

**RECOVERING FROM THE “BAD GUYS” AND
THEIR ADVISORS — FIDUCIARY DUTIES TO CREDITORS,
DEEPENING INSOLVENCY, AND *IN PARI DELICTO***

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I. INTRODUCTION

In the past ten years, bankruptcy trustees, creditors committees, and individual creditors have increasingly pursued litigation to augment the distribution of bankruptcy estate assets. That litigation often focuses on the debtor’s former officers, directors, and professional advisors. The success of such litigation, however, usually hinges on three ever-evolving doctrines that are somewhat unique to the bankruptcy world: (1) fiduciary duties to creditors; (2) deepening insolvency; and (3) *in pari delicto*. The first two doctrines may supplement the available claims and remedies, but the third doctrine may entirely preclude any recovery from the former professional advisors. This paper provides an overview of these important doctrines.

II. FIDUCIARY DUTIES TO CREDITORS

Officers and directors owe well-established fiduciary duties to their corporation and its shareholders. As the corporation approaches insolvency, these fiduciary duties expand to include creditors. Thus, it is essential to review the nature, scope, and limitations of such duties in a solvent corporation before addressing them in the insolvency context.

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A. Fiduciary Duties in a Solvent Corporation

1. To Whom Are Fiduciary Duties Owed?

Officers and directors of a solvent corporation owe fiduciary duties to both the corporation and its shareholders.² They ordinarily do not owe such duties to creditors.³ Nor do they owe fiduciary duties to holders of stock options or convertible debentures prior to the purchase or conversion of those interests.⁴ It is presumed that creditors, like optionees, and debenture holders, are capable of protecting themselves through the contractual agreements that govern their relationships with the corporation.⁵ Creditors may also rely upon important protections under fraudulent conveyance law and federal bankruptcy law.⁶ Officers and directors of a solvent corporation, therefore, owe fiduciary duties only to the corporation and those who bear the residual risk associated with its operations, the shareholders.⁷

² See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). Although this seminar is being held in Texas, this paper focuses largely on Delaware law because (a) many public corporations (and those hoping to be public) are organized in Delaware; (b) a federal court in Texas would apply Delaware law to matters involving the internal affairs of a Delaware corporation, including the duties of its directors; and (c) Delaware courts have produced an extensive and reasonably cohesive body of corporate law relevant to the subject of this paper.

³ See, e.g., *Geyer v. Ingersoll Publications Co.*, 621 A.2d 784, 787 (Del. Ch. 1992) (“[T]he general rule is that directors do not owe creditors duties beyond the relevant contractual terms absent ‘special circumstances’, e.g., fraud . . . or a violation of a statute.”).

⁴ See *FS Photo, Inc. v. Picturevision Inc.*, 61 F. Supp. 2d 473, 484 (E.D. Va. 1999); *Powers v. British Vita, P.L.C.*, 969 F. Supp. 4, 5 (S.D.N.Y. 1997); *Simons v. Cogan*, 549 A.2d 300, 302-03 (Del. 1988).

⁵ See *Production Resources Group, LLC v. NCT Group, Inc.*, 863 A.2d 772, 787 (Del. Ch. 2004).

⁶ See *id.*

⁷ This does not mean that officers and directors should decline any consideration of creditors and other constituencies. Rather, it means that they should be “primarily focused on generating economic returns that will exceed what is required to pay bills in order to deliver a return to the company’s stockholders.” *Id.*; see also *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 176 (Del. 1986) (indicating that directors can consider interests of other constituencies if they are rationally related to furthering the interests of shareholders).

