has recognized that it would be impracticable for the sole indication of insolvency to be whether a corporation's liabilities exceeded its assets, particularly when considering the business realities common with start-up companies.¹⁹

Equitable (Cash Flow) Test

Courts also have applied an "equitable" test (sometimes referred to as a "cash

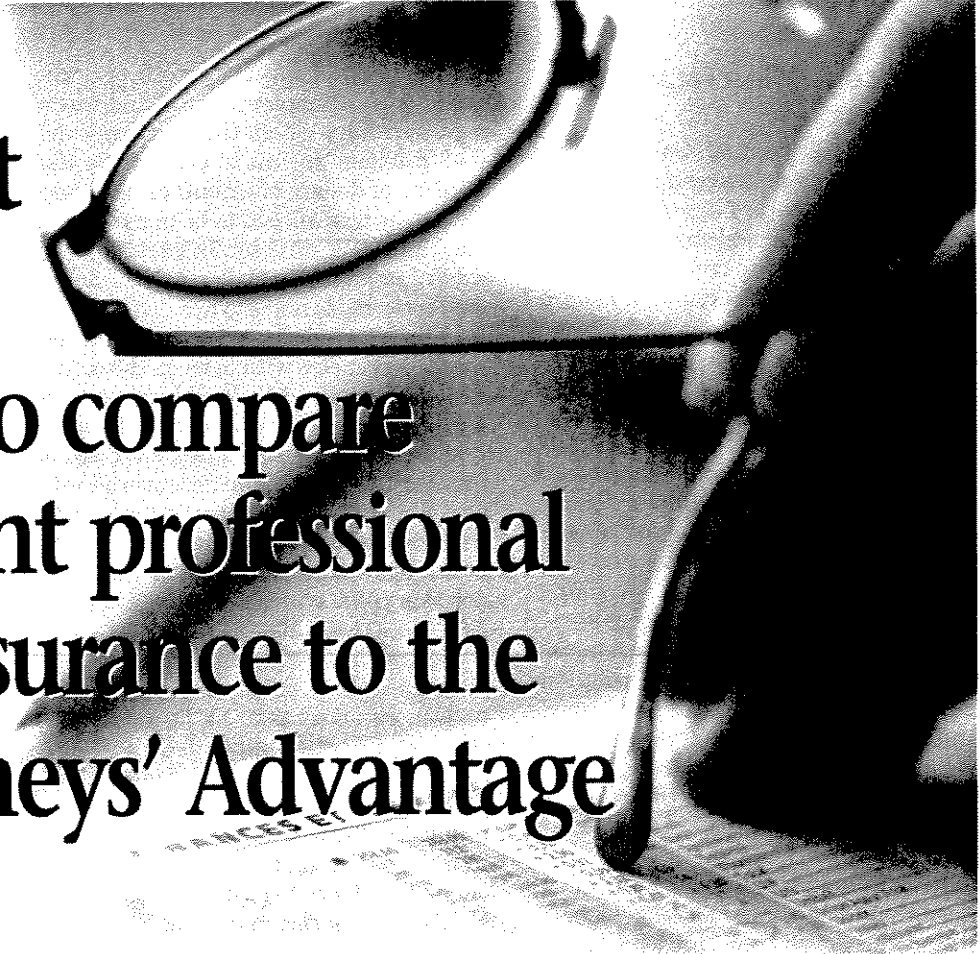
flow" test) to evaluate whether a corporation is able to pay its debts as they come due.²⁰ Under the equitable test, a company would be deemed to be insolvent if it was unable to pay its debts as they fell due in the usual course of business.²¹

The Pereira Decisions

Purporting to apply Delaware law, the court in *Pereira v. Cogan* ("*Pereira I*")²² applied both a balance sheet test and a cash flow test in determining that the debtor had been operating in the zone of insolvency for nearly all of its existence.²³ In applying this cash flow test, the court reviewed: (1) whether the debtor corporation was able to pay its debts as and when they became due; and (2) the debtor corporation's ability to obtain enough cash to pay for its projected obligations and fund its business requirements for working capital and capital expenditures with a reasonable cushion to cover the variability of its business needs over time.²⁴

Because the foregoing cash flow test evaluated the corporation's ability not only to pay its current bills, but also to meet anticipated working capital needs and pay future obligations, the court in the recently decided *Pereira II* case²⁵ concluded that the cash flow test did not comport with either the balance sheet or equitable tests under Delaware law.²⁶ As a result, the *Pereira II* court determined the cash flow test as applied could not be used to determine whether a corporation is insolvent under Delaware law.²⁷ It is unknown how various courts will determine the issue in the future, and there continues to be considerable uncertainty in figuring out when a corporation is within the zone of insolvency.²⁸

Pereira I also addressed fiduciary duties issues. The case arose from an adversary proceeding brought by Chapter 7 trustee Pereira against Marshall S. Cogan, who was the founder, former chief executive officer, and controlling shareholder of Trace International Holdings, Inc. ("Trace"), and other directors and certain officers of Trace. The trustee alleged, among other claims, breach of fiduciary duties to creditors. After an exhaustive review of the facts, the district court in *Pereira I* held that the trustee had standing to bring a claim for breach of fiduciary duty on behalf of the corporation's creditors.²⁹ However, this decision was vacated in *Pereira II* on June 30, 2005, and the case was remanded by the Second Circuit Court of Appeals.³⁰



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The Production Resources Decision

The years following the *Credit Lyonnais* decision have been interesting ones, with some commentators speculating that *Credit Lyonnais* created an entirely new fiduciary duty owed to creditors by corporate directors.³¹ The decision in *Pereira I* appeared to support this concept.³² Thus, with more than a little trepidation, practitioners have awaited clarification of issues left unanswered in *Credit Lyonnais* and subsequent decisions of other jurisdictions. Fortunately, Vice Chancellor Strine's review and analysis in *Production Resources*³³ provides considerable guidance for those counseling troubled corporations.

The dispute in *Production Resources* arose in the context of an uncollected debt. After years of frustrated attempts to collect from defendant NCT Group, Inc. ("NCT") in the Connecticut state courts, the plaintiff and then-judgment creditor Production Resources Group, L.L.C. ("PRG") sought the appointment of a receiver for NCT from the Delaware Court of Chancery.

In its Delaware pleadings, PRG also argued that the directors and a key non-director officer of NCT had breached a number of fiduciary duties, which PRG alleged were owed to creditors due to NCT's alleged insolvency. PRG argued it had standing to bring claims for breach of fiduciary duty directly against the directors and that such claims were not barred by exculpatory provisions contained in the debtor's certificate of incorporation. Although the case involved the court's consideration of the defendants' motion to dismiss, and therefore did not represent an ultimate decision on the merits, the court nonetheless embarked on a thorough review of fiduciary duty in the context not only of insolvent corporations, but also of corporations deemed to be in the zone of insolvency.

NCT was a publicly traded Delaware corporation with its principal place of business in Connecticut.³⁴ A technology and communications company incorporated in 1986, the court found NCT to have been operating at a deficit since at least 1998.³⁵ The finding was based in part on information included in NCT's public filings, which included NCT's acknowledgement that it was unable on numerous occasions to repay debt as it came due.

From at least 2001, NCT and its affiliates were kept afloat by funds provided by one primary creditor, Carole Salkind. Al-

though Salkind was not an officer or director of NCT (apparently Salkind was a legal secretary whom the court believed had "dubious" means to account for the millions of dollars of capital infused into NCT), she was alleged to be married to a one-time NCT director. In exchange for capital provided by Salkind, NCT delivered convertible notes to her.

Upon NCT's default thereof, it secured the Salkind notes with liens on the corporation's assets and Salkind became a secured creditor of the corporation. In addition to the convertible notes, NCT and a number of its subsidiaries entered into various consulting agreements with Salkind's spouse and son pursuant to which aggregate payments of \$240,000 per year (plus warrants and options for NCT stock) were allegedly paid.

Recognizing that on a fully diluted basis, Salkind beneficially owned substantially more shares than NCT's charter authorized, the court supported the plaintiff's allegation that Salkind was NCT's *de facto* controlling shareholder. NCT's chief financial officer admitted in deposition testimony that funds provided by Salkind often were deposited into the accounts of NCT's subsidiaries instead of NCT, "precisely to frustrate the ability of PRG to collect on debts due it from NCT."³⁶

Regarding NCT's management, the court assumed (at least for the pleading stage) that, at a minimum, the two inside NCT directors—who also served as the corporation's chief executive officer and president and earned substantial salaries and bonuses from NCT, notwithstanding its financial status—must have known of Salkind's *de facto* control over NCT. Citing a combination of conduct that generated an "aroma of fiduciary infidelity,"³⁷ the court found a pattern of improper self-enrichment at NCT based on the payment of the executives' compensation, the corporation's default of its obligations to PRG, and the payments to parties related to Salkind.

Stating that disposition of matters raised in *Production Resources* depended on a proper understanding of the nature of claims that belong to corporations and the reasons creditors are accorded the protection of fiduciary duties when corporations become insolvent, the court embarked on a detailed review and analysis of these issues. The court recited a general statement of law that creditors typically may not allege fiduciary duty claims against corporate directors who, as fiduciaries, may pursue the course of action

they believe best for the corporation and its stockholders, as long as the directors honor the legal obligations they owe to the company's creditors in good faith.³⁸ After reviewing the seminal *Credit Lyonnais* decision,³⁹ the court stated that the *Credit Lyonnais* holding and spirit clearly emphasized that directors would be protected by the business judgment rule if they, in good faith, pursued a less risky business strategy, precisely because they feared that a more risky strategy might render the firm unable to meet its legal obligations to creditors and other constituencies.⁴⁰

The court concluded that the decision in *Credit Lyonnais* was not intended to expand the fiduciary duty claims to which corporate directors would be exposed. Instead, it was designed to reflect a "shield" for directors against stockholder claims that directors had a duty to undertake extreme risk, as long as the company would not technically breach any legal obligations.⁴¹

Without discussion, the *Production Resources* court acknowledged that the Delaware Supreme Court had presented a different view on the issue of what consideration directors should give to the interests of creditors of an insolvent or nearly insolvent corporation in *Omnicare, Inc. v. NCS Healthcare, Inc.*⁴² *Omnicare* arose from a review of deal protection measures adopted by a corporation's directors in connection with the sale of the financially distressed NCS Healthcare, Inc.

The corporation's directors conducted an extensive market search and located a buyer (Genesis Health Ventures, Inc.) that not only agreed to a purchase price sufficient to liquidate debts due to creditors, but also would make a substantial payment to the corporation's stockholders. Having been relegated to the role of a stalking horse for Omnicare, Inc. in another transaction, Gemini conditioned its purchase offer on a locked-up deal. Thwarted in its eleventh-hour attempt to win the deal by means of a tender offer, Omnicare sued to stop the proposed merger between Gemini and NCS Healthcare.

In an unusual split decision, the majority (applying a standard of enhanced scrutiny) held that, together, the merger agreement and controlling stockholders' voting agreement created an absolute lockup that resulted in the negation of a "fiduciary out" provision, which the majority determined constituted a breach of fiduciary duty by the corporation's directors.⁴³ The majority decision in *Omnicare*

has been criticized by some commentators,⁴⁴ and then-Chief Justice Veasey (who vigorously dissented in *Omnicare*) has stated that even under the standard of enhanced scrutiny applied by the majority (with which standard the then-Chief Justice disagreed), the directors' conduct should have been upheld, particularly because of the "dilemma facing the board in view of [the corporation's] specter of insolvency."⁴⁵

Some believe the *Omnicare* decision may have signaled a trend of examining board conduct more closely under a standard of enhanced judicial scrutiny,⁴⁶ and many have urged that the decision be limited to its unique facts. Indeed, while not likely representative of a sea-change, a possible retreat or limitation of *Omnicare* may be evidenced by the recent decision in *Orman v. Cullman*.⁴⁷

Nature of Claims: Derivative or Direct

In addressing the nature of claims brought against corporate directors by creditors, the *Production Resources* court concluded that a corporation's insolvency does not change the primary object of the

directors' fiduciary duties: the corporation itself.⁴⁸ However, a corporation's insolvency makes the creditors (as opposed to stockholders) the principal constituency that would be injured by breaches of fiduciary duty resulting in a reduction of the company's value. Thus, creditors have standing to pursue claims based on such breaches.⁴⁹

Because the corporation remains the object of the directors' fiduciary duties, the *Production Resources* court indicated that creditor claims based on breaches of such duties typically would be derivative.⁵⁰ In so stating, the court cited the 2004 Delaware Supreme Court case of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*⁵¹

Tooley represents a departure from the historic "special injury" test used to determine whether claims should be direct or derivative. *Tooley* instead adopted a two-part test for making such determinations, which evaluates whether the corporation or suing stockholders, individually: (1) suffered the alleged harm; and (2) would receive the benefit of any recovery or other remedy.⁵² The *Tooley* court further stated that any direct injury claimed must be "independent of any alleged injury to the

corporation," and that a stockholder claiming direct injury must "demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation."⁵³

Before relying on the notion that breach of fiduciary claims brought by creditors against corporate directors are squarely derivative, practitioners should note that the *Production Resources* court also recognized circumstances may exist where directors display a "marked degree of animus" toward a particular creditor such that the directors expose themselves to direct creditor claims.⁵⁴ For example, NCT's chief financial officer admitted that capital infused by *de facto* controlling shareholder Salkind was deposited into accounts of NCT subsidiaries with the express purpose of frustrating PRG's ability to collect debt owed to it by NCT. This created a "flavor" of self-dealing and a suspicious pattern of dealing, raising the legitimate concern that the NCT board was engaging in preferential treatment of Salkind.⁵⁵ Accordingly, the court would not rule out the possibility that PRG could prove the NCT board had engaged in con-

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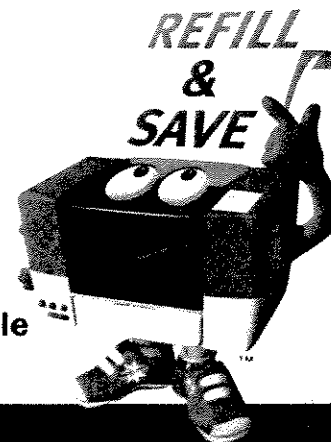
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duct supporting a direct claim by PRG, as a particular creditor, for breach of fiduciary duty.⁵⁶

Certain facts alleged by the plaintiff creditor in *New Crawford Valley, Ltd. v. Benedict* are not dissimilar,⁵⁷ although arguably the defendant directors in *New Crawford* benefited more directly from their actions than did the directors in *Production Resources*.⁵⁸ In *New Crawford*, the plaintiff's allegations included, among other things, that when the debtor corporation was, in fact, insolvent, the defendant directors caused a corporate debtor to make payments due to the corporation to a separate corporation, of which defendant directors were the sole shareholders. The plaintiff alleged this was done to defeat the claims of plaintiff and other creditors.⁵⁹

The court reiterated that in such circumstances, the directors' duty requires that they not transfer corporate property for their own benefit (even if they are the sole shareholders), thereby defeating a creditor's claim,⁶⁰ and that directors who breach this duty are personally liable to the creditor for such malfeasance.⁶¹ The

New Crawford court did not reach a decision on the merits of the case; it remanded the case for further proceedings consistent with the views set forth in the opinion.⁶² Thus, the court did not address the issue of whether the plaintiff's claims would be direct or derivative.⁶³

Acknowledging again that when a firm is insolvent the directors owe fiduciary duties to creditors, the *Production Resources* court expressed concern over the content of the fiduciary duties owed.⁶⁴ In discussing the issue, the court concluded that directors must retain the right to engage in good faith negotiations with creditors.⁶⁵ Additionally, citing the 1931 case of *Asmussen v. Quaker City Corp.*,⁶⁶ the court recognized circumstances may exist where directors appropriately prefer particular creditors over others of equal priority, as long as that decision is not motivated by self-interest.⁶⁷

Implications of Exculpatory Provisions

The court in *Production Resources* also considered the implications of exculpatory provisions in a corporation's certificate

of incorporation and under applicable law. It determined that although creditors are not specifically mentioned in the exculpatory provisions of Delaware General Corporation Law ("DGCL") § 102(b)(7),⁶⁸ these provisions nonetheless apply, regardless of whether derivative claims for breach of fiduciary duty are brought by stockholders or creditors.⁶⁹

The *Production Resources* court considered the reasoning of the district court opinion in a related case, and as restated in *Pereira I*,⁷⁰ that creditors have no opportunity to negotiate the provisions of a corporation's charter, and thus should not be bound by its exculpatory provisions.⁷¹ Acknowledging strong disagreement with this position, the *Production Resources* court recited a number of existing methods creditors may use to protect themselves, including negotiated contractual rights, strong covenants (as well as the implied covenant of good faith and fair dealing), liens, and the laws of fraudulent conveyance.⁷²

Moreover, the court in *Production Resources* stated that the "statutorily-authorized" protections of exculpation are most needed in situations where the corporation is insolvent, because directors otherwise could be subject to after-the-fact bias and unwarranted conclusions that they acted with less than due care if their strategies do not succeed.⁷³ The court also noted that allowing exculpatory provisions to bar creditors' claims does not upset their expectations, inasmuch as creditors ordinarily have not bargained to collect the corporation's debts from the directors or officers.⁷⁴

Returning to the facts of the case at hand, the court concluded that, absent special circumstances, claims involving alleged breaches of the duty of care would be barred by the exculpatory provisions of DGCL § 102(b)(7) and the NCT charter. Also absent special circumstances, the court indicated the business judgment rule would apply to the decisions of the corporation's directors.⁷⁵ Following established Delaware statutory and case law, the court recognized that certain claims cannot be exculpated, including those based on alleged acts or omissions not in good faith and those involving intentional misconduct or a knowing violation of law (such as breaches of the duty of loyalty).⁷⁶

Applying these principles to the allegations presented in the PRG amended complaint, the *Production Resources* court found, among other things, that the fol-

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lowing were suggestive of self-interest and bad faith: (1) the funding of NCT through *de facto* shareholder Salkind; (2) the deposit of funds from Salkind into subsidiary accounts to avoid collection efforts by PRG; and (3) the substantial compensation paid to the corporation's inside directors for services rendered as chief executive officer and president. Accordingly, the court held that the complaint set forth a cognizable claim for breach of fiduciary duty.⁷⁷

Notwithstanding its comprehensive analysis of issues involving the zone of insolvency cases, the facts presented in *Production Resources* did not require an exploration of what the court termed the "metaphysical" boundaries of the zone of insolvency.⁷⁸ Therefore, although instructive, the discussion of fiduciary duties relating to the zone of insolvency in *Production Resources* may still be regarded as *dicta*. Moreover, although opinions of the Delaware Court of Chancery are afforded great deference, the ultimate answer on what fiduciary duties are owed by directors of corporations in the zone of insolvency must be determined, as it relates to Delaware corporations, by the Delaware Supreme Court, which has yet to directly address the issue.⁷⁹

Other Considerations

Although notable for its comprehensive evaluation and analysis of many areas involving the duties of directors of distressed corporations, the court in *Production Resources* did not address a number of issues relating to the zone of insolvency. Following is a brief discussion of select cases practitioners may find helpful in dealing with corporate insider matters, attorney liability, and joint liability.

Corporate Insider Issues

One circumstance not addressed by the court in *Production Resources* is the relatively common situation where a corporate insider also is a creditor.⁸⁰ The Delaware Court of Chancery in *Odyssey Partners, L.P. v. Fleming Companies, Inc.* ("*Odyssey Partners II*"),⁸¹ dealt with such a situation. *Odyssey Partners II* involved a suit brought by minority stockholders against corporate directors and a majority stockholder who also was a corporate creditor. Citing the following finding in a related case involving the same parties,⁸² the court recited that

fiduciary obligation does not require self sacrifice. More particularly, it does

not necessarily impress its special limitation on legal powers held by one otherwise under a fiduciary duty, when such collateral legal powers do not derive from the circumstances or conditions giving rise to the fiduciary obligation in the first instance. Thus one who may be *both a creditor and a fiduciary* (e.g., a director or controlling shareholder) *does not by reason of that status alone have special limitations* imposed upon the exercise of his or her creditor rights.⁸³ (*Emphasis added.*)

In apparent contradiction, another court, in *Continuing Creditors' Committee of Star Telecommunications, Inc.* ("*Star Telecom*"),⁸⁴ citing *Cede & Co. v. Technicolor*,⁸⁵ espoused that a director's duty of loyalty

mandates that the best interest of the corporation and its shareholders takes precedence over *any* interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.⁸⁶ (*Emphasis added.*)

Interestingly, the *Star Telecom* court also found unsupportable the premise as alleged by the plaintiff that a director who owns significant stock cannot cast a disinterested vote.⁸⁷

Representatives of private equity and venture capital firms frequently serve (in fact, these firms expressly bargain for the right to have their representatives serve) as directors of the firm's portfolio companies. Individuals designated to serve as directors often are also directors or officers, and at times stockholders, of the private equity/venture capital firm. Further, it is common for the structure of investments in portfolio corporations to include a debt layer. These common business realities may signal a possible conflict of interest.⁸⁸

Such a conflict may provide fertile ground for possible breach of loyalty claims that arise from self-dealing and attempt to circumvent possible protections available through exculpatory provisions that bar duty of care claims.

Surely, the expectation of investors and the companies they support is not that investors must set aside their firms' interests when they serve as portfolio company directors, even when the corporations become financially distressed. In fact, this arguably is the very time the investors most need to protect their interests.⁸⁹ However, cases such as *Cede* and *Star Telecom* fail to account for how the expectations of investors will be preserved. Thus, it is not unlikely that more disputes may arise over issues of how these groups may act to protect their individual interests as stockholders and creditors, while simultaneously fulfilling fiduciary duties as corporate directors. This issue is particularly thought-provoking in situations where the corporation has no independent directors to whom such decisions can be delegated.⁹⁰

Attorney and Joint Liability

Practitioners counseling insolvent corporations or corporations within the vicinity of insolvency should be mindful of possible claims that may be brought against them for aiding and abetting alleged breaches of fiduciary duty of the corporation's directors. A recent case decided by the Colorado Court of Appeals, *Anstine v. Alexander*,⁹¹ is instructive.

Anstine involved an appeal of a verdict of joint liability in connection with a determination that corporate counsel had aided and abetted a breach of fiduciary duty of the corporation's president. In applicable part, the suit at the trial court lev-

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el involved claims for breach of fiduciary duty brought by a bankruptcy trustee against the president of a bankrupt corporation. In addition to claims made against the president, the trustee alleged that the corporation's attorneys had committed malpractice and had aided and abetted the president's breach of fiduciary duty.⁹² The jury found for the attorneys on the malpractice claim, but against them on the issue of aiding and abetting the president's breach of fiduciary duty.

The Colorado Court of Appeals considered whether the trustee had standing to pursue claims against the attorneys for aiding and abetting the president's breach of fiduciary duty, and concluded in the affirmative.⁹³ The court disagreed with the attorneys' argument that they could not be liable to the corporation's creditors for aiding and abetting the president's breach of fiduciary duty because the attorneys did not owe a duty to the third-party creditors.⁹⁴

Relying on *Holmes v. Young*,⁹⁵ the *Anstine* court identified a three-prong test for a claim for aiding and abetting a breach of fiduciary duty, requiring: (1) breach by a fiduciary of a duty owed to the plaintiff; (2) knowing participation in the breach by the defendant; and (3) damages.⁹⁶ Commenting that the duty of care owed by the attorneys to their corporate client did not emanate from the fiduciary duty owed by the corporation's president to the corporation, the court concluded that the attorneys nonetheless could be found to have aided and abetted the president's breach of fiduciary duty if the three criteria were met, notwithstanding the jury's finding that the attorneys had not committed legal malpractice *vis-à-vis* the corporation.⁹⁷

The court noted that lawyers do not ordinarily owe fiduciary duties to non-clients. However, the court also recognized under *Holmes* that there is no requirement of a separate fiduciary duty for attorneys to be held accountable for aiding and abetting the breach of fiduciary duty of another who has such a duty.⁹⁸

Regarding joint liability for damages caused by the president's breach of fiduciary duty, the *Anstine* court concluded that the elements necessary to establish an aiding and abetting claim do not, as a matter of law, include the elements necessary to find joint liability under Colorado law.⁹⁹ The court set aside the trial court's amendment to the judgment against the attorneys whereby joint liability would have been imposed. It remanded the case for a new trial on the issue of joint liability.

As of this writing, the attorneys have petitioned the Colorado Supreme Court for *certiorari*. The Colorado Bar Association has filed an *amicus* brief on the issue of whether the Court of Appeals erred in holding that an attorney can be liable to a non-client on a claim of aiding and abetting the client's breach of fiduciary duty when the attorney properly discharged his or her duties to the client.

Conclusion

In Colorado, it remains to be determined whether courts will follow Delaware's lead in *Production Resources* or if rulings of other jurisdictions will carry more weight. Nonetheless, *Production Resources* has much to teach regarding the complex matters involved in guiding corporations through financially troubled times. However, many questions are still unanswered regarding when corporations will be deemed to be in the zone of insolvency and exactly how the directors of financially distressed corporations will be required to fulfill their fiduciary duties. Nevertheless, those directors responsible for shepherding companies in difficult times may find that the decisions of *Production Resources*, *Pereira II*, and *Orman* allow them to breathe just a bit easier.

NOTES

1. *Production Resources*, 863 A.2d 772 (Del.Ch. Nov. 17, 2004).

2. Veasey, "What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments," 153 *U. Penn L.Rev.* 1399, 1429 (2005).

3. *Geyer v. Ingersoll Publ. Co.*, 621 A.2d 784 (Del.Ch. 1992).

4. *Production Resources*, *supra*, note 1 at 790, 791, citing *Geyer*, *supra*, note 3 at 787. The fiduciary duties of directors to preferred shareholders are generally considered to be contractual in nature, and directors do not owe this constituency a fiduciary duty to protect their rights and privileges.

5. *New Crawford Valley, Ltd. v. Benedict*, 877 P.2d 1363, 1369 (Colo.App. 1993) (creditors found to have sufficiently stated claim for breach of fiduciary duty against corporation's directors on allegation that directors of insolvent corporation instructed corporation's debtors to make payments to another corporation in which directors were sole shareholders; if corporation insolvent, its directors deemed trustees for it and its creditors). See also *Collie v. Becknell*, 762 P.2d 727 (Colo.App. 1988) (directors of insolvent corporation deemed to be trustees for its creditors); *Rosebud Corp. v. Boggio*, 561 P.2d 367 (Colo.App. 1977) (directors of insolvent corporation owe duty to creditors of their corporation not to divest corporate prop-

erty for their own benefit and thereby defeat corporate creditor's claim).

6. *Credit Lyonnais*, No. 12150, 1991 WL 277613 (Del.Ch. 1991).

7. *Id.* at *34 n.55.

8. *Id.*

9. *Id.* Such a settlement would result in only a \$2 million increase in the corporation's equity value, assuming an existing litigation alternative with even a 25 percent probability of success (which, if achieved, would result in a materially higher equity value).

10. *Credit Lyonnais*, *supra*, note 6.

11. *Id.* at *34.

12. *Id.*

13. *Geyer*, *supra*, note 3 at 787-90 (in defining insolvency for purposes of determining when fiduciary duty to creditors arises, insolvency means insolvency in fact rather than insolvency due to statutory filing; fiduciary duties to creditors arise when fact of insolvency can be established). See also *Pereira v. Cogan*, 294 B.R. 449, 519 (Bankr.S.D.N.Y. 2003) ("*Pereira I*"), *vacated and remanded*, No. 03-5035(L), 03-5055(CON), 2005 WL 1532318 (2nd Cir. 2005) ("*Pereira II*").

14. *U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, LLC*, 864 A.2d 930, 947 (Del.Ch. 2004), *vacated on other grounds*, No. 36, 2005 WL 1353766 (Del. 2005) (insolvency determined in two ways in Delaware: (1) corporation is unable to pay debts when due in the ordinary course; (2) corporation liabilities exceed reasonable market value of its assets). See also *Love v. Olson*, 645 P.2d 861, 864 (Colo.App. 1982) (Normally question for trier of fact, term "insolvency" may vary, depending on legal and factual context within which it is considered.) Referring to other Colorado case law, the court indicated that a trial court should consider whether a debtor is able to "pay his debts . . . in the ordinary course of business, whether the debtor has so little property left after [an alleged fraudulent conveyance] that his creditors' ability to collect through a judicial process is impaired, and the type of business in which the debtor is engaged."

15. *See Brandt v. Hicks, Muse & Co., Inc. (In re Healthco)*, 208 B.R. 288 (Bankr.D.Mass. 1997); *LaSalle Nat'l Bank v. Perelman*, 82 F.Supp.2d 279 (D.Del. 2000).

16. *MFS/Sun Life*, 910 F.Supp. 913, 939 (S.D.N.Y. 1995).

17. *Joy Recovery*, 286 B.R. 54 (Bankr.N.D.Ill. 2002).

18. *Id.* at 77.

19. See *Francotyp-Postalia AG & Co. v. On Target Tech, Inc.*, No. 16330, 1998 WL 928382 (Del.Ch. 1998).

20. See, e.g., *In Re Healthco*, *supra*, note 15; *LaSalle Nat'l Bank*, *supra*, note 15; *Odyssey Partners, L.P. v. Fleming Cos., Inc.*, 735 A.2d 386 (Del.Ch. 1999).

21. *Klamath Falls*, 864 A.2d at 947-48, *vacated on other grounds*, No. 36, 2005 WL 1353766 (Del. 2005).

22. The district court in *Pereira I*, *supra*, note 13, concluded that the breach of fiduciary

claims brought by the trustee against the defendant officers and directors of the corporation were equitable claims (trustee in *Pereira I* sought remedy of restitution) that did not require a jury trial. The court in *Pereira II*, citing the intervening decision of the U.S. Supreme Court in *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 708 (2002), acknowledged that actions for breach of fiduciary duty are historically equitable. However, the court found that the nature of the relief sought by the trustee in *Pereira II* was really for compensatory damages and not restitution (because the defendants appealing the decision in *Pereira II* were not personally enriched by controlling shareholder Cogan's deeds). *Pereira II*, *id.* at *5-9. This determination led to the vacation and remand of *Pereira I*.

23. *Pereira I*, *supra*, note 13 at 501-12, *vacated and remanded on other grounds by Pereira II*, *supra*, note 13.

24. *Id.*

25. *Pereira II*, *supra*, note 13.

26. *Id.* at *12. See note 22, *supra*, for a discussion of the Second Circuit's decision to vacate and remand *Pereira I*. See also notes 27 and 30, *infra*.

27. *Pereira II*, *supra*, note 13 at *12. Of importance, however, the Second Circuit stated in *dictum* that although the cash flow test as applied in *Pereira I*, *supra*, note 13, did not apply for purposes of the insolvency determination,

at least parts of the expert witness testimony offered during the bench trial relating to the insolvency test likely would apply to the trustee's claims of improper payment of dividends and stock redemptions under Delaware General Corporation Law ("DGCL") §§ 160 and 174. The Second Circuit instructed the district court to determine this issue on remand, expressly noting the district court's identification of appropriate standards for these determinations. See also the Colorado Business Corporation Act ("Colorado Act") at CRS § 7-106-401(3). Note also the provisions of CRS § 7-106-401(4) (directors may base determination that distribution would not be prohibited under CRS § 7-106-401(3) on either financial statements prepared on basis of "accounting practices and principles that are reasonable under the circumstances" or on fair valuation or other method reasonable under the circumstances).

28. See *Veasey*, *supra*, note 2 at 1430 ("Thus, when a corporation is in the vicinity of insolvency—whatever that is—creditors may be considered to be in the pool of residual owners, and therefore become beneficiaries of the fiduciary duties owed to the residential owners."). (*Emphasis added.*)

29. *Pereira I*, *supra*, note 13 at 521.

30. *Pereira II*, *supra*, note 13 at *10-11, *citing Geyer*, *supra*, note 3 at 787-88 and *Production Resources*, *supra*, note 1 at 792-93. The *Pereira II* court held that, "although corporate officers

and directors owe fiduciary duties to creditors when a corporation is insolvent in fact, these duties do not expand the circumscribed rights of the trustee, who may only assert claims of the bankrupt corporation, not its creditors." *Pereira II*, *supra*, note 13 at *10. See note 22, *supra*, for a discussion of the Second Circuit's decision to vacate and remand *Pereira I*.

31. See, e.g., Barondes, "Fiduciary Duties of Officers and Directors of Distressed Corporations," 7 *Geo. Mason L.Rev.* 45 (1998). See also Hughes Hubbard & Reed LLP, "Duties to Creditors When a Company is in the 'Vicinity of Insolvency'; No More Rubber Stamping, Please," *Client Advisory* (Aug. 2003) ("*Pereira* is a wake-up call to directors and officers . . . telling them they can be personally liable to creditors for failing to manage their business properly if the company is in the 'vicinity of insolvency.'").

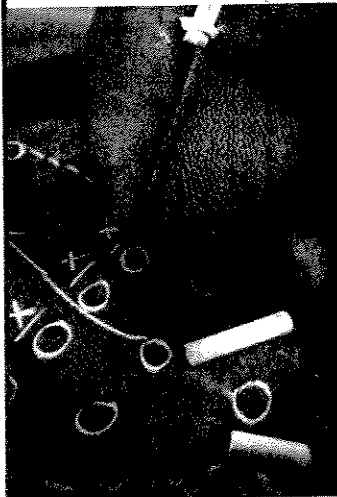
32. *Pereira I*, *supra*, note 13 at 449. See also *In re Toy King Distributors, Inc.*, 256 B.R. 1 (Bankr.M.D.Fla. 2000) (finding presumption of applicability of business judgment rule to have been overcome by self-dealing by defendant directors, court held that directors of Florida corporation in vicinity of insolvency owe fiduciary duty to corporation's creditors).

33. *Production Resources*, *supra*, note 1.

34. As noted by the court, NCT's stock was traded only on "pink sheets"; NCT did not file financial statements with the Securities and Exchange Commission. NCT also failed to hold

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regular stockholders meetings, alleging the corporation could not sustain the cost of noticing and providing such meetings. *Production Resources*, *supra*, note 1 at 772 and 778.

35. In an attempt to defeat allegations it was insolvent or within the zone of insolvency, defendant NCT attempted to characterize itself as a start-up entity. The court recognized there are cases suggesting that a company whose balance sheet reflects liabilities in excess of its assets might not be insolvent if the company can raise money to pay its bills in a commercially reasonable manner; nevertheless, the court determined that the manner in which NCT was keeping itself afloat was not commercially reasonable. See *Production Resources*, *supra*, note 1 at 779 and 782. See also *Francotyp-Postalia*, *supra*, note 19 at *5.

36. *Production Resources*, *supra*, note 1 at 781.

37. *Id.*

38. *Id.* at 787.

39. *Id.* at 788-91.

40. *Id.*

41. *Id.* Interestingly, although *Production Resources* is widely touted for its interpretation of footnote 55 of *Credit Lyonnais*, *supra*, note 6, as creating a "shield" for directors to insulate them from certain stockholder claims, this "shielding" concept was discussed earlier by the bankruptcy court for the Northern District of Illinois in the case of *In re Ben Franklin Retail Stores, Inc.*, 225 B.R. 646, 655 (N.D.Ill.

1998), *amended and superseded*, 2000 WL 28266 (N.D.Ill. 2000) ("The chancellor's solution was to shield [such] directors from liability to shareholders by declaring that their duty is to serve the interests of the corporate enterprise, encompassing all its constituent groups, without preference to any. That duty, therefore, requires directors to take creditor interests into account. . .").

42. *Omnicare*, 818 A.2d 914 (Del. 2003).

43. *Id.* at 939.

44. See, e.g., *Veasey*, *supra*, note 2 at 1458-65 (referencing at 1460 the view of commentator Charles Hanson that the *Omnicare* dissent "recognized reality"). See Hanson, "Omnicare v. NCS Healthcare: The Chief Justice Got It Right," *Corp.* (Oct. 15, 2004) at 5. See also Griffith, "The Costs and Benefits of Precommitment: An Appraisal of *Omnicare v. NCS Healthcare*," Paper 15, *U. Conn. School of Law Working Paper Series* (2004).

45. See, e.g., *Veasey*, *supra*, note 2 at 1458-65.

46. See *Omnicare*, *supra*, note 42 at 946 (*Veasey*, C.J., dissenting) ("[O]ne hopes that the [m]ajority rule announced here—though clearly erroneous in our view—will be interpreted narrowly and will be seen as *sui generis*.").

47. *Orman*, No. 18039, 2004 Del. Ch. LEXIS 150 (Del.Ch. Oct. 20, 2004) (differentiating *Omnicare* decision, court upheld certain deal protections used in connection with sale of stock involving controlling stockholders). Although *Orman* did not involve a distressed company, it was cited with favor by the court in *Continuing Creditors' Committee of Star Telecom, Inc.*, No. Civ. A. 03-278-KAJ, 2004 WL 2980736 (D.Del. 2004) ("*Star Telecom*"). This case involved decisions of directors of a corporation deemed to be within the vicinity of insolvency, and was cited for the proposition that to allege a breach of the duty of loyalty based on acts or omissions of the directors, a plaintiff is required to "plead facts demonstrating that a majority of the board that approved the transaction in dispute was interested and/or lacked independence." *Star Telecom*, at *9, citing *Orman*, *id.* at *23.

48. *Production Resources*, *supra*, note 1 at 792. See also *In Re Adelpia Communications Corp.*, 323 B.R. 345, 387 (Bankr.D.Del. 2005), citing *Production Resources*, *supra*, note 1 at 791, with favor, for the proposition that the directors' obligations "are to the firm itself." Of note, although one of the "managed entities" in *Adelpia* was a Colorado entity, the case does not address the issue of fiduciary duties of directors of insolvent or nearly insolvent entities under Colorado law. See also *Veasey*, *supra*, note 2 at 1431 ("This means that, as the corporation slides toward insolvency, the benefits of maximizing the value of the corporation will shift from stockholders to creditors, but, on this view, the duties of the board remain the same.").

49. *Production Resources*, *supra*, note 1 at 792.

50. Assuming that creditors have standing to bring derivative claims (an issue for which there currently exists a split of authority), once

a corporation enters the zone of insolvency, an unanswered question of *Production Resources* is how creditors and stockholders would share standing. The court noted that it may be both creditors and stockholders who could bring derivative suits in such a situation, and each likely would have different opinions as to what strategies are best for the corporation. *Production Resources*, *supra*, note 1 at 789 n.56.

51. *Tooley*, 845 A.2d 1031 (Del. 2004).

52. *Id.* at 1033.

53. *Id.* at 1039.

54. *Production Resources*, *supra*, note 1 at 797. See also *Star Telecom*, *supra*, note 47 at *6 (alleging corporate misfeasance and malfeasance of type court indicated was most frequently challenged in derivative suits, but was brought directly by plaintiff because of bankruptcy context within which case arose).

55. *Production Resources*, *supra*, note 1 at 800-01.

56. *Id.*

57. *New Crawford*, *supra*, note 5 at 1369. Also note the court's comments that it might be debatable whether the duty owed to the plaintiff, as one of the corporation's creditors, actually was a fiduciary duty versus some other form of duty. *Id.*

58. In *New Crawford*, *supra*, note 5, corporate funds were directed to a corporation of which the defendant directors were the sole shareholders. In *Production Resources*, *supra*, note 1, two defendant directors also were corporate officers whom the court indicated may have benefited at the expense of creditor NCT from the deposit into a subsidiary corporation of funds provided by *de facto* controlling shareholder Salkind (by making funds available to pay their substantial compensation when the corporation was insolvent or nearly insolvent). Similarly, Salkind was presumed by the court to have enjoyed preferential treatment at NCT's expense by, among other things, enabling entities owned or controlled by her spouse and son to receive payments for consulting services at a time when the corporation was insolvent or nearly insolvent. An unanswered question is whether Salkind would have continued to fund the corporation's cash flow requirements if the benefits enjoyed from such funding went to satisfy the judgment to PRG and perhaps other creditors besides Salkind (in her status as a secured [and perhaps insider] creditor). She might not have elected to do so. However, this election itself, although likely resulting in the corporation's liquidation, still may have been in the corporation's best interest. In fact, in accepting funding from Salkind, the insolvency of NCT may have been deepened, possibly leading to claims against Salkind, the directors, and perhaps others based on that theory.

59. *New Crawford*, *supra*, note 5.

60. *Id.*, citing *Becknell*, *supra*, note 5.

61. *Id.* See also *Rosebud Corp.*, *supra*, note 5.

62. *New Crawford*, *supra*, note 5 at 1374.

63. The plaintiff in *Becknell*, *supra*, note 5, who was found by the court to be a member of

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the entity at the time of the offending conduct, brought a derivative claim on the issue of usurpation of a corporate opportunity. The plaintiff, who was both a member of the firm and also a creditor, brought a direct claim against the defendant (also a member of the firm) for breach of fiduciary duty, alleging that the defendant diverted corporate property for his own benefit. The court found that the defendant breached his fiduciary duty to the plaintiff, as a creditor, and that the trial court had not erred in holding the defendant liable to plaintiff for such breach. *Becknell, supra*, note 5 at 731. Accordingly, Colorado has precedent for finding fiduciaries of insolvent entities directly liable to a particular creditor. Nonetheless, these cases may be differentiated from the facts of cases such as *Pereira I, supra*, note 13, where defendant directors other than the controlling shareholder did not benefit from their conduct, or where the benefit is more tangential and less direct than was evidenced in these Colorado cases.

64. *Production Resources, supra*, note 1 at 797.

65. In an interesting retrospective, former Delaware Supreme Court Chief Justice E. Norman Veasey commented that "the directors' judgment could shade toward rights of creditors if that course of action comports with the best interests of the corporate entity." *See Veasey, supra*, note 2 at 1431.

66. *Asmussen*, 156 A. 180 (Del. Ch. 1931) (stating rule that corporations are permitted to discriminate between creditors of equal priority, as long as directors are not engaged in self-dealing). As noted in *Geyer*, an exception may apply if the preferred creditor also is a corporate insider. *Geyer, supra*, note 3 at 787.

67. *Production Resources, supra*, note 1 at 797. *See also Geyer, supra*, note 3 at 787.

68. DGCL § 102(b)(7) provides that the certificate of incorporation may include a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision does not eliminate or limit the liability of a director: (1) for any breach of the director's duty of loyalty to the corporation or its stockholders; (2) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law; (3) under § 174 of Title 8, DGCL §§ 101 to 398 *et seq.*; or (4) for any transaction from which the director derived an improper personal benefit. Similarly, CRS § 7-108-401(1) provides that Colorado corporations may provide in their articles of incorporation for the elimination or limitation of personal liability of the corporation's directors or shareholders for monetary damages for breach of fiduciary duty, if, as provided by CRS § 7-108-402(1), such provisions cannot eliminate or limit the liability of the corporation's directors or shareholders for: (1) breaches of the directors' duty of loyalty to the corporation or its shareholders; (2) acts or omissions not in good faith or that involve intentional miscon-

duct or knowing violation of law and certain other actions; or (3) any transaction from which a director directly or indirectly derived an improper personal benefit.

69. *Production Resources, supra*, note 1 at 793.

70. *Pereira I, supra*, note 13 at 533, citing *Pereira v. Cogan*, No. 00 CIV. 619(RWS), 2001 WL 243537 at *11 and n. 14 (S.D.N.Y. 2001).

71. *Pereira I, supra*, note 13 at 533-34. The district court held that the directors were not protected by exculpatory provisions of the DGCL for a breach of the duty of care because creditors in this situation are not bound by the DGCL or the corporation's certificate of incorporation. Citing *Production Resources*, the *Pereira II* court vacated this holding, holding instead that although not specifically mentioned in DGCL § 102(b)(7), this section nonetheless by its plain terms applies to all claims belonging to the corporation, whether such claims are asserted by stockholders or creditors. *Pereira II, supra*, note 13 at *11. In *Production Resources*, the court also acknowledged provisions of the Model Business Corporation Act ("MBCA") that specifically limit the exculpatory provisions of DGCL § 102(b)(7) to exclude third-party liability. *See* MBCA § 2.02 at 2-16, off. cmt. i (3d. ed. 1997).

72. *Production Resources, supra*, note 1 at 790.

73. *Id.* at 794.

74. *Id.* Note the court's acknowledgement that only claims of a corporation asserted derivatively by creditors would be barred by the DGCL § 102(b)(7); any claims creditors possess themselves against a corporation or its directors (such as claims for breach of contract, common law, or statutory torts) are not barred thereby.

75. *Production Resources, supra*, note 1. *See also Star Telecom, supra*, note 47 at *10, citing *Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001) (if defendant does not breach duty of loyalty to company, defendant is permitted to rely on business judgment rule or exculpatory provision, if applicable, as shield from liability for breach of duty of care). *See also Veasey, supra* note 2 at 800.

76. *Production Resources, supra*, note 1 at 800 n.84; *accord* CRS § 7-108-402(1).

77. *Production Resources, supra*, note 1 at 800.

78. *Id.* at 790.

79. *See Veasey, supra*, note 2 at 1432.

80. *Production Resources, supra*, note 1 at 781 and 800. The court in a number of instances referred to Salkind's status as a *de facto* shareholder, but in this proceeding did not deal with Salkind's rights as a creditor of NCT.

81. *Odyssey Partners (Odyssey Partners II)*, 735 A.2d 386 (Del.Ch. 1999).

82. *Odyssey Partners v. Fleming Co.*, 1996 WL 422377 *3 (Del.Ch. 1996) (case authored by Chancellor Allen; referred to as "*Odyssey Partners I*").

83. *Odyssey Partners II, supra*, note 81 at 415.

84. *Star Telecom, supra*, note 47.

85. *Cede*, 634 A.2d 345, 361 (Del. 1993).

86. *Id.* at *8. *See also Adelpia, supra*, note 48 at 387, citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) for its holding that "[w]hen directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. . . . The requirement of fairness is unflinching in its demand that where one

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stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts." The *Adelphia* court also rejected the defendants' argument that the entire fairness doctrine should not apply to the case because it did not involve a merger or acquisition. *Adelphia*, *supra*, note 48 at 387. The court noted, as a preliminary matter, that the factual context of the case, based on what the court deemed a "mixed question of fact and law," was that each of the entities at issue was "hopelessly" insolvent. *Id.*

87. *Star Telecom*, *supra*, note 47 at *8. *See also Production Resources*, *supra*, note 1 at 795, where the court summarily stated that an exculpatory charter provision does not insulate directors who have engaged in conscious wrongdoing or unfair self-dealing. This may imply that under Delaware law, self-dealing that is not unfair could be excused.

88. *See, e.g., In re Freeport-McMoran Sulphur, Inc. Shareholder Litig.*, No. 16729, 2005 WL 1653923 (Del. Ch. 2005) ("Freeport").

89. *But see In re Papercraft Corp.*, 211 B.R. 813 (W.D.Pa. 1997), *aff'd*, 323 F.3d 228 (3d Cir. 2003). The court found that a venture capital firm breached its fiduciary duty to Papercraft

Corp. ("Papercraft") and other creditors of Papercraft (in which corporation the venture firm owned stock issued as part of an earlier leveraged buyout) by engaging in self-dealing. The court found that through the venture firm's representative on Papercraft's board of directors, the firm was able to gain an unfair advantage over other creditors in connection with the reorganization of Papercraft; the venture firm also was determined to have usurped a corporate opportunity of Papercraft by failing to disclose to Papercraft the opportunity to buy claims at significantly less than face value.

90. *See, e.g., Freeport*, *supra*, note 88, where the court dissects the roles and relationships of various directors and officers of interrelated corporations, addressing issues such as social and prior business relationships among the directors of entities in connection with a merger of two affiliated corporations. Additionally, note that ostensibly independent directors may find themselves vulnerable to treatment as *de facto* insiders because of close personal relationships with conflicted directors. *See, e.g., Pereria I*, *supra*, note 13 at 529, *vacated on other grounds* (basis for finding outside directors liable for breaches of duty of loyalty was in part because

directors had close relationship with controlling stockholder). *See also In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 921 (Del.Ch. 2003) (director may be compromised not only by financial interest but also from existence of personal or other relationships with interested party; court rejected view that directors independent unless dominated and controlled by interested parties). *Cf. Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 833 A.2d 961, 979 (Del.Ch. 2003), *aff'd*, 845 A.2d 1040 (Del. 2004) (in context of demand futility, although some personal or professional relationships might raise reasonable doubt as to whether director can appropriately consider demand, not all (or even most) such relationships rise to this level).

91. *Anstine*, No. 03CA1037, 2005 WL 913503 (Colo.App. 2005).

92. *Id.* at *2.

93. *Id.*

94. *Id.* at *4.

95. *Holmes*, 885 P.2d 305 (Colo.App. 1994).

96. *Id.* at 305.

97. *Anstine*, *supra*, note 91 at *4.

98. *Id.* at *4-5.

99. *Id.* at *7. ■

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