

**GOOD FAITH AND THE WALT DISNEY COMPANY DERIVATIVE LITIGATION --
GUIDANCE FOR DIRECTORS OF DELAWARE CORPORATIONS**

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I. HOLLYWOOD MEETS DELAWARE

- A. Between October 20, 2004 and January 19, 2005, many of The Walt Disney Company's present and former directors traveled to Georgetown, Delaware for a 37-day, well-publicized trial regarding whether the Company's directors breached their fiduciary duties in connection with the spectacular hiring and even more spectacular firing of Michael Ovitz, "the most powerful man in Hollywood," a little more than one year later. With his termination, Mr. Ovitz left the Company with a package of benefits that the plaintiffs argued was worth approximately \$140 million.
- B. On August 9, 2005, Chancellor William B. Chandler, III of the Delaware Court of Chancery issued his 174-page post-trial decision in *In re The Walt Disney Company Derivative Litigation*, Consol. C.A. No. 15452 (Del. Ch. Aug. 9, 2005) ("*Disney IV*"). Although the Court ultimately found that the directors were not personally liable for monetary damages for their role (or lack thereof) in the

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hiring and firing of Michael Ovitz, the Opinion is rife with criticism of the Disney directors.

- C. This outline focus on those criticisms and the lessons that directors may take from the *Disney* case so that they may become better stewards of the corporate franchise and avoid, or at least enable themselves to better defend against, similar claims for breach of the still murky duty to act in good faith.

II. GUIDING PRINCIPLES OF DELAWARE LAW

- A. It is axiomatic that the business and affairs of a Delaware corporation are managed by or under the direction of its board of directors, 8 *Del. C.* § 141(a), with broad powers of delegation. *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 943 (Del. 1985) (“an informed decision to delegate a task is as much an exercise of business judgment as any other”). Because courts are ill equipped to engage in *post hoc* substantive review of business decisions, the business judgment rule “operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation.” *Zapata Corp. v. Maldonado*, 420 A.2d 779, 782 (Del. 1981). The business judgment rule provides that courts will presume that in making a business decision, “the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).
- B. The business judgment rule provides disinterested and independent directors with significant comfort that they will not be held liable to stockholders as a consequence of their business decision. In *Smith v. Van Gorkom*, however, the Delaware Supreme Court held a board of directors personally liable for their breach of the fiduciary duty of care in agreeing to sell the corporation to an

unrelated third party without sufficient exploration of the underlying factual framework or available alternatives. 488 A.2d 585, 868-69 (Del. 1985).

- C. The *Van Gorkom* decision sent shockwaves through the corporate community, threatened the wealth-producing risk-taking that the business judgment rule is intended to promote, and exacerbated a crisis in directors and officers insurance. The Delaware General Assembly promptly responded by enacting Section 102(b)(7) of the General Corporation Law, which permits corporations to include a provision in their charter limiting or eliminating directors' liability for monetary damages for breaches of the fiduciary duty of care, but not breaches of the duty of loyalty or for "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law."
- D. Following the enactment of Section 102(b)(7) and outside of the context of divided loyalties, changes in control, defensive measures, or transactions involving a controlling stockholder, directors again felt secure in knowing that they could engage in risk-taking that may, in hindsight, be viewed as "stupid" "egregious" or "irrational", so long as a majority of the board was both disinterested and independent. *See Aronson*, 473 A.2d at 815 and *In re Caremark Int'l Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996); *Gagliardi v. TriFoods Int'l Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996).
- E. At about the time of the Enron and WorldCom debacles, the Chancellor issued an opinion in the Ovitz/Walt Disney matter that many worried put directors of Delaware corporations in the cross-hairs for personal liability. In *In re The Walt Disney Company Derivative Litigation*, 825 A.2d 275 (Del. Ch. 2003) ("*Disney*

III) the Court of Chancery held that the allegations in plaintiffs' complaint that the directors "consciously and intentionally disregarded" their fiduciary responsibilities gave "rise to a reason to doubt whether the board's actions were taken honestly and in good faith" which excused demand and stated a viable claim for a "breach of the directors' obligation to act honestly and in good faith in the corporation's best interests" that would not be exculpated under the Company's Section 102(b)(7) based charter provision. *Id.* at 286 and 289.

- F. Since *Disney III*, corporate lawyers, scholars, commentators and directors have wondered whether *Disney* would be the next *Smith v. Van Gorkom*, holding disinterested and independent directors liable for monetary damages for their business decision and undercutting the value of a Section 102(b)(7) based exculpatory provision. More importantly for those without an immediate interest in the case were the questions that *Disney III* raised: does *Disney III* reflect enhanced vigilance in the wake of Enron and other recent corporate scandals, or was it simply a perfect storm of bad facts, artful pleading, and application of deferential procedural standards; and if it is the latter, how could directors avoid being named in similar suits or have the lawsuits dismissed that will inevitably be brought under this undefined and amorphous good faith standard?
- G. On August 9, 2005, with his post-trial Opinion, the Chancellor signaled that his earlier decision in *Disney III* did not reflect a fundamental change in the way Delaware courts would review business decisions, and that *Disney III* is best read as the reasoned result of the combination of a pleading that contained

particularized and bad facts (many of which were ultimately not proven) and an application of deferential procedural standards on a motion to dismiss.

- H. *Disney IV* does not significantly clarify the elusive concept of good faith, but rather recognizes and extols its flexibility. The Chancellor did seize the opportunity created by this well publicized case to emphasize deficiencies in the Disney directors' decision-making process with the expressed purpose of instructing directors how to act as better stewards of the assets of stockholders. *See Disney IV*, slip op. at 5, 134, 161.

III. BACKGROUND OF THE WALT DISNEY COMPANY DERIVATIVE LITIGATION

- A. The rise and fall of Michael Ovitz is a story born in Hollywood that has received Hollywood treatment from *Vanity Fair* and others. What follows is necessarily an abbreviated version of that story.
1. Michael Ovitz was one of the biggest names in Hollywood when his longtime friend, Disney CEO Michael Eisner, approached him about becoming the Company's president after the unfortunate and untimely death of the Company's former president, Frank Wells.
 2. Mr. Ovitz, who at the time was enjoying a multi-million dollar income from his highly successful talent agency, demanded both an opportunity to participate in the upside of Disney's success and "downside protection" if he were to consider joining The Walt Disney Company.
 3. Eisner, with the assistance of the chairman of Disney's compensation committee, Irwin Russell, negotiated with Ovitz on behalf of the Company and reached an agreement under which Ovitz would receive a five-year contract with two tranches of options. The first tranche consisted of three

million options vesting in equal parts in the third, fourth and fifth years of the employment agreement. The second tranche consisted of two million options that would vest immediately if Ovitz and the Company renewed his employment.

4. The employment agreement sought to protect both parties in the event that Ovitz's employment ended prematurely and provided that absent certain defined causes, neither party could terminate the agreement without penalty. If Ovitz left the Company for any reason not permitted by the employment agreement, he would forfeit any benefits remaining under the employment agreement and could be enjoined from working for a competitor. If Disney fired Ovitz for any reason other than gross negligence or malfeasance, Ovitz would be entitled to a non-fault termination ("NFT") payment which consisted of his remaining salary, \$7.5 million a year for any unaccrued bonuses, the immediate vesting of his first tranche of options and a \$10 million cash payment. *Disney IV*, slip op. at 16-17.
5. Within a year of his hiring, it became apparent that the Ovitz-Eisner combination would not enjoy the success that Wells and Eisner had shared at the Company.
6. Eisner inquired of the Company's General Counsel as to whether there was cause to terminate Ovitz, and thereby avoid the substantial NFT payout to Ovitz. Sanford Litvack, the Company's General Counsel,

advised Eisner that there was no cause to terminate Ovitz under the employment agreement. *Id.* at 68.

7. Ultimately, Eisner terminated Ovitz and the Company honored its contractual obligations by paying to Ovitz his NFT benefits under his employment agreement with the Company.
- B. A group of stockholders, no doubt urged on by the size of the NFT payment, quickly sued the directors and officers alleging that they breached their fiduciary duties with respect to the hiring and firing of Ovitz.
- C. The Court of Chancery initially dismissed all of plaintiffs' claims for failure to make a demand on the disinterested and independent directors and for failure to state a claim. The Court began by noting that the

issues presented by this litigation, while larger in scale, are not unfamiliar to this court. Just as the 85,000-ton cruise ships *Disney Magic* and *Disney Wonder* are forced by science to obey the same laws of buoyancy as Disneyland's significantly smaller *Jungle Cruise* ships, so is a corporate board's extraordinary decision to award a \$140 million severance package governed by the same corporate law principals as its everyday decision to authorize a loan. . . . Nature does not sink a ship merely because of its size, and neither do courts overrule a board's decision to approve and later honor a severance package, merely because of *its* size.

In re The Walt Disney Co. Derivative Litigation, 698 A.2d 959, 350 (Del. Ch. 1996) ("*Disney I*").

- D. On appeal the Delaware Supreme Court upheld the dismissal of the original complaint for failure to make demand on the board, finding that although the process of the board may have been "casual, if not sloppy and perfunctory," the complaint did not raise a reasonable doubt that the directors were independent or should not be protected by the business judgment rule. *Brehm v. Eisner*, 746 A.2d

244, 249 (Del. 2000) (“*Disney II*”). The Supreme Court, however, also permitted the plaintiffs to replead their demand futility claims and remanded the case to the Court of Chancery.

E. Heeding the advice of the Delaware Supreme Court, plaintiffs made a books and records demand on the Company pursuant to Section 220 of the Delaware General Corporation Law, and used the results of that demand to craft an amended complaint, which was met with another motion to dismiss. *In re The Walt Disney Co. Deriv. Litig.*, 825 A.2d 275 (Del. Ch. 2003) (“*Disney III*”).

1. In their amended complaint, plaintiffs brought breach of fiduciary duty claims against the Disney directors alleging that they had “abdicated all responsibility to consider appropriately an action of material importance to the corporation.” *Id.* at 278.

2. The amended complaint, as characterized by the Court, alleged that:

a. The Company approved an executive compensation contract negotiated by Eisner with his long-term friend of 25 years, without the board reviewing a draft of the agreement, without analyzing its costs, without information comparing it to industry standards and with barely any discussion.

b. The terms of the contract ultimately negotiated, several of which were significantly different than those described to the compensation committee, gave Ovitz stock options that were “in the money” when issued and allegedly provided a total award of over \$140 million to Ovitz in the event of a non-fault termination,

which would occur as long as Disney did not terminate Ovitz for gross negligence or malfeasance.

c. The final agreement was negotiated and signed after Ovitz began serving the corporation.

d. After barely a year of employment, Ovitz sought to exit the Company and Eisner assisted him in obtaining a non-fault termination. Eisner sent a letter to the board indicating that Ovitz would receive a non-fault termination. The board never approved granting the non-fault termination, as was allegedly required by the corporation's by-laws, never questioned it and never sought a fault-based termination.

3. The director defendants once again moved to dismiss, arguing that the action was derivative and that the plaintiffs failed adequately to allege that demand was excused because a majority of the board was disinterested and independent and monetary damages were not available for a breach of the duty of care under the Company's exculpatory charter provision.

4. This time the Chancellor denied the motion to dismiss, holding that the amended complaint gave reason to doubt that the directors exercised business judgment, stating:

the facts alleged in the new complaint suggest that the defendant directors *consciously and intentionally disregarded their responsibilities*, adopting a "we don't care about the risks" attitude concerning a material corporate decision. Knowing or deliberate indifference by a director to his or her duty to act faithfully and with appropriate care is conduct, in my opinion, that may not have been taken honestly and in good faith to advance the

best interests of the company. Put differently, all of the alleged facts, if true, imply that the defendant directors *knew* that they were making material decisions without adequate information and without adequate deliberation, and that they simply did not care if the decisions caused the corporation and its stockholders to suffer injury or loss. Viewed in this light, plaintiffs' new complaint sufficiently alleges a breach of the directors' obligation to act honestly and in good faith in the corporation's best interests for a Court to conclude, if the facts are true, that the defendant directors' conduct fell outside the protection of the business judgment rule.

Id. at 289. Demand was, therefore, excused.

5. The Court also rejected the claim of the directors that the complaint, "at most, [alleged] a breach of the directors' duty of care" and they were, therefore, protected from personal liability for monetary damages under the corporation's Section 102(b)(7) provision because the facts pled gave "reason to doubt whether the board's actions were taken honestly and in good faith, as required under the second prong of *Aronson*." *Id.* at 286.

F. *Disney III* left the corporate world wondering:

1. was this a new paradigm in corporate jurisprudence that would subject more corporate decisions to the scrutiny of trial in the wake of Enron and other corporate scandals?
2. could every breach of duty of care claim be pled as a failure to act in good faith?
3. what does the concept of "good faith" mean in practical application?
4. what does it take to plead a claim for lack of good faith or have one dismissed?

IV. THE CONCEPT OF GOOD FAITH AND THREATENED EROSION OF SECTION 102(B)(7) PROTECTIONS.

- A. The *Disney III* opinion caused concern not seen since *Van Gorkom*. A legally viable claim for breach of an amorphous concept such as “good faith” threatened the security provided by a Section 102(b)(7) charter provision and, perhaps, implicated common exclusions in directors’ and officers’ insurance policies. No longer was it sufficient simply to be disinterested and independent because an adequately pled good faith claim, subject only to the requirements of Rule 11, would allow a claim for monetary damages that would survive a motion to dismiss.
- B. To be fair, the arguable erosion of Section 102(b)(7) protection began before *Disney III*.
1. In *Malpiede v. Townson*, 780 A.2d 1075, 1094 (Del. 2001), the Delaware Supreme Court held that, as a matter of law, Section 102(b)(7) bars a complaint at the motion to dismiss stage only if it states “an unambiguous, residual” breach of the duty of care claim and nothing else.
 2. In *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001), the Delaware Supreme Court held that the exculpatory effect of a Section 102(b)(7) provision only becomes a proper focus of judicial scrutiny after the directors’ potential personal liability for the payment of monetary damages for breach of fiduciary duty is established. While not “erosion” per se, this decision has the practical procedural effect of subjecting directors, in some instances, to costly discovery prior to being exonerated from paying damages.

3. Several recent federal cases also outline how Section 102(b)(7) protections have been eroded by the expansion of the good faith concept to cover inaction by the board that previously might have been thought to fall solely under the concept of due care and to not implicate the concept of good faith.
4. In *McCall v. Scott*, 250 F.3d 997 (6th Cir. 2001), the Sixth Circuit, applying its understanding of Delaware law, held that a complaint alleging “conscious disregard of known risks” alleged action that would not be protected under the company’s Section 102(b)(7) provision and excused demand.
 - a. In addition, the Court stated, “while it is true that duty of care claims alleging only grossly negligent conduct are precluded by a § 102(b)(7) waiver provision, it appears that duty of care claims based on reckless or intentional misconduct are not.” 250 F.3d at 1000. This legal conclusion went beyond any existing holding of the Delaware Courts by equating intentional misconduct (which is an explicit exception to exculpation in Section 102(b)(7)) with recklessness (which is not).
 - b. Noting that most claims in which reckless or intentional misconduct are alleged involve breaches of the duty of loyalty or allegations of a lack of good faith, the Court construed the complaint as alleging that the directors did not act in good faith for

purposes of determining whether the claims were precluded by the Section 102(b)(7) provision:

Here, [p]laintiffs accuse the directors not merely of ‘sustained inattention’ . . . but rather of ‘intentional ignorance of’ and ‘willful blindness to’ ‘red flags’ signaling fraudulent conduct throughout [the company]. Accordingly, regardless of how plaintiffs style their duty of care claims, we find that they have alleged a conscious disregard of known risks, which conduct, if proven, cannot have been undertaken in good faith.

Id. at 1001.

5. In *In re Abbott Laboratories Derivative Shareholders Litigation*, 325 F.3d 795, the Seventh Circuit, under Illinois law, but explicitly purporting to apply Delaware standards, held that a director exculpation provision did not protect directors from monetary liability for fines arising out of a consent decree relating to sustained inattention over a six-year period to regulatory violations -- even though the board’s inattention did not involve criminal activity or fraud -- with the result that defendants’ motion to dismiss plaintiffs’ derivative suit for failure to make demand was denied. At least one commentator noted that *Abbott* was “probably a sign of increasing judicial activism regarding directors’ decisions.” 28 *Bank and Corporate Governance Law Reporter* 1104 (August 2002).
6. Although, unlike in *McCall*, there was no criminal or fraudulent activity in *Abbott*, the court’s focus remained on the conscious decisions of the directors and whether the decision to not act could have been made in good faith and in the best interests of the corporation.

C. *Disney III*, like *McCall* and *Abbott*, suggested that knowing and deliberate indifference to a material corporate decision or a potential risk of harm to the corporation may be sufficient to give rise to a finding of bad faith sufficient to overcome the protections of an exculpatory charter provision.

V. THE STRUGGLE TO DEFINE GOOD FAITH

A. In the aftermath of the *Disney III* opinion, courts struggled to distinguish the claims for failure to act in good faith that the Chancellor found viable in *Disney III* from dismissible and/or monetarily exculpated claims for breach of fiduciary duty. Two cases helped clarify the pleading requirements for a good faith claim, and one case simply recognized overlap between good faith and the duty of loyalty, finding a breach of the duty of loyalty “and/or” good faith.

B. In *Guttman v. Huang*, 823 A.2d 492 (Del. Ch. 2003), Vice Chancellor Strine suggested that Delaware Courts will be quite cautious in characterizing director conduct as a “good faith” violation, and indeed, that the pleading burden for establishing such a claim is formidable.

1. In *Guttman*, stockholders brought a derivative action alleging, *inter alia*, that the directors failed to prevent accounting irregularities that caused the company to restate its financial statements.

2. Defendants moved to dismiss for failure to demonstrate that demand was excused under Court of Chancery Rule 23.1, arguing that in order for demand to be excused, plaintiff was required to demonstrate that a majority of the directors faced a “substantial likelihood of liability” for breach of fiduciary duty by failing to oversee the company’s compliance with accounting and disclosure standards.

3. The Court characterized the claim as a “*Caremark*” claim, in reference to *In re Caremark Int’l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996), and held that the nonparticularized assertions that the directors failed to prevent accounting irregularities “did not come close” to pleading a *Caremark* claim. Importantly, the Court held that the *Caremark* opinion “articulates a standard for liability for failures of oversight that requires a showing that the directors breached their duty of loyalty by failing to attend to their duties in good faith. Put another way, the decision premises liability on a showing that the directors were conscious of the fact that they were not doing their jobs.” *Guttman*, 823 A.2d at 506.
4. In an intriguing footnote, Vice Chancellor Strine probed the relationship between the duty of loyalty and good faith:

A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation’s best interest. . . . It does no service to our law’s clarity to continue to separate the duty of loyalty from its own essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement. There might be situations when a director acts in subjective good faith and is yet not loyal (e.g., if the director is interested in a transaction subject to the entire fairness standard and cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally. The reason for the disloyalty (the faithlessness) is irrelevant, the underlying motive (be it venal, familial, collegial, or nihilistic) for conscious action not in the corporation’s best interest does not make it faithful, as opposed to faithless. . . .

Id. at 506, n.34.

- C. It may be a rare case, indeed, where the Court finds directors to be unexculpated on the basis of a failure to act in good faith without finding a breach of the duty of

loyalty, as the two concepts are closely interrelated. *See In re Emerging Communications S'holders Litig.*, 2004 WL 1305745, at *39 n.184 (Del. Ch.) (employing the “and/or” phraseology “because the Delaware Supreme Court has yet to articulate the precise differentiation between the duties of loyalty and of good faith.”). That is little comfort, however, for disinterested and independent directors hoping to be dismissed from claims alleging a failure to act in good faith prior to trial.

D. In *Official Committee of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins*, 2004 WL 1949290 (Del. Ch.), the Court of Chancery found that a majority of the Board of Directors who approved certain challenged transactions were disinterested and independent but that Plaintiffs’ claim that the Board “consciously and intentionally disregarded its responsibilities” was sufficient to survive a motion to dismiss for failure to state a claim. *Id.* at *10.

1. Vice Chancellor Noble’s commentary was enlightening as to the way the Court might view good faith claims on a motion to dismiss. The Court noted that “one may alternatively conceptualize the holding in [*Disney III*] as a duty of care claim that is so egregious . . . that it falls within [the good faith] exception to the general exculpating power of § 102(b)(7)” and stated that the pleading requirement was a “high bar” but that the facts plead were sufficient to meet that bar on a motion to dismiss. *Id.* at *9 n.37 and *12.

2. With what appears to be a degree of skepticism, however, he noted that the “future course of this proceeding, obviously, will depend upon whether the facts which Plaintiff can prove match its allegations.” *Id.* at *12 n.58.

VI. *DISNEY IV* -- “DO’S AND DON’TS” GUIDANCE FROM DELAWARE

- A. Ultimately, the *Disney* plaintiffs were unable to prove the facts to match their allegations. However, the 37-day trial in Georgetown, Delaware provided the Chancellor with a platform to provide guidance on the deficiencies in the Disney board’s decision-making process that, while not giving rise to ultimate monetary liability, subjected them to a lengthy trial on whether their decision was a “good faith” business judgment. *In re The Walt Disney Company Derivative Litigation*, Del. Ch., Consol. C.A. No. 15452, Chandler, C., slip. op. (Aug. 9, 2005) (“*Disney IV*”).
- B. The Chancellor began his analysis by noting:

[s]tripped of the presumptions in their favor that have carried them to trial, plaintiffs must now rely on the evidence presented at trial to demonstrate by a preponderance of the evidence that the defendants violated their fiduciary duties and/or committed waste. More specifically, in the area of director action, plaintiffs must prove by a preponderance of the evidence that the presumption of the business judgment rule does not apply either because the directors breached their fiduciary duties, acted in bad faith or that the directors made an ‘unintelligent or unadvised judgment,’ by failing to inform themselves of all material information reasonably available to them before making a business decision.

Id. at 126-27. By beginning his analysis with this prominent comment, the Chancellor appears to suggest that particularized factual allegations combined with deferential procedural standards played a significant role in his decision in *Disney III*.

- C. The Chancellor also made clear that *Disney III* did not reflect a new paradigm of corporate jurisprudence in the wake of recent corporate scandals. Indeed, the Chancellor began his opinion by noting the enhanced legislative focus on corporate governance, in the wake of Enron, WorldCom and other debacles but that,

Unlike ideals of corporate governance, a fiduciary's duties do not change over time. . . . Times may change, but fiduciary duties do not. Indeed, other institutions may develop, pronounce and urge adherence to ideals of corporate best practices. But the development of aspirational ideals, however worthy as goals for human behavior, should not work to distort the legal requirements by which human behavior is actually measured. Nor should the common law of fiduciary duties become a prisoner of narrow definitions or formulaic expressions. It is thus both the province and special duty of this Court to measure, in light of all the facts and circumstances of a particular case, whether an individual who has accepted a position of responsibility over the assets of another has been unremittingly faithful to his or her charge.

Id. at 2-3.

- D. Although *Disney IV* states: “To act in good faith, a director must act at all times with an honesty of purpose and in the best interests and welfare of the corporation,” *Id.* at 124, the Opinion does not significantly clarify what the concept of good faith is. Rather, the Chancellor recognizes the lack of clarity with respect to whether the obligation to act in good faith is a third fiduciary duty and the lack of clear parameters in applying the concept of good faith, commends its flexibility by suggesting that good faith may fill a gap to protect stockholders when the traditional duties of care and loyalty are not implicated, and reaffirms the holding in *Disney III* that “the concept of *intentional dereliction of duty*, a *conscious disregard for one’s responsibilities*, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith.” *Id.*

at 119-23; 135 n.487. He does, however, catalog what he characterizes as the three “most salient” examples of a failure to act in good faith: (1) “where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation”; (2) “where the fiduciary acts with the intent to violate applicable positive law”; and (3) where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.” *Id.* at 124-25.

E. Although none of the directors was found to have breached his or her fiduciary duties, the Chancellor repeatedly noted in his 174-page Opinion that the directors failed to satisfy corporate best practices. The Chancellor seized the opportunity to explain not only why the plaintiffs’ proof failed, but also what the Disney directors could have done better, in part “because of the possibility that the Opinion may serve as guidance for future officers and directors, not only of the Walt Disney Company, but of other Delaware corporations.” *Id.* at 5.

F. Presumably, by recognizing the errors of the Disney officers and directors and following the Chancellor’s guidance directors may avoid arming derivative suit plaintiffs with facts that allow them to adequately plead a claim for failure to act in good faith. As stated by the Chancellor, below are things that various Disney directors could have done better.

1. Eisner

a. Eisner’s “Machiavellian (and imperial) nature as CEO” made him responsible for many of the “failings in process that infected and

handicapped the board's decision-making abilities." *Id.* at 135, 150.

- b. Eisner stacked "his" board of directors with friends and acquaintances "who though not necessarily beholden to him in a legal sense, were certainly more than willing to accede to his wishes and support him unconditionally than truly independent directors." *Id.* at 135-36.
 - i. Director Russell was Eisner's personal attorney.
 - ii. Director Mitchell was hand selected by Eisner to serve on the board and eventually became chairman with remuneration of about \$500,00 annually.
 - iii. Director Bowers is an administrator of a private school attended by three of Eisner's children and to which Eisner and entities related to the Company have made substantial contributions.
 - iv. Director O'Donovan was president of Georgetown University where Eisner served on the board of directors for six years, where Eisner's son attended college until 1992, and to which Eisner made a \$1 million donation in 1996 at O'Donovan's request.
- c. Eisner never called a board meeting, and obtained no consent or authorization from the board before agreeing to hire Ovitz, before agreeing to the substantive terms of Ovitz's employment

agreement, or before issuing a press release about the hiring -- stretching the outer boundaries of his authority as CEO in a transaction of significance to the Company. *Id.* at 136-38, 140.

d. Eisner made no effort to inform the full board of his discussions with Ovitz until they were essentially completed and an agreement in principle had been reached. *Id.* at 137.

2. Russell

a. Failed to independently and objectively verify representations made by Ovitz's negotiators regarding his income with his prior company. *Id.* at 144.

b. Failed to investigate Ovitz's background. *Id.*

c. In addition, Russell was Eisner's personal attorney *and* represented the Company in the negotiations with Ovitz. *Id.*

3. Poitier and Lozano (as members of the Company's compensation committee)

a. Became involved in the process of Ovitz's hiring very late in the game. *Id.* at 148.

b. Failed to review and discuss the then existing draft of the full text of the Ovitz employment agreement. *Id.* at 154.

c. Did not have an expert (Bud Crystal) make a formal presentation at the compensation committee meeting in order for the committee and the board to rely on that expert's analysis. *Id.*

d. Failed to review the compensation consultant's report.

4. Litvack (as legal counsel)
 - a. Failed to speak up when Russell incorrectly informed the responsible committee that Ovitz's 1995 bonus (which the committee later reconsidered) was contractually required. *Id.* at 169-71.
 - b. Like Eisner, created no written record to support his "no cause" to terminate Ovitz decision.
5. In addition, the Disney board had a few collective failures:
 - a. It failed to ensure that its minutes were correct, reflected who attended meetings, or the consideration given to a significant transaction, including the absence of a record of topics considered during executive sessions.
 - b. The Court also bemoaned the fuzzy record created by the minutes with respect to the amount of time the Compensation Committee devoted to its consideration of the Ovitz employment agreement.
 - c. The Court was troubled by a press release the Company issued indicating that Ovitz would continue to serve as an advisor and consultant, noting that the release was either untrue or the result of sloppy work.

VII. CONCLUSION -- A GUIDE TO GOOD FAITH CORPORATE GOVERNANCE

- A. The Delaware Supreme Court has yet to have its say on the definition of "good faith" or the rulings in *Disney IV*, which case is currently on appeal. Thus, there are still unanswered questions regarding the viability of a "good faith" claim in Delaware.

1. We know from *Elkins* that the pleading burden is formidable, from *Guttman* that the Court will not hesitate to dismiss a claim that is properly characterized under the rubric of the duty of care, and from *Disney IV* that a “bad faith” claim is not easily proven at trial.
 2. We also know from *Emerging Communications* and *Disney IV* that good faith claims will often overlap with claims for breach of the duty of loyalty.
- B. Although *Disney IV* did not significantly clarify the standards or practical application of the concept of good faith, the Chancellor has provided practical guidance for directors so that they may avoid being named in these actions in the first instance and have the evidence that they can use to defend themselves if they are named in such actions.
1. Directors should make sure that that board and committee minutes are taken by a skilled professional and that they mention all major topics.
 2. Where appropriate, minutes should reflect the amount of time spent on each issue. This can be particularly important where the board or a committee considers numerous topics, some of which are routine and some of which require greater discussion.
 3. Committee and board meetings should be scheduled so that the directors have sufficient time to complete their business. Avoid simply scheduling committee meetings for 30 or 60 minutes before a scheduled board meeting or risk an inference that the committee was rushed to complete its deliberations. If committee meetings run over into the time of a

subsequent board meeting, let them. But make sure the board minutes reflect the time the meeting actually started, not the time it was scheduled to start.

4. EACH director should review the minutes before approving them and make sure that they are correct. Demonstrably sloppy minutes, even on non-core issues, increase the risk that a court will not be comfortable years later in relying upon them as a presumptively accurate record of what occurred.
5. The presiding director should prepare and retain an attendance list and list of topics discussed during executive sessions.
6. Directors should ensure that the company has an adequate corporate information and reporting system, and make sure that even high level officers honor that system. Specifically, the directors should have an explicit understanding with the Company's general counsel that he or she will notify directors when a board meeting is advisable with respect to a particular matter, and insist that they be notified if a meeting is required.
7. If directors independently become aware of a "red flag" concerning a material matter which is not resolved to complete satisfaction upon consultation with management, they should insist on vetting the matter with the board or the appropriate board committee.
8. Directors and committee members should engage in active discussions and deliberations regarding transactions under their charge and review pertinent documents when it is possible.

9. Directors and committee members should have experts provide formal presentations to committees or the board when advising on a significant transaction to enrich their information base and maximize the likelihood that the committee or board members' reliance on that advice in making their decision will be respected by a reviewing court. In short, avoid second-hand reliance on expert advice and reports.
 10. Directors should be familiar with the charter or scope of authority of the board's various committees. Such familiarity will enhance the ability of directors to delegate, in good faith, matters to other directors.
 11. Directors and committee members should insist upon sufficient time to permit them to do their work.
 12. Directors should control senior management so that the board is not hamstrung in its ability to effectively consider a business decision, for example, by a premature management press release.
- C. As far as we can tell, the laws of buoyancy still apply in Delaware. But a good sailor does not rely on the laws of buoyancy alone. He maintains his boat, checks his gauges, instructs his crew and pays attention to the weather. Like a good sailor, by heeding the Chancellor's advice in *Disney IV*, which is really nothing new, directors may save themselves from the "trial" experienced by the Disney directors.