Plaintiffs' And The ABCs (Anywhere But Chancery)

Law360, New York (June 19, 2012, 1:42 PM ET) -- For decades, Delaware and in particular, its Court of Chancery, has been considered the "go-to" place for sophisticated corporate litigation. It is not difficult to understand why. The majority of public corporations are incorporated in Delaware, as are many private corporations, and directors and officers of Delaware corporations are automatically subject to jurisdiction in Delaware as a consequence of so serving.

Hence, it is not surprising that plaintiffs would regularly chose to bring suit where they can be assured that jurisdiction over the defendants will not be an issue. In addition, in light of the large pool of corporate defendants subject to jurisdiction in Delaware, the Court of Chancery has had the opportunity to hear cases and issue decisions on a vast array of corporate law issues. This has created a deep reservoir of jurisprudence which not only directs and shapes future judicial decision-making, but also provides valuable guidance to corporate actors making business decisions.

Further, because the Court of Chancery has no juries, litigants know that a chancellor or vice chancellor, steeped in Delaware corporate law, will be presiding over their case and will bring substantial, specialized experience to bear on the decision, as opposed to a judge or jury of general experience who may not grasp or attach the same importance to nuances in the corporate law.

There are also more mundane (but nonetheless important) reasons for litigants to embrace the Court of Chancery. For anyone who has appeared at a "cattle call" motion session in another court, the opportunity to appear before the Court of Chancery when your case is the only one scheduled to be heard in that session is a positive luxury.

Also alluring is the fact that in the Court of Chancery, you can be assured that your papers have been read and considered ahead of time and that sufficient time has been reserved for argument, rather than hearing from the motion judge that your papers have not yet been reviewed and, in fact, your papers haven't yet been located in the court's files, and given the backlog of other cases waiting to be called in the session, you are afforded scant time to make your argument.

Compounding the difficulty in many states is the fact that judges rotate through different courts, and the judge that hears your summary judgment motion may not be the same judge who heard your motion to dismiss and, indeed, may have no familiarity with the case's history. In short, as compared to many state courts in particular, the ordered world of the Court of Chancery is considered a more efficient, responsive and consistent environment in which to operate.

Over recent years, however, the plaintiffs' bar, at least, has become less enamored with Delaware.[1] Even though the vast majority of public corporations and many private corporations, as well, are incorporated in Delaware, very few have their principal place of business in Delaware. Consequently, a plaintiff contemplating bringing suit against a Delaware corporation and its officers and directors almost always has the option of bringing suit somewhere other than Delaware.

In recent years, more and more plaintiffs have been pursuing this alternative path and filing suit in the jurisdiction in which the company has its principal place of business, rather than Delaware as the state of incorporation. Perhaps there is no better evidence of plaintiffs' increasing migration from Delaware than the fact that more and more corporations are adding provisions in their bylaws requiring stockholder suits to be brought exclusively in the Delaware Court of Chancery, to combat against having to litigate in other venues.

Under the internal affairs doctrine, Delaware corporations and their directors facing corporate governance and breach of fiduciary duty claims should still have those claims governed by Delaware law, regardless of where suit is filed. Why then are plaintiffs choosing to file outside of Delaware, if Delaware law will nonetheless govern the dispute?

The answer appears to be, at least in part, because of a perception that non-Delaware judges applying Delaware law may be less demanding and more forgiving of a plaintiff than those in the Court of Chancery, in at least two respects: as regards the application of substantive law and pleading standards to test the sufficiency of a plaintiff's complaint at the outset of the case, as well as the decision whether to reward a plaintiff with attorneys' fees at the case's conclusion.

Wanting to Be First Doesn't Mean You Get to Rush

It is rare in the current litigation environment that a corporation and its directors will face just one stockholder lawsuit when a significant corporate transaction or event is announced, such as a merger or a less-than-stellar quarterly result. Instead, multiple stockholders, represented by different law firms, bring a wave of lawsuits challenging the same transaction or event. This, in turn, leads to competition among the plaintiffs to be the "first filed" case, as each seeks to have (or have a piece of) the lead plaintiff role.

But being first often means that a complaint is filed on a "rush" basis, without a detailed investigation into the circumstances surrounding the challenged activity. While some situations, such as a challenge to a proposed merger, may be inherently time-constrained and require a concentrated investigative effort, Delaware courts expect the effort to be undertaken nonetheless.

Moreover, many actions challenge purely historical activity or events — such as the wave of stock option back-dating cases in the late-2000's that challenged activity dating back years in the past. In these situations, there is ample time to conduct a thorough investigation before filing a suit, and the only apparent reason for not doing so is if one is trying to be first to the courthouse. Indeed, Vice-Chancellor Travis Laster recently observed the economic reality that motivates a plaintiff to rush to the courthouse:

A plaintiffs' firm only can obtain a fee if it first obtains a result. A firm cannot obtain a result if a competitor gains control of the case. Many jurisdictions are perceived to follow a "first-filed" rule that gives control within that jurisdiction to the first stockholder plaintiff and associated law firm to file a representative action. Many jurisdictions likewise are perceived to give precedence to a "first-filed" action versus later-filed actions in other jurisdictions. When an event occurs that could provide grounds for a representative action, the first-filed rule incentivizes plaintiffs' lawyers to file as fast as possible in an effort to gain control of the litigation. Motivated by first-to-file pressure, plaintiffs' firms rationally eschew conducting investigations and making books and records demands, fearing that any delay would enable competitors to gain control of the litigation and freezeout the diligent lawyer. No role, no result, no fee.[2]

While acknowledging the economics facing plaintiffs and their attorneys, whether the situation at hand is time-constrained or not, the Court of Chancery has not been entertained by plaintiffs who appear to "file first and investigate later," especially where they have declined to use the tools that the law expressly provides to enable such investigative efforts, such as the right to request access to a corporation's pertinent books and records before filing suit.

In short, plaintiffs who perceive — rightly or wrongly — that they face greater demands from the courts in Delaware, and a correspondingly greater risk that their case may be dismissed at the outset if they do not meet Delaware's standards, may elect to "try their luck" elsewhere, and it appears that this is precisely what increasing numbers of plaintiffs are doing.

Needing to Get Paid

Corporations and those who represent them are well-aware that the announcement of a major corporate event — in particular, a proposed merger or acquisition — will spawn numerous lawsuits. Lawsuits that challenge the price of the proposed deal and the disclosures made to stockholders regarding the transaction are common, and experienced corporate actors and their advisors can readily anticipate and factor in such suits as part of the proverbial "price of doing business."

Faced with multiple suits and the overriding business objective of getting the desired deal done, many corporations will take the path of least resistance and agree to relatively modest changes in the

disclosure documents to address some of the plaintiffs' concerns. In addition, in an effort to bring the matter to a quick resolution, corporations will frequently also agree not to challenge a request by the plaintiffs for attorneys' fees, at least up to a certain amount.

The Court of Chancery, however, has not always been willing to embrace these arrangements, particularly when they do not bear the marks of a thorough effort, and the court has instead looked for evidence that the plaintiffs and their attorneys added real value to the process before approving an award of fees. Plaintiffs, and more importantly, those who represent them, may elect to bring such cases outside of Delaware in the hope that other courts, especially those with overburdened dockets, will not take the time or effort to parse through unopposed fee requests.

Psychological Warfare

Filing suit outside of Delaware may also increase the likelihood that corporations and their directors will be more willing to settle. Corporations, their directors and officers, and the attorneys who typically represent them favor predictability in both process and outcomes. While nothing is certain, it is far easier to predict how the Court of Chancery is likely to approach and resolve a particular corporate governance issue than an unknown judge with no track record on the issue in another jurisdiction.

Faced with a judge who is struggling to manage a general docket and who has little to no record of ruling on complex fiduciary duty claims, a corporation may decide that it is in its best interests to settle, particularly if the case can be settled on an economical basis, rather than proceed with litigation.

Conclusion

Despite the fact that the Court of Chancery has, in fact, been willing to award plaintiffs substantial fee awards in representative cases, there remains a perception that plaintiffs may be better off filing elsewhere. While it seems unlikely that the Court of Chancery will lose its reputation for being the leading court for resolving corporate disputes, the plaintiffs' willingness to explore other venues does not yet appear to be abating. This trend, in turn, requires corporations, their directors and officers, and the attorneys who represent them to be increasingly prepared to litigate their Delaware corporate governance disputes outside of Delaware.

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