Conclusion

I might have limited my comments, both in scope and length, to honestly felt and richly deserved tributes to the intelligence of an outstanding Chancellor whose term spanned the most intellectually challenging period in corporate law since the courts worked through the problems of establishing a corporation's separate identity in the late nineteenth century. However, Bill Allen's accomplishments as Chancellor of Delaware are too significant not to warrant more substantive admiration. As I've tried to convey in this brief essay, Bill was a consummate judge, and an inspired architect of corporate law. I envy my friends at NYU who will have him as a colleague.

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A STEP BEYOND — REFLECTIONS ON THE JURISPRUDENCE OF CHANCELLOR WILLIAM T. ALLEN

BY A. GILCHRIST SPARKS, III*

Chancellor William T. Allen served Delaware from June 1985 until June 1997 as its nineteenth Chancellor. During that twelve-year period he issued 483 written opinions, most dealing with corporate matters, and countless orders and oral rulings, while at the same time fulfilling his Constitutional role as Chief Judge of the Court of Chancery and a member of the Board of Pardons. During Chancellor Allen's term, I had the honor of being a member of the Delaware corporate bar and was privileged to practice before him. It is now my further privilege to reflect upon those aspects of his jurisprudence, apart from the hard work evidenced by the facts recited above, which have established Chancellor Allen's national preeminence as a judge and a leader in the development of corporate law and governance.

Chancellor Allen brought to the bench a sharp and probing intellect, as well as a passion for harmonizing the corporate law as he saw it with the practicalities faced by those charged in the real world with governing corporations. His vision in addressing any particular case in the corporate area extended far beyond the facts at hand to a sensitivity

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as to how his legal rulings might be applied or misapplied in other contexts.

For the practitioner, Chancellor Allen's passion and vision presented both the challenge and excitement of preparing to engage in an intellectual exchange concerning the nuances of corporate governance that was likely to go well beyond any point developed in prior case law or even in the briefs of the parties. The same passion and vision manifested itself in the Chancellor's opinions, which displayed his sensitivity to any misapplication of corporate legal principles by explaining in precise detail the assumptions and logic which underlaid his decisions, as well as the limitations of those rulings. In my view, it was this willingness of the Chancellor to go a step beyond what may have been required to decide the particular case at hand in order to share with the reader his opinions of how his reasoning fit within the broader scheme of corporate governance that distinguished his legal work and set him apart from other jurists. Furthermore, he was a rigorous legal thinker and a nationally-respected proponent of thoughtful development of corporate governance precepts and practices. Four specific examples drawn from Chancellor Allen's opinions are sufficient to illustrate the various ways in which his jurisprudence has enriched not only the corporate law but also the broader field of corporate governance.

Chancellor Allen was an architect of legal principles. A clear example of this contribution is found in his high profile decision concerning the contest for control of Warner Communications, Inc. between Time Inc. and Paramount Communications Inc.[1] In that case, shareholders argued that the proposed stock-for-stock merger of Time and Warner triggered *Revlon* duties, requiring Time's board to enhance short-term shareholder value.[2] This argument was based on the fact that the merger would have resulted in Warner shareholders' receipt of sixty-two percent of the stock of the combined company and statements of certain Time directors that the market might perceive the Time-Warner merger as putting Time up "for sale."[3] The Chancellor, adopting a change of control test, concluded that the transaction did not trigger *Revlon* duties since, after the merger, control of the combined entity would remain in the hands of a "large, fluid, changeable and changing market."[4] On appeal, the Delaware Supreme Court, while affirming, stated that it

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[1]Paramount Communications, Inc. v. Time, Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990).

[2]*Id.* at 93,278, *reprinted in* 15 DEL. J. CORP. L. at 736.

[3]*Id.* at 93,279, *reprinted in* 15 DEL. J. CORP. L. at 737.

[4]*Id.* at 93,280, *reprinted in* 15 DEL. J. CORP. L. at 739.

premised its rejection of plaintiffs' *Revlon* claim on different grounds, holding that *Revlon* duties were not triggered because the target had not initiated an active bidding process seeking to sell itself or to effect a business reorganization involving a clear breakup of the company or abandoned its long-term strategy to seek an alternate transaction involving a breakup of the company.[5]

The failure of the Delaware Supreme Court in *Time* to embrace the more precise reasoning of the Chancellor as to when *Revlon* duties did and did not apply in a stock-for-stock merger ultimately led to further litigation in a different case involving the same point and, ironically, one of the same parties. In *Paramount Communications Inc. v. QVC Network Inc.*,[6] dealing with the contest between QVC and Viacom, Inc. to acquire Paramount, the Delaware Supreme Court belatedly embraced Chancellor Allen's change of control test.[7] Distinguishing *Time*, in which no control passed because the surviving corporation had no controlling shareholder, the Delaware Supreme Court held in *QVC* that the fact that control would pass in the Viacom transaction to Viacom's controlling shareholder triggered the Paramount board's *Revlon* obligation to seek the best immediate value for its shareholders.[8] This legal construct developed by Chancellor Allen now serves as a fundamental precept relied upon by corporate lawyers in advising directors as to their duties in stock-for-stock mergers.

Chancellor Allen was also an integrator. By this I refer to the blending in his decisions of principles derived from both law and economics. Indeed, one supposes from reading the Chancellor's opinions that before signing each one he asked himself two questions — do the principles of law as applied promote the interests of justice, and are they "efficient?"[9]

Perhaps the best known example of Chancellor Allen's use of economic and risk analysis to derive a legal concept is the discussion in

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[5]Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1990).

[6]637 A.2d 34 (Del. 1994).

[7]*Id.* at 44.

[8]*Id.* at 46-48; *see also* Arnold v. Society for Sav. Bancorp, Inc., 650 A.2d 1270 (Del. 1994) (explaining that a potential change of control in a stock-for-stock merger triggers the *Revlon* obligation to maximize current share value because it deprives target stockholders of the opportunity to receive a control premium for their stock in the future).

[9]*See, e.g.*, Court Transcript of Ruling of the Court on Proposed Settlement and Application for Attorneys' Fees and Expenses at 5, *In re* Times Mirror Co. Shareholders Litig., No. 13,550 (Del. Ch. Nov. 30, 1994) (No. 13,550) ("And it is not in the social interest — that is, the interest of the economy generally — to have a rule [against discriminatory treatment among stockholders of the same class] that prevents efficient transactions from occurring.").

footnote 55 of his opinion in *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*,[10] wherein he concluded that directors of companies acting "in the vicinity of insolvency" owed their primary fiduciary duty to the corporate enterprise (which may indirectly include the interest of creditors) rather than to the shareholders alone. He reached that conclusion not by reference to prior case law or abstract legal principles, but instead, by constructing an elaborate hypothetical which analyzed the varying risk appetites of creditor and shareholder constituencies in a corporation on the brink of insolvency.

Chancellor Allen was also a teacher, gifted at synthesizing and occasionally restating in his terms legal principles developed by others. For example, in one recent decision, he proceeded to sum up in a single paragraph almost ten years of Delaware Supreme Court teachings concerning *Revlon* duties:

> This existing uncertainty respecting the meaning of "Revlon duties" was substantially dissipated by the Delaware Supreme Court's opinion in *Paramount*. The case teaches a great deal, but it may be said to support these generalizations at least: (1) where a transaction constituted a "change in corporate control", such that the shareholders would thereafter lose a further opportunity to participate in a change of control premium, (2) the board's duty of loyalty requires it to try in good faith to get the best price reasonably available (which specifically means that the board must at least discuss an interest expressed by any financially capable buyer), and (3) in such context courts will employ an (objective) "reasonableness" standard of review (both to the process and the result!) to evaluate whether the directors have complied with their fundamental duties of care and good faith (loyalty). Thus, *Paramount* in effect mediates between the "normalizing" tendency of some prior cases and the more highly regulatory approach of others. It adopts an *intermediate level of judicial review* which recognizes the broad power of the board to make decisions in the process of negotiating and recommending a "sale of control" transaction, so long as the board is

[10]No. 12,150, 1991 Del. Ch. LEXIS 215, at *108 n.55 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099, 1155 n.55 (1992).

informed, motivated by good faith desire to achieve the best available transaction, and proceeds "reasonably".[11]

Finally, Chancellor Allen was a policy maker, having mastered the art of using his position as a respected Chancellor and observer of corporate trends to influence the development of both corporate conduct and corporate law. His opinion in *In re Caremark International Inc. Derivative Litigation*,[12] which has sparked national interest in the area of corporate compliance programs, typifies this trait. In *Caremark*, as an antecedent to his consideration of the fairness of a settlement in a derivative action, the Chancellor addressed the subject of director liability for failure to adequately monitor the activities of subordinate officers and employees. His analysis went far beyond the authorities cited by the parties in the single brief filed in support of the settlement. The sources which he called upon in that analysis are indicative of his diligence, his multidisciplinary approach, his ability to synthesize, and his willingness to share his insights to further the cause of sound corporate governance. The straightforward conclusion he reached typifies his sensitivity to the balancing of competing policy considerations in the corporate governance area.

In *Caremark*, the Chancellor began his analysis of the duty to monitor issues with a review of incidents in "recent business history" in which the actions of officers and employees had adversely affected the welfare of corporations. Drawing upon nonlegal sources as diverse as *The Economist*, *Business Week*, and the *New York Times*, the Chancellor recalled for his readers the events leading up to the displacement of senior management at both Solomon, Inc. and Kidder, Peabody, and "the extensive financial loss and reputational injury suffered by Prudential Insurance as a result [of] its junior officers' misrepresentations in connection with the distribution of limited partnership interests."[13]

Next, turning to the practical effects of legal developments entirely outside of the traditional corporate law sphere, he observed that the Organizational Sentencing Guidelines[14] adopted in 1991 by the United States Sentencing Commission pursuant to the Sentencing Reform Act of 1984[15] "offer powerful incentives for corporations today to have in place

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[11]Equity-Linked Investors, L.P. v. Adams, No. 15,513, 1997 Del. Ch. LEXIS 64, at *15 (Del. Ch. Apr. 25, 1997) (emphasis added).

[12]698 A.2d 959 (Del. Ch. 1996).

[13]*Id.* at 968 (footnote omitted).

[14]UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL ch. 8 (1994).

[15]Pub. L. No. 98-473, tit. II, § 212(a)(2); 18 U.S.C. §§ 3331-4120 (Supp. 1995).

compliance programs to detect violations of law, promptly to report violations to appropriate public officials when discovered, and to take prompt, voluntary remedial efforts."[16]

Having set the stage, the Chancellor then reviewed the 1963 decision of the Delaware Supreme Court in *Graham v. Allis-Chalmers Manufacturing Co.*,[17] which had addressed the question of potential liability of Allis-Chalmers' board members for losses experienced by the corporation as the result of actions by lower-level employees in violation of the antitrust laws of the United States. Focusing upon the *Graham* court's statement in that case that "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists,"[18] the Chancellor concluded that a broad interpretation of *Graham* — to the effect that "a corporate board has no responsibility to assure that appropriate information and reporting systems are established by management — would not . . . be accepted by the Delaware Supreme Court in 1996, in [his] opinion."[19] Chancellor Allen based that view not only upon subsequent Delaware Supreme Court jurisprudence indicating the seriousness with which the Delaware corporation law views the role of the corporate board,[20] but also upon what he viewed as inevitable changes in corporate governance practices resulting from the potential impact of the federal organizational sentencing guidelines.[21]

Turning to the standard which should be applied in 1996 to a claim of director liability for corporate loss predicated upon ignorance of liability-creating activities within a corporation, Chancellor Allen concluded that "only a sustained or systematic failure of the board to exercise oversight . . . will establish the lack of good faith that is a necessary condition to liability."[22] Finally, sharing his thought process,

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[16]*In re Caremark*, 698 A.2d at 969.

[17]188 A.2d 125 (Del. 1963).

[18]*In re Caremark*, 698 A.2d at 969 (quoting *Graham*, 188 A.2d at 130).

[19]*Id.* at 969-70.

[20]*Id.* at 970 (citing Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), and Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994)).

[21]*Id.* at 971.

[22]*In re Caremark*, 698 A.2d at 969 at 971. Typical of Chancellor Allen's precision and foresight, his characterization of a systematic failure to monitor as establishing a "lack of good faith" would appear to be a studied choice of words designed to obviate in future cases any director defense to derivative claims for money damage predicated upon charter provisions adopted pursuant to DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1996), as to which acts "not in good faith" are a specific exception.