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Articles

Disney Goes Goofy: Agency, Delegation, and Corporate Governance

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INTRODUCTION

The Delaware Supreme Court delivered its final opinion in the highly publicized case, *Brehm v. Eisner* (the *Disney* case), which involved the firing without cause of Disney's president, Michael Ovitz.¹ This not-for-cause termination resulted in a \$130 million severance package after only fourteen months of service.² Ovitz's termination was effected on Disney's behalf by its chief executive officer (CEO) Michael Eisner.³

The Delaware Supreme Court affirmed the chancery court's decision, ruling that the business judgment rule protected the decision to terminate Ovitz, and the accompanying severance payment.⁴ Consequently, the defendant directors and officers did not violate their fiduciary duties or commit waste.⁵ Much scholarly writing has been

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1. *Brehm v. Eisner* (*In re Walt Disney Co. Derivative Litig.*), 906 A.2d 27 (Del. 2006).

2. *Id.* at 35.

3. *Id.* at 43-44.

4. *Id.* at 73.

5. *Id.* at 35-36. Shareholders alleged violations of the duty of care, duty of good faith, and duty of loyalty, as well as corporate waste. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 745-56 (Del. Ch. 2005). In order to prove "waste," plaintiff must show "an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." *Glazer v. Zapata Corp.*, 658 A.2d 176, 183 (Del. Ch. 1993). Generally, this means that plaintiff-shareholders must show that the transaction "served no corporate purpose" or that the corporation "received no consideration at all." *White v. Panic*, 783 A.2d 543, 554 (Del. 2001). Due to this onerous burden, corporate waste is rarely found. See *In re Walt Disney Co. Derivative*

generated surrounding the decision in the *Disney* case; this commentary has focused on the Delaware Supreme Court's examination of executive compensation, the business judgment rule, director fiduciary duties, and, in particular, the duty of good faith.⁶

The Delaware Supreme Court's holding in *Disney* indeed is important due to the protection that the court afforded to directors and officers under the business judgment rule. However, the court seems to have committed a crucial (and thus far ignored) oversight in its analysis: *did Eisner, as CEO, have the authority to terminate Ovitz without cause?* Fundamental principles of agency law and corporate governance militate against Eisner's authority as CEO to unilaterally fire Disney's president. Surprisingly, the court spent only two pages of its forty-eight page decision addressing this question.⁷ This Article explores the gaps in the court's reasoning surrounding this important issue, as well as the ramifications flowing from this reasoning.

The implications of this aspect of the court's decision in *Disney* are far reaching. Indeed, in this climate of post-Sarbanes-Oxley corporate governance, great emphasis is placed on the concept of independent directors.⁸ The Sarbanes-Oxley Act,⁹ stock exchange rules, and scores of court opinions laud the vigilant presence of independent directors as a check and balance on corporate insiders.¹⁰ With this framework in mind,

Litig., 907 A.2d at 749.

6. See, e.g., Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 218 (2006) (discussing the duty of good faith); Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on Disney, Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398, 402-03 (2007) (discussing the business judgment rule and the duty of good faith); Nadelle Grossman, *Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform*, 12 FORDHAM J. CORP. & FIN. L. 393, 397 (2007) (discussing directors' fiduciary duties); Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 855-57 (2007) (suggesting a two-part test relying on structural bias and gross negligence to show lack of good faith); Jennifer S. Martin, *The House of Mouse and Beyond: Assessing the SEC's Efforts to Regulate Executive Compensation*, 32 DEL. J. CORP. L. 481, 487 (2007) (discussing executive compensation); Hillary A. Sale, *Monitoring Caremark's Good Faith*, 32 DEL. J. CORP. L. 719, 720-21 (2007) (discussing the duty of good faith).

7. See *Brehm*, 906 A.2d at 68-70.

8. See, e.g., 148 CONG. REC. E 1470, 1475 (July 29, 2002) (statement of Lynn Turner, former Chief Accountant, Securities Exchange Commission) ("We need to definitely strengthen the corporate governance. It has failed us. We need good, independent corporate boards, just like we need good, independent analysts and good, independent auditors."); Executive Compensation and Related Person Disclosure, Securities Act Release No. 8732A, Exchange Act Release No. 54302A, Investment Company Act Release No. 27444A, 71 Fed. Reg. 53,158 (Sept. 8, 2006).

9. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

10. See Securities Exchange Act of 1934 § 10A(m)(3)(A), Pub. L. No. 291, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78j-1(m)(3)(A) (2006)) (requiring independent directors to serve on the audit committee); NYSE, Inc., Listed Company Manual § 303A.01 (2003) (requiring a majority of the board of directors to be independent); NASDAQ, Inc., Manual Rule 4350(c) (2003) (requiring

the importance of the Delaware Supreme Court's oversight becomes evident: to what degree will the positive role that independent directors ostensibly play be diminished when CEOs are permitted to take unilateral actions such as the one in the *Disney* case? Indeed, what adverse impact on corporate governance will resonate when extraordinary business decisions such as these can be taken by the CEO? Ironically, in spite of the Delaware Supreme Court's consistent support, at least in theory, for independent directors to play a meaningful role in corporate governance,¹¹ this decision in practical effect gives undue deference to extraordinary unilateral actions implemented by dominant CEOs.

I. THE MAGIC KINGDOM: OVITZ, EISNER, AND DISNEY

For our purposes here, the *Disney* saga begins with the tragic death in April 1994 of Frank Wells, the then-president and chief operating officer (COO) of the Walt Disney Company (Disney), in a helicopter crash.¹² CEO Michael Eisner temporarily assumed the presidency of the company until his diagnosis with heart disease hastened Disney's need to hire a new president.¹³ Eisner looked to his long-time friend Michael Ovitz, founder of Creative Artist Agency (CAA) and "one of the most powerful figures in Hollywood."¹⁴

At the time, Ovitz was involved in discussions with Music Corporation of America (MCA) to serve as chairman and CEO of MCA.¹⁵ The terms being negotiated offered Ovitz "3.5% of MCA, \$1.5 million in Seagram shares, and a seven-year contract (with a three-year

majority independence on the board of directors); *see also, e.g.*, *Stone v. Ritter*, 911 A.2d 362, 366-67 (Del. 2006) (discussing the importance of director independence in demand futility cases); *Paramount Commc'ns v. QVC Network*, 637 A.2d 34, 44 (Del. 1994) (discussing independent director scrutiny of sale of control transactions); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985) (discussing the importance of director independence in the decision to use defensive tactics in the corporate takeover context).

11. *See, e.g., Paramount Commc'ns*, 637 A.2d at 44 (discussing the importance of independent directors in sale of control transactions); *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1285 (Del. 1989) (discussing the role of independent directors in scrutinizing transactions); *Unocal*, 493 A.2d at 955 (discussing the role of independent directors in the use of defensive tactics in corporate takeovers); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1981) (establishing independence as the first part of a two-part test for determining the legitimacy of a special litigation committee). *See generally* MARC I. STEINBERG, *CORPORATE INTERNAL AFFAIRS: A CORPORATE AND SECURITIES LAW PERSPECTIVE* 157-61, 240-42 (1983); Victor Brudney, *The Independent Director: Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597 (1982).

12. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 699 (Del. Ch. 2005), *aff'd sub nom. Brehm v. Eisner*, 906 A.2d 27 (Del. 2006).

13. *See* Bernard Weinraub, *Despite His Defeat in Disneyland, Ovitz Remains a Force to Reckon with*, N.Y. TIMES, Dec. 14, 1996, at A35; *see also In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 699; Gold, *supra* note 6, at 410.

14. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 701; *see also* Gold, *supra* note 6, at 410-11.

15. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 701.

renewal option) that paid a seven-figure salary with performance-based cash bonuses."¹⁶ For various reasons, however, no agreement was consummated,¹⁷ and Ovitz returned to CAA until he learned that his close friend and associate at CAA was leaving for MCA.¹⁸

During this time period, Eisner and Irwin Russell, the chairman of Disney's compensation committee, more aggressively pursued negotiations with Ovitz.¹⁹ At CAA, Ovitz was making about \$25 million annually and owned 55% of the company, which he made clear that he would not give up without "downside protection."²⁰ During the course of negotiations, Ovitz somehow acquired a mistaken impression of his likely role in Disney's governance structure: Ovitz relied on several statements Eisner had made to him, and understood that "he and Eisner would run Disney as partners."²¹ Despite Ovitz's mistaken impressions and a series of complex negotiations regarding compensation structure, a deal was eventually wrought between Ovitz and Disney that seemed agreeable to both parties. Ovitz agreed to assume the presidency of Disney, but would not become COO or co-CEO; Disney agreed to an employment agreement with Ovitz valued at \$23.6 million per year, with a two-year renewal option that would raise the estimated value to \$24.1 million per year.²²

A term sheet for the agreement (but not the actual agreement) was eventually presented to the compensation committee of Disney's board of directors, which met for a total of one hour to consider Ovitz's employment as well as four additional unrelated matters.²³ At that meeting, the compensation committee unanimously approved the general terms of the agreement.²⁴ At subsequent executive and regular sessions of the board of directors, the board deliberated further, voting unanimously to hire Ovitz as president.²⁵ The compensation committee

16. *Id.* See generally Hubert B. Herring, *Michael Ovitz: The 5 Million Option Man at Disney*, N.Y. TIMES, Nov. 26, 1995, at F10.

17. JAMES B. STEWART, *DISNEY WAR* 199–200 (2005).

18. See Kim Masters, *The Power Shuffle: For the Titans of Tinseltown, A High-Stakes Game of Musical Chairs*, WASH. POST, Aug. 20, 1995, at G1; see also *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 701. Ron Meyer, Ovitz's close friend and partner at CAA, left the agency to join Universal (formerly MCA, the company with which Ovitz himself had been negotiating). STEWART, *supra* note 17, at 202.

19. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 702.

20. *Id.*; see also STEWART, *supra* note 17, at 213.

21. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 703; see also STEWART, *supra* note 17, at 212–13; Weinraub, *supra* note 13, at A35.

22. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 706.

23. *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 40 (Del. 2006); *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 708; see also Edwin W. Hecker, Jr., *Fiduciary Duties in Business Entities*, 54 KAN. L. REV. 975, 997 (2006).

24. *Brehm*, 906 A.2d at 40; *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 708–09; Gold, *supra* note 6, at 412.

25. *Brehm*, 906 A.2d at 40–41; *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 708–09.

met one more time to consider certain issues relating to “stock options”; at the conclusion of this meeting, the compensation committee ratified the entire employment agreement.²⁶

The terms of the employment agreement consisted of an annual salary of \$1 million and a performance-based discretionary bonus.²⁷ The agreement also included two tranches of stock options that would provide Ovitz downside protection.²⁸ The contract contained a five-year term, with an extension and renewal option.²⁹ Finally, both parties were protected from premature termination of the employment agreement.³⁰ For example, if Ovitz prematurely terminated the agreement, he would forfeit any unaccrued benefits, and could arguably be precluded from working for any of Disney’s competitors.³¹ More importantly for the purposes of this Article, if Disney terminated Ovitz “for any reason other than gross negligence or malfeasance,” then the resulting no-fault payment would include (i) Ovitz’s “remaining salary, [(ii)] \$7.5 million a year for unaccrued bonuses, [(iii)] the immediate vesting of his first tranche of options[,] and [(iv)] a \$10 million cash out payment for the second tranche of options.”³² Thus, Ovitz’s premature termination by Disney for any reason other than gross negligence or malfeasance would result in a substantial, if not exorbitant, severance payment.

After several months with the company, it became apparent that Ovitz did not fit into the corporate culture at Disney.³³ Eisner ultimately communicated to Ovitz that he should begin seeking other employment opportunities, which eventually culminated in negotiations to “trade” Ovitz to Sony; however, only a select few of Disney’s directors were even aware that Ovitz was given permission to negotiate with Sony.³⁴ Unfortunately for Disney, the deal with Sony was never consummated,

26. *Brehm*, 906 A.2d at 41; *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 710.

27. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 703.

28. *Id.*

29. *Id.* at 703–04.

30. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 703, 705; see also STEWART, *supra* note 17, at 218–19.

31. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 704; see STEWART, *supra* note 17, at 273. There seems to have been some disagreement in the facts as to whether the employment agreement actually contained a valid covenant not to compete. See *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 704 n.32.

32. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 704; see also Steven H. Kropp, *Corporate Governance, Executive Compensation, Corporate Performance, and Worker Rights in Bankruptcy: Some Lessons from Game Theory*, 57 DEPAUL L. REV. 1, 33 (2007).

33. *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 42 (Del. 2006); see also Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 651 (2004).

34. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 724–25; STEWART, *supra* note 17, at 258, 264–65; Bernard Weinraub, *Ovitz, Hollywood Power Broker, Resigns from No. 2 Job at Disney*, N.Y. TIMES, Dec. 13, 1996, at A1.

and Ovitz remained at Disney.³⁵ At the next board meeting, Eisner's dissatisfaction with Ovitz's performance and desire to terminate him was never formally discussed.³⁶ However, Eisner personally informed a majority of the directors about the emerging "Ovitz problem."³⁷

Despite public statements where Eisner and Ovitz sought to dispel rumors of discord at Disney, Eisner continued drafting a series of letters indicating his opinion that Ovitz was no longer welcome at Disney and that his future with the company was doubtful.³⁸ Eisner began discussing possibilities for Ovitz's termination with General Counsel Sanford Litvack; Eisner wished to explore whether Disney could fire Ovitz for cause, or whether it would have to implement a not-for-cause termination.³⁹ This distinction was critical because, according to the terms of Ovitz's employment agreement, a not-for-cause termination would trigger a substantial severance payment, while a termination for cause would avoid such payment.⁴⁰ At the next board meeting, Ovitz's termination was not discussed in full session with the board.⁴¹ Indeed, although "[b]y then the board knew that Ovitz was going to be fired," the board in fact renominated him to another three-year term on the board.⁴² At the executive session that followed the meeting, Eisner informed those directors present that he intended to fire Ovitz in the near future.⁴³

Finally, after Ovitz returned from holiday with another board member who revealed some of Eisner's feelings to Ovitz, Ovitz realized that his time with Disney was quickly coming to a close.⁴⁴ Ovitz met with Eisner and, through Russell (who served as chair of Disney's compensation committee), began negotiating his departure from Disney.⁴⁵ Eventually, Eisner met with Ovitz at Eisner's mother's

35. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 725.

36. *See id.* at 726.

37. Eisner and several board members testified that Eisner had discussed with a majority of the corporate directors the problems with Ovitz's performance as president. *Id.* Note that informal discussion among directors does not a board meeting make. *See infra* note 118 and accompanying text.

38. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 725-30. Eisner sent some of these letters to his colleagues, including Irwin Russell, but failed to send them to Ovitz himself. *See, e.g., id.* at 727; STEWART, *supra* note 17, at 264-68. These letters conveyed Eisner's dissatisfaction with Ovitz, including his distaste for Ovitz's personality and leadership skills at Disney. *See In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 725-29.

39. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 728; STEWART, *supra* note 17, at 273; Ben White, *Eisner Denies Seeing Ovitz as Threatening: CEO Says He Relied on Legal Adviser*, WASH. POST, Nov. 18, 2004, at E3.

40. The terms of the employment agreement limited "cause" to gross negligence and malfeasance. *See Gold, supra* note 6, at 411; *supra* notes 30-32 and accompanying text.

41. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 730.

42. *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 44 (Del. 2006).

43. The Chancellor found that at a minimum, Eisner, Stanley Gold, Reveta Bowers, Ray Watson, and Robert Stern, and perhaps others as well, were in attendance at the executive session. *Id.*

44. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 732.

45. *Id.*

apartment, where he informed Ovitz that he was being terminated without cause, and would therefore receive his contractual not-for-cause termination compensation of almost \$130 million.⁴⁶ Eisner and Ovitz then agreed on a press release and “memorialized” the termination in a letter signed the next day by Disney’s general counsel, Sanford Litvack, and dated December 12, 1996.⁴⁷ As the Delaware Supreme Court observed, “[t]he board was not shown the [December 12] letter, nor did it meet to approve its terms.”⁴⁸ On December 12, 1996, Disney issued a press release disclosing the termination, which it disseminated to its board of directors.⁴⁹ Ovitz thus was terminated from the Disney presidency, despite the fact that, in the words of the Delaware Chancery Court, “the Disney board had never met in order to vote on, or even discuss, the termination at a full session, and few if any directors did an independent investigation of whether Ovitz could be terminated for cause.”⁵⁰ In fact, the full board did not convene again until January 27, 1997, almost a week after several shareholders filed their lawsuits.⁵¹

II. DETHRONING THE PRINCE OF THE MAGIC KINGDOM: AUTHORITY TO REMOVE PRINCE NOT-SO-CHARMING OVITZ

Plaintiffs in the *Disney* case brought a multitude of claims against the company and its fiduciaries.⁵² For the purposes of this Article, the foregoing analysis will focus on only one of those claims: whether Eisner, alone and without Disney’s board of directors, was authorized to terminate Ovitz.⁵³ The Delaware Supreme Court dedicated only two pages of its forty-eight page opinion to discussion of this subject,⁵⁴ despite the fact that this issue was critical when considering not only plaintiffs’ claims, but also the wider implications impacting Delaware corporate governance.

46. *Id.* at 732, 734; STEWART, *supra* note 17, at 274.

47. *Brehm*, 906 A.2d at 45; STEWART, *supra* note 17, at 274–75.

48. *Brehm*, 906 A.2d at 45.

49. *See In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 735; Paul Farhi, *Ovitz Departs Disney After 16 Months*, WASH. POST, Dec. 13, 1996, D1; *see also* STEWART, *supra* note 17, at 276.

50. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 736; *see also Brehm*, 906 A.2d at 45.

51. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 739. Two derivative shareholder suits were filed in the Delaware Chancery Court, and yet another suit was filed in state court in California; the cases were eventually consolidated. *See In re Walt Disney Co. Derivative Litig.*, No. 15452, 1997 Del. Ch. LEXIS 25 (Del. Ch. Mar. 13, 1997).

52. These claims included those based on breaches of the fiduciary duties of care and loyalty (including allegations that the defendants acted in bad faith) as well as the commission of waste. *See In re Walt Disney Co. Derivative Litig.*, 907 A.2d at 696.

53. *See id.* at 724–40.

54. *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 68–70 (Del. 2006).

A. FOLLOWING THE LEADER: THE SUPREME COURT'S ANALYSIS

The Delaware Supreme Court began its analysis of this issue by examining Disney's constitutive documents. Disney's certificate of incorporation provides that the company's officers "shall hold their offices for such terms and shall carry out such duties as are determined solely by the Board of Directors, subject to the right of the Board of Directors to remove any officer . . . at any time with or without cause."⁵⁵ Article IV of the company's bylaws states that the CEO "shall, subject to the provisions of these Bylaws and the control of the Board of Directors, have general and active management, direction and supervision over the business of the Corporation and over its officers."⁵⁶ The court continued its analysis of CEO Eisner's authority based upon these two provisions contained in the certificate of incorporation and the company bylaws.⁵⁷

The supreme court next suggested two hypothetical cases in which a clear answer would exist.⁵⁸ First, there would be no concurrent power of removal in the CEO and the board of directors if the certificate of incorporation exclusively vested such power of removal in the board.⁵⁹ Thus, "absent an express delegation of authority from the board, the presiding officer would . . . not have a concurrent removal power."⁶⁰ It is important to emphasize at this point that the court made a fundamental flaw in its analysis. If the certificate of incorporation vested exclusive removal power in the board of directors, then no board resolution could validly provide concurrent removal power in any officer because under settled principles of corporate governance, a mere board resolution cannot override or contradict the subject company's bylaws or certificate of incorporation.⁶¹ Indeed, the court may have intended to refer to *ratification* of an agent's actions, but this is distinct from the exclusivity of removal authority. This topic will be explored further below.⁶²

In the other hypothetical situation, there would be concurrent removal power if "the governing instruments expressly placed the power of removal in both the board and specified officers."⁶³ According to the

55. *Id.* at 69 (footnote omitted).

56. WALT DISNEY CO., AMENDED AND RESTATED BYLAWS OF THE WALT DISNEY COMPANY 9 (1999) [hereinafter DISNEY BYLAWS], available at <http://corporate.disney.go.com/media/corporate/DisneyBylaws.pdf>.

57. *Brehm*, 906 A.2d at 68–69.

58. *Id.* at 68.

59. *Id.* at 69.

60. *Id.*

61. See *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1080 (Del. Ch. 2004) (referencing that bylaws are of a lower tier than a corporation's certificate of incorporation and stating that "a board cannot override a bylaw requirement by merely adopting a resolution"); HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 15 (3d ed. 1983).

62. See *infra* Part II.F.

63. *Brehm*, 906 A.2d at 69.

court, however, Disney's governing documents "could reasonably be interpreted either way" and are "ambiguous" because they "do not vest the removal power exclusively in the board, nor do they expressly give the Board Chairman/CEO a concurrent power to remove officers."⁶⁴

Based upon this ambiguity, the Delaware Supreme Court resorted to rules of construction (including the rules of construction relating to the interpretation of contracts) to determine whether Eisner had concurrent power with the board of directors to remove officers.⁶⁵ According to the court, "extrinsic evidence clearly supports the conclusion that the board and Eisner understood that Eisner . . . had concurrent power with the board to terminate Ovitz as President."⁶⁶ Such extrinsic evidence included the testimony of various board members who believed that Eisner had the authority to terminate Ovitz without their approval, and the general counsel's testimony that many Disney officers had been terminated without action from the board of directors.⁶⁷ The court therefore found that "Eisner possessed, and exercised, the power to terminate Ovitz unilaterally."⁶⁸ This holding followed from an analysis that seemingly considered solely two provisions in the company's governing documents and the testimony of various directors and officers of the company, some of whom were defendants in the case.⁶⁹ At no point in its analysis did the Delaware Supreme Court go beyond this evidence to examine the law of agency or general principles of Delaware corporate governance. In fact, despite the court's statement that it would resort to rules of construction, the court declined sufficiently to do so.⁷⁰

B. WHISTLING WHILE WE WORK: CONSTRUCTION OF DISNEY'S GOVERNING DOCUMENTS

Consistent with the Delaware Supreme Court's opinion, this Article likewise begins its analysis in the same manner: with the governing documents of the Walt Disney Company. As the opinion states, the certificate of incorporation provides that officers "shall hold their offices for such terms and shall carry out such duties as are determined solely by the Board of Directors, subject to the right of the Board of Directors to remove any officer . . . at any time with or without cause."⁷¹ This language describes the authority of the board over officers' tenures and duties. Officers are to hold their offices "for such terms" as are

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.* at 69–70.

68. *Id.* at 70.

69. The court refers to the testimony of several board members and General Counsel Sanford Litvack. *Id.* at 69–70.

70. *See id.* at 69.

71. *Id.* at 68.

determined “solely” by the board of directors. Thus, the court read this statement and applied it “solely” to the right of the board of directors to determine the terms and duties of officers. The following phrase, which describes the power to remove officers, does not repeat the word “solely.” In fact, it provides that such officers are “subject to the right of the Board of Directors to remove any officer.”⁷²

The Delaware Supreme Court accordingly adhered to a questionable interpretation of Disney’s certificate of incorporation; because the word “solely” is not repeated before the right of removal, the phrase is construed as not granting an exclusive right of removal to the board of directors.⁷³ Unfortunately, the court expended little effort in ascertaining whether the certificate of incorporation provides for exclusive board authority for this matter. Indeed, while the word “solely” vests the Disney board of directors with the exclusive right to determine the terms and duties of offices and officers, query whether the term “solely” should be read to apply to the phrase that immediately follows, regarding the removal of officers.

Based on the supreme court’s decision, although not for certain, the court apparently deems important the presence of the comma before the phrase “subject to the right of the Board of Directors to remove any officer.”⁷⁴ Under long-settled Delaware law, “[t]he same rules which govern the construction of statutes, contracts and other written instruments, are made use of in construing the provisions and determining the meaning of charters and grants of corporate powers and privileges.”⁷⁵ Thus, when considering the importance of a comma in construing language contained in a subject corporation’s certificate of incorporation, familiar rules of statutory and contractual construction should apply.

In general, punctuation may be employed as an aid in construing a contract.⁷⁶ However, “[w]hen construing the meaning of contractual

72. *Id.* Although the chancery court opinion does not explicitly address this issue, Chancellor Chandler read the certificate of incorporation and the bylaws, as well as the board resolution electing Ovitz as president, to create a concurrent power of removal. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 774 (Del. Ch. 2005), *aff’d sub nom.* *Brehm v. Eisner*, 906 A.2d 27 (Del. 2006). The chancellor relies on the language of the documents, the custom and practice of Disney, and the “implied authority” of the CEO to reach the conclusion that the certificate of incorporation did not deprive Eisner of the power to remove Ovitz from the company’s presidency. *Id.* at 774–75. Thus, Chancellor Chandler seems to read the certificate of incorporation’s express delegation of exclusive board authority narrowly, consequently broadening the powers of the CEO.

73. *Brehm*, 906 A.2d at 69.

74. *Id.* at 68.

75. *Lawson v. Household Fin. Corp.*, 152 A. 723, 726 (Del. 1930); *see Benihana of Tokyo, Inc. v. Benihana, Inc.*, 906 A.2d 114, 120 (Del. 2006); *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 342–43 (Del. 1983).

76. *Plymouth Mut. Life Ins. Co. v. Ill. Mid-Continent Life Ins. Co. of Chi., Ill.*, 378 F.2d 389, 391 (3d Cir. 1967); *see also New Castle County, Del. v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.*, 174

terms, [courts] will not allow sloppy grammatical arrangement of the clauses or mistakes in punctuation to vitiate the manifest intent of the parties as gathered from the language of the contract.”⁷⁷ Indeed, the United States Supreme Court has recognized that punctuation “is a most fallible standard by which to interpret a writing,” and therefore should only be resorted to “when all other means fail.”⁷⁸ Hence, in the context of statutory interpretation, punctuation may not necessarily be decisive in determining the meaning of the statute.⁷⁹

Thus, the Delaware Supreme Court in *Disney* evidently placed undue reliance on the presence of the comma between the phrase bestowing upon the board the *sole* power to determine terms and duties, and the phrase subjecting those officers to removal by the board. While punctuation may provide assistance in construing Disney’s certificate of incorporation, the comma alone should not be sufficient to create what the court considers an ambiguity.

As important, the fact that the word “solely” is separated from the phrase addressing officer removal does not necessarily mean that the two phrases should be read in strict isolation. Indeed, perhaps the more reasonable construction is that the term “solely” applies to both the power to determine terms and duties, and the power to remove officers with or without cause. Such a reading becomes more compelling when considering that the phrase “subject to” seems to connect the two clauses together, thereby suggesting that “solely” should apply to the removal clause as well.

Furthermore, Delaware adheres to an objective theory of contracts, applying the plain meaning rule in construing contracts, which presumes that “the language of a contract governs when no ambiguity exists.”⁸⁰ This rule presumes that the intent of the parties is to be determined by

F.3d 338, 348 n.10 (3d Cir. 1999).

77. *Interim Healthcare, Inc. v. Spherion Corp.*, 884 A.2d 513, 555 (Del. Super. Ct. 2005) (footnote omitted) (internal quotation marks omitted). See generally *Levy v. Hayes Lemmerz Int’l, Inc.*, No. 1395-N, 2006 Del. Ch. LEXIS 68, at *28 (Del. Ch. Apr. 5, 2006).

78. *Ewing’s Lessee v. Burnet*, 36 U.S. 41, 54 (1837); see also *In re W.T. Grant Co.*, 4 B.R. 53, 71 (Bankr. S.D.N.Y. 1980).

79. See, e.g., *Costanzo v. Tillinghast*, 287 U.S. 341, 344 (1932); *United States v. Morris*, 928 F.2d 504, 507 (2d Cir. 1991).

80. *Med. Wind Down Holdings III, Inc. v. InnerDyne, Inc. (In re Med. Wind Down Holdings III, Inc.)*, 332 B.R. 98, 104 (Bankr. D. Del. 2005) (internal quotations omitted) (emphasis omitted); see also *Ingram v. Thorpe*, 747 A.2d 545, 547 (Del. 2000) (discussing the plain meaning rule as applied to statutes); *Sanders v. Wang*, No. 16640, 1999 Del. Ch. LEXIS 203, at *18 (Del. Ch. Nov. 8, 1999) (discussing the plain meaning rule in connection with a stock ownership plan); *Haft v. Haft*, 671 A.2d 413, 417 (Del. Ch. 1995) (discussing the objective theory of contract formation in construing a stock transfer and irrevocable proxy transaction). “Under the plain meaning rule of contract construction, if a contract is ‘clear on its face, the Court should rely solely on the clear literal meaning of the words.’” *Sanders*, 1999 Del. Ch. LEXIS 203, at *18 (quoting *Demetree v. Commonwealth Trust Co.*, No. 14354, 1996 Del. Ch. LEXIS 112, at *11 (Del. Ch. Aug. 27, 1996).

giving the contract terms “their ordinary meaning,” and that such meaning “should not be ‘torture[d]’ to impart ambiguity where none exists.”⁸¹ Moreover, under the “plain meaning” rule, the court should not resort to use of extrinsic evidence if the contract terms are unambiguous.⁸² Against this backdrop, the court’s treatment of this issue is troubling. Clearly, the court should have been more circumspect to ensure that its seemingly casual finding of ambiguity in the terms of the certificate of incorporation did not create an ambiguity where, in fact, none existed.⁸³

The court next sought to read further ambiguity into the certificate of incorporation provision by considering it in conjunction with the bylaws, which provide that the CEO “shall, subject to the provisions of the Bylaws and the control of the Board of Directors, have general and active management, direction, and supervision over the business of the Corporation and over its officers.”⁸⁴ Taken together, the court found that Disney’s corporate governing documents are ambiguous, thereby enabling the court to consider legal rules of construction and extrinsic evidence to resolve the ambiguity.⁸⁵ However, whether these provisions should be read as being ambiguous, and thereby necessitating application of rules of construction and extrinsic evidence, is a difficult question that the court declined to analytically resolve.

On their face, it may be asserted that the certificate of incorporation and bylaws⁸⁶ do not create the requisite ambiguity. As such, resort to extrinsic evidence therefore becomes unnecessary and indeed impermissible if Delaware adheres to the “plain meaning” rule. It is true that “where the language is not expressed with that clarity of expression which permits of but one reasonable interpretation, the language must be said to be ambiguous, and resort must be had for assistance through certain well-established legal rules of construction.”⁸⁷

However, it is also true that the Delaware General Corporation Law provides that a company’s bylaws “may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or

81. *MBIA Ins. Corp. v. Royal Indem. Co.*, 426 F.3d 204, 210 (3d Cir. 2005) (citing *Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992)); *I.U. N. Am., Inc. v. A.I.U. Ins. Co.*, 896 A.2d 880, 885 (Del. Super. Ct. 2006) (footnote omitted).

82. See *MBIA Ins. Corp.*, 426 F.3d at 210; *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997).

83. *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 69 (Del. 2006).

84. *Id.* at 68; see *DISNEY BYLAWS*, *supra* note 56.

85. *Brehm*, 906 A.2d at 68–69.

86. More specifically, Article Ten of Disney’s certificate of incorporation, and Article IV of the company’s bylaws.

87. *Standard Power & Light Corp. v. Inv. Assocs., Inc.*, 51 A.2d 572, 576 (Del. 1947); see *In re Explorer Pipeline Co.*, 781 A.2d 705, 713–14 (Del. Ch. 2001).

powers or the rights or powers of its stockholders, directors, officers or employees.”⁸⁸ This statute precludes Disney’s bylaws from validly containing a provision that is inconsistent with the authority granted to the board of directors in the certificate of incorporation. Furthermore, a bylaw that conflicts with the certificate of incorporation is a nullity.⁸⁹ Indeed, a corporation’s bylaws may never contradict the corporation’s certificate of incorporation.⁹⁰

Delaware law is therefore clear that the certificate of incorporation governs over the company bylaws, and that the bylaws cannot contradict or be inconsistent with the certificate of incorporation and thus must be construed in a manner consistent with the certificate of incorporation. Because it would be error to read Disney’s bylaws as inconsistent with the certificate of incorporation, the bylaw provision empowering the CEO with “general and active management, direction, and supervision over the business of the Corporation and its officers” cannot be interpreted as contradicting or being inconsistent with the board’s authority over officers under the certificate of incorporation. Any such contradiction or inconsistency would render the bylaw provision a nullity.⁹¹ Under such circumstances, the provision in the certificate of incorporation would therefore govern. While the bylaws may address additional matters or provide greater specificity to provisions of the certificate of incorporation,⁹² they should not be read to create an ambiguity in the terms of Disney’s governing documents.

C. THE “BEAR NECESSITIES” OF THE BOARD: DELEGATION, STERILIZATION, AND ABDICATION

Clearly, the certificate of incorporation of a company cannot contradict Delaware General Corporation Law.⁹³ The law therefore

88. DEL. CODE ANN. tit. 8, § 109(b) (2001).

89. *Centaur Partners, IV v. Nat’l Intergroup, Inc.*, 582 A.2d 923, 929 (Del. 1990) (“Where a by-law provision is in conflict with a provision of the charter, the by-law provision is a ‘nullity.’”); *see, e.g., Burr v. Burr Corp.*, 291 A.2d 409, 410 (Del. Ch. 1972); 1 DAVID A. DREXLER ET AL., *DELAWARE CORPORATION LAW AND PRACTICE* § 9.03 (Supp. 2007).

90. *See* DEL. CODE ANN. tit. 8, § 109(b); *see also* *Oberly v. Kirby*, 592 A.2d 445, 458 n.6 (Del. 1991).

91. *See Centaur Partners*, 582 A.2d at 929; *Burr*, 291 A.2d at 410. Nonetheless, if the certificate of incorporation is interpreted as ambiguous, then the bylaws may be considered to help determine the meaning of the certificate of incorporation. *See generally* 8 WILLIAM MEADE FLETCHER, *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 4190 (West, perm. ed. 2001).

92. *See* DEL. CODE ANN. tit. 8, § 109(b) (“[B]ylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.”); *Hollinger Int’l, Inc. v. Black*, 844 A.2d 1022, 1078 (Del. Ch. 2004) (recognizing that the broad authority to adopt bylaws under section 109(b) is subject to the limitation that “bylaws may not conflict with law or the certificate of incorporation”).

93. *Gaskill v. Gladys Belle Oil Co.*, 146 A. 337, 340 (Del. Ch. 1929); HENN & ALEXANDER, *supra* note 61.

establishes a hierarchy that determines the respective weight of each authority: the “by-laws must succumb to the superior authority of the charter; the charter if it conflicts with the statute must give way; and the statute, if it conflicts with the constitution, is void.”⁹⁴ An examination of the corporation law in Delaware therefore becomes another step in the analysis.

Delaware law generally provides that the business and affairs of each corporation shall be conducted by or under the direction and supervision of its board of directors.⁹⁵ Accordingly, it is the subject corporation’s board of directors, rather than its executive officers, that has ultimate responsibility for overseeing the corporation.⁹⁶ Although the board of directors possesses this broad power of management and oversight, it nonetheless also has the authority to delegate certain functions to officers and employees.⁹⁷ When delegation occurs, it is customary for the board to delegate such authority to officers, who act as agents of the corporation.⁹⁸ Generally, the officers of the corporation are agents whose actions within the scope of their authority can bind the corporation to third parties.⁹⁹ While this power to delegate is broad, certain limits apply.¹⁰⁰ Specifically, corporate directors may not delegate duties that “lie ‘at the heart of the management of the corporation.’”¹⁰¹

Delegation of authority thus becomes an important factor to consider when determining Eisner’s power to terminate Ovitz. Again, while the power to delegate is broad, certain limits exist on the board’s ability to delegate its authority.¹⁰² The board of directors may not “avoid

94. *Gaskill*, 146 A. at 340; see *Roven v. Kotter*, 547 A.2d 603, 605 (Del. Ch. 1988) (noting that it is an “elementary principle of Delaware law” that bylaws are subordinate to the certificate of incorporation); HENN & ALEXANDER, *supra* note 61 (recognizing the “substatutory intracorporate hierarchy of provisions, in the form of articles of incorporation, bylaws, shareholder resolutions, [and] board of directors resolutions”).

95. DEL. CODE ANN. tit. 8, § 141(a) (with the exception as otherwise provided by statute or in the subject corporation’s certificate of incorporation); see *Campbell v. Loew’s, Inc.*, 134 A.2d 852, 856 (Del. Ch. 1957); see also *Olson Bros., Inc. v. Englehart*, 211 A.2d 610, 615 (Del. Ch. 1965).

96. *Grimes v. Donald*, 673 A.2d 1207, 1214 (Del. 1996); *In re Bally’s Grand Derivative Litig.*, No. 14644, 1997 Del. Ch. LEXIS 77, at *12–13 (Del. Ch. June 4, 1997); 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS* § 4.16 (3d ed. Supp. 2008).

97. See BALOTTI & FINKELSTEIN, *supra* note 96.

98. *Id.*

99. DREXLER ET AL., *supra* note 89, § 14.02 (Supp. 2006); 2 FLETCHER, *supra* note 91, § 434; 1 RODMAN WARD, JR. ET AL., *FOLK ON THE DELAWARE GENERAL CORPORATION LAW* § 142.6 (4th ed. Supp. 2006).

100. See DEL. CODE ANN. tit. 8, § 141.

101. *Grimes*, 673 A.2d at 1214 (quoting *Chapin v. Benwood*, 402 A.2d 1205, 1210 (Del. Ch. 1979), *aff’d sub nom. Harrison v. Chapin*, 415 A.2d 1068 (Del. 1980)).

102. The “board may not either formally or effectively abdicate its statutory power and its fiduciary duty to manage or direct the management of the business and affairs of the corporation.” WARD, JR. ET AL., *supra* note 99, § 141; see also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 956–57 (Del. 1985) (holding that the board of directors had the power to oppose a tender offer where the board had reasonable grounds to believe that a takeover bid presented danger to corporate policy

its active and direct duty of oversight.”¹⁰³ Lack of such directorial oversight “irremediably taints the design and execution of the transaction.”¹⁰⁴ Thus, while the board may delegate the management of ordinary business affairs to officers, it must retain its broad duty of oversight. This leads to an examination of the interrelated concepts of sterilization and abdication.

The New York Court of Appeals articulated the concept of “board sterilization” in *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*¹⁰⁵ There, the shareholders entered into an agreement in which the management and supervision of the corporation was vested in a “manager.”¹⁰⁶ This agreement essentially divested the board of directors of any authority to oversee the corporation or to elect or remove the “manager,” by designating the manager, stripping the board of directors of the authority to remove that manager, and vesting the manager with complete authority to direct the supervision, operation, and management of the corporation’s business and policies.¹⁰⁷ The New York high court found that such an agreement violated that state’s corporation law, which provided that the “business of a corporation shall be managed by its board of directors.”¹⁰⁸ In reaching its decision, the court concluded that the powers of the board of directors were “completely sterilized.”¹⁰⁹ This decision highlights the relationship between sterilization, abdication, and the nondelegation of certain functions of the board of directors.

Likewise, Delaware law declines to give “legal sanction to agreements that have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters.”¹¹⁰ Delaware courts hold that such delegation is an

and effectiveness, and the defensive tactic was reasonable in relation to the threat posed).

103. *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1281 (Del. 1988) (discussing the role of directors to rely in good faith on the opinions of officers in the context of a sale of control); *see also* *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 373 (Del. 2006) (“In the absence of red flags, good faith in the context of oversight must be measured by the directors’ actions ‘to assure a reasonable information and reporting system exists’ and not by second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome.” (citation omitted)); *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996) (framing the question of duty of care in terms of the directors’ “good faith effort to be informed and exercise judgment”).

104. *Mills Acquisition*, 559 A.2d at 1280–81 (discussing the directors’ breaches of fiduciary duties in relation to a sale of control).

105. 77 N.E.2d 633, 634–35 (N.Y. 1948).

106. *Id.* at 634.

107. *Id.* at 634–35.

108. *Id.* at 633–35; *accord* DEL. CODE ANN. tit. 8, § 141(a) (2001) (“[The] business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors.”).

109. *Long Park*, 77 N.E.2d at 635; *see also* *Triggs v. Triggs*, 385 N.E.2d 1254, 1255 (N.Y. 1978) (finding that provisions of a stock purchase agreement which contained provisions that purportedly sterilized the board of directors were, in practice, ignored).

110. WARD, JR. ET AL., *supra* note 99, § 141.1.2 (relying on *Chapin v. Benwood Found., Inc.*, 402 A.2d 1205, 1210 (Del. Ch. 1979)); *see also* *In re Bally’s Grand Derivative Litig.*, No. 14644, 1997 Del.

“abdication” of directorial authority.¹¹¹ The concept of abdication is similar to the concept of “sterilization,” although the analysis shifts its focus: in sterilization, the focus frequently is on the shareholders and shareholder agreements,¹¹² while in abdication, the analysis generally focuses on action or inaction by the board of directors itself.¹¹³ In this respect, query whether the Disney board of directors abdicated its essential statutory duties.

The fact-finder found that, as of December 12, 1996, the date on which Eisner, Litvack, and Ovitz memorialized the termination, “the Disney board had never met in order to vote on, or even discuss, the termination at a full session, and few if any directors did an independent investigation of whether Ovitz could be terminated for cause.”¹¹⁴ Likewise, much like the full board, “neither the [executive performance plan committee] nor the compensation committee had a vote on the matter, and it seems as though they had yet to have a substantive discussion of whether Ovitz could be terminated for cause.”¹¹⁵ Such inaction regarding the termination and whether such termination could be made for cause suggests an abdication of directorial duty. Not only was the board of directors not given the opportunity to vote on Ovitz’s termination, the matter was never substantively discussed at a duly convened meeting. Nor is this a case where authority was delegated to an appropriate committee of the board of directors,¹¹⁶ as neither the compensation nor any other committee focused on the matter of Ovitz’s termination. Rather, the decision to fire the president and putative “de facto chief operating officer”¹¹⁷ of the company was made solely by Eisner with input by a select few others. In this respect, it must be remembered that the “mere fact that directors are gathered together does not a meeting make.”¹¹⁸ Thus, Eisner’s attempts to personally

Ch. LEXIS 77, at *12–13 (Del. Ch. June 4, 1997); 1 CORPORATE GOVERNANCE: LAW AND PRACTICE § 4.01 (Bart Schwartz & Amy L. Goodman eds., 2004).

111. See WARD, JR. ET AL., *supra* note 99, § 141.I.3; see also Grimes v. Donald, 673 A.2d 1207, 1214 (Del. 1996); DREXLER ET AL., *supra* note 89, § 13.01.

112. See Long Park, 77 N.E.2d at 634–35; see also Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918).

113. See Grimes, 673 A.2d at 1214–15; see also Aaron D. Jones, *Corporate Officer Wrongdoing and the Fiduciary Duties of Corporate Officers Under Delaware Law*, 44 AM. BUS. L.J. 475, 506 (2007).

114. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 736 (Del. Ch. 2005), *aff’d sub nom.* Brehm v. Eisner, 906 A.2d 27 (Del. 2006).

115. *Id.*

116. See DEL. CODE ANN. tit. 8, § 141(c) (2001 & Supp. 2006).

117. STEWART, *supra* note 17, at 212.

118. Fogel v. U.S. Energy Sys., Inc., No. 3271-CC, 2007 Del. Ch. LEXIS 178, at *7 (Del. Ch. Dec. 13, 2007) (citing Box v. Box, No. 14238, 1996 Del. Ch. LEXIS 16, at *14–15 (Del. Ch. Feb. 15, 1996)). In *Fogel*, the court found that the corporation never actually held a meeting to terminate its CEO, and thus any action taken during a purported meeting to terminate the CEO was void. See *id.* at *9–10. The court in *Fogel* noted that “[s]imply ‘polling board members does not constitute a valid meeting or effective corporate action.’” *Id.* at *7–8 (citation omitted). The facts of *Disney* bear close similarity to the situation in *Fogel*. For example, Eisner testified that he had personally discussed terminating Ovitz

contact and inform a majority of Disney's board do not imbue the decision with board of director action. Ovitz's termination thus seems largely devoid of any meaningful form of director oversight. The board appears to have abdicated its obligation to oversee the management of the corporation by failing to even discuss Ovitz's departure and the terms of his not-for-cause termination.

D. CREATIVE ARTISTS AND AGENCY

This brings the analysis to perhaps its most important point: agency. Indeed, having examined the language of Disney's governing documents and the principles of Delaware corporation law, there remains the critical task of discerning Eisner's authority as chief executive officer under the scope of agency law. Remarkably, the Delaware Supreme Court never addressed this issue. Under the law of agency, in construing the enforceability of contracts entered into by the corporation at the direction of a high-level corporate officer such as the CEO, numerous courts have relied on principles of actual authority and inherent agency power.¹¹⁹

The *Restatement (Third) of Agency* describes actual authority as "when, at the time of taking action that has legal consequences for the principal, the agent reasonably believes, in accordance with the principal's manifestations to the agent, that the principal wishes the agent so to act."¹²⁰ The key examination for actual authority thus rests with the principal's manifestations to the agent. Actual authority may be either "express" or "implied." Generally, "express authority" refers to actual authority that a principal has expressed in a detailed or specific manner.¹²¹ Implied authority generally includes the agent's authority "to take action designated or implied in the principal's manifestations to the agent and acts necessary or incidental to achieving the principal's objectives, as the agent reasonably understands the principal's

with several board members, but failed to address the matter formally at a duly convened meeting of the full board. See *supra* note 37 and accompanying text. Under the principles recently articulated in *Fogel*, such informal discussions should *not* be considered valid action by the board of directors.

119. See, e.g., *Gumpert v. Bon Ami Co.*, 251 F.2d 735, 738–39 n.1 (2d Cir. 1958) (questioning whether hiring another corporate officer absent express board delegation is incident to corporate officer's power); *Liberty Mut. Ins. Co. v. Enjay Chem. Co.* (now Exxon Corp.), 316 A.2d 219, 222 (Del. Super. Ct. 1974) (identifying three types of authority: express, implied, and apparent); *Menard, Inc. v. Dage-MTI, Inc.*, 726 N.E.2d 1206, 1212 (Ind. 2000) (finding that a company was bound to a contract by the inherent authority of its president); *Newberry v. Barth, Inc.*, 252 N.W.2d 711, 714–15 (Iowa 1977) (finding that a corporate agent lacked express, implied, apparent, and inherent power to bind the corporation to a real estate transaction).

120. RESTATEMENT (THIRD) OF AGENCY § 2.01 (2006). See generally 3 AM. JUR. 2D Agency § 70 (2002).

121. RESTATEMENT (THIRD) OF AGENCY § 2.01 cmt. b; 3 AM. JUR. 2D Agency § 70; see also *Billops v. Magness Constr. Co.*, 391 A.2d 196, 197–98 (Del. 1978).

manifestations and objectives when the agent determines how to act.”¹²² In both express and implied actual authority, the authority is derived from the relationship between the principal and the agent, based on either manifestations or statements from the principal to the agent.

Query whether Eisner acted with actual authority when terminating Ovitz. In order to have actual authority, the “principal must make a manifestation . . . that expresses this willingness” to allow another party to act as its agent.¹²³ Such authority could come from the certificate of incorporation or the bylaws; however, this Article has already addressed the inconclusiveness of the certificate of incorporation and bylaws in conferring concurrent removal power on both Eisner and the board of directors.¹²⁴ Thus, Eisner may well have lacked the actual authority to unilaterally fire the president of Disney. If Eisner lacked actual authority, then analysis must focus on whether Eisner possessed any other form of agency power.

In contrast to actual authority, apparent authority involves the reasonable belief held by a third party.¹²⁵ Apparent authority has been defined as “the power held by an agent or other actor to affect a principal’s legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal’s manifestations.”¹²⁶ Thus, the power of an agent under apparent authority may be determined based upon the manifestations between the principal and the third party. This is because the third party must have a reasonable belief that is “traceable to the principal’s manifestations.”¹²⁷ Apparent authority, therefore, does not require manifestations between the principal and the agent, just “expressive conduct” between the principal and the third party.¹²⁸

122. RESTATEMENT (THIRD) OF AGENCY § 2.02. See generally *Guyer v. Haveg Corp.*, 205 A.2d 176, 180 (Del. Super. Ct. 1964).

123. RESTATEMENT (THIRD) OF AGENCY § 3.01 cmt. b.

124. Assuming the certificate of incorporation properly authorized the CEO to terminate officers unilaterally, the question then arises whether such delegation would be valid as a matter of law. Such an inquiry becomes a matter of *delegation and abdication*, rather than a matter of agency. Under Delaware law, the operative inquiry would be whether such delegation removes from the board its duty of oversight, so as to violate section 141(a) of the Delaware General Corporation Law. See DEL. CODE ANN. tit. 8, § 141(a) (2001). This question is distinct from whether a transaction is “extraordinary” for the purposes of agency power. For further analysis of delegation and abdication, see *supra* Part II.C and accompanying text. For a discussion of what is “ordinary” and “extraordinary,” see *infra* Part II.E and accompanying text.

125. See RESTATEMENT (THIRD) OF AGENCY § 3.01 cmt. b.

126. RESTATEMENT (THIRD) OF AGENCY § 2.03; see *Billops*, 391 A.2d at 198; 3 AM. JUR. 2D *Agency* § 76.

127. RESTATEMENT (THIRD) OF AGENCY § 2.03.

128. *Id.* § 3.03 cmt. b; see also *Finnegan Constr. Co. v. Robino-Ladd Co.*, 354 A.2d 142, 144–45 (Del. Super. Ct. 1976).

Indeed, an agent acting solely with apparent authority lacks actual authority.¹²⁹

Inherent authority is a concept that is somewhat related to apparent authority. The *Restatement (Third) of Agency*, adopted in 2005, declines to use the term “inherent authority” because it considers such authority to be covered by other doctrines (such as respondeat superior).¹³⁰ Despite the *Restatement (Third)*’s perspective, the doctrine of inherent authority has been analyzed for decades, if not centuries, in U.S. case law.¹³¹ Accordingly, this Article will examine inherent authority as articulated by the *Restatement (Second)* and the courts. Under the *Restatement (Second) of Agency*, inherent authority refers to the “power of an agent which is derived not from authority, apparent authority or estoppel, but solely from the agency relation and exists for the protection of persons harmed by or dealing with a servant or other agent.”¹³²

Inherent authority and apparent authority are therefore related concepts. Indeed, inherent authority and apparent authority seem so similar that courts have had difficulty drawing a distinction between the two concepts.¹³³ This difficulty in application of those two broad principles of agency is one (of the many) reasons why the *Restatement (Third)* elects to abolish the use of the term “inherent” authority.¹³⁴ Because of the difficulty in separating these two concepts, they will be considered together (along with what is often called “implied” authority¹³⁵).

Inherent authority has been found to provide broad powers to an agent, based upon the customary authority of the agent. In *Menard, Inc. v. Dage-MTI, Inc.*, for example, the Indiana Supreme Court found that inherent authority bound a corporation to a contract executed by its president.¹³⁶ In *Menard*, the court held that an agent acts with inherent authority when engaging in transactions that usually accompany or are

129. See 3 AM. JUR. 2D *Agency* § 75 (2002); RESTATEMENT (THIRD) OF AGENCY § 2.03 cmt. b; see also *In re Mulco Prods., Inc.*, 123 A.2d 95, 103 (Del. Super. Ct. 1956).

130. See RESTATEMENT (THIRD) OF AGENCY § 2.01 cmt. b; Gregory S. Crespi, *The Proposed Abolition of Inherent Agency Authority by the Restatement (Third) of Agency: An Incomplete Solution*, 45 SANTA CLARA L. REV. 337, 354 (2005).

131. See, e.g., *Gumpert v. Bon Ami Co.*, 251 F.2d 735, 738–39 (2d Cir. 1958); *Roscoe Co. v. Lewis Univ.*, Coll. of Law, 398 N.E.2d 1083, 1086 (Ill. App. Ct. 1979) (identifying inherent authority as one of the three ways a principal may be bound by his agent); *Fidelity & Cas. Co. of N.Y. v. Carroll*, 117 N.E. 858, 859 (Ind. 1917) (discussing the agency inherent in certain corporate offices); *Newberry v. Barth, Inc.*, 252 N.W.2d 711, 714 (Iowa 1977).

132. RESTATEMENT (SECOND) OF AGENCY § 8A (1958); see also *Menard, Inc. v. Dage-MTI, Inc.*, 726 N.E.2d 1206, 1211 (Ind. 2000).

133. Crespi, *supra* note 130, at 354.

134. See *id.*; see also RESTATEMENT (THIRD) OF AGENCY § 2.01 cmt. b.

135. Some courts consider implied and inherent authority as similar concepts. See RESTATEMENT (THIRD) OF AGENCY § 2.01.

136. 726 N.E.2d 1206, 1212 (Ind. 2000).

incidental to transactions that that agent is authorized to conduct, provided the third party reasonably believes that the agent is authorized, and has no notice to the contrary.¹³⁷ In reaching this decision, the court recognized that the president of a corporation is one of the officers through which the corporation normally acts. As a result, the court found that the president's actions were those that "usually accompany or are incidental to transactions [that he was] authorized to conduct."¹³⁸

Generally, the prevailing view is that the "president of a corporation is empowered to transact, without special authorization from the board of directors, all acts of an ordinary nature which are incident to the office by usage or necessity and to thus bind the corporation."¹³⁹ Stated conversely, acts that are extraordinary in nature are outside the bounds of an executive's inherent authority. Of course, when courts and treatises refer to the "president" of a corporation, they merely refer to the chief executive, whether that officer is referred to as "president" or "CEO."¹⁴⁰ References to the "president," for the purposes of this discussion, therefore, will not be intended to refer to Ovitz, but rather Eisner, as the CEO of Disney.

Under Delaware law, a CEO of a corporation may engage in ordinary acts which are incident to his office,¹⁴¹ and "by virtue of his office he may enter into a contract and bind his corporation in matters arising from and concerning the usual course of the corporation's business."¹⁴² These powers inhere to the chief executive as a result of her position as such.¹⁴³ As has already been discussed, however, these powers of the chief executive are not without limit under Delaware law.¹⁴⁴ Implicit in this analysis, therefore, is the concept that an agent's authority

137. *Id.*

138. *Id.* at 1214 (citations omitted) (internal quotation marks omitted).

139. 2A FLETCHER, *supra* note 91, § 559. Thus, "the president of a corporation has no apparent authority to bind the corporation to an unusual, extraordinary, or unreasonable contract." *Id.* § 592.

140. See 19 C.J.S. *Corporations* § 553 (2007) ("The president is frequently the chief executive officer of the company and invested with broad general powers of management, and accordingly has many implied powers.").

141. *Canister Co. v. Nat'l Can Corp.*, 63 F. Supp. 361, 367 (D. Del. 1945) ("The president, as a general agent of a corporation, may perform all acts of an ordinary nature which by usage are incident to the office.").

142. *Joseph Greenspon's Sons Iron & Steel Co. v. Pecos Valley Gas Co.*, 156 A. 350, 352 (Del. Super. Ct. 1931); see also *Italo-Petroleum Corp. of Am. v. Hannigan*, 14 A.2d 401, 406 (Del. 1940).

143. See *Canister Co.*, 63 F. Supp. at 367.

144. See, e.g., *Andrew Jergens Co. v. Woodbury, Inc.*, 273 F. 952, 962 (D. Del. 1921) (stating that execution of a contract that completely divests a corporation of all its assets "is, in the absence of corporate authorization or ratification, beyond the power of the president of a corporation to make"); *Bruch v. Nat'l Guar. Credit Corp.*, 116 A. 738, 740 (Del. Ch. 1922) (finding that a corporate president has "no implied or inherent power to consent to the appointment of a receiver" to wind-up the corporation's affairs); *Atl. Ref. Co. v. Ingalls & Co.*, 185 A. 885, 886 (Del. Super. Ct. 1936) (explaining that the president of a corporation "has no implied or presumed authority" to bind the corporation by a contract of guaranty, in which the corporation does not have an interest).

may not exceed the “legitimate scope” of what is necessary to perform the agent’s delegated duties.¹⁴⁵

E. THE “INCREDIBLES” OF THE TRANSACTION: WHAT IS EXTRAORDINARY?

Transactions authorized under the inherent or implied authority of a chief executive officer must, therefore, be ordinary.¹⁴⁶ The next step in the analysis of Eisner’s authority to unilaterally terminate Ovitz from Disney’s presidency thus rests with the nature of the transaction: was this an unusual or extraordinary transaction? Such questions regarding the ordinary or extraordinary nature of a transaction are usually questions of fact.¹⁴⁷

In one of his several opinions in the *Disney* case, Chancellor Chandler described the “corporate board’s *extraordinary* decision to award a \$140 million severance package” to Ovitz.¹⁴⁸ It is interesting that the chancellor refers to the Disney *board’s* decision as “extraordinary,” when the decision to award this severance package was, in fact, made by CEO Eisner.¹⁴⁹ Also, in this casual reference to the payment, the chancellor chooses to use the word “extraordinary” to describe the termination.¹⁵⁰ Of course, such casual language does not characterize the transaction as “extraordinary” as a matter of law. Nonetheless, the chancellor’s use of this term is indicative that Ovitz’s termination, thereby triggering the \$130 million severance package, was no ordinary matter.

With respect to the economics of the transaction, for the fiscal year ending September 29, 2007, Disney reported \$35.51 billion in revenues and \$4.687 billion in net income.¹⁵¹ These financial figures reflect the fact that Disney is a huge corporation. In 2007, Disney ranked sixty-fourth on the Fortune 500 list.¹⁵² When faced with these financial numbers, a severance payment of over \$130 million may appear rather insignificant. Indeed, in the chancery court opinion, Chancellor Chandler addresses the fact that, relative to the size of the corporation, the terms of Ovitz’s

145. *Kolcum v. Bd. of Educ.*, 335 A.2d 618, 623 (Del. Super. Ct. 1975); see also *Amtower v. Hercules Inc.*, No. 97C-09-018, 1999 Del. Super. LEXIS 107, at *31 (Del. Super. Ct. Feb. 26, 1999).

146. See *WARD, JR. ET AL.*, *supra* note 99, § 142.6 (arguing that, even “if an officer is also a general manager” with powers that “are markedly broader than the inherent powers of a president or other officer,” those powers still have limits); *Colish v. Brandywine Raceway Ass’n*, 119 A.2d 887, 891 (Del. Super. Ct. 1955) (holding that, although general managers are considered to possess broad powers, they still have “no implied authority to enter into [an] unusual and extraordinary contract”).

147. *Lee v. Jenkins Bros.*, 268 F.2d 357, 370 (2d Cir. 1959); see also *Mgmt. Techs. v. Morris*, 961 F. Supp. 640, 648 (S.D.N.Y. 1997); *DREXLER ET AL.*, *supra* note 89, § 14.02 (2007).

148. *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 350 (Del. Ch. 1998), *aff’d in part, rev’d in part sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (emphasis added).

149. *Id.*

150. *Id.*

151. *Walt Disney Co.*, Annual Report (Form 10-K), at 28–29 (Nov. 21, 2007).

152. *Largest U.S. Corporations*, *FORTUNE*, Apr. 30, 2007, at F-3.

employment and termination seem small.¹⁵³ However, as is well recognized, quantitative magnitude is not the only factor to consider when analyzing the importance of a transaction; one must also consider the qualitative impact of the transaction to assess its overall magnitude.¹⁵⁴ Significantly, although Chancellor Chandler recognizes the overall size of the corporation relative to the payment, he still describes the severance package as “extraordinary.”¹⁵⁵

The qualitative features of a transaction cannot be ignored during analysis. For example, in the context of assessing qualitative materiality of a misrepresentation in a financial statement, the staff of the Securities and Exchange Commission (SEC) has promulgated Staff Accounting Bulletin 99 (SAB 99).¹⁵⁶ Under SAB 99, the SEC staff advised that both the “quantitative” and the “qualitative” aspects of an item must be evaluated.¹⁵⁷ Also, as observed by the Ninth Circuit Court of Appeals, in ascertaining whether a transaction is extraordinary, “a payment made by a company that would otherwise be unremarkable may be rendered extraordinary by unusual circumstances.”¹⁵⁸ Admittedly, materiality, at times, is distinct from extraordinariness, but overlap between the two concepts provides a useful tool for analysis. Furthermore, when determining whether authority was delegated to a chief executive officer, the “likelihood that a board intends to delegate authority for a particular matter usually will be related inversely to the significance of the action for the corporation.”¹⁵⁹ Also of relevance is the Ninth Circuit’s inclusion of the circumstances surrounding the transaction, and the purpose of the transaction (in addition to the size of the transaction), in its list of

153. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 768 n.533 (Del. Ch. 2005), *aff’d sub nom.* Brehm v. Eisner, 906 A.2d 27 (Del. 2006).

154. SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150, 45,151 (1999); *see, e.g.*, *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 163 (2d Cir. 2000) (evaluating the materiality of a transaction according to both quantitative and qualitative factors).

155. *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 432, 350 (Del. Ch. 1998).

156. SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (1999) (stating that a fact is deemed material if a reasonable investor would consider such information important in making an investment or voting decision); *see also* *Basic, Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988); *Dearlove*, SEC Initial Decision Release No. 315, 2006 SEC LEXIS 1684, at *143 (July 27, 2006) (recognizing that SAB 99 expresses the SEC’s view that financial misstatements are not immaterial merely because they fall below a numerical threshold).

157. SEC Staff Accounting Bulletin 99, 64 Fed. Reg. at 45,151; *see Ganino*, 228 F.3d at 163 (finding SAB 99 “persuasive guidance” for evaluating materiality focusing on both quantitative and qualitative factors); *see also In re Huntington Bancshares, Inc.*, Securities Act Release No. 8579, Exchange Act Release No. 51,781, 85 SEC Docket 1433 (June 2, 2005) (noting that materiality analysis for financial misstatements under SAB 99 requires an analysis of both quantitative and qualitative factors).

158. *SEC v. Gemstar-TV Guide Int’l, Inc.*, 401 F.3d 1031, 1045 (9th Cir. 2005), *cert. denied sub nom.* Yuen v. SEC, 546 U.S. 933 (2005); *see also Ganino*, 228 F.3d at 163–64.

159. *Mgmt. Techs., Inc. v. Morris*, 961 F. Supp. 640, 648 (S.D.N.Y. 1997) (discussing whether a CEO, whose position was never created in the company bylaws, had the authority to act in insolvency proceedings in the United Kingdom).

“context-specific” factors for determining extraordinariness under the Sarbanes-Oxley Act.¹⁶⁰ Such an analysis clearly embraces the qualitative aspects, and not solely the quantitative size, of the transaction.

At first glance, Ovitz’s no-fault termination payment appears to be a nonevent, constituting less than 1% of Disney’s assets and income.¹⁶¹ Chancellor Chandler reflected on this small percentage.¹⁶² Under a qualitative measure, however, a different rationale comes into play. Exorbitant termination severance payments to the president of a Fortune 100 company may potentially cause havoc to a company’s market following, particularly institutional shareholders who are concerned with vibrant corporate governance standards.¹⁶³ To thus point solely to quantitative dollar amounts ignores the economic reality underlying such conduct. Under standards of modern corporate governance, the termination and severance payments to Ovitz were of a material nature, deserving of board of director consideration.

To illustrate further, under the Sarbanes-Oxley Act, the term “extraordinary” payment has been defined as a payment “that would not typically be made by a company in its customary course of business.”¹⁶⁴ The Ninth Circuit, in conducting its analysis of what constituted such an “extraordinary” payment, considered “[c]ontext-specific factors such as the circumstances under which the payment is contemplated or made, the purpose of the payment, and the size of the payment.”¹⁶⁵ These factors thus constitute part of a fact-specific inquiry into the context and circumstances surrounding the payment. The Ninth Circuit has thus held that payment of \$29.48 million and 5.27 million shares of restricted stock to a corporate CEO constituted an “extraordinary” payment under section 1103 of the Sarbanes-Oxley Act.¹⁶⁶

160. *Gemstar-TV Guide*, 401 F.3d at 1045. See generally JOHN T. BOSTELMAN, *THE SARBANES-OXLEY DESKBOOK* (2008); MARC I. STEINBERG, *ATTORNEY LIABILITY AFTER SARBANES-OXLEY* (2008); Joseph F. Morrissey, *Catching the Culprits: Is Sarbanes-Oxley Enough?*, 2003 COLUM. BUS. L. REV. 801 (2003).

161. See Walt Disney Co., Annual Report (Form 10-K), at 28–29 (Nov. 21, 2007) (reporting assets of almost \$61 billion in 2007 and net income of \$4.687 billion).

162. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 768 n.533 (Del. Ch. 2005), *aff’d sub nom. Brehm v. Eisner*, 906 A.2d 27 (Del. 2006).

163. See *A Vote Against Disney*, N.Y. TIMES, Feb. 25, 1997, at B7; Paul Farhi, *Disney’s Dizzying Bonus Approved for CEO Eisner: Dissenters Protest ‘Lucrative’ Package at Shareholders Meeting*, WASH. POST, Feb. 26, 1997, at C11; Bruce Orwall & Joann S. Lublin, *The Rich Rewards of a Hollywood Exit*, WALL ST. J., Dec. 16, 1996, at B1.

164. *Gemstar-TV Guide*, 401 F.3d at 1045 (holding that payments to company insiders during an SEC investigation for securities fraud were “extraordinary” under the Sarbanes-Oxley Act).

165. *Id.* The transactions to which the court applied its test for “extraordinariness” consisted of a payment of \$29.48 million and 5.27 million shares of restricted stock to the CEO, and a payment of \$8.16 million, 1.1 million shares of common stock, and 353,680 of restricted stock to the CFO. *Id.* at 1037. These payments, occurring amidst accusations of accounting inconsistency, were part of a “resignation” agreement with the corporate board in which the CEO and CFO agreed to resign from their offices, but remain employees. *Id.*

166. *Id.* at 1045–46.

In *Disney*, Eisner, rather than the board of directors, fired the company's president, thereby triggering a not-for-cause termination package totaling over \$130 million; this \$130 million payment compensated Ovitz for fourteen months of work in the Disney presidency.¹⁶⁷ In the words of Holman Jenkins of the *Wall Street Journal*, "nobody in the real world, not even in the far-out precincts of Hollywood, gets that kind of money for flubbing up after a year on the job."¹⁶⁸ In fact, Ovitz's not-for-cause termination amounted to "the equivalent of more than 5000 weeks of salary after just over a year on the job."¹⁶⁹ In the decision below, Chancellor Chandler opined that:

[A] reasonably prudent CEO . . . would not have acted in as unilateral a manner as did Eisner when essentially committing the corporation to hire a second-in-command, appoint that person to the board, and provide him with one of the largest and richest employment contracts ever enjoyed by a non-CEO.¹⁷⁰

Indeed, one reporter posed the question: "if somehow Mr. Ovitz had earned that kind of payoff so quickly, why would Mr. Eisner push out such a valuable property, and so expensively?"¹⁷¹ Thus, while the amount of compensation paid to Ovitz in relation to the overall size of Disney may not be that immense, the gargantuan qualitative scope of the termination and subsequent severance payment have been well explored.

F. RATIFICATION BY THE HOUSE OF MOUSE

Finally, the doctrines of ratification and estoppel provide alternatives to actual and apparent authority under agency law. Ratification refers to the "affirmance of a prior act done by another, whereby the act is given effect as if done by an agent acting with actual authority."¹⁷² Ratification thus serves to confirm the legitimacy of a prior act on behalf of the principal.¹⁷³ In a related manner, estoppel refers to situations in which an actor's manifestations "induce[d] the third party to make a detrimental change in position."¹⁷⁴ When these manifestations have induced such detrimental reliance, the actor making the

167. *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 35 (Del. 2006).

168. Holman W. Jenkins, Jr., *Beavis and Butt-head Do the Disney Shareholders*, WALL ST. J., Jan. 7, 1997, at A17.

169. Eric Dash, *Hire by the Contract Now, Risk a Big Regret Later*, N.Y. TIMES, Jan. 12, 2007, at C1, C6.

170. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 761-62 (Del. Ch. 2005), *aff'd sub nom. Brehm v. Eisner*, 906 A.2d 27, 35 (Del. 2006).

171. A.M. Rosenthal, Op-Ed., *Hardtack for the Journey*, N.Y. TIMES, Dec. 17, 1996, at A25.

172. RESTATEMENT (THIRD) OF AGENCY § 4.01(1) (2006); *see also* *Hannigan v. Italo Petroleum Corp.*, 47 A.2d 169, 173 (Del. 1945); *Lewis v. Vogelstein*, 699 A.2d 327, 334-35 (Del. Ch. 1997).

173. *Hannigan*, 47 A.2d at 173.

174. RESTATEMENT (THIRD) OF AGENCY § 4.08; *see also* *McCabe v. Williams*, 45 A.2d 503, 505 (Del. 1944).

manifestations may be “estopped” from denying the transaction’s validity.¹⁷⁵

The timing of the ratification is an important element of confirming authority.¹⁷⁶ A critical distinction must be drawn, however, between ratification in the past for previous actions, and ratification for a present action. Several Disney officers in the past had been fired without any action from the board of directors.¹⁷⁷ “Implied authority of the president of a corporation cannot be inferred from the fact that in other instances the president’s previously *unauthorized* acts have been ratified by the board of directors.”¹⁷⁸ In other words, the concepts of ratification and implied authority must not be conflated when determining a chief executive’s authority to bind the corporation. Thus, when considering whether Eisner possessed the authority to terminate Ovitz independent of the board of directors, manifestations that may be deemed “ratifications” for past unauthorized terminations of other Disney officers cannot be considered a source for Eisner’s present inherent or implied authority to unilaterally fire Ovitz.

Furthermore, by implication, other officers may well have been lower-level officers, but Ovitz was president. Thus, even if previous acts in fact were authorized or ratified, Ovitz’s termination and severance are of an entirely different category. The firing of the number-two executive in the corporate hierarchy should be treated differently than the dismissal of lower level officers such as corporate vice presidents.

Nonetheless, even if Eisner originally lacked the authority to unilaterally terminate Ovitz from Disney’s presidency, thereby triggering the severance payment, the board of directors ratified the transaction. Ratification of a transaction may occur by virtue of the principal’s “fail[ure] to object to it or to repudiate it.”¹⁷⁹ Because the Disney board of directors declined to object to Ovitz’s termination, the board, in all practicality, ratified the transaction. Indeed, “[m]any directors believed that Eisner had the power to fire Ovitz on his own and that he did not need to convene a board meeting to do so.”¹⁸⁰

For the purposes of this Article, however, ratification and estoppel are immaterial: the principal impact of the *Disney* case lies not in the

175. RESTATEMENT (THIRD) OF AGENCY § 4.08; 3 AM. JUR. 2D *Agency* § 79 (2002); *see also* Guyer v. Haveg Corp., 205 A.2d 176, 181 (Del. Super. Ct. 1964).

176. RESTATEMENT (THIRD) OF AGENCY § 4.05; *see also* 3 AM. JUR. 2D *Agency* § 177 (2008).

177. *See* Brehm v. Eisner (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 69–70 (Del. 2006).

178. 18B AM. JUR. 2D *Corporations* § 1337 (2004) (emphasis added) (citing Stoneman v. Fox Film Corp., 4 N.E.2d 63 (Mass. 1936)).

179. RESTATEMENT (THIRD) OF AGENCY § 4.01 cmt. f (2006); 3 AM. JUR. 2D *Agency* § 193 (2008); Law v. Cross, 66 U.S. 533, 539 (1861).

180. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 736 (Del. Ch. 2005), *affd sub nom.* Brehm v. Eisner, 906 A.2d 27, 35 (Del. 2006).

legitimacy of Ovitz's not-for-cause termination payment, but rather in the scope of CEO authority. Indeed, the Delaware Supreme Court had the opportunity to decide the case in favor of the defendants based on the doctrine of ratification, which would have avoided the consequence of unduly expanding the powers of the chief executive to act independently of the board. The fact that the board likely ratified the decision to terminate Ovitz without cause pales in importance when compared to the fact that the Delaware Supreme Court has expanded the authority of a chief executive at the expense of corporate boards of directors.

III. A WHOLE NEW WORLD? IMPACT OF *DISNEY* ON GOOD GOVERNANCE AND DIRECTOR INDEPENDENCE

In the current climate of corporate governance, great emphasis is placed on the concept of "independent" directors serving on corporate boards.¹⁸¹ In this regard, the major securities markets have rules requiring that all listed companies have a majority of independent directors.¹⁸² For example, the New York Stock Exchange (NYSE) requires that listed companies have "a majority of independent directors" as part of its corporate governance requirements.¹⁸³ In the NYSE's commentary, it explains that requiring independent directors "will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest."¹⁸⁴ NYSE rules also require that the nominating/corporate governance committee, compensation committee, and the audit committee be comprised entirely of independent directors.¹⁸⁵ Similarly, the NASDAQ Stock Market (NASDAQ) contains a requirement that a majority of the board of directors of listed companies be comprised of independent directors.¹⁸⁶ In addition, the NASDAQ rules require that the compensation committee and the audit committee be comprised solely of independent directors.¹⁸⁷

Both the NYSE and NASDAQ have specific requirements for what qualifies as "independence" for the purposes of director qualification. For example, NYSE rules require that the company's board of directors affirmatively establish that the director in question has no "material relationship" with the company in order to meet the standard for

181. ABA COMM. ON CORPORATE LAWS, CORPORATE DIRECTOR'S GUIDEBOOK 38 (5th ed. 2007) [hereinafter ABA GUIDEBOOK].

182. *Id.*; see *infra* notes 183-87 and accompanying text.

183. NYSE, Inc., Listed Company Manual § 303A.01 (2003).

184. *Id.* § 303A.01 cmt.

185. *Id.* §§ 303A.04(a), 303A.05, 303A.07(b).

186. NASDAQ, Inc., Manual Rule 4350(c) (2006).

187. *Id.* R. 4350(c)(3), 4350(d)(2)(A)(i). With respect to the Sarbanes-Oxley Act's requirements in this regard, see *infra* notes 194-96 and accompanying text.

independence.¹⁸⁸ In addition, the NYSE rules identify certain relationships that defeat independence.¹⁸⁹ Such relationships include: being an employee of the company within the previous three years or having an immediate family member that was an executive officer within those three years, receiving \$120,000 in direct compensation (other than directors' fees and pensions) from the company during any twelve-month period within the previous three years, working for the company's auditor under certain circumstances, serving as an executive officer of another company with respect to which any of the company's present executive officers serve on such other company's compensation committee, and being a current employee of a company that made payments to or received payments from the present company within the past three years if those payments exceed the greater of \$1 million or 2% of the company's consolidated gross revenues.¹⁹⁰ Each of these disqualifications also implicates directors whose immediate family members meet such criteria.¹⁹¹ NASDAQ rules contain similar requirements and tests for director independence.¹⁹² Both stock exchanges also have rules requiring executive sessions to be attended by independent directors.¹⁹³

The Sarbanes-Oxley Act also contains requirements of independence.¹⁹⁴ Under Sarbanes-Oxley, the audit committee of a publicly held company must be comprised solely of independent directors.¹⁹⁵ Sarbanes-Oxley has its own definition of "independence," separate from the definitions used by the stock exchanges. Under Sarbanes-Oxley, a director is not considered independent for qualification as an audit committee member if such director accepts any

188. NYSE, Inc., Listed Company Manual § 303A.02(a).

189. *Id.* § 303A.02(b).

190. *Id.*

191. *Id.*

192. A director will not be considered "independent" if, during the preceding three years: he was employed by the company; with certain exceptions, he or a family member received over \$120,000 from the company over any twelve-month period; his family member was an executive of the company; he or a family member was a partner, controlling shareholder, or executive of a company that paid or received the greater of \$200,000 or 5% of the recipient's gross revenues; he or a family member served as an executive of another company for which an executive of the present company served on the compensation committee; he or a family member participated in the outside audit of the company; or he is an "interested person" according to the Investment Company Act of 1940. NASDAQ, Inc., Manual Rule 4200(a)(15).

193. NASDAQ, Inc., Manual Rule 4350(c)(2) (defining an executive session as a meeting of board directors at which only "independent" directors are present); NYSE, Inc., Listed Company Manual § 303A.03 (defining an executive session as a meeting of board directors at which only "non-management" directors are present); NYSE, Inc., Listed Company Manual § 303A.03 cmt. (explaining that such executive sessions are designed to "promote open discussion" among independent directors).

194. Securities Exchange Act of 1934 § 10A(m)(3)(A), Pub. L. No. 291, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78j-1(m)(3)(A) (2006)).

195. *Id.*; see also 148 CONG. REC. S6327, 6332 (daily ed. July 8, 2002) (statement of Sen. Sarbanes).

compensatory fee (other than director fees) from the company, or is an affiliated person of the company or any of its subsidiaries.¹⁹⁶ “Affiliated persons” are defined generally to include those persons owning or controlling at least 5% of the outstanding stock of the company.¹⁹⁷

Furthermore, publicly held companies must identify in their annual proxy statements to their shareholders the names of the respective company’s independent directors.¹⁹⁸ In addition, the company must disclose specified information that it considered when making its independence determination.¹⁹⁹ Based upon these developments in the law, the Corporate Director’s Guidebook²⁰⁰ states that in order to function most effectively, the board of directors of a public corporation “must exercise independent judgment in carrying out its responsibilities.”²⁰¹ Thus, director independence today “is a prevailing theme in corporate governance, if not always in corporate law.”²⁰² Indeed, in reviewing his twelve-year term on the Delaware Supreme Court, former Chief Justice E. Norman Veasey recognized the “courts’ deepened reliance on independent directors and an expectation that directors will act thoughtfully and in good faith.”²⁰³ Other observers also have reflected that the “move to independent directors, which began as a ‘good governance’ exhortation, has become in some respects a mandatory element of corporate law.”²⁰⁴ Sarbanes-Oxley, stock exchange

196. Securities Exchange Act of 1934 § 10A(m)(3)(B); cf. NASDAQ, Inc., Manual Rule 4200(a)(15) (2003); NYSE, Inc., Listed Company Manual § 303A.02(b) (2003).

197. Securities Exchange Act of 1934 § 3(a)(19) (codified as amended at 15 U.S.C. § 80a-2(a)(3)).

198. See SEC Schedule 14A, Item 7, 17 C.F.R. § 240.14A-101 (2008).

199. *Id.*; see ABA GUIDEBOOK, *supra* note 181, at 39 (“Public corporations must disclose in their annual meeting proxy statements the names of the independent directors, as well as the principles underlying the independence determination and any transactions, relationships, or arrangements not otherwise disclosed that were considered by the board in determining whether the director is independent.”).

200. The Corporate Director’s Guidebook is a guidebook published by the ABA Committee on Corporate Laws of the ABA Section of Business Law. *Id.* at vii. The Committee on Corporate Laws recently released its fifth edition, which espouses the theme of the “increasingly vital role that directors play in protecting investors’ interests and in directing and overseeing corporate strategy and its execution by senior officers.” *Id.* The Committee was chaired by former Chief Justice of the Delaware Supreme Court, E. Norman Veasey. *Id.* at viii.

201. *Id.* at 38.

202. E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1472 (2005).

203. *Id.* at 1406.

204. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1468 (2007). In 1978, then SEC Chairman Harold M. Williams emphasized the importance of independent directors in the corporate governance framework. Harold M. Williams, Chairman, Securities Exch. Comm’n, Address at the Fifth Annual Securities Regulation Institute: Corporate Accountability (Jan. 18, 1978). See generally Ralph C. Ferrara & Marc I. Steinberg, *A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980).

rules, and court decisions have thus brought about many reforms; the impact of these reforms is to elevate the importance of the independent director in the corporate governance framework.²⁰⁵

More specifically within Delaware case law, Delaware courts recognize, and indeed emphasize, the importance of independent directors. Vice Chancellor Strine has acknowledged “the strong role that our law gives to independent directors.”²⁰⁶ For example, in related party transactions, the role of disinterested directors in the quest to achieve fairness has been stressed.²⁰⁷ In the shareholder derivative suit context, in ascertaining demand futility, Delaware courts examine the disinterestedness and independence of the subject directors.²⁰⁸ In this setting, the Delaware courts place great emphasis specifically on the independence of special litigation committees in seeking the termination of shareholder derivative actions.²⁰⁹ Furthermore, in sale of control transactions, the Delaware Supreme Court has focused on the particularly critical role that independent directors play, emphasizing the importance of independent directors in determining the good faith use of defensive measures in corporate takeovers.²¹⁰

With this current climate of corporate governance in mind, the wider implications of the *Disney* case become more apparent. This holding

205. Gordon, *supra* note 204, at 1539; *see also* *Paramount Commc'ns v. QVC Network*, 637 A.2d 34, 44 (Del. 1994) (discussing the importance of independent directors in sale of control transactions); *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1281, 1285 (Del. 1989) (discussing the role of independent directors in scrutinizing transactions); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (discussing the role of independent directors in the use of defensive tactics in corporate takeovers); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788–89 (Del. 1981) (establishing independence as the first part of a two-part test for determining the legitimacy of a special litigation committee).

206. *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 647 (Del. Ch. 2005).

207. *See, e.g.*, *Krasner v. Moffett*, 826 A.2d 277, 286 (Del. 2003) (holding that, where the majority of the board had potential self-interest in a merger, the independence of a special committee of disinterested directors used to approve the merger is a fact-intensive inquiry); *Marciano v. Nakash*, 535 A.2d 400, 404 (Del. 1987) (referring to the importance of majority approval of disinterested directors for interested director transactions); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710–11 (Del. 1983) (discussing the general test of fairness that should be applied to related-party transactions, and specifically cash-out mergers).

208. *See, e.g.*, *Fagin v. Gilmartin*, 432 F.3d 276, 283 (3d Cir. 2005) (applying Delaware law in finding that demand was not excused because the mere fact that a director is also an officer does not defeat that director's independence); *Stone v. Ritter*, 911 A.2d 362, 366–67 (Del. 2006) (discussing the standards for finding demand futility if the directors are not disinterested and independent); *Braddock v. Zimmerman*, 906 A.2d 776, 786 (Del. 2006) (discussing the role of a “new” board of independent directors determining demand-excuse); *Beam v. Stewart*, 845 A.2d 1040, 1049 (Del. 2004) (discussing the standards for establishing interest or lack of independence in demand futility cases); *Desimone v. Barrows*, 924 A.2d 908, 943 (Del. Ch. 2007) (finding that plaintiff had not pleaded facts with sufficient particularity to establish demand excusal).

209. *See, e.g.*, *Zapata*, 430 A.2d at 788–89 (establishing independence as the first part of a two-part test for determining the legitimacy of a special litigation committee).

210. *Paramount Commc'ns*, 637 A.2d at 44; *Mills Acquisition*, 559 A.2d at 1285; *Unocal*, 493 A.2d at 955.

goes well beyond a mere reaffirmance of the business judgment rule. Rather, the *Disney* case raises serious questions about the efficacy of recent corporate governance reforms. The emphasis on director “independence” has been recognized by legislators, courts, regulators, the private sector, scholars, and observers alike. Reforms have accentuated the need for “independent” directors to serve on boards in order to improve corporate governance in the United States. Nonetheless, if such reforms are as important as they seem, then how can they be reconciled with the *Disney* case? If a CEO such as Michael Eisner can legitimately wield such unilateral power as was demonstrated in this case, the inquiry is raised whether the Delaware courts are willing to enunciate meaningful corporate governance standards in controversial cases.

Furthermore, assuming that concurrent removal power was conferred upon Eisner in the certificate of incorporation and bylaws, another important (and as of yet unanswered) question arises: whether delegation of an *extraordinary* matter is an unlawful delegation constituting directorial abdication.²¹¹ Indeed, what consequence would follow if such extraordinary delegation is not unlawful abdication? By implication, it would seem that many of the current corporate governance reforms involving independent director oversight could possibly be evaded through express delegation in corporate certificates of incorporation, bylaws, and board resolutions.

CONCLUSION

The *Disney* case recognized Eisner’s unilateral actual authority to terminate without cause the company’s president, causing the issuance of a \$130 million severance payment. This event took place with no board of director discussion or approval. Thus, we come to the critical question, the answer to which is not yet resolved: to what degree will this decision adversely impact the role of independent directors in effectuating meaningful corporate governance? In this regard, the Delaware Supreme Court overlooked the consequences of its decision in *Disney*. The decision fails to reconcile Eisner’s expansive authority with the emerging importance of director independence in corporate governance.

Chancellor Chandler recognized Eisner’s “imperial” control at Disney: “[b]y virtue of his Machiavellian (and imperial) nature as CEO, and his control over Ovitz’s hiring in particular, Eisner to a large extent is responsible for the failings in process that infected and handicapped the board’s decisionmaking abilities.”²¹² This is ironic in the face of the

211. See *supra* note 124 and accompanying text.

212. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 760 (Del. Ch. 2005), *aff’d sub nom. Brehm v. Eisner*, 906 A.2d 27 (Del. 2006).

Delaware courts' own opinions emphasizing the importance of independent directors. If a corporate CEO has the authority the Delaware Supreme Court casually embraces in the *Disney* case, then how is the public to interpret that court's own opinions extolling the presence of independent directors as a safeguard in corporate governance? The answer may well be that the court is perceived as engaging in mere "jawboning," declining to enforce these exhortations in the "real" world where serious money damages and other significant sanctions are at issue.²¹³

In the wake of the various corporate scandals during the last decade, corporate governance standards thus have come under greater scrutiny. An important aspect of this scrutiny has been the emphasis on the service of independent directors in the corporate boardroom. The Delaware Supreme Court's decision in the *Disney* case, however, is difficult to reconcile with the perceived importance of independent directors. Indeed, if principles of agency and delegation truly confer such unilateral power upon the chief executive, as the court seems to suggest, then the effect of independent directors on meaningful corporate governance is diminished.

213. Cf. *Smith v. Van Gorkom*, 488 A.2d 858, 893 (Del. 1985) (holding directors of the subject company personally liable for their violation of the duty of care during a corporate merger). The legislative response to the holding in *Van Gorkom* was the enactment of raincoat provisions protecting directors from personal liability in duty of care situations. See DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). As has already been discussed, the court could have avoided the specter of director liability by applying the doctrine of ratification. See *supra* notes 172-77 and accompanying text.
