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THE DELAWARE SUPREME COURT CLARIFIES DIRECTOR DUTIES IN *DISNEY*

By Peter L. Welsh

Introduction

On June 8, 2006, the final chapter was written in the decade-long shareholder litigation stemming from the hiring and termination of Michael Ovitz by the Walt Disney Company ("Disney" or the "Company"), and the payment to Ovitz of approximately $130 million in severance.[1] After nearly ten years of litigation, two motions to dismiss, two appeals, extensive fact and expert discovery, a motion for summary judgment and a trial on the merits, the Delaware courts have found that the Disney directors did not breach their fiduciary duties and did not commit corporate waste as a result of the decisions to agree to, and to pay, lucrative severance under Ovitz's employment agreement. The Chancery Court held in 2005, following a trial on the merits, that the directors' decisions are protected by the business judgment rule. And the Delaware Supreme Court has now upheld the Chancery Court's post-trial decision.[2]

The fact that the Delaware Supreme Court has upheld the Chancery Court's post-trial decision is unremarkable in itself. The Chancery Court's decision was well-reasoned and brought some much needed – and long overdue – moderation to the dispute over Ovitz's severance. What is remarkable about the Supreme Court's decision is that it restores the all-important distinction between a breach of the fiduciary duty of care, on the one hand, and a breach of the fiduciary duty of good faith, on the other hand. That distinction had been blurred by decisions of the Chancery

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"BYE, BYE 'TRIAD'"

By Peter L. Welsh

On November 6, 2006, the Delaware Supreme Court issued an important decision solidifying its holding in *In re Walt Disney Derivative Litigation* and putting to rest any lingering uncertainty surrounding one of the erstwhile "triad" of fiduciary duties – the fiduciary "duty of good faith."

In *Stone v. Ritter*,[1] the Delaware Supreme Court upheld the Chancery Court's dismissal, under Rule 23.1, of a complaint alleging breaches by the directors of AmSouth Bancorporation of their so-called *Caremark* oversight duties. Under *Caremark*, directors of a Delaware corporation may be liable for breach of fiduciary duty for a "sustained or systematic" failure to exercise appropriate oversight of the company's operations and, in particular, of its compliance with the law.[2] In 2004, AmSouth paid some $50 million in penalties to resolve various investigations into possible violations of the anti-money laundering prohibitions of the Bank Secrecy Act. Shareholders of AmSouth then sued the directors claiming that they should be held personally liable for the penalties and related costs.[3] The Plaintiffs claimed that Section 102(b)(7) could not protect the directors because the directors had allegedly violated their fiduciary duty of good faith and therefore did not qualify for Section 102(b)(7)'s protections. The Chancery Court and the Supreme Court each, in its turn, rejected this claim.

In upholding dismissal by the Chancery Court, the Supreme Court cited on several occassions to its June 2006 decision in the *Disney* case for the proposition that only a knowing or intentional breach of fiduciary duty will take director conduct outside of the protections afforded by Section 102(b)(7):

> As evidenced by the language [used in *Caremark*], the *Caremark* standard for so-called 'oversight' liability draws heavily upon the concept of director failure to act in good faith. That is consistent with the definition(s) of bad faith recently approved by this Court in its recent *Disney* decision, where we held that a failure to act in good faith requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence).[4]

In addition, the Supreme Court then clarified the necessary basis for bringing a *Caremark* claim following *Disney* and *Stone*:

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> We hold that *Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.[5]

Finally, in *Stone*, the Supreme Court also laid to rest the doctrinal dispute over whether the obligation to act in good faith is a separate fiduciary duty under Delaware law. It is not: “[A]though good faith may be described colloquially as part of the ‘triad’ of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty.”[6] Instead, the court held, the obligation to act in good faith, properly understood, is subsumed within the duty of loyalty.

[1] C.A. No. 1570-N, 2006 WL 3169168 (Del. Nov. 6, 2006)

[2] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).

[3] *Stone*, 2006 WL 3169168, at *3.

[4] *Id.* at *5.

[5] *Id.* at *6.

[6] *Id.*

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Court and the Supreme Court issued earlier in the case. With its 2006 decision, the Supreme Court has restored the *status quo ante*.[a] As a consequence, it should become more difficult for shareholder plaintiffs to plead claims for a breach of the fiduciary duty of good faith based on what have long been considered merely "honest mistakes of judgment."[3]

The Chancery Court's Factual Findings

The facts as found by the Chancery Court in its August 2005 post-trial decision, and upheld by the Supreme Court in June of 2006, may be summarized as follows:

In the summer of 1995, Michael Eisner, then chairman and chief executive officer of Disney, sought to hire Michael Ovitz as the Company's new president. At the time, Ovitz was considered one of the most successful businessmen in Hollywood. He was widely-regarded as an "exceptional corporate executive" and a "highly successful and unique entrepreneur."[4] Ovitz was also being courted by MCA, a competitor of Disney, with rumors of a lucrative pay package awaiting Ovitz at MCA should he choose to accept.[5] Ovitz was, at the time, the founder, chairman, chief executive and 55% shareholder of the top talent agency in Hollywood, Creative Artists Agency ("CAA"). He was reportedly earning some $20-25 million a year at CAA. Eisner and Disney wanted Ovitz to leave CAA and come to Disney. Yet, "Ovitz made it clear that he would not give up his fifty-five percent interest in CAA without downside protection."[6] In the ensuing negotiations with Disney, Ovitz drove a hard-bargain, seeking upside potential, in the form of options on approximately five million shares of Disney stock, as well as downside protection, in the form of automatic acceleration of a substantial portion of those options in the event of a "no fault termination."[7] As such, the Ovitz pay package was, in the words of the Delaware Supreme Court, "specifically structured to compensate Ovitz for walking away from $150 million to $200 million of anticipated commissions from CAA over the five-year . . . contract term."[8]

> **"After nearly ten years of litigation . . . the Delaware courts have found that the Disney directors did not breach their fiduciary duties and did not commit corporate waste as a result of the decisions to agree to, and to pay, lucrative severance under Ovitz's employment agreement."**

During the negotiations with Ovitz, Eisner consulted with Sid Bass and Roy Disney, two of the largest individual shareholders of the company, who both supported hiring Ovitz.[9] Eisner and Irwin Russell, the chairman of the compensation committee of the Disney Board, negotiated the terms of Ovitz's employment agreement and compensation, including Ovitz's severance in the event of a "no fault" termination, with Russell taking the "lead role" in the negotiations.[10] With the assistance of Raymond Watson, a member of the compensation committee, and with the advice of a compensation consultant, Russell conducted a financial analysis of Ovitz's pay package.[11]

On August 13, 1995, Ovitz accepted Disney's offer to join the Company as its president.

That evening, Ovitz attended a dinner with Eisner, Disney's chief financial officer, Stephen Bollenbach, and Disney's general counsel, Sanford Litvack. At the outset of the dinner, Bollenbach and Litvack pointedly informed Ovitz that they would not report to Ovitz and would continue to report to Eisner instead. This encounter, by all accounts, was the start of what would prove to be the rocky and ultimately unsuccessful integration of Ovitz into The Walt Disney Company.[12]

On August 14, 1995, the Company announced Ovitz's hiring. "The reaction," of investors to the announcement, noted the Supreme Court, "was extremely positive: Disney was applauded for the decision, and Disney's stock price rose 4.4% in a single day, thereby increasing Disney's market capitalization by over $1 billion."[13]

On September 26, 1995, the compensation committee met for approximately one hour. Among other matters considered at the meeting was Ovitz's hiring and proposed compensation. Mr. Watson presented to the committee members concerning Ovitz's compensation.[14] Following the presentation, the committee approved the terms of Ovitz's agreement. At a meeting of the board of directors following the compensation committee's meeting, Director Watson presented to the full board concerning Ovitz's compensation.[15] Following Watson's presentation, the board of directors voted unanimously to hire Ovitz. At a subsequent meeting held on October 16, 1995, and following a presentation by Litvack, the compensation committee approved the award, pricing and terms of Ovitz's stock options.[16]

Although Ovitz performed well at first, Ovitz's employment with Disney ultimately did not go well. Ovitz had difficulty integrating into the "egalitarian" culture at Disney.[17] The court noted that Ovitz and Disney were a "mismatch of cultures and styles."[18] By mid 1996, it became apparent that the difficulties Ovitz was having at the Company were less and less likely to be resolved.[19] By the fall of 1996, "directors were discussing that the disconnect between Ovitz and the Company was likely irreparable and that Ovitz would have to be terminated."[20] In mid-September of 1996, Eisner asked Litvack to communicate to Ovitz that "Eisner no longer wanted Ovitz at Disney and that Ovitz should seriously consider other opportunities," including an opportunity that Eisner had cultivated for Ovitz at the Sony Corporation.[21]

By the fall of 1996, Eisner hoped to terminate Ovitz for cause and thereby avoid a "no fault termination" under Ovitz's employment agreement, and therewith the approximately $130 million severance package that would accrue to Ovitz. Eisner asked the Company's general counsel, Sanford Litvack, to analyze whether the Company had grounds to terminate Ovitz for cause.[22] Litvack initially concluded that Ovitz could not be terminated for cause and that a "no fault termination" was inevitable.[23] Eisner asked Litvack to look at the question again and more carefully. In response, Litvack reviewed Ovitz's employment agreement "and reviewed all the facts concerning Ovitz's performance of which he was aware."[24] Litvack, who certainly had no allegiance to Ovitz (as demonstrated by his conduct at the August 13, 1995, dinner with Ovitz),[25]

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concluded that the question of whether Ovitz could be terminated for cause "was not a close question and, in fact, Litvack described it as a 'no-brainer.'"[26] Eisner testified that, when Litvack informed him of this conclusion, Eisner "'checked with almost anybody that [he] could find that had a legal degree, and there was just no light in that possibility. It was a total dead end from day one.'"[27]

On November 26, 1996, an executive session of the Disney board was held, at which Ovitz's fate was sealed. The board voted to terminate Ovitz without cause. On December 12, 1996, Disney issued a press release announcing Ovitz's termination.[28]

Overview of the Litigation

On January 3, 1997, certain Disney shareholders filed a derivative action against the Disney directors alleging breach of fiduciary duty and waste in connection with the negotiation and triggering of Ovitz's severance. On October 7, 1998, the Chancery Court allowed the defendants' motions to dismiss the complaint with prejudice on the grounds that the plaintiffs had failed to make demand on the Disney board and that demand was not excused.[29] The Chancery Court held, in particular, that the plaintiffs had not alleged, with particularity, facts creating a reasonable doubt: (i) as to the independence of a majority of the Board; or (ii) that the decisions in question were the product of a valid exercise of the directors' business judgment.[30] On February 9, 2000, in a lengthy opinion that largely comported with the Chancery Court's opinion dismissing the case, the Delaware Supreme Court reversed the Chancery Court's dismissal of the complaint with prejudice and concluded simply that "[b]ecause of the unusual nature of this case and the rulings in this opinion, the interests of justice require that the dismissal ordered in paragraph 1 of the Order of the Court of Chancery shall be without prejudice."[31]

After the Supreme Court's reversal of the Chancery Court's dismissal of the case with prejudice, the plaintiffs conducted limited "books and records" discovery,[32] and thereafter filed an amended complaint. On May 28, 2003, the Chancery Court denied the defendants' second motion to dismiss. The Chancery Court held, in particular, that the amended complaint sufficiently alleged breaches of the directors' fiduciary duties in connection with the hiring and termination of Ovitz.[33] The defendants had argued that, at most, the plaintiffs had alleged a breach of the directors' fiduciary duty of care and that such a claim was subject to dismissal under the exculpation provision in the Disney certificate of incorporation and Del. Gen. Corp. Law § 102(b)(7). The Chancery Court rejected this argument and held that the plaintiffs had alleged more than merely a duty of care claim. As the court explained,

> [t]hese facts, if true, do more than portray directors who, in a negligent or grossly negligent manner, merely failed to inform themselves or to deliberate adequately about an issue of material importance to their corporation. Instead, the facts alleged in the new complaint suggest that the defendant directors *consciously and intentionally disregarded their responsibilities*, adopting a "we don't care about the risks" attitude concerning a material corporate decision. Knowing or deliberate indifference by a director to his or her duty to act faithfully and with appropriate care is conduct, in my opinion, that may not have been taken honestly and in good faith to advance the best interests of the company.[34]

The Court held that the allegations in the amended complaint stated a claim for breach of the directors' duty of good faith and that, consequently, such claims were not subject to dismissal under Section 102(b)(7).[35]

The Chancery Court's 2003 decision paved the way for the eventual trial on the merits. That trial was conducted over 37 days, between October 20, 2004, and January 19, 2005.[36]

In August of 2005, the Chancery Court issued its post-trial decision. In that decision, the court found that the Disney directors did not violate *any* of their fiduciary duties, including their duty of care. The court found, in particular, that the decision to hire Ovitz and dangle an exceptionally lucrative compensation (and potential severance) package was approved by the board and the compensation committee and was reasonable under the circumstances.[37] As for the grant to Ovitz of a "no fault termination," thereby triggering the automatic vesting of a significant portion of his stock options, the Chancery Court found that "Eisner's actions in connection with [Ovitz's] termination are, for the most part, consistent with what is expected of a faithful fiduciary. . . I conclude that the plaintiffs have not demonstrated by a preponderance of the evidence that Eisner breached his fiduciary duties or acted in bad faith in connection with Ovitz's termination and receipt of the [no fault termination]."[38] Each of these findings applied likewise to the directors who approved the "no-fault termination" of Ovitz.

"What is remarkable about the Supreme Court's decision is that it restores the all-important distinction between a breach of the fiduciary duty of care, on the one hand, and a breach of the fiduciary duty of good faith, on the other hand."

The plaintiffs filed a timely appeal.

The Duty of Care, the Duty of Good Faith and Section 102(b)(7)

On appeal, the Delaware Supreme Court affirmed the Chancery Court on nearly all points. In particular, the court held that the Chancery Court's finding that the Disney directors had not breached any of their fiduciary duties was not clearly erroneous and would be upheld.[39] Importantly, the court also took the opportunity to clarify the fiduciary duty of good faith and, in particular, how that duty may be distinguished from the fiduciary duty of care. The court made clear that plaintiffs seeking to assert a claim for breach of the duty of good faith must allege more than merely gross negligence, even extreme gross negligence. This is an especially noteworthy feature of the Supreme Court's opinion.

Section 102(b)(7)

The distinction between the fiduciary duty of care and the fiduciary duty of good faith is a key factor affecting the risk of personal liability faced by directors of Delaware corporations. The reason is Delaware's exculpation statute – Del. Gen. Corp. Law § 102(b)(7) – provides that directors of Delaware corporations may be

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protected from personal liability for breaches of their fiduciary duty of care, but *not* against breaches of their fiduciary duty of good faith. In particular, Section 102(b)(7) provides that the Certificate of Incorporation of a Delaware corporation may include,

> [a] provision eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law.[40]

Most Delaware corporations, including Disney, have adopted the requisite charter provision.

A charter provision adopted pursuant to Section 102(b)(7) is effective to bar all derivative claims – as well as direct shareholder claims – alleging only a breach of the fiduciary duty of care. Section 102(b)(7) applies to derivative claims for breach of fiduciary duty brought by shareholders or creditors of the corporation.[41]

"[T]he Supreme Court has clarified that, without other conduct or additional factors, the duty of care applies to claims of carelessness or mismanagement, regardless of how egregious the conduct is alleged to be."

Furthermore, Section 102(b)(7) is applicable at the pleading stage of litigation and may form a sufficient basis for dismissal with prejudice of a complaint that alleges nothing more than a breach of the fiduciary duty of care.[42] As such, Section 102(b)(7) is a critical protection for directors of Delaware corporations.

The 2003 Chancery Court's Decision and Section 102(b)(7)

The Chancery Court's 2003 decision threatened to weaken much of the protection traditionally provided by Section 102(b)(7). In the *Disney* case, it was held, at an early stage of the case, that the decision to hire Ovitz and to offer him a lucrative severance package, in the event of his termination, was made by a disinterested and independent board of directors.[43] Likewise, the decision to approve a no-fault termination of Ovitz was made by a disinterested and independent board.[44] There was, therefore, no viable claim of disloyalty, nor was there any other actionable claim of a conflict of interest on the part of the Disney board. The entire case hinged, instead, on whether the plaintiff had sufficiently alleged a breach of the fiduciary duty of good faith.[45] In its 2003 decision, the Chancery Court held that the plaintiff had done so.

What is particularly remarkable about the Chancery Court's decision in *Walt Disney III* is that, in holding that the plaintiffs had stated a viable claim for a breach of the fiduciary duty of good faith, the Chancery Court cited to allegations that had long been considered classic duty of care allegations. The court pointed to, among other things in the amended complaint, the following allegations:

- The compensation committee met "for just one hour" to consider, among other matters, Ovitz's employment agreement;
- The compensation committee "spent the least amount of time during the meeting discussing Ovitz's hiring";
- "[N]o copy of the . . . draft employment agreement was actually given to the committee";
- The committee members received, instead, an "incomplete" "summary" of the agreement;
- "[T]he committee also lacked the benefit of an expert to guide them through the process";
- "[N]o presentations, spreadsheets, written analysis, or opinions were given by any expert";
- The committee approved the retention of Ovitz without receiving the final employment agreement;
- The committee "did not condition their approval on being able to review the final agreement";
- At the subsequent Board meeting, "no expert was present to advise the board";
- "Nor were any documents produced to the board for it to review before the meeting regarding the Ovitz contract";
- "The board did not ask for additional information to be collected or presented regarding Ovitz's hiring";
- "According to the minutes, the Old Board did not ask any questions about the details of Ovitz's salary, stock options or possible termination";
- "The Old Board also did not consider the consequences of a termination, or the various payout scenarios that existed"; and
- "Nevertheless, at that same meeting, the Old Board decided to appoint Ovitz president of Disney."[46]

These allegations are highly reminiscent of those made in the classic duty of care case, *Smith v. Van Gorkom*.[47] *Van Gorkom* involved another allegedly hasty and ill-considered high dollar transaction – the sale of the Trans Union Corporation to the Pritzker family. *Van Gorkom*, like *Disney*, contained allegations that an imperious chief executive officer negotiated a transaction while providing little to no information to the company's board of directors.[48] The CEO then allegedly presented the transaction to the board of directors as a *fait accompli*.[49] The board then allegedly considered the transaction during a relatively short meeting.[50] The Trans Union board also did not retain a financial advisor to assist in assessing the Pritzkers' offer for the corporation.[51] The transaction was attacked as financially unwise. On these facts, the Delaware Supreme Court held that the directors had not breached their fiduciary duties of loyalty or good faith but that they had breached their fiduciary duty of care in approving the sale of Trans Union, and they could be held personally liable, as a consequence.[52]

Delaware's Section 102(b)(7) was enacted following the Supreme Court's decision in *Van Gorkom* and was intended specifically to prevent future *Van Gorkom*s. Yet, the plaintiffs in *Disney* were able to proceed to trial on essentially the same theory as the plaintiffs in *Van Gorkom*. Indeed, in its post-trial decision, the Chancery Court explicitly compared the *Disney* case to *Van Gorkom* and found that the *Disney* case, while similar in many "striking" respects, was actually *less* egregious in numerous

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important ways than the circumstances of the transaction in *Van Gorkom*.[53] The Court found that the Disney board was better informed, better prepared and engaged in more meaningful deliberations than the board of Trans Union.[54] Also, the transaction in *Disney* was less material, less sweeping and involved far fewer dollars than the acquisition of the entire Trans Union Corporation by the Pritzkers.[55] Section 102(b)(7) was meant to render cases like *Van Gorkom* – and *a fortiori*, those (like *Disney*) that involve less serious allegations of fiduciary duty breaches – non-actionable. The Disney certificate of incorporation had availed itself of the protections afforded by Section 102(b)(7). Yet, the Disney plaintiffs survived dismissal in spite of the exculpatory charter provision.[56]

The Supreme Court Reinforces the Duty of Good Faith

In its 2003 decision in *Walt Disney III*, the Chancery Court held that the amended complaint stated a claim for a breach of the fiduciary duty of good faith and, therefore, the complaint was not subject to dismissal under Section 102(b)(7). The difficulty with the Chancery Court's 2003 decision is that the conduct alleged appeared, to many, to constitute nothing more than egregious breaches of the duty of care.[57] Indeed, the Chancery Court seemed to allow for bad faith claims based on little – or nothing – more than extreme (and perhaps persistent) carelessness. While there are persuasive doctrinal reasons for eliding the distinction between the duty of care and the duty of good faith, the very real practical problem with doing so is that the more akin the duty of good faith and the duty of care become, the easier it becomes for shareholder or creditor plaintiffs – and especially creditor plaintiffs in the bankruptcy context – to plead around Section 102(b)(7) in what is really nothing more than a duty of care case.[58] In the context of many failed business decisions, it is all too easy for a competent plaintiff's attorney to take conduct that is, in fact, nothing worse than gross negligence – involving nothing more than "honest mistakes of judgment" – and cast it as a "knowing and deliberate indifference to a potential risk of harm to the corporation" – and to do so consistent with Rule 11. Following the Chancery Court's decision in *Walt Disney III*, this is precisely what attorneys representing shareholder plaintiffs and creditors began to do with greater frequency.

In their appeal to the Delaware Supreme Court, the plaintiffs in *Disney* pressed the court to hold explicitly that a particularly strong claim for breach of the fiduciary duty of care – whether styled as a claim for extreme gross negligence or for recklessness – could state a claim under Delaware law for a breach of the duty of good faith and, thereby, avoid an exculpatory charter provision adopted pursuant to Section 102(b)(7). The Supreme Court rejected the plaintiffs' attempt to expand the duty of good faith in this manner and, in doing so, took the opportunity to clarify the duty of good faith under Delaware law. In a passage that one suspects was directed, in part, at the considerable attention that has been paid to the issue since *Walt Disney III* was decided, the Supreme Court noted that,

> [i]n this case, appellants assert claims of gross negligence to establish breaches not only of director due care but also of the directors' duty to act in good faith. Although the Chancellor found, and we agree, that the appellants failed to establish gross negligence, to afford guidance we address the issue of whether gross negligence (including a failure to inform one's self of available material facts), without more, can also constitute bad faith. The answer is clearly no.
>
> From a broad philosophical standpoint, that question is more complex than would appear, if only because (as the Chancellor and others have observed) "issues of good faith are (to a certain degree) inseparably and necessarily intertwined with the duties of care and loyalty. . . . ." But, in the pragmatic, conduct-regulating legal realm which calls for more precise conceptual line drawing, the answer is that grossly negligent conduct, without more, does not constitute and cannot constitute a breach of the fiduciary duty to act in good faith. The conduct that is the subject of due care may overlap with the conduct that comes within the rubric of good faith in a psychological sense, but from a legal standpoint those duties are and must remain quite distinct. Both our legislative history and our common law jurisprudence distinguish sharply between the duties to exercise due care and to act in good faith, and highly significant consequences flow from that distinction.[59]

With these relatively brief observations, the Delaware Supreme Court has done much to clarify the uncertainty surrounding the duty of good faith in the wake of the Chancery Court's decision in *Walt Disney III*. Following the Supreme Court's decision in *Walt Disney V*, shareholder and creditor plaintiffs seeking to plead around an exculpatory charter provision adopted pursuant to Delaware's Section 102(b)(7) will face significant hurdles. Above all, they will be required to point to more than merely extremely careless decision-making by corporate directors, although it remains to be seen what such a complaint must allege, in particular.

Conclusion

The Delaware Supreme Court's decision affirming the Chancery Court's post-trial decision in the Walt Disney Company shareholder litigation is a welcome clarification of fiduciary duties under Delaware law. In particular, the Supreme Court has done much to resolve the uncertainty around the duty of good faith, generally, and the availability of the protections afforded by Section 102(b)(7) in classic duty of care cases, in particular. In its recent decision, the Supreme Court has clarified that, without other conduct or additional factors, the duty of care applies to claims of carelessness or mismanagement, regardless of how egregious the conduct is alleged to be. As a result, directors of Delaware corporations should, in the future, find themselves better protected against shareholder and creditor claims challenging unsuccessful business decisions.

1 The ten years of litigation is, moreover, a cost that the Disney shareholders and Disney's D&O insurers will be required to bear. *See* Del. Gen. Corp. Law, § 145(c) (providing for mandatory indemnification for defense costs to the extent that a director is "successful on the merits.")

2 *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006) (herein "*Walt Disney V*").

3 *See, e.g., Cheff v. Mathes*, 199 A.2d 548, 555 (Del. Ch. 1964); *see also Trenwick Am. Litig. Trust v. Ernst & Young, LLP*, 906 A.2d 168, 193 (Del. Ch. 2006) ("But business failure is an ever-present risk. The business judgment rule exists precisely to ensure that directors and managers acting in good faith may pursue risky strategies that seem to promise great profit. If the mere fact that a strategy turned out poorly is in itself sufficient to create an inference that the directors who

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approved it breached their fiduciary duties, the business judgment rule will have been denuded of much of its utility.")

[4] *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 704 (Del. Ch. 2005) (herein "*Walt Disney IV*").

[5] *Id.* at 701. Though not addressed in the Chancery Court's decision, MCA had reportedly offered Ovitz a package valued at some $250 million. *See* David Leiberman, "The Wizard of Hollywood's Move to MCA Could Upend Tinsletown," *USA Today*, 1B (June 2, 1995).

[6] *Walt Disney IV*, 907 A.2d at 702.

[7] *Id.*

[8] *Walt Disney V*, 906 A.2d at 58; *see also Walt Disney IV*, 907 A.2d at 705 ("Two days later, Crystal faxed his memorandum to Russell. In the memo, Crystal concludes that the [Ovitz Employment Agreement] would provide Ovitz with approximately $23.6 million per year for the first five years, or $23.9 million a year, over a seven-year period, if Disney and Ovitz exercised the two-year renewal option." Those sums, Crystal opined, would approximate Ovitz's current annual compensation at CAA.)

[9] *Walt Disney IV*, 907 A.2d at 702.

[10] *Id.*

[11] *Id.* at 704-05.

[12] *Id.* at 706-07.

[13] *Walt Disney V*, 906 A.2d at 40.

[14] *Id.*

[15] *Id.* at 41.

[16] *Id.*

[17] *Id.* at 42.

[18] *Id.*; *Walt Disney IV*, 907 A.2d at 713.

[19] *Walt Disney V*, 906 A.2d at 42.

[20] *Id.*

[21] *Id.*

[22] *Id.* at 43.

[23] *Id.*

[24] *Id.*

[25] *Id.* at 43-44.

[26] *Id.*

[27] *Id.*

[28] *Id.* at 45.

[29] *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342 (Del. Ch. 1998) ("*Walt Disney I*").

[30] *Walt Disney I*, 731 A.2d at 364-65; *see also Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).

[31] *Brehm v. Eisner*, 746 A.2d 244, 267 (Del. 2000) (herein "*Walt Disney II*").

[32] *See* Del. Gen. Corp. Law § 220.

[33] *See In re Walt Disney Deriv. Litig.*, 825 A.2d 275, 289 (Del. Ch. 2003) (herein "*Walt Disney III*").

[34] *Id.*

[35] *Id.*

[36] *Walt Disney V*, 906 A.2d at 34.

[37] *Walt Disney IV*, 907 A.2d at 753 n.447.

[38] *Walt Disney V*, 906 A.2d at 73.

[39] *Id.* at 60-61.

[40] Del. Gen. Corp. Law § 102(b)(7).

[41] *Production Resources Group, LLC v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 2004).

[42] *Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001) (Rule 12(b)(6) motion granted under the business judgment rule and Delaware's exculpation statute); *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720 (Del. Ch. 1999) (same); *In re Frederick's of Hollywood, Inc. S'holders Litig.*, No. C.A. 15944, 2000 WL 130630 (Del. Ch. Jan. 31, 2000) (same); *Nebenzahl v. Miller*, No. CIV. A. 13206, 1996 WL 494913, at *2-3 (Del. Ch. Aug. 29, 1996) (same); *In re Wheelabrator Techs. Inc. S'holder Litig*, C.A. No. 11495, 1992 WL 212595 (Del. Ch. Sept. 1, 1992) (same).

[43] Although the plaintiff had initially attempted to allege that "a majority of the board was beholden to Eisner," this claim was initially rejected by the Chancery Court in *Disney I* and that finding was upheld by the Supreme Court in *Disney II. See Walt Disney II*, 756 A.2d at 258. That finding was never seriously questioned thereafter.

[44] *Id.*

[45] *Walt Disney V*, 906 A.2d at 52. ("Because no duty of loyalty claim was asserted against the Disney defendants, the only way to rebut the business judgment rule's presumptions would be to show that the Disney defendants had either breached their duty of care or had not acted in good faith.")

[46] *Walt Disney III*, 825 A.2d at 280-81.

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

[48] *Id.* at 874.

[49] *Id.*

[50] *Id.*

[51] *Id.* at 876-77.

[52] *Id.*

[53] *Walt Disney IV*, 907 A.2d at 767-68.

[54] *Id.*

[55] *Id.*

[56] *Walt Disney III*, 825 A.2d at 280-81.

[57] *See, e.g.*, Robert Baker, "In re Walt Disney: What It Means to the Definition of Good Faith, Exculpatory Clauses, and the Nature of Executive Compensation," 4 FL. ST. U. BUS. REV. 261, 269 (2004-2005) ("It seems that the Disney decision blurs the line between this elevated recklessness standard for good faith and the traditional gross negligence standard for duty of care breaches."); Matthew Berry, "Does Delaware's Section 102(b)(7) Protect Reckless Directors from Personal Liability? Only if Delaware Courts Act in Good Faith," 79 WASH. L. REV. 1125 ("Contrary to the *Van Gorkom* court's decision, the *Disney* Chancery Court suggested that directors' reckless conduct breaches the duty of good faith");
Tara Dunn, "The Developing Theory of Good Faith in Director Conduct: Are Delaware Courts Ready to Force Directors to Go Out of Pocket After Disney IV?"
83 DENV. U. L. REV. 531 (2005)("[I]n *Disney II*, the Chancery Court found plaintiffs' well-pleaded claim based on the duty of care to fairly raise the question of whether Disney directors acted in good faith.")

[58] *See, e.g., Off. Comm. of Unsecured Creditors of Integrated Health Svcs., Inc. v. Elkins*, No. Civ. A. 20228-NC, 2004 WL 1949290, at *12 (Del. Ch. Aug. 24, 2004) ("Again, the Complaint alleges Compensation Committee approval and Board ratification of an Elkins request without any 'consideration, deliberation, or advice from *any* expert.' Because I must accept this allegation as true on a motion to dismiss, I deny the Motions to Dismiss as to this claim.")

[59] *Walt Disney V*, 906 A.2d at 64-65 (citations omitted).

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