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Fiduciary Duties in Distressed Corporations: Second-Generation Issues

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ABSTRACT

This Article examines variations in corporate fiduciary duties arising from financial distress. This Article argues whether there is an affirmatively enforceable duty under the principles of *Credit Lyonnais* is not moot, because, inter alia, the availability of aiding and abetting liability for breach of fiduciary duty will give rise to a greater set of potentially liable defendants (aiding and abetting a fraudulent transfer typically not separately giving rise to liability), allowing a court to reverse some outcomes that would otherwise obtain under the *in pari delicto* doctrine and the *Wagoner* rule, and will expand the remedies available.

This Article proposes that the application of the business judgment rule to directors' operation of a distressed firm should be, if anything, stronger than the corresponding provision applied to a solvent firm. The rationale is a contrary right would create an anomalous option for creditors having expressly negotiated approval rights—one that would be difficult to value and that would create greater costs of investigation in order to avoid being a "winner" in a contest presenting a winner's curse.

This Article also examines the interplay of corporate distress with approval of conflict of interest and final period transactions. It concludes that during distress short of insolvency, fiduciary duties to maximize firm value on a sale should continue to be owed to stockholders and approval of conflict-of-interest transactions by disinterested stockholders should continue to shift the burden of proof as to a transaction's fairness.

Lastly, this Article, following *Malone v. Brincat*, argues for an increase in the duty of candor during distress regarding communications to creditors. Financial creditors consider information a debtor provides in deciding whether to exercise contractually negotiated control rights. Creditors should be entitled to rely on truthfulness even if the debtor is unaware of a particular action the creditor may take in reliance. As proposed, a creditor would not need to prove a distressed debtor made a statement for purposes of influencing the creditor's conduct because financial creditors may be presumed to be deciding whether to exercise remedies on an ongoing basis. Other elements of a cause of action, including whether a defendant failed to exercise the appropriate care in assuring the accuracy of the statement, would remain unchanged.

ROYCE DE R. BARONDES*

Fiduciary Duties in Distressed Corporations: Second Generation Issues

I. INTRODUCTION

THIS ARTICLE SEEKS TO PROVIDE INSIGHTS INTO PROPERLY framing the contours of the fiduciary duties owed by those managing solvent corporations operating in the vicinity of insolvency. In a majority of jurisdictions (according to the count of others), courts shift fiduciary duties to creditors upon a corporation's insolvency.[1] The decision spawning over a decade's worth of scholarship on the subject is the Delaware Chancery Court's opinion in *Credit Lyonnais Bank Nederland v. Pathe Communications Corp.*[2]

This Article examines the interstices of a number of areas of law. Normal state principles governing fraudulent conveyances and transfers[3] and federal bankruptcy law bear on the issue. In addition, other corporation law provisions, for example,

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1. Unsecured Creditors Comm. of Debtor STN Enters., Inc. v. Noyes (*In re* STN Enters.), 779 F.2d 901, 904–05 (2d Cir. 1985) ("Thus, the 'majority rule' permits recovery by creditors of an insolvent corporation for mismanagement as if the corporation itself were plaintiff, while the 'minority rule' precludes suit by injured creditors of an insolvent corporation, although a suit for misappropriation or diversion of corporate property may stand on different and more solid footing.") (citations and footnote omitted). The support for this principle is not unanimous. *See, e.g.*, Helm Fin. Corp. v. MNVA R.R., Inc., 212 F.3d 1076, 1081–82 (8th Cir. 2000) ("Even assuming for purposes of analysis that the distribution of [a wholly owned subsidiary's] stock [to the debtor's stockholders] left [the debtor] nearly or actually insolvent, or that defendants knew, or reasonably should have known, that insolvency was likely to occur as a result of the distribution, no breach of fiduciary duty occurred because defendants did not treat themselves to a preference over [a judgment creditor of the debtor] and other creditors."). Assorted authority is collected in Royce de R. Barondes, *Fiduciary Duties of Officers and Directors of Distressed Corporations*, 7 GEO. MASON L. REV. 45, 63 n.54 (1998), and a more recent collection is provided in WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING § 5.2.6.3 (1996 & Supp. 2002).
2. No. Civ. A. 12150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991).
3. UNIF. FRAUDULENT CONVEYANCE ACT, 7A U.L.A. 6–273 (1999); UNIF. FRAUDULENT TRANSFER ACT, 7A U.L.A. 274–365 (1999). The principles also may interact with each other. *See generally* Kittay v. Atl. Bank of N.Y. (*In re* Global Serv. Group LLC), 316 B.R. 451, 465 (Bankr. S.D.N.Y. 2004) ("Allegations that an insolvent corporation made a fraudulent transfer state a claim for breach of fiduciary duty . . . .").

the limit on corporate distributions to shareholders[4] and principles regulating dispositions of firms,[5] may apply.

The law of fiduciary duties applied to distressed corporations should be a comprehensive whole, consistent both internally and externally with other principles such as federal and state laws governing debtor-creditor relations. A wealth of authority, in case-law and academic commentary, is potentially pertinent. The purpose of this Article is to assemble some of the components of that whole, without describing the full multifield context of the academic discussion of the issues, providing a comprehensive solution, or cataloguing the full range of variation among jurisdictions from Delaware corporation law.

Others may assert that none of these duties should be imposed by law, but instead governed by express contracting between the parties. That appears to be a hyper-abstract approach to analyzing efficiency—*hyper-abstract* meaning the analysis evidences a level of economic abstraction that has, in abstraction, omitted pertinent nuance—producing questionable conclusions. Two reasons immediately come to mind.

First, this hyper-abstract view focuses on the long-term without adequately addressing the short-term and the intermediate-term consequences. Many debtor-creditor relationships that present these issues are long-term relationships. Their duration may be thirty years or more, perhaps representing more than a generation in case-law development of the pertinent fiduciary duties. Simply relegating all this to express contract does not address how the law should treat relationships already formed under contracts that cannot practicably be renegotiated at this time, for example, long-term, publicly traded debt. Appropriate resolution of these cases is needed and should not be sacrificed for purposes of developing a mechanism to address temporally distant disputes.

Second, some of the subjects of these duties may be difficult to negotiate. The debtor-creditor relationships that some assert should be simply governed by express contract would, one supposes, be voluntary transactions, not debtor-creditor relationships arising from tort claims. Some matters may be sufficiently sensitive

4. *E.g.*, DEL. CODE ANN. tit. 8, §§ 170, 174 (2001 & Supp. 2004); MODEL BUS. CORP. ACT § 6.40 (2005). *Compare* Munford v. Valuation Research Corp. (*In re* Munford, Inc.), 97 F.3d 456, 460 (11th Cir. 1996) (holding state limit on corporate payment of dividends and stock repurchases under GA. CODE ANN. § 14-2-91 (1988), and GA. CODE ANN. §§ 14-2-154(a)(1)–(2) (1982), applied to consideration received by stockholders of firm acquired in reverse triangular merger); Wieboldt Stores, Inc. v. Schottenstein, 94 B.R. 488, 510–12 (N.D. Ill. 1988) (denying motion to dismiss claim that distribution unlawful under 805 ILL. COMP. STAT. 5/8.65(a)(1), 9.10(c)(1) (1983), was affected by a leveraged buyout structured as a tender offer for all the target's stock in which substantially all the target's assets were pledged to finance the loan funding the tender offer), *with* C-T of Va., Inc. v. Barrett (*In re* C-T of Va., Inc.), 958 F.2d 606, 612–14 (4th Cir. 1992) (holding amounts received by stockholders of firm acquired in reverse triangular merger had not received distributions subject to the limit on dividends provided by Virginia corporation law, VA. CODE ANN. § 13.1-653(C) (1989)).

5. *See infra* Part V (discussing fairness of conflict-of-interest transactions and *Revlon* duties).

that, in the ordinary case, it taints the process of forming the mutual trust required to enter into a business relationship to raise them.[6]

For example, one of the fiduciary duties owed by those managing a corporation, at least a Delaware corporation, is a duty of candor.[7] Although my personal recollection of practice is limited by both the fact that I engaged in private transactional practice for only a limited amount of time and that the experiences I had in practice are now somewhat shrouded in my memory by the passage of time, I cannot recall a circumstance in which opposing counsel expressly urged that his client be permitted to make affirmative misstatements to me or my client. Indeed, a review of asset purchase agreements in the Contracting and Organizations Research Institute (CORI) database[8] confirms that, at least in that sample of contracts, parties do not negotiate contract provisions allowing one party to "lie."[9]

It is perhaps common for parties to provide for a similar result by negotiating contract provisions stating that one party has not relied on certain information or that a warranty arising from any statement is disclaimed.[10] But that only serves to further the point. If it were not difficult to discuss issues relating to a contracting party's freedom to lie, it would be stated more directly, or at least stating it directly would occur occasionally where the other formulations seem not to work consistently.[11]

A normal justification for the hypothetical-bargain standard of contract law[12] is that it provides off-the-rack rules mimicking what the parties would have bar-

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6. Although not in the area of debtor-creditor law, *Favrot v. Barnes*, 332 So. 2d 873, 875 (La. Ct. App. 1976) (waiver of affirmative marital obligations), *rev'd in part*, 339 So. 2d 843 (La. 1976) (reversing as to "whether the earning capacity of an unemployed, divorced wife bars her from alimony absent a compelling reason which prevents her from accepting employment"), *superseded by statute*, 1979 La. Acts 72, *as recognized in* Arrendell v. Arrendell, 390 So. 2d 927, 929 (La. Ct. App. 1980), raises expressly negotiated issues that, one supposes, generally would not be the subject of an express *ex ante* agreement, although there might be some general implicit expectations in that regard.

7. *See infra* Part V.3.

8. CORI: Contracting and Organizations Research Institute, http://www.cori.missouri.edu (last visited Oct. 17, 2006).

9. A search of all the 866 asset purchase agreements currently in the database for the words *lie*, *lied*, and *lies* disclosed only four agreements. Each used the word in some other way, e.g., as to whether a subsequent lawsuit would "lie" in a particular a particular location. *E.g.*, Asset Purchase Agreement by and among SRS California Operations LLC, Noble Logistic Services, Inc. (CA), Noble Logistic Services, Inc. (MI), and Noble International, Ltd. at 32 (March 24, 2003).

10. *See, e.g.*, Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc., 382 F. Supp. 2d 411, 416 n.4 (S.D.N.Y. 2003) (construing contract stating, inter alia, "'Except for the representations and warranties contained in this Article III, neither the Sellers nor any other Person make any express or implied representation or warranty on behalf of or with respect to the Sellers, the Business or the Purchased Assets, and the Sellers hereby disclaim any representation or warranty not contained in this Article III.'").

11. *See id.* at 417 (noting that the effectiveness of disclaimers of reliance on misrepresentations is influenced by whether the disclaimer "tracks the substance of the alleged misrepresentation . . . ") (citation omitted).

12. *E.g.*, David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815, 1815–16 (1991) ("To interpret contracts, lawyers ask: what would the parties have agreed to had they explicitly adverted to the issue? That is, the interpreter constructs a 'hypothetical bargain': he

gained for without the associated cost.[13] A separate justification is that the process of reaching the bargain may alter the relationship between the parties and perhaps prevent formation of contracts that would be beneficial were the default rule properly selected. Raising some issues in negotiation, such as whether one party is free to lie as long as the lie is not made in anticipation of reliance,[14] simply may inhibit formation of mutual trust required necessary to form some contracts.

In sum, this Article reaches the following conclusions:

- *The existence of an affirmatively enforceable duty under the principles of* Credit Lyonnais *is not moot, because, inter alia, the existence of aiding and abetting liability*[15] *for breach of fiduciary duty will give rise to a greater set of potentially liable defendants, and increase the remedies otherwise available where the duties contemplated by* Credit Lyonnais *are not affirmatively enforceable (aiding and abetting a fraudulent transfer typically not separately giving rise to liability). Whether there is a fiduciary duty running directly to the creditors is important because in the absence of direct obligations, the prior participation of management in the transaction may prevent assertion by the trustee of an aiding and abetting claim.*[16]
- *The application of the business judgment rule to directors' operations of distressed firms should be, if anything, stronger than the corresponding provisions as applied to solvent firms, because a contrary right would create an anomalous option for creditors having expressly negotiated approval rights. Similarly, the current trend finding charter provisions limiting liability to creditors or trustees for breaches of fiduciary duties of care is desirable.*
- *The determination of the time horizon for which corporations are managed should continue to be delegated to management, notwithstanding distress.*
- *During distress short of bankruptcy proceedings, fiduciary duties to maximize firm value on a sale should continue to be owed to stockholders. Approval of conflict-of-interest transactions by disinterested stockholders should continue to shift the burden of proof as to the fairness of the transaction.*

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determines how the parties would have bargained to treat the situation that has arisen had it been directly presented to them at the time they were forming the contract.").

13. *E.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 34 (1991) ("Why not just abolish corporate law and let people negotiate whatever contracts they please? The short but not entirely satisfactory answer is that corporate law is a set of terms available off-the-rack so that participants in corporate ventures can save the cost of contracting. Corporate law—and in particular the fiduciary principle enforced by courts—fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance.").

14. Reliance is an element of the tort of misrepresentation. *See infra* note 127 and accompanying text.

15. Aiding and abetting a fraudulent transfer typically does not separately give rise to liability.

16. *See, e.g.*, Mediators, Inc. v. Manney (*In re* Mediators, Inc.), 105 F.3d 822, 825 (2d Cir. 1997).

- *During distress, the obligation of candor under* Malone v. Brincat[17] *should appertain to communications with creditors, thereby creating a duty not to make affirmative misstatements, regardless of whether the communication is in connection with approval of a particular action by the creditors. Financial creditors will consider the information provided in connection with deciding whether to exercise contractually negotiated control rights, and they should be entitled to rely on truthfulness even if the debtor is not aware of a particular action the creditor may take in reliance.*
- *In disputes with a trustee or creditors, principles of implicit ratification of an officer or director having taken a corporate opportunity should be enhanced. The clearest case for allowing creditors to bring an action for breach of corporate opportunity obligations involves opportunities in which the director or officer will be competing with the distressed debtor.*

Before turning to the analysis, it is helpful to make one final remark concerning the scope of this Article. This Article will not emphasize the difference between obligations that give rise to direct claims and those that can be asserted only derivatively. Litigation of the corresponding duties to creditors will frequently be raised in bankruptcy—a trustee may be bringing the claims if the creditors cannot directly—so that procedural obstacles to pursuing these claims in solvent corporations lose their force.[18] This Article, for ease of exposition and because the typical procedural obstacles will not apply in the context of litigation of these issues in bankruptcy, may refer to stockholders as beneficiaries of fiduciary duties in contexts where a claim for breach can be brought only derivatively.[19] Of course, whether a claim may be brought only in a representative capacity is a separate question from whether there is a duty owed to a specific nonstockholder constituency.[20]

17. 722 A.2d 5 (Del. 1998).

18. Understanding which claims can be brought may become more complex where a lawsuit is initiated by the creditors in the name of a trustee, as illustrated in *Ranalli v. Ferrari* (*In re* Unifi Commc'ns, Inc.), 317 B.R. 13 (D. Mass. 2004). *See generally* Alan R. Lepene & Sean A. Gordon, *The Case for Derivative Standing in Chapter 11: "It's the Plain Meaning, Stupid,"* 11 AM. BANKR. INST. L. REV. 313 (2003).

19. *See generally* Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004) (restating the distinction between direct and derivative claims).

20. For example, Delaware law provides that for willful or negligent payments of unlawful dividends, directors have joint and several liability "to the corporation, and to its creditors in the event of its dissolution or insolvency." DEL. CODE ANN. tit. 8, § 174(a) (2005). Drexler et al. indicate that the current law is that "this provision . . . prevent[s] a single creditor from bringing an action at law against a director to recover illegal dividends." DAVID A. DREXLER ET AL., DELAWARE CORPORATION LAW & PRACTICE § 20.06, (2005) (describing this as the outcome in *John A. Roebling's Sons Co. v. Mode*, 43 A. 480 (Del. Super. 1899) and stating that a statutory revision following *John A. Roebling's Sons Co.* was superseded by a 1937 statutory revision reinstating the outcome in *John A. Roebling's Sons Co.*).

II. THE ISSUE IS NOT MOOT

1. *Different Scope of Persons Potentially Liable*

In *Credit Lyonnais*, the court stated:

> *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.*
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> . . . .
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> *. . . [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.*
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> . . . .
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> *. . . [T]he [issuer] board or its executive committee had an obligation to the community of interest that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity.*[21]

In that case, the "duty," if it can be called that,[22] to non-shareholder constituencies was used in a defensive context—to defend the propriety of action by those managing the corporation against a claim that an improper constituency's interests were being promoted.[23] An initial question is whether the contemplated duty gives rise to affirmatively enforceable obligations, a matter that has been previously ex-

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21. Civil Action No. 12150, 1991 Del. Ch. LEXIS 215, at *108–09 & n.55 (Del. Ch. Dec. 30, 1991).

22. The uncertainty in terminology arises from ambiguity in whether there is a duty affirmatively enforceable by creditors.

23. *See Credit Lyonnais*, 1991 Del. Ch. LEXIS 215, at *5, *106 (discussing a claim that a member of a distressed firm's executive committee breached a fiduciary duty owed a controlling stockholder by delaying sales of firm assets). *See generally* Odyssey Partners, L.P. v. Fleming Cos., 735 A.2d 386, 420 (Del. Ch. 1999) ("Moreover, in arguing that the defendant directors' failure to file for bankruptcy law protection was a violation of the board's fiduciary duties to the stockholders, plaintiffs overlook that the board was obligated to consider and protect interests other than those of the stockholders. When bankruptcy and foreclosure are compared, and the effects of both on the shareholders, creditors and other corporate constituencies balanced, the decision to proceed with the foreclosure cannot be said to have been made in bad faith or a manner that was disloyal to ABCO, taken as a whole.").

amined by courts, which have expressed varying conclusions,[24] and discussed by commentators.[25]

A threshold question in assessing the significance of case law finding an enforceable duty owed to creditors of firms operating in the vicinity of insolvency is whether it makes any difference at all. If the remedies this theory makes available merely duplicate remedies available under other principles, the matter merits little discussion. The issue is not, in fact, moot. One illustration[26] involves aiding and abetting liability for breach of fiduciary duty, which expands upon the liability regime otherwise available in two ways. As developed below, the availability of a remedy for breach of fiduciary duty changes the nature of the remedy available and adds potentially liable defendants who otherwise would not be liable.

As a general matter, conspiracy to commit and aiding and abetting a tort may give rise to liability.[27] Where actionable, the elements for aiding and abetting a breach of fiduciary duty are as follows: "(1) the existence of a fiduciary relationship,

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24. *See, e.g.*, Kittay v. Flutie N.Y. Corp. (*In re* Flutie N.Y. Corp.), 310 B.R. 31, 57 (Bankr. S.D.N.Y. 2004) ("A court will find that breach of fiduciary duty is properly alleged when the Debtor was insolvent or rendered insolvent by a fraudulent transfer or was operating in the vicinity of insolvency at the time of or immediately after the transfer."); Weaver v. Kellogg, 216 B.R. 563, 580–84 (S.D. Tex. 1997) (applying Texas and Delaware law to deny summary judgment on claims asserting corporate opportunity doctrine violations in a corporation allegedly in the vicinity of insolvency); Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 790 n.57 (Del. Ch. 2004) (reviewing critically arguments that there should be an affirmatively enforceable duty qualitatively different from that during solvency and stating, "I doubt the wisdom of a judicial endeavor to second-guess good-faith director conduct in the so-called zone.").

Somewhat ironically, the court in *Production Resources*, in discussing the issue, impugned, apparently as counterfactual, "extreme hypotheticals involving directors putting cash in slot machines." *Id.* There is, however, authority involving this kind of activity. *Dwyer v. Jones* (*In re* Tri-State Paving, Inc.), 32 B.R. 2 (Bankr. W.D. Pa. 1982) involved officers who withdrew all the funds the debtor had in its bank account and gambled it all in Las Vegas "to win enough money . . . to pay the corporate-debtor's creditors." *Id.* at 3. The strategy failed. *See id.* at 4–5. Of course, it is unlikely that a reported case would involve managers who successfully adopted such a strategy. Yet, such a strategy may be beneficial for creditors. *See* Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485, 1491 n.19 (1993) (reporting that the founder of Federal Express successfully adopted such a strategy during a period of financial difficulty).

25. *See* Barondes, *supra* note 1, at 69–71.

26. There is no intent to provide an exhaustive catalogue of differences, which could include different statutes of limitations, *see generally* Weaver v. Kellogg, 216 B.R. 563, 586 (S.D. Tex. 1997) (two-year statute of limitations for breach of fiduciary duty tolled when "a corporation's board is composed of alleged wrongdoers") (citing Resolution Trust Corp. v. Acton, 49 F.3d 1086, 1090 (5th Cir. 1995)).

27. The following discussion of the distinction between conspiracy to commit a tort and aiding and abetting a tort is provided in *F.D.I.C. v. Romaniello*, No. CV 92-0294248, 1992 WL 369557, at *1 (Conn. Super. Ct. Dec. 3, 1992):

> In *Halberstam v. Welch*, 705 F.2d 472, the court traces the development of the liability of a secondary defendant for the tortious conduct of a primary wrongdoer. The court focuses on two variations of the theory of vicarious liability, ". . . (1) conspiracy, or concerted action by agreement, and (2) aiding and abetting, or concerted action by substantial assistance." *Id.* at 477. It finds that these "bases of liability correspond to the first two subsections in the Restatement (Second) of Torts, section 876 (1979) . . . ." It quotes that section on "Persons Acting in Concert" as follows:
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> For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he
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> (a) does a tortious act in concert with the other or pursuant to a common design with him . . . or

(2) a breach of the fiduciary's duty and (3) a knowing participation in that breach by the defendants who are not fiduciaries."[28] Although historically there was some curious authority in the Seventh Circuit,[29] currently a number of jurisdictions hold that one may be liable for aiding and abetting a breach of fiduciary duty.[30] On the

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(b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself . . . .

The first of these the court designates "conspiracy;" the latter, "aiding-abetting." The court finds that "[T]he prime distinction between civil conspiracies and aiding-abetting is that a conspiracy involves an agreement to participate in a wrongful activity. Aiding-abetting focuses on whether a defendant knowingly gave 'substantial assistance' to someone who performed wrongful conduct, not on whether the defendant agreed to join the wrongful conduct." The court continues, "[T]here is a qualitative difference between proving an agreement to participate in a tortious line of conduct, and proving knowing action that substantially aids tortious conduct." *Id.* at 478.

28. Weinberger v. Rio Grande Indus., Inc., 519 A.2d 116, 131 (Del. Ch. 1986) (citing Gilbert v. El Paso Co., 490 A.2d 1050, 1057 (Del. Ch. 1984), *aff'd*, 575 A.2d 1131 (Del. 1990)). Proof of damage is also required. *See Gilbert*, 490 A.2d at 1057.

29. The court in *Koutsoubos v. Casanave* stated, "Illinois has never recognized the tort of aiding and abetting a breach of a fiduciary duty." 816 F. Supp. 472, 475 (N.D. Ill. 1993) (quoting Cenco, Inc. v. Seidman & Seidman, 686 F.2d 449, 452 (7th Cir. 1982) ("There is no tort of aiding and abetting under Illinois law or, so far as we know, the law of any other state.")). Assorted authority recognizing aiding and abetting predating *Cenco* includes, *Penn Mart Realty Co. v. Becker*, 298 A.2d 349, 351 (Del. Ch. 1972) (stating the test quoted *supra* text accompanying note 28, other than the last four words thereof, and stating, "The directors of a corporation stand in a fiduciary relationship to the corporation's shareholders. And one who knowingly joins with any fiduciary, including corporate officials, in a breach of his obligation is liable to the beneficiaries of the trust relationship") (citations omitted) and *Jackson v. Smith*, 254 U.S. 586, 589 (1921) (firm's receiver breached fiduciary duty by agreeing to be a joint venturer in the purchase of firm assets in a foreclosure sale, where the court stated, "[O]thers who knowingly join a fiduciary in such an enterprise likewise become jointly and severally liable with him for such profits"). *See generally* Steelvest, Inc. v. Scansteel Serv. Ctr., Inc., 807 S.W.2d 476, 485 (Ky. 1991) (citing eight cases preceding 1970 in eight different court systems as authority for a similar proposition). *See also* Aluminum Mills Corp. v. Citicorp N. Am., Inc. (*In re* Aluminum Mills Corp.), 132 B.R. 869, 892 (Bankr. N.D. Ill. 1991) (denying the motion to dismiss claim against the lender who allegedly paid $100,000 to a company owned by one defendant to induce defendant directors to breach their fiduciary duties to the debtor by releasing claims against the lender and noting that, "[u]nder Illinois law, [a] third party's inducement of, or knowing participation in, a breach of duty by an agent is a wrong against the principal that may subject the third party to liability.") (quoting Corroon & Black of Ill., Inc. v. Magner, 494 N.E.2d 785, 790 (Ill. App. Ct. 1986)). Modern authority construing Illinois law includes *Shapo v. Engle*, No. 98C7909, 1999 U.S. Dist. LEXIS 17966, at *60 (N.D. Ill. Nov. 10, 1999) ("Although it seems that at one point Illinois did not recognize a tort of aiding and abetting a breach of fiduciary duty, it appears that such a claim is now viable.") and *Technic Eng'g, Ltd. v. Basic Envirotech, Inc.*, 53 F. Supp. 2d 1007, 1012 (N.D. Ill. 1999) (stating, in connection with a claim that officers of an insolvent closely held corporation breached a fiduciary duty to a creditor and were assisted by a family member who allegedly was not an officer, that Illinois law recognizes liability "for inducement or participation in breaches of fiduciary duties.").

30. *See* Smith v. Arthur Andersen L.L.P., 175 F. Supp. 2d 1180, 1193, 1198–1201 (D. Ariz. 2001) (denying motion to dismiss claims against an accounting firm as allegedly either a primary violator or an aider and abettor of a breach of fiduciary duty in, inter alia, communications with the Securities and Exchange Commission); *id.* at 1206 (denying underwriter's motion to dismiss claims alleging aiding and abetting a breach of fiduciary); *id.* at 1208–09 (same as to outside general counsel); Adena, Inc. v. Cohn, 162 F. Supp. 2d 351, 357–58 (E.D. Pa. 2001) (denying outside counsel's motion to dismiss claims of aiding and abetting a breach of fiduciary duty; controlling stockholder used assets of closely held corporation for personal purposes, including payment of legal fees owed defendant for matters not relating to that corporation); AmeriFirst Bank v. Bomar, 757 F. Supp. 1365, 1369 n.2, 1379–80 (S.D. Fla. 1991) (denying a motion to dismiss claims against an individual the construction industry for allegedly aiding and abetting the breach of fiduciary duties owed to a savings and loan and a subsidiary, stating, "[T]he majority of case law, including that in Florida, recognizes a cause of

other hand, it appears that the current trend is to hold no separate civil liability exists in comparable contexts against an aider and abettor of a fraudulent conveyance.[31] Nonetheless, aiding and abetting qualitatively more egregious misconduct defrauding creditors, such as hiding assets, has resulted in criminal liability under other principles[32] and participation in managerial malfeasance that is a tort, in

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action for aiding and abetting common law torts, such as breach of fiduciary duty."); *Weinberger*, 519 A.2d at 131 (granting motion to dismiss claims that acquiror in two-step acquisition by omitting information about the target in a press release aided and abetted disclosure-based fiduciary duty breach by management of the target); *Gilbert*, 490 A.2d at 1057 (stating, in discussing a tender offeror's alleged aiding and abetting of a breach of fiduciary duty by the target's directors by virtue of the terms negotiated with the target that allegedly preferred the directors individually, "It is well settled that a third party who knowingly participates in the breach of a fiduciary's duty becomes liable to the beneficiaries of the trust relationship."); Joel v. Weber, 602 N.Y.S.2d 383, 384 (N.Y. App. Div. 1993) (denying law firm's motion to dismiss claims that it aided and abetted a breach of fiduciary duty; breach involved diversion by entertainer's former management company of partnership distributions due the entertainer; funds used to pay legal fees to the management company's outside counsel (a defendant)). *See generally* Bancroft-Whitney Co. v. Glen, 411 P.2d 921, 936 (Cal. 1966) (unfair competition claim in connection with corporate president's breach of fiduciary duty benefiting competitor). *Compare* Time Warner Entm't Co. v. Six Flags Over Ga., LLC, 537 S.E.2d 397, 407 (Ga. Ct. App. 2000) ("Although this court has never explicitly recognized a cause of action for aiding and abetting a breach of fiduciary duty, we have at least twice implicitly acknowledged that such claims are viable. We have explicitly 'acknowledged an aiding and abetting cause of action in . . . fraudulent conveyances.' ") (citations omitted), *vacated*, 534 U.S. 801 (2001), *remanded to*, 563 S.E.2d 178 (Ga. Ct. App. 2002) (reaffirming the punitive damages award), *cert. denied*, 538 U.S. 977 (2003), *with* Munford v. Valuation Research Corp. (*In re* Munford, Inc.), 98 F.3d 604, 613 (11th Cir. 1996) ("In this case, we decline to extend aider and abettor liability to breaches of fiduciary duty concluding that Georgia courts would not recognize such a cause of action.").

31. Ernst & Young LLP v. Baker O'Neal Holdings, Inc., No. 1:03-CV-0132-DFH, 2004 WL 771230, at *14 (S.D. Ind. Mar. 24, 2004) ("[T]he Florida Supreme Court . . . recently joined the multitude of other courts in holding that there is no accessory liability for fraudulent transfers under the Uniform Fraudulent Transfer Act."); *see also, e.g.*, Chepstow Ltd. v. Hunt, 381 F.3d 1077, 1088 (11th Cir. 2004); Freeman v. First Union Nat'l Bank, 865 So. 2d 1272, 1277 (Fla. 2004). *But see, e.g.*, *Munford*, 98 F.3d at 613 (stating one party "notes that Georgia courts have acknowledged an aiding and abetting cause of action in torts involving violence, the sale of unregistered securities, breaches of covenants with employment contracts, and fraudulent conveyances"). *See generally* William L. Siegel, *Attorney Liability: Is This the New Twilight Zone?*, 27 U. MEM. L. REV. 13 (1996) (discussing assorted theories of liability against lawyers assisting in asset protection, including aiding and abetting).

32. *See, e.g.*, United States v. Dolan, 120 F.3d 856, 863, 868–69 (8th Cir. 1997) (affirming lawyer's conviction for conspiracy to commit bankruptcy fraud, 18 U.S.C. § 371 and concealing or aiding and abetting the concealment of a bankrupt's assets, 18 U.S.C. §§ 152, 2; defendant, inter alia, made false statements concerning the debtor's assets); United States v. Webster, 125 F.3d 1024, 1027, 1034–36 (7th Cir. 1997) (affirming sufficiency of evidence for convicting lawyer under 18 U.S.C. §§ 152(1), 2(a), of aiding and abetting debtor's fraudulent concealment of assets in bankruptcy proceeding; defendant formed a corporation to which the assets of the debtor's business were conveyed and prepared worksheets form which debtor's schedule of assets were created omitting the debtor's stock in the corporation); United States v. Brown, 943 F.2d 1246, 1250–52, 1256–57 (10th Cir. 1991) (affirming sufficiency of evidence to sustain a lawyer's conviction for violation of 18 U.S.C. § 371 for conspiracy to defraud the United States, where a reasonable jury could conclude the defendant "discussed [the debtor's] assets with [the debtor] and how to conceal them during the deposition" and "actively participated in the conspiracy by failing to reveal the undisclosed assets to the bankruptcy trustee" and by destroying records; reversing the conviction, however on another basis); *id.* at 1253 (affirming sufficiency of conviction for mail fraud, 18 U.S.C. §§ 2, 1341, arising from false communication to trustee); United States v. Connery, 867 F.2d 929, 936 (6th Cir. 1989) (reversing trial court's granting of judgment of acquittal in favor of a lawyer as to aiding and abetting the filing of a false bankruptcy claim under 18 U.S.C. §§ 152, 2, on basis that trial court erred in finding that "[a]t best, the Government introduced evidence that shows that [the defendant] aided in the filing of a proof of claim which he knew was subject to dispute by the debtor and other creditors")

addition to a breach of fiduciary duty, has resulted in third-party liability under principles of civil conspiracy.[33] This distinction is significant because the existence of affirmatively enforceable fiduciary duties can materially increase the potential liability of third-party professionals such as accountants, investment bankers and lawyers.[34] Indemnification is unlikely to mitigate the potential liability materially because this kind of claim would be most typically brought against a professional upon the insolvency of the client—the party who might naturally provide an indemnification.

In sum, the existence of a fiduciary duty owed directly to creditors expands the scope of creditors' claims by enhancing the potential liability of those who aid and abet a fraudulent conveyance because aiding and abetting a breach of fiduciary duty is actionable, whereas aiding and abetting a fraudulent transfer is not.

This is not, however, the sole incremental increase in liability that would arise were there to be a fiduciary duty owed directly to creditors of distressed firms. Such a duty could be used to correct a second anomalous outcome—one involving mat-

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(quoting the trial court); United States v. Tashjian, 660 F.2d 829, 831–32, 840–42 (1st Cir. 1981) (reversing conviction for aiding and abetting, under 18 U.S.C. §§ 152, 2, in connection with a "bust out" scheme involving ordering goods intending not to pay and to declare bankruptcy, finding the defendants purchased goods the seller had not included in the "bust out" scheme).

33. The actions that have been the objects of civil conspiracy and that have given rise to liability to co-conspirator professionals not arising from a breach of fiduciary duty, have been qualitatively more egregious than the actions that might give rise to aiding and abetting for breach of fiduciary duty. Thus, lawyers knowing actions in seeking to hide assets or engaging in sham transactions to prevent collection on a judgment have given rise to civil liability. *See, e.g.*, McElhanon v. Hing, 728 P.2d 256, 265 (Ariz. Ct. App. 1985) (considering sham consideration for transfer of stock in lawsuit in which a lawyer was a defendant; one stockholder conveyed his interest to another after becoming aware of a verdict against the conveying stockholder by a third stockholder), *vacated in part on other grounds*, 728 P.2d 273 (Ariz. 1986). Other authority addresses claims by judgment creditors or those whose pending claims have given rise to attempts to secrete assets. *E.g.*, Hadar Leasing Int'l. Co. v. D.H. Overmyer Telecasting Co. (*In re D.H.* Overmyer Telecasting Co.), 53 B.R. 963, 981 (N.D. Ohio 1984) (affirming liability against lessor for conspiracy involving backdating leases for purposes of limiting recovery of lessee's secured creditor); Dalton v. Meister, 239 N.W.2d 9, 12 (Wis. 1976) (actions in anticipation of trial designed to "liquidate and secrete" assets that could be realized subsequent to judgment). Aiding and abetting a breach of fiduciary duty can create liability in less egregious cases, i.e., circumstances where the complaining creditor is not a judgment creditor or does not have a pending claim. A collection of pertinent authority is provided in Milton Roberts, Annotation, *Right of Creditor to Recover Damages for Conspiracy to Defraud Him of Claim*, 11 A.L.R. 4th 345 (1982 & Supp. 2005).

One of the more aggressive applications of civil conspiracy to bring a claim against a third party professional is provided by *Likover v. Sunflower Terrace II, Ltd.*, 696 S.W.2d 468 (Tex. Ct. App. 1985), where the court found there was sufficient evidence to support a lawyer's civil liability for having conspired to participate in wrongfully compelling the payment of $400,000. *Id.* at 473. The case involved a deed recorded by mistake; one party, with the advice of counsel, postponed correcting the deed and sought to use the mistake as bargaining power to settle breach of contract disputes for a favorable payment of $400,000. Although the attempt to coerce payment of $400,000 was unsuccessful, the court found an adequate basis for liability that the wrongful action harmed the victim on account of consequential construction delays, *id.* at 474, and found that there was an adequate basis for punitive damages of $400,000. *Id.* at 475–76. *See supra* note 27 and accompanying text (discussing civil conspiracy).

34. *See, e.g.*, *Smith*, 175 F. Supp. 2d at 1192, 1205–09 (accounting firm, underwriter, and general counsel); *Adena, Inc.*, 162 F. Supp. 2d at 357–58 (outside counsel); *Joel*, 602 N.Y.S.2d at 384 (outside counsel).

ters of agency law, specifically, the *in pari delicto* defense and the *Wagoner* rule.[35] Following *Wagoner*, courts have applied the *in pari delicto* principle to prevent a trustee's assertion of claims against a third-party professional who participated with the debtor's former management in fraudulent conduct. *Hirsch v. Arthur Andersen & Co.*, for example, applies the principle to prevent a trustee's assertion of claims against an accounting firm that allegedly participated in the debtor's Ponzi scheme "because of the [d]ebtors' collaboration with the defendants[ ] in promulgating and promoting the . . . Ponzi schemes."[36] These principles have been applied to Delaware corporations.[37] Thus, unless there is a basis for a direct claim by the creditors, there would not be a remedy, which would essentially prevent parties in some contexts from engaging third-party gatekeepers under contracts providing practicable remedies for breach. If there is a fiduciary duty owed directly to creditors of distressed corporations, aiding and abetting a fiduciary duty would provide such a claim.

That is not to say that this claim would be a perfect solution. The claim would depend on the malfeasance occurring when the corporation was distressed. It also is not being argued that this theory of liability is superior to reversal of the *Wagoner* rule. Two more limited points are being made here. First, whether there is a direct duty can influence the outcome of litigated cases in a material way. Second, this theory provides a basis under which courts can reverse outcomes under the *Wagoner* rule without having to overrule directly *Wagoner* and its progeny.

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35. *See generally* Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 120 (2d Cir. 1991). The proper way for ordinary agency law principles to treat imputation of knowledge in this type of circumstance produced changes between drafts of *Restatement (Third) of Agency*. *See generally* Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187, 1215–21 (2003) (discussing an illustration in RESTATEMENT (THIRD) OF AGENCY § 5.04 at 123, ilus. 3 (Tenative Draft Nov. 3, 2002), concerning imputation of knowledge of an officer to a corporation in connection with malpractice claims against auditor).

36. 72 F.3d 1085, 1094 (2d Cir. 1995). *See* Mediators, Inc. v. Manney (*In re* Mediators, Inc.), 105 F.3d 822, 825 (2d Cir. 1997); *Smith*, 175 F. Supp. 2d at 1199 (citing *In re* Stat-Tech, Secs. Litig., 905 F. Supp. 1416, 1422 (D. Colo. 1995)) (stating, *inter alia*, in connection with not applying the *Wagoner* rule, "Where, as is alleged here, the Complaint alleges a far-reaching scheme to continue a company in business past its point of insolvency and systematically looting it, it cannot be said that such conduct benefitted the corporation."); Wieboldt Stores, Inc. v. Schottenstein, 94 B.R. 488, 507-08 (N.D. Ill. 1988) (debtor-in-possession permitted to maintain claims against former Board of Directors for breach of fiduciary duty, distinguishing *Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad Co.*, 417 U.S. 703 (1974), on the basis that the claims were being asserted on behalf of unsecured creditors).

37. Official Comm. of the Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand, LLP, 322 F.3d 147, 152, 161–66 (2d Cir. 2003) (referencing Texas law where debtor was a Delaware corporation); Wechsler v. Squadron, Ellenoff, Plesent & Sheinfeld, L.L.P., 212 B.R. 34, 44 n.9 (S.D.N.Y. 1997) (applying New York law in connection with claims alleging malpractice by a New York law firm by a trustee for a Delaware corporation having a principal place of business in New York). *See generally In re* Danish, Exchange Act Release No. 39931, 1998 SEC LEXIS 800, at *2 (Apr. 30, 1998), *available at* http://www.sec.gov/litigation/admin/3439931.txt (identifying the debtor in *Wechsler* as a Delaware corporation).

A second distinction would be the type of remedy. An aider and abettor of a breach of fiduciary duty is liable for compensatory damages.[38] A jurisdiction might also allow punitive damages.[39] On the other hand, liability for a fraudulent transfer typically results in a rescission of the transaction in question. A recent Seventh Circuit opinion states:

> *[W]e are aware of no reported cases in which monetary damages were awarded under the IUFTA, and courts such as* Robinson *have held under their state version of the UFTA that monetary damage awards are only appropriate where reconveyance of the fraudulently transferred property is impossible or where the subject property has depreciated in value. Policy considerations would support such a rule, as it would avoid speculation as to the value of conveyed assets.*[40]

The former remedy could be significantly larger.

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38. Steelvest, Inc. v. Scansteel Serv. Ctr., Inc., 807 S.W.2d 476, 486 (Ky. 1991) (stating, in connection with two third parties who formed a partnership to finance a venture to be run by a corporate fiduciary allegedly in violation of proscriptions against competing against one's principal, "[O]ne who knowingly aids, abets, or joins a fiduciary in the breach of his duty in order to make a profit becomes jointly liable with the fiduciary for such profits. It can be inferred that both [of two defendants'] corporations are, in a sense, their alter egos and are the instrumentalities through which these parties profited, all to the detriment of the [victim corporation], and the benefits which accrued to the individuals now take on the form of corporate assets."); Whitney v. Citibank, N.A., 782 F.2d 1106, 1117–20 (2d Cir. 1986) (examining aiding and abetting liability of commercial bank that, to obtain a deed in lieu of foreclosure from its debtor, a limited partnership having a general partner as sole limited partner, paid $200,000 to two of three partners for their consent; and affirming the award to the third partner of that $200,000 (less legal expenses) plus an additional $236,677 in compensatory damages, representing a somewhat complex estimate, and $1.5 million in punitive damages).

39. *Whitney*, 782 F.2d at 1117–20 (2d Cir. 1986); Roth v. Mims, 298 B.R. 272, 292–300 (N.D. Tex. 2003) (noting compensatory damages including consequential damages are available for breaches of a fiduciary duty, affirming award of compensatory damages equal to the difference between an estimate of the debtor's value ($2,049,000) and the value received ($262,500), and $1 million in punitive damages, noting the bankruptcy court found, in a matter not part of the appeal, that the buyer of the debtor's assets was jointly and severally liable for the compensatory and punitive damages under an aiding and abetting theory); *cf.* Holmes v. Lerner, 88 Cal. Rptr. 2d 130 (Cal. Ct. App. 1999) (business consultant to general partnership found liable to other partner for conspiracy and aiding and abetting fraud and breach of fiduciary duty; awarding compensatory damages for loss of partnership interest; jury also awarded punitive damages); Time Warner Entm't. Co. v. Six Flags Over Ga., LLC, 537 S.E.2d 397, 416 (Ga. Ct. App. 2000) (affirming an award of punitive damages against a general partner (and persons controlling the general partner) of a limited partnership for breach of its fiduciary duty to limited partners in the management of the partnership), *vacated*, 534 U.S. 801 (2001), *remanded to*, 563 S.E. 2d 178 (Ga. Ct. App. 2002) (determining the extent of punitive damages), *cert. denied*, 538 U.S. 977 (2003).

40. DFS Secured Healthcare Receivables Trust v. Caregivers Great Lakes, Inc., 384 F.3d 338, 354, 355 (7th Cir. 2004), *certified question accepted by* DFS Secured Health Care Receivables Trust v. Caregivers Great Lakes, Inc., No. 94S00-0410-CQ-447, 2004 Ind. LEXIS 895, at *1 (Ind. Oct. 13, 2004) (identifying one of three certified questions as, "Is an award of monetary damages under the IUFTA available only where reconveyance of the fraudulently transferred property is impossible or where the subject property has depreciated in value?"); *accord* Forum Ins. Co. v. Devere Ltd., 151 F. Supp. 2d 1145, 1148 (C.D. Cal. 2001) ("UFTA allows only equitable remedies such as avoidance, attachment, an injunction, or appointment of a receiver. Upon finding an UFTA violation, the court may cancel the transfer or impose a lien against the transferred property, but it may not award damages . . . . A conspiracy claim does not expand the remedies afforded by UFTA.").

2. The Different Scope Will Influence Market Outcomes

Now that distinctions regarding who is potentially liable and the nature of the remedy have been identified, the question arises whether the distinctions are meaningful. A brief assessment reveals that the increased scope of liability can influence incentives, which would alter market outcomes and therefore be significant. Before confirming that the distinctions can make a difference, it bears mentioning that it is easier to identify that the distinctions can influence market outcomes than to assess whether the increased scope of the potentially liable parties is desirable.

Consider whether creditors should be able to recover consequential damages against an aider and abettor of a distressed corporation's transaction that did not promote the creditors' interests. Allowing the claim provides compensation for harm actually incurred. As an initial matter before considering market reaction to the legal rule, if consequential damages cannot be recovered by creditors, some adverse consequences of distressed corporations' actions will be externalized. Of course, the initial allocation of cost will affect market prices. If the costs are allocated to creditors, creditors will charge more for extending credit. If the costs are allocated to professionals who advise distressed corporations, those costs will be reflected in prices charged to distressed corporations by the professionals.

In either case, the costs will be reflected in what corporations are charged, but that does not mean that they will have the same effect. Even if the costs are passed on to the same aggregate extent, the costs will not necessarily be ultimately imposed on debtor corporations in the same way. There will be a variation in the impact on market prices if the parties on whom the law may initially impose the costs vary in terms of their ability to discriminate among their customers along two

The Uniform Fraudulent Transfer Act has a residual remedial provision allowing the award of "any other relief the circumstances may require." UNIF. FRAUDULENT TRANSFER ACT § 7(a)(3)(iii). 7A U.L.A. 339 (1999). Some authority construing this provision has been described as allowing "compensatory" damages, albeit in the nature of tracing the proceeds of property instead of consequential damages. *See, e.g.*, Profeta v. Lombardo, 600 N.E.2d 360, 361–64 (Ohio Ct. App. 1991) (allowing recovery of compensatory damages equal to the amount realized on a subsequent sale of property fraudulently transferred). Other authority addresses the availability of monetary relief for purposes of assessing the right to a jury trial on the issue, Hansard Constr. Corp. v. Rite Aid of Florida, Inc., 783 So. 2d 307, 308–09 (Fla. Dist. Ct. App. 2001), or in other circumstances not referencing a right to recover consequential damages. *E.g.*, Morris v. Askeland Enters., Inc., 17 P.3d 830, 831–32 (Colo. Ct. App. 2000) (holding punitive damages unavailable under the UFTA under a principle that punitive damages are not available in equitable actions, in connection with monetary award for fraudulent transfer of funds from corporation to sole shareholder). Lastly, some authority awards monetary damage where the equitable remedy is inadequate. Summers v. Hagen, 852 P.2d 1165, 1170 (Alaska 1993) (noting it was following the minority rule, stating, in connection with a request for "expenses included interest on a loan from a 'high-risk loan company,' attorneys' fees, damages for emotional distress and exemplary damages . . . [i]f voiding the transfer is inadequate, however, the plaintiff is entitled to damages equaling the lesser of the value of the property fraudulently transferred or the amount of the debt. The value of the fraudulently transferred property should be determined as of the time of the fraudulent transfer or when the creditor reduces the debt to judgment, whichever occurs later. Because the underlying debt sounds in contract, not in tort, exemplary damages and damages for emotional distress are not authorized. Interest and attorney fees are allowable to the extent authorized under Alaska Civil Rules 78(e) and 82. Additional awards for interest and attorney fees are not allowable, as they would constitute double-dipping.").

dimensions. The discrimination can be (i) in the form of identifying those debtors likely to create costs imposed externally and (ii) in the form of varying pricing among customers. It would appear that third-party professionals engaged by distressed firms would necessarily be better at the former. An investment bank assisting in recapitalizing a distressed firm necessarily knows the firm is in distress. A creditor extending long-term credit, on the other hand, may do so well in advance of the financial distress. Allocating these costs to those who are providing assistance at the time of distress is more likely to facilitate the first way, identified as (i), above, to facilitate discrimination in pricing to more effectively allocate the costs to those whose activities will result in malfeasance.

Allowing creditors to bring the claims against third party professionals also facilitates discrimination in pricing—allocating the costs of malfeasance to those who engage in it—in the second way, identified as (ii), above. That is because of a timing issue. Prices charged by creditors under terms negotiated long before distress are sunk. They, as sunk costs, won't influence whether a debtor engages in malfeasance during distress.[41] On the other hand, the costs of engaging a professional at the time of distress are not sunk costs as of the time the firm is deciding how to proceed in distress. So higher fees passed-on by professionals who anticipate a greater risk of aiding and abetting liability can influence the debtor's decisionmaking during distress.

In sum, for two different reasons, costs of malfeasance during distress are more likely to be shifted to those who do not engage in malfeasance during distress if creditors cannot bring aiding and abetting claims against professionals who aid and abet debtors' malfeasance during distress. To put it another way, where creditors cannot bring the aiding and abetting claims against these professionals, there will be more distressed debtor malfeasance.

To be clear, this discussion does not conclude that liability should be imposed on these third-party professionals. The only conclusion stated here is that it makes a difference on which individuals or parties the duty is imposed. One can make a plausible argument that liability should not be imposed on the third-party professionals. The potential liability imposed on a third-party professional found to have aided and abetted an action resulting in an ultimate insolvency can be quite large. Imposition of this liability may cause the best professionals to avoid doing business with distressed firms.[42] Large potential liabilities would create incentives for doing this kind of work favoring professional firms, particularly thinly capitalized firms,

41. It is possible, of course, that covenants in credit agreements may have been adequately worded to restrain this subsequent malfeasance. The point here is that the covenants are a blunt tool which are not as good as the the opportunity to fully negotiate at the time of distress, as would the third party professional.

42. *Cf.* Royce de R. Barondes et al., *Underwriters' Counsel as Gatekeeper or Turnstile: An Empirical Analysis of Law Firm Prestige and Performance in IPOs*, CAPITAL MARKETS L.J. (forthcoming 2007) (manuscript at 26, on file with authors) (asserting potential liability may be a factor in a complex mechanism by which the level of law firm compensation is set, accounting for a matching in reputation levels of clients and law firms).

that could externalize the cost of a large judgment for aiding and abetting a breach of fiduciary duty. It is not clear that it is ultimately desirable to create disincentives for large, highly sophisticated professional firms to advise distressed firms. The distressed firms may ultimately get worse advice. Of course, to reach a definitive conclusion, one would also need to consider the extent to which all professionals could segregate potential liability through, for example, incorporation of separate entities.

Thus, the principal purpose of the discussion in this subpart is limited. It identifies one context in which the affirmative enforceability of *Credit Lyonnais* duties can alter the extent to which parties are granted a right to a remedy, in a way that will influence market conduct. The issue is therefore not moot.

III. ANALOGOUS ISSUES CREATED BY PREFERRED STOCK

As a final preliminary matter of background, it should also be noted that issues of directors dealing with conflicting constituencies are not unique to conflicts between creditors and stockholders in distressed corporations. Although this Article is not the place to provide a comprehensive recounting of how legal principles of corporate finance have regulated conflicts between holders of preferred stock and common stock, it bears mention that these conflicts have been litigated in a variety of contexts. Four types of contexts of these disputes are identified below, to provide a sense of how courts have gone about resolving conflicts between holders of claims having conflicting interests.

The first illustration involves antidilution provisions. Well-drafted antidilution provisions typically provide that after an extraordinary event, convertible stock will be convertible into whatever property the holder would have received in the extraordinary event that the stock had been converted immediately before the event.[43] Various circumstances, however, may cause holders of preferred stock to seek protections above those that have been bargained for by contract. Courts typically hold that holders of preferred stock are limited to the express protection provided by contract.[44]

43. *See, e.g.*, Wood v. Coastal States Gas Corp., 401 A.2d 932, 938–39 (Del. 1979); Mariner LDC v. Stone Container Corp., 729 A.2d 267, 274 (Del. Ch. 1998).

44. *See Mariner LDC*, 729 A.2d at 278–79 (stating, in construing antidilution rights, that the rights are principally contractual and that preferences and limitations will not be implied) (citing Elliott Assocs., L.P. v. Avatex Corp., 715 A.2d 843, 852–53 (Del. 1998)). *See generally* HB Korenvaes Invs. L.P. v. Marriott Corp., Civ. A. No. 12922, 1993 WL 257422, at *14 (Del. Ch. July 1, 1993) (concluding antidilution provisions prohibited dividend that would have resulted in a negative conversion price); DREXLER ET AL., *supra* note 20, § 15.13 ("[W]here the matter for directorial action directly concerns the preferences or limitations affecting a class or classes of preferred stock, the scope of the directors' obligation is contractual, and the rights of preferred stockholders vis-à-vis the corporation will generally be measured strictly by the terms of the charter provisions creating such preferences or limitations.").

It bears mention, however, that in connection with the allocation of consideration between holders of preferred stock and holders of common stock, authority provides fiduciary duties may cabin discretion in allocation of the consideration between the two constituencies. Jedwab v. MGM Grand Hotels, Inc., 509 A.2d

The second illustration involves the payment of dividends on preferred stock. Preferred stock frequently provides that arrearages on dividends prevent payment on junior stock, and that some level of continued arrearages will allow the holders of the stock to elect a specified number of directors.[45] *Baron v. Allied Artists Pictures Corp.*[46] involves a challenge to a board's failure to declare dividends on preferred stock sufficient to eliminate the separate right of the preferred stockholders to elect a portion of the board. The court describes the test as follows: "Before a court will interfere with the judgment of a board of directors in refusing to declare dividends, fraud or gross abuse of discretion must be shown. And this is true even if a fund does exist from which dividends could legally be paid."[47] In this case as well, then, a court has in large measure left the decision to management, few circumstances being triggered by the fraud or gross abuse standard. *Burton v. Exxon Corp.*[48] involves payment of dividends on a senior class of preferred stock, the entire class of which was owned by the controlling shareholder, without payment of dividends on a junior class.[49] The court held the dividend must be judged under the intrinsic fairness test.[50] Applying the test, the court concluded the test had been met,[51] rejecting the argument that the funds should have been retained and invested until the firm had sufficient funds to pay dividends in arrears on all classes of preferred stock.[52]

A third illustration involves a corporation that changed its assets by conveying some assets to a subsidiary whose stock was spun-off and by the acquisition from a controlling stockholder of other assets, ultimately changing the nature of the issuer's assets.[53] In dismissing the breach-of-fiduciary-duty claim, the court stated that "[w]hen . . . the corporate actions complained of are expressly contemplated by

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584, 594 (Del. Ch. 1986) (favorably commenting on plaintiff's allegation that holders of preferred stock are entitled to a "fair" portion of merger consideration). *See generally* DREXLER ET AL., *supra* note 20, § 15.13.

45. Exchange listing requirements may impose this kind of obligation. *See* New York Stock Exchange, Listed Company Manual § 313.00(C), *available at* http://www.nyse.com/lcm/1078416930972.html?enable=section&snumber=3&snumber=313.00 ("Preferred stock, voting as a class, should have the right to elect a minimum of two directors upon default of the equivalent of six quarterly dividends. The right to elect directors should accrue regardless of whether defaulted dividends occurred in consecutive periods.").

46. 337 A.2d 653 (Del. Ch. 1975).

47. *Id.* at 659 (internal citations omitted). Elsewhere in the opinion the delegation to management seems less clear: "[T]he contractual right to elect a majority of the board continues until the dividends can be made current in keeping with proper corporate management, but that it must terminate once a fund becomes clearly available to satisfy the arrearages and the preference board refuses to do so." *Id.* at 658.

48. 583 F. Supp. 405 (S.D.N.Y. 1984).

49. *Id.* at 415–20.

50. *Id.* at 416.

51. *Id.*

52. *Id.* at 419. The analysis includes an interesting turn of phrase: "It is true that stockholders are owners of the corporation and expect to share in its profits. However, these expectations can be crushed. As investors, the stockholders bear the risk that the company may not make profits in which they can share." *Id.* at 418 (citation omitted).

53. Winston v. Mandor, 710 A.2d 835, 836 (Del. Ch. 1997).

a certificate, the duties and obligations of the corporation and its preferred stockholders are governed exclusively by their contract."[54]

A fourth context raising similar issues involves the allocation of consideration in connection with an acquisition of an issuing firm. Delaware authority indicates that holders of preferred stock have a right to a "fair" allocation of consideration when the firm is being acquired in a merger.[55] In general, however, unless the directors had improper personal reasons for seeking to allocate a greater portion of the consideration to one class of stock, such as a material disproportionate interest in that class, a claim alleging the directors breached a duty of loyalty in allocating merger consideration will fail.[56]

In sum, as a general rule, in disputes between classes of claimants with opposing interests, the courts have simply relegated resolution of the matter to the parties themselves. This approach is desirable because there is a lack of rigorous and well-defined principle (producing, as applied, a clear unique result) to guide an alternative approach.

IV. PRINCIPLES GOVERNING THE SCOPE OF THE FIDUCIARY DUTY

Part II identified a circumstance in which potential liabilities will be affected by whether the principles of *Credit Lyonnais* result in an affirmatively enforceable fiduciary duty. Further review of the doctrine is warranted.

A proper crafting of fiduciary duties requires consideration of the extent to which such duties will affect the performance of distressed corporations. It is helpful as a preliminary matter to set forth a few principles that should guide the analysis of the *Credit Lyonnais* duties. First, imposition of liability for failure to maximize

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54. *Id.* at 845 (also denying motion to dismiss claims alleging violation of antidilution provisions of preferred stock).

55. Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 594 (Del. Ch. 1986). A cash-out merger would not constitute a liquidation entitling the holder of preferred stock to any stated liquidation preference, unless there is an express provision to that effect in the terms of the securities. *See* Rothschild Int'l Corp. v. Liggett Group Inc., 474 A.2d 133, 136 (Del. 1984).

56. *In re* General Motors Class H S'holders' Litig., 734 A.2d 611, 618 (Del. Ch. 1999) (discussing alternative bases for applying the business judgment rule—the absence of a material disproportionate interest in one class of stock and stockholder vote approving the transaction). The court's discussion merits quotation:

> Since the two stockholder groups had potentially divergent interests, plaintiffs believe that they state a duty of loyalty claim merely by alleging that the Board treated one group unfairly—even if it was for reasons unrelated to director self-interest. In my view, that is not the law. Rather, the plaintiffs must plead facts from which one could infer disloyalty or bad faith on the part of GM's directors, in the sense that the directors acted for reasons inimical to their fiduciary responsibilities. An allegation that properly motivated directors, for no improper personal reason, advantaged one class of stockholders over the other in apportioning transactional consideration does not state a claim for breach of the duty of loyalty.

Id. Application of the entire fairness standard in reviewing allocation of merger consideration where the directors have significant interests that diverge from those of one class of stock is illustrated by *Tele-Communications, Inc. Shareholders Litigation,* No. Civ.A. 16470, 2005 WL 3642727, at *6–14 (Del. Ch. Jan. 10, 2006) (denying defendants' motion for summary judgment).

simultaneously the interests of two constituencies having different interests is not defensible. Second, the governing principles should not facilitate self-dealing. Third, legal rules should not force distressed firms into insolvency by preventing activities necessary to allow ongoing operations to continue pending resolution of distress, and should not materially impede desirable actions necessary for distressed firms to resolve financial distress.

Prior to reviewing these three principles, it is helpful to note that there are multiple components to traditional fiduciary duties of directors, including how the directors consider the interests of the stockholders outside of distress. The duties contemplated by *Credit Lyonnais*, however, are *sui generis*. In part, they are necessarily so because they form a transition between two regimes—management of the clearly solvent firm and management of the insolvent firm—that involve qualitatively different duties to the ultimate beneficiaries, the stockholders and the creditors, respectively. For example, Delaware law has long permitted disparate treatment of creditors by those managing an insolvent corporation.[57] On the other hand, adverse disparate treatment of shares of the same class ordinarily would not be permitted.[58] Thus, in the transitional area, there must be differential treatment of some of the duties that normally appertain for the benefit of the pertinent constituency, the stockholders or the creditors. Some of the duties must disappear but others simply shift.

These three principles do not have the same effect on all components of directors' customary fiduciary duties in solvent corporations. The principles may highlight the desirability of restructuring some of the fiduciary duties, but not others, when a corporation is in distress. Yet because these fiduciary duties are *sui generis*, that variation in treatment is not inherently inappropriate.

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57. Asmussen v. Quaker City Corp., 156 A. 180, 181 (Del. Ch. 1931) ("[T]he weight of authority favors the view that as among creditors, no trust exists which prevents the directors of an insolvent corporation from preferring some over others, notwithstanding the corporation is in failing circumstances and manifestly headed for disaster.").

On a complementary level, exercise of creditors' rights against a distressed debtor by a creditor who is a majority stockholder may not be burdened by a fiduciary duty flowing to the debtor. *See* Odyssey Partners, L.P. v. Fleming Cos., 735 A.2d 386, 388, 406 & n.18 (Del. Ch. 1999) (stating, as to actions by Fleming, the debtor's majority stockholder and sole secured creditor, "Fleming is said to have breached its fiduciary duties by exercising *de facto* control over ABCO and a majority of its directors, in such a manner as to 'frustrate or foil' ABCO's efforts to raise needed financing or capital, in order to protect Fleming's position as controlling shareholder. . . . [Additionally,] Fleming acquired the shares by operation of law, as the high bidder at the statutory foreclosure sale. In the circumstances, there is no precedent for applying a fiduciary duty analysis to the conduct of the January 9, 1996 foreclosure sale or the terms of Fleming's winning bid.").

58. *See generally* R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 5.6 (through 2002 supplement) ("The general rule within each class or within each series (where the class is divided into series) is that voting rights of the stock may not be varied to discriminate between shares of the same class or (where the class is divided into series) between shares of the same series."); *id.* § 5.28 ("The directors may not discriminate among stockholders of the same class or series in the payment of a dividend."). *But see generally* Providence & Worcester Co. v. Baker, 378 A.2d 121, 121 n.2, 124 (Del. 1977) (holding valid a charter provision providing one vote for each share up to fifty shares and one vote for every twenty more shares and limiting an individual to no more than 25% of the outstanding voting power).

1. *Multiple Principals*

It has long been recognized that a fiduciary cannot simultaneously promote the interests of principals having varying interests.[59] There is not an obvious reason liability should be imposed on a class of business participants for failing to perform this impossible task. Financial distress cannot be eliminated by fiat, and because distressed firms need managers, legal rules should not place on them duties that cannot be complied with. This provides a justification for the outcomes discussed above[60] where in contexts in which parties have negotiated contract provisions addressing extraordinary transactions, courts do not intrude into decision making that involves "pie splitting" between preferred stockholders and common stockholders.[61] It would appear to be sufficiently uncontroversial so that additional explanation is unnecessary.

Reference to preferred stock also raises a second issue that further complicates a determination of the proper principles. Even if one includes as constituents only stockholders and creditors as creditors, resolution of the issues raised by *Credit Lyonnais* can involve resolution of competing claims among multiple constituencies. If the point is to have a corporation's directors promote the interests of the then-current residual claimants, preferred stockholders may be appropriate constituents. Preferred stock frequently will have a liquidation preference.[62] Where the corporation's net assets are positive but less than that aggregate liquidation preference, preferred stockholders are the residual claimants.

Of course, a corporation may have multiple classes of preferred stock, having varying relative liquidation preferences. Subordinated debt presents similar issues. Where a corporation has negative net assets but can pay senior claims, the subordinated creditors are residual claimants.[63] In sum, there may be a succession of classes

59. *E.g.*, Gann v. Zettler, 60 S.E. 283, 283 (Ga. Ct. App. 1908) ("It is recorded of Him 'who spake as never man spoke' that, 'seeing the multitudes, he went up into a mountain, and when he was set his disciples came unto him; and he opened his mouth and taught them; saying, . . . 'No man can serve two masters; for either he will hate the one and love the other, or else he will hold to the one and despise the other.' So, also, is our law.").

60. *See supra* Part III.

61. *See supra* notes 55–56 and accompanying text (discussing fiduciary duties in the context of allocation of merger consideration).

62. *See* Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281, 288–89 tbl.2, 290–91 (2003) (providing statistics for and discussing liquidation preferences).

63. When insolvency straddles the amount of debt subordinated, there can be the awkward circumstance of multiple classes of residual claimants who are not *pari passu* (e.g., trade creditors to whom the subordinated creditors were not subordinated). The trade creditors will not be effectively *pari passu* with subordinated creditor, who abruptly become residual claimants when the ratio of the assets of the firm to its liabilities (a ratio less than firms that are insolvent on a balance sheet basis) equals the ratio of the senior debt to the sum of the senior and subordinated debt (as derived below). Trade creditors also will not be *pari passu* with senior creditors whose percentage residual claim changes abruptly in that circumstance as well.

The derivation of the first proposition is as follows:

Define α as the ratio of the firm's assets to its liabilities, implying that Senior creditors will recover the following, up to the amount of their senior claims:

of residual claimants as a corporation becomes increasingly distressed. The existence of numerous tranches of potential residual claimants would militate against some affirmatively enforceable duty shifting among constituents of distressed corporations.[64] In those cases, as the number of tranches increases, the burden on management to select the proper constituency increases. As discussed below,[65] for some types of fiduciary duties, however, this problem is more manageable than others.

2. *Facilitating Self-Dealing*

A fundamental precept of developed analysis of business organization law is that the separation of ownership from control creates incentives for suboptimal behavior.[66] The problem is particularly acute because the judicial system is not well crafted to identify some of this suboptimal behavior. An examination of the development of the *Credit Lyonnais* duties should consider the extent to which the principles produce legal rules that make it more difficult for undesirable self-dealing to be identified, and give rise to liability, in judicial proceedings.

3. *Operation of Distressed Firms and Resolution of Distress*

One focus of the principles governing management of a distressed firm should be maximization of aggregate distressed firm value. That is not to say distributional concerns—how the principles will influence allocation of value among different classes of claimants—are necessarily irrelevant. The focus, however, should be on whether developing legal principles will impede actions that are collectively desirable. In particular, the developing notions of duties in distressed corporations need to be examined from the perspective of whether they will materially impede the ongoing, ordinary operation of distressed corporations[67] and whether they will inhibit the formulation, adoption, or implementation of desirable attempts to resolve the distress outside the ordinary course.

$$\alpha \textit{ liabilities} \frac{\textit{senior debt} + \textit{subordinate debt}}{\textit{senior debt} + \textit{subordinated debt} + \textit{other debt}}$$

For senior creditors to recover in full, the above amount equals *senior debt*, which occurs when:

$$\alpha = \frac{\textit{senior debt}}{\textit{senior debt} + \textit{subordinated debt}}$$

64. *See generally* Equity-Linked Investors, L.P. v. Adams, 705 A.2d 1040 (Del. Ch. 1997) (denying holders of preferred stock equitable relief seeking to enjoin a transaction to fund further operations where the corporation had a net worth less than the aggregate liquidation preference of the preferred stock).

65. *See infra* notes 106–18 and accompanying text (discussing disclosure obligations).

66. *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 7 (1932) ("The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear.").

67. *See generally* Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 797 (Del. Ch. 2004) (discussing possible fraud liability for omissions in negotiations with creditors).

The existence of affirmatively enforceable fiduciary duties to trade creditors and, perhaps, some other creditors including employees raises issues that are qualitatively different from the implications of duties owed to shareholders. Continuing operation of a distressed corporation typically will include ongoing contracting with current creditors, such as the purchase of additional inventory and services on trade credit and revision of existing employment relationships. A corporation's relationships with its shareholders certainly can involve post-relationship contracting (e.g., stock buybacks) and frequently does in connection with stock-buybacks triggered by termination of employment.[68] Nevertheless, the scope of the interactions between a distressed corporation and its creditors can be expected to be qualitatively different in frequency from the transactions between a corporation and its shareholders. This qualitative difference creates possible concerns with importing into the regulation of distressed corporations, for the benefit of creditors, certain components of the fiduciary duties that ordinarily apply to solvent corporations. Two that may have a particularly significant effect on the ability of a distressed corporation to continue operations or to resolve its distress are discussed below: a fiduciary's disclosure obligations in transactions with the beneficiary of the fiduciary duty[69] and a fiduciary's obligation to assure fair pricing in those transactions.[70]

V. IMPROPERLY FRAMING THE ISSUE AS MERELY A QUESTION OF EXPANDING THE SCOPE OF ACTIVITIES PROTECTED FROM JUDICIAL REVIEW BY THE BUSINESS JUDGMENT RULE

One might argue that the duty initially formulated in *Credit Lyonnais* simply represents an increase in the scope of directors', and potentially officers',[71] activity that, by virtue of the business judgment rule, is not subject to judicial review. Under this view, the business judgment principle has a number of components. First, it exculpates directors from liability to creditors for disinterested management decisions, supplementing the limit on liability to the corporation generally applicable when

68. *See, e.g.*, Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 432–33 (7th Cir. 1987) (examining a private corporation's repurchase of stock from a retiring employee where the issuer had then-undisclosed ongoing negotiations to be acquired); McGrath v. Zenith Radio Corp., 651 F.2d 458, 464–65 (7th Cir. 1981) (examining alleged breach of contract of employment entered into in connection with acquisition of plaintiff's former employer in consideration of, *inter alia*, plaintiff's sale of stock in his former employer and release of options to purchase additional shares).

69. *See infra* notes 106–18 and accompanying text.

70. *See infra* notes 119–26 and accompanying text.

71. There appears to be curiously little case law directly addressing the extent to which officers benefit from the business judgment rule. For example, in the preeminent treatise on the business judgment rule, DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 98–99 (5th ed. 1998), the authors state that authority specifically addressing whether the duty applies to officers is "sparse," and note only a handful of cases including some containing nondefinitive language, e.g., "'may' be covered," "[u]nder the circumstances of this case," and "generally applies." A discussion of the merits of the various positions is beyond the scope of this Article.

the corporation is solvent. Second, it further restricts the ability of a court to entertain challenges to some managerial decisions in distressed corporations.

One problem with this view is that the law of fiduciary duties applied to distressed corporations should be a comprehensive, internally consistent whole. Indeed the purpose of this Article is to begin to develop some of the components of that whole. The articulation of the issue *Credit Lyonnais* identifies also brings to mind other contexts in which the fiduciary duties of distressed firms need to be examined. Four of those contexts are discussed below:

(i) Which constituency of a distressed corporation may, by approving a transaction in which management is interested, diminish the judicial scrutiny that would otherwise apply;

(ii) The effect of distress on *Revlon* duties;

(iii) The effect of distress on the disclosure obligations of distressed corporations to their creditors and other aspects of the negotiation between distressed corporations, including the implications of *Malone v. Brincat*;[72] and

(iv) The effect of distress on the manner in which corporations consider corporate opportunities that insiders are interested in taking for themselves.

1. *Traditional Formulation of the Business Judgment Rule*

In discussing whether the refinement in directors' duties initiated by *Credit Lyonnais* can be viewed as simply a slight enlargement of the business judgment rule, it is helpful to begin by identifying that rule and the principles underlying its adoption. The fiduciary duties of directors, as cabined by the business judgment rule, are best viewed as reflecting the scope of judicial competence. Lawyers acting in a judicial capacity are not well suited to reviewing previously made business decisions. Courts are, however, competent to assess the propriety of how the decision-making process was constructed—whether appropriate information was gathered, whether appropriate experts were consulted, and whether there were conflicts of interest. Recognition of this limit on judicial competence is reflected in the business judgment rule,[73] which has been described as follows:

72. 722 A.2d 5 (Del. 1998).

73. Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 278 (Alaska 1980), *quoting* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("Judges are not business experts."); Solash v. Telex Corp., No. Civ.A 9518, Civ.A. 9528, Civ.A. 9525, 1988 WL 3587, at *8 (Del. Ch. Jan. 19, 1988) (stating, in introducing a discussion of the business judgment rule, "Because businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts and because there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with such skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith."); Janssen v. Best & Flanagan, 662 N.W.2d 876, 883 (Minn. 2003) (referencing the rationale in extending the business judgment rule to nonprofit corporations); *see* Daniels v. Thomas, Dean & Hoskins, Inc., 804 P.2d 359, 367 (Mont. 1990).

> *The business judgment rule has been well formulated by Aronson and other cases.* See, e.g., Aronson, *473 A.2d at 812 ("It is a presumption that in making a business decision the directors . . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation."). Thus, directors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.*[74]

2. *Fairness Review in Distressed Firms—Earn-Outs*

i. *De Facto Elimination of Fairness Review in Distressed Firms*

Of course, the business judgment rule does not, as an initial matter, insulate decision-making that involves conflicts of interest. Under *Weinberger v. UOP, Inc.*[75] and its progeny, "[a] controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness."[76] Procedurally,

> *[t]he initial burden of establishing entire fairness rests upon the party who stands on both sides of the transaction. However, an approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff.*[77]

Alternatively, some Delaware authority indicates that where the disposition involves an interested party transaction with one not considered controlling the corporation, informed approval in good faith by a majority of disinterested stockholders subjects the transaction to review under the business judgment rule.[78]

74. Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000).

75. 457 A.2d 701, 710 (Del. 1983).

76. Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994). Where an acquisition is formulated as a tender offer followed by a short-form squeeze-out merger, however, the transaction is subject to a less intrusive standard of review. *See* Glassman v. Unocal Exploration Corp., 777 A.2d 242, 243 (Del. 2001); Solomon v. Pathe Commc'ns Corp., 672 A.2d 35, 39 (Del. 1996); *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 435 (Del. Ch. 2002).

77. *Kahn*, 638 A.2d at 1117 (citation omitted). *See generally In re* Emerging Commc'ns, Inc. S'holders Litig., No. Civ.A. 16415, 2004 WL 1305745, at *31 (Del. Ch. May 3, 2004) (burden of proof not shifted by approval by special committee and minority stockholders where company disclosed some projections but failed to disclose more recent projections).

78. *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1203–04 (Del. Ch. 1995) ("Even if the ratified transaction does not involve a controlling stockholder, the result would not be to extinguish a duty of

The question arises of how a court will interpret these judicially crafted provisions in the context of a distressed corporation.[79] What constituency's approval, if any, would be sufficient to shift the burden to those challenging the transaction? A combination of constituencies voting collectively would be problematic. There is not a clear mechanism for weighting various constituencies, and leaving the weighting to management creates problems. One can expect constituencies to have differing desires. Requiring separate votes of and approval by creditors and stockholders is likely not to result in both constituencies approving (to say nothing of the more complex circumstance where there are separate classes of each). Because management can play a key role in running a reorganized firm,[80] it does not seem prudent to adopt a principle under which disinterested approval cannot be obtained and the burden of proving the fairness of the transaction is kept on managers.

If the constituency to be promoted is left to management to identify, which would be one extension of the business judgment approach to understanding *Credit Lyonnais* duties, management will have much greater flexibility to defend inefficient self-dealing by carefully selecting a constituency or combination of constituencies whose interests are allegedly being promoted. For example, any voluntary sale in which a class of creditors, the common stockholders, or a class of preferred stock voluntarily participated might be sustainable, the voluntary participation of one of these classes suggesting, at least in some cases, that the particular constituents approve, or will approve if required to vote separately.[81]

In sum, the contours of fiduciary duties in distressed corporations need to be formulated to address more than *ex post* creditor complaints concerning whether the corporation was well managed. They also need to identify the constituency whose approval of an interested-director or interested-controlling-shareholder transaction can shift the burden of proof to those challenging the transaction.

A process allowing this kind of approval is needed to implement a system that prevents conflict-of-interest transactions produced by improper self-dealing. One would assume that the approval of the constituency whose interests the board is to promote at that time would be required in order to shift the burden of proof. Were the two not the same, the disinterested approval might frequently be withheld sim-

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loyalty claim. In such cases the Supreme Court has held that the effect of shareholder ratification is to make business judgment the applicable review standard and shift the burden of proof to the plaintiff stockholder.").

79. *See generally* Aluminum Mills Corp. v. Citicorp N. Am., Inc. (*In re* Aluminum Mills Corp.), 132 B.R. 869, 891 n.21 (Bankr. N.D. Ill. 1991) (stating that shareholder ratification merely estops the shareholders and "does not apply in the context of the liquidation of an insolvent company, for in such a case, it is the creditors who will benefit from any recovery" (quoting *In re* Western World Funding, Inc., 52 B.R. 743, 772 (Bankr. D. Nev. 1985))).

80. *See, e.g.*, LaSalle Nat'l Bank v. Perelman, 82 F. Supp. 2d 279, 282, 288 (D. Del. 2000) (controlling stockholder proposing to invest $350 million in recapitalization of the debtor).

81. *See generally In re* Emerging Commc'ns, Inc. S'holders Litig., No. Civ.A. 16415, 2004 WL 1305745, at *31 (Del. Ch. May 3, 2004) ("But no Delaware case has held that burden-shifting can be accomplished by a tender of shares rather than by an actual vote.").

ply because the potentially approving constituency sought more of the "pie." In other words, the disapproval might be for reasons other than that the transaction improperly represented managerial self-dealing.

If the selection of the constituency to be promoted in that context is simply delegated to management, that choice is likely to remove from judicial oversight a material percentage of transactions designed to resolve financial distress in which management personally participates.[82] That delegation could effectively eviscerate the fairness obligations in conflict-of-interest transactions with distressed firms.

ii. Uncertainty in Structuring the Terms of Extraordinary Transactions—Earn-outs

Under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[83] and its progeny, "in a sale of corporate control the responsibility of the directors is to get the highest value reasonably attainable for the shareholders."[84] For a number of reasons, a final period resolution of a distressed corporation is particularly likely to be found substantively objectionable to at least one constituency. It is well understood among financial economists and legal scholars that leverage can create incentives for a stylized corporation being managed on behalf of its stockholders to invest in negative return activities because the risk of failure can be disproportionately borne by creditors.[85] Famous footnote fifty-five of *Credit Lyonnais*[86] reflects this principle.

The converse incentive can also exist in a distressed corporation being managed for the benefit of its creditors. Creditors, who have capped claims, would not benefit from the incremental value of strategies that increase a stylized firm's value over the amount of the creditors' claims. Admittedly, this broad statement of principle is somewhat incomplete. A creditor whose claims are not immediately due may benefit from increased current value to the debtor. Such a creditor is ultimately concerned about solvency when its claim becomes due and payable, and increases in current solvency can make it more likely the debtor will be solvent when the credi-

82. *See generally supra* note 80.

83. 506 A.2d 173, 182 (Del. 1986).

84. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1989).

85. *See, e.g.*, Katherine H. Daigle & Michael T. Maloney, *Residual Claims in Bankruptcy: An Agency Theory Explanation*, 37 J.L. & ECON. 157, 157 (1994) (shareholders' incentives to engage in excessive risk taking are "particularly acute" when the firm is distressed); Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485, 1486, 1488–91 (1993); George G. Triantis, *A Theory of the Regulation of Debtor-in-Possession Financing*, 46 VAND. L. REV. 901, 912 (1993).

There also is a theoretical argument that an insolvent firm will in fact "underinvest" in projects, i.e., fail to enter into transactions that would be profitable from the perspective of the firm as a whole, because of indifference. This theory is based on the notion that shareholders will not invest new equity (or other efforts) needed to permit implementation of a new project having a positive return, if the portion of the return to be realized by shareholders will be inadequate, because the returns will be given to other stakeholders, i.e., creditors. *See* WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE 258–61 (5th ed. 1993); Triantis, *supra*, at 911.

86. Civil Action No. 12150, 1991 Del. Ch. LEXIS 215, at *108–09 & n.55 (Del. Ch. Dec. 30, 1991).

tor is to be paid. Nevertheless, just as the possibility that adverse outcomes will disproportionately be borne by creditors can influence the incentives of a firm managed for the benefit of its stockholders, the possibility that positive outcomes will disproportionately benefit stockholders can alter the incentives of a distressed firm managed for the benefit of creditors.

This concern is not simply theoretical. One basic issue in the structuring of a sale of a firm is whether the purchase price will include deferred payments based on the firm's post-sale performance, sometimes called "earn-outs."[87] If the distressed firm can negotiate a noncontingent sale price component at least equal to the aggregate amount of the creditors' claims, a seller managed for the benefit of the creditors alone will be indifferent to the amount of any additional contingent compensation. This conclusion represents a context-specific application of the more general point that has been previously made concerning the desire of creditors to "collapse [the] probability distributions" of potential outcomes.[88] Of course, the shareholders, and a hypothetical constituent seeking to maximize aggregate firm value, would not be indifferent.

Use of contingent compensation can be important in allowing a seller to maximize the value it realizes. It can mitigate informational disadvantages a buyer has that may otherwise yield lower purchase prices. Adoption of legal principles that shift the incentives for using contingent compensation are therefore of potential concern.

iii. Identifying a Principle for Resolving the Duties

Credit Lyonnais identifies an issue that, on reflection, cannot be summarily resolved by simply asserting that when a corporation becomes distressed, directors are given greater leeway to promote non-shareholder constituencies. Two possible theoretical concerns have been noted in the context of extraordinary transactions designed to resolve distress. First, that approach, delegating to management the authority to decide which constituency to promote, would eviscerate fairness review as to many distressed corporations; some class of participating constituents would consent. Second, creditors and stockholders of distressed firms may have diametrically op-

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87. Maier defines "earn-out" provisions as follows: "Sometimes a portion of the consideration payable to the shareholders of the target company will be contingent on the future productivity of the target company or (less commonly) on the productivity of the combined group as a whole." Thomas A. Maier, *How Lawyers Use Financial Information: Mergers, Acquisitions, Valuation and Other Transactions—and Their Impact on Reported Financial Results*, *in* BASICS OF ACCOUNTING & FINANCE: WHAT EVERY PRACTICING LAWYER NEEDS TO KNOW, at 351, 365 (PLI Corp. Law & Practice Course Handbook Series No. 6560, 2005).

88. *See, e.g.*, Thomas H. Jackson & Robert E. Scott, *On The Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155, 158 (1989).

A circumstance that might be considered analogous is presented in *McMullin v. Beran*, 765 A.2d 910 (Del. 2000). In that case, the Delaware Supreme Court held that minority shareholders had properly pleaded violations of fiduciary duties of directors in connection with the negotiation and approval of a sale of a majority-owned subsidiary in connection with, inter alia, improper emphasis on the controlling stockholder's desire for immediate receipt of cash. *Id.* at 921–23.

posed views concerning the use of a customary compensation provision in the sale of a business—an earn-out. Earn-outs can be beneficial in mitigating the adverse consequences of information asymmetries between buyers and sellers. Elimination of their use in the disposition of distressed corporations is therefore likely not to be joint wealth maximizing. Promoting consideration of creditors' interests, however, could require avoiding this structure.

These theoretical concerns are accompanied by post-*Credit Lyonnais* authority examining the final period resolution of a distressed corporation. A few courts have noted a tension between typical board fiduciary duties on the sale of a firm and the altered fiduciary duties arising from distress or insolvency.[89] One court stated, "It is commonplace to say that the directors of [the debtor] (due to its balance sheet insolvency) owed a fiduciary duty to the Noteholders in considering the authorization of the Merger. It is a more difficult proposition to apply that legal precept to the facts presented in this case."[90] As recently noted by the Delaware Court of Chancery in *Production Resources Group, L.L.C. v. NCT Group, Inc.*,[91] the decision in *Omnicare, Inc. v. NCS Healthcare, Inc.*[92] highlights that the issues identified in *Credit Lyonnais* are problematic upon disposition of the firm. In *Omnicare*, the court found to be an unlawful abdication of an insolvent corporation's directorial authority entering into deal-protection provisions[93] for a merger agreement designed "to assure that the . . . creditors were paid in full and that the . . . stockholders received the highest value available for their stock."[94] Significantly, the opinion references the minority stockholders, not the creditors of the insolvent corporation, in identifying the beneficiaries of fiduciary duties whose interests had been inadequately protected by the directors.[95]

Proceeding on the assumption that it is desirable to allow distress to be resolved outside of bankruptcy proceedings, the need to allow review of managerial deci-

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89. On the other hand, the court in *Wiebolt Stores, Inc. v. Schottenstein*, 94 B.R. 488 (N.D. Ill. 1988), rejected the argument of the former directors of an allegedly insolvent corporation that their *Revlon* duties sanctioned their approval of an LBO. *Id.* at 510. The court held this rationale to be inapplicable because the sale of the firm was not inevitable. *Id.* That approach could produce a curious outcome; if the sale became inevitable by virtue of greater distress, the board then would not have to consider creditors' interests.

90. Angelo, Gordon & Co. v. Allied Riser Commc'ns Corp., 805 A.2d 221, 226, 228 (Del. Ch. 2002) (examining a transaction that, in the view of the creditor's board, enhanced the likelihood of debt repayment).

91. 863 A.2d 772, 788 n.51 (Del. Ch. 2004) (referencing "a decision that arguably reflects a very different perspective than *Credit Lyonnais*").

92. 818 A.2d 914 (Del. 2003).

93. The agreement provided that the board would submit the plan to the stockholders for their approval even if the board subsequently withdrew its recommendation of the transaction, *id.* at 933 (referencing Delaware General Corporation Law § 251(c) (DEL. CODE ANN. tit. 8, § 251(c) (2002), West, Westlaw DE-STMANN02 database through 2002 Regular Sess.), *amended by* Corporations—General Amendments, 2003 Delaware Laws Ch. 84 (S.B. 127)), and omitted a fiduciary-out. *Id.* at 936. Approval was assured because stock held by controlling stockholders, who were directors, was also irrevocably agreed to be voted in favor of the transaction. *Id.*

94. *Id.* at 938.

95. *Id.* at 937.

sion-making for purposes of decreasing self-dealing indicates that it will not be efficient to allow managers to determine at the time of distress whose interest to promote. The determination needs to be made *ex ante* so that there is a constituency that can bring an action monitoring management.

Characterizing the rights of potential constituents as options illuminates the issue. Frequently, banks and other creditors that provide capital will have bargained for certain express rights to participate in the management of a corporation. Some of the more intrusive powers to influence management will be actuated when financial distress triggers covenants allowing acceleration of indebtedness.[96] The point of these rights is to enable these creditors to monitor how the business is being run and to have the ability to require that corrective action be taken while the debtor is still capable of being rescued.

Making creditors the intended[97] beneficiaries of fiduciary duties is different from making stockholders the intended beneficiaries of the duties. Creditors will have retained the ability to challenge actions the creditors wish the corporation to undertake. Imposing a separate fiduciary duty owed to the creditors of these distressed firms gives creditors two sets of rights: Either the creditors can intervene, using the expressly negotiated rights, or the creditors can choose not to intervene, relying on the possibility that if things do not turn out well, they can bring a claim for breach of fiduciary duty.

Consider a distressed firm contemplating two courses of action, A and B. The distress, triggering covenants, may have enabled some creditors to influence the choice. Assume the creditors desire choice A. If the corporation's management chooses A, the creditors will not object, the course will be pursued, and the creditors will have retained some ability to challenge the propriety of the action as a breach of fiduciary duty. If the corporation's management chooses B, the creditors will object and force the selection of choice A.

That does not mean management would be helpless in this circumstance. It could seek express approval of any action, as part of seeking to estop the creditors in any subsequent challenge. This would be similar to the approval of the fairness of management conflict-of-interest transactions discussed above,[98] but it would be more burdensome because it would also apply to the wider array of transactions in which management is disinterested. That process, if frequently invoked, would deviate from what one normally envisions as the efficient delegation of decision-making to informed directors, and the officers they appoint.

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96. *See supra* note 44.

97. Of course, some of these fiduciary duties cannot be directly enforced by shareholders, but can only be enforced in a derivative capacity. Solely for purposes of ease of explication, much of the discussion in this Article elides that distinction.

98. *See supra* notes 75–82 and accompanying text.

iv. Balancing Representation to Replicate Aggregate Wealth Maximization

Part of the customary fiduciary duty scheme seems well designed, perhaps inadvertently, to accommodate issues of distressed corporations. Under *Paramount Communications, Inc. v. Time*, part of what is delegated to directors is the determination of the time horizon considered by directors in managing a corporation.[99] Selection of the time horizon can be particularly important in allocating value between creditors and equity holders in distressed corporations.[100] There may be a schizophrenic quality to the management of a distressed corporation as a result. Unless management seeks to promote the interests of creditors, managerial decision-making may be subject to being overruled piecemeal as to activities implicating contractual approval requirements.

Yet keeping the issue of time horizon within the powers delegated to management may give management sufficient flexibility to accommodate goals of maximizing aggregate wealth within the contours of their decision-making subject to limited review by creditors having focused, contractually negotiated approval rights. Because creditors will have express rights to intrude into decision-making that are not accompanied by a comparable right in stockholders, creditors may have relatively more ability to influence choices that have an impact on the time horizon being pursued. It is possible that, where promotion of the interests of the creditors may not reflect the time horizon in the best interests of all constituencies collectively, having fiduciary duties owed to stockholders may be helpful in providing balance in management.

v. Conclusions as to Contours of Default Legal Rules

These concerns might be harmonized in the following conclusions. First, the application of the business judgment rule should, if anything, be stronger, not weaker, as to claims by creditors in connection with alleged breaches of duties of care. When creditors have the ability to influence management decisions but nevertheless allow management to proceed in a particular way, those creditors should be, if anything, more limited in their ability to challenge the activity *ex post*. Any other outcome creates an option. The option is undesirable because, inter alia, it will be difficult to price *ex ante*, suggesting that creditors will not pay for the option *ex ante*. It is also problematic because it needlessly enhances potential personal liability of directors, which is not desirable insofar as these individuals are risk-averse. Thus, the trend toward applying the business judgment rule in claims by credi-

99. 571 A.2d 1140, 1154 (Del. 1990) ("Delaware law confers the management of the corporate enterprise to the stockholders' duly elected board of representatives. The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals. That duty may not be delegated to the stockholders." (citation omitted)).

100. *See supra* note 88 and accompanying text.

tors[101] and toward enforcing against creditors charter provisions limiting director liability to creditors[102] is desirable.

Second, determination of the appropriate time horizon for measuring firm strategies should continue to be delegated to management notwithstanding distress. If the obligation were to follow creditors' desires, the principle could drive managers to ignore future profits not inuring to the benefit of creditors having capped claims.

Third, the fiduciary duties to maximize firm value on the sale of a solvent but distressed firm should continue to be owed to stockholders. In some distressed firms, creditors will have bargained for express approval rights. Neither constituency's interests, however, will be directly aligned with the interests of the constituencies as a whole. Requiring that directors seek to promote the interests of stockholders creates a balance in which the competing interests can be resolved through negotiation at which both creditors, having whatever express approval rights they have negotiated, and equityholders are represented. Creating a model of resolution of final-period problems based on bargaining between competing constituencies is likely superior to requiring that directors simultaneously maximize the returns to constituencies having competing interests.[103] It also creates a single constituency whose interests are to be promoted, which limits the ability of management to cloak self-dealing by purporting to represent a noncommon stockholder constituency. And it allows a single constituency to approve a conflict-of-

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101. *E.g.*, Pereira v. Farace, 413 F.3d 330, 342 (2d Cir. 2005) (charter provision eliminating director liability to the fullest extent permitted by law prevents assertion by trustee, whether brought on behalf of the corporation or on behalf of the creditors, seeking monetary damages against directors for breach of duty of care; applying Delaware law), *cert. denied*, 126 S. Ct. 2286 (2006); Angelo, Gordon & Co. v. Allied Riser Commc'ns Corp., 805 A.2d 221, 229 (Del. Ch. 2002) ("My preliminary view is that, even where the law recognizes that the duties of directors encompass the interests of creditors, there is room for application of the business judgment rule."); Continuing Creditors' Comm. of Star Telecomms., Inc. v. Edgecomb, 385 F.Supp. 2d 449, 462–63 (D. Del. 2004); *see* Weaver v. Kellogg, 216 B.R. 563, 584 (S.D. Tex. 1997) (implicitly approving application of the business judgment rule in claims of mismanagement of a distressed corporation); *cf.* LaSalle Nat'l Bank v. Perelman, 82 F. Supp. 2d 279, 292 (D. Del. 2000) (discussing actions in implementing a recapitalization developed one month before a voluntary bankruptcy petition was filed, where the debtor's reorganization was not approved by the bankruptcy court until one and one-half years later); *cf. In re* Rego Co., 623 A.2d 92, 109 n.35 (Del. Ch. 1992) (citing Devereux v. Berger, 284 A.2d 605 (Md. 1971) ("When directors of a dissolved Delaware corporation are, during the course of winding up corporate affairs, required to make decisions affecting various classes of interest holders, they are protected from liability in doing so, so long as they act disinterestedly, with due care and in good faith.")); Comm. of Creditors of Xonics Med. Sys., Inc. v. Haverty (*In re* Xonics Systems), 99 B.R. 870 (Bankr. N.D. Ill. 1989); *see also* Dennis J. Connolly & Wendy R. Reiss, *Second Circuit Says Exculpation Provisions Apply to Trustee Claims Against Directors*, AM. BANKR. INST. J., Sept. 2005, at 26; Growe v. Bedard, No.Civ. 03-198-B-S, 2004 WL 2677216 (D. Me. Nov. 23, 2004); Steinberg v. Kendig (*In re* Ben Franklin Retail Stores Inc.), No. 97C7934, 97C6043 2000 WL 28266 (N.D. Ill. Jan. 12, 2000).

102. *E.g.*, Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 798 (Del. Ch. 2004).

103. *Cf.* C-T of Va., Inc. v. Barrett (*In re* C-T of Va., Inc.), 958 F.2d 606, 612 (4th Cir. 1992) (stating, in rejecting one party's argument that consideration received by stockholders in the firm's acquisition in a reverse triangular merger constituted a distribution subject to limits on corporate dividends, that it would impracticable for directors to fulfill *Revlon* duties in maximizing sales price in an acquisition structured as a merger if the directors also had to consider whether the acquirer would remain solvent following the sale).

interest transaction, shifting the burden of proof as to fairness, retaining the ability of some independent group (the stockholders) to act as a check on managerial self-dealing.

vi. Waiver

A final question is the extent to which these duties should be waivable. At the moment, only tentative observations, not firm conclusions, have been developed. Although at the moment empirical evidence is not being supplied to support the proposition, one might hypothesize that it is particularly important to focus on restraining self-dealing when assessing whether these duties can be revised by agreement, a charter provision, or the like. It has been noted by others that one of the advantages of property rules is that they create uniform sets of rights. The point is that, in some contexts, they allow efficient abstraction—the rights are the rights, and one need not separately investigate the scope of rights that are the subject of market transactions. A limited set of rights also facilitates comparison between possible investments in corporations.

This principle also has been applied to corporation law.[104] If we have "corporations" that have different rules pertaining to how self-dealing in distress is controlled, there will be additional costs in ascertaining the operative rules for individual corporations. The expenditure would be beneficial to make on an individual basis because, as distress approaches, those with greater knowledge will be more likely to sell their ownership stakes to those who are less informed. That some would benefit from these expenditures does not justify, however, creating a legal scheme that makes the expenditures desirable on an individual basis. In the aggregate, the expenditures represent the costs to assemble information that is only valuable by virtue of the pertinent legal rule. No one would have to make the expenditures if legal rules did not allow for multiple possible relationships. At the moment, no empirical evidence is being presented concerning the value from allowing, for example, corporations to elect to have the burden of proof of fairness of conflict-of-interest transactions shift on distress to approval by creditors. All that can be said is that it is not clear that the aggregate value of allowing this would exceed the aggregate cost arising from investigating whether particular corporations had adopted such provisions.[105]

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104. *See generally* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2000).

105. There are also distributional concerns. Less-informed investors would be less likely to investigate, and would therefore be more likely to be disadvantaged. The costs of allowing waiver would need to include precaution costs expended by less-informed investors, e.g., in the hiring of investment advisers, any consequences of disproportionate bearing of these costs on persons particularly more risk-averse than others and the possibility that those with access to the information would use it as part of implicit commercial bribery to influence other corporate decision-making (e.g., an investment firm providing the information in advance to "favored" customers who may steer future business, in the same way that initial public offerings have been allocated in the past).

3. *Fairness of Terms Negotiated with Creditors; Disclosure Obligations*

Consideration of *Credit Lyonnais* raises the issue of how any duties owed to non-shareholder constituencies will influence a distressed corporation's dealings with its creditors. Typically, of course, a corporation's contracting with trade creditors is the product of ordinary market transactions in which the corporation is not required to defer to the interests of the creditors. The traditional rule as to employment relationships is the same—in negotiating the terms of an employee's compensation, the parties are not fiduciaries of each other.[106]

Somewhat anomalous in this regard is the application of federal insider trading prohibitions on the sale of shares, which in market transactions could easily be to persons who are not already shareholders.[107] Nevertheless, insider trading prohibitions apply to a fiduciary's sales of shares on the basis of material nonpublic information.[108] Thus, a full extension upon distress or insolvency of the fiduciary duties owed to stockholders could appertain to each extension of credit in distress or in insolvency. Of course, federal insider trading principles would not apply to many extensions of credit, as they would not involve the sale of a security.[109] But, on a similar theory, a court applying general state anti-fraud provisions, for example, fraud provisions not limited to the purchase or sale of a security, could find fiduciary obligations applying in a transaction creating the fiduciary relationship.

Of course, a determination that fiduciary obligations did not apply to a transaction creating a fiduciary relationship would not dispose of the issue of the nature of fiduciary obligations owed to creditors of distressed corporations. In the course of normal operations, distressed corporations will contract with existing creditors, and the issue of the scope of fiduciary duties appertaining to that contracting requires resolution. Two types of duties are discussed below: First, a court could seek to reform the process by which these contracts are negotiated by imposing disclosure obligations that would not appertain in market transactions between independent parties. Second, a court could impose a fairness obligation.

i. Disclosure

Particularly thorny consequences of classifying creditors as beneficiaries of fiduciary duties of distressed corporations are raised by disclosure obligations of fiduciaries. There are two possible theories giving rise to altered disclosure obligations. In some contexts, when a fiduciary contracts with the beneficiaries of the duties, the fiduciary operates under heightened disclosure obligations, even as to transactions

106. *See, e.g.*, RESTATEMENT (SECOND) OF AGENCY § 390 cmt. e (1958) ("A person is not ordinarily subject to a fiduciary duty in making terms as to compensation with a prospective principal.").

107. *See generally* Chiarella v. United States, 445 U.S. 222, 227 n.8 (1980) (citing authority that references *Gratz v. Claughton*, 187 F.2d 46, 49 (2d Cir. 1951)—authority construing the not patently analogous section 16, 15 U.S.C. § 78 (2005)).

108. *Id.*

109. *See* 17 C.F.R. § 240.10b-5 (2005).

that are not modifications of relationships that gave rise to the fiduciary obligation.[110] Transactions between a corporation and its stockholders alleging breach of fiduciary duty typically, however, involve transactions in the securities,[111] which raises substantial questions concerning whether other transactions, such as those not involving the instrument creating the beneficiary relationship, would trigger disclosure obligations. *Malone v. Brincat,*[112] however, suggests another basis for duties concerning disclosure. In that case, the Delaware Supreme Court stated:

> *When the directors are not seeking shareholder action, but are deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of fiduciary duty. That violation may result in a derivative claim on behalf of the corporation or a cause of action for damages. There may also be a basis for equitable relief to remedy the violation.*[113]

The *Brincat* opinion at times seems to peg the duty to the fact that the stockholders elected the directors.[114] At other points, however, the opinion indicates these duties "derive[ ] from the combination of the fiduciary duties of care, loyalty and good faith."[115]

Conceptualizing creditors as beneficiaries of fiduciary obligations can significantly affect how a distressed corporation is required to be run. Consider, for example, subsequent purchases of goods or services on trade credit. Imposing a fiduciary duty of candor to creditors would require greater disclosure of the corporation's financial position.

The effect would not be limited to trade creditors. A typical strategy to recapitalize a distressed firm involves repurchasing the corporation's outstanding debt at reduced prices, perhaps as part of an exchange offer.[116] In the face of sparse authority, there has been some disagreement in the literature concerning whether traditional norms—principles independent of *Credit Lyonnais*—impose disclosure

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110. *See, e.g.*, Martin v. Heinold Commodities, Inc., 510 N.E.2d 840, 845 (Ill. 1987) (indicating, in a context reminiscent of a "one bite" rule, that a prior agency relationship in which a broker effected a transaction might give rise to a fiduciary duty in connection with subsequent transactions).

111. *See, e.g.*, Birbeck v. Am. Toll Bridge Co. of Cal., 2 A.2d 158, 165 (Del. Ch. 1938) (stockholders exchanged their stock for stock in a second, newly formed corporation in a transaction organized by officers of the corporation; the court ordered cancelation, as a "secret" profit, of stock acquired by those officers in the successor corporation disproportionate to their interests in the initial corporation).

112. 722 A.2d 5 (Del. 1998).

113. *Id.* at 14 (internal citation omitted).

114. *Id.* at 10–11 ("Shareholders are entitled to rely upon the truthfulness of all information disseminated to them by the directors they elect to manage the corporate enterprise.").

115. *Id.* at 11.

116. *See, e.g.*, Allen L. Weingarten, *Consensual Non-Bankruptcy Restructuring of Public Debt Securities*, 23 REV. SEC. & COMMODITIES REG. 159, 161 (1990).

obligations on the corporation.[117] A disclosure obligation could materially influence the outcome of attempted debt repurchases not accompanied by a simultaneous exchange offer. A simultaneous exchange offer, on the other hand, could impose candor obligations.[118]

Debt repurchases may be a single component of a multipart plan of recapitalization. For example, additional equity may be contemplated. Plans for subsequent equity infusions could well be material to bondholders deciding whether to accept a repurchase offer. Application of fiduciary duties would clarify the pertinent legal landscape, affecting the efficacy of debt repurchases in resolving distress. Whether a corporation should be able to repurchase its debt without disclosing other material plans is a complex subject, the analysis of which is beyond the scope of this Article. The point being made here is more limited: treating creditors as the beneficiaries of a corporation's fiduciary duties will, as to distressed corporations, influence this currently open issue. The decision is consequential in this context. Moreover, because a corporation's operations typically involve greater ongoing communication between the firm and its creditors than between the firm and its stockholders—communication that is much more voluminous—the disclosure obligation under *Brincat* could be implicated in numerous communications with creditors. The required communications could accelerate exercise of creditors' remedies and limit the corporation's options in resolving distress.

ii. Fair Terms

Fiduciary duties in some contexts require that any contract between the fiduciary and the beneficiary of the duty be on fair terms. The precise contours of such a duty to stockholders are, unfortunately, not entirely clear. For example, Loewenstein and Wang have recently noted:

> *On the more general question as to whether the corporation owes fiduciary duties to an individual stockholder, the decided cases are surprisingly mixed. Some courts hold, as a general proposition, that a corporation does owe a fiduciary duty to an individual shareholder, although others conclude the opposite.*

117. *E.g.*, *In re* Worlds of Wonder Sec. Litig., No. C875491SC, 1990 WL 260675 (N.D. Cal. Oct. 19, 1990) (discussing insider trading claim asserted by holders of convertible bonds); 18 DONALD C. LANGEVOORT, INSIDER TRADING REGULATION, ENFORCEMENT & PREVENTION § 3:12, at 3-21 (2005) ("The approach more consistent with *Chiarella* is that no abstain or disclose obligation arises in connection with trading in debt securities, leaving liability in such a case to rest on the misappropriation theory . . . ."); Richard Hall, *Recent Developments in Duties of Disclosure and Candor*, *in* CORPORATE GOVERNANCE INSTITUTE: BLUEPRINT FOR GOOD GOVERNANCE IN THE 1990S, at 719, 727 (PLI Corp. Law & Practice Course Handbook Series No. 1053, 1998) ("It is not clear whether the requirement that an issuer not be trading in its own securities applies to repurchases of debt securities or equity securities other than common stock. As the analytic basis for the disclosure requirement under Rule 10b-5 is the fiduciary duty owed to certain securityholders, the better view seems to be that repurchases of debt securities and preferred stock (at least non-convertible preferred stock) should not give rise to any disclosure requirement.") (footnote omitted).

118. *See* Weingarten, *supra* note 116, at 163–65.

> *Possibly, in some jurisdictions, a company otherwise has no fiduciary duty to an individual stockholder, but does breach a fiduciary duty to a shareholder from whom it purchases stock without disclosing material, nonpublic information. Obviously, from a doctrinal viewpoint, this is troubling. So, from the initial question noted above, one is led quickly to the general question of the corporate fiduciary duty to an individual stockholder and its implications.*[119]

Transactions in the securities themselves to which Cox and Hazen indicate "[d]isclosure obligations clearly attach,"[120] are perhaps most likely to give rise to fairness obligations as well.[121] Because the contours of the actual duties to stockholders are different from other fiduciary duties[122] and are also not fully formulated, however, it is difficult to assess the extent to which these incompletely formulated fiduciary duties would be revised upon distress.[123]

A final wrinkle involves principles governing close corporations. Some jurisdictions, including Massachusetts[124] but excluding Delaware,[125] have in the past sought to impose on stockholders of closely held corporations the norms of conduct typically applied to partners in a partnership.[126] Creative counsel might seek to assert in a jurisdiction following this norm that, where a distressed corporation has a relatively small number of creditors, the creditors benefit from, and are subject to, fiduciary duties akin to those in partnerships.

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119. Mark J. Loewenstein & William K.S. Wang, *The Corporation as Insider Trader*, 30 DEL. J. CORP. L. 45, 48–49 (2005) (footnotes omitted).

120. 3 JAMES D. COX & THOMAS L. HAZEN, COX & HAZEN ON CORPORATIONS § 21.8, at 1282 n.13 (2d ed. 2003).

121. One potentially relevant case is *Birbeck v. American Toll Bridge Co. of California*, 2 A.2d 158 (Del. Ch. 1938), a case involving stockholders who exchanged their stock for stock in a second, newly formed corporation in a transaction organized by officers of the corporation. The court ordered cancelation, as a "secret" profit, of stock acquired by those officers in the successor corporation disproportionate to their interests in the initial corporation. *Id.* at 165.

122. An interesting adverse relationship between a controlling stockholder and the corporation was at issue in *Odyssey Partners, L.P. v. Fleming Cos.*, 735 A.2d 386, 406 & n.18 (Del. Ch. 1999). The court indicated that a controlling stockholders' acquisition of the assignment of a commercial loan made to the corporation is not subject to fiduciary constraints.

123. One potentially analogous case is *PPI Enterprises (U.S.), Inc. v. Del Monte Foods Co.*, No. 99 Civ. 3794(BSJ), 2000 WL 1425093, at *10 (S.D.N.Y. Sept. 26, 2000). In that case, the court stated that no fiduciary duty owed was owed by corporation directly to holders of preferred stock who were selling the stock. The court consequently dismissed an aiding and abetting claim against an investment bank.

124. *See generally* Lewenberg v. Del Regno, No. Civ.A. 1999-5681-C, 2001 WL 1517571, at *3 (Mass. Super. Ct. Oct. 24, 2001) (examining partnership-like duties in closely held corporation in connection with a stockholder's terminating employment and disclosure obligations concerning an associated stock repurchase).

125. Donahue v. Rodd Electrotype Co. of New England, Inc., 328 N.E.2d 505, 515 (Mass. 1975) ("[W]e hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.") (footnotes omitted).

126. Nixon v. Blackwell, 626 A.2d 1366, 1379–81 (Del. 1993) (rejecting an assertion that that "there should be any special, judicially-created rules to 'protect' minority stockholders of closely-held Delaware corporations" not incorporated under the close corporation provisions).

iii. Principles Underlying a Potential Approach

One may hypothesize that it is relatively unusual for a sophisticated business entity, in the course of negotiations, to seek expressly the right to lie to the other party. That does not mean parties do not lie. Nor does it mean that they do not, in negotiations, recast their desire to avoid liability for false or misleading statements in more palatable terms. A seller of a business might, for example, assert that it is providing all information that it knows but wants to avoid the transaction costs of postsale squabbles.

A typical formulation of fraud liability, based on one provided by Prosser and Keeton, is as follows: (i) a false representation, ordinarily of fact; (ii) the defendant's knowledge the statement is false or that he does not have a sufficient basis to make the representation; (iii) an intention to induce the plaintiff to act, or to refrain from acting in reliance; (iv) justifiable reliance by the plaintiff; and (v) damage.[127]

Consider the nature of the relationship between a distressed corporate debtor and financial creditors. A debtor might seek to make misleading statements that would influence the creditor in deciding whether to exercise remedies available by virtue of covenant defaults.[128] In this way, the relationship between the distressed debtor and its trade creditors may be qualitatively different. The distressed debtor may be engaged in ongoing transactions with its trade creditors involving extensions of credit, and the pending transaction that may be influenced by a misstatement may be patent. One potentially desirable component of an affirmative fiduciary duty to creditors of distressed corporations, then, could be the imposition of a duty, paralleling that formulated in *Brincat,* requiring communications between creditors and distressed debtors be accurate, regardless of whether a transaction was pending.

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127. This statement is a highly edited version of the elements stated in W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 105, at 728 (5th ed. 1984); nothing original to the author of this Article is stated, but the editing of the original is sufficiently extensive that the marks indicating alteration would materially inhibit legibility. The original states in full:

> 1. A false representation made by the defendant. In the ordinary case, this representation must be one of fact.
>
> 2. Knowledge or belief on the part of the defendant that the representation is false—or, what is regarded as equivalent, that he has not a sufficient basis of information to make it. This element is often given the technical name of "scienter."
>
> 3. An intention to induce the plaintiff to act or to refrain from action in reliance upon the misrepresentation.
>
> 4. Justifiable reliance upon the representation on the part of the plaintiff, in taking action or refraining from it.
>
> 5. Damage to the plaintiff, resulting from such reliance.

Id. (footnotes omitted).

128. The *Brincat* opinion in fact expressly notes that the plaintiffs allegedly did not sell and therefore did not have a claim under federal securities law. Malone v. Brincat, 722 A.2d 5, 13 (Del. 1998).

This proposed principle of corporation law is designed to address management of a corporation, not the general principles of rights creditors have against debtors.[129] The proposed principle is that misstatements designed to influence whether a creditor exercises contractually acquired rights to control a now-distressed debtor should be actionable without proof that the debtor anticipated reliance. It is not designed to address general principles of debtor-creditor law and statements made to influence normal creditors' rights (e.g., repossession of collateral and initiation of legal proceedings to collect on matured and unpaid obligations).

An affirmatively enforceable fiduciary duty in favor of creditors of distressed corporations is being proposed here. That raises the question whether it can simultaneously coexist with a similar fiduciary duty for the benefit of the stockholders. It is submitted that these two fiduciary duties can properly coexist, and that creating this fiduciary duty does not, therefore, put directors in the untenable position of having necessarily conflicting duties to two constituencies having different interests. In brief, the reason is that a duty to be candid with one constituency does not impose a concomitant obligation not to be candid with other constituencies.

Even under general agency principles, an implied term of a contract engaging an independent contractor is that the principal will not interfere in the independent contractor's method of performance.[130] Thus, the Restatement illustrates:

> *P, a lawyer, employs A, another lawyer, to conduct a case in which P is the defendant, A agreeing to follow P's instructions as to the manner of conducting suit. Subsequently, P directs A to violate a proper but nonobligatory agreement which A, with P's consent, had made with opposing counsel. A is under no duty to obey this direction and is privileged to withdraw from the case if P persists.*[131]

In sum, some level of discretion concerning the manner in which performance is rendered is left in the agent. Directors, of course, are not agents of stockholders and do not owe stockholders the duty of obedience owed by independent contractor agents to their principals.[132] Thus, a conclusion that duties of candor are owed to two classes of constituencies having potentially conflicting interests is not necessarily inconsistent with traditional notions of the scope of the duties that would be owed to a single constituency.

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129. *But cf.* ROBERT CHARLES CLARK, CORPORATE LAW § 2.6, at 91–92 (1986) (identifying as principles that should collectively produce a coherent body of law principles of veil piercing, fraudulent conveyance and equitable subordination). *See generally* C-T of Va., Inc. v. Barrett (*In re* C-T of Va., Inc.), 958 F.2d 606, 613 (4th Cir. 1992) (noting the availability of fraudulent conveyance statutes as a means of addressing creditors' grievances in discussing why corporation law restrictions on dividends did not restrict payment of consideration in a reverse triangular merger).

130. RESTATEMENT (SECOND) OF AGENCY § 385 cmt. a (1958).

131. *Id.* § 385 illus. 2.

132. *Id.* § 14C & cmt. a.

It may be that imposing duties of candor applicable to both equityholders and creditors would produce results that, in the immediate term, are worse for equityholders than not imposing these obligations. In that way, one might view these additional duties as inconsistent with the obligation owed to common stockholders. But if one views beneficiaries of fiduciary duties as not necessarily entitled to demand lack of candor with third parties, there would appear to be more of a basis for imposing on those managing a distressed corporation a duty to speak accurately when speaking. To put it another way, *Brincat* imposes an affirmative duty of candor in some contexts. But this is an asymmetric duty; it does not impose an obligation to avoid candor with others.

VI. COMPETITION AND CORPORATE OPPORTUNITIES

Weaver v. Kellogg[133] illuminates the interaction of fiduciary duties owed to other constituencies with the corporate opportunity doctrine. These concerns are not trivial, particularly in the case of smaller corporations.

Although the language of the opinion is not entirely clear on this point, *Broz v. Cellular Information. Systems, Inc.* appears to indicate that a financial inability of a corporation to take advantage of what otherwise would be a corporate opportunity exculpates the fiduciary who takes advantage of the opportunity.[134] Although the *Broz* opinion is not express on the point, this interpretation of *Broz* implies that the *Credit Lyonnais* duties do not extend to corporate opportunities. The language in *Broz* allowing a fiduciary contemplating an action that might constitute usurpation of a corporate opportunity not to consider the possible consequences of a subsequent acquisition of the distressed firm[135] is not inconsistent.

The A.L.I. principles, on the other hand, do not have this broad exculpation.[136] Following the A.L.I. approach in this circumstance creates difficulties if the *Credit Lyonnais* duties are to extend to corporate opportunities. The problem is that insiders are likely to inadvertently violate the pertinent requirements. The insider seeking to take advantage of the opportunity would not necessarily have any reason to know of the interests of creditors of the distressed corporation. Multiple creditors might be interested in a particular opportunity, presenting questions of which creditor should be offered the opportunity. There is not a simple mechanism in place that would allow the creditors to vote—determining the number of votes for each creditor, for example.

133. 216 B.R. 563, 580–84 (S.D. Tex. 1997).

134. 673 A.2d 148, 151, 155 (Del. 1996).

135. *Id.* at 156.

136. 1 AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.05 n.8 (1994) ("Section 5.05 contemplates that whenever an opportunity, as defined in § 5.05(b), is present, it is to be offered to the corporation, which may then determine whether the obstacles to accepting the opportunity are insuperable or can be avoided. If the opportunity is never offered to the corporation, the director or senior executive who takes the opportunity may not thereafter defend on the ground that there was no opportunity because the corporation was unable to accept it.").

Lastly, in the case of smaller distressed corporations, one can expect a significant amount of informality in the way in which corporate opportunities are relinquished. In the course of trying to stay afloat, resources may be diverted away from what may appear unimportant matters of legal housekeeping. If the informality can be subsequently challenged by a trustee, or the creditors bringing a direct action, the law will have created a potentially significant adverse consequence that can be inadvertently created.

Weaver v. Kellogg[137] illustrates the problems. In that case, the court denied a motion for summary judgment on claims alleging breach of the corporate opportunity doctrine. The corporation, which had only two shareholders (who, at the pertinent times, also were the sole directors), loaned the shareholders money, which allegedly was used to purchase other businesses.[138] Notwithstanding the defendants' argument that the transactions were implicitly approved or ratified,[139] the court stated, inter alia, "Defendants would not, in any case, have had the right to waive the rights of [the corporation's] creditors."[140] The court ultimately concluded,

> *"The Court holds that Plaintiff may therefore prevail on his breach of corporate duty claims if he shows, for each allegedly wrongful transaction, that [the corporate debtor] was, at the time, in 'the vicinity of insolvency[;]' that the transaction led to [the corporate debtor's] insolvency; or that the transaction was a fraudulent conveyance, as defined by the federal and state statutes. . . ."*[141]

A concern with inadvertent failure to waive properly a corporate opportunity is offset by concern that a corporate opportunity or other breach of a duty may be waived in undesirable circumstances. Distress may cause stockholders, or those acting on their behalf, to be indifferent. For example, the return to the corporation from taking an opportunity may in some future states only benefit the creditors. That indifference could result in stockholders waiving fiduciary obligations where the waiver is not in the best interests of all constituencies. One might seek to treat differently (i) direct competition with the distressed corporation and (ii) opportunities coming to the insiders' attention solely by reason of his office with the corporation. Tests of corporate opportunities typically reference opportunities that in fairness belong to the corporation. That does not really provide an actual test. A better principle in the context of distress is as follows: If the corporation is insolvent, the creditors, with capped claims, would benefit. Their failure to have exercised creditors' remedies, however, suggests that creditors should not be able to challenge the activity *ex post*. If the corporation is distressed but solvent, creditors

137. 216 B.R. 563 (S.D. Tex. 1997).
138. *Id.* at 579–81.
139. *Id.* at 581.
140. *Id.* at 582.
141. *Id.* at 584 (quoting *Credit Lyonnais*) (citation omitted).

are particularly disadvantaged only by actions that decrease corporate value but not merely as much as acts that prevent the corporation from further increasing its solvency. Where the corporation is distressed or insolvent, ratification of the taking of the corporate opportunity by stockholders, which would shift the burden of proof to one challenging the fairness to the corporation of the taking of the opportunity,[142] provides a muted signal concerning fairness to the corporation. One may therefore seek to distinguish between competition with the distressed corporation, and opportunities in other geographic areas or in lines of business only related to the distressed corporation's business. On this basis, one might find as actionable by, or on behalf of, the creditors officers or directors improperly competing with the corporation or improper, premature actions in preparing to compete. An illustration is provided by *Roth v. Mims,*[143] in which during distress the president made arrangements for sale of the distressed corporation's assets and employment with a firm that would operate the assets.[144]

VII. CONCLUSIONS

This Article demonstrates that existence of an affirmatively enforceable duty under the principles of *Credit Lyonnais* is not moot. The existence of aiding and abetting liability for breach of fiduciary duty will give rise to a greater set of potentially liable defendants and will increase the remedies otherwise available were the duties contemplated by *Credit Lyonnais* not affirmatively enforceable (aiding and abetting a fraudulent transfer typically not separately giving rise to liability).

Moreover, the issues raised by *Credit Lyonnais* highlight a basic problem that has not yet been definitively addressed: which constituency's approval of a distressed corporation's conflict-of-interest transactions will result in the application of the business judgment rule. This Article argues that during distress short of bankruptcy proceedings, fiduciary duties to maximize firm value on a sale should continue to be owed to stockholders. Approval of conflict-of-interest transactions by disinterested stockholders should continue to shift the burden of proof as to the fairness of the transaction.

This Article also argues that the obligation of candor under *Malone v. Brincat* should appertain to communications with creditors, thereby creating a duty not to make affirmative misstatements, regardless of whether the communication is in connection with approval of a particular action by the creditors. Financial creditors will consider the information provided in connection with deciding whether to exercise contractually negotiated control rights, and creditors should be entitled to rely on truthfulness even if the debtor is not aware of a particular action the creditor may take in reliance.

142. Schreiber v. Bryan, 396 A.2d 512, 520–21 (Del. Ch. 1978).
143. 298 B.R. 272, 277–78 (N.D. Tex. 2003).
144. *Id.*

That parties do not expressly bargain for these rights does not mean that providing them would be inefficient. The nature of the subject matter—one's ability to lie—makes it difficult to address in contract formation. Parties may not raise the issue in negotiations because doing so inhibits the trust necessary to enter into voluntary contractual relationships. If it were not difficult to raise this issue, it would be the subject of express bargaining, and at least some of the parties would not avoid using the colloquial term "lie" where the typical formulations do not invariably limit liability. Nevertheless, a search of the 866 asset purchase agreements in the CORI contract database identified no contract in which the parties included language addressing "lies."

Lastly, this Article argues in favor of the developing trend extending application of the business judgment rule to alleged violations of duties of care during distress by or on behalf of creditors, and to applying charter exculpation provisions to eliminate that liability. In reaching this conclusion, this Article examines the extent to which an alternative conclusion creates options in creditors that are difficult to value and are therefore problematic.