

BREACH OF TRUST PROTECTION FOR CORPORATE EXECUTIVES IN BANKRUPTCY

MORE PROTECTION FOR CORPORATE (AND ONLY CORPORATE) OFFICERS IN BANKRUPTCY...FRAUD STOPS AT THE BANKRUPTCY COURTHOUSE DOOR



THE HOLDING

The Ninth Circuit Court of Appeals recently held that corporate directors facing suits for personal liability for allegedly engaging in a breach of their fiduciary duty and trust which harmed their companies do NOT face personal liability if the officer files Bankruptcy.

While most liabilities are dischargeable (eliminated) in bankruptcy, those predicated on breach of trust as a fiduciary trustee are usually NOT. However, the Court ruled that under bankruptcy law, the Director and/or Officer in a corporation is not held to that same high fiduciary duty and may have such claims discharged in the bankruptcy court.

The decision was unanimous by the Court and held that Gregory Cantrell, a former executive at Cal-Micro Inc. is not liable for \$1.3 million in debt despite allegations that he breached his fiduciary duty. "While Cantrell in his capacity as an officer exercised some control over corporate assets of Cal-Micro, it does not follow that Cantrell was a fiduciary within the meaning of the bankruptcy code," wrote the Judge. Cantrell had been sued by the company for using corporate funds for his own personal benefit.

Citing a 1940 California Supreme Court decision, *Bainbridge v. Stoner*, 16 Cal. 2d 423, the court held that although directors and officers have some fiduciary duties, "...the relationship is not one of trust but of agency." Which means that the law holding that breach of fiduciary duty is not discharged in bankruptcy would NOT apply to corporate officers and directors since they are NOT fiduciaries but agents, thus held to a much lower level of obligation. Bankruptcy will protect them.

SO, CAN YOU IGNORE BREACH OF FIDUCIARY DUTY LIABILITY IN COURT? NO...

1. The Case applies only to the Bankruptcy Court, not to any other court. The agents of the corporation remain civilly liable if they breach their obligations...but may find protection if they then file bankruptcy. See our web article on [Bankruptcy](#) for more information on that procedure.



2. Other fiduciaries, such as Trustees of Trusts, Executors of Estates and Partners have NOT been afforded this unique protection by the bankruptcy courts. (Another good reason to avoid partnerships if you plan to start a business. The same court has specifically held that partners ARE trustees thus do not have this protection.)

3. Essentially, then, this ruling only protects corporate officers who have or face a personal judgment against them predicated on their actions while performing duties for the corporation. Bankruptcy will protect them from allegations of breach of trust.

What Does This Mean for Owners of Corporations?

1. You will have the protection of bankruptcy if the company or shareholders sue you for breach of your fiduciary duty.

2. Bankruptcy is not a piece of cake but is sometimes better than the alternative of endless litigation.

3. Such protection is unique to corporations.

What Does This Mean for Wronged Parties?

1. Unlike most claims for fraud and breach of duty, you can be stymied by the bankruptcy courts if you file an action against a corporate officer or director. However, bankruptcy is likely to ruin the defendant in any event, so the case may still be worthwhile.

2. When beginning a new business entity, if you want maximum protection, try to create a fiduciary duty greater than that imposed on corporate officers and directors...try to use other entities (partnerships, perhaps LLCs) or contractual protections if you can.

3. And remember...this is only the Ninth Circuit...in other states and jurisdictions (outside of California and the West) other laws may apply...

