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NOTES BEARING INTEREST

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The Chair's Comments


William B. Gwyn Jr.

For those of you who attended our Section Annual Meeting in Pinehurst, you enjoyed great programs as well as a variety of opportunities for fellowship with other business lawyers from across our state. Attendance was at an all-time high, and we again thank members of the Corporate Counsel Section for their contributions as joint planners and co-sponsors of the event. Also, many thanks to Stuart Johnson and Lisa McDougald, co-chairs of the Planning Committee, and to Steve Lynch, chair of our CLE Committee, for their leadership in planning this event.

One of the highlights of the annual meeting was presentation of the first

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In re Disney:

A Stroll Through Chancellor Chandler's Magic Kingdom

By Stephen F. Later

Introduction

The decision of the Delaware Supreme Court in **In re The Walt Disney Company Derivative Litigation**, 906 A.2d 27 (Del. 2006) is notable for its elaboration upon the good faith required of corporate directors, and, yet, **Disney** is significant, too, for its consideration of corporate minutes. The appropriate level of corporate minutes – minimal minutes that record acts without notes of discussion, minutes that record acts and synopses of debate, and verbatim transcripts of the proceedings – is a subject of longstanding debate amongst lawyers. **Disney** offers valuable guidance to lawyers in their advice to clients about the best manner in which to record corporate minutes.

Disney Litigation

Disney was a shareholder derivative action brought against Michael Ovitz ("Ovitz"), the former president of The Walt Disney Company ("Disney"), and the Disney directors in office at the time of the execution of an employment agreement between Ovitz and Disney (the "OEA") pursuant to which, Ovitz, terminated without cause just 14 months into the five-year OEA, collected a $130 million severance package. **Disney** addressed the sufficiency of the directors' discharge of their duties of care and loyalty in their 1995 approval of the OEA and, ultimately, the directors' entitlement to the protections of the business judgment rule and its presumption that, so long as there is no evidence of director fraud, bad faith or self-dealing and "any rational business purpose"[1] can be attributed to the directors' decision, corporate directors "acted on an informed basis… and in the honest belief that the action taken was in the best interests of the company [and its shareholders]."[2]

The **Disney** court turned, naturally, to the corporate record related to the approval of the OEA. Chancellor William B. Chandler III, in denial of a pre-trial motion to dismiss, noted the thin record of informed debate amongst the directors and thus concluded that the evidence was insufficient to support application of the business judgment rule prior to trial.

Chancellor Chandler observed that the Disney compensation committee, without the assistance of an executive compensation expert, reviewed the terms of the OEA but that committee members received an incomplete "rough summary" of the OEA in lieu of a draft of the OEA or "any of the materials already produced by Disney regarding Ovitz's possible employment. No spreadsheet or similar type of analytical document showing the potential payout to Ovitz throughout the contract, or the possible cost of his severance package upon a non-fault termination, was created or presented."[3] The Chancellor was, in fact, compelled to further note in his trial opinion that "[i]t would have been extremely helpful to the Court if the minutes had indicated in any fashion that the discussion relating to the OEA was longer and more substantial than the discussion relating to the myriad of other issues brought before the compensation committee that morning."[4]

The Delaware Supreme Court ultimately affirmed the conclusion of the trial court that the directors' review of the issue was sufficient but wrote that, "although the commit-

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tee's process did not fall below the level required for a proper exercise of due care, it did fall short of what best practices would have counseled."[5] The Supreme Court continued that, under a best practices scenario, "all committee members would have received, before or at the committee's first meeting…, a spreadsheet or similar document prepared by (or with the assistance of) a compensation expert…. Making different, alternative assumptions, the spreadsheet would disclose the… [payouts under the OEA] in each circumstance that might foreseeably arise…. The contents of the spreadsheet would be explained to the committee members, either by the expert who prepared it or by a fellow committee member similarly knowledgeable about the subject. That spreadsheet, which ultimately would become an exhibit to the minutes of the compensation committee meeting, would form the basis of the committee's deliberations and decision."[6]

The court noted, in fact, that, "[h]ad that scenario been followed, there would be no dispute (and no basis for litigation) over what information was furnished to the committee members or when it was furnished."[7] The failure of the Disney board to maintain sufficient corporate minutes thus resulted in a decade of litigation and a 37-day trial of the claims against the Disney directors.

North Carolina Application

As the "center of the corporate universe,"[8] the decisions of Delaware courts are, of course, instructive to corporate practitioners in North Carolina. Indeed, although "North Carolina does not blindly follow Delaware corporate law…, it frequently looks to the wealth of experience and sound guidance found in the Delaware corporate law decisions when issues of first impression arise."[9]

The North Carolina Business Corporation Act (the "Act") provides that corporate directors are charged with oversight of corporate affairs and states that "[a] director shall discharge his duties as a director… (1) [i]n good faith, (2) [w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances, and (3) [i]n a manner he reasonably believes to be in the best interests of the corporation."[10] Further, in the absence of knowledge otherwise, "directors are entitled to rely on information, opinions, reports or statements prepared or presented by corporate officers or employees reasonably believed to be reliable and competent, legal counsel, public accountants and others reasonably believed to be within their professional or expert competence, and board committees reasonably believed to merit confidence."[11]

Finally, whereas corporate directors are exposed to personal liability for, inter alia, gross neglect, mismanagement, and fraud, the business judgment rule shields directors from errors of judgment made in good faith. The business judgment rule "creates, first, an initial evidentiary presumption that in making a decision the directors acted with due care (*i.e.*, on an informed basis) and in good faith in the honest belief that their action was in the best interest of the corporation, and second, absent rebuttal of the initial presumption, a powerful substantive presumption that a decision by a loyal and informed board will not be overturned by a court unless it cannot be attributed to any rational business purpose"[12] and thus "protects corporate directors from being judicially second-guessed when they exercise reasonable care and business judgment."[13]

It is thus critical in North Carolina, as in Delaware, that corporate directors ensure the adequacy of the records of their proceedings in order to enjoy the protections afforded by the business judgment rule.

The references to minutes in North Carolina law are brief and, unfortunately, uninstructive. Section 16-01(a) of the Act provides that "[a] corporation shall keep as permanent records minutes of all meetings of its incorporators, shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation."[14] There is, however, no elaboration upon the applicable, or indeed the expected, standards therefor.

Further, in North Carolina as in Delaware, "[a]s a general rule the minutes of a corporation are the best evidence of its acts, resolutions, and proceedings; and, when they are complete, when no fraud or mistake is shown, and it does not appear that there is any error or omission, parol evidence is not admissible to contradict, modify, or vary the record. If the language is ambiguous or its meaning is indefinite, or if the minutes are incomplete and fragmentary, parol evidence may be heard to show what was done."[15]

The North Carolina Court of Appeals addressed the proper scope of the minutes, albeit in the context of a county board of commissioners and its obligations under the North Carolina Open Meetings Law,[16] and noted that "[t]heir purpose is to reflect matters such as motions made, the movant, points of order, and appeals-not to show discussion or absence of action."[17] The Court of Appeals cited Robert's Rules of Order Newly Revised and its statement that the minutes "should contain mainly a record of what was *done* at the meeting, not what was *said* by the members."[18] Indeed, whereas **Disney** commends the annexation to the minutes of all materials distributed to board members, Robert's Rules of Order Newly Revised simply notes that "[w]hen a committee report is of great importance or should be recorded to show the legislative history of a measure, the assembly can order it 'to be entered in the minutes,' in which case the secretary copies it in full in the minutes."[19]

Conclusion

The traditional position, which generally favors minimal minutes, is that this approach reduces the likelihood of inaccuracies and the opportunities for exploitation by adverse parties because barebones minutes will not, for example, include detrimental statements in the course of debate or reveal the brevity of debate on certain topics. The decisions of corporate directors face increased attention, from regulators and litigants, in the wake of corporate misfeasance that prompted the Sarbanes-Oxley Act of 2002 and a tide of shareholder activism.

Therefore, as **Disney** indicates that insufficient minutes stand to jeopardize application of the business judgment rule to board actions, it appears that best practices dictate that corporate minutes (a) include thorough summaries of board proceedings, discussions, and presentations in order to evidence the informed debate of the directors, in which cursory notations that "a general discussion followed" are not likely to be sufficient, and

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(b) include, as appendices, materials distributed to board members at the meeting. Finally, although parol evidence may be admissible to supplement, but not to contradict, the minutes, the importance of a thorough corporate record is underscored by the unlikely prospect that, in the context of derivative or other litigation, corporate directors will look forward to contested efforts to introduce additional evidence of board meetings in efforts to secure the protections of the business judgment rule.

However, the risks that undergird the traditional preference for skeletal minutes clearly remain valid and, in our litigious environment, timely, and increased diligence is thus required of clients in all matters related to the decisions of corporate directors. The avoidance of self-inflicted damage in the corporate record – from evidence of perfunctory consideration of important matters to omissions or inaccuracies related to decisions and decision making – requires not just minutes that reflect the best practices identified by the **Disney** court but due care in their preparation by the corporate secretary and in their review and approval by the directors. Consequently, all notes of the proceedings (and drafts thereof) should be delivered to the corporate secretary for synthesis in the minutes and thereafter disposed of pursuant to corporate document retention policies not to obscure the record or, of course, to subvert legal process, but, rather, to prevent the exploitation of incorrect or incomplete extracts of the proceedings.[20]

The production of comprehensive minutes, although clearly significant for purposes of the business judgment rule, is not without drawbacks. It is quite possible that boardroom candor will, in fact, suffer as directors, mindful of a thorough record and concerned about the potential role of their comments in litigation, limit their remarks and thus erode the deliberative function of the board. There is thus an ironic tension within the **Disney** opinion as its minutes-related requirements, intended to promote good governance, stand to chill the internal debate that is essential to a thoughtful and constructive board of directors. ■

End Notes

1. **Sinclair Oil Corp. v. Levien**, 280 A.2d 717, 720 (Del. 1971).

2. **Aronson v. Lewis**, 473 A.2d 805, 812 (Del. 1984).

3. **In re Walt Disney Co. Deriv. Litig.**, 825 A.2d 275, 280 (Del. Ch. 2003).

4. **In re Walt Disney Co. Deriv. Litig.**, 907 A.2d 693, 768 n.539, (Del. Ch. 2005), *aff'd sub nom.*, **Brehm v. Eisner** (**In re Walt Disney Co. Deriv. Litig.**), 906 A.2d 27 (Del. 2006).

5. 906 A.2d 27, 56.

6. **Disney**, 906 A.2d at 56.

7. **Disney**, 906 A.2d at 56.

8. E. Norman Veasey, *Musings from the Center of the Corporate Universe*, 7 DEL. L. REV. 163, 166-167 (2005).

9. **In re Wachovia Shareholders Litigation**, 2003 WL 22996328, 14 (N.C.Super. Dec. 19, 2003).

10. N.C. Gen. Stat. § 55-8-30(a).

11. N.C. Gen. Stat. § 55-8-30(b); *see* N.C. Gen. Stat. § 55-8-30(d).

12. Russell M. Robinson II, *Robinson on North Carolina Corporation Law*, § 14.06, at 14-16-14-17 (2005).

13. **HAJMM Co. v. House of Raeford Farms**, 94 N.C.App. 1, 10, 379 S.E.2d 868, 873, *review on additional issues allowed*, 325 N.C. 271, 382 S.E.2d 439 (1989), *and modified, aff'd in part, rev'd in part on other grounds*, 328 N.C. 578, 403 S.E.2d 483 (1991).

14. Section 142(a) of the Delaware General Corporation Law similarly states that "[o]ne of the officers shall have the duty to record the proceedings of the meetings of the stockholders and directors in a book to be kept for that purpose."

15. **Respess v. Rex Spinning Co.**, 191 N.C. 809, ____, 133 S.E. 391, 394, (1926).

16. N.C. Gen. Stat. §§ 143-318.9 to 143-318.18.

17. **Multimedia Publishing of North Carolina, Inc. v. Henderson County**, 145 N.C.App. 365, 373, 550 S.E.2d 846, 852, (2001).

18. **Multimedia Publishing**, 145 N.C.App. at 373, 550 S.E.2d at 852 (quoting Henry M. Robert, *Robert's Rules of Order Newly Revised* (9th ed.), § 47, at 458 (1990) (emphasis in original)).

19. Henry M. Robert, *Robert's Rules of Order Newly Revised* (10th ed.), § 48, at 454 (2000).

20. American Society of Corporate Secretaries, *Corporate Minutes: A Monograph for the Corporate Secretary*, at 6 (2006).

LATER PRACTICES WITH ROBBINS MAY & RICH LLP IN PINEHURST.