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I. Introduction

Disney is the leading case on executive compensation.[1] It took ten years to litigate and six individual decisions to adjudicate it to a conclusion.[2] At issue was the propriety of the hiring and then firing of Michael Ovitz as the Walt Disney Company's ("Disney") president on terms that resulted in his walking away from Disney with over $130 million after only fourteen months on the job. The shareholders' grievance was the excessive payout, and the bungling that left the corporate treasury substantially depleted and the executive ranks without a talented president and successor to Michael Eisner. This grievance was real: Ovitz's hiring had been applauded by the stock market, and on the hiring announcement, the Disney stock capitalization bounced by $1 billion;[3] however, once Disney fired Ovitz, those exuberant expectations were dashed, and Disney was left worse off than before.

In the Delaware courts, the amount of money at issue was more a measure of the solemnity and consideration required of the board than the appropriateness or fairness of the compensation. Indeed, compensation was not addressed. The amount of compensation for any executive is a business question for the board, not really within the purview of the courts. The Delaware Supreme Court alluded to the fact that the amount at issue was huge by ordinary standards, but not extraordinary as a business matter for Disney, an observation not germane to the decision before it, which the court acknowledged.[4] The case starkly, and rightfully, shows the limitations of judicial review in matters of executive compensation.[5]

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1. The reference to the *Disney* case is a collective reference to all the opinions both in the Supreme Court of Delaware and in the Chancery Court. The first opinion was *In re the Walt Disney Co. Derivative Litigation*, which dismissed the original complaint, 731 A.2d 342 (Del. Ch. 1998) [hereinafter *In re* Disney Derivative Litigation]. The appeal was *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000), granting plaintiffs leave to replead in part. Following the appeal, *In re the Walt Disney Co. Derivative Litigation*, 825 A.2d 275 (Del. Ch. 2003) [hereinafter *In re* Disney Litigation], dealt with the motion to dismiss the amended complaint, which was denied. After discovery, defendant, Michael Ovitz, moved for summary judgment, granted in part, denied in part in *In re Walt Disney Company Derivative Litigation*, No. 15452, 2004 WL 2050138 (Del. Ch. Sept, 10, 2004). The opinion, after the trial, was rendered in *In re the Walt Disney Company Derivative Litigation*, 907 A.2d 693 (Del. Ch. 2005) [hereinafter *In re* Disney] and the final decision by the Supreme Court was *In re* Walt Disney Co. Derivative Litigation, 906 A.2d 27 (Del. 2006) [hereinafter *In re* Disney Final].

2. *See supra* note 1. The original complaint was filed in January 1997 following Ovitz's termination in December 1996. *In re* Disney Final, 906 A.2d at 35. For further discussion, see *infra* Part III.

3. The percentage increase was 4.4 percent. *In re* Disney Final, 906 A.2d at 40.

4. *Id.* at 54 n.72.

5. *Compare with* Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007) (dealing with the backdating of options) *and* Sanders v. Wang & Computer Assocs., No. 16640, 1999 WL 1044880 (Del. Ch. Nov. 8, 1999) (involving an improper adjusting of the number of options). Both cases deal with excess but within the framework of departures by the board from limits set by stockholders. Generally, compensation is a matter of business judgment, including payments on termination, such as golden parachutes. *See, e.g.*, Gaillard v. Natomas, 208 Cal. App. 3d 1250 (1997).

The courts'[6] examination of the board's decision was on the process employed, the manner in which Disney proceeded to determine and approve Ovitz's compensation and contractual arrangements. The plaintiffs claimed the company displayed a lack of due care or good faith in this determination. Unfortunately, the courts' review of Disney's process tells us little about the regulation of executive compensation, which was clearly out of control in the executive market place, the backdrop against which the *Disney* case was brought and decided. The courts wanted to inform and set standards,[7] but their examination of the deliberative process was not truly informative because the courts looked at minimum standards that did not breach duties of care and good faith instead of setting exemplary rules. Indeed, exemplary rules were regarded as aspirational and not a measure of fiduciary duties.[8] More importantly, the strategic role of the board of directors in corporate governance—the replacement (or providing for the succession) of the chief executive officer ("CEO"), an issue on which there is sparse judicial learning or reflection—was not really addressed by the courts and not vigorously pursed by the plaintiffs who were distracted by the payout to Ovitz and doggedly sought reimbursement for the corporate treasury. This neglect of the succession issue constituted a failure of imagination on the part of the plaintiffs, as will be seen.

Nonetheless, *Disney* is important for what it decides and for what it does not decide. *Disney* clarifies the definition of due care and for the first time defines in a comprehensive fashion the concept of good faith. The case tells us in explicit terms that director liability is a rare event, which is as it should be, despite sensitive issues, media condemnation of pay abuses, and irate stockholders. The courts correctly found that the board acted with due care and in good faith in hiring Ovitz and that the termination without cause was also done in good faith. The courts did not address succession, however, which was the reason for hiring Ovitz in the first place and most likely the reason for his firing. As noted, the plaintiffs allowed the succession issue to lapse. This was unfortunate, particularly so because this was a missed opportunity for the plaintiffs, and there is a real need to address such an important issue in the life of every corporation. Failures in succession are bound to occur again.

The central thesis of this essay is that Michael Eisner, like many CEOs, was probably more concerned with retaining his power than with installing his suc-

6. In Part I, the reference to "the courts" is a collective reference to both the Delaware Chancery Court and Delaware Supreme Court.

7. *In re* Disney, 907 A.2d at 760 ("For the future, many lessons of what not to do can be learned from defendants' conduct here."). The Chancery Court goes on to say that "nevertheless" the defendants did not act in bad faith and at most were ordinarily negligent; guidance is limited to executive compensation and severance. *See id*. at 698–99.

8. *See id*. at 697–98, 745 n.399.

cessor.[9] The firing of Ovitz resulted in Eisner serving as CEO for another nine years, practically doubling his tenure. His concern with retaining power was ever-present in his dealings with his board and in the negotiations and termination of Ovitz. His concern with retention of power and control over the succession process resulted, in my view, in his acting in bad faith in hiring Ovitz, and it inevitably caused Ovitz's dismissal and the resulting excessive payout.[10] Although the law of bad faith was not fully explicated at the outset of the case, it was still sufficient to properly guide the actions of the executives and the board of directors. Eisner's ability to thwart the succession process resulted from the Disney board improperly empowering Eisner with the duty to hire his own successor. By itself, this empowerment of Eisner was not a breach of the duty of care or an action taken in bad faith under current legal standards. Yet, where there is passivity on the part of the board, as in this case, judicial oversight and strict examination is required of the care taken in the decision process. Moreover, Eisner's self-interest in retaining his power should have had an impact on the question of the independence of the board dominated by Eisner—an analysis not made by the courts because succession was not considered.[11] Like so many cases that are extensively litigated because of the amounts at stake, the monetary stakes distract from the underlying issues, and the case winds up only obliquely dealing with the reality of the issues in the boardroom. As in this case, the problems of succession before the Disney board of directors, inherent in the hiring and firing of Ovitz, were never addressed. Nevertheless, the extensive allegations and copious fact findings from the lengthy trial in *Disney* can be used to provide a case study in corporate governance and CEO succession.

Accordingly, this essay will consider the issues arising out of the hiring and dismissal of Ovitz, including the appropriateness of his compensation, and explore the issues involving the choice of a successor to Eisner and the role of the board in the hiring process. Part II will present the facts of the *Disney* case and set out the applicable law. Part III will focus on how the courts defined the questions they would consider and will illuminate the turning point in the case where the succession issue was dismissed and allowed to lapse. Part IV will review the courts clarification of due care and the definition of good faith. Part V will apply the courts' definitions to the hiring of Ovitz, and Part VI will apply the definitions to the facts in the case relating to succession to consider what we can learn from the case about the role of the board in the succession process.

9. The word of art is "entrenching" himself. Entrenchment is scrutinized under the rationale set out in *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) and its progeny.

10. The conclusion is a matter of opinion. There was no adversarial challenge on this issue, defense, or direct finding of fact by the court, but there is a very complete set of facts from which to draw this conclusion as will be seen. *See In re* Disney, 907 A.2d at 699–745.

11. *See* discussion *infra* Part III.

II. Facts and Applicable Law[12]

Michael Ovitz entered into his employment agreement with Disney in August 1995 to serve as president for five years.[13] Only fourteen months later, he was terminated without cause and given severance of approximately $130 million.[14] Although all expectations were that Ovitz, a seasoned and effective executive, would serve admirably, his hiring turned out to be a massive mistake.

Michael Ovitz's hiring was motivated by two events. In April 1994, Frank Wells, then Disney's president and chief operating officer ("COO"), was killed in a helicopter crash.[15] Wells and Eisner had enjoyed remarkable success running Disney for ten years.[16] There was a need to replace Wells because Disney had recently acquired Cap Cities/ABC and doubled its size, but no viable candidate was found internally, and Eisner assumed Wells's positions as well as maintaining his current role of CEO.[17]

As the Chancery Court put it, "for a brief moment, the Company was able to stave off the need to replace Wells."[18] Eisner, however, was diagnosed with heart disease within three months of Wells's death and had quadruple bypass surgery.[19] His illness forced consideration of a successor. According to the Chancery Court: "Over the next year, Eisner and Disney's board of directors discussed the need to identify Eisner's successor."[20] And these events and discussions were the "springboard" from which Eisner acted.[21]

Eisner and Ovitz had known each other for twenty-five years, both professionally and socially.[22] Eisner had become seriously interested in recruiting Ovitz in early 1995, but their actual discussions had been unproductive because Music Corporation of America ("MCA") had made Ovitz an offer that Disney could not match.[23] The Ovitz-MCA discussion fell apart, however, and MCA

12. This essay does not treat the issue of Ovitz's fiduciary duties to Disney. For a complete statement of the facts, covering nearly fifty pages, refer to the Chancery Court's post-trial opinion, see *In re* Disney, 907 A.2d at 699–745.

13. *Id.* at 704–07.

14. *See In re* Disney Final, 906 A.2d 27, 35 (Del. 2006).

15. *In re* Disney, 907 A.2d at 699.

16. *Id*.

17. Interestingly, as it turned out, Robert Eiger, who ultimately became the CEO replacing Eisner, was running ABC at the time. The question becomes how earnestly Eisner or the board looked for a replacement at the time. There is no record of any search.

18. *In re* Disney, 907 A.2d at 699. The Chancery Court understands or is implying that there was no urgency to replace Wells at that time. It was Eisner who was able to hold the line.

19. *Id*.

20. *Id*.

21. *Id.* No committee is mentioned by the Chancery Court, and no process other than discussion by the whole board was implemented.

22. *Id*.

23. *Id*. at 702.

instead hired Ron Meyer, the number two man at Creative Arts Associates ("CAA"), Ovitz's company.[24] Meyer's departure changed Ovitz's mindset and life.[25] He did not want to run CAA without Meyer.[26] Thus, Ovitz became eager to join Disney and negotiations began in July 1995.[27]

The negotiations were in two phases, each affecting the other. The first was Ovitz's role, and the second was the financial terms. Eisner dealt directly with Ovitz on Ovitz's role and Disney's needs that Ovitz would fill.[28] Irwin Russell, a member of the compensation committee and Eisner's personal lawyer, took the lead, subject to Eisner's oversight, in negotiating the financial terms.[29]

At the outset of the negotiations between Ovitz and Eisner, Ovitz learned that Eisner wanted him to bring to bear his skills to correct current weaknesses, which were identified as poor talent relationships and stagnant foreign growth.[30] Ovitz wanted assurance that Eisner was sincere in his desire to reinvent Disney and that Ovitz's vision was shared. At some point in these preliminary negotiations, Eisner gave Ovitz the assurances he desired, and Ovitz came to understand that he and Eisner would run Disney as "partners."[31] This partner relationship meant that they would operate as co-CEOs. Eisner accepted this sharing of the CEO position, but both men understood that Eisner was the chairman and would be Ovitz's superior.[32] They would, however, work in unison, and the relationship would be "akin to the one that exists between senior and junior partners."[33] It was this understanding that paved the way for the financial negotiations.

Russell learned in the financial negotiations that Ovitz owned 55 percent of CAA and earned approximately $20 to $25 million a year.[34] Ovitz made it clear that he would not give up his position and control of his company without an upside comparable to his current earnings and "downside" protection.[35] The contract, to meet these requirements, was for a five-year term, with various stock option arrangements providing for upside opportunities and downside protec-

24. *Id*. at 701.

25. *Id*.

26. *Id*.

27. *Id*. at 701–02.

28. *Id*. at 702.

29. *Id*.

30. *Id*. at 703.

31. *Id*.

32. *Id*.

33. *Id*.

34. *Id*. at 702.

35. Downside protection was mandatory, and it was the basis for Ovitz's negotiation for all his own clients and himself. *See id*. at 702–03.

tion.[36] Russell told Eisner and Ovitz that the negotiated terms represented "an extraordinary level of executive compensation."[37] Indeed, he cautioned that Ovitz's salary would be at the top level of CEOs' salaries and would exceed Eisner's.[38] In addition, the stock options exceeded standards normally applied to Disney and would raise very strong criticisms.[39] To help in the negotiations and the ultimate presentation to the compensation committee and then to the board, Russell recruited Graef Crystal, an expert in executive compensation, and Raymond Watson, a compensation committee member and former Disney board chairman.[40] Watson was particularly experienced in Disney's executive compensation packages because he had worked on both Frank Wells's and Eisner's contracts.[41]

There is no question that these men understood all the ramifications of the Ovitz employment contract, including the severance arrangements and the costs of early termination. If there could be any doubt, it is easily assuaged by the fact that before the agreement was adopted, it had to be recast for tax purposes and all aspects of the economics had to be preserved, which required fully understanding the terms and their ramifications.[42]

The negotiation that was begun in early-July was in full swing by mid-July and came to its end game on August 12, 1995.[43] On that date, Ovitz and Eisner were vacationing together with their families in Aspen, Colorado.[44] In the afternoon, Eisner told Ovitz that Sid Bass, a large Disney shareholder, was flying to Aspen for dinner and that "either we are going to have a deal by the time he lands . . . or we're not, . . . [and] the deal will be gone."[45] Ovitz was given until 6:00 p.m. to agree on the financial terms, which dealt with the non-controversial recasting of the options for tax purposes.[46] The second part of the Eisner ultimatum required Ovitz to abandon the idea of being co-CEO and to relinquish sig-

36. *Id*.

37. *Id.* at 704.

38. *Id*.

39. *Id*.

40. *Id*. at 704–05.

41. *Id*. at 704.

42. *See id*. at 708. An in-house attorney at Disney concluded the package had negative tax implications so Russell, Crystal, and Watson each analyzed the proposed changes to reach the terms of the compensation package. *Id.* at 708–09.

43. *Id.* at 706.

44. *Id.* at 706 n.54.

45. *Id.* From the beginning, Sid Bass had made it clear to Eisner that he would not support Ovitz sharing equal power. *Id*. at 702 n.21. The dialogue is right out of the movie *The Godfather*. There is no reason to expect that life would not imitate art in the movie business.

46. *Id*. at 706 n.54, 708.

nificant operating authority.[47] Ovitz was offered the job of president, but not of COO,[48] the position once held by Wells and now retained by Eisner.

Ovitz agreed, but there was more to come the next day. With the signing now imminent, Sanford Litvack, Disney's general counsel, and Stephen Bollenbach, the chief financial officer, rebelled against reporting to Ovitz.[49] Both insisted on separating all operating decisions in their spheres from Ovitz and reporting directly to Eisner.[50] Even now it is difficult to define the scope of authority that Ovitz would have at the general corporate level because no one with any real responsibility would be reporting to him. Eisner, however, supported his lieutenants, which assured and reaffirmed his power while diminishing Ovitz's position.

Nevertheless, Ovitz accepted the terms, and the employment agreement was signed.[51] Immediately before the public announcement, Eisner called his directors (other than those on the compensation committee, who were called by Watson) to tell them of the deal and the announcement.[52] Eisner heard objections from three directors.[53] These objections did not dissuade him. The announcement was made, and the stock took its $1 billion bounce.[54]

On September 26, 1995, the compensation committee met for the first time to consider the proposed terms of Ovitz's employment agreement and, among other things, Russell's $250,000 compensation for negotiating the Ovitz deal.[55] At the executive committee meeting, the board was told about the reporting structure to which Ovitz had agreed, but Eisner did not report the last minute rebellion of Litvack and Bollenbach.[56] Neither Litvack nor Bollenbach were pre-

47. *Id*. at 706 n.54.

48. *Id.* at 706.

49. *Id.*

50. *Id.*

51. The Chancery Court stated that Eisner was able to assuage Ovitz's concerns about his "shrinking authority" and colorfully found that "Ovitz, with his back against the wall, acceded to Litvack and Bollenbach's terms." *Id.* at 707. But Ovitz had a history of success as much as or more so than Eisner, and he could believe, despite the handicaps that Eisner had imposed (e.g., retaining both CEO and COO lines of power), that he could "reinvent Disney" as he had the movie business, which would certainly make him a power to be reckoned with. He could believe that he would have the authority to make changes because Eisner had argued against his joining MCA on the basis that MCA would not give him the "free hand" that Eisner would give him. *Id*. at 718 n.177. The Chancery Court noted this observation about having a free hand as a matter of irony. *Id*.

52. *Id.* at 707–08.

53. *See* Brehm v. Eisner, 746 A.2d 244, 250 (Del. 2000).

54. *In re* Disney, 907 A.2d at 708 n.73.

55. *Id.* at 708, 709 n.88. Also on the agenda were compensation packages for various Disney employees. *Id.* at 708.

56. *Id.* at 710.

sent, and thus their not reporting to Ovitz was not raised.[57] The agreement with Ovitz was signed on October 1, 1995.[58]

The termination of Ovitz fourteen months later without cause illuminates the hiring and the role Ovitz served as a possible successor. The plaintiffs argued that Ovitz failed to follow Eisner's directives and was insubordinate, reasons enough to fire him for cause.[59] Ovitz countered that Eisner micromanaged, "prevent[ing] Ovitz from having the authority necessary to make . . . changes . . . ."[60] The chancellor found that the trial record did not support the allegations of insubordination.[61] The plaintiffs claimed that Ovitz was a habitual liar, but the court found no evidence of material falsehood during Ovitz's tenure.[62]

Ovitz's relationship with Eisner had deteriorated by mid-September 1996 to the point that Eisner told Litvack to tell Ovitz that he was not working out at Disney, and he should start looking for a graceful exit.[63] Yet, his exit was anything but graceful. Ovitz did not want to leave as a "loser" and instead told Litvack that he was committed to make the job arrangement work.[64]

Litvack reported back to Eisner who told him to see Ovitz again and to tell him in no uncertain terms that Eisner no longer wanted Ovitz at Disney.[65] Ovitz responded to Litvack on his second try that he was not leaving and Eisner would have to tell him to his face.[66] On September 30, 1996, the board met in an executive session with Ovitz not present, and Eisner told his directors that he was having continuing problems with Ovitz's performance.[67] That same evening, however, Eisner and Ovitz appeared on *Larry King Live* and told the audience that there were no problems between them, and everything was working out well, refuting all Hollywood gossip.[68] But the next day Eisner wrote a remarkable letter to Russell and Watson, the two directors who had negotiated Ovitz's employment terms, telling them of his lack of trust for Ovitz and Ovitz's

57. *Id.* at 710 n.90.

58. *Id.* at 711.

59. *Id.* at 718.

60. *Id.*

61. *Id.* at 714.

62. *See id.* at 720–22.

63. *Id.* at 724.

64. *Id.* at 724–25.

65. *Id.* at 724.

66. *Id*. It can be inferred that Ovitz understood Eisner very well, and that Eisner wanted Ovitz to terminate voluntarily without Eisner having to admit to making a mistake becomes exceeding clear as Ovitz resisted termination.

67. *Id*. at 726.

68. *Id*.

failure in any way to alleviate Eisner's workload.[69] The purpose of the letter was to prevent Ovitz from succeeding him at Disney.[70]

Eisner tried to get Ovitz to join Sony, but Ovitz informed Eisner on November 1, 1996, that his discussions with Sony did not work out.[71] Eisner met with Ovitz personally on November 13, 1996, and told him directly that he was not welcome at Disney, but Ovitz would not accept the rejection, and he insisted that would stay and "chain himself to his desk" if need be.[72]

All during this period, Eisner was working with Litvack to see if he could terminate Ovitz for cause, but Litvack told him that there was no cause, and it was imprudent to try to avoid the costly payment because it would damage Disney's reputation.[73] Finally on November 25, 1996, at an executive session outside of Ovitz's presence, Eisner told his directors that he would fire Ovitz by year-end, without cause.[74] Eisner charged one of the directors, Gary Wilson, a friend of Ovitz, to speak to Ovitz while they were on a Thanksgiving sailing trip to the British Virgin Islands.[75]

When told by Wilson of the year-end firing, Ovitz insisted that if he could survive until Christmas, he would fix everything.[76] Wilson dispelled the illusion that the relationship was fixable, causing Ovitz to capitulate finally and to negotiate his severance based on a termination without cause.[77]

The case against Disney arose as a derivative action in which the plaintiffs did not make a demand on the corporation to bring suit against the directors.[78] Demands are excused where facts are pleaded with particularity to show that the directors were not independent, did not exercise reasonable business judgment in

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69. *Id.*

70. *Id*. at 726–27 (citing Letter from Michael Eisner, Chairman & CEO, Walt Disney Co., to Irwin Russell, Chairman, Comp. Comm., Walt Disney Co. & Raymond Watson, Member, Comp. Comm., Walt Disney Co. (Oct. 1, 1996) ("If I should be hit by a truck, the company simply cannot make [Ovitz] CEO or leave him as president with a figurehead CEO. It would be catastrophic. I hate saying it, but his strength of personality together with his erratic behavior and pathological problems, and I hate saying that, is a mixture leading to disaster for this company.")). It is no accident that the letter should follow the *Larry King Live* interview because Eisner had publicly affirmed Ovitz's status while wanting to get rid of him and had to dispel all ambiguity.

71. *Id.* at 727.

72. *Id*. And, yet again, Eisner's will was thwarted. Eisner had all the power but could not use it. In Part VI, we try to understand the dynamic at work.

73. *Id.* at 728–30.

74. *Id.* at 731. Although there is no written record of the executive session, it is clear that the discussion centered around the firing of Ovitz. *Id.* at 730.

75. *Id.* at 731.

76. *Id.* at 732.

77. *See id.*

78. *See In re* Disney Derivative Litigation, 731 A.2d 342 (Del. Ch. 1998).

good faith, or their actions constituted corporate waste.[79] Derivative actions are difficult to bring successfully because the plaintiff must plead, with particularity, the factual basis for the claim in the first instance and then must overcome the presumptions of the business judgment rule that the directors are presumed to have acted in the best interests of the corporation.[80] The directors will prevail unless plaintiff meets the burden of showing that the directors are not independent, did not exercise due care, or acted in their own self-interest or wastefully.[81] Waste is the most difficult standard because corporate assets must literally be given away to constitute waste.[82] The huge sum paid to Ovitz for his short period of employment, however, got the Delaware Supreme Court's attention. The plaintiffs alleged that Ovitz got more by leaving than by staying. The history of the plaintiffs' complaint and its treatment is set out below.

III. The Scope of the *Disney* Case

The *Disney* complaint was a cornucopia of grievances. First filed on January 8, 1997, it was amended for adjudication on May 28, 1997, and it was dismissed by the Chancery Court in 1998.[83] It was submitted to the Delaware Supreme Court for review in September 1999 and was dismissed with leave to amend in February 2000.[84] The complaint was eighty-eight pages, two hundred eighty-five paragraphs, and characterized by the Delaware Supreme Court in *Brehm* as a "pastiche of prolix invective."[85] Although also described as "inartfully drafted," it was "troubling . . . on the merits."[86] The Delaware Supreme Court acknowledged that Ovitz's payout was "exceedingly lucrative, if not luxurious"[87] compared to his value to Disney, and the approval and termination of Ovitz were "casual, if not sloppy and perfunctory."[88] The Delaware Supreme Court found the sheer size of the payout "push[ed] the envelope of judicial respect for business judgment of directors in making compensation decisions."[89]

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79. *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984) (setting forth requirement for particularized pleading, forbidding the use of conclusory statements without factual basis), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

80. *See id.*

81. *See id.*

82. *See id.*

83. Brehm v. Eisner, 746 A.2d 244, 248 (Del. 2000).

84. *Id.*

85. *Id.* at 249.

86. *Id.*

87. *Id*.

88. *Id*.

89. *Id; see also In re* Disney Final, 906 A.2d 27 (Del. 2006) (upholding the principle that a director must be found to be grossly negligent in order to overcome the presumption of the business judgment rule).

Like most opinions, there were numerous statements of the issues before the Delaware Supreme Court. The broadest statement by the Delaware Supreme Court was this: "The issue is whether plaintiffs have alleged particularized facts creating a reasonable doubt that the actions of the defendants were protected by the business judgment rule."[90] This statement covers everything in the complaint. At the outset of its opinion, however, the Delaware Supreme Court set out the three particular issues that it saw before it, two of which were whether the board breached its fiduciary duty by (1) approving an extravagant and wasteful contract with Ovitz, or (2) a severance arrangement that was more bountiful than performance.[91] The Delaware Supreme Court couched these particular issues in terms of financial excess, which are matters within the business judgment of the board, or waste, the most difficult claim to prove. The third issue was whether the directors were independent.[92]

The allegations in the complaint set out the full story of the need for a plan of succession and how the hiring of Ovitz would fulfill this need.[93] The Delaware Supreme Court described the specific allegations that present the succession issue in all its potency. As mentioned above, Frank Wells, the president and COO, had recently died in a helicopter crash. Accordingly, the complaint alleged, the "[b]oard knew that Disney needed a strong second-in-command."[94] Such knowledge was manifest because Disney had recently acquired Cap Cities/ABC, a transaction that doubled the size of Disney and required assimilation. This daunting task had fallen on Eisner whose health was not good, having just undergone quadruple bypass surgery. The plaintiffs then noted that Eisner had a history of undermining potential successors.[95] The Delaware Supreme Court quoted this important allegation: "Eisner had demonstrated little or no capacity to work with important or well-known subordinate executives who wanted to position themselves to succeed him."[96] The court then noted the complaint's recitation of the departures of Jeffrey Katzenbach, Richard Frank, and Stephen Bollenbach, all talented and experienced executives.[97] The plaintiffs' reasonable conclusion was set out by the court as logical from the preceding allegations. In the Delaware Supreme Court's words: "Thus, the [b]oard knew that, to increase the chance for long-term success, it had to take extra care in reviewing a decision to hire Disney's new president."[98]

90. *Brehm*, 746 A.2d at 255.

91. *Id*. at 248–49.

92. *See generally id.*

93. *Id*. at 250.

94. *Id.*

95. *Id.*

96. *Id*.

97. *Id.*

98. *Id*.

The hiring of Ovitz as a successor and setting the stage for review of the succession process could not have been more plainly stated. At least it would appear so, except for the next words (after the above quoted sentence) that it utters: "But Eisner's decision that Disney should hire Ovitz as its president was not entirely well-received."[99] That sentence, the beginning of a new paragraph, sounds and looks like a non-sequitur. What do the objections by three board members told about the prospect of hiring Ovitz—told just before the public announcement—have to do with the need for an able successor and the due care in the approval process required to ensure the long term success of Disney? It seems the Delaware Supreme Court was answering the argument about the care taken, stating or at least observing that objections by three important board members showed due care, particularly if the objections were overcome in the course of considering Ovitz. These actions could show that there was at least some discussion and contemplation behind the decision. Contemplation, of course, would also include the $1 billion increase in market capitalization value on the announcement.[100] The Delaware Supreme Court, however, then pointed to a deficiency in the complaint.[101] There was a failure "to allege with particularized facts that the three objecting directors changed their initial reaction through anything other than . . . discussion and . . . contemplation."[102]

The Delaware Supreme Court was pointing to changes in the director's votes caused by Eisner's dominance or coercion. The failure noted by the Delaware Supreme Court to allege coercion in the complaint served to dismiss the due care issue related to succession. But the Delaware Supreme Court was also pointing to a path that could be pursued. Nonetheless, the effect was to make it more difficult to plead the context of succession in the approval process because specific factual allegations of Eisner's coercion of his directors would have had to be stated and proved. Such level of specificity had proved difficult for the plaintiffs. There was, however, much to be said about Eisner and coercion.[103] To be fair, the Chancery Court, on the repleading, showed that there was much to be said by considering Eisner's overbearing behavior in the context of employing Ovitz.[104] But, as noted, the plaintiffs did not ask the Chancery Court to look at the larger

99. *Id*.

100. What was the market reflecting, the employment of Ovitz, the assurance of succession, or both? My view is that the market had to assume both, but the question is what Eisner and the directors were considering, which will be discussed later.

101. *Brehm*, 746 A.2d at 251.

102. *Id.*

103. The plaintiffs could have marshalled the facts and broadened the context, but my view is that they were apparently looking for low hanging fruit, rather than difficult to prove claims.

104. *See generally In re* Disney, 907 A.2d 693, 718–19 (Del. Ch. 2005).

question of how that behavior affected the board's obligation to provide for a successor and its failures in approving Ovitz as the successor.[105]

Having dispensed with the plaintiffs' allegations as to the care required in matters of succession by showing (or inferring) indicia of contemplation by the directors in dealing with the three nay saying directors, the Delaware Supreme Court turned to what it regarded as the key allegation in the case: excessiveness in payout. The plaintiffs expressed this key allegation as the board's failure to inform itself of the total costs of the contract, especially the severance, which apparently permitted Ovitz to earn more by exiting than by fulfilling his contract. This key allegation charged a breach of the duty of care.

At this point, with the court's recognition and labeling of the key allegation, the case had taken its narrow focus and direction. The Chancery Court had held that "no reasonable doubt can exist as to Eisner's disinterest in the approval of the Employment Agreement, as a matter of law."[106] The Delaware Supreme Court affirmed and took issues of loyalty out of the case, except to the extent of actions in bad faith.[107] Such affirmation also took out of the case the issue of the independence of the board of directors. If Eisner was "disinterested," then his domination of the directors, particularly those who worked for him or were beholden to him, did not affect their independence. The failure of the defendants to approach the issue of director independence from the point of view of Eisner's entrenching actions (and the attendant coercion) shows their failure of imagination. Eisner's desire to retain all the levers of power, continuing to be both CEO and COO, was not raised in any specific way that required the court to address it. Finding Eisner's "interest" in retaining power would have then affected the court's view of the board's independence.[108]

In repleading, the plaintiffs principally addressed the financial matters before the compensation committee and the resulting excessive payout. This approach resulted in plaintiffs' loss of the case. Of course, this loss was not immediately obvious once the plaintiffs repleaded. Only later did the plaintiffs quarrel with the Delaware Supreme Court on what it had decided earlier in *Brehm*, which they then found too restrictive.[109] At that moment, however, the plaintiffs

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105. *See id.* at 697 (discussing the sole issue as involving the compensation and severance package given to Ovitz). See discussion *infra* Part VI for more on the succession issue and the Chancery Court's view of Eisner's coercion and culpability.

106. *In re* Disney Derivative Litigation, 731 A.2d 342, 356 (Del. Ch. 1998).

107. *See Brehm*, 746 A.2d at 257–58. The plaintiffs claimed that Eisner's "interest" was in getting Ovitz a huge amount of compensation, which would then benefit him because it would have the effect of ratcheting up his own pay. *Id.* at 257. This claim was easily dismissed by the Delaware Supreme Court in *Brehm* because the options granted to Ovitz were dilutive to Eisner. *Id.* Eisner's actions of entrenching himself was never raised, although it would have opened up the matter of self-interest in a much more direct and appealing way than allegations that he was looking to increase his compensation.

108. *In re* Disney Derivative Litigation, 731 A.2d at 356; *see* discussion *infra* Part VI.

109. *In re* Disney Final, 906 A.2d at 54, nn.70–72.

saw an opening in the excessive payout argument and were probably encouraged by a speech by then Chief Justice Norman Veasey indicating that the court would approach matters of excessive compensation with renewed vigor.[110] In that speech, Chief Justice Veasey introduced the thought that the concept of good faith could be a test of disingenuousness and dishonesty in measuring performance standards for compensation.[111] Of course, his speech had nothing to do with the *Disney* case, but it recognized that compensation was out of control.

The plaintiffs repleaded with vigor by addressing the excessive payout and introduced allegations of the directors' bad faith into the complaint. As described by the Chancery Court: "In short, the new complaint alleges facts implying that the Disney directors failed to 'act in good faith and meet minimal procedural standards of attention.'"[112] This complaint withstood the motion to dismiss and the case was then tried.[113]

IV. Duty of Care and Actions in Good Faith

Disney makes two contributions to Delaware's corporate jurisprudence. It distinguishes between principles of corporate law and desirable or aspirational practices, and it defines good faith. The plaintiffs alleged that a number of practices were near universal for large exchange-traded companies, such as meetings of the board (or portions of meetings) held without management present and assessment by the directors of management's—particularly the CEO's—performance.[114] Neither of these practices were followed by Disney. These allegations of marginal practice were a springboard for the Delaware courts to consider and reflect on the difference between bedrock fiduciary duty obligations that are constant, and practices—exemplary or aspirational—that cannot be a measure of care or good faith. The particular exemplary practices that the plaintiffs alleged Disney did not follow do not figure or receive comment in the Delaware Supreme Court's final decision because they relate only to Eisner's overbearing behavior affecting succession.[115] In considering the actions of the compensation committee and the board in regard to due care, however, the Delaware Supreme Court mentioned a number of desirable procedures, such as providing the directors with

110. *See* E. Norman Veasey, *Reflections on Key Issues of Professional Responsibilities of Corporate Lawyer's in the Twenty-First Century*, 12 WASH. U.J.L. & POL'Y 1 (2003) [hereinafter *Reflections*]; *see also* E. Norman Veasey, *State-Federal Tension in Corporate Governance and the Professional Responsibilities of Advisors*, 28 J. CORP. L. 441 (2003).

111. *See Reflections*, *supra* note 110.

112. *In re* Disney Litigation, 825 A.2d 275, 278 (quoting Gagliardi v. Trifoods Int'l, 683 A.2d 1049, 1052 (Del. Ch. 1996)).

113. *Id.* at 291.

114. *Brehm v. Eisner*, 746 A.2d 244, n.29 (Del. 2000) (noting director retreats and requirements as to stock ownership).

115. *See In re* Disney Final, 906 A.2d. at 64.

term and spreadsheets that described compensation in all its aspects, including compensation for performance and for severance.[116] But it concluded that the directors were informed well enough to have acted with due care.[117]

Whether the directors acted in good faith required the court to define good faith. The Chancery Court first addressed the definition with respect to the new pleading charging actions in bad faith. The Chancery Court described the aspects of the complaint charging bad faith as "[s]hrouded in the fog of this hazy jurisprudence."[118] Nonetheless, the Chancery Court concluded that plaintiffs pleaded a non-exculpable breach of fiduciary duty to the extent that they alleged a conscious and intentional disregard of their responsibilities by the directors by failing "to 'act in good faith and meet minimal proceduralist standards of attention.'"[119]

For the chancellor, bad faith is the product of certain moral failings that result in the directors placing their own interests, preferences, or appetites above the welfare of the corporation.[120] These failings include greed, hatred, lust, envy, revenge, shame, or pride; basically, a near complete list of the seven deadly sins. He then added sloth, the kind that results in the "systematic or sustained shirking of duty."[121] In other words, being asleep at the switch. Ignorance by itself is not such a moral wrong unless it is the result of the other failings. Thus, the chancellor avoided an overlap with the duty of care, which is exculpable to the extent of gross negligence.

The Delaware Supreme Court approved the definition "as legally appropriate, although not . . . exclusive."[122] Bad faith, for the court, fits between the extremes of (1) actual intent to do harm, and (2) gross negligence.[123] Bad faith is then, in this continuum, a conscious disregard of ones' duties. In *Stone v. Ritter*, we learn that bad faith is a subset of the duty of loyalty, not an independent basis for liability, and can be described in certain contexts—most notably where there is a systematic failure to act—as a necessary condition to the breach of the duty of loyalty.[124]

With this jurisprudence clarified, we are now ready to look at the facts of the *Disney* case, first as pleaded in the new and finally amended complaint and after trial, and then in the broader context of succession where the CEO is to have a designated successor.

116. *See id.* at 56.

117. *Id*. at 51–75. For more on the examples raised by the plaintiffs, see also discussion *infra* Part VI.

118. *In re* Disney, 907 A.2d 693, 754 (Del. Ch. 2005).

119. *In re* Disney Litigation, 825 A.2d 275, 278 (Del. Ch. 2003) (quoting Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996)).

120. *In re* Disney, 907 A.2d at 754 (quoting Guttman v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003)).

121. *Id.*

122. *In re* Disney Final, 906 A.2d at 67.

123. *Id.*

124. 911 A.2d 362 (Del. 2006).

V. Application of the Law to the Hiring Decision

Looked at solely as a hiring decision, little fault can be found with the care taken by the Disney compensation committee or the board in employing Ovitz. There was much said and many allegations made about sloppiness and failures of attention and care,[125] but the record after trial shows that such was not the case.[126] The arrangements were heavily negotiated by two members of the compensation committee, Irwin Russell and Raymond Watson, both experts in executive compensation.[127] These men were well placed on the four member compensation committee. They, along with Graef Crystal, the compensation expert, felt that the compensation and the severance arrangements were necessary to attract Ovitz and get his commitment.[128] There was no confusion about the generosity of the package relative to other presidents of public companies. They also felt that the amount might subject Disney to criticism, and they did their best to craft it to get Ovitz in a harness with a clear upside and downside protection.[129] As previously discussed, the arrangements had to be recast for tax purposes after they were agreed to in principle, and that exercise made sure that there could be no doubt about the amount and terms of the upside or the severance.[130] There are questions about what the other two committee members, Sidney Poitier and Ignacio Lozano, knew, but the findings were that they were briefed at the compensation committee meeting and the court found that they were informed.[131] Although there are questions about whether the attention given was as flighty and superficial as the board in *Smith v. Van Gorkom*,[132] the court properly points out that this situation was different. There was no sloth or failure of preparation by the time of the compensation meeting, and two of the four committee members negotiated the arrangements, advised by Crystal, a compensation expert.[133] This level of expertise was not available or brought to bear in *Van Gorkom*.[134]

There was a structural problem, however, that impaired the ability of committee and the board to act in an informed manner. This structural issue is more apparent in the Delaware Supreme Court's decision than in the Chancery's, but

125. *See generally* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

126. *See In re* Disney, 906 A.2d 693 (Del. Ch. 2005).

127. Russell was Eisner's lawyer and Watson was the former CEO. Russell was ultimately paid $250,000 for his efforts. *In re* Disney, 907 A.2d at 709 n.88.

128. Ovitz was earning $20 to $25 million dollars per year at CAA, and it is difficult to quarrel with the inducement necessary for him to leave the firm he founded. *Id*. at 702.

129. *Id.* at 703.

130. *Id.* at 708.

131. *See id.* at 771.

132. 488 A.2d 858 (Del. 1985).

133. *In re* Disney, 907 A.2d at 769.

134. *See id.*

it is present in both. The structural issue was the respective roles of the committee and the board under Disney's governing documents.[135] The plaintiffs raised it as a question of whether there was proper authorization of the employment of Ovitz.[136] The challenge required careful analysis by the court.

The structural issue can be stated simply. The compensation committee had a very narrow role, which was merely the fixing of compensation. The committee did not have the authority to hire Ovitz, although in considering his compensation it had to consider his talent and how that talent would be utilized. Its charter was more suited to dealing with existing officers than with new hires. The board's job was to hire, but not set the compensation or terms of severance, which was delegated to the compensation committee. There is something other worldly about this bifurcation because the committee acted first and worked out all the terms before the hiring decision, thus, putting the cart before the horse.

A more sound approach would have been to have the board determine whether Ovitz should be hired, and on what general terms, and then have the committee work out the details of compensation. This sound approach required only a change of the order of decision making, not a change in governing documents. The effect of the use of the committee before the board acted will be considered in Part VI. At this stage, it is difficult to say whether the order materially affected the information that each group had before they made the decision, although it was coercive on the board and likely to have affected its deliberations.

VI. Application of the Law to the Succession Process

There are certain human truths that are axioms of succession. CEOs die or become severely ill, and their exits can be sudden and even tragic. Sometimes these officers lose their way or their vision, and they refuse to acknowledge it and hold on much too long. Crisis management on the death of a CEO is difficult, but there is a clear path: the board starts a search, appoints an interim executive or committee, and sorts through the talent pool. Where, as in a situation like Disney's, there are intimations of mortality, such as Eisner's quadruple bypass, succession can be prepared for like any other business risk.

But many companies are not prepared for very human reasons. CEOs tend to cement their power, enhance, and protect it, rather than provide for a smooth exit. Indeed, the longer the CEO is in office, the more difficult it will be to dislodge him or her. Certain CEOs become identified with their companies such

135. The Delaware Supreme Court refers to governing documents, but the roles of the committee could only be set out, as is customary for all corporations, in the bylaws, which were subject to amendment by the board. Accordingly, their respective roles were easily amendable by the board. In this case, the committee acted first and then the matter was brought to the board so there was no reason or need or incentive to make changes by the board at that time. *See In re* Disney Final, 906 A.2d 27 (Del. 2006).

136. *See In re* Disney, 907 A.2d at 761.

as Eisner at Disney, Maurice Greenberg at AIG, and Robert Woodruff at Coca Cola. Few of us can remember their successors, and yet, the companies often prosper and exceed prior performance.[137] This fact brings us to another human truth against which succession is played out: There is a large talent pool of executives from which to find a successor. No person is irreplaceable. But care is necessary in the selection of the successor, and mistakes can be made if there is not a proper structure in place. Disney is not the only example of such a mistake.[138] The mistakes are always disasters—inordinate expenses of time and money filled with great stress. As the plaintiffs alleged, special care must be taken where there is an entrenched CEO.[139]

Implicit in the *Disney* case was the delegation to Eisner of the responsibility to find his successor. No succession committee had been set up. No process was in place, but there were discussions about succession, the impetus of which was Frank Wells' death and Eisner's health problems.[140] Leaving the process to Eisner was unwise and probably ensured failure. Such failure cannot be deemed to be, by itself, a breach of fiduciary duty or a failure to act in good faith by consciously disregarding the board's duty, but it is a powerful fact in any array of unwise decisions or omissions.

Succession was on the table from the outset of negotiation. Indeed, the negotiation by Eisner with Ovitz began with the thought, at least by Ovitz, that Eisner and Ovitz would be co-CEOs.[141] This idea was not merely a matter of ego on Ovitz's part. Disney had doubled its size with the acquisition of Cap Cities/ABC, and Ovitz was a CEO with enormous ability and success in dealing with show business talent, packaging movies, programming shows and commercials.[142] His expertise was global. The discussions between the two men were about reinventing Disney, a heady project for both, especially for Ovitz who was making a significant life change.[143] As previously stated, it was not until a month into the negotiations, the evening of August 12, 1995, just before they

137. Woodruff was a legendary CEO, known as "the boss" and ruled Coca Cola for six decades. He made it into the modern day global giant. He was succeeded by Roberto C. Goizueta, a Cuban refugee, trained as a chemical engineer. When Goizueta took office in 1981, a share of Coca Cola stock was worth $35.88, and "by the time he died in 1997, the same share was worth the equivalent of $2,209.72." Andrew Martin, *Does Coke Need A Refill?*, N.Y. TIMES, May 27, 2007, at C1.

138. *See* Richard Siklos and Geraldine Fabrikant, *Family Feud at CBS and Viacom*, N.Y. TIMES, July 20, 2007, at C9 (showing that Viacom, controlled by Sumner Redstone, has a history of failures of succession—Frank Biondi, Jr., was forced out in 1996, Mel Karazin in 2004 and Tom Freston in 2006, after only eight months; Shari Redstone, his daughter, is the latest victim).

139. Brehm v. Eisner, 746 A.2d 244, 250 (Del. 2000).

140. *See In re* Disney, 907 A.2d at 699.

141. *See id*. at 703.

142. *See id.* at 700–02.

143. Ovitz wanted assurances that Eisner was sincere about reinventing Disney and Eisner was able to "assuage Ovitz's concerns." *Id*. at 703.

were to sign the agreement in principle and announce their deal, that Eisner definitely addressed the scope of Ovitz's authority. Until then, Ovitz thought that he would be co-CEO, but Eisner told Ovitz that he would not support the co-CEO arrangement. His offer was to make Ovitz president. The office of president, however, was not to be the office held by Wells, who was COO. Eisner wanted to continue to be both CEO and COO. Ovitz was then put to a decision with the economics in place, after psychologically preparing himself to leave CAA. Ovitz was no stranger to this kind of pressure, but Eisner had orchestrated the change in the job superbly, using a form of bait and switch tactics. Ovitz agreed, but the erosion in responsibility was not over. With the signing and announcement imminent, Litvack and Bollenbach rebelled against reporting to Ovitz.[144] Both had seen what Eisner had just done to Ovitz and they insisted on separating all operating decisions in their spheres from Ovitz.[145]

Eisner, at that moment, had to make a critical decision to attenuate further Ovitz's authority and substantially reduce the probability of Ovitz being his successor. If Eisner thought of Ovitz at that moment as the successor, he would have told Litvack and Bollenbach that their attempt at insurrection was extremely foolish because when Ovitz did take the helm, he would not see them as loyal, and their careers at Disney would be over. Such warning would have quashed the revolt and left no doubt as to the future. But Eisner had seen Ovitz's weakness, and he supported his lieutenants, which enhanced his power while diminishing Ovitz's power and possible succession.

Counsel for Ovitz should have told him to terminate discussions because if he could not win this point when he had leverage, he would be on a downward path to oblivion. No one would respect him and the position offered was not really a position that put him directly in line for succession. If Eisner died, there would be a large gap in the executive ranks and Ovitz as president, but not COO (having no one at the divisions reporting to him), would be competing with a host of vice presidents running large businesses within the empire.[146] Whatever Ovitz's counsel was on this issue, he had crossed the Rubicon, the point of no return, and agreed to the further dilution of authority.

The agreement was then signed, and immediately before the public announcement, Eisner called his board and experienced the three objecting directors.[147] By the time of the board meeting, which was not until over a month

144. *Id.* at 706.

145. *Id.*

146. As it turned out, Robert Eiger (running ABC) ultimately ascended to the CEO position. Joe Roth, also a power at Disney, ran the Disney studio. Both men, Eiger and Roth, had ambitions conflicting with Ovitz and complained about his performance. Eisner's game of pushing Ovitz aside was worth the candle for Eisner because, as noted earlier in the text, Eisner kept his power for another nine years until October 2005, practically doubling his tenure.

147. *See* Brehm v. Eisner, 746 A.2d 244, 250–51 (Del. 2000).

later, the stock had already had its bounce of over $1 billion, and the daily trading assumed that the employment of Ovitz was a done deal.[148] At the executive session of the board following the compensation committee approval, the reporting structure to which Ovitz had agreed was reported, but Eisner did not describe or explain the midnight rebellion of Litvack and Bollenbach, and neither Litvack or Bollenbach attended the meeting.[149] Although both the Chancery Court and the Delaware Supreme Court mention this omission and make no further comment about it, it is fair to say that the omission may not be material in the hiring decision because Ovitz agreed to the terms and the hiring had been effected, subject to the board. The board approved the employment of Ovitz as president on the terms described by Eisner, with Eisner remaining as CEO and COO.[150]

Eisner had fulfilled his charge of getting a talented president, and a possible successor, which could only satisfy the board. But withholding the information about the rebellion was material on the issue of succession in two respects. Sensitive directors could then have seen that Eisner did not consider Ovitz as his successor, and they could have questioned whether succession had been assured or sidestepped. Moreover, they could have questioned whether, despite Eisner's assurances, Ovitz and Eisner could work together. This was the point in the meeting—after he had assured the board that he and Ovitz could work together—that the board should have asked Eisner to leave the board room. All doubts could then have been aired. The directors might well have developed a point of view on the issue as to what Disney was accomplishing in hiring Ovitz. Members of the compensation committee had worked with Ovitz and might have been able to give first hand observations about the negotiations with Ovitz.[151] But the board never met without Eisner being present and in control.

Ovitz's history of working solely at a private company opened the issue of whether he could make the transition to a public company. But there was another related issue that was relevant, but not discussed: Ovitz had never reported to another person. In all his career, from a very young age, he had been CEO of CAA, used to running his own show.[152] Legitimate inquiry would have opened the questions of (1) how was the relationship with Eisner going to work, and (2)

148. *In re* Disney Final, 906 A.2d 27, 40 (Del. 2006).

149. *In re* Disney, 907 A.2d at 710. The court is careful to say that the "board was informed of the reporting structure that Eisner and Ovitz agreed to" but there is a reasonable inference to be drawn that none of the details of the erosion in Ovitz's expectations were reported. *Id.* Eisner's deliberately not informing the board of the rebellion supports the inference that report of the rebellion would have raised the issue of whether Ovitz was a successor.

150. *Id.* at 710.

151. Poitier saw Eisner as able to make the transition from private to public, positioned to run the company. Lozano saw Eisner as making the transition, not mentioning succession. The difference in opinions as to Ovitz's role could have been discussed. *See id.* at 707, 766.

152. *See generally id.* at 700–01.

what were Ovitz's expectations in terms of a timetable for transition? This was a huge failure, which arose from not using or talking to an executive search firm about the expectations of candidates for the number two spot. The executive search firm would have told the board that it would be very difficult to hire a successor without a succession plan in place to be monitored by the board. The omission of discussing Ovitz's expectations and role candidly raised the obvious question of whether Eisner was holding on to the reins of power too tightly. Although Eisner had mesmerized Ovitz, he had a duty to be candid with the board about the negotiation.

The board was misused in a process chosen by Eisner. Given the role of the board and the limited role for the compensation committee, Eisner should have sought approval of the board before working out the terms of the deal with the compensation committee. The board was presented with a done deal that was signed and delivered. If consulted first, the board could have considered the reasons for hiring Ovitz, the scope of his duties, and the cost of the contractual arrangements. The board could still have left the particulars of the contractual arrangements to the committee. Further, the board should have met before the public announcement of any employment agreement. From Eisner's behavior, it is clear that more than manipulation was motivating him. He treated his board as "leaky," not capable of considering Ovitz without talking to others, either by leaking the information about Ovitz directly to the media or through failure to hold board room confidences. Many board rooms are "leaky." This does not justify treatment of directors as rubber stamps, giving only a few moments notice before announcement, then seeking approval after everything has been worked out and already released to the market as accomplished. Leaky boards necessitate late day meetings (after the market has closed) or weekend meetings. This is common practice. Counsel always asks if the board is leaky and then acts accordingly. Leaks from the board room do not justify vitiating the authority or role of the board.

The question is whether Eisner's (1) control of the succession process, (2) failure of candor with the board, and (3) use of the compensation committee to, in effect, wrap up the deal before taking the deal to the board for its necessary approval, constituted bad faith. Although self-interest, as ordinarily covered by breaches of the duty of loyalty, was dismissed from the case, there was self-interest, as covered by the obligation to act in good faith, inherent in the succession process. This issue of self-interest is applicable in respect of whether Eisner was seeking to preserve his power or release it. Moreover, there is a question about whether the passivity of the board, even after leaving the role of finding a successor to Eisner, amounted to bad faith.

Eisner was an imperial CEO. The Chancery Court labels him as such.[153] No CEO has been held liable for the kinds of actions taken by Eisner, but until *Disney* the courts had not explored this aspect of self-interest encompassed in actions taken in bad faith in the process of succession. Being "imperial" is not a status wrong; the actions themselves must amount to conscious wrongdoing. But the state of mind is worth briefly exploring. The "imperial" state of mind is an existential condition that is called "being in bad faith" by Sartre.[154] In that state of mind the person does not consider seriously any adverse criticism or feel compelled to recognize the truth of criticism. To exemplify the state of mind, Sartre refers to Mozart's *The Marriage of Figaro* and refers to Susannah's statement to Figaro: "To prove that I am right would be to recognize that I can be wrong."[155] This was Eisner's state of mind, and it affected his actions. Eisner insisted on being a free actor with others implementing his actions, such as his compensation committee. He did not justify his decisions and withheld facts if they would raise questions. He had been right so often and for so long that he demanded that everyone defer. His board did not question; it approved. All board collegiality was lost, and the review process of the board was eviscerated.

Was Eisner acting in bad faith? Not as to the hiring, the Chancery Court found.[156] The key finding for the Chancery Court after noting his domination of the board was: "On the other hand, I do not believe that the evidence, considered

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153. *Id.* at 760. The Chancery Court finds him to be the "most culpable." *Id.* The Chancery court also brilliantly concludes that:

> It is precisely in this context - an imperial CEO or controlling shareholder with a supine or passive board - that the concept of good faith may prove highly meaningful. The fiduciary duties of care and loyalty, as traditionally defined, may not be aggressive enough to protect shareholder interests when the board is well advised . . . .

Id. at 761 n.487. The culpability was not enough to find bad faith because the issues before the court were limited to the payout and not impending succession.

154. *See* JEAN-PAUL SARTE, THE PHILOSOPHY OF JEAN-PAUL SARTRE 137–66 (Robert Denoon Cumming ed., Vintage Books ed. 2003) (1965); *see also* JEAN-PAUL SARTRE, BEING AND NOTHINGNESS 86–116 (Hazel E. Barnes trans., Wash. Square Press 1992) (1943) [hereinafter BEING AND NOTHINGNESS]. Recovery from "bad faith" is called "authenticity" by Sartre. Such imperial state of mind is captured in Sumner Redstone's disavowal of the contribution of his children to the success of Viacom or CBS. He sent a letter to *Forbes* magazine, published on its website, to the effect that, although he gave stock in the companies to his children, "it is I, with little or no contribution of their part, who built these great media companies with the help of the boards of both companies." Geraldine Fabrikant, *Redstone Criticizes Daughter, Who Then Says She May Sell*, N.Y. TIMES, July 21, 2007, at C9. It takes little imagination to see the reference to the respective boards as a matter for public consumption, but not truly a personal belief on his part.

155. *See* BEING AND NOTHINGNESS, *supra* note 154, at 99. In Sartre's words: "It is only thus, in fact, that I can feel that I escape all reproaches." *Id.*

156. *See In re* Disney, 907 A.2d at 760–61 The Chancery Court is very realistic about Eisner's overbearing behavior and blames him "to a large extent" for the failings in the process that infected and handicapped the board's decision making abilities. *Id.* at 760. He stacked "his" board with friends and dominated them. *Id.* But the court finds Eisner's interest aligned with the corporation's interest in setting compensation and severance and thus finds the board independent. *Id.* at 778–79.

fairly, demonstrates that Eisner actively took steps to defeat or short-circuit a decisionmaking process that would otherwise have occurred."[157] The decision-making process was about the compensation and severance package of Ovitz, not his succession or the attenuation of Ovitz's authority in the negotiation process. The Chancery Court mentioned the withheld information about the Litvack and Bollenbach rebellion, also mentioned by the Delaware Supreme Court, but this omission was not found to be as material to hiring as it would be to succession.[158]

What then about succession? Although Eisner did not mean to cause Disney harm, his pride (one of the moral failings leading to actions taken in bad faith identified by Chancellor Chandler)[159] may have resulted in his placing his own interest in preserving and protecting his power (which he regarded in the interests of Disney) above the interests of Disney. The remarkable letter of October 1, 1996, to Russell and Watson shows how personal the issue of succession had become for Eisner. He said in the letter, "[i]f I get hit by a truck, the company cannot simply make [Ovitz] CEO . . . . It would be catastrophic."[160] If not in death, surely not in life would Eisner relinquish his position to Ovitz. In Eisner's appearance on *Larry King Live*, he had praised Ovitz, which was a massive mistake from his point of view and must be deemed to show his own weakness.[161] This foolhardy television gambit had occurred because Eisner was not prepared to admit to a personal failure or a mistake in judgment and, therefore, had to support Ovitz publicly, with the consequence that Ovitz had become a true, but unwanted contender.[162]

There was another revealing writing, a letter dated November 11, 1996, by Eisner, not sent to Ovitz, but reported by Eisner to his close associates and Litvack. In it Eisner tries to tell Ovitz: "We are beyond the curing state. We are now in salvation. I would like to remain friends, to end this so it looks like you decided it, and to be positive and supportive . . . ."[163] Eisner still did not want to admit to error, and the salvation for Ovitz was also Eisner's salvation. Eisner wanted Ovitz to admit to a mistake and, thus, Eisner would have his power intact and untarnished. Ovitz understood this well and resisted in the hope that

157. *Id*. at 761.

158. *See id.* at 763.

159. *See supra* notes 120–21 and accompanying text.

160. *In re* Disney, 907 A.2d at 727.

161. The weakness, in my estimation, is not being willing to suffer criticism or justify his behavior in any formal way, like Susannah. *See supra* notes 154–55.

162. It seems obvious now that the symptoms that had necessitated bypass surgery had been relieved by the surgery, and Eisner felt capable of continuing to run Disney.

163. *In re* Disney, 907 A.2d at 727.

Eisner would give up.[164] But Eisner's power was at risk and he could not give up. Ultimately, with his own power at stake, Eisner got Ovitz to resign.[165]

Thus, placing the question of succession before the court would have opened up the question of entrenchment and self-interest, and it would have made all the difference in reviewing the behavior of the defendants. Allowing the context of succession to lapse in the case was the plaintiffs' failure, a failure of imagination and business understanding.

What are presented here in this essay are reasonable inferences that color Eisner's actions and point to culpability and bad faith. But there has been no trial or fact finding, or an opportunity to present a defense. We do not have to decide the case. It is enough to identify the succession process as frequently occurring, and the actions taken to retain control as appearing in bad faith. There is a cause of action here because of the court's recognition of the scope of bad faith, which should deter others from repeating the Disney failure or encourage plaintiffs to pursue not merely the payout in the failure in hiring, but the process of succession as acted out in a specific case.

VII. Conclusion

Disney is the leading case on the process involved in setting executive compensation. The case is not, however, about the actual amount of compensation. Setting the amount of compensation and severance is a business question, and the only true reviewable issues are whether the board was reasonably well-informed and independent. But *Disney* is also the leading case on succession. Succession requires a much more complex decision process than hiring. Succession affects the future of the corporation, and it requires the board to exercise judgment on whether and to what extent the CEO is to be involved. The board's role also consists of monitoring the arrangements after employment to assure that the succession process, which by its very nature is ongoing until succession occurs, is not being derailed. The jurisprudence of entrenchment is applicable here, and like the oversight necessary under *Unocal*,[166] the succession process must also be open to review by the courts to make sure that the transition is being properly effected. Change in the CEO is also a change in control. The composition of the board will change. Everyone on the board, in addition to the CEO, can be charged with "interest" in the outcome, which justifies court oversight.

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164. *Id.* at 728.

165. The record shows that Eisner would have liked to have dismissed Ovitz for cause. Dismissal for cause would show that Ovitz was incorrigible and insubordinate and no one, not even a saint, could live with him. But no one at Disney would support him on this dismissal for cause. Litvack fought Eisner at every turn, from the point of view of how Ovitz was treated, how he performed, and how such termination would affect Disney's reputation. Dismissal without cause was painful for Eisner because he was admitting that he could not live with his "friend" of many years and had misjudged the situation, but he had no choice. Litvack's resistance is set out in *In re* Disney Final, 906 A.2d 27, 44 & nn.26-28 (Del. 2006).

166. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

The most sensitive succession situations are those in which the CEO has been running the company for a substantial period of time and there has been a previous failure in succession, such as Disney. A fair minded process for succession in which there is a committee of the board charged with the responsibility and where the CEO reports to the committee (but does not manage the process), is easy to arrange, as are the experts needed to advise the committee. More difficult is implementing such a process. And that implementation is subject to challenge in the courts for the failures that may result. The board and the committee have to understand that *Disney* does not condone such a business failure unless the succession decisions are made pursuant to a sensible process in the exercise of reasonable business judgment and are made in good faith.