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In re The Walt Disney Co. Derivative Litigation Rewritten

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In August 1995, The Walt Disney Company entered into an employment agreement with Michael Ovitz. The terms of the agreement provided that Ovitz would become the company president and serve in that role for five years. Yet a short fourteen months later, the company terminated Ovitz without cause. The severance payment was valued at $130 million.

Whether — and how — the board of directors, together with Michael Eisner (Chief Executive Officer) and Sanford Litvack (Executive Vice President and General Counsel), made those decisions have been the subject of considerable public speculation. These questions are at the core of this matter, which presents the appeal of a post-trial opinion of the shareholder derivative actions. The Chancery Court ruled on several pre-trial opinions, one of which was appealed to this Court, resulting in a trial. After a 37-day trial, the Chancellor issued an opinion finding that the plaintiffs had failed to meet the requisite standard of proof for a derivative challenge based on either a breach of fiduciary duties or waste against the board and Eisner, Litvack, and Ovitz. Despite our serious misgivings about the directors’ actions and approach — namely the one-off and non-inclusive decision-making atmosphere, the composition of the board in terms of its lack of gender diversity (for example), and the actions of Eisner, Ovitz, and Litvack as outlined below — we ultimately agree with the Chancery Court and uphold its findings.

I

This case has its roots in the approach of a CEO who faced health issues and wanted to control his succession (and maybe his successor). The board, which appears to have been well-stocked with primarily male friends of the CEO, and which operated a bit like the type of private men’s clubs that have been on the wane for many years now,¹ went along with the CEO’s proposal, raising few questions about the strategy,

¹ For example, lawsuits and other pressure resulted in changes to the granting of alcohol licenses that essentially made it impossible for private clubs that did not allow certain groups (like women to
compensation, or execution. This is what happens when a board lacks diversity and the creative friction that diversity creates. It is what happens when a board has fewer than three women on it, and it is what happens when the CEO decides to hire a friend with whom he has had a social relationship for over twenty-five years – and over whom he believes he can exercise control. Nevertheless, these choices, although inconsistent with good corporate governance, arguably careless, and possibly even lacking in emotional intelligence, do not amount to actions not taken in good faith – at least not unless we are prepared to rule that a board that is virtually all male itself lacks good faith. Therefore, these choices are not ones for which we can impose liability, no matter how tempted we might be.

A

In order to understand the decision, it is best if we begin with a description of the process and players. Michael Eisner, the chair and CEO, was good friends with Michael Ovitz, who had a long history with the Creative Artists Agency (CAA), in which he was a founding partner. CAA was a privately held premier Hollywood talent agency, controlled by Ovitz and Ron Meyer. In April 1994, after Eisner had a heart attack and realized that he might not live forever, he spent time thinking about a potential successor and focused on Ovitz, a friend of twenty-five years. Ovitz, in turn, had just learned that his co-founder was leaving CAA for a position that Ovitz had wanted, thus making it unpalatable for Ovitz to remain at CAA. At the time, Eisner had been president of Disney for only three months, having succeeded Frank Wells, who had died in a helicopter crash a year earlier. Following Wells’s death, Disney created a shortlist of potential internal successors (and no external candidates) but found none of them viable. Thus, Eisner assumed the presidency.

In the spring of 1995, after initial discussions between Eisner and Ovitz, and apparently little consultation with the board of directors, Eisner reached out to


It may also be symptomatic of the entertainment industry’s business model that undervalues women – and a company that is famous for perpetuating gender stereotypes and overemphasizes female characters’ physical appearance. See, e.g., Mia Adessa Towbin et al., Images of Gender, Race, Age, and Sexual Orientation in Disney Feature-Length Animated Films, 15 J. FEMINIST FAM. THERAPY 19 (2004). In more than half of such films, Disney also fails to feature at least two women who talk to each other about something other than a man – a test widely known as the “Bechdel test,” named after the American cartoonist Alison Bechdel, in whose 1985 comic strip Dykes to Watch Out For the test first appeared. Alison Bechdel, Dykes to Watch Out for (1986).


Id. (citing Tr. 3997:24–3999:4; see also 6025:7–19).

Eisner did discuss the Ovitz possibility with Roy Disney (a director) and Sid Bass, who were two of the company’s largest shareholders.
Irwin Russell, an entertainment lawyer who was Eisner’s personal attorney and the chair of Disney’s Compensation Committee, to strike a deal. Russell negotiated with Ovitz’s attorney and was told, but did not verify, that Ovitz was making between $20 and $25 million per year from CAA and owned 55 percent of the company. Ovitz insisted that he would not give up that ownership interest without downside protection.

When Russell had put together the basic terms of Ovitz’s agreement, he provided a case study of it to both Eisner and Ovitz. Russell noted that the compensation seemed extraordinary, stating that the proposed salary was at a very high level for any corporate officer and higher than Eisner’s. He further noted that the stock option grant exceeded Disney’s standards and would be subject to criticism. His words fell on (tone) deaf ears, and the case study was not provided to any other board member.

Due to Disney’s policy against front-loading contracts, Russell and Eisner looked for other ways to provide Ovitz with downside protection. When considering his compensation, however, the compensation committee did not consider Ovitz’s agreement with Ron Meyer and Bill Haber to transfer their interests in CAA in exchange for 75 percent of the next four years’ revenues. The negotiations resulted in a salary of $1 million and a bonus (which Ovitz was told would be approximately $7.5 million annually) with a very lucrative multi-year option package – which would allow Ovitz to receive payments even if he was fired for reasons other than gross negligence or malfeasance. Disney also agreed to purchase Ovitz’s personal jet for $187,000 more than its appraised value, his BMW at acquisition cost and not its depreciated market value, and his computers at replacement value instead of book value.

In Russell’s opinion, it was “appropriate to provide Ovitz with downside protection and upside opportunity” – even if all of the risk of the arrangement were transferred to Disney. Indeed, Russell apparently felt that regardless of the anticipated “very strong criticism,” Disney needed to address the “lifestyle challenges” Ovitz would face when leaving CAA’s considerable cash compensation and perquisites, because at Disney, a public company, the cash compensation would be lower.

As the facts make clear, Disney was very willing to offer up that protection, even though when Ovitz negotiated to leave CAA, he transferred his interests with an agreement for an exchange of revenues over a multi-year period, subject to some financial benchmarks. It was unclear that Ovitz would receive the projected revenues or even whether CAA would be profitable in his absence; therefore, arguably, this potential compensation should not have been considered. Nevertheless, the record indicates that the Disney Compensation Committee did not consider the tentativeness of this arrangement.

Although Russell conducted all the initial negotiations on his own, he did consult other experts, notably all men, but “only after there was a good possibility of a deal” and the “financial terms of the OEA [were] sufficiently concrete.” He engaged Graef Crystal, a compensation consultant, and Ray Watson, another member of the

6 907 A.2d at 704 n.40, 704.
compensation committee, in the process. Crystal’s report, however, was presented after extensive discussion between the three men, working through “various assumptions and manipulat[ing] inputs in order to generate a series of values” attributable to the agreement. The report highlighted the low-risk, high-return aspect of the package, to which Crystal was “philosophically opposed.” Most concerning to Crystal was the $50 million option appreciation guarantee, with an in-the-money windfall available at the end of five years. Russell raised these concerns to Eisner alone, who stated that he did not read the package the same way and pushed back. As a result, Crystal revised his views in part, but remained concerned about the overall size of the compensation package, which, notably, was larger than that of any public company officer at the time. Crystal’s revised report was completed six days after the original memo and four days after the letter agreement (“OLA”) was signed and the press release issued.

During the same week, Eisner spoke with Ovitz and worked through proposed “titles” and what turned out to be significant opposition from key Disney officers. Ovitz apparently believed that he and Eisner would be equals and co-CEOs, but Eisner was not interested in sharing his title as Chair. In addition, Sanford Litvack, who was General Counsel, and Steve Bollenbach, who was Chief Financial Officer, were both opposed to Ovitz’s hire. They felt privileged not just to express that view but also to demand that they not report to Ovitz. The record indicates that Litvack believed that he should be getting the job and resented Ovitz. Bollenbach’s reasons for opposing Ovitz were less clear. Bollenbach’s “testimony seemed disingenuous . . . when he pinned his resistance on the fact that he had been part of a cohesive trio.” His testimony emphasizes the degree of privilege the male leaders of Disney exhibited. The result was that Eisner went back to Ovitz to tell him that he would become the president but not the chief operating officer, and that two of Disney’s key officers would continue to report to Eisner. With “his back against the wall,” and despite the “mutiny,” Ovitz agreed to accept the conditions.

A mere two days following Crystal’s original memo and only four days after contacting Watson, Eisner and Ovitz signed the OLA, which was made public that day. Eisner then proceeded to inform the rest of the compensation committee and the board, by phone and individually, although it remains unclear whether he

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7 Id. at 704.
8 Id. at 706-07.
9 Id.
10 Id. at 707.
11 Making the OLA public only furthered Eisner’s overconfidence that Ovitz was the right candidate and that his compensation was appropriate. J. Edward Russo & Paul J. H. Schoemaker, Managing Overconfidence, MIT Sloan Mgmt. Rev., Jan. 1992, at 12 (“[W]e often lean toward one perspective, and the natural tendency is to seek support for our initial view rather than to look for disconfirming evidence.”)
discussed the terms (as opposed to the decision). During the same period, an attorney at Disney worked to translate the terms into actual compensation and discovered that the tax implications were problematic. As a result, Russell, and not the committee, concluded they should eliminate the provision guaranteeing the $50 million option appreciation and revised it to achieve the back-end guarantee.

More than a month later, the compensation committee met to address multiple Disney compensation issues, including Ovitz’s agreement. The meeting lasted one hour. Crystal’s analysis and concerns, including that there were no public company presidents with compensation comparable to Ovitz’s, were not provided to the committee. Indeed, the committee was given only Watson’s analysis, which used a different methodology. Crystal testified that he was available by phone, but no-one called – likely because they did not receive his report. In addition to voting to compensate Ovitz at this meeting, the committee voted to pay Russell for his negotiations and work on Ovitz’s compensation over the prior month, at the rate of $250,000.

Next, the full board, which had only one female member, convened in executive session, where it learned of the unique reporting structure but not of the concerns of Bollenbach and Litvack. Eisner led the discussion, and Watson and Russell responded to questions. Then, the board voted unanimously to elect Ovitz as President; however, it was not until almost three weeks later that the Disney Compensation Committee actually approved the terms of Ovitz’s employment agreement (OEA) and Ovitz’s option award.

B

Ovitz officially became President on October 1, 1995, and it quickly became apparent that he was not going to succeed. Indeed, within months, the disconnect between Ovitz and his style versus that of Disney – and public companies more generally – became painfully obvious. From the beginning, the Ovitz–Litvack–

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12 Delaware courts have criticized this kind of informal process. See, e.g., Cellular Info. Sys., Inc. v. Broz, 663 A.2d 1185, 1186 (Del. Ch. 1995) (emphasizing the importance of board formality and the group dynamics of board action in corporate law: “Formality in such circumstances is not ‘mere formality,’ but is treated by courts as important because it tends to focus attention on the need for deliberation and the existence of accountability structures. With respect to group dynamics, it is an old rule that boards may act with legal effect only at duly convened meetings at which a quorum is present. Again, functional reasons underlie the law’s insistence on correct form. See Robert C. Clark, Corporate Law 110–112 (1986).”)

13 Although board members are sometimes compensated for taking on considerable extra work, at best this is an odd situation. If Disney needed outside counsel to negotiate with Ovitz, the far better practice would have been for the company to hire counsel rather than using a member of the board. Eisner and Russell created the impression that Russell was being enriched through his relationship with the company. Nevertheless, $250,000, while a very significant sum of money to most of us, was – to a Hollywood entertainment lawyer like Russell – presumably not sufficient to call his judgment into question.
Bollenbach situation operated with tension, with Ovitz struggling to accept the agreed-upon reporting structure. Further, within a month of starting in the role, Litvack began to complain about Ovitz’s aggressive style, and Eisner indicated that the relationship might not improve.

When the January 1996 corporate retreat occurred, the challenges became even more apparent. At a Disney resort in Florida, the group engaged in activities and visits to the parks, with group transportation by bus. Ovitz, however, refused to ride the bus with Eisner and others, insisting on a limousine. He also declined to participate in activities and made inappropriate demands of park employees. In short, Ovitz declined to be part of the group or the culture.

This individualistic approach continued, and the relationship with Eisner began to deteriorate such that by the summer of 1996, Eisner had spoken with multiple directors about Ovitz’s failure to adapt to Disney’s culture. One board member, Gary Wilson, said that when he went cycling in France with Eisner and Ovitz in June of 1996, he realized that the rumors were true and there was a problem with Ovitz assimilating into the company.

Thus, by the fall of 1996, just over one year after the initial hiring discussions, the board members shifted gears and began to focus on whether to terminate Ovitz, responding to what they were hearing internally and externally. The media was reporting on tensions within the team, including an article based on an interview with Bollenbach. Eisner told the board that he “did not trust” Ovitz, noting non-compliance with expense policies and other concerns. Litvack said the same and complained of “spin” and being “handled.” Ovitz, of course, told a different story. He complained of Eisner’s micro-managing and explained that his inability to get things done or gain traction at Disney was due to his different philosophy.

Once again, Eisner took matters into his own hands. First, he sent Litvack to tell Ovitz that Eisner no longer supported or wanted him at Disney. Ovitz responded that if Eisner wanted him out, he “could tell him so to his face.” Second, after this childish approach failed, Eisner urged a “trade” to Sony. This too failed.

The board as a whole did not discuss the deteriorating relationship with Ovitz. Instead, Eisner spoke with some but not all members, relaying concerns and challenges. He also wrote a letter stating that if he were to be hit by a truck, Ovitz should not be named CEO, noting erratic behavior and pathological problems. But only Russell and Watson saw this letter.

Eisner’s public comments, however, were in stark contrast. For example, both Eisner and Ovitz appeared on Larry King’s show and refuted the rumors about their relationship and Ovitz’s position. Eisner even stated that “[i]f given the chance, he would hire Ovitz again.” These comments certainly appear to be a shameless

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14 907 A.2d at 720.
15 Id. at 725.
16 Id. at 726.
attempt to cover the real situation and – although this is not a court that addresses federal securities law – might well be in the zone of securities fraud.

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As the situation progressed, it became clear that Ovitz would not exit and make the problem go away. Eisner then began to press for termination, and he asked Litvack about the grounds for doing so. Litvack revisited the agreement, refreshing his understanding of “malfeasance” and “gross negligence.” He reviewed the facts of which he was aware (to be distinguished from collecting all possible facts or requesting an outside investigation), but “freely admitted” that he did no legal research, did not consult outside counsel, and produced no written work product at all. Doing so, in his view, was a “CYA tactic.” Nevertheless, Litvack concluded that it was a “no-brainer” that Ovitz could not be terminated for cause, and he relayed that view to Eisner. Eisner, in turn, “checked with almost anybody” (to be distinguished from anyone he could name) and concluded there was no for-cause option.

It also appears that Litvack decided that approaching Ovitz to negotiate a decreased exit package was not an option, despite the fact that the original agreement anticipated at least five years of employment. Litvack’s view was that Ovitz would not agree, and any attempt to coerce him would be bad for Disney. Thus, Litvack never proposed a for-cause termination or used it as a negotiating tool to, for example, extract a lower payout. Indeed, the only negotiation over Ovitz’s termination seems to have been the rejection of extra benefits that he requested.

Apparently not wanting to engage in a “public hanging,” at its November meeting, the board renominated Ovitz to a three-year term. Immediately afterwards, a subset of the board held an executive session to discuss the problems with Ovitz. Unfortunately, there are no minutes that record evidence of the discussion. Throughout this time, Ovitz apparently believed that the situation could still be rectified.

After this board meeting and several conversations with board member Wilson, Ovitz finally began to comprehend that his time at Disney was running out. Thereafter, the negotiations, which were minimal, commenced. Although Ovitz made many demands – including “keeping his seat on the board, obtaining a consulting/advising arrangement with Disney, the continued use of an office and staff (but not on the Disney lot), continued health insurance and home security, continued use of the company car and the repurchase of his plane” – the resulting

17 Id. at 728.
18 Id. at 729 n.264.
19 Id. at 729 n.269 (citing Tr. 614:24-10).
20 Id. at 729 n.270 (citing Tr. 438:10-21).
21 Id. at 730 n.276 (citing Tr. 377:21-3772:16).
termination agreement provided that Ovitz would receive a payout consistent with his original contract, which was a very substantial sum.\(^2\)

In the midst of this, the Executive Performance Plan Committee (EPPC) met to consider annual bonuses for executive officers. At this meeting, Russell informed his fellow board members of the impending termination and then recommended they pay Ovitz his $7.5 million-dollar discretionary bonus, without – it appears – any discussion of whether or why, despite Ovitz’s performance issues and impending termination. Indeed, it appears that Russell may have incorrectly advised the board that the bonus was contractually obligated despite the discretionary language in the contract. No-one spoke up or contradicted Russell, including Litvack, who later said he did not want to embarrass Russell (to be distinguished from hewing to his fiduciary duties). Indeed, shortly thereafter, Russell and Litvack “sheepishly” admitted that the bonus was a mistake, noting that “it would be illogical and impossible to justify any bonus one day and fire [Ovitz] the next.”\(^3\) Then, they asked the EPPC to rescind the bonus, which it did.

As discussions with Ovitz moved forward, discussions with individual board members continued. When a termination was finally agreed upon, it was memorialized in a letter and announced publicly – without the board having seen the letter or the terms. Apparently, the board members felt that Eisner had the power to make the decision on his own, and Eisner did not attempt to contact board members by phone to discuss it. The company did send copies of the termination letter to each board member, but with no additional information. Litvack signed the letter, and he did so only because no-one else was available.

The resulting payout to Ovitz was $130 million. Today, this is a substantial sum; ten years ago, it was worth even more. The plaintiffs, concerned about a payout of this size for what amounted to approximately fourteen months of problematic employment, filed the litigation that led to the trial and this review.

II

On appeal, we review the Chancery Court’s findings for errors in the application of the law, while respecting its first-hand decision-making with respect to the facts. There are two sets of decisions by the board at issue: the OEA and non-fault termination (NFT), as well as a series of decisions by Eisner, Litvack, and Ovitz. We separate the latter group because these three people are officers who are agents of the company, and their role and choices are cabined differently than decisions of the board. The Chancery Court found that neither the board nor the officers breached their fiduciary duties of care and loyalty, and we agree. Nevertheless, we

\(^2\) Id. at 732–33.

\(^3\) Id. at 739 n.350 (citing PTE 93).
address the directors and officers separately, clarifying that although the directors may avail themselves of the business judgment rule, the officers may not.

A

The plaintiffs argued that the board violated its fiduciary duties with respect to both the OEA and the NFT. Delaware law deploys the business judgment rule to protect business decisions where “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.” These are rebuttable presumptions, and to do so, the plaintiffs must prove that the board members were not entitled to the protections of the business judgment rule, either because they did not make a decision or because they acted in a grossly negligent or non-good faith manner. Success would result in a burden shift to the defendants to prove their actions were entirely fair to the corporation. The Court of Chancery rejected the plaintiffs’ arguments; thus, burden shifting to the defendants did not occur.

There are alleged breaches of fiduciary duty in this case. The first focuses on the duty of care, which is subject to a gross negligence standard. The second is the duty to act in good faith. There are at least three categories of actions that fall into the good-faith space. The first is where a fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation. The second is where the fiduciary acts to violate applicable positive law. The third occurs when the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for her duties. The first two categories are not at issue here, and we hold that the Chancery Court correctly found that the directors did not violate the third one.

2

The plaintiffs’ arguments center on questions about whether the board had a legal obligation to approve the OEA, the hiring of Ovitz, or the NFT. The answer, in this case, is that the board was required to approve only one of these, the actual hiring of Ovitz, which the Chancery Court found it did. Decisions about compensation at Disney are relegated, under the bylaws, to the compensation committee. The Chancery Court found that the appropriate bodies – the board for hiring and the compensation committee for the OEA and NFT – did exercise their duties.

25 See Tomczak v. Morton Thiokol, Inc., Civ. A. No. 7861, 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990) (“In the corporate context, gross negligence means ‘reckless indifference to or a deliberate disregard of the whole body of stockholders’ or actions which are ‘without the bounds of reason.’”).
Moreover, having read the company’s governing documents, we find that the Chancery Court did not err in its interpretation of those documents. The board was not required to approve either the compensation or the termination of Ovitz, and compensation was the province of the compensation committee. In light of these legal findings and given that we are bound by the lower court’s factual determinations, we do not reverse its decision with respect to the board and its good-faith decision-making. That being said, we think it worth expounding further on the role of the board, the privilege of serving as a director, and – even if it did not constitute a breach of fiduciary duty – the flawed process deployed at Disney.

3 As Section I of this opinion makes clear, Eisner set out to hire a friend of twenty-five years as his potential successor at Disney. The framing for this decision was that Eisner suffered a heart attack just months after stepping into the role of CEO, when his predecessor was killed in a helicopter accident. Thus, the Disney Board was faced in rapid succession with concerns about succession.

Although one member of the compensation committee was actively engaged in the negotiations, the others appear to have been informed by phone, and even then only when the deal was largely complete. The same is true for the board, which did not question even the extraordinary sum. As stated previously, the board was not obligated to do so. Moreover, under Delaware law, the board was entitled to rely on the committee’s determinations, but that does not mean it was required to do so. Indeed, the board had the right and the opportunity to question the committee’s approach. It did not do so. The question is why. The answer appears to be, in part, because of Eisner’s method of speaking with directors individually, which we regard as a poor substitute for convening the full board and engaging in a discussion.26

The same is true of the NFT, which again Russell “negotiated” in his role as Chair of the compensation committee. We stress the word “negotiated” here, because there does not appear to have been any negotiation beyond the rejection of Ovitz’s demands that exceeded the terms of the OEA. In reliance on Litvack, Russell moved forward with an understanding that anything other than a no-fault termination was a non-starter and simply put the terms into writing.

Note what did not happen here. The board did not vote on, or even meet to discuss, the termination. The directors did not ask for an independent investigation to determine whether a for-cause termination was possible. And even though the compensation committee discussed the matter, it did not vote on it. Indeed, there seems to have been some confusion among board members as to whether they needed to vote or convene. Some thought that Eisner had the power to make the decision on his own – although that power does not, itself, determine the board’s

26 See Bros, 663 A.2d at 1186.
role; others apparently assumed that if they needed to be involved, Litvack would have notified them.

In short, Ovitz was terminated without cause and without board discussion of the facts and circumstances. Ovitz received a payout under his contract without an internal investigation, seemingly without pushback and, instead, with the apparent assumption by Litvack that doing so was required (and his testimony at trial indicated that he has not changed his mind in the ensuing decade). 27 Indeed, it appears that Ovitz was terminated in much the same fashion that he was hired: by Eisner and Russell, without consultation or engagement with others. It also appears he was an unlikely fit from the beginning.

For many unschooled in corporate law and fiduciary duties, this recitation of facts would seem to lead to only one conclusion: this board, or at least Eisner and some directors, must be liable. How could a fiduciary not ask more questions? How could a fiduciary – or a group of them – allow Ovitz to leave with such outrageous compensation? How could they not convene to address the matter?

The answer lies in this Court’s role, the law, and, we venture to say, the composition of the Disney Board. This Court does not tell fiduciaries how to do their jobs better, desirous as that would be at times – including in this particular case. Nevertheless, this is not the first time that we have opined on one-off approaches, but we hope that it is the last. 28 To be clear, we think that individual phone calls from a CEO in lieu of a telephonic board meeting, for example, are a very poor substitute for an inclusive process that benefits from the multiple views of an array of directors – particularly a diverse array, as we discuss below. Yet, whatever we think about the “process” here and the many ways in which we note below that it could have been better, we will not find liability for failing to meet an aspirational view – even if it is our own – of what the best practices or ideal corporate governance standards are.

As unsavory as some might find this statement, particularly when it results in a payment of $150 million for fourteen months of employment, it is the cornerstone of Delaware law and a core strength of corporate governance more generally. Director fiduciaries are granted wide latitude in business decision-making (to be distinguished from the abdication of decision-making). There are, of course, limits on those degrees of freedom. Directors must act faithfully and honestly on behalf of the shareholders, and as long as they do so, their choices are allowed.

Shareholders do at times – as in this case – disagree with the decisions and outcome. Reasonable people can do so, but reasonable disagreement is not our standard, and nor should it be, particularly in hindsight. Recall that in a public

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27 Itself a very male approach. Allan Pease & Barbara Pease, Why Men Don’t Listen & Women Can’t Read Maps: How We’re Different and What to Do About It 139 (2001) (Men see asking for directions as “admitting they are wrong, and to be wrong is to fail”).

28 See Brnz, 663 A.2d 1180.
company like Disney, the shareholders have made a choice. In exchange for limited liability, they have given up the right to manage, to make management decisions, and to second-guess those decisions over time. There are many reasons for this trade-off, not least of which is that risk and profits are largely correlated and also are not completely predictable. If we want business leaders to take risks and to innovate and generate the profits that shareholders desire, we must accept that shareholders will not like every decision – particularly later, when the decision has proved flawed. Nevertheless, that is the choice shareholders make when they invest in companies. Absent board member disloyalty, or gross negligence (which in most companies is exculpated), liability is not available. The obligation of directors is to act in good faith to make informed decisions that are untainted by self-interest. Without proof of the failure to do so, the argument is really one about the choice of the decision-makers or the wisdom of the decision, both of which will vary. On this point, however, our law is clear: these areas are the purview of the directors – not the shareholders, and not the court.

That being said, as is our standard approach, the Court does provide guidance when a board falls short of best practices, and that certainly is the case here. The imperial nature of Eisner, his approach to the board, and the decisions with respect to the hiring and firing of Ovitz are stunning. And even if board approval was not required at all stages of the Ovitz saga, the decision to hire him was tied to succession planning for Eisner, who had only recently (and as a result of a lack of a succession plan) succeeded Wells. These are certainly the type of decisions about which the board might well have been concerned and into which it might even have inserted itself, despite the proverbial “nose in, fingers out” adage. Therefore, in the hope of improving future processes, we expound on the process and the opportunities for the board, creating the possibility that the opinion might provide some guidance to other officers and directors of the many corporations subject to Delaware law.

Succession planning at the top is a key role of the board, yet this board appears not to have engaged fully in the process. Instead, the board members deferred to Eisner even when doing so resulted in his hiring an old friend with a compensation package larger than that of any other public company officer. One might pause here to ask how that happened. The answer appears to be deference and a clublike atmosphere, in which individual and/or side conversations with board members were more common than convening the board for a thorough discussion.

In the case of the Disney Board, the decision to convene would in normal course have been made by the chair – here, Eisner. Nevertheless, other board members could have asked for a meeting. They were not required to do so, legally; yet, we pause to ask whether the process would have been improved if they had done so. We think yes. We still firmly believe that good processes produce better substance. In short, boards should take the time to do it right, in a thorough and inclusive manner. Nevertheless, given the composition of the board, we are skeptical that process alone would have produced better results. We address that point next.
In general, boards have great flexibility to organize their structure and to operate in a manner that enables them to fulfill their legal duties and responsibilities. State corporate law vests the ultimate power and duty to manage the business of the corporation with the board of directors and permits the board to delegate tasks and functions to committees. In the aftermath of Enron, however, the federal government intervened with requirements that at least some committees of the board be comprised solely of independent directors. What the statutes and regulations do not address, however, is the diversity of those directors – independent or not.

We turn to that point now, addressing the issue of diversity and elaborating on our skepticism about whether process alone might have improved the Disney Board’s decision-making. There were two boards here: the one at the time of the OEA, and the one at the time of the NFT. Our analysis applies to both. The OEA board comprised fifteen people and the NFT board sixteen, only one of whom was a woman. One woman on a board of fifteen or sixteen people is simply not enough. The research is very compelling: a board needs at least three women before gender diversity brings results, and the reason for that requirement is inclusion. We address diversity first and then turn to inclusion. In doing so, we draw on the work of multiple governance groups and a burgeoning area of empirical research. This Court has often considered finance-related research in various valuation and other contexts. Today, we expand the use of academic and corporate research to elaborate on board composition. The facts of this case, and so many others, compel us to do so, in the hope of shedding light on best practices related to shareholder value. To be sure, at this time the work in this area is somewhat nascent; nevertheless, it is compelling.

Diverse teams, including boards, perform better. Companies with greater diversity have increased productivity and profitability. Increasing the number of women

30 Id. at § 141(c).
32 David A. Braun, Debra L. Brown & Vanessa Anastasopoulos, Women on Boards: Not Just the Right Thing . . . But the “Bright” Thing, Conference Board of Canada Rep. 341-02, at 12 (2002) (finding boards need a critical mass of women to change their behavior and performance: “[R]esearch into attitudes of men towards women in management indicates that a critical mass of 35 per cent may be necessary before male subjects’ attitudes change. At times, then, one, or even two, women on an 11-person board may not be sufficient to promote change, and even this level of commitment may be only of a token nature.”).
33 See, e.g., In re Caremark Int’l Inc. Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996) (twelve out of thirteen directors were male); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (ten male directors).
and minorities in the business-place and on the board, if done while developing inclusion, produces an environment that is conducive for creative friction or positive fact-based debates that result in innovation and growth.\textsuperscript{35}

For example, a 1995 study by the Covenant Investment Group found that businesses committed to promoting minority and women workers had higher annual returns than companies without diversity.\textsuperscript{36} In fact, the returns for the diverse firms were more than double those of their counterparts (18.3 percent versus 7.9 percent).\textsuperscript{37} The market’s reaction to firms recognized for their diversity gains is consistent, revealing positive increases in stock prices for those companies compared to others that are subject to sanction over discrimination.

The same is true for boards of directors. Recent research has shown that board diversity can “enhance the bottom line.”\textsuperscript{38} Moreover, and key to this case, a heterogeneous board can help to avoid the groupthink that is so perilous to creative and effective decision-making.\textsuperscript{39} The concept of groupthink is rooted in the work of Irving Janis, and despite it being more than thirty years old, many boards have failed to heed the teachings. The simple fact is that people like people who are like themselves. Although this tendency is not evil, it can be pernicious. This is especially true in the boardroom, where if people have similar backgrounds and attitudes, they are particularly likely to follow each other’s leads and fail to engage in effective challenge and debate – the hallmarks of a diverse and inclusive culture. In simple terms, groupthink occurs when people follow the leader, even unknowingly.

We should not be surprised by this outcome. When people engage with people similar to themselves, the conversation is easier, less stilted, more comfortable. That comfort, however, is exactly what gets in the way of good outcomes. Discussions that arise from different viewpoints tend to be more fact-based and are correlated with better business outcomes.\textsuperscript{40} These discussions might feel like conflict,

\textsuperscript{35} Diversity and the Boardroom, supra note 24, at 98 (“In this study, the Conference Board concluded that board diversity can enhance shareholder value. In sum, ‘leading companies are integrating diversity into corporate objectives with the belief that a diverse workforce can help generate new ideas and help companies be more responsive to diverse markets.’”)); see also Poppy Lauretta McLeod et al., Ethnic Diversity and Creativity in Small Groups, 27 SMALL. GROUPESS 248, 251, 256-57 (1996) (finding that ethnically diverse workgroups, including Asian, African, and Hispanic Americans, produced higher quality ideas than all-Anglo groups).


\textsuperscript{37} Id.


\textsuperscript{40} Orlando C. Richard, Racial Diversity, Business Strategy, and Firm Performance: A Resource-Based View, 43 ACAD. MGMT. J. 164 (2000) (“Proponents of diversity maintain that different
but they actually produce the friction that is key to the power and benefits of diversity.\textsuperscript{44}

No doubt this is the reason that institutional investors increasingly call for more diversity in companies and in the boardroom.\textsuperscript{42} Gender-diverse boards are less likely to suffer from groupthink. They are more likely to consider alternatives, enrich the quality of ideas, and provoke livelier boardroom discussions, all of which leads to enhanced decision-making.\textsuperscript{43} Thus, the sense of infallibility and excessive optimism associated with groupthink (and which arguably was evident in Ovitz’s hiring) is less likely to occur.\textsuperscript{44} In part this is true because “women are less affected than men by the over-optimism bias.”\textsuperscript{45} And it appears that more women means more accountability: boards with three or more women are more likely to adopt policies that guard against self-serving behavior, which is rooted in conflicts of interest and ethical

opinions provided by culturally diverse groups make for better-quality decisions \ldots{} and appear useful for making valuable judgments in novel situations. Heterogeneity in decision-making and problem-solving styles produces better decisions through the operation of a wider range of perspectives and a more thorough critical analysis of issues.”); see also Cox, supra note 39; Charlan Jeanne Nemeth, Minority Dissent as a Stimulant to Group Performance, in Productivity and Process in Groups 95 (Stephen Worchel, Wendy Wood & Jeffry A. Simpson eds., 1992); Poppy L. McLeod & Sharon A. Lobel, The Effects of Ethnic Diversity on Idea Generation in Small Groups, ANN. MEETING OF THE ACAD. OF MGMT. (1992).

\textsuperscript{41} See, e.g., Niclas L. Erhardt et al., Board of Director Diversity and Firm Financial Performance Management Publications, MGMT. PUBL`NS (2003), https://lib.dr.iastate.edu/management_pubs/10 (citing Cecily Cannan Selby, From Male Locker Room to Co-ed Board Room: A Twenty-Five Year Perspective, in Women on Corporate Boards of Directors: International Challenges and Opportunities 239 (Robert J. Burke & Mary C. Mathis eds., 2000): “Selby \ldots{} interviewed women board members from top U.S. firms and observed that by including gender diversity on their boards firms concomitantly included diversity in other experiences and values. She notes that the ‘questioning culture’ of a board can be influenced, in a positive respect, by having women board members.”).

\textsuperscript{42} Since the 1990s, institutional investors including TIAA-CREF, one of the nation’s largest institutional investors, and CalPERS, the largest public pension fund in the U.S., have been emphasizing the need for directors with diverse experience. See Steven A. Ramirez, A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?, 77 ST. JOHN’S L. REV. 837, 847 (2003). TIAA-CREF issued a “Policy Statement on Corporate Governance” in the early 1990s, which expressed the desire for more diversity in the boardroom, and in 2000, TIAA-CREF expanded on that statement by saying that diversity in “experience, gender, race and age” should be considered as a director qualification. See TIAA-CREF, Policy Statement on Corporate Governance (March 2000). Additionally, CalPERS stated in 1998 that “[w]ith each director nomination recommendation, the board [should] consider[,] the mix of director characteristics, experiences, diverse perspectives and skills that is most appropriate for the company.” See Cal. Pub. Employee Ret. Sys., Corporate Governance Core Principles & Guidelines: The United States 6 (Apr. 15, 1998).


\textsuperscript{44} See Warren E. Watson, Kamalesh Kumar & Larry K. Michaelsen, Cultural Diversity’s Impact on Interaction Process and Performance: Comparing Homogenous and Diverse Task Groups, 36 ACAD. MGMT. J. 590 (June 1993).

lapses – thus increasing accountability.46 Further, as a recent Catalyst report reveals, companies with the highest representation of women on their top management teams had a 35.1 percent higher return on equity and a 34 percent higher total return to shareholders than companies with the lowest female representation.47 Given the fiduciary duties of directors, we are hard pressed to see a downside to adding more women to boards. Indeed, board diversity appears to be a proverbial “no-brainer.”

Of course, diversity can also produce differences of opinion that may result in arguments. In the words of the CEO of Bell Atlantic, “[i]f everybody in the room is the same, you’ll have a lot fewer arguments and a lot worse answers.”48 This view is confirmed by the research, which indicates that companies that “effectively manage diversity” can achieve improvements in their human resource efficiency, marketing effectiveness, and innovation and creativity.49 What does effectively managing diversity mean? At least in part, it means that the boardroom operates in an inclusive manner, where all members feel a sense of belonging, a role in the mission, and a say in the governance.50 That is partly why the research indicates that to access the value of having women on the board, there should be a minimum of three women.51 These numbers can help to prevent tokenism, where some board members are treated differently from others, and can create more room for the comfortable expression of ideas, which is a form of inclusion. The numbers foster participation, which is the key to unleashing the power of diversity.52

In short, the Disney Board had three diverse members, but because it did not operate in an inclusive manner, it squandered the power of that diversity.53 Recall, for example, that the two diverse members of the compensation committee were not included in discussions. Yet, to access the creative friction and corporate metrics that

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46 Braun et al., supra note 72.
48 Geoffrey Colvin, The 50 Best Companies for Asians, Blacks, & Hispanics, FORTUNE MAG. (July 19, 1999).
51 Judy B. Rosener, America’s Competitive Secret: Utilizing Women as a Management Strategy 152–21 (1995) (finding that a single board member is often dismissed as a token, and two are not enough to be taken seriously, but three female board members give the board a critical mass).
52 See Diversity and the Boardroom, supra note 34, at 119 (citing 1998 AMA Survey Senior Management Teams: Profiles and Performance, AM. MGMT. ASS’N 7 (1998) (“[T]he Association concluded that ‘it is not the predominance of any one group, but rather the participation of numerous diverse members that seemed to lead to superior performance.’”)).
53 Susan E. Jackson, Consequences of Group Composition for the Interpersonal Dynamics of Strategic Issue Processing, 8 ADVANCES IN STRATEGIC MGMT. 345, 370–71 (1992) (arguing that ineffective norms and processes can squander the potential benefits of diversity by stifling the expression of disagreement).
diversity produces, the board needed to embed inclusive debates and discussions into its culture.

There are some simple rules to consider that might improve boardroom practices: No interrupting; everyone speaks once before anyone speaks twice; and all ideas are on the table before they are critiqued. These might sound like the basic rules of kindergarten, but they are not.54 They are the norms of good conversation and debate.55 They are also the norms of participative boards, those “characterized by high CEO and board power, discussion, debate, and disagreement,” and they are associated with higher numbers of female directors.56 According to Catherine Daily, “Importantly, participative boards [are also] significantly associated with higher perceived and objective company performance.”57

Indeed, we venture to say that if this board had benefited from the power of gender diversity and an inclusive culture, the outcome might have been different in several ways. First, the board might not have hired Ovitz – at least not without discussion and debate. Second, it might not have paid him more than any other public company officer at the time. Third, it might not have granted him an array of embarrassing perquisites. Fourth, it might not have agreed to a no-fault termination with a huge payout. Fifth, although we are tongue-in-cheek here, the board might have kept minutes, which could have been extremely helpful in this process and potentially saved considerable expense. And sixth, the board might have engaged in better and more conscientious practices that would have allowed it to win dismissal on the front end, thus saving both the board and Delaware taxpayers the costs of multiple briefs, considerable discovery, a trial, and this second appeal.

Consider the following situations implicating questions of diversity. The OEA Compensation Committee had four members, two of whom were men of color. In addition to Russell and Watson, who were discussed previously and both of whom played actual roles in the Ovitz compensation process, were Ignacio Lozano, a Mexican American, and Sidney Poitier, a Bahamian American and former client of Ovitz. Neither Lozano nor Poitier were invited to play a role or included in the process, except for a brief call at the end to apprise them of the existing decisions. Indeed, Russell first called Poitier the day before the OEA was signed and the press

54 Robert Fulghum, All I Really Need to Know I Learned in Kindergarten: Uncommon Thoughts on Common Things (1988).
55 Emily Post & Peggy Post, Emily Post’s Etiquette (17th ed. 2004).
56 Catherine M. Daily et al., A Decade of Corporate Women: Some Progress in the Boardroom, None in the Executive Suite, 20 STRATEGIC MGMT. J. 93, 97 (1999).
57 Id. Indeed, this Court deploys norms to build its own inclusive culture, ensure that input from all members factors into outcomes, and avoid our own versions of one-of-fiving. See David A. Skeel, Jr., The Unanimity Norm in Delaware Corporate Law, 83 VA. L. REV. 127 (1997) (analyzing the Delaware Supreme Court’s norm of unanimous opinions and the practices that have been put in place to protect this norm, including avoiding conversations between individual justices – as opposed to the group – about pending opinions).
release issued, and notified Lozano only after the press release went out.58 Moreover, the trial testimony indicated that neither person of color was told of Crystal’s concerns about the pay package or made privy to the analysis. Indeed, prior to the phone calls, Russell and Watson discussed, finalized, and presented the OEA without sharing Crystal’s concerns or any others. Although Lozano and Poitier could have pushed back on the decision, the lack of an inclusive process made it less likely that they would do so. It is not therefore surprising that they did not. For example, when Russell and Watson presented their findings and conclusions for a vote, half of the committee had already drafted and approved of the OEA. Arguably, Russell and Watson did not value Poitier and Lozano’s opinions and marginalized them as members, making it harder for either of them to question – let alone challenge – the preexisting decisions. The two men may have been assimilated, but they were not included.59 Indeed, marginalization and tokenism result in this type of disempowerment. Participation, not predominance, is what produces the effects of diversity; and inclusion, which certainly did not happen here, is vital.560

Everything we have just said applies also to Bower, an African American and the lone female on the Disney Board. She was not on the compensation committee. Even if she had been, it is unlikely, given the treatment of Lozano and Poitier, that she would have been consulted or included in any way. Indeed, her testimony reveals that she, too, was a marginalized board member. She was not an actor or Hollywood powerhouse. She was the headmaster of the local prep school that Eisner’s children attended. One might even argue that, given her background, other board members might have believed she was unlikely to know much about these sorts of employment contracts or compensation agreements; yet, if included in discussions, she might have had a sense about potential public reaction to the enormity of the compensation and exit packages.

A more diverse board, operating in an inclusive manner, might well have called formal meetings of both the compensation committee and the board to review compensation and termination decisions. As the research indicates, inclusive meetings with a diverse array of directors are likely to result in attention to facts and objective evidence – spreadsheets and data, for example – and are therefore more likely to result in better decision-making.61 Inclusive meetings could have benefited

58 Indeed, both Lozano and Poitier testified as to their approval of the hiring of Ovitz, but neither mentioned any discussion as to their opinion – or if they were even asked – about the terms of Ovitz’s compensation package. This signals a lack of inclusion in the “important” decisions.

59 Nicola Pless & Thomas Maak, Building an Inclusive Diversity Culture: Principles, Processes and Practice, 54 J. Bus. ETHICS. 129, 130 (2004) (noting that assimilation results in minorities and women underperforming because they are not heard or included and thus cannot add value to corporate performance).

60 See Diversity and the Boardroom, supra note 34, at 119.

from creative friction, and they might have checked the egos and optimism that infected the “process” that did occur. Indeed, it is possible that someone might even have raised the fact that the NFT provisions could apply in the eventuality that Ovitz failed spectacularly and quickly.

Unfortunately, in 2006, despite considerable conversation about and calls for diversity, the failure to address it does not amount to a breach of a board’s fiduciary duty, at least not of the loyalty variety. And, as previously stated, this board was protected by an exculpation clause that relieved it from liability for breaches of anything less. Thus, we are left with citing the evidence and acting within our role as an educator for boards about process and power, in the hope that change will occur, and with the goal of creating space that would – in the future – create the possibility of liability if ignored.

B

Before we conclude, we need to address Ovitz, Eisner, and Litvack. All three of these men are officers, and although we agree with the Chancery Court that they are not liable, we want to clarify what their duties were and the fact that the business judgment rule simply does not apply to them. In short, officers are different from directors.

Officers of a corporation, like directors, owe fiduciary duties. Yet, unlike directors, officers are agents and are not subject to exculpation. They are also not subject to the business judgment rule, which is a common law invention designed to encourage the board in its risk-taking and decision-making, but which we have not previously applied to corporate officers. Cases against corporate officers are rare, in part because this state clarified only recently its jurisdiction over them, and in part because the actions often at issue in these sorts of cases are board-level decisions.

We begin with Ovitz. We agree with the Chancery Court that Ovitz did not become a fiduciary until he signed the OEA. One might ask whether Ovitz might have thought about whether and how he wanted to enter Disney – and whether a package of the magnitude at issue here would send the types of signals that it appears he sent after starting his job. Nonetheless, regardless of the privilege inherent in his negotiations for the OEA and the NFT, Ovitz assumed no fiduciary duties to the corporation until he was actually an employee. Thus, he was free to use his privilege to negotiate for an outrageous package, and he did so.

Plaintiffs also argue that Ovitz violated his duties in accepting the NFT provisions of the OEA when he was terminated. We do not agree. Ovitz did not make this decision, did not like this decision, and did not see it coming. Once the decision was made, Ovitz was entitled to the terms of the OEA, including the amounts in the deliberation measure, including: number of case facts discussed, number of factual inaccuracies, number of uncorrected inaccurate statements, and amount of “missing” evidence cited).
No matter how wasteful the payout of the NFT may appear, the decision to payout the terms of the NFT was not waste. Waste will be established in the rare "unconscionable case where directors irrationally squander or give away corporate assets." Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000). Here, the payout of a contractually obligated amount was not waste. Additionally, the approval of the NFT provisions was not wasteful, because despite the large payout sum, the terms had a rational business purpose: to persuade Ovitz to join Disney. Thus, this claim of waste also fails.

62 Because the $7.5 million-dollar bonus awarded to Ovitz prior to his termination was later rescinded, there was no harm done and thus no basis for damages to be awarded. See In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 45 n.34 (Del. 2006).

63 No matter how wasteful the payout of the NFT may appear, the decision to payout the terms of the NFT was not waste. Waste will be established in the rare "unconscionable case where directors irrationally squander or give away corporate assets." Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000). Here, the payout of a contractually obligated amount was not waste. Additionally, the approval of the NFT provisions was not wasteful, because despite the large payout sum, the terms had a rational business purpose: to persuade Ovitz to join Disney. Thus, this claim of waste also fails.