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CORPORATE & SECURITIES LAW UPDATE

Delaware Court: Inadequate Process May Cost Disney Board Protection of Business Judgment Rule

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Delaware Court: Inadequate Process May Cost Disney Board Protection of Business Judgment Rule

In a surprise decision, Delaware's Court of Chancery has concluded that the shareholder derivative lawsuit against Walt Disney Co. and its directors (In Re *Walt Disney Co. Derivative Litigation*, Del. Ch. C.A. No. 15452, 5/28/03) can proceed on the claim that the board breached its fiduciary duties in approving a lucrative severance package of former CEO Michael Ovitz. The case underscores the importance of good governance processes at public company boards.

Facts Alleged: The facts alleged by plaintiffs paint a picture of directors who, in more than a negligent or grossly negligent manner, failed to inform themselves or to deliberate adequately about an issue of material importance to the company. The specific board decision was the approval of a severance package for former CEO Michael Ovitz. Plaintiffs claim that the Disney board of directors failed to exercise any business judgment or make any good faith attempt to fulfill its fiduciary duties. They 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 involving \$40 million in cash compensation and \$140 million in stock compensation. The Court decided that, if true, the facts could support a decision that the conduct fell outside the protection of the business judgment rule.

Implications: This case has tremendous importance at a time when executive compensation is under intense media and shareholder scrutiny. It underscores the importance of appropriate corporate governance process, including consultation with professionals in major compensation decisions. At a minimum, Boards and Compensation Committees should carefully consider the structure of major compensation and termination arrangements, and potential alternatives, in light of the corporate purposes being served by those arrangements.

Fenwick & West is available to discuss the *Walt Disney* case and any compensation process concerns that you may have. Please telephone Scott Spector at (650) 335-7251.