

2015

## The Fourteenth Annual Albert A. DeStefano Lecture On Corporate, Securities & Financial Law At The Fordham Corporate Law Center

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## LECTURE

**THE FOURTEENTH ANNUAL ALBERT A. DESTEFANO  
LECTURE ON CORPORATE, SECURITIES, AND FINANCIAL  
LAW AT THE FORDHAM CORPORATE LAW CENTER**

**CONTINUITY AND CHANGE IN DELAWARE CORPORATE  
LAW JURISPRUDENCE**

WELCOME & INTRODUCTORY REMARKS  
*Sean Griffith*

LECTURER  
*Chief Justice Myron T. Steele*

## LECTURE

### THE FOURTEENTH ANNUAL ALBERT A. DESTEFANO LECTURE ON CORPORATE, SECURITIES & FINANCIAL LAW AT THE FORDHAM CORPORATE LAW CENTER†

### CONTINUITY AND CHANGE IN DELAWARE CORPORATE LAW JURISPRUDENCE

#### WELCOME AND INTRODUCTORY REMARKS

*Sean Griffith*\*

Fordham University School of Law

#### LECTURER

*Former Chief Justice Myron T. Steele*\*\*

Delaware Supreme Court

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† The lecture was held at Fordham University School of Law on March 6, 2014.

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**WELCOME AND INTRODUCTORY REMARKS**

SEAN GRIFFITH: Welcome everyone. My name is Sean Griffith. I'm the T.J. Maloney Chair in Business Law here at Fordham and Director of the Fordham Corporate Law Center. It's my great pleasure to welcome you to the Fourteenth Annual Albert A. DeStafano Lecture on Corporate Securities and Financial Law. We're delighted to have former Delaware Supreme Court Chief Justice Myron T. Steele here to give tonight's lecture on "Continuity and Change in Delaware Corporate Law Jurisprudence." I want to thank you all for coming, especially to the many members of our board of advisors that I see tonight. Also the Becker Ross Law Firm and Howard Justvig who's in attendance tonight. The many students that I see, thank you. The alums who are here as well. And of course, I have to thank Ann who is floating around here somewhere without whom we couldn't do anything here at the Corporate Center. I'll be introducing Justice Steele shortly.

The Corporate Center is grateful for the sponsorship of the Becker Ross firm in establishing this lecture for their former partner Albert A. DeStefano. Albert DeStefano started at Fordham Law School as an evening student. He worked during the day and still managed to make Law Review and graduate at the top of his class. He went on to become a partner at the Becker Firm, specializing in corporate matters, particularly mergers and acquisitions. In his spare time, he devoted himself to charitable causes and worked here as an adjunct professor, sharing his enormous knowledge and experience with our students. Albert passed away in 2012, but through this lecture, he continues to inspire passion for corporate practice in others. In his honor, we're thrilled to welcome to deliver the Fourteenth Annual Albert A. DeStefano Lecture former Delaware Supreme Court Chief Justice Myron T. Steele.

Justice Steele graduated from the University of Virginia and received both his J.D. and LL.M. from the University of Virginia School of Law. He served on active duty in the U.S. Army and retired as a Colonel in the Delaware Army National Guard. He began his legal career in Delaware with the firm of Prickett, Jones, and Elliott of Wilmington and Dover, where he remained for eighteen years, eventually becoming a litigation partner. He's a twenty-five year veteran of the Delaware Judiciary. In 2000, he was appointed to Delaware's top court and became the Chief Justice in 2004, just stepping down from that role at the end of last November.

While he was on the bench, Justice Steele published more than three hundred opinions involving disputes among members of limited liability companies, limited partnerships, shareholders, and managers of publically traded and closely held corporations. He was highly regarded among his colleagues as a consensus builder and successfully balanced board authority with shareholder rights. While he presided over the court during one of the most dramatic periods of change in corporate law, the court sometimes gave more latitude in the obligations of board members to their investors and sometimes enforced very large damages claims where directors had ignored important conflicts of interest.

Beyond his work in the courtroom, Justice Steele speaks and frequently writes on issues of corporate governance and corporate law, including a brilliant 2005 article in the *Business Lawyer* entitled “On Corporate Law Federalism: Threatening the Thaumatrope.”<sup>1</sup> He loves to tell people about the Thaumatrope. The Chief Justice previously taught at the University of Pennsylvania Law School, and currently teaches at Pepperdine Law School in the winter and the University of Virginia Law School where he’s a regular member of the faculty. Justice Steele has consistently appeared in annual lists of leading lawyers in America and top judges in America. He’s served as the President of the Conference of Chief Justices of the United States and as a Chairman of the Board of Directors of the National Center for State Courts. In October 2012, he received the Judicial Leadership Award from the U.S. Chamber Institute for Legal Reform. It’s a pleasure to have Justice Steele with us tonight. Please join me in welcoming him to Fordham Law School.

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1. Sean J. Griffith & Myron T. Steele, *On Corporate Law Federalism: Threatening the Thaumatrope*, 61 BUS. LAW. 1 (2005).

LECTURE: CONTINUITY AND CHANGE IN DELAWARE CORPORATE LAW  
JURISPRUDENCE

CHIEF JUSTICE STEELE: Thank you very much Professor Griffith. In the spirit of candor, something with which all Delaware Lawyers are constantly either at odds or reminded of, the article that Professor Griffith talked about was co-authored by Professor Griffith and myself.<sup>2</sup> We won't talk about who did most of the thinking or who did most of the writing, but I'm not going to let him get away without taking credit. The Thaumatrope was his idea, it took him awhile to explain it to me, but after he got through to me, I completely bought into the entire thesis.

It's a privilege to be here tonight, to be a part of this lecture series, and to be at Fordham Law School. One of my favorite law clerks when I was on the Supreme Court is a Fordham Law School graduate, Nate Emertiz. You should be very proud of him, the job he did for the court, and the lawyer that he has become in Delaware. For all the students here, you could look no further to find a better example of a graduate of Fordham who has excelled in the corporate law arena in a state that's known for its corporate law.

Well, let me begin by suggesting that the following quote is a recurring theme, not just of this address, but in my mind throughout my entire career involved in corporate law. And it's very appropriate because I'm quoting Justice Brandeis, someone from New York. He said, "that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."<sup>3</sup> Although he said this in a dissent, these are words that I always remember and repeat as often as I can. And whenever I can make a Federalist statement like that and attribute it to Justice Brandeis and the City of New York, I'm not missing the opportunity.

As Professor Griffith pointed out, I'm no longer Chief Justice. I told him, "if you ask me to do it on this date, I will no longer be what he referred to as a quote 'distinguished jurist.'" I told him "there's a risk that on March 6, 2014 I might not be a jurist any longer." That's the bad news—I'm not the Chief Justice of the Delaware Supreme Court

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2. *Id.*

3. *New State Ice Co. v. Liebmann*, 285 U.S. 262, 387 (1932) (Brandeis, J., dissenting).

anymore. The good news, particularly for this lecture, is that I can draw, nevertheless, on forty-three years of practice, twenty-five years as a judge, and comment far more freely on trends developing in the Delaware courts related to the internal governance of Delaware corporations than I ever could when I was a Vice Chancellor or Chief Justice.

My objective tonight is in part to inform, but primarily to be provocative. What I want to do in this lecture is to draw your attention to what I believe will be predictable changes in corporate governance that applies to the internal affairs of Delaware corporations and explain why I think the changes are going to happen. If you disagree with those predictions, I welcome it. I'm just trying to help you think about what will happen going forward.

There are in fact changes afoot and not just because of substantial personnel changes at the highest level on the courts. I swore in our new Chief Justice, Leo Strine, last week. We will shortly have a new Chancellor, who is taking Chief Justice Strine's old position. The mere fact that those two positions are going to change inevitably says there will be new thinking, maybe not of a different generation, but certainly from younger people making the decisions. My father was an Army officer, and he said, "the only thing you can be guaranteed in the Army is when there's a new post commander, every one-way street will immediately be switched to run the other way. All the services in the chapel will change. The Jewish, the Catholic, and the Protestant services will all switch times, and worst of all, they'll change the hours of the package store." So there will be changes when leadership changes. But, I don't think you'll see a change in the approach to the application of doctrinal principles or in the doctrines themselves unless they occur incrementally and in a way that's almost entirely predictable and clearly thoughtful.

Because my time here tonight is limited, I will focus on three areas that I think bear watching. None are nuanced, none will surprise you, but I'm going to talk in broader policy terms, rather than slither through the weeds of individual cases. I suspect the students do enough case studies in their classrooms, that they don't need to hear it from me. I do not intend my remarks to even pretend to be the presentation of an academic paper. These will be, and I use a non sequitur, reflections on the future.

## FRAMEWORK

The framework is as follows:

First, the impact of ever-increasing multi-forum litigation. What I like to refer to as the dance for damages and attorney's fees. You're probably aware that in M&A, ninety-six percent of deals in 2012 over one billion dollars were litigated:<sup>4</sup> sixty-five percent in multi-forum jurisdictions and only sixteen percent in Delaware Chancery Court alone,<sup>5</sup> despite the fact that more than fifty percent of the publically traded corporations of this country are chartered in Delaware.<sup>6</sup> The rest are in various constituency jurisdictions where the plaintiffs believe the courts will serve their interests.

Second, is the so-called Nevada/Delaware/North Dakota debate,<sup>7</sup> which reflects what Justice Brandeis said. Competition between the states is exciting in my view. That competition is akin to the competition between German and English among our founders when they debated whether or not to have an official language. I don't know German. It's probably a wonderful language to know, but if that's the debate, it'll go the same direction. And I'll explain why.

And last, the impact of so-called shareholder activism. Whatever that term may mean to you.

Any one of these topics, in my view, deserve an hour or more, so I can only highlight the issues. I can't conceivably exhaust even the issues that derive from each.

Now a major caveat. I'm not trying to persuade anyone to accept my view or to agree with my predictions, but after almost twenty years on Chancery and the Delaware Supreme Court and the speaker circuit, my predictions flow from some firmly held beliefs. So to be fair to you, you should know the direction from which I come. First, private ordering shapes better corporate governance than prescriptive legislation

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4. See OLGA KOUMRIAN, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2013 M&A LITIGATION, 2-3 (2014).

5. See ROBERT M. DAINES & OLGA KOUMRIAN, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2012 M&A LITIGATION, 2-3 (2013).

6. See *About Agency*, STATE OF DELAWARE: THE OFFICIAL WEBSITE OF THE FIRST STATE, <http://corp.delaware.gov/aboutagency.shtml>.

7. Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935 (2012).



and regulation. Second, I distrust what I characterize as faith-based corporate governance. Change may be all the rage, but it must flow from empirically-based decision making, accompanied by a cost-benefit analysis because the latter is, in my view, the only thoughtful way to improve performance. Better performance should be the goal and the only goal for corporate governance and change in corporate governance. The benefits that come to the corporate entity and to investors and the community at large, only occur when corporate governance's direction is to improve the performance of the managers, directors, and large controlling stockholders of our publicly traded corporations. Now let me start on the three areas with some specificity.

#### MULTI-FORUM LITIGATION

First, as a litigator one of my favorite topics is multi-forum litigation. Multi-forum litigation is expensive, disruptive, and likely to create inconsistent rulings. It also undermines predictability and causes uncertainty. And in my view and experience, lack of predictability and uncertainty are the arch-enemies of businesses' and investors' interests.

There have been two responses to this ever-increasing problem, particularly in the M&A arena. The first is the development of the so-called forum selection bylaw or clauses in charters. Such bylaws may be adopted unilaterally by a board, or a board may propose the bylaw and then subject it to a stockholder vote. It gives that corporation the opportunity to decide where a suit, brought on its behalf, should be filed, which in turn limits the stockholders' options in where to file the suit.<sup>8</sup> The second way is a combined initiative between the conference of Chief Justices of the United States and the Federal Judicial Conference to create a template for cooperation between the federal system, which refers to this litigation as multi-district, and the states, which generally refer to it as multi-forum or multi-jurisdictional litigation. The template is now published on the website of the Federal Judicial Center.<sup>9</sup> It's intended to suggest to judges how to interact with each other and litigants in order to lessen the expense and the likelihood of

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8. See *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 941-42 (Del. Ch. 2013).

9. *Ten Steps to Better Case Management: A Guide for Multidistrict Transferee Judges*, UNITED STATES JUDICIAL PANEL ON MULTIDISTRICT LITIGATION & FEDERAL JUDICIAL CENTER (2d Ed. 2014), [http://www.fjc.gov/public/pdf.nsf/lookup/ten-steps-mdl-judges-2d.pdf/\\$file/ten-steps-mdl-judges-2d.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/ten-steps-mdl-judges-2d.pdf/$file/ten-steps-mdl-judges-2d.pdf) (last visited Dec. 29, 2014).

unpredictability, uncertainty, and inconsistent rulings. Hopefully, it will get legs, and trial judges in all areas, not just corporate governance, will look to this center's publication to help develop a cooperative and collegial relationship between jurisdictions.

For years there's been, at least in Delaware as I understand it, what I've always believed to be, a sensible plan to handle multi-jurisdiction or multi-forum litigation. What Delaware does is yield where our core interests are not directly affected. Our new Chief Justice wrote an article on the subject four months ago and it suggests to me what will happen going forward in Delaware.<sup>10</sup> The first-filed rule, which applied in Delaware for many, many years, is archaic. We should look to the best interest of the stockholders, rather than just go by rote to who filed the suit first and where. Delaware has two options if the suit is filed in Delaware, as well as in some other jurisdiction. It can either stay the Delaware action or dismiss it outright. And Delaware will do one or the other when the issues presented do not affect a core interest of Delaware corporate law.

The fundamental issue, I think, going forward in Delaware's reflection on multijurisdictional litigation or multi-forum jurisdiction is when the state's law might be applied or interpreted for the first time in a particular context (i.e., a case of first impression). If so, Delaware will not yield. Delaware courts should be the first, as we see it, to address an interpretation of the Delaware General Corporation Law or any issues that arise that are subject to the internal affairs doctrine.<sup>11</sup> And we will respect the same principle for other jurisdictions. We have a system in Delaware where, under our constitution, questions of law can be certified from the federal courts, from the high courts of each of the states, from the SEC, and now from bankruptcy judges directly to the Delaware Supreme Court.<sup>12</sup>

Recently the Ninth Circuit certified a question of law to the Delaware Supreme Court that addressed what happened to extinguished

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10. Leo E. Strine, Jr. et al., *Putting Stockholders First, Not the First-Filed Complaint*, 69 BUS. LAW. 1 (2013).

11. See *In re First Interstate Bancorp Consol. S'holder Litig.*, 729 A.2d 851, 865 (Del. Ch. 1998) (explaining that the internal affairs "doctrine states that the management of the internal affairs of a corporation will be subject to the law of the state of incorporation").

12. DEL. CONST. art. IV, § 11(8).

derivative claims in the event of a merger.<sup>13</sup> We thought it was helpful to sorting out multi-jurisdiction litigation when the Ninth Circuit took the time to certify the question to the Delaware Supreme Court, rather than undertake the question themselves. That's a pragmatic solution and an alternative I suggest most states should consider. It took an amendment to our state constitution<sup>14</sup> to permit the practice, but it happened, and it's beneficial, we think, to the development of Delaware law.

Most importantly, counsel and the courts must work together to resolve the multi-forum issue. It can't be solely affected by the chance of a bad or weak case succeeding in a district that's unfamiliar with corporate law. Plaintiffs who have a weak case tend to want to file in a district where the judges are not familiar with an issue of corporate law. These judges may get an issue of corporate law once every five or ten years, or maybe only once in their careers. Alternatively, there are districts like the Southern District of New York and Delaware where these issues arise frequently. Plaintiff's lawyers tend to say when they have a promising case on the merits, they'll come to the Southern District or to Delaware, but when they have a weak case, they'll go elsewhere. It's also in part, and sadly I report, fee-driven. Where are the plaintiff's lawyers most likely to excel in achieving a fee for their efforts? Not always the jurisdiction that is the logical jurisdiction for the case to be filed.

Now one of the answers I mentioned earlier in the outline—forum selection bylaws. Forum selection bylaws are largely an idea arising out of the minds of lawyers at Wachtell Lipton here in New York. As a matter of contract between stockholders, managers, directors, and the corporation itself, the corporation's board of directors under Section 141 of our General Corporation Law manages and directs the affairs of the corporation.<sup>15</sup> They can adopt a bylaw that says for certain cases, suit can be filed by our stockholders against us or on our behalf only in a particular state. Now logically, when someone charters in a particular state, it doesn't take a rocket scientist to figure out that the benefits aren't from a lower franchise tax or from loose accountability standards. The benefit is from a court system that's familiar with the issues that will arise, and a court that is efficient and effective at disposing of those

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13. *Arkansas Teacher Ret. Sys. v. Countrywide Fin. Corp.*, 75 A.3d 888 (Del. 2013).

14. DEL. CONST. art. IV, § 11(8).

15. DEL. CODE tit. 8, § 141(a) (2014).

issues in a way that's most cost effective to the parties involved. That's what draws the litigation. It makes perfect sense to think in terms of a forum selection bylaw if it will restrict litigation uniquely focused on the internal affairs of a corporation to one jurisdiction to the exclusion of all others. It's an immediate resolution to the problem of the expense and inconsistency I mentioned earlier that can arise out of multi-forum jurisdiction.

Our new Chief Justice recently decided as Chancellor that forum selection bylaws unilaterally adopted by a board are facially valid under Delaware law.<sup>16</sup> It was left for another day, the question of as applied, what would the result be after adopting a single foreign selection bylaw?

This question was addressed in a case from the Northern District of California, which came before this Delaware forum bylaw case. In the *Galaviz* case,<sup>17</sup> the Oracle board had adopted unilaterally, a forum selection bylaw that designated Delaware as the sole place to litigate derivative suits. Now, derivative suits (i.e. suits brought on behalf of the corporation) should surprise no one. Logic at least suggests to me that the corporation should decide where to bring a suit if they are to bring one. And if you're bringing it on their behalf, can't they contract with you to bring it in a particular state or forum as opposed to others? Well, the Federal District Court in Northern California said, I'm not sure about the validity under Delaware law, but I don't have to decide whether this is valid under Delaware law. I decide venue and the venue can be in the Federal District Court in the Northern District of California.<sup>18</sup> But more importantly, whether that conclusion is right or wrong, Justice Richard Seeborg touched on factors that I think affect "as applied" going forward. First, the wrongdoing that the board was accused of, the breach of fiduciary duty, occurred before the board adopted the forum selection bylaw. The stockholders of course, in order to pursue a derivative suit, had to own the shares at the time the wrongdoing occurred and had to continue to own them. So his view was, well it may be, and again, I don't have to decide it, he says, valid under Delaware law. I'll let a Delaware court decide that. But basically without using the same language, Justice Seeborg said the same thing that Chief Justice Strine

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16. *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 954 (Del. Ch. 2013).

17. *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal 2011).

18. *See id.* at 1175.

issued his caveat about. When the forum bylaw is applied, you may not be able to successfully implement it.<sup>19</sup>

So I suggest to you, that whether you adopt a forum selection clause in a charter, which would be ratified in effect by two thirds of the stockholders in order to effectively amend the charter, whether the board adopts it unilaterally as a bylaw, whether you adopt the bylaw then submit it to stockholders for their approval (another prophylactic to validate the bylaw), or whether you automatically include a forum selection clause in your initial charter, you have to focus on how it will ultimately be applied in a real world scenario. It's all contextual, so it's not an automatic antiseptic that you have a forum selection bylaw. You have to be careful, even if you have the legal right to adopt it, in the way in which you apply it to make sure the circumstances to which it applies fairly treat the stockholders.

Now what really amazes me about this is opposition from the proxy advisors. These in my view are knee-jerk faith-based corporate governance in experts. They oppose all forum selection bylaws, and they do so because it restricts stockholder options to sue in various forums. Look, didn't I just say it's expensive and disruptive to have multi-forum jurisprudence or multi-jurisdiction litigation? Why would someone advising stockholders say you should oppose something that's going to lower the cost of your investment. To me, it's just incomprehensible, but I'm sure they can explain their rationale for it. Every time I've heard them explain it, I still don't get it.

But I call to your attention this area of the law moving forward because it, to me, is very exciting. Whether it is the ultimate solution to the problem of multi-jurisdictional litigation or not, there's going to be a fount of litigation as corporations continue to adopt these bylaw or charter changes, whether they submit to the shareholders or not, because it's all going to focus on how they're applied in a given situation. And the points Chief Justice Strine made will be litigable points along the way. Delaware made its first statement, which is that these clauses are facially valid,<sup>20</sup> but the litigation is going to focus on how they are actually applied in various contexts.

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19. *See id.*

20. *See Boilermakers Local 154 Ret. Fund*, 73 A.3d at 954 (holding that a Board-adopted forum selection bylaw governing disputes as to corporation's internal affairs was facially valid under the statute).

## SHAREHOLDER ACTIVISM

Now, the next part of the framework, shareholder activism. Again, define it any way you wish. In my preferred system for the world, and I think in the minds of all Delaware judges, engaged if not antagonistic stockholders add positive value as a check on director authority and are a catalyst for corrective accountability, so long as their efforts focus on improved performance and not the advancement of political or personal agendas—a major caveat in my view. Delaware courts, it seems to me, will increasingly recognize the benefits that engaged investors bring to the table.

Who can ignore the real world de-retailization of stock ownership? We now know that, as of 2012, institutional investors hold seventy-five percent of the shares in publicly traded US corporations.<sup>21</sup> We also know that most of these institutional investors either have in-house expertise or the capacity to hire experts to help them shape their decision-making. We hope that the expertise leads to their desire to improve performance and not simply to be disruptive and antagonistic for the reasons that I suggested earlier.

And I believe that the Delaware courts recognize that stockholder interests vary. There may be seventy-five percent institutional ownership, but it is by no means a monolithic block of interest. They're not sharing the same views, and they don't agree on interests and objectives. They range from long-term investors, like Vanguard or Fidelity or some passive pension funds, to arbitrageurs, whose investment window is days, maybe sometimes hours, and certainly not what some people euphemistically call the long-term of three to five years. But they are highly sophisticated.

I think, as case law moves forward in Delaware, institutional investors will continue to be able to act under Delaware law in their own interest. This will continue to be the case despite some suggesting the image of sharks circling a bloody carcass in the water. And as Chief Justice Strine, in my view, famously said recently in a case, well actually it said to the lawyers in a transcript and not in an opinion, "what troubles you about sharks circling in the water? There is, after all, a

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21. Frank Aquila & Jinhee Chung, *As Institutional Investor Influence Grows: Is Now the Time for Shareholder Engagement?*, Bloomberg BNA (Jan. 25, 2013), <http://www.bna.com/as-institutional-investor-influence-grows-is-now-the-time-for-shareholder-engagement/>.

bloody carcass there and you have to expect sharks to circle the carcass.” The wolf pack theorists, where aggressive investors get together in a block interest and frustrate the interest of the balance of the stockholders and the corporation itself, is another characterization.

Delaware, I think, will continue to protect the sacrosanct shareholder franchise from board or management interference. I think we’ll continue the policy of allowing stockholders who are not controllers to vote in their own interest without imposing fiduciary duties on them regardless of their shark or wolf pack mentality. They’ll still be able to vote and act in their own best interest, regardless of motive.

But there are issues that need to be resolved. Let me call the *Air Products and Chemicals v. Airgas* case to your attention.<sup>22</sup> In that case, there was a hostile tender offer, which the board opposed, and both a poison pill and a staggered board—powerful defensive weapons against an unwelcomed hostile tender offer. The board decided that the final tender offer fell below the fair value of the corporation’s shares. They estimated fair value to be in the range of \$120. So, they kept the pill in place and fought a slate at a board election committed to remove the staggered board. A majority of the board concluded that they would trigger the pill and frustrate the tender offer if they must. Chancellor Chandler said at the end of the day, I’m constrained by the doctrine in Delaware of substantive coercion, which you probably know is the theory that the board is there to protect the stockholders from themselves because they may do the wrong thing.<sup>23</sup> This is troubling to me. They may tender at \$70 (then a substantial premium to market) when the board had analyzed the value of the shares to be \$78 in the long term, even though it was trading in the mid \$40s at the time the \$70 tender offer was put forth.<sup>24</sup> His frustration with the constraint I think resulted from what I just talked about. He knew that most of those stockholders were institutional stockholders.

Substantive coercion was developed in the 1960’s and 1970’s when the majority of stockholders were retail stockholders (and perhaps poor investors, like my wife and myself, who didn’t know what the heck they were doing, but they invested anyway because it seemed fashionable). The doctrine was designed to protect them from ill-advised and hasty

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22. *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48 (Del Ch. 2011).

23. *Id.* at 108.

24. *Id.* at 56.

uninformed judgments. Chancellor Chandler declined to remove or enjoin the pill because he had to rule consistent with precedent. But he observed the doctrine has limited value to the court under circumstances, as he saw it, where all the information that was material to stockholder decision making was in the public domain or came out through the course of the litigation, and the directors admitted that the stockholders had all the information they needed to exercise rational judgment.<sup>25</sup> Isn't there a point in time where the court should enjoin the pill? Shouldn't the stockholders be able to decide freely, without the threat of a pill, to accept or reject the tender offer?

The court should no longer rely on substantive coercion as a basis to keep the pill in place. I predict to you it's only a matter of time before substantive coercion is history. Because when you have a seventy-five percent institutional stockholder base, it's not like you're their guardian. They're perfectly capable of making their own decisions and you can't segregate stockholders and say, "Well, I'm going to protect the five percent retail stockholders here," or "I don't like the five percent arbitrageurs and the balance are institution investors." Under Delaware law, you can't segregate shareholders' interests. You have to treat them all as shareholders.

So my prediction is, if that issue comes to the Delaware Supreme Court, and it did not in *Air Products*, that the result would be different. Going forward you'll see substantive coercion disappear. But that doesn't mean the problem has disappeared. There are still issues. Minority investor board members, whether they're there by election or agreement, have issues of dual loyalty. The aggressive activist stockholder wants their people on the board. Once they're on the board and they've been put there as the result of the action of an activist shareholder, to whom do they owe fiduciary duties of loyalty? Traditional Delaware law says you owe it to the corporation.<sup>26</sup> As soon as you get on that board, no matter from whence you come, your duties of loyalty and care, and to exercise them in good faith, are owed to the corporation and to its stockholders. Not to the entity that may have elected you to the board, which may be only one in a multifaceted group of stockholders.

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25. *Id.* at 78.

26. R. FRANKLIN BALOTTI & JESSIE A. FINKELSTEIN, DUTY OF LOYALTY, DEL. L. OF CORP. AND BUS. ORG. § 4.16 (Wolters Kluwer 2015).



Vice Chancellor Laster is one of the smartest people I know, and I said that when I didn't have to appear before him. He suggested in a speech recently that it's time to just understand that the world is different today, and there will be dual loyalties, and you'll just have to decide whether that duty of loyalty under a particular contextual circumstance could be contemporaneously owed and discharged to both, or whether it was discharged improperly as to one.<sup>27</sup> But, in his words, don't continue this prejudice against activist stockholder board seats and those who hold them. Very interesting concept. It is out there compared to current Delaware law, but that may be the direction that we're going.

Another issue that arises out of the dual loyalty problem is confidentiality. You can enter into confidentiality agreements, but how do you comply with a confidentiality agreement if you owe a duty of loyalty to the person with whom you're barred from sharing? That hasn't been sorted out. I have no idea how it will be sorted out, but it is a very tricky and very difficult question.

Finally, I want to talk about, the recent investment banker cases, *El Paso*,<sup>28</sup> *Del Monte*,<sup>29</sup> and *Southern Peru*<sup>30</sup> and debunk the thought that the Delaware judges are attempting to regulate the investment banking industry and that lawyers simply don't "get" conflicts the way investment bankers understand and live with conflicts. All the Delaware courts are doing in those cases and of course, I assume you have knowledge about those cases, is saying that boards, in order to carry out their duty of loyalty and care appropriately, should make a fulsome investigation into the existence of conflicts with investment bankers and then disclose those conflicts. While they may still wish to hire investment bankers despite their conflicts, they must disclose their rationale for doing so to stockholders. It is not an indictment of investment bankers. It is not an attempt to tell investment bankers how to run their business. The Delaware judges fully understand that a lawyer's conception of what constitutes a conflict is not the same as an investment banker. And there are certainly times in the multi-limited partnership arena, such as the publicly traded master limited

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27. J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 *Wm. Mitchell L. Rev.* 1443, 1452-53 (2014).

28. *In re El Paso Corp. S'holders Litig.*, 41 A.3d 432 (Del. Ch. 2012).

29. *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011).

30. *In re S. Peru Copper Corp. S'holders Derivative Litig.*, 52 A.3d 761 (Del. Ch. 2011).

partnerships that deal in the oil and gas industry, where there are a limited number of investment bankers that they can turn to in the first place.

So there will be conflicts. The point is the board, in order to discharge its fiduciary duties, needs to find out about the conflicts, assess them, make a reasonable business judgment about whether to still use that investment banker, and disclose that conflict and what they've done about it to their stockholders before they ask the stockholders to vote on an acquisition or a sale.

Watch for a case called *Rural Metro*,<sup>31</sup> which is to be decided by Vice Chancellor Laster. It's been under advisement now for a period of time. He's doing the ninety-day dance. We have a rule in Delaware that all cases must be decided within ninety days of submission.<sup>32</sup> It could have been decided today for all I know while I was on the train coming here, but watch for that case, because there's a really significant issue. You all know that under most state law and certainly Delaware, directors can be exculpated from breaches of their duty of care. But when it's established that they have breached their duty of care, there may be no damages assessed to them because they're exculpated. But, what if there's a corresponding complaint against the investment bankers completely subsumed by the same facts on an aiding and abetting theory? The law says you can't be an aider and abettor unless there's an underlying breach.<sup>33</sup> But, what about when there's an underlying breach that's been exculpated? Is it still a breach? If a tree falls in the woods, does it still make a noise? That's what he's going to answer in *Rural Metro*. It's a hugely significant issue because the investment banks throughout this country are highly apprehensive about the possibility that an underlying board breach of fiduciary duty for which directors are exculpated could nevertheless result in damages arising out of an aiding and abetting theory being assessed against investment banks or other financial advisors.

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31. *In re Rural Metro Corp. Stockholders Litig.*, 88 A.3d 54 (Del. Ch. 2014).

32. Del. Supr. Ct. Administrative Directive No. 175 (2010).

33. *In re Rural Metro*, 88 A. 3d at 97.

## NEVADA, DELAWARE, AND NORTH DAKOTA DEBATE

Finally, in my view, the best model for corporate governance is a fluid, not a static, one. So I turn to define three templates—the so-called Nevada, Delaware, and North Dakota debate.

I'm going to assume that everybody pretty much understands what Nevada has added to the competition for better corporate governance. I'll give them the benefit of the doubt, I'll call it a competition for charters. Nevada has said we are going to allow charters to exculpate directors for breaches of duty of loyalty.<sup>34</sup> A concept that would never will be allowed in Delaware. That puts them firmly, in some people's view, on the right in this balancing of authority and accountability, a radical shift from traditional fiduciary duty law. Delaware remains in the middle. We're trapped by Section 141 that says directors and no one else manages and directs the affairs of the corporation,<sup>35</sup> but we're sensitive to stockholder rights and we hold directors accountable when they breach their fiduciary duty of loyalty or when they act with a conscious disregard of a known duty, which is our definition of a lack of good faith.

And then there's North Dakota. In 2007, North Dakota adopted the entire smorgasbord of faith-based corporate governance.<sup>36</sup> Everything you could think of—all twenty-two of the items being discussed in the academic world and in the marketplace. I won't go through them all, but if you chartered under North Dakota's special section of their corporation law, you must separate the office of chairman and CEO.<sup>37</sup> Whether it was in the best interest of the corporation or not, there was just this assumption that it had to be because the faith based madrassas that come up with these ideas of what constitutes corporate governance said it was. Majority voting. No staggered boards. Proxy access, although that's been frustrated by the SEC, no one can have proxy access now. But they were offering at the time, the same terms that were going to be eventually proposed in one of the five bills that resulted in watered down Dodd-Frank.

Now, I personally think it's fabulous that all those alternatives are offered. But if you see it as the left wing view in the competition for

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34. NEV. REV. STAT. § 78.138(7) (2014).

35. DEL. CODE ANN. tit. 8, § 141(a) (2014).

36. N.D. CENT. CODE § 10-35 (2007).

37. N.D. CENT. CODE § 10-35-06.

charters, well it's not working out so well. North Dakota had two publicly traded corporations in 2007,<sup>38</sup> when they adopted everybody's wish list of faith based corporate governance. And just two remain.<sup>39</sup> So, no vote has yet gained a majority to move from Delaware to North Dakota in order to take advantage of faith based corporate governance. Stockholders see the smorgasbord for what it is.

However, Nevada worries me for one important reason. If you move too far in protecting directors and frustrating the Common Law Fiduciary Duty regime that's been in place for hundreds of years, you run the risk of political entities and constituencies going to the federal government and inviting that institution's meddling. Meddling with all the adverse consequences typically flowing from the ill-advised presumption that the Feds can and will do a better job than the states. History in my view teaches us that federal responses to crises, real or perceived, often result in an immediate alleged solution developed in an atmosphere super charged by constituency politics overlaid by the Feds penchant for refusing to admit mistakes and policy failures that results in no corrective action or any process designed for careful reevaluation.

#### CONCLUSION

Delaware's Common Law incrementally based system will continue to adapt to accommodate needed change, and the balance of director authority and accountability will continue to acknowledge stockholders' capacity to engage and exercise independent judgment. The balance may appear to shift on the margins from a director-centric model, but the shift will be more glacial than lightening striking. An occasional case will perhaps strike fear in the hearts of mankind, watch carefully for *Rural Metro*. But Delaware will largely remain thoughtful, predictable, and informed by facts and business practices. As far as change is concerned, that's how it has been, that's what it will be, and in my opinion, that's how it should be. Thank you very much.

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38. Joshua P. Fershee, *The North Dakota Publicly Traded Corporations Act: A Branding Initiative Without a (North Dakota) Brand*, 84 N.D. L. REV. 1085, 1085 (2008).

39. Liz Hoffman, *Icahn Likes North Dakota for Shareholders, But State Fails to Draw Public Companies*, THE WALL STREET JOURNAL, Oct. 28, 2013, available at <http://www.wsj.com/articles/SB10001424052702304655104579163681660025274>.