THE MAGIC OF *DISNEY*: TURNING BEST PRACTICES INTO STANDARDS OF PERFORMANCE

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I. INTRODUCTION

Corporate law has undergone somewhat of a transformation in recent years, largely as a result of such scandals as Enron and WorldCom.[1] If it is assumed that a failure in governance is partially, if not wholly, responsible for these corporate debacles, director conduct should be a focus of reform in the future. Therefore, the common law business judgment rule should play a role in this reform. The business judgment rule seeks to protect board members' decisional authority, yet in doing so it may give them too much discretion.[2] This Comment asserts that the business judgment rule, as applied against the standards of director conduct implicitly proposed by the Delaware Court of Chancery in *In re Disney Derivative Litigation*,[3] may be an appropriate mechanism for courts to meaningfully review board decisions, thereby ensuring the good faith efforts of directors in their corporate undertakings.

The *Disney* decision provides useful guidelines that, while (according to the court) inapplicable in the case itself, may steer courts, and directors themselves, in the right direction in the future. As previous Delaware case law indicates,[4] best practices, as articulated by

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1 Mark J. Loewenstein, *The Quiet Transformation of Corporate Law*, 57 SMU L. REV. 353, 353 (2004).

2 *See* Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 409–10 (2005).

3 *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 907 A.2d 693 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

4 *See, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

courts, can evolve into standards of conduct; the *Disney* decision has the potential to create such standards for directors.[5]

Despite corporate failures, courts continue to give directors the protection of the business judgment rule,[6] perhaps because of the adoption by many of the "gatekeeper" theory of corporate failure.[7] This theory blames the failures on the inadequacies of the corporate gatekeepers—the corporations' independent auditors and analysts—and ignores, to some extent, the role played by directors in the downfall of their corporations.[8] An alternative theory treats the collapses as a true failure of corporate governance, thus implicating the business judgment rule and its role in protecting directors from liability.[9] Those that subscribe to this latter theory argue that if directors are allowed to act without limitation on their powers, scandals are likely to continue to occur.[10]

No matter the cause, the wave of corporate scandals roused a hope that there would be a shift toward imposing more stringent standards on corporate directors at the state level—standards deemed necessary to prevent similar problems in the future.[11] This Comment will explore the events leading up to this anticipated shift and will discuss the transformation of Delaware corporate law since the failures of Enron, WorldCom, and others, in considering whether such a shift has occurred and whether such a shift is likely to ever occur.

[5] *See* H. Lowell Brown, *The Corporate Director's Compliance Oversight Responsibility in the Post* Caremark *Era*, 26 DEL. J. CORP. L. 1, 6 (2001) (noting that the *Caremark* decision "has fueled the discussion of the board's role in ensuring compliance").

[6] Fairfax, *supra* note 2, at 410. For a discussion of the business judgment rule, see *infra* Part III.B.

[7] John C. Coffee, Jr., *Understanding Enron*: "*It's About the Gatekeepers, Stupid,*" 57 BUS. LAW. 1403 (2002), *reprinted in* ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 125, 127 (Nancy B. Rapoport & Bala G. Dharan eds., 2004).

[8] *Id.* at 127, 130–31 (defining "gatekeepers" as those "reputational intermediaries who provide verification and certification services to investors").

[9] *Id.* at 125.

[10] *See* Fairfax, *supra* note 2, at 394–95.

[11] Rolin P. Bissel, *Delaware's Disney Decision: A Star is Born?*, LEGAL BACKGROUNDER, Vol. 20, No. 49, Oct. 7, 2005, *available at* http://www.wlf.org/upload/100705LBBissell.pdf (noting that the director-friendly business judgment rule is "thought by some to be over the hill in the post-Enron and Sarbanes-Oxley era"). The Sarbanes-Oxley Act itself seems to assume that both theories—the gatekeeper theory and the governance theory—played a role in the failures. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended at 15 U.S.C. §§ 7201–7266 (Supp. IV 2004) and in scattered sections of 11 U.S.C., 28 U.S.C., and 29 U.S.C. (Supp. III 2003 and Supp. IV 2004)) (imposing regulations on both corporate gatekeepers and corporate agents).

Part II of this Comment provides a summary of the events leading up to the failure of Enron and other corporate debacles and sets forth the federal response to the failures thus far.[12] Part II also looks at Delaware's relationship with the federal government with respect to how the fear of federal intrusion shapes state law and judicial opinions.[13] Part II further examines Delaware's reactions to Enron, noting that Delaware indicated early on an unwillingness to change its judicial approach to shareholder suits despite the scandals and changes in federal corporate law.[14] Part III provides a general overview of director fiduciary duties and their relationship to the business judgment rule.[15] Part III also includes a brief look at the history of and policies behind the business judgment rule.[16]

Part IV examines recent case law in Delaware implicating the business judgment rule. Part IV first looks at the Delaware Court of Chancery's 1996 decision in *In re Caremark International*, which resulted in a modification of the standards of director oversight.[17] Part IV next examines the Court of Chancery's 2003 decision regarding the Disney litigation (*Disney I*), and then moves on to the 2005 decision (*Disney II*), both of which focus on director due care and good faith.[18] Based on the analysis in Part IV, this Comment concludes that Delaware courts have, in the past, turned best practices into standards of conduct and argues that, despite commentary to the contrary, the *Disney I* decision is likely to serve as a signal to directors that conduct falling below the level of best practices will not be readily tolerated in the future.[19]

II. ENRON AND ITS CONSEQUENCES

A. *The Downfall*

Enron's downfall resulted from a host of failures: the failure of the board to supervise properly the management of the company; the failure of corporate gatekeepers effectively to monitor corporate activity; and the failure of institutional investors, stock analysts, and

[12] *See infra* Parts II.A, II.B.
[13] *See infra* Part II.C.
[14] *See infra* Part II.C.1.
[15] *See infra* Part III.A.
[16] *See infra* Part III.B.
[17] *See infra* Part IV.A.
[18] *See infra* Parts IV.B, IV.C.
[19] *See infra* Part V.

government regulators to realize exactly what was going on.[20] Enron officials flagrantly abused accounting procedures—manipulating them to make the company appear substantially more profitable (and therefore a better investment) than it actually was.[21]

The prelude to Enron's collapse, and the company's ultimate failure, shocked the corporate world and the investing public.[22] It was initially thought that the shock would wear off before long.[23] The initial alarm, however, was magnified when similar problems were discovered at WorldCom and other firms.[24] Investigations relating to the collapse of Enron and WorldCom indicated that directors failed in fulfilling their duty to supervise and direct the management of the corporations.[25] With directors seemingly incapable of handling their own affairs, the public demanded a governmental response.[26]

B. Federal Government's Response to Enron

1. The Sarbanes-Oxley Act

The federal government's primary response to the corporate scandals was the Sarbanes-Oxley Act of 2002 ("Act" or "Sarbanes-Oxley").[27] In passing the Act, Congress attempted to remedy the perceived problems with corporate law that may have led to the financial crises of companies such as Enron and WorldCom.[28] "The centerpiece of Sarbanes-Oxley is internal controls: the checks and balances that make sure public companies record assets, liabilities, and other items accurately on financial statements. Under Sarbanes-Oxley, companies must make sure their controls are sound, then have an

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[20] D. GORDON SMITH & CYNTHIA A. WILLIAMS, BUSINESS ORGANIZATIONS: CASES, PROBLEMS, AND CASE STUDIES 312 (2004).

[21] Jeffrey D. Van Niel, *Enron—The Primer*, *in* ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 3, 13 (Nancy B. Rapoport & Bala G. Dharan eds., 2004).

[22] *See* William T. Allen, *Corporate Governance and a Business Lawyer's Duty of Independence*, 38 SUFFOLK U. L. REV. 1, 1 (2004).

[23] SMITH & WILLIAMS, *supra* note 20, at 312–13.

[24] *Id.* at 313.

[25] E. Norman Veasey, *Corporate Governance and Ethics in the Post-Enron/WorldCom Environment*, 38 WAKE FOREST L. REV. 839, 839–40 (2003).

[26] SMITH & WILLIAMS, *supra* note 20, at 313.

[27] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended at 15 U.S.C. §§ 7201–7266 (Supp. IV 2004) and in scattered sections of 11 U.S.C., 28 U.S.C., and 29 U.S.C. (Supp. III 2003 and Supp. IV 2004)). The Act consists of four laws: the Public Company Accounting Reform and Investor Protection Act of 2002, the Corporate and Criminal Fraud Accountability Act of 2002, the White-Collar Crime Penalty Enhancement Act of 2002, and the Corporate Fraud Accountability Act of 2002. *Id.*

[28] Loewenstein, *supra* note 1, at 358.

auditor sign off on them."[29] With respect to perceived regulatory problems in the accounting industry, for example, the Act created an accounting oversight board.[30] Sarbanes-Oxley also instituted new auditing rules in response to the perceived problems with corporate gatekeepers.[31]

Another common link among corporations involved in corporate scandals, which Sarbanes-Oxley seeks to correct, is failure of the directors to fulfill their fiduciary obligations to the corporations, especially with respect to remaining adequately informed and monitoring the dealings of other corporate actors.[32] In addition to implementing procedures to ensure director independence, a significant part of the legislation, known as rule 404, seeks to remedy this problem by imposing direct restrictions on corporations' internal operations.[33] The rule, which applies to public companies, requires corporations to conduct internal reviews of their own control systems and then to hire an outside auditor to authenticate the findings of the review.[34]

Similarly, section 302 of the Act "requires a company's CEO and CFO to certify in each annual or quarterly report both that they are responsible for establishing and maintaining internal controls designed to ensure that material information is made known to them and that they have evaluated the effectiveness of those controls."[35] Taken together, the rules imposed by Sarbanes-Oxley increase directors' responsibility to keep themselves adequately informed about corporate affairs.

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[29] Diya Gullapalli, *Living with Sarbanes-Oxley: How Companies Are Coping in the New Era of Corporate Governance*, WALL ST. J., Oct. 17, 2005, at R1.

[30] Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7211 (Supp. IV 2004):

> The board is meant "to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors."

Id.

[31] Sarbanes-Oxley Act of 2002, Pub. L. 107-204, § 201(a), 116 Stat. at 771–72.

[32] Fairfax, *supra* note 2, at 398–99.

[33] Deborah Solomon, *At What Price? Critics Say the Cost of Complying with Sarbanes-Oxley is a lot Higher Than it Should Be*, WALL ST. J., Oct. 17, 2005, at R3.

[34] *Id.*

[35] Fairfax, *supra* note 2, at 402.

C. *Interplay Between State Law and Federal Law*

Traditionally, the internal operations of corporations have been, for the most part, governed by the law of their states of incorporation.[36] Most significantly, this area of state governance includes the relationship between a corporation and its shareholders.[37] The federal government plays a role in certain areas, especially with respect to the relationship between the corporation and the capital markets, but generally restrains itself from intruding on state matters.[38] The exception to this rule, as observed by the adoption of Sarbanes-Oxley, is when the government observes conduct on the part of corporations that has the potential to harm the public.[39] When the risk to the public outweighs concerns of federalism, the federal government intervenes and regulates the states.[40]

Despite certain attempts on the part of Congress and the SEC, state law essentially reigned supreme in the arena of corporate law until the early twenty-first century.[41] For example, when the issue of seemingly excessive executive compensation first came up, both the SEC and Congress responded by requiring disclosure in an issuer's annual proxy statement regarding executive compensation, but these actions had little impact on matters of actual corporate governance.[42] These measures, adopted in the early 1990s, did not alter the executive compensation practices of most corporations.[43] In effect, the federal government took control of the "external aspects of corporate behavior" and the states continued to regulate the internal affairs of the corporations.[44]

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[36] *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478–79 (1977).

[37] Loewenstein, *supra* note 1, at 354.

[38] *Id.*

[39] *See Id.* at 355. Courts have been reluctant to allow too much federal intrusion in areas traditionally confined to state authority. *Id.* at 355–56.

[40] Lucian A. Bebchuk & Assaf Hamdani, *Litigation Reform since the PLSRA: A Ten-Year Perspective: Panel Three: Sarbanes-Oxley Governance Issues: Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793, 1829 (2006) (noting that "thus far . . . federal intervention [into corporate law] typically has been limited to periods of financial crisis").

[41] Loewenstein, *supra* note 1, at 355–57.

[42] *Id.* at 356:

> "The Commission promulgated a set of rules that dramatically increased the amount of disclosure regarding executive compensation in an issuer's annual proxy statement . . . . Congress . . . amend[ed] the tax code to limit the deductibility of executive compensation in excess of $1 million . . . ."

Id.

[43] *Id.* at 357.

[44] *Id.*

1. Delaware and the Federal Government

State corporate statutes, especially those in Delaware, are largely pro-director, vesting corporate board members with a significant amount of power.[45] Delaware generally tries to avoid federal interference, and thus maintain its pro-director stance, by checking its own laws in response to how it thinks federal law will handle certain issues.[46] Thus, even if matters remain in the domain of state law, the risk of federal action has the power to influence, and at times dictate, Delaware law.[47] This trend is promoted by the fact that the federal government has authority to reverse state corporate law with which it does not agree.[48]

The Sarbanes-Oxley Act marked the first real attempt on the part of the federal government to regulate matters traditionally governed by the states, and Delaware was expected to react in a way that would impede further federal encroachment.[49] Unsurprisingly, shortly following Enron, Vice Chancellor Strine of the Delaware Court of Chancery responded by noting that "[r]isk-free capitalism is an oxymoron, and we endanger much by tampering with a system of corporate governance that, while imperfect, continues to serve our nation well."[50] Likewise, Chief Justice E. Norman Veasey of the Delaware Supreme Court stated his opinion that "[c]ourts should be reluctant to interfere with or second-guess the good faith business decisions of directors," thereby reinforcing the importance of the business judgment doctrine even in the post-Enron context.[51]

These comments reflect a certain disinclination on the part of the Delaware judiciary to change the way it addresses shareholder derivative actions, and thus the way it examines director conduct. Courts in general are instructed to "err on the side of the directors" and to "recognize that directors can only be expected to fulfill" limited and defined duties.[52] Moreover, Vice Chancellor Strine made a point of noting that Enron was not a Delaware corporation, again in-

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[45] *See* Fairfax, *supra* note 2, at 396.

[46] Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 591–92 (2003) ("[W]hen . . . matters formally remain matters of Delaware law, if the risk of federal action heavily influences Delaware, it follows that even when federal authorities do not take the issue away, federal power may make Delaware law.").

[47] *Id.*

[48] *Id.* at 592.

[49] *See* Veasey, *supra* note 25, at 842, 844.

[50] Leo E. Strine, Jr., *Derivative Impact? Some Early Reflections on the Corporation Law Implications of the Enron Debacle*, 57 BUS. LAW. 1371, 1374 (Aug. 2002).

[51] Veasey, *supra* note 25, at 849.

[52] Strine, *supra* note 50, at 1393 (emphasis omitted).

dicating an unwillingness to change the way Delaware, in particular, conducts itself.[53] While recognizing that shareholder suits were likely to continue or, more likely, increase, following Enron, Vice Chancellor Strine indicated no desire to change the way such claims should be evaluated.[54]

To be sure, some viewed the decision in *Disney I*[55] as a "prime example" of Delaware's reaction to the Sarbanes-Oxley Act, noting that the Act and surrounding talk about corporate governance have "pushed Delaware to view director actions more critically."[56] But if the *Disney I* was a reaction to the potential of federal intrusion, the *Disney II* decision was equally a response to critics, who viewed *Disney I* as being an unreasonable application of the business judgment rule.[57] Yet as will be seen, *Disney II*, while not imposing liability on the directors, may have the effect of creating higher standards for director conduct in the future.

III. FIDUCIARY DUTIES AND THE BUSINESS JUDGMENT RULE

A. *Fiduciary Duties*

Delaware's reluctance to react to the imminent intrusion of the federal government following Enron rests in part on the insistence that directors should be left in charge of their corporations.[58] Directors are fiduciaries of the corporations they manage.[59] Generally, directors have two principal duties—the duty of care and the duty of loyalty.[60] The duty of care covers a director's individual actions with respect to the corporation, as well as the director's obligation to supervise and keep himself or herself informed regarding corporate ac-

[53] *Id.* at 1373 n.5.

[54] *See id.* at 1374.

[55] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 907 A.2d 693 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006). *See infra* Part IV.

[56] *See, e.g.*, David Marcus, *Disney's Dudley Do-wrong in Delaware*, CORP. CONTROL ALERT, July 23, 2003, *available at* LEXIS, News Library.

[57] *See* David Marcus, *The New Disney Ruling: A Response to Changing Times*, DEL. L. WKLY., Aug. 31, 2005, *available at* LEXIS, News Library.

[58] Veasey, *supra* note 25, at 842.

[59] *See, e.g.*, Harvey Gelb, *Director Due Care Liability: An Assessment of the New Statutes*, 61 TEMP. L. REV. 13, 13–14 (1988) ("In the traditional corporate model the board of directors, which is elected by the shareholders, is given the ultimate power to manage the corporation. With this grant of power there comes responsibility, and directors are viewed as fiduciaries with certain duties to their corporations.").

[60] WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE, LEGAL AND ECONOMIC PRINCIPLES 150, 164 (8th ed. 2002).

tivity.[61] Under the duty of care, corporate officers and directors are charged with exercising the care, skill, and prudence of "like persons in a like position" in making corporate decisions.[62] This language would suggest that directors and officers may be held liable for negligence, yet the imposition of liability for a breach of the duty of care is very rare.[63] As such, the duty is imposed largely as an aspirational guideline, but on some occasions, it is also used as a liability-creating rule.[64]

Under Delaware law, the standard for proving a violation of the duty of care, in most cases, is gross negligence with a presumption of good faith in favor of the directors.[65] Further, even where directors are held to have breached the duty, they can escape liability by proving the "entire fairness" of the transaction.[66] The "entire fairness" standard requires directors to prove the transaction had (1) a fair price (at which point the substantive merits of the decision are considered), and (2) fair dealing.[67]

The second fiduciary duty, the duty of loyalty, is imposed largely to prevent officers and directors from using "their position of trust and confidence to further their private interests."[68] The most common breaches of the duty of loyalty include engaging in self-dealing transactions, failure to disclose a corporate opportunity to the corporation, unfair competition, and resisting a corporate takeover that may be in the best interest of the shareholders.[69] The duty essentially requires that a director act in the best interest of the corporation, putting aside his or her own interests in favor of those of the shareholders.[70]

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[61] Fairfax, *supra* note 2, at 397.

[62] KLEIN & COFFEE, *supra* note 60, at 150.

[63] *Id.*

[64] *Id.* at 151. The situations in which liability is most likely to be imposed are those involving an undisclosed conflict of interest on the part of the director, or where the director was knowingly inattentive. *See id.*

[65] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[66] Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1162 (Del. 1995).

[67] *Id.* at 1162–63.

[68] Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

[69] KLEIN & COFFEE, *supra* note 60, at 165–70.

[70] Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 253–54 (Del. 2000).

B. The Business Judgment Rule

1. General Principles

The business judgment rule is one of the most important doctrines in all of corporate law.[71] The rule acts as a shield to director liability by protecting directors and officers from liability for bad or harmful business decisions as long as the contested decision was "informed."[72] Simply put, the business judgment rule is a qualifying rule on corporate directors' fiduciary duties, directing courts not to examine the substantive merits of business decisions.[73]

The business judgment rule protects corporate directors' decisions from substantive review if four conditions are met.[74] First, the board must exercise its business judgment by making a decision.[75] Second, the board must utilize a reasonable decision making process, i.e., board members must take reasonable steps to become adequately informed as to all material information available about the decision.[76] Third, the board must have acted in good faith in making the decision.[77] Finally, the decision must have been made by a disinterested board.[78]

The Delaware Supreme Court has described the rule as follows:

> It is a presumption 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. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party

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[71] *See, e.g.*, Stephen Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 83 (2004) ("The business judgment rule pervades every aspect of state corporate law, from the review of allegedly negligent decisions by directors, to self-dealing transactions, . . . and so on.").

[72] Smith v. Van Gorkom, 488 A.2d 858, 864 (Del. 1985).

[73] *See* Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000). In *Brehm*, the court expressed its view that the concept of "substantive due care" is "foreign to the business judgment rule." *Id.* Although the business judgment rule affects both of the fiduciary duties, it is most directly tied to the duty of care. *See* Douglas M. Branson, *Intracorporate Process and the Avoidance of Director Liability*, 24 WAKE FOREST L. REV. 97, 97–98 (1989).

[74] Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 441 (1993).

[75] *Id.* A decision not to act also meets this requirement. *Id.*

[76] *Id.*

[77] *Id.*

[78] *Id.*

challenging the decision to establish facts rebutting the presumption.[79]

A plaintiff seeking to overcome the business judgment rule must take several steps. First, the plaintiff must rebut the presumption that the decision was informed.[80] The presumption can be rebutted by a showing of fraud, bad faith, or self-dealing on the part of the directors, or by demonstrating that the directors have made "an unintelligent or unadvised judgment."[81] Although Delaware courts currently describe the rule as non-substantive,[82] director liability under the business judgment rule "is predicated upon concepts of gross negligence."[83] If a plaintiff fails to prove gross negligence with respect to whether the decision was "informed," he or she is not entitled to any remedy.[84] If, however, the plaintiff is successful in rebutting the presumption, the burden then shifts to the directors to prove the "transaction was entirely fair."[85]

In the landmark case of *Smith v. Van Gorkom*, the Delaware Supreme Court held the directors of Trans Union Corporation (a public corporation), liable for approving the sale of the company in a merger transaction essentially because they ignored possible better offers.[86] The court focused on evidence that the board did not spend adequate time in deciding to approve the merger and that there was no documentation to speak of concerning the transaction.[87] Furthermore, there was evidence that the corporation's senior management opposed going through with the sale.[88] In light of these procedural defects, the court concluded that the decision could not have been an exercise of proper business judgment.[89] The *Van Gorkom* court thereby applied the business judgment rule to review the

[79] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (internal citations omitted).

[80] Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).

[81] *Id.* (quoting Mitchell v. Highland-W. Glass, 167 A. 831, 833 (Del. Ch. 1933)).

[82] *See In re* Walt Disney Co. Derivative Litig. (*Disney II*), 907 A.2d 693, 746–47 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1165 (Del. 1995).

[83] *Van Gorkom*, 488 A.2d at 873 (quoting *Aronson*, 473 A.2d at 812).

[84] Emerald Partners v. Berlin, 787 A.2d 85, 91 (Del. 2001) (internal citations omitted).

[85] *Id.* (internal citations omitted). For a discussion of the entire fairness standard, see *supra* Part III.A.

[86] *Van Gorkom*, 488 A.2d at 893.

[87] *Id.* at 869, 874. The court relied specifically on evidence that the board agreed to the transaction after meeting for only two hours, without so much as reviewing a term sheet of the contemplated transaction. *Id.*

[88] *Id.* at 867.

[89] *Id.* at 874.

method by which the board made the contested decision.[90] Under this rule, if the process used to make a decision is not reached in an "informed and deliberate manner," the directors are not entitled to the protection of the business judgment rule.[91]

2. Policy Behind the Business Judgment Rule

The business judgment rule can be understood as a device to relieve the pressure on courts to analyze business decisions.[92] From a judicial perspective, the rule recognizes that courts have little ability to adequately evaluate corporate issues.[93] From a business perspective, the rule recognizes that some risk is required, and even desirable, in the business context. Thus, liability cannot be imposed for every deviation from paradigmatic conduct on the part of board members.[94]

The business judgment rule embodies the tension between authority and accountability that underlies all of corporate law.[95] On the one hand, directors need to have enough authority to effectively manage their corporations.[96] On the other hand, there must be rules in place to hold board members accountable for misuse of their power.[97] This tension has driven much of the controversy over the business judgment rule to date.[98]

IV. REACTION IN THE COURTS

After Enron, it was expected that there would be a shift toward imposing more stringent standards on corporate directors to better protect shareholder interests.[99] While some action has been taken on the federal level, the questions now are what, if anything, has Delaware learned from the corporate failures, and how will it choose to respond to the changes in federal standards governing corporate law. The following cases suggest that while the expected shift has not yet

[90] *Id.* at 874–88.
[91] *Id.* at 873.
[92] Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993).
[93] *See In re* Walt Disney Co. Derivative Litig. (*Disney II*), 907 A.2d 693, 746 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).
[94] Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052–53 (Del. Ch. 1996).
[95] *See* Bainbridge, *supra* note 71, at 84.
[96] *Id.* at 84–85.
[97] *Id.*
[98] *See* Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 11–12 (2005).
[99] *See generally* Bissel, *supra* note 11.

fully occurred, change is in the air—change that will serve to protect shareholders from rampant managerial opportunism.

A. In re Caremark

Apart from their decision-making function, corporate directors are charged with the responsibility of monitoring the corporation's management.[100] This duty includes oversight of the corporation's policies with respect to compliance with laws and regulations.[101] While compliance with the law is generally advisable, it has never been clearly established that boards are *required* to ensure such compliance.[102] *In re Caremark* is illustrative of this point.[103]

Caremark International, Inc. was engaged in providing health care services.[104] It was prosecuted for violating the federal Anti-Referral Payments Law for making certain "consulting" and "research" payments to health care providers who recommended patients to Caremark.[105] Caremark ultimately settled with both the government and various private entities for more than $250 million.[106] Based on the events of the criminal proceedings, several derivative actions were filed against Caremark.[107] Caremark also settled these claims, promising to discontinue the disputed practices and to create a new compliance committee.[108]

In *In re Caremark*, the Delaware Court of Chancery was called upon to evaluate the resulting settlement agreement.[109] The underlying suit alleged breach of fiduciary duty on the part of the directors for failure to detect and correct violations of state and federal law by certain Caremark employees.[110] While approving the settlement as fair and reasonable, the court established that directors may be held personally liable for losses resulting from a corporation's failure to act in accordance with applicable legal standards.[111] Further, the de-

100 *See* Brown, *supra* note 5, at 14–15.
101 *Id.*
102 *Id.* at 6.
103 *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).
104 *Id.* at 961.
105 *Id.* at 964.
106 *Id.* at 961.
107 *Id.* at 964.
108 *Id.* at 966.
109 698 A.2d at 960–61.
110 *Id.* at 960.
111 *Id.* at 970.

cision suggested an elevation of directors' monitoring duties.[112] Chancellor Allen, who authored the opinion, determined that:

> [A] director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards.[113]

The Chancellor's suggestion that boards should be responsible for ensuring corporate compliance with the laws was influenced by the "increasing tendency, especially under federal law, to employ the criminal law to assure corporate compliance with external legal requirements."[114] Specifically, the Chancellor found that the adoption of the federal Sentencing Guidelines for Organizations—which imposed enhanced penalties on corporations convicted of crimes—provided "powerful incentives for corporations" to implement effective compliance systems.[115]

The 1963 decision of *Graham v. Allis-Chalmers Mfg. Co.*, however, provided 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."[116] Chancellor Allen was able to distinguish *Graham* by interpreting it to stand for the proposition that "absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf."[117] Further, an interpretation of *Graham* that "a corporate board has no responsibility to assure that appropriate information and reporting systems are established by management . . . would not, in any event, be accepted by the Delaware Supreme Court in 1996."[118] Again relying on the new federal Sentencing Guidelines for support, the court found that "[a]ny rational person attempting in good faith to meet an organizational governance responsibility would be bound to take [the enhanced penalties] into account . . . ."[119]

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112 *Id.*
113 *Id.* (internal citation omitted).
114 *Id.* at 969.
115 *In re Caremark*, 698 A.2d at 969.
116 188 A.2d 125, 130 (Del. 1963).
117 *In re Caremark*, 698 A.2d at 969.
118 *Id.* at 969–70.
119 *Id.* at 970.

Caremark was not an official ruling on the subject and arguably undermined existing Delaware Supreme Court precedent.[120] The decision has, however, been influential with respect to the conduct of Delaware corporations.[121] For example, it is now standard practice for corporate attorneys to advise clients to adopt comprehensive compliance programs, providing for increased communication with employees, rigorous monitoring and auditing, and discipline for perceived violations.[122] Furthermore, *Caremark*'s proposition that compliance with the laws is part of a directors' duty to monitor "finds substantial agreement and support in the corporate governance thinking of the Securities and Exchange Commission, the American Law Institute, and the American Bar Association."[123]

While articulating what were essentially best practices, the proposed standards that came out of *Caremark* opinion have been taken to heart by both business entities and the courts.[124] The decision has successfully heightened the level of attention directors pay to their oversight responsibilities under the duty of care.[125] *Caremark* therefore suggests that best practices can evolve into the industry standard with respect to director duties in Delaware.

B. *Disney I*

1. The Facts

Before delving into the most recent in the string of decisions that came out of the Disney shareholder litigation, it is useful to look at the Delaware Court of Chancery's 2003 opinion regarding this case. The facts of the case are briefly summarized here. Disney's Chairman and CEO, Michael Eisner, sought to engage Michael Ovitz as its new president.[126] In October of 1995, Eisner eventually succeeded, but only after offering Ovitz an enticing contract.[127]

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[120] Veasey, *supra* note 25, at 850.

[121] *See* Brown, *supra* note 5, at 6.

[122] KLEIN & COFFEE, *supra* note 60, at 155.

[123] Brown, *supra* note 5, at 31–32.

[124] *See* Veasey, *supra* note 25, at 849–50 ("Such compliance systems could reasonably be expected to identify wrongdoing when a compliance program could benefit the corporation under federal sentencing guidelines . . . . [M]y personal view is that the expectations of directors . . . progressed in the thirty-plus years from *Graham* to *Caremark*.").

[125] Brown, *supra* note 5, at 144.

[126] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 907 A.2d 693, 700–01 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

[127] *Id.* at 703, 711.

The most interesting provision of the contract, and indeed the provision from which the litigation arose, was the provision concerning the termination of the contract. Ovitz's employment agreement (OEA) provided certain terms under which Ovitz would be permitted to leave the company without penalty.[128] If Ovitz left for any other reason, he would forfeit any right to outstanding benefits under the OEA and could be prevented "from working for a competitor."[129] If, on the other hand, Ovitz was fired without cause (that is, for any reason besides gross negligence or malfeasance), Disney would be obliged to make a payment—the non-fault termination (NFT)—consisting of his remaining salary under the OEA and $7.5 million a year, which represented unaccrued bonuses.[130] In addition, the first tranche of Ovitz's options would vest immediately upon termination, and he would receive a payment of $10 million for the second tranche.[131]

As is often the case with Hollywood power couples, what was expected to be a happy marriage between Eisner and Ovitz faded very quickly. Problems, largely due to Ovitz's failure to adapt to Disney's corporate culture, arose as early as January 1996, just three months after his tenure as president officially began.[132] By the fall of the same year, it became apparent that the difficulties were not likely to be resolved, and that Ovitz, one way or another, would have to leave the company.[133]

In September of 1996, Sanford Litvack, Disney's general counsel, approached Ovitz and advised him that it would be best if Ovitz started looking for new employment.[134] Litvack further conveyed that "Eisner no longer wanted Ovitz at Disney."[135] Ovitz contemplated

> [T]he non-contentious terms of Ovitz's employment agreement (the "OEA") were $1 million in annual salary and a performance-based, discretionary bonus . . . . Ovitz would receive a five-year contract with two tranches of options. The first tranche consisted of three million options . . . and if the value of those options at the end of the five years had not appreciated to $50 million, Disney would make up the difference. The second tranche consisted of two million options that would vest immediately if Disney and Ovitz opted to renew the contract.

Id. at 703 (internal citations omitted).

[128] *Id.* at 703–04.

[129] *Id.* at 704 (internal citations omitted).

[130] *Id.*

[131] *Id.* at 704.

[132] *Disney II*, 907 A.2d at 713 (noting that the other board members found Ovitz "a little elitist for the egalitarian Walt Disney [employees]").

[133] *Id.* at 714.

[134] *Id.* at 724.

[135] *Id.*

employment at Sony, but things did not work out, leaving Disney with seemingly only one option—to terminate Ovitz.[136] Ovitz was officially terminated, without cause, effective December 12, 1996.[137] Under the terms of his contract, Ovitz was entitled to the NFT, which was valued at over $140 million.[138]

2. The Suit

Following Ovitz's termination, plaintiff shareholders initiated the derivative action, alleging that the Disney directors breached their fiduciary duties to the corporation, first in approving the OEA, and again in terminating Ovitz without cause, thereby entitling him to the receipt of the NFT.[139] Plaintiffs sought money damages from defendant directors and Ovitz and/or rescission of the termination agreement, or compensation for Disney's alleged damages "and disgorgement of Ovitz's unjust enrichment."[140]

In its 2003 decision, the Delaware Court of Chancery determined that, based on an investigation of the "tools at hand," plaintiffs alleged sufficient facts that, "if true, arguably support . . . plaintiffs' claims for relief . . . and are sufficient to excuse demand and to state claims that warrant development of a full record."[141] Specifically, the court was referring to allegations that Eisner made the decision to hire Ovitz unilaterally and without fully informing the rest of the board about the employment agreement, and that the board likewise played virtually no role in deciding the terms of Ovitz's termination.[142]

In considering defendants' motion to dismiss, the court phrased the issue as whether the plaintiffs alleged "particularized facts that raise doubt about whether the challenged transaction is entitled to the protection of the business judgment rule."[143] In finding for the plaintiffs, the court held that "[a] fair reading of the . . . complaint . . . gives rise to a reason to doubt whether the board's actions were taken honestly and in good faith . . . ."[144] The court further found that "the facts belie any assertion that the . . . Boards exercised *any*

[136] *Id.* at 728.
[137] *Id.* at 734.
[138] *In re* Walt Disney Co. Derivative Litig. (*Disney I*), 825 A.2d 275, 279, 286 (Del. Ch. 2003).
[139] *Id.* at 277–79.
[140] *Id.* at 278.
[141] *Id.* at 279.
[142] *Id.* at 287–89.
[143] *Id.* at 285–86.
[144] *Disney I*, 825 A.2d at 286.

business judgment or made *any* good faith attempt to fulfill the fiduciary duties they owed to Disney and its shareholders."[145] The court therefore found that the evidence presented raised a "reason to doubt" that defendants should be afforded the protection of the business judgment rule.[146]

C. Disney II

The Delaware Court of Chancery rendered its decision regarding the Disney litigation in August of 2005.[147] The stage was set for the court to do a "rigorous job of protecting shareholders."[148] The court, however, ruled for defendants on all counts, holding that the accused board members had not breached their fiduciary duties to the corporation and that the decision to terminate Ovitz and to make the subsequent NFT payment did not constitute waste.[149] The Court of Chancery further confirmed the viability of the business judgment rule, declaring that "fiduciaries who act faithfully and honestly on behalf of those whose interests they represent are indeed granted wide latitude in their efforts to maximize shareholders' investment."[150] After a brief review of the history of the rule, the court went on to examine whether the protections of the rule should apply to each defendant on a director-by-director basis.[151]

1. The Decision to Hire Ovitz

The court first concluded that Eisner did not breach his duty of care in deciding to hire Ovitz via the extension of a highly lucrative employment contract.[152] "[L]iability for a breach of the duty of care

[145] *Id.* at 287.

[146] *Id.* at 289–90.

[147] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 907 A.2d 693, 697 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

[148] Fairfax, *supra* note 2, at 419 (quoting Marc Gunther, Ovitz v. Eisner: *Boards Beware!*, FORTUNE, Nov. 10, 2003, at 176). In fact, following the *Disney I* decision, former Delaware Court of Chancery Judge William Allen noted that the decision could hint that "the Delaware courts are responding to the Enron and WorldCom headlines and the intrusion, so to speak, of the federal government into the internal governance of corporations." *Id.* at 418 (internal citations omitted). According to Fairfax, this statement "confirmed the impact that Enron and Sarbanes-Oxley had on Delaware courts' willingness to increase directors' liability in order to ensure greater adherence to directors' fiduciary responsibilities." *Id.* at 418.

[149] *Disney II*, 907 A.2d at 697. This decision was later affirmed by the Delaware Supreme Court. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 35–36 (Del. 2006).

[150] *Disney II*, 907 A.2d at 697–98.

[151] *Id.* at 756–79.

[152] *Id.* at 762.

can arise . . . '*from a board decision* that results in a loss because that decision was ill advised or 'negligent' . . . [or] from an *unconsidered failure of the board to act* in circumstances in which due attention would, arguably, have prevented the loss.'"[153] Any decision made by a director, of course, is entitled to the protections of the business judgment rule, which raises the standard of review to gross negligence.[154]

Based on a prior ruling, the court determined that a consideration of any improper motives or non-independence of the board members would not be appropriate.[155] The court therefore framed the issue of Eisner's liability as whether plaintiffs could "demonstrate by a preponderance of the evidence that Eisner was either grossly negligent or acted in bad faith in connection with Ovitz's hiring and the approval of the OEA."[156] "[I]n order for a plaintiff to successfully plead that the directors acted with gross negligence . . . the plaintiff should articulate 'facts that suggest a *wide* disparity between the process the directors used . . . and that which would have been rational.'"[157]

Here, Eisner made the decision to hire Ovitz, as well as what terms to offer him, virtually unilaterally.[158] Two members of the board initially denounced the decision.[159] The corporation's compensation committee met for only one hour to review the anticipated terms of the OEA, and this was not the only subject of the meeting.[160] At an executive meeting held later the same day, the board voted unanimously to elect Ovitz as Disney's new president.[161] By this point, Ovitz and Eisner had already signed a letter agreement outlining the terms of Ovitz's employment, and a press release had been made announcing Ovitz's hiring.[162]

Despite these factual findings, the court dismissed all charges against defendants, spending a good deal of its time distinguishing

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[153] *Id.* at 749 (quoting *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996)).

[154] *Id.* at 762.

[155] *Id.* at 762 n.495 (citing Brehm v. Eisner, 746 A.2d 244, 257–58 (Del. 2000)).

[156] *Disney II*, 907 A.2d at 762.

[157] *Id.* at 750 n.429 (quoting Guttman v. Huang, 823 A.2d 492, 507 n.39 (Del. Ch. 2003)).

[158] *Id.* at 762.

[159] *Id.* at 706.

[160] *Id.* at 708.

[161] *Id.* at 710.

[162] *Disney II*, 907 A.2d at 708. Both of these events took place on August 14, 1995. *Id.* The compensation committee meeting was held on September 26, 1995, and Ovitz officially assumed his position on October 1, 1995. *Id.* at 708, 711.

Disney II from *Van Gorkom*.[163] While noting that the factual similarities between the two cases were "striking," the court ultimately distinguished *Van Gorkom* on four main grounds.[164] First, the court found that the transaction in *Van Gorkom* was "fundamentally different" from the one at issue in *Disney II* because the merger decision in *Van Gorkom* was more material to Trans Union than was the decision to hire Ovitz to Disney.[165] Second, although the board in *Disney II* spent less time in making its decision than did the Trans Union board, the time spent was "not insignificant."[166] Third, unlike the members of the Trans Union board, the Disney board was "provided with a term sheet of the key terms of the OEA and a presentation was made by [knowledgeable board members]."[167] Finally, whereas Trans Union's senior managers were in complete opposition to the merger, Disney's management "generally saw Ovitz's hiring as a boon for the Company."[168]

In distinguishing the cases in such a manner, the court drew a very fine line between rational and irrational action. Indeed, similarly to *Van Gorkom*, a press release announcing Ovitz's hiring was made *before* the board had voted on the issue, and before most of the board was fully informed about the issue.[169] In fact, an argument can

[163] *Id.* at 766–70.

[164] *Id.* at 767.

[165] *Id.* at 768 n.533 (noting that Eisner's procedure of entering into the letter agreement without prior board authorization and the compensation committee's approval of the OEA "based upon a term sheet and upon less than an hour of discussion, seem[ ] eminently reasonable given the OEA's (relatively small) economic size"). The consideration of the reasonableness of the decision based on economic terms runs counter to the basic premise of the business judgment rule that courts should not evaluate the substantive merits of board decisions. Courts should not be swayed by the economic reasonableness of a transaction if the process by which the decision was reached is fundamentally flawed. *See* Smith v. Van Gorkom, 488 A.2d 858, 875 (Del. 1985) ("[I]n the absence of other sound valuation information, the fact of a premium alone does not provide an adequate basis upon which to assess the fairness of an offering price.").

[166] *Disney II*, 907 A.2d at 768.

[167] *Id.* at 769.

[168] *Id.*

[169] The court tried to downplay this fact by noting that the directors' "level of knowledge or involvement before [the date of the meeting] is only relevant insofar as it informs the Court as to their accumulated knowledge on September 26, when the business judgment was made" and that the letter agreement "was expressly subject to the approval of the board and compensation committee." *Disney II*, 907 A.2d at 767 n.522. This assertion seems contrary to the principle presented in *Van Gorkom* that "[t]he determination of whether a business judgment is an informed one turns on whether the directors have informed themselves *prior to making a business decision*, of all material information reasonably available to them." *Van Gorkom*, 488 A.2d at 872 (emphasis added) (internal citations and quotations omitted).

be made that Eisner's conduct was worse than that of Trans Union's Chairman and CEO, Jerome W. Van Gorkom. Van Gorkom at least presented the illusion that other courses of action were possible.[170] Here, there were no alternatives—Eisner wanted Ovitz and only Ovitz.

Another distinction, not emphasized by the court, is that in *Van Gorkom*, the Delaware Supreme Court analyzed the board as a whole.[171] The *Disney II* court evaluated liability on a director-by-director basis, indicating that the duty of care is a duty owed by each individual director as an individual.[172] Since no one director's conduct on his own was worthy of culpability, the court could not impose liability on any one of them.[173] This result gives rise to the question of whether a different decision would have been reached if the board had been examined collectively.

2. The Decision to Terminate Ovitz

The court also concluded that Eisner, who "alone possessed the authority to terminate Ovitz and grant him the NFT," did not breach his fiduciary duties and acted in good faith taking such action.[174] In a statement of seeming sympathy for Eisner, the court noted, "Eisner unexpectedly found himself confronted with a situation that did not have an easy solution."[175]

The court found that Eisner was entitled, in his capacity as CEO, to make what he considered to be the "best" decision regarding how to handle the problems with Ovitz.[176] The court further concluded that Eisner was entitled to rely on defendant Litvack's statement that he had consulted with outside counsel with regard to whether Ovitz could be fired with cause, notwithstanding the court's declaration that it was "not convinced that Litvack did indeed speak with [outside counsel] regarding the cause issue."[177]

3. Ideal Practices Distinguished From Legal Practices

Notwithstanding its decision in favor of defendants, the court did acknowledge that the Disney board, especially Eisner, was respon-

170 *Van Gorkom*, 488 A.2d at 868.
171 *Id.* at 889.
172 *Disney II*, 907 A.2d at 760.
173 *Id.*
174 *Id.* at 777–78.
175 *Id.* at 778.
176 *Id.*
177 *Id.* at 778 n.591.

sible for some wrongdoing.[178] The court hedged this view, however, by proclaiming that "[t]his court strongly encourages directors and officers to employ best practices . . . . But Delaware law does not—indeed, the common law cannot—hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices . . . ."[179]

This statement, on its face, could be an indication that Delaware will be applying the business judgment rule strictly in the future. Upon closer consideration of the opinion as a whole, however, a different conclusion can be drawn. While the court ruled for the defendants, it noted that "[f]or the future, many lessons of what not to do can be learned from defendants' conduct here."[180] Additionally, and perhaps more significantly, the court stated:

> Recognizing the protean nature of ideal corporate governance practices, particularly over an era that has included the Enron and WorldCom debacles, and the resulting legislative focus on corporate governance, it is perhaps worth pointing out that the actions (and the failures to act) of the Disney board that gave rise to this lawsuit took place ten years ago, and that *applying 21st century notions of best practices in analyzing whether those decisions were actionable would be misplaced.*[181]

This statement is undoubtedly reminiscent of *Caremark*[182] and its reference to changes in federal regulations. It can therefore be viewed as an indication that cases in which the "21st century notions of best practices" need to be applied will arise in the future.[183]

Further, while it is not entirely clear what those best practices may be, the *Disney II* court did provide some guidance on this matter. For example, the court suggested that more detailed documentation might be required in the future.[184] In discussing the minutes of the

[178] *Disney II*, 907 A.2d at 760–61. For example, the court recognized that

> Eisner to a large extent is responsible for the failings in process that infected and handicapped the board's decisionmaking abilities. Eisner stacked his (and I intentionally write 'his' as opposed to 'the Company's') board of directors with friends and acquaintances who . . . were certainly more willing to accede to his wishes and support unconditionally than truly independent directors.

Id. The court further noted that "Eisner's actions in connection with Ovitz's hiring should not serve as a model for fellow executives and fiduciaries to follow. His lapses were many. . . . *He stretched the outer boundaries of his authority as CEO by acting without specific board direction or involvement.*" *Id.* at 762–63 (emphasis added).

[179] *Id.* at 697.

[180] *Id.* at 760.

[181] *Id.* at 697 (emphasis added).

[182] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

[183] *Disney II*, 907 A.2d at 697.

[184] *Id.* at 768 n.539.

board meeting at which the OEA was approved, the court noted that "[i]t would have been extremely helpful to the Court if the minutes had indicated in any fashion that the discussion relating to the OEA was longer and more substantial than the discussion relating to the myriad of other issues brought before the compensation committee that morning."[185]

In addition, with respect to expert advice, the court observed that while it is not "necessary for an expert to make a formal presentation at the committee meeting in order for the board to rely on that expert's analysis, . . . that certainly would have been the better course of action."[186] The court further seemed troubled by Eisner's "Machiavellian (and imperial) nature as CEO," thus suggesting that Delaware will be looking more closely at the issue of director independence in the future.[187] While the court did not go so far as to say explicitly that such issues would play a more important role in future cases, there was the implication that these suggestions should be heeded seriously.

V. A NEW STANDARD FOR DIRECTOR CONDUCT?

Disney II teaches important lessons about what is expected of directors—lessons that boards seem to be in need of in recent times. While insufficient to impose liability, the conduct characterized as "ordinary negligence" by the *Disney II* court provides insight as to how board members can meet the "[a]spirational ideals of good corporate governance practices . . . that go beyond the minimal legal requirements" [188]—requirements that were apparently satisfied by the Disney board. The board should take an active role in the management of the business, not leaving the CEO to "enthrone[ ] himself as the omnipotent and infallible monarch of his [own] personal Magic Kingdom . . . ."[189] Further, directors should fully inform themselves, using all available resources, before making critical decisions affecting the company, and fully document any and all board meetings.[190]

These lessons, taken together with *Caremark*, have implications for director conduct and the business judgment rule in Delaware. If one likens Sarbanes-Oxley to the federal Sentencing Guidelines that motivated the decision in *Caremark*, one can readily conclude that

[185] *Id.*
[186] *Id.* at 769.
[187] *Id.* at 760.
[188] *Id.* at 745 n.399 (citing Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000)).
[189] *Disney II*, 907 A.2d at 763.
[190] *See id.* at 764–65.

boards will be strongly encouraged, if not required, to hold themselves to higher standards in future corporate decision-making.[191] After all, as *Caremark* has shown, best practices can evolve into the industry standard—especially when encouraged by courts and new federal regulations.[192]

The business judgment rule remains an "elusive" aspect of corporate law,[193] yet *Disney* provides clues as to its ultimate formulation in Delaware. While critics of the rule argue either that it allows directors too much freedom in corporate decision-making[194] or that it restricts directors from properly exercising their management duties,[195] the relevant case law reveals that any restrictions imposed by the business judgment rule can be better explained by examining the context in which it is applied. While the basic definitions of fiduciary duties may not change over time, history may change the way in which those definitions are utilized.[196] Where the historical context requires a heightening of the standards by which director conduct is to be judged (for example, following a series of corporate scandals implicating director action/inaction), any application of the business judgment rule should be altered accordingly. The logical result is as follows: the higher the standards against which director conduct is examined, the less likely it is that the business judgment rule will protect decisions that do not conform to those standards. Viewed this way, the rule seeks to restrict director conduct only as far as is necessary to ensure that directors conduct themselves in accordance with their fiduciary obligations.

Thus, if Delaware directors heed the "suggestions" of *Disney II*, this decision has the potential to reshape the way shareholder derivative actions are reviewed. The business judgment rule would still not examine substantive decisions. The rule would only look at the procedural aspect of a board's decision making, asking either "was the decision informed or in bad faith?" or "based on the procedures, was

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[191] *See* Veasey, *supra* note 25, at 850 ("Today, the 'utter failure' to follow the minimum expectations of the evolving standards of director conduct [and] the minimum expectations of Sarbanes-Oxley . . . might . . . raise a good-faith issue.").

[192] *See* Brown, *supra* note 5, at 6. Brown noted that the *Caremark* decision "has fueled the discussion of the board's role in ensuring compliance. . . . As a result, directors would be well advised to attend to the corporation's compliance efforts, even in the absence of a definitive statement of the board's responsibility." *Id.*

[193] *Id.* at 11.

[194] *See generally* Fairfax, *supra* note 2.

[195] *See generally* Bainbridge, *supra* note 71.

[196] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 907 A.2d 693, 697 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

this a breach of fiduciary duty?" The difference, that which will hold directors more accountable, will be the scrutiny with which procedures are examined. For example, a decision may be "uninformed" if there are inadequate minutes to show what was actually discussed at a board meeting, or if the board did not consult an expert with respect to the decision. Additionally, a failure to comply with the provisions of the Sarbanes-Oxley Act could be considered to be in bad faith. In short, the best practices articulated by the Delaware Court of Chancery have the potential to become the new standards against which director conduct is measured when evaluating a breach of fiduciary duty claim.

IV. CONCLUSION

While it may be true that courts cannot impose liability upon corporate directors for deviating from paradigmatic conduct, it is also true that both courts and directors need guidance when it comes to evaluating decisions in a way to promote the best interests of the corporation and its shareholders. Based on the progression of the *Disney* litigation, it became clear that a shift toward more stringent standards for directors was expected, at least up to the point of the 2005 decision. It is also clear, however, that such a shift did not occur. But the *Disney* decision does provide clues for the future.

As the Delaware Court of Chancery itself noted, "[u]nlike ideals of corporate governance, a fiduciary's duties do not change over time. How we understand those duties may evolve and become refined, but the duties themselves have not changed, *except to the extent that fulfilling a fiduciary duty requires obedience to other positive law*."[197] This statement likely refers to the Sarbanes-Oxley Act and to other acts that may be passed in the future, perhaps some as a result of Delaware's inaction in this instance.

But the statement may have more broad-reaching implications. After all, the nature of fiduciary duties, like ideals of corporate governance, needs to change with the "law" of society.[198] This change can be accomplished by applying the business judgment rule by measuring director conduct against those "ideals of corporate governance." The business judgment rule examines board procedures. If those procedures are required to comport with the ideals, or at least above average standards, of corporate governance, the business judgment rule will become a mechanism whereby courts can mean-

[197] *Id.* (emphasis added).
[198] *Id.*

ingfully evaluate board decisions without sacrificing either accountability or authority.

Perhaps the Delaware Court of Chancery can be taken at its word that one of the reasons no liability was imposed on the Disney directors was that the conduct in question took place ten years before the collapse of Enron. If this is the case, the business judgment rule will look somewhat different in the future. While preventing review of the substantive decisions of directors, the rule's presumption may be overcome by a showing of a violation of one of the suggested procedures in *Disney*. In any event, the Delaware Court of Chancery, through its decision in *Disney*, has sent a powerful message to corporate directors: even though fiduciary duties do not change, standards of director conduct do, and directors should be prepared to meet the standards implicitly imposed by the court in *Disney* in the future.