

"Across the Board"



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Judge visits Disneyland, comes away satisfied.

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Readers will recall that the decision of Austin J in *ASIC v. Rich* concerning the duties of the chairman of One.Tel raised some eyebrows in several respects. The standards apparently expected of company chairmen were being fixed some time after the event, by reference to the views of expert practitioners of the art of company directorship, not "the law", and those views in turn seemed to be aspirational in content, rather than expressed by reference to previous legal decisions.

Exactly the same concerns arose in the recent Delaware decision in the case of *Disney shareholders vs the Disney Board and Michael Ovitz*. But the judge was clearly alert to the issues and delivered a judgement which must be frustrating to plaintiff lawyers in the US, but reassuring to directors and their advisers (and insurers!)

The decision is the most recent of the US corporate 'spectacles' and while lengthy, is well worth reading. The judge, Chancellor Chandler, has a good turn of phrase and is not reluctant to use it. When he says "As I will explain in painful detail hereafter" - the pain was his, not ours. He continues in words that sum up his decision:

there are many aspects of [the directors'] conduct that fell significantly short of the best practices of ideal corporate governance. Recognizing the protean nature of ideal corporate governance practices, particularly over an era which has included the Enron and WorldCom debacles, and the resulting legislative focus on corporate governance, it is perhaps worth pointing out that the actions (and the failures to act) of the Disney board that gave rise to this lawsuit took place ten years ago, and that applying 21st century notions of best practices in analysing whether those decisions were actionable would be misplaced.

He continued: *Delaware law does not – indeed the common law cannot – hold fiduciaries liable for a failure to comply with the aspirational ideal of*

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best practices, any more than a common-law court deciding a medical malpractice dispute can impose a standard based on ideal – rather than competent or standard – medical treatment practices, lest the average medical practitioner be inevitably found derelict.

The decision arose from a group of shareholders suing the directors in connection with the 1995 hiring, and 1996 firing, of Michael Ovitz which cost the company US\$140million in severance pay. The judgement totally exonerates the directors.

The expert witness sought to be relied on concerning governance standards, was Professor Deborah DeMotte, who visited Australia last year; she is a well known corporate law academic, but not, I infer, a company director. The attempt by the plaintiffs to have her give evidence about the custom and practice of corporate governance in Delaware corporations at the relevant time, was largely rejected, on the basis

that she was really giving evidence about the law. The law is a matter for the judge, and not something about which evidence can be given.

In his decision, the judge rightly points out that whilst business decisions may go spectacularly awry, as long as directors' fiduciary duties were adhered to, we should not hold them liable – to do so would drive all directors to the extreme end of the risk aversion scale. The decision points out that best practice corporate governance always includes compliance with fiduciary duties, but compliance with fiduciary duties, is 'not always enough to meet or satisfy what is expected by the best practices of corporate governance'.

The introduction to the decision concludes that "Even where decision makers act as faithful servants, however, their ability and the wisdom of their judgements will vary. The redress for failures that arise from faithful management must come from the markets, through the action of shareholders, and the free flow of capital, and not from this Court. [Otherwise] the entire advantage of the risk-taking, innovative, wealth-creating engine that is the Delaware Corporation would cease to exist, with disastrous results for shareholders and society alike."

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On the face of it, the outraged shareholders now have cause to feel doubly outraged. Their derivative action has come to nought – leaving them (and other shareholders with similar grievances) with only two possible courses of action in seeking what they believe to be ‘justice’ – the removal of directors through regular elections, or the Wall Street Walk....neither of which have proved effective. Indeed the former remains elusive in practice in the US. And while the directors won, they won't be putting the decision on their CVs.

You may think that this dispute will not end with this decision. In fact the judge acknowledges the likelihood of an appeal when stating that “I have tried to outline carefully the relevant facts, in a detailed manner to the voluminous record.....in an effort to ensure meaningful appellate review”. However that prospect may have receded to some extent with the decision to appoint the COO, Mr

Iger, to replace the CEO, Mr Eisner, and the resolution of the differences between the board and former directors

Roy Disney (Walt's nephew) and Stanley Gold.

What lessons for Australia? The decision does not in any sense bind Australian courts, but is a useful reminder that directors are to be held to account not for failures to achieve aspirational best practice, but for failures to do their duty, and that distinction needs to be maintained.

An aside to any journalists who think corporate wrongdoing should be as easy and quick to prove as any other crime: take a good look at the case of Disney, which was a civil case – with the lower standards of proof which that entails. The trial consumed 37 sitting days, 9,360 pages of transcripts from 24 witnesses, as well as thousands of pages of deposition transcripts, and 1,033 trial exhibits that filled more than 22 3 ½ inch binders! All about the hiring, and firing, of one man.

Note - The case was decided on 9 August 2005 and should be available in due course at <http://courts.delaware.gov/opinions/>, but could not be accessed at that site at the time of writing.