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The Delaware Court of Chancery and Public Trust

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REMARKS

THE DELAWARE COURT OF CHANCERY AND PUBLIC TRUST

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It is daunting when a Chancery judge is surrounded by professors from great legal institutions who often critique and write about our decisions. I confess some trepidation that I may be graded on what I'm about to say, but I hope that will not happen.

The Chancellor is the Chief Judge of the Court of Chancery. I do not know how much you know about my court, but let me describe a little bit about it. It is an old court by our standards, having been created over 217 years ago in 1792.[1] Over that time, there have been thirty-seven judges who have served on the Delaware Court of Chancery.[2]

In 1792, the Delaware Court of Chancery had a single Chancellor, one individual, and it remained that way until the early 1940s, when the Legislature added the first vice chancellor.[3] Over time, as the court became busier and its reputation grew, it was expanded to five members: the chancellor and four vice chancellors.[4] The five members of the court handle all of the cases, with each judge carrying about 250 cases. I assign the cases, as they are filed, to individual judges; each judge handles his assigned cases from cradle to grave, until they are concluded.

Now, the chancellor does not have many duties beyond those of the vice chancellors. I have administrative functions and budgetary duties in addition to my caseload. Having served as a vice chancellor once, I can tell you that I like to compare the position of chancellor to being that of a caretaker at a graveyard: I am over everyone, but no one listens to me.

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* The Honorable William Chandler, III was appointed Chancellor of the Delaware Court of Chancery in 1997 and has served on the bench for twenty years.

1. William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery—1792–1992*, *in* COURT OF CHANCERY OF THE STATE OF DELAWARE—1792–1992 (1993), *available at* http://courts.delaware.gov/courts/Court%20of%20Chancery/?history.htm.

2. *Id.*

3. *Id.*

4. *Id.*

It is, of course, a great honor and privilege to serve on the Delaware Court of Chancery. So, when Professor Lyman Johnson called me and asked me to speak about the particular subject that is the focus of today's program, he said, "Bill, I'd like you to talk about what the Court of Chancery and other courts and judges might do to try to instill confidence and trust in the public with respect to our financial institutions after what's happened in this financial meltdown—the economic debacle we are now experiencing."

I immediately thought, "I doubt that I am the right person to address this subject." Courts, as you know, are specialized governmental institutions, but they are reactionary in nature. They are not proactive. Courts do not reach out to solve problems, to reform behavior, or to reform institutions. We respond to problems that are brought to the courts, and we adjudicate them, but in a limited and incremental fashion.

The goal of the court is really to earn respect and trust. Not to instill it in others, but to earn the trust and respect of the public that we serve. We do not have a standing army to carry out our orders. Thus, we rely on the consent of those whom we direct either to pay civil damages, to disgorge property, or to obey our injunctive orders. To achieve voluntary compliance without an army requires you to have the respect and consent of those you are directing and commanding.

Lizanne Thomas mentioned the business judgment rule and fiduciary duties during her presentation. That is one of the reasons I enjoyed her talk, and in the end she returned to the importance of doing what is right. That is the charm, so to speak, of the Court of Chancery. Not only do we require people to meet legal standards, legal rules that are announced in advance, but we expect people—directors and managers usually—to behave in a way that is fair and equitable. We have the power to strike down actions that might be technically legal when those actions work an inequity or unfairness.

Our corporate law in Delaware has one principal foundation, and that is our corporate statute[5]—a statute both broad and enabling and that emphasizes self-ordering. It grants directors and managers of public companies great discretion as to how they will deploy the assets of the company, the latitude to choose, and the most efficient means to do so.[6]

Our law requires managers and directors to do two things: first, to obey positive law and the statutory commands of the Delaware General Corporation Law.[7] Those latter commands are limited in number, such as having an annual meeting of shareholders who will elect the board of direc-

5. DEL. CODE ANN. tit. 8, ch. 1 (2008).

6. *Id.* § 4.

7. *Id.*

tors as well as stockholder approval of important transactions in the company's life, such as a merger or dissolution.[8]

Second, beyond meeting these fundamental positive law and statutory requirements, directors and managers must do something more: they must comply with equitable principals known as their fiduciary duties.[9] Fiduciary duties are an ancient concept in our law, and one that the Delaware Court of Chancery inherited from the English common law more than 300 years ago.

Only two words comprise "fiduciary duty," but they have enormous scope and significance. "Duty" can be traced etymologically to the Latin verb *debere*, or "to owe," signifying that an action is required, that some affirmative conduct is expected or required.[10] "Fiduciary" is a word that traces its lineage back at least three or four centuries.

One of the earliest corporate law cases was by the Lord Chancellor of England in 1742: the Sutton case.[11] The Lord Chancellor was addressing the actions of corporate directors before him. He said that directors, like agents or trustees, were required to act with fidelity and reasonable diligence.[12] The word "fidelity" is another Latin-derived term that figures prominently in our law.[13]

Fidelity, faithfulness, devotion, and loyalty: these are the words that infuse Delaware's fiduciary duty law. These terms encompass the second standard that all corporate directors and managers must meet. To repeat, they must meet not only the fundamental laws of the Delaware statute and the regulatory laws of our nation, of course, but they must also satisfy the requirements or demands of their fiduciary duties.

Now, the chancellors must explain the basis for every decision. There are no juries in the Court of Chancery, so in every instance, we are personally responsible for our decisions. Our opinions must carefully explain why a director or manager has not lived up to his or her fiduciary responsibility. Many academics have referred to the opinions of the Court of Chancery as akin to parables; that is, they read like morality stories describing the behavior of directors and managers, both the good behavior and the bad.[14] The academics have said—and I largely agree with them—that one can, over time, weave these parables and stories together to form a road map, an

8. *Id.*

9. *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).

10. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 856 (11th ed. 2003).

11. *Charitable Corp. v. Sutton*, 26 Eng. Rep. 642, 645 (Ch. 1742).

12. *Id.*

13. MERRIAM-WEBSTER'S, *supra* note 10, at 465.

14. *See, e.g.*, Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573 (2005).

acceptable path for directors and officers of companies, so they can know what is expected of them.[15]

What do we mean by the terms "loyalty," "fidelity," "good faith," "fair dealing," "honesty of purpose," and "integrity"? We use these words deliberately in our opinions, but carefully and in context. They are repeated by the financial and business press, who report our opinions and quote our language. They are written about by professors. The lawyers who counsel directors write client memos using the same language—the same strongly-worded, moralistic terms—found in our opinions.

Then, in meetings with directors or officers of the company, these same lawyers use the "parables" in an effort, we hope, to educate their clients about what is expected in the way of appropriate behavior: what are the appropriate standards of conduct in the business world, and what to do, and what not to do, as a fiduciary.

These stories or "parables" are one method by which the court, as an institution, tries to earn respect from its constituents and the public. In telling these stories, we are obligated to defend and rationally explain the decisions we have reached and to persuade our audience that they are correct, as well as fair, and sensible. That is, we must persuade that the result is just.

I would describe that goal as the first obligation of the opinion writing exercise—to reach and defend a just result. The second function, though less formal, is to educate and inform others, in addition to the parties before us. Most people think that judicial decisions are aimed at the parties and litigants who are before the court, and that is entirely true. But often, judges are conscious of the fact that they are addressing a much broader audience in the opinions than just the immediate litigants. Chancery judges realize that our opinions will be explained to directors and officers of other companies, so we write with that educational function in the back of our minds.

These lessons, moreover, are transmitted in several ways. One way, as I mentioned, is that the "parables" are told through client memos and lawyers interacting with clients. Another is through the business press that covers our decisions. Yet another method is through the judges themselves talking to directors. We frequently speak at directors' colleges, where directors come to learn more about fiduciary duties and legal requirements.

We are not the only ones who do this, of course. There are many institutions that explain these principles to directors, but I think it is important that the judges of my court, as well as the Delaware Supreme Court, make the effort to explain the meaning and import of our decisions as an aspect of our institutional duty.

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15. *See, e.g.*, DONALD J. WOLFE ET AL., NOTABLE DELAWARE CORPORATE DECISIONS 2005: DELAWARE-CENTRIC MUSINGS ON DISNEY, TOYS "R" US, TCI, UNISUPER, AND EXAMEN, 1543 PL1/CORP 441 (2006).

Now, another way in which judicial opinions operate to influence behavior is through an *in terrorem* effect. I have heard others say that directors are highly reputation-sensitive people. If they are reputation-sensitive, then one might expect that judicial opinions will be taken to heart, because the opinions are written in a personalized tone—personalized in the sense that we call specific directors out. If you are a party in the case and you are a named director, and your conduct falls below the standard and is either unfair or inequitable—for example, acting in bad faith, disloyally, dishonestly, or fraudulently—your conduct is held up for all the world to see. We do not use pseudonyms; we use the actual names of the directors, lawyers, or other professionals involved.

Thus, by "naming names," we obviously send a strong message. Some view this as a form of "public censure." Others refer to it as "shaming," which incentivizes or motivates others to avoid the same fate by avoiding certain conduct and by recognizing the standards that will be applied to them. There are other institutions besides the Court of Chancery that do the very same thing. Institutional investors, for example, engage in similar forms of public censure, as do activist shareholders and the business press.

In the brief time I have left, let me add a final note of caution about this, however, because there are limits that courts should not exceed—or which they ought not exceed—in the effort to educate or teach.

We are common law judges, and the common law grows incrementally, decision by decision. There is danger in judges departing from the historical common law tradition by making statements that sound too much like proclamations or broad policy-like statements. In doing so, judges leave their proper domain—and where their institutional legitimacy is most secure—and cross into the sphere of legislators and regulators.

Common law judges must be careful not to reach out to decide or comment on issues beyond the case before them. Rather, we must decide each case, and only that case, based on its own facts and circumstances. We can employ a moralistic tone in an opinion, and we can use terms such as "good faith," "fidelity," "loyalty," "honesty," and "devotion"—words that have powerful moral connotations. But such words must be deployed deliberately and carefully in specific circumstances, where justified; one must be careful not to over-use such language or risk diminishing its force.

Let me leave you with a final thought: while judges can employ fiduciary duty language to shape behavior, its effectiveness really depends upon the degree to which the court, as an institution, is respected. In other words, the court's success in reforming behavior depends on the degree to which those who are the object of such reforms respect and honor the institution. This circles back to my initial point about the primary objective of judges being to protect the reputation of the institution on which they serve. You do that by being mindful of a judge's proper role.

The five judges on the Court of Chancery know the great history and reputation of the court, built over two hundred years. We all consider our positions as a sacred trust that has been granted to each of us at this moment in history, a trust that we will eventually pass on to those who will come after us. And our job is to protect it and preserve it, and to ensure that the court's reputation is enhanced, and not diminished, during our trusteeship.

That is how I envision the judges of the Delaware Court of Chancery, as Lizanne Thomas was saying, "doing the right thing." When we do the right thing, we will earn the respect and trust of the lawyers, and the businessmen and businesswomen, and the general public whose respect and consent form the foundation of the Court of Chancery. It is in this process that we help shape and restore public confidence in our institutions, whether they are financial or legal institutions.