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CORPORATE GOVERNANCE AND FIDUCIARY DUTY:  
THE “MICKEY MOUSE RULE” OR LEGAL  
CONSISTENCY, PROTECTION OF SHAREHOLDER  
EXPECTATIONS, AND BALANCED DIRECTOR  
AUTONOMY

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INTRODUCTION

After a decade of litigation, Chancellor Chandler of the Court of Chancery of Delaware gave a resounding “No” to the question of whether Walt Disney Company’s board of directors breached their fiduciary duty or committed waste in connection with the hiring and no-fault termination of Michael Ovitz.<sup>1</sup> However, Chancellor Chandler began his opinion with a careful qualification:

[I]n 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 . . . applying 21st century notions of best practices in analyzing whether those decisions were actionable would be misplaced.<sup>2</sup>

This qualification begs the question: Would the outcome of the *Disney* litigation have been different under “21st century notions of best practices”? This note argues that the outcome would have been the same. First, from a common law perspective, Chancellor Chandler’s own opinion states that “[u]nlike ideals of corporate governance, a fiduciary’s duties do not change over time . . . [and] the common law cannot hold fiduciaries liable for a failure to comply with the aspirational ideals of best practices . . . .”<sup>3</sup>

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<sup>1</sup> *In re The Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 697 (Del. Ch. 2005) [hereinafter *Disney*], *aff’d*, 906 A.2d 27 (Del. 2006) [hereinafter *Disney Final*].

<sup>2</sup> *Disney*, 907 A.2d at 697.

<sup>3</sup> *Id.*

This statement clearly dispels any suggestion that Delaware's common law changed to reflect the so-called "21st century notions of best practices." This opinion was echoed by Justice Jacobs of the Delaware Supreme Court, who affirmed the Chancellor's "well-crafted 174 page Opinion" as "correct and not erroneous in any respect."<sup>4</sup> Second, from a statutory and regulatory law perspective, Sarbanes-Oxley<sup>5</sup>—with a focus on external financial reporting, internal audit objectivity, and board audit committee independence—did little or nothing to change a director's fiduciary duty with regard to decision-making and general management oversight.<sup>6</sup> Third, while Self-Regulating Organizations ("SROs")<sup>7</sup> increased the level of director independence required for a publicly traded corporation to list its stock ("listing requirements"),<sup>8</sup> these heightened requirements failed to create a private right of action.<sup>9</sup>

If common law has not incorporated heightened shareholder aspirations and increased federal regulation does not address a director's responsibilities specific to decision-making and general management oversight,

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<sup>4</sup> *Disney Final*, 906 A.2d at 35.

<sup>5</sup> Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in various sections of 15 U.S.C. and 18 U.S.C.).

<sup>6</sup> See Lyman P.Q. Johnson & Mark A. Sides, *The Sarbanes-Oxley Act and Fiduciary Duties*, 30 WM. MITCHELL L. REV. 1149, 1155-78 (2004) (discussing the specific areas of the Sarbanes-Oxley Act that have potential to impact corporate governance and fiduciary duties, including the SEC's delegation to SROs to develop certain heightened standards to better regulate the industry).

<sup>7</sup> Financial exchanges are for-profit organizations that "bring buyers and sellers of capital together" as well as "self-regulating organizations ("SROs") who are responsible for monitoring the market in which they operate. John W. Carson, *Conflicts of Interest in Self-Regulation: Can Demutualized Exchanges Successfully Manage Them?* 1-2 (World Bank Policy Research Working Paper No. 3183, 2003) (explaining that financial exchanges, who "operate markets that bring buyers and sellers of capital together," are generally the only self-regulating organizations in most jurisdictions, and who—as SROs—are "important sources of standards and safeguards [designed] to facilitate efficient markets and promote market integrity," thus making the regulatory role of financial exchanges a "significant contributor to securities markets' credibility"); see also Roel C. Campos, SEC Comm'r, *New Challenges in Regulating Financial Markets: Remarks at NYU Stern* (Mar. 24, 2006), <http://www.sec.gov/news/speech/spch032406rcc.htm> (last visited Dec. 16, 2006) (arguing that the existing system of self-regulation presents a conflict of interest given financial markets are no longer "utility-like venues for trading" but rather for-profit organizations with an emphasis on raising money and business development, and proposing a new system of regulation for financial exchanges).

<sup>8</sup> Listing requirements are the set of standards determined by each stock exchange as necessary for a publicly held corporation to be allowed to list their stock on that exchange. The purpose of listing requirements is to "promote the integrity and reputation" of the specific exchange and are the core of the exchange's self-regulation. NASDAQ Listing Requirements, <http://www.nasdaq.com/about/LegalComplianceFAQs.stm> (last visited Sept. 28, 2005).

<sup>9</sup> Johnson & Sides, *supra* note 6, at 1210 (citing John F. Olson, *How to Really Make Audit Committees More Effective*, 54 BUS. LAW. 1097, 1100 n.15 (1999)).

the obvious question is whether the body of law that governs director responsibility should change, and if so, how?

This note uses the *Disney* decision and Delaware law as a case study to discuss the arguments for and against the current law governing fiduciary duty, and proposes a legal approach that will better balance shareholder expectations with director autonomy. Part I discusses the history of corporate governance in Delaware. Part II provides a summary of the *Disney* facts, procedural posture and holding. Part III analyzes the *Disney* case in light of 21st century notions of best practices. Part IV discusses the arguments for and against the current law. Part V concludes by providing a solution that provides the ability to adapt a consistent legal approach to corporate structure, organization, culture, and shareholder expectations—while establishing a better balance between director autonomy and director accountability to the shareholder.

I. THE HISTORY AND EVOLUTION OF CORPORATE GOVERNANCE WITH RESPECT TO FIDUCIARY DUTY

A. *Common Law Rules of Due Care, Loyalty, Good Faith, Waste and the Business Judgment Rule*

Prior to 2001, the federal government had limited its role in the area of corporate law to enacting laws requiring corporations to disclose certain information to investors, most of which was related to initial public offerings and securities trading.<sup>10</sup> Meanwhile, the vast majority of corporate law was state common law.<sup>11</sup> While the balance between federal and state corporate common law has arguably started to shift, state common law still plays a central role in corporate law.<sup>12</sup>

Within the area of state common law, Delaware has been recognized as having one of the most mature and highly respected bodies of corporate law.<sup>13</sup> Delaware's prominence in this area stems from the fact that roughly

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<sup>10</sup> Jeffrey D. Hern, *Delaware Courts' Delicate Response to the Corporate Governance Scandals of 2001 and 2002: Heightening Judicial Scrutiny on Directors of Corporations*, 41 WILLAMETTE L. REV. 207, 207-08 (2005).

<sup>11</sup> *Id.* at 208.

<sup>12</sup> *Id.* at 208-09.

<sup>13</sup> See E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1414 (2005).

60% of Fortune 500 companies, as well as companies listed with the major U.S. stock exchanges, are incorporated within its borders.<sup>14</sup>

Within Delaware's body of common law there is an overarching principle termed the "business judgment rule" under which corporate fiduciary duties are tested.<sup>15</sup> In Delaware common law there are four relevant corporate fiduciary duties: the duty of due care, the duty of loyalty, the duty of good faith, and the waste doctrine.<sup>16</sup>

### 1. The Business Judgment Rule

The business judgment "rule" dictates that a court must presume a director based his decision on an informed and honest belief that the decision was in the best interests of the corporation and its shareholders.<sup>17</sup> The business judgment rule is not a stand-alone, substantive rule of law; rather, it is a presumption that the director acted in good faith.<sup>18</sup> The business judgment rule bars a plaintiff from recovering under a legal or equitable theory, based on director *action*, in the absence of fraud, bad faith or self-dealing.<sup>19</sup> Failure of a director to exercise his business judgment through *inaction* is not protected under the business judgment rule, but instead is judged under a gross negligence standard.<sup>20</sup>

If the plaintiff is able to rebut the presumption of the business judgment rule with proof that indicates a director acted in bad faith, was disloyal, or committed waste, then the burden shifts to the director to demonstrate otherwise.<sup>21</sup> The application of the business judgment rule is per-

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<sup>14</sup> "As of February 19, 2004, Delaware had more than 615,000 business entities, 275,000 domestic corporations" and roughly sixty percent of Fortune 500 companies and companies listed on the three primary United States stock exchanges (NYSE, ASE, NASDAQ). *Id.* at 1403 (citing Telephone Interview with Richard J. Geisenberger, Assistant Secretary of State of Delaware (Mar. 7, 2005)); Stephen Taub, *Influential Delaware Judge Slams Sarbox*, (July 6, 2005), <http://www.cfo.com/article.cfm/4149256> (last visited Dec. 20, 2006).

<sup>15</sup> *See Disney*, 907 A.2d 693, 746-47 (Del. Ch. 2005); Veasey & Di Guglielmo, *supra* note 13, at 1421.

<sup>16</sup> *See Disney Final*, 906 A.2d 27, 52 (Del. 2006); *Disney*, 907 A.2d at 746-47.

<sup>17</sup> *Disney*, 907 A.2d at 747 (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

<sup>18</sup> *Id.* at 746-47.

<sup>19</sup> *Id.* at 747 (quoting *Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988) and citing *In re J.P. Stevens & Co., Inc. S'holders Litig.*, 542 A.2d 770, 780 (Del. Ch. 1988)).

<sup>20</sup> *Id.* at 748 (citing *Aronson*, 473 A.2d at 813; and referring to *Seminaris v. Landa*, 662 A.2d 1350 (Del. Ch. 1995) and *In re Baxter Int'l, Inc. S'holders Litig.*, 654 A.2d 1268 (Del. Ch. 1995)). *But see Rabkin v. Phillip A. Hunt Chem. Corp.*, 1987 WL 28436 at \*1-3 (Del. Ch. 1987) (sole Delaware case holding that ordinary negligence would suffice to establish liability for director inaction).

<sup>21</sup> *Disney*, 907 A.2d at 747 (citing *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001)).

formed on an individual basis, director-by-director, with a focus on the *process* employed by each director in reaching his business decision.<sup>22</sup>

The business judgment rule evolved due to a clear recognition that the role of a corporate director is to manage the business affairs for the corporation he or she serves by making decisions that, by their very nature, involve risk.<sup>23</sup> This rule protects and promotes this role by precluding a court from unreasonably substituting its own judgment or the benefit of hindsight analysis on the business affairs of a corporation.<sup>24</sup> In so doing, the rule is consistent with shareholder expectations that their directors will know the business and seek to maximize shareholder value through hard work and objective decision-making.<sup>25</sup>

## 2. The Duty of Due Care

Delaware's fiduciary duty of due care requires directors to "use that amount of care which ordinarily careful and prudent men would use in similar circumstances,"<sup>26</sup> and "consider all material information reasonably available" when making business decisions.<sup>27</sup> This definition implies that the test for the duty of due care is that of standard negligence (e.g., a "reasonable director" standard).<sup>28</sup> However, Delaware law has held that corporate loss resulting from a director's negligent decision, or failure to act, is only a breach of the duty of due care if the director was *grossly* negligent.<sup>29</sup> To establish gross negligence, the plaintiff must establish a reckless indifference for, or deliberate disregard of, the shareholders.<sup>30</sup> Additionally, a plaintiff can establish gross negligence if the director's actions fall outside

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<sup>22</sup> *Id.* at 748 (citing *In re Emerging Commc'ns Inc. S'holders Litig.*, 2004 WL 1305745 at \*38 (Del. Ch. 2004)); Veasey & Di Guglielmo, *supra* note 13, at 1421. In *Disney Final*, the appellants argued that the Court of Chancery was legally required to evaluate the actions of the board collectively. The Delaware Supreme Court rejected this argument without reaching the merits because the appellants failed to present this argument to the trial court and because appellants could not establish that the outcome would have been different if analyzed collectively. 906 A.2d at 55.

<sup>23</sup> *Disney*, 907 A.2d at 746 (citing 8 DEL. CODE ANN. tit. 8 § 141(a) (2005)).

<sup>24</sup> *Id.* (quoting *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993) (citing *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1280 (Del. 1988)).

<sup>25</sup> *See* Veasey & Di Guglielmo, *supra* note 13, at 1422.

<sup>26</sup> *Disney*, 907 A.2d at 749 (quoting *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963)).

<sup>27</sup> *Id.* (quoting *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000)).

<sup>28</sup> *See* BLACK'S LAW DICTIONARY 470 (2d pocket ed. 2001).

<sup>29</sup> *Disney*, 907 A.2d at 749 (citing *Brehm*, 746 A.2d at 259).

<sup>30</sup> *Id.* at 750 (quoting *Tomczak v. Morton Thiokol, Inc.*, 1990 WL 42607 at 12 (Del. Ch. 1990) (quoting *Allaun v. Consol. Oil Co.*, 147 A. 257, 261 (Del. Ch. 1929), and citing *Gimbel v. Signal Cos., Inc.*, 316 A.2d 509, 615 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974)).

the “bounds of reason.”<sup>31</sup> However, claims under the duty of due care—whether for questionable decisions or a conscious decision to refrain from action—will usually be reviewed under the “director-protective” business judgment rule.<sup>32</sup>

As long as the director’s decisions were pursuant to a rational process and made in *good faith* to advance the corporation’s interest, the court will not consider the content of the director’s decision—regardless of how “stupid,” “egregious,” or “irrational” the decision may appear.<sup>33</sup> Delaware law explains that a rule allowing an “objective” evaluation of actual decisions would require “ill-equipped judges and juries” to second-guess directors at the expense of the investor’s long-term interests.<sup>34</sup> Director *inaction* will only constitute a breach of the duty of due care if the plaintiff establishes a “sustained or systematic failure [of a director] . . . to exercise reasonable oversight.”<sup>35</sup>

Given the extremely high standard of liability required to show a breach of the duty of due care, these violations are rarely found.<sup>36</sup>

### 3. The Duty of Loyalty

Delaware law imposes a strict rule for the fiduciary duty of loyalty.<sup>37</sup> This duty forbids corporate directors from using their position of trust to further their own *private* interest (i.e., “self-dealing”).<sup>38</sup> Directors are required to take affirmative steps to put the interests of the corporation and its shareholders above their own non-mutual interests.<sup>39</sup> These steps include refraining from any action that would deprive the corporation of profit or advantage.<sup>40</sup> Additionally, directors are required to act in an “adversarial

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<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at 749-50 (citing *In re Caremark Int’l Derivative Litig.*, 698 A.2d 959, 967-68 (Del. Ch. 1996)).

<sup>33</sup> *Id.* at 750 (citing *In re Caremark Int’l Derivative Litig.*, 698 A.2d 959, 967-68 (Del. Ch. 1996)).

<sup>34</sup> *Id.*

<sup>35</sup> *Disney*, 907 A.2d at 750 (quoting *In re Caremark Int’l Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996)).

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 750-51.

<sup>38</sup> *Id.* at 751 (quoting *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939)); *see generally* Veasey & Di Guglielmo, *supra* note 13, at 1451 (stating that it is analytically preferable to treat good faith and loyalty as separate duties, partially because self-dealing is required for breach of loyalty but not for breach of good faith).

<sup>39</sup> *Disney*, 907 A.2d at 751.

<sup>40</sup> *Id.*

and arms-length manner” when negotiating transactions between the corporation and the director himself.<sup>41</sup>

#### 4. The Duty of Good Faith

While Delaware law had long mentioned a duty of good faith, it had not yet been explicit on whether there was a separate fiduciary duty of good faith, or whether this duty was merged into the duty of loyalty.<sup>42</sup> Moreover, under the business judgment rule Delaware law presumes that director decisions are exercised in good faith.<sup>43</sup> Due to these two facts, Delaware law had not clearly defined the duty of good faith until the *Disney* litigation.<sup>44</sup>

In *Disney II*, Chancellor Chandler denied the director-defendants’ motion to dismiss, relying in part on the potential breach of the duty of good faith.<sup>45</sup> Chancellor Chandler used the *Disney II* opinion to clearly define what constitutes *breach* of the duty of good faith. Breach of the duty of good faith occurs if the directors “*consciously and intentionally disregarded their responsibilities*, adopting a ‘we don’t care about the risks’ attitude concerning a material corporate decision.”<sup>46</sup> Moreover, “[d]eliberate indifference and inaction *in the face of a duty to act*” epitomizes bad faith.<sup>47</sup> Later, in the *Disney* trial opinion, Chancellor Chandler

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<sup>41</sup> *Id.* (citing *In re The Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 290 (Del. Ch. 2003) [hereinafter *Disney II*]).

<sup>42</sup> *Id.* at 753-54 (discussing situations where a director acts in good faith, yet still breaches the duty of loyalty because he fails to prove the fairness of a transaction to which he himself was a party; but stating that it is not possible for a director to act in bad faith and yet still act with loyalty). *But see* Hillary Sale, *Delaware’s Good Faith*, 89 CORNELL L. REV. 456, 460 (2004) (suggesting that there is a separate duty of good faith, which is defined by the motives underlying the director’s conduct; thus, the focus is on the director’s approach to a decision to determine if the director was indifferent or acted egregiously); Veasey & Di Guglielmo, *supra* note 13, at 1441 (stating that the Chancellor’s 2003 denial of the defendant’s motion to dismiss in the *Disney* litigation creates two new questions: (1) whether self-dealing is required to breach the duty of loyalty; and (2) whether good faith is a free-standing fiduciary duty (citing *Disney II*, 825 A.2d 286, 289)).

<sup>43</sup> *Disney*, 907 A.2d at 755.

<sup>44</sup> Veasey & Di Guglielmo, *supra* note 13, at 1441-42 (stating that the Chancellor’s 2003 breach of good faith definition—a director’s conscious and intentional disregard for his responsibilities—is the law unless the Delaware Supreme Court rules otherwise); *Disney*, 907 A.2d at 755 (reaffirming the definition of good faith set out in the earlier denial of the defendant’s motion to dismiss); *Disney II*, 825 A.2d at 289.

<sup>45</sup> *Disney II*, 825 A.2d at 278.

<sup>46</sup> *Id.* at 289; *Disney*, 907 A.2d at 755 n.459 (stating that § 102(b)(7) also seems to equate bad faith with intentional misconduct).

<sup>47</sup> *Disney*, 907 A.2d at 755 (interpreting this rule as the intention behind the Delaware Supreme Court’s holding in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), when it stated that directors could not abdicate their duty, but rather were under a statutory duty to act).

clarified that there was more than one appropriate standard for bad faith.<sup>48</sup> On appeal to the Delaware Supreme Court, Justice Jacobs admitted that the law regarding bad faith was not well-developed.<sup>49</sup> However, Justice Jacobs described a breach of the duty of good faith in terms of a continuum.<sup>50</sup> At one end of the spectrum is “subjective bad faith,” where the conduct is intended to cause harm and is without question bad faith.<sup>51</sup> Meanwhile, at the other end of the spectrum is gross negligence, where the conduct is actually a breach of the duty of due care and *cannot* also be considered bad faith.<sup>52</sup> In between these two opposite ends of the spectrum falls the standard articulated by Chancellor Chandler.<sup>53</sup>

Under this continuum, Justice Jacobs’ holding makes crystal clear that gross negligence alone can *never* suffice to rebut the business judgment rule.<sup>54</sup> Thus, even under the more clearly defined duty of good faith, plaintiffs must still rebut the presumption that directors acted in good faith.<sup>55</sup> Plaintiffs can only rebut this presumption by proving that the director *intentionally* (1) acted to further an interest other than one in the shareholders’ best interest; (2) violated applicable law; or (3) failed to act in the face of a *duty* to do so.<sup>56</sup>

## 5. The Doctrine of Waste

Delaware courts have defined corporate waste as a director irrationally squandering corporate assets.<sup>57</sup> To prove waste, the plaintiff must establish that an exchange was “so one-sided that no business person of ordinary, sound judgment could conclude that the corporation . . . received adequate

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<sup>48</sup> *Id.* (restating the standard for bad faith to focus on the “intentional dereliction of duty” and/or the “conscious disregard for one’s responsibilities,” while not discussing the overall attitude that directors adopted toward the risks created by their conduct, or lack thereof).

<sup>49</sup> *Disney Final*, 906 A.2d 27, 63-64 (Del. 2006).

<sup>50</sup> *Id.* at 64-67.

<sup>51</sup> *Id.* at 64.

<sup>52</sup> *Id.* at 64-65.

<sup>53</sup> *Id.* at 66-67.

<sup>54</sup> *Id.* at 64-66 (supporting this absolute conclusion by observing that to equate gross negligence with bad faith would “eviscerate” the protections the Delaware General Assembly built into 8 Del. C. § 102(b)(7) and 8 Del. C. § 145(a)-(b). In the first, corporations are allowed to exculpate their directors for gross negligence. In the latter, directors can be indemnified from liability for gross negligence. In both statutes bad faith is specifically excluded.)

<sup>55</sup> *Disney Final*, 906 A.2d at 62-67.

<sup>56</sup> *Disney*, 907 A.2d at 755-56 (citing *Gagliardi v. Trifoods, Int’l*, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996)); *Disney II*, 825 A.2d 286, 289-90 (Del. Ch. 2003).

<sup>57</sup> *Disney*, 907 A.2d at 748-49 (citing *Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000)).

consideration.”<sup>58</sup> In light of the heavy burden the plaintiff must meet, it is not surprising that Delaware courts rarely find that directors committed corporate waste.<sup>59</sup>

However, because the Delaware Supreme Court has held that every act of waste constitutes bad faith,<sup>60</sup> if a court were to find corporate waste, neither the exculpatory provisions of Delaware’s opt-out statute (discussed below), nor the business judgment rule, would protect a director from liability.<sup>61</sup>

### B. *Statutory Law—Delaware’s “Opt-Out” Statute and Sarbanes-Oxley*

Delaware state law includes an “Opt-Out” statute that gives shareholders the opportunity to preemptively exonerate directors.<sup>62</sup> The now infamous Sarbanes-Oxley Act of 2002 imposes additional, more stringent financial reporting and internal audit requirements.<sup>63</sup> However, the Sarbanes-Oxley Act also incorporates some provisions that could trump both the common law and Delaware’s “Opt-Out” statute, if applicable to the facts of a given case.<sup>64</sup>

#### 1. Delaware’s “Opt-Out” Statute

Following the 1980’s era of hostile takeovers, corporations encountered difficulties attracting qualified directors.<sup>65</sup> As a result, in 1986 Delaware enacted § 102(b)(7), which *allowed* shareholders to preemptively exonerate directors from personal liability for gross negligence.<sup>66</sup> If the shareholders elect to incorporate the § 102(b)(7) provision into the corporate charter, the court is prohibited from finding directors personally liable for a

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<sup>58</sup> *Id.* (quoting *Brehm*, 746 A.2d at 263).

<sup>59</sup> *Id.* at 748.

<sup>60</sup> *Id.* at 749 (referring to *White v. Panic*, 783 A.2d 543, 553-55 (Del. 2001) (citing *J.P. Stevens & Co. S’holders Litig.*, 542 A.2d 770, 780-81)).

<sup>61</sup> *Id.* at 747, 751.

<sup>62</sup> DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

<sup>63</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in various sections of 15 U.S.C. and 18 U.S.C.).

<sup>64</sup> *Id.*; see also *Johnson & Sides*, *supra* note 6, at 1195, 1205, 1225.

<sup>65</sup> *Veasey & Di Guglielmo*, *supra* note 13, at 1432.

<sup>66</sup> *Id.*; see also *Disney*, 907 A.2d at 747, 751-52 (discussing that the Delaware General Assembly enacted the “opt-out” statute in response to the landmark decision in *Van Gorkom*, 488 A.2d at 858, where the Delaware Supreme Court refused to apply the business judgment rule because the director’s decision to approve a merger was not the product of an informed business judgment; *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985)).

breach of the duty of due care.<sup>67</sup> The statute does not, however, allow shareholders to exonerate directors for breach of loyalty or good faith, a knowing violation of the law or situations in which the director received an improper personal benefit.<sup>68</sup> The Delaware Supreme Court has held that if the corporation has a shareholder-approved “opt-out” provision in its corporate charter and a shareholder complaint fails to allege facts that fairly implicate the breach of loyalty or good faith, the complaint will be dismissed.<sup>69</sup>

“[O]ne of the primary purposes of [the statute] is to encourage directors to undertake risky, but potentially value-maximizing, business strategies, so long as they do so in good faith.”<sup>70</sup> The statute allows shareholders the *ex ante* option to prevent judicial hindsight evaluation of a director’s decision that, despite being made in good faith, results in a financial loss.<sup>71</sup> Thus, the statute encourages individuals to serve as directors by granting them assurance that, as long as they act within the law and in good faith, the corporation will bear any losses that result from the exercise of their duties.<sup>72</sup> The vast majority of Delaware corporations have elected to include this provision in their certificate of incorporation.<sup>73</sup>

## 2. Sarbanes-Oxley Act of 2002

In the aftermath of the Enron and WorldCom debacles, Congress enacted the Sarbanes-Oxley Act. Sarbanes-Oxley established prescriptive requirements for external financial reporting, internal audit objectivity and board audit committee independence.<sup>74</sup> Sarbanes-Oxley largely pre-empted state common law in these targeted areas.<sup>75</sup> However, Sarbanes-Oxley did relatively little, if anything, to address the general principles of director

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<sup>67</sup> *Disney*, 907 A.2d at 752 (citing *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001)).

<sup>68</sup> DEL. CODE ANN. tit. 8, § 102(b)(7)(i-iv) (2001).

<sup>69</sup> *See Veasey & Di Guglielmo*, *supra* note 13, at 1435 (citing *Emerald Partners v. Berlin*, 726 A.2d 1215, 1224-25 (Del. 1999)).

<sup>70</sup> *Disney*, 907 A.2d at 752 (quoting *Prod. Res. Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 777 (Del. Ch. 2004)).

<sup>71</sup> *See id.*

<sup>72</sup> *Veasey & Di Guglielmo*, *supra* note 13, at 1433 (quoting *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) (quoting FOLK ON THE DELAWARE GENERAL CORPORATE LAW: FUNDAMENTALS § 145.2 (Edward D. Welch et al. eds., 2001))).

<sup>73</sup> *Disney*, 907 A.2d at 752.

<sup>74</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in various sections of 15 U.S.C. and 18 U.S.C.).

<sup>75</sup> *Johnson & Sides*, *supra* note 6, at 1209-10.

fiduciary duty.<sup>76</sup> Delaware's Vice Chancellor Leo Strine argued that Sarbanes-Oxley requires corporate directors to spend a substantial portion of their time fulfilling regulatory mandates that are in large part unrelated to the core problems that gave rise to the legislation.<sup>77</sup> Vice Chancellor Strine further noted that Sarbanes-Oxley has had the "perverse effect" of impinging on the time directors have to monitor and oversee the corporation's interests.<sup>78</sup>

Given the focus of Sarbanes-Oxley, the area of director fiduciary duty remains, arguably, within the full control of state common law.<sup>79</sup> That said, there are two sections of Sarbanes-Oxley that could *possibly* be used to prosecute breach of general fiduciary duty: the ethics code requirement<sup>80</sup> and corporate counsel's duty to report breach of management fiduciary duty.<sup>81</sup>

#### a. Ethics Code Requirement

Section 406 of the Sarbanes-Oxley Act defines an ethics code as an optional set of written standards that are designed to deter wrongdoing such as conflicts of interest and violation of applicable laws and regulations.<sup>82</sup> The code should also be designed to promote honest and ethical conduct, prompt reporting of code violations, and ensure accountability for adherence to the code.<sup>83</sup>

Under Section 406, a public corporation is required to disclose *whether* it adopted an ethics code for its senior officers.<sup>84</sup> If a corporation has adopted an ethics code, it must provide immediate public disclosure of any changes to the code.<sup>85</sup> If a corporation has not adopted an ethics code, it must publicly disclose its reasons for not doing so.<sup>86</sup> The code, if adopted, should apply to the principal executive, financial and accounting officers, or to persons performing similar functions.<sup>87</sup>

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<sup>76</sup> *Id.* at 1219 (arguing that instead of pre-empting state fiduciary common law, Sarbanes-Oxley will likely *influence* state fiduciary analysis).

<sup>77</sup> Taub, *supra* note 14 (quoting Vice Chancellor Leo Strine in a speech delivered to the European Policy Forum).

<sup>78</sup> *Id.*

<sup>79</sup> See Johnson & Sides, *supra* note 6, at 1209-10.

<sup>80</sup> 15 U.S.C.S. § 7264 (2005).

<sup>81</sup> 15 U.S.C.S. § 7245 (2005).

<sup>82</sup> 17 C.F.R. § 229.406 (2003).

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

b. Corporate Counsel Requirement to Report Breach of Fiduciary Duties

Section 307 of the Sarbanes-Oxley Act places a disclosure requirement on all attorneys who represent public corporations before the SEC.<sup>88</sup> Under this requirement, attorneys are required to report material violations of fiduciary duty to the chief legal counsel or chief executive officer of the corporation, and if necessary, to the board of directors.<sup>89</sup> Failure to comply with this requirement could result in temporary or permanent suspension of the right to practice in front of the SEC, but does not create a private right of action.<sup>90</sup>

C. *Self-Regulating Organization Heightened Listing Standards*

After the passage of Sarbanes-Oxley, the SEC issued a set of standards that required publicly traded corporations to maintain a board audit committee that is comprised of independent directors.<sup>91</sup> The SEC also issued a new rule under the Exchange Act to clarify the definition of “independent director.”<sup>92</sup> The SEC required all national stock exchanges and associations to create or amend their listing requirements to include the new SEC standards for board audit committee independence.<sup>93</sup>

Following the SEC’s new standards, the New York Stock Exchange (“NYSE”), American Stock Exchange (“AMEX”), NASDAQ and the National Association of Securities Dealers (“NASD”) implemented heightened listing requirements.<sup>94</sup> These requirements included provisions for greater board of director independence and an increased role for independent directors.<sup>95</sup> The NYSE also required separate committees comprised of independent directors for both corporate governance and compensation.<sup>96</sup> Additionally, the NYSE required all companies to adopt corporate govern-

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<sup>88</sup> 15 U.S.C.S. § 7245.

<sup>89</sup> *Id.*

<sup>90</sup> 17 C.F.R. § 205.6-7 (2005).

<sup>91</sup> See Johnson & Sides, *supra* note 6, at 1158 (explaining that the SEC enacted the “Standards Related to Listed Company Audit Committees” to heighten the requirements imposed on the audit committees for publicly traded corporations).

<sup>92</sup> *Id.* (stating that the SEC issued Rule 10A-3 under the Exchange Act to clarify the term “independent director” and complement the Standards Related to Listed Company Audit Committees).

<sup>93</sup> *Id.*

<sup>94</sup> J. Robert Brown, Jr., *The Irrelevance of State Corporate Law in the Governance of Public Companies*, 38 U. RICH. L. REV. 317, 369 (2004); Johnson & Sides, *supra* note 6, at 1158.

<sup>95</sup> Brown, *supra* note 94, at 369-70.

<sup>96</sup> Johnson & Sides, *supra* note 6, at 1162.

ance standards and required the chief executive officer, at the risk of public reprimand, to annually certify that he knew of no violations of the governance standards.<sup>97</sup> NASDAQ required that board of director nominations and compensation be approved by a majority of independent directors or by a completely independent board.<sup>98</sup>

While these heightened listing requirements are appropriately targeted to help ensure board members make objective business decisions and exercise responsible management oversight, these requirements do not create a private right of action.<sup>99</sup> In fact, the only remedy available is for the exchange to de-list the corporation's stock.<sup>100</sup>

## II. *IN RE THE WALT DISNEY COMPANY DERIVATIVE LITIGATION*

### A. *Facts*

In April 1994, following ten years of delivering remarkable results for Disney, Frank Wells, President and Chief Operating Officer, died in a helicopter crash.<sup>101</sup> Shortly thereafter, Michael Eisner ("Eisner"), Disney's Chairman and CEO, underwent quadruple bypass surgery.<sup>102</sup> The unfortunate timing of these two events set off an enormous amount of speculation that convinced Eisner of the need to hire a new President.<sup>103</sup>

Eisner's first choice was his long-time friend, Michael Ovitz ("Ovitz"), the creator and then-partner of Creative Artist Agency ("CAA").<sup>104</sup> At that time, CAA was the premier talent agency in Hollywood.<sup>105</sup> CAA employed 550 individuals, represented 1400 top Hollywood actors, directors, writers and musicians, and earned \$150 million in annual revenues.<sup>106</sup> Ovitz himself was considered one of the most powerful figures in Hollywood, with a 55% share of CAA and an annual compensation of \$20 million.<sup>107</sup> Given this success, Ovitz was sought after in the entertainment industry.<sup>108</sup> In fact, Ovitz was in negotiations with Music Corporation

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<sup>97</sup> *Id.* at 1166-67.

<sup>98</sup> *Id.* at 1170-71.

<sup>99</sup> Brown, *supra* note 94, at 372.

<sup>100</sup> *Id.*

<sup>101</sup> *Disney*, 907 A.2d 693, 699 (Del. Ch. 2005).

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.* at 699-700.

<sup>105</sup> *Id.* at 700-01.

<sup>106</sup> *Id.*

<sup>107</sup> *Disney*, 907 A.2d at 701-02.

<sup>108</sup> *Id.* at 701.

of Americas (“MCA”) when Eisner first proposed the idea that Ovitz join Disney.<sup>109</sup> MCA had offered Ovitz a lucrative deal—Ovitz would be Chairman and CEO, earn a seven-figure base salary and receive performance-based cash bonuses of up to five times the base salary.<sup>110</sup> However, in June 1995, negotiations between Ovitz and MCA concluded without reaching a mutual agreement on a contract.<sup>111</sup> Immediately thereafter, Eisner began pursuing Ovitz with the support of two of Disney’s largest shareholders, one of whom was also a director.<sup>112</sup>

Eisner and Irwin Russell (“Russell”), the chairman of the compensation committee and Eisner’s personal attorney, knew they could not match or exceed MCA’s offer and therefore focused on finding a compromise that both Disney and Ovitz could accept.<sup>113</sup> The proposed compromise was for a five-year employment agreement that granted Ovitz a \$1 million annual salary, an annual performance-based bonus, and stock options for three million shares that were guaranteed to appreciate to \$50 million by the end of the five-year term.<sup>114</sup> The employment agreement included a two-year renewal option exercisable at the end of the initial five-year term.<sup>115</sup> If the renewal option was exercised, Ovitz would be granted additional stock options for two million shares that were exercisable as of the date of renewal.<sup>116</sup> The proposed employment agreement also included a provision intended to protect both parties in the event of premature employment termination.<sup>117</sup> If Ovitz left Disney without cause, he forfeited the remaining benefits under the plan.<sup>118</sup> If Disney terminated Ovitz without cause, Disney was required to pay Ovitz a no-fault payment consisting of: Ovitz’s remaining salary; \$7.5 million a year for unaccrued bonuses; immediate vesting of the options guaranteed under the initial five-year employment agreement;

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<sup>109</sup> *Id.* at 702.

<sup>110</sup> *Id.* at 701.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* at 702.

<sup>113</sup> *Disney*, 907 A.2d at 702.

<sup>114</sup> *Id.* at 703.

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* The terms of Ovitz’s employment agreement changed slightly before final approval of the plan, replacing the \$50 million guarantee with (1) reduction in option strike price from 115% to 100% of Disney stock price on the day of grant for the options granted upon extension of the employment agreement; (2) \$10 million severance payment if the company chose not to renew Ovitz’s contract; and (3) an altered renewal option consisting of five years, \$1.25 million per year in base salary, the same bonus structure as given in the first five-year term and the grant of an additional three million in options. *Id.* at 708.

<sup>117</sup> *Id.* at 703-04.

<sup>118</sup> *Id.* at 704.

and a \$10 million cash payment for options granted upon renewal of the initial employment agreement.<sup>119</sup>

Although Russell fully recognized the need for such an extraordinary compensation package to attract Ovitz, an “exceptional corporate executive” and a “highly successful and unique entrepreneur,” he admitted that this package was above that of any CEO in corporate America (including Eisner himself) and significantly higher than that of any corporate president.<sup>120</sup> Realizing this compensation would likely raise criticism, Russell enlisted the help of both a current and past member of the board compensation committee to conduct a case study intended to reply to the expected criticism.<sup>121</sup> During this study, Ovitz’s compensation was estimated at \$23.6 million for each of the first five years or a total of \$23.9 million for each of the seven years if the employment agreement was extended, per the option.<sup>122</sup> While the study raised some significant concerns that the package gave Ovitz too good a deal with low risk and high returns, the only director made aware of these concerns was Eisner.<sup>123</sup> Moreover, at this point in the negotiations, only three directors were aware of the employment agreement details.<sup>124</sup>

On August 12, 1995, Eisner and Ovitz entered into a “handshake deal” for Ovitz to join Disney and on August 14, Eisner and Ovitz signed an agreement outlining the basic terms of Ovitz’s employment.<sup>125</sup> It was not until this point that Eisner called the remaining uninformed board members to tell them of the impending deal.<sup>126</sup> Although Ovitz’s employment was conditioned on Board approval, Eisner issued a press release disclosing the agreement publicly—a press release that resulted in a 4.4%, or \$1 billion, single-day stock price increase.<sup>127</sup> On September 26, 1995, over a month after this press release, the board compensation committee unanimously approved Ovitz’s employment agreement.<sup>128</sup> The compensation committee’s approval was given during a one-hour meeting that considered five different, but important, compensation subjects, including Russell’s

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<sup>119</sup> *Disney*, 907 A.2d at 704.

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

<sup>122</sup> *Id.* at 705.

<sup>123</sup> *Id.* at 705-06.

<sup>124</sup> *Id.* at 706. The only three board members aware of the negotiations and impending deal with Ovitz were Eisner, Russell (who was negotiating the deal) and Watson (who was assisting in the compensation case study). *Id.* at 702-06.

<sup>125</sup> *Disney*, 907 A.2d at 706-07.

<sup>126</sup> *Id.* at 707.

<sup>127</sup> *Id.* at 708; Post Trial Answering Brief for Non-Ovitz Defs.’ at 10, *Disney*, 907 A.2d 693 [hereinafter Defs.’ Answer].

<sup>128</sup> *Disney*, 907 A.2d at 708-09.

\$250,000 compensation for negotiating the Ovitz deal.<sup>129</sup> The full Board, after asking questions of both Eisner and Russell, also unanimously approved hiring Ovitz during the executive meeting held later the same day.<sup>130</sup> On October 1, 1995, after four months of negotiations, analysis and case studies, Ovitz began his tenure as the President of Disney.<sup>131</sup>

Unfortunately, Ovitz did not perform as an “exceptional corporate executive” in the eyes of Disney.<sup>132</sup> Instead, by the summer of 1996, it was evident that the elitist Ovitz was having difficulties adjusting to the egalitarian Disney culture and working for his long-time friend, who turned out to have a completely different corporate philosophy.<sup>133</sup> It was also apparent that these differences were unlikely to be resolved.<sup>134</sup>

In late 1996, Eisner began negotiations to work out the details of Ovitz’s termination.<sup>135</sup> After several consultations with Disney’s corporate counsel, it was agreed that Disney did not have sufficient justification to terminate Ovitz for cause and would have to pay the no-fault termination payment included in Ovitz’s employment agreement.<sup>136</sup> During discussions with Ovitz regarding his termination, Ovitz made several requests above and beyond the agreed upon no-fault termination payment.<sup>137</sup> Eisner denied every additional request Ovitz made, agreeing only to live up to the employment agreement—which was a fortune in itself.<sup>138</sup> On December 12, 1996, Eisner issued another press release—this time announcing Ovitz’s termination.<sup>139</sup> Thus, Ovitz’s employment ended much as it had begun: with a press release that occurred before the Disney Board met, discussed, or voted on Eisner’s decision.

## B. *Procedural Posture*

In early 1997, two shareholders, William and Geraldine Brehm (“Brehms”) filed a derivative action on behalf of the Disney Company al-

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<sup>129</sup> *Id.*; Defs.’ Answer, *supra* note 127, at 10 n.19.

<sup>130</sup> *Disney*, 907 A.2d at 710.

<sup>131</sup> *Id.* at 711.

<sup>132</sup> *Id.* at 713-718.

<sup>133</sup> *Id.* at 713-14, 718.

<sup>134</sup> *Id.* at 714.

<sup>135</sup> *Id.* at 728.

<sup>136</sup> *Disney*, 907 A.2d at 728.

<sup>137</sup> *Id.* at 733 (stating that Ovitz requested to keep his seat on the Disney board, be given a consulting role with Disney, be provided with the continued use of an office and staff, be allowed to maintain his health insurance, home security and company car benefits, and requested the company repurchase his private plane).

<sup>138</sup> *Id.*

<sup>139</sup> *Id.* at 735.

leging that twelve current or former directors (“Board”) had breached their fiduciary duties in connection with the hiring and no-fault termination of Michael Ovitz.<sup>140</sup> The director-defendants moved for a judgment on the pleadings, claiming that the Brehms failed to state a claim under Court of Chancery Rule 12(b)(6) and failed to make a demand on the Board to pursue the alleged cause of action under Rule 23.1.<sup>141</sup> Because of the defendants’ reply and the Chancery Court’s refusal to allow the plaintiffs to move the Disney litigation to California, the Brehms filed an amended complaint that substantially enlarged the lawsuit.<sup>142</sup> The amended complaint added: (1) sixteen new plaintiffs; (2) the current Disney Board as additional defendants; (3) claims for breach of the duty to disclose; and (4) a claim against Ovitz for breach of contract.<sup>143</sup> Chancellor Chandler dismissed the suit under both Rules 12(b)(6) and 23.1 with prejudice.<sup>144</sup> In so doing, Chancellor Chandler held the facts in the pleading failed to create a reasonable doubt that the Disney Board acted with self-interest, lacked independence or failed to apply their business judgment in approving or honoring Ovitz’s employment agreement.<sup>145</sup> In holding the director-defendants were protected by the business judgment rule, Chancellor Chandler stated that just as “[n]ature does not sink a ship merely because of its size . . . neither do courts overrule a board’s decision to approve and later honor a severance package, merely because of its [\$140M] size.”<sup>146</sup>

The Delaware Supreme Court remanded for the sole purpose to allow the plaintiffs an opportunity to better plead the facts.<sup>147</sup> Chief Justice Veasey, speaking for the court, agreed that the complaint, as submitted, failed to create reasonable doubt of the defendants’ disinterest or lack of independence; however, he believed that some of the facts called into ques-

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<sup>140</sup> *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 351 (Del. Ch. 1998) [hereinafter *Disney I*].

<sup>141</sup> *Id.* Under Delaware corporate law, the cause of action belongs to the corporation. Before a stockholder can bring an action, he must: (1) demand that the corporation pursue the cause of action; (2) prove the corporation improperly denied his request, or alternately; (3) demonstrate that demand on the board would be futile. DEL. CT. CH. R. 23.1. *See also* Jaclyn J. Janssen, *In re Walt Disney Company Derivative Litigation: Why Stockholders Should Not Put Too Much Faith in the Duty of Good Faith to Enhance Director Accountability*, 2004 WIS. L. REV. 1573, 1577 (2004) (explaining Rule 23.1).

<sup>142</sup> *Disney I*, 731 A.2d at 351 (citing *In re The Walt Disney Co. Derivative Litig.*, No. 15-452 (Del. Ch. 1997), where the Chancery Court refused to allow the Brehms to voluntarily dismiss the suit in Delaware to bring the same suit in California, holding this tactical change of forums would prejudice the defendants).

<sup>143</sup> *Id.*

<sup>144</sup> *Id.* at 361, 364-65, 379.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.* at 350.

<sup>147</sup> *Brehm v. Eisner*, 746 A.2d 244, 248 (Del. 2000), *aff’g in part, rev’g in part Disney I*, 731 A.2d 342.

tion the applicability of the business judgment rule.<sup>148</sup> Because Chief Justice Veasey sympathized with the plaintiffs' inability to plead facts with "particularity" when the facts were not public knowledge, he allowed the plaintiffs limited discovery and the opportunity to amend the complaint.<sup>149</sup>

On remand, with the benefit of an enhanced pleading of the facts, Chancellor Chandler denied the director-defendants' second motion to dismiss. Chancellor Chandler held that the facts, if true, evidenced a conscious and intentional disregard for a material corporate decision, adopting instead a "we don't care about the risks" attitude.<sup>150</sup> If the plaintiffs could prove these facts, the director's actions would be precluded from the protection of the business judgment rule or Delaware's "opt-out" exculpatory statute.<sup>151</sup> In allowing the plaintiffs to go to trial, Chancellor Chandler stated that Delaware law justified dismissing honest errors made by directors.<sup>152</sup> However, Chancellor Chandler clarified that Delaware law would not dismiss egregious process failures that implicated directors' honesty and good faith intentions because "the law must be strong enough to intervene against abuse of trust."<sup>153</sup>

### C. *Chancery Court Holding*

After almost eight years of procedural decisions, the Disney shareholders finally had their day in court.<sup>154</sup> Following thirty-seven days of trial, twenty-four witnesses and a review of "thousands of pages of deposition transcripts and 1,033 trial exhibits," the Chancery Court concluded that the Disney directors did not act in bad faith or commit corporate waste, and were thus protected by the business judgment rule.<sup>155</sup>

### D. *Delaware Supreme Court Holding*

Not surprisingly, the Delaware Supreme Court heard the *Disney* appeal en banc, and delivered a unanimous opinion.<sup>156</sup> Justice Jacobs, speak-

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<sup>148</sup> *Id.* at 268.

<sup>149</sup> *Id.*

<sup>150</sup> *Disney II*, 825 A.2d 286, 289-91 (Del. Ch. 2003).

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* at 291.

<sup>153</sup> *Id.*

<sup>154</sup> Disney shareholders initiated the derivative action in January 1997, for a trial that ultimately commenced on October 20, 2004. *Disney Final*, 906 A.2d 27, 35 (Del. 2006).

<sup>155</sup> *Disney*, 907 A.2d 693, 697 (Del. Ch. 2005).

<sup>156</sup> *Disney Final*, 906 A.2d at 35.

ing for the Court held that Chancellor Chandler's "factual findings and legal rulings were correct and not erroneous in any respect."<sup>157</sup> Thus, in the final episode of this eight-year conflict between Disney shareholders and their elected Board, the Delaware Supreme Court re-affirmed the high standard required to prove breach of fiduciary duty.<sup>158</sup>

### III. *DISNEY*, IF DECIDED UNDER "21ST CENTURY NOTIONS OF BEST PRACTICES"

Chancellor Chandler carefully qualified his opinion in the *Disney* litigation as being decided under the relevant law at the time of the alleged breach of fiduciary duty, not under "21st century notions of best practices."<sup>159</sup> While this statement might inspire hope in future plaintiffs and strike fear in directors who are left to wonder what rule of law might embody "21st century notions,"<sup>160</sup> neither has any reason to expect a change.<sup>161</sup> Rather, as predicted by Professor Larry Ribstein, Chancellor Chandler's admonitions are more likely a conscious acknowledgment of the political context of the day, while still refusing to buckle to the political pressure to impose liability where, under Delaware's defendant-friendly law, none exists.<sup>162</sup>

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<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Disney*, 907 A.2d at 697.

<sup>160</sup> See generally Editorial, *The Happiest Board on Earth*, L.A. TIMES, Aug. 11, 2005, at B12 [hereinafter *Happiest Board*] (cautioning that the *Disney* opinion was not a "free pass" to corporate leaders, because had the suit been filed after Sarbanes-Oxley, the outcome might have been different); *Delaware Chancery Addresses Directors' Fiduciary Duties in Walt Disney Case*, [http://www.hunton.com/files/tbl\\_s10News%5CFileUpload44%5C12093%5CDisneyClientAlert.pdf](http://www.hunton.com/files/tbl_s10News%5CFileUpload44%5C12093%5CDisneyClientAlert.pdf) (last visited Dec. 20, 2006) (cautioning that the *Disney* opinion left room to re-define the gross negligence standard under post-Enron corporate governance practices).

<sup>161</sup> See generally *Chancellor Rules in Favor of Disney Directors in Closely Watched Stockholder Litigation*, [http://www.friedfrank.com/cmemos/050818\\_chancellor\\_rules.pdf](http://www.friedfrank.com/cmemos/050818_chancellor_rules.pdf) (last visited Dec. 20, 2006) (opining that the *Disney* ruling is welcome news that confirms the "continuing vitality of the business judgment rule . . . and the very limited circumstances" where Delaware directors are at risk for personal liability); *Delaware Chancery Court in Disney Affirms Business Judgment Rule Deference; Failure to Abide by Best Practices Not Tantamount to Fiduciary Duty Breach*, <http://www.paulweiss.com/files/Publication/6a65daf2-21f8-4bf6-b541-15d10b8c652b/Presentation/PublicationAttachment/67209454-45e8-4c88-a5b9-16d0c3c27ff5/MA081805.pdf> (last visited Dec. 20, 2006) [hereinafter Paul Weiss] (arguing that the Court of Chancery "resisted the temptation and opportunity" in a politically charged environment to abrogate the protections of the business judgment rule and instead held that "redress must come from the markets and . . . free flow of capital").

<sup>162</sup> See Larry Ribstein, *A Disney Preview*, July 10, 2005, <http://www.busmovie.typepad.com/ideo>

### A. *Common Law*

Despite Chancellor Chandler's initial qualification, there is no reason to believe the common law duties of due care, loyalty and good faith, the doctrine of waste, and the business judgment rule changed following the Enron and WorldCom debacles. As Chancellor Chandler subtly wove into his introductory statements in the *Disney* opinion, "the common law cannot hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices . . . ."<sup>163</sup> Justice Jacobs echoed this position when he gave an example of a "best scenario" that Disney directors could have followed to avoid litigation, but agreed that falling short of this "best scenario" did not equate to breach of fiduciary duty.<sup>164</sup> The common law is, by its very nature, law created by the evolution of judicial decisions. If courts are unwilling to apply the lessons learned from events such as Enron and WorldCom, then by definition the common law has not, and will not, change.

Former Delaware Supreme Court Chief Justice E. Norman Veasey stated in 2005 that while the duty of good faith is the "hallmark of the evolving expectations of directors," the *expectation* is only an aspirational standard of conduct which may not necessarily result in legal liability.<sup>165</sup> Former Chief Justice Veasey clarified that these "hallmark" standards, while highly desirable, do not define standards of liability.<sup>166</sup> In *Disney*, for example, Chancellor Chandler excused Ovitz's actions with a simple statement that it was irrelevant whether Ovitz failed shareholder *expectations* of his abilities as long as he was not grossly negligent or malfeasant.<sup>167</sup> Chancellor Chandler also excused Eisner's actions, which admittedly fell short of what shareholders *expected* from fiduciaries, because Eisner's failure to thoroughly involve the Board was not a legal violation.<sup>168</sup>

In his 2005 summary of changes in Delaware corporate law, former Chief Justice Veasey also stated that the trend of the Delaware Supreme

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blog/2005/07/a\_disney\_previe.html (last visited Dec. 20, 2006) (predicting the opinion Chancellor Chandler delivered, but suggesting that the political pressures of the day would affect the language of the opinion).

<sup>163</sup> *Disney*, 907 A.2d at 697.

<sup>164</sup> *Disney Final*, 906 A.2d 27, 56 (Del. 2006).

<sup>165</sup> E. Norman Veasey, *Corporate Governance and Ethics in a Post Enron/WorldCom Environment*, 72 U. CIN. L. REV. 731, 735 (2003) [hereinafter Veasey, *PostEnron/WorldCom*]; Veasey & Di Guglielmo, *supra* note 13, at 1419 (citing *Brehm v. Eisner*, 746 A.2d 244, 255-56 (Del. 2000)).

<sup>166</sup> Veasey & Di Guglielmo, *supra* note 13, at 1419 (citing *Brehm*, 746 A.2d at 255-56 and discussing the conundrum of whether these aspirational best practices will evolve into norms that could result in liability-producing acts or omissions).

<sup>167</sup> *Disney*, 907 A.2d at 718.

<sup>168</sup> *Id.* at 762-63.

Court has been to reverse dismissals that occurred at the pleading stage.<sup>169</sup> This genre of opinions was, in many cases, intended to raise questions stemming from extreme allegations and provide guidance that the corporate world should begin adopting best practices, without actually imposing personal liability.<sup>170</sup> Veasey concluded his article by stating that substantive law had not changed, but rather any change in litigation outcomes was due to improved pleadings by the plaintiffs.<sup>171</sup> This type of guidance can be clearly seen in *Disney*, where Chancellor Chandler concluded that while various aspects of Ovitz's hiring reflected an absence of best practices, the standards used to determine the legal conduct of fiduciaries were not the same as those used in determining best practices. While Chancellor Chandler "hope[d] that this case [would] serve to inform stockholders, directors and officers of how [Disney] fiduciaries under performed,"<sup>172</sup> he resisted the pressures presented in a politically charged environment to abrogate traditional protections afforded directors under Delaware's business judgment rule.<sup>173</sup>

### B. *Statutory Law*

Delaware's opt-out statute has not been revised since Enron or WorldCom.<sup>174</sup> Moreover, Disney shareholders specifically incorporated the exculpatory provisions of the opt-out statute into the Disney corporate charter.<sup>175</sup> Thus, even in the new era of heightened expectations, Disney's directors would not be held personally liable absent a finding of bad faith or breach of the duty of loyalty—neither of which was found.<sup>176</sup>

Despite a suggestion to the contrary,<sup>177</sup> Sarbanes-Oxley would also fail to alter the *Disney* outcome. As Chancellor Strine observed in his speech to

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<sup>169</sup> Veasey & Di Guglielmo, *supra* note 13, at 1406.

<sup>170</sup> *Id.*; see also Jonathan Macey, *Idea: Delaware: Home of the World's Most Expensive Raincoat*, 33 HOFSTRA L. REV. 1131, 1137 (2005) (explaining that the perceived juxtaposition between the decision not to dismiss the second complaint, while still giving a complete victory to the defendants two years later could be based on Delaware's desire to keep attorneys in business, yet also retain their wealth of corporate charters).

<sup>171</sup> Veasey & Di Guglielmo, *supra* note 13, at 1497.

<sup>172</sup> *Disney*, 907 A.2d at 772.

<sup>173</sup> Paul Weiss, *supra* note 161.

<sup>174</sup> See generally DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

<sup>175</sup> *Disney*, 907 A.2d at 757 (stating that Disney incorporated Del Code Ann Tit. 8 § 102(b)(7) into its certificate of incorporation).

<sup>176</sup> *Id.* at 756-57.

<sup>177</sup> See *Happiest Board*, *supra* note 160 (warning that the Disney decision did not give directors a "free pass," but rather pointedly noting that the result might have differed if the shareholders had filed suit after Sarbanes-Oxley was passed).

the European Policy Forum, Sarbanes-Oxley incorporates sensible ideas into “narrow provisions of dubious value.”<sup>178</sup> These narrow provisions target the accuracy of external financial reporting, internal audit objectivity and board audit committee independence.<sup>179</sup> Given this very narrow focus, the “value” that Sarbanes-Oxley adds to the shareholder is minimal because actionable violations of the Sarbanes-Oxley provisions will typically also be actionable under traditional fraud.<sup>180</sup> Additionally, neither the ethics code, nor the requirement for corporate counsel reporting would likely impact the court’s decision.

First, the Sarbanes-Oxley ethics code is only a suggested control that is intended to apply to the principal executive and financial officers, not necessarily to the board, and does not include an enforcement mechanism or private right of action.<sup>181</sup> More importantly, even if Disney had adopted an ethics code and applied this code to its board of directors, it is unlikely that *trusting* the Chairperson and CEO to make decisions almost entirely without consultation would violate an *ethical* responsibility of *directors*. In fact, Delaware law has recognized that directors of large, multi-function corporations traditionally dedicate less than all of their time to their role as directors and must satisfy their obligations through appointing officers, delegating authority and monitoring officer performance against established goals.<sup>182</sup> Additionally, there was no suggestion that Eisner or any board members, with the possible exception of Russell and Ovitz himself,<sup>183</sup> received any personal benefit from the hiring and firing of Ovitz.<sup>184</sup> The simple fact that the stock price jumped on the day Ovitz was announced as the new Disney President would be insufficient in any era to prove some intended personal benefit—even the wildly successful Eisner could not pre-

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<sup>178</sup> Taub, *supra* note 14.

<sup>179</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in various sections of 15 U.S.C. and 18 U.S.C.).

<sup>180</sup> Taub, *supra* note 14.

<sup>181</sup> 17 C.F.R. § 229.406 (2003); Johnson & Sides, *supra* note 6, at 1185, 1189-90 (stating that the SROs adopted the Ethics Code requirement and expanded it to give it some “teeth,” by ensuring an enforcement mechanism exists and *protections* (but not private rights) are offered to those reporting violations).

<sup>182</sup> Defs.’ Answer, *supra* note 127, at 34 (quoting *Grimes v. Donald*, 1995 WL 54441, at \*8 (Del. Ch. Jan. 11, 1995), citing Del. Code Ann. tit. 8, § 141(a) (2006) (providing that corporate business shall be managed by or under the direction of a board of directors)).

<sup>183</sup> *Disney*, 907 A.2d at 708-09 n.88 (stating that Russell received \$250,000 as compensation for negotiating Ovitz’s employment agreement); *id.* at 757-58 (holding that Ovitz did not breach his duty of loyalty by receiving the Non-Fault Termination payment because he did not initiate the termination proceedings or participate in the decision to terminate Ovitz, or the decision that his termination was without cause; rather Ovitz appropriately remained uninvolved in the Corporation’s decision-making process as related to his termination).

<sup>184</sup> See generally *Disney*, 907 A.2d 693.

dict the market's reaction to the news.<sup>185</sup> Additionally, there is no suggestion that any board member acted to liquidate stock options when this spike in the stock price occurred.<sup>186</sup>

Second, Sarbanes-Oxley's requirement for corporate counsel to report potential violations of fiduciary duty<sup>187</sup> cannot apply when, as in the *Disney* case, the executives acted under the full advice of corporate counsel.<sup>188</sup> In the *Disney* case, Eisner involved corporate counsel prior to finalizing the terms of Ovitz's salary, and in fact modified the terms upon counsel's recommendation.<sup>189</sup> Eisner also heavily involved corporate counsel during the termination decision, asking on more than one occasion whether Disney could legally terminate Ovitz for cause.<sup>190</sup> Because Eisner involved and followed the advice of corporate counsel in both the final employment agreement between Ovitz and Disney and the decision to honor this legal obligation a year later, Disney's corporate counsel did not have a breach of fiduciary duty that he could legitimately report. The *process* Eisner followed was one any shareholder would expect: Eisner consulted with legal counsel to create and later honor Disney's legal obligations.

### C. Listing Requirements

Listing requirements have gone a long way toward requiring additional board of director independence and heightened ethics standards.<sup>191</sup> However, these requirements would not change the outcome in the *Disney* case. Even if the Disney Board had explicitly met the criteria for independence set out in the listing requirements, it is unlikely the directors would have exhibited different behavior because Disney appeared to attract "hands-off" board members. While some of the board members had close connections with Eisner,<sup>192</sup> it was the *entire* Board that was content to allow Eisner to all but commit Disney to hire Ovitz before formally informing the

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<sup>185</sup> See *id.* at 708 (stating that the stock price increased 4.4%, or \$1 billion, on the day Ovitz was announced as Disney's new President).

<sup>186</sup> See generally *Disney*, 907 A.2d 693.

<sup>187</sup> 15 U.S.C. § 7245 (2006).

<sup>188</sup> *Disney*, 907 A.2d at 708.

<sup>189</sup> *Id.*

<sup>190</sup> *Id.* at 728-30.

<sup>191</sup> Johnson & Sides, *supra* note 6, at 1156, 1158-74, 1176-77.

<sup>192</sup> The Disney board consisted of at least four of Eisner's personal friends or acquaintances: Russell was his personal attorney; Mitchell was a friend chosen to sit as Chairman of the board for a \$500,000 annual salary; Bowers was the administrator of the private school attended by the Eisner children; and O'Donovan was a fellow board member of Georgetown University's board of directors. *Disney*, 907 A.2d at 760-61 n.488.

Board and giving it an opportunity to vote.<sup>193</sup> Both the compensation committee and the full Board unanimously approved Ovitz's hiring and compensation package without questioning the sequence in which the actions took place.<sup>194</sup> This example of the Disney directors' approach to oversight reflects a culture of preferring the CEO manage the company and allow the directors very high-level, and arguably after-the-fact, oversight of decisions. While listing requirements might succeed in preventing a CEO from stacking the board with friends, these requirements cannot create a different corporate culture or change the type of director sought by the company, (i.e., "hands-off" versus "hands-on"). Moreover, even if the Disney Board breached the listing requirements, these requirements do not create a private right of action.<sup>195</sup> The most severe action that could have arisen from a breach was to de-list Disney's stock.<sup>196</sup>

#### D. *Likely 21st Century Holding*

In light of the discussion above, it is highly unlikely that Chancellor Chandler, or Justice Jacobs, would have ruled any differently under current ideals of corporate best practices and post-Enron law. Despite suggestions to the contrary, post-Enron law simply does not address the basic management oversight that was at the core of the shareholder's claim in the Disney case.<sup>197</sup> It is far more likely that Chancellor Chandler's qualifying language was the only legally acceptable response he could offer in light of the political pressure he was under to find liability in the Disney case.<sup>198</sup>

### IV. ARGUMENTS FOR AND AGAINST CURRENT LAW

#### A. *Arguments for Current Law*

The current legal structure is premised on the rationale that investor interests are best served if directors have the latitude and autonomy to as-

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<sup>193</sup> See *id.* at 708-10 (summarizing the one-hour Compensation Committee meeting where the Committee unanimously approved the terms of Ovitz's employment agreement, and the subsequent Executive Board of Directors meeting where the directors unanimously approved the decision to hire Ovitz).

<sup>194</sup> *Id.* at 709-10, 761-62.

<sup>195</sup> Brown, *supra* note 94, at 372.

<sup>196</sup> *Id.*

<sup>197</sup> See *Happiest Board*, *supra* note 160 (noting Judge Chandler's suggestion that the Disney case might have turned out differently under Sarbanes-Oxley).

<sup>198</sup> See Ribstein, *supra* note 162.

sess risk, cost and expected returns without fear that bad judgment will result in personal liability.<sup>199</sup> The high burden required of plaintiffs in establishing liability prevents a finding of director liability simply because, in hindsight, the director made the wrong call. By refusing to constrain boards of directors with prescriptive procedures and regulations, Delaware law gives the board of directors broad flexibility to act in what it believes is the best interest of the corporation, relying on the shareholder and fiduciary duty to keep the board faithful to its duties.<sup>200</sup> However, in clear cases of director bad faith and breach of the duty of loyalty, such as seen in Enron and WorldCom, the common law would effectively impose liability. In these cases, the directors are stripped of both the presumption of the business judgment rule and Delaware's opt-out statute—leaving them to defend their actions under the duty of loyalty and good faith.<sup>201</sup> Under such a structure, directors are more willing to serve corporations and do so in a risk-balanced, reward-seeking fashion to maximize shareholder return.<sup>202</sup>

#### B. *Arguments Against Current Law*

Under the current legal structure, directors do not have a consistent legal expectation. Directors cannot know with any certainty if their actions will qualify as sufficient under a subjective “reasonable director” standard. This subjectivity of this standard is further compounded by the fact that it is applied by different fact finders that will range from a jury of “peers” to a well-seasoned judge with experience in corporate law. By the same token, the standard of liability is set so high that director breaches are rarely found, even when well deserved.<sup>203</sup>

In an attempt to recognize the limitations plaintiffs face in attempting to discover facts that are not public knowledge, Delaware courts have made it relatively easy for plaintiffs to state a claim against corporations.<sup>204</sup> As a result, plaintiffs have an incentive to initiate litigation every time they do

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<sup>199</sup> Veasey & Di Guglielmo, *supra* note 13, at 1413, 1422-28.

<sup>200</sup> See Taub, *supra* note 14 (citing Vice Chancellor Strine's speech to the European Policy Forum).

<sup>201</sup> *Disney*, 907 A.2d 693, 746-47 (Del. Ch. 2005) (quoting *Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988) and citing *In re J.P. Stevens & Co., Inc. S'holders Litig.*, 542 A.2d 770, 780 (Del. Ch. 1988)); Veasey & Di Guglielmo, *supra* note 13, at 1435 (citing *Emerald Partners v. Berlin*, 726 A.2d 1215, 1224 (Del. 1999)).

<sup>202</sup> See Veasey & Di Guglielmo, *supra* note 13, at 1424, 1433.

<sup>203</sup> See *supra* notes 36 & 59 and accompanying text.

<sup>204</sup> See, e.g., *Disney II*, 825 A.2d 275, 291 (Del. Ch. 2003).

not like the results of a decision.<sup>205</sup> However, because the burden they face to establish actual liability is so high, plaintiffs rarely succeed in litigation.<sup>206</sup> The result of this combination of “easy to plead but tough to succeed” is a costly, time-consuming process that only further diminishes shareholder return.

Judges and juries do not have the expertise, generally speaking, to make “reasonable director” assessments, nor the benefit of a legal rule that allows consistent application to all cases. Despite the fact-finder’s best efforts, personal subjective values are likely to creep into the decision of liability regardless of whether the finding of liability truly upholds the values of the corporation, directors and shareholders.

#### V. PROPOSED SOLUTION: A FRAMEWORK TO BALANCE DIRECTOR AUTONOMY, SHAREHOLDER EXPECTATIONS, AND LEGAL CONSISTENCY

In an environment where individuals, independently or via investment firms, make investment decisions based on personal preferences, including level of risk tolerance, corporate culture, industry knowledge, and similar considerations, corporations do not have “generic” shareholders with “generic” expectations or ideals for what constitutes director best practices. At one end of the spectrum, shareholders may prefer a hands-off board that encourages management to take risks believed to reap rewards. At the other end of the spectrum shareholders may prefer a hands-on board that requires management to produce sustained results through cautious, approved risk-taking. Thus, what is in one corporation a blatant violation of shareholder trust might be exactly the type of risk-taking the shareholder bargained for in another corporation. Judges, however, do not have the luxury of tailoring the current rule of law to allow for customized shareholder expectations. As a result, generic rules applied by current state common law are not effective in ensuring directors are faithful to the expectations of their particular shareholders. Additionally, the vagueness and subjectivity of the current state common law creates legal uncertainty for directors and can result in inconsistent application of the rule of law. It is clear that the law cannot continue as is—directors need legal certainty and the courts need a consistent approach they can apply to customized shareholder expectations.

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<sup>205</sup> See Macey, *supra* note 170, at 1137 (arguing that Chancellor Chandler’s opinion encouraged future lawsuits with a “please file claims” sign on the door of the court to ensure demand for attorney’s services remained strong, despite the fact that Delaware law would remain generally pro-defendant).

<sup>206</sup> See Veasey & Di Guglielmo, *supra* note 13, at 1496-1503.

In adopting a new legal rule—be it common law or statutory—we should refrain from specifically prescribing the duties of a corporate director. A “one-size-fits-all” approach will not adequately address the needs of each unique corporation or incorporate the expectations of each unique shareholder group. Moreover, a prescriptive rule will likely decrease the willingness of individuals to serve on corporate boards. Instead, the law should allow shareholders to have a direct impact on the rules against which their corporate board is judged. For example, former SEC Chairman William Donaldson backed a proposal that would allow larger shareholders to replace supine board members with their own nominees.<sup>207</sup> This approach, while a good start to giving shareholders more control over the persons that are selected to protect the shareholders’ interests, does not address the problem of how directors are judged in court for possible breach of fiduciary duty.

With that in mind, this note proposes to change the Model Business Corporation Act to include an option for corporations to adopt, with shareholder approval, a Board of Director Responsibilities and Authority Guideline (“BRAG”). The BRAG would specify the level of review and approval required for all types of transactions and decisions encountered by the corporation. The BRAG, as a minimum, would specify those transactions that require senior management and/or board of director approval. The BRAG could also be extended to include lower level management decisions and approvals. In concept, low-risk, low-value decisions would require low-level management approval. As risk and value increase, the level of management and/or board approval required would also increase.

Each corporation would establish its own BRAG consistent with its culture and shareholder risk tolerance. Thus, the BRAG would allow the shareholders to decide at what level of decision-making they want the board of directors to be involved and at what level they are comfortable with the board delegating authority to the corporation’s management. The BRAG would allow a corporation to embed shareholder expectations in its decision-making process and create a system to ensure these expectations were honored.

By way of example, in a corporation like Disney, the BRAG might reasonably include some of the following responsibilities and associated delegation of authority.<sup>208</sup>

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<sup>207</sup> *Happiest Board*, *supra* note 160 (mentioning Donaldson’s proposal, but noting that the proposal met with vigorous corporate opposition).

<sup>208</sup> This example is illustrative only.

<u>Transaction Description</u>	<u>Required Level of Approval</u>					
	<u>Board of Directors</u>	<u>CEO</u>	<u>President</u>	<u>Vice President</u>	<u>Controller</u>	<u>General Counsel</u>
Elect/Terminate Senior Executives	A	E	--	--	E	E
Establish Executive Compensation	A	E	--	--	E	E
Enter into Joint Ventures	>\$500M	\$500M	E	E	E	E
Enter into Contracts	>\$500M	\$500M	\$250M	\$100M	E	E
Invest Capital	>\$500M	\$500M	\$250M	\$100M	E	E
Approve Expense Budget	>\$1000M	\$1000M	\$500M	\$250M	E >\$250M	E >\$250M
Extend Credit	>\$100M	\$100M	\$50M	\$25M	E	E >\$25M
Write Off Assets	>\$100M	\$100M	\$50M	\$25M	E	E >\$25M

A = Approval Required (regardless of value)  
E = Endorsement Required (regardless of value, unless noted)  
\$XXM = Approval Authority Threshold

Unlike federal laws, such as Sarbanes-Oxley, this proposed change in the Model Corporation Business Act should allow a private right of action to recover damages but should not address criminal liability—an area already covered by other legislation. In the event of shareholder litigation against a corporation that had adopted the BRAG, a court would test the director's potential breach of fiduciary duty against the corporation's shareholder-approved BRAG. If the corporation chose not to adopt the BRAG, the court would default to state common law. By making the BRAG optional, motivated shareholders could seize the opportunity to help write the rules by which the corporation they invest in is governed and later judged. Meanwhile, the new optional rules would not go so far as to force shareholders to make changes where, in the shareholders' view, none are needed. Nor would the new optional rule impose a different set of regulations in the absence of the BRAG. Thus, shareholders would be free to stay with the "Mickey Mouse Rule" enunciated in the Disney opinion, or assist in developing and adopting custom rules to govern the actions of the corporation—both in everyday business decisions and, if necessary, in court.

This proposed legal approach would provide corporate directors greater legal certainty in the execution of their duties; it would also provide shareholders with protection commensurate with their ex ante expectations. The BRAG would prevent application of the “reasonable director standard.” The reasonable director standard is a vague standard that requires the fact-finder to determine director liability based on his or her biased, and likely limited, understanding of a director’s responsibilities. Instead, by applying the requirements of the corporation’s BRAG, the fact-finder would be able to determine director liability based on an objective review of the director’s actions as compared to the responsibilities outlined in the shareholder-approved BRAG.

#### CONCLUSION

Recognizing that every corporation has a different structure and culture upon which shareholders rely, this legal approach would allow the courts to review potential breaches of fiduciary duty against these unique shareholder expectations.

The proposed rule would ensure four key results. First, the rule would ensure a consistent legal approach when dealing with potential breach of fiduciary duty. Second, the rule would provide directors with more legal clarity on the discharge of their duties. Third, the rule would diminish the number of frivolous or long shot shareholder lawsuits filed. Additionally, fewer claims would survive motions to dismiss unless the actions the shareholders challenged specifically violated the BRAG. Finally, the rule would establish a system of dual accountability for both directors and shareholders to ensure the corporation’s pursuit to maximize shareholder value was performed in a mutually agreed manner.