

Director & Officer Duties: What Every Leader Should Know

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Earlier this year, the FDIC, acting as receiver for Silicon Valley Bank (“SVB”), filed a breach of fiduciary duty lawsuit against six officers and eleven directors of the bank. The FDIC alleged that these individuals ignored internal risk warnings, prudent banking standards, and SVB’s own risk management policies in pursuit of short-term profits and a boost to the stock price of SVB Financial Group (SVBFG).

According to the complaint, SVB’s downfall stemmed from critical errors, including an overreliance on long-term, unhedged, interest-rate-sensitive securities. This exposed the bank to significant risk amid a rising interest rate environment. Compounding the issue, executives allegedly manipulated internal risk models to conceal problems rather than address them. Between 2021 and mid-2022, SVB removed key interest rate hedges in an effort to inflate short-term earnings and SVBFG’s stock price, increasing its exposure to rate volatility. In late 2022, despite signs of financial distress, SVB paid a \$294 million dividend to its parent company, further depleting its capital reserves.

This filing serves as a timely reminder of the critical responsibilities that directors and officers (D&Os) hold—especially during periods of financial instability. The current environment of uncertainty, market volatility, and fear of recession heightens the risk of bankruptcies and the accompanying scrutiny of the actions of officers and directors. What should directors and officers consider when a company transitions from solvency to insolvency?

D&O Duties

Two fundamental fiduciary duties exist under Delaware law¹: the duty of care and the duty of loyalty.

Fulfilling the Duty of Care

To satisfy the duty of care, directors and officers must make decisions based on a reasonably informed process. This means they must actively gather and consider all material information relevant to a decision.

The standard for breaching this duty is gross negligence. Delaware law—specifically §102(b)(7) of the Delaware General Corporation Law—permits corporations to include charter provisions that exculpate directors from monetary liability for breaches of the duty of care. While this makes awarding money damages rare, breaches may still give rise to equitable remedies or support claims for aiding and abetting.

Fulfilling the Duty of Loyalty

The duty of loyalty requires directors and officers to act in good faith and in the **best interest of the company**, not in pursuit of

personal benefit. This duty focuses on avoiding conflicts of interest.

To fulfill the duty of loyalty, directors and officers must be disinterested, meaning having no personal financial stake in the matter, and independent, or in other words not being under the control or influence of someone with a personal financial interest.

Who Are the Duties Owed To?

Directors and officers must remember that fiduciary duties are owed to the corporation itself, with the goal of maximizing the value of the enterprise.

- **When the company is solvent**, fiduciary duties are effectively owed to shareholders, as they are the residual beneficiaries of the corporation's success. Ordinarily, the board of directors owes fiduciary duties to both preferred and common stockholders. However, in the event of a conflict between their interests, the board is obligated to prioritize the interests of common stockholders over those of preferred stockholders
- **When the company becomes insolvent**, the focus shifts. Insolvency gives creditors standing to bring derivative claims for breaches of fiduciary duties since the value of the enterprise is now effectively for their benefit.

A corporation is considered insolvent under two main tests: 1) **balance sheet test** – when liabilities exceed the fair market value of assets; and 2) **cash flow test** – when the corporation is unable to pay its debts as they come due.

This evolving fiduciary landscape underscores the importance of responsible governance, especially when a company is under financial stress. Directors and officers must remain vigilant, informed, and unbiased to fulfill their legal and ethical obligations—and avoid the kind of fallout we saw with SVB. A couple of other examples of director and officers' actions that led to successful breach of fiduciary duty claims come from the case of TransCare Corporation and AMC.

TransCare – Insider Transaction

In TransCare, a Chapter 7 trustee brought claims against the sole director of TransCare. TransCare Corporation was a Delaware corporation headquartered in Brooklyn, New York. TransCare Corporation, by and through its subsidiaries, provided ambulance services to hospitals and municipalities for emergency and non-emergency patients and paratransit services to the New York Metropolitan Transit Authority ("MTA") for individuals with disabilities. At all relevant times, Lynn Tilton served as the sole director of TransCare. The officers of TransCare did not have the authority to (a) approve an annual operating plan budget or any interim operating plan or budget; (b) negotiate the sale or disposition of any assets; (c) recapitalize or make other changes in the capital structure; (d) disclose any financial information to any third party; (e) enter into any contract or license agreement not contemplated by the approved Annual Plan (of which there was none); (f) enter into any financing or loan agreement; (g) dispose of any unusable asset or write off any receivable, or make a charitable contribution; (h) change auditors; (i) engage legal counsel; (j) settle or compromise any claim; (k) engage any consultant; or (l) conduct any reduction in force.

Accordingly, Tilton made all decisions for TransCare and managed TransCare through her employees at related entities. TransCare encountered financial difficulties and Tilton decided to split it into OldCo and NewCo. First, OldCo would be wound down in one of two ways: (i) outside of bankruptcy over ninety days followed by Chapter 7 or (ii) through a Chapter 11. Second, Patriarch Partners Agency Services, LLC, an entity indirectly owned and controlled by Tilton and acting as an administrative agent for a term loan extended to TransCare, would foreclose on collateral and sell it to NewCo which would continue to operate as a going concern. The foreclosure and sale to NewCo became the problem. Lynn Tilton's fundamental error was turning what should have been an arm's-length sale into a one-sided, self-dealing foreclosure and sale to herself without any of the procedural safeguards that Delaware law requires for "entire fairness." In particular, she:

1. **Controlled every step of the deal** — conceived, negotiated, approved, and executed the strict foreclosure and subsequent sale through her own affiliates, with no independent board or special committee involvement.
2. **Fixed the price unilaterally** — she set the \$10 million "foreclosure credit" herself (and even miscalculated it, including

receivables she never bought), rather than having a neutral advisor or market process test the value.

3. **Failed to explore alternatives** — she never retained a financial advisor to solicit third-party offers, didn't consider a Section 363 sale in bankruptcy, didn't seek debtor-in-possession financing or reach out to known interested buyers, and simply decided that only she would lend to or buy the assets.

By standing on both sides of the transaction and excluding any bargaining, oversight, or competitive bidding, she tainted both the process ("fair dealing") and the price ("fair price"), breaching her fiduciary duties of loyalty and good faith.

AMC – Interfering with Shareholder Vote

In the case of AMC, its board was accused of using its power to issue new securities and structuring those securities' voting rights to sideline ordinary shareholders, force through dilutive capital raising proposals, and secure a management-friendly outcome—even when the bona fide majority of investors opposed it. AMC's board ran afoul of basic shareholder-protection principles in several ways.

Despite retail investors rejecting two proposals (in Jan. and June 2021) to increase the number of authorized common shares, the board kept coming back, effectively trying to dilute holders who'd already rejected the proposal."

In July 2022, instead of going back to common holders, the board created a new class of units (APEs) that enjoyed special voting rules—unvoted APEs would be "tacked on" proportionally to the votes cast, magnifying the weight of any single APE vote. This design guaranteed that APE holders could override the common stockholders en masse, even if most common shares sat out the vote.

After the unsuccessful public sale of APEs, AMC quietly sold \$75 million worth of them to Antara Capital and swapped additional units for debt relief—on the explicit condition that Antara vote them in lockstep with management's agenda. Leveraging those "committed" votes, the board pushed through both (a) an increase in authorized common shares (to enable APE conversion) and (b) a 1-for-10 reverse split—despite a clear lack of support (or even participation) from the ordinary shareholders.

Because most common holders either voted "no" or didn't vote, the Antara backed APE votes tipped the scales. The plain effect was to disenfranchise the broad base of retail investors—many of whom had amassed shares precisely to have a voice in corporate governance. By structuring the APE vote the way they did, the board effectively "hijacked" the voting process, turning what should have been a straightforward shareholder decision into an engineered outcome.

Retail investors brought lawsuits alleging that the board had breached its duty of loyalty (by putting its own fundraising goals ahead of shareholders' interests) and duty of care (by adopting convoluted voting schemes without proper disclosure or shareholder debate). The court's preliminary block on converting APEs into common shares underscores that the directors have to exercise extreme caution when they use corporate power to intrude on shareholder rights.

Key Takeaways for Leadership

1. **Stay Informed:** Implement robust risk monitoring and reporting systems.
2. **Act Swiftly:** Confront bad news
3. **Guard Capital:** Resist dividend payments or share buybacks when liquidity or solvency is in question.
4. **Document Decisions:** Keep minutes and expert analyses to demonstrate an informed process.
5. **Prevent Conflicts:** Establish clear recusal policies and independence protocols.

By anchoring decision making in these fiduciary principles—especially during times of financial stress—directors and officers

can both protect the enterprise and shield themselves from liability.

On March 25, 2025, Delaware adopted amendments to Section 144 of the DGCL that became effective immediately and among other things, establish statutory safe harbors in defense of breach of fiduciary duty actions related to controlling stockholder transactions and interested director and officer transactions.