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Delaware Court Finds Continued Compensation to Incapacitated Chairman Could Render Directors Liable for Claims of Waste and Bad Faith

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In an unusual finding, the Delaware Court of Chancery held that demand was partly excused and claims for corporate waste, bad faith and unjust enrichment could proceed against CBS Corporation for compensation paid to its former Executive Chairman, Sumner Redstone, who later became Chairman Emeritus. The plaintiff alleged that Mr. Redstone became incapacitated yet continued to receive compensation for work he did not perform.

The court noted that claims of corporate waste and bad faith require a plaintiff to show that the board's decision was "so egregious or irrational" that it could not be based on a valid assessment of a company's best interest, and amount to an "extreme factual scenario." In making its determination, the court reviewed the salary payments made to Mr. Redstone as Executive Chairman pursuant to an employment agreement. Under the agreement, the compensation committee could only increase, but not decrease, Mr. Redstone's salary. Either party could also terminate the agreement. The agreement required Mr. Redstone to be "actively engaged" in working with the board and management, including providing overall leadership and strategic direction, offering guidance and support, coordinating board activities and communicating with shareholders.

According to the court, "it should have been abundantly clear to the members of the board" that instead of being "actively engaged," Mr. Redstone was no longer providing meaningful services to the company beginning at some point in late 2014 or in 2015, including no longer physically attending any board meetings, only introducing himself on the telephone at multiple board meetings in 2014 and early 2015, not speaking at all at other board meetings held in 2015 and not participating on any analyst calls in 2015. The court also cited to numerous press articles reporting his impairment in 2015. In addition, emails and other correspondence indicate that several directors knew about Mr. Redstone's condition, including from having visited him personally.

The court made clear that it did not expect the board to have terminated Mr. Redstone's employment immediately after he fell ill, that he was entitled to "be treated in a dignified and respectful manner," but the company made "no effort" to consider the financial impact of his incapacity for approximately twenty months. The record did not show that his capacity or his ability to perform was "discussed in any meaningful sense." It was "[g]laringly absent" the lack of a memorandum or other writing "candidly assessing Redstone's capabilities and the pros and cons of terminating" the employment agreement.

The court concluded that Mr. Redstone's contributions to the company after May 2014 were "so negligible and inadequate" that "no person of ordinary, sound business judgement" would find them worth the millions of dollars of salary that were paid to Mr. Redstone. In addition, the failure to inquire into his health and at least consider terminating the employment agreement over a twenty-month period reflects a "conscious disregard" of the directors' fiduciary duties.

As for payments rendered to him as Chairman Emeritus beginning in early 2016, the court found that the company chose to continue to pay Mr. Redstone a salary for services that it allegedly knew he could not render, and the decision to award him an ongoing salary of a million dollars under the circumstances were wasteful and lacked justification.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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