February 2017

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CORPORATE GOVERNANCE GUIDELINES—A DELAWARE RESPONSE

Harvey Gelb*

INTRODUCTION

Institutional investors including private pension funds, public pension funds, investment companies, insurance companies, banks, and foundations hold a significant amount of all equities in the 1000 largest U.S. corporations.¹ This institutional ownership has set the stage for an increase in the shareholder role in the publicly held corporation.²

There is a corporate governance movement spearheaded by public-pension fund investors.³ Corporate governance aspirations of a num-

¹ MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 160 (8th ed. 2000).
² See id. at 161.
³ See generally id. at 162-63.

Much of the current institutional-shareholder activism in the United States has been led by public-pension funds. In part this is because public-pension funds have fewer ties to management than other types of institutional investors, and are therefore not as subject to conflict-of-interest problems. In part too, this activism is related to the fact that public-pension funds often follow indexation strategies. . . . Although public-pension
ber of pension fund investors comprehend a variety of subjects including
the orientation of new directors, board compensation, executive sessions
of outside directors, board independence, and a host of others. The pri-
mary focus in this article is on governance guidelines involving board
independence and director liability for breaches of fiduciary duty. It
deals with the judicial response of one of the nation’s most important
corporate law courts, the Delaware Supreme Court, to the quest of insti-
tutional investors for good governance practices. It considers the
chances of success in obtaining much help in attaining such practices
from state judicial or legislative sources and refers briefly to other possi-
bilities for achieving good governance goals.

I. CORPORATE GOVERNANCE GUIDELINES

A. Board and Committee Independence: Pension fund inves-
tors and others may consider it especially important for a corporation to
have independent directors in dominating numbers on its board of direc-
tors and certain board committees. For example, the California Public
Employees Retirement System (CalPERS) calls board independence the
cornerstone of accountability, and AFL-CIO Guidelines indicate that
directors select, monitor, and compensate management and therefore
should be independent. The benefit of independence is seen by con-
templating the alternative where board members and committee mem-
bers are cronies of, or dependent on, the Chief Executive Officer (CEO)
and management, and are unable to function effectively. To be more

Id.; See also id. at 158-66 (providing an excellent discussion of institutional investors,
social and legal forces affecting their role in corporate governance, possible constraints
on their activities, areas in which they can play a meaningful role, and forms that their
involvement in corporate governance might take).

4. See, e.g., HOLLY J. GREGORY, INTERNATIONAL COMPARISON OF CORPORATE
GOVERNANCE BEST PRACTICES: INVESTOR VIEWPOINTS, Table of contents i (2000).

5. CALIFORNIA PUBLIC EMPLOYEES’ RETIREMENT SYSTEM, U.S. CORPORATE
GOVERNANCE VEST PRACTICES AND GUIDELINES 7 (Core Principle III. A) (1998)
[herinafter CALPERS]. See also GREGORY, supra note 4, at 6.

6. INVESTING IN OUR FUTURE: AFL-CIO PROXY VOTING GUIDELINES, § IV.A.2.
(1997) [hereinafter ALF-CIO] (“In general, the voting fiduciary should support share-
holder proposals seeking to require that a majority of directors be independent. . . .
Board independence is critical so that directors may carry out their duties to select,
monitor and compensate management.”). See also GREGORY, supra note 4, at 6, 66.
specific, among the important roles for directors in the eyes of institutional investors are: selection, evaluation, dismissal, and succession of CEOs; resolution of CEO and management compensation issues; evaluation of management; and establishment of proper auditing and controls. There may and sometimes should be significant differences of perspective between the monitors and monitored, the evaluators and evaluated, and the compensators and compensated. In addition, the merits of takeover efforts aimed at their companies may generate conflicting views among management, directors, and investors. It is only natural that investors, who want directors to play an authentic role vis-a-vis the CEO and management, would not want cronies, rubber stamps or others dependent on CEOs to control boards and important committees. On the other hand, boards consisting primarily of independent directors may, within limits, provide advantages.

1) Checks and Balances: In America, we are accustomed to the advantages of a system of government with checks and balances and separation of powers. Borrowing from our highly successful, though sometimes frustrating government model, it can be seen that authentic checks and balances and separation of powers provide more accountability than cronyism, dependence, and passivity. Still the analogy to government should not be carried too far. Running a business need not become as adversarial, bitter or political as divided government.

2) Positive Contribution to the Board: Passive directors who lack independence may not provide much assistance to the CEO and management by way of insights and rational contributions to the prosperity of the business; active directors who are independent can feel more comfortable in challenging the ideas of management and offering fresh insights to the company. Admittedly, inside and dependent directors may have more knowledge about the company and be in an excellent position to offer their advice to management but, to the extent that they do not fear to do so, they can do so as a minority of directors or merely as employees rather than directors. If a board and committee are to have useful and authentic roles within the corporation, they should consist primarily of well-qualified and independent persons.

3) Personality and Character: Notwithstanding the independence of directors, their contributions to corporations may be limited by personality and character. General Motors (GM) Board of Directors Guidelines point out that board members must be active, not passive, to

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7. See GREGORY, supra note 4, at §§ 1, 18, 21, 22, A, and K.
achieve the goals that a board is responsible for.\textsuperscript{8} The Council of Institutional Investors (CII) states that meaningful board oversight may depend most on a routine basis on the quality and commitment of board members.\textsuperscript{9} The Business Roundtable puts it well when it says that the substance of good corporate governance is more important than its form and refers to the personal stature and self-confidence of directors as well as the attitude of the CEO.\textsuperscript{10}

4) Independent Directors not a Panacea: Despite the advantages of independent directors with respect to boards and committees, they are not a panacea for corporate governance problems. Even if members are experienced, have strong personalities, and are bright enough to do a fine job, they must be furnished with adequate information in advance of decisions in order to perform properly.\textsuperscript{11} They also need to have executive sessions without the presence of management in order to have freer discussion.\textsuperscript{12} Although corporate governance guidelines may refer to such elements,\textsuperscript{13} the informational one may be particularly difficult to satisfy. Moreover, directors may have biases favorable


The General Motors Board of Directors represents the owners' interests in perpetuating a successful business, including optimizing long term financial returns. The Board is responsible for determining that the Corporation is managed in such a way to ensure this result. This is an active, not a passive, responsibility. The Board has the responsibility to ensure that in good times, as well as difficult ones, management is capably executing its responsibilities. The Board's responsibility is to regularly monitor the effectiveness of management policies and decisions including the execution of its strategies.

\textit{Id. See also} GREGORY, supra note 4, at 4.

\textsuperscript{9} COUNCIL OF INSTITUTIONAL INVESTORS, CORPORATE GOVERNANCE POLICIES, Preamble, 1 (Sept. 2000) [hereinafter CII] ("Although the Council believes that the meaningful oversight a board provides may owe most, on a routine basis, to the quality and commitment of the individuals on that board, policies also play an important governance role."). See also GREGORY, supra note 4, at 84.

\textsuperscript{10} THE BUSINESS ROUND TABLE, STATEMENT ON CORPORATE GOVERNANCE, I. Introduction, 1-2 (Sept. 1997) ("However, The Business Roundtable wishes to emphasize that the substance of good corporate governance is more important than its form; adoption of a set of rules or principles or of any particular practice of policy is not a substitute for, and does not itself assure, good corporate governance.").

\textsuperscript{11} \textit{See generally} GENERAL MOTORS, supra note 8, at Guideline 21; CII, supra note 9, at Position C.1. See also GREGORY, supra note 4, at 54.

\textsuperscript{12} CII, supra note 9, at Position C. 4. See also GREGORY, supra note 4, at 39.

\textsuperscript{13} CII, supra note 9, at Core Policy 1, 4; CALPERS, supra note 5, at Core Principle III. A. 1-2; TIAA-CREF; POLICY STATEMENT OF CORPORATE GOVERNANCE 2 (Oct. 1997); BUSINESS ROUND TABLE, supra note 10, at 10 (III. Structure and Operations of the Board); AFL-CIO, supra note 9, at 4 (§ IV.A.2). GENERAL MOTORS, supra note 8, at Guideline 7, 14, 22. See also GREGORY, supra note 4, at § 12.
to the corporate CEO or curry favor with management to avoid controversy, remain on the board, and be invited to be on other boards.

5) Legal Advantages to the Board and to Management from Independence of Directors: As will be discussed later, the presence and approval of certain transactions by independent and disinterested directors may provide litigation benefits to interested parties who are targets in lawsuits attacking such transactions under fiduciary duty theories. In the sense that the vigilance or effectiveness of courts is diminished by the approval of independent and disinterested directors of the challenged behavior of management or interested parties, there may be a sacrifice of investor protection. Admittedly the presence of a board majority of independent directors should have a beneficial effect in heading off improper transactions and protecting investments. And perhaps the old saying that an ounce of prevention is worth a pound of cure should apply to the notion that lawsuits will somehow better protect investors than independent directors heading off problems at the pass. Still, the ideal would be to deter inappropriate lawsuits without judicial abandonment of investors where the behavior of interested persons and fiduciaries needs to be tested.

6) Definition of Independence: It is one thing to speak of independent directors. It is another to define who they are. This article considers the subject primarily in connection with a Delaware case \(^\text{14}\) and guidelines of the CII. \(^\text{15}\) A variety of definitions have been articulated. For example, General Motors by-law 2.12 provides:

“Independent Director” shall mean a director who: (i) is not and has not been employed by the corporation or its subsidiaries in an executive capacity within the five years immediately prior to the annual meeting at which the nominees of the board of directors will be voted upon; (ii) is not . . . a significant advisor or consultant to the corporation or its subsidiaries; (iii) is not affiliated with a significant customer or supplier of the corporation or its subsidiaries; (iv) does not have significant personal services contract(s) with the corporation or its subsidiaries; and (v) is not affiliated with a tax-exempt entity that received significant contributions from the corporation or its subsidiaries; and (vi) is not a spouse, parent, sibling, or child of any person described by (i) through (v). \(^\text{16}\)

\(^{14}\) See infra notes 43-50 and accompanying text.

\(^{15}\) See infra note 57 and accompanying text.

\(^{16}\) General Motors Board Guidelines, Guideline 8 (1997) (citing General Motors By-Laws § 2.12); see also CalPERS, supra note 5, at 15 (App. B-1); TIAA-CREF,
The lack of certainty as to the judicial definition of director independence for purposes of litigating, which is discussed later, may undermine its utility in investor protection. Obviously, too generous a view of independence for purposes of judicial deference undermines investor protection provided by litigation.

B. Fiduciary Duties: Institutional investors express concern about fiduciary responsibilities and liabilities. The CII calls for training by independent sources for directors with respect to fiduciary duties, and speaks of directors' obligations and reliance. An objective of CalPERS is to establish accountability between a corporation's management and its owners, and it calls board independence the cornerstone of accountability. TIAA-CREF (CREF) speaks of the primary responsibility of directors to foster long-term success consistent with fiduciary responsibility to shareholders. CREF guidelines contain considerable information on the subject of fiduciary oversight. CREF states that "[d]irectors should be held liable to the shareholders and the corporation for violations of their duty of loyalty or their fiduciary duty involving gross or sustained and repeated negligence." The AFL-CIO generally supports personal liability of directors for fiduciary breaches for liability arising from gross negligence and favors personal liability because "the trustees believe the great responsibility and authority of directors justify holding them accountable for their actions." Although the AFL-CIO takes that general position, it does recognize that there may be times to support liability-limiting proposals when the company persuasively argues that they are necessary to attract and retain directors. Still there are a number of specific situations where the voting fiduciary is advised to oppose limits on director's liability.

As will be seen, there are a number of state statutes permitting

\[supra\] note 13, at 2; CII, \[supra\] note 9, at Explanatory Notes to Core Policies; AFL-CIO, \[supra\] note 6, at § IV.A.1.C.ii, IV.A.2.

17. CII, \[supra\] note 9, at Position C.3; see also GREGORY, \[supra\] note 4, at 72.

18. CALPERS, \[supra\] note 5, at 3 (Corporate Governance Facts) ("CalPERS believes the core principles and guidelines represent the foundation for accountability between a corporation's management and its owners and will serve as a tool to enhance this relationship."). See also GREGORY, \[supra\] note 4, at 3.

19. CALPERS, \[supra\] note 5, at 7 (Core Principle III.A). See also GREGORY, \[supra\] note 4, at 6.

20. TIAA-CREF, \[supra\] note 13, at 2. See also GREGORY, \[supra\] note 4, at 6.

21. TIAA-CREF, \[supra\] note 13, at 3-4. See also GREGORY, \[supra\] note 4, at 87.

22. AFL-CIO, \[supra\] at note 6, at 6 (§ IV.A.7). See also GREGORY, \[supra\] note 4, at 6.

23. AFL-CIO, \[supra\] note 6, at 6 (§ IV.A.7). See also GREGORY, \[supra\] note 4, at 87.

24. AFL-CIO, \[supra\] note 6, at 6 (§ IV.A.7).
corporations to insert in their charters certain director liability limiting provisions in conflict with the express policies of CREF and the AFL-CIO and with the concept of director responsibility that may be necessary to satisfy institutional investors generally. Arguably these charter provisions, or the statutes authorizing them, or both, should be eliminated. By way of example the exculpatory statutory provision permitted in Delaware, which will be discussed later, does go far in specific cases in lessening director responsibility.

Besides exculpatory provisions, there are other obstructions to the pursuit of directors for fiduciary wrongdoing. For example, the demand requirement in shareholder derivative actions against directors for the alleged breach of fiduciary duty, and disinterested and independent director approval of a conflict of interest transaction may greatly handicap shareholders challenging the transaction.

II. DELAWARE LAW AND THE BREHM CASE

A. Brehm v. Eisner Case: Because many corporations with which investors are concerned are incorporated in Delaware, the extent to which Delaware law requires or encourages the adoption of corporate governance guidelines espoused by institutional investors is important. As stated earlier, the focus in this article is on guidelines involving director liability and director independence. One of the obstacles to encouraging director accountability through potential legal liability is the demand requirement in shareholder derivative suits. For example, under Delaware law it may be required that a shareholder, before bringing a derivative suit on behalf of a corporation, first make a demand on its board of directors. The board then has a chance to pursue the matter.

25. See, e.g., infra note 141 and accompanying text.
26. See supra note 22 and accompanying text.
27. See infra note 141 and accompanying text.
28. See infra note 31 and accompanying text.
29. See generally infra note 36 (defining the business judgment rule). See also infra notes 120-29 and accompanying text.
30. See DELAWARE SECRETARY OF STATE, FORTUNE 500 LIST (2000) (indicating that 237 companies were both incorporated in Delaware and listed as being in the top 500 by the annual FORTUNE MAGAZINE Fortune 500 list. Data compiled by and on file with the Delaware Secretary of State.) See also, Steven Lipin, Deals and Deal Makers: Firms Incorporated in Delaware are Valued More by Investors, WALL STREET JOURNAL, Feb. 28, 2000, at 12-13; JESSE H. CHOPER ET. AL., CASES AND MATERIALS ON CORPORATIONS 236 (5th ed. 2000).
31. See Zapata v. Maldonado, 430 A.2d 779, 784 (Del. 1981) (discussing the requirement for demand on the board of directors in a derivative suit unless demand would be futile); see also id. at 780 n.1 ("Court of Chancery Rule 23.1 states in part: 'The complaint shall also allege with particularity the efforts, if any, made by the plain-
Delaware courts have permitted a litigation committee appointed by the corporate defendant and consisting of disinterested and independent directors to have the power of an independent board to move to dismiss litigation on the basis that it is detrimental to the best interest of the corporation. If demand on the board is made, and the decision referred to a litigation committee, that committee’s decision is protected by the business judgment rule. In a case where demand on the board is required, a plaintiff’s failure to make the demand will result in dismissal of the case.

In some circumstances demand on the board may be excused as futile. A stockholder derivative complaint, however, predicated on a demand futile theory would be “subject to dismissal for failure to set forth particularized facts creating a reasonable doubt that the director defendants were disinterested and independent or that their conduct was protected by the business judgment rule.” If a case is determined to be a demand futile case, then even though it may properly be brought without making a demand on the board, the corporation may set up a litigation committee to consider the appropriateness of the suit. Should that committee recommend that litigation not be continued, however, its recommendation is subject to stricter judicial scrutiny than it would be in a demand required case. In the demand futile case, if the committee moves to dismiss the litigation, then as a first step the court shall deny the motion if it “determines either that the committee is not independent or has not shown reasonable bases for its conclusions, or, if the court is not satisfied for other reasons relating to the process, including but not

32. See id. at 786 (“The committee can properly act for the corporation to move to dismiss derivative litigation that is believed to be detrimental to the corporation’s best interests.”).
33. See id. at 784 n.10.
34. See id. at 780 n.1. Failure to make demand when required results in facts insufficient to satisfy pleading requirements set forth in Court of Chancery Rule 23.1.
35. See id. at 784.
36. Brehm v. Eisner, 746 A.2d 244, 248 (Del. 2000). The court explains the business judgment rule as follows:

[Directors’ decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.

Id. at 264 n.66.

37. See Zapata, 430 A.2d at 786.
limited to the good faith of the committee. . . ."  

38. Id. at 789.


40. See id. 789. The court further elaborates that:

This means, of course, that instances could arise where a committee can establish its independence and sound bases for its good faith decisions and still have the corporation’s motion denied. The second step is intended to thwart instances where corporate actions meet the criteria of step one, but the result does not appear to satisfy its spirit, or where corporate actions would simply prematurely terminate a stockholder grievance deserving of further consideration in the corporation’s interest. The Court of Chancery of course must carefully consider and weigh how compelling the corporate interest in dismissal is when faced with a non-frivolous lawsuit. The Court of Chancery should, when appropriate, give special consideration to matters of law and public policy in addition to the corporation’s best interests.


42. See Spiegel, 571 A.2d at 775-76 ("[S]tockholders who. . . make a demand which is refused, subject the board’s decision to judicial review according to the traditional business judgment rule.").

43. See supra note 36.

44. See Brehm, 746 A.2d at 248-49.

Brehm v. Eisner (Brehm) involved a derivative action based on alleged breaches of fiduciary duty by directors with respect to an employment agreement involving Michael S. Ovitz as president of Walt Disney Company. The defendant directors included Disney’s chairman of the board and CEO Michael Eisner and other members of its board. The Delaware Supreme Court had before it allegations involving fiduciary breaches in two instances: first, that the Board approved an extravagant and wasteful employment agreement with Ovitz; second, that the Board (as later constituted) approval of a non-fault termination of the agreement constituted an extravagant and wasteful decision.

The magnitude of the stakes involved in the Brehm case is illustrated by several
portions of the court’s summarization of the essence of plaintiffs’ factual allegations on the key issues before the court:

The Employment Agreement provided for three ways by which Ovitz’ employment might end. He might serve his five years and Disney might decide against offering him a new contract. If so, Disney would owe Ovitz a $10 million termination payment. Before the end of the initial term, Disney could terminate Ovitz for “good cause” only if Ovitz committed gross negligence or malfeasance, or if Ovitz resigned voluntarily. Disney would owe Ovitz no additional compensation if it terminated him for “good cause.” Termination without cause (non-fault termination) would entitle Ovitz to the present value of his remaining salary payments through September 30, 2000, a $10 million severance payment, an additional $7.5 million for each fiscal year remaining under the agreement, and the immediate vesting of the first 3 million stock options (the “A” Options).

The complaint alleged “that the Old Board failed properly to inform itself about the total costs and incentives of the Ovitz Employment Agreement, especially the severance package. This is the key allegation related to this issue on appeal.” The complaint charged

the New Board with waste, computing the value of the severance package agreed to by the Board at over $140 million, consisting of cash payments of about $39 million and the value of the immediately vesting “A” options of over $101 million. The Complaint quotes Crystal, the Old Board’s expert, as saying in January 1997 that Ovitz’ severance package was a “shocking amount of severance.”

The allegation of waste is based on the inference most favorable to plaintiffs that Disney owed Ovitz nothing, either because he had resigned (de facto) or because he was unarguably subject to firing for cause.

The complaint also charged that the directors were not disinterested and independent.

The court admitted to having concerns about lavish executive

45. Id. at 250 (citations omitted).
46. Id. at 251.
47. See id. at 253.
48. See id. at 249.
compensation, boards living up to the highest standards of good corporate practices, the sloppy and perfunctory procedures followed by the Board, and even its business judgment in making its compensation decisions.49 Yet the court, citing Chancery Rule 23.1, pointed out that the real issue in the case was whether the complaint should be dismissed for failure to make demand on the board of directors because it did not "set forth particularized facts creating a reasonable doubt that the director defendants were disinterested and independent or that their conduct was protected by the business judgment rule."50

Thus, the question of whether demand was excused involved two prongs. The first, "whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent . . . ,"51 would apply in determining whether a majority of the Board in office when plaintiffs filed the action was disinterested and independent.52 The determination must be made as to whether that majority was incapable, due to personal interest or domination and control, of objectively evaluating a demand that the Board assert the corporation's claims that the plaintiffs were raising, or otherwise remedy the alleged injury.53 Alternatively, plaintiffs may justify excusing demand if under the particularized facts alleged a reasonable doubt is created that "the challenged transaction was otherwise the product of a valid exercise of business judgment."54

Since the derivative suit involves a claim belonging to the corporation, which is being pursued by shareholders, it may involve taking control of the suit away from the corporation, which is allegedly injured by the misbehavior of directors, and placing it in the hands of shareholders. The Delaware Supreme Court explained the rationale of Rule 23.1 as follows:

On the one hand, it would allow a plaintiff to proceed with discovery and trial if the plaintiff complies with this rule and can articulate a reasonable basis to be entrusted with a claim that belongs to the corporation. On the other hand, the rule does not permit a stockholder to cause the corporation to expend money and resources in discovery and trial in the stockholder's quixotic

49. See id.
50. Id. at 248.
52. See Brehm, 746 A.2d at 257.
53. See id.
54. Aronson, 473 A.2d at 814.
pursuit of a purported corporate claim based solely on conclusions, opinions or speculation . . . . The demand requirement serves a salutary purpose. First, by requiring exhaustion of intracorporate remedies, the demand requirement invokes a species of alternative dispute resolution procedure which might avoid litigation altogether. Second, if litigation is beneficial, the corporation can control the proceedings. Third, if demand is excused or wrongfully refused the stockholder will normally control the proceedings.\textsuperscript{55}

Delaware case law, says its Supreme Court:

[I]t is designed to create a balanced environment which will: (1) on the one hand, deter costly, baseless suits by creating a screening mechanism to eliminate claims where there is only a suspicion expressed solely in conclusory terms; and (2) on the other hand, permit suit by a stockholder who is able to articulate particularized facts showing that there is a reasonable doubt either that (a) a majority of the board is independent for purposes of responding to the demand, or (b) the underlying transaction is protected by the business judgment rule.\textsuperscript{56}

B. \textit{Brehm v. Eisner} and Corporate Governance: The CII filed an Amicus Curiae brief with the Delaware Supreme Court in the \textit{Brehm} case. The CII argued that it was critical that the Delaware Supreme Court adopt a workable definition of “independent directors,” that such a definition must take into account the realities of corporate governance, that the CII has adopted a workable definition of the term comporting with corporate reality, and that the lower court’s conclusion that a majority of Disney’s directors were independent must be reversed.\textsuperscript{57} The CII is self-described “[a]s a non-profit association of pension funds that addresses investment and corporate governance issues on behalf of its members (who collectively manage over a trillion dollars in investments on behalf of millions of employees and beneficiaries).”\textsuperscript{58} The CII stated that it has significant interests in issues of corporate governance, including the definition and importance of independent directors, and filed its brief, “to present the court with its views, and the views of its members, as to the importance of establishing meaningful standards for

\textsuperscript{55} Brehm, 746 A.2d at 255.
\textsuperscript{56} \textit{Id.}
\textsuperscript{58} \textit{Id.} at 1-2.
evaluating directors' independence, and to assist the court in formulating appropriate standards for that purpose." 59

In arguing that the Delaware Supreme Court should adopt a workable definition of independent directors, the CII pointed out that "[d]irector independence is one of the cornerstones of Delaware's system of corporate governance," 60 and that independent directors' decisions are accorded substantial deference by the courts of Delaware. 61 The CII referred to the court's recognition of the primacy of the independent director concept in corporate law as follows: "The requirement of director independence inheres in the conception and rationale of the business judgment rule. The presumption of propriety that flows from an exercise of business judgment is based in part on this unyielding precept . . . ." 62

The CII saw the Delaware policy of deference as wise where there is true independence 63 but pointed out that this precept does not hold "unless directors are truly independent-i.e., unless they have no interests at stake other than the best interests of the corporation." 64 The CII observed little guidance in Delaware law for determining what constitutes true director independence, stating as follows:

Unfortunately, under the current state of the law there is very little guidance for determining what constitutes true director "independence." To be sure, this Court has made some general pronouncements regarding the meaning of the term "independent director." For example, the Court has stated that "[i]ndependence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences," 65 and that directors may be found to have lost their independence upon the allegation of "such facts as would demonstrate that through personal or other relationships the directors are beholden to [a] controlling person." 66 The Court has not, however, provided any specific guidance on how to determine whether a director is being governed by "extraneous

59. Id. at 2.
60. Id. at 8.
61. See id.
62. Id. (quoting Aronson, 473 A.2d 805, 816 (Del. 1984)). For further discussion of judicial deference to actions of those labeled as independent and disinterested see infra notes 120-29 and accompanying text.
63. See id.
64. Id. at 9.
65. Id. (quoting Aronson, 473 A.2d at 816).
66. Id. (quoting Aronson, 473 A.2d at 815).
considerations or influences" or is "beholden" to another. Consequently, courts attempting to apply the demand futility test have been left to their own devices to determine what facts will lead to a finding that a director lacks independence. Not surprisingly, this has led to a myriad of conflicting decisions which only muddy the waters on this issue further.67

In the absence of clear standards for evaluating director independence, the CII argued, courts often defer to decisions of self-proclaimed "independent directors."68 The amicus brief argued that this approach works "to the detriment of corporations and their shareholders, who are forced to live with the decisions of directors who are not acting in the corporation's best interests."69 Thus to preserve the integrity of Delaware's corporate governance system, the CII called for more particularized standards for evaluating director independence so that shareholders, corporations, and courts have a consistent, reliable basis for determining the independence of directors.70

In addressing the realities of corporate governance the CII stated that CEOs wield substantial control over the corporation and that the board of directors that makes decisions without regard for the wishes of the CEO simply does not exist in the real world; that boards routinely defer to CEOs for the simple reason that if they do not, they will quickly find themselves without a CEO; that if a CEO wants to change corporate counsel or find a new vendor, the company will; that if a CEO wants the company to donate money or stop making donations to a particular university, the company will.71 The CII further explained that if a CEO wants to increase or decrease an executive officer's salary, the company will; that if a CEO does not want the company to engage in a particular transaction, the company will not do so; that this is not the way corporations are supposed to work but is the way most of them do work, and

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67. Id. (comparing Benerofe v. Cha, No. 14614, 1998 WL 83081, at *4 (Del. Ch. Feb. 20, 1998) (reasonable doubt exists as to director's independence from company's controlling stockholder when director is also an officer of company); Lewis v. Aronson, No. 6919, 1985 WL 11553 (Del. Ch. May 1, 1985) (fact that directors are officers of company does not affect their independence from controlling stockholder); Steiner v. Meyerson, No. 13139, 1995 WL 441999, at *9-10 (Del. Ch. July 19, 1995) (reasonable doubt exists as to independence of director who serves as company's outside counsel); Maldonado v. Flynn, 597 F.2d 789, 794 (2d Cir. 1979) (director's independence is not affected by his position as company's outside counsel absent evidence of quid pro quo)).
68. See id. at 10.
69. Id.
70. See id.
71. Id. at 11.
that courts must take that fact into account when considering the issue of director independence.\textsuperscript{72} The CII further stated:

\begin{quote}
When viewed in light of these realities, it is clear that a director cannot maintain a business relationship with a corporation, yet still maintain independence from the corporation’s CEO. For example, a director who serves as a company’s outside counsel, even if he has never dealt directly with the CEO and has no personal interest in a transaction being supported by the CEO, would still be unable to exercise truly independent judgment when considering the transaction because he would know that the CEO wields the power to replace his firm as the corporation’s counsel. The same would be true of directors who are affiliated with one of the company’s suppliers or with a charitable organization that receives significant grants from the company, or of directors with any other business relationship with the company or any of its affiliates. The lack of independence becomes even clearer when the director is an officer of the corporation itself, since the officer’s compensation and continued employment are then subject to the direct control of the CEO. . . .
\end{quote}

In sum, a director should be considered non-independent from the company and its CEO whenever he/she has a nontrivial connection to the company aside from his/her directorship. Anyone with a nontrivial connection to the company is necessarily beholden to the company and the CEO. To ignore this reality is to perpetuate a legal fiction—that the interests of the CEO and the corporation are somehow separable—that disserves stockholders by encouraging judicial deference to directors with conflicting interests.\textsuperscript{73}

The CII emphasized the importance of its corporate governance policy that “two-thirds of a corporation’s directors be independent from potentially compromising financial, familial or professional relationships.”\textsuperscript{74} It stated that “[t]his policy is widely accepted and is now in use at 52.5 percent of S&P 500 companies.”\textsuperscript{75} “[T]he Council define[d] an ‘independent director’ as someone whose ‘only nontrivial professional, familial or financial connection to the corporation or its CEO is his or

\textsuperscript{72} See id.
\textsuperscript{73} Id. at 11-12.
\textsuperscript{74} Id. at 13.
\textsuperscript{75} Id.
her directorship.' 76 The CII went on to specify circumstances that create a presumption of non-independence:

- [W]here the director has been employed by the corporation or an affiliate in an executive capacity;

- where the director is, or in the past two years has been, an employee or owner of a firm that is one of the corporation’s or its affiliate’s or the CEO’s paid advisers or consultants;

- where the director is employed by, or has a five percent or greater ownership interest in, a significant customer or supplier;

- where the director is employed by, or has a five percent or greater ownership interest in, a debtor or creditor of the corporation if the amount owed exceeds 1% of the corporation’s or the third party’s assets;

- where the director has, or in the past two years has had, a personal services contract with the CEO, the corporation or one of its affiliates;

- where the director is employed by, or serves as an officer or director of, a non-profit corporation, foundation, university or other organization that receives significant grants or endowments from the corporation or one of its affiliates;

- where the director is a relative of an executive of the corporation or one of its affiliates;

- where the director is part of an interlocking directorate in which the CEO or other executive officer of the corporation serves on the board of another corporation that employs the director. 77

As a result of its analysis of the case the CII concluded that "the Court of Chancery abused its discretion in determining Eisner was disinterested in the Employment Agreement transactions, and that a majority

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76. Id.
77. Id. at 14-16.
of the Board was independent of Eisner.\textsuperscript{78} The CII's belief was that the Court of Chancery erred in determining plaintiffs "failed to plead sufficient particularized facts to demonstrate that demand was excused."\textsuperscript{79}

C. Delaware Law v. Ideal Corporate Governance Practices:
In \textit{Brehm} the Delaware court expended little time in explaining how the case before it involved a question of Delaware law about directors liability for lack of due care in the decision-making process and for waste\textsuperscript{80} of corporate assets, and not a case about the failure of directors to establish and carry out ideal corporate governance practices.\textsuperscript{81} The court quite simply explained that good governance practices include compliance with law establishing corporate fiduciary duties, but the law of such duties and remedies for violating them are distinct from the aspirational goals of ideal corporate governance practices.\textsuperscript{82} The court alluded to a practical link of aspirational ideals with legal requirements in that the adoption of the former may sometimes reduce litigation and help directors avoid liability even though not required by corporation law and not really definitions of standards of liability.\textsuperscript{83} In considering the legal impact of aspirational ideals, the court referred to complaint quotations from a \textit{Wall Street Journal} article critical of the Board's functioning as follows: "[T]he directors own little stock; they do not 'hold a regular retreat'; they 'don't meet regularly in the absence of company executives such as Mr. Eisner'; and they do not 'give Mr. Eisner a written assessment of his performance' as do '89% of the nation's biggest industrial corporations.'"\textsuperscript{84}

The Delaware Supreme Court, while referring to the CII as an eminently prestigious corporate governance organization,\textsuperscript{85} declined to

\begin{itemize}
\item \textsuperscript{78} \textit{Id.} at 18.
\item \textsuperscript{79} \textit{Id.}
\item \textsuperscript{80} The court in \textit{Brehm} defined waste as follows:
\begin{quote}
Roughly, a waste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade. Most often the claim is associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. Such a transfer is in effect a gift. If, however, there is any substantial consideration received by the corporation, and if there is a good faith judgment that in the circumstances the transaction is worthwhile, there should be no finding of waste, even if the fact finder would conclude ex post that the transaction was unreasonably risky.
\end{quote}
\textit{Brehm}, 746 A.2d at 263.
\item \textsuperscript{81} \textit{See} \textit{id.} at 255-56.
\item \textsuperscript{82} \textit{See} \textit{id.} at 256.
\item \textsuperscript{83} \textit{See} \textit{id.}
\item \textsuperscript{84} \textit{Id.} at n.29.
\item \textsuperscript{85} \textit{See} \textit{id.} at n.30.
\end{itemize}
rule on the CII’s request for a better definition of independent directors saying it was unnecessary to do so. This did not prevent the court from citing a somewhat indefinite test: “Independence means that a director’s decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences.” Put somewhat differently but still without much specificity the court said:

In this case, the issues of disinterestedness and independence involved in the first prong of Aronson are whether a majority of the New Board, which presumably was in office when plaintiffs filed this action, was disinterested and independent. That is, were they incapable, due to personal interest or domination and control, of objectively evaluating a demand, if made, that the Board assert the corporation’s claims that are raised by plaintiffs or otherwise remedy the alleged injury? This rule is premised on the principle that a claim of the corporation should be evaluated by the board of directors to determine if pursuit of the claim is in the corporation’s best interests.

The court agreed with the Court of Chancery that no reasonable doubt existed as to Eisner’s disinterest in the approval of the Employment Agreement as a matter of law and that plaintiffs had not demonstrated a reasonable doubt that Eisner was disinterested in granting the Non-Fault Termination. Because the court held that the complaint did not create a reasonable doubt of Eisner being disinterested in the Ovitz Employment Agreement, it stated that it “need not reach or comment on the analysis of the Court of Chancery on the independence of the other directors for this purpose.”

Specifically addressing the issue of whether a reasonable doubt was created that a majority of the Board in office was disinterested and independent when plaintiffs filed their action, the court referred to plaintiffs’ central allegation that a majority of the Board was beholden to Eisner, noting that it was not alleged that they were beholden to Ovitz. The court alluded to plaintiffs’ theory that Eisner advanced the interests of Ovitz primarily because a lavish contract for the latter would help Eisner gain in his quest to have his own compensation lavishly in-

86. See id. at 258 n.40.
87. Id. at 256 n.31 (quoting Aronson, 473 A.2d at 814).
88. Id. at 257.
89. See id. at 258.
90. Id.
91. See Brehm, 746 A.2d at 257.
creased. The court found this claim not supported by well-pleaded facts and referred to the Court of Chancery findings that the allegations were illogical and counterintuitive, saying that Eisner's interest in maximizing his compensation at the expense of Disney and its shareholders cannot reasonably be inferred from the facts in the amended complaint; that at times material to the litigation Eisner owned several million Disney stock options and it would not be in Eisner's economic interest to cause the company to issue millions of additional options unnecessarily and at considerable cost; that such a gesture would not maximize Eisner's compensation package but it would dilute the value of his own substantial holdings; that "[e]ven if the impact on Eisner's option value were relatively small, such a large compensation package would, and did, draw largely negative attention to Eisner's own performance and compensation"; and that "[a]ccordingly no reasonable doubt can exist as to Eisner's disinterest in the approval of the Employment Agreement, as a matter of law." The court also felt that no reasonable doubt had been demonstrated that Eisner was disinterested in granting the Non-Fault Termination and thus allowing Ovitz to receive substantial severance benefits. The chancery court had also noted that "[n]othing alleged by Plaintiffs generates a reasonable inference that Eisner would benefit personally from allowing Ovitz to leave Disney without good cause."

What a different view the CII had! That "eminently prestigious corporate governance organization" argued that the detailed allegations in the amended complaint, particularly because plaintiffs had not had an opportunity to take discovery, were more than sufficient to create a reasonable doubt as to Eisner's disinterestedness. The CII pointed to plaintiffs' allegations that Eisner was personally interested in the approval of the Employment Agreement because Ovitz had been a close personal friend of his for over twenty-five years, he had hand picked him as his second in command over the objections of several board members, and because he unilaterally negotiated the Employment Agreement with Ovitz. Referring to the Court of Chancery, the CII said its first error was to discount the importance of the personal friendship between Eisner

92. See id.
93. See id.
94. Id.
95. Id.
96. See id.
97. Id. at 257-58.
98. See Amicus Curiae Brief at 21.
99. See id.
and Ovitz. The Delaware Supreme Court did not even discuss the personal friendship argument and the CII's assertion in connection with it that all of Eisner's decisions with respect to the Employment Agreement have substantially benefited Ovitz.

The CII also noted that until plaintiffs had an opportunity to conduct discovery regarding the dilution that Eisner would suffer in connection with his own stock options, and to compare that dilution with the adverse economic effects on Eisner if a dispute over Ovitz's compensation package affected his own compensation, there was no basis on which to conclude where Eisner's economic interests lie. Therefore, it was argued, the Court of Chancery erred in holding that Eisner was disinterested in the transactions surrounding the Employment Agreement as a matter of law. Of course, as pointed out above, the Delaware Supreme Court evidently and simply agreed with the chancery court.

It is informative and worthwhile to consider also the views expressed by the CII concerning the independence of a number of directors other than Eisner for several reasons. First, those views illustrate the application of the principles of an important investor organization relative to the independence issue in a variety of factual situations. Second, as indicated above, the Delaware Supreme Court avoided reviewing the independence of directors other than Eisner and may ultimately be influenced by the CII positions. Third, the views of the CII demonstrate in a mostly persuasive manner an alleged lack of independence of the directors from an investor perspective, which may or may not match up ultimately in whole or in part with judicial views in Delaware and elsewhere. At some future point courts will need to rule on the extent of their agreement with principles of corporate governance such as those espoused by the CII relating to director independence. Fourth, the general proposition of the CII is that if Eisner is interested in the Ovitz transaction and the majority of directors are not independent of Eisner or the Disney corporation then majority independence is lacking. An important insight into the CII position is contained in the following passage from its amicus brief:

The Court of Chancery erred by analyzing each director's independence from Eisner by examining only the direct relationship between that director and Eisner. Many of the directors, while arguably not having direct ties to Eisner, are nonetheless be-

100. See id.
101. See id. at 22.
102. See supra note 90 and accompanying text.
holden to Disney. For example, Roy Disney, Litvack and Nunis are officers of the company whose livelihoods are directly dependent on Disney. Since Disney is a prime example of a CEO-controlled corporation, directors who (like Roy Disney, Litvack and Nunis) are beholden to Disney are necessarily beholden to Eisner.\(^{103}\)

The views of the CII concerning the independence of a number of directors follow.

**Roy Disney:** The CII argued that plaintiffs' allegations that Roy Disney is an officer of Disney and receives a substantial salary are sufficient to raise a reasonable doubt as to his independence from the company and therefore from Eisner. It also criticized the Court of Chancery for surmising that because Roy Disney and his family owned approximately $2.1 billion of Disney stock, his primary concern would be to protect the value of that stock and not to act solely to placate Eisner.\(^{104}\) The CII felt the Court of Chancery abused its discretion based solely on speculation as to Roy Disney's economic motivations to conclude that he was independent from Eisner despite his position as a corporate executive officer.\(^{105}\)

**Litvack and Nunis:** The CII pointed out that these two are executive officers of Disney whose continued employment and compensation are subject to Eisner's power and authority.\(^{106}\) The CII stated that under its definition of independence these two directors would be deemed non-independent because Disney employs them in an executive capacity.\(^{107}\) The CII took issue with the chancery court's opinion asserting that it "can be read to suggest that a director can remain independent of a corporate CEO despite being employed by the corporation as an officer . . . ."\(^{108}\) The CII stated that "[a]ny director who serves as a corporate officer is necessarily beholden to the corporation for his/her livelihood, and in view of the CEO's position of authority within the corporation, such directors must also be considered beholden to the CEO."\(^{109}\)

**Gold:** According to the CII, Gold is Roy Disney's personal attorney and president and CEO of a company owned by Roy's family. Ac-

\(^{103}\) Amicus Curiae Brief at 20.
\(^{104}\) See id. at 24-25.
\(^{105}\) See id. at 25.
\(^{106}\) See id.
\(^{107}\) See id. at 26.
\(^{108}\) Id.
\(^{109}\) Id.
According to the CII, the Court of Chancery found these facts insufficient to establish Gold’s lack of independence because plaintiffs failed to establish Roy’s lack of independence. Since the CII believed Roy was not independent from Eisner, it took the position that Gold’s dependence on Roy impaired his independence from Eisner.\(^\text{110}\)

**Stern:** According to the CII, Stern designed many buildings for Disney as well as an Eisner home, and Eisner had the power to select or refuse to select Stern’s firm for future projects for Disney. The CII agreed with the chancery court’s decision as to Stern since Eisner is clearly in a position to influence Stern’s continued business with Disney—business that brought significant income to Stern and his firm in the past.\(^\text{111}\)

**Walker:** The CII indicated that the Court of Chancery found that plaintiffs failed to establish a reasonable doubt as to Walker’s independence because he had no direct financial dealings with Eisner and because sums, which the now retired Walker receives from the company, are based on contracts that pre-date Eisner’s affiliation with Disney. The CII took the position that Walker has a nontrivial connection with Disney by virtue of his valuable contract rights and depends upon the company for a significant part of his income, and that Eisner presumably could cause the company to refuse to honor its contract with Walker. Thus, it was argued Walker has a personal incentive to remain within Eisner’s good graces. The CII also argued that Walker’s contract rights gave him a personal interest in Disney’s future performance, which he could reasonably expect to improve if Eisner’s personal choice for president were approved and if the controversy over that person leaving the company were minimized. The CII therefore felt that Walker had a personal interest in approving the Employment Agreement and the Non-Fault Termination on the terms proposed by Eisner.\(^\text{112}\)

**Wilson:** Among the arguments raised as to Wilson is the one that:

Contrary to the Court of Chancery’s decision, a reasonable doubt exists as to Wilson’s independence from Eisner because Wilson has a nontrivial connection with Disney and Eisner aside from his directorship. Although Wilson may have already received all the financial benefits to which he was entitled from Disney, the

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110. See id. at 27.
111. See id.
112. See id. at 28.
fact remains that Wilson received those benefits as a direct result of Eisner’s recommendations. . . . This, coupled with the fact that Wilson’s wife’s design firm has done work for Disney and presumably has hopes of doing more work for the company in the future, raises at least a reasonable doubt that Wilson would be willing to defy Eisner’s wishes when voting to approve the Employment Agreement and the Non-Fault Termination.  

O’Donovan: The CII argued that O’Donovan, as president of a university receiving donations from Eisner, is non-independent even though he receives no personal benefit from the grants.

Bowers: The CII took the position that while one’s receipt of directors’ fees will not ordinarily be deemed to affect one’s independence or disinterestedness, if such fees constitute a substantial portion of the director’s income, they should be considered part of the mix of information that may lead to a finding of non-independence. Bowers is also the head of a private school, which Eisner’s children attended, and plaintiffs did not yet have an opportunity to take discovery and know what donations Eisner or Disney made to the school.

Mitchell: According to the CII, Mitchell has several nontrivial connections with Disney other than his directorship, which create conflicting interests. The CII cited his consulting arrangement with Disney and took the Court of Chancery to task for speculating that Mitchell would not consider $50,000 in consulting fees material on the ground that there is no basis for that conclusion at this stage of the proceedings when plaintiffs have been unable to take discovery from Mitchell. The CII also spoke of Mitchell’s possible expectation of continuing his relationship with Disney and increasing the income he receives and also pointed to his affiliation with a law firm that serves as counsel to Disney, which raises a reasonable doubt as to his independence, saying that Eisner had the power to replace Mitchell’s firm at any time.

The CII took the position that the Court of Chancery erred in finding a majority of the Board to be independent and capable of considering a demand by plaintiffs, stating that a reasonable doubt existed as to the independence of at least twelve of seventeen directors who approved

113. Id. at 29.
114. See id. at 30.
115. See id.
116. See id. at 31.
117. See id.
118. See id. at 32.
the Employment Agreement and at least eleven of sixteen who approved
the Non-Fault Termination. As indicated earlier the Delaware Su-
preme Court saw no need to review the CII claims relative to director
independence from Eisner.

D. Judicial Deference: The CII, as stated earlier, pointed to
the importance of the director independence issue, stating that independent
directors’ decisions are accorded substantial deference by the courts
of Delaware. The CII gave an illustration of the requirement of direc-
tor independence as inhering in the conception and rationale of the busi-
ness judgment rule. And of course, issues of demand futility are im-
portant in shareholder derivative suits.

The deference given approval of self-interested transactions by
disinterested directors is discussed by a leading authority on corporate
law:

Most states have adopted statutes, like those of California,
Delaware, New York, and the Model Act, that address the effect
of approval of self-interested transactions by disinterested direc-
tors. However, most of these statutes have been adopted since
1970, and there is only a limited body of case law construing the
statutes. An important question under these statutes is whether
they preclude a judicial inquiry into the fairness of self-
interested transactions that have been approved by disinterested
directors. Many of the statutes are susceptible to the interpreta-
tion that approval by disinterested directors precludes a judicial
inquiry into fairness, but all or almost all the statutes can be in-
terpreted not to preclude such an inquiry.

That same authority states, “some courts have stated that a duty-
of-loyalty statute only renders a self-interested transaction not automati-
cally voidable (that is, not voidable even if fair) or shifts the burden of
proof.” Further, “[t]he position of the Delaware law on these issues is
not completely clear.” Suffice it to say that the directors would need
to have the requisite independence from those who are interested in or-
der for their approvals to merit deference.

119. See id. at 34.
120. See id. at 8.
121. See supra note 62 and accompanying text. See generally supra note 36 (stating
definition of the business judgment rule).
122. EISENBERG, supra note 1, at 632.
123. Id. at 633.
124. Id.
Other examples of the importance of independent director approval in corporate litigation may be cited. For instance a Delaware Supreme Court case considered a cash out merger brought by a class action plaintiff who challenged the elimination of minority shareholders.\textsuperscript{125} The court pointed to a question of breach of fiduciary duty and stated that the problem occurred because there were common Signal-UOP directors participating at least to some extent in the UOP board's decision-making processes without full disclosure of the conflicts they faced.\textsuperscript{126} The court said:

Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arms length\textsuperscript{127}. . . . Since fairness in this context can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them, it is unfortunate that this course apparently was neither considered nor pursued.\textsuperscript{128} . . . Particularly in a parent-subsidiary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness.\textsuperscript{129}

E. The Delaware Information Problem: The Delaware Supreme Court noted plaintiffs' complaint that the system of requiring a stockholder to plead particularized facts in the derivative suit is basically unfair because the court's limits on discovery do not allow for marshalling the facts needed to establish that demand is excused.\textsuperscript{130} The CII amicus brief credited plaintiffs with giving as much detail as they were able to do without conducting discovery with respect to facts supporting their allegations of interestedness and lack of independence.\textsuperscript{131} The CII pointed to the limited (if any) access to information about directors' interrelationships with their corporations and with corporate insiders and the difficulty plaintiffs encounter because of unavailability of discovery in pleading sufficient facts to demonstrate demand futility.\textsuperscript{132} Citing

\begin{footnotesize}
\textsuperscript{125} See Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983).
\textsuperscript{126} See id. at 709.
\textsuperscript{127} Id. at n.7 (citing Harriman v. E.I. du Pont De Nemours and Co., 411 F.Supp. 133 (D.C. Del. 1975)).
\textsuperscript{128} Id. (citing Johnston v. Greene, 121 A.2d 919, 925 (Del. 1956)).
\textsuperscript{129} Id. (citing Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 886 (Del. 1970); Puma v. Marriott, 283 A.2d 693, 696 (Del. Ch. 1971)).
\textsuperscript{130} See Brehm, 746 A.2d at 266.
\textsuperscript{131} See Amicus Curiae Brief at 18-19.
\textsuperscript{132} See id. at 19, n.8.
\end{footnotesize}
cases precluding plaintiffs from taking discovery before responding to a motion to dismiss for failure to demonstrate demand futility, the CII elaborated as follows:

In the past, this Court has suggested that stockholders can overcome this difficulty by using the statutory inspection procedure of 8 Del. C. § 220 to gather information regarding director independence and interestedness before filing their complaints. The Section 220 alternative, however, is far from perfect. First, although Section 220 contemplates a summary proceeding, it frequently takes several months for a stockholder to enforce its inspection rights under the statute. In cases involving imminent corporate transactions, such delays make Section 220 an impractical means of gathering pre-suit information. Second, even in cases where timing is not an issue, Section 220 only provides plaintiffs with access to information within the corporation’s possession. Such information constitutes only a small portion of the universe of facts regarding potential conflicts of interest on the part of corporate directors. In the present case, for example, a Section 220 demand may have yielded information about the Director Defendants’ relationships with Disney, but would not have shed light on their relationships with Eisner personally. Accordingly, the Council respectfully submits that the Court should provide some means by which plaintiffs may reasonably discover the nature and extent of directors’ interestedness and independence before their complaints are dismissed for failure to establish demand futility. For example, corporations could be required to affirmatively disclose which of their directors are independent and which are not.133

The Delaware Supreme Court gave little comfort to plaintiffs or the CII with respect to the information argument, stating that plaintiffs may have the “tools at hand” to develop the necessary facts134 and that “plaintiffs may seek relevant books and records of the corporation under Section 220 . . . if they can ultimately bear the burden of showing a proper purpose and make specific and discrete identification, with rifled precision, of the documents sought.”135 Saying that plaintiffs must establish that the books and records are essential to accomplishing their articulated purpose for inspection136 the court, without presuming on how to direct the Court of Chancery with respect to deciding a proceed-

133.  Id.
134.  See Brehm, 746 A.2d at 266.
135.  Id.
136.  See id. at 267.
ing under Section 220, stated that "[f]rom a timing perspective, however, we note that such a proceeding is a summary one that should be managed expeditiously." More sympathy was offered by the concurring Justice Hartnett who said that "[p]laintiffs must not be held to a too-high standard of pleading because they face an almost impossible burden when they must plead facts with particularity and the facts are not public knowledge."

It certainly appears that Delaware pleading requirements and discovery limitations pose a serious obstacle to stockholder derivative suits on a demand excused basis.

F. Exculpatory Statutes—e.g., Delaware section 102(b)(7): Reference was made earlier to CREF positions regarding director liability for violations of the duty of loyalty or for gross or sustained and repeated negligence. It was noted that there are state statutes permitting corporate charter provisions limiting or eliminating director liability in certain cases involving breaches of fiduciary duty. One important state statute is section 102(b)(7) of the Delaware corporation law, which allows:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under section 174 of this title, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. All references in this paragraph to a director shall also be deemed to refer (x) to a member of the governing body of a corporation which is not authorized to issue capital stock, and (y) to such other person or persons, if any, who, pursuant to a provision of the certificate of incorporation in accordance with section 141(a) of this title, exercise or perform any of the powers or duties otherwise conferred or imposed upon the board of directors by this title.

137. Id.
138. Id. at 268.
139. See supra note 21 and accompanying text.
140. 8 Del.C. § 102 (2000).
A charter provision properly drafted under this statute may be used to limit or eliminate director liability to the corporation or shareholders for gross negligence. If investors are serious about director responsibility for gross negligence they must find a way to rid corporation charters of such provisions.

It is noteworthy that a charter provision under section 102(b)(7) might have cut off significant claims of plaintiffs in cases involving behavior as controversial even as that in Brehm. Still, the exceptions to exculpation under section 102(b)(7) may allow some claims to be pursued that may look like gross negligence or sustained inattention but may be classified as good faith or loyalty, or intentional misconduct claims. For example, irrationality may tend to show bad faith\(^{141}\) that would render a 102(b)(7) exculpatory provision inapplicable.

III. CONCLUSION

So much hope for proper corporate governance has been pinned on independent directors. Courts defer to their decisions in varying degrees in diverse situations. Major pension fund investors cry out for them to dominate boards. The CII argued for more certitude in Delaware’s judicial definition of independent directors.

The Delaware Supreme Court rejected arguments of the CII about the conflicting interests of the CEO Eisner, ignoring his twenty-five year friendship with Ovitz\(^{142}\) and thereby avoided the CII’s invitation to speak with precision in dealing with the independence of other defendant directors.\(^{143}\) And this gentle judicial approach toward director defendants was taken in a case where the court admitted that it appeared from the complaint that the compensation and termination payout for Ovitz were exceedingly lucrative, if not luxurious, compared to his value to the company, and that the processes of the boards of directors in dealing with the approval and termination of his Employment Agreement were casual if not sloppy and perfunctory.\(^{144}\) Moreover, even though the Delaware Supreme Court left plaintiffs with an opportunity to file an amended complaint relative to the Old Board’s decision in approving the employment agreement and the New Board’s decision regarding the non-

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\(^{141}\) See generally Brehm, 746 A.2d at 264 ("Irrationality . . . may tend to show that the decision is not made in good faith.")

\(^{142}\) See supra notes 100-01 and accompanying text.

\(^{143}\) See supra note 86 and accompanying text.

\(^{144}\) See supra note 49 and accompanying text.
fault termination, plaintiffs remained subject to difficult Delaware discovery rules.46

Is there much hope that courts will accept standards like those of the CII in dealing with questions of independence and disinterest for purposes of determining the deference due director decisions or the impact of demand requirements under Rule 23.1? Is there much hope that the Delaware Supreme Court will allow more reasonable information gathering techniques for plaintiffs in derivative suits? Is judicial help in achieving ideal corporate governance guidelines on the way? The Delaware Supreme Court quite candidly pointed away from itself as a potential fount of progress for achieving good corporate governance guidelines:

The inquiry here is not whether we would disdain the composition, behavior and decisions of Disney's Old Board or New Board as alleged in the Complaint if we were Disney's stockholders. In the absence of a legislative mandate, that determination is not for the courts. That decision is for the stockholders to make in voting for directors, urging other stockholders to reform or oust the board, or in making individual buy-sell decisions involving Disney securities.47

Such an attitude by the Delaware Supreme Court is not surprising. It is unlikely that courts or legislatures of Delaware or other states will move in the direction of subjecting directors and other corporate officials to greater risks of liability. To do so might engender a push for incorporation in other states offering less risk and more liability leniency. It therefore is the task of shareholders, including institutional shareholders who are so inclined, to use their votes, their market power, their powers of persuasion, and public relations tools to encourage corporations to adopt corporate guidelines to their liking. In the absence of uniform federal fiduciary standards made applicable to America's corporations by federal legislation, it is doubtful that corporate law will mandate levels of director responsibility advocated by the CII and others. Furthermore, in today's political climate, it is unrealistic to expect legislation at the federal level.

In addition to the problem of corporate governance guidelines,

145. See Brehm, 746 A.2d at 262 (regarding Old Board decision), and at 266 (regarding New Board decision).
146. See generally Amicus Curiae Brief at 19 n.8. See also supra notes 130-38 and accompanying text.
147. Brehm, 746 A.2d at 256.
section 102(b)(7) of the Delaware Corporate Law and similar statutes in other states, which in one way or another allow directors to be excused from liabilities, even for gross negligence, impair the ability of shareholders to protect themselves.

Furthermore, even acceptance of the CII definition of independent directors would not totally guarantee their independence or make directors as protective as might be desired. Certainly domination of corporate boards by directors who are at least not dependent on the CEO, could lead to better protection of the corporation and its investors. But independence is a matter of degree, and it is possible that a group of directors, who initially meet the standards of independence set forth by the CII, working together with the CEO and other officials over a period of time, may not remain sufficiently strong, vigilant, and independent so as to give as much protection to the corporation and its investors as might have been envisioned.

Judicial deference to the decisions of so-called disinterested and independent directors is another matter. Abdication or near abdication by courts in reviewing conflict of interest transactions, simply because of their approval by allegedly disinterested and independent directors, is inappropriate. Perhaps some litigation benefit—like a shifting of the burden of proof of fairness to plaintiffs—should be given in cases where disinterested or independent directors have approved questioned transactions. That would provide some incentive for using disinterested or independent directors. But the fairness of conflict of interest transactions should remain open to judicial review. If a plaintiff is able to establish the unfairness of such a transaction, plaintiff ought to be able to obtain relief.

In addition, unreasonable information access for litigants may block their opportunity to pursue meritorious derivative litigation. For a court to require particularized pleading, as does Delaware to the degree set forth in Brehm, and at the same time limit discovery about the independence of directors so as to prevent the gathering of needed information to help make allegations sufficient, even in a case as extreme as the Brehm case, is unreasonable.

Finally, section 102(b)(7) of the Delaware Corporation Law and similar statutes in other states which permit limiting or eliminating liability for the gross negligence of directors is not good policy. A posi-

148. See supra note 140 and accompanying text.
149. See generally supra note 36.
tion such as the one taken by CREF, which would hold directors liable for violation of their duty of loyalty or their fiduciary duty involving gross or sustained and repeated negligence, is a fair one. The need to deter or to dispose of inappropriate lawsuits early should not lead to the elimination of proper ones based on egregious behavior. Surely a proper balance can be struck.

150. See supra notes 20-21 and accompanying text.