



CHAPTER 7: Deepening Insolvency Claims against Officers and Directors

1. Generally

Deepening insolvency claims against officers and directors have generated conflicting authorities. These claims often borrow from the general body of fiduciary law. Authorities that reject such claims often rest their decisions based on an exculpatory clause in a corporate charter, on redundancy of claims, or on a lack of facts sufficient to show causation.

2. Claims Stated against Officers, Directors and Their Corporations

The following cases upheld claims for relief against officers and directors on a deepening insolvency theory or with deepening insolvency as a theory of damages:³⁶⁰

- *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co.* (finding that under Pennsylvania law, “deepening insolvency” may give rise to a cognizable injury. Creditor’s committee had standing to bring “deepening insolvency” claim on behalf of debtor corporations against sole shareholders of corporation).³⁶¹
- *Collins v. Kohlberg & Co. (In re Southwest Supermarkets LLC)* (finding that deepening insolvency properly pled as a theory of damages against corporate parent and officers for causes of action based on breach of fiduciary duty, gross negligence and mismanagement).³⁶²
- *In re LTV Steel Co.* (finding that a claim was stated against officers and directors of corporate debtor where they had concealed or misstated the debtor’s true financial condition, thereby permitting a deepening of the insolvency of the corporation).³⁶³
- *In re Total Containment Inc.* (finding that trustee stated a claim for deepening insolvency against officers, directors and con-

360 Presented here chronologically by year.

361 *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340 (3d Cir. 2001).

362 *Collins v. Kohlberg & Co. (In re Sw. Supermarkets LLC)*, 325 B.R. 417 (Bankr. D. Ariz. 2005).

363 *In re LTV Steel Co.*, 333 B.R. 397 (Bankr. N.D. Ohio 2005).

trolling shareholders for continuation of corporate debtor's business, which increased debtor's debt by \$17 million).³⁶⁴

- *Rahl v. Bande* (finding that claim was stated for deepening insolvency against officers and directors of debtor corporation).³⁶⁵
- *Alberts v. Tuft (In re Greater Southeast Community Hospital Corp. I)* (finding that breach-of-fiduciary-duty claims were stated against some officers and directors where damages were pleaded on the basis of deepening insolvency).³⁶⁶
- *Campbell v. Cathcart (In re Derivium Capital LLC)* (finding that claim was stated against members of the debtor limited liability company who wrongfully prolonged the debtor's corporate life, causing the debtor to incur additional liabilities).³⁶⁷
- *In re Fleming Packaging Corp.* (finding that trustee's complaint stated a claim against corporate officer for deepening insolvency where it was alleged that officer caused fraudulent and dishonest continuation of corporate business causing substantial injury to the corporation's property).³⁶⁸
- *Buckley v. O'Hanlon* (finding that defendants knowingly misrepresented the state of the debtor's financial health with the intent to cause the debtor to continue to incur more liabilities than it could repay, so deepening insolvency claim was per-

364 *Miler v. Dutil (In re Total Containment Inc.)*, 335 B.R. 589 (Bankr. E.D. Pa. 2005).

365 *Rahl v. Bande*, 328 B.R. 387 (S.D.N.Y. 2005).

366 *Alberts v. Tuft (In re Greater Se. Cmty. Hosp. Corp. I)*, 353 B.R. 324 (Bankr. D.D.C. 2006).

367 *Campbell v. Cathcart (In re Derivium Capital LLC)*, 380 B.R. 407, 424 (Bankr. D.S.C. 2006).

368 *Rafool v. The Goldfarb Corp. (In re Fleming Packaging Corp.)*, 336 B.R. 398 (Bankr. C.D. Ill. 2006).

mitted to proceed and business judgment rule did not preclude deepening insolvency claim where bad faith was alleged).³⁶⁹

- *In re Eugenia VI Venture Holdings Ltd. Litigation* (finding that New York recognizes deepening insolvency as a theory of damages to support a separate tort, including breach of fiduciary duty; however, stating that “a manager’s negligent but good faith decision to operate insolvent business will not subject him to liability for deepening insolvency”).³⁷⁰
- *Official Committee of Unsecured Creditors v. Hendricks (In re Dwight’s Piano Co.)* (finding that in claim against debtor’s former chief executive officer for breach of fiduciary duty, “a specific and quantified injury that has resulted from a breach of fiduciary duty need not be proven” and that deepening insolvency is a valid measure of damages under Delaware corporations law).³⁷¹
- *Kapila v. Clark (In re Trafford Distributing Center Inc.)* (finding that deepening insolvency was a valid theory of damages to support trustee’s claim against debtor’s principal for alleged breach of fiduciary duty where conduct of debtor’s sole shareholder and director in months preceding corporation’s bankruptcy filing engaged in scheme to drain corporation of its assets).³⁷²
- *Official Committee of Administrative Claimants v. Bricker* (holding that the creditors’ committee had standing to bring cause of action against debtor’s former CEO).³⁷³

369 *Buckley v. O’Hanlon*, 2007 U.S. Dist. LEXIS 22211 (D. Del. March 28, 2007).

370 *In re Eugenia VI Venture Holdings Ltd. Litig.*, 649 F. Supp. 2d 105, 125-26 (S.D.N.Y. 2008) (internal quotation marks and citations omitted).

371 *Official Comm. of Unsecured Creditors v. Hendricks (In re Dwight’s Piano Co.)*, 424 B.R. 260, 287 (S.D. Ohio 2009).

372 *Kapila v. Clark (In re Trafford Distrib. Ctr. Inc.)*, 431 B.R. 263 (Bankr. S.D. Fla. 2010).

373 *Official Comm. of Administrative Claimants v. Bricker*, 2010 U.S. Dist. LEXIS

3. Claims Not Stated against Officers and Directors

The following cases have found that plaintiffs cannot properly state a claim for deepening insolvency against officers, directors and shareholders:³⁷⁴

- *Feltman v. Prudential Bache Securities* (“The Court agrees with Plaintiffs that an ‘artificial and fraudulently prolonged life ... and ... consequent dissipation of assets’ constitutes a recognized injury for which a corporation can sue under certain conditions [citation omitted]. The Court finds, however, that under the circumstances alleged in the complaint, the corporations were not injured by their prolonged life.”).³⁷⁵
- *Florida Department of Insurance v. Chase Bank of Texas National Association* (dismissing deepening insolvency claim due to lack of evidence of damages, stating, “Our holding today does not demonstrate the absence of a remedy in this type of case. Without expressing an opinion on the merits of any particular option, policyholders might bring a class action to attempt fraud or breach of fiduciary duty claims against a NAIC trustee; the California Insurance Commissioner, who the California Supreme Court has held to be a representative of California policyholders, might bring such claims on their behalf; a receiver in Florida’s position might prevail on a deepening insolvency theory or recover from officers and directors of the insurance company; or an insurance commissioner might sue the trustee for contribution if the insurance company and trustee acted as joint tortfeasors and applicable

99140, at *41 (N.D. Ohio Sept. 22, 2010).

374 Presented here chronologically by date.

375 *Feltman v. Prudential Bache Sec.*, 122 B.R. 466, 473 (S.D. Fla. 1990).

state law allows. In the present case, however, the correct combination of legal theories, proper plaintiffs, and evidence on damages is not present”).³⁷⁶

- *Kittay v. Atlantic Bank of New York (In re Global Services Group LLC)* (finding that managers were not liable on deepening insolvency claim and were protected by business judgment rule where managers made negligent but good-faith decision to continue to operate insolvent business, stating, “To overcome the business judgment rule, a complaint must contain specific allegations that the fiduciary acted in bad faith or with fraudulent intent”).³⁷⁷
- *Devon Mobile Communications Liquidating Trust v. Adelpia Communications Corp. (In re Adelpia Communications Corp.)* (“Although the *Goldin* case dealt with a breach of fiduciary duty cause of action, the Court believes this reasoning is applicable to the deepening insolvency context, as this Court has ruled that to be held liable for deepening insolvency, a party must have been able to foresee that the debtor was being operated for an improper purpose. Further, a complaint that fails to allege that the ‘[i]nsider defendants prolonged [debtor’s] life to misappropriate the transfers ... received’ does not state a cause of action for deepening insolvency.”).³⁷⁸
- *In re Total Containment Inc.* (finding that although claim stated against certain individual defendants, facts did not demonstrate that corporate entities were involved in the con-

376 *Fla. Dep’t of Ins. v. Chase Bank of Tex. Nat’l Ass’n*, 274 F.3d 924, 935-36 (5th Cir. 2001).

377 *Kittay v. Atl. Bank of N.Y. (In re Global Serv. Grp. LLC)*, 316 B.R. 451, 461 (Bankr. S.D.N.Y. 2004).

378 *Devon Mobile Commc’ns Liquidating Trust v. Adelpia Commc’ns Corp. (In re Adelpia Commc’ns Corp.)*, 324 B.R. 492, 500 (Bankr. S.D.N.Y. 2005) (citations omitted).

tinued operations of the debtor or that they “acted tortiously in the accretion of future debt by the debtor”).³⁷⁹

- *Boles v. Filipowski (In re Enivid Inc.)* (dismissing liquidation trust’s deepening insolvency claim against debtor’s former officers and directors for failure to state a claim because no harm was alleged and because claim was subsumed in other claims).³⁸⁰
- *Fleming Packaging* (finding that where claim for deepening insolvency against director or officer who is alleged to have breached a fiduciary duty is identical to a claim for breach of fiduciary duty, it is not appropriately plead as a separate cause of action).³⁸¹
- *Official Committee of Unsecured Creditors of Verestar Inc. v. American Tower Corp. (In re Verestar Inc.)* (dismissing claim of deepening insolvency against directors due to charter provision exculpating director from liability for breach of duty, stating that “the Verestar exculpatory charter provision relieves the director Defendants of all liability except for breach of the duty of loyalty and knowing, willful violations of law or fraud, and there is no basis, without more being alleged, to equate a charge of ‘deepening insolvency’ with a knowing and willful violation of law or breach of the duty of loyalty”).³⁸²
- *Liquidating Trustee of the Amcast Unsecured Creditor Liquidating Trust v. Baker (In re Amcast Industrial Corp.)* (dismissing deepening insolvency claim against directors where “[t]he adoption of such a cause of action would negate the

379 *In re Total Containment Inc.*, 335 B.R. 589, 621-22 (Bankr. E.D. Pa. 2005).

380 *Boles v. Filipowski (In re Enivid Inc.)*, 345 B.R. 426, 453 (Bankr. D. Mass. 2006).

381 *In re Fleming Packaging*, 351 B.R. 626, 640 (Bankr. C.D. Ill. 2006).

382 *Official Comm. of Unsecured Creditors of Verestar Inc. v. Am. Tower Corp. (In re Verestar Inc.)*, 343 B.R. 444, 477 (Bankr. S.D.N.Y. 2006).

business judgment rule and force directors of an insolvent corporation to be the personal guarantors of a business strategy's success").³⁸³

- *Official Committee of Unsecured Creditors v. Foss (In re Felt Mfg. Co.)* (dismissing creditors' committee's claim for deepening insolvency against debtor's former officers and directors, predicting that New Hampshire law would not recognize a cause of action for deepening insolvency).³⁸⁴
- *Hedback v. Tenney (In re Security Asset Capital Corp.)* (dismissing deepening insolvency claim against two directors of chapter 11 debtor as redundant of claims for breach of fiduciary duty).³⁸⁵
- *Mukamal v. Bakes* (affirming the bankruptcy court's dismissal of a deepening insolvency claim against officers and directors, noting that Delaware law does not recognize a cause of action for deepening insolvency and concluding that *Trenwick* held that "officers and directors do not breach the duty of loyalty by exercising their business judgment and continuing to operate an insolvent corporation rather than entering bankruptcy and preserving assets to pay creditors").³⁸⁶
- *Official Committee of Unsecured Creditors of Midway Games Inc. v. National Amusements Inc. (In re Midway Games Inc.)* (rejecting deepening insolvency as a valid claim in light of *Trenwick* and also dismissing creditors' committee's breach-of-fiduciary-duty claims against corporation's

383 *Liquidating Tr. of the Amcast Unsecured Creditor Liquidating Trust v. Baker (In re Amcast Indus. Corp.)*, 365 B.R. 91, 119 (Bankr. S.D. Ohio 2007).

384 *Official Comm. of Unsecured Creditors v. Foss (In re Felt Mfg. Co.)*, 371 B.R. 589 (Bankr. D.N.H. 2007).

385 *Hedback v. Tenney (In re Sec. Asset Capital Corp.)*, 390 B.R. 636, 645-46 (Bankr. D. Minn. 2008).

386 *Mukamal v. Bakes*, 378 Fed. App'x 890, 900-901 (11th Cir. 2010).

directors because it was a disguised deepening insolvency claim, where breach of duty of claim was based on breach of duty of care by allowing corporation to enter into agreement intended to provide corporation with cash, instead of filing for bankruptcy).³⁸⁷

- *Official Committee of Unsecured Creditors of TOUSA Inc. v. Technical Olympic S.A. (In re TOUSA Inc.)* (dismissing deepening insolvency claims as barred by Delaware law, but letting stand claims for breach of fiduciary duty against directors, officers and managers of corporate debtor and its debtor-subidiaries, noting different facts than those in *Mukamal v. Bakes*).³⁸⁸

387 *Official Comm. of Unsecured Creditors of Midway Games Inc. v. Nat'l. Amusements Inc. (In re Midway Games Inc.)*, 428 B.R. 303, 315-16 (Bankr. D. Del. 2010).

388 *Official Comm. of Unsecured Creditors of TOUSA Inc. v. Technical Olympic S.A. (In re TOUSA Inc.)*, 437 B.R. 447, 465 (Bankr. S.D. Fla. 2010).