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## Avoiding the Thickets of Guesswork: The Delaware Supreme Court and Certified Questions of Corporation Law

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# AVOIDING THE THICKETS OF GUESSWORK: THE DELAWARE SUPREME COURT AND CERTIFIED QUESTIONS OF CORPORATION LAW

*The Honorable Henry duPont Ridgely, Justice,  
Supreme Court of Delaware\**

## I. INTRODUCTION

IT is indeed a pleasure for me to return to the SMU Corporate Counsel Symposium. I always enjoy returning to Texas. My nine-year-old granddaughter does as well, though she is not with me on this trip. My granddaughter also loves to read. She is a voracious reader and has already finished all seven J.K. Rowling Harry Potter books. More than four hundred million copies of J.K. Rowling's books have been sold in over two hundred countries.<sup>1</sup> One of J.K. Rowling's Harry Potter novels includes a quotation that reminds me of the challenges judges and regulators face in determining novel issues of another state's law when that state's highest court has not yet addressed the issue.

In *Harry Potter and the Half-Blood Prince*, Professor Albus Dumbledore, the Headmaster of Hogwarts, explains to Harry, "From this point forth, we shall be leaving the firm foundation of fact and journeying together through the murky marshes of memory into thickets of wildest guesswork."<sup>2</sup> Guesswork, of course, is a risky way to proceed in the real world. But educated guesswork is what judges and regulators must do in predicting how another state would decide a novel issue of state law.

Today, I will speak about how to avoid those thickets of guesswork on issues of corporation law through the mechanism of certifying questions. Counsel in corporate cases can educate judges and regulators on the advantages to all parties of using the certified question of law process when circumstances permit it.

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\* I wish to acknowledge and express my appreciation to my judicial law clerk, Michael Stephen Darby, for his research assistance for these remarks.

This essay was adapted from the Keynote Address given by Justice Ridgely at the 18th Annual SMU Corporate Counsel Symposium in Dallas, Texas, on October 1, 2010. The text is largely unchanged and preserves the informal language of Justice Ridgely's speech.

1. Guy Dammann, *Harry Potter Breaks 400m in Sales*, THE GUARDIAN (June 18, 2008, 12:30 PM), <http://www.guardian.co.uk/books/2008/jun/18/harrypotter.news>.

2. J.K. ROWLING, *HARRY POTTER AND THE HALF-BLOOD PRINCE* 197 (2005).

I intend to cover this afternoon the history of certifying questions of law, including its roots in England and the U.S. Supreme Court's endorsement fifty years ago, the Uniform Law Commission's success in promulgating the Uniform Certification of Questions of Law Act, Delaware's certified question process, examples of missed opportunities to certify that lead to excess uncertainty, delay and expense, and conclude with success stories in the use of this process by federal courts, the SEC, and my own Court. In each success-story instance, the choice was made not to journey through murky marshes of memory into thickets of guesswork but to get a timely answer from the ultimate authority on the state law involved. Of course, I need to disclaim from the outset that to the extent that I express any opinions today, they are my own and not formal expressions of the Delaware Supreme Court.

## II. HISTORY

The certified question of law has a richer history than one might suspect. The British Law Ascertainment Act of 1859 provided for certification of questions of law within the British Empire.<sup>3</sup> In its preamble, the drafters of that Act stated its purpose as follows: "[G]reat Improvement in the Administration of the Law would ensue if Facilities were afforded for more certainly ascertaining the Law administered in one Part of Her Majesty's Dominions when pleaded in the Courts of another Part thereof."<sup>4</sup> Two year later, the Foreign Law Ascertainment Act of 1861 provided for certification of questions to foreign states.<sup>5</sup>

In the United States, the Supreme Court's decision in *Erie Railroad v. Tompkins*<sup>6</sup> was the primary catalyst for the development of the process of the certification of questions of law.<sup>7</sup> Because the U.S. Supreme Court in *Erie* required federal courts to follow state law in non-federal matters, post-*Erie* federal courts have been placed in the unenviable position of ascertaining state law, even where the question presented is an issue of first impression.<sup>8</sup> That unenviable experience is shared by state courts as well.<sup>9</sup>

The first effort to solve this thorny problem began in Florida. In 1960, Justice Frankfurter spoke highly of a Florida statute that provided for certification: "The Florida Legislature, *with rare foresight*, has dealt with the problem of authoritatively determining unresolved state law involved in federal litigation by a statute which permits a federal court to certify such a doubtful question of state law to the Supreme Court of Florida for

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3. See British Law Ascertainment Act, 1859, 22 & 23 Vict., c. 63, § 1 (Eng.).

4. *Id.* c. 63, preamble.

5. See Foreign Law Ascertainment Act, 1861, 24 & 25 Vict., c. 11, § 1 (Eng.).

6. 304 U.S. 64 (1938).

7. See UNIF. CERTIFICATION OF QUESTIONS OF LAW ACT, Prefatory Note, 12 U.L.A. 46 (1995).

8. *Id.*

9. See *id.*

its decision.”<sup>10</sup> Fourteen years later, in *Lehman Brothers v. Schein*, the U.S. Supreme Court again endorsed the certification of questions of law.<sup>11</sup>

Some members of the U.S. Supreme Court cautioned against perceived dangers. In his dissenting opinion in *Clay v. Sun Insurance*, Justice Douglas explained: “I desire to give renewed protest to our practice of making litigants travel a long, expensive road in order to obtain justice. . . . Some litigants have long purses. Many, however, can hardly afford one lawsuit, let alone two.”<sup>12</sup> Justice Rehnquist had a somewhat different view. In his concurring opinion in *Lehman Brothers v. Schein*, he explained: “State certification procedures are a very desirable means by which a federal court may ascertain an undecided point of state law . . . [b]ut . . . the use of such a procedure is more a question of the considerable discretion of the federal court.”<sup>13</sup> Justice Rehnquist continued: “[W]hile the certification procedure is more likely to produce the correct determination of state law, additional time and money are required to achieve such a determination.”<sup>14</sup>

### III. UNIFORM CERTIFICATION OF QUESTIONS OF LAW ACT

As the certification process began to gain popularity in the United States, the desire arose for uniformity. In 1967, the Uniform Law Commission promulgated the Uniform Certification of Questions of Law Act.<sup>15</sup> The Commission has supplied amended versions of the Uniform Act in 1990 and 1995.<sup>16</sup> Today, forty-eight states and the District of Columbia have adopted a certification process, in one form or another.<sup>17</sup> At a minimum, each of these states allows for certification from the U.S. Supreme Court or from a federal appeals court.<sup>18</sup> New Jersey and North Carolina have yet to amend their law to provide for certification to their highest courts.<sup>19</sup>

Notwithstanding this progress, the Uniform Law Commission has expressed concerns that the process is not used “as frequently as it could and should be”.<sup>20</sup> I agree. Despite the Uniform Act, many states have

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10. *Clay v. Sun Ins. Office Ltd.*, 363 U.S. 207, 212 (1960) (emphasis added).

11. 416 U.S. 386 (1974).

12. *Clay*, 363 U.S. at 227–28 (Douglas, J., dissenting).

13. *Lehman Bros.*, 416 U.S. at 394.

14. *Id.* at 395.

15. Uniform Law Commission, *Summary, Uniform Certification of Questions of Law [Act] [Rule] (1995)*, available at [http://www.nccusl.org/Update/uniformact\\_summaries/uniformacts-s-ucoqolar95.asp](http://www.nccusl.org/Update/uniformact_summaries/uniformacts-s-ucoqolar95.asp).

16. *Id.*

17. 17A CHARLES ALAN WRIGHT, ARTHUR R. MILLER, EDWARD H. COOPER & VIKRAM DAVID AMAR, *FEDERAL PRACTICE AND PROCEDURE: JURISDICTION* § 4248 n.30 (3d ed. 2007).

18. *See id.* § 4248.

19. *See id.* § 4248 n.30.

20. *See* UNIF. CERTIFICATION OF QUESTIONS OF LAW ACT, Prefatory Note, 12 U.L.A. 46 (1995).

adopted slightly modified versions of it.<sup>21</sup> The Uniform Law Commission, as well as a leading commentator on the subject, cite the lack of uniformity as the primary cause of this underutilization.<sup>22</sup>

It should be noted that the Uniform Act only allows a state's highest court or one of its intermediate appellate courts to certify a question to another state's highest court.<sup>23</sup> In fact, in its commentary, the Uniform Law Commission expressed concern about extending the power to intermediate appellate courts.<sup>24</sup> It stated that its apprehension was somewhat alleviated because "[t]he receiving court has the discretion to accept or reject a certified question and can use this power to avoid being burdened by an excessive number of certified questions."<sup>25</sup> The fact is many states do not allow for certification from trial-level courts—state or federal.<sup>26</sup> Delaware does.<sup>27</sup> While there are important considerations involved, such as fear of overburdening state courts of last resort, I see an advantage, based upon my own experience, to allow all trial courts to certify novel questions of law.<sup>28</sup>

For example, when I was the president judge of Delaware's Superior Court, I was faced with a novel question of Missouri law that was extremely important to the outcome of an environmental insurance coverage case where eight hundred million in claims were at issue.<sup>29</sup> I was required to determine the meaning of certain pollution exclusion clauses under Missouri law.<sup>30</sup> The exclusions included an exception, which reinstated coverage if the polluting activity was "sudden and accidental."<sup>31</sup> Courts across the country were divided on the meaning of this phrase. In my opinion, I explained that "[b]ecause the Missouri courts ha[d] not resolved the issue, [my] task [was] to discern how the Missouri Supreme Court would rule if presented with the issue."<sup>32</sup> I relied on a variety of sources, including an Eighth Circuit opinion and Webster's Third New International Dictionary.<sup>33</sup> But it was no easy task. I was tempted to consider what the late President Harry S Truman, the only president born in Missouri, would have considered the language to plainly mean. What would Harry say? I was in the thicket of educated guesswork.

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21. *Id.*

22. *See id.* & n.3 (citing Ira P. Robbins, *The Uniform Certification of Questions of Law Act: A Proposal for Reform*, 18 J. LEGIS. 127, 183 (1992)).

23. *See id.* § 2.

24. *See id.* § 2 cmt.

25. *Id.*

26. *See* WRIGHT, MILLER, COOPER & AMAR, *supra* note 17, § 4248.

27. DEL. CONST. art. IV, § 11(8); DEL. SUP. CT. R. 41(a)(ii).

28. Alternatively, if a state supreme court is not empowered to accept certified questions from a trial court, that trial court may attempt to certify the question to its supreme court with a request to have the question certified to the other state supreme court.

29. *Monsanto Co. v. Aetna Cas. & Sur. Co.*, No. 88C-JA-118, 1993 WL 563253 (Del. Super. Ct. Dec. 9, 1993).

30. *Id.* at \*5.

31. *Id.*

32. *Id.* at \*7.

33. *Id.* at \*7-8.

When federal courts enter this thicket, they have looked to a variety of sources for making a prediction. For example, the Third Circuit recently explained its approach as follows:

([I]n the absence of any clear precedent of the state's highest court, we must predict how that court would resolve the issue.) ("In making such a prediction, we . . . consider relevant state precedents, analogous decisions, considered dicta, scholarly works, and any other reliable data tending convincingly to show how the highest court in the state would resolve the issue at hand." Furthermore, in the absence of direct authority from the [state's] [s]upreme [c]ourt, we may treat as persuasive authority decisions of the [intermediate appellate courts of the state]. ("[A]n intermediate appellate state court is a datum for ascertaining state law which is not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court of the state would decide otherwise.")<sup>34</sup>

These protocols raise the question—why not just ask the state supreme court? In Delaware, you can.

#### IV. DELAWARE HISTORY

In 1983, Delaware amended its Constitution to provide for the certification of questions of law to the Delaware Supreme Court.<sup>35</sup> Article IV, Section 11(8) of the Delaware Constitution provides: The Supreme Court shall have jurisdiction

[t]o hear and determine questions of law certified to it by other Delaware courts, the Supreme Court of the United States, a Court of Appeals of the United States, a United States District Court . . . or the highest appellate court of any other state, where it appears to the Supreme Court that there are important and urgent reasons for an immediate determination of such questions by it.<sup>36</sup>

In 2007, section 11(8) was amended to provide the Delaware Supreme Court with jurisdiction over questions certified to it by the United States Securities and Exchange Commission.<sup>37</sup>

Section 11(8) further provides that "[t]he Supreme Court may, by rules, define generally the conditions under which questions may be certified to it and prescribe methods of certification."<sup>38</sup> In 1984, the Court amended the Supreme Court Rules to provide the process by which questions may be certified.<sup>39</sup> In Delaware Supreme Court Rule 41(b), we provide examples of reasons to accept certification, including when "[t]he

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34. *Travelers Indem. Co. v. Dammann & Co.*, 594 F.3d 238, 244 (3d Cir. 2010) (citations omitted) (quoting respectively *Hunt v. U.S. Tobacco Co.*, 538 F.3d 217, 220–21 (3d Cir. 2008); *Edwards v. HOVENSA, LLC*, 497 F.3d 355, 361 (3d Cir. 2007); *West v. Am. Tel. & Tel. Co.*, 311 U.S. 223, 237 (1940) (internal quotation marks and citations omitted)).

35. 64 Del. Laws 446 (1983).

36. DEL. CONST. art. IV, § 11(8).

37. 76 Del. Laws 34 (2007).

38. 64 Del. Laws 446.

39. *See id.*

question of law is of first instance" in Delaware,<sup>40</sup> when "[t]he decisions of the trial courts are conflicting upon the question of law,"<sup>41</sup> or when "[t]he question of law relates to the constitutionality, construction or application of a statute of [Delaware] which has not been, but should be, settled by the Court."<sup>42</sup>

Since the amendment of Delaware's Constitution, the Delaware Supreme Court has accepted and answered numerous certified questions. We have accepted questions from the U.S. Court of Appeals for the Second,<sup>43</sup> Third,<sup>44</sup> Seventh,<sup>45</sup> Eleventh,<sup>46</sup> and District of Columbia<sup>47</sup> Circuits. We also have accepted twelve questions from the U.S. District Court for the District of Delaware,<sup>48</sup> two questions from the U.S. District Court for the Southern District of New York,<sup>49</sup> and one question each from the U.S. District Courts for the Southern District of Florida<sup>50</sup> and the Eastern District of Pennsylvania.<sup>51</sup> Finally, we have accepted one question from the Securities and Exchange Commission.<sup>52</sup>

Although we are empowered to accept certified questions from Delaware trial courts, I prefer to review a case filed in Delaware with the full benefit of our lower courts' reasoning. In matters of corporation law, for example, the experience and wisdom of Delaware trial judges, who regularly determine and apply Delaware law, add to the analysis. Moreover, there is the absolute right of the parties in Delaware to file a direct appeal upon entry of a final judgment in the case. On the other hand, when courts from foreign forums certify questions to us, they may have less familiarity with the nuances of Delaware corporation law, and we otherwise may not have the opportunity to review the issue. Therefore, it is more likely for us to accept certified questions from a foreign forum.

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40. DEL. SUP. CT. R. 41(b)(i).

41. DEL. SUP. CT. R. 41(b)(ii).

42. DEL. SUP. CT. R. 41(b)(iii).

43. *See Shaw v. Agri-Mark, Inc.*, 663 A.2d 464 (Del. 1995).

44. *See, e.g., Kerns v. Dukes*, 707 A.2d 363 (Del. 1998); *Penn Mut. Life Ins. Co. v. Oglesby*, 695 A.2d 1146 (Del. 1997); *Konstantopoulos v. Westvaco Corp.*, 690 A.2d 936 (Del. 1996).

45. *See Riblet Prods. Corp. v. Nagy*, 683 A.2d 37 (Del. 1996).

46. *See Duncan v. Theratx, Inc.*, 775 A.2d 1019 (Del. 2001).

47. *See Farahpour v. DCX, Inc.*, 635 A.2d 894 (Del. 1994).

48. *See Waters v. United States*, 787 A.2d 71 (Del. 2001); *Cont'l Ins. Co. v. Burr*, 706 A.2d 499 (Del. 1998); *Potter v. Peirce*, 688 A.2d 894 (Del. 1997); *United States v. Anderson*, 669 A.2d 73 (Del. 1995); *United States v. Cumberbatch*, 647 A.2d 1098 (Del. 1994); *Rales v. Blasband*, 634 A.2d 927 (Del. 1993); *Wallace v. Archambo*, 619 A.2d 911 (Del. 1992); *Miller v. Spicer*, 602 A.2d 65 (Del. 1991); *Richardson v. Town of Ocean View*, 535 A.2d 1346 (Del. 1988); *Fiat Motors of N. Am. v. Mayor of Wilmington*, 498 A.2d 1062 (Del. 1985); *Mitchell v. Comm'n on Adult Entm't Establishments*, 577 A.2d 754 (Del. 1990) (refusing to answer); *Nemours Found. v. Manganaro Corp.*, 565 A.2d 280 (Del. 1989) (refusing to answer).

49. *See Lambrecht v. O'Neal*, 3 A.3d 277 (Del. 2010); *A.W. Fin. Servs. v. Empire Res., Inc.*, 981 A.2d 1114 (Del. 2009).

50. *E.I. DuPont de Nemours & Co. v. Fla. Evergreen Foliage*, 744 A.2d 457 (Del. 1999).

51. *Hoesch v. Nat'l R.R. Passenger Corp.*, 677 A.2d 29 (Del. 1996).

52. *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227 (Del. 2008).

The ability of other forums to certify questions of Delaware corporation law to the Delaware Supreme Court is indispensable for one specific reason: the internal affairs doctrine.<sup>53</sup> As Justice White explained in *Edgar v. MITE Corp.*,

The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands.<sup>54</sup>

Even though Delaware is the home of 63% of Fortune 500 companies, 55% of the U.S. firms on the New York Stock Exchange and the NASDAQ, and 80% of the U.S. IPOs since 2003,<sup>55</sup> actions concerning the internal affairs of those corporations are not always litigated in the Delaware courts. When other courts are confronted with these cases, the internal affairs doctrine requires them to apply Delaware law.<sup>56</sup> Therefore, if another jurisdiction is faced with a significant and unanswered question of Delaware corporation law, it makes sense for counsel to suggest consideration of a certification of the question to the Delaware Supreme Court. Otherwise, it is a missed opportunity.

## V. MISSING OPPORTUNITIES IN DELAWARE

Let me give you some examples of missed opportunities I have noted. Litigation based upon the case of *Credit Lyonnais Bank v. Pathe Communications* is illustrative.<sup>57</sup> In that case, Chancellor Allen addressed the role of the board when a corporation was in the “vicinity of insolvency.”<sup>58</sup> In footnote fifty-five of *Credit Lyonnais*, Chancellor Allen described the “community of interests that [a] corporation represents.”<sup>59</sup> In discussing “hypothetical” directors who believe they owe duties to groups other than shareholders, Chancellor Allen commented:

Such directors will recognize that in managing the business affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.<sup>60</sup>

Courts, lawyers, and executives in other jurisdictions struggled in understanding the significance of the Chancellor's dicta and speculated

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53. See *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982).

54. *Id.* (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. b (1971)).

55. E-mail from Richard J. Geisenberger, Chief Deputy Sec'y of State, State of Del., to author (Sept. 24, 2010, 14:19 EST) (on file with author).

56. See *Edgar*, 457 U.S. at 645.

57. 17 DEL. J. CORP. L. 1099 (Del. Ch. 1991).

58. *Id.* at 1155.

59. *Id.* at 1155 n.55.

60. *Id.*



whether, under Delaware law, directors of corporations that were in the zone of insolvency owed a duty to creditors. For example, in 2004, the U.S. District Court for the Southern District of New York cited Chancellor Allen's footnote fifty-five as authoritative Delaware law.<sup>61</sup> Relying on *Credit Lyonnais*, the district judge concluded that a corporation, which was in the zone of insolvency, owed fiduciary duties to its creditors.<sup>62</sup> In that case, it turned out that he was wrong.

Two years later, the U.S. District Court for the Southern District of Texas reached a different conclusion.<sup>63</sup> In *Floyd v. Hefner*, in 2006, the district judge held that "Chancellor Allen's opinion did not even purport to create a cause of action that would allow creditors to sue the directors of a corporation. It merely exonerated directors who chose to maintain a corporation's long-term viability."<sup>64</sup> It turned out that she was right.

Approximately sixteen years after Chancellor Allen's opinion in *Credit Lyonnais*, the Delaware Supreme Court was finally provided the opportunity to settle the debate. In *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*,<sup>65</sup> the Court explained that

[w]hen a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.<sup>66</sup>

Similar to the "zone of insolvency" claim, we also have addressed the viability of the so-called "deepening insolvency" claim. The 2003 case of *In re Exide Technologies*<sup>67</sup> is illustrative. There, the Bankruptcy Court for the District of Delaware relied on a Third Circuit decision that interpreted Pennsylvania law, as well as "the Delaware courts' policy of providing a remedy for an injury," to predict that the "Delaware Supreme Court would recognize a claim for deepening insolvency."<sup>68</sup>

Fortunately, just three years later, the Delaware Court of Chancery had the opportunity to correct this misstatement of Delaware corporate law. Vice Chancellor Strine, in *Trenwick America Litigation Trust v. Ernst &*

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61. *Roselink Investors, L.L.C. v. Shenkman*, 386 F. Supp. 2d 209, 215 (S.D.N.Y. 2004).

62. *Id.* at 215–16.

63. *Floyd v. Hefner*, No. H-03-5693, 2006 WL 2844245, at \*17 (S.D. Tex. Sept. 29, 2006).

64. *Id.*

65. 930 A.2d 92 (Del. 2007).

66. *Id.* at 101.

67. Official Comm. of Unsecured Creditors v. Credit Suisse First Boston (*In re Exide Techs., Inc.*), 299 B.R. 732 (Bankr. D. Del. 2003).

68. *Id.* at 752. The bankruptcy court likely could have certified a question to the Delaware Supreme Court. Although article IV, section 11(8) of the Delaware Constitution does not specifically empower the Delaware Supreme Court to accept certified questions from bankruptcy courts, at least one state supreme court has interpreted a grant of power to accept certified questions from a federal district court to include the power to accept questions from the bankruptcy court of that district. See *In re Shepard Co.*, 342 A.2d 918, 921–22 (R.I. 1975).

Young,<sup>69</sup> explained that “[t]he concept of deepening insolvency has been discussed at length in federal jurisprudence, perhaps because the term has the kind of stentorian academic ring that tends to dull the mind to the concept’s ultimate emptiness.”<sup>70</sup> In concluding that Delaware law does not recognize a “deepening insolvency” claim, the Vice Chancellor remarked, “[T]he fact of insolvency does not render the concept of ‘deepening insolvency’ a more logical one than the concept of ‘shallowing profitability.’”<sup>71</sup>

Had a federal or state court taken advantage of the process of the certification of questions of law that the Delaware Constitution provides, the Delaware Supreme Court may have resolved, at a much earlier date, the question raised by Chancellor Allen’s *Credit Lyonnais*<sup>72</sup> footnote as well as the viability of a “deepening insolvency” claim. Why does that matter?

Missed opportunities have several consequences. First, they frustrate courts and litigants, as they try to “guess” what conclusions another state’s highest court would reach in the case. Second, these missed opportunities create uncertainty in the business community, as directors and officers attempt to fulfill their duties as fiduciaries of a corporation and to properly structure transactions. Third, depending upon the determination of the local court, parties may be wrongfully required to incur the expense of litigation, settlement, or even personal judgments against them. If courts used the certification process in appropriate circumstances, these unfortunate consequences could be avoided or, at least, correctly resolved at an earlier time.

## VI. SUCCESS STORIES

But there are success stories. Three examples of the advantageous use of the certification process come to mind. My first example involves the Securities and Exchange Commission’s certification of two questions of law to the Delaware Supreme Court in the 2008 case of *CA, Inc. v. AFSCME Employees Pension Plan*.<sup>73</sup> AFSCME, a CA stockholder, proposed a bylaw for inclusion in CA’s 2008 proxy materials.<sup>74</sup> The proposed bylaw required CA’s board of directors to cause the corporation to reimburse stockholders for reasonable expenses incurred in nominating candidates in contested director elections.<sup>75</sup> CA notified the SEC’s Division of Corporation Finance (the Division) of its intention to exclude the bylaw from the proxy materials and requested a “no-action letter.”<sup>76</sup> CA

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69. 906 A.2d 168 (Del. Ch. 2006), *aff’d sub nom.* *Trenwick Am. Litig. Trust v. Billett*, 931 A.2d 438 (Del. 2007).

70. *Id.* at 204.

71. *Id.* at 205.

72. *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc’ns Corp.*, 17 DEL. J. CORP. L. 1099, 1155 n.55 (Del. Ch. 1991).

73. 953 A.2d 227 (Del. 2008).

74. *Id.* at 229.

75. *Id.* at 229–30.

76. *Id.* at 230.

and AFSCME each obtained legal opinions from Delaware law firms and submitted them to the Division.<sup>77</sup> Because these legal opinions of Delaware law were conflicting, the SEC, at the request of the Division, certified the following two questions to the Delaware Supreme Court: first, whether the proposed bylaw was a proper subject for action by shareholders as a matter of Delaware law; and, second, whether the bylaw, if adopted, would cause CA to violate any Delaware law to which it was subject.<sup>78</sup>

To answer the first question, we relied on provisions of the Delaware General Corporation Law. Specifically, we looked to section 109(a), which provides that

the power to adopt, amend or repeal bylaws shall be in the stockholders . . . ; provided, however, any corporation may, in its certificate . . . confer the power to adopt, amend or repeal bylaws upon the directors. . . . The fact that such power has been so conferred upon the directors . . . shall not divest the stockholders . . . of the power, nor limit their power to adopt, amend or repeal bylaws.<sup>79</sup>

Despite the theoretical vesting of concurrent power in both the board and the shareholders, we concluded that “Section 109(a) does not exist in a vacuum”<sup>80</sup> and that it must be read with Section 141(a), which provides that “[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors.”<sup>81</sup> Although we determined that “the shareholders’ statutory power to adopt, amend or repeal bylaws is not coextensive with the board’s concurrent power and is limited by the board’s management prerogatives under Section 141(a),”<sup>82</sup> we also recognized that there is some “shareholder action that Section 109(b) permits yet does not improperly intrude upon the directors’ power to manage [the] corporation’s business and affairs under Section 141(a).”<sup>83</sup> We held that “purely procedural bylaws do not improperly encroach upon the board’s managerial authority under Section 141(a),”<sup>84</sup> including AFSCME’s proposed bylaw. In concluding our analysis of the first certified question, we stated: “The shareholders of a Delaware corporation have the right to participate in selecting the contestants for election to the board.”<sup>85</sup>

In analyzing the SEC’s second certified question—whether the bylaw, if adopted, would cause CA to violate any Delaware law to which it was subject—we relied on Delaware’s robust body of caselaw to conclude that, under certain circumstances, AFSCME’s proposed bylaw could

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77. *Id.*

78. *Id.* at 230–31.

79. *Id.* at 231 (quoting DEL. CODE ANN. tit. 8, § 109(a)).

80. *Id.* at 231–32.

81. *Id.* at 232 (quoting DEL. CODE ANN. tit. 8, § 141(a)).

82. *Id.* at 232.

83. *Id.* at 234.

84. *Id.* at 235.

85. *Id.* at 237 (internal quotation marks omitted).

cause CA directors to breach their fiduciary duties.<sup>86</sup> Specifically, we looked to the 1994 case of *Paramount v. QVC*<sup>87</sup> and the 1998 case of *Quickturn Design Systems, Inc. v. Shapiro*.<sup>88</sup> In those cases, the Court invalidated binding contractual arrangements that the board of directors had voluntarily imposed on themselves because those contracts limited the extent to which the directors could exercise their fiduciary duties.<sup>89</sup>

We properly characterized AFSCME's proposed bylaw as a "binding bylaw that the shareholders [sought] to impose involuntarily on the directors in the specific area of election expense reimbursement."<sup>90</sup> As a result, the bylaw as written could "prevent the directors from exercising their full managerial power in circumstances where their fiduciary duties would otherwise require them to deny reimbursement to a dissident slate," and, thus, it would violate Delaware law.<sup>91</sup>

Our opinion in *AFSCME* provided courts and the SEC with important guidance. First, it reaffirmed the bedrock principle in Delaware that the directors manage the business and affairs of a corporation. And second, the opinion confirmed that shareholder bylaws on process are permitted, but they may not interfere with the board's ability to fulfill its fiduciary duties. The speed with which the Court answered the question is also worth noting: we accepted the SEC's questions on July 1, heard oral argument on July 9, and issued an opinion on July 17.<sup>92</sup>

My second example involves the most recent case in which the Delaware Supreme Court has accepted a certified question of law. Just this past summer, in *Lambrecht v. O'Neal*,<sup>93</sup> we accepted a certified question from the U.S. District Court for the Southern District of New York. There, plaintiffs filed derivative actions on behalf of Merrill Lynch to recover losses of \$3.6 billion Merrill allegedly suffered in transactions that occurred before Bank of America acquired Merrill.<sup>94</sup> When Merrill became a wholly-owned subsidiary of Bank of America, the plaintiffs' shares were converted to Bank of America shares, and the district court dismissed the actions because the plaintiffs were no longer Merrill shareholders and, thus, lacked standing to assert derivative claims on Merrill's behalf.<sup>95</sup>

The plaintiffs then brought the actions as "double derivative actions," whereby they sought to force the Bank of America board, as Merrill's parent, to compel the Merrill board to bring the actions.<sup>96</sup> The defend-

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86. *See id.* at 238.

87. 637 A.2d 34 (Del. 1994).

88. 721 A.2d 1281 (Del. 1998).

89. *AFSCME Emps. Pension Plan*, 953 A.2d at 238–39 & nn. 26–30 (citing *Quickturn Design Sys., Inc.*, 721 A.2d 1281, and *QVC*, 637 A.2d 34).

90. *See id.* at 239.

91. *Id.* at 239–40.

92. *See id.* at 227, 231.

93. 3 A.3d 277 (Del. 2010).

94. *Id.* at 279.

95. *Id.*

96. *Id.* at 279–80.

ants moved to dismiss the complaint, contending that, to sue double derivatively, the plaintiffs were required to show that they were and continued to be Bank of America shareholders both at the time of Merrill's alleged wrongdoing and after the merger.<sup>97</sup> The defendants further argued that Bank of America was a shareholder of Merrill at the time of Merrill's alleged misconduct.<sup>98</sup> Under the defendants' model, a double derivative action was two lawsuits in one; first, a derivative action by the stockholder of the parent and a second derivative action of the parent as a stockholder of the subsidiary.

After hearing oral argument and considering the defendants' novel ground for granting the motion to dismiss, the district court appropriately certified the following question to the Delaware Supreme Court:

Whether plaintiffs in a double derivative action under Delaware law, who were pre-merger shareholders in the acquired company and who are current shareholders, by virtue of a stock-for-stock merger, in the post-merger parent company, must also demonstrate that, at the time of the alleged wrongdoing at the acquired company, (a) they owned stock in the acquiring company, and (b) the acquiring company owned stock in the acquired company.<sup>99</sup>

The defendants contended that this was the proper model to provide standing in a double derivative suit. We concluded that the defendants' model was incorrect and, therefore, answered the certified question in the negative.<sup>100</sup>

In reaching that conclusion, we identified several conceptual flaws in the defendants' model. First, we noted that such a model effectively would preclude any plaintiff from bringing a double derivative suit "except in bizarrely happenstance circumstances."<sup>101</sup> We explained that "our precedents not only validate but also encourage the bringing of double derivative actions in cases where standing to maintain a standard derivative action is extinguished as a result of an intervening merger."<sup>102</sup> Second, we explained that the defendants' proposed requirement that Bank of America own Merrill stock at the time of the alleged wrongful conduct was unsupported by Delaware law.<sup>103</sup> As the parent of Merrill, Bank of America did not need to proceed derivatively; rather, Bank of America could enforce the claim by the direct exercise of its complete control over Merrill as its parent.<sup>104</sup> Third, we explained that the defendants' proposed requirement that the plaintiffs own Bank of America stock at the time of Merrill's alleged misconduct was also incorrect.<sup>105</sup>

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97. *Id.*

98. *Id.*

99. *Id.* at 280.

100. *Id.* at 287, 293.

101. *Id.* at 288.

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.* at 289.

Just as Bank of America, itself, did not need to own Merrill stock at the time of the alleged misconduct, the plaintiffs were not required to own Bank of America stock at that time; rather, the plaintiffs were required to own Bank of America stock only at the time they sought to bring the action.<sup>106</sup> Fourth, we rejected the defendants' contention that their model represented the correct policy under Delaware law—defendants argued that their model respected the corporate separateness of Bank of America and Merrill and barred what the defendants termed, a “de facto continuation of the pre-merger original derivative action.”<sup>107</sup> Rather than a de facto continuation, we concluded that the double derivative action was a “new, distinct action in which standing to sue . . . rest[ed] on a different temporal and factual basis—namely, the failure of the BofA board, post-merger, to enforce the premerger claim of its wholly-owned subsidiary.”<sup>108</sup> Under this structure, “the policies favoring both the preservation of the corporate separateness of the parent and subsidiary and the prevention of abusive derivative suits are fully respected.”<sup>109</sup> We also rejected the defendants' reliance on the 2004 court of chancery opinion in the case of *Saito v. McCall*.<sup>110</sup> In doing so, “[w]e conclude[d] that, insofar as *Saito* address[ed] the issue presented here, [*Saito*] [did] not represent sound Delaware law.”<sup>111</sup>

In *Lambrecht*, just as in *AFSCME*, we answered difficult and important questions of Delaware corporate law without delay. These were not easy issues to resolve, and a foreign court could have reached completely different conclusions. Other courts, boards, and shareholders may have relied on those determinations for years, just as occurred with the misinterpretation of *Credit Lyonnais*. Given these dismal consequences, the value of the certified question process is apparent.

My last example for you today illustrates the important point that, although the Delaware Supreme Court often accepts certified questions of law, the Court, itself, will not hesitate, in appropriate circumstances, to certify questions of law to another state's highest court. The road of the certified question is indeed a two-way street.

In March of this year, we certified a question to the New York Court of Appeals in the case of *Teachers' Retirement System of Louisiana v. PricewaterhouseCoopers*.<sup>112</sup> There, the Delaware Court of Chancery dismissed shareholder derivative claims against PricewaterhouseCoopers.<sup>113</sup> The court of chancery held that the alleged misconduct of AIG's senior officers was imputed to AIG, and once imputed, AIG's claims against

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106. *Id.*

107. *See id.* 289–90 (emphasis omitted).

108. *Id.* at 290.

109. *Id.*

110. *Id.* (rejecting a holding of *Saito v. McCall*, 30 DEL. J. CORP. L. 650 (Del. Ch. 2004)).

111. *Id.*

112. 998 A.2d 280, 280 (Del. 2010) (certified question answered by *Kirschner v. KPMG LLP*, No. 152, slip op. 07415, 2010 WL 4116609 (N.Y. Oct. 21, 2010)).

113. *Id.*

PricewaterhouseCoopers for failure to perform its auditing responsibilities in accordance with professional standards were barred as a matter of New York law under its *in pari delicto* doctrine.<sup>114</sup> An appeal to the Delaware Supreme Court followed. We concluded that “a resolution of [the] appeal depends on significant and unsettled questions of New York law that are properly answered, in the first instance, by the New York Court of Appeals.”<sup>115</sup> Accordingly, we certified the following question to that court:

Would the doctrine of *in pari delicto* bar a derivative claim under New York law where a corporation sues its outside auditor for professional malpractice or negligence based on the auditor’s failure to detect fraud committed by the corporation; and, the outside auditor did not knowingly participate in the corporation’s fraud, but instead, failed to satisfy professional standards in its audits of the corporation’s financial statements?<sup>116</sup>

The case has been argued before the New York Court of Appeals, so we will soon know the answer without educated guesswork on our part.

## VII. CONCLUSION

Even Justice Douglas, who initially criticized the mechanism in *Clay*, eventually recognized the virtues of certifying questions of law. Fourteen years after calling the process “a long, expensive road in order to obtain justice,”<sup>117</sup> Douglas, in *Lehman Bros. v. Schein*,<sup>118</sup> succinctly described its utility: “We do not suggest that where there is doubt as to local law and where the certification procedure is available, resort to it is obligatory. It does, of course, in the long run save time, energy, and resources and helps build a cooperative judicial federalism.”<sup>119</sup> Today, his words still ring true.

To conclude, the certification of questions of law enjoys a rich history. It has grown in popularity as more and more states adopt procedures by which their state supreme courts can answer certified questions. This leads to more efficient and accurate determinations of state law. With a more predictable and certain body of law, parties can construct their relations more efficiently, with less uncertainty, and at reduced cost. Rather than journey to the “thickets of guesswork,” there is a better way.

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114. *Am. Int’l Group, Inc. v. Greenberg*, 965 A.2d 763, 817–30 (Del. Ch. 2009).

115. *See Teachers’ Ret. Sys.*, 998 A.2d at 280.

116. *Id.* at 282–83.

117. *Clay v. Sun Ins. Office Ltd.*, 363 U.S. 207, 227 (1960) (Douglas, J., dissenting).

118. 416 U.S. 386 (1974).

119. *Id.* at 390–91.

# Articles



