ROUNDTABLE: LEADING ISSUES FACING THE STRINE COURT†

JOHN C. COFFEE, JR.[1]: In our planning, I referred to this as the "*chutzpah*" panel, because people were specially selected for this panel based on that criterion. We have tried to find a balance between academics and practitioners, but the real standard is facing the living immortals of the Delaware Chancery Court. Who could stand up and offer them advice and criticism?

Fortunately, we are outside of Delaware, and no Delaware judge has contempt jurisdiction beyond the boundaries of Delaware! But we are hoping we can get specific advice. I have asked each of the panelists to give their comments in an "Op-Ed" style—"Op-Ed" in the sense that it is going to be provocative, but the footnotes will not be there.

What should the Delaware Chancery Court most be thinking about over future years? How are their problems going to change? Where are the areas where the answers have to be rethought?

We are going to do this simply alphabetically, and I do not think I am going to give any introductions. We are going to start with Lucian Bebchuk, who is both an academic and occasional litigant in Delaware's courts. Lucian, the floor is yours.

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[1] Adolf A. Berle Professor of Law, Director of the Center on Corporate Governance, Columbia University School of Law.

LUCIAN A. BEBCHUK[2]: Thank you, Jack. I am going to speak briefly about a couple of basic issues having to do with the ability of shareholders to sell the company and to replace directors. Stuff that I have said before, but I have the sense from Jack that it might be useful to bring this up and put on the table today. In some sense that stuff might have been unresolved in the existing jurisprudence, and I think it would be something worthwhile for the chancery court and the judiciary to continue thinking about. And I am not going to talk about this from the perspective of what I would do if I were on the Delaware Chancery Court, because for practical and busy people like yourselves, that is not a very interesting counterfactual. So I am just going to discuss the way some of the views that were expressed by the new Chancellor and the former Chancellors should lead to some refinement of existing jurisprudence.

So let me start with the ability of shareholders to sell the company and the issue of "substantive coercion."[3] The three Delaware Chancellors had very clear views on this. Chancellor Allen was clearly uncomfortable with unlimited use of substantive coercion, and he tried to place some limits on the ability of the board to say "no" by claiming inadequate price. Chancellor Chandler and everyone here either worked on or carefully read the *Airgas*[4] monument to his opinion. It stated very clearly that in his view, this inducive consensus declaring an inadequate offer should not be sufficient to maintain the appeal.[5]

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[3] *See* Paramount Commc'ns, Inc. v. Time, Inc. (*Time-Warner*), 571 A.2d 1140, 1153 n.17 (Del. 1989) (noting that commentators have recognized "*substantive coercion*, . . . the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value," as a particular type of threat posed by a hostile offer) (alteration and emphasis in original).

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

[5] *See id.* at 158–71.

Chancellor Strine stated his own views about this also over time. If you look at the *Chesapeake*[6] opinion from 2000, there is a beautiful paragraph there that I wish I could have written—such a strong statement about the problems with substantive coercion. It says, "Our law should also hesitate to ascribe rube-like qualities to stockholders. If stockholders are presumed competent to buy stock in the first place, why are they not presumed competent to decide when to sell in a tender offer after an adequate time for deliberation has been afforded them?"[7] So that is Chancellor Strine in 2000. In 2002, in an article from the *Stanford Law Review* called "The Professorial Bear Hug,"[8] Chancellor Strine responded to a piece the critics and I wrote kind of presenting data about how the combination of a staggered board and opposing appeal can make shareholders of companies that have it worse off in a big way—not just in the short run, but also in the long run. And Chancellor Strine asked the question—obviously, as a judge he does not give answers—but he asked the question: "Is there really a threat to shareholders that justifies the potential loss of a valuable opportunity in the hands of directors who may be wrong about the right price and the right time in which to sell?"[9] So we have those consistent views expressed about the problem with having an unlimited use of substantive coercion. And I hope that this is something that over time, therefore, might lead to refinement.

A few things about the current state of the doctrine of substantive coercion as it has developed over the last twenty-five years. It has developed into a situation in which it is not qualified in the way that in *Moran*[10] it seemed it would be

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[6] *See* Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000).

[7] *Id.* at 328 (emphasis omitted).

[8] Leo E. Strine, Jr., *The Professorial Bear Hug: The ESB Proposal as a Conscious Effort to Make the Delaware Courts Confront the Basic "Just Say No" Question*, 55 STAN. L. REV. 863 (2002).

[9] *Id.* at 883.

[10] *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 n.14 (Del. 1985) (noting that *Unocal* had found a coercive threat in the context of a

qualified and refined and limited over time. As an academic, I find it hard to explain to students—they are kind of puzzled by this for some of the reasons that Chancellor Allen was trying so eloquently to put into *Chesapeake* and Chancellor Chandler so forcefully and clearly put into *Airgas*.[11] It was also difficult for the Delaware Supreme Court to accept as it was developing it over time.

There is also substantial empirical evidence that use of this combination of staggered boards and appeals is definitely costly to shareholders. There is a large amount of empirical evidence that shows that staggered boards, because of the possibility of being used to enable substantive coercion, are associated not only with lower firm values, but with many other worse dimensions of firm performance in decision making.

And lastly, a tolerant approach to substantive coercion is something that is clearly, strongly, and overwhelmingly resisted by shareholders. So if you look at shareholder proposals submitted last year for board declassification, they get seventy-five percent of the votes cast. If you take out insider votes, the numbers become very large. If we did not know that the company was counting the vote, you might think that there was something funny about getting such supermajorities in favor of declassification. You also see that when those proposals pass, boards are very responsive. They de-stagger the boards, and therefore tie their own hands, so to speak, from using substantive coercion in the way that the current jurisprudence otherwise allows.

Let me go to the next topic, and again, I am going to say more about what I think follows from the views that were expressed by the distinguished line of chancellors rather

two-tier tender offer and possible greenmail) (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 956 n.12 (Del. 1985)).

[11] *See* Air Prods. & Chems. v. Airgas, 16 A.3d 48, 101 (Del. 2011) ("Thus, while I agree theoretically with former-Chancellor Allen's and Vice Chancellor Strine's conception of substantive coercion and its appropriate application, the Supreme Court's dictum in *Paramount* (which explicitly disapproves of *Interco*) suggests that, unless and until the Supreme Court rules otherwise, that is not the current state of our law.").

than by my own views. So on elections, you know we can start with Chancellor Allen's famous statement in *Blasius*[12] about the shareholder franchise being the fundamental underpinning of the legitimacy of the corporate structure. Chancellor Chandler has made various statements embracing the strong conception about the importance of shareholder franchise. And the new chancellor, Chancellor Strine, is a strong believer in this—indeed, he has for the last decade advocated in various pieces that Delaware amend its corporate code to make it easier for shareholders to replace directors.[13]

Now, the Delaware Legislature has not followed what Chancellor Strine has recommended, and it has moved a bit in the direction of having various possible default arrangements from which companies can opt out. But I want to emphasize and to put on the table here that the differences in defaults to publicly traded companies matters a huge deal. It is one thing to say you can have it and opt out. It is another to say that if shareholders want to have it, they need to mount a major effort—which is difficult given the various rules we have—to change the rules. This is very difficult in some publicly traded companies. If you take, for example, majority voting—which is now recognized as best practices—Delaware has changed its rules to make it clear that you can opt into majority voting, and the majority of the S&P 500 companies have done so. But if you go outside the S&P 500, the overwhelming majority of the universe of publicly traded companies—including Delaware companies—still do not have it, even though institutions have clearly expressed views that this would be a good idea. And that is because it is difficult for the shareholders to get it when Delaware is setting as the default not to have it, and

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[12] *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.").

[13] *See, e.g.*, William B. Chandler, III & Leo B. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents from One Small State*, 152 U. PA. L. REV. 953, 999–1000 (2003).

Delaware still has a default of plurality voting and no proxy access.

Now, obviously the chancery court cannot change this, so what should it do? The chancery court obviously does not have the means to change the default arrangements in Delaware that have resulted, in most Delaware companies, in a system of elections that makes it more difficult for shareholders to replace directors than Chancellor Allen and Chancellor Strine and Justice Jacobs and others have thought would be desirable. But the chancery court does regularly examine various choices that boards make that also have an effect on the ease with which shareholders can replace directors. They examine bylaws that impose long advance notice for nominating directors or that sometimes put a burden on some disclosure requirements. They review poison pills that might keep block holders' ownership low, so it might be difficult for them to run a proxy fight. I will not go through the whole list, but many of you know this set of choices.

What I would urge the court to do is: when it comes to passing on board choices with deeper impact on shareholder franchise, to make decisions in recognition of two things that were so well expressed by the various chancellors and other Delaware judges. One, that shareholder franchise—given what Delaware has done with respect to defensive tactics—has been limited in some respects. The law has gone in a way that has tied the shareholders' hands with respect to their ability to sell the company; and tied the shareholders' hands in terms of the ability to change the charter and other rules or arrangements. The second thing that must be kept in mind is that boards are operating against a system of legislative defaults that already make it more difficult for shareholders to replace directors than this distinguished line of chancellors said is desirable.

And I hope that recognizing those two points might lead the chancellors to scrutinize some choices as closely as I think would be desirable. I think that refining the doctrine going forward in this way would be good for shareholder value, would be good for economic efficiency, would be consistent with the expressions of institutional investors. But also—and this was the gist of my remarks today—it would serve the policy objectives that seem to be deeply felt and well expressed by the distinguished line of former chancellors and the new chancellor. Thank you.

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ANDRE G. BOUCHARD[14]: I am going to make two points in my time today. The first point I am going to make is a doctrinal point about what, if anything, in my view, the court should do or think about doing to address the controlled mindset phenomenon that is raised in *Southern Peru*.[15] The second point may not be so provocative, but it will be a blatantly promotional commercial for the Delaware Court of Chancery in terms of the initiatives that it has already undertaken, and, I think, will continue to try and undertake in the future—to really use its preeminence in solving corporate disputes in less traditional—not necessarily totally adjudicative—functions.

On the first point: *Southern Peru*. Chancellor Strine, in his very eloquent way—as usual—uses lots of nice terminology about the "altered state of the controlled mindset,"[16] and "the controlled mindset twister,"[17] which I found very fascinating when reading the opinion. The essence of what he is discussing there is a frame of reference where outside directors in control-shareholder transactions are only really willing to look at the option that the controller puts on the table. They are not willing to push

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[15] *See In re* S. Peru Copper Corp. S'holder Derivative Litig., C.A. No. 961-CS, 2011 WL 6440761 (Del. Ch. Oct. 14, 2011). In *Southern Peru*, shareholders brought a derivative action challenging the company's acquisition of another corporation controlled by Southern Peru's controlling stockholder. The chancery court found that the transaction failed to meet the "entire fairness" standard, and that the defendant directors had breached their duty of loyalty because they had allowed the controlling shareholder to dictate the terms of the acquisition.

[16] *Id.* at *30.

[17] *Id.* at *38.

back, seek additional negotiating leverage, consider really any fundamentally important options other than what the controller puts on the table, essentially leaving them with a binary decision between accepting what the controller does or saying "no." And saying "no" to the controller—who you typically know pretty well because he or she put you on the board in the first place—is a very difficult thing to do.

What were some of the manifestations of that in the opinion? Just to put some meat on the bones there. One, the actual resolution of the committee was very cramped and very limited to only being able to evaluate the specific transaction that was on the table. Yes, there was some negotiation back and forth, and that is reflected in the opinion, but there was not a seeking of a broader mandate. Two, as everybody I am sure has already read the opinion knows, the critical moment in terms of analyzing values was being willing to accommodate the deviation from looking at the trading value of Southern Peru and being able to rationalize the mentality of devaluing that currency in order to find a way to make the "give and the get" equate with each other. A third example of the manifestation of this controlled mindset was that even after the deal had been signed, in the five-month or so period when that occurred, there was an opportunity to change the recommendation and not taking advantage of the opportunity even though the value of Southern Peru stock had increased markedly.

What is interesting to me is all the things the Chancellor was describing in the *Southern Peru* opinion are not really new. If you look at that opinion carefully, I think the *Loral*[18] case is probably cited ten times when Chancellor Strine is

[18] *In re* Loral Space & Commc'ns Inc., C.A. Nos. 2808-VCS, 3022-VCS, 2008 WL 4293781 (Del. Ch. Sept. 19, 2008). In *Loral*, the chancery court found that Loral's board did not follow a fair process (in failing to make a "market check") when it entered into an agreement under which the company's controlling shareholder purchased a substantial additional equity interest in the company. Rather than invalidating the transaction, the chancery court "reformed" the agreement to convert the preferred stock that the shareholder would have received into non-voting common stock on terms it deemed fair to Loral. *Id.* at *32.

talking about the controlled mindset. And I think *Loral* has been in many other opinions. I know from my personal experience this past year in dealing with controller shareholder situations and talking to committee directors, that that really exists in their body language, in their orientation, and in how they approach it.

So what does the court do about that in the future? The problem that I see—and I think the problem which the court has to address—is: there is a very binary way that liability for directors is assessed in Delaware. On the one hand you are going to have joint and several liability, which is basically the nuclear option for a director; or you can have full exculpation on the other extreme.

The problem—at least the problem that I perceive—is that there is really no middle ground. There is no middle place to go to, and that is really a problem. Why? Because, almost invariably, directors are going to be exculpated from liability. It is exceedingly rare for a director of a Delaware corporation who has not personally put money in his pocket in a deal—as it should be, by and large—to have any liability. They will be exculpated. The directors in *Southern Peru* were dismissed pretrial.[19]

So you go into a trial in the situation where you are evaluating facts—what is the reality? The reality is: these directors had very little exposure to personal liability. But why should there not be some other way to look at the law—from the perspective of more of a deterrent on the behavior of the directors, the outside directors? They gain director fees, sometimes $200,000, $300,000 a year. Maybe they should be disgorged or dealt with in some other intermediate way. That is the question I think—or *a* question—that the court is going to have to confront as it goes forward.

My second point is really much more pedestrian. That is: what are the things that the court is going to do to innovate and to keep on the cutting edge of being the premier forum in the United States—and even internationally, as long as it

[19] *See id.* at *19 (dismissing Special Committee defendants from the case "because the plaintiff had failed to present evidence supporting a non-exculpated breach of their fiduciary duty of loyalty").

has a Delaware connection—for resolving business disputes? Justice Jacobs last night gave a really nice talk[20] in introducing Chancellor Chandler that gave some of the history and displayed how Delaware was really very fortunate in the 1978 *Sante Fe*[21] decision to have the federal government leave the body of M&A law to be developed in the state court system. After that, Delaware, on its own, has worked very hard to take initiatives to expand on that. In 2003, it added technology disputes to its jurisdiction. In 2003, it also added the ability of chancellors and vice chancellors to mediate disputes. So that disputes that involve the consumer, a business entity either working in Delaware or incorporated in Delaware, and over a million bucks, if it is just for money damages, in a case not already pending, can be mediated by a member of the court.[22]

There is also the option of having a vice chancellor or chancellor mediate disputes that are in existence in the court. And then just a couple of years ago, Delaware expanded the jurisdiction of the court and provided that the chancellor and the vice chancellors can serve as arbitrators in cases that fall within the same classifications.[23] There is a challenge to that pending right now where the court, the state, and the judges have been sued.[24] That case is

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[20] *See* Jack B. Jacobs, *Introduction: A Brief History of the Delaware Court of Chancery*, 2012 COLUM. BUS. L. REV. 406 (2012).

[21] *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977). The *Santa Fe* plaintiffs argued that a transaction that otherwise conformed to Delaware's short-form merger statute violated Securities and Exchange Commission Rule 10b-5 (prohibiting any "artifice to defraud" shareholders) because the sole purpose of the transaction was to eliminate minority shareholders. In rejecting this argument, the Supreme Court held that Rule 10b-5 does not create a private federal cause of action for shareholders and that their remedy is available only under state law.

[22] *See* DEL. CODE ANN. tit. 10, § 347 (2012).

[23] *Id.* § 349.

[24] *See* Del. Coal. for Open Gov't, Inc., v. Strine, No. 11-01015, 2011 WL 6401166 (D. Del. Oct. 25, 2011). The Coalition filed a complaint against the State of Delaware and the Delaware Court of Chancery and its five members, challenging the constitutionality of Section 349 of the Delaware Code. The group alleged that the provisions violated the First and Fourteenth Amendments of the U.S. Constitution because they

currently pending on the theory that that violates the First Amendment's right of access to public courts. By way of disclaimer, my firm is involved representing the state in that, so I am not going to discuss the merits of that case. But I am going to assume we are going to see our way clear through the challenge and I think what you are going to find is that the path forward for Delaware is beyond these multi-jurisdictional skirmishes we are going through now. Delaware will have a more advanced role, a more intensive role in the area of arbitrating disputes. One thing that was sort of interesting to me is that there is a real push, especially internationally, to try to get greater jurisdiction over international disputes bringing in companies from the United States as well. The arbitration system is very respected. The core value to it is being able to solve disputes confidentially and privately, which is obviously the basis of the challenge in the case, and if you do not have that you cannot function effectively, so we will see where it goes. But I am confident that through these kinds of mechanisms, Delaware is going to continue to be a leader in the next decade to come.

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JEFFREY N. GORDON[25]: Right. Before I do, I just want to say what a terrific day this has been, and express my own appreciation to my colleague, Jack Coffee, and my former student, Bill Savitt, for putting this together. A little bit of a hand for them.

[*Audience Applause*]

I am going to talk about executive compensation. The question is: what are the leading issues facing the court—I

provide that arbitration proceedings for certain business disputes conducted in the chancery court are to be treated as confidential and not open to the public.

[25] Richard Paul Richman Professor of Law and Co-Director of the Center for Law and Economic Studies, Columbia University School of Law.

guess we can call it the "Strine Court." One critical issue is the attitude that the court will bring to the challenges of activist shareholders, including how Delaware Section 112 is going to be construed when it comes to access to the issuer or proxy, and the efforts by managements to extend the scope of the poison pill via broad ownership thresholds and ever broader definitions of beneficial ownership.[26]

Now, some may see this in terms of a board-centric—as opposed to a shareholder-centric—governance pattern, or long-term versus short-term patterns of creating value. But there is a different perspective that I would suggest ought to play an important role in how the courts evaluate those decisions. And that is the way that I think the Court's past governance decisions have played an important role in first, the sharp rise in the level of executive compensation; second, the change in the form of executive compensation to one that strongly favors stock options and other forms of stock-related pay; and third, to the growth of the pattern of extremely large payouts in changes-in-control, not only in acquisitions, but also in cases in which the CEO has been forced to resign, notably after unsatisfactory performance—so-called "pay for failure."

My claim is—and it is not a *Disney*[27]-type claim as you will see—that much of what we take for granted in executive compensation in the United States—and indeed, even in the world—has its roots in the decisions of the Delaware courts.

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[26] *See* DEL. CODE. ANN. tit. 8, § 112 (2012) (providing that a corporation's bylaws may require the inclusion of shareholder nominees in proxy solicitation materials relating to the election of directors); *id.* § 113 (providing that a corporation's bylaws may permit the reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies in connection with an election of directors).

[27] *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005). Disney Shareholders brought a derivative suit alleging gross negligence by the board of directors in its approval of the compensation package for Michael Ovitz, the company's president. Ovitz left the company after only one year and received $140 million for his year of work at the company. The chancery court found no liability for the directors. *See id.* at 758–60 (rejecting claims of waste); *id.* at 760–69 (rejecting claims of gross negligence against individual directors).

Further, decisions taken in the next term of the court will crucially affect whether existing compensation patterns will persist or change. So this is sort of an "Occupy Delaware" reaction.

This is a sophisticated audience, and there is not a lot of time. So I am just going to set out the dots of the argument—eventually they will be connected up in a paper, but I assume you can do a lot of dot connecting on your own.

The first dot: the core governance issue is the monitoring of managerial performance on behalf of the owners of the firm—the shareholders in a public firm. And a related core issue is finding a monitoring mechanism, which can be multiple mechanisms, that provides the most effective monitoring per unit of cost.

Second dot: there are three families of monitoring mechanisms: market movements that lead to control shifts; internal governance structures, such as boards, that may be accountable to shareholders; and the contracts with managers that try to tie managerial performance to shareholder goals. And in various ways these can add to or replace one another in the package of ways that we try to monitor managerial performance.

Third dot: The core of my claim is that, over the past generation, Delaware case law has limited the monitoring possibilities, both through markets and through internal governance structures, and thereby placed a heavy burden—you might say *too* heavy a burden—on the contractual relationships, the compensation arrangements, to perform their monitoring function. This has happened most notably in a series of Delaware decisions that give managers and boards a "just say no" defense to hostile bids, and which in turn, by way of an "adaptor response," have led to a significant increase in stock option pay for general incentive alignment, and to golden parachutes—in particular the feature of accelerated option vesting.

The fourth dot: this has produced compensation payouts in the transactions in control that are very large—that may read to the public as undeservedly large—and to very large payouts where CEOs are fired for poor performance, but which trigger the golden parachutes that may read to the public-at-large as *outrageously* large.

The fifth dot: the consequence has been to put boards on the spot—and the *court* on the spot—in reviewing compensation decisions. Boards are frankly embarrassed as they try to justify the consequences of a regime, the structural foundations of which were established by the court itself—structural foundations that may be quite distortionary in the market for managerial services.

Sixth dot: because the market for executive services is national, even worldwide, the Delaware effect has shifted the entire demand curve for managerial services. The effect has been viral.

Seventh dot: over the next Chancellor's term, the court will have the opportunity to revisit the structural foundations because markets are providing new ways for managerial monitoring that may be cheaper than certain compensation arrangements. Ownership patterns have changed. Collaboration costs among owners are lower. The Internet, of course, factors largely in this. Markets have provided new ways for shareholder activists to acquire an economic stake and to maximize the return on their monitoring activity.

Eighth dot: this gives rise to a new potential for shareholder activism. But an important thing to remember is this: the typical shareholder activist who owns a small stake is at most a catalyst. It is the institutional owners who own the majority of the stock who must ultimately be persuaded.

The critical decisions are those on the rules on the use of Section 112 which offer a new way to make the internal governance mechanism more effective and the terms of the pill which affect the economic terms on which the shareholder activists can perhaps play their catalyst role.

So with a few more minutes remaining, let me just go back and add a few sub-dots. I want to return back to those original moments in the 1980s because the history is important here. The effect of the decisions relating to hostile bids was to deprive the shareholders of one very effective way to discipline managers who had not succeeded. At the same time, there was a significant ownership change going on. The institutional investors were strongly ascendant. They strongly believed in the need to align these managerial incentives, and so that is the point at which the parties essentially had this new consensus: stock-based pay, "golden parachutes."

If you look at change—and scholars have done this—in the rise of stock options over the period, stock options were basically a "new economy" idea which was designed for—and especially worked for—those new firms: the high-tech firms who could not afford to pay managers in cash. They were borrowed from old economy firms, and frankly, in the wake of any other way for the shareholders to attain incentive alignment, they performed that function. Golden parachutes were, in effect, a way for the shareholders to buy back the takeover resistance endowment that the Delaware courts had given to managers. And indeed my colleague Robert Jackson has got data that if you look at parachute payments for the current year, roughly three quarters of the payments are associated with the accelerated vesting of options.

So, the point I want to make is: some of these core structural elements came in response to Delaware legal decisions. And the decisions in the next go-round, which will affect the access that the shareholders have to the board and thus the internal governance procedures and the way that activists can play the catalyst role, will *also* affect executive compensation. Because, with other ways to discipline management, we will not look to the incentive alignment. That will not be the defense of some of the executive comp arrangements which make so many uneasy. There will be the chance to rethink that as we bring on board new sorts of governance mechanisms that the shareholders have on hand.

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EDWARD ROCK[28]: It is a great pleasure to be here, in particular to pay tribute to Bill Chandler, who has been a really wonderful Chancellor and before that a wonderful member of the Delaware Chancery Court. It is irresistible to be able to put my two cents into the continuing Chancellors as to what they should be worrying about, and some of them are here, so it really is a pleasure.

The key problem of corporate law that all of us have sort of been taught in law school that academics have worried about for thirty years, fifty years, seventy years—it is beyond, certainly, my memory—is the shareholder-manager agency cost problem. And there are academics who continue to worry about the shareholder-manager agency cost problem.[29] And I want to suggest that that is not such a big problem compared to other agency cost problems, and that as the Delaware court moves forward, having a good sense of what are the major problems and what are the minor problems is important in figuring out how to characterize conduct and figuring out what the issues are that people need to worry about.

Classically, corporate law addresses three agency cost problems: the shareholder-manager problem; the problem between controlling and non-controlling shareholders; and the agency cost problem between shareholders and creditors.

Historically, going back thirty, forty, fifty years, when we really did have significant managerial agency costs, there were excessive retained earnings—so-called "free cash flow." And that by itself largely protected creditors and limited the shareholder-creditor agency cost problem—so much so that

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[28] Saul A. Fox Distinguished Professor of Business Law, University of Pennsylvania Law School.

[29] *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1754 (2001) ("In the typical agency relationship, one person (the principal) wants to pay another (the agent) to perform some task that the principal is unable or unwilling to perform for herself. But hiring an agent to do something for you immediately raises the question: How can you make sure your agent does a good job?").

in U.S. corporate law, the creditor protection features of corporate law largely atrophied.

What I want to suggest is that since the 1980s, and certainly since the early 1990s, our world has been transformed—that managerial agency costs have been substantially reduced. And there are various ways of explaining how that happened. Part of it was huge amounts of equity-based compensation that turned managers from thinking in managerial terms to thinking like shareholders. There have also been changes in board composition. And we have had obviously greater concentration of shareholdings, greater shareholder activism, increased shareholder power.

One indicator of what seems to me to be a transformation of the landscape is that free cash flow has largely disappeared. You can see that in various ways: in terms of negative net equity issuance, in terms of distributions to shareholders, and, the evidence that I find really most powerful and most interesting, in the supply of AAA corporates. Since the early 1980s, we are down from sixty-two AAA non-financial corporate bond issuers to four. If you remember nothing else in this presentation, this chart is a really important and interesting chart, because for one thing we have all these legal regulations to say you have to invest in AAA debt. Right? But what we see here is the supply has been contracted, which is one explanation Charles Calomiris gives for why there was an appetite for AAA-rated, subprime debt. But another way of looking at this is that the free cash flow problem has disappeared, because companies have paid out their free cash flow.

A shareholder-centric system—whether created by law as it is in the United Kingdom or in the rest of the world, or created by practice, as I argue it is created in the United States—generates shareholder-creditor agency cost problems that demand measures to protect creditors. The rest of the world, aside from the United Kingdom, has concentrated ownership, which largely solves the shareholder-manager problem, replacing it with a very strong form of the controlling shareholder and non-controlling shareholder problem. The United Kingdom has dispersed ownership, but it has a very shareholder-centric corporate law. And, it seems to me that our practices in rules, which have developed over the last fifty, sixty years in a largely managerial system, have to adapt. The Delaware system has shifted to be a shareholder-centric system, not through any shifts in the law, but through shifts in practice. Having done that, people have to be aware that there is a shareholder-creditor agency cost problem. We have to remind ourselves of that, and be on the lookout for it.

There are three main sorts of shareholder-creditor agency cost problems. There is asset dilution, namely when shareholders, through their control of the firm, shovel assets out to shareholders ahead of creditors; asset substitution, by increasing the riskiness of the firm's business; and debt dilution, by adding unanticipated new debt.

Now the question is: once you recognize that you have a problem of shareholder-creditor agency, how do you handle it? And that is obviously a very long story with regard to what the implications are for Delaware. The first way you handle it is contracts. And one would expect that the front line of creditor protection is writing contracts. But of course, contracts have to be interpreted, and in interpreting contracts, it seems to me that the Delaware courts should be alive to equity's incentive to take advantage of creditors. That if you think of managers as having huge equity incentives, then you have to ask if when managers act, are they doing it to benefit equity at the cost of debt? I have not done a survey, but there seems of late to be at least a couple of interesting cases raising issues that are potentially shareholder-creditor kinds of issues—for instance, *Liberty Media*.[30]

[30] Bank of N.Y. Mellon Trust Co. v. Liberty Media Corp., C.A. No. 5702-VCL, 2011 Del. Ch. LEXIS 66 (Del. Ch. Apr. 29, 2011), *aff'd*, 29 A.3d 225 (Del. 2011). In *Liberty Media*, the defendant corporation proposed to split off certain businesses into a new public entity. Bank of New York Mellon, as bond trustee, challenged the transaction, arguing that, taken together with other split-offs already completed, it violated a bond indenture provision prohibiting the transfer of substantially all the company's assets unless the transferees agreed to assume the bond

A second way to handle the shareholder-creditor agency problem is compensation. We have used equity compensation as a tool to change managers who think like managers into managers who think like shareholders, but you can overdo it. And the goal, we have to remind ourselves, of course, is valuable companies in a valuable society—not maximizing equity for maximizing equity's sake. So one thing to think about is having management compensation that combines equity with debt to better align managers' interests with firm value, as opposed to equity value. Compensation, likewise can affect how courts characterize management conduct, because in the same way that the Delaware courts looked to see how big an equity stake the board has in trying to evaluate whether the board has acted in the interest of shareholders—and here I am thinking of *Unitrin*[31] and the fact that the board in *Unitrin* had $430 million or so of equity—if the question is a shareholder-creditor problem, then you want to know to what extent do managers have pure equity incentives, or both equity and debt incentives. The most prominent sorts

obligations. The chancery court held that the proposed split-off and prior transactions were not sufficiently related and that the transactions could not be aggregated for purposes of the successor obligor provision.

[31] *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995). American General announced a plan to merge with Unitrin by purchasing $2.6 billion of Unitrin shares at $50 per share. *Id.* at 1370. Believing this offer undervalued the company, the Unitrin board adopted a poison pill. The board also announced a share repurchase program, which would have reduced the company's outstanding shares and potentially increased the percentage held by board members to a level that would allow them to block any merger. *Id.* at 1370, 1378–79. The Delaware Supreme Court held that in applying enhanced scrutiny under *Unocal*, the chancery court was first required to determine whether the board's defensive measures were "draconian" by being either "preclusive or coercive." The Supreme Court found that the poison pill and the share repurchase were not coercive and that repurchase program was not necessarily preclusive, although each measure made a takeover more difficult. However, the Supreme Court remanded the case to the court of chancery to determine whether the Unitrin board's actions "individually and collectively" were within the range of defensive measures that would be reasonable and proportionate under the second *Unocal* prong. *Id.* at 1390.

of inside debt, of course, are deferred compensation and pension benefits.

Finally, we have to think about legal rules. One of the most striking features of the United Kingdom is that it is a shareholder-centric corporate law system. At the same time, they have robust creditor protections through their wrongful trading statute.[32] One effect of that is that directors of a U.K. firm, in approving a highly-leveraged transaction, worry that the deal may go bankrupt, because a deal that quickly goes bankrupt after being approved creates a significant degree of potential liability for the directors who approved it under the wrongful trading statute. One way they handle that is to demand solvency opinions before approving highly-leveraged transactions with the effect—I am told, I have not done any systematic work on this—of transactions being less leveraged.

Then finally there is the old corporate creditor protection law.[33] We do not teach much about legal capital and about restrictions on dividends or restrictions on share repurchases, but the law is there, and in the appropriate case, the doctrines are available if a court finds a case that they view as equity opportunism vis-a-vis creditors. For instance, an LBO that fails quickly is really nothing more than a share repurchase that has rendered the firm insolvent. And we know from the share repurchase doctrines and cases that a share repurchase that renders the firm insolvent violates Delaware law—it violates the restriction on repurchasing shares.

So the question to close with is the extent to which, as we move forward—if I am right that shareholder-creditor issues

[32] *See* Insolvency Act of 1986 ch. 45, § 214 (Eng.) (providing that an insolvent company's directors may be liable for "wrongful trading" where they continued operations despite knowing that there was no reasonable prospect of avoiding insolvency, unless they "took every step with a view to minimising [sic] the potential loss to the company's creditors").

[33] *See* DEL. CODE ANN. tit. 8, § 174 (2012) (holding directors of a company that unlawfully declares and pays a dividend jointly and severally liable to the corporation and its creditors for the amounts paid, if at any time within six years after the dividend is paid, the corporation becomes insolvent or is liquidated).

are significant issues on the horizon—in thinking about the fiduciary duties of directors, we should begin to think the way the United Kingdom thinks about a key part of the director's function as to avoid insolvency. And let me stop there.

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PAUL K. ROWE[34]: Well, I thought that I would address things from the perspective of the transaction planner. Also known as "client." Also known as "defendant."

To step back for a minute and think about what an odd situation the whole corpus of M&A law and practice is: here we have a type of transaction which is presumptively legal, but which we also presume every instance of which will be examined by a court—and as you have heard earlier today, increasingly examined by two courts. We have not had too many instances of two actual preliminary injunctions involving the same transaction, but it is clearly the wave of the future.

From the transaction planner's perspective, if he or she were asked—"What is the issue facing the court of chancery?"—I think the answer would be the same answer you would have heard any time within the last thirty or forty years, which is: how does the court reconcile the classic common law function of applying equity to new situations with developing the doctrines with predictability? Because from the perspective of the transaction planner, of course, the substance of the law barely matters—it is the level of predictability that matters. So that is always going to be a challenge to any common law court, but particularly the court of chancery, where so much of the legal cases that come before it involve people who have read and studied and debated the opinions that have come down over the years.

There is a lot of theory around, and there are a lot of new ideas. One of the interesting developments is partly due to technology and partly the way the courts and the system

[34] Partner, Wachtell, Lipton, Rosen & Katz.

have evolved. You not only have to read opinions, but you get transcripts zipping around the Internet, blog posts about things that have been said at conferences like this, and so forth. So the corpus of things that a transaction planner has to look to in order to decide whether he or she may be personally liable for the potential tens or hundreds of millions of dollars that can be the judgment if things go wrong has expanded enormously to the point where each time you sit down and plan a transaction, you are essentially making a bet that the law as you have discovered it is going to continue to be applied. I do not think that is the situation, but it is clearly an issue that should be on the forefront of trying to keep the balance in the court between the development of new doctrines and the continued ability to plan transactions.

On the issue of multi-forum litigation, we heard from members of the court, we heard from a representative of the plaintiff side of the caption, and we heard from members of the professoriate. From the defense side, it should be clear that defendants have no incentive to multiply litigation. The problem is that we are essentially pawns in the system—we can be sued. In a recent case I had last year, we were sued in five different courts, each one of them with potentially different rules. And of course, it is the plaintiffs who make the forum choice. And aside from trying to implement a bylaw or charter amendment that would attempt to concentrate the litigation in the state of incorporation, there is absolutely nothing we can do about it. We hope that the judges on the various courts can coordinate things to the extent that coordination is necessary. We hope that where Delaware is the state of incorporation, Delaware will be the state that the plaintiffs choose. But it is a problem as to which there is essentially no clear solution. And those are my remarks.

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HILLARY A. SALE[35]: I am glad to be here today. In fact, I think it is a real honor to be invited to honor Bill Chandler and to toast to the end of the Chandler era on the court and also to look forward to new Chancellor Strine's era on the court.

I want to talk about a concept of "publicness"—something I have written about in the context of corporate governance—and then apply it to Delaware.

I think often that when we talk about governance and the standard concept of governance, we refer to shareholders, officers and directors. I think in today's world, though, we have to acknowledge that the concept of governance is much broader—that in fact many other actors play a very significant role in the governance of public companies. In particular—and Mark Roe talked about this this morning when he talked about the federal aspect—with respect to Congress.[36] The media plays a significant role in corporate governance, and of course bloggers play a significant role in corporate governance as well.

When companies are able deftly to manage all of those aspects of their governance, they actually have greater legitimacy. And I think perhaps the same is applicable to the great state of Delaware and its infamous corporate courts. I think, in fact, the failure to truly understand publicness and to pay attention to it has significant long run costs.

Shareholders, for example, who cannot effect change in their companies on the inside then move to the outside. And we start to see responses to those shareholders that many of us actually would prefer not to see, but that become the answer as a result of their sense that their opportunities from within are so impoverished.

And of course one classic example—not classic, but one very salient example right now—is the Occupy Wall Street movement, which I would define as a form of outside

[35] Walter D. Coles Professor of Law and Professor of Management, Washington University School of Law.

[36] *See Panel: Delaware's World: Who Are Its Competitors?*, 2012 COLUM. BUS. L. REV. 640, 640–48 (2012).

governance. I gather the Occupy Delaware movement almost kept Vice Chancellor Glasscock from attending today. So obviously it is salient in Delaware as well.

We have seen this kind of thing happen in other contexts. They are not quite as dramatic as the Occupy Wall Street movement, but they are the kinds of things that Mark Roe and many of us have written about. For example, the result of other constituencies pushing for change in a place where they think that they can be heard better—Congress—than they can be heard, perhaps, in Delaware. And the result is the changes that we get in Sarbanes-Oxley or the Dodd-Frank Act, with the federal government's role extending far beyond a disclosure-enforcing substance regime that we have under the securities laws to be directly involved in state governance decisions.

These are changes arguably that co-opt Delaware's power. I do not think I am saying anything that other people have not thought about—I am just reiterating that this is kind of important for the state of Delaware and its jurists to be thinking about.

So then it takes me to the question of whether Delaware actually gets it. Does Delaware get this sense of publicness? And I was looking for evidence of that. I have some evidence of the "yes" and some evidence of the "no." For example, as I suggested a minute ago, Chancellor Strine's speech today might arguably be evidence of an understanding of publicness for the state of Delaware. The proxy access changes in Delaware, which we have seen as categorized perhaps as reactionary—and yet we know that Chancellor Strine, among others, was writing about it some time ago. And forum selection provisions, which I think are kind of an interesting response to publicness. I will just use that as an aside to say I think Delaware got it wrong, meaning, that is, forum selection does not belong in the articles or the charter, it belongs in the bylaws with the shareholder vote. Suing is about as basic as it gets for shareholders, and if they can not make their own forum selection provisions, or at least control the corporate decision on that by having it in the bylaws with the shareholder vote, then I think probably we are making the wrong choice.

Executive compensation, which Jeff Gordon just talked about, is obviously one of the biggest issues facing corporations today and one of the ones that is gaining the most public attention today. And here we have some evidence, which I would see differently, perhaps, than Bernie Black did earlier, of Delaware making a classic Delaware move in these areas.

Indeed, Chancellor Chandler made two classic moves. One is in *Citigroup*,[37] where he dismissed most of the case but left open issues on the compensation paid to CEO Charles Prince on his way out. I call that a classic Delaware move because it left open the possibility of something which may be foreclosed after litigation—witness *Disney*[38]—but does at least allow for room for discovery and a full discussion about what happened in that particular situation. And of course *Ryan v. Gifford*,[39] which was actually quite a

[37] *See In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009). In *Citigroup*, shareholders brought a derivative action against officers and directors, alleging breach of fiduciary duty for failure to monitor and disclose the company's subprime lending exposure. The plaintiffs also claimed waste with respect to the company's purchase of a portfolio of subprime loans, the board's failure to suspend the company's share repurchase programs, and the board's approval of a compensation package for the company's retiring chief executive officer. *See id.* at 111–12. The chancery court dismissed all of the claims, except for the claim of waste with respect to the retirement compensation, for failure to make a "demand" on the board prior to commencing the suit and for failure to adequately plead "demand futility." *See id.* at 112.

[38] *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005); *see also supra* note 27.

[39] *See* Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007). Shareholder Ryan brought a derivative action against senior executive of Maxim Technology Corporation, claiming breach of fiduciary duty and unjust enrichment based on alleged backdating of stock options in violation of shareholder-approved stock option and incentive plans. However, Ryan had only become a Maxim shareholder by reason of that company's merger with a company of which he was a shareholder. The chancery court dismissed all of Ryan's claims for the period prior to which he became a Maxim shareholder, but allowed all other claims to proceed. *See id.* at 361.

clear statement about certain choices in the executive compensation realm. And more recently we have seen some opinions about the clear conflict that officers have when they are negotiating executive compensation, and how companies have to be really careful about it.

So I would put all those in the evidence of: "yes," there is some evidence that Delaware understands its publicness. I think, however, when I turn to the evidence of "no," I would go right back to executive compensation. The recent *Goldman Sachs*[40] opinion is an example of something some could argue was a missed opportunity for at least some further comment conversation on the subject of executive compensation. However, I have to grant—because I have not read all the briefings in the case—that maybe the plaintiffs did not do a good enough job pleading in that case, of pulling in outside facts. But some of the numbers, to somebody sitting back and reading it, are quite shocking. And then I would say executive compensation will keep coming back in Delaware, it will come back in different ways because 1) it is very salient now; and 2) Dodd-Frank has made it even more salient. In a world of "say-on-pay" and "say-on-frequency" votes, and potentially the disclosure of worker pay, which we will assume to be dramatically different than the CEO pay, we will begin to see more pressure and pushback and more conversation about compensation in a way that just cannot be avoided. And of course those provisions are classic evidence of Mark Roe's point this morning about how

[40] *See In re* Goldman Sachs Grp., Inc. S'holder Litig., CA No. 5215-VCG, WL 4826104 (Del. Ch. Oct. 12, 2011). Goldman Sachs shareholders brought a derivative action against corporate directors alleging breach of fiduciary duties by failing to properly analyze and rationally set compensation levels for corporate employees, and failure to adequately monitor corporation's operations. Specifically, plaintiffs alleged that because Goldman's directors consistently based compensation for the firm's management on a percentage of net revenue, "Goldman's employees had a motivation to grow net revenue at any cost and without regard to risk." *Id.* at *4. The chancery court dismissed all of the claims for failure to state a claim and failure to make a pre-suit "demand" on the board of directors.

different groups have successfully managed to make changes in Washington that they are not able to make any other way.

The result of those "say-on-pay" votes, and potentially the result of corporations choosing to ignore them, is likely to be two-fold. One will be bylaw provisions where shareholders attempt to enforce disclosure by directors about the choices they made in response to a negative "say-on-pay" vote. Another will be votes on directors, and I have been talking to some directors recently about how concerned they are about facing a reelection campaign after a negative or even marginal "say-on-pay" vote.

So what does all of that mean for Delaware going forward? I think what it means is that Delaware needs to refocus on some of the things that it has done quite well over the years. Strategic decision making, something that Professor Steven Davidoff talked about this morning,[41] is something that Delaware has generally done quite well. And here are some examples of extremely strategic decision making in the past: *Caremark*,[42] a settlement opinion which clearly shifted the dialogue for directors, for academics, and for lawyers about what the role of directors is; another line of cases that I think was extremely strategic—and this is my definition of strategic, I am not saying the judges were being strategic or implying any negative connotations in that

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[41] *See Panel: The Evolution of M&A Litigation in the Chandler Era*, 2012 COLUM. BUS. L. REV. 602, 625 (2012).

[42] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996). Caremark shareholders brought a derivative action alleging that members of the company's board breached their fiduciary duty of care by failing to supervise adequately the conduct of Caremark employees, thereby exposing Caremark to fines and liability from employee violations of federal and state laws and regulations applicable to health care providers. The chancery court found that the record did not support the conclusion that directors lacked good faith in the exercise of their monitoring responsibilities. *See id.* at 971–72. However, the court approved a settlement, based in part on "express assurances that Caremark will have a more centralized, active supervisory system in the future." *Id.* at 972.

regard—is the *Malpiede*[43] line of cases which picked up from *Caremark* in the Rule 102(b)(7)[44] response and eventually, over time, crafted room for a conversation about good faith and the possibility of good faith being something more than just a lack of a financial conflict of interest. And then of course Delaware's constitutional amendment for certification with the SEC.[45]

So I will close with a couple more remarks about where Delaware will be looking in the future, and where everybody will be looking to Delaware in the future. Obviously executive compensation will be extremely key, as I said before. And then the response to executive compensation decisions not just in the form of litigation but either in the form of bylaw amendments for change or shareholder votes on directors who have not been as responsible as shareholders would have liked. And that of course will present all the questions that have been talked about today in the context of the shareholder franchise and the role of the court in protecting the franchise, on which the court has relied many times for dismissing shareholder claims—saying, "If you don't like it, you can vote them out." Thank you.

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[43] *See In re* Frederick's of Hollywood, Inc. S'holders Litig., Consol. C.A. 15944, 2000 Del. Ch. LEXIS 19 (Del. Ch. Jan. 31, 2000), *aff'd sub nom.*, Malpiede v. Townson, 780 A.2d 1075, 1096 (Del. 2001) (dismissing a shareholder class action alleging breach of the duty of due care because the exculpatory provision in the corporate charter, authorized by Section 102(b)(7) of the Delaware Code, barred any claim for money damages against the director defendants based solely on the board's alleged breach of that duty).

[44] *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2012).

[45] *See* DEL. CONST. art. IV, § 11, cl. 8 (allowing the Delaware Supreme Court "to hear and determine questions of law certified to it by . . . the United States Securities and Exchange Commission . . . where it appears to the Supreme Court that there are important and urgent reasons for an immediate determination of such questions by it").

GREGORY P. WILLIAMS[46]: Thank you, Jack. I want to say, I do not think that the biggest issues facing the court in the next ten or twelve years during the Strine era will be substantive issues. I think our court is very much capable of dealing with whatever substantive issues arise, and I honestly believe that we are all very good at making complicated that which is pretty simple.

If you think about the fundamental aspects of Delaware law with respect to fiduciaries, you have to understand that you, Mr. Fiduciary, are someone who has chosen to manage someone else's money. You do not have to do that, but you have chosen to do that. So if you do it, you must do it in an informed way. You must do it in a loyal way, in the sense that you cannot favor your own interests over the people whose money you are managing. You have to do it in a way that shows good faith—that shows that you are acting really for their best interests. And if you do all those things, you will be okay. And if you do not—if you engage in self-dealing, etc.—you are going to have some issues in front of the court. You are going to have to explain yourself, and the burden may well be on you.

If you understand that, I think you can give a lot of advice to directors of Delaware corporations in a lot of situations and do quite well. So I do not think it is all that complicated. The changes that will come up in our law, the court can deal with. They have done it for many years. That will not be a problem.

The biggest issue that I see facing the court is the management and the oversight of the system of stockholder litigation that we now have in Delaware. I think this is clearly the biggest thing for the court to focus on, and the court is very focused on it.

I think this not just an issue for the Strine court. I think it is an issue for all of us who make our living in large part from stockholder litigation. That is the reality.

Defense lawyers—and I am not above it myself—make snide comments about the plaintiffs' lawyers. It is pretty

[46] Director, Richards Layton & Finger.

stupid. We are the sort of people who make a living selling insecticide, and if the insects went away, we would be out of business—we would have nothing to do. I hope you take that as a compliment, my friends in the plaintiffs' bar. But I mean that, we are all dependent on each other, and we all have to work with the court to make sure that our system stays intact.

I think we always have to have in mind that, at any given time, we need to be prepared for some objective, outside, informed entity to closely examine what we are doing here, and have that entity determine whether or not our system of stockholder litigation is a net plus to the United States and global economies. And I think that is true today—I think that the check of stockholder litigation is in fact a net plus. I think if you let these directors loose without a real check, we would have more significant problems than we now have. So going forward, we just have to always be prepared to answer that question in the positive and have some outside entity agree with us that our stockholder litigation system is a net positive. Because if we do not—if there is ever a time when someone concludes that this is not right, what is happening in Delaware—then we run the risk of losing what has now become the bulk of our practice.

And I want to talk about some changes since I started doing this in 1982 in terms of stockholder litigation. The plaintiffs' lawyers are now much, much more capable on the whole than they were back in the early days. And I say "on the whole" because there were and are people who were plaintiffs' lawyers back then who were great lawyers. The late Ralph Ellis was as capable and honorable as any attorney I ever dealt with on either side of the aisle. And others as well. But the stockholders' lawyers on the whole are just better now. The whole stereotype of the guy who the only thing he is worried about in the deposition is "what kind of Danish are we ordering?" is out of date. That is not something that is a real world issue these days.

I also think a big change is that the number of lawyers engaging in this plaintiffs' practice has dramatically increased. You hear about more lawsuits outside Delaware.

I think this is because there are more lawsuits, and there are just more people who are rationally finding this practice attractive. So that is a real change. It is a real change in my world that most public deals now result in litigation, no matter how arms-length, no matter how much of a premium there is, no matter how strategic the deal, no matter how reasonable the deal protection. There will be lawsuits filed, no matter the size. And I think that is a change from years ago.

Another very important change is that stockholder litigation is no longer the footnote or the asterisk; it is often the main event. It used to be in the 1980s and 1990s, the big litigation would be between two companies, often an acquirer and their target. That was the main show, and the plaintiffs were there, but at the second table and did not add that much, frankly. That has really changed in that there are fewer business-on-business major lawsuits and more major lawsuits that are generated by the stockholders' plaintiffs' bar.

Another major change I think is that defendants are almost always willing to settle now. There are not that many companies that are going to take a principled stand and say, "You know what? We have a clear majority of outside directors, we are qualified, good people. We are honest people." And most clients I deal with really do fit that description. "We tried to do the best we could. We have world class advisors. We did nothing wrong. So defend us. Let's see what happens. If the Delaware courts are so good, let's find out. Let's see if they can come to the right result." There are not a lot of companies that have that attitude these days, and I think there is one reason for that that I will come back to.

And this is another big change: I believe, as somebody who does this on a daily basis, that there is escalation in fee awards. I am not here to argue whether that is good or bad. But I believe the numbers are just bigger. In the last year or two, let me give you big numbers: *Del Monte*,[47] I believe it is approximately $25 million all-in; *Philadelphia Stock Exchange*:[48] $16.5 million; *CVS*,[49] $20 million; *Alberto-Culver*,[50] $3.25 million; *MediaComm*,[51] $3 million. Many cases involving million-dollar-plus awards, and many cases involving pedestrian amounts between $500 thousand and a million. Where I grew up, in Bear, Delaware, that was a lot of money. Still is, actually.

And so I do not believe that there is this concept of decreasing fee awards in Delaware. I think it is quite the opposite, and I think that is why you see many more people getting into this game. I frankly see that for the first time in my career, if you have the willingness to do this for your career, I am not sure that it is often a rational decision to stay at a firm like Richards, Layton & Finger. If you are a good young lawyer, and what you really want to do is make a boatload of money, you really maybe ought to think about the plaintiffs game.

And I think that is something that is happening for the first time in terms of the relative attractiveness of plaintiff and defense counsel. I think that is in part due to what I think is the last sort of new development related to the fact that defendants are always willing to settle. Much of the

[47] *See In re* Del Monte Foods Co. S'holders Litig., Consol. C.A. No. 6027-VCL, 2011 Del. Ch. LEXIS 94 (Del. Ch. June 27, 2011) (initially awarding lead counsel fees and expenses of $2.75 million, denying the other fee applications without prejudice, and permitting them to be renewed at a later time).

[48] *See* Ginsburg v. Phila. Stock Exch., Inc., C.A. No. 2202-CC, 2008 Del. Ch. LEXIS 164 (Del. Ch. July 2, 2008) (awarding attorneys' fees of $16 million plus interest, and reimbursement of reasonable expenses in the amount of $ 640,000).

[49] *See* Notice of Pendancy of Class Action, Proposed Settlement of Class Action, and Settlement Hearing, La. Mun. Police Emps. Ret. Sys. v. Crawford, C.A. No. 2635-CC (Del. Ch. Apr. 16, 2007).

[50] *See* Transcript of Settlement Hearing at 45–47, *In re* Alberto-Culver Co. S'holder Litig., C.A. No. 5873-VCS (Del. Ch. Feb. 21, 2011) (awarding attorneys' fees of $3.25 million on contested application where settlement eliminate reduced termination fee and provided supplemental disclosure).

[51] *See* Trial Pleading in Haverhill Ret. Sys. v. Mediacom Commc'ns Corp., C.A. No. 5552-VCS, 2010 WL 2357724 (Del. Ch. 2010).

contingent fee nature of this work is gone. That is the reality. The reality is, if you get a public deal and you have a plaintiff, you sue. Because the defendants are willing to settle, you are not at risk. You will get a settlement, you will get some money. It may only be a few hundred thousand bucks. Too bad, but you will get some money.

And so those are all changes that I have seen in the last ten years. I would say with respect to the fees, the perspectives of the plaintiffs' and defendants' counsel are vastly different. If Stuart Grant's comments today reflect generally the view of plaintiffs' lawyers that they are not getting paid sufficient fees, I think there is just a wide variance of the views of the plaintiffs' lawyers and the views of many defense counsel.

I believe all these factors, whether you like them or not, will lead to an increase above and beyond where we are now in stockholder litigation. I think in ten years, we are going to look back and think that this world of stockholder litigation today was relatively mild compared to where we are going to be in ten years.

That is why I think monitoring and controlling our system, which includes defense counsel, plaintiffs, etc., is going to be key for the court. And the court is clearly focused on it, and you see some things that have happened recently.

One of the professors noted today that there has been some criticism of plaintiffs' lawyers. Sometimes plaintiffs' lawyers have deserved criticism, and I would say, as somebody who deals with the plaintiffs' lawyers on a daily basis, I think that criticism had a positive effect. I think the plaintiffs' lawyers ought to, as a whole, be thanking the court for that criticism because it has caused them to do their jobs better and more effectively.

There has also been effusive praise for plaintiffs' lawyers. That was not in the slides today, but let me tell you, as many times as I have walked out of the court recently hearing plaintiffs' lawyers criticized, I have heard them showered with praise for the work they have done. And I walk out with my co-counsel, who says, "Wow, that was getting to the point of nauseating me." And I say, "I understand, but it is what the court does. The court is managing the process." So there is criticism, but there is also praise.

There is also scrutiny of defense counsel. You saw that in the *Nighthawk*[52] situation. You saw that in the *Revlon* decision, a couple years ago,[53] where there was criticism of plaintiffs' lawyers. If you go back and read that, you will find a fair amount of criticism of the defense lawyers, too. It was handed out to both sides.

You also see a different attitude from the court with respect to defense lawyers and settlement hearings. Back in the old days—and I believe the people who do this regularly will agree—you did not really prepare as a defense counsel for a settlement hearing. You might take a legal pad. You want to take the record jacket, just for appearances sake. But your role was to be prepared to stand up and say persuasively, "Your Honor, defendants support the settlement as well." That was it, and then you sat down. It was easy money, the easiest way to earn your hourly rate.

Now that has all changed. As defense counsel, when you go to a settlement hearing, you had better be prepared to explain the settlement—explain how you got there, explain your dealings with the plaintiffs' lawyer. So there is increased scrutiny on the defense counsel. My point is: the court is focused on this stockholder litigation process.

Finally, there is a great focus on attorney fees in the court. I think it is an evolving area of our law right now. I think that is fair to say. You see more hotly contested fee applications than you ever did. The plaintiffs' expectations, the defendants' expectations—there is a wider gap now, I think, than there ever used to be. And that is why you see

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[52] *See* Report of Special Counsel at 2, Scully v. Nighthawk Radiology Holdings, Inc., C.A. No. 5890-VCL (Mar. 11, 2011) (investigating potential collusive forum shopping, but noting that forum shopping is not necessarily problematic in and of itself and may be "unquestionably proper or part of the zealous advocacy expected of attorneys").

[53] *See In re* Revlon, Inc. S'holders Litig., 990 A.2d 940 (Del. Ch. 2010) (finding that lead counsel representing owners of common stock in earlier-filed actions provided inadequate representation and thus would be replaced, and that new counsel would be used to determine if proposed settlement was fair).

these issues being litigated. So we all need to take our ownership in the system and make sure that it is something that will withstand scrutiny.

I have several very quick, specific items—since we were encouraged to give specific advice. I would suggest to my friends on the plaintiffs' side of things that more and more firms ought to do what the best firms do, and that is: back away from the clean, arms-length strategic deals and just do not bring those lawsuits. I think it is in your long-term interests not to do so.

I think, on the defense side of things, some of us need to be exploring more with our clients than we currently do, whether or not they want to litigate and defend themselves as opposed to agree to a settlement which someone will someday attack. I am often surprised with my dealings and conference calls with very good co-counsel, how quickly on the defense side the conversation turns to settlement. "Well, we can probably do a disclosure settlement or a disclosure-plus, and we will sort of work our way there." I do not think that in a lot of cases we are actually presenting to our clients the option of fighting. I think we should explain to our clients: "Okay, here are the risks, but here is how good your case is. You got some really good advice from people along the way, and if you are going to be a repeat player in this business, you might want to think about not settling so easily." I find oftentimes we are not getting to that conversation because we passed "Go" and went right to settlement. I think that is something that defense counsel can do.

I think that plaintiffs' counsel has to police themselves better in terms of their affidavits and overstaffing on their litigations. On the defense side of things, our clients do not tolerate that anymore. They do not pay for it and you just cannot have access to people at depositions. I think it would be of interest to the plaintiffs' bar to police that themselves, so that they are not asking the court to approve fees that a client would not approve.

I would say from the court's perspective, my advice to the court—the court has never asked for my advice, I get that, I understand—but I am going to give it anyway. We were asked to give *chutzpah*; we were not asked to be stupid. Nevertheless, I am going to give the court some advice, and that is: do not try to do anything other than achieve a fair and just result in your cases. Do not try to do anything other than have all litigants, the plaintiffs and defendants, feel after they leave your courtroom that they were treated fairly. Chancellor Chandler was the absolute master of that. He was a judge who made everyone feel that they got a fair shake. I really believe that, and I feel both sides would agree.

But from the court's perspective, we do not need you to worry about trying to lure plaintiffs' firms to Delaware. Do not worry about it. Just issue good decisions—that is what the court of chancery does best—and we will all be fine.

We also do not need you to worry about defendants and corporations fleeing Delaware because they see these big decisions and they see multi-billion-dollar awards. Do not worry about it. If people want to leave, they are going to leave. But you do what you do best, which is issue good decisions that you believe are fair and just, and the rest of this, the flight of lawsuits elsewhere, it will all take care of itself. That is all I have.