

University of Pennsylvania Carey Law School

Penn Law: Legal Scholarship Repository

Comparative Corporate Governance and
Financial Regulation

Select Seminar Papers

Spring 2016

Executive Compensation: *Mannesmann v. Disney* - A Case Study

Do Hee Jeong
University of Pennsylvania

Maurice Weidhaas
Goethe University

Follow this and additional works at: https://scholarship.law.upenn.edu/fisch_2016



Part of the [Benefits and Compensation Commons](#), [Business Organizations Law Commons](#), [Comparative and Foreign Law Commons](#), and the [European Law Commons](#)

Repository Citation

Jeong, Do Hee and Weidhaas, Maurice, "Executive Compensation: *Mannesmann v. Disney* - A Case Study" (2016). *Comparative Corporate Governance and Financial Regulation*. 8.
https://scholarship.law.upenn.edu/fisch_2016/8

This Seminar Paper is brought to you for free and open access by the Select Seminar Papers at Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Comparative Corporate Governance and Financial Regulation by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact PennlawIR@law.upenn.edu.

Seminar Paper on Comparative Corporate Governance



Executive Compensation: *Mannesmann v. Disney* - A Case Study

Do Hee Jeong (Penn Law)

Maurice Weidhaas (Goethe University)

Introduction

Mannesmann and *Disney* are both cases that involved executive compensation schemes that have received great public criticism for their sizes in Germany and the U.S. Although the bonus payment in *Mannesmann* dwarfed the severance payout in *Disney*, the court in *Mannesmann* concluded that the board had committed waste while the court in *Disney* found no basis for breach of fiduciary duty or corporate waste.

As such, this paper seeks to offer comparative thoughts on the driving forces that may have led to contrasting results. Part I and Part II of the paper offers extensive review of *Mannesmann* and *Disney*, respectively, highlighting some of the key features of the facts and reasoning in the cases. Part III provides comparative insight that the differing level of deference towards corporate boards, and the different underlying legal and corporate governance systems in both countries appear to explain, at least in part, the paradoxical verdicts of the cases. Part IV concludes the paper with final remarks regarding the implications of *Mannesmann* and *Disney* in their respective jurisdictions.

A. Part I: The Compensation of Klaus Esser after the Mannesmann/Vodafone Merger

The *Mannesmann/Vodafone* merger, being the biggest merger of all time so far¹, was the very first successful hostile takeover in Germany and the succeeding trials gave an enormous boost to the German Corporate Governance debate in regard to executive compensation.

The first part of the paper wants to give a general overview of the state of executive debate in Germany before the takeover and the influence on the debate afterwards. First the legal and theoretical context of the time before the said takeover will be presented. Then the corporate governance structure of *Mannesmann* in terms of executive remuneration will be depicted, followed by a summary of the most important facts regarding the *Mannesmann AG* in general and the context of the takeover. Thereafter, the “Mannesmann”-Verdict of the German Federal Court of Justice will be reviewed, followed by a critical analysis of the problems of executive remuneration, depicted or unresolved by the verdict. Additionally, the process of the granting of the controversial compensation will be illustrated. To conclude, part I of the paper closes with an overview of the influence of the *Mannesmann* case on German legislation.

I. The Compensation Practice in Germany before Mannesmann

In order to be able to relate to the noteworthiness of Essers compensation after the *Mannesman* takeover and its influence on the German Corporate Governance debate, one has to look at the legal background of that time.

1. Legal Provisions on Executive Compensation

The German legal system at the time featured some mandatory regulations in the German Stock Corporation Act (“Aktengesetz” or “AktG”) regarding the provisions and requirements as well as the process of the granting of compensations. Back then, the voluntary recommendations of the German Corporate Governance Codex (“Deutscher Corporate Governance Kodex” or “DCGK”)² were not in force until February 26th, 2002 and therefore have not been available to *Mannesmann*.

¹ Knipp, Der Deal, 11–12.

² „Corporate Governance Kodex – Endfassung“ - NZG, 273.

a. The Supervisory Board as the Decision Making Body in regard to Executive Compensation

The board of directors of German stock companies (“AGs”) is structured according to the “two-tiers”-model and consists of the board of directors (“Vorstand”), and the supervisory board (“Aufsichtsrat”).³

The management board is in charge of operating business of the company according to § 76 para. 1 AktG.⁴ In Contrast to that, the supervisory board is appointing and supervising the management board, § 111 para. 1 AktG^{5,6}

According to § 84 para. 1 AktG⁷ and § 112 AktG⁸, the supervisory board is the primary decision making body, when it comes to questions regarding human resources.⁹ Thus, it is also in charge of the negotiation of compensation agreements.¹⁰ Thereby the supervisory board represents the whole corporation and has to decide on behalf of the interests of the company (compare §§ 116 para. 1¹¹, 93 para. 1 AktG¹²). The supervisory board consists of at least three members – and according to § 95 AktG¹³ this number increases in relation to the equity capital of the company up to 21 members. Furthermore, the composition of the board has to take the codetermination of employees into consideration.¹⁴ In a German AG that employs more than 500 persons of staff in total, one third of the supervisory board has to consist of representatives of the employees, in larger corporations with more than 2.000 persons of staff, of even half of the seats of the supervisory board.¹⁵

This structure leads to an accumulation of potentially colliding interests. Consequently, the process of decision making in the supervisory board can be of long duration. To sustain the efficient working, the supervisory board is capable of forming committees to which it can

³ *Cheffins*, The American Journal of Comparative Law 2001, 497, (514).

⁴ In the Version of June 9th, 1998, BGBl. I 1998, 1242.

⁵ In the Version of April 27th, 1998, BGBl. I 1998, 786.

⁶ *Cheffins*, The American Journal of Comparative Law 2001, 497, (514).

⁷ In the Version of May 4th, 1976, BGBl. I 1976, 1153.

⁸ In the Version of Sept. 6th, 1965, BGBl. I 1965, 1089.

⁹ *Hüffer*, Aktiengesetz, § 84, m.n. 13.

¹⁰ *Baums*, in: *Baums/Wertenbruch/Lutter u. a., Festschrift für Ulrich Huber zum siebzigsten Geburtstag*, 657, (658).

¹¹ In the Version of Sept. 6th, 1965, BGBl. I 1965, 1089.

¹² In the Version of March 25th, 1998, BGBl. I 1998, 590.

¹³ In the Version of June 9th, 1998, BGBl. I 1998, 1242.

¹⁴ *Gevurtz*, The American Journal of Comparative Law 2007, 453, (474).

¹⁵ *Cheffins*, The American Journal of Comparative Law 2001, 497, (514).

delegate specific tasks through § 107 para. 3 AktG^{16,17} The expulsion of representatives of the employees for the sake of efficiency is nevertheless prohibited.¹⁸

One of the most important and frequently implemented committees is the personnel committee.¹⁹ The competence to enter into, end or change existing contracts of members of the board is often delegated to such committees.²⁰ This includes the bargaining of the composition of compensation agreements.²¹

b. The Provisions on executive Compensation according to § 87 para. 1 AktG

The mandatory provisions on executive pay are defined in § 87 para. 1 AktG²². The supervisory board or the delegated committee is addressed in this section.²³ With § 87 para. 1 AktG²⁴ being an incarnation of the theory of performance related justice²⁵, every compensation of executive staff has to be appropriate. § 87 para. 1 AktG²⁶ ties the appropriateness of a compensation to two criteria, the responsibility of the executive and the state of the company. All kinds of benefits, including the salary, stock options and severance packages have to be taken into consideration.²⁷

The link of executive pay to these factors contributes that the amount of compensations never exceeds the financial means of the company as a prevention of abuse and further that the reward of the executive takes his value to the corporation into consideration.²⁸ This provides conditions which focus on the growth and development of the company. Nevertheless, the section is rather abstract and misses any specific limits on executive pay and thereby leaves a final decision to the discretion of the supervisory board.²⁹

¹⁶ In the Version of Dec. 19th, 1985, BGBl. I 1985, 2355.

¹⁷ *Pape*, Vergütungs- und Abfindungszahlungen an Vorstandsmitglieder deutscher Aktiengesellschaften im Fall feindlicher Unternehmensübernahmen, 22–23.

¹⁸ *Semler*, in: *Kroppf/Semler* § 107 AktG, m.n. 258.

¹⁹ *Semler*, in: *Kroppf/Semler* § 107 AktG, m.n. 257.

²⁰ *Semler*, in: *Kroppf/Semler* § 107 AktG, m.n. 259.

²¹ *Pape*, Vergütungs- und Abfindungszahlungen an Vorstandsmitglieder deutscher Aktiengesellschaften im Fall feindlicher Unternehmensübernahmen, 23–24.

²² In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

²³ *Pape*, Vergütungs- und Abfindungszahlungen an Vorstandsmitglieder deutscher Aktiengesellschaften im Fall feindlicher Unternehmensübernahmen, 30.

²⁴ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

²⁵ *Peltzer*, in: *Lutter/Schneider*, Festschrift für Marcus Lutter zum 70. Geburtstag, 571, (586).

²⁶ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

²⁷ *Hefermehl/Spindler*, in: § 87 AktG, m.n. 12.

²⁸ *Pape*, Vergütungs- und Abfindungszahlungen an Vorstandsmitglieder deutscher Aktiengesellschaften im Fall feindlicher Unternehmensübernahmen, 37.

²⁹ *Brauer*, NZG 2004, 502, (504).

2. Importance of Executive Pay

Due to the historically grown influence of stakeholder interests within the decision-making process of German stock companies, the orientation of these enterprises focusses rather on the interests of the company than those of the shareholders.³⁰ This specific characteristic of the German Corporate Governance system has far-reaching impact, especially on the determination of payments packages.

Most likely, an executive whose payment depends on the decision of a stakeholder influenced board, will tend to decide in favor of the company, rather than in the interest of shareholders.³¹ Therefore, the function of executive pay to serve as an incentive to protect shareholder's interests is and was not very distinct in Corporate Germany.³² This is supported by the fact, that German companies at that time had not been as dependent from stock market investors, as their Anglo-American counterparts, due to the possibility of external financing from banks.³³ There was simply no need to be shareholder orientated, because through its insider orientation, Corporate Germany was rather isolated from the market of corporate control at the time of the *Mannesmann* takeover.³⁴

Furthermore, it was widely debated by German scholars at the time whether or not a compensation was meant to be a performance-based compensation according to § 87 para. 1 AktG³⁵, due to the lack of verdicts on this subject.³⁶

II. The Corporate Governance Structure of the Mannesmann Concern

Being a German Stock Company, Mannesmann complied with the mandatory provision of the German Stock Corporation Act. The ownership structure of Mannesmann was exceptional for a German conglomerate, as its shares were highly fragmented and lacked major controlling shareholders.³⁷ Moreover, a majority of approximately 60% of *Mannesmann's* shares were

³⁰ *Haar*, in: Thomas, Research Handbook on Executive Pay, 486, (489); *Jürgens/Rupp/Vitols*, Economy and Society 2000, 54, (56–57).

³¹ *Cheffins*, The American Journal of Comparative Law 2001, 497, (515).

³² *Kolla*, German Law Journal, 829, (831).

³³ *Haar*, in: Thomas, Research Handbook on Executive Pay, 486, (488).

³⁴ *Haar*, in: Thomas, Research Handbook on Executive Pay, 486, (488).

³⁵ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

³⁶ *Hoffmann-Becking*, NZG 1999, 797, (799); *Fleischer*, DStR, 1279, (1281); *Körner*, NJW 2004, 2697, (2698).

³⁷ *Streeck/Höpner*, Alle Macht dem Markt?, 153; *Höpner/Jackson*, MPIfG Discussion Paper 01/4 2001, (43).

hold by foreign investors, making it the German company with the most international ownership structure.³⁸

The numbers of employees exceeded more than 31000 in 1952³⁹ and grew up to more than 130.000 in 1999⁴⁰. Because of *Mannesmann*'s historical participation in the mining and steel industry, the corporation had to comply with the most extensive co-determination regulations ("Montanmitbestimmung"⁴¹) existing in the German legal system.⁴² Consequently, the employees exercised a lot of influence through their representatives. Therefore, half of the seats of the supervisory board were elected by the employees, while the other half was elected by the stockholders.⁴³

Furthermore, the supervisory board of Mannesmann made use of § 107 para. 3 AktG⁴⁴ and delegated its competence on personnel matters as well as compensation decisions to a committee, the so called "Präsidium". It consisted of four members; Josef Ackermann and Joachim Funk who were elected by the stockholders, and Jürgen Ladberg and Klaus Zwickel, elected by the employees.⁴⁵

III. The Context of the Mannesmann Takeover

1. The State of the Mannesmann AG before the Takeover

The Mannesmann Corporation began with the foundation of the *Mannesmannröhren-Werke AG* on July 16th 1890 by the brothers Max and Reinhard Mannesmann.⁴⁶ This corporation was specialized in the production of tubes. At the beginning of the 20th century they included a steel and a mining department in the business plan transforming the corporation into a diversified conglomerate.⁴⁷ In the 70s the company changed its structure, away from the departments of steel and mining and towards engineering.⁴⁸ In the following years,

³⁸ *Höpner/Jackson*, MPIfG Discussion Paper 01/4 2001, (25).

³⁹ *Wessel*, *Kontinuität im Wandel*, 282-283, 360.

⁴⁰ *Clarke*, *International Corporate Governance*, 405.

⁴¹ Although Mannesmann took action against the application of these extensive regulations on co-determination through several legal proceedings and succeeded in 1999, the structure of the board of directors did not change until the takeover and is therefore not subject of this paper. (See: *Höpner/Jackson*, MPIfG Discussion Paper 01/4 2001, (33)).

⁴² *Höpner/Jackson*, MPIfG Discussion Paper 01/4 2001, (32).

⁴³ *Gevurtz*, *The American Journal of Comparative Law* 2007, 453, (460).

⁴⁴ In the Version of Dec. 19th, 1985, BGBl. I 1985, 2355.

⁴⁵ *Pape*, *Vergütungs- und Abfindungszahlungen an Vorstandsmitglieder deutscher Aktiengesellschaften im Fall feindlicher Unternehmensübernahmen*, 9.

⁴⁶ *Wessel*, *Kontinuität im Wandel*, 13.

⁴⁷ *Wessel*, *Kontinuität im Wandel*, 139 f..

⁴⁸ *Wessel*, *Kontinuität im Wandel*, 383.

Mannesmann continued to include a car component manufacturer and bought a weapon- as well as a watch manufacturer.⁴⁹ But the most far-reaching change was the implementation of the telecommunication business into business structure of the Mannesmann group

This was possible due to the liberalization of the German telecommunications market⁵⁰ through the Law on the restructuring of the postal system and telecommunication (Poststrukturgesetz⁵¹) in 1989. Mannesmann started the mobile telephone network provider "D2" on December 7th in the same year, marking its entry into the business with high tech technology.⁵²

The Mannesmann conglomerate had become highly diversified and the individual divisions had to compete against each other in terms of investments and human resources. While de-investing in its former core division, the producing of tubes, the telecommunication division benefited from two thirds of all investments made by the Mannesmann AG between the years 1990 and 1999.⁵³ This led to the decision to spin-off the traditional business from the group and to focus on the telecommunication market, as it promised the best revenue and development in the future.⁵⁴ The IPO for the other divisions was planned to be held in 2000 and was broadly supported by both the management as well as the representatives of the employees.⁵⁵ This plan was boosted by the new CEO Klaus Esser, who had succeeded Joachim Funk as chair of the management board in May 1999.⁵⁶

Esser expanded the Mannesmann's telecommunication division by acquiring the German telecommunication corporation *o.tel.o* as well as the Italian corporations *Omnitel* and *Infrastada*.⁵⁷ At this point, Mannesmann and Vodafone had been considered allies on the European market. Vodafone holds a 34,8% stake in *Mannesmann Mobilfunk*, a subsidiary of Mannesmann specialized in mobile communication networks, and they even participated together in *E-plus*.⁵⁸ This all changed with the takeover bid for the British mobile network

⁴⁹ *Streeck/Höpner*, *Alle Macht dem Markt?*, 153.

⁵⁰ *Höpner/Jackson*, MPIfG Discussion Paper 01/4 2001, (23).

⁵¹ „Gesetz zur Neustrukturierung des Post- und Fernmeldewesens und der Deutschen Bundespost“ (Poststrukturgesetz – PostStruktG) as of June 8th 1989, BGBl. I 1989, 1026.

⁵² *Slodczyk*, *Handelsblatt* 04.02.2007, (3).

⁵³ *Höpner/Jackson*, *Leviathan* 2001, 544.

⁵⁴ *Höpner/Jackson*, MPIfG Discussion Paper 01/4 2001, (24).

⁵⁵ *Streeck/Höpner*, *Alle Macht dem Markt?*, 156–157.

⁵⁶ *Höpner/Jackson*, MPIfG Discussion Paper 01/4 2001, (23).

⁵⁷ *Adams*, in: *Nutzinger*, *Regulierung, Wettbewerb und Marktwirtschaft*, 295, (297).

⁵⁸ *Höpner/Jackson*, *Eur Manage Rev* 2006, 142, (148).

provider *Orange (UK)* in October 1999, which jeopardized *Vodafone*'s dominant position in its domestic market.⁵⁹

2. The Process of the Takeover in Chronological Order

Provoked by Mannesmann's push into the British mobile telecommunication market, *Vodafone*'s CEO, Chris Gent offered a friendly merger tender to the German conglomerate on November 14th, 1999.⁶⁰ This offer was rejected by Esser who pursued to maintain Mannesmann's independence.⁶¹ As a consequence, *Vodafone* launched a hostile offer, directly addressing Mannesmann's stockholders in December 1999.⁶² The strategy was to swap 53,7 % of *Vodafone*-Shares for every Mannesmann-Share and to convince the stockholders from the merits that a joint conglomerate would offer.⁶³ In January 2000, Esser tried to convince the French *Vivendi* to serve as a "white knight" by forming a partnership.⁶⁴ But these plans were destroyed by *Vodafone*'s CEO Chris Gent, who negotiated a joint venture in the internet business with *Vivendi* and offered the prospect of buying *Orange* after the takeover.⁶⁵

Having lost the "white knight" as a rescue option, and the stockholders being convinced by the financial incentives promised by *Vodafone*, Esser changed Mannesmann's defensive strategy and started to bargain the conditions of a friendly takeover again.⁶⁶ This resulted in a final deal on February 3rd, 2000 and consisted of a swap of Mannesmann-shares for 360€ per share.⁶⁷

3. The Aftermath of the Takeover

a. Essers "Golden Parachute": The Payment of the compensation

After the successful takeover of Mannesmann by *Vodafone*, two Members of the "Präsidium", Josef Ackermann and Joachim Funk met on the February 4th, 2000 and discussed a proposal which envisaged to grant Esser and other executive officers an

⁵⁹ *Höpner/Jackson*, Eur Manage Rev 2006, 142, (148).

⁶⁰ *Adams*, in: Nutzinger, Regulierung, Wettbewerb und Marktwirtschaft, 295, (297).

⁶¹ *Berger-Walliser*, SSRN Journal 2009, (8).

⁶² *Bauman/Palmiter/Partnoy*, Corporations Law and Policy, 97.

⁶³ *Höpner/Jackson*, Leviathan 2001, 544, (555).

⁶⁴ *Clarke*, International Corporate Governance, 409.

⁶⁵ *Clarke*, International Corporate Governance, 409.

⁶⁶ *Bauman/Palmiter/Partnoy*, Corporations Law and Policy, 97.

⁶⁷ *Bauman/Palmiter/Partnoy*, Corporations Law and Policy, 97.

appreciation award for their efforts in the process of the takeover.⁶⁸ This proposal came from one of the members of the supervisory board of the *Mannesmann AG*, Mr. Kin Ning Fok, who was managing director of the Hong Kong based *Hutchison Whampoa* conglomerate.⁶⁹

Hutchison Whampoa had become the largest single stockholder holding 10,2% in stake of the *Mannesmann AG* through Mannesmanns' takeover of *Orange (UK)* in 1999, where *Hutchison Whampoa* had held a 49% stake.⁷⁰ The Hong Kong based conglomerate had been encouraging Esser defensive strategy in the takeover and had supported the management of Mannesmann.

During the meeting on the said February 4th, 2000, Josef Ackermann and Joachim Funk both agreed on the bonuses, including appreciation awards for Esser and other executive officers in the amount of EUR 15 million each.⁷¹ This amount represented the consensus of both, *Hutchison Whampoa* and *Vodafone*.⁷² After that, they informed Klaus Zwickel, who was in another meeting. Zwickel supported the idea to grant an appreciation award but disagreed with the amount proposed.⁷³ Furthermore he acted on the assumption, that *Vodafone* and not *Mannesmann* would pay these awards.⁷⁴ Unaware of this misunderstanding he abstained, well knowing that this would lead to a majority of votes supporting the payment.⁷⁵

Jürgen Ladberg, the fourth and final member of the Präsidium, was thereby outvoted. He was nonattendant due to health related problems and protested against the decision later, when being informed about.⁷⁶

The "Präsidium's" agreement was repeated and confirmed in a circular memorandum on February 28th, 2000 and on the same day Esser received his appreciation award in the amount of EUR 15,5 Million.⁷⁷ Esser, who's contract would not end before 06.20.2004, agreed with *Vodafone's* management to leave the supervisory board preterm in June 2000.⁷⁸ In return he received the full compensation for the remaining time of his employment contract and

⁶⁸ Adams, in: Nutzinger, Regulierung, Wettbewerb und Marktwirtschaft, 295, (298).; *Gevurtz*, The American Journal of Comparative Law 2007, 453, (8).

⁶⁹ Kolla, German Law Journal, 829, (832).

⁷⁰ Höpner/Jackson, MPIfG Discussion Paper 01/4 2001, (25).

⁷¹ Adams, in: Nutzinger, Regulierung, Wettbewerb und Marktwirtschaft, 295, (299).; *Pistor*, in: Hopt, Corporate governance in context, 249, (268).

⁷² Adams, in: Nutzinger, Regulierung, Wettbewerb und Marktwirtschaft, 295, (298).

⁷³ *Gevurtz*, The American Journal of Comparative Law 2007, 453, (8).

⁷⁴ *Jahn*, Zeitschrift für Rechtspolitik 2004, 179, (181).

⁷⁵ *Gevurtz*, The American Journal of Comparative Law 2007, 453, (8).

⁷⁶ *Jahn*, Zeitschrift für Rechtspolitik 2004, 179, (181).

⁷⁷ Adams, in: Nutzinger, Regulierung, Wettbewerb und Marktwirtschaft, 295, (299).; *Kolla*, German Law Journal, 829, (832).

⁷⁸ Adams, in: Nutzinger, Regulierung, Wettbewerb und Marktwirtschaft, 295, (299).

additionally the maximum of achievement related bonuses, resulting to a total of approximately EUR 14,5 Million. Taking into account the appreciation award, the former CEO received thus altogether more than EUR 30 Million.⁷⁹

b. The Fate of Mannesmann/Vodafone

After the takeover the subsidiaries of the *Mannesmann* corporation were sold by *Vodafone* in the year 2000.⁸⁰ The fate of the sold divisions differed: while the pipe manufacturing division experienced a good comeback under its new owner *Salzgitter AG*, the engineering division under *Siemens* had to endure numerous redundancies.⁸¹ Only the telecommunication division was integrated into the business structure of *Vodafone* and is still prosperous until today.⁸² The renaming of *Mannesmann/Vodafone* to *Vodafone GmbH* followed in 2001.⁸³

IV. The Impact of the Mannesmann Case for the German corporation law

1. The "Mannesmann"-Verdict of the Federal Court of Justice

In February 2003, the former members of the Mannesmann Präsidium were charged to have violated § 266 ("Untreue", breach of trust) of the German Penal Code⁸⁴ ("Strafgesetzbuch" or "StGB").⁸⁵ But long before that, in 2001, German prosecutors had already investigated the conformity of the payment of the appreciation awards with German law.⁸⁶

In September 2003, the District Court of Düsseldorf judged that the granting of the payments does not meet the threshold for a violation of § 266 para. 1 of the German Penalty Code^{87,88}. According to the District Court, although having committed a breach of duty according to the German Stock Corporation Act, these violations had not been "aggravated" enough to constitute a breach of fiduciary duties within the meaning of § 266 para. 1 StGB^{89,90}. Such an "aggravated" form of breach of duty was considered to be necessary in order to give

⁷⁹ Adams, in: Nutzinger, Regulierung, Wettbewerb und Marktwirtschaft, 295, (299).

⁸⁰ Jürgen Kuri, Heise Online 11.06.2002.

⁸¹ Knipp, Der Deal, 220–221; Seidlitz, Die Welt 12.11.2009, (2).

⁸² Seidlitz, Die Welt 12.11.2009, (2).

⁸³ Jürgen Kuri, Heise Online 11.06.2002.

⁸⁴ In the Version of Jan. 26th, 1998, BGBl. I 1998, 164.

⁸⁵ Gevurtz, The American Journal of Comparative Law 2007, 453, (8).

⁸⁶ Clarke, International Corporate Governance, 415.

⁸⁷ In the Version of Jan. 26th, 1998, BGBl. I 1998, 164.

⁸⁸ District Court Düsseldorf, NJW 2004, 3275.

⁸⁹ In the Version of Jan. 26th, 1998, BGBl. I 1998, 164.

⁹⁰ NJW 2004, 3275, 3283.

consideration to the fact, that the granting of the bonuses was a business judgment.⁹¹ The prosecutor took action against this verdict by applying to the highest appellate body in Germany, the Federal Court of Justice.

In its decision from December 21st 2005 the Federal Court of Justice set aside the acquittals and remitted the case back to the lower instance.⁹² In terms of Corporate Governance, the line of argumentation of the court with regard to the legal assessment of the decision of the Mannesmann's compensation committee is most interesting. The Court held that the accused violated their fiduciary duties regarding the corporation's assets through the granting of the "appreciation awards".⁹³ Such kind of compensation was never intended in the executives' employments contracts and therefore lacked any legal basis.

However, the compensation would have been admissible when its granting provided an advantageous entrepreneurial purpose, as long as this advantage was in a reasonable relation to the reduction of corporate funds.⁹⁴ According to the tribunal, Esser's efforts during the takeover could not constitute such an advantage, although Mannesmann's stock increased approximately by 120%⁹⁵, because such efforts were already compensated through the arrangements within his employment contract. Especially in respect to the fact, that the company had just been overtaken by a competitor, the payment could not serve as an additional incentive nor could it promote any corporate objectives.⁹⁶ Therefore, according to the Federal Court of Justice, the compensation constituted a waste of corporate assets.⁹⁷ In particular from a shareholder's point of view, the payments were disadvantageous, as the stock prices had already increased and the ratio for the swap of shares was already defined, independently from the bonus.⁹⁸ Consequently, the *Mannesmann AG* was subject to a pecuniary losses, caused by the disadvantageous decision of the members of the "Präsidium", which violated § 266 para. 1 StGB⁹⁹.

⁹¹ *Bauman/Palmiter/Partnoy*, Corporations Law and Policy, 99.

⁹² Federal Court of Justice No. 3 StR 470/04 BGHSt 50, 331 = NJW 2006, 522.

⁹³ NJW 2006, 522, (523, m.n. 12).

⁹⁴ NJW 2006, 522, (524, m.n. 18); *Bauman/Palmiter/Partnoy*, Corporations Law and Policy, 100–101.

⁹⁵ *Höpner/Jackson*, Eur Manage Rev 2006, 142, (151); *Reinisch*, CEO-Compensation, 45.

⁹⁶ NJW 2006, 522, (525, m.n. 27).

⁹⁷ NJW 2006, 522, (524, m.n. 19).

⁹⁸ NJW 2006, 522, (525, m.n. 27).

⁹⁹ In the Version of Jan. 26th, 1998, BGBl. I 1998, 164.

Regarding the approval of the compensation packages by *Vodafone*, which theoretically could remedy the violation of § 266 para. 1 StGB¹⁰⁰, the tribunal noted that *Vodafone* at the time of approval held only 9,8 % of the capital stock. Being a juridical person with distinct assets, according to the German legal system, these assets are entitled to the shareholders in total. Therefore, an approval could have been only decided by the general assembly of the shareholders or a sole shareholder.¹⁰¹ *Vodafone* became a controlling shareholder with 98,66 % of the capital stock in March 2000 and the sole shareholder not until 2002.¹⁰² But since an ex post approval is not admissible, the violation of the German Penalty Code was not remedied.

2. Critical Analysis of the "Mannesmann"-Verdict in regard to Corporate Governance

Despite the fact that the verdict of the Federal Court of Justice is relatively complex, even more problems and aspects than those depicted by the tribunal are worth to elaborate on. Therefore, through a more extensive approach, this analysis tries to include considerations on Corporate Governance aspects of executive remuneration beyond the wording of the verdict.

a. "Breach of Trust"

In order to investigate a "breach of trust", one has to carve out the fiduciary duties which the members of the supervisory board are charged with.

The members of the supervisory board have an extended scope of discretion due to the fact, that their decisions are of entrepreneurial nature.¹⁰³ This discretion is limited by the duty to protect and safeguard the welfare of the corporation and is incarnated through § 87 para 1 AktG¹⁰⁴.¹⁰⁵ The interests of both, shareholders and creditors are indirectly protected too, as the corporate assets have to be protected. The granting of the compensation may constitute a breach of this duty if the decision is not consistent with these interests.¹⁰⁶ This would be the case, if the "appreciation awards" were economically unjustifiable.¹⁰⁷ Such a justification could be seen in the creating of an additional incentive for future executives that the exceptional efforts, like those of the management board of *Mannesmann*, would be

¹⁰⁰ In the Version of Jan. 26th, 1998, BGBl. I 1998, 164.

¹⁰¹ NJW 2006, 522, (525-526, m.n. 32).

¹⁰² *Bauman/Palmiter/Partnoy*, Corporations Law and Policy, 103.

¹⁰³ *Münzberg*, ZRFG 2006, 126, (127).

¹⁰⁴ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹⁰⁵ *Körner*, NJW 2004, 2697, (2698).

¹⁰⁶ *Kolla*, German Law Journal, 829, (834).

¹⁰⁷ *Maier*, German Law Journal 2006, 603, (608).

awarded.¹⁰⁸ This consideration would even include executives, that leave the corporation as this award would still serve as an example for the succeeding executive staff.¹⁰⁹ Both, the District Court of Düsseldorf and the Federal Court of Justice declined such an approach, as these tribunals failed to see any future benefit for *Mannesmann* as a corporation, having lost the takeover battle against their competitor *Vodafone*.¹¹⁰

A very relevant aspect, underrated by both the tribunals and the literature of the time, might be that the *Mannesmann AG* had lost its economic independence, but through the merger, a new conglomerate, *Mannesmann/Vodafone GmbH* was born, consisting of 49,5% of the former *Mannesmann AG* and 50,5% of the former *Vodafone plc.*¹¹¹ As the German corporate law dogmatically classifies corporations as legal persons with a distinct asset, it seems questionable that only because two corporations merge, their objectives are treated as being independent and maybe even opposed to another, while the objectives of the majority corporation dominate the objectives of the minority part until the objectives of the latter vanish. Just because *Mannesmann* had been taken over by *Vodafone*, *Mannesmann* still exists within the newly formed conglomerate of *Vodafone*.¹¹² More likely, at least from the authors point of view, the objectives of the two merging corporations integrate into a joint objective, aligned with the future business plan of the joint conglomerate. Taking this into account, the decision of the supervisory board might be economically justifiable as it offers incentives not to future *Mannesmann* executives, but rather executives of the newly joint *Vodafone* conglomerate. And as the approval of *Vodafone* (and thereby also its shareholders) to the granted compensation indicated, this incentive might have been supported by the majority of the shareholders of the joint conglomerate. This would result in a different evaluation of the supervisory boards liability, because following these considerations, the decision would be economically justifiable and therefore would not constitute a breach of the fiduciary duties.

Nevertheless, at least from a point of view that is not supporting the efficiency of “shareholder value” orientated positions, it might be a disputable question, whether the efforts of an executive are purchasable at all, or if such “efforts” are rather a mandatory necessity to

¹⁰⁸ Münzberg, ZRFG 2006, 126, (127).

¹⁰⁹ Hoffmann-Becking, NZG 2006, 127, (128–129).

¹¹⁰ NJW 2004, 3275, (3279-3280); NJW 2006, 522, (524, m.n. 19).

¹¹¹ Rolshoven, German Law Journal 2004, 935.

¹¹² Hoffmann-Becking, NZG 2006, 127, (128).

qualify for a manager position and that therefore all kinds of excessive compensation of executives constitute unjustifiable wastes of corporate assets.¹¹³

b. "Appropriate" Ratio of the compensation

When analyzing the opinion of the court, it is remarkable that the Federal Court of Justice did not clarify or elaborate on the aspect of appropriateness in the light of § 87 para. 1 AktG¹¹⁴. This is due to the fact, that the court held the payment of the bonus itself inadmissible independent of the pure amount.¹¹⁵ Nevertheless, the aspect of “commensurability” within the meaning of § 87 para. 1 of the German Stock Corporation Act¹¹⁶ is worth to elaborate on.

Except from the references to the executive’s responsibility and the overall state of the respective corporation, the norm does not provide any benchmarks on which supervisory boards could orientate on. The defendants tried to convince the tribunal in their testimonies, that comparable severance packages were granted by foreign compensation committees on a regular basis and would therefore reflect the common compensation practice. When making a decision, supervisory boards have to compare the compensation practices from comparable corporations to comply with the requirement of an “appropriate” compensation in accordance with § 87 para. 1 AktG¹¹⁷. This approach has been supported by German Scholars at the time.¹¹⁸

Klaus Esser’s defensive strategy was targeted to illustrate that his EUR 15 Million bonus was neither unique, nor excessive, which was confirmed by the testimonies of experts.¹¹⁹ Not only national compensation standards, but also international standards have to serve as a comparative value when determining the “value” of a manager, because according to his experience and professionalism, a talented executive could be poached by a competitor.¹²⁰ Consequently, there is a market for highly qualified managers which provides reliable conclusion on the construction of § 87 para. 1 AktG¹²¹.¹²² Following Esser’s point of view,

¹¹³ *Fonk*, NZG, 248, (252).

¹¹⁴ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹¹⁵ NJW 2006, 522, (524, m.n. 19).

¹¹⁶ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹¹⁷ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹¹⁸ *Körner*, NJW 2004, 2697, (2698–2699); *Fleischer*, DStR, 1279, (1280–1281); *Kort*, NJW 2005, 333, (333–334); *Tegtmeier*, Die Vergütung von Vorstandsmitgliedern in Publikumsaktiengesellschaften, 278; et al..

¹¹⁹ *Kolla*, German Law Journal, 829, (834–835).

¹²⁰ *Kort*, NJW 2005, 333, (333–334).

¹²¹ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹²² *Tegtmeier*, Die Vergütung von Vorstandsmitgliedern in Publikumsaktiengesellschaften, 278.

Mannesmann's supervisory board had integrated legitimate considerations into its decision process and therefore had not exceeded its scope of discretion.

Ackermann argued that compared to the pecuniary advantages that *Mannesmann's* shareholders profited from, even a bonus payment of EUR 1 billion would have been appropriate.¹²³ The total of all the granted compensations after the takeover represented only 0,05% of the value achieved through the increase of the stock value.¹²⁴ If the tribunal only had to decide whether or not the amount of the granted compensations was appropriate according to § 87 para. AktG¹²⁵, strong evidence indicates that the court might have agreed with the position of the defendants. The fact that the severance packages amounted to the highest compensation ever granted in Germany at the time¹²⁶, cannot be a valid legal argument, as it ignores the reference to the gains of the company.

But such a hypothetical approach prevails that the payment could have been classified as indemnity for the early termination of the contract rather than a remuneration for the service as an executive.¹²⁷ When it comes to the prevailing *Mannesmann* case, such consideration must fail, as the "Präsidium" clearly granted the payment as "appreciation award" for the manager's efforts during the takeover as well as in the previous strategic restructuring of the corporation.¹²⁸ Consequently, the evaluations of the tribunal of the Federal Court of Justice are coherent, when presuming that these efforts already had been compensated through the terms in the employment contracts and therefore the "appreciation awards" constituted an additional bonus.¹²⁹ The payment of such a bonus lacks a legal basis and is, according to the tribunal in its judgement¹³⁰, inadmissible because it does not grant any benefits for the *Mannesmann AG* and therefore has no justifiable purpose.¹³¹

3. Relevant changes in Legislation after the Mannesmann takeover

a. Introduction of the German Corporate Governance Codex

Additional voluntary recommendations were introduced on the 02.26.2002 through the German Corporate Governance Codex. These recommendations have not been available to

¹²³ *Kolla*, German Law Journal, 829, (834–835).

¹²⁴ *Deborah Sturman*, Manager Magazin 10.02.2004.

¹²⁵ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹²⁶ *Brauer*, NZG 2004, 502, (505).

¹²⁷ *Körner*, NJW 2004, 2697, (2698).

¹²⁸ *Jahn*, Zeitschrift für Rechtspolitik 2004, 179, (180).

¹²⁹ NJW 2006, 522, (525, m.n. 27).

¹³⁰ NJW 2006, 522, (524, m.n. 19).

¹³¹ *Hoffmann-Becking*, NZG 2006, 127, (128).

the supervisory Board of *Mannesmann* at the time compensations were made, but were already taken into consideration in the verdict of the Federal Court of Justice¹³² and influenced the debates in this context. Through the implementation of the Codex in its verdict, the Federal Court of Justice consolidated the importance and the impact of the DCGK for future jurisprudence and compensation practice in Germany.¹³³

In its original version from 2002, the DCGK provides additional elaboration on how to construe the rather abstract provision of § 87 para. 1 AktG¹³⁴ in Number 4.2.3. of the codex and thereby helps to construe the element of “appropriateness”.¹³⁵ Despite being “voluntary”, the German legislator increased the influence of the DCGK even further through the introduction of the Transparency and Disclosure Act (“Transparenz- und Publizitätsgesetz” or “TransPuG”)¹³⁶, which implemented § 161 AktG¹³⁷, obligating all public listed companies to declare which of recommendations they follow.¹³⁸

Since then, the codex and especially its recommendations regarding executive compensation have been subject to amendments. In the version as of May 21st, 2003, the DCGK provides even recommendations on how to limit the effect of windfall options.¹³⁹

To conclude, the introduction of the German Corporate Governance Code was influenced through the problems in executive compensation that became clear through the startling *Mannesmann/Vodafone* merger especially because of the chronological coincidence.

b. Amendment of § 87 para. 1 AktG

The wording of § 87 para. 1 AktG¹⁴⁰ has been improved through the introduction of the Act on the Appropriateness of Board Remuneration (“Vorstandsangemessenheitsgesetz” or “VorstAG”)¹⁴¹. The newly implemented sentence 2 of § 87 para. 1 AktG¹⁴² obligates corporations to orientate their structure of remuneration according to a sustainable

¹³² Compare NJW 2006, 522, (524, m.n. 17; 525, m.n. 25).

¹³³ Münzberg, ZRFG 2006, 126, (129).

¹³⁴ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹³⁵ Körner, NJW 2004, 2697, (2700).

¹³⁶ “Gesetz zur weiteren Reform des Aktien- und Bilanzrechts, zu Transparenz und Publizität“ (Transparenz- und Publizitätsgesetz – TransPuG) as of June 19th, 2002, BGBl. I 2002, 2681.

¹³⁷ In the Version of June 19th, 2002, BGBl. I 2002, 2681.

¹³⁸ Körner, NJW 2004, 2697, (2700).

¹³⁹ Körner, NJW 2004, 2697, (2700).

¹⁴⁰ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹⁴¹ “Gesetz zur Angemessenheit der Vorstandsvergütung” July 31th 2009, BGBl. I 2009, 2509.

¹⁴² In the Version of July 31th 2009, BGBl. I 2009, 2509.

development of the corporation. This additional provision was a result of the financial crisis and constitutes another criteria of the interests of the corporation.¹⁴³ With the Mannesmann Verdicts, being the very first judgements on the question of exorbitant compensations of managers of stock-listed companies¹⁴⁴, the process of amending the legal provisions in Germany began.

c. Other changes regarding executive compensation

Through the introduction of the Executive Board Remuneration Disclosure Act (“Vorstandsvergütungs-Offenlegungsgesetz” or “VorstOG”)¹⁴⁵ in 2005, supervisory boards in Germany got a new reference point. The German Commercial Code (“Handelsgesetzbuch” or “HGB”) was modified through the VorstOG and provided from then on regulations on the Disclosure of the compensations of German Corporations. It was now far more easy to take into consideration the remuneration agreements of other supervisory boards and thereby comparing the “market values” of executives. With the instrument of comparison, the interpretation of appropriateness of § 87 para. 1 AktG¹⁴⁶ became more accessible.

In 2003, the German Government considered to solve the problem of excessive manager remunerations through the implementation of caps, but rejected this approach shortly afterwards, in particular because of conflicts with the German Constitution.¹⁴⁷

¹⁴³ *Weber*, in: § 87 AktG, m.n. 30.

¹⁴⁴ *Hoffmann-Becking*, NZG 1999, 797, (799); *Fleischer*, DStR, 1279, (1281); *Körner*, NJW 2004, 2697, (2698).

¹⁴⁵ „Gesetz über die Offenlegung der Vorstandsvergütungen“ (Vorstandsvergütungs-Offenlegungsgesetz - VorstOG) as of Oct. 5th, 1994, BGBl. I 1994, 2930.

¹⁴⁶ In the Version of July 31th 2009, BGBl. I 2009, 2509.

¹⁴⁷ *Körner*, NJW 2004, 2697, (2700).

B. Part II: *Disney*, Too Big for the Business Judgment Rule?

I. Introduction

The *Disney* shareholder litigation is one of the most famous cases amongst students of corporate governance in the U.S. This is not surprising given the amount of public scrutiny that ensued after one of the biggest executive payouts at the time. In terms of optics, the *Disney* litigation could not have occurred at a worse time for corporate America. The average annual salary in America, adjusted for inflation, rose ten-percent from \$ 32,522 in 1970 to \$ 35,864 in 1999.¹⁴⁸ By comparison, over the same period, the average real annual compensation of the top 100 C.E.O.s in America multiplied more than thirty-fold from \$1.3 million to \$37.5 million according to *Fortune* magazine—this is equivalent to thirty-nine times the pay of an average worker to more than 1,000 times, respectively.¹⁴⁹ Notable bankruptcies such as Global Crossing, Qwest, Worldcom and Enron have also led many observers to question the link between poor firm performance and executive compensation of firm managers.¹⁵⁰ As eloquently put by a 2002 *New York Times* article, critics at that time identified that “the invisible handshake in the boardroom” dictated executive compensation, “not the invisible hand of the market.”¹⁵¹

Naturally, a \$ 130 million severance package to an executive who served only a fourteen-month tenure and left the position with a questionable report card fired up the public’s skepticism towards the *Disney* board. However, though the severance payout in *Disney* was extraordinary, the Delaware courts’ decision was not, arguably. To the Delaware courts, *Disney* was simply a business judgment case that was no different from other business judgment cases brought by shareholders in a publicly traded company. *Disney* did outline best practices future boards should adopt in making executive compensation decisions. But, it had little to do with the actual magnitude of the compensation package. As such, the decade of litigation seems to not have added much more substantively to how Delaware courts review executive compensation.

¹⁴⁸ Paul Krugman, *For Richer*, N.Y. TIMES (Oct. 20, 2002), available at <http://www.nytimes.com/2002/10/20/magazine/for-richer.html?pagewanted=all>.

¹⁴⁹ *Id.*

¹⁵⁰ See Rajesh Aggarwal, *Executive Compensation and Corporate Controversy*, 27 VERMONT L. REV. 849, 850 (2003).

¹⁵¹ Krugman, *supra* note 148.

Rather, *Disney* appears to actually show the limitations of Delaware’s business judgment rule when evaluating executive compensation decisions. Not only does the business judgment presumption present a formidable challenge for plaintiffs given its strong process-driven inquiry, but it also does not factor in possible rent extractions that may have been obtained by management through its influence—directly or indirectly—over the board. While the corporate waste doctrine is an alternative way of challenging executive compensation, and particularly the actual merits of it, in reality, it does not seem to be a practically viable one. Its analysis is usually intertwined with that of other breach of fiduciary duty claims and consequently presents a low bar for the defendant board. Despite the Delaware courts’ strong reliance on the business judgment rule, their justifications for providing such deference in the executive compensation context does not seem completely convincing either.

This paper is organized as follows: Section II summarizes the decade-long litigation and the opinions published by both the Delaware Chancery and Supreme Courts; Section III highlights the limitations of the business judgment rule and corporate waste doctrine in light of the *Disney* holding; Section IV offers preliminary insight as to why the justifications for the business judgment rule that the Delaware courts rely on in *Disney* do not seem completely convincing; and Section V provides the conclusion to the paper.

II. *Disney*, a Close Call or Easy Business Judgment Case?

1. Background Facts

Disney’s engagement with Michael Ovitz began in 1994 as a result of the death of Frank Wells, Disney’s predecessor president to Ovitz. Michael Eisner, the CEO of Disney at the time, looked to Ovitz to fill the vacant presidency. Ovitz was the founder and majority owner of Creative Artists Agency (CAA), a premier talent agency that generated above \$150 million in annual revenues and over \$20 million in annual income for Ovitz. Accordingly, Ovitz was regarded as one of the most powerful figures in Hollywood and an attractive candidate for Eisner. In addition, Eisner and Ovitz’s twenty-five-year personal relationship naturally led to this courtship.

By mid-July 1995, full-swing negotiations between Ovitz and Eisner came underway. While Ovitz and Eisner hammered out their respective roles at the company, Irwin Russell, Disney’s director and chairman of the compensation committee lead in negotiating the financial terms of Ovitz’s employment agreement (the hereinafter, the “OEA”). Considerable negotiations

took place regarding the downside protection demanded by Ovitz for giving up his lucrative position at CAA, including a 55% interest in the agency, to join Disney. This provision became a key feature in the OEA and focal point of the shareholder litigation. To evaluate the financial terms of the employment agreement, Russell worked with Graef Crystal, an executive compensation consultant and Raymond Watson, Disney's compensation committee member who helped structure Wells and Eisner's compensation packages previously.

On September 26, 1995 the compensation committee met to consider the proposed terms of the OEA. Though a term sheet summarizing major features of the OEA was distributed at the meeting, the draft of the actual OEA was not.¹⁵² The committee considered historical comparables, namely Eisner and Wells' option grants from the past, and the calculations run by Russell, Crystal and Watson. After an hour-long meeting, the committee unanimously approved the OEA terms subject to "reasonable further negotiations within the framework of the terms and conditions" outlined in the OEA.¹⁵³ On October 16, the committee approved amendments to Ovitz's stock options under the OEA.

Under the OEA, Ovitz would serve as the president and second highest-ranking executive officer at Disney for five years. In addition, the downside protection in the OEA provided that should Disney terminate Ovitz other than for gross negligence or malfeasance, Ovitz would be entitled to a no-fault termination (hereinafter, "NFT") payment consisting of:

(1) his base salary for the remainder of the contract; (2) three-quarters of the maximum annual bonus which he might have received had he stayed with Disney for the remainder of the contract . . . (3) immediate vesting of all stock options to which he would have been entitled for the five years of his contract; and (4) \$ 10 million in lieu of the stock options to which he would have been entitled had the contract been extended for a second five year period.¹⁵⁴

Prior to the OEA being approved, Russell did caution that Ovitz's salary would be at the top level for any corporate officer; the stock options granted under the OEA would exceed the standards applied within corporate America and would "raise very strong criticism."¹⁵⁵

¹⁵² *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, *38 (Del. 2006) (hereinafter, *Disney II*, Del.).

¹⁵³ *Id.*

¹⁵⁴ Franklin A. Gevurtz, *Disney in a Comparative Light*, 55 AM. J. COMP. L. 453, 457 (2007).

¹⁵⁵ *Disney II*, Del. at *38.

Russell did acknowledge however, that Ovitz was an “exceptional corporate executive who merited downside protection” to make up for the reduced cash compensation he would receive at a public company like Disney as opposed a privately held business like CAA.¹⁵⁶ While the board members did not know Ovitz well, other than through his personal connections through Eisner, “his credential seemed impeccable. . . . [and t]he overriding impression was that he was an effective businessman with vast creative contacts.”¹⁵⁷ The market reaction was also generally positive after a press release announced Ovitz’s hiring on the day of the OEA signing. Disney received praise for the decision and its stock price rose 4.4% in a single day, increasing the company’s market capitalization over \$ 1 billion.¹⁵⁸

Despite these optimistic reactions, the relationship between Ovitz and Eisner, and ultimately with Disney quickly deteriorated. By fall of 1996, Ovitz’s “poor fit” with his fellow executives became obvious.¹⁵⁹ Increasingly, Eisner and other executives had less trust in Ovitz and believed Ovitz failed to adopt Disney’s culture. Eisner continuously consulted with Sanford Litvack, Executive Vice President and Disney’s General Counsel to explore whether Ovitz could be terminated under the OEA for cause to prevent the NFT payment. After reviewing Ovitz’s performance and with the support of Disney’s litigation and legal departments, Litvack concluded there would be no cause for the termination.¹⁶⁰ Similarly, despite the plaintiffs’ allegations, the court *ex-post* did not find support in the record that Ovitz had acted improperly in office, habitually lied or violated firm policies.¹⁶¹

Ovitz’s short, fourteen-month tenure at Disney officially ended on December 27, 1996. Ovitz was terminated without cause, triggering the NFT provisions within the OEA. In sum, he received a severance payment valued approximately at \$ 130 million.

2. History of the *Disney* Litigation

About a month after the termination, on January 1997, Disney shareholders brought a derivative action against Ovitz and Disney’s directors, alleging breaches of fiduciary duty and waste of corporate assets for the compensation committee’s approval and payment of the

¹⁵⁶ *Disney II*, Del. at *38.

¹⁵⁷ Kenneth M. Rosen, *Review: Mickey, Can you Spare a Dime? “Disneywar,” Executive Compensation, Corporate Governance, and Business Law Pedagogy*, 105 MICH. L. REV. 1151, 1160 (2007) (quoting JAMES STEWART, *DISNEYWAR* 212 (Simon & Schuster 2005)).

¹⁵⁸ At least, the court did not find support for those allegations in the trial record. *See Disney II*, Del. at *40.

¹⁵⁹ *Disney II*, Del. at *42.

¹⁶⁰ *Disney II*, Del. at *43-44.

¹⁶¹ *Disney II*, Del. at *42.

severance package under the NFT provisions. First, the plaintiffs alleged that the board breached its duty of care; the board only deferred to Eisner without carefully considering the ramifications of the termination provision when approving the OEA. Second, the plaintiffs argued that the termination provision that resulted in a \$130 million payout constituted corporate waste because it gave perverse incentives for Ovitz to lose his job rather than keep it.¹⁶²

The entire litigation process spanned almost a decade resulting in five published court opinions: three from the Delaware Chancery Court and two from the Delaware Supreme Court.¹⁶³ The Disney plaintiffs commenced their uphill battle with the Delaware Chancery Court's dismissal of their Complaint for failing to plead that they had either made a demand upon the Disney board or making such demand would be futile. While the Chancery Court acknowledged that "[t]he case appear[ed] to be exceptional because of the sheer dollar amount involved" the fact that the amount was "larger than almost anyone anywhere will receive in a lifetime" did not mean that "conventional corporate governance laws of Delaware d[id] not apply[.]"¹⁶⁴ Despite the media sensation and public interest surrounding the case, the Chancery Court opinion was relatively commonplace. As any other matter in Delaware involving derivative suits challenging board decisions, the Chancery Court's opinion centered on the demand requirement based on *Aronson v. Lewis*¹⁶⁵ and "viewed the situation as an unremarkable exercise of business judgment."¹⁶⁶

On appeal, the plaintiffs faced a more sympathetic bench. The Delaware Supreme Court acknowledged that based on the plaintiffs' Complaint, contrary to the Chancery Court's findings, the matter was rather a "close case."¹⁶⁷ The Delaware Supreme Court noted that the

¹⁶² The plaintiffs had also brought other claims against the defendants, namely allegations of the board approving the NFT provisions in bad faith and concluding that Ovitz could not be terminated for cause in breach of its fiduciary duties. However, given the focus of this paper is on executive compensation, the paper addresses only on the duty of care allegations in regards to the approval of the severance package and the corporate waste claim. The court's in-depth handling of the duty of faith claim is significant in that a Delaware court has for the first time defined what constitutes bad faith—"fiduciary conduct motivated by an actual intent to do harm." *Disney II*, Del. at *64. Given that the plaintiffs have not claimed that the board had an actual intent to do harm, the duty of faith claim bears little weight on whether agreeing to the severance constitutes a breach of fiduciary duties for the purposes of this paper. The court also quickly dismissed this claim on the same basis, although it has gone lengths to define bad faith as a distinct fiduciary duty from duty of care. In addition, the inquiry of whether terminating Ovitz without cause was a breach of fiduciary duty also sheds little light on the executive compensation piece of the opinion.

¹⁶³ Gevurtz, *supra* note 154 at 458.

¹⁶⁴ *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 350-51 (Del. Ch. 1998) (hereinafter, *Disney I*, Del. Ch.).

¹⁶⁵ 473 A.2d 805 (Del. 1983).

¹⁶⁶ Gevurtz, *supra* note 154 at 458.

¹⁶⁷ *In re Walt Disney Co. Derivative Litig.*, 746 A.2d 244, 249 (Del. 2000) (hereinafter, *Disney I*, Del.).

compensation and NFT payout for Ovitz “were exceedingly lucrative, if not luxurious, compared to Ovitz’ [sic] value to the Company[,]” and the approval and termination of the OEA by the board were “casual, if not sloppy and perfunctory.”¹⁶⁸ It further elaborated that “the processes of the [board] were hardly paradigms of good corporate governance practices. . . [and] the sheer size of the payout to Ovitz, as alleged, pushe[d] the envelop of judicial respect for the business judgment of directors in making compensation decisions.”¹⁶⁹ Ultimately, the Delaware Supreme Court did affirm the lower court’s dismissal of the plaintiffs’ Complaint because the plaintiffs’ “deficient pleadings” were “so inartfully drafted.”¹⁷⁰ But, in an important post-script, the Delaware Supreme Court instructed the Chancery Court to provide plaintiffs reasonable opportunity to amend its Complaint with more particularized facts to meet the minimum pleading standard in Delaware.

With the advice of the Delaware Supreme Court to furnish more facts, the plaintiffs’ amended Complaint sufficiently plead a breach of fiduciary duties and creation of corporate waste its second time at the Chancery Court. Unlike the original Complaint, the amended Complaint instead portrayed the board as failing to exercise any real decision-making role in Disney’s dealings with Ovitz. The Complaint alleged that the “Disney directors failed to exercise *any* business judgment and failed to make *any* good faith attempt to fulfill their fiduciary duties to Disney and its stockholders.”¹⁷¹ The Chancery Court opinion focused on the potential influence of Eisner and Ovitz’s friendship on the favorable treatment Ovitz may have received in his OEA, and found that, if true, the alleged facts in the Complaint implied that “the defendant directors *knew* that they were making material decisions without adequate deliberation, and they simply did not care if the decisions caused . . . serious injury or loss.”¹⁷² Depicting the board as passively abdicating decisions to Eisner based on his personal relationship with Ovitz was sufficient to provide a detailed factual pleading of wrongful conduct by the board.¹⁷³

After a protracted trial and litigation that spanned over a few years, the Chancery Court finally delivered its third written opinion once again finding that the directors’ conduct did not fall outside the protections of the business judgment rule. In its extensive opinion though, the Chancery Court remained critical of Disney directors and Eisner in particular for falling

¹⁶⁸ *Disney I*, Del. at 249.

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 278 (Del. Ch. 2003).

¹⁷² *Id.* at 289.

¹⁷³ *Gevurtz*, *supra* note 154 at 458.

“significantly short of the best practices of ideal corporate governance.”¹⁷⁴ In addition, the Chancery Court also unfavorably commented on the potential the personal relationship between Eisner and the board may have influenced the decision. Specifically, the opinion provides that “Eisner stacked his . . . board of directors with friends and other acquaintances who, though not necessarily beholden to him in a legal sense, were certainly more willing to accede to his wishes and support him unconditionally than truly independent directors.”¹⁷⁵

Though Eisner and the Disney directors failed to exercise best practices in approving the NFT, the Chancery Court clearly circumscribed its role in assessing business decisions made in good faith. It restricted its role by providing that “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.”¹⁷⁶ The court should not second-guess the substance of the decision made by “faithful servants,” even if that decision leads to failure.¹⁷⁷ A year later, the Delaware Supreme Court affirmed the findings of the Chancery Court.

3. Delaware Supreme Court Holding of *Disney*

First, the Delaware Supreme Court affirmed the Chancery Court’s finding that the committee members were adequately informed of the consequences in approving the OEA with NFT provisions that could potentially result in a gargantuan payment. While the court scorned the sloppy decision-making process, it did not find that the directors’ actions fell below the duty of care standard. The court’s analysis centered on how far the committee’s actions deviated from “best practices” that could have been adopted in an ideal scenario. The best practice would have been for all the committee members to have received before or during the September 26 meeting a document prepared by a compensation expert detailing the amount Ovitz would receive under the OEA in each foreseeable hypothetical situation.¹⁷⁸ Specifically, the expert document would have outlined the amount of NFT payments that would have been made for each of the five years under the initial term of the OEA had Ovitz been terminated

¹⁷⁴ *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 697 (Del. Ch. 2005) (hereinafter, *Disney II*, Del. Ch.).

¹⁷⁵ *Id.* at 760.

¹⁷⁶ *Id.* at 698.

¹⁷⁷ *Id.*

¹⁷⁸ *Disney II*, Del. at *56.

for no cause.¹⁷⁹ Russell, Crystal and Watson all would have attended the September 26 meeting to explain and answer questions regarding the document.¹⁸⁰

Although the board's process clearly fell below this standard, the court found that the board was still adequately informed. During the September 26 meeting, the compensation committee considered a term sheet that summarized the key components of the NFT provisions. From this summary alone, the committee knew that the severance payment would consist of about \$ 40 million in cash alone.¹⁸¹ While no single document provided an estimate of the value of the options in the NFT provisions, the trial testimony about spreadsheets that were prepared for the compensation committee meetings provided support that the board was informed of the magnitude of the options. First, the options under the severance payout were modeled after options granted to Eisner and Wells, and the committee would have known the potential value range of Ovitz's options based on these precedents.¹⁸² In addition, Watson, Russell and Crystal met to value the potential Ovitz options and the spreadsheets of these calculations were shared during the September meeting.¹⁸³ Lastly, a large value of the options under the severance payout reflected the amount of downside protection Ovitz was demanding. The committee knew that Ovitz would be foregoing \$150 to \$ 200 million CAA commissions to join Disney, the amount that Ovitz demanded as protection for leaving CAA.¹⁸⁴ As a result, although the record left "much to be desired . . . the evidentiary record was sufficient to support the conclusion that the compensation committee had adequately informed itself of the potential magnitude of the entire severance package, including the options."¹⁸⁵

Second, in the last and also revealingly shortest section of the opinion, the Delaware Supreme Court upheld the Chancery Court's finding that the payment of the severance to Ovitz did not constitute corporate waste. The court reasoned that the plaintiffs' waste claim was meritless on its face because Disney was contractually obligated to pay the NFT amounts to Ovitz for a no cause termination.¹⁸⁶ Furthermore, committing Disney to this contractual obligation itself also did not constitute waste because the NFT provisions did not create irrational incentives for Ovitz to get himself fired, contrary to the plaintiffs' arguments. First, the NFT had a

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.* at *57.

¹⁸² *Id.*

¹⁸³ *Id.*

¹⁸⁴ *Id.* at *58.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at *74-75.

rational business purpose—to incentivize Ovitz make a costly leave from CAA; and second, Ovitz did not have control over whether he would be fired, with or without cause and given Ovitz’s reputational costs and friendship with Eisner, the court could not find any basis in the record for Ovitz to sign the OEA with the intention of immediately departing Disney.¹⁸⁷

III. Limitations of Judicial Review of Executive Compensation

Criticism against executive compensation in publicly traded corporations appears to center around two points. First, executive compensation is too large, whether measured in absolute or relative terms.¹⁸⁸ Second, senior executives effectively set their own compensation because of the influence they yield over the board, whether directly or indirectly due to their close interactions.¹⁸⁹ Both concerns appear to drive the plaintiffs’ Complaint in *Disney*.¹⁹⁰ It is little surprise then that a \$ 130 million severance payout to someone who held a position for only fourteen months and had debatable performance during the short tenure also came under strong public scrutiny.

Despite the unprecedented magnitude of the severance payout however, the actual amount played very little, if not any role in the Delaware courts’ decisions. As illustratively put by the Delaware Chancery Court in its first opinion:

Just as the 85,000-ton cruise ships *Disney Magic* and *Disney Wonder* are forced by science to obey the same laws of buoyancy as Disneyland’s significantly smaller *Jungle Cruise* ships, so is a corporate board’s extraordinary decision to award a \$ 140 million severance package governed by the same corporate law principles as its everyday decision to authorize a loan. . . . Nature does not sink a ship merely because of its size, and neither do courts overrule a board’s decision to approve and later honor a severance package, merely because of *its* size.”¹⁹¹

¹⁸⁷ *Id.*

¹⁸⁸ See MELVIN ARON EISENBERG & JAMES D. COX, *CASES AND MATERIALS: CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS* 753 (10th ed. 2011).

¹⁸⁹ Shelley DuBois, *Why Chief Executives’ Pay Keeps Rising* (*Fortune*, 1985), *FORTUNE* (March 11, 2012), available at <http://fortune.com/2012/03/11/why-chief-executives-pay-keeps-rising-fortune-1985/> (republishing a 1985 article covering why executive compensation keeps on rising to show this phenomenon still continues today).

¹⁹⁰ Hereinafter, “*Disney*” refers collectively to all opinions published by the Delaware Chancery and Supreme Courts during the litigation.

¹⁹¹ *Disney I*, Del. Ch. at 350.

While the Delaware Supreme Court was more sympathetic to the plaintiffs on appeal, the tone set by the Chancery Court in its first opinion continued through the life of the litigation. Ovitz's severance payout was extraordinary, as acknowledged by members of the Disney board, and even by both the Delaware Chancery and Supreme Courts. Nevertheless, from the courts' perspective, setting Ovitz's compensation was not an extraordinary business matter for Disney.¹⁹² Determining the amount of executive compensation was rather an ordinary business decision, the merits of which lay outside the Delaware court's purview as any other business decision made in good faith.

Disney does outline best practices future boards should follow in setting executive compensation. The Delaware courts also heavily scorned the Disney board for engaging in sloppy practices. However, *Disney* has not added much substantively to the executive compensation debate. *Disney* rather shows the limitations created by the business judgment presumption in the executive compensation context. Evaluating the process in reaching a business decision misses the possible rent extractions in compensation packages that may have been created by the influence management may yield over the board. Specifically, *Disney* shows how formidable the business judgment presumption can be for plaintiffs challenging executive compensation in publicly traded corporations even after they successfully show demand futility. In addition, although directors can be liable for corporate waste, *Disney* also illustrates how alleging corporate waste does not provide a meaningful alternative to challenging executive compensation in public corporations given the high bar set for plaintiffs and the interconnected nature of the waste claim with other fiduciary duty concerns presented before the bench. Lastly, *Disney* also calls into question the justifications the Delaware courts often use to support their deference to the board through the business judgment presumption.

1. Business Judgment Rule: Duty of Care

Disney illustrates the limitations of the business judgment rule in addressing shareholder challenges against executive compensation. The court's analysis in evaluating whether a board's duty of care has been breached to determine if the business judgment presumption applies focuses solely on the process rather than the merits of the decision. As a result, even if the board's actions fell well below best practices in making an executive compensation

¹⁹² See Lawrence Lederman, *Disney Examined: A Case Study in Corporate Governance and CEO Succession*, 52 N.Y.L. REV. 558, 558 (2007).

decision, the plaintiffs are unable to rebut the business judgment presumption if the disinterested board and compensation committee had taken the minimal steps to inform themselves of the NFT payout. Unfortunately, without a finding of bad faith or lack of arms-length negotiations, the existing business judgment standard does not take into account the rent extractions in executive compensation that may have been obtained through the influence the executive officers may have over the board.

Delaware courts lend great deference to the board's business decisions. They presume that "in making a business decision[,] the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."¹⁹³ As a result, Delaware courts will not second-guess a board's decision unless the plaintiffs show that the directors have breached their fiduciary duties to rebut this presumption. If this is shown, the burden shifts to the directors to demonstrate that the challenged decision was entirely fair to the corporation and its shareholders. Naturally, a significant part of shareholder derivative suits is spent battling over the presumption. To rebut the presumption, the fiduciary duty of care requires directors "use that amount of care which ordinarily careful and prudent men would use in similar circumstances" and "consider all material information reasonably available" in making business decisions.¹⁹⁴ In reviewing whether the directors were adequately informed of all material information, "a director's duty of care can never appropriately be judicially determined by reference to the *content of the board decision* that leads to a corporate loss, apart from consideration of the good faith or rationality of the process employed."¹⁹⁵ Liability for breaching duty of care does not form simply because the board's decision was found to be substantively wrong or bad *ex-post* so long as the directors were adequately informed.¹⁹⁶

Based on *Disney's* experience however, it does not seem too difficult for the board to show that it has adequately informed itself. The board can satisfy its procedural duties simply "by reading some materials and asking some questions."¹⁹⁷ The facts presented in *Disney* made it a close case. The Delaware Supreme Court acknowledged that the sheer size of the payout pushed the envelope for the business judgment presumption even based on the plaintiffs' original Complaint that was found to be inadequately plead. Although setting executive

¹⁹³ Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

¹⁹⁴ *Disney II*, Del. Ch. at 749.

¹⁹⁵ *In re Caremark Int'l*, 689 A.2d 959, 967-68 (1996).

¹⁹⁶ *Id.*

¹⁹⁷ See Lucian Arye Bebchuk, Jesse M. Fried & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 781 (2002).

compensation is within the business judgment purview of the board, the personal relationship between Eisner and Ovitz, and the asymmetrical power dynamic between Eisner and the board raised red flags. Eisner and Ovitz enjoyed a twenty-five year friendship and a large part of the negotiations happened between the two outside of formal channels. Talks over the financial terms of the OEA between Eisner, Ovitz and Russell began before the board's formal approval to even hire Ovitz in the first place. Furthermore, the compensation committee approved the terms of the OEA based on a term sheet rather than an actual draft of the OEA during a short, one-hour meeting. Also striking, the board members did not know Ovitz well, other than through his personal connections with Eisner.

Despite these deficiencies, the Delaware Supreme Court nonetheless affirmed that the board had adequately informed itself. The board, after all, had knowledge of the potential size of the payout, according to the court. Russell, Watson and Crystal produced spreadsheets of the valuations. The compensation committee did receive a term sheet at the September 26 meeting summarizing key provisions from the OEA to understand the size of the cash payment. And, the committee could infer the size of the options through Wells and Eisner's compensation packages, and amount of downside protection Ovitz was seeking.

Given this rather minimal bar, it is difficult to see how plaintiffs can successfully challenge an executive compensations scheme based on a duty of care claim where the court's focus is on the decision-making process rather than the substance of the executive compensation. The plaintiffs' amended Complaint was successful in meeting Delaware's pleading standards by providing particularized facts that painted a passive board that abdicated all decision-making power and independence to Eisner. But, unless the compensation committee had no knowledge of the content or ramifications of a compensation scheme, it appears difficult or even "all but impossible to prove any of these violations" if the independent committee had been furnished with even the minimal level of information regarding the executive compensation.¹⁹⁸ In modern, publicly traded corporations that have independent committees for executive compensation, at least from a process point of view, the boards appear to be shielded from most shareholder challenges.

¹⁹⁸ *Id.* at 779. An empirical study of all executive compensation cases from 1912 to 2000 available through Lexis and Westlaw databases shows that the overall success rate for bringing a duty of care claim is only thirty-percent in Delaware. Randall S. Thomas & Kenneth J. Martin, *Litigating Challenges to Executive Pay: An Exercise in Futility?*, 79 WA. U. L. REV. 569, 582 (2001). The authors define success as: 1) success against a defendant's motion to dismiss for failure to make demand, 2) success against a motion to dismiss for failure to state a claim, 3) success against a defendant's motion for summary judgment, 4) victory in trial court, and 5) victory on appeal. *Id.* at 581.

Admittedly, whether an executive compensation package that was approved by an independent and adequately informed committee is, by definition, appropriate is debatable. But, if one accepts the approach that the executive compensation should be set at an optimal level for creating shareholder value, this limitation to the business judgment rule is particularly concerning. Bebchuk, Fried and Walker’s “managerial power approach” provides that the compensation packages approved by the board “often deviate from optimal contracting because directors are captured or subject to influence by management, sympathetic to management, or simply ineffectual in overseeing compensation.”¹⁹⁹ For frame of reference, under the optimal contracting approach, executive compensation in public corporations is designed to minimize agency costs between the senior executives and shareholders; the compensation scheme is viewed as being structured to maximize shareholder value.²⁰⁰ The deviations from optimal contracting provide executives with excess level of executive compensation—rent extractions—than would be optimal for shareholders.²⁰¹ In practice, “the chief executive often has his hand in the pay-setting process almost from the first step” given the practical closeness between the board and management.²⁰² Ultimately, the rents extracted by the executives add fuel to the criticism that there is lack of correlation between the level of compensation and corporate performance.²⁰³ As such, although formal channels and structures exist, the influence executive officers wield over the directors whether directly or indirectly may affect the size of the executive compensation, even if the influence does not rise to legally reprehensible levels.

Without evidence suggesting egregious board conduct, such as approving the compensation in bad faith or unfair dealings, the existing business judgment standard does not seem to factor in the influence management may have on the board in sizing the compensation package. Even if one does not fully subscribe to the managerial power approach, there is still a flavor of a rather passive board that followed Eisner’s lead in approving the OEA in *Disney*. After Wells’ death, Eisner first approached Ovitz and continued his talks with Ovitz over the OEA even when the board had not yet formally approved Ovitz as the successor president. In reviewing the plaintiffs’ amended Complaint, the Delaware Chancery Court focused on the twenty-five-year friendship that Eisner and Ovitz enjoyed, and how that relationship could

¹⁹⁹ Bebchuk et al., *supra* note 197 at 751, 754.

²⁰⁰ *Id.* at 753-54.

²⁰¹ *Id.* at 754.

²⁰² Shelley DuBois, *Why Chief Executives’ Pay Keeps Rising (Fortune, 1985)*, FORTUNE (March 11, 2012), available at <http://fortune.com/2012/03/11/why-chief-executives-pay-keeps-rising-fortune-1985/>.

²⁰³ See Eisenberg & Cox, *supra* note 188 at 753.

have led to a higher payout for Ovitz. Specifically, as already noted above, the Chancery Court highlights that “Eisner stacked his . . . board of directors with friends and other acquaintances who, though not necessarily beholden to him in a legal sense, were certainly more willing to accede to his wishes and support him unconditionally than truly independent directors.”²⁰⁴ Eisner took the leading negotiating role while the board and the committee merely approved the terms Eisner had put together with Ovitz during their ad hoc meetings. But, the court’s duty of care analysis does not factor this in.

While the board and compensation committee took minimal steps to be informed of the magnitude of the NFT payout, it would be interesting to determine how much of that figure was driven by the rather asymmetric relationship between Eisner and the board. Even if this is something that can be measured, regrettably, the duty of care inquiry does not take this dynamic into account. Whether this type of consideration should be part of the duty of care analysis, admittedly, is open to debate. But, based on *Disney*, what is clear is that the duty of care standard and ultimately the business judgment rule do not take into account the relationship dynamic between management and the board that could affect executive compensation decisions, even if the board has not engaged in any egregious behavior that questions its intent or honesty to the corporation.

2. Corporate Waste

The corporate waste doctrine also does not seem to serve a meaningful alternative for plaintiffs challenging executive compensation. Unlike duty of care, the corporate waste doctrine allows plaintiffs to challenge the executive compensation itself, rather than the process of approving it. However, as seen in *Disney*, as long as the board presents a rational justification, it is difficult for plaintiffs to challenge the compensation because of the high bar for proving corporate waste.

When the plaintiff fails to rebut the presumption that in making a business decision, the directors acted in an informed basis, in good faith and in honest belief that the action taken was in the best interest of the corporation, “she is not entitled to any remedy, be it legal or equitable, unless the transaction constitutes waste.”²⁰⁵ The standard for waste “is a corollary of the proposition that where business judgment presumptions are applicable, the board’s

²⁰⁴ *Disney II*, Del. Ch. at 760.

²⁰⁵ *Disney II*, Del. Ch. at 747 (citing *Grow v. Perot*, 539 A.2d 180, 187 (Del. 1988)).

decisions will be upheld unless it cannot be attributed to any rational purpose.”²⁰⁶ Chancellor Allen defined the principle of waste in *Lewis v. Vogelstein*:

[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 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.”²⁰⁷

The plaintiff must essentially show that a board committed corporate waste by making a completely irrational decision or by making a gift unsupported by any consideration.²⁰⁸ Chancellor Allen further adds that if “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.”²⁰⁹ Similar to the business judgment presumption, Delaware courts maintain that “[c]ourts are ill-fitted to attempt to weigh the ‘adequacy’ of consideration under the waste standard or, ex post, to judge appropriate degrees of business risk.”²¹⁰

As illustrated in *Disney*, this standard for waste is difficult for the plaintiff to meet. The Delaware Chancery Court acknowledges that corporate waste is rarely found in Delaware courts because “the applicable test imposes such an onerous burden upon the plaintiff” to prove an exchange is so one-sided that no business person of ordinary, sound business judgment could conclude that the corporation has received adequate consideration.²¹¹ Based on this rather high standard, as long as the board can provide a justification for the executives’ salary, the board can relatively easily defeat the corporate waste claim. Bebchuk, Fried and Walker even goes as far to argue that “[s]upport can be marshaled for even the most patently

²⁰⁶ *Disney II*, Del. at *74 (citing *Sinclair Oil Corp. Levien.*, 280 A.2d 717, 720 (Del. 1971)) (internal quotes omitted).

²⁰⁷ 699 A.2d 327, 336 (1997).

²⁰⁸ Bebchuk et al., *supra* note 197 at 781.

²⁰⁹ *Disney I*, Del. at 246 (citing *Lewis v. Vogelstein*, 699 A.2d 327, 336 (1997)).

²¹⁰ *Id.*

²¹¹ *Disney II*, Del. Ch. at 749.

unreasonable plans,” citing a study that no appellate court cases involving publicly traded firms affirmed an order to reduce managerial compensation on the theory of gift or waste.²¹²

On the surface, *Disney*'s facts appear perfectly ripe for a corporate waste claim. The NFT payment was extraordinarily large, the board was rather passive and followed Eisner's lead, and the decision-making process was sloppy. Yet, tellingly, in its shortest section, the Delaware Supreme Court's opinion quickly dismisses the waste claim because the board had a rational basis behind the large size of the severance. The fact that the board contractually obligated itself to pay the severance may have made the Delaware Supreme Court's decisions easier. But, even if one ignores this obligation, the court easily dismissed the claim because the Disney board had consideration for the large severance package: the incentive and protection for Ovitz to forego his lucrative position at CAA. While the NFT payout may have been large, there was a reason for this amount. Whether this consideration was an appropriate exchange with the NFT payment however is not subject to the court's review.

Ironically, while the corporate waste doctrine provided the *Disney* plaintiffs with an alternative avenue to challenge executive compensation, it is difficult to conceive of a situation in reality where a board that does not violate the business judgment rule would be found to commit waste.²¹³ Rather, the court's inquiry in determining corporate waste appears to overlap with its inquiry for allegations involving breach of fiduciary duties, such as the duty of care. In *Disney*, where the board engaged in negotiations with Ovitz and took steps to be adequately informed of the magnitude of the NFT payment, even if they were far from best practices, it would be difficult to argue that the NFT payment was such a one-sided transaction that it lacked any consideration. The board was informed of the size of the NFT payout partly based on the downside protection Ovitz sought, and this demand also served as the justification for the board to award such a large severance. The type of irrational decision required for showing corporate waste would be hard to find in a board that merited the business judgment presumption.

While corporate waste formally affords the plaintiffs with an alternative avenue to challenge executive compensation schemes, in reality, it does not seem to offer a meaningful channel to do so. Similar to the business judgment rule, the corporate waste doctrine appears to be a

²¹² Bebchuk et al., *supra* note 197 at 781 (citing Mark J. Loewenstein, *Reflections on Executive Compensation and a Modest Proposal for (Further) Reform*, 50 S.M.U. L. Rev. 201 214-15 (1996)).

²¹³ See Thomas & Martin, *supra* note 198 at 584 (providing that “waste claims often allegedly rise or fall with the success of other claims in the complaint.”).

formidable obstacle for plaintiffs in publicly traded companies that have independent compensation committees and default processes set in place in reviewing and approving executive compensation. Thus, while *Disney* sparked great public interest, it seems to be another Delaware case exemplifying its business judgment standard.

IV. Justifications for the Business Judgment Rule, Too Boilerplate?

Given the limitations of the business judgment rule, do the Delaware courts' justifications for providing the board with such a presumption make sense in the executive compensation setting? Even in evaluating the corporate waste claim, the Delaware Supreme Court specifically noted in its first opinion that the court would not adjudicate on the merits of deciding on the compensation *ex-post*. However, the justifications for granting the business judgment presumption in *Disney* do not seem completely convincing.

Delaware courts commonly cite two overarching reasons for their deference. First, they defer to the board's decision because the board has superior expertise and knowledge in the business affairs of the corporation in question.²¹⁴ Second, judges second-guessing the board's decision would make the executives less inclined to take risks in implementing aggressive strategies that may actually bring benefits to the shareholders.²¹⁵

Disney is no exception. The Delaware Chancery Court notes that "courts are ill equipped to engage in *post hoc* review of business decisions" given the board is the ultimate manager of the corporation with best knowledge of the corporation's affairs.²¹⁶ In addition, in the beginning of its opinion, the Delaware Chancery Court writes at great length to circumscribe the court's role in evaluating business decisions because should the court apportion liability based on the ultimate outcome of decisions made in good faith, "those decision-makers would necessarily take decisions that minimize risk, not maximize value."²¹⁷ However, these justifications are not completely satisfying.

²¹⁴ See 1 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 cmt. d (American Law Institute 2005) (providing that deference is given to the judgment of the board "in order to protect directors and officers from risks inherent in hindsight reviews of their unsuccessful decision, and to avoid the risk of stifling innovation and venturesome business activity"); see also D.A. Jeremy Telman, *The Business Judgment Rule, Disclosure, and Executive Compensation*, 81 TULANE L. REV. 829, 839-40 (2007) (arguing that the existing justifications for the business judgment rule fail to protect the vital interests of the corporation against litigation threats and rather only protects directors).

²¹⁵ See 1 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 cmt. d (American Law Institute 2005).

²¹⁶ *Disney II*, Del. Ch. at 746.

²¹⁷ *In re Walt Disney*, 907 A.2d at 698.

First, the court's deference to the board's business expertise stretches only so far. It is true that the managers and board are the experts of the business and affairs of their corporation. But, judges often evaluate the merits of decisions made by other specialists without deference. Aided with expert witnesses, judges often opine on decisions of other professionals in fields requiring specialized expertise.²¹⁸ For example, they do not routinely defer to the medical judgment of doctors who are alleged to have committed medical malpractice or the engineering expertise of product designers who are accused of designing a product that caused plaintiffs injury.²¹⁹ Similarly, based on personal experience, in most family court cases where expert witnesses are usually not introduced, judges do not defer to the decisions of parents even if their negligent actions were unintentional or all possible precautions were taken given the circumstances. Perhaps one can argue that many judges are themselves parents and are experienced "experts" on what the best interest of the child is. But, given strong socioeconomic and cultural factors that can drive parenting decisions, and the complexity of the psychology of children, judges may not be in the best position to determine whether a parent acted in the best interest of the child or which spouse should have custody. After all, parents are the experts who know their children best.

Yet, because judges in family court see divorce and custody cases everyday, we consider them to be experts on the subject matter and defer to *their* judgment. Similar arguments can be made for courts like the New York State Supreme Court's Commercial Division where we expect judges to have specialized knowledge in commercial transactions and disputes.²²⁰ Given Delaware courts encounter shareholder derivative suits frequently, it is difficult to see why Delaware courts would not have the specialized expertise to adjudicate on the business decisions of directors, especially with the aid of expert witnesses. This is particularly the case for executive compensation decisions given that directors themselves consult outside experts to set the compensation scheme for their executives.

In fact, *Disney* had six expert witnesses, one of whom explained why the ultimate payout was excessive.²²¹ Though the Chancery Court found the witness testimonies unhelpful given their conflicting opinions,²²² this is common in other types of hearings involving expert testimonies presented by the parties. It is unclear what makes business decisions, or at least executive

²¹⁸ Telman, *supra* note 214 at 841.

²¹⁹ *Id.*

²²⁰ *Id.* at 843.

²²¹ *In re Walt Disney*, 907 A.2d at 740-45.

²²² *Id.*

compensation decisions so exceptional that judges do not feel comfortable evaluating the merits of those decisions while they feel competent to do so in other areas of the law.

Second, the justification that directors need to be shielded from liability for making risky decisions necessary for the growth of the corporation is also not completely convincing either. While directors may have had to pay damages out of their own pockets in certain cases, such as Enron and WorldCom, these are exceptional cases involving criminal wrongdoings and not representative.²²³ In addition, there are other measures to protect directors outside of the courtroom. In place of deference to directors, state legislators have also created alternative measures of safeguards intended to shield directors from liability for their business decisions.²²⁴ For example, after the business community's backlash against the Delaware Supreme Court's decision in *Smith v. Van Gorkom* that found for a breach of duty of care for the first time in Delaware,²²⁵ Delaware legislators amended its Corporations Law to permit shareholders to waive director liability for breach of duty of care in the corporation's bylaws.²²⁶ In addition, Delaware law grants more protection by allowing corporations to indemnify their officers and directors against liability in civil or criminal actions.²²⁷ Given existing protective measures for director liability and potential for other alternative means of circumscribing directors from liability, the argument that directors need deference in the courtroom to take necessary but risky pursuits for the corporation is not completely convincing. Even if providing less deference through the business judgment rule does have a chilling effect on the board's necessary but risky activities, this could be reversed through legislative process such as post-*Van Gorkom*.

Although critical in nature, the purpose of this section is not to advocate that these justifications are unfounded. But, it is to suggest perhaps that the justifications for the business judgment rule particularly in the executive compensation setting may be too boilerplate

V. Conclusion

While more research is admittedly needed, *Disney* shows some of the limitations of applying the business judgment rule in executive compensation cases. Furthermore, despite the

²²³ Telman, *supra* note 214 at 845-46.

²²⁴ Telman, *supra* note 214 at 846.

²²⁵ 488 A.2d 858 (Del. 1985).

²²⁶ DEL. CODE ANN. tit. 8 § 102(b)(7) (2001).

²²⁷ Telman, *supra* note 214 at 846.

Delaware courts' strong reliance on the business judgment presumption, it is unclear whether the justifications for doing so are completely convincing. Perhaps the most significant limitation with the business judgment presumption however is that its inquiry does not seem to factor in the rent extractions that may be obtained by the managers in setting their executive compensation. For modern corporations with independent committees and structures put in place for deciding executive compensation, it is difficult for plaintiffs to challenge executive compensation in contexts where the compensation may not be optimal for shareholders but procedurally liability-proof. New developments, such as say-on-pay and mandatory pay-ratio disclosures may better guide the managers and board in setting executive compensation that is better aligned with creating shareholder value. But, challenging executive compensation through litigation in Delaware does not seem to be a promising channel for shareholders based on the experience from *Disney*.

C. Part III: Comparative Aspects of *Mannesmann* and *Disney*

Both *Disney* and *Mannesmann* appear to be ideal candidates for comparative study. Ovitz and Esser held executive positions, served only about a year for their respective corporations, and received severance packages that the public thought were enormous. Nevertheless, the amount of these packages and performance of each executive could not differ less. Although Esser's efforts had been widely accepted as a success for the company,²²⁸ he was only awarded around EUR 30 million for his accomplishments with the merger of Mannesmann with Vodafone.²²⁹ By contrast, while Ovitz's performance was more controversial, he nevertheless received a compensation amounting to \$130 million.²³⁰ Furthermore, the Disney board appears to have engaged in sloppier decision making than their Mannesmann counterparts. Based on these facts, it is rather counterintuitive that the German Federal Court of Justice struck down the appreciation award for Esser's success in merging the two corporations, while the Delaware Courts upheld the NFT payment to Ovitz who had questionable performance during his short-lived position at Disney.

We offer an explanation for this seemingly paradoxical outcome that while both jurisdictions adopt a version of the business judgment rule, the Germans courts generally appear more skeptical of board decisions than their Delaware counterparts. Accordingly, Delaware courts seem to have more confidence in shareholders and market forces to remedy exorbitant executive compensation schemes and other faulty board decisions. However, while the two judicial systems appear to maintain a different appreciation for board deference, we also acknowledge that this point should not be overemphasized. First, key factual differences between the cases may also explain the counterintuitive holding, although we do not find them completely convincing: the NFT payment for Ovtiz was part of the employment agreement while Esser's payment was not, and the employee representative, Zwickel abstained during the vote for the bonus payment for Esser. Second, *Mannesmann* and *Disney* were litigated under two different legal systems: *Mannesmann* was adjudicated at the criminal division of the German Federal Court of Justice while *Disney* was a civil, shareholder derivative suit brought before one of the most specialized courts in corporate law. We elaborate on these shortcomings in turn, after a discussion of the different levels of business judgment deference maintained in the two jurisdictions.

²²⁸ Gevurtz, *supra* note 154 at 453.

²²⁹ Adams, in: Nutzinger, Regulierung, Wettbewerb und Marktwirtschaft, 295, (299); Körner, NJW 2004, 2697, (2697).

²³⁰ Fleischer, DStR 2005, 1318, (1319).

I. Two Different Takes on the Business Judgment Rule

Both *Mannesmann* and *Disney* recognize an iteration of the business judgment rule—the notion that the courts should be reticent towards second-guessing the decisions of disinterested directors who are undoubtedly the experts in running the business affairs of the corporation in question.²³¹ In fact, according to the German Federal Court of Justice, the business judgment rule was imported from the U.S. and codified into German corporate law in § 93 AktG.²³² Despite this similarity however, it is hard to overlook the fact that the cases would have probably come out differently had *Mannesmann* been a Delaware case, while *Disney* a German one.

While the takeover of Mannesmann by Vodafone was seen as a success by both the board members and the market, the Federal Court of Justice nevertheless concluded that approving Esser's bonus breached the directors' duties to the corporation because it yielded no advantage for the corporation. On the other hand, although Ovitz was found to be an incompatible fit to Disney and only enjoyed a fourteen-month tenure, the Delaware Supreme Court concluded that paying the \$130 million NFT payments did not breach any fiduciary duty or constitute waste. As such, while both German and Delaware courts may adopt a form of business judgment rule, one driving force that seems to have led to these divergent results is the different level of deference each court affords the board of directors. Overall, German courts appear to be less deferential to the board of directors than Delaware courts, possibly a reflection of the general attitude towards executive compensation in each respective country.

As described in the previous section, Delaware courts provide the business judgment presumption to preclude itself from unreasonably imposing on the internal business and affairs of a corporation. Directors are the experts of their corporation and the courts should not substantively review these decisions but for limited circumstances that call into question the legitimacy of the decision-making process or intent of the directors or management. In Germany, § 87 para. 1 AktG²³³ mandates that the compensation of every executive staff be “appropriate,” given their responsibilities and state of the corporation. But, the section does

²³¹ Gevurtz, *supra* note 154 at 463; *see also* Berger-Walliser, *supra* note 61 at 11.

²³² In the Version of Sep. 22nd, 2005, BGBl. I 2005, 2802. *See also* Berger-Walliser, *supra* note 61 at 9.

²³³ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

not place any specific limits on executive pay to leave the final discretion to the supervisory board.²³⁴ Specifically, in *Mannesmann*, the Federal Court of Justice notes that:

Remuneration of officers is part of the executive and strategic tasks of the supervisory board and therefore generally open to a relatively wide margin of business judgment and discretion. Accepting such a margin of business judgment is called for because taking entrepreneurial decisions generally involves striking a balance between possible future risks and prospects . . . that the quality [of such decisions] sometimes can only be known in hindsight. Hence no breach of duty can be found where a decision is based on a sense of responsibility, on diligent collection of all relevant data and is aimed solely toward furthering the company's best interest.²³⁵

Similar to the Delaware courts, the Federal Court of Justice also shares concerns of hindsight bias and focuses on granting sufficient flexibility to encourage risky but beneficial pursuits. The Federal Court of Justice's language above also looks almost identical to Delaware's duty of care standard. Yet, despite this rather striking overlap, the German and Delaware courts came to two different conclusions while the facts of their respective cases appear to point to the contrary.

In *Mannesmann*, the Federal Court of Justice ruled that the bonus provided absolutely no advantage for the corporation—essentially, a waste claim in the United States—on three grounds.²³⁶ The third justification that the bonus would not provide incentives for the successor executives of Vodafone in particular “shows [the court's] willingness to second guess business judgments under circumstances in which a more deferential court might find a rational basis sufficient to uphold the directors' decision.”²³⁷ As noted previously in the paper,²³⁸ the Federal Court of Justice appears to gloss over the possibility that the bonus may indeed have an incentivizing impact on successor executives. While the court treats Mannesmann's interests as separate from that of Vodafone because of the takeover, it is also

²³⁴ Brauer, NZG 2004, 502, (504)

²³⁵ FRANKLIN A. GEVURTZ, GLOBAL ISSUES IN CORPORATE LAW 100 (2006) (quoting portions of the *Mannesmann* opinion translated by David Donald, Alexander Klauser, Klaus Linke & Katherina Pistor).

²³⁶ The three justifications again, are: 1) Esser was not entitled to the bonus because he received all he was entitled to under his employment contract; 2) given Esser was leaving the corporation, the bonus would not be an incentive for him to perform well on behalf of Mannesmann; and finally, 3) the bonus would not provide incentives for other employees because Vodafone had taken over the Mannesmann management and Mannesmann would not reap the advantages from creating a reputation that the new firm awards good results.

²³⁷ Gevurtz, *supra* note 154 at 464.

²³⁸ See *supra* section A.IV.2.a.

plausible that objectives of the two merging corporations integrate into one. Granting Esser the bonus, which Vodafone had approved, could have been economically justifiable. It may have provided incentives for the executives of the newly-joint Vodafone conglomerate, which included Mannesmann after the merger.²³⁹ However, despite this plausible justification, the court did not apply § 93 AktG²⁴⁰ because it considered that Mannesmann directors had breached their corporate trust in terms of the German penal code and committed a waste of corporate assets.²⁴¹

On the other hand, despite both the Delaware Chancery and Supreme Courts' strong criticism that the Disney board conducted activities far below best practices, they nevertheless granted the Disney directors the business judgment presumption and found for a rational basis behind Ovitz's gargantuan payout. Though the Disney board and compensation committee did not initiate the negotiations with Ovitz and went through a sloppier process in approving the OEA than the Mannesmann directors in confirming Esser's bonus, the Delaware courts found that the Disney directors were adequately informed. Most importantly, the Delaware Supreme Court quickly dismissed the plaintiffs' waste claim given there was a rational basis for the rather large payout. The Delaware Supreme Court accepted that the payout served as inducements for Ovitz to leave his lucrative position to join Disney without further inquiry into the merits of such justification. So long as there was consideration, the Delaware courts would not question the decision to make the payout.

While the purpose of this paper is not to assess the merits of each court's decisions, the two contrasting findings appear to show that German courts are more skeptical than their Delaware counterparts in evaluating executive compensation decisions by corporate boards. While the Federal Court of Justice rejected Mannesmann's justifications for the bonus, it is unclear the Delaware courts would have done the same had *Mannesmann* been brought under their review especially given the waste doctrine "is almost never used by American courts."²⁴²

As reviewed above, in Delaware, defendant directors can relatively easily show that they have been adequately informed and provide a rational justification that the payout has some purpose in advancing the corporation's interests. On the other hand, the German Federal Court of Justice in *Mannesmann* appears to be looking for more than a rational justification

²³⁹ See Gevurtz, *supra* note 154 at 464.

²⁴⁰ In the Version of Sep. 22nd, 2005, BGBl. I 2005, 2802.

²⁴¹ Berger-Walliser, *supra* note 61 at 12; NJW 2005, 522, (523, m.n. 12).

²⁴² Berger-Walliser, *supra* note 61 at 12.

for the bonus. In fact, the discretion that the supervisory board in *Mannesmann* could have exercised was rather limited. According to the Federal Court of Justice's reasoning, in a corporation similarly situated as Mannesmann, the supervisory board's only way to decide in accordance with their fiduciary duties to protect the corporate assets would have been to decline the bonus all together.²⁴³ By contrast, even in maintaining a level of deference to the Disney board, the Delaware courts could have inquired more into the justification the board provided for the large NFT payment. Even if incentivizing Ovitz was a valid basis for the downside protection, was \$130 million necessary to achieve this end?

Most interestingly however, the differing levels of deference demonstrated are actually ironic given Germany's two-tier board model that structurally limits the amount of control executive officers are able to exert on the board members in making business decisions. Given the rigid division between the board of directors and the supervisory board, and half of the Mannesmann supervisory board consisted of employee-elected members, it seems more intuitive that the Federal Court of Justice grant more deference to the Mannesmann board.²⁴⁴ After all, the lack of a mandatory two-tier system in the U.S. affords less structural protections against the comingling between the executive officers and the board. The possibility for executives to make rent extractions appears considerably less in a two-tiered board than a unitary one. The facts of *Disney* actually also provide evidence of Eisner wielding some influence over the board in deciding upon the OEA. But, even if the *Disney* facts do not provide for a perfunctory decision-making process, the fact that the prevailing corporate board structure in the U.S. is unitary seems to suggest that Delaware courts should be less deferential to the board than their German counterparts. This is especially the case since all board decisions in Germany reflect not only the interest of shareholders but also that of other stakeholders in the corporation, such as its employees.

This rather paradoxical juxtaposition in the cases seems to be a symptom of a more general, societal skepticism towards the board of directors in Germany than the U.S. Whether this contrasting attitude stems from "the statist tendencies in German political and economic philosophy, which [...] often has endorsed an active role for government bureaucracy in managing economic matters" or American-centrist philosophy "more willing to put trust in

²⁴³ NJW 2006, 522, (525, m.n. 27).

²⁴⁴ See Gevurtz, *supra* note 154 at 471. ("Despite the insulating impact of a two-tier board, German courts, as exemplified by *Mannesmann*, have not given the supervisory board the same degree of deference in dealing with the management board that the Delaware courts routinely give to so-called disinterested directors, who approve transactions involving fellow members of unitary boards.").

private ordering and markets” is beyond the scope of this paper.²⁴⁵ Nevertheless, the difference in deference granted to the boards in the two cases appears to be representative of the contrasting views towards board decisions that are held in each country.

For example, German stock company law contains provisions specifically addressing the limits on executive compensation. As noted above, § 87 para. 1 AktG²⁴⁶ mandates that the executive compensation be “appropriate.” In making this decision, all kinds of benefits, including the salary, stock options and severance packages must be taken into consideration.²⁴⁷ Linking executive pay to these factors is intended to prevent the executive compensation from exceeding the financial means of the company to prevent any abuse and ensure the award take the executive’s value to the corporation into consideration.²⁴⁸ These provisions set the outermost limits to the discretion the German courts give to executive compensation decisions. By contrast, the Delaware corporate statute contains no explicit statement setting any limits on executive compensation. The absence of such a provision seems to indicate a difference in attitude towards executive compensation. Even if § 87 para. 1 AktG²⁴⁹ does not set more defined restrictions on executive compensation, it still shows more involvement by the legislators in curbing executive compensation in Germany than in the U.S. Having a statute like this also “empowers courts to review compensation with a greater scrutiny than would more generalized notions of fiduciary duty” in jurisdictions where such legal “bite” does not exist.²⁵⁰ Even if equipped with broad strokes, German courts have the backing of explicit statutory language they can fall back on, while the Delaware courts do not have this type of blessing.

Lastly, while Delaware corporate law does not provide an explicit provision restricting executive compensation, unlike German corporate law, it does allow directors to waive away their duty of care—a provision that frequently creates barriers for plaintiffs challenging executive compensation. § 102(b)(7) of the Delaware corporate statute allows a corporation’s certificate of incorporation to include a provision prohibiting the recovery of monetary damages from directors that is exclusively based on a violation of duty of care.²⁵¹ As a result,

²⁴⁵ Gevurtz, *supra* note 154 at 469.

²⁴⁶ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

²⁴⁷ Hefermehl/Spindler, in: § 87 AktG, m.n. 12.

²⁴⁸ Pape, Vergütungs- und Abfindungszahlungen an Vorstandsmitglieder deutscher Aktiengesellschaften im Fall feindlicher Unternehmensübernahmen, 37.

²⁴⁹ In the Version of Oct. 5th, 1994, BGBl. I 1994, 2930.

²⁵⁰ Gevurtz, *supra* note 154 at 481.

²⁵¹ 8 Del. C. § 102(b)(7) (providing that a corporation may include in its certificate of incorporation “[a] provision eliminating or limiting the personal liability of a director to the corporation or its stakeholders for

in addition to Disney, “[t]he vast majority of Delaware corporations have a provision in their certificate of incorporation that permits exculpation to the extent provided for by § 102(b)(7).”²⁵² Chief Justice Leo Strine provides that the justification for such exculpation “is to encourage directors to undertake risky, but potentially value-maximizing, business strategies, so long as they do so in good faith [. . . especially] when despite the directors’ good intentions, [the challenged transaction] did not generate financial success.”²⁵³ § 102(b)(7) was enacted in Delaware as a response to the backlash that ensued after the first Delaware case finding for a breach of duty of care in *Smith v. Van Gorkom*.²⁵⁴

As such, § 102(b)(7) seems to value the potential value-maximization of risky undertakings rather than possible decrease in deterrence for the board to fulfill its due care obligations. On the flip side, § 102(b)(7) also seems to entrust more confidence in the ability of other actors than the courts, namely shareholders and market forces to herd the actions of directors and managers towards maximizing shareholder value. While § 87 para. 1 AktG and § 102(b)(7) cover overlapping but different areas of the law, the existence and absence of such statutes in each respective country reflect the varying level of trust given to the board and confidence that the board’s actions can be regulated without the government’s hands. As such, § 87 para. 1 AktG and § 102(b)(7) appear to be on almost opposite ends of this spectrum.

Of course, there are other factors that need to be considered in evaluating the different outcomes in the two cases, including the fact that one was a criminal and the other was civil case, as it will be discussed in the following section. However, the two cases do reveal that the German and Delaware courts adopt a different level of deference in approaching executive compensation decisions, although both acknowledge that the courts should allow directors to exercise a certain level of discretion in managing their corporations. Though the two-tiered board structure in Germany suggests that the German courts would be more deferential than Delaware, the opposite reality indicates that German corporate culture in general appears more skeptical of board decisions than in the U.S. Because of this greater concern, Germany seems to have a two-tiered board and law setting limits on executive compensation in the first place while Delaware corporate law appears to assume a less intrusive role and seems to value

monetary damages for breach of fiduciary duty as a director [...] provided that such provision shall not eliminate or limit the liability of a director [...] for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law [...].”)

²⁵² *Disney II*, Del. Ch. at 752.

²⁵³ *Prod. Res. Group, LLC v. NTC Group, Inc.*, 863 A.2d 772, 777 (Del. Ch. 2004).

²⁵⁴ 488 A.2d 858 (Del. 1985).

board flexibility in undertaking potentially risky but fruitful endeavors for the corporation than in Germany.

II. Other Driving Factors Behind the Contrasting Holdings

While *Mannesmann* and *Disney* do show two jurisdictions exhibiting different levels of deference towards board decisions, this point should not be overemphasized given two major distinctions that also seem to explain the conclusions reached by each respective court. First, though certain facts from the cases appear to make them ripe for comparison, two factual differences deserve some attention in explaining the divergent holdings. Second, the fact that *Mannesmann* was a criminal case while *Disney* a civil, shareholder derivative suit raises some question about the comparability of the two cases.

1. Factual Distinctions

Two factual differences may provide some explanation behind the conclusions reached by each court, although we conclude that they are not entirely convincing.

First, Ovitz's NFT payment was a contractually binding obligation for Disney while Esser's bonus was not part of his employment agreement with Mannesmann. In evaluating the corporate waste claim, the Delaware Supreme Court immediately dismisses the claim by citing that Disney was contractually bound to make the payment for a no-fault termination. The court concluded that payment of a contractually obligated amount could not constitute waste and considered whether agreeing to such a payment in the first place met the threshold for a waste claim. On the other hand, the *Mannesmann* court focuses on the fact that the bonus for the merger was not intended in Esser's employment contract with the corporation. The Federal Court of Justice emphasizes that the payment was awarded to Esser gratuitously for past performance after his exit from the corporation had only been decided. Accordingly, Esser's appreciation award went beyond the contractual obligations between Mannesmann and Esser, and had no legal basis. In similar cases where the award was not based on prior agreement, the Delaware courts have also found for a waste of corporate assets.²⁵⁵

Second, though the decision-making process of the Mannesmann board was sounder than the Disney board's, it also had its own deficiency. Namely, the proposal for the appreciation

²⁵⁵ David C. Donald, *Approaching Comparative Company Law*, 14 FORDHAM J. CORP. & FIN. LAW 84, 101 (2008) (citing *Fidanque v. Am. Maracaibo Co.*, 92 A.2d 311, 321 (Del. Ch. 1952) and *Lewis v. Hett*, C.A. No. 6752 1984 WL 8258 (Del. Ch. Sept. 4, 1984) as examples).

award was approved by the Präsidium because Klaus Zwickel, the employee representative abstained from the vote during the February 4, 2000 meeting. During the February meeting, Josef Ackermann and Joachim Funk, two members of the Präsidium, both agreed on the bonuses. Though Zwickel felt that the bonus did not relate to employee concerns, he did not want to obstruct the bonus and abstained “recognizing that his participation without a negative vote allowed the Präsidium to adopt the bonus.”²⁵⁶ During the trial, Zwickel reportedly stated that it has been “common practice” for employee representatives to abstain from big board decisions where the opinions of the employee representatives did not align with employees’ interests—“representatives of the workers wanted to let firms pay spectacular salaries but avoid the jibes of their comrades.”²⁵⁷ Jürgen Ladberg, the fourth and final member of the Präsidium who did not attend the meeting, was thereby outvoted despite his protest against the decision later.²⁵⁸

As such, in evaluating the waste claim, the German Federal Court of Justice focuses on the deficiency that the employee representative did not affirmatively approve of the appreciation award. Without Zwickel’s affirmative vote, the board’s approval may have merited higher scrutiny by the Federal Court of Justice, compared to had the proposal been passed with the full support of the employee representative.

While these factual discrepancies may provide some explanation to the contrasting holdings, we argue that they are not completely convincing. First, while it is true that unlike Ovtiz’s NFT payment, Esser’s appreciation award was not part of his employment contract, the Delaware Supreme Court *did* consider whether agreeing to such a payment in the first place constituted corporate waste. As the German Federal Court of Justice entertained whether agreeing to pay the appreciation award constituted waste, the Delaware Supreme Court did the same by analyzing whether the board’s agreement to a contractual obligation that included a large no-fault payout constituted waste. The second factual distinction—Zwickel’s abstention vote—while more persuasive, also falls short. While this procedural deficiency may have swayed the German Federal Court of Justice’s decision against the Mannesmann directors, that fact that the Delaware Courts were faced with a more deficient decision-making process seems to negate this point. Rather, the fact that a court faced with a more perfunctory decision-making process is willing to uphold the outcome of that process demonstrates more

²⁵⁶ Gevurtz, *supra* note 154 at 461.

²⁵⁷ *German Industrial Relations Slowly Losing Their Chains*, ECONOMIST (Feb. 19, 2004), available at <http://www.economist.com/node/2447475>.

²⁵⁸ *Jahn*, *Zeitschrift für Rechtspolitik* 2004, 179, (181).

deference towards those decision-makers. Recognizing that the board's conduct fell below best practices, the Delaware Supreme Court still held that the directors met their minimum duty of care and accepted their justification for the payment. On the other hand, it is clear that procedurally, the Mannesmann board did meet all the requirements in approving the appreciation award, even if Zwickel abstained from his vote. The Präsidium received majority approval needed to approve the award. As such, the fact that Zwickel's abstention led to the contrasting holding seems to actually support the conclusion that German courts in whole are more skeptical of board decisions than their colleagues in Delaware.

2. Criminal v. Civil Suits

Furthermore, the reader should also take into account that *Mannesmann* was a criminal case, while *Disney* a civil one. While both courts have entertained the business judgment rule, they did so in two different legal contexts that “serve distinct functions and receive very different treatment from the courts.”²⁵⁹

The exchange supervisory commission in Germany was much more underdeveloped and thereby weaker compared to its American counterpart.²⁶⁰ Additionally, instruments like derivative suits and shareholder activism in general were rather uncommon in Germany at the time of *Mannesmann*. Consequently, it is not surprising that prosecutors fill this gap in order to review—from a German point of view—obviously exceptional compensations, like in *Mannesmann*. On the other hand, in *Disney*, the decisions of the Delaware court were made on the basis of corporate law, as the U.S. legal system offers a broader range of instruments to challenge corporate governance related problems. The legal basis on which a court has to review a case may have a great impact on the courts' approach on the prevailing problem.²⁶¹

Fundamentally, in both the U.S. and Germany, civil remedies found in corporate law are primarily remedial or coercive, while criminal penalties serve a punishing and deterrent purpose for societally recognized wrongful conduct.²⁶² In addition, in a civil case, the alleged harm is contained between the two parties—for example, between the corporation, as represented by the shareholders, and the directors in *Disney*. Derivative suits, by definition are purposed to address the harms directors caused on the corporation itself. In contrast, in a

²⁵⁹ Donald, *supra* note 255 at 100.

²⁶⁰ Deborah Sturman, *Manager Magazin* 10.02.2004.

²⁶¹ Donald, Working Paper Series No. 77, (14); Berger-Walliser, *supra* note 231 at 13.

²⁶² Donald, *supra* note 255 at 100 n.77.

criminal prosecution like *Mannesmann*, the claim is between the respective state and the directors that might have violated national law. The scope of the latter is much more far-reaching, as a state is representing all of its citizens. In a criminal prosecution, the alleged harm is not only one that resulted between the directors and the shareholders of the company, but also one that resulted from violation of democratically legitimized laws between the directors and the general public.

This is complicated by the fact that corporate governance in the U.S. is also much more focused on the shareholder perspective, which may explain the more sophisticated system of protection of shareholder interests in the U.S. than in Germany.²⁶³ Reviews of executive compensation centers on the harm to the corporation and thereby to the corporation's shareholders. On the other hand, in corporate Germany at the time, the shareholder orientation was not as distinctive.²⁶⁴ In Germany's more stakeholder-orientated system, not only does approval of executive compensation need the approval of other stakeholders in the company beyond just shareholders, but evaluating the alleged harm to the corporation also seems to take into account these other interests in return.

Given the differing legal context and interests considered in each respective court, the comparability between *Mannesmann* and *Disney*, admittedly, may not be as strong. Whether in a criminal or civil law system, it is still true that the German courts and legislators in general appear more skeptical of board decisions than their counterparts in Delaware. The juxtaposition of the two-tier board system and § 87 para. 1 AktG on the one hand, the unitary board and § 102(b)(7) on the other illustrates this point. But, this point should not be overemphasized given that the two cases were decided under different legal systems that provide for different remedies and balance differing interests. While the German Federal Court of Justice's stronger skepticism towards the *Mannesmann* board may be a driving force behind the contrasting holdings, the fact that *Mannesmann* was a criminal case may have also led to such outcome. The latter point has not yet been studied in depth in the comparative literature of *Mannesmann* and *Disney*, and warrants further attention.

²⁶³ Kolla, German Law Journal, 829, (843). With globalization, there is a growing trend in Germany to view corporate governance in a more shareholder-centered way. In a more shareholder-orientated Germany, to challenge executive compensation, it is not sufficient to make allegations largely motivated by social and political considerations based on the accusation that the law has been violated in a matter that is relevant for criminal law. In light of this point, the lack and the need for more efficient and specialized legal instruments within the German legal system, as in the time of *Mannesmann* becomes inherent.

²⁶⁴ Jürgens/Rupp/Vitols, *Economy and Society* 2000, 54, (54, 55).

D. Conclusion

“It is another property of the human mind that whenever men can form no idea of distant and unknown things, they judge them by what is familiar and at hand.”

--Giambattista Vico (1744)²⁶⁵

To conclude, one could say that *Mannesmann* in Germany and *Disney* in the U.S. were indicators for the prevailing problems regarding executive compensation of the respective corporate governance systems. In both cases, the courts appear to look to what is familiar when confronted with an issue untested before.

In terms of Germany, *Mannesmann* had clearly shown that corporate Germany was no longer isolated. As a matter of fact, Germany was slowly developing a market for corporate control accompanied with the increasing influence of shareholder-orientated companies. The takeover of *Mannesmann* by *Vodafone* might mark the moment, when globalization has reached the level of corporate structures and corporate governance in Germany. Consequently, the German practice of executive remuneration had to be acclimatized with the international and especially the U.S. practice of compensation in order to keep competitive in the simultaneously developing market for highly skilled managers.

In the U.S., the executive compensation for *Ovitz* shows the high level of executive compensation received by executive officers in the U.S., especially when compared to their counterparts abroad. *Disney* has become a poster-child case for those who criticize that executive compensation in the U.S. is excessive, particularly when the pay for average Americans has not grown as much and income inequality is widening. Despite *Disney*'s inopportune timing at this juncture however, it does not appear that the case has, or could have added much in curbing or better guiding executive compensation to be in line with the corporation's best interest from a doctrinal standpoint. While more actions have been taken to better monitor executive compensation since *Disney*, the executive compensation issue seems to be something that needs to be tackled from outside the courtroom in the U.S. While derivative suits may serve as a backstop remedy, it does not seem to be an effective measure in guiding executive compensation to be better aligned with the corporation's interest. While

²⁶⁵ GIAMBATTISTA VICO, NEW SCIENCE 19 (T.G. Bergin & M.H.Fisch trans., Anchor Books 1961).

Germany seems to be shifting towards an executive compensation model based on the U.S.', one of the big takeaways from Germany may be the different societal perspective towards executive compensation. While there are criticisms of the high level of executive compensation in the U.S., it is not a culturally ingrained skepticism that seems to guide the legislation in executive compensation and corporate governance in general.

1. Bibliography

- Adams, Michael*, Vorstandsvergütungen, Der Fall Mannesmann und DaimlerChrysler, in: Nutzinger, Hans G., Regulierung, Wettbewerb und Marktwirtschaft, Festschrift für Carl Christian von Weizsäcker, Göttingen 2003, 295–362.
- Bauman, Jeffrey D./Palmiter, Alan R./Partnoy, Frank*, Corporations Law and Policy, Materials and problems, 7. Ed., St. Paul 2010.
- Baums, Theodor*, Anerkennungsprämien für Vorstandsmitglieder, in: Baums, Theodor/Wertenbruch, Johannes/Lutter, Marcus e.a., Festschrift für Ulrich Huber zum siebenzigsten Geburtstag, Tübingen 2006, 657–675.
- Berger-Walliser, Gerlinde*, Executive Compensation in Germany and the U.S. Compared to French Legislation, SSRN Journal (2009)
- Brauer, Markus*, Die aktienrechtliche Beurteilung von "appreciation awards" zu Gunsten des Vorstands, NZG (2004), 502–509.
- Cheffins, Brian R.*, The Metamorphosis of "Germany Inc.", The Case of Executive Pay, The American Journal of Comparative Law 49 (2001), 497.
- Clarke, Thomas*, International Corporate Governance, A Comparative Approach, London, 2007.
- Deborah Sturman*, Klaus Esser und die Mickey Mouse, Manager Magazin (10.02.2004), <http://www.manager-magazin.de/unternehmen/artikel/a-285755.html> (Accessed on 29.12.2015).
- Donald, David C.*, Approaching Comparative Company Law, Working Paper Series No. 77.
- Fleischer, Holger*, Zur Angemessenheit der Vorstandsvergütung im Aktienrecht (Teil I), DStR 2005, 1279.
- Fleischer, Holger*, Zur Angemessenheit der Vorstandsvergütung im Aktienrecht (Teil II), DStR (2005), 1318.

- Fonk, Hans-Joachim*, Die Zulässigkeit von Vorstandsbezügen dem Grunde nach, Aktienrechtliche Anmerkungen zum Urteil des LG Düsseldorf, NZG 2004, 1057 Mannesmann, NZG 2005, 248.
- Gevurtz, Franklin A.*, Disney in Comparative Light, *The American Journal of Comparative Law* 55 (2007), 453–492.
- Haar, Brigitte*, Executive Compensation under German corporate law: reasonableness, managerial incentives and sustainability in order to enhance optimal contracting and to limit managerial power, in: Thomas, Randall S., *Research Handbook on Executive Pay*, Cheltenham et. al., 2012, 486–505.
- Hoffmann-Becking, Michael*, Gestaltungsmöglichkeiten bei Anreizsystemen, NZG (1999), 797.
- Hoffmann-Becking, Michael*, Vorstandsvergütung nach Mannesmann, NZG (2006), 127.
- Höpner, Martin/Jackson, Gregory*, An Emerging Market for Corporate Control?, *The Mannesmann Takeover and German Corporate Governance*, MPIfG Discussion Paper 01/4 (2001).
- Höpner, Martin/Jackson, Gregory*, Entsteht ein Markt für Unternehmenskontrolle?, *Der Fall Mannesmann*, *Leviathan* 29 (2001), 544–563.
- Höpner, Martin/Jackson, Gregory*, Revisiting the Mannesmann takeover, How markets for corporate control emerge, *Eur. Manage Rev.* 3 (2006), 142–155.
- Hüffer, Uwe*, *Aktiengesetz*, Vol. 53, 6. Ed., Munich 2004.
- Jahn, Joachim*, Lehren aus dem Fall Mannesmann, *Zeitschrift für Rechtspolitik* (2004), 179–218.
- Jürgen Kuri*, Vodafone beendet die Mannesmann-Geschichte, *Heise Online* (11.06.2002), <http://www.heise.de/newsticker/meldung/Vodafone-beendet-die-Mannesmann-Geschichte-63471.html> (Accessed on 29.12.2015).
- Jürgens, Ulrich/Rupp, Joachim/Vitols, Katrin*, Shareholder Value in an Adverse Environment: The German Case, *Economy and Society* 29 (2000), 54–79.

- Knipp, Thomas*, Der Deal, Die Geschichte der grössten Übernahme aller Zeiten, 1. Edition, Hamburg 2007.
- Kolla, Peter*, The Mannesmann Trial and the Role of the Courts, German Law Journal Vol. 05 No. 07, 829–847.
- Körner, Marita*, Die Angemessenheit von Vorstandsbezügen in § 87 AktG Eine unbeachtete Vorschrift?, NJW (2004), 2697.
- Kort, Michael*, Das Mannesmann Urteil im Lichte von §87 AktG, NJW (2005), 333.
- Kroppf, Bruno/Semler, Johannes*, Münchener Kommentar zum Aktiengesetz, 2. Vol., Munich, 2004 (zitiert: *Kroppf/Semler*).
- Maier, Stefan*, A Close Look at the Mannesmann Trial, German Law Journal 7 (2006), 603,
- Münzberg, Thomas*, Das Mannesmann-Urteil des Bundesgerichtshofs, ZRFG (2006), 126.
- Nussbaum, Matthias*, Golden handshakes and golden parachutes, Severance packages for corporate executives 2005.
- Pape, Torsten*, Vergütungs- und Abfindungszahlungen an Vorstandsmitglieder deutscher Aktiengesellschaften im Fall feindlicher Unternehmensübernahmen 2004.
- Peltzer, Martin*, Wider den "greed"-Betrachtungen zu §§ 86 und 87 AktG, in: Lutter, Marcus/Schneider, Uwe-Helmut (Hrsg.), Festschrift für Marcus Lutter zum 70. Geburtstag, Deutsches und europäisches Gesellschafts-, Konzern- und Kapitalmarktrecht, Cologne 2000, 571.
- Pistor, Katharina*, Legal Ground Rules in Coordinated and Liberal Market Economies, in: Hopt, Klaus J., Corporate governance in context, Corporations, states, and markets in Europe, Japan, and the US, Oxford, New York 2005, 249–280.
- Reinisch, David C.*, CEO-Compensation, Vergütungssysteme zwischen Effizienz und Gerechtigkeit, Berlin, Münster 2012.
- Rolshoven, Max Philipp*, Last Word - Acquittals in the Mannesmann Trial, German Law Journal 8 (2004), 935–940,

Seidlitz, Frank, 10 Jahre Mannesmann-Übernahme, Wie ein Brite die Deutschland-AG sprengte, Die Welt (12.11.2009), <http://www.welt.de/5188616> (Accessed on 29.12.2015).

Slodczyk, Katharina, Mannesmann - Die Engländer kommen, 60 Jahre deutsche Wirtschaftsgeschichte, Handelsblatt (04.02.2007), http://www.handelsblatt.com/archiv/60-jahre-deutsche-wirtschaftsgeschichte-mannesmann-die-englaender-kommen/v_detail_tab_print/2765192.html (Accessed on 29.12.2015).

Streeck, Wolfgang/Höpner, Martin, Alle Macht dem Markt?, Fallstudien zur Abwicklung der Deutschland AG, Vol. 47, Frankfurt, New York 2003.

Tegtmeier, Stefan, Die Vergütung von Vorstandsmitgliedern in Publikumsaktiengesellschaften, Eine vergleichende Untersuchung zum deutschen, englischen und US-amerikanischen Recht, Frankfurt am Main et. al., 1998.

Wessel, Horst A., Kontinuität im Wandel, 100 Jahre Mannesmann 1890 - 1990, Düsseldorf 1990.