Summary of Remarks by Justice Henry duPont Ridgely

It is indeed a pleasure to be with you today. I bring you greetings on behalf of all the Justices of the Delaware Supreme Court. And to the extent I express any opinions today, they are my own and not expressions of the Delaware Supreme Court.

Today, I am going to speak to you about our Delaware experience with derivatives in the courts. Specifically, I will discuss how Delaware judges stay up to date on complex legal issues, some principles of contract interpretation under Delaware law, the specific interpretation of master agreements like the ISDA Master Agreement, and some examples of derivative-oriented cases that we see in Delaware.
How Judges Stay Up to Date

Delaware’s unique judicial education opportunities:

- Continuing Legal Education (CLE) Requirements

- Participation at Conferences
  - Delaware judges “regularly interact with academics, shareholder groups, corporate directors, mergers and acquisitions lawyers and corporate litigants around the country to keep current on the most recent business developments. These interactions provide valuable insights on the fast moving business and capital markets, in which the complexity of transactions constantly evolves.”¹

- Delaware Annual State Judicial Conference
  - Most recently, P.R.I.M.E. Finance provided continuing legal education to the five judges on the Delaware Court of Chancery

and the five Justices of the Delaware Supreme Court as well as several judges of our Complex Commercial Litigation Division of our Superior Court.

○ Who provided the training:
  ▪ Daniel Cunningham, Esq. – Quinn Emanuel Urquhart & Sullivan, LLP
  ▪ Jeffery Golden, Esq. – Chairman of PRIME Foundations
  ▪ Rick Grove, Esq. – Rutter Associates, LLC
  ▪ Hon. Ben F. Tennile (Retired) – Chief Judge of N.C. Business Court
  ▪ Willem Calkoen, Esq. – NautaDutilh

○ Topics Discussed
  ▪ History of the Development of Derivatives
  ▪ Economic Basics of Derivatives
  ▪ Valuing Forwards and Futures
  ▪ The Evolution of Swaps
  ▪ Options
  ▪ Key Provisions of the ISDA Master Agreement
  ▪ Credit Derivatives
  ▪ How to Price/Value a Swap at Inception and After Inception
  ▪ Key Court Decisions
How Do Derivative Cases Get into Delaware State Courts?

Disputes involving swaps and other derivatives have been litigated in Delaware. Thus far, these cases arise either out of a contract dispute or a breach of a fiduciary duty claim against a corporation’s directors. These fiduciary duty suits can arise either as a direct claim or a derivative claim. Let me pause to point out that derivatives and shareholder derivative lawsuits are not the same. But just to be clear, a derivative lawsuit is a claim brought by a shareholder in the name of the corporation itself against the directors or officers for harm suffered by the corporation. Any damages awarded go to the corporation itself rather than the plaintiff. Whereas derivatives or swaps are the financial instruments whose value derives from and is dependent on the value of an underlying asset.

Interpretation of Derivative Agreements: Contract Law

Derivative contracts can be the subject of a breach of contract claim. All Delaware courts—including the Court of Chancery, the Superior Court, and the Supreme Court—follow common law principles of contract interpretation.
Generally, the purpose of contract interpretation is to discover the common intent of the parties.\(^2\) And “Delaware adheres to the ‘objective’ theory of contracts;” in other words “a contract’s construction should be that which would be understood by an objective, reasonable third party.”\(^3\)

“When the contract is clear and unambiguous, we will give effect to the plain-meaning of the contract’s terms and provisions.”\(^4\) But where the language of the contract is unclear, ambiguous, or would lead to an absurd result, then we will follow traditional canons of contract interpretation. And just because the parties argue that the contract’s language is unclear or ambiguous does not mean that it is so. Rather, ambiguity is determined by the court.

Although Delaware courts traditionally look to the intent of the contracting parties to determine the meaning of an agreement, standardized contract language requires a court to conduct a different analysis. Bond indentures and derivative

\(^2\) United Rentals, Inc. v. RAM Holdings, Inc., 937 A.2d 810, 830 n.92 (Del. Ch. 2007).
\(^4\) Id. at 1159–60.
transactions often use market-facilitating boilerplate language. In order to promote market stability, courts in Delaware “endeavor to apply the plain terms of such provisions in a uniform manner.”

Standard provisions in bond indentures or a master service agreement are “not the consequence of the relationship of particular borrowers and lenders and do not depend upon [the] particularized intentions of the parties.” So instead of considering the intent of the parties, Delaware courts will look to “the accepted common purpose of such provisions.” This often means that a court will look to the drafters of the language to derive the commonly accepted meaning, even if there is evidence that the parties had a different interpretation.

Another instance of lawsuits with derivative issues in Delaware involves corporate cases where the plaintiff alleges a breach of a fiduciary duty for

---

6 *Id.* (quoting *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1048 (1982)).
7 *Id.* (quoting Dennis J. Connolly & William Hao, *X Marks The Spot: Contractual Interpretation of Indenture Provisions*, 17 J. BANKR. L. & PRAC. 1, 12 (2008)).
purchasing a derivative. This would occur where a shareholder or creditor alleged that a director or an officer breached either her duty of care or loyalty when she directed the corporation to purchase risky or otherwise imprudent derivatives. These cases require that Delaware judges understand the financial instruments involved in order to decide the underlying claim.

When a board’s investment decision are challenged, in most cases the board will be protected by the Business Judgment Rule. Under the business judgment rule, “directors’ decisions are presumed to have been made on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.”

“The rule operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation.” The burden is on the plaintiff to rebut the presumption by showing a breach of a fiduciary duty.

\[\text{\footnotesize \textsuperscript{8}} \text{ Ivanhoe Partners v. Newmont Min. Corp.}, 535 A.2d 1334, 1341 (Del. 1987). \]
\[\text{\footnotesize \textsuperscript{9}} \text{ Cede & Co. v. Technicolor, Inc.}, 634 A.2d 345, 360 (Del. 1993). \]
\[\text{\footnotesize \textsuperscript{10}} \text{Id. at 361.} \]
Otherwise, the rule shields directors from personal liability if the directors’ decision can be attributed to any rational business purpose.\(^{11}\)

In order to overcome the presumption of business judgment, a plaintiff is required to demonstrate either that the director breached his duty of care or duty of loyalty, which includes the duty of good faith. For example, in *Lambrecht v. O’Neal* we accepted a certified question on standing to bring a double derivative action from the Southern District of New York where the plaintiffs claimed that Merrill Lynch’s senior management and directors breached their fiduciary duties by having the bank underwrite collateralized debt obligations and disregarding warnings about its mortgage-related activities.\(^{12}\) After we answered the certified question, the claim was eventually dismissed by the U.S. District Court for the failure to pursue demand.\(^{13}\)

---

\(^{11}\) *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

\(^{12}\) *Lambrecht v. O’Neal*, 3 A.3d 277, 280 (Del. 2010).

Finally in *Arkansas Teacher Retirement System v. Countrywide Financial Corp.*, the plaintiffs alleged a breach of fiduciary duty against former Countrywide officers and directors related to its credit default swaps and mortgage-backed security activities.\(^{14}\) There were actually two cases against Countrywide. The first case brought in Delaware settled, which we affirmed.\(^{15}\) The second case answered a procedural question on post-merger standing of shareholders under Delaware’s fraud exception whose ownership interest was divested by a merger. After we answer the question in the negative, the U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal of the complaint.

\(^{14}\) 75 A.3d 888, 890 (Del. 2013).

\(^{15}\) *Arkansas Teacher Ret. Sys. v. Caiafa*, 996 A.2d 321 (Del. 2010).