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SMU Dedman School of Law
Legal Studies Research Paper
Number 00-39

**This paper can be downloaded without charge
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DISNEY GOES GOOFY: AGENCY, DELEGATION & CORPORATE GOVERNANCE

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ABSTRACT

In the wake of the corporate debacles that have occurred in the last decade, there has been an increasing legislative and judicial focus on the reform of corporate governance standards. Such reforms, including the Sarbanes-Oxley Act, sing the praises of independent directors in effectuating meaningful corporate governance. The Delaware courts as well have emphasized the importance of independent directors in the corporate governance framework.

The Delaware Supreme Court's decision in Disney seems to be a reaffirmance of the business judgment rule as applied to corporate directors; however, the court's highly-publicized decision ignores a crucial component of the case: the Delaware Supreme Court implicitly holds that Michael Eisner, as CEO of Disney, had the authority to unilaterally terminate the number-two officer in the corporation and to authorize a severance payment of over \$130 million without action from the board of directors. By expanding the unilateral power of the chief executive officer to bind the corporation to such extraordinary transactions, the Disney court's holding thus slights independent director service on corporate boards. Indeed, under the court's reasoning in Disney, the effect of independent directors on meaningful corporate governance is diminished.

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The authors thank Professors Roy Anderson, Alan Bromberg, Nathan Cortez, Greg Crespi, and C. Paul Rogers III, for their thoughtful comments. We also express our appreciation to Mr. Ignacio Hirigoyen for his research assistance.

I. INTRODUCTION

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

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. Consequently, the defendant directors and officers did not violate their fiduciary duties or commit waste.³ Much scholarly writing has been 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.⁴

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

² *Id.* at 35.

³ *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 the Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 745 (Del. Ch. 2005), *aff’d*, 906 A.2d 27, 35 (Del. 2006). 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). Corporate waste is thus rarely found because of this highly onerous burden. *See* 907 A.2d at 749.

⁴ *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 (2006) (discussing the duty 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 (2007) (discussing executive compensation); Hillary A. Sale, *Monitoring Caremark’s Good Faith*, 32 DEL. J. CORP. L. 719 (2007) (discussing 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 (2007) (discussing directors’ fiduciary duties); Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833 (2007) (suggesting a two-part test relying on structural bias and

The Delaware Supreme Court's holding in *Disney* indeed is important due to the protection 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 unilaterally to fire Disney's president. Surprisingly, the court spends only two pages of its forty-eight-page decision addressing this question.⁵ 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.⁶ The Sarbanes-Oxley Act, stock exchange rules, and scores of court opinions laud the vigilant presence of independent directors as a check-and-balance on corporate insiders.⁷ With this framework in mind, the importance of the Delaware Supreme Court's oversight becomes evident: To what degree will the positive role that independent

gross negligence to show lack 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 (2007) (discussing the business judgment rule and the duty of good faith).

⁵ See 906 A.2d at 68-70. In fact, only one West Key Note is devoted to this issue: see *id.* at 68 (West Key Note 31).

⁶ See, e.g., *Corporate Accountability Hearing*, 148 CONG. REC. E. 1470, 1475 (2002) (statement of Lynn Turner, former Chief Accountant, SEC) ("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."); *Conference Report on H.R. 3763, Sarbanes-Oxley Act of 2002*, 148 CONG. REC. H5462 (2002); Executive Compensation and Related Person Disclosure, Securities Act Release No. 8732A, Exchange Act Release No. 54302A, 71 Fed. Reg. 53,158 (Sept. 8, 2006).

⁷ See Securities Exchange Act of 1934 § 10A(m)(3)(A), 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 majority independence on the board of directors). See, e.g., *Stone v. Ritter*, 911 A.2d 362, 366-367 (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, 955 (Del. 1985) (discussing the importance of director independence in the decision to use defensive tactics in the corporate takeover context).

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,⁸ this decision in practical effect gives undue deference to extraordinary unilateral actions implemented by dominant CEOs.

II. THE MAGIC KINGDOM: OVITZ, EISNER & DISNEY

For our purposes here, the *Disney* saga tragically begins with the death in April 1994 of Frank Wells, the then-president and chief operating officer of the Walt Disney Company (“Disney”), in a helicopter crash.⁹ 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.¹⁰ Eisner looked to his long-time friend Michael Ovitz, founder of Creative Artist Agency (“CAA”) and “one of the most powerful figures in Hollywood.”¹¹

⁸ See, e.g., *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). 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).

⁹ *In re the Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 699 (Del. Ch. 2005), *aff’d*, 906 A.2d 27, 35 (Del. 2006).

¹⁰ See Bernard Weinraub, *Down, But Probably Not Out, in Hollywood: Despite His Defeat in Disneyland, Ovitz Remains a Force to Reckon With*, N.Y. TIMES, Dec. 14, 1995, at A35; see also 907 A.2d at 699; Gold, *supra* note 4, at 410.

¹¹ 907 A.2d at 701; see also Gold, *supra* note 4, at 410-11.

At the time, Ovitz was involved in discussions with Music Corporation of America (“MCA”) to serve as chairman and CEO of MCA. The terms being negotiated offered Ovitz 3.5% of MCA, \$1.5 million in Seagram shares, and a seven-year contract, with a renewal option, that paid a seven-figure salary with performance-based cash bonuses.¹² For various reasons, however, no agreement was consummated,¹³ and Ovitz returned to CAA until he learned that his close friend and associate at CAA was leaving for MCA.¹⁴

At this point, Eisner and Irwin Russell, the chairman of Disney’s compensation committee, more aggressively pursued negotiations with Ovitz. 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.”¹⁵ 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 their relation would be similar to a “partnership.”¹⁶ 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

¹² 907 A.2d at 701; see generally Hubert B. Herring, *Earning It: Michael Ovitz: The 5 Million Option Man at Disney*, N.Y. TIMES, Nov. 26, 1995, § 3, at 10.

¹³ JAMES B. STEWART, *DISNEY WAR 199-200* (Simon & Schuster 2005).

¹⁴ 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 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 13, at 202.

¹⁵ 907 A.2d at 702; see also STEWART, *supra* note 13, at 213.

¹⁶ Weinraub, *supra* note 10, at A35; STEWART, *supra* note 13, at 212-13; see also 907 A.2d at 703.

\$23.6 million per year, with a two-year renewal option that would raise the estimated value to \$24.1 million per year.¹⁷

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.¹⁸ At that meeting, the compensation committee unanimously approved the general terms of the agreement.¹⁹ At subsequent executive and regular sessions of the board of directors, the board deliberated further, voting unanimously to hire Ovitz as president. The compensation committee 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.²⁰

The terms of the employment agreement consisted of an annual salary of \$1 million and a performance-based discretionary bonus. The agreement also included two tranches of stock options that would provide Ovitz downside protection. The contract contained a five-year term, with an extension and renewal option. Finally, both parties were protected from premature termination of the employment agreement.²¹ 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.²² More importantly for the purposes of this article, if

¹⁷ 907 A.2d at 706.

¹⁸ 906 A.2d at 40; *see also* Edwin W. Hecker, Jr., *Fiduciary Duties in Business Entities*, 54 KAN. L. REV. 975, 997 (2006).

¹⁹ 907 A.2d at 708-09; Gold, *supra* note 4, at 412.

²⁰ 906 A.2d at 41; 907 A.2d at 710-11.

²¹ 907 A.2d at 703, 705; *see also* STEWART, *supra* note 13, at 218-19.

²² 907 A.2d at 704; *see* STEWART, *supra* note 13, 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* 907 A.2d at 704 n.32.

Disney terminated Ovitz “for any reason other than gross negligence or malfeasance,” then the resulting non-fault payment would include (i) Ovitz’s remaining salary, (ii) \$7.5 million per year for unaccrued bonuses, (iii) “the immediate vesting of his first tranche of options[, (iv)] and a \$10 million cash out payment for the second tranche of options.”²³ 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.²⁴ 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.²⁵ Unfortunately for Disney, the deal with Sony was never consummated, and Ovitz remained at Disney. At the next board meeting, Eisner’s dissatisfaction with Ovitz’s performance and desire to terminate him was never formally discussed. However, Eisner personally informed a majority of the directors about the emerging “Ovitz problem.”²⁶

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

²³ 907 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).

²⁴ 906 A.2d at 42; *see also* Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 IOWA J. CORP. L. 625, 651 (2004).

²⁵ Bernard Weinraub, *Ovitz, Hollywood Power Broker, Resigns from No. 2 Job at Disney*, N.Y. TIMES, Dec. 13, 1996, at A1; STEWART, *supra* note 13, at 258, 264-65; 907 A.2d at 724-25.

²⁶ Eisner and several board members testified that Ovitz had discussed with a majority of the corporate directors the problems with Ovitz’s performance as president. 907 A.2d at 726. Note that informal discussion among directors does not a board meeting make. This point is discussed further below. *See infra* note 97 and accompanying text.

longer welcome at Disney and that his future with the company was doubtful.²⁷ 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.²⁸ 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.²⁹ At the next board meeting, Ovitz's termination was not discussed in full session with the board. Indeed, although "[b]y then the board knew that Ovitz was going to be fired," the board in fact re-nominated him to another three-year term on the board.³⁰ At the executive session that followed the meeting, Eisner informed those directors present that he intended to fire Ovitz in the near future.³¹

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. Ovitz met with Eisner and, through Russell (who served as chair of Disney's compensation committee), began negotiating his departure from Disney. Eventually, Eisner met with Ovitz at Eisner's mother's apartment, where he informed Ovitz that he was being

²⁷ 907 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 13, at 264-68. These letters conveyed Eisner's dissatisfaction with Ovitz, including his distaste for Ovitz's personality and leadership skills at Disney. *See* 907 A.2d at 725-29.

²⁸ STEWART, *supra* note 13, at 273; 907 A.2d at 728; Ben White, *Eisner Denies Seeing Ovitz as Threatening: CEO Says He Relied on Legal Adviser*, WASH. POST, Nov. 18, 2004, at E3.

²⁹ Under the terms of the employment agreement, cause was limited to gross negligence and malfeasance. *See supra* notes 21-23 and accompanying text; Gold, *supra* note 4, at 411.

³⁰ 906 A.2d at 44.

³¹ 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.*

terminated without cause and would therefore receive his contractual not-for-cause termination compensation of almost \$130 million.³² 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, 1996.³³ As the Delaware Supreme Court observed, “[t]he board was not shown the [December 12] letter, nor did it meet to approve its terms.”³⁴ On December 12, 1996, Disney issued a press release disclosing the termination, which it disseminated to its board of directors.³⁵ 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.”³⁶ In fact, the full board did not convene again until January 27, 1997, almost a week after several shareholders filed their lawsuits.³⁷

III. 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. 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

³² 907 A.2d at 732, 734; STEWART, *supra* note 13, at 274.

³³ STEWART, *supra* note 13, at 274-75; 906 A.2d at 45.

³⁴ 906 A.2d at 45.

³⁵ See Paul Farhi, *Ovitz Departs Disney after 16 Months*, WASH. POST, Dec. 13, 1996, D1; *id.* at 735; see also STEWART, *supra* note 13, at 276.

³⁶ 907 A.2d at 736; see also 906 A.2d at 45.

³⁷ 907 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 the Walt Disney Co. Derivative Litig.*, Consolidated C.A. No. 15452, 1997 Del. Ch. LEXIS 25 (Mar. 13, 1997).

terminate Ovitz. The Delaware Supreme Court dedicated only two pages of its forty-eight-page opinion to discussion of this subject,³⁸ despite the fact that this issue was critical when considering not only plaintiffs' claims, but also the wider implications impacting Delaware corporate governance.

A. Following the Leader: The Supreme Court's Analysis

The Delaware Supreme Court begins 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."³⁹ Article IV of the company's bylaws states 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."⁴⁰ 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.⁴¹

The Supreme Court next suggests two hypothetical cases in which a clear answer would exist.⁴² 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

³⁸ *Brehm v. Eisner (In re the Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 68-70 (Del. 2006).

³⁹ *Id.* at 68-70 (Del. 2006).

⁴⁰ *Id.*; *see also* Amended and Restated Bylaws of the Walt Disney Company, *available at* <http://corporate.disney.go.com/media/corporate/DisneyBylaws.pdf>.

⁴¹ 906 A.2d at 68-69.

⁴² *Id.* at 68.

board.⁴³ Thus, “absent an express delegation of authority from the board, the presiding officer would ... not have a concurrent removal power.”⁴⁴ 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. The court overlooks that, under settled principles of corporate governance, a mere board resolution cannot override or contradict the subject company’s bylaws or certificate of incorporation.⁴⁵ 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.⁴⁶

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.”⁴⁷ According to the 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.”⁴⁸

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

⁴³ *Id.* at 69.

⁴⁴ *Id.*

⁴⁵ 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, *LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* § 15 (3d ed. 1983).

⁴⁶ See *infra* notes 147-54 and accompanying text.

⁴⁷ 906 A.2d at 69.

⁴⁸ *Id.*

whether Eisner had concurrent power with the board of directors to remove officers. 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.”⁴⁹ 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.⁵⁰ The court therefore found that “Eisner possessed, and exercised, the power to terminate Ovitz unilaterally.”⁵¹ This holding follows from an analysis that seemingly considers 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.⁵² At no point in its analysis does 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 declines sufficiently to do so. Rather, the court proceeds to consider extrinsic evidence under the guise of “rules of construction.”⁵³

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

⁴⁹ *Id.*

⁵⁰ *Id.* at 69-70.

⁵¹ *Id.* at 70.

⁵² The court refers to the testimony of several board members and General Counsel Sanford Litvack. *Id.* at 69-70.

⁵³ *See id.* at 69.

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.”⁵⁴ This language describes the authority of the board over officers’ tenures and duties. Officers are to hold their offices “for such terms” as are determined “solely” by the board of directors. Thus, the court reads this statement and applies “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.”⁵⁵

The Delaware Supreme Court accordingly adheres 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.⁵⁶ Unfortunately, the court expends 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

⁵⁴ *Id.* at 68.

⁵⁵ *Id.* Although the chancery court opinion does not explicitly address this issue, Chancellor Chandler reads the certificate of incorporation and the bylaws, as well as the board resolution electing Ovitz as president, to create a concurrent power of removal. 907 A.2d at 774. The chancellor relies on the language of the documents, the custom and practice of Disney, and the “implied authority” of the chief executive officer 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 board authority narrowly, consequently broadening the powers of the chief executive officer.

⁵⁶ 906 A.2d at 69.

of Directors to remove any officer”⁵⁷ 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.”⁵⁸ 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 apply.

In general, punctuation may be employed as an aid in construing a contract.⁵⁹ However, “when construing the meaning of contractual terms, [the court] 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.”⁶⁰ Indeed, the U.S. 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.”⁶¹ Hence, in the context of statutory interpretation, punctuation may not necessarily be decisive in determining the meaning of the statute.⁶²

⁵⁷ *Id.* at 68.

⁵⁸ *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).

⁵⁹ *Plymouth Mut. Life Ins. Co. v. Ill. Mid-Continent Life Ins. Co. of Chicago, 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 F.3d 338, 348 n.10 (3d Cir. 1999).

⁶⁰ *Interim Healthcare, Inc. v. Spherion Corp.*, 884 A.2d 513, 555 (Del. Super. Ct. 2005) (internal quotations and citations omitted); *see generally Levy v. Hayes Lemmerz Int’l, Inc.*, 2007 Del. Ch. LEXIS 68, *28 (Del. Ch. 2007).

⁶¹ *Ewing’s Lessee v. Burnet*, 36 U.S. 41, 54 (1837); *In re W.T. Grant Co.*, 4 B.R. 53, 71 (Bankr. S.D.N.Y. 1980).

⁶² *See, e.g., Costanzo v. Tillinghast*, 287 U.S. 341, 344 (1932); *United States v. Morris*, 928 F.2d 504, 507 (2d Cir. 1991).

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.”⁶³ This rule presumes that the intent of the parties is to be determined by giving the contract terms “their ordinary meaning” and that such meaning “should not be ‘torture[d]’ to impart ambiguity where none exists.”⁶⁴ Thus, the court’s cavalier treatment of this issue is troubling. Clearly, the court should have been more circumspect to ensure that its

⁶³ *Med. Wind Down Holdings III, Inc. v. InnerDyne, Inc.*, 332 B.R. 98, 104 (Bankr. D. Del. 2005) (internal quotations, citations, and emphasis omitted). *See generally* *Ingram v. Thorpe*, 747 A.2d 545, 547 (Del. 2000) (discussing the plain meaning rule as applied to statutes); *Sanders v. Wang*, 24 Empl. Benefits Cas. (BNA) 1924, 1999 Del. Ch. LEXIS 203 (Del. Ch. 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*, 24 Empl. Benefits Cas. (BNA), 1999 Del. Ch. LEXIS 203 at *18.

⁶⁴ *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).

seemingly casual finding of ambiguity in the terms of the certificate of incorporation did not create an ambiguity where in fact none existed.⁶⁵ According to Delaware’s “plain meaning” theory of contract construction, however, the court should not resort to use of extrinsic evidence if the contract terms are unambiguous.⁶⁶

The court next seeks 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.”⁶⁷ Taken together, the court finds 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.⁶⁸ 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 bylaws⁶⁹ 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

⁶⁵ 906 A.2d at 69.

⁶⁶ See *MBIA Ins. Corp.*, 426 F.3d at 210; *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997).

⁶⁷ 906 A.2d at 68; see Amended and Restated Bylaws of the Walt Disney Company, available at <http://corporate.disney.go.com/media/corporate/DisneyBylaws.pdf>.

⁶⁸ 906 A.2d at 68-69.

⁶⁹ More specifically, Article Tenth of Disney’s certificate of incorporation and Article IV of the company’s bylaws.

for assistance through certain well-established legal rules of construction.”⁷⁰ 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 powers or the rights or powers of its stockholders, directors, officers or employees.”⁷¹ This statute therefore 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.⁷² Indeed, a corporation’s bylaws may never contradict the corporation’s certificate of incorporation.⁷³ 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.

It would therefore be error to read Disney’s bylaws as inconsistent with the certificate of incorporation. Thus, 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

⁷⁰ *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).

⁷¹ DEL. CODE ANN. tit. 8, § 109(b) (2007).

⁷² “Where a by-law provision is in conflict with a provision of the charter, the by-law provision is a ‘nullity.’” *Centaur Partners, IV v. Nat’l Intergroup, Inc.*, 582 A.2d 923, 929 (Del. 1990). *See, e.g., Burr v. Burr Corp.*, 291 A.2d 409, 410 (Del. Ch. 1972); DELAWARE CORPORATION LAW AND PRACTICE § 9.03 (2006).

⁷³ *See* DEL. CODE ANN. tit. 8, § 109(b); *see also Oberly v. Kirby*, 592 A.2d 445, 458 n.6 (Del. 1991).

render the bylaw provision a nullity.⁷⁴ 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,⁷⁵ they should not be read to create an ambiguity in the terms of Disney’s governing documents.

C. The “Bare Necessities” of the Board: Delegation, Abdication, & Sterilization

Even more fundamental, however, is that the certificate of incorporation of a company cannot contradict Delaware General Corporation Law.⁷⁶ The law therefore 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.”⁷⁷ 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.⁷⁸ Clearly, it is the subject corporation’s board of directors, rather than its executive officers, that has ultimate

⁷⁴ See *Centaur Partners, IV*, 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 intent of the meaning of the certificate of incorporation. See generally FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 4190 (2007).

⁷⁵ See DEL. CODE ANN. tit. 8, § 109(b) (providing that “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 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 § 109(b) is subject to the limitation that “bylaws may not conflict with law or the certificate of incorporation”).

⁷⁶ *Gaskill v. Gladys Belle Oil Co.*, 146 A. 337, 340 (Del. Ch. 1929); HENN & ALEXANDER, *supra* note 45, § 15.

⁷⁷ *Gaskill*, 146 A. at 340; *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 45, § 15 (recognizing the “substatutory intracorporate hierarchy of provisions, in the form of articles of incorporation, bylaws, shareholder resolutions, and board of directors resolutions”).

⁷⁸ 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 generally, *Olson Bros., Inc. v. Englehart*, 211 A.2d 610 (Del. Ch. 1965).

responsibility for overseeing the corporation.⁷⁹ 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. When delegation occurs, it is customary for the board to delegate such authority to officers, who act as agents of the corporation.⁸⁰ Generally, the officers of the corporation are agents whose actions within the scope of their authority can bind the corporation to third parties.⁸¹ While this power to delegate is broad, certain limits apply. Specifically, corporate directors may not delegate duties that “lie ‘at the heart of the management of the corporation.’”⁸²

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.⁸³ The board of directors may not “avoid its active and direct duty of oversight.”⁸⁴ Lack of such directorial oversight “irremediably taints the

⁷⁹ *Grimes v. Donald*, 673 A.2d 1207, 1214 (Del. 1996); *In re Bally’s Grand Derivative Litig.*, Consol. C.A. No. 14644, 1997 Del. Ch. LEXIS 77 (Del. Ch. June 4, 1997), slip op. at 16; R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS* § 4.17 (Aspen 2002).

⁸⁰ BALOTTI & FINKELSTEIN, *supra* note 79, at § 4.16.

⁸¹ *DELAWARE CORPORATION LAW AND PRACTICE* § 14.02 (2006); *FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS* § 434 (2007); *FOLK ON DELAWARE CORPORATION LAW* § 142.6 (2001) [hereinafter *FOLK*].

⁸² *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)).

⁸³ 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.” *FOLK*, *supra* note 81, § 141. *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 953-54 (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 and effectiveness, and the defensive tactic was reasonable in relation to the threat posed).

⁸⁴ *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1281 (Del. 1989) (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 v. Ritter*, 911 A.2d 363, 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”); *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”).

design and execution of the transaction.”⁸⁵ 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 concept of board “sterilization” is related as well to delegation of authority. For example, the New York Court of Appeals articulated the concept of sterilization in *Long Park, Inc. v. Trenton-New Brunswick Theaters Co.*⁸⁶ There, the shareholders entered into an agreement in which the management and supervision of the corporation was vested in a “manager.” 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. 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.”⁸⁷ In reaching its decision, the court concluded that the powers of the board of directors were “completely sterilized.”⁸⁸ This decision highlights the relationship between sterilization, abdication, and the non-delegation of certain functions of the board of directors.

⁸⁵ *Id.* at 1280-81 (discussing the directors’ breaches of fiduciary duties in relation to a sale of control).

⁸⁶ 77 N.E.2d 633 (N.Y. 1948).

⁸⁷ *Id.* at 633-35. *Accord* DEL. CODE ANN. tit. 8, § 141(a) (2007) (providing that the “business and affairs of every corporation ... shall be managed by or under the direction of a board of directors”).

⁸⁸ *Long Park, Inc.*, 77 N.E.2d at 635; *see also* *Triggs v. Triggs*, 385 N.E.2d 1254 (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).

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.”⁸⁹ Delaware courts hold that such delegation is an “abdication” of directorial authority.⁹⁰ 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,⁹¹ while in abdication, the analysis generally focuses on action or inaction by the board of directors itself.⁹² In this respect, query whether the Disney board of directors abdicated its essential statutory duties.

As of December 12, 1996, the date on which Eisner, Litvack, and Ovitz memorialized the termination, the fact-finder found that “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.”⁹³ 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.”⁹⁴ Such inaction regarding the termination and

⁸⁹ FOLK, *supra* note 81, at § 141 (relying on *Chapin v. Benwood Found., Inc.*, 402 A.2d 1205, 1210 (Del. Ch. 1979)); *see also In re Bally’s Grand Derivative Litig.*, Consol. C.A. No. 14644, 1997 Del. Ch. LEXIS 77, at *12-13 (Del. Ch. June 4, 1997); 1-4 CORPORATE GOVERNANCE: LAW AND PRACTICE § 4.01 (Bart Schwartz & Amy L. Goodman, eds., 2007).

⁹⁰ *See id.*; *see also Grimes v. Donald*, 673 A.2d 1207 (Del. 1996); DELAWARE CORPORATION LAW AND PRACTICE § 13.01 (2006).

⁹¹ *See Long Park, Inc.*, 77 N.E.2d at 634; *see also Manson v. Curtis*, 119 N.E. 559, 562 (N.Y. 1919).

⁹² *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).

⁹³ *In re the Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 736 (Del. Ch. 2005), *aff’d*, 906 A.2d 27, 35 (Del. 2006).

⁹⁴ 907 A.2d at 736.

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,⁹⁵ 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"⁹⁶ 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."⁹⁷ Thus, Eisner's attempts to personally 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 & 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

⁹⁵ See DEL. CODE ANN. tit. 8, § 141(c) (2007).

⁹⁶ STEWART, *supra* note 13, at 212.

⁹⁷ Fogel v. U.S. Energy Sys., Inc., C.A. No. 3271-CC, 2007 Del. Ch. LEXIS 178, at *7 (Dec. 13, 2007) (citing Box v. Box, C.A. No. 14238, 1996 Del. Ch. LEXIS 16, at *14-15). In *Fogel*, the court found that the corporation never actually held a meeting to terminate its chief executive officer, and thus any action taken during a purported meeting to terminate the CEO was void. See *id.* at *13. The court in *Fogel* noted that "[s]imply 'polling board members does not constitute a valid meeting or effective corporate action.'" *Id.* at *7 (citations omitted). The facts of *Disney* thus bear close similarity to the situation in *Fogel*. For example, Eisner testified that he had personally discussed terminating Ovitz with several board members, but failed to address the matter formally at a duly-convened meeting of the full board. See *supra* note 26 and accompanying text. Under the principles recently articulated in *Fogel*, such informal discussions should *not* be considered valid action by the board of directors.

officer under the scope of agency law. Remarkably, this issue was never addressed by the Delaware Supreme Court. 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.⁹⁸

The Third Restatement 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.”⁹⁹ 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.¹⁰⁰ 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 manifestations and objectives when the agent determines how to act.”¹⁰¹ 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.

⁹⁸ See, e.g., *Gumpert v. Bon Ami Co.*, 251 F.2d 735, 738-739 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, 1211 (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 (Iowa 1977) (finding that a corporate agent lacked express, implied, apparent, and inherent power to bind the corporation to a real estate transaction).

⁹⁹ RESTATEMENT (THIRD) OF AGENCY § 2.01 [hereinafter AGENCY THIRD]; see generally 3 AM. JUR. 2D Agency § 70.

¹⁰⁰ 3 AM. JUR. 2D Agency § 70; AGENCY THIRD, *supra* note 99, § 2.01 cmt. b; see generally *Billops v. Magness Constr. Co.*, 391 A.2d 196, 197 (Del. 1978).

¹⁰¹ AGENCY THIRD, *supra* note 99, § 2.02; see generally *Guyer v. Haveg Corp.*, 205 A.2d 176, 180 (Del. Super. Ct. 1964).

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.¹⁰² 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.¹⁰³ 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. Apparent authority may be 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.”¹⁰⁴ 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.” Apparent authority therefore does not require manifestations between the principal and the agent,

¹⁰² AGENCY THIRD, *supra* note 99, § 3.01 cmt. b.

¹⁰³ 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. 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* notes 78-97 and accompanying text; for a discussion of what is “ordinary” and “extraordinary,” see *infra* notes 122-44 and accompanying text.

¹⁰⁴ *Id.* § 2.03; see *Billops*, 391 A.2d at 198; 3 AM. JUR. 2D *Agency* § 76.

just “expressive conduct” between the principal and the third party.¹⁰⁵ Indeed, an agent acting solely with apparent authority lacks actual authority.¹⁰⁶

Inherent authority is a concept that is somewhat related to apparent authority. The Third Restatement 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*).¹⁰⁷

Despite the Third Restatement’s perspective, the doctrine of inherent authority has been analyzed for decades, if not centuries, in U.S. case law.¹⁰⁸ Accordingly, this article will examine inherent authority as articulated by the Second Restatement and the courts. Under the Second Restatement 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.”¹⁰⁹

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.¹¹⁰ This difficulty in application of those two broad principles of agency is one (of the many) reasons why the Third Restatement elects to abolish the

¹⁰⁵ AGENCY THIRD, *supra* note 99, § 3.03 cmt. b; *see generally* Finnegan Constr. Co. v. Robino-Ladd Co., 354 A.2d 142, 144-45 (Del. Super. Ct. 1976).

¹⁰⁶ *See* 3 AM. JUR. 2D Agency § 75; AGENCY THIRD, *supra* note 99, § 2.03 cmt. b; *see also* *In re Mulco Prods., Inc.*, 123 A.2d 95, 103 (Del. Super. Ct. 1956).

¹⁰⁷ *See* 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 (2005); AGENCY THIRD, *supra* note 99, § 2.01 introductory note.

¹⁰⁸ *See, e.g., Gumpert*, 251 F.2d at 738-39; *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); *Newberry*, 252 N.W.2d at 714; *Fidelity & Cas. Co. of N.Y. v. Carroll*, 117 N.E. 858 (Ind. 1917) (discussing the agency inherent in certain corporate offices).

¹⁰⁹ RESTATEMENT (SECOND) OF AGENCY § 8A (1958); *see also* *Menard, Inc. v. Dage-MTI, Inc.*, 726 N.E.2d 1206, 1211 (Ind. 2000).

¹¹⁰ Crespi, *supra* note 107, at 354.

use of the term “inherent” authority.¹¹¹ Because of the difficulty in separating these two concepts, they will be considered together (along with what is often called “implied”¹¹² authority).

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.*,¹¹³ for example, the Indiana Supreme Court found that inherent authority bound a corporation to a contract executed by its president. In *Menard*, the court held that an agent acts with inherent authority when engaging in transactions that usually accompany or are incidental to transactions which that agent is authorized to conduct, provided the third party reasonably believes that the agent is authorized and has no notice to the contrary.¹¹⁴ 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 [in which he was] authorized to conduct.”¹¹⁵

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.”¹¹⁶ Stated conversely, acts which are extraordinary in nature are outside the bounds of an executive’s

¹¹¹ See *id.*; see also AGENCY THIRD, *supra* note 99, §§ 1.03, 2.01 introductory note.

¹¹² Some courts consider implied and inherent authority as similar concepts. See AGENCY THIRD, *supra* note 99, § 2.01.

¹¹³ *Menard, Inc. v. Dage-MTI, Inc.*, 726 N.E.2d 1206 (Ind. 2000).

¹¹⁴ *Id.* at 1212.

¹¹⁵ *Id.* (citations and quotations omitted).

¹¹⁶ FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 559 (2007). Thus, “the president of a corporation has no apparent authority to bind the corporation to an unusual, extraordinary, or unreasonable contract.” *Id.* § 592.

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.”¹¹⁷ References to the “president,” for the purposes of this discussion, therefore, will not be intended to refer to Ovitz, but rather Eisner, as the chief executive officer of Disney.

Under Delaware law, a chief executive officer of a corporation may engage in ordinary¹¹⁸ acts which are incident to his office, 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.”¹¹⁹ These powers inhere to the chief executive as a result of her position as such. As has already been discussed, however, these powers of the chief executive are not without limit under Delaware law.¹²⁰ Implicit in this analysis, therefore, is the concept that an agent’s authority may not exceed the “legitimate scope” of what is necessary to perform the agent’s delegated duties.¹²¹

¹¹⁷ 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.”)

¹¹⁸ It is “reasonable to assume that the general manager of a corporation may make contracts in the ordinary course of business.” *Canister Co. v. Nat’l Can Corp.*, 63 F. Supp. 361, 367 (D. Del. 1945).

¹¹⁹ *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. v. Hannigan*, 14 A.2d 401, 406 (Del. 1940).

¹²⁰ For example, 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. *Atl. Ref. Co. v. Ingalls & Co.*, 185 A. 885, 886 (Del. Super. Ct. 1936). In addition, a corporate president has “no implied or inherent power” to consent to the appointment of a receiver to wind-up the corporation’s affairs. *Bruch v. Nat’l Guar. Credit Corp.*, 116 A. 738, 740 (Del. Ch. 1922). Also, execution of a contract which 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.” *Andrew Jergens Co. v. Woodbury, Inc.*, 273 F. 952, 962 (D. Del. 1921).

¹²¹ *Kolcum v. Bd. of Educ.*, 335 A.2d 618, 623 (Del. Super. Ct. 1975); *see generally Amtower v. Hercules Inc.*, C.A. No. 97C-09-018 WTQ, 1999 Del. Super. LEXIS 107, at *31 (Feb. 26, 1999).

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.¹²² 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.¹²³

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.¹²⁴ It is interesting that the chancellor refers to the Disney *board’s* decision as “extraordinary,” a decision that in fact was made by CEO Eisner. Also, in this casual reference to the payment, the chancellor chooses to use the word “extraordinary” to describe the determination. 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 \$35.510 billion in revenues and \$4.687 billion in net income.¹²⁵ Based

¹²² Even “if an officer is also a general manager ... [with powers] which are markedly broader than the inherent powers of a president or other officer,” those powers still have limits. *FOLK*, *supra* note 81, at § 142.6. Although general managers are considered to possess broad powers, they still have “no implied authority to enter into this unusual and extraordinary contract.” *Colish v. Brandywine Raceway Ass’n*, 119 A.2d 887, 891 (Del. Super. Ct. 1955).

¹²³ *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); *DELAWARE CORPORATION LAW AND PRACTICE* § 14.02 (2006).

¹²⁴ *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).

¹²⁵ *The Walt Disney Co.*, Annual Report (Form 10-K), at 31-32 (Sept. 29, 2007).

upon these financial figures, it is clear that Disney is a huge corporation, ranking sixty-fourth on the Fortune 500 list.¹²⁶ 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 employment and termination seem small.¹²⁷ 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.¹²⁸ Significantly, although Chancellor Chandler recognizes the overall size of the corporation relative to the payment, he still describes the severance package as "extraordinary."¹²⁹

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 (the "SEC") has promulgated Staff Accounting Bulletin 99 ("SAB 99").¹³⁰ Under SAB 99, the SEC staff advised that both the "quantitative" and the "qualitative" aspects of an item must be evaluated.¹³¹ Also, as observed by a federal appellate court, in ascertaining whether a transaction is extraordinary, "a payment

¹²⁶ *Largest U.S. Corporations*, FORTUNE, Apr. 20, 2007, at 210.

¹²⁷ 907 A.2d at 768, n.533.

¹²⁸ See, e.g., Staff Accounting Bulletin 99, 17 C.F.R. pt. 211 subpt. B, 64 Fed. Reg. 45,150 (Aug. 19, 1999); *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).

¹²⁹ 731 A.2d at 350.

¹³⁰ Staff Accounting Bulletin 99, 64 Fed. Reg. at 45,150. See generally *In re 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).

¹³¹ 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 according on both quantitative and qualitative factors); see also *In re Huntington Bancshares, Inc.*, Securities Act Release No. 8579, Exchange Act Release No. 51,781 (June 2, 2005) (noting that materiality analysis for financial misstatements under SAB 99 requires an analysis of both quantitative and qualitative factors).

made by a company that would otherwise be unremarkable may be rendered extraordinary by unusual circumstances.”¹³² 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.”¹³³ 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 “context-specific” factors for determining extraordinariness under the Sarbanes-Oxley Act.¹³⁴ 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 one percent of Disney’s assets and income.¹³⁵ Chancellor Chandler reflected on this small percentage.¹³⁶ Under a qualitative measure, however, a different rationale comes into play. Exorbitant termination severance payments to the president of a Fortune 100 company¹³⁷ may potentially cause havoc to a company’s market following, particularly

¹³² Sec. & Exch. Comm’n v. Gemstar-TV Guide Int’l, Inc., 401 F.3d 1031, 1045 (9th Cir. 2005), *cert. denied sub nom.* Yuen v. Sec. & Exch. Comm’n, 546 U.S. 933 (2005); *see also Ganino*, 228 F.3d at 163-64.

¹³³ 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).

¹³⁴ *Gemstar-TV Guide Int’l, Inc.*, 401 F.3d at 1045. For literature on the Sarbanes-Oxley Act, *see, e.g.*, J.W. BOSTELMAN, *THE SARBANES-OXLEY DESKBOOK* (2005); MARC I. STEINBERG, *ATTORNEY LIABILITY AFTER SARBANES-OXLEY* (2007); Joseph Morrissey, *Catching the Culprits: Is Sarbanes-Oxley Enough?*, 2003 COLUM. BUS. L. REV. 801 (2003).

¹³⁵ Disney reported assets of almost \$61 billion in 2007 and net income of \$4.687 billion. The Walt Disney Co., Annual Report (Form 10-K), at 31-32 (Sept. 29, 2007)

¹³⁶ 907 A.2d at 768 n.533

¹³⁷ In 2007, Disney ranked 64 on the Fortune 500. *See Largest U.S. Corporations*, FORTUNE, Apr. 20, 2007, at 210.

institutional shareholders who are concerned with vibrant corporate governance standards.¹³⁸ 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.”¹³⁹ 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.”¹⁴⁰ 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.¹⁴¹

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-

¹³⁸ See Paul Farhi, *Disney’s Dizzying Bonus Approved for CEO Eisner: Dissenters Protest ‘Lucrative’ Package at Shareholder Meeting*, WASH. POST, Feb. 26, 1997, at C11; *A Vote Against Disney*, N.Y. TIMES, Feb. 25, 1997, at B7; Bruce Orwall & Joann S. Lublin, *Entertainment: The Rich Rewards of a Hollywood Exit*, WALL ST. J., Dec. 16, 1996, at B1.

¹³⁹ *Gemstar-TV Guide Int’l, Inc.*, 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).

¹⁴⁰ *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. These payments, occurring amidst accusations 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.* at 1037.

¹⁴¹ *Id.* at 1045-46.

million payment compensated Ovitz for fourteen months of work in the Disney presidency.¹⁴² 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.”¹⁴³ In fact, Ovitz’s not-for-cause termination amounted to “the equivalent of more than 5,000 weeks of salary after just over a year on the job.”¹⁴⁴ 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.”¹⁴⁵ 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?”¹⁴⁶ 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.”¹⁴⁷

¹⁴² *Brehm v. Eisner (In re the Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 35 (Del. 2006).

¹⁴³ Holman W. Jenkins, Jr., *Business World: Beavis and Butt-head Do the Disney Shareholders*, WALL ST. J., Jan. 7, 1997, at A17.

¹⁴⁴ Eric Dash, *Hire by the Contract Now, Risk a Big Regret Later*, N.Y. TIMES, Jan. 12, 2007, at C1.

¹⁴⁵ *In re the Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 761-62 (Del. Ch. 2005), *aff’d*, 906 A.2d 27, 35 (Del. 2006).

¹⁴⁶ A.M. Rosenthal, Editorial, *On My Mind; Hardtack for the Journey*, N.Y. TIMES, Dec. 17, 1996, at A25.

¹⁴⁷ AGENCY THIRD, *supra* note 99, § 4.01(1); *see also* *Lewis v. Vogelstein*, 699 A.2d 327, 334 (Del. Ch. 1997); *Hannigan v. Italo Petroleum Corp.*, 47 A.2d 169, 173 (Del. 1945).

Ratification thus serves to confirm the legitimacy of a prior act on behalf of the principal. In a related matter, estoppel refers to situations in which an actor's manifestations "induce[d] the third party to make a detrimental change in position."¹⁴⁸ When these manifestations have induced such detrimental reliance, the actor making the manifestations may be "estopped" from denying the transaction's validity.¹⁴⁹

The timing of the ratification is an important element of confirming authority.¹⁵⁰ 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.¹⁵¹ "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."¹⁵² 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

¹⁴⁸ AGENCY THIRD, *supra* note 99, § 4.08; *see also* McCabe v. Williams, 45 A.2d 503, 505 (Del. 1944).

¹⁴⁹ 3 AM. JUR. 2D Agency § 79; AGENCY THIRD, *supra* note 99, § 4.08; *see generally* Guyer v. Haveg Corp., 205 A.2d 176, 181 (Del. Super. Ct. 1964).

¹⁵⁰ AGENCY THIRD, *supra* note 99, § 4.05; *see generally* 3 AM. JUR. 2D Agency § 177.

¹⁵¹ *See* Brehm v. Eisner (*In re* the Walt Disney Co. Derivative Litig.), 906 A.2d 27, 69 (Del. 2006).

¹⁵² 18B AM. JUR. 2D Corporations § 1337 (2007) (emphasis added) (citing Stoneman v. Fox Film Corp., 4 N.E.2d 63 (Mass. 1936)).

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 other 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 "failing to object to it or to repudiate it."¹⁵³ Because the Disney board of directors declined to object to Ovitz's termination, the board, in all practicality, ratified the transaction. Indeed, many "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."¹⁵⁴

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

¹⁵³ 3 AM. JUR. 2D *Agency* § 193; AGENCY THIRD, *supra* note 99, § 4.01 cmt. f; *Law v. Cross*, 66 U.S. 533, 539 (1861).

¹⁵⁴ *In re the Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 736 (Del. Ch. 2005), *aff'd*, 906 A.2d 27, 35 (Del. 2006).

IV. A WHOLE NEW WORLD? IMPACT OF *DISNEY* ON GOOD GOVERNANCE & DIRECTOR INDEPENDENCE

In the current climate of corporate governance, great emphasis is placed on the concept of “independent” directors serving on corporate boards. In this regard, the major securities markets have rules requiring that all listed companies have a majority of independent directors.¹⁵⁵ 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.¹⁵⁶ 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.”¹⁵⁷ NYSE rules also require that the nominating/corporate governance committee, compensation committee, and the audit committee be comprised entirely of independent directors.¹⁵⁸ 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.¹⁵⁹ In addition, the NASDAQ rules require that the compensation committee and the audit committee be comprised solely of independent directors.¹⁶⁰

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

¹⁵⁵ ABA COMM. ON CORPORATE LAWS, CORPORATE DIRECTOR’S GUIDEBOOK 38 (5th ed. 2007) [hereinafter CORPORATE DIRECTOR’S GUIDEBOOK].

¹⁵⁶ NYSE, Inc., Listed Company Manual § 303A.01 (2003).

¹⁵⁷ *Id.* § 303A.01 cmt.

¹⁵⁸ *Id.* §§ 303A.04(a), 303A.05, 303A.07(b).

¹⁵⁹ NASDAQ, Inc., Manual Rule 4350(c) (2003).

¹⁶⁰ *Id.* Rule 4350(c)(3), (d). With respect to the Sarbanes-Oxley Act’s requirements in this regard, *see infra* notes 166-68 and accompanying text.

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 independence.¹⁶¹ In addition, the NSYE rules identify certain relationships that defeat independence. 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 \$100,000 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.¹⁶² Each of these disqualifications also implicates directors whose immediate family members meet such criteria.¹⁶³ NASDAQ rules contain similar requirements and tests for

¹⁶¹ NYSE, Inc., *supra* note 156, § 303A.02(a).

¹⁶² *Id.* § 303A.02(b).

¹⁶³ *Id.*

director independence.¹⁶⁴ Both stock exchanges also have rules requiring executive sessions to be attended by independent directors.¹⁶⁵

The Sarbanes-Oxley Act also contains requirements of independence. Under Sarbanes-Oxley, the audit committee of a publicly-held company must be comprised solely of independent directors.¹⁶⁶ 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 compensatory fee (other than director fees) from the company or is an affiliated person of the company or any of its subsidiaries.¹⁶⁷ “Affiliated persons” are defined generally to include those persons owning or controlling at least five percent of the outstanding stock of the company.¹⁶⁸

Furthermore, publicly-held companies must disclose in their annual proxy statements to their shareholders the names of the respective company’s independent directors, along with the

¹⁶⁴ 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 \$100,000 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., *supra* note 159, Rule 4200(a)(15).

¹⁶⁵ *See generally*, NYSE, Inc., *supra* note 156; NASDAQ, Inc., *supra* note 159. An executive session is a meeting of board directors at which only “independent” or “non-management” directors are present. NYSE, Inc., *supra* note 156, § 303A.03; NASDAQ, Inc., *supra* note 159, Manual Rule 4350(c)(2). Such executive sessions are designed to “promote open discussion” among independent directors. NYSE, Inc., *supra* note 156, § 303A.03 cmt.

¹⁶⁶ Securities Exchange Act of 1934 § 10A(m)(3)(A), 15 U.S.C. § 78j-1(m)(3)(A) (2006); *see also Public Company Accounting Reform and Investor Protection Act of 2002*, 148 CONG. REC. S6327, 6332 (July 8, 2002) (statement of Sen. Sarbanes).

¹⁶⁷ Securities Exchange Act of 1934 § 10A(m)(3)(B). *Accord* NASDAQ, Inc., *supra* note 159, Rule 4200(a)(15); NYSE, Inc., *supra* note 156, § 303A.02(b). For a discussion of the definition of independence under these stock exchange rules, see *supra* notes 161-64 and accompanying text.

¹⁶⁸ Securities Exchange Act of 1934 § 3(a)(19) (referring to 15 U.S.C. § 80a-2(a)(3)).

factors establishing each director's independence; in addition, the company must disclose any other information that it considered when making its independence determination.¹⁶⁹ Based upon these developments in the law, the Corporate Director's Guidebook¹⁷⁰ 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."¹⁷¹ Thus, director independence today "is a prevailing theme in corporate governance, if not always in corporate law."¹⁷² 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."¹⁷³ 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."¹⁷⁴ Sarbanes-Oxley, stock exchange rules, and court decisions have thus brought about many reforms; the impact of these

¹⁶⁹ CORPORATE DIRECTOR'S GUIDEBOOK, *supra* note 155, at 39.

¹⁷⁰ The Corporate Director's Guidebook is a guidebook published by the ABA Committee on Corporations. *See generally id.* at vii. The Committee on Corporations 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.

¹⁷¹ *Id.* at 38.

¹⁷² E. Norman Veasey & Christine T. DiGuglielmo, *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).

¹⁷³ *Id.* at 1406.

¹⁷⁴ 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. *See Williams address, Corporate Accountability*, at 26, before the Fifth Annual Securities Regulation Institute, San Diego, California (Jan. 18, 1978), cited in STEINBERG, *supra* note 8, at 20. *See generally* Ralph C. Ferrara & Marc I. Steinberg, *Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980).

reforms is to elevate the importance of the independent director in the corporate governance framework.¹⁷⁵

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.”¹⁷⁶ For example, in related party transactions, the role of disinterested directors in the quest to achieve fairness has been stressed.¹⁷⁷ In the shareholder derivative suit context, in ascertaining demand futility, Delaware courts examine the disinterestedness and independence of the subject directors.¹⁷⁸ 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.¹⁷⁹ Furthermore, in sale of control transactions, the Delaware Supreme Court has focused on the particularly critical role

¹⁷⁵ See, e.g., *id.* at 1539; *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).

¹⁷⁶ *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 647 (Del. Ch. 2005).

¹⁷⁷ 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 (Del. 1987) (referring to the importance of majority approval of disinterested directors for interested director transactions); *Weinberger v. UOP*, 457 A.2d 701 (Del. 1983) (discussing the general test of fairness that should be applied to related-party transactions).

¹⁷⁸ See, e.g., *Fagin v. Gilmartin*, 432 F.3d 276, 283 (3d Cir. 2005) (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, 366-367 (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 (Del. Ch. 2007) (finding that plaintiff had not pleaded facts with sufficient particularity to establish demand excusal).

¹⁷⁹ See, e.g., *Zapata Corp.*, 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).

that independent directors play, emphasizing the importance of independent directors in determining the good faith use of defensive measures in corporate takeovers.¹⁸⁰

With this current climate of corporate governance in mind, the wider implications of the *Disney* case become more apparent. This holding 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 chief executive officer 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 properly 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.¹⁸¹ 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.

¹⁸⁰ *Paramount Commc'ns*, 637 A.2d at 44; *Mills Acquisition Co.*, 559 A.2d at 1285; *Unocal Corp.*, 493 A.2d at 955.

¹⁸¹ See *supra* note 103 and accompanying text.

V. 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."¹⁸² This is ironic in the face of the 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.¹⁸³

¹⁸² *In re the Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 760 (Del. Ch. 2005), *aff'd*, 906 A.2d 27, 35 (Del. 2006).

¹⁸³ *Cf.* *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1982) (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) (2007). As has already been discussed, if the court truly wanted to avoid the specter of director liability, it could have done so by applying the doctrine of ratification. *See supra* notes 147-54 and accompanying text.

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.