AMBIGUITY IN CORPORATION LAW

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It is sometimes noted by an honoree attending a testimonial that the experience is a little like attending one's own funeral. On both occasions balance is out and appreciation alone is heard. The honoree, unlike the deceased, experiences this unusual treat as a bit strange, even if pleasant. But stranger still would be the experience of the honoree taking an active part in the process — for the body to sit up and speak. This is roughly my role on this occasion. As I completed my work as a judge in June 1997, I learned that the editorial staff of The Delaware Journal of Corporate Law desired to commemorate my passing, so to speak, with some commentary in one of its volumes. I was asked to add something to that which others might say. It seemed ungracious to decline, yet, like the fellow in the casket, my active participation seems a bit problematic.

I am, of course, deeply suspect as a judge of the usefulness of the work that occupied me, largely to the exclusion of all else, for twelve years. The flaws and limitations it reflects and the worthiness of any contributions that are embedded in it are for others to assess if they are so inclined. Nevertheless, perhaps I can contribute to this volume in two ways. Most importantly, I would like to employ this opportunity to note "for the record," so to speak, my professional debt to a number of Delaware judges and lawyers and to record the deep honor I felt in being able to serve for twelve years as Chancellor of Delaware. This I do at the conclusion of these comments.

I thought also that I might use this occasion to ruminate a bit about some basic aspects of the corporation law, the tension that occupies its core, and the judge's role in assisting the system to move along productively. More personally, I thought I could explain, if briefly and informally, some background perceptions concerning the judicial process when it deals with a certain kind of corporation law problem.

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Let me start with a general observation — the practice of corporation law and the adjudication of human conflict turning on questions of corporation law, when accomplished at its most expert level, entails more than technical knowledge. At its most sophisticated and

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accomplished level this activity ultimately takes on an artistic aspect. By this somewhat provocative statement I do not mean to deny that a great deal of technical knowledge, both of corporation, and securities law doctrine (and history) and of corporate finance is essential for even a competent performance as a corporate law advisor or judge. Indeed, I suppose that technical shortcomings — an incomplete or inaccurate understanding of the economic and the corporate finance underpinnings of corporate law doctrine — is perhaps the most frequent source of dysfunctional legal rulings in corporation law. In saying that expert practice of corporation law or of corporate law judging ultimately entails artistic judgments, I do not mean to minimize the technical learning that plays a part in expertise. I do mean to emphasize that technical knowledge, whether financial or doctrinal, is not all that is necessary for mastery of this field. Mastery requires artistry. What this short essay tries to do in a nonacademic way, is to point out the underlying economic forces — the tension I referred to — inherent in the form of the publicly traded corporation that makes ambiguity a productive, if risky, condition of corporation law and makes imagination and artistry important ingredients to success in working in this area of law. That at least is the thesis.

The tension I refer to is the tension between the ways in which long-term wealth may be maximized through broad managerial discretion and the ways long-term wealth maximization may be thought to require protections that entail limitation on the power of management. This tension follows from the fundamental nature and the source of utility of the corporate form and it accounts in substantial part for the inability of the corporation law to deal clearly and decisively with its most difficult recurring problem — directorial duties in defending against a hostile takeover.

**Purpose of Corporate Law**

Stated broadly, but I think accurately, the elemental purpose of corporation law is the facilitation of cooperative activity that produces wealth. A net increase in total wealth, other things remaining unchanged, is an absolute good. With increased wealth, all other things remaining the same, there is a greater ability to relieve human suffering and enhance life. That is an unqualified good. While we no longer take much notice of the fact, the corporate form is a powerful engine for wealth
production. We no longer think of our legal forms of organization in such terms, but that is in part because we have lost sight of the profound effects that this form of organization produces.

**HOW THE CORPORATE FORM INCREASES TOTAL WEALTH**

Corporation law facilitates wealth creation principally by creating a legal structure that makes it substantially cheaper for investors to commit their capital to risky ventures. It does this through the innovation of tradable share interests, centralized management, limited liability, and the entity concept itself. The interaction of these legal characteristics facilitates diversification of investments and centralization of management. This allows capital to subject itself to greater risk. It is the ability to increase the degree of risk that can be rationally accepted that provides the greatest source of the efficiency of the corporate form.

Much of this utility depends upon investors allowing themselves to be safely passive. In other words, corporation law, understood in the "big picture" sense, is chiefly about facilitating long-term capital growth. Owners of capital will commit their capital to a long-term investment with the characteristics of common stock offers — no maturity date and no promising return on capital — at a comparative low cost, only if assured that (1) some agency (centralized management) will be available to monitor changing markets, technology, and other environmental factors and to adjust the corporation's business plans continually in response to changes from those sources; and (2) despite the very broad discretion that that monitoring and timely acting requirement entails, that agency will be sufficiently constrained or incented to assure that investors' interests will be advanced over the term of an indefinite and unknown future, as responsive changes are made. *Thus, much of the utility of the publicly traded corporate form derives from the fact that shareholders will be passive and managements only loosely constrained in their exercise of discretionary judgment.* Therefore, it can be seen that the proper orientation of corporation law is the protection of long-term value of

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1We once took greater notice of the wealth-creating effects that this organizational form produces. At the close of the last century, Columbia University's President Nicholas Murray Butler was quoted as saying that "I weigh my words when I say that . . . the limited liability corporation is the greatest single discovery of modern times." *James Willard Hurst, The Legitimacy of the Business Corporation in the Laws of the United States 1780-1970,* at 9 (1970).

2There is, of course, more than a little irony in this fact in this age in which the collapse of the Soviet empire so dramatically demonstrates the importance of the form of social organization of economic activity.
capital committed indefinitely to the firm. That protection is afforded not because the law has been captured by capitalist interests, but because the greatest production of goods and services is apt to be produced by a system that offers such protections.

**CORE CORPORATE LAW PROTECTIONS OF CAPITAL**

The corporate law provides a few vital sources of assurance to shareholders which allow investors, to a substantial extent, to be rationally passive in most circumstances. Primarily, corporate law affords common stock a right to vote.

This right to vote is elemental. Most importantly, the vote includes the right to elect a board of directors annually; to vote on charter amendments; and to vote for certain fundamental corporate transactions. The shareholders’ right to vote ultimately forces incumbent management to be attentive to investor concerns at the risk of ouster in a proxy contest.

The right of shareholders to sell their share interests without any corporate or management concurrence, is fundamental as well as an economic source of constraint on the exercise of management discretion. It makes possible the "takeover" market and in a similar way forces management to keep investor interests in mind as they manage the enterprise.

The third elementary right of shareholders is the right to hold management accountable under the developed law of fiduciary obligation. That duty constrains self dealing of various kinds, albeit quite imperfectly, and protects to some extent the right to vote and the right to sell.

**CROSS-EFFICIENCY EFFECTS OF THE CORPORATE FORM**

Each of these sources of constraint offer to owners of capital assurances that will tend to lower the cost at which capital will be made available to an enterprise. But in some respects these capital-protecting devices — especially the loosely defined fiduciary duty protection — do so at a cost. These unspecified commands to act with loyalty and care add uncertainty as well, which is costly. One way of looking at the fundamental tension of corporation law is to see how these two effects of the fiduciary duty may pull in opposite directions.

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3The right to vote is, of course, a default right, meaning it may be adjusted or eliminated by the corporate charter. But in virtually all (but not all) public corporations the common stock has this right.
The costs that fiduciary obligations impose are easy to identify in a general way. Clear, "hard and fast" legal rules reduce uncertainty and allow business people to contract relatively efficiently. They allow parties to avoid undesirable consequences by contracting around them. There is utility in this and indeed a utility that proponents of the efficiency inducing properties of the Delaware General Corporation Law often claim for it, with some justification. But this ability that certainty in the boundaries of legal obligation creates also creates the risk that agents — such as corporate management — might deploy such well-defined rules cleverly (and technically correctly), but with the purpose in mind not to advance long-term interests of investors, but to pursue some different purpose. It could happen. Thus, at least in that corner of contract law occupied by corporation law, clarity itself may be thought to be a qualified good, not an unqualified good.

The fiduciary concept adds ambiguity. That ambiguity is capable of causing either a net cost (i.e., adding more certainty than is optimum to the governance system) or a net benefit. Whether the corporate law is at one end of this spectrum of economic effects or the other depends on the way the fiduciary duty is enforced. Unfortunately, there is no science currently available that permits the precise measurement of these cross-cutting efficiency effects in general (i.e., systemically) or in a particular firm. Thus, I assert that, at its most sophisticated level, corporation law is presently an artistic enterprise.

JUDICIAL DUTY IN AN AMBIGUOUS WORLD

The judge confronted with a problem involving fiduciary duty (and the lawyer advising with respect to what one might expect from such a judge) knows he has no science to alert him to the fact that he has entered the dangerland where he threatens to interject excessive uncertainty into the process. One response to this uncertainty, as in other contexts in which the facts and effects in the "real world" of legal rules or rulings are not fully understood — whether in legislative halls or in courts — is for the formulation of legal rulings to become moralistic. This technique was tried by the Delaware courts in some takeover cases.

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4That is, adding just enough ambiguity to assure investors of the existence of ex post protection for their investment.

5At the risk of seeming pointlessly repetitive, that is when the judicial process would be in effect adding uncertainty costs that are not more than offset by efficiency gains that arise from the ex ante prospect of capital protection.
One thinks especially of Smith v. Van Gorkom\textsuperscript{6} and Macmillan.\textsuperscript{7} While the appeal of the moralistic technique of opinion drafting may be strong in circumstances where community standards may be honestly portrayed as having been breached — fraud or looting by a fiduciary being paradigm business problems — I am frank to say that my opinion writing tastes typically were not satisfied with this approach as a technique for resolving questions of power in the corporate form. As I viewed these matters, more often than not, the most interesting conflicts in corporation law are engendered not by "bad guys" seeking with guile to protect or advance private interests. The difficult and interesting questions arise from differing, but plausible, conceptions of what constitutes right action in the circumstances. So, for the interesting questions, the moralistic approach seemed, to me, essentially mistaken or at least not an attractive approach.

Eschewing moralism, where competing visions of what right conduct demands was involved does not, however, offer an alternative model within which to write opinions in these more difficult, technically unclear, and morally ambiguous corporate law cases. The pursuit of systematic efficiency, an alternative approach and one with a powerful legitimating argument to support it, is problematic for the reasons mentioned: the cross-efficiency effects that uncertainty in the definition of corporate rights and duties has disarms the science to some extent. Moreover, judicial opinions expressed directly in terms of efficiency do not fit easily within our traditional vocabulary of judicial opinions.\textsuperscript{8} In part this is for reasons of judicial nonexpertise in this form of reasoning and, in part, because the law has been considered an autonomous (and indeed somewhat moralistic) enterprise. Judicial work has been thought or been presented as not involving choices that turn on controversial subjects such as efficiency.

\textbf{PRAGMATISM IN LAW AND LIFE}

Thus, with respect to these corporate control cases, I had no technique that offered me \textit{in principle} a single right solution to all cases. I never solved this problem. The technique I tended to use — which was aided in fact by the extraordinary time pressures under which Court of Chancery judges are required to stop thinking and to act — was both

\textsuperscript{6}488 A.2d 858 (Del. 1985).
\textsuperscript{7}Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989).
\textsuperscript{8}See, e.g., Ira S. Bushey & Sons, Inc. v. United States, 398 F.2d 167 (2d Cir. 1968) (Friendly, J.)
pragmatic and pedantic. It was pragmatic, not in the sense of unprincipled, but in the sense of constituting a detailed working out in a highly specific way of an accommodation between contrary principles underlying corporation law and contrary arguments concerning the efficiency effects of rulings. Thus, the opinions — mine as well as others — tended to be long and highly specific. Decisions were informed by reference to some grand principle — shareholder choice, for example, or the utility of not second-guessing management decisions made in good faith — but why that principle and not its contrary was applied got only a highly specific, not an easily generalized, answer. The whole opinion offered a more or less convincing (depending on the individual reader) and candid account of why the case was decided as it was, but often generalizations were difficult to generate, I am sure.

Ideally this "pragmatic" technique could move over a substantial period from principles to generalizations that were more rule-like, in an organic and accretionary process. The model thus was not deductive, but invited induction by others. It was case bounded and judicial; not rule promulgating and legislative in spirit. Other Court of Chancery judges were infused with a similar spirit and attitude. The process seemed to be productively functioning in the mid-1980s, for example, with respect to the question of whether and under what circumstances a court might compel a board to redeem a stock rights plan. Every member of the Court of Chancery contributed one or more rulings to the law of this subject which, while reasonable minds might disagree, I thought was evolving from complete ambiguity to an arguably productive balance. However, powerful dicta in the Delaware Supreme Court's opinion in the *Time Warner* case concluded that process.9

On some occasions, when what constituted right action could be generalized with some confidence, my opinions in corporate law cases did tend to be not pragmatic but pedantic, in the sense that they frankly did try to encourage right action. That is, on those occasions when I concluded that it was rather clear what protection of long-term capital investment required, I would feel greater ability to advise the practicing bar of that view.10 Thus, for example, how a special committee should

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10 I assumed that corporate lawyers, as well as corporate directors, are more proficient than the average rational calculator of risks, costs, and benefits of alternative actions. Nevertheless, I have assumed (and believe) that those lawyers and directors are moral persons who would, all other things aside, prefer to do the right thing if they understand what right action requires. Thus, when I believed I saw with confidence what the long-term capital enhancing rule would be I thought a social benefit might be produced by announcing it with sufficient clarity to assist such a process.
act — that is, the standard it should employ in a merger transaction\textsuperscript{11} was addressed in this way as was the director's obligation to take reasonable steps to assure adequate information reporting systems are in place.\textsuperscript{12}

The technique of many of my opinions in the corporate control context, however, was not pedantic in this way. It might be called pragmatic as I have done, but since the term pragmatism is widely misunderstood and unfairly degraded, perhaps I can call the technique contextualism.\textsuperscript{13} Such an approach is, of course, eminently subject to criticism. Most evidently these opinions written over twelve years cannot easily be summarized. Their "teachings" cannot easily be generalized and restated. In this I accuse myself and plead guilty.\textsuperscript{14} Equally likely is a criticism that would claim that this contextualized process is not really law at all, since it assumes that there is not in principle one right answer to all legal problems. A third criticism of this technique is that even if it works well in practice, since it is admittedly "artistic" in part, employing it leaves the effectiveness of our legal system too dependent on the vagaries of talent, taste, and appetite that will occur over the range of persons who come to occupy judicial office. These are all worthy criticisms that could sustain debate, but, as the one-sided nature of the funeral oration permits, I will pass over them for the most part. I prefer to refer to what I see as some of the benefits of this contextualized approach to adjudication, at least in the setting of the cross-efficiency effects that the publicly financed corporate form engenders.

Most importantly, this approach can (indeed it must, if done credibly) be high in candor. Candor is the first among a list of essential virtues of judicial opinions in a democracy. Candor is not, however, without social risks and costs. It can expose uncertainty in choice and thus it may be thought a risk to judicial legitimacy in a democracy. While the risks are real, their existence is not conclusive. It is more


\textsuperscript{12}See In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

\textsuperscript{13}See John Patrick Diggins, The Promise of Pragmatism: Modernism and the Crisis of Knowledge and Authority (1994); Hans Joas, Pragmatism and Social Theory (1993).

\textsuperscript{14}The deeper criticism, which I do not accept, but do not deal with here, is that this process is not law and if it is not law, it has no other ground for legitimization of the coercive effect it entails. I believe there are sound answers to any such criticism, but the whole subject is huge and deep and difficult. Not fit for this chat.
important, in my opinion, that the citizens who willingly subject themselves to the rule of law understand what that process really is; understand when and why choice is unavoidable; understand that choices made have been made openly in an intellectually honest way and that the judicial process, as a whole, is subject to democratic control. If a case decision necessitates a difficult choice, that fact should be exposed and all choices made should be justified with good reasons. It is neither honest, nor I suppose intelligent, to attempt to hide choice when choice is compelled by circumstance. A judicial system that exposes its grounds — its real grounds, which may extend beyond a set of doctrinal expressions — is in the end, the better system of government.

The contextualized approach to adjudication of ambiguous questions offers that advantage. Moreover, it discourages grand generalizations and the propounding of rules. It, therefore, reflects judicial modesty and self-restraint. These too are, on balance, virtues in this legal order at this time and especially in the narrow area where I have been directing my thoughts. Most clearly true is that where the matter is left unanswered by legislation and legal doctrine, and the subject divides the population. The contextualized approach, in the spirit of the common law, decides only the specific case and awaits the future formation of clearer signals.

The criticism that this technique is too dependent on the individual who is doing the judging is powerful, but we might be able to formulate some acceptable answers to it, were we to try. Such answers might involve assertions that the judge employing this technique is controlled in a number of significant ways. First, he or she is part of a product of a professional culture that has shaped the judge professionally. This professional commitment to law and to our legal system will not itself be sufficient to determine the answer to heretofore unanswered legal questions, but it will inevitably limit the range of choices deemed acceptably judicial by the judge. Secondly, he or she is embedded in a structure of authority within which judicial judgments are reviewed by other courts or set aside by legislation. These constraints are not perfect either, of course, but they do sharply reduce the prospect of an eccentric result surviving. Finally, it might be asserted that every technique of human decision that involves language inevitably involves ambiguity. In such systems, agents may not be perfectly controlled. Insofar as the principled-based contextualized approach to judicial decisions that I tended to adopt in these difficult corporate cases leaves a residuum of discretion, it is not unique in this. But, in fact, the criticism that this technique is too dependent on the particular talents of the judge who happens to be called upon to decide the case, I admit, was a criticism that
I addressed to myself from time to time and felt to have a force. I doubt that I possess all the skills necessary to make these sort of informed, creative, good faith judgments indefinitely with the confidence that I would over time increase, not decrease, net human welfare and happiness.

Because deciding specific cases in equity in a highly contextualized way is not a practice that offers the comfort of high confidence, because it is to some extent "artistic," and because this practice of contextualism (which suffuses equity jurisdiction) keenly forces one to feel the responsibilities attached to judicial office, I do not promote it or recommend it to others. For me, it was the principal path that my efforts and imagination permitted me when doctrinal techniques honestly applied failed to generate a definitive answer. I thought of each case as an opportunity to craft a just result with due regard for the effect that such a ruling, to the extent it could be generalized, would have on others in the future. But I realized that, beyond its effect on the very parties to the litigation, each judicial ruling is not a command. Instead, it is an offering to history, both to the men and women of a future moment who will work with it anew to try to achieve their ends, and to future judges who will try once more to work out the requirements of justice in a new setting.

I close by noting for the record, so to speak, my most important professional debts. I want to acknowledge publicly my profound gratitude to and affection for my legal mentors and good friends, from whom I did learn and continue to learn the most important lessons a professional needs to learn. Chief among them are the Honorable Walter K. Stapleton of the United States Court of Appeals for the Third Circuit and Andrew B. Kirkpatrick, Esquire, of the Delaware bar. Both of these men represent the finest blend of character, temperament, learning, and judgment that the legal profession may hope to inspire. I benefitted enormously by being able as a young lawyer to observe and work with both of them. More importantly, I am most grateful for their years of friendship. I am grateful too to the Delaware Bar Association, Governor Tom Carper, and the members of the General Assembly who conferred upon me honors that any Delaware lawyer would be moved to accept, and especially to Chief Justice E. Norman Veasey who showered me with kind attention. To each of my colleagues over the years on the Court of Chancery whose cooperation, diligence, intelligence, and esprit de corps made my professional life a joy, I have expressed my thanks and deep respect and reiterate those feelings now. Those colleagues self-consciously sought and seek excellence in their work and this is the secret to their success, past and future.