TOUSA, *USACAFES*, AND THE FIDUCIARY DUTIES OF A PARENT'S DIRECTORS UPON A SUBSIDIARY'S INSOLVENCY

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I. **Introduction**

The recent economic climate has increased the tension between a variety of legal doctrines that, until relatively recently, were rarely considered together. Law regarding fiduciary duties, including those of controlling stockholders or parent entities, has been around for many years; law regarding limited liability companies and limited partnerships, and their controlling entities, is not as developed. The effect of insolvency on these doctrines is even less certain. In October 2010, the U.S. Bankruptcy Court for the Southern District of Florida issued its opinion in *In re TOUSA, Inc.*,[1] dealing with the intersection of all these issues. It is noteworthy because it appears to be the first reported opinion holding that a subsidiary's creditors committee may assert derivative claims for breach of fiduciary duty against not only the insolvent debtor/subsidiary's directors but also the directors of the debtor's parent. In this article, we examine the *TOUSA* opinion, and the doctrines it relies on, in an attempt to understand how these doctrines should be treated together.

Entities typically have wide discretion in how they deal with their wholly owned subsidiaries. Indeed, courts have recognized that wholly owned subsidiaries exist (and are created) for the purpose of serving their parent's needs.[2] Thus directors of such a subsidiary owe fiduciary duties to manage the subsidiary in the

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[1]*In re TOUSA, Inc.*, 437 B.R. 447, 53 Bankr. Ct. Dec. (CRR) 220 (Bankr. S.D. Fla. 2010).

[2]E.g., *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, 545 A.2d 1171, 1174 (Del. 1988) (stating that, "in a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders"); *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 173 (Del. Ch. 2006), judgment aff'd, 931 A.2d 438 (Del. 2007) ("Wholly-owned sub-

best interests of the parent and its stockholders. In other words, a parent may treat its wholly owned subsidiary as a wallet to be opened as necessary in support of the parent's business.[3] However, all of that can change when the subsidiary is insolvent—at that point, the parent may have to take into account the interests of the subsidiary's creditors. The *TOUSA* court went a step further and added to the arsenal of creditors by holding that insolvent subsidiaries (through a creditors committee) could pursue a claim for breach of fiduciary duty against their parent's directors. *TOUSA*'s ruling was based in part on the Delaware Court of Chancery's *USACafes* opinion, which had held that, in certain circumstances, the directors of a corporate general partner could owe fiduciary duties to the limited partners.

In this article, we explore *TOUSA*'s rationale—including the Delaware law thatit relied on—and a line of Delaware authority suggesting a different result. We then discuss the effects of insolvency on fiduciary duties and examine the broader question of whether the *USACafes* doctrine should generally permit fiduciary suits against a parent's directors upon a subsidiary's insolvency. We conclude that the *TOUSA* court's result was not fully supported by Delaware law, and that *TOUSA* improperly expanded the holding of *USACafes*. We also suggest that *USACafes* should have only limited application in the insolvency context

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sidiaries are expected to operate for the benefit of their parent corporations; that is why they are created") *Trenwick America Litigation Trust v. Billett*, 931 A.2d 438 (Del. 2007) (TABLE).

[3]This often takes the form of operating subsidiaries guarantying the parent's debts (even though the subsidiary itself receives no direct benefit from providing the guaranty). Cf. Del. Code Ann. tit. 8,. § 122(13) ("Every corporation created under this chapter shall have power to . . . [m]ake contracts, including contracts of guaranty and suretyship, incur liabilities, borrow money at such rates of interest as the corporation may determine, issue its notes, bonds and other obligations, and secure any of its obligations by mortgage, pledge or other encumbrance of all or any of its property, franchises and income, and make contracts of guaranty and suretyship which are necessary or convenient to the conduct, promotion or attainment of the business of (a) a corporation all of the outstanding stock of which is owned, directly or indirectly, by the contracting corporation, or (b) a corporation which owns, directly or indirectly, all of the outstanding stock of the contracting corporation, or (c) a corporation all of the outstanding stock of which is owned, directly or indirectly, by a corporation which owns, directly or indirectly, all of the outstanding stock of the contracting corporation, which contracts of guaranty and suretyship shall be deemed to be necessary or convenient to the conduct, promotion or attainment of the business of the contracting corporation, and make other contracts of guaranty and suretyship which are necessary or convenient to the conduct, promotion or attainment of the business of the contracting corporation").

and that cases like *TOUSA* should instead proceed under claims for aiding and abetting breach of fiduciary duty.

II. **The *TOUSA* Case**

A. **Background**

TOUSA involved a family of companies navigating the real estate meltdown of the late 2000s. TOUSA, Inc. is a public company that builds homes in a number of regions around the U.S. After complications arose from the 2005 acquisition of the homebuilding assets of a Florida company, TOUSA and its affiliates filed Chapter 11 cases on January 29, 2008.

Briefly, the *TOUSA* story is as follows:[4] TOUSA went public in 1998 and—while growing quickly—found itself owing more than $1 billion in unsecured bond indebtedness as a result of a number of acquisitions.[5] In 2005, TOUSA Homes, L.P. (Homes LP), a wholly owned subsidiary of TOUSA, formed a joint venture with another entity to acquire certain Florida-based homebuilding assets of Transeastern Properties, Inc.[6] Homes LP contributed $90 million in cash to the joint venture, which was also funded by nearly $700 million in debt.[7] TOUSA and Homes LP both executed guaranties in connection with the debt financing.[8]

The joint venture quickly became a victim of the housing downturn, and the Transeastern lenders began litigation against TOUSA and Homes LP.[9] In July 2007, TOUSA settled the litigation, promising to pay more than $421 million to certain Transeastern lenders.[10] To finance the settlement, TOUSA borrowed $500 million, all of which was secured by the assets of certain TOUSA subsidiaries (called the Conveying Subsidiaries in the *TOUSA* opinion) (the "Transaction").[11] In a 182-page post-trial opinion issued in October 2009, the bankruptcy court found

[4]This summary is taken from an opinion issued in a different adversary proceeding in TOUSA's bankruptcy case involving the same transactions. See *In re TOUSA, Inc.*, 422 B.R. 783 (Bankr. S.D. Fla. 2009).

[5]TOUSA, 422 B.R. at 787.

[6]TOUSA, 422 B.R. at 787–88.

[7]TOUSA, 422 B.R. at 788.

[8]TOUSA, 422 B.R. at 788.

[9]TOUSA, 422 B.R. at 789.

[10]TOUSA, 422 B.R. at 789.

[11]TOUSA, 422 B.R. at 789.

the liens and security interests granted by the Conveying Subsidiaries in the Transaction to have been fraudulent transfers.[12]

In a separate adversary proceeding, the Creditors' Committee sued—on behalf of the Conveying Subsidiaries' bankruptcy estates[13]—the individuals who managed TOUSA and its subsidiaries,[14] claiming breaches of fiduciary duties in approving the granting of the liens and security interests to the Transeastern lenders. That suit led to the *TOUSA* opinion.

B. The *TOUSA* opinion

The *TOUSA* complaint contained five counts: (1) breach of fiduciary against TOUSA's directors for effecting the Transaction; (2) if TOUSA's directors were found not to owe any fiduciary duties to the Conveying Subsidiaries, in the alternative, aiding and abetting breach of fiduciary duties by TOUSA's directors for directing the Subsidiaries' directors and managers to effect the Transaction; (3) breach of fiduciary duty against the Conveying Subsidiaries' directors and managers for their part in the Transaction; (4) breach of fiduciary duty against a particular member of TOUSA's board who did not take part in approving the Transaction; and (5) aiding and abetting breach of fiduciary duty against Technical Olympic S.A.[15] The *TOUSA* court addressed

[12]TOUSA, 422 B.R. at 786.

[13]The various TOUSA debtors had jointly administered Chapter 11 cases. As is typical absent an actual conflict, one creditors' committee was formed to represent the creditors of all the TOUSA entities. The opinion reflects that the named plaintiff was the creditors' committee of "TOUSA, Inc., et al.," seeming to indicate that the committee of the parent as well as the committees of the subsidiaries were the plaintiffs. The complaint's opening paragraph uses the same terminology but goes on to confirm that the suit is filed "on behalf of and as the representative of the bankruptcy estates of the Conveying-Subsidiaries." First Amended Adversary Proceeding Complaint at 1, Official Committee of Unsecured Creditors of TOUSA, Inc. v. Technical Olympic, S.A. (In re TOUSA, Inc.), Adv. Pro. No. 09-01616-JKO, ECF No. 93 (Bankr. S.D. Fla. Feb. 19, 2010) [hereinafter Complaint]. Given the qualifying language, it is not clear why TOUSA's own committee would be a proper plaintiff. This article focuses on the claims as being brought on behalf of the estates of the Conveying Subsidiaries, not the estate of TOUSA.

[14]It is important to note that the claims for breach of fiduciary duty were not brought against any parent entity—only against individuals. Only one corporate entity was sued, Technical Olympic S.A. While Technical Olympic was the majority stockholder of TOUSA, it was sued only for aiding and abetting breach of fiduciary duties, not for any breach of fiduciary duties of its own. Complaint ¶¶ 185–88.

[15]Complaint ¶¶ 163-88.

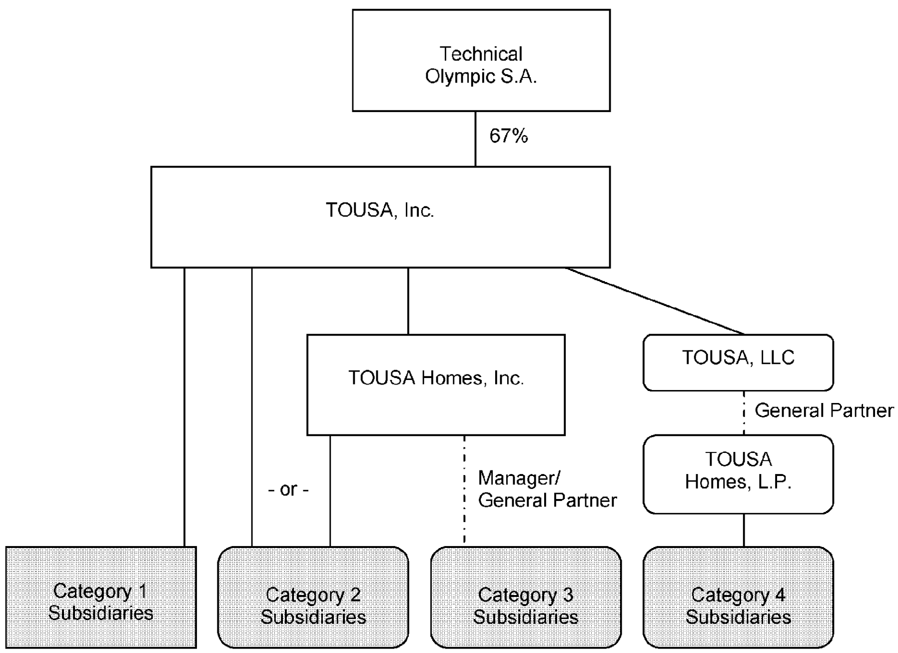
"seven motions to dismiss by twenty defendants" and denied each of them.[16]

The corporate structure of the TOUSA companies is not discussed in detail in the opinion, but it is relevant to the discussion here. Before the bankruptcy, roughly 67% of TOUSA's common stock was owned by Technical Olympic S.A., a publicly traded Greek company.[17] TOUSA itself was the parent of TOUSA

[16]TOUSA, 437 B.R. at 451–52. While not discussed further in this article, the court denied the motion to dismiss the fourth count, holding that the director's recusal did not grant him full protection. TOUSA, 437 B.R. at 455.

[17]TOUSA, Inc., Quarterly Report (Form 10-Q), at 9 (May 27, 2008).

Homes, Inc. (Homes Inc.).[18] The 34 Conveying Subsidiaries (mostly Delaware entities but some organized in other states) fall into a few broad categories:[19] (1) 10 were corporations; (2) 13 were limited liability companies (LLCs) that had TOUSA or Homes Inc. as a sole member; (3) six were LLCs or limited partnerships (LPs) that had Homes Inc. as a manager or a general partner; and (4) two were LLCs in which the sole member was Homes LP (the general partner of which was TOUSA, LLC, of which the sole member was TOUSA).[20] A simplified family tree is set forth below for clarity:[21]



[18]Corporate Structure, http://www.tousa.com/corp_structure.html (last visited November 8, 2010).

[19]Certain facts presented below are taken directly from the Complaint that was the subject of the *TOUSA* opinion. The facts drawn from the Complaint are assumed to be true for purposes of understanding the opinion, but the authors take no position on the actual truth or falsity of the facts alleged.

[20]Complaint ¶¶ 14-48. The remaining Conveying Subsidiaries included an LP in which TOUSA Realty, Inc. was the general partner; a trust; and an LLC managed by individuals. Complaint ¶¶ 14-48.

[21]Except where noted, solid lines reflect 100% ownership; dashed lines reflect a general partner or LLC manager relationship. Rounded rectangles are LLCs or LPs; other rectangles are corporations. The sole member of the Cate-

The fiduciary claims brought in relation to the four categories of Conveying Subsidiaries differ depending on the category in which each subsidiary resides. For category one subsidiaries, the fiduciary claims were brought against the subsidiary corporations' directors.[22] Regarding category two subsidiaries, the fiduciary claims were brought against the directors of the subsidiary's sole member (i.e., the directors of either TOUSA or Homes Inc.).[23] For category three subsidiaries, the Committee asserted fiduciary claims against the subsidiary's individual managers as well as against the directors of Homes Inc.[24] With respect to category four subsidiaries, the fiduciary claims reached up the chain to TOUSA's directors.[25]

The court's analysis of the legal issues proceeded in three main parts. First, the court held that the Committee was asserting derivative claims—not direct claims—for breaches of fiduciary duties owed to the Conveying Subsidiaries.[26] The Court stated that the defendants' contentions that "the conveying subsidiaries and their creditors are not owed fiduciary duties upon insolvency . . . fl[ew] in the face of well-settled case law."[27] Citing a number of well-known cases, the Court held that directors of "an insolvent, wholly-owned subsidiary owe fiduciary duties to the subsidiary and its creditors" and that directors of an insolvent subsidiary may not let it be " 'plundered for the benefit of its parent corporation.' "[28]

The court accepted the allegations that the Conveying Subsidiaries were insolvent and therefore held that the Conveying Subsidiaries "and their stakeholders, including creditors, were owed

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gory 2 Subsidiaries is either TOUSA or Homes, Inc.; none of those subsidiaries is jointly owned by TOUSA and Homes, Inc.

[22]E.g., Complaint ¶ 16.

[23]E.g., Complaint ¶ 18.

[24]E.g., Complaint ¶ 15.

[25]E.g., Complaint ¶ 40.

[26]TOUSA, 437 B.R. at 456–57. The court reasoned that the harm and remedy both ran to the estates of the Conveying Subsidiaries themselves, not to individual creditors. TOUSA, 437 B.R. at 456.

[27]TOUSA, 437 B.R. at 457.

[28]TOUSA, 437 B.R. at 458–59 (citing, among others, *In re Scott Acquisition Corp.*, 344 B.R. 283, 46 Bankr. Ct. Dec. (CRR) 196 (Bankr. D. Del. 2006); *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), judgment aff'd, 931 A.2d 438 (Del. 2007); and *In re Teleglobe Communications Corp.*, 493 F.3d 345 (3d Cir. 2007), as amended, (Oct. 12, 2007).

fiduciary duties for purposes of these motions to dismiss."[29] The court also noted that the Conveying Subsidiaries were owed fiduciary duties by the directors of the Subsidiaries.[30] It then moved to the next step, invoking the Delaware Court of Chancery's *USACafes* opinion.[31] "Delaware law," stated the court, "expressly rejects the notion that directors of a corporation owe no fiduciary duties to a limited partnership or LLC controlled by that corporation."[32]

In the second portion of the opinion, the court held that the Creditors' Committee's complaint had adequately alleged a claim that the individual defendants had breached their duties of loyalty and care.[33] The court noted that directors of an insolvent subsidiary may not allow it to be "plundered" for the benefit of its parent and described the key allegation that the Conveying Subsidiaries "received little or nothing in return for the liens on their assets and that the cash proceeds of the July 2007 transaction went to satisfy the obligations of others."[34]

Finally, the court held that the Complaint adequately pleaded a claim for aiding and abetting breaches of fiduciary duties.[35] The defendants allegedly "used insolvent subsidiary debtors' assets to expand the parents' pie at the expense of the subsidiaries' non-

[29] TOUSA, 437 B.R. at 459. It should be noted that, although *TOUSA* was decided after the Delaware Supreme Court's *Gheewalla* decision, this description of fiduciary duties upon insolvency has a decidedly pre-*Gheewalla* flavor. The Delaware Supreme Court held that "directors owe fiduciary duties to the corporation" and refused to recognize a situation in which "directors of an insolvent corporation owe direct fiduciary duties to creditors." *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92, 101, 103 (Del. 2007). While the creditors of an insolvent corporation have "standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties," Gheewalla, 930 A.2d at 101, it is not true that directors of an insolvent Delaware corporation owe direct fiduciary duties to creditors. The case cited by the *TOUSA* court was a pre-*Gheewalla* opinion of the Delaware Bankruptcy Court stating that "upon insolvency directors of a wholly-owned subsidiary owe fiduciary duties to the subsidiary and its creditors." Scott Acquisition Corp., 344 B.R. at 290. But see Scott Acquisition Corp., 344 B.R. at 289 ("the fact of insolvency does not change the primary object of the director's duties, which is the firm itself").

[30] TOUSA, 437 B.R. at 459.

[31] TOUSA, 437 B.R. at 460 n.44 (citing *In re USACafes, L.P. Litigation*, 600 A.2d 43, Fed. Sec. L. Rep. (CCH) P 96056 (Del. Ch. 1991)).

[32] TOUSA, 437 B.R. at 460.

[33] TOUSA, 437 B.R. at 460–63.

[34] TOUSA, 437 B.R. at 462, 464.

[35] TOUSA, 437 B.R. at 463–64.

parent stakeholders."[36] Ultimately, each of the defendants' motions to dismiss were denied.[37]

III. Fiduciary Duties of Parents and Their Directors

Most of the *TOUSA* opinion is not novel, although it combines, in heretofore novel ways, a complex web of Delaware law regarding parent-subsidiary relations, fiduciary duties, and insolvency. The issue most pertinent here is the holding that TOUSA's directors owed fiduciary duties to the Conveying Subsidiaries' creditors.[38] The *TOUSA* court's reasoning on that issue rests on a syllogism based on Delaware law: creditors of insolvent subsidiaries are owed fiduciary duties by the parent; under *USACafes*, directors of a corporate parent owe fiduciary duties to a LLC or LP controlled by that parent; therefore, directors of a parent owe fiduciary duties to the creditors of an insolvent LLC or LP subsidiary. This syllogism depends greatly on the proposition that directors of a corporate entity that controls an LLC or LP owe fiduciary duties to that LLC or LP. But that is not necessarily true under Delaware law.

While a person in control generally may be held to owe fiduciary duties to those whose property she controls, those fiduciary duties might not be coextensive with—or exist in the same circumstances as—the full panoply of duties typically owed by directors of Delaware corporations. More recently, the Delaware Court of Chancery has read *USACafes* narrowly and held that a valid claim for breach of fiduciary duty by the director of a corporate general partner (or an LLC's manager) is made only when the director obtains a personal benefit at the expense of the entity. The *TOUSA* court did not perform such an analysis.[39]

A. Fiduciary duties of parents, subsidiaries, and their directors

The baseline law regarding fiduciary duties owed by directors of parents and subsidiaries varies depending on the parent's level of ownership. For example, a "parent corporation does not owe fi-

[36] TOUSA, 437 B.R. at 464.

[37] TOUSA, 437 B.R. at 465.

[38] Or Homes Inc.'s directors, in the appropriate case. See supra note 24. That distinction is not important for purposes of the article.

[39] *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, *10 (Del. Ch. 2009).

duciary duties to its [solvent] wholly-owned subsidiaries."[40] Similarly, "in a parent and wholly-owned subsidiary context, the directors of the [solvent] subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders."[41]

The situation is different for non-wholly owned subsidiaries. Directors of a non-wholly owned subsidiary owe fiduciary duties to all the subsidiary's stockholders and may not simply follow the parent's wishes.[42] Moreover, the parent of a non-wholly owned subsidiary may owe fiduciary duties to the subsidiary's minority stockholders.[43]

Furthermore, the fiduciary duties owed by a parent of a non-wholly-owned subsidiary may stretch a long way up the corporate ladder—at least from an entity standpoint.[44] In *Deutsch v. Cogan*, the Delaware Court of Chancery held that fiduciary obligations to a corporation's minority stockholders were owed by, among others, the following: the corporation's majority stockholder (A), A's

[40] Trenwick Am. Litig., 906 A.2d at 191; see also Trenwick 906 A.2d at 173 ("Parent corporations do not owe [wholly owned] subsidiaries fiduciary duties. That is established Delaware law."); Anadarko Petroleum Corp., 545 A.2d at 1174 ("Anadarko acknowledges that a parent does not owe a fiduciary duty to its wholly owned subsidiary"); Teleglobe Commc'ns Corp., 493 F.3d at 367 n.24 (noting that, under Delaware law, there is "nothing wrong (or even unusual) about a parent causing its . . . subsidiary to act in a way that benefits the corporate family but harms the individual subsidiary").

[41] Anadarko, 545 A.2d at 1174; see also Trenwick, 906 A.2d at 173 ("Wholly-owned subsidiary companies are expected to operate for the benefit of their parent corporations; that is why they are created"); Trenwick 906 A.2d at 202 ("because the Trenwick America board, as directors of a wholly-owned subsidiary, was entitled to follow the parent's instructions unless those instructions required the board to violate the legal rights of others, no due care claim may be brought against them"); Teleglobe, 493 F.3d at 366 ("Delaware courts have recognized that parents and their wholly owned subsidiaries have the same interests because all of the duties owed to the subsidiaries flow back up to the parent").

[42] See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701, 709–10 (Del. 1983).

[43] See, e.g., *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110, 1113–15 (Del. 1994); *Cinerama, Inc. v. Technicolor, Inc.*, 17 Del. J. Corp. L. 551, 1991 WL 111134, *19 (Del. Ch. 1991) ("when a shareholder, who achieves power through the ownership of stock, exercises that power by directing the actions of the corporation, he assumes the duties of care and loyalty of a director of a corporation").

[44] As will be discussed below, there is a distinction between holding the controlling stockholder as a corporate entity liable for breach of duty to the subsidiary and its stakeholders and holding the directors of that corporate entity liable.

100% owner (B), B's 100% owner (C), and the majority holder of C's stock (D).[45] The court held that "[A] clearly owed fiduciary obligations to [the corporation's] minority shareholders," and "because [D] exercised control over [A] through [C] and [B], those companies and [D] also owed fiduciary obligations to [the corporation's] minority shareholders."[46] Similarly, the Court of Chancery in *Primedia* found that investment firm KKR controlled Primedia, Inc.—and therefore owed fiduciary duties to Primedia's minority stockholders—through a "complex structure of intermediate entities," including a layer of LPs and their general partner.[47]

B. *USACafes*

In the 1991 *USACafes* case,[48] the Delaware Court of Chancery extended this principle, on the basis of trust law concepts, to reach inside the controlling entity and touch the individual directors of a corporate general partner. The suit was a class action brought by holders of limited partnership interests in USACafes, L.P., challenging a purchase by Metsa Acquisition Corp. of substantially all of USACafes' assets for $73 million.[49] Among the defendants in the case were USACafes' corporate general partner; the Wyly brothers, who owned all of the general partner's stock, sat on its board and owned 47% of USACafes' limited partnership

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[45] *Deutsch v. Cogan*, 580 A.2d 100, 102, 107 (Del. Ch. 1990).

[46] Cogan, 580 A.2d at 107 ("Such fiduciary obligations run necessarily to protect the interest of the minority from domination and overreaching by the controlling shareholder" (internal quotation marks omitted)).

[47] *In re Primedia Inc. Derivative Litigation*, 910 A.2d 248, 251, 257 (Del. Ch. 2006); see also Primedia Inc. Derivative Litigation, 910 A.2d at 251 ("An amalgamation of investment partnerships owns approximately 60% of Primedia's outstanding common stock. Six limited partnerships collectively own 40.34%; of Primedia's common stock. KKR Associates, L.P. is the general partner of each of these investment entities and possesses sole voting and investment power over them. KKR 1996 Fund L.P. is the record owner of 20.91%; of Primedia's common stock. KKR Associates 1996, L.P. is the sole general partner of KKR 1996 Fund. KKR 1996 GP, LLC is the sole general partner of KKR Associates 1996 and thus possesses sole voting and investment power over KKR 1996 Fund. When the dust settles, this web of entities allegedly gives KKR Associates and KKR 1996 GP voting and investment power over 61.25%; of Primedia's common stock. Importantly, every general partner of KKR Associates and every member of KKR 1996 GP is a member of the limited liability company that serves as the general partner of KKR.").

[48] *In re USACafes, L.P. Litigation*, 600 A.2d 43, Fed. Sec. L. Rep. (CCH) P 96056 (Del. Ch. 1991).

[49] USACafes, 600 A.2d at 45.

units; and the general partner's other directors.[50] Among the allegations arrayed against these defendants were that (1) the general partner's directors received "substantial side payments," in the realm of $15 to $17 million, that induced them to approve the asset sale at an unfairly low price; and (2) the general partner and/or its directors were insufficiently informed to make a valid business judgment about the asset sale.[51]

The Wylys and the other director defendants moved to dismiss, arguing that—while the general partner owed fiduciary duties to the limited partners—the directors of the general partner did not.[52] The court found "no corporation law precedents directly addressing the question whether directors of a corporate general partner owe fiduciary duties to the partnership and its limited partners."[53] Nevertheless, the court stated that the answer to the question "seems to be clearly indicated by general principles and by analogy to trust law."[54]

As a general principle, the court stated that "one who controls property of another may not, without implied or express agreement, intentionally use that property in a way that benefits the holder of the control to the detriment of the property or its beneficial owner."[55] The court also found that "a large number of trust cases . . . stand for a principle that would extend a fiduciary duty" owed by directors of corporate general partners to a limited partnership.[56] Applying those authorities, the court held the "theory underlying fiduciary duties [to be] consistent with recognition that a director of a corporate general partner bears such a duty towards the limited partnership."[57] The court also cited to cases holding a controlling stockholder of a corporate general partner "personally liable for breach of fiduciary duty to limited partners," noting that those cases supported "the recognition of such duty in directors of the General Partner who, more directly than a con-

[50] USACafes, 600 A.2d at 45-46.

[51] USACafes, 600 A.2d at 46.

[52] USACafes, 600 A.2d at 47. The director defendants also moved to dismiss for lack of personal jurisdiction; the court's analysis is not addressed herein.

[53] USACafes, 600 A.2d at 48.

[54] USACafes, 600 A.2d at 48.

[55] USACafes, 600 A.2d at 48.

[56] USACafes, 600 A.2d at 48. That is, directors and officers of a corporate trustee may be in a fiduciary relation to the beneficiaries of the trust administered by that corporation. USACafes, 600 A.2d at 48–49.

[57] USACafes, 600 A.2d at 49 (noting that the duty "extends only to dealings with the partnership's property or affecting its business").

trolling shareholder, are in control of the partnership's property."[58]

The *USACafes* court expressly disclaimed any attempt to "delineate the full scope of that duty," but it held that the duty "surely entails the duty not to use control over the partnership's property to advantage the corporate director at the expense of the partnership."[59] The director defendants' motion to dismiss was therefore denied because the complaint sufficiently alleged facts that would establish (if true) that the "director defendants have breached fiduciary obligations imposed upon them as directors of a Delaware corporation or have participated in a breach of such duties by the General Partner."[60]

C. **The progeny of *USACafes***

After *USACafes* was decided, other cases in the Delaware Court of Chancery applied its holding regarding directors of a corporate general partner. One of the first was *James River* in 1995.[61] Holding that an entity called "JRP" had a "duty of loyalty to the Partnership and the other partner because it controls the general partner through the votes of its three of the six directors," the court also held (citing *USACafes*) that JRP's directors "have fiduciary duties to the Partnership and its limited partners because they control the Partnership property."[62]

In the 1999 *Boston Celtics* case, plaintiffs challenged a reorganization of a publicly traded limited partnership, alleging that the directors of the corporate general partner received a specific personal benefit.[63] The court called it "well settled that . . . the directors of a corporate General Partner who control the partnership, like the directors of a Delaware corporation, have the fidu-

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[58]USACafes, 600 A.2d at 49.

[59]USACafes, 600 A.2d at 49.

[60]USACafes, 600 A.2d at 50.

[61]*James River-Pennington Inc. v. CRSS Capital, Inc.*, 20 Del. J. Corp. L. 815, 1995 WL 106554 (Del. Ch. 1995).

[62]James River, 1995 WL 106554 at *11.

[63]*In re Boston Celtics Ltd. Partnership Shareholders Litigation*, 1999 WL 641902, *5 (Del. Ch. 1999) (listing, among the allegations, that the directors allegedly "became substantial majority owners of a privately held partnership not subject to corporate tax . . . and free from regulation under the Investment Company Act, as opposed to the owners of 47.8%; of the outstanding units of a publicly traded partnership subject to corporate tax").

ciary duty to manage the partnership in the partnership's interests and the interests of the limited partners."[64]

Wallace v. Wood was decided two months later.[65] The *Wallace* court (citing *USACafes*) stated that, "under certain circumstances, directors of a corporate general partner . . . may owe fiduciary duties to the partnership and to the limited partners."[66] The *Wallace* court recognized that *USACafes* "did not attempt to delineate the full extent of these duties," but it cited with approval *USACafes*' statement that "they must surely entail 'the duty not to use control over the partnership's property to advantage the corporate director at the expense of the partnership.' "[67] The court in the 2001 *Gotham Partners* case similarly stated that, "[u]nder settled precedent, directors of corporate general partners of limited partnerships have been held to be fiduciaries of the limited partners, and subject to liability for implementing unfair, self-dealing transactions."[68]

These cases applied *USACafes* to individual directors of an LP's corporate general partner in fairly limited circumstances: where the directors were alleged to have benefitted themselves at the LP's expense. But the Court of Chancery has also cited *USACafes* to expand the application of fiduciary duties to parents and controlling entities of the corporate general partner.[69] For example, the *Wallace* court extended fiduciary duties to the general partner's parents and affiliates, finding sufficient allegations that those parents and affiliates controlled the affairs of the partnership.[70] *Bigelow*, decided in 2001, cited *Wallace* for the proposition that "those affiliates of a general partner who exercise

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[64]Boston Celtics, 1999 WL 641902 at *4 (footnote omitted) (quoting USACafes, 600 A.2d at 48–50).

[65]*Wallace ex rel. Cencom Cable Income Partners II, Inc., L.P. v. Wood*, 752 A.2d 1175 (Del. Ch. 1999).

[66]Wallace, 752 A.2d at 1180.

[67]Wallace, 752 A.2d at 1180 (quoting USACafes, 600 A.2d at 49).

[68]*Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 795 A.2d 1, 34 (Del. Ch. 2001).

[69]Issues arising from that holding are not addressed extensively herein, since *TOUSA* applied fiduciary duties only to individuals and not to the parent corporate entities. Nevertheless, that extension of fiduciary duties seems more appropriate and in line with cases such as *Deutsch v. Cogan*, 580 A.2d 100 (Del. Ch. 1990). That is, while fiduciary duties to the subsidiary's minority equity holders may travel up the controlling corporate chain to the extent those controllers exercise their power, those duties do not break through the corporate skin to impose liability on the directors inside those parent corporations.

[70]Wallace, 752 A.2d at 1182.

control over the partnership's property may find themselves owing fiduciary duties to both the partnership and its limited partners."[71] In 2008, the Court of Chancery decided *Cargill*, which involved an action by a representative of a Delaware statutory trust against the trust's managing owner and its parent entities.[72] Discussing *USACafes*, *Wallace*, and *Bigelow*, the *Cargill* court held that the 100% parent and 100% grandparent of the trust's managing owner had "a duty not to use their control over the Trust or its property to advantage [the grandparent] or [the parent] at the expense of the Trust."[73]

D. *Bay Center* and the Court's limitation of *USACafes*

The cases described in the previous section did not significantly expand the application of *USACafes* to individual directors. Most of those cases applied *USACafes* in similar contexts, and the extensions of *USACafes* related only to the controlling corporate entities themselves (not to individual directors).

Cases applying *USACafes* to individual directors generally did so in a hesitant manner. In its 2000 *Gotham Partners* opinion, the Court of Chancery noted that the "fiduciary duties owed by directors of a corporate general partner to the limited partnership under [Delaware's LP Act] have yet to be fully defined."[74] The court referred to *USACafes* as "less venerable[75] but largely unquestioned precedent" and suggested that the decision was "in some senses unorthodox."[76] The court stated that, "[w]hen limited partners contract to join a limited partnership run by a corporate general partner, a rote traditional approach would impose fidu-

[71] *Bigelow/Diversified Secondary Partnership Fund 1990 v. Damson/Birtcher Partners*, 2001 WL 1641239, *8 n.42 (Del. Ch. 2001); see also Bigelow, 2001 WL 1641239 at *8 ("Defendants are generally said to have used their control of the affairs of the Partnership to receive unearned disposition fees, management contracts, and 'equity kickers' from the eventual purchasers of the Partnerships' properties").

[72] *Cargill, Inc. v. JWH Special Circumstance LLC*, 959 A.2d 1096, 1100 (Del. Ch. 2008).

[73] Cargill, 959 A.2d at 1121.

[74] *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 27 Del. J. Corp. L. 247, 2000 WL 1476663, *12 (Del. Ch. 2000) (citing USACafes, 600 A.2d at 43).

[75] The court was comparing the *USACafes* doctrine to "long-established principles of Delaware corporation law" providing that the directors of the corporate general partner owe fiduciary duties to the general partner and its 100% stockholder. Gotham Partners, 2000 WL 1476663 at *19.

[76] Gotham Partners, 2000 WL 1476663 at *19–20.

ciary duties solely upon the corporate general partner as an entity."[77] Under what the court called this "more strictly traditional approach," the limited partners would "be able to look to only the general partner in the first instance to seek redress for any breach of duty" and only upon "abuse of the corporate form by the owners of the corporate general partner that would justify veil piercing would the limited partners be able to look beyond the corporate partner to others for redress."[78] Under a reading of the LP agreement in question, the court granted summary judgment in favor of the outside directors on the general partner's board; in doing so, the Court noted some concern with the notion that a director's service on a general partner's board would "potentially expose[] her to a triable claim for breach of the duty of loyalty whenever she makes a good-faith decision about a transaction between the partnership and an affiliate of the general partner."[79]

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[77]Gotham Partners, 2000 WL 1476663 at *20; see also *Gotham v. Hallwood Realty Partners, L.P.*, 1998 WL 832631, *5 (Del. Ch. 1998) (noting the "reality that it is the general partner who owes the limited partners fiduciary duties, not the management of the general partner, even though they make the decisions for that business entity").

[78]*Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 27 Del. J. Corp. L. 247, 2000 WL 1476663, *20 (Del. Ch. 2000). In its decision after trial, the court held the general partner's directors jointly and severally liable for the general partner's breach of its contractual fiduciary duties. Gotham Partners, 795 A.2d at 34. Interestingly, the Delaware Supreme Court's affirmance of that portion of the Chancery opinion suggests that *USACafes* must be limited as stated later in this article. That is, the Delaware Supreme Court held that "the Court of Chancery properly held [the General Partner's directors] jointly and severally liable with the General Partner for aiding and abetting the General Partner's breach of fiduciary duties created by the Partnership Agreement." *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 172 (Del. 2002); see also Gotham Partners, 817 A.2d at 173. The court then reiterated the requirements for a claim of aiding and abetting—including that the defendant must be a non-fiduciary. Gotham Partners, 817 A.2d at 172; see also text accompanying note 131 infra. Logically, therefore, the General Partner's directors were not fiduciaries, contradicting the entire premise of *USACafes*.

[79]*Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 27 Del. J. Corp. L. 247, 2000 WL 1476663, *22 (Del. Ch. 2000). This proposition is particularly troubling because general partners (and/or their directors) in the LP or LLC context may be and often are expressly allowed in governing agreements the freedom to compete with the entities. See, e.g., First Amended and Restated Agreement of Limited Partnership of Enterprise GP Holdings L.P. § 7.5(c) (granting the corporate general partner's directors (but not the general partner) the right to "engage in businesses of every type and description . . ., including business interests and activities in direct competition with the business and activities of the Partnership or its subsidiaries, and none of the same shall con-

In its discussion, the *Gotham Partners* court specifically noted that *USACafes* "involved serious accusations of actual personal self-dealing by the individual directors of a corporate general partner."[80] The court described *USACafes* in similarly limited terms a year later. Referring to the "awkward position occupied by directors of corporate General Partners," the *Gelfman* court stated that those directors owe fiduciary duties "akin to those owed by corporate directors to stockholders . . . where [they] have acted in a way that is potentially advantageous to their personal interests and at the expense of the limited partners."[81] Because it was alleged that "the General Partner breached the modified loyalty duties it owed to the Outside Investors, to the personal benefit of the individual defendants," the court denied the directors' motion to dismiss.[82]

In 2009, the Court of Chancery applied this reasoning to limit the application of *USACafes* to individual directors. *Bay Center* involved a failed condominium development project, and the plaintiff alleged that Alfred Nevis—the owner and manager of an LLC that was itself the managing member of the LLC in question—had breached his fiduciary duties.[83] Referring to the *Gotham Partners* and *Gelfman* cases, the court noted that *USACafes* "raises some difficult policy issues and disregards corporate

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stitute a breach of this Agreement or any duty expressed or implied by law to the Partnership or its subsidiaries or any Partner"), available at Enterprise GP Holdings L.P., Current Report (Form 8-K), Ex. 3.1 (Sept. 1, 2005). Similarly, parents (and/or their directors) in the corporate context may be allowed to compete with their subsidiaries. See Del. Code Ann. tit. 8, § 122(17). As a baseline matter, any *USACafes* analysis in the LLC or LP context must be undertaken carefully in light of the entity's governing documents.

[80] *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 27 Del. J. Corp. L. 247, 2000 WL 1476663, *20 n.58 (Del. Ch. 2000). The court added: "Even then-Chancellor Allen was careful to indicate that the scope of duty owed by the general partner's directors 'may well not be so broad as the duty of the director of a corporate trustee' " *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 27 Del. J. Corp. L. 247, 2000 WL 1476663, *20 n.58 (Del. Ch. 2000) (quoting USACafes, 600 A.2d at 49).

[81] *Gelfman v. Weeden Investors, L.P.*, 792 A.2d 977, 992 n.24 (Del. Ch. 2001).

[82] *Gelfman v. Weeden Investors, L.P.*, 792 A.2d 977, 992 n.24 (Del. Ch. 2001) (noting allegations that each of the directors of the corporate general partner "increased his proportionate ownership in the Partnership at the expense of the Outside Investors").

[83] *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, *1 (Del. Ch. 2009).

formalities in a manner unusual for Delaware law."[84] The court nevertheless applied *USACafes*, "given the defendants' acceptance of the *USACafes* line of cases."[85]

However, the *Bay Center* court refused to take a broad view of the fiduciary duties imposed by that line of cases. "*USACafes* suggests that controlling affiliates do not have the full range of traditional fiduciary duties, although that case specifically disclaims any effort to fully delineate the scope of controlling affiliate duties."[86] Furthermore, the cases applying the doctrine had "not ventured beyond the clear application stated in *USACafes*: 'the duty not to use control over the partnership's property to advantage the corporate director at the expense of the partnership.' "[87] "Limiting the application of *USACafes* to this duty," the court held, "provides . . . a rational and disciplined way of protecting investors in alternative entities with managing members who are themselves entities, while not subjecting all the individuals who work for managing members to wide-ranging causes of action."[88]

The court in *Bay Center* then held that a plaintiff must plead that an individual director of an LLC's managing member personally benefited himself at LLC's expense before fiduciary duties under *USACafes* may be imposed.[89] Because the plaintiff had sufficiently pleaded that Nevis "used his control over [the LLC's] as-

[84]Bay Center, WL 1124451 at *9 n.44.

[85]Bay Center, WL 1124451 at *9 n.44.

[86]Bay Center, WL 1124451 at *9. The court also noted that "[l]ater cases have similarly declined to expound on the full scope of *USACafes* duties." Bay Center, WL 1124451 at *10.

[87]Bay Center, WL 1124451 at *10 (citing *Boston Celtics*, *Bigelow*, *Wallace*, and *USACafes*). But cf. USACafes, 600 A.2d at 49 ("Consider, for example, a classic self-dealing transaction: assume that a majority of the board of the corporate general partner formed a new entity and then caused the general partner to sell partnership assets to the new entity at an unfairly small price, injuring the partnership and its limited partners. Can it be imagined that such persons have not breached a duty to the partnership itself? And does it not make perfect sense to say that the gist of the offense is a breach of the equitable duty of loyalty that is placed upon a fiduciary?").

[88]*Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, *10 (Del. Ch. 2009).

[89]*Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, *10 (Del. Ch. 2009) ("Bay Center must therefore plead that Nevis benefited himself at the expense of [the LLC]").

sets to stave off personal liability," the court denied a motion to dismiss under *USACafes*.[90]

E. Issues in applying *USACafes*

Besides the issues noted in *Gotham Partners*, *Gelfman*, and *Bay Center*, the *USACafes* doctrine is an uneasy fit with other aspects of Delaware law. Indeed, *USACafes* came as a bit of a surprise to many practitioners. As the leading treatise on Delaware LPs states, before *USACafes*:

> the authors did not believe that the fiduciary duty of directors of a corporate general partner to the stockholders of [the] corporation or the fiduciary duty of a corporate general partner to the limited partners of the limited partnership of which it is a general partner would, in and of themselves, justify a court's holding that the directors of the corporate general partner owed a fiduciary duty to the limited partners of the limited partnership of which the corporation (and not the directors) was the general partner.[91]

That treatise's authors identify two "particularly troubling aspects" of *USACafes*:[92] First, directors of a corporate general partner are placed in a difficult position with "potentially conflicting and irreconcilable fiduciary duties (the director's traditional fiduciary duty to the stockholders of the corporation of which [she] is a director, and the director's new partnership fiduciary duty)."[93] Second, the directors of a corporate general partner may owe a direct duty to the limited partners that could be breached even if the general partner itself has not breached its duty.[94]

Delaware case law in the corporate context suggests a third

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[90] *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, *10 (Del. Ch. 2009).

[91] Martin I. Lubaroff & Paul M. Altman, Lubaroff & Altman on Delaware Limited Partnerships § 11.2.11, at 11-32.2 (1995, 2010 Supp.); see also Lubaroff & Altman, at § 11-32.3 (stating that, before *USACafes*, "many practitioners believed that a director had no duties to a limited partner").

[92] Lubaroff & Altman, at 11-35.

[93] Lubaroff & Altman, at 11-35 to 11-36. Such a conflict can be seen by contrasting a director's potential "up-the-ladder" *USACafes* duties with, for example, *Case Financial, Inc. v. Alden*, 2009 WL 2581873, *7 (Del. Ch. 2009). In that case, the Court of Chancery allowed a parent company to assert direct claims for breach of fiduciary duty against an officer for actions taken at a subsidiary that indirectly harmed the parent—"down-the-ladder" liability.

[94] The treatise's authors "do not believe that *USACafes, L.P.* should be read to permit this possibility." Lubaroff & Altman, § 11.2.11, at 11-36. This issue is particularly interesting because the fiduciary duties of a general partner or a managing member may be eliminated altogether in the entity's governing agreement. Del. Code Ann. tit. 6,. § 17-1101(d) (LP Act), § 18-1101(d) (LLC Act). The Court of Chancery appears to have addressed the concern somewhat in its

problem: traditionally, directors of a controlling stockholder do not owe direct fiduciary duties to the controlled subsidiary. The Court of Chancery has suggested that it would be "unwise to extend the application of those duties as it would undermine a primary benefit of the corporate form."[95] In its 2006 *Trenwick* decision, the Court of Chancery stated that, as a matter of Delaware law, the plaintiff could "not assert claims on behalf of [subsidiary] Trenwick America against the [parent] board of directors without piercing Trenwick's veil in some manner."[96] In other words, if there was a "breach of fiduciary duty by conduct at the Trenwick-level toward Trenwick America, the proper defendant is Trenwick itself, as the parent corporation, not the directors of Trenwick."[97]

While the Court of Chancery worries about "undermin[ing] a primary benefit of the corporate form"[98] and states that "Delaware law does not blithely ignore corporate formalities,"[99] Delaware courts have not expressly set forth a doctrinal reason that the law should treat LLCs, LPs, and statutory trusts differently in this respect from corporations. Indeed, in *Gotham Partners*,

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2001 *Gotham Partners* decision, holding that directors of a corporate general partner "cannot be held liable for breach of fiduciary duty in a situation where the General Partner, because of its compliance with a contractual safe harbor, does not owe such liability." Gotham Partners, L.P., 795 A.2d at 34. But cf. USACafes, 600 A.2d at 49 ("Indeed in some instances, for example the use by a director of confidential information concerning the partnership's business not yet known by the board of the general partner, there may be no breach of loyalty or care by the general partner itself to abet, yet there may be director liability to the partnership by the director").

[95] *Oliver v. Boston University*, 2000 WL 1038197, *7 (Del. Ch. 2000).

[96] Trenwick Am. Litig. Trust, 906 A.2d at 194; cf. *Gotham v. Hallwood Realty Partners, L.P.*, 1998 WL 832631, *5 (Del. Ch. 1998) (noting the "reality that it is the general partner who owes the limited partners fiduciary duties, not the management of the general partner, even though they make the decisions for that business entity").

[97] Trenwick, 906 A.2d at 194 ("Delaware law does not blithely ignore corporate formalities and the Litigation Trust has not explained how the Trenwick directors, as opposed to Trenwick, can be deemed to be a 'controlling stockholder' group that owes fiduciary duties to a subsidiary."). The court also noted policy concerns with expanding liability in such a way, particularly when considering directors' exculpation from certain breaches of fiduciary duty. See Trenwick, 906 A.2d at 194. To avoid unforeseen results, the Delaware LP treatise recommends defining in the partnership agreement the fiduciary duties owed by the directors of a corporate general partner. Lubaroff & Altman, § 11.2.11, at 11-35.

[98] *Oliver v. Boston University*, 2000 WL 1038197, *7 (Del. Ch. 2000).

[99] Trenwick, 906 A.2d at 194.

the Court of Chancery noted that, under the "more strictly traditional approach," even with respect to challenges by limited partners, "[o]nly if there had been abuse of the corporate form by the owners of the corporate general partner that would justify veil piercing would the limited partners be able to look beyond the corporate partner to others for redress."[100] Yet *USACafes* has thus far been applied to LPs, a statutory trust, and an LLC[101] but never to a corporation.

The reason might lie in the nature of the "person" managing the entity's business and affairs. A corporation is managed by its board of directors, which must be filled with natural persons.[102] An LP, on the other hand, is managed by a general partner, which may be a corporate entity.[103] *USACafes* appears to be motivated by the desire to break through the corporate skin and attach liability—in an appropriate circumstance—to the actual individuals, the natural persons, responsible for wrongdoing. In the corporate context, those individuals are easy to spot: they serve on the corporation's board of directors. In the context of LLCs and LPs, the courts must look inside the entity serving as a fiduciary.

Some of the concerns implicated by *USACafes* have been mitigated by later developments in the Court of Chancery. For example, *Bay Center*'s limitation of *USACafes* ensures that a director of the corporate general partner only owes *USACafes* duties once she acts at the partnership's expense to her own personal benefit. In that context, the concern of a recurrent conflict between duties to the partnership and duties to the general partner's stockholders is significantly reduced. That is, a director abusing the partnership's assets for personal gain is conceptually very different from—and deserving of less protection

[100] *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 27 Del. J. Corp. L. 247, 2000 WL 1476663, *20 (Del. Ch. 2000); cf.*Gotham v. Hallwood Realty Partners, L.P.*, 1998 WL 832631, *5 (Del. Ch. 1998) (stating that allowing demand in a derivative suit on behalf of an LP to be made against a general partner's directors, rather than against the general partner itself, would "undermine this state's established policy of respecting the legal fiction of the business entity").

[101] It should be noted that the defendants in *Bay Center* apparently did not dispute *USACafes*' application to an LLC.*Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451 (Del. Ch. 2009) (noting that the "defendants [did] not challenge the general applicability of [the *USACafes*] doctrine in the LLC context").

[102] Del. Code Ann. tit. 8, § 141(b).

[103] Del. Code Ann. tit. 6, § 17-101(5), (14) (defining "general partner" as a "person," and "person" to include any type of corporate entity).

than—a director acting in good faith in the interests of the general partner's stockholders but arguably at the expense of the partnership. *Bay Center*'s limitation of the *USACafes* duty does not, however, resolve the concern noted above that imposing "up-the-ladder" fiduciary duties "undermines a primary benefit of the corporate form." Nonetheless, imposing *USACafes* duties only where the directors of the corporate general partner have acted for their own personal benefit at least requires a plaintiff to prove something quite akin to one aspect of the veil-piercing test—that the director is actively using the general partner's control over the partnership for improper personal gain.[104]

IV. **Fiduciary Duties in Insolvency**

The fiduciary issues discussed above are further complicated by the issue of insolvency. That is, the allocation of fiduciary duties between wholly owned subsidiaries and their parents may change significantly when the subsidiary is insolvent. When a Delaware corporation becomes insolvent, directors must consider what is in the best interests of the corporation as a whole, including creditors. As the Delaware Supreme Court held in *Gheewalla*:

> It is well settled that directors owe fiduciary duties to the corporation. When a corporation is *solvent*, those duties may be enforced by its shareholders, who have standing to bring *derivative* actions on behalf of the corporation because they are the ultimate beneficiaries of the corporation's growth and increased value. When a corporation is *insolvent*, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value.
>
> Consequently, the creditors of an *insolvent* corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties.[105]

In its 2007 *Teleglobe* opinion, the Third Circuit held that, under *Gheewalla*, the parent of an insolvent subsidiary must take into account the interests of the subsidiary's creditors: "If the [subsidiaries] were solvent, then all duties flowed back up to [the parent] as the only party with a legitimate interest in the [subsidiar-

[104] *Cf. Irwin & Leighton, Inc. v. W.M. Anderson Co.*, 532 A.2d 983, 987 (Del. Ch. 1987) ("two elements are essential for liability under the instrumentality doctrine. First the dominant corporation must have controlled the subservient corporation and second, the dominant corporation must have proximately caused plaintiff harm through misuse of this control" (internal quotation marks omitted)).

[105] Gheewalla, 930 A.2d at 101; see also Trenwick Am. Litig. Trust, 906 A.2d at 195 ("[O]ur law already requires the directors of an insolvent corporation to consider, as fiduciaries, the interests of the corporation's creditors who, by definition, are owed more than the corporation has the wallet to repay").

ies'] success . . . However, if the [subsidiaries] were insolvent, then their creditors also had a legitimate interest in their success."[106] The *TOUSA* court relied on *Teleglobe* and similar cases in holding that, upon the Conveying Subsidiaries' insolvency, fiduciary duties were owed to the Conveying Subsidiaries' creditors, even though the Conveying Subsidiaries were wholly owned.[107]

In an additional wrinkle, the *TOUSA* court appears to have reached a result inconsistent with Delaware law as revealed a few weeks after the *TOUSA* opinion. That is, unlike for corporations, creditors of an insolvent LLC cannot maintain a suit for breach of fiduciary duties—whether directly or derivatively—for two reasons. First, *Gheewalla* makes clear that a corporation's creditors do not have standing to bring direct claims for breach of fiduciary duty, even when the corporation is insolvent; *Gheewalla* merely authorized creditors to obtain *derivative* standing.[108] Second, nearly half (13) of the Conveying Subsidiaries are Delaware LLCs (and one is a Delaware LP).[109] The Delaware Court of Chancery held, about a month after *TOUSA* was issued, that—although the rule is different for Delaware corporations—creditors of Delaware LLCs (even insolvent LLCs) may not bring derivative actions on behalf of the LLCs.[110] It is thus unclear whether, under Delaware law, the *TOUSA* Court was authorized to allow the Creditors Committee to bring the derivative claims

[106]Teleglobe, 493 F.3d at 386; see also Teleglobe, 493 F.3d at 367 ("the only interest of a wholly owned subsidiary is in serving its parent. That doing so may not always involve maximizing the subsidiary's economic value is of little concern. If the subsidiary is not wholly owned, however, in the interest of protecting minority shareholders we revert to requiring that whoever controls the subsidiary seek to maximize its economic value with requisite care and loyalty. Similarly, if the subsidiary is insolvent, we require the same in the interest of protecting the subsidiary's creditors." (citation omitted)); see also supra note 29.

[107]TOUSA, 437 B.R. at 459 ("Because the conveying subsidiaries are alleged to have been insolvent, they and their stakeholders, including creditors, were owed fiduciary duties for purposes of these motions to dismiss.").

[108]*Gheewalla*, 930 A.2d at 103 ("we hold that individual *creditors* of an *insolvent* corporation have *no right to assert direct* claims for breach of fiduciary duty against corporate directors"). In fact, defendants in the *TOUSA* case had moved to dismiss in part on the grounds that the claims brought by the Creditors' Committee were direct, but the *TOUSA* court held that the claims were derivative and therefore proper. *In re TOUSA, Inc.*, 437 B.R. 447, 455–457 (Bankr. S.D. Fla. 2010).

[109]Complaint ¶¶ 15-41.

[110]*CML V, LLC v. Bax*, 6 A.3d 238, 239 (Del. Ch. 2010); see also Bax, 6 A.3d at 246 (suggesting that the same analysis would apply to Delaware LPs).

pleaded on behalf of the Conveying Subsidiaries organized as Delaware LLCs or LPs.[111]

V. Applying *USACafes*

The complications involved in *USACafes* are exacerbated in the insolvency context. For the *TOUSA* court's syllogism to hold, the duties imposed by *USACafes* on directors of a corporate general partner would have to take creditors into account upon the LP's insolvency. However, the *TOUSA* court's reliance on *USACafes* does not square perfectly with Delaware's more recent, limited application of *USACafes* duties. Furthermore, *TOUSA* applies *USACafes* in a situation far beyond its typical application—to provide for fiduciary duties that benefit creditors in insolvency. The larger question is whether applying *USACafes* in the insolvency context is appropriate as a general matter.

A. *USACafes* in the *TOUSA* opinion

As noted above, parents owe fiduciary duties to their insolvent subsidiaries because, upon insolvency, another constituency emerges whose interests matter: the subsidiaries' creditors.[112] However, the Creditors' Committee in *TOUSA* did not sue the parent entities of the Conveying Subsidiaries for breach of fiduciary duties; it only sued the individuals serving as directors of those parent entities.[113] Because up-the-ladder individuals—not entities—were sued, the *Teleglobe* rationale, standing alone, would have been insufficient to reach most of the defendants,[114] and the motions to dismiss would have been granted. The *TOUSA*

[111]See generall, Russell C. Silberglied, LLCs Are Different: Credits of Insolvent LLCs Do Not Have Standing to Sue for Breach of Fiduciary Duty. But Can a Creditors' Committee Be Granted Standing? (publication pending) (suggesting that bankruptcy courts likely would not be authorized to grant a committee derivative standing in an LLC absent a unique provision in the operating agreement).

[112]See Teleglobe, 493 F.3d at 367, 386; Scott Acquisition Corp., 344 B.R. at 290.

[113]See Complaint ¶¶ 163-84. Presumably the plaintiff Creditors' Committee did not sue the parent entities, TOUSA and Homes Inc., because they were also debtors and lacked deep pockets or perhaps because it was also their creditors' committee as well, and a recovery from them would have damaged the committee's other constituencies.

[114]The defendant directors of the Conveying Subsidiaries are in a different circumstance, since it is not controversial to assert that they owed fiduciary duties to the Conveying Subsidiaries or that the Conveying Subsidiaries' creditors had standing to assert derivative claims on behalf of the Conveying Subsidiaries. See, e.g., Gheewalla, 930 A.2d at 101; Trenwick Am. Litig. Trust, 906 A.2d 168 ("That is because as directors of [subsidiary] Trenwick America, these

court therefore turned to *USACafes* to break through the corporate skin and allow, at least at the pleading stage, the possibility of liability against the directors of TOUSA and Homes Inc.[115]

The question is whether, under the Court of Chancery's interpretation of *USACafes* (in *Bay Center* and similar cases), the *TOUSA* court applied Delaware law correctly. The answer, it seems, is not really. Under *Bay Center*, the Creditors' Committee was required to have pleaded that the TOUSA directors "benefited [themselves] at the expense of [the Conveying Subsidiaries]."[116] While the Committee made some limited allegations regarding directors' personal interest in the transaction,[117] the court did not focus on those. Several of those allegations were that interests in the parent entities themselves (e.g., employment at Technical Olympic, employment at TOUSA, and/or stock ownership in TOUSA) provided personal benefits to the defendant directors.[118] However, while employment at the parent entities may be a personal benefit, it does not appear to have come "at the expense" of the Conveying Subsidiaries. Similarly, "personal benefits" derived from stock ownership in TOUSA would be no different from the benefits derived by every other TOUSA stockholder.[119] On the other hand, allegations were made that one particular director was to be "eligible for a multi-million dollar bonus payment if TOUSA settled claims arising out of the Transeastern Debt."[120] The *TOUSA* court should have wrestled with these allegations and determined which, if any, stated a valid claim under

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[director] defendants would be, in the language of many of our cases, described as owing fiduciary duties to Trenwick America as an entity." (footnote omitted)).

[115] See TOUSA, 437 B.R. at 460.

[116] *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, *10 (Del. Ch. 2009).

[117] Complaint ¶¶ 153-62.

[118] Complaint ¶¶ 153-61.

[119] Cf. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (stating that "directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally"). Further, countenancing such allegations as "personal benefits" to the directors would exacerbate the concern regarding the no-win situation the directors of a parent are placed in—an irreconcilable conflict between the subsidiary's creditors and the parent's stockholders. See supra notes 79, 93.

[120] Complaint ¶ 162. As for the TOUSA directors generally, the Complaint simply alleges that, "[b]y virtue of TOUSA Board Directors' positions, a fiduciary relationship existed between each TOUSA Board Director and the Conveying-Subsidiary he/she served." Complaint ¶ 164. The alleged breaches of

Bay Center. Based on the facts alleged, and only if the court had found the allegations to be well-pleaded and plausible, it appears to us that only the allegations regarding the settlement bonus should have sufficed (on a 12(b)(6) standard) to impose *USACafes* duties under *Bay Center*.[121]

B. Applying *USACafes* in insolvency

From a more global perspective, the question is whether *USACafes* should apply at all upon an LP or LLC's insolvency. *Bay Center* already limits the application of *USACafes* to impose duties only when a plaintiff makes well-pleaded allegations that the general partner's directors chose a course of action to benefit themselves (not simply the general partner itself) at the expense of the LP. Beyond that, we suggest that courts should be wary, for a number of reasons, about applying *USACafes* to impose liability upon a subsidiary's insolvency.

First and foremost, transactions that benefit the parent rarely benefit the parent's directors personally as required by *Bay Center*. But even in those limited circumstances, the transaction typically may be attacked as a fraudulent transfer. For example, *Bay Center* would be implicated if the transaction in question involved an insolvent LP selling its crown jewel to the corporate general partner's sole director for an inadequate price. That scenario also describes a fraudulent transfer because it is a transfer for less than reasonably equivalent value while the LP was insolvent.[122] Where traditional existing causes of action amply protect creditors and provide for a recovery, courts should be hesitant to expand novel causes of action to redress those same issues.[123] Because fraudulent transfer law already provides redress where the entity is insolvent, *Bay Center*'s interpretation

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fiduciary duties involved the TOUSA directors' "failing to investigate and inform themselves properly of the effect of the Transaction on the Conveying-Subsidiaries and their creditors, . . . abdicating their decision-making authority on behalf of the Conveying-Subsidiaries and not acting in the best interests of the Conveying-Subsidiaries, and . . . entering into the Transaction solely to benefit TOUSA, Homes LP, and TOUSA's shareholders." Complaint ¶ 167.

[121] See, e.g., USACafes, 600 A.2d at 46 (noting allegations that the defendant directors received "side payments").

[122] See 11 U.S.C.A. § 548; Del. Code Ann. tit. 6, § 1304.

[123] See, e.g., Trenwick Am. Litig. Trust, 906 A.2d at 198 ("my refusal to conclude that a wholly-owned subsidiary may sue the directors of its parent company on the premise that the improvident business strategies ultimately led to the bankruptcy of the subsidiary does not leave open a gap in the law. There is no gap . . . [due to, among other things,] a body of law that might fairly be called the 'law of fraudulent transfer' "); Trenwick Am. Litig. Trust, 906 A.2d at

of *USACafes* should only be useful to plaintiffs where the personal benefit received by the parent's director is just a portion of the allegedly faithless transaction (for example, where the director is alleged to have received a kickback for approving a larger transaction). In any event, *USACafes* should not be applied more broadly than as set forth in *Bay Center*—there must be a well-pleaded allegation of personal benefit to the individual director. Practically speaking, such allegations are probably easier to make in the context of a solvent company (kickbacks to approve deals, increases in equity holdings in the entity, etc.) than in the context of an insolvent company (side payments to approve loans).[124]

Other problems with applying *USACafes* include the possibility that the parent's directors may have contractual or statutory immunity to such claims. Operating or partnership agreements often abrogate common law "corporate opportunity doctrine" by specifically providing that the general partner or managing member (and/or its directors) may compete with the LP or LLC.[125] Such agreements may also eliminate fiduciary duties that would otherwise be owed by the general partner's (or managing

205 ("The rejection of an independent cause of action for deepening insolvency does not absolve directors of insolvent corporations of responsibility. Rather, it remits plaintiffs to the contents of their traditional toolkit, which contains, among other things, causes of action for breach of fiduciary duty and for fraud"); *In re Fleming Packaging Corp.*, 2005 WL 2205703, *9 (Bankr. C.D. Ill. 2005) (dismissing deepening insolvency count of complaint as redundant of breach of fiduciary duty claim).

[124]Given the recent pronouncement that creditors of Delaware LLCs and LPs as a general matter do not have standing to sue derivatively, *CML V, LLC v. Bax*, 6 A.3d 238 (Del. Ch. 2010), the application of *USACafes* to insolvent, wholly owned subsidiaries that are alternative entities might face a more practical hurdle: unless a trustee is appointed (or unless bankruptcy courts hold that creditors committees are not suing "derivatively" in the same sense as used in the *CML* opinion), no one may have an economic incentive to pursue such claims.

Moreover, the LLC Act includes "specific statutory features that appear designed (at least in part) with creditors in mind, and which creditors can use to obtain additional rights and protections." CML, 6 A.3d at 250. These include, among others, the right to enforce capital calls if a creditor extends credit in reliance on a member's obligation, see Del. Code Ann. tit. 6, § 18-502(b), and the ability to provide for rights to creditors in the operating agreement even though the creditors are not a party to the operating agreement, CML, 6 A.3d at 250. Given these possible rights for creditors of an LLC, even the need for a *USACafes* remedy is questionable.

[125]See, e.g., supra note 79. Subsidiaries that are Delaware corporations may also, in their charters, renounce their interests in particular businesses, see Del. Code Ann. tit. 8, § 122(17), thereby allowing their parents (or their directors) to compete with them for business.

member's) directors.[126] If a subsidiary's organizational documents specifically allow the parent (and/or its directors) to compete with the subsidiary (and therefore pursue interests at odds with the subsidiary), on what basis may the subsidiary complain that the way it was managed benefited the parent rather than the subsidiary?

Finally, it should be noted that imposing on directors of parent entities new fiduciary duties that spring into existence upon the subsidiary's insolvency is more problematic than requiring the directors of a company to consider creditor interests (among others) when the company itself becomes insolvent. After all, it is not a stretch to require directors to keep active tabs on the financial status and solvency of a company that the director knows he is a fiduciary of.[127] However, directors of the *parent* are not ordinarily charged with actively monitoring the financial

[126]E.g., *Lonergan v. EPE Holdings, LLC*, 5 A.3d 1008, 1017 (Del. Ch. 2010).

The *TOUSA* court (correctly) did not seem to apply *USACafes* to the Conveying Subsidiaries that were corporations. See TOUSA, 437 B.R. at 460–61. As noted above, *USACafes* has not been applied in the corporate context. See supra text accompanying notes 98–103. Even if it did, *USACafes* should not apply to the decision of a wholly owned subsidiary to grant a guaranty when the subsidiary is a corporation. After all, Delaware corporate law expressly provides that "[e]very corporation . . . shall have power to . . . make contracts of guaranty and suretyship which are necessary or convenient to the conduct, promotion or attainment of the business of . . . (b) a corporation which owns, directly or indirectly, all of the outstanding stock of the contracting corporation." Del. Code Ann. tit. 8, § 122(13). In other words, Delaware law contemplates that a subsidiary may guaranty the debts of its parent or grandparent—even though, viewed entirely from the perspective of the subsidiary, that entity becomes less valuable after the guaranty.

To be sure, the power to make such a guaranty does not mean that a subsidiary is immune from the consequences of fraudulent transfer law. E.g., Del. Code Ann. tit. 6, § 1304(a). Thus, the first *TOUSA* opinion correctly viewed the Transaction through the lens of fraudulent transfer law even though it was expressly allowed under Section 122(13) for those Conveying Subsidiaries that are Delaware corporations. But if a guaranty cannot be proved to be a fraudulent transfer, the rationale for imposing liability under fiduciary law is questionable. Moreover, it is difficult to understand the utility of holding directors of the parent liable if the transaction is held to be a fraudulent transfer and therefore is avoided.

Of course, section 122(13) is a provision of Delaware's corporation law, and an analogous provision does not appear in the LP or the LLC Act. The Delaware LP and LLC Acts do specifically authorize an entity to "make contracts of guaranty or suretyship" but do not mention benefitting the parent or affiliates. See Del. Code Ann. tit. 6, §§ 17-106(c), 18-106(c).

[127]See, e.g., *Burroughs v. Fields*, 546 F.2d 215, 217 (7th Cir. 1976) (finding fraud where a director paid himself a commission when his company was on the brink of insolvency "at a time when he knew or should have known the condi-

health of the *subsidiary*. When the parent is a private-equity firm that has hundreds of wholly owned subsidiaries, one could assume that many directors of the private-equity parent do not (indeed, could not) keep day-to-day tabs on all of their subsidiaries' financial status. To create unknown fiduciary duties that may be breached unwittingly is just not good policy and might result in qualified individuals refusing to serve as directors—an outcome that the Delaware courts would likely seek to avoid.[128]

VI. Aiding and Abetting Breach of Fiduciary Duty

The *TOUSA* court also allowed an aiding and abetting claim to survive against the TOUSA directors.[129] That aiding and abetting claim might have been more analytically sound than the breach claim under *USACafes*, particularly given the *Bay Center* analysis above. Aiding and abetting claims often are asserted in the alternative to *USACafes* claims. In *USACafes* itself, the Court of Chancery noted that the "same result [as reached in the case] might be rationalized as aider and abettor liability," although it ultimately avoided that path, noting that it was "unsure what such indirection would add that is useful where a self-dealing

tion of the corporation"); *U.S. v. Spitzer*, 261 F. Supp. 754, 755 (S.D. N.Y. 1966) (noting that any director, officer, or stockholder who controls the affairs of the corporation is assumed to be aware of all outstanding claims against the debtor and can be liable for failure to inform himself or herself of such claims or acting in disregard of such information). Indeed, although the opinion itself was challenged, there is evidence that TOUSA's directors received a solvency opinion regarding the consolidated TOUSA family of companies. See Complaint ¶ 150.

[128]See, *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 27 Del. J. Corp. L. 247, 2000 WL 1476663, *22 (Del. Ch. 2000) ("As a final factor, I must also confess concern that adopting Gotham's argument would create a disincentive for qualified persons to serve as directors of corporate general partners. While anyone who serves in such a capacity must expect to deal with the possibility of litigation, it is quite another thing for such a person to accept service that potentially exposes her to a triable claim for breach of the duty of loyalty whenever she makes a good-faith decision about a transaction between the partnership and an affiliate of the general partner"); Trenwick Am. Litig. Trust, 906 A.2d at 194 (rejecting attempt to impose liability on directors of parent and noting that "to sanction such bizarre claims would discourage board service"); cf. *Stifel Financial Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) ("The invariant policy of Delaware legislation on indemnification is to promote the desirable end that corporate officials will resist what they consider unjustified suits and claims, secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated. Beyond that, its larger purpose is to encourage capable men to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve." (citation and internal quotation marks omitted)).

[129]TOUSA, 437 B.R. at 463–64.

transaction or other diversion of partnership property is alleged."[130]

The interesting point about an aiding and abetting claim is that the aider and abettor *cannot* be a fiduciary. That is, to plead a such a claim, a plaintiff must show the following: "(1) the existence of a fiduciary relationship; (2) a breach of the fiduciary's duty; (3) knowing participation in the breach by a *non-fiduciary defendant*; and (4) damages."[131] Indeed, the Court of Chancery in *Wallace* stated that an aiding and abetting claim would therefore seem to be "inconsistent with plaintiffs['] primary argument [under *USACafes*] that each defendant owes fiduciary duties to the Limited Partners,"[132] since the aiding and abetting claim requires that the defendants not owe fiduciary duties. The *Wallace* court nevertheless did not dismiss the mutually exclusive aiding and abetting claim, noting that it "may later decide, after discovery or at trial, that plaintiffs cannot prove the pleaded requisite control necessary to establish the existence of a fiduciary relationship between each defendant and the Limited Partnership and/or the Limited Partners."[133] This holding is consistent with federal practice of allowing a plaintiff to plead inconsistent theories in the alternative and proceed in that manner through trial.[134]

In cases where a personal benefit to a directors supporting *USACafes* duties (as interpreted by *Bay Center*) is not alleged, we suggest that courts should focus their analysis on whether the claim against the directors passes muster as one asserting aiding and abetting breaches of the parent's fiduciary duties. The parent's directors would therefore face only, at most, second-level liability unless they derive some personal benefit at the subsid-

[130]USACafes, 600 A.2d at 49.

[131]*In re NYMEX Shareholder Litigation*, 2009 WL 3206051, *12 (Del. Ch. 2009) (emphasis added).

[132]Wallace, 752 A.2d at 1184.

[133]Wallace, 752 A.2d at 1184. The court in Bay Center similarly refused to dismiss claims for aiding and abetting, which had been brought in the alternative. Although the court did not discuss its reasons in detail, one could surmise that its reasons were similar to those in *Wallace*. Cf. *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, *10 n.50, *11 (Del. Ch. 2009).

[134]See, e.g., *Instituto De Prevision Militar v. Merrill Lynch*, 546 F.3d 1340, 1352, 46 Employee Benefits Cas. (BNA) 1041, Fed. Sec. L. Rep. (CCH) P 94888 (11th Cir. 2008) (noting that the Federal Rules of Civil Procedure allow plaintiffs to plead inconsistent theories); *Murray v. Fairbanks Morse*, 610 F.2d 149, 164 n.17 (3d Cir. 1979) (same).

iary's expense. Such a result would comport with the views of some commentators, contrary to some dicta in *USACafes* itself, that the directors of a general partner should not be liable for breach of fiduciary duty when the general partner itself has not breached a fiduciary duty.[135] After all, when viewed through the lens of aiding and abetting, if the general partner has not breached a duty, there is nothing to aid and abet.

Furthermore, relegating these claims to an aiding and abetting standard does not absolve individual directors of liability in situations that warrant liability.[136] Therefore, rather than stretch the notion of fiduciary duties beyond the traditional bounds of Delaware law, courts facing *USACafes* claims should, if possible (and if no personal benefit has been pleaded), allow them to proceed only as claims for aiding and abetting breach of fiduciary duty. In our view, the *TOUSA* court properly allowed the aiding and abetting claim to go forward at the Rule 12(b)(6) stage.

Interestingly, the claims of aiding and abetting asserted in *TOUSA* suggested that the other defendants breached their fiduciary duties by approving a fraudulent transfer to the Transeastern lenders.[137] Delaware law—and that of many (but not all) other states—is clear that there is no tort for aiding and abetting a fraudulent transfer.[138] Thus where the cause of action centers on the fact that the transfer was constructively or actively fraudulent, the proper defendant is the initial or subsequent transferee.[139] But that rule does not mean that this aspect of the *TOUSA* opinion was wrongly decided. Directors certainly can breach their fiduciary duties by approving a transaction if they fail to act in an informed manner, do not act in good faith, or act in self-interest in approving a transfer. If the transfer also happens to qualify as a fraudulent transfer under UFTA or 11

[135] See supra note 94.

[136] E.g., Gotham Partners, L.P., 817 A.2d at 172–73. As noted above, the Delaware Supreme Court's partial affirmance of the 2001 *Gotham Partners* decision suggests that *USACafes* may be better seen as an aiding and abetting doctrine. See supra note 78.

[137] Complaint ¶¶ 169–71, 185–88.

[138] See Trenwick Am. Litig. Trust, 906 A.2d at 203 (holding there is no such claim under "federal bankruptcy law or Delaware law" and collecting majority view, non-Delaware cases).

[139] Trenwick Am. Litig. Trust, 906 A.2d at 203; see also 11 U.S.C.A. § 550(a) (providing that a trustee can recover an avoided transaction (such as a fraudulent transfer) from an "initial transferee," "the entity for whose benefit such transfer was made," or "any immediate or mediate transferee of such initial transferee").

U.S.C.A. § 548, the directors' breach of fiduciary duty in approving the transaction is not absolved. But the breach is not that the transfer that the directors approved qualifies under UFTA or Bankruptcy Code section 548 as a fraudulent transfer; it is that the directors approved a transaction that they would not have if they had acted loyally, in good faith, and with due care.

VII. **Conclusion**

The *TOUSA* opinion combines a few separate strands of Delaware law—all of which have been undergoing change in recent years—and comes to a conclusion never before reached in a reported decision: that directors of a parent might owe fiduciary duties to, and be personally liable to, the parent's wholly owned subsidiary if the subsidiary is insolvent. The primary underpinning for this holding, *USACafes*, involved a non-wholly owned subsidiary, and even in that context *USACafes* has been significantly limited by more recent opinions like *Bay Center* to situations where the directors received a personal benefit from the transaction. The authors suggest that, for wholly owned, insolvent subsidiaries, parent directors' duties should at least be limited as described in *Bay Center* and that there are policy reasons for even further narrowing the situations, if any, in which such directors could be held liable.

Indeed, the authors suggest that the better approach—in the absence of a personal benefit to the directors at the subsidiary's expense—would be to view any liability of a parent's directors to the insolvent subsidiary through the prism of aiding and abetting. While in *USACafes* itself the court viewed this as an "indirection," the court likely did not foresee the progeny that *USACafes* would sprout or its application to cases like *TOUSA*. Further, the *Wallace* court (as in *TOUSA*) allowed the two theories—*USACafes* liability and an aiding and abetting theory—to proceed to trial, even though they are mutually exclusive. In the absence of well-pleaded allegations of personal benefit, it would be preferable for courts in the future to focus on the latter, not the former.