

CORPORATE OFFICERS & DIRECTORS LIABILITY

Seminar

Delaware Bench, Bar Try to Clear Jams At Intersection of State, Federal Law

During a daylong seminar April 16 at Widener University School of Law in Wilmington, Delaware's state and federal judges as well as lawyers worked out ways to avoid collisions and delays in cases where corporate and bankruptcy law intersect.



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They produced tentative solutions to common conflicts over jurisdiction, scheduling and choice of law that arise when corporations file for bankruptcy protection.

NEW PROBLEMS, NEW PROTOCOLS

"Nothing like this has ever been done before," said Justice Jack Jacobs of the state Supreme Court. "It's wonderful that we could develop useful protocol today — like

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certifying questions (on Delaware corporate law issues) from the bankruptcy courts directly to the Delaware Supreme Court.”

That innovative procedure would allow bankruptcy judges to quickly get a definitive ruling from Delaware’s highest court on thorny issues of state corporate law.

Jacobs and the other jurists also applauded Vice Chancellor J. Travis Laster’s suggestion that bankruptcy judges, who can see “the big picture” in a complex corporate bankruptcy, should initially “call the ball” on where various parts of the case should be litigated.

But if there is doubt as to who should handle various legal battles in multifaceted cases, “I should be able to simply pick up the phone and talk with the other judge” about where an issue should be decided, Laster said.

Litigation that turns on first-impression issues of Delaware corporate law is best handled by the Chancery Court, the judges agreed.

The judges and Delaware’s corporate and bankruptcy law practitioners joined law professors in panel discussions that defined problems and suggested solutions to issues that arise because of the different ways that state law and federal bankruptcy law approach the issues of:

- Fiduciary duty and the power of directors and officers to control the bankrupt company.
- Balancing the rights of the insolvent company’s shareholders, creditors and management.
- The scope of the business judgment rule in deciding liability for actions leading up to the bankruptcy filing.
- The unique challenges presented by the bankruptcy of privately held corporations and limited liability companies (hybrid business entities that are part corporation and part partnership).

CONGRESS CREATES CONFLICT

Some of the conflict that the conference attendees coped with was created when Congress reformed the federal bankruptcy laws in 1978, Laurie Silverstein of Potter, Anderson & Corroon in Wilmington said.

Judges participating in the Widener University School of Law Seminar Judicial Roundtable

Delaware Supreme Court

Justice Randy Holland
Justice Jack Jacobs

Delaware Chancery Court

Vice Chancellor J. Travis Laster

Delaware Superior Court - Complex Commercial Litigation Division

Judge Jan Jurden

U.S. Bankruptcy Court for the District of Delaware

Chief Judge Kevin Gross
Judge Kevin Carey
Judge Brendan Shannon
Judge Christopher Sontchi

She explained that in a Chapter 11 bankruptcy, where the company plans to reorganize rather than liquidate, Congress allowed the firm's officers and directors to remain in charge of its operation but balanced that with:

- A creditors committee as an advocate for lenders, vendors and other debt holders.
- An equity committee to represent shareholder interests.
- A bankruptcy trustee to look after the interests of the post-petition estate.
- A bankruptcy court judge to rule on everything from transactions to the plan confirmation.

That makes for much legal maneuvering by various interest groups, Delaware U.S. Bankruptcy Judge Brendan Shannon said.

Since the failed company is now governed by a mixture of Delaware corporate law and federal bankruptcy law, conflicts are inevitable over which court should have jurisdiction over various issues and whether Delaware state law or federal bankruptcy law should apply, he said.

BENEFIT OF THE DOUBT

For instance, Delaware's business judgment rule gives the decisions of directors the benefit of the doubt unless they are obviously ill-informed or conflicted, but bankruptcy law provides no such deference and generally favors creditors over shareholders, said University of Pennsylvania law professor David Skeel.

"I think the application of the business judgment law in bankruptcy should be limited at best," Skeel said.

Therefore, shareholders will often seek to establish their rights in an action in the Chancery Court, and the seeds of jurisdictional conflict are planted, he added.

Heather Lennox of the law firm Jones Day noted the issues in bankruptcy cases are now complicated by the number of large companies that have been removed from the public domain via buyouts by private equity firms.

"The result is that many companies are highly leveraged, so (in bankruptcy) there's little choice but to sell, and there are fewer independent directors to rely on for objective decisions," she said.

At the seminar, the assembled judges and lawyers focused on a procedure for quickly resolving jurisdictional, procedure and choice-of-law issues among state and federal courts in Delaware.

However, the same procedures could be used to prevent jams and clashes in the multistate litigation that is common in large bankruptcies, according to professor Lawrence Hamermesh, who heads Widener's corporate law department.

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