

Letter to the Editors

The Economist

Corporate Governance in America - The rights and wrongs

Ovitz - 13/8/05 - a p. 50.

Being interested in good corporate governance, I have followed *The Economist's* advice and have read Chancellor Chandler's ruling In Re the Walt Disney Company. Juridical opinions in complicated matters often impress along the lines of the familiar fable of the blind men trying to describe an elephant from a first encounter limited to touching. So it is that I perceive a very different drama from the splendid quotation (strains of Chariots of Fire) with which *The Economist* concludes its generally favorable view of the opinion: "The entire advantage of the risk taking, innovative, wealth-creating engine that is the Delaware corporation would cease to exist, with disastrous results for shareholders and society alike."

We can agree that this is indeed a story about the modern corporation and the role of the state and courts of Delaware. Let's start at the beginning. During the ten year hegira of this litigation - the Chancellor even draws the dry fly along the surface of the readers' consciousness to intimate the possibility that his judgment might have been different if he applied contemporary standards, but more of that later. A few events stand out on the time line. After years of legal squabbling about the adequacy of the pleadings, a 2nd Amended Complaint was filed on January 3, 2002. During the Spring of 2002, evidence of wide spread governance failures in America increased in intensity leading up to the largest bankruptcy in history - that of World Com. This provided the spark for long stalled federal legislation - known as Sarbanes Oxley or SOX - to move out of the Senate Banking Committee, through the House, the Full Senate, the Conference Committee and the President's Rose Garden signature at the end of July 2002. This measure is the most significant incursion of federal power into what has been the jealously guarded preserve of state legislatures over corporate governance since the 1930s. The usually diligent state lobbyists and lawyers were caught napping by the rapidity of the federal response to the World Com Bankruptcy. The Delaware Chancery Court denied the motion to dismiss the amended complaint on May 28, 2003 and let it be known that they welcomed the opportunity to draw "bright lines" in an appropriate case showing the limits of directorial negligence. Over the next two years highly articulate members of the Delaware Chancery Court began appearing at a variety of conferences, among them one at Harvard Law School, meetings of the Council of Institutional Investors and even to the International Corporate Governance Network in London to persuade all who would listen that there is no need for a federal corporation law - matters can be left in the prudent hands of the Delaware Chancery Court. The Delaware juridical establishment was fighting for the continuation of its life as the lauded and hugely paid center of global corporate law. The reelection of President Bush in November 2004 was interpreted as a repudiation of further federal involvement in corporate governance, an impression bolstered by the rather early retirement of SEC Chairman Donaldson. By mid 2005 the fever of federal reform had broken; Delaware was again safe as the corporation law capital of the world. The Disney case gave an opportunity to reassure the Delaware core constituency - the

CEOS of USA, inc. The legally relevant holdings by the Chancery court provide the broadest imaginable comfort for corporate managements to domicile in Delaware, while the flowery dicta give intoxicating whiffs of concern, reform and future promise to the unwary.

Let's read what the Chancellor wrote[^]:

1. **This Court strongly encourages directors and officers to employ best practices, as those practices are understood at the time a corporate decision is taken. But Delaware law does not- indeed, the common law cannot - hold fiduciaries liable for a failure to comply with the aspirational ideal of best practice.....[2]**

Is the Chancellor saying - we really wish that you would do what appears to be right, but don't count on us to provide other than moral legitimation? Where does this leave corporate governance? If courts are not going to enforce failures to conform to its standards, what is the incentive for corporate directors to do so? Is this the equivalent of - do what I say, not what I do? Plainly put, corporate governance is styled as a "feel good" collection of legally irrelevant notions.[♥] **As I stated earlier, however, the standards used to measure the conduct of fiduciaries under Delaware law are not the same standards used in determining good corporate governance [161]**

2. **It is perhaps worth pointing out that actions (and the failures to act) of the Disney board that gave rise to this lawsuit took place ten years ago, and that applying 21st century notions of best practice in analyzing whether these decision were actionable would be misplaced. [2]**

Is this a suggestion that the applicable law may have changed over the last decade? Some may read that the court is implying that a stricter accountability would be enforced if the Disney directors' alleged improper conduct had taken place in 2004 and not 1994. We have noticed some confusion over the relevancy, if any, of corporate governance standards. Just when it appears clear that the court has held they have no legal significance, we encounter comments like that set forth above. At the risk of perpetuating the confusion, lets give the court the last word **Times may change but fiduciary duties do not.[3]**

3. **[T]he 'liability of the directors must be determined on an individual basis because the nature of their breach of duty (if any), and whether they are exculpated from liability for that breach, can vary for each director - [109]**

Directors are famously devoid of individual power, they are relevant only as they are

[^] The text of the opinion will be in **bold**, as will the page on the typewritten opinion on which the statement occurs.

[♥] Note footnote #399 - **All good corporate governance practices, include compliance with statutory and case law establishing fiduciary duties. But the law of corporate fiduciary duties and remedies for violation of those duties are distinct from the aspirational goals of ideal corporate governance practices. Aspirational ideals of good corporate governance practices for boards of directors that go beyond the minimal legal requirements of the corporate law are highly desirable, often tend to benefit stockholders, sometimes reduce litigation and can usually help directors avoid liability. But they are not required by the corporation and do not define standards of liability. Brehm v. Eisner, 766 A2nd 244,256 (Del.2000)**

participants in group activity. How then can one ascertain the unique circumstances of individual directors for the purpose of assigning liability? There is no ready mechanism available to ascertain their motivations or how they resolve any conflicts of interest. Is this just another verbal nicety that facilitates not finding the board legally accountable?

4. [T]he potential compensation was economically not material to the Company. [158] Does this mean that - *de minimis non curat lex* - the Chancery court will not enforce fiduciary misconduct involving very large enterprises if the amount in question is *only \$150,000,000*. If that is true, is the several billion dollar liability of Exxon (a New Jersey corporation, but never mind) in the Valdez negligence not recognizable by the Delaware Courts?

5. to my mind, these actions fall far short of what shareholders expect and demand from those entrusted with a fiduciary position. Eisner's failure to better involve the board in the process of Ovitz's hiring, usurping that role for himself, although not in violation of law, does not comport with how fiduciaries of Delaware corporations are expected to act.[140] Here we go again. What happened was not up to fiduciary standards, but the Chancery Court will do nothing to enforce such recited obligations. Who is going to enforce them? Why should anyone comply with what is not required? Would they risk liability in doing so? The Chancellor contents himself with lavish (and attention getting) denunciation of Eisner and simple libel of Russell, George Mitchell, Bowers and O'Donovan “**...sycophantine tendencies...**” **fn #488** in aid of what? To what law are they accountable? What law have they transgressed?

6. “...I conclude that Eisner's actions in connection with the termination are, for the most part, consistent with what is expected of a faithful fiduciary.” Does this mean that one could be “for the most part” pregnant? Is fiduciary compliance a matter of degree?

All in all the taxpayers of the State of Delaware are well served by their judiciary, the rest of us, not so well.

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