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Delaware's "Zone of Insolvency" Doctrine Refined –
Supreme Court Limits Creditor Claims Against Directors

The Delaware Supreme Court has held that creditors of a Delaware corporation may not assert direct claims for breach of fiduciary duty against the corporation's directors, even if the breach allegedly occurs when the corporation is insolvent or in the "zone of insolvency." Indeed, the opinion intimates further that creditors may not bring fiduciary duty claims even derivatively on behalf of a corporation that is in the "zone of insolvency," but not actually insolvent, at the time of an alleged breach.

The Supreme Court's decision, 2007 WL 1453705 (May 18, 2007), affirmed the Chancery Court's dismissal of a claim by the North American Catholic Educational Programming Foundation – a creditor of Clearwire Holdings, Inc. – that directors of Clearwire breached their fiduciary duties by, among other things, allegedly permitting the depletion of Clearwire's assets while the company was insolvent or in the "zone of insolvency." The Supreme Court concluded first that creditors of a corporation merely in the "zone of insolvency" – a condition short of actual insolvency – at the time of an alleged breach of fiduciary duty may not bring direct claims against directors. Protected by contract and other law (such as bankruptcy and fraudulent conveyance law), such creditors should not be heard to assert that directors of a solvent corporation owe them any fiduciary duty. Rather, "[w]hen a solvent corporation is navigating in the zone of insolvency . . . directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners."

The Supreme Court further concluded that, although creditors of a corporation that is actually insolvent at the time of an alleged breach of fiduciary duty have standing to maintain *derivative* claims against directors, they too may not assert *direct* claims for breach of fiduciary duty. According to the Court, permitting a corporation's creditors to bring such direct claims would "create a conflict between those directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors." On the other hand, permitting a corporation's creditors to bring derivative claims in insolvent cases creates no such conflict, because a valid derivative claim seeks recovery of value belonging to the firm as a whole.

The Delaware Supreme Court's decision thus establishes that creditors of an insolvent corporation may recover from directors for breach of fiduciary duty only *if* they can meet the stringent requirements of derivative suits, including presumably the requirement that a plaintiff must hold a stake in the corporation at the time of the directors' alleged wrongdoing. Moreover, the decision suggests that creditors may not bring *any* claim against directors – neither direct nor derivative – for a breach of fiduciary duty that occurs while a solvent corporation is in the "zone of insolvency," however defined. Although the Court did not expressly decide that issue, its pronouncement that directors of a corporation in the "zone of insolvency" must continue to advance the interests of shareholders strongly indicates that shareholders alone may complain of fiduciary wrongs absent actual insolvency.

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