Securities Regulation Daily Wrap Up, CORPORATE GOVERNANCE—Delaware Chief Justice Strine to retire, (Jul. 9, 2019)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Mark S. Nelson, J.D.

Plaudits from Delaware and SEC officials for Chief Justice Strine's lengthy service on the Court of Chancery and, more recently, on the Delaware Supreme Court, underscore that Strine was equally respected professionally as he was, at times, controversial.

Delaware Chief Justice Leo Strine announced that he will retire later this year from the state's supreme court. Strine, a titan of the corporate bar in the state whose Chancery Court is often recognized as America's corporate court put his unique stamp on many ground-breaking decisions as Chancellor and then as a member of state supreme court majorities that frequently upheld Chancery Court opinions, albeit sometimes with tweaks. Strine also has been no stranger to controversy during his tenure on the Delaware bench.

SEC Chairman Jay Clayton praised Strine's engagement with issues important to investors: "His contributions have extended well beyond the courtroom and the Commission has benefited substantially from his willingness to engage with us on a range of topics important to our investors and our markets." Commissioner Robert Jackson likewise acknowledged Strine's influence in the field of corporate law: "More than that, the Chief Justice is an intellectual leader, on the cutting edge of how best to protect the American families who rely upon our companies to build a sustainable future."

Delaware Governor John Carney also lauded Strine: "Since our time in Governor Carper's office, he has served as Chancellor and Vice-Chancellor on Delaware's Court of Chancery and as Chief Justice, leading our world-class judiciary, helping to protect Delaware's reputation as the premier venue for business litigation, and working to make our criminal justice system more fair for all Delawareans."

Investor protection. Recently, Chief justice Strine has argued via academic papers for supermajority shareholder votes on corporate political spending. To bring this about, Strine has urged in one such paper that the largest asset managers should step into the void and prevent a "double legitimacy problem" which he said allows companies to spend on political goals that have nothing to do with why shareholders invested in those companies.

Said Strine: "Precisely because Worker Investors hold investments for the long term and have diversified portfolios that track the whole economy, political spending by corporate managers to tilt the regulatory playing field is harmful to them, as humans who suffer as workers, consumers, and citizens when companies tilt the regulatory process in a way that allows for more pollution, more dangerous workplaces, less leverage for workers to get decent pay and benefits, and more unsafe products and deceptive services."

Expanded role for business judgement rule. As Chancellor, Strine had the opportunity to address the legal significance of controllers in multiple contexts. For example, in *Southern Peru Copper*, Strine held in a post-trial opinion that the acquisition by Southern Peru Copper of Minera Mexico, S.A. de C.V. flunked entire fairness (fair dealing and fair price), the standard agreed to by the parties. Strine also found that a burden shift from the defendant to the plaintiff was unjustified primarily because: (1) "burden-shifting should not depend on the after-the-fact vote result but should instead require that the transaction has been conditioned up-front on the approval of a majority of the disinterested stockholders;" and (2) "the defendants have not met their burden to show that the vote was fully informed." Strine further explained that a burden shift would not have altered the result he reached in the case. Strine fixed the remedy at $1.263 billion.

According to Strine's description of the facts in *Southern Peru Copper*, the case is not unique: "Rather than tell the controller to go mine himself, the special committee and its advisors instead did something that is indicative of the mindset that too often afflicts even good faith fiduciaries trying to address a controller. Having been empowered only to evaluate what the controller put on the table and perceiving that other options were off the menu because of the controller's own objectives, the special committee put itself in a world where there was only one strategic option to consider, the one proposed by the controller, and thus entered a dynamic where at best it had two options, either figure out a way to do the deal the controller wanted or say no."

The Delaware Supreme Court would later uphold the remedy and a fee award of more than $300 million.

In the *M&F Worldwide* case, Strine would confront a related question that had eluded the state's supreme court regarding a merger where twin deal protections were both present, that is, the deal was approval by the special committee *and* by a majority of the noncontrolling stockholders. Said Strine: "Although rational minds may differ on the subject, the court concludes that when a controlling stockholder merger has, from the time of the controller's first overture, been subject to (i) negotiation and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors, the business judgment rule standard of review applies."

The Delaware Supreme Court affirmed Strine's decision in M&F Worldwide, while noting, as Strine had, that Delaware precedent had suggested confusing results by bifurcating the analysis and, thus, requiring approval by "*either* a Special Committee *or* the majority of the noncontrolling stockholders…"

In yet another related case, Strine wrote the Delaware Supreme Court opinion upholding the Chancery Court decision regarding what would become known as the Corwin cleansing rule.

Forum selection clauses. Strine would also break ground regarding forum selection clauses, which could be perceived as giving companies chartered in Delaware a head-start in litigation over internal corporate matters. More recent cases would test the limits of the rationale for allowing such clauses.

In the *Boilermakers* case, Chevron and FedEx, both Delaware corporations, had adopted bylaws that required matters regarding their internal affairs to be litigated in the Delaware Chancery Court. Each company's certificate of incorporation granted its board authority to adopt bylaws under Delaware law. Chevron and FedEx cited the risk of multi-forum litigation as the main reason for adopting forum selection bylaws. The plaintiffs, consisting of municipal retirement funds, challenged Chevron's and FedEx's forum selection bylaws on the grounds that these companies' boards lacked authority under Delaware law to adopt them and because the bylaws are contractually invalid. The plaintiffs also alleged that Chevron's and FedEx's boards breached their fiduciary duties.

According to Strine's opinion in *Boilermakers*, Delaware Code Chapter 8, Section 109(b) gives a company wide latitude to adopt bylaws "not inconsistent" with its certificate of incorporation. The court readily found the bylaws here were not facially invalid. The court also found the forum selection bylaws to be contractually valid. Strine noted that a company's bylaws are a "broader contract" between the company, its officers and directors, and its shareholders, which the Delaware General Corporation Law allows a board to unilaterally amend. According to Strine, Chevron's and FedEx's shareholders understood this arrangement when they bought their shares.

Late last year, in *Sciabacucchi v. Salzberg*, Vice Chancellor Laster declined to extend the *Boilermakers* rational to certificates of incorporation adopted by Blue Apron Holdings, Inc., Stitch Fix, Inc., and Roku, Inc. that required suits under the Securities Act of 1933 to be brought in federal court. In a related proceeding, the vice chancellor awarded $3 million in fees and expenses to the plaintiffs. Two main reasons informed the court's decision: (1) Securities Act claims are external to the corporation; and (2) the U.S. Supreme Court had within the year held that state law suits alleging only Securities Act claims may be brought in state court and they cannot be removed to federal court.

Unicorns and Caremark. It is axiomatic in Delaware law that the *Caremark* claim is one of the toughest cases to allege given the need for the plaintiff to demonstrate that a corporation either had no internal controls or its overseers chose to ignore them. Thus, *Caremark* claims have become a kind of unicorn, a type of case nearly

consigned to legal mythology. But in a recent decision by the Delaware Supreme Court, and written by Chief Justice Strine, the court brought such a case to life.

In *Marchand v. Barnhill*, shareholders alleged that executives and directors of Blue Bell Creameries USA, Inc., a major ice cream maker, breached their duties of care and loyalty regarding a dilutive private equity deal that was supposed to rescue the company after its business nearly collapsed following a fatal listeria outbreak involving its products. The crux of the suit was an alleged failure by the company's executives and directors to oversee the safety of the company's operations. The court quickly found that the chancery court erred in not finding that the complaint sufficiently alleged reasonable doubt regarding one extra director's lack of independence; thus, demand was not excused.

The Delaware Supreme court stated the Caremark standard thus: "Under *Caremark* and this Court's opinion in *Stone v. Ritter*, directors have a duty 'to exercise oversight' and to monitor the corporation's operational viability, legal compliance, and financial performance. A board's 'utter failure to attempt to assure a reasonable information and reporting system exists' is an act of bad faith in breach of the duty of loyalty."

The court noted that the plaintiffs had sought books and records and otherwise proceeded in an appropriate manner under Delaware law. Specifically, the court focused on what the plaintiffs had found, including many instances of red or yellow flags not presented to the board and a lack of discussion of food safety by the board. Perhaps the most telling finding was the absence of a board committee devoted to food safety issues.

Controversial Chancery Court opinions. The role of Delaware Chancellor and Vice Chancellor can at times seem destined to bring their holders into open conflict with the Delaware Supreme Court. During his tenure on the Delaware judiciary, Strine would find himself on both sides of these cases.

For example, in *Gatz Properties, LLC v. Auriga Capital Corporation*, the Delaware Supreme Court upheld Strine's finding that an LLC manager violated his contracted-for fiduciary duties. The court, however, took the opportunity to caution Delaware judges about addressing issues not properly before the court. Here, the provocation was an "excursus" by Strine on his interpretation of Delaware's LLC statute that would find the existence of "default" fiduciary duties.

Said the Delaware Supreme Court (*per curiam*): "During oral argument before this Court, counsel understood the trial court opinion to mean that 'because the Court of Chancery has repeatedly decided an issue one way,... and practitioners have accepted it, that this Court, when it finally gets its hands on the issue, somehow ought to be constrained because people have been conforming their conduct to' comply with the Court of Chancery's decisions. It is axiomatic, and we recognize, that once a trial judge decides an issue, other trial judges on that court are entitled to rely on that decision as stare decisis. Needless to say, as an appellate tribunal and the court of last resort in this State, we are not so constrained."

The state justices then offered a more general warning: "We remind Delaware judges that the obligation to write judicial opinions on the issues presented is not a license to use those opinions as a platform from which to propagate their individual world views on issues not presented."

As Chief Justice, Strine found himself on the other side of a controversial decision by a Chancery Court judge in *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, where the Delaware Supreme Court determined that Vice Chancellor Laster had applied the wrong standard in an appraisal case by using the 30-day average unaffected market price rather than the deal price minus synergies. The vice chancellor had theorized that his approach would better account for certain agency costs. (It is hard to tell how much of what the court said can be attributed to Strine or any individual justice because, as in *Gatz*, the decision was *per curiam*).

The state justices explained their objections to the vice chancellor's appraisal theory: "This multitude of concerns gives us pause, as does the evident plausibility of Verition's concern that the trial judge was bent on using the thirty-day average market price as a personal reaction to being reversed in a different case. In a reargument decision addressing the petitioner's argument to this effect, the Vice Chancellor denied that this was the case. We take him at his word."

The Delaware Supreme Court, in a footnote, quoted from Vice Chancellor Laster's remarks on the matter in an earlier opinion: "I personally do not believe that I issued the Post-Trial Ruling out of frustration. To the contrary, I personally believe that I engaged in a lengthy, laborious (in both senses), and reasoned effort to implement Delaware Supreme Court precedent."

Vice Chancellor Laster's opinion had also gone on to state the following: "For starters, I am not a legal titan. I am a state court trial judge. I personally do not think that the role of a trial judge accommodates active resistance to Delaware Supreme Court pronouncements. I rather view the job as calling for adherence to Delaware Supreme Court precedent. While I think it is fair game for a trial judge to suggest potential changes in the law, I do not believe that a trial judge has the flexibility to disregard the Delaware Supreme Court's holdings, nor do I think that a trial judge should look for clever ways to evade their implications. When a new precedent arrives, I view my job as requiring that I update my understanding of Delaware law to incorporate the new precedent. *** That is what I tried to do in this case."

IndustryNews: CorporateFinance CorporateGovernance CorpGovNews GCNNews DirectorsOfficers FedTracker Securities FiduciaryDuties