DIRECTOR AND OFFICER LIABILITY WHEN "ZONE OF INSOLVENCY" CASES GO TO TRIAL

Adjudications of the Credit Lyonnais-Vicinity of Insolvency Case

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Since the Delaware Chancery Court handed down its famous footnote in *Credit Lyonnais* some 14 years ago, attorneys have been counseling the directors and officers of corporate clients on how to fulfill their fiduciary duties in the amorphous "vicinity of insolvency." We advise directors and officers on how to broaden their perspective beyond the shareholder-centric corporate paradigm and to avoid decisions taken (or not taken) which might adversely affect the so-called "corporate enterprise." Forests surely have been decimated to produce innumerable memoranda for these clients, citing footnote 55 in *Credit Lyonnais* and providing a detailed series of "do's" and "don'ts," in an effort to keep our clients out of trouble. Focus has been put on generally applicable principles like the business judgment rule, implementing appropriate board review processes and securing fairness opinions. The end result (we hope) is that, based on our legal advice, our clients become better equipped to navigate their way through financings, strategic transactions, foreclosures, dissolutions or even bankruptcy.

A question we sometimes get from clients, however, is this: "When has a court *actually* found a director or officer liable for one of these vicinity of insolvency claims?" Reading between the lines, the client may be asking exactly how *egregious* a director or

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officer's conduct would have to be to be found liable under *Credit Lyonnais*' vicinity of insolvency standard.

The question is a good one. Who actually wins these cases when they go to trial, and how often do such trials occur? The answer may surprise you. In the 14 years since the *Credit Lyonnais* ruling, there have been literally only a few cases involving *Credit Lyonnais* vicinity of insolvency claims that actually have gone to trial and been decided on the merits.[1] According to *Westlaw.com*, there have been approximately 32 decisions applying (or at least discussing) the shifting of directors' and officers' duties in the vicinity of insolvency. Of those cases, only three appear to have gone to trial and were fully adjudicated on the merits. The remaining cases appear to have been disposed of through motions to dismiss, motions on the pleadings or summary judgments.

What does this dearth of caselaw mean? Ideally, perhaps it means that attorneys are counseling corporate clients effectively, and, as a result, there simply are few breaches of fiduciary duty to be litigated. More realistically, however, it means that the majority of such cases that are filed settle before trial, just as with the vast majority of other civil litigation. The impetus to settle these cases also is fueled by the fact that in the typical action against a director or officer alleging breach of her "shifted" fiduciary duties in the vicinity of insolvency, a directors and officers liability insurance policy ("D&O insurance") provides coverage for the underlying alleged wrongful acts of the director or officer. After some discovery and motion practice, the D&O insurance carrier typically will authorize a settlement. Money is paid out and claims are dismissed. In sum, while it

[1] We selected *Credit Lyonnais* for this survey because it is one of the seminal cases on the duties of a director or officer in the vicinity of insolvency under Delaware law – the law applicable to most of our corporate clients. There are, of course, other lines of cases from other jurisdictions that also may address this type of fiduciary duty.

is fair to say that litigation frequently may be commenced against directors and officers alleging breach of *Credit Lyonnais* duties, an eventual monetary settlement is just too attractive to pass up, and the case, for better or worse, dies on the vine. Since the terms of such settlements are not publicly reported, we thus have little data to analyze in order to assess the true cost of cases alleging breaches of such duties.

Our client's original question, however, must still be answered: When has a court really found a director or officer liable for a vicinity of insolvency claim? A review of the few court decisions available is quite instructive and does, in fact, provide some meaningful guidance to the client and attorney alike. Of the few reported decisions, *Odyssey* highlights some of the time-tested principles we advocate: involvement of counsel, a board which actively considers all available options and the structuring of a transaction that is as fair as possible to the corporation's stakeholders. A second case, *In re Schultz*, highlights the risk of "freezing out" outside directors on a board of directors. Finally, the third case, *In re Flutie*, presents the type of fact pattern which might lead an observer to wonder how the defendant (the debtor's principal) ever believed he could *evade* a vicinity of insolvency claim.

Odyssey Partners, L.P. v. Fleming Cos., Inc., 735 A.2d 386 (Del. Ch. 1999)

Odyssey may not necessarily represent the classic paradigm of well-advised directors and officers successfully navigating through the vicinity of insolvency. Nevertheless, the case has several positive points about how directors can utilize the advice of counsel, the board process and their board's industry experience to ultimately defeat a *Credit Lyonnais* claim.

Relevant Facts

The various transactions at issue here are somewhat difficult to explain in a summary manner. At bottom, the litigation arose out of a foreclosure sale at which defendant Fleming Co., Inc. ("Fleming") acquired 100% of the stock of ABCO Markets Inc. ("ABCO Markets"), the operating subsidiary of ABCO Holding, Inc. ("ABCO"). At the time of the sale, Fleming was both the majority shareholder and sole secured creditor of ABCO, that debt being secured by a pledge of essentially all ABCO's assets, including the ABCO Markets stock. While several parties appeared at the foreclosure sale, Fleming made the only bid, equal to the value of the debt foreclosed. As part of the transaction, Fleming undertook to pay all of ABCO's unsecured creditors in full. After these transactions, ABCO was left as a shell corporation without material assets, liabilities or operations, and its common stock was valueless.

The plaintiffs, Odyssey Partners L.P. ("Odyssey Partners") and certain other parties who were minority shareholders of ABCO, were predictably unhappy with the results of the transactions and subsequently sued Fleming in the Delaware Chancery Court. The plaintiffs alleged various breaches of fiduciary duties, including vicinity of insolvency duties, by Fleming and four former members of ABCO's board of directors. As damages, Plaintiffs sought recovery of the value of their ABCO shares at the time of the foreclosure sales, which they claimed to have been approximately $6.1 million.

As is relevant to the litigation, in 1988 ABCO purchased a series of grocery stores, relying in part on debt financing from Fleming. In 1991, with the supermarket business becoming a tougher industry in which to turn a profit, ABCO restructured its capital structure with an eye to off-loading some of the debt that was threatening to

cripple the company. The restructuring involved Fleming extending trade credit to ABCO, the exchange of debt for ABCO preferred stock, execution of a shareholders' agreement allowing Fleming to fill two board seats and ABCO granting a junior lien to Fleming on ABCO's assets. A second restructuring of ABCO's capital structure occurred in 1992. Odyssey Partners, although it participated in the 1992 restructuring, decided not to invest in the restructuring, instead leaving it to Fleming to once again loan much-needed capital to ABCO. The 1992 restructuring also resulted in the creation of ABCO Holdings, modification of existing supply agreements between Fleming and ABCO and the renegotiation of certain shareholder agreement. All parties to the 1992 restructuring understood that as a result of Fleming stepping up to the plate once again, Fleming would become ABCO's largest shareholder, its largest supplier and one of its two secured creditors.

Despite these restructurings, ABCO continued to struggle financially and in 1994, it defaulted on its senior secured credit facility. Shortly thereafter, ABCO began a search for yet more capital, hiring successive investment bankers to develop proposals that would make the company liquid once more. Ultimately, no silver bullet was found. In September 1995, ABCO defaulted on both its senior and junior secured debt. Fleming once again stepped into the breach, granting a $5 million extension on ABCO's outstanding trade payables. ABCO's default on its debt obligations also caused a default under the supply and credit agreement it had with Fleming. This in turn allowed Fleming to exercise warrants that gave it ownership of a majority of ABCO's outstanding shares.

At the same time, one of the Fleming-appointed directors approached other board members and informed them that Fleming was considering various recapitalization

options, including purchase of the now-defaulted senior debt. The reaction was summed up by one board member: "[h]urray, we are finally getting some capital into the company." *Odyssey Partners*, 735 A.2d at 395. However, in the months that followed and as the details of Fleming's plan were made known, it became evident that Fleming's recapitalization proposals were not being greeted with such enthusiasm by all of the ABCO directors or minority shareholders. Fleming ultimately purchased the senior debt, exercised its warrants to take ownership to 50.1% of the company and foreclosed on ABCO's assets. At the foreclosure sale, Fleming, acting through counsel, offered $66 million, representing the indebtedness being foreclosed. Thereafter, all creditors, secured and unsecured, were paid in full. The owners of ABCO equity, including plaintiffs, received nothing.

In their lawsuit, plaintiffs specifically attacked the defendant directors, claiming that they acted disloyally and in bad faith in favoring Fleming's interests over those of ABCO or its minority shareholders. Plaintiffs focused, in particular, on the directors' approval of Fleming's purchase of the senior debt, their acquiescence in the ensuing foreclosure and their failure to consider alternatives to foreclosure, including chapter 11 bankruptcy protection. The court found that such assertions were unsupported at trial and ultimately entered judgment for all defendants. In its decision, the court found that while ABCO was clearly insolvent at the time of challenged transactions (given the serial defaults on the senior and junior debt obligations), the defendant directors fully discharged their duties to creditors.

Court's Holding

For our purposes, what factors or evidence did the court consider in finding that the defendant directors had met their *Credit Lyonnais* duties? Importantly, the court began its analysis by noting that when the ABCO board met for the last time prior to Fleming's foreclosure sale, the company's counsel specifically advised the directors of the changed nature of their fiduciary duties in light of ABCO' insolvency, *i.e.*, their duty to take into consideration the interests of creditors as well as those of shareholders in determining whether or not to approve Fleming's acquisition of the senior debt for the purpose of foreclosing on it. The court opined that most of the directors perceived (correctly) that ABCO's debt load was greater than the fair market value of its assets and that there were, as a practical matter, no viable alternatives to the threatened foreclosure. The court noted that in response to one of the director's concerns that ABCO would not be able to meet its unsecured obligations pending the foreclosure sale, one of the Fleming directors stated that, conditioned on the agreement of the directors to proceed with the foreclosure sale, Fleming would undertake to pay all of ABCO's unsecured debt obligations, *regardless* of the outcome of the foreclosure sale. The court found that Fleming had indeed advanced ABCO sufficient funds in order to pay ABCO's unsecured creditors (thus avoiding the very harm of which the plaintiffs were complaining.) The court found that this concession by Fleming protected the interests of ABCO's general creditors, while also protecting the interests of the shareholders (including the plaintiffs) and the corporate enterprise by providing a mechanism to keep ABCO supplied and operating during the interim period leading up to the foreclosure sale. With this concession in hand, the directors voted to approve the sale of the senior debt to Fleming by a vote of 5 to 1.

Addressing the plaintiffs' contention that the ABCO board's failure to undertake a substantive discussion of the pros and cons of ABCO filing for chapter 11 evidenced the defendants' disloyalty or lack of good faith, the court found that the directors had spoken informally about the bankruptcy option in the weeks prior to the November 20, 1995 board meeting. The court also found that the directors had included counsel (including bankruptcy counsel) in several discussions concerning options to foreclosure, and deferred to the directors' experience that retail grocery bankruptcies amounted to nothing more than liquidation sales.

Applying *Credit Lyonnais,* the court found that the board was obligated to consider and protect interests other than those of the shareholders. According to the court, when bankruptcy and foreclosure were compared -- and the effects of both on the shareholders, creditors and other corporate constituencies balanced -- the decision to proceed with the foreclosure could not have been said to have been made in bad faith or in a manner that was disloyal to ABCO. On the other hand, the court found that at least the majority of directors reasonably believed that a bankruptcy filing would produce negative returns for all of the ABCO constituencies, including its shareholders.

In re Shultz, 208 B.R. 723 (Bankr. M.D. Fla. 1997)

Schultz can best be thought of as a cautionary tale about family-run corporations, the risk of freezing out outside directors and the need to have someone (yes, the very same outside directors) take a stand against transactions that serve to benefit only the family and leave the corporate enterprise insolvent and its creditors "holding the bag."

Relevant Facts

The defendant Arthur Schultz ("Schultz") and members of his family were directors of Miramar Resources, Inc. ("Miramar"), a NASDAQ traded company which operated gas and oil wells in Colorado.[2] Miramar had an eight-person board of directors, including five members of the Shultz family and three non-Shultz family outside directors. In July 1991, Miramar retained an investment banking firm, Whitehall Company, Ltd. ("Whitehall"), concerning a possible sale of the Schultz family's interest in Miramar. As a separate engagement, Whitehall also was retained by a group of entities known as the Dominion Group ("Dominion") to locate publicly-traded companies where the management of the company was willing to relinquish control. Whitehall brought the Shultz family and Dominion together. Whitehall brokered the sale of the control of Miramar, and Dominion agreed to pay the Shultz family $1 million for that control. Schultz's father, also a Miramar director, contacted the outside directors of Miramar and requested that they execute a document authorizing Miramar to enter into a series of transactions, including a sale of Miramar stock to Dominion for $1 million.

Schultz resigned from the board on July 17, 2001. The various board resolutions relating to the Shultz family's exit from Miramar were subsequently discussed at a board of directors' meeting in late July. Although Schultz had resigned, he nevertheless attended the meeting. The outside directors (who had never even *heard* of Dominion) objected to the resolutions and insisted that they be provided a due diligence package on the transaction and that a fairness opinion on the value of Miramar be rendered before they would approve the transaction. A second board of directors' meeting was held three

[2] Certain facts have been taken from the bankruptcy court's Findings of Fact entered in the adversary proceeding commenced by Miramar in its chapter 11 case against Schultz and others. The adversary proceeding is styled *Miramar Resources, Inc. v. Dominion Investment Limited et al. (In re Miramar Resources, Inc.),* Chapter 11 Case No. 91-24033-DEC, Adv. No. 92-2263-SBB (D. Colo. Oct. 13, 1993).

days later. Despite the outside directors' "line in the sand" drawn at the first meeting concerning the request for due diligence and a fairness opinion, no diligence was provided and no fairness opinion was ever rendered. Nevertheless, the board approved the various transactions, with the Schultz family directors voting yes and the outside directors voting no. Schultz did not attend this meeting.

In October 1991, Miramar filed for bankruptcy protection in the District of Colorado. Thereafter, an adversary proceeding was brought by Miramar against Schultz and other defendants, alleging breaches of fiduciary duty. No defendants appeared to defend that action and the bankruptcy court subsequently entered judgment on behalf of Miramar against the defendants in the amount of $1,051,404. In its ruling, the bankruptcy court concluded that the various breaches of fiduciary duty by the Schultz family directors went well beyond a simple failure to abide by customary business practices. Rather, the court found that the transactions were approved without *any* consideration as to whether they were fair to the company or its shareholders. Although not specifically applying a *Credit Lyonnais* type analysis to the facts, the court determined that the Schultz family directors engaged in a "bizarre" series of transactions with the overriding purpose being their own personal enrichment.

We also find it interesting that in its findings of fact (which were subsequently adopted by the *Schultz* court), the *Miramar* court found that the July 20 and 23 board minutes, prepared by the company's outside counsel, did *not* accurately reflect the resolutions passed at either of those meetings. Likewise, the court found that the form 8-K filed by Miramar relating to the transaction did not accurately reflect the discussions or

decisions made at the July board meetings and that the outside directors were not consulted in the 8-K's preparation and never received a copy of it.

Schultz filed his own chapter 7 case on February 16, 1996 in bankruptcy court in Florida. Through bankruptcy, he sought to discharge various debts, including the bankruptcy court judgment in favor of Miramar. Miramar objected to the discharge and a bankruptcy court trial was held. At trial, Miramar asserted that Schultz should be considered a "trustee" of Miramar pursuant to the Delaware Trust Fund doctrine and the duties imposed by *Credit Lyonnais* on directors of companies on the brink of insolvency. Miramar asserted that given such circumstances, discharge of the Miramar judgment under § 523 of the Bankruptcy Code was inappropriate.

Court's Holding

The court began its analysis by making the common-sense observation that Miramar was *solvent* at the time of the July 2001 transactions in question. However, as the court noted, the standard is whether a corporation is in the 'vicinity of insolvency' (the court actually uses the term "brink,") and found that Schultz was aware that the contemplated transactions would have rendered Miramar insolvent once they were consummated. The court therefore concluded that Schultz knew that Miramar was on the "brink of insolvency" just prior to the transactions. Applying a *Credit Lyonnais* analysis, the court found that Schultz, although not technically still a Miramar director, nevertheless had a duty to act in the best interests of the company. The court concluded that he failed in that duty. The court observed that Schultz was, at the very least, aware of the actions of the board of directors. Although he did not take an active role as a director in Miramar, Schultz nonetheless was present when certain decisions were made

that ultimately adversely affected the corporation. Further, Schultz personally stood to profit from the transactions and knew that the outside directors originally had objected to the transactions without due diligence materials or a fairness opinion. In light of these facts, the court found that Schultz had further duties to act in the best interest of the other directors and shareholders in relation to the money received from Dominion. Indeed, one of the outside directors specifically testified at trial that he recalled Schultz asking if obtaining the fairness opinion would cause a delay in the transactions. Regardless of his motivations, however, Schultz failed to ensure that the outside directors received appropriate information concerning the transactions, the requested fairness opinion was obtained or the proceeds from the sale of the company were distributed properly (*i.e.,* to more than just family members).

In re Flutie N.Y. Corp., 310 B.R. 31 (Bankr. S.D.N.Y. 2004)

Flutie is most instructive as a "what *not* to do" case. As discussed below, the debtor's principal (and his father) were found personally liable for a series of fraudulent transactions and ordered to pay back some $1.8 million. This case is most notable for the basic failure on the part of the debtor and its principals to observe the barest of corporate formalities, keep proper records or in fact understand the difference between "personal" and "corporate" expenses.

Relevant Facts

Flutie New York Corp. *d/b/a* Company Management ("Flutie N.Y." or the "Debtor") was in the business of representing fashion models. Flutie N.Y.'s principal was Michael Flutie ("Flutie") and his father Albert Flutie was president and 100% shareholder. Flutie N.Y. was not Flutie's first foray into the world of fashion models (or indeed bankruptcy court.) In 1990, Flutie created MFME Management Company

("MFME"), another model management company. MFME used "Company Management" as its *d/b/a*. MFME in turn licensed the use of "Company Management" to the newly-formed Flutie N.Y. and transferred the assets of MFME to Flutie N.Y. In 1997, MFME filed for bankruptcy protection. Flutie N.Y. carried on substantially the same business as MFME and Flutie continued to represent substantially the same models he had with MFME. Nor was Flutie content with just running Flutie N.Y. In 1999, Flutie formed Flutie Media, which started as a public relations business for other companies, as well as for the Flutie N.Y. models. In 2001, Flutie began winding down the operations of Flutie N.Y. and transferred its remaining assets to Flutie Media, including use of the name "Company Management." As a result of the closure of the Flutie N.Y. business, Flutie Media and Flutie began to represent models formerly represented by Flutie N.Y., as well as its former public relations clients.

Apparently seized by the entrepreneurial bug again, in early 2002, Flutie began to operate his modeling company under a new corporate entity, Victoria Suns — which also happened to do business as Company Management. Beginning in mid-2003, and while continuing to operate Victoria Suns, Flutie apparently switched business plans again, deciding to manage only the individual models and not work on individual jobs or on invoicing. As part of this transition, Flutie advised the models on agencies who could handle their work and accompanied the models to meetings with agencies who would take over their representation. Flutie continued to earn commissions on their work while acting as their personal manager.

Flutie N.Y. filed for chapter 7 bankruptcy protection in August 21, 2002 and a chapter 7 trustee subsequently was appointed. To no one's great surprise (except perhaps

Flutie's), the chapter 7 trustee for Flutie N.Y. shortly thereafter filed an adversary proceeding against Flutie, his father, and certain related entities, seeking to hold the defendants liable for the debts of the estate and seeking the return of funds transferred to the defendants by Flutie N.Y. After a three-day trial, the bankruptcy court found Flutie and his father personally liable for the debts of Flutie N.Y., concluding:

> Michael Flutie, as the controlling and dominant figure in the operation of Flutie N.Y., notwithstanding the figurehead position of his father as president, breached his fiduciary duties to Flutie N.Y. when he permitted and actively orchestrated the transfer of assets from Flutie N.Y. Michael Flutie stripped the assets of the Debtor, with the concurrence of his father. Debtor's estate has been rendered insolvent, as a direct result of the looting, domination and control of the Debtor by Michael Flutie and his fraudulent transfers of the Debtors assets to himself, to members of his immediate family, to other persons or corporations controlled or dominated by Michael Flutie.

In re Flutie N.Y. Corp., 310 B.R. at 58.

Court's Holding

What did the bankruptcy court focus on in reaching its determination specifically that Flutie and his father breached their *Credit Lyonnais* "vicinity of insolvency" duties to the corporate enterprise? As a threshold matter, the court credited testimony from the trustee's accountant that Flutie N.Y. was insolvent almost since its inception in 1995 and remained in the vicinity of insolvency through the date of its bankruptcy petition. The court further found that Flutie N.Y. had valid, binding model contracts and that Flutie was responsible for procuring the breach of those contracts (and thereby destroying the financial well-being of Flutie N.Y.) by having the models work for related Flutie entities and other modeling agencies.

Flutie certainly did not help his case by failing to observe any corporate formalities between his various business entities. The court specifically found that the

corporate forms Flutie used were solely designed to promote Flutie's own modeling management business, and that the transition of his business from entity to entity was done with complete disregard for corporate formalities. Somewhat incredibly, based on the evidence presented at trial, there appeared to have been no board of directors' meetings, no board votes, and stock certificates were never issued for any of the corporate entities.

Nor was Flutie's case helped by his apparent inability to provide any documentation to support the transfers challenged by the chapter 7 trustee. During the trial, the trustee presented Flutie N.Y.'s general ledger as *Exhibit A* of its practice of paying Flutie's (and certain of his father's) personal expenses, including rent, car lease payments, utility bills and payments for Flutie N.Y.'s American Express corporate card. While the Amex card was intended for corporate expenses, it was apparent that Flutie had used it for personal expenses. The evidence presented showed that Flutie charged gasoline, hardware and lumber for his house in the Hamptons, a bicycle, groceries, movie tickets, drug store items, liquor and lift tickets for a ski trip to Aspen. As the court noted, some of these charges may indeed have been for legitimate expenses, but Flutie had "utterly failed to present any credible evidence that these charges were anything other than Michael Flutie's use of the Flutie N.Y. corporate form to enjoy a standard of living that he could not personally afford -- ultimately, Flutie N.Y. could not afford it either." *In re Flutie N.Y. Corp.*, 310 B.R. at 53.

For his defense, Flutie in part argued unsuccessfully that he had never received a salary from Flutie N.Y., instead relying on loans from the company in lieu of salary, and Flutie N.Y. received compensation in the form of his services. With the exception of the

general ledger itself, there was no documentation provided for any of the purported loans and the court rejected Flutie's contentions out of hand.

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<u>*Lessons Learned from the Credit Lyonnais Trials*</u>

What are the common lessons to be learned from these three seemingly disparate cases? Broadly speaking, the court in each case focused on *process* and *documentation*. As discussed above, the existence of expanded fiduciary duties in the vicinity of insolvency should cause directors to choose a course of action that best serves the entire corporate enterprise rather than any single group. Process in this context thus can be defined as evidence that the board of directors, officers or the company's principals chose an appropriate course of action, observed corporate formalities, passed resolutions after due consideration and appeared to consider all available options before them. It is vital that the process reflect that directors and officers acted on an informed basis, demonstrated a heightened duty of inquiry and devoted more time and attention to the corporation's affairs than is traditionally required when a corporation is financially healthy.

Of the three cases, *Odyssey* presents the best case for process. The *Odyssey* board remained informed and engaged throughout the insolvency and foreclosure process. They considered advice of counsel and established an adequate record that they weighed various options and came to the conclusion that a bankruptcy filing would not be in the best interests of the corporate entity as a whole. *Schultz* had some minimal level of process (*i.e.,* the board was requested to authorize the necessary papers for the sale transaction), but the process proved wholly inadequate, given the systematic freeze-out of

the outside directors. Moreover, it is well settled that directors who have substantial stockholdings or who represent a major shareholder may be considered "interested" vis à vis creditors when voting on transactions while the corporation is at or near insolvency. Such directors may not be entitled to the benefit of the business judgment rule, and absent approval by a majority of disinterested directors, may have to prove the entire fairness of the transaction. Thus the Schultz family, instead of pushing through the transactions, should have allowed the three outside directors to ratify the transaction, after supplying them adequate documentation, in order to avoid having to show the fairness of the entire transaction. The Schultz family, however, probably would have failed to meet this evidentiary burden anyway, as the challenged transactions *only* benefited them. Finally, *Flutie* presents perhaps the easiest case on process, because there was no apparent process for the court to consider.

Adequate process alone, however, will not protect directors and officers facing a *Credit Lyonnais*-type claim. That process must be well documented. It is particularly important that directors or officers of struggling companies maintain adequate documentation of their decision-making process, including the business and legal advice they receive and rely upon to make their decisions. In *Odyssey*, although the documentation of the bankruptcy option could have been stronger and clearer, the court credited certain board minutes that dealt with the bankruptcy option and appeared to credit testimony that the bankruptcy option was considered formally and informally by the board. In *Schultz*, documentation was pivotal in the case against the Schultz family directors. Failure to secure the fairness opinion was sufficient for Miramar to successfully argue against Schultz's § 523 discharge. (The underlying bankruptcy ruling

also demonstrated numerous apparent shenanigans with both the board minutes and subsequent SEC filings.) Again, *Flutie* is easy because the debtor's principal was unable to produce any documentation concerning transfer of the debtor's funds (although the documentation in *Flutie* dealt more with receipts and financial statements than with board minutes or resolutions).

So, as a client might ask, what's the real take-away from this? How do you distill *Odyssey*, *Schultz* and *Flutie* into concrete, bottom line points to be used by directors and officers who ultimately are on the front lines on this?

We sum the issues up in five bullet points:

- Seek appropriate business and legal counsel that is tailored to the transaction or events at issue.
- Establish and maintain appropriate process and document it accurately every step of the way. Full participation by outside directors is crucial.
- Stay informed. Directors and officers need to devote more time and attention to a corporation's affairs than is required when a corporation is financially healthy.
- Make sure the paper trail reflects acknowledgment of the corporation's (and officers and directors') expanded duties in the zone of insolvency.
- Choose courses of action that best serve the entire corporate enterprise rather than any single group. Shareholders' wishes should not be directors or officers' only concern.

Finally, we realize that no discussion of the *Credit Lyonnais* vicinity of insolvency claims is complete without acknowledging the Delaware Chancery Court's decision last year in *Production Resources Group, L.L.C. v. NCT Group, Inc*. Hailed by some as good news for directors of Delaware corporations, *Production Resources Group* can be interpreted to mean that *Credit Lyonnais* did not, in fact, create new fiduciary duties for directors. Instead, what *Credit Lyonnais* really did, by requiring the consideration of the interests of all corporate stakeholders, was to provide a "shield" to protect directors from

disgruntled shareholders claiming that the directors did not act in the shareholders' best interest. We will reserve our judgment on the ultimate effects of *Production Resources Group*, but continue to believe that zone of insolvency claims will present very real hazards to our corporate clients for the foreseeable future.

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