"Deep" Impact: Can a Tort Theory of Deepening Insolvency Survive in the "Options Backdating" Era?

Phillip G. Lewis
University of Kentucky

2007
NOTES

"Deep" Impact: Can a Tort Theory of Deepening Insolvency Survive in the "Options Backdating" Era?

Phillip G. Lewis

I. INTRODUCTION

Despite humble beginnings as mere dictum in a 1983 Seventh Circuit opinion, the theory of deepening insolvency has seen a rapid expansion within the legal community, becoming the object of much scholarly debate. In recent years, deepening insolvency has proven to be quite the chameleon, adapting to fit inconspicuously into our legal environment as either a measure of damages or an independent cause of action in tort. Notwithstanding sparse case law on the subject, speculation as to the applicability of the tort theory of deepening insolvency has grown by leaps and bounds since the tort theory's genesis in the 2001 case of Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc. Lafferty's proposition—that "an injury to the [debtors'] corporate property from the fraudulent expansion of corporate debt and prolongation of corporate life" was remedied as

1 J.D. expected 2008, University of Kentucky College of Law; B.S., Economics, B.B.A., Finance, University of Kentucky, 2001. I would like to thank the members of the Kentucky Law Journal for their faithful assistance in the editing process. Additionally, I would like to extend special thanks to my family for its support and understanding during my research-induced mood swings, and also my father for, at a young age, initiating my interest in the stock markets.

2 Schacht v. Brown, 711 F.2d 1343, 1350 (7th Cir. 1983) (postulating that a "corporate body is ineluctably damaged by the deepening of its insolvency, through increased exposure to creditor liability"); see also Sabin Willett, The Shallows of Deepening Insolvency, 60 Bus. L. 549, 550 (2005) (noting the dictum of Schacht as causing the evolution of the theory of deepening insolvency).

3 According to LEXIS, the topic of deepening insolvency has been covered in sixty-one law reviews and journals (last searched May 19 2007).


6 Id. at 351

7 Id. at 347.
a tort—has led to a wave of decisions recognizing the tort in other jurisdictions. However, as pointed out in previous works, the greatest criticism of this tort theory is its "novelty." 8

Armed with only the Lafferty decision, judges have been called into the role of fortune teller and have been asked to evaluate not only whether courts in their jurisdictions would recognize such a claim in tort but also to whom this liability extends. 9 The results have been mixed, to say the least. 10 Despite minor setbacks, 11 the theory has been recognized as an independent cause of action in a variety of jurisdictions. 12 Moreover, a variety of third party professionals, such as financial advisors 13 and most recently bankers 14 and lenders, 15 can be held liable in tort for deepening the insolvency of a business enterprise by eroding its intrinsic value. Further stretching of the Lafferty holding to include situations in which mere "negligence" has caused the injury to corporate property, instead of the requisite "fraudulent prolongation of a corporation's life," 16 adds to the uncertainty as to the outcome in any given insolvency case.

Faced with the recent case law and fear of reprisal, it is not far-fetched to say that many members of the business community are hesitant to engage in any activities with a corporation that has fallen on hard times. The spring and summer of 2006 have offered a brand new avenue concerning applicability of the deepening insolvency claims. 17 Still reeling from the havoc caused by Enron's improprieties, 18 directors and officers of several

---

9 See infra notes 62-78 and accompanying text.
10 See infra notes 62-105 and accompanying text.
11 See infra notes 79-105 and accompanying text.
12 See, e.g., In re LTV Steel Co., 333 B.R. 397, 422 (Bankr. N.D. Ohio 2005) (noting growing acceptance of tort theory of deepening insolvency and collecting complementary cases from other jurisdictions).
16 See Schacht v. Brown, 711 F.2d 1343, 1350 (7th Cir. 1983).
17 See infra notes 106-84 and accompanying text.
18 To find out more about the pain and suffering faced by creditors, employees, and stakeholders when the Enron house of cards came tumbling down, see Enron Home Page, http://www.enron.com (last visited Mar. 2, 2007); see also ENRON: THE SMARTEST GUYS IN THE ROOM (Magnolia Pictures 2005).
DEEPENING INSOLVENCY THEORY

of the country’s largest publicly traded companies find themselves embroiled in a controversy further exposing corporate greed and stakeholder abuse, which has been dubbed “options backdating.”

Options backdating occurs when “a company grants stock options to key employees that are dated to a time in the past when the stock price was lower than the stock’s current price.” This scheme thereby guarantees the holder of such options a handsome profit. While options backdating is not per se illegal, the extraneous effects of the options backdating scandal could lead to a deepening insolvency claim against company directors, officers and lenders. However, fret not, dear malfeasant and greedy corporate executives, because help is already on the way. Three 2006 decisions, including one from the Delaware Court of Chancery, have cast serious doubt upon the viability of maintaining a deepening insolvency claim against company directors or lenders.

This Note stands for the proposal that, although a deepening insolvency claim could manifest in tort against corporate defendants, recent decisions have vitiolated any likelihood of success in bringing such an action. Part II of this Note will briefly detail the development of Lafferty and its application in subsequent cases. Part III will identify recent cases that have questioned the Lafferty decision and evaluate the effect on the future of deepening insolvency. Part IV will investigate the events that have brought “options backdating” into the American lexicon, including a detailed account of the role of hedge funds as a catalyst in an option backdating firm’s move into the “zone of insolvency.” Finally, Part V will conclude this discussion by setting forth the reasons why a deepening insolvency claim against a backdating corporation would prove an unnecessary and inefficient use of corporate time and money due to its inherently duplicative nature.


20 Financial Terms: Defining Money, CHI. SUN-TIMES, Sept. 11, 2006, at 54.


22 See infra notes 185–99 and accompanying text.

23 See infra notes 94–105 and accompanying text.

24 Trenwick Am. Litig. Trust v. Ernst & Young, LLP, 906 A.2d 168, 205 (Del. Ch. 2006).

25 See infra notes 169–82 and accompanying text.

26 “Insolvency” is defined as “[t]he condition of being unable to pay debts as they fall due or in the usual course of business.” BLACK'S LAW DICTIONARY 354 (8th ed. 2004). The “zone of insolvency” is considered to be the time at which the possibility of insolvency is very likely for an operating, perhaps solvent, corporation. See Credit Lyonnais Bank Nederland N.V. v. Pathe Commc'n, No. 12150, 1991 Del. Ch. LEXIS 215 at *108 (Del. Ch. Dec. 30, 1991).
Deepening insolvency has received much attention for its malleability into the tort law environment. However, its roots date back much further, first taking shape as a way for courts to "avoid imputing the wrongdoing of corporate directors and officers to a bankrupt plaintiff corporation" then later as a "theory of standing and damages." In its latter form, the difference in a corporation's "increased exposure to creditor liability" and available assets was proof positive that impropriety had occurred and the corporation was exposed to damages at least in amounts equal to the amount of that diminution.

A. The Lafferty Decision

Given the role Lafferty has played in molding the damage theory of deepening insolvency and recognizing it as an injury in its own right, an examination of the landmark decision is also warranted in this Note, even though it has been discussed exhaustively in recent scholarly works. Lafferty involved a "Ponzi scheme" allegedly operated by William Shapiro and family via two lease-financing companies, Walnut Equipment Leasing Company ("Walnut") and its wholly owned subsidiary, Equipment Leasing Corporation of America ("ELCO"). Because Walnut's financial hardships prevented it from raising money through an issuance of corporate debt securities, Shapiro created ELCO as a wholly owned subsidiary. Despite being "fraudulently marked as an independent business entity," ELCO's lone purpose was to provide Shapiro a company with a rosy financial outlook that could serve as a debt issuing conduit for Walnut's benefit.
To provide an image of financial prudence, Shapiro allegedly misstated both companies' financials and conspired with an accountant and an underwriter\textsuperscript{39} to present positive professional opinions of the failing companies' viabilities.\textsuperscript{40} These improprieties allowed Shapiro to obtain registration of their debt securities, culminating in the offer and sale of these securities to the investing public.\textsuperscript{41}

Ultimately, the companies were unable to repay the debt, and the venture ended in the bankruptcy of both Walnut and ELCOA.\textsuperscript{42} Subsequently, a Bankruptcy trustee appointed a Committee to represent the claims of the companies' unsecured creditors.\textsuperscript{43} On behalf of the corporation, the Committee initiated an action against Shapiro and the third party professionals for their roles in "'wrongfully expand[ing] the [D]ebtors' debt out of all proportion of their ability to repay and ultimately forc[ing] the [D]ebtors to seek bankruptcy protection.'"\textsuperscript{44} Although characterizing this activity as deepening insolvency,\textsuperscript{45} the U.S. District Court summarily dismissed the Committee's claims.\textsuperscript{46}

The Committee subsequently appealed to the Third Circuit Court of Appeals.\textsuperscript{47} After finding that the Committee had standing to bring the case on behalf of the corporation,\textsuperscript{48} the court moved to the determination of whether deepening insolvency was a viable theory of injury under Pennsylvania law.\textsuperscript{49} Armed with little jurisdictional guidance to handle the novel claim,\textsuperscript{50} the Court of Appeals predicted how a Pennsylvania state court would decide the matter, using "law of the other jurisdictions and . . . policy underlying Pennsylvania tort law . . . ."\textsuperscript{51}

The Third Circuit's ultimate decision to recognize deepening insolvency as an independent cause of action rested upon three conclusions.\textsuperscript{52} The \textit{Lafferty} court's primary conclusion that the theory was "essentially sound" in character was based on modern bankruptcy law, where a corporation,

\begin{itemize}
\item \textsuperscript{39} As it happens, this co-defendant will live in infamy as the case's namesake, R.L. Lafferty & Co.
\item \textsuperscript{40} \textit{Lafferty}, 267 F.3d at 345.
\item \textsuperscript{41} \textit{Id}.
\item \textsuperscript{42} \textit{Id}.
\item \textsuperscript{43} \textit{Id}.
\item \textsuperscript{44} \textit{Id} at 347 (quoting the Amended Complaint) (alterations in original).
\item \textsuperscript{45} \textit{Id} (Deepening insolvency is characterized by the court as "injury to . . . corporate property from the fraudulent expansion of corporate debt and prolongation of corporate life.").
\item \textsuperscript{46} \textit{Id} at 340.
\item \textsuperscript{47} \textit{Id}.
\item \textsuperscript{48} \textit{Id} at 349.
\item \textsuperscript{49} \textit{Id}.
\item \textsuperscript{50} \textit{Id}.
\item \textsuperscript{51} \textit{Id}.
\item \textsuperscript{52} \textit{Id}.
\end{itemize}
though insolvent, may find value in its underlying property. To justify further the "soundness" in the principle, the court noted that deepening insolvency could also disturb the corporation's "relationships with its customers, suppliers, and employees," and thereby diminish the overall value of its corporate assets. Secondly, the Lafferty court concluded that the theory could discourage directors' and officers' fraudulent behavior that attempts to prolong the life of an insolvent corporation. Relying heavily on Schacht v. Brown, the Lafferty judges proposed that the harms of such actions could be averted, and the value within an insolvent corporation salvaged, if the corporation is dissolved in a timely manner, rather than kept afloat with spurious debt. The court also explained that "[g]rowing acceptance of the deepening insolvency theory confirms its soundness," whereas several other jurisdictions have recognized a "cognizable injury to corporate debtors" where the life of the enterprise had been fraudulently extended. As its final justification, the Lafferty court relied on "one of the most venerable principles in Pennsylvania jurisprudence where there is an injury, the law provides a remedy." By identifying that "tort law attempts to place the injured party in the same position he occupied before the injury," the court held that where corporate assets are damaged by deepening insolvency, Pennsylvania tort law would remedy such an injury.

B. Expanding Lafferty to Other Jurisdictions

Subsequent cases invoking Lafferty have put their own interpretations on the benchmark case's holding. Take, for instance, In re Flagship Healthcare, which was decided shortly after Lafferty. There, a Florida bankruptcy court held that a bankruptcy trustee had made a viable deepening insolvency claim against a third party financial advisory firm which had offered the

53 Id.
54 Id. at 350.
55 Id.
56 Schacht v. Brown, 711 F.2d 1343, 1350 (7th Cir. 1983) (noting that in the absence of deepening insolvency, possible incentives may be garnered by wrong-doing officers who fail to disclose such insolvency to shareholders).
57 Lafferty, 267 F.3d at 350.
58 Id.
59 Id. at 351.
60 Id. (quoting Hahn v. Atlantic Richfield Co., 625 F.2d 1095, 1104 (3rd Cir. 1980)).
61 Id. ("Where 'deepening insolvency' causes damages to corporate property, we believe that the Pennsylvania Supreme Court would provide a remedy by recognizing a cause of action for that injury."). As the holding indicates, Lafferty applies "deepening insolvency" only in situations arising under Pennsylvania law where a fraudulent behavior or activity clearly extends a corporation's life past the point of its initial insolvency.
debtor corporation guidance concerning possible acquisition candidates. 63

Relying on Lafferty, the Flagship court stated that if the firm’s financial valuation was negligently given and caused the debtor corporation to assume additional debt, an injury occurred to the corporate body, regardless of whether the corporation was insolvent before the valuation. 64 Though failing to apply the fraud requirement inherent in the Lafferty decision, the Flagship court succeeded in expanding Lafferty’s reach to third-party professionals, who were now amendable under a less stringent standard of culpability than previously applied to deepening insolvency claims.

Lafferty received further affirmation in 2003 by In re Exide Technologies. 65 In this case, a committee consisting of a corporation’s unsecured creditors brought a claim of deepening insolvency against a secured lender who had further extended the corporation’s line of credit from $650 million to $900 million to facilitate the acquisition of a competitor. 66 In consideration for this extension of credit, the debtor corporation provided “significant additional collateral and guarantees” to the secured lender. 67 The corporation’s financial situation rapidly worsened shortly after the acquisition, causing the corporation to amend the loan agreement which extended to the secured lender additional collateral in an effort to stall the collection process. 68 The substance of the allegations behind the insolvency claim was that the “[l]enders caused the [d]ebtors to acquire [the competitor company] so that they could obtain the control necessary to force the [d]ebtors fraudulently to continue its business for nearly two years at ever-increasing levels of insolvency.” 69 Reminiscent of Lafferty, the Delaware Bankruptcy Court made an effort to predict how the Delaware Supreme Court would rule in such a situation. 70 The Bankruptcy Court held that the three factors elucidated in Lafferty would also be controlling in Exide. 71 The Exide court noted that the “theory of deepening insolvency, particularly in a bankruptcy context, was a sound one,” 72 that there was “a growing acceptance of the theory among courts,” 73 and that, in regards to whether deepening insolvency constitutes an injury recognized under state law, “Delaware adheres to the same principle as Pennsylvania referred to in Lafferty.” 74

63 Id. at 728–29.
64 Id. at 728.
66 Id. at 736.
67 Id.
68 Id.
69 Id. at 750–51.
70 Id. at 751
71 Id.
72 Id.
73 Id.
74 Id. at 752.
Exide successfully expanded Lafferty’s grip of culpability to include lenders, but the significance of the Exide decision has more to do with the jurisdiction in which the decision was rendered rather than any particular expansions to the underlying theory of deepening insolvency. By postulating that the Delaware Supreme Court would recognize a claim of deepening insolvency, Exide opened the door for the theory’s widespread expansion into the corporate arena. Given that a majority of American companies are incorporated in the state of Delaware,75 Exide’s expansion of Lafferty to this jurisdiction could have serious ramifications to the manner in which most companies do business.

In sum, Lafferty and its successors, Flagship and Exide, have expanded deepening insolvency’s role in modern business practices. The cases stand for the idea that directors, officers, and even third-party professionals can be found liable in tort for deepening the insolvency of a debtor corporation. Also, and perhaps more significantly, a court amalgamating the Flagship and Exide holdings may justify a finding that culpability may be extended to third-party professionals who do not fraudulently prolong a corporation’s life but who act in a negligent manner that leads to insolvency. Such a holding could be devastating to the American economy. For instance, if such precedent is controlling in a jurisdiction, a risk-adverse lender fearing future ramifications of a loan may think twice before lending to a financially struggling, but otherwise solvent, corporation. Conversely, due to fear of future third-party liability, it is probable that expanding Lafferty would hinder a financially struggling company’s overall ability to contract with other businesses. Hesitation to make what formerly amounted to “normal” contract would significantly impede not only the speed at which companies do business but also the costs of doing business via higher transaction costs, such as higher interest rates to compensate for additional risks inherent in a deal where mere negligence could leave a company in future legal peril.76

Lenders may be put in a situation where fear of possible insolvency causes them to put more restrictions on how a company uses borrowed funds. This action could substantially limit the company’s ability to pursue innovative, higher risk projects, which would significantly decrease the overall growth of American business77 and leave American consumers at the pricing whim of overseas competitors in domestic product markets. Additionally, higher transaction costs could affect company profitability, thereby generating less reward for corporate shareholders and possibly pushing

---

75 The state of Delaware is the corporate home of over half a million companies, including over fifty percent of all publicly traded companies and sixty percent of the Fortune 500 businesses. See Del. Div. of Corp. Homepage, http://state.de.us/corp (last visited Feb. 27, 2007).

76 See RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 433 (5th ed. 1998) (discussing effect of additional risks in contracting on interest rates).

77 Id. at 434.
DEEPENING INSOLVENCY THEORY

companies closer to possible insolvency if the business model fails or if demand for a company's products deteriorates.\(^7^8\) Either scenario could spell trouble for not only American businesses but also for the Americans who work in these businesses and consume these business products, causing demand for the products and services of foreign companies, possibly operating under less restrictive commercial laws, to increase.

III. CASTING DOUBT ON \textit{Lafferty}: Trenwick and its Predecessors

Since \textit{Exide}, several cases have cast doubt upon the viability of a separate and independent claim of deepening insolvency. These decisions not only question the expansions to the \textit{Lafferty} holding applied in previous cases\(^7^9\) but also serve as strong precedent for future denials of tort-related deepening insolvency actions.

A. Global Service Group and its Progeny: Negligence is Not Enough

Decided shortly after \textit{Exide}, the case of \textit{In re Global Service Group LLC} echoed \textit{Lafferty}'s proviso that a finding of fraud was requisite for any deepening insolvency claim.\(^8^0\) In \textit{Global Service}, a U.S. Bankruptcy Court in New York was faced with the following question reminiscent of \textit{Lafferty}: Can a lender who loans money to an insolvent debtor corporation be liable for injuries sustained to the debtor under a deepening insolvency claim?\(^8^1\) The complaint alleged that the defendant, Atlantic Bank, based on its relationship with the debtor corporation, Global Service Group LLC, “knew or should have known that the debtor would be unable to repay its loans due to its financial condition, but loaned the debtor money anyway . . . .”\(^8^2\) These loans allegedly caused other creditors to extend money to Global Service Group, which “prolong[ed] its corporate existence and incur[red] increased debt which would have been avoided without the Atlantic Bank loans.”\(^8^3\) The \textit{Global Service} court, correctly applying the \textit{Lafferty} holding, announced that “[p]rolonging an insolvent corporation’s life, without more, will not result in liability” under a deepening insolvency claim.\(^8^4\) Instead, the court mandated that “one seeking to recover for ‘deepening insolvency’ must show that the defendant prolonged the company’s life in breach of a separate duty, or committed an actionable tort that contributed to the continued

\(^{78}\) Id. at 433.
\(^{79}\) See supra notes 62–78 and accompanying text.
\(^{81}\) Id. at 455.
\(^{82}\) Id.
\(^{83}\) Id. at 456.
\(^{84}\) Id. at 458.
operation of a corporation and its increased debt."\textsuperscript{85} In this court's opinion, the ultimate problem associated with a deepening insolvency theory is that the theory falsely assumes an insolvent company is "under an absolute duty to liquidate . . . and anyone who knowingly extends credit to the insolvent company breaches an independent duty in the nature of aiding and abetting the managers' wrongdoing."\textsuperscript{86} The court would rather rest an action on a breach of fiduciary duty in contravention of the business judgment rule, extending liability either to directors and officers or, if insolvency occurs, to the creditors of the corporation, if a showing of "bad faith" or "fraudulent intent" is made.\textsuperscript{87}

Since \textit{Global Service}, subsequent cases have also recognized the necessity of a finding of fraud before applying tort law to an action. In \textit{In re Vartec Telecom, Inc.}, a U.S. Bankruptcy Court in Texas decided that deepening insolvency would not be recognized in the state as a separate tort because the theory of injury was already encapsulated in existing torts, such as a breach of fiduciary duty or accounting malpractice.\textsuperscript{88} In \textit{Oakwood Homes},\textsuperscript{89} the U.S. Bankruptcy Court in Delaware was again asked to play fortune teller\textsuperscript{90} by predicting not only how the Delaware Supreme Court would decide the case, but, also due to a dispute between the parties as to which state's law would apply to the claims, how the New York Court of Appeals and North Carolina Supreme Court would weigh in on the issue of deepening insolvency.\textsuperscript{91} Giving great deference to \textit{Lafferty}, the \textit{Oakwood} court disagreed with \textit{Global Service}'s complete rejection of the doctrine of deepening insolvency but stated mere negligence was insufficient to sustain a complaint.\textsuperscript{92} The court cited that a showing of fraud, including its five elements of "representation of a material fact, falsity, scienter, reliance and injury," must be provided for a successful deepening insolvency claim.\textsuperscript{93} \textit{Global Service} and its progeny helped tighten up the \textit{Lafferty} holding by recognizing the \textit{Lafferty} court's desire to apply the tort concept of deepening insolvency to actions which included an element of fraud. To interested parties worried about facing culpability under deepening insolvency claims founded upon \textit{Exide}'s looser negligence standard, these decisions must have been viewed as good news. However, the most significant chinks in the tort armor of deepening insolvency had yet to come.

\textsuperscript{85} Id.
\textsuperscript{86} Id. at 459.
\textsuperscript{87} Id. at 460–61.
\textsuperscript{88} \textit{In re Vartec Telecom, Inc.}, 335 B.R. 631, 644 (Bankr. N.D. Tex. 2005).
\textsuperscript{89} \textit{In re Oakwood Homes Corp.}, 340 B.R. 510 (Bankr. D. Del. 2006).
\textsuperscript{90} See supra notes 52, 70, and accompanying text.
\textsuperscript{91} \textit{Oakwood}, 340 B.R. at 528.
\textsuperscript{92} Id. at 534.
\textsuperscript{93} Id. (quoting Vermeer Owners, Inc. v. Guterman, 585 N.E.2d 377, 387 (N.Y. 1991)).
B. Strengthening the Opposition: CitX, Verestar, and Trenwick

The strongest affirmation that a deepening insolvency action cannot stand on negligence alone was provided by In re CitX Corporation.\textsuperscript{94} The CitX court noted that "Lafferty holds only that fraudulent conduct will suffice to support a deepening-insolvency claim under Pennsylvania law" and that "a claim of negligence cannot sustain a deepening insolvency cause of action."\textsuperscript{95}

Despite recent attempts to limit Lafferty's expansion,\textsuperscript{96} the harshest blows to the deepening insolvency theory had yet to manifest. Just a few days after the CitX opinion was delivered, the U.S. Bankruptcy Court for the Southern District of New York predicted in In re Verestar, Inc.\textsuperscript{97} that "Delaware state courts would not permit recovery against directors on an independent tort of deepening insolvency where the debtor had a permissible corporate charter provision, pursuant to 8 Del. C. § 102(b)(7), generally exculpating directors from monetary damages other than for claims of bad faith or breach of the duty of loyalty."\textsuperscript{98}

Finally, in August of 2006, Trenwick American Litigation Trust v. Ernst & Young, LLP\textsuperscript{99} laid to rest the speculation as to how a Delaware state court would rule on a deepening insolvency claim. The Chancery Court proposed that "under Delaware law, 'deepening insolvency' is no more of a cause of action when a firm is insolvent than a cause of action for 'shallowing profitability' would be when a firm is solvent."\textsuperscript{100} Noting the risk directors take in their ultimate quests for success in their businesses, the court also mandated that "[t]he incantation of the word insolvency . . . should not declare open season on corporate fiduciaries."\textsuperscript{101} The court declared that "rejection of an independent cause of action for deepening insolvency does not absolve directors of insolvent corporations of responsibility" and that plaintiffs are instead "remit[ted] . . . to the contents of their traditional toolkit, which contains, among other things, causes of action for breach of fiduciary duty and for fraud."\textsuperscript{102} With such statements, the court characterized an injury evaluation under a deepening insolvency theory by the equitable principles of breach and business judgment inherent in corporation law.\textsuperscript{103} Therefore, if the corporation is acting in good faith and exercis-

\textsuperscript{94} In re CitX Corp., 448 F.3d 672 (3rd Cir. 2006).
\textsuperscript{95} Id. at 681. For a full commentary on this case, see Brighton, supra note 8.
\textsuperscript{96} See supra notes 80–95 and accompanying text.
\textsuperscript{97} In re Verestar, Inc., 343 B.R. 444 (Bankr. S.D.N.Y. 2006).
\textsuperscript{98} Brighton, supra note 8, at 69.
\textsuperscript{99} Trenwick Am. Litig. Trust v. Ernst & Young, LLP, 906 A.2d 168 (Del. Ch. 2006).
\textsuperscript{100} Id. at 174.
\textsuperscript{101} Id.
\textsuperscript{102} Id. at 205
\textsuperscript{103} Id.
ing due diligence, actions in the realm of insolvency "are protected by the business-judgment rule, and any other conclusion would be contrary to accepted legal standards."104

In sum, the current deepening insolvency theory at work today dictates that under Delaware law, unless evidence is presented to the contrary, a corporation's directors and officers, while acting in good faith and exercising due diligence, cannot be found liable under a separate and independent allegation of deepening that corporation's insolvency. However, Trenwick failed to address the consequences of a deepening insolvency claim against third party professionals, such as lenders. Applying Trenwick's holding to Global Service's proviso that fiduciary duty transfers to the creditors of a corporation once that corporation is insolvent,105 one could glean from this information that, in applying Delaware law to causes of action against third party lenders, the business judgment rule will also shield them from liability unless a showing of bad faith is made.

IV. The Options Backdating Scandal

For the purposes of this section, it is critical to keep in mind the difference between debt and equity financing as it concerns the establishment of a corporation. When a corporation is in its beginning stages, it may choose to issue either debt or equity in the corporation as a means of financing its burgeoning business. Debt financing usually exists in the form of bonds,106 which means the corporation borrows money from others to finance its ventures. The corporation in this respect would become the debtor, while the lenders of the money would be its creditors.107 The creditors retain no

104 Brighton, supra note 8, at 69.

105 See In re Global Serv. Group LLC, 316 B.R. 451, 460 (Bankr. S.D.N.Y. 2004) ("Once insolvency ensues, the fiduciary duties of corporate officers and directors also extend to creditors."); see also Luis Salazar, Is the Tide Turning on D&O Claims?, 24-APR Am. Bankr. Inst. J. 1, 45 (Apr. 2005) (proposing that, given Global Service's holding that fiduciary duty extends to the creditors of an insolvent corporation, a successful deepening insolvency cause of action must allege the fiduciary acted in bad faith or committed fraud in order to "overcome the protections of the business-judgment rule").

106 "Bonds" are defined as "long term debt securities that are secured by collateral of the corporation," whereas debentures are long term unsecured debt securities, whose value is determined by corporation's general credit rating as identified by a major credit rating service, such as Moody's or Standard & Poor's. Wesley B. Truitt, The Corporation 109 (2006). For more information concerning the credit rating services of Moody's and Standard & Poor's, see http://www.moodys.com (last visited Feb. 27, 2007) and http://www.standardandpoors.com (last visited Feb. 27, 2007). For a detailed discussion of corporate bonds, see Marcel Kahan, Rethinking Corporate Bonds: The Trade-Off Between Individual and Collective Rights, 77 N.Y.U. L. Rev. 1040 (2002).

107 "Debtor" is defined as "[o]ne who owes an obligation to another, esp[ecially] an obligation to pay money." Black's Law Dictionary 433 (8th ed. 2004). Conversely, "creditor" is defined as "[o]ne to whom a debt is owed." Id. at 396.
entitlements to any profits or revenues—their only claim against a corporation lies in the ability to receive payments upon the interest and principal mandated in the loan agreement.\textsuperscript{108} However, creditors, who retain rights in the assets of the corporation up to the amounts of their lending, bear fewer costs of monitoring the corporation because they must worry only about the value of the underlying assets “earmarked to repay their loans” and not about potential insolvency.\textsuperscript{109} The bondholders’ rights to their investment in the corporation are dictated by the trust indenture, which essentially is a contract between the corporation issuing the bonds and a trustee for the bondholders that mandates the rights of each party to the agreement.\textsuperscript{110} The trustee has no obligation to act on behalf of the bondholders until there is a default in payment of either principal or interest by the corporation.\textsuperscript{111} At this point, the trustee exercises the powers articulated to him by the terms of the indenture, which may include the power to redeem any delinquent interest or principal payments in full amount or even the power to “call in” the full value of the debt owed by the corporation.\textsuperscript{112}

Equity financing involves the issuance of common stock in the corporation. Purchasers of these shares of stock become owners in the corporation, insomuch as they would be entitled to corporate earnings distributions, voting powers for the corporation’s board of directors, and for a public corporation, the ability to sell the stock to other prospective buyers in the secondary market at prices that supply and demand dictate.\textsuperscript{113} Equity purchasers in a corporation share in the benefit of possible unexpectedly high returns in their investment, whereas a corporate lender is expecting a return on its investment of a fixed amount.\textsuperscript{114} However, because a corporation could become completely insolvent, equity purchasers may find themselves in an unenviable position when compared to corporate lenders, as the former bears the lion’s share of the risk and monitoring costs as they keep tabs on their more speculative investment.\textsuperscript{115}

In the case of insolvency within a public corporation, equity purchasers may find themselves better prepared for exiting an investment than a corporate lender. For instance, equity purchasers within a public corporation can always sell their ownership interests in the corporation, or stock, on the secondary market, or stock exchange in which the corporation is listed, at

\textsuperscript{108}See Truitt, supra note 106, at 108.
\textsuperscript{109}See Posner, supra note 76, at 436.
\textsuperscript{113}See Truitt, supra note 106, at 108.
\textsuperscript{114}See Posner, supra note 76, at 438.
\textsuperscript{115}See id. at 436.
the first sign of trouble.116 Given the fixed nature of the agreement entered
into between a corporate lender and the borrowing corporation, a corporate
lender has no viable exit strategy at the point of insolvency and becomes
a prisoner to the bankruptcy proceedings.117 Stocks, as related to executive
compensation, are the underlying catalyst of the options backdating scan-
dal,118 but it is important for purposes of evaluating prospective deepening
insolvency claims to remain mindful of the bondholders’ rights within the
corporate structure.

A. Executive Compensation

Compensation packages for senior executives of many large corporations
are substantial to say the least. The median CEO base salary for the 500
largest U.S. companies was $950,000 in 2003.119 In an effort to sweeten the
pot for these executives, and possibly circumvent the tax law,120 corpora-
tions often provide supplemental income in the form of executive bonus
pay. In 2003, the median bonus these CEOs received was $1,064,000,121 and
much of these bonus packages was in the form of stock options. In 2005,
the average chief executive’s pay, including salary, bonus, stock, and stock
options grants, was $10,500,000, a figure over 369 times higher than the
average worker’s salary.122

Generally, stock options are a grant of stock that the employee must
keep for a stipulated number of years before “exercising the option” and
buying the stock at the price listed on the face of the option.123 This “option
price” is typically determined by the market value of the share, as deter-
mined by the public exchange on which it is traded, on the date of option
granting.124 Herein lies the appeal of a stock option for both the company

116 This statement assumes that the corporation’s stock is publicly traded on a major
exchange and that there is a readily available market for the shares. For more discussion of the
major U.S. exchanges, see infra note 124.
117 See Posner, supra note 76, at 445–46.
118 See infra notes 119–70 and accompanying text.
119 See Truitt, supra note 106, at 87.
120 Publicly held companies cannot deduct any executive’s compensation that exceeds
$1 million a year as a business expense unless tied to performance. See I.R.C. § 162(m) (West
2006). The company’s method of circumventing the tax code by sweetening the pot with
stock bonuses is considered to be a catalyst in the appearance of the options backdating prac-
tice. See Jonathan Peterson, Law on Executive Pay May Have Backfired, SEATTLE TIMES, Sept. 7,
121 See Truitt, supra note 106, at 87.
122 See Joann S. Lublin & Scott Thurm, Money Rules: Behind Soaring Executive Pay, Decades
of Failed Restraints—Instead of Damping Rewards, Disclosure, Taxes, Options Helped Push Them
123 Truitt, supra note 106, at 88.
124 The two major stock exchanges for public corporations in the U.S. are the New York
and the executive. The purpose is to award the executive for good performance, so the hope is that the stock's price will be much higher at the time of exercise, due to exemplary company performance, than when the option was originally issued.\textsuperscript{125} For instance, if an executive is granted the option to purchase in three years 1,000 shares of Company X for $10 per share, and after that three-year period, due to the company's superb performance, the shares are trading for $50 per share in the secondary market,\textsuperscript{126} the executive will pay only $10,000 for shares worth $50,000, realizing a windfall of $40,000.\textsuperscript{127} Stock options not only help bolster the compensation level for executives working for the upper-tier U.S. companies but also can also serve to bring superior performers to upstart companies. As stated by Securities and Exchange Commission\textsuperscript{128} Chairman Christopher Cox, "for growth companies, the use of stock options as compensation offers a way to conserve resources while attracting top-flight talent in highly competitive markets."\textsuperscript{129} When properly used, stock options can serve an important purpose in generating and sustaining corporate viability.

\textbf{B. Sarbanes-Oxley Act: Getting Tough on Corporate Governance}

In response to various corporate scandals of the early twenty-first century,\textsuperscript{130} Congress enacted the Sarbanes-Oxley Act ("Act") to increase the SEC's oversight ability of American corporations.\textsuperscript{131} The Act "increase[d] accountability of corporate officers by requiring greater disclosure requirements and harsher penalties for violations of securities laws."\textsuperscript{132} The Act not only required top-level executives, such as a corporation's CEO and CFO, to take personal responsibility for the veracity of all corporate financial documents but also required corporations to establish certain internal

\textsuperscript{125} TRuTT, supra note 106, at 89.
\textsuperscript{126} See supra note 124 and accompanying text.
\textsuperscript{127} This example is modeled after the one provided in TRuTT, supra note 106, at 89.
\textsuperscript{128} Hereinafter "SEC."
\textsuperscript{130} See supra note 18 and accompanying text. For more information concerning the Worldcom scandal, which also caused shockwaves throughout the corporate world, see http://www.worldcomlitigation.com (last visited Feb. 27, 2007).
\textsuperscript{132} TRuTT, supra note 106, at 197.
controls "designed to ensure discovery of material information." Another component of the Act, section 403, which was considered to be a "relatively obscure" provision at the time of inception, has now become the key factor spearheading the options backdating scandal. Section 403 requires "public company officers and directors to report their receipt of stock options within two days of the grant," as opposed to reporting grants at "the end of the fiscal year," as previously mandated. It was not until a few years after section 403's implementation that the problems amenable under this provision would be detected.

C. How a Midwestern Professor Reshaped Wall Street

In 2005, Eric Lie, an assistant professor of finance at the University of Iowa, ran across something peculiar. In the years preceding Sarbanes-Oxley, companies had become increasingly proficient in granting stock options to executives at low stock prices. Professor Lie's subsequent study "document[ed] negative abnormal stock returns before and positive returns after CEO option grants between 1992 and 2002." Lie's research showed that the exceptional ability displayed by corporate officers to provide low stock price grants has significantly diminished since Sarbanes-Oxley. This research provided evidence of direct manipulation of stock options granted to corporate officers, or what has come to be known as "options backdating."

133 Id. at 198.
134 David Henry, A SarbOx Surprise; the New Requirements are Slowing Options Tricks, BUS. Wk., Jun. 12, 2006, at 38.
136 Hearing on Stock Options Backdating, supra note 129 (testimony of Mark Olsen, Chairman, Public Co. Accounting Oversight Board).
137 Id. (testimony of Christopher Cox, Chairman, Securities and Exchange Commission).
139 See infra notes 141–68 and accompanying text.
140 See Hearing on Stock Options Backdating, supra note 129 (testimony of Erik Lie) [hereinafter "Lie Testimony"]).
141 Erik Lie, On the Timing of CEO Stock Option Awards, 51 MGMT. SCI. 802 (2005) [hereinafter "Lie Article"].
142 See Lie Testimony, supra note 140.
144 See Lie Testimony, supra note 140; Henry, supra note 134.
145 Lie's research efforts have not gone unrewarded, as he is now entertaining consulting
In general, options backdating is the "retrospective pricing of stock option grants." Specifically, options are "backdated" when the "issuer selects a date in the past on which its stock was trading at a low price, and retrospectively 'grants' the option as of that past date," allowing "the executive to exercise the option at a lower price than the stock's market price on the day the issuer's board or compensation committee actually approved the grant." Therefore, if a company was attempting to backdate stock options in a manner to reward a director for valuable service, a company could pick a date in the past in which the company's stock was trading on the listing stock exchange at a historical low to maximize that director's potential profit at the time of option exercise. For example, suppose that on the current date, the company's stock is trading at $30 per share. Prior to Sarbanes-Oxley, an opportunistic company could refer to a date up to a year earlier when the company's stock was trading at a historical low, such as $10 per share, and use this date as the date of option grant. If this company granted the director an option for 2,000 shares of stock with an exercise price of $10 per share on the date of the historical low, the company would have effectively given the director a present-day right to $60,000 worth of stock for $20,000, resulting in a $40,000 windfall to the director. In sum, the options would be retrospectively issued "in the money," meaning that the options had a positive cash value at the date of issue. Essentially, the company would get away with granting the director a $40,000 cash bonus disguised as a successful option exercise.

Lie's study has caused several companies to appear on the SEC radar for options improprieties, including many small Silicon Valley compa-
and such prominent names as United Healthcare and Apple. As of April 17, 2007, 140 companies have been implicated. These misappropriations have caused company founders, CEOs, and corporate counsels, once admired by their employees and industry peers, to leave their positions in shame. Outrageous examples of corporate greed have manifested, including an African manhunt for one fugitive backdating CEO and the improbable receipt and exercise of options made from beyond the grave by one recently deceased corporate executive. Such incidents have left investors wondering where it all will end.

Backdating can have serious consequences for offending companies. One legal scholar has noted several areas in which backdating may expose companies to liability, such as accounting issues creating liability under

153 Silicon Valley is an area of Northern California which serves as headquarters for many of the country's technology companies, including such household names as Apple Computer, Yahoo!, Google, and eBay. For more information regarding this unique area, see Santa Clara County, California's Historic Silicon Valley, http://www.cr.nps.gov/nr/travel/santaclara/intro.htm (Feb. 27, 2007).


158 See Bandler & Forelle, supra note 154.

159 See Paul Davies, A Second Comverse Ex-Executive Pleads Guilty, WALL ST. J., Nov. 3, 2006, at A3 (reporting on the former general counsel of Comverse Technology, who is a Harvard Law School graduate, pleading guilty to conspiracy charge related to backdating stock options.).

160 See Charles Forelle, Kara Scannell & Paul Davies, A Fugitive's Haven in Africa Turned Out to be Anything but—Kobi Alexander is Arrested in Namibia; the Tip Off was a Hefty Bank Transfer, WALL ST. J., Sep. 28, 2006, at A1; Manhunt for Comverse Ex-Chief Ends in Africa, CHI. TRIB., Sept. 28, 2006, at 2 (discussing the arrest of former CEO of Comverse Technology, Inc. in Namibia following a two-month international manhunt).

161 See Peter Grant, James Bandler & Charles Forelle, Cablevision Gave Backdated Grant to Dead Official—Two Directors Quit Key Posts Amid Earnings Restatement; An Award for a Consultant, WALL ST. J., Sept. 22, 2006, at A1 (noting that a probe released information that options were given to the vice chairman after his death but were backdated, making it appear as though they were granted while he was still alive).
DEEPENING INSOLVENCY THEORY

securities law, certain Sarbanes-Oxley violations, and multiple violations of federal tax law. One violation that should be specifically noted is the provision of Sarbanes-Oxley requiring that companies found to have misled the investing public in their financials must restate their financial results for the time periods in controversy. This earnings restatement can impede a company's ability to produce its current quarterly reports. The failure to file a timely quarterly financial statement can leave a company in default with current bondholders, giving bondholders an option to "call in" their outstanding debts immediately, some of which may not be fully due for several years. Though this provision may leave a minor blemish on the balance sheets of behemoth companies such as United Healthcare and Apple, smaller cash-strapped companies may find themselves entering into the realm of insolvency, leaving bankruptcy or additional credit facilities as their only recourse.

D. Hedge Funds: Profiting from Pain in the Distressed Debt Market

The financial dissipation of these backdating companies has produced opportunistic behavior by hedge funds looking to make a quick profit. Generally, a hedge fund cannot be characterized in any standard definitions, as its ability to function in multiple financial markets using varied financial statements created by backdating.

162 See Vanyo & Weisman, supra note 21, at *5–9 (noting potential liability under Rule 10b-5 of the Securities and Exchange Act of 1934 for inaccurate financial disclosure statements created by backdating).

163 Id. at *10.

164 Id. at *13.

165 Sarbanes-Oxley Act of 2002, section 304 requires the CEO and CFO to repay the company all incentive or equity-based compensation and stock sale profits they receive within a year after any accounting misconduct resulting in a restatement. 15 U.S.C.S. § 7243 (LexisNexis 2006).

166 See Backdating Sparks Bond Battle, CFO MAG., Aug. 30, 2006, at 5 (noting that delays in earnings restatement due to backdating probe can cause companies to miss reporting their current earnings).

167 Id.; see also Beth Bar, A Company's Tardy SEC Reports Prompt Debt Default Finding, 234 LEGAL INTELLIGENCER, Oct. 3, 2006, at 4; Hedge Funds Look to Cash in on Late Filings by Companies, CHI. TRIB., Sept. 13, 2006, at 9; Peter Lattman & Karen Richardson, Hedge Funds Play Hardball with Firms Filing Late Financials, WALL. ST. J., Aug. 29, 2006, at A1.


169 See supra note 167 and accompanying text.

cial tools makes it its own animal. However, as suggested by then-SEC Chairman William H. Donaldson, the term hedge fund "has developed into a catch-all classification for many unregistered privately managed pools of capital." Unlike other investment funds, such as mutual funds, which find themselves investing in certain capital markets under the guidelines of the SEC and their own fund goals, hedge funds are not constrained by any certain investment model or strategy, returning gains to private investors by exploiting pricing discrepancies in any financial instrument they so choose to invest.

Hedge funds typically have been veiled in secrecy concerning their operations and investors' identities, with most investing clients being high net worth individuals who are less concerned about investment strategy and more concerned about absolute returns. Given the limited number of investors in such funds and the high net worth of these individuals, hedge funds have found themselves excluded from SEC oversight applied to most managed funds. Hedge funds typically invest in liquid markets, creating ease in the transfer to and from different investment options. Hedge funds have seen increased prominence in financial markets during the last several years. From 1994 to 2004, the number of funds in existence increased from 1,100 to 5,700, and estimated investments in hedge funds grew from $324 billion to $592 billion since the turn of the century.

Given their flexibility to trade within a wide variety of financial instruments, hedge funds have leapt at the opportunity to take advantage of market pricing inefficiencies with respect to companies currently in the options backdating spotlight. Backdating companies, due to their financial instability and concerns as to the legitimacy of earnings, have seen their


173 See McClean, supra note 171, at 109-10; Bevilacqua, supra note 170, at 259.

174 See Bevilacqua, supra note 170, at 259.

175 See McClean, supra note 171, at 116-17.

176 See Bevilacqua, supra note 170, at 259.

177 See Recent Developments in Hedge Funds Hearing, supra note 172 (prepared statement of Sen. Paul S. Sarbanes).
corporate bond ratings deteriorate. As a result, questions about company viability have also caused concerns as to whether these companies will be unable to pay the current debts they have, causing bond prices to trade at a discounted value in the open market. Though hedge funds have always looked at this discounted pricing as a means of taking over the debt of a corporation and forcing changes in management, hedge funds are currently seizing these opportunities to buy the distressed company's debt at a discount in hopes of accelerating the debt to a quick payout in the amount of face value upon the company's failure to file earnings. Another opportunity presents itself if, as in the case of United Healthcare, the bondholders get a quick settlement in consideration for not calling in the corporation's defaulted bonds. Therefore, the options backdating scandal has also provided another avenue for hedge fund managers to make a quick buck by operating in the distressed debt environment.

V. DEEPENING INSOLVENCY IN THE OPTIONS BACKDATING ERA

The hedge funds, by investing in such a manner, have given corporations limited options in dealing with recalcitrant bondholders. Corporations can either (1) avoid default by paying a lump-sum settlement to the bondholders to stop any debt acceleration process, (2) try to pay off the complete amount of the outstanding debt, or (3) go under and quit business operations. Assuming that the latter is not a viable choice, the question remains whether either of the remaining activities could result in viable claims under a deepening insolvency theory against two parties of defendants: (a) the corporation's directors and officers, or (b) the lenders facilitating additional credit on behalf of a borrowing corporation in an effort to pay off either a lump sum settlement to bondholders or the entire amount of the outstanding debt. As proposed earlier, deepening insolvency, though still viable in theory, has been dealt serious blows by recent case law which will affect a plaintiff's ability to bring such a claim with any degree of success.

179 See id. (discussing activities of opportunistic hedge funds which scour the financial markets for bond mispricing in an effort to increase returns); see also supra note 168 and accompanying text.
180 See, e.g., Nocera, supra note 178; see also Christopher C. Wheeler & Amir Attaran, Declaring the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation, 39 STAN. J. INT'L L. 253 (2003) (discussing the actions and evolution of "vulture funds").
181 See supra notes 166–68.
182 See supra note 166–68.
183 See supra notes 169–82 and accompanying text.
184 See supra notes 79–105 and accompanying text.
A. Possible Deepening Insolvency Claims against Directors and Officers

Director and officer liability, specifically as it relates to an insolvent corporation trying to bargain with various creditors for an extension of its corporate life, raises the issue of deepening insolvency possibly being alleged against these parties. The argument is that the directors and officers, acting with knowledge that the firm is insolvent or unable to satisfy outstanding liabilities, may try to borrow more money in an effort to provide either payment of a lump sum settlement to satisfy a bondholder’s request or to provide full payment of all outstanding debts. In theory, such a wrongful expansion in debt outside the corporation’s ability to pay would, by definition, meet the Lafferty litmus test of deepening insolvency. Obviously, directors’ borrowing with knowledge of an inability to repay the debt would constitute fraud. However, if the decision by the directors and officers is made in good faith and the corporation is amenable to Delaware law, the business judgment rule should shield the parties from liability, in accord with Trenwick. Trenwick’s only limitation is the possibility that the decision may be reversed upon appeal. Otherwise, the finding of fraud in the transaction should limit plaintiffs to their “traditional toolkit” of claims whose remedies lie in actions for breach of specific corporate fiduciary duties. Without a reversal, Trenwick should mitigate Lafferty’s impact outside of Delaware, as most courts look to Delaware for guidance in modern corporate law. Therefore, even with a finding of fraud in the transaction, deepening insolvency claims against corporate executives should be rendered obsolete.

In conclusion, it should also be noted that, due to certain boilerplate provisions of the contract signed in the corporate capacity, directors and officers are typically excluded from personal liability to bondholders in the trust indenture. Directors and officers considering the ramifications of dealing with vulture hedge funds trying to make a quick buck should be

185 See supra notes 166–68 and accompanying text.
186 Id.
188 “Fraud” is defined as “[a] knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment.” BLACK’S LAW DICTIONARY 685 (8th ed. 2004).
189 See Trenwick Am. Litig. Trust v. Ernst & Young, LLP, 906 A.2d 168, 205 (Del. Ch. 2006).
190 As of May 19, 2007, Trenwick has yet to be challenged on appeal.
191 Trenwick, 906 A.2d at 205 (noting that plaintiff’s “traditional toolkit” consists of “causes of action for breach of fiduciary duty and for fraud”).
193 See Salazar, supra note 105, at 46 and accompanying text.
194 See Kahan, supra note 106, at 1065.
comforted in this fact, so long as they are acting in good faith in the bargain-
ing process.

B. Possible Deepening Insolvency Claims against Lenders

Could lenders who provide credit facilities to companies seeking to pay off bondholders be found liable for corporate damages via a deepening insolvency claim? Global Service certainly provided that lenders who had knowledge of the debtor’s bleak financial future could be amenable to such an action when fraud is shown.\(^{195}\) However, though Trenwick did not speak directly on the lender liability subject, it appears the principles of fiduciary duty would also cover this situation within Delaware. As previously stated, Global Service extended fiduciary duties to the creditors of a corporation when that corporation is found to be insolvent.\(^{196}\) Therefore, applying Trenwick to this situation, it seems that once a creditor is found to owe a fidu-

\footnotesize{VI. Conclusion

Directors and officers of corporations involved in the options backdating scandal have many reasons to worry: the erosion of corporate assets attributable to litigation or payoff of bondholders; fears of business failure or the wilting of investor confidence in a given brand; and the probability of SEC sanctions, including penalties and possibly jail time. Corporate executives and the lenders that may eventually provide capital to them in an effort to postpone possible financial deterioration should not have to worry about

\footnotesize{195 See supra notes 80-87 and accompanying text.
197 See Trenwick Am. Litig. Trust v. Ernst & Young, LLP, 906 A.2d 168, 205 (Del. Ch. 2006).
198 See Kahan, supra note 106, at 1044 ("Most aspects of bondholder rights . . . are not regulated by the Trust Indenture Act and are thus left open to contracting."). One could glean from this statement that bondholder rights will typically be governed by state contract law.
the possibility of additional damages being laid upon them via a finding of injury in tort under a theory of deepening insolvency.

Recent decisions such as Trenwick stand for the premise that the ultimate reason deepening insolvency fails as a separate and distinct cause of action is because a corporation’s leaders should be allowed flexibility in deciding how to run their business. This flexibility allows decision makers to take calculated risks with their enterprises, providing companies with the ability to bring innovative products to the marketplace. Ages of case law have already provided remedies to curb a corporation’s ability to neglect their inherent duties. When evaluated in this light, it is readily apparent why deepening insolvency will not survive. Because of its “duplicative” nature within the law, the theory provides no unique remedy to plaintiffs. Any claims brought under a theory of deepening insolvency could easily be brought under their original incarnations, which are the modern remedies for breach of a specific duty owed to the insolvent corporation and remedies allowable under state contract law.