

June 12, 2006

**Delaware Supreme Court Affirms Disney Case:
the Business Judgment Rule Prevails**

In a unanimous and masterful decision, the Delaware Supreme Court has affirmed the Court of Chancery's rejection of all the stockholder claims challenging the conduct of the Disney directors in the 1995 hiring and 1996 termination of Michael Ovitz (see our memorandum of August 10, 2005).

Justice Jacobs' opinion for the Court is a welcome demonstration that the Delaware courts remain unrattled by the on-going corporate governance debate on executive compensation, succession planning and severance. The opinion hews to settled and fundamental doctrine, and powerfully depicts how little the stockholders' challenges implicated any legal nuances but, rather, failed because under the Business Judgment Rule director decision-making is protected from second guessing by the presumption that the directors acted on an informed basis and in good faith — a presumption that can be overcome only by a factual showing that the directors breached their duties of care and loyalty or acted in bad faith. The opinion is welcome reassurance that the drumbeat of the stockholder activist and academia attacks will not change the fundamental protections that Delaware has always accorded director business decisions.

On the question of the directors' "duty of good faith," the Supreme Court rejected the argument that decision-making without adequate information and deliberation amounts to bad faith. Contrawise, the Court explained that "bad faith" could result from two different forms of behavior: activities motivated by an actual intent to do harm ("substantive bad faith"); or "intentional dereliction of duty, a conscious disregard for one's responsibilities." Importantly, the Court emphasized that gross negligence, even including failure to inform one's self of material facts, *cannot* constitute bad faith. The Court's discussion of the "duty of good faith" signals an effort to limit that concept, and prevent its wholesale employment as the key to unlock the long-standing protections afforded directors under Delaware law.

The Delaware Supreme Court's opinion closes a potentially worrisome chapter in the ongoing development of fiduciary duty law with a note that should be comforting to those concerned about the potential spill-over of the oft-rancorous corporate governance debates into the realm of legal rule and liability standards: that the Delaware courts remain steadfast in drawing the necessary distinctions between "best practices" and liability-producing behavior, and in eschewing what may sometimes seem the popular fix in favor of the well-tested legal doctrines that have encouraged risk-taking and creation of stockholder value. The opinion likewise reflects that the Delaware courts recognize the reality that the corporate boardroom is at times not a perfect laboratory or even a law school classroom.

M. Lipton
T.N. Mirvis
P.K. Rowe

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