Middle Atlantic – Law Firms

Delaware Law: Always Ahead Of The Curve

The Editor interviews ***David C. McBride****, Partner, Young Conaway Stargatt & Taylor, LLP*

Editor: While at the same time you are a litigator, you have been involved in much merger activity in Delaware courts. Could you describe some of the most noteworthy transactions?

McBride: We were actually involved in one of the first hostile takeover cases ever litigated in Delaware back in the early '80s, followed by the Revlon case where we represented the then hostile bidder that acquired Revlon. That is one of the landmark decisions in Delaware law in terms of mergers and acquisitions. We were involved in the defense of Phillips Petroleum, in Paramount's effort to acquire Time-Warner, and in QVC's effort to acquire Paramount. A recent transaction involving litigation in which we were involved was between Hollinger International, Inc., which we represented, and its one time controlling stockholder, Conrad Black, and his holding company, Hollinger Inc.

Editor: Do you want to tell us more about that case?

McBride: Following a stockholder demand, a special committee of the board investigated certain transactions between Hollinger International and certain affiliates of Conrad Black and came to the conclusion that they were improper. Black entered into an agreement to pay back certain money and also agreed to undertake a process to investigate the possible sale of the company or its assets, but then he reneged on both. He then attempted to sell control of the company by selling his own holding company in a deal that would have benefited only Conrad Black and his affiliates, not the stockholders of Hollinger International. The board then made a determination to sue him to both enforce the agreements and to block his attempt to sell the company on his own. The board succeeded with the Delaware court finding that he had breached both his contractual obligations and fiduciary duties. We then subsequently litigated with him when he attempted to block Hollinger International from selling what he claimed were substantially all of its assets. In fact, the court disagreed with him and the sale went forward.

Editor: As part of a long tradition Delaware courts are the venue in which much corporate law is made. Could you describe the reasons why Delaware has led other states in attracting U.S. and foreign companies?

McBride: Basically three things account for this. One is that we keep our statutes up to date in terms of trying to eliminate ambiguities and in trying to make certain that the statute allows businesses to operate in the most efficient and modern fashion. The second factor is the Delaware Court of Chancery's level of sophistication and experience when addressing complex factual situations and applying the law to those situations – either in cases of stockholders seeking to prevent breaches of fiduciary duty or in its efforts to evaluate decisions that boards of directors have made. It's that level of sophistication that allows litigants to know that their case is going to be heard and evaluated by someone who can follow a complex situation and understand it. The third reason that I think is often misunderstood, or maybe underappreciated, is that there is not any corporate law that could be successful, particularly on the stage that Delaware's law operates on, if it didn't have intellectual legitimacy. The Court of Chancery is critical in that regard because our statute is not a regulatory statute. The major mechanism for policing Delaware corporations as to the conduct of Delaware fiduciaries is the Court of Chancery. The Court has formulated that role with great skill and judgment in knowing when there has been or has not been a breach, which has given the court a legitimacy that I think is widely respected throughout the country, both by stockholder advocates and by management.

David C. McBride

Editor: What has led other state courts to follow Delaware decisions as precedents?

McBride: The reason is the respect in which the Court is held and the fact that Delaware has a more developed body of law resulting from having the opportunity to confront a lot of situations that other courts only infrequently confront. It is not just time-tested in terms of a number of written opinions, but it is time-tested in terms of much that goes on in Delaware corporations and even in the Court of Chancery that never ends up in any written opinion. The Court can see how the law operates at the ground level, and can test out its own principles and see if they are working as they should.

Editor: Do you see recent developments in the law undermining the Business Judgment Rule, such as Sarbanes-Oxley?

McBride: I think that the Business Judgment Rule still operates in Delaware as it always has; Sarbanes-Oxley has not changed the legal rule. Sarbanes-Oxley evidences a degree of suspicion, if you will, about the conduct of directors and boards that is somewhat inconsistent with the underlying philosophy of the Business Judgment Rule. I don't think that Sarbanes-Oxley has in any way put directors at any greater risk before the Court of Chancery than prior to its adoption. Sarbanes-Oxley does create federal causes of action in certain circumstances that can create liability, and it may have increased to a certain extent the level of expectation as to the standard of care that the community expects as to what a reasonable person would do in making a business decision. It hasn't changed the law.

Editor: Do you think the balance between state and federal regulation has been shifted more toward federal regulation in the area of corporate governance?

McBride: I have a little different take on that relationship. I think that federal law really addresses what I call a regulatory concern, and state law addresses both fiduciary concerns and enabling concerns. The whole purpose of statutes that allow for the creation of legal entities is to facilitate the organization of business activity. That is a legitimate and important concern regardless of the level of regulatory concern that the federal government may have with respect to certain areas that may overlap to some degree with state regulation. I don't necessarily view the federal law in a situation where you would say that a federal intrusion has in someway diminished the state's authority. I think that the state and the federal regimes can operate quite compatibly, recognizing that each serves a different function. The state's function is to enable and facilitate business activity and organization. To a certain extent the federal function is to respond to abuses when they occur at a national level. The state shares that concern but shares it on a more micro level in the sense that it is responding to abuses on a case-by-case basis when applying fiduciary duties. I don't think that there is necessarily any inconsistency or preclusion between the two.

Editor: **Delaware General Corporation Law is also held in high esteem. You are the Chairman of the Executive Council of the Corporate Law Section of the Delaware State Bar Association. Please describe some of the changes in Delaware Law that are in keeping with its role as "primus inter pares" among state laws. You alluded to the fact that Delaware legislation is intended to stay ahead of the curve. What role has your Executive Council played?**

McBride: Going back historically, every year there are a number of technical amendments to correct ambiguities that have been identified in the statutes by corporate practitioners raising questions as to how the statutory language would operate in a particular fact pattern not anticipated at the time the language was written. We respond to those ambiguities and attempt to clarify them so that any uncertainty about corporate transactions is eliminated. Perhaps equally important, our Executive Council responds to current developments in the outside world. For example, several years ago we amended our statute in two respects at about the time that a number of the corporate scandals emerged – in order to help stockholders enforce their rights and to enforce fiduciary duties of directors and officers. Delaware has a statute that allows stockholders to obtain books and records of a corporation. The Delaware Supreme Court has repeatedly told stockholders that before they file derivative class actions, if they don't know the facts, they ought to make a books and records request to find out what the facts are. Three years ago we amended the books and records statute to allow stockholders to not only obtain the books and records of the corporation in which they own stock but also to obtain books and records of the subsidiary corporations owned or controlled by parent corporations, thereby expanding the ability of the stockholders to investigate the conduct of the corporate enterprise.

Another rule recently implemented concerned the director consent-to-service statute that presumes that anyone who agrees to serve as a director of a Delaware corporation agrees to submit to the jurisdiction of the Delaware courts for resolution of claims relating to conduct as a director. In light of certain of the developments and scandals that occurred in 2003, we expanded that statute to subject certain of the top officers of Delaware corporations to similar jurisdiction, so that there would be one court in which fiduciaries could be held accountable should stockholders have complaints.

This year the Council and the Corporate Section of the Delaware Bar are responding to concerns about whether the directors should be elected by plurality or majority vote, which has resulted in some controversy. We received proposals last summer from a number of institutional stockholders and groups representing them suggesting that the Delaware statute be amended on this issue. Currently, the statute provides that unless the corporation's bylaws require a greater vote than a plurality vote, those candidates receiving a plurality of votes win. If shareholders of a corporation wish to establish majority voting, they may do so in the bylaws.

The institutional shareholders want to amend the statute to provide that a director is elected by a majority vote unless the bylaws or certificate of incorporation provides otherwise. In computing whether a director receives a majority vote, shares present at a meeting either in person or by proxy, but not voted, so-called "withheld votes," would count as negative votes or votes against the re-election of the director. The Council studied that issue and with the Section came to the conclusion that benefits and detriments to majority voting are so close a call that it would be unwise for Delaware to mandate majority voting for all corporations. But we did conclude that we ought to amend the statute in ways to facilitate shareholders' ability to adopt majority voting if that is the shareholders' choice. We have two proposals that are still in the process of deliberation by the Bar Association, but if approved, will be introduced in the General Assembly in early May of this year. They are designed to facilitate the ability of stockholders to effectuate majority voting. One would provide that a bylaw provision adopted by stockholders which mandates majority voting could not be changed by the board of directors. The importance of that is that bylaws can be adopted by stockholders without any board action. The other proposal concerns the fact that a number of corporations have instituted or are considering bylaws that would provide that directors resign if they do not receive a specified vote. We are proposing that the statute be amended to allow directors to submit resignations that are effective at some future time or conditioned on a future event, such as failure to receive a specified vote. We are also amending the statute so that resignations that are submitted that are to be conditioned upon the failure of the director to receive the specified vote can be made irrevocable. This is so that if a director submits such a resignation, he can't withdraw it or renege. This facilitates a mechanism by which majority voting can be implemented.

Editor: Why have institutional shareholders taken the position in favor of majority voting?

McBride: From the point of view of stockholders running proxy contests the plurality vote mechanism is actually the preferable form for the simple reason that it provides for a lower vote to replace an incumbent director with a new director. But the reason that a number of institutional stockholders are in favor of majority voting is because they have in effect given up on proxy contests because they are deemed to be too expensive, owing in part to compliance with SEC disclosure obligations. But I think that stockholder advocates might be premature in giving up on proxy contests since the SEC is considering a proposed rule right now that may make proxy contests much easier and less expensive by virtue of allowing proxy solicitations to be provided through a Web site. If proxy contests were to become less costly, then plurality voting should be the structure favored by shareholder activists.

Please email the interviewee at dmcbride@ycst.com with questions about this interview.