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By Faith Grossnickle

A Disney Tale

THE DELAWARE CHANCERY Court's August decision in the Disney case was a wake-up call to corporate secretaries and general counsel. Having now had a chance to digest the decision and review the eight-year-history of messy, public litigation over Michael Ovitz's hiring, it's time to consider some of the lessons the case offers in-house lawyers.

Board minutes are much more important than you'd think. Consider the Ovitz case.

These lessons include the importance of having the board follow a decision-making process that thoughtfully considers conflict of interest and independence issues affecting board members and executive officers. Corporate secretaries, many of whom also hold the GC title, should also reevaluate the way they plan for board meetings, set agendas, and write minutes in light of the Disney case.

The Disney decision followed a 37-day trial in which the court scrutinized the role of The Walt Disney Company's board of directors, its compensation committee, its CEO, Michael Eisner, and its general counsel, Sandy Litvak, in the hiring and termination of Michael Ovitz. A close friend of Eisner, Ovitz briefly served as Disney's president.

In the litigation, plaintiff shareholders argued that Disney's directors breached their fiduciary duties of care and good faith when they approved Ovitz's hiring and the terms of his employment contract, which promised $140 million in severance if he were terminated "without cause."

Although the court ultimately concluded Disney's directors had satisfied their fiduciary duties, it was extremely critical of their conduct. While holding that Delaware law does not require boards to comply with corporate governance "best practices," it said boards that resolve conflict of interest and independence issues and maintain the integrity of their decision-making process will have a big advantage in stockholder litigation. This advantage is particularly significant, the court said, when it comes to winning dismissal before trial.

Unfortunately, Disney did not have this advantage. In 2003, the court refused to dismiss the plaintiffs' complaint before trial, stating that it contained credible allegations that Disney's directors "consciously and intentionally disregarded their responsibilities." These allegations were based on board minutes that were so meager they called into question whether the directors had exercised any business judgment whatsoever in Ovitz's hiring.

If Disney's GC and secretary had records demonstrating the board had gone through substantive deliberations before hiring Ovitz, it's very likely the case would have been dismissed. The directors would not have had to testify, and the company's reputation would not have been damaged.

The key ingredient to obtaining dismissal before trial on breach of fiduciary duty claims is a substantive decision-making process. The elements of this process are:

- consideration of conflicts of interest, independence issues, and possible stockholder litigation;
- a thoughtful process for planning board meetings;
- board meetings at which there is discussion, deliberation, and decision-making; and
- meeting minutes and related briefing materials that show the directors collectively exercised their business judgment to

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advance the company's interests.

Disney had none of these. The shareholders' complaint went to trial because the board was insensitive to conflict of interest and independence concerns and its entire decision-making process was flawed. Instead, Disney had to fall back on directors' testimony and personal records. These ultimately rebutted the allegations of conflict of interest and showed that the directors had considered the matters at issue.

Corporate secretaries and general counsel never want to put their companies in this position. Instead, in-house counsel handling board matters need to keep minutes of meetings that demonstrate that the directors, "acting as a board," exercised their business judgment in a good faith effort to advance the interests of the company.

Writing good meeting minutes is a matter of balance. Attempts to summarize long discussions in great detail risk being incomplete. Summaries of short discussions can lead to useless generalizing comments, such as "Discussion ensued." Instead, good minutes need to describe the basis on which the board exercised its business judgment and satisfied its fiduciary duties.

The phrase "acting as a board" is also important. Under Delaware law, directors cannot act individually. Board and committee actions must be taken as a group, at meetings convened for the purpose of discussion, deliberation, and decision-making. To protect against stockholder litigation, the minutes of board and committee meetings must be detailed enough to demonstrate that when directors engaged in the decision-making process and exercising their business judgment, they were:

- acting in good faith;
- reasonably informed; and
- not disqualified by any conflict of interest.

None of these requirements can be met without a thoughtful process for planning board meetings. Corporate secretaries and general counsel should arrange board meetings so that all important issues are alotted adequate time for a thorough, formal discussion. In the Disney court's view, the main impediment to the decision-making process was Eisner's highly informal style with his board. He frequently discussed significant matters one-on-one or in small groups. Informal meetings aren't inappropriate and indeed may be essential to getting anything accomplished. But formal discussion and deliberation need to occur at board-meetings and be documented in the minutes, even if the directors have discussed a matter informally beforehand.

The final impediment in the Disney case was the composition of the board itself. Although it had a number of technically "independent" directors, the court found them to be weak and too accommodating to the CEO. He also criticized their qualifications and independence.

If Eisner had opened the board meeting just prior to Ovitz's hiring with a statement about his own potential conflict of interest, if Eisner had gone over the information that had been given to many directors individually, if there had been questions and discussion, and if the minutes had reflected this, Disney's story would have been much different.

Corporate secretaries need to take these factors into account when they plan board agendas and write minutes. A thoughtful planning process begins with an early consideration of conflicts of interest and independence matters, and a review of the meeting's proposed agenda. This review can be done by a lawyer or by a director who understands what needs to happen at meetings for fiduciary duties to be fulfilled.

Since directors have a duty to be reasonably informed about matters they act upon, the planning process must:

- anticipate the topics on which directors will need information;
- allow time for appropriate briefing materials to be sent out in advance; and
- address the need for presentations from appropriate executives and experts.

A thoughtful planning process should produce an agenda that provides an appropriate amount of time to be devoted to unusual, controversial, or risky matters. In Disney's case, the plaintiffs seized upon the fact that the compensation committee met for less than an hour and devoted very little of that time to Ovitz's contract.

In the end, if the secretary or general counsel is sensitive to conflict of interest and independence concerns and has a substantive decision-making process in place, all that may stand between him and a dismissal before trial is the quality of his board minutes.

THE MORAL OF THE STORY

- Speak with board members regularly to spot possible conflicts of interest.
- When unavoidable conflicts are discovered, make a full disclosure in the board minutes and consider having the conflicted party abstain from the discussion and/or the vote on the matter.
- For major issues, make sure all discussion, deliberation, and decision-making occur in the board meetings, not in informal gatherings.
- Retain independent experts to advise on matters that could be perceived as unusual, controversial, or risky—especially if they involve technical expertise or judgments about what would be customary in a particular situation.
- Best practices standards apply to various matters, such as major transactions, accounting issues, and regulatory compliance. Get knowledgeable, independent legal advice to ensure that the decision-making process meets these criteria.