

## Lessons from Ovitz

It will be naïve for directors to seek comfort in Delaware judge Chandler's decision to allow Michael Ovitz to keep his \$140m severance package.

This is an event which took place almost a decade ago. The case was brought by shareholders in January 1997. The same judge threw it out in October 1998. Delaware Supreme Court reinstated it. In January 2002 the shareholder brought the case once again alleging directors were "grossly negligent" in approving Ovitz's severance payment. This time they enhanced value to \$130m. It was the changed landscape of post Enron and post enactment of Sarbanes-Oxley that made Judge Chandler admit the suit in June 2003. Though the judge pointed out that the directors' conduct fell significantly short of best practices of corporate governance, he had to take into account the context of corporate governance as it was in 1995 and 1996 when it was common for CEOs to pack the boards with compliant directors and use them as rubber stamps.

As for the lessons for today's directors, this is what he has to say: "Are there aspects of Ovitz's hiring that reflect the absence of ideal corporate governance?" he asks. "Certainly, and I hope that this case will serve to inform shareholders, directors and officers of how the company's fiduciaries underperformed."

We must not overlook another important aspect. This is not a company where the management has destroyed shareholder value. The Judge could not help noticing that despite all his faults Eisner has created value for the shareholders. He is presiding over a company that is going through a financial turnaround. Disney's profit recovery has continued in the third quarter with better-than-expected earnings. Third quarter earnings have recorded an increase of 41%. The results have exceeded analysts' forecast. The other directors in the docks are the ones who destroyed earnings. Corporate governance is an issue of both performance and conformance. In fact, conformance without performance is an almond without a kernel.

There is a clear message in the judgement that while Ovitz judged in the context he was awarded the severance package could keep that, the directors who behave similarly now are unlikely to go Scot-free.

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