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J. WILLIAM CALLISON, MARK A. GROVIC, JAMES J. HANKS, JR., ROGER A. LANE, CARL E. METZGER

Twilight in the Zone of Insolvency: Fiduciary Duty and Creditors of Troubled Companies

THE DUTY TO CREDITORS IN PRACTICE

RICHARD BOOTH: This is the panel about practice aspects of the duty to creditors, DTC, I guess is what we are calling it now. This panel is moderated by Jim Hanks who is a graduate of this law school, 1967 graduate, a great friend of the law school. He has endowed our faculty lounge in memory of his parents, so you can go up and visit that.

In any event, Jim is a partner at Venable and teaches at Cornell and Northwestern law schools, as well as twice at Bucerius Law School in Hamburg, Germany. He has also served on the ABA's Corporate Laws Committee from time to time. So he is among the people that bring you the Model Business Corporation Act, although I think he is not currently on that committee.

JAMES HANKS: I am a liaison to that committee.

RICHARD BOOTH: He is almost on that committee. In any event, I will turn it over to Jim to introduce his panel.

JAMES HANKS: We have a very, very good panel here today. First, we have Mark Grovic who is with the New Markets Growth Fund, University of Maryland School of Business—a very interesting undertaking.

And then we have three lawyers from firms that I think of as being among the most dynamic, growing, cutting-edge firms in America. These are firms that—well, I am not sure of the history of each of them, but I think it is safe to say—fifty years ago none of these three firms were as well known or as celebrated as they are today. And I think that it really says something about each of their firms that each of these three lawyers here today has developed the expertise or the knowledge and background and experience that they bring to us.

On my right is Roger Lane who is with the Greenberg Traurig firm; and then next to him is Carl Metzger, a partner with the Goodwin Proctor firm; and then Bill Callison with the Denver office of Faegre & Benson. And each of these lawyers, together with Mark, is going to talk with us today about some of the practice and practical aspects of the issue of duties to the creditors.

What we thought we would do is start off with each of them giving a short presentation of their views and then we will open it to a general conversation. So, Carl, do you want to start off?

CARL METZGER: Sure. As Roger and I were saying before this panel began, it is rare for us to have a day like this where we can really sit back and reflect on some of the history, some of the theory behind some of the legal doctrines that we are all required to try to practice every day. And it is so different than what our clients typically are looking for. They are really looking for very quick advice, very practical advice. Hopefully, it is something, from their perspective, that they can just read on their BlackBerry between their meetings and move on.

And so, when I may be before a board of directors talking about the zone of insolvency and expanded fiduciary duties, I have had the experience of being stopped by a director who will say, "Wait, what are the actual situations in which directors have been found liable when a case has been tried on the merits for a breach of these kinds of expanded duties?" And that was really the genesis for the article that Brian Mukherjee and I worked on, really looking at cases under *Credit Lyonnais*[1] that did go to trial where liability had been found for individual directors and officers.[2]

And as you might imagine, there really are not that many of those cases. But I do think when you look at them, you can pull out some practice points and some advice for those directors who are under the press of time and want that quick short advice, what are the real key selling points that they should know. And, so in my opening remarks, I want to focus on that.

The first category of lessons or points that I would like to make is what I would put under the basket of what I call the airplane rule. What I mean by that is, you are on an airplane and there is an emergency and the oxygen masks drop and you are sitting there next to your small child. Whose mask do you put on first? Your first thought might be to put the mask on the child and it is actually counter intuitive. You are not supposed to put the mask on the child first, you are supposed to put the mask on yourself first so that then you can help the child or others. In that sense, one of the first things I start with directors, and, in truth, one of the things they are most concerned about, is what about protecting themselves first? What steps should they be taking?

If I am advising an individual, let us say someone from a venture capital firm, or a private equity firm, the first issue might be should they stay on the board. It may be that things have moved far enough along that they are going to have liability

1. Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., No. Civ. A. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

2. Carl E. Metzger & Brian Mukherjee, Director and Officer Liability When "Zone of Insolvency" Cases Go to Trial 2-3 (Nov. 2005) (unpublished manuscript, on file with The University of Maryland School of Law), *available at* http://www.law.umaryland.edu/conferences/Twilight/METZGER.pdf (last visited May 16, 2007).

whether they get off now or not and they would rather stay and try to help pull that plane out of that nose dive and see if they can lift it back up.

But if it is pretty clear that that plane is going down, it may be the right time then to grab a parachute and jump out. It may not make you popular with the other board members, but it may be a decision you should at least think about.

Second, you want to look at risk areas that really impact you personally in terms of personal liability, wage laws that could apply, Warren Act[3] liability. I have had companies where environmental liability issues may attach, where for an individual director, there could be personal liability. And so, part of it from a risk-management perspective is just assessing what are the risks? Is there anything we can do now to address that? Next, what other protections are in place, again, for that individual from personal liability? Should anything be done to shore up those protections?

D&O insurance is a critical area. I have had a client literally on his own board of a company where to save money one of the financial executives did not pay the D&O insurance premiums. Are you setting aside money for a tail policy for runoff coverage in the event the company does go into bankruptcy or otherwise goes through some type of dissolution of sale of assets? And even looking at the terms and conditions of that D&O insurance, for example, the insured versus insured exclusions. Is the area of bankruptcy carved back, that then it will still allow coverage for some bankruptcy related claims?

In terms of indemnification rights and the exculpation provisions that hopefully are already baked in there, are they really up to snuff? Should we kick the tires on that? Is there anything further that we should do? That is my first category of practice points that we address.

The next category, and this is really the big one, relates more to the idea that it is not just about doing the right thing, but it is about documenting that you tried to do the right thing. Because ultimately at the end of the day, you may have chosen wrong, you know. The board may have made mistakes, and simply going back and trying to recreate the history that you were doing your best—that is an exercise you may have to go through.

But, believe me, having had to go through that, that exercise will be a lot easier if in real time as you were going through those events, the board was very conscious about documenting that they were trying to do the right thing. So the protections that may be available under the business judgment rule or 102(b)(7),[4] that the previous panel was talking about, I am going to have a better shot of getting you in behind those protections, behind those shields, if we have done a good job of documenting this process.

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3. 43 U.S.C. §§ 523 et seq. (2006).

4. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001 & Supp. 2004); *see also* Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981).

And that leads to a number of steps. First of all, and this is a point that Russell properly touched on, is identifying if you are in the zone, when you may be approaching that zone, showing that you considered the issue of whether or not you are in the zone. And then also, understanding the expanded duties and expanded constituencies that may now be in play.

One of the cases that is talked about in our article is a situation where the Court actually found that because the board acknowledged these expanded duties and seemed to have been informed about them and understood them, the Court actually gave that board more deference in terms of the judgments that it then made.[5] I would go as far as saying, consider specifically the creditor constituencies and their interests. It does not mean you are changing the course of what you are doing, but acknowledging those interests and getting that on the record.

Another problem that often comes up in the heat of the moment of what often feels like an emergency room case that has just walked in the door, we see boards that sometimes are trying to cut corners about the corporate formalities. It is imperative that we have this meeting tonight. We are going to have an all hands call, get the board all together. From my perspective, though, when you are looking at the accident scene afterwards, it is critical that all of the corporate formalities, the notice issues, the minutes, all of that be properly observed. It is going to make the board look much more diligent and much more organized when ultimately that record is open to second guessing.

Finally, related to that is the idea of making sure that you have full participation of the board, particularly in terms of independent directors. This may be a time where there are tensions between people, where people are considering, maybe going off the board or distancing themselves. If you are responsible for that board, you really have to try to bring people together, make sure they understand that whatever attention they were giving this board when the company was financially healthy, they now have to give them more attention. And the record will want to reflect that people really made that commitment to being more involved, and you want to be able to demonstrate that.

Next, often times what comes up is some kind of significant corporate transaction. It may be a sale of some of the assets. It may be new debt that is incurred. You want to make sure that there is a record that you considered all of the available alternatives.

Now, sometimes a client will say to me, well, there were no other alternatives and I cannot prove a negative. I think, in fact, you can or you can get pretty damn close to it. If there really are not any other alternatives, if this is the only purchaser for these assets, et cetera, show the diligence that you or some of your advisors went through to find other purchasers.

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5. Odyssey Partners, L.P. v. Fleming Cos., 735 A.2d 386, 418 (Del. Ch. May 13, 1999).

Get on the record in the minutes in the board meetings that this is the best opportunity that is out there and that you have done a good job in the time constraints that you had to explore what other alternatives were available and to explain why you chose the path that you did. Related to that is sometimes transactions with insiders will come up. I would love to see those transactions minimized to the extent possible because you know that those transactions are going to be subject to a high degree of scrutiny if this thing ever blows up. And so to the extent that you are going to engage in those kinds of transactions, it may be anything from retention pay to who you are selling assets to. Make sure, again, that the process was handled correctly in terms of the approval of this, ideally by your independent directors, disinterested directors and that, again, the business justification is laid out very clearly.

JAMES HANKS: May I ask you one question about insider transactions?

CARL METZGER: Sure.

JAMES HANKS: There is no question that insider transactions and all transactions of a company that is flirting with insolvency are going to be subject to a more intense scrutiny by the creditors. You are not suggesting, though, are you, that there would be any more different standard applied using the Delaware section 144 Safe Harbor statute[6] than would be the case in a non-insolvency situation, are you?

CARL METZGER: I am not. And that is an important point. I am glad you made that, Jim, although I will tell you that while legally that may be our position, practically speaking in the mind of a judge, I think he may still have their intent as higher up when it is some kind of inside transaction, some kind of interested party transaction.

JAMES HANKS: Now, Delaware section 144 is actually three safe harbors. One is the approval of a disinterested directors, another is approval of disinterested stockholders, which is generally not feasible or practical, certainly in the short term.[7]

And third is that the transaction be "fair" to the corporation.[8] What does fair to the corporation mean when you are in a near insolvency situation?

CARL METZGER: And I guarantee you it is going to be like the infamous description of the pornography test. "I know it when I see it."[9] That is going to be difficult to determine in advance. And, again, it is going to be viewed with the skewed protective of hindsight after the fact.

To sum all of this up, I think it comes down to understanding those expanded duties, being active as a board member, being active on an informed basis using advisors like lawyers or other financial advisors, and not just using them generally, but making sure that the advice you are getting is tailored to the particular issues at

6. DEL. CODE ANN. tit. 8, § 144 (2001 & Supp. 2004).
7. *Id.* at 144 (a)(1)-(2) (2001 & Supp. 2004).
8. *Id.* at 144 (a)(3) (2001 & Supp. 2004).
9. Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

hand. Finally, for parties having interest in some of those transactions, make sure that those interests are fully disclosed and could stand up to the kind of scrutiny that Jim mentioned.

LARRY RIBSTEIN: Suppose you are presenting the alternatives to the board and the board says, okay, one of these alternatives is to favor the creditors significantly more than it favors the shareholders. Are you telling us that you cannot do that because of our fiduciary duties to creditors in the near insolvent situation?

CARL METZGER: No. I think what I am trying to do is build a record so that if you do choose that path, you will at least have built a record to suggest that you gave due consideration to everybody's interests.

LARRY RIBSTEIN: Okay. So you are saying that as long as we build the record, you are not going to get in trouble on a fiduciary duty basis for favoring the shareholders.

CARL METZGER: I think the important point to make is—

LARRY RIBSTEIN: You have to answer that yes or no.

CARL METZGER: Because we have a court reporter, I would object to the question as being vague and ambiguous in terms of getting in trouble.

JAMES HANKS: Try telling a judge that, your question is vague and ambiguous.

CARL METZGER: The practical point here, and what I would emphasize if I got asked that question by a director at board meeting is that I am not telling you that any of these practice points are going to eliminate the risk that you could get in trouble. What we are trying to do here is minimize that risk. And if you are talking about getting in trouble meaning being sued, in this case to a point, Russell made on the first panel, frivolous claims that are going to name you as a defendant alleging that whichever door you chose, door number one, two or three, was the wrong one, those claims are going to come in. And so I think part of what this panel is focusing on is what puts us in the best position to then be able to move to dismiss that claim and most likely be successful.

LARRY RIBSTEIN: Are you telling me, the director, that as long as we go through these steps we are going to be protected by the business judgment rule?

CARL METZGER: I am saying that I think you are putting yourself in a better position to be in those protections. Based on the mess that was described by the first panel, you are not going to get that kind of blanket assurance, I do not think by anybody.

RUSSELL SILBERGLIED: I will just raise the point that from a practice standpoint, does anybody who is in practice remember the last time they guaranteed a result to a client?

CARL METZGER: Right.

JAMES HANKS: Does not your question, though, illustrate the basic problem here? Take the Model Act formulation of a director's duties which is the black letter, that directors must act with a reasonable belief that what they are doing is in the

best interest of the corporation, underscore the word corporation, not stockholders.[10]

It was actually written in the singular. Each director must act with a reasonable belief that what he or she was doing is in the best interest of the entity as opposed to the stockholders, much less one stockholder or a group of stockholders.[11] Is that not right?

And if that is right, if the director's duties run to the entity, then is Chancellor Allen wrong when he talked about a shifting of the duties to the creditors because at any given time they are going to be the owners of, the residual claimants of the corporation?[12] When the company is solvent, that is the stockholders. When the company is not solvent, that is going to be the creditors because there is not going to be enough residue to be available to the stockholders.

But should that change the director's duties from running to the entity to running to some group of claimants on the right side of the balance sheet whether they are above that bright clear horizontal line that the accountants draw, that we all know is not so bright and clear, between debt and equity?

LARRY RIBSTEIN: I am simply trying to emphasize the problem that has been presented today that the panel has discussed. After Carl's talk, I could emphasize the problem that he has to get into on the ground when the courts do not make clear whether there are duties or not in this situation.

ROGER LANE: Let me stick my head in the barrel. I think the key thing is for the board of directors to seek to identify and, as necessary, build a process around any potential conflict of interest situations. Because I think that is the one way place where you can get hit with a duty of loyalty claim and liability can arise. If you stay out of that box and you have directors who are taking action, balancing alternatives and balancing interests, and do not target a particular creditor, I think they are going to gain the benefit of the business judgment rule more times than not.

LAWRENCE HAMERMESH: The question follows from Larry's to some extent. When you plan a board process, I hope you do not exclude directors who own a lot of common stock on the theory that they have some conflict even at the time of insolvency. Is that the case?

CARL METZGER: Yes. I do not think, practically speaking, you could, in many situations.

LAWRENCE HAMERMESH: And that suggests that Jim Hanks is absolutely right, we do not care about shifting through the debt between creditors and stockholders. We care about the obligations of the entity.

10. MODEL BUS. CORP. ACT. § 8.30(a) (1984) (amended 1998).

11. *Id.*

12. *See* Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., No. Civ. A. 12150, 1991 WL 277613, at *54, n. 55 (Del. Ch. Dec. 30, 1991).

CARL METZGER: Right. And that gets to the point, harkening back again to Russell's comments that we must be careful we are not talking about shifting duties but about expanded duties, which may sound like word sniping, but those words become very important when a judge is reviewing the record.

JAMES HANKS: I am not even prepared to concede that the duties expand. I am saying, why should not the duties be to the entity and they continue to be to the entity? The stockholders of Microsoft at the end of today are going to be a different group of people than the stockholders of Microsoft at the opening of the market today? There may become different residual owners as a result of the fluctuation of how well the company does, whether it is solvent, insolvent, in the zone of insolvency, in the neighborhood of insolvency, or floating over insolvency. Why do the director's duties remain to the entity? Why should that not be the doctrinal answer as well as the practical answer?

PARTICIPANT: Because the entity is a legal fiction. The concept of benefits or anything running to a corporation is completely meaningless. Anything that you can pretend to point to that is some sort of a benefit or cost of incorporation, I can deconstruct into cost or benefits running to a specific stakeholder. You are punting the question if you say that the duty runs to the entity. You have to identify the stakeholders and think about who benefits.

JAMES HANKS: Saying that the corporation is a legal fiction is a maxim. It is a legal person.

PARTICIPANT: That is one of the most useless analogies, particularly in this setting. And I mean quite literally that anything that you try to point to as perhaps a benefit to or action taken in the interest of the entity, I can show you that what you are really doing is at best showing that something is in the interest of a particular stakeholder other than the entity, ultimately coming down to human beings.

As you think through the process with particular people, given that a company benefits from growing and being profitable, what we are saying is that the employees benefit from continued employment; customers benefit from continued access to goods and services and suppliers; and their employees' benefit from being able to engage in business with this company. Shareholders benefit as individuals from the appreciation of the stock prices. The entity ultimately does not benefit. There is no merit.

JAMES HANKS: You can say the same thing about human beings. My wife and child benefit if I do well. I benefit and my child benefits if my wife does well. The same thing can be said about human beings. Each human being has affiliated constituencies—people who have interests in how well that human being does economically or otherwise.

PARTICIPANT: But that is in addition to individual personal interest. I have a genuine interest in and of myself in continuing to be alive regardless of whether that also extends to someone else. It is not the same to a corporation. Ultimately, it

is not that the corporation and its stakeholders have a certain interest. The corporation interest is nothing more than the sum of its stakeholders.

MARK GROVIC: When you are sitting on a board and faced with these issues—which is why I think Richard has me up here today because I am on the boards of lots of real estate companies, and we have the good fortune of facing insolvency issues on a regular basis—you can force yourself, if you have to, to think in terms of this abstract concept of the entity. You can sit around and as a group try and do that. And I think it is possible to some extent.

But part of what I wanted to bring up later on, which I think is relevant now, is that you really, as a board of directors, almost in all cases, have some really strong inclination toward the liquidation option where you should not take your eye off the equity ball. But the equity ball, from where we come from, is a very efficient point of view in running companies.

JAMES HANKS: Yes. I used the word residue earlier instead of equity because I did not want to confuse the issue of debt and equity and the fact that in insolvency there is no equity, but there is a residue.

MARK GROVIC: Right.

JAMES HANKS: So that is why I referred to residue to the extent that there is residue. I would love to pursue several of these points but here we are about halfway or more through our time and we have only gotten through the first initial presentation.

Roger, do you want to pick us up from here?

ROGER LANE: I will make some quick remarks. Because we are being taped, I will just note that the views I am about to express are not even my own.

In sitting here, I am reminded of a parable of two siblings in the attic. If you have two kids, one may be a thoughtful, cautious kid, and the other could be more impulsive. And the thoughtful kid that is up in the attic, he always thinks about what might happen if an attic door is opened, and what might lie beyond, and whether it is worth opening the door. When we work on a theoretical basis, we are kind of working on that basis. As a practitioner, it is a little bit different. And I am going to come at this from the opposite end—who is asserting these claims, and what are we going to say about them.

As a practitioner, if I have a client who is a creditor, I am a bit like the other kid in the attic. I go through a simple syllogism: there is a door—a potential avenue for relief. Doors like to be opened, so this door wants to be opened. In other words, I am going to try to find a way to assert this claim if my client needs the claim asserted.

So what is the impetus for these claims? Where do they really come from? Number one, when you are filing a claim of this type, typically you are seeking assets beyond the estate. You are seeking to capture a D&O policy. That is why you attempt to sue directors individually. There is no other reason. And, typically, either the traditional remedies for creditors will be inadequate, or the corporate assets will

be inadequate, to satisfy the creditors' claims. So, if you are representing a creditor, particularly an unsecured creditor, there is a tremendous motive to file such claims. So that is one thing that is going on.

Another thing that is going on, I think, is that the Court of Chancery is thinking about a broad sense of fiduciary duty, or more properly revisiting the ancient concept of the fiduciary, in an effort to arrive at a coherent means of addressing these claims. Think of the trust fund doctrine, and the concept of being in a court of equity. There is a sense in the Court of Chancery in which, in this area, at least, we are revisiting the concept of what it means to be a fiduciary, and what it means to be a chancellor in equity. The Court is willing to consider circumstances anew on a classic fact-specific, common law basis, without necessarily knowing in advance exactly where the theory goes.[13] And in that sense we, as practitioners, open the attic door, and the courts join in exploring where the path leads. We do not have a preset result.

I think there is a sense, in that context, in which we are exploring whether the traditional creditor remedies are exhaustive, or even adequate. We do not know the answer to those questions.

So I think that is some of what is going on, and I think we are going to see a resurgence in this area, not a cutback in terms of the assertion of these claims. We have just spent four years loading the economy with subordinated debt. The last time we did this was in the mid to late '80s with a lot of buyouts. Some number of those deals are going to go bang, inevitably, and we are going to be fighting about reclassification of debt to equity and other such stuff, just as we did in the early '90s.

I think there will be plenty of quasi-derivative claims brought by creditors. I do not mean to dismiss those claims, those are some of the things that will put my children through school and so on. In fact, that is where most of the litigation will happen. The issue that I think is fascinating in this area is whether there is such a thing as a direct creditor claim. Picking up on a comment that Vice Chancellor Strine made, could a board that is not self-interested take action that exhibits such animus towards a particular creditor that the creditor could have a direct fiduciary claim? Or are there other potential direct creditor claims?

Let me give you some examples. I hope my remarks so far make it clear that I have no theory at this point, just factual puzzles. Here is an example: we say that debt can negotiate its covenants and fully protect itself. Imagine you have a secured lender, a senior secured lender that has a stock pledge right and a parent company that is a holding company, and all of the pledged stocks are stocks of the subsidiaries—the actual operating units. All of this stock is pledged to the secured lender, and the secured lender has proxy rights, as well. And in the event of a material breach, the secured lender can vote the company stock, can flush the board.

13. *See In re* Rego Co., 623 A.2d 92, 95 (Del. Ch. 1992) (explaining the trust fund doctrine).

Well, what if the board goes in and amends the charter to prohibit action by shareholder written consent? Is there a creditor remedy in the traditional arsenal to deal with that, or does a creditor need a fiduciary duty claim to force the point, a direct claim of the type that the stockholder would have had? I think that is a very interesting question.

Similarly, as to the *Revlon*[14] and *QVC*[15] cases, which were mentioned, there was a paper a few years back about those cases and the debtor's exclusive period to propose a plan of reorganization in bankruptcy.[16] If you put to one side, for the moment, the ticklish issue of the Supremacy Clause, the paper asked whether a creditor would have a claim that exclusivity should be terminated to permit a corporate auction, or would a creditor have that claim five minutes before the bankruptcy petition is filed?[17] I think these are really interesting issues that bear further exploration.

MARK GROVIC: Have you seen where it is possible for debtors to have sort of a majority of the blocking rights to the shareholders? So the duty would be on the creditor to foresee that possibility and contractually prevent it. If they did not, then it is their responsibility. We do that as minority shareholders every day.

ROGER LANE: Right. I think that is one example.

MARK GROVIC: It is a great example. I have been thinking about that all night.

ROGER LANE: Can you really anticipate everything that—

MARK GROVIC: We try to, otherwise we lose.

ROGER LANE: Right. And yet, can a creditor really anticipate everything that the board might do? I think that is the impetus for implying a direct right of action—the idea that there is some need to fill a gap. And I have a situation that involves just this, it so happens. And so it is a very interesting and difficult question, because you can contract for a lot, but you cannot think of everything. Parties attempt to use the covenant of good faith to cover the situation, for example, but that covenant is a covenant of the corporation, not the directors.

JAMES HANKS: But that argument did not win in the *Metlife* case.[18]

ROGER LANE: Right.

JAMES HANKS: Back in the '80s.

ROGER LANE: Back in the day.

JAMES HANKS: Was there a question of insolvency in that case? No, I think it was just loading on the additional junk debt that drove down the price of the bonds.

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14. Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986).

15. QVC Network, Inc. v. Paramount Commc'ns Inc., S'holders Litig., 637 A.2d 34 (Del. 1994).

16. Robert A. Klyman & Michael S. Lurey, *The Revlon Duty As Cause to Terminate Exclusivity: A New Strategy For Effecting Corporate Change in Chapter 11*, 4 J. BANKR. L. & PRAC. 621 (1995).

17. *Id.* at 633–35.

18. Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1522 (S.D.N.Y. 1989).

And I guess Metlife was the bond holder and it sued saying that the board should not have done that. But it lost.[19]

ROGER LANE: Right. Exactly.

JAMES HANKS: And the Court in the Second Circuit said you could have and should have thought of this. You cannot invoke some sort of overhanging interstitial duty to save you from what you failed to anticipate.[20] There is a question all the way in the back.

FRED TUNG: On the question of gap, and the illustration in here and the *Metlife* case as well, I think it is taking sort of more of a policy oriented. So you have one case where there is a gap, but however the case turns out, presumably there is not going to be a gap next time.

In other words, the market now covers the *Metlife* problem because the market figured out, well, there was a gap, and we filled it. And if that is right, if at least amongst sophisticated creditors, they sort of adapt to this sort of strategy—how to get around covenants—and the lenders come back and strategize about how to tighten up, if that works pretty well, then it seems to me that we are less concerned about it, having background rules to cover the incidental case where there is a sort of innovation in the strategy with one side or the other.

ROGER LANE: And I think that is a position that merits exploration. In other words, do we believe in the model that says, just as insurance policies evolve, as new director risks are identified and addressed accordingly, do we trust that the process of negotiating secured debt instruments will likewise respond?

A flip side of that is that once a stock pledge right has been triggered or, another example we chatted about, maybe once a creditor has been reclassified as equity, do they then actually directly assume shareholders' rights, and is there really no problem? But if so, is that really what we want? And I think that is a very interesting vortex to explore. Typically if you are in bankruptcy and you reclassify someone's equity, the thought is that they have gone down somehow. But if they inherit a bunch of fiduciary claims, and the statute of limitations has been extended two years by the bankruptcy petition, that is intriguing. I do not think we know where all of that goes, or may go.

LARRY RIBSTEIN: The question is what are the implications? I think it is pretty clear that creditors cannot anticipate everything that might come down the pike. They cannot do it by specific covenants and they cannot do it by pricing risk completely accurately. So the question is, what are the implications of that? Do you impose a fiduciary duty and if you do, does that apply to any contract in which it is impossible to predict the risks down the line or is there some special reason to do it in bond-type contracts versus other types of contracts?

19. *Id.* at 1526.

20. *Id.* at 1522.

JAMES HANKS: Or if you want to introduce that question, I would throw another potential axis of distinction and that would be public debt versus private debt. Maybe we feel the need to protect debt holders to a greater extent if the debt is public rather than private where the investors have less of an opportunity to influence the terms. I do not subscribe to that because even in a public debt situation, there are intermediaries, the underwriters, who are supposed to be negotiating for the public debt holders.

MARK GROVIC: I do not want to concede that point, which you cannot conceive of every option because minority shareholder protection representatives in that context implies fifteen points which on a theoretical basis cover the different—there is only so many things you can do with capital structure, the proxy given rights. These are very, very sophisticated.

JAMES HANKS: Well, we are going to try to move it along further so that we get in the remaining two initial presentations that are going to be more like summary presentations.

WILLIAM CALLISON: Thank you for having me here. I am a Marylander and it is wonderful to come home. Also, anything I say cannot be held against me in future expert witness work.

I want to reiterate two points in my paper.[21] I want to look at an extreme case, which is a Colorado Court of Appeals case.[22] And then I want to look at some practical things. I am not a litigator. I do not know anything about courts. I do not want to know anything about courts. You guys do that stuff. And I am not a bankruptcy lawyer.

But I want to look at some of the practical problems in the creditor fiduciary area. My big picture on Delaware is that *Credit Lyonnais*[23] opened the door, and *Geyer*[24] opened it farther without much discussion. Contrary to what Professor Ribstein stated earlier, I think there is a holding there. The court might have reached a similar conclusion on different grounds, but it did state that when the insolvency exception arises, it creates fiduciary duties for directors for the benefit of creditors.[25] *Production Resources*[26] and others influenced this. And, in Delaware, with a little bit more of a literary reading, *Production Resources* followed precedent and held the same thing.[27]

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21. J. William Callison, *Why A Fiduciary Duty Shift to Creditors of Insolvent Business Entities is Incorrect As a Matter of Theory and Practice*, 1 J. Bus. & Tech. L. 431 (2007).

22. Anstine v. Alexander, 128 P.3d 249 (Colo. Ct. App. 2005).

23. Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'n Corp., 1991 WL 277613 (1992).

24. Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784 (Del. Ch. June 18, 1992).

25. *Id.* at 787.

26. Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772 (Del. Ch. Nov. 17, 2004).

27. *Id.* at 798.

I think that the Vice Chancellor in *Production Resources* was troubled by that conclusion and cabined it as a derivative case. However, there still is this "loose lips sink ships" statement of fiduciary duties in *Production Resources*.[28]

Not all judges are as smart as the Delaware Chancery judges. I am from the boonies, Denver, Colorado. When you get out there, it is not even on *The New Yorker* map anymore. A recent Colorado case shows the danger of this language. The case is *Anstine*[29] and it is cited in my paper. Trustee sued a corporation, its president and its outside legal counsel in state court, arguing that the president breached duties of care and that counsel aided and abetted in the breach. There was a jury verdict in trustee's favor. The law firm appealed the aiding and abetting claim on a variety of grounds. One ground for the appeal focused on whether the president owed fiduciary duties to creditors. Without that, there was nothing to aid or abet.

The Court of Appeals held that if the company was insolvent, which it was, a hypothetical judgment lien creditor could sue the president of the corporation for breach of fiduciary duty to creditors, and could also bring a breach claim alleging that there was a breach to the corporation.[30]

Importantly, the court also held that a defense that the president might otherwise assert in a derivative action, and which the president's counsel tried to assert in the claim against them on the aiding and abetting claims, was not available.[31] The business judgment rule is not mentioned, not a word about BJR in that decision.

So if you look at this from my perspective, the movement towards this expansion of fiduciary duties, in my state, maybe it is going to come other places, has taken a distinctly non-Delaware turn. And creditors have been held to have fiduciary claims and unlike in *Production Resources*, the claims are direct.

A reaction to *Anstine* has been for our corporate laws committee to draft corrective legislation. The legislation says, "a director or officer of the corporation shall have neither any fiduciary or other duty to, nor any liability to, any creditor or any person other than the corporation . . . nothing in this section shall affect duties or liabilities to shareholders of the corporation."[32]

So we have a corrective bill. We are trying to trump the *Anstine* case. I suspect that this is going to be contested. I suspect trial lawyers are going to be in there, I suspect bankruptcy trustees are going to be in there, I suspect there are going to be interest groups in there. However, if there is any traction, I guarantee we are going

28. *See id.*

29. Anstine v. Alexander, 128 P.3d 249 (Colo. Ct. App. 2005).

30. *Id.* at 254–55.

31. *Id.*

32. Speaker is referencing a draft of proposed legislation which was later enacted in a different form. *See* Colo. Rev. Stat. § 7-108-401(5) (2006).

to extend that to LLCs, Limited Liability Partnerships, LLLPs and any other entity that we can put our finger on.

Second, my paper looks at theory and practice and concludes that the shift is not well-founded in either. Paraphrasing Lech Walesa who said, "let Poland be Poland," I say "let creditors be creditors." They can seek remedy under creditor laws and the "F" word, "fiduciary" in this case, should be kept out of it for practical reasons.

First, the big question is when a shift occurs over time in which entities move into insolvency, become insolvent, come back out, and become solvent again, what the heck is going on. This requires a constant tallying of assets and liabilities, which is difficult. It is certainly difficult for counsel that is going to be aiding and abetting things.

It also requires a definition of insolvency. If you look at the case law, it is not exactly clear. The Delaware cases go to balance sheet definition,[33] yet Vice Chancellor Strine's language, in *Production Resources*, basically stated that the definition is balance sheet insolvency with, "no reasonable prospect that the business can be successfully continued in the face thereof."[34]

So, is insolvent being down and always being down? Who knows? You are going to find different states going different ways. I think this is a complex uncertain area and is clearly subject to twenty-twenty hindsight. It lends itself to unfairness. It is a dangerous situation for directors. This mandates that they err on the side of insolvency and protect themselves, and this is going to affect how they run the entity, and perhaps not for the better.

Second, creditors are not homogenous. So there is a question of who benefits from the shift. Some creditors are protected by contract and collateral. Some creditors are deeply under water. The under water creditors are like shareholders. They want to bet the ranch. That is the only way they are going to get out.

So, who should owe the fiduciary to and have you just shifted priorities by doing that? If you look at the residual interests, directors say okay, shareholders have residual, now trade creditors or somebody else has a residual interest or they are going to get the benefit, having just amplified those people over the secured creditors. What the heck does that mean? So, I think that is a tricky issue.

Third is whether the business judgment rule applies and how that affects the outcome. I suspect that the answer is yes. Vice Chancellor Strine indicated that the answer is yes in Delaware.[35] But I think there is some case law to the contrary, and it is a "who knows?" question.

And lastly, I deal with contract-based entities: LLCs, partnerships, et cetera. The question then becomes whether, when, and how you extend director duties to con-

33. *See* 11 U.S.C. § 101(32)(A) (2006) (defining insolvent as "the sum of such entity's debts is greater than all of such entity's property, at a fair valuation" under the balance sheet method).

34. Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 782 (Del. Ch. 2004).

35. *See id.* at 799 (noting that "the 102(b)(7) clause clearly protects the directors").

tract-based entities. And I think you have to, if the concepts are correct in the corporate arena, they probably apply in the unincorporated arena. What effect is given to duty modification and elimination to the operating agreement when third parties assert the duties of managers in the operating agreement?

Say, here is our duty of care and over this time line you are heading into insolvency. Hey, if we are going to contract, we will provide that the care standard goes down. You do not have the same duties. Can the agreement permit self-dealing, usurpation, and competition by managers who also would be members when the LLC is insolvent? Can you do this by contract? What is the effect?

Can the operating agreement establish a form of business judgment rule by agreement that favors managers who also happen to be members, perhaps, most likely, when there would be arguably no protection or a different form of protection under business judgment principles applied as a matter of state law.

I do not think anybody has the answer to any of these questions. I know there is no case law out there, I think this creditor shift in an unincorporated business just begs a bunch of questions. In theory, my reaction was, we do not need it. "Let creditors be creditors." Get a judgment lien. Sue on it. If there is a chose in action, foreclose on it. Do what you can. I do not think that it has been developed very well. But the fiduciary word ought to stay out of the picture. Thank you.

JAMES HANKS: Bill, thanks very much for that very cogent exposition. I would just like to make one comment on what we were discussing earlier and that is, I think what you said further emphasizes the significance both economically and legally of the corporation as a separate person as far as stockholders are concerned. I think you made the point very well in so far as creditors were concerned.

I know you and I disagree on this, but if you think of duties running to stockholders, it seems to me you get even more potential variation than with creditors because who are the stockholders? In a highly simplified corporation, you could have a 25 year old yuppie and an 85 year old widower. One is very income oriented, the other is growth oriented.

You expand that out even just a little bit to a public corporation where you have—you cannot even know who your shareholders are. So, if you say that the duty runs to the shareholders rather than the entity, you do not know who it is that your duty runs to. They are all hidden behind the company, you do not have any idea who the beneficial owners are.

Second, they have got wildly different interests and you will never—even if you could find out who all these ultimate economic interest holders are—figure out what their interests are. There is no way to know that.

Third, their interests can change as their circumstances change.

And, fourth, they themselves will change. They will be a constantly changing group of people. I think what you said with respect to creditors, I agree with entirely. The contract orientation, people are worried about creditor remedies. Creditors have a heck of a lot more remedies than stockholders have got, and they can be

a shifting group of people with shifting interests as well. And how is a board ever to know who they are or what their interests are at any given time?

And why should it not be that a board simply would say they are what their contract says they are?

Well, that brings us to Mark. Mark, can you give us your perspective, please.

MARK GROVIC: I hope my perspective is a little bit interesting because I spent a lot of time on boards of companies that are struggling to either be home runs or go out of business. In the early stage or the VC route, we often find ourselves in that situation.

So I want to go really quickly, and what I would enjoy most is some more of these sort of hypothetical situations, where you say, as a board member, how would I want to react there? How do I either claim the duty to another constituency or not and what makes sense from my point of view. So I would enjoy some more of that.

I just want to make a few points. First off, it seems to me that there are a lot of things going on when you get a case where there is this sort of claim potential. There are a lot of capital structure issues—

JAMES HANKS: What potential?

MARK GROVIC: Creditor claim, wanting a fiduciary duty, needing a fiduciary duty. When you get yourself into this situation, I reference the *Odyssey* case,[36] because I actually did a venture fund with an MD from *Odyssey*, and they are a VC fund. This was a very particularly relevant case for me. And in my opinion, they should have lost because they did not fund when it was time for them to participate in the next round of financing.

And we all know as venture capitalists that if you pass on a round, your rights are likely to get obliterated. If the company goes south and you have not participated, you cannot sue at that point and say, oh, well, I was protected by some other duty because you have to participate in subsequent capitalization.[37]

I am glad to see that *Odyssey* lost. I know there is boilerplate in all of the things that lawyers sort of put in our documents, but there is a rule in our industry that if you do not step up to the plate, you cannot sue in retrospect and say my rights were not—in this case, the creditor was the majority shareholder. They put themselves into that situation. There were a lot of conflicts, things going on here. I think that is probably more relevant than some of the other things going on. I would ask the group here who is much more familiar with the case law, I would like to talk about cases, in your opinion, where the outcome was unjust or inequitable because there is lots of different sort of grasping at legal theories here.

But I have found in the cases that I just briefly reviewed in participation of this, that I agree with most of the outcomes.

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36. Odyssey Partners, L.P. v. Fleming Cos., 735 A.2d 386 (Del. Ch. 1999).

37. *See id.* at 406–07, 411–12, 415–16.

So, judges are trying to get where they want to go, maybe not always by the right means. I would like to discuss cases where somebody uses some of these theories to really come to a completely wrong point of view. I think it is more serving intents, that maybe they can get to some other means.

The insolvency definition for me is especially difficult, and it is been addressed so I do not want to belabor the point. But most of our companies have negative equity accounts. And some of them will give me a ten times return. And what we have to anticipate are two types of liquidity and I do not know that the courts are particularly well-versed to try and anticipate, to label something in the sphere of insolvency or insolvent, the two types of liquidity, we spend a lot of time analyzing. One, liquidity to just go day to day, make payroll, stay in business. But true liquidity for—from capital markets to potentially raise money from strategic buyers, to cut deals with—there are all kinds of sources of capital from VCs to angels to the public market. But a lot of times there are deals that you cut with your IP to stay in business and do OEM deals, this sort of thing.

It is a very, very complicated view of whether or not the company is under water and when should you start looking at the creditors at that point, especially in our companies, which are high growth and everybody knows are pretty binary.

So, for the duty to come down to our level I think it would be absurd. In a public company I think it makes a lot more sense. We have gone over at length debtors might have contract rights, and that is where they should stay. I will not talk about that, although I do feel pretty strongly that they are sophisticated parties and they should be able to negotiate the terms.

JAMES HANKS: How do you feel about preferred stockholders?

MARK GROVIC: That is where I am headed now. Every deal we do is preferred stock. And sort of, my last point, because I want to play devil's advocate, I do not like the fact that I tend to agree with almost everyone here. I usually like to mix it up a little bit. In preferred stock, we try and get the best of the both worlds, so we have our down side protection, we have our coupons, we have our redemption rights. And then we want to convert whenever we want and participate in any up side.

And we get a fiduciary duty by the right of having the ability to convert. And we take our board seats and we are treated just as common shareholders to the extent that it benefits us.

And then we have our down side protection. We do not take any security. And that, whenever I teach capital structure at Maryland, I always talk about the spectrum because even the debtors that we do our deals with are always taking more.

So there is this whole, you know, what difference does it really make? So from a devil's advocate, we are all providing capital to the company, and there should be a duty to all of the capital providers. But my answer to that is, when you look at boards, especially at our level, everybody is representative, people put money in the company as shareholders.

So if a bank wants protection, have the guts to step up and take a board seat. Otherwise, you do not have a right to have people at the board meeting talking about your interests.

JAMES HANKS: But why do you think that is protection?

PARTICIPANT: What do you do with board observers?

MARK GROVIC: You listen to them. There is not a huge difference in my boards between an observer and—so come to the board meeting and speak your case and you are going to be heard. I mean, we are all respectful. Everybody wants to do business with the bank again. Another issue.

JAMES HANKS: Before we pass on from that. You talked about being able to place a director on the board, having voting rights, giving the right to one or more board seats. You do not think that directors that are elected by the preferred stockholders have any different duties or are governed by any different standards than directly elected by the common stockholders, do you?

MARK GROVIC: No.

CARL METZGER: Can I just jump in on that? I think, I would agree with your answer, Mark, that from a legal perspective their duties are not different, but from a practical perspective, they are in a different position.

And they really have to be careful about how they play that role. Because they are really wearing two different hats there in terms of the duties they owe, both to the organization that has put the capital into this company and then their duties as directors of that company.

And a lot of the issues that we get faced with practically day to day are trying to help people juggle those sometimes conflicting responsibilities.

JAMES HANKS: I see Larry Hamermesh nodding vigorously. Larry, I have got to ask you, what are you thinking as you nod.

LAWRENCE HAMERMESH: This is the age-old problem, I know we are talking about fiduciary duties to creditors here. But there was a very good paper presented last month out at the University of Iowa by one of our colleagues named Frank Parham who pointed out, and I think it is one of the papers in this context, that there are a lot of great points in the corporate structure where interest starts to diverge if you are within the stockholders body, which as you have already pointed out how there are differentials.

We talked a lot about those who engage in hedging. He is very interested in those who do not. There is a break for preferred stockholders and the common stockholders in reference to liquidation, in reference to destruction. There is a break point between option holders and stockholders.

JAMES HANKS: There is a break point in each of the series in classes of the preferred.

LAWRENCE HAMERMESH: Sometimes they have board representation, sometimes they do not. Where they do or where they do not, where are these fiduciary duties

supposed to kick in is the question we talked about? What constituency is supposed to talk about it when you walk into the board room? I think this is the biggest unsolved problem in corporate law. How do you tell your clients, as directors who they are it supposed to think about when—

JAMES HANKS: Life gets easier if you think of their duties as running to the entity.

RUSSELL SILBERGLIED: I agree with what Carl said, and I want to add to it. One of the few cases ever in Delaware, forget about insolvency cases, one of the few cases ever in Delaware that resulted in a money judgment against directors is *Weinberger v. UOP*.[38] And in that case, the reason that the directors got slapped is because they were on the board, or at least the ones who did get slapped were on the board of both parent and sub. And the Delaware Supreme Court was quite clear in stating that it is true they might wear two hats, but that does not diminish their fiduciary duties in the capacity of either one.[39]

From a practice standpoint, advising a director standpoint, that makes it tough because you tell them this, and you tell them that you can get potentially slapped. I mean, we are not even talking about insolvency cases right now. That, in fact, in *Weinberger v. UOP* they did get slapped.

But the question then comes, okay, so what do I do with that? And it is going to be—I think as Roger was stating—a very fact specific case and difficult advice to give, and I think that is where challenging issues come in.

MARK GROVIC: We deal with it really in an up front fashion because the diversion between our shareholder interest and our fiduciary duties are really, really clear. So in most cases, maybe the bigger company is more complicated, but in a lot of cases as a fiduciary, I know that I have to vote one way on the board, and we have attorneys present at our board meeting, and we often say, okay, if we do not want to vote for this, what is our fiduciary duty?

And then as shareholders we know that we do not have to vote that way. And we structure the deal, initially, that to the extent that we can, under legal structure, we get the blocking right at the shareholder level, so we do not have to vote against our self interest.

And then at the board level we have to vote a certain way consistent with our fiduciary duties as advised by counsel. And to the extent where we can vote as shareholders to block something and we are in a situation where we have to act as fiduciary, then our duty does go to this theoretical entity, and we have to vote that way.

And at that point we know it when we see it. We know what that means. That this is in the best interest of the business, we are voting again for our self interest.

38. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

39. *Id.* at 710–11.

But to the extent possible, we put those decisions on the shareholders and put blocking rights.

JAMES HANKS: Is it possible that it may actually be better—and I am responding to something that you said about observers a few minutes ago—is it possible that if you are there because you are representing the preferred stockholders or a creditor or somebody else, you may be better off? You may be better able to make your client's case as an observer than as a director because as an observer you are not governed by these duties, the performance of which may not be in your particular client's interest.

As an observer you can go in there. If you are more than just an observer, if you are a talker observer, you can say whatever you want.

PARTICIPANT: My observers got sued any way.

CARL METZGER: I just want to say, I have one client that is a venture capital firm that will not have board seats, only board observer seats for that reason, for that purpose.

RUSSELL SILBERGLIED: I do not know if this is the appropriate panel to answer it, but the question, how often do these conversations actually occur, the trade off conversations? I know we wanted to talk about hypotheticals, but I guess I can speak against them because that seems to me a lot of what this discussion is about—the hypothetical of the board sitting down and saying, well, if we make a decision X, it is better for the creditors. If we make decision Y, it is better for the preferred shareholders. My instinct would be that those explicit conversations very rarely ever occur at the board level.

WILLIAM CALLISON: I tend to get those questions from my colleagues. For some reason, they think I know something and they call me. I have probably have had five of these types of situations in the last two and a half months. So I think that as the economy continues to swing, it is going to come up.

MARK GROVIC: Unless you raise another round of capital. At the early stage, you raise another round, once a year, I have ten portfolio companies. Once a year for every company, we have very explicit discussions with diverging interests between shareholders and—

ROGER LANE: You asked for a case, and I would recommend you read *Kahn v. Lynch.*[40] You can also read Vice Chancellor Strine's discussion of it in *Cox Communications.*[41] Basically it says that the courts, under certain circumstances, will impose a fiduciary duty upon controlling shareholders, and even if you let the minority vote on the matter, you cannot get back to the business judgment rule.[42] You can shift the burden of proof, but that is it.

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40. Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110 (Del. 1994).
41. *In re* Cox Commc'ns, Inc., S'holders Litig., 879 A.2d 604 (Del. Ch. 2005).
42. *Id.* at 616–17.

So, when you have got a troubled company, you can end up with a preferred holder who is a majority holder and then the traditional expedient of voting one way at the board level and voting the other way at the shareholder level might not be effective. That is another difficult piece to this, you have a whole other layer to look at in terms of who has the fiduciary duty.

MARK GROVIC: That is between the fiduciary and the shareholder?

ROGER LANE: Correct.

MARK GROVIC: I only have one more point and that is when boards of directors start to think of other constituencies, I am a good liberal, and a lot of the money that I manage has been double bottom line or even money, all that kind of stuff. That is where I come from. But when we are at the board level starting to think about employees, environment, it usually is not making for the most successful company.

And to the extent that you are not thinking about shareholder value and building shareholder value, so the entity, I would argue, should be defined almost in all cases, except the absolute most extreme ones in liquidity, as building shareholder value, whoever that shareholder may be. And that is the best way to run a company. I have seen companies run that way and companies not run that way. And it does not work any other way.

JAMES HANKS: It is kind of interesting in the post-Enron, super-heated, overcharged corporate environment that we are now living in sort of a corporate global warming. There is a lot less discussion than there used to be about duties to other constituencies, employees, local communities. Sadly, there is a lot less discussion that I am hearing about diversity on boards. I think some of these things have kind of gotten pushed to one side now.

As far as the non-shareholder constituency issues that go back to the late '80s and early '90s, I completely agree with you, and for lots of reasons. One being, I think it is difficult enough to be a director and sort out what is in the best interest of the entity and how to build shareholder value.

If you are simultaneously trying to do that, but think about what the interests are of people whose interests can be, and often are, adverse from an economic point of view to the entity, like employees rather than their getting more wages whereas—

MARK GROVIC: Or creditors.

JAMES HANKS: —or creditors who have an interest in getting more interest and getting paid in certain ways, then I do not know how you sort it out. Of course, a lot of these entities—these people ten, fifteen years ago were saying there ought to be some board duties—are also people that look out for themselves by contract and are often protected by other laws like minimum wage laws, OSHA, fraudulent conveyance laws, and local laws, and the best remedy of all, the power of tax.

ROGER LANE: That is a great example, if I can jump in, because a lot of the statutes were passed in the late '80s in response to *Revlon*, and like *Credit Lyonnais*, they were intended as a shield. If you think back to that time, we were all "Born in

the USA,"[43] and there was concern that foreign investors had just bought Rockefeller Center, and so on. So the way to protect the board, it was thought, was to have something the board could take into account, other than maximizing shareholder value, in resisting a takeover.

JAMES HANKS: Yes. In that sense they were very cynical pieces of legislation. And I think about 30, 35 states have them. I wrote a couple of articles on non-solvent constituency statutes.[44]

But, your antennae has got to go up whenever you see management and labor unions marching arm in arm at the state capitals to enact any piece of legislation like they did with respect to these non-shareholders constituency laws, which are to be sure, discretionary, permissible. Most of the states have them. I think it is Connecticut that actually has one that is mandatory.[45]

RICHARD BOOTH: I think Indiana, too.[46]

JAMES HANKS: I do not know how corporations in those states deal with them. I do not know of a single situation, I would be interested if anybody in the audience does, where a board of directors operating under one of those laws has actually had the guts to say, we are going to turn down a $45 all cash, all shares offer with no protection for any of these constituencies and we are going to accept a $40 all cash, all shares offer because it includes promises not to close any plants, to continue civic and charitable contributions at the same level and a lot of other goodies. I do not know of that case.

ROGER LANE: I mean, a well-advised board would have just said no. They would not go into the details, they would just say no.

JAMES HANKS: Yes. Would say no to the $40 bid.

ROGER LANE: They would just say no the bid, if they possibly could. You would not go into that.

JAMES HANKS: I am assuming that a company has put itself in *Revlon* mode and said we have got these two competing bids.

ROGER LANE: I do not know of that case either.

JAMES HANKS: I do not know if one ever existed.

PARTICIPANT: If you want a case, an English case where the board did that.

JAMES HANKS: What case was that?

PARTICIPANT: *Revlon Engineers.* It is an English case. The board had several alternatives on the table. They picked the one which to them influenced jobs and vari-

43. Bruce Springsteen, *Born in the U.S.A.*, *on* BORN IN THE U.S.A. (Sony 1984).

44. *See* James J. Hanks Jr., *Playing with Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97 (1991); James J. Hanks Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207 (1988).

45. CONN. GEN. STAT. § 33-756(d) (2006).

46. IND. CODE § 23-1-35-1(d) (2006).

ous other things in relation to contingencies. And the Court endorsed that. They said as long as it did not make the shareholders any worse off, they could do that.

JAMES HANKS: I am going to come to you right after the break and get a cite for that. I think Larry Hamermesh is going to do the same thing. We are going to take a question from the gentleman right here and then we will close up.

LARRY RIBSTEIN: The question is for Mark Grovic that relates to the point that you were talking about with stakeholders. First of all, I just want to preface this by saying that I wished that I lived in Hanks' world where people no longer discussed this, because they do in my world—anyway, stakeholder duties after in the wake of Enron. It does not seem like Enron reduced that discussion at all. But for Mark Grovic, do you see the possibility of duties to creditors being contingent with possible responsibilities to other non-shareholders and stakeholders?

MARK GROVIC: As opposed to equity?

LARRY RIBSTEIN: Right. Have you considered the extent to which a duty to the creditors might create tensions with possible responsibility that you have to other non-shareholder stakeholders?

MARK GROVIC: No. I am still focused on maximizing shareholders values.

JAMES HANKS: Well, I think that brings us to lunch time. I hope you will join me in thanking our panelists.