Anywhere But Chancery

Ted Mirvis sounds an alarm and suggests some solutions

TED MIRVIS: The real news from the litigation front has been—probably this phenomenon began with the private equity deals but it's now common to every kind of deal—there has been just an explosion of shareholder litigation in any kind of deal transaction. We've done some statistics which show that the number of deals that get sued is dramatically up over the last two years but more particularly those involved in Delaware companies, it's now twice as likely as it was previous that the litigation will be brought and litigated outside of Delaware. . . .

The phenomenon of "Anywhere But Chancery"—I think there are a couple of points to make about why it's happening and what the cures are. I think it's the plaintiffs' bar kind of paying a back-handed compliment to the Delaware courts. They perceive that there is greater settlement value outside of Delaware, that there's a greater vagary in the results, that you never know what you're going to get. We can talk here or in the Delaware courts about p2p and Footnote 10 of *Caremark* and how *Revlon* duties intersect with the Unocal scrutiny and the double helix of Siliconix, you take that maybe to a state court judge someplace who's never had a corporate case and it's a little, it can be a little unnerving. I mean, you say, "Here's five recent decisions each of which is 94 pages long and you read those five decisions and you can sort of get a basic idea of the vocabulary." Someone once commented on a panel that trying to argue Delaware fiduciary duty cases outside of Delaware is like taking Gallatoire's secret recipes and giving them to a Jack-In-The-Box short-order cook. It doesn't always work so well.

And the plaintiffs' bar understands that. We've talked to the plaintiffs' lawyers in settlements and they will tell you that they have clubbed together, they have made deals with each other, that they have different fee schedules for the 49 states versus the first state. They told me that they made a pact at one point that they would not do disclosure-only settlements outside of Delaware because they think they have greater power outside of Delaware.

But let's get to the cures because there are cures I think available here. The old cure, by the way, doesn't work. The old cure used to be either the plaintiffs' bar would police itself. That's not happening any more. Or you could go to the non-Delaware court and ask it for a stay. We've just been unsuccessful in doing that, because the non-Delaware courts have become much more accessible, many of them have quote-unquote—talk about mini-me's—they have quote-unquote "Chancery divisions"?—and they are in the business and they will not stay themselves voluntarily. But the one thing we've been working on that is a kind of a new technology is—and I'd like to hear if anybody has a reaction to it—suppose a Delaware corporation adopted a bylaw that basically said that, you know—maybe it has to be in the charter, but let's see if we can do it in a bylaw—that basically creates a contract between the corporation and the directors that says any stockholder claims of breach of fiduciary duty can only be brought in the Delaware courts.

Now, after all—and I see Rob [Kindler] grimacing—these are internal corporate matters and Section 109 of the Delaware statute says that the bylaws can say anything that's not illegal or contrary to the charter that relates to the business of the corporation, the conduct of its affairs and its rights and powers, or the rights and powers of its

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stockholders, directors, officers or employees. 109 is very broad and we have with us here the king, the absolute king of bylaws, Professor Bebchuk, who uses bylaws for other purposes, but I don't see why [*laughter*] a bylaw like this wouldn't work, and I think something like this is going to have to happen because this is a very serious problem.

[*slide of Professor Bebchuk as Elvis*]

You see, we have the king of bylaws with us.

There's one other thing that can be done and a number of these motions have been made across the country—I know of no decisions on it—but the Delaware carve-out can be used in a much more powerful way than it has been up to now. Without going into great detail, the statutory language isn't great because the statutory language doesn't say that any covered action can only be brought in the state of incorporation, but the legislative history is great. The legislative history makes it clear that no matter what Congress said in the statute, what Congress clearly meant was that suits under the exception had to be limited to the state in which the issuer of the security is incorporated. That's why it's called the Delaware carve-out.

VICE CHANCELLOR STRINE:

There's a judge in Wisconsin who referred to plaintiffs' lawyers as "maggots on the carcass of a wounded body". . . .

JIM MORPHY:

That's probably the best way to go to lunch.

The reason I think this is a significant problem is because in deal litigation—and, look, 90 percent of deal litigation is settled—but the most dangerous parts of deal litigation are the cases that aren't settled. And there a lot of people who think there is a new paradigm in the plaintiffs' bar to keep these cases alive and to litigate them to damages post-closing. Two or three years down the road when we've seen perhaps—take a private equity deal where the exit has been done at five times the price and everything has turned out great—those cases can become very, very valuable down the road particularly in jurisdictions outside of Delaware, which after all there can be a jury trial going on . . . .

I'm a litigator—and there's only one rule in litigation: Three things matter—location, location, location. I think this is a problem but I think there will be a cure. I think some company soon, I hope, is going to adopt a bylaw like this—or perhaps a charter amendment—and I don't know why the stockholders wouldn't vote for it, frankly—and put an end to this.

Anybody think that bylaw has got a shot at being upheld?

JESSE FINKELSTEIN: I think it's an interesting concept but, you know, we've had little luck, especially in the state of California, for example, in respecting these concepts. When states believe that a citizen of that state has been injured by some conduct, they generally tend to seize jurisdiction. On the other hand, there is a whole series of cases going back to the sixties in New York where you've got dismissals on *forum non conviens* or other grounds where New York Supreme Court has said, "Look, this is a matter of internal affairs, going off the *Rogers* U.S Supreme Court case, and the internal affairs issues should be settled in the state of incorporation and that's where we're going to send these things, and we'll just dismiss them because we're too busy and there's no reason for us to get involved.

VICE CHANCELLOR STRINE: I think generally . . . there is just a fragmentation in the plaintiffs' bar, due to a lot of events that you can read about, that has caused there to be more of a melee. I think the reality is that there is nothing—you know, you can do these charter amendments, there are probably tools—but there is nothing that prevents people from suing. One of the interesting phenomena that really business leaders have to look at themselves, the last place the plaintiffs bar would ever think of suing in the past would be in the company's state, you know, the headquarters. Delaware was the fair forum. It says something about the way management teams are regarded in their own communities that plaintiffs would think of it as an attractive place to sue. And some of these LBOs, right, remember all the constituency statutes all got sold as protecting communities and employees? Well, when the current management team is going to take the traditional public company private, it might just be a good place for a plaintiff's lawyer atmospherically to sue them in their home state. . . There's a judge in Wisconsin who referred to plaintiffs' lawyers as "maggots on the carcass of a wounded body". . . .

JIM MORPHY: That's probably the best way to go to lunch.

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