IN THE

Supreme Court of the State of Delaware

No. 411, 2005

IN RE THE WALT DISNEY COMPANY DERIVATIVE LITIGATION,

WILLIAM BREHM and GERALDINE BREHM, as Trustees and Custodians; MICHAEL GRENING; RICHARD KAPLAN and DAVID KAPLAN, as Trustees; THOMAS M. MALLOY; RICHARD J. KAGER and CAROL R. KAGER, as Joint Tenants; MICHAEL CAESAR, as Trustee for Howard Gunty, Inc. Profit Sharing Plan; ROBERT S. GOLDBERG, I.R.A.; MICHAEL SHORE; MICHELE DeBENDICTIS; PETER LAWRENCE, I.R.A.; MELVIN ZUPNICK; JUDITH B. WOHL, I.R.A.; JAMES C. HAYS; and BARNETT STEPAK,

Plaintiffs Below, Appellants,

v.

MICHAEL D. EISNER, MICHAEL S. OVITZ, STEPHEN F. BOLLENBACH, SANFORD M. LITVACK, IRWIN RUSSELL, ROY E. DISNEY, STANLEY P. GOLD, RICHARD A. NUNIS, SIDNEY POITIER, ROBERT A.M. STERN, E. CARDON WALKER, RAYMOND L. WATSON, GARY L. WILSON, REVETA F. BOWERS, IGNACIO E. LOZANO JR., GEORGE J. MITCHELL, LEO J. O'DONOVAN, THOMAS S. MURPHY and THE WALT DISNEY COMPANY,

Defendants Below, Appellees.

APPEAL FROM COURT OF CHANCERY OF THE STATE OF DELAWARE IN AND FOR NEW CASTLE COUNTY CONS. C.A. No. 15452-N

APPELLANTS' OPENING BRIEF

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NATURE AND STAGE OF THE PROCEEDINGS

This case, brought derivatively on behalf of The Walt Disney Company ("Disney" or the "Company"), arises from Michael D. Eisner's ("Eisner") decision in August 1995 to hire Michael S. Ovitz ("Ovitz") as Disney's President and provide Ovitz with a five-year employment agreement (the "OEA") containing potentially very costly provisions favoring Ovitz if Disney terminated him without cause ("Non-Fault Termination" or "NFT"). In December 1996, Ovitz left the Company and received a full $130 million NFT payout. Eisner arranged for the termination and full NFT payout without any consideration or approval by the Board.

In *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (*en banc*) ("*Brehm*"), this Court reversed the Court of Chancery's ("trial court") decision to dismiss the complaint with prejudice. *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342 (Del. Ch. 1998) ("*Disney I*"). Plaintiffs filed their Second Amended Complaint on January 3, 2002, after having received documents from Disney pursuant to a request made under 8 *Del. C.* § 220. Defendants moved to dismiss on April 19, 2002. On May 28, 2003, the trial court denied the motions to dismiss. *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275 (Del. Ch. 2003) ("*Disney II*"). Discovery ensued.

Following the close of discovery, Ovitz moved for summary judgment. On September 10, 2004, the trial court granted Ovitz's motion in part and denied it in part. *In re Walt Disney Co. Derivative Litig.*, 2004 Del. Ch. LEXIS 132 ("*Disney III*"). The trial was set for October 18, 2005.

On the eve of trial, well after the close of discovery, Disney produced approximately 11,000 pages of documents purportedly from Ovitz's Disney work files, nearly doubling the volume of prior productions. Seeking to avoid a "trial by ambush," plaintiffs immediately requested a three-month trial adjournment to undertake discovery into the Ovitz performance issues to which these documents mainly pertained. The trial court rejected the request, offering plaintiffs only a two-day adjournment. *See* A1154 at 53:5-13. The trial commenced on October 20, 2004, and ended on January 19, 2005.

On February 4, 2005, the parties simultaneously filed extensive submissions concerning their respective evidentiary objections to a total of 160 documents and 151 portions of trial and deposition testimony. Within hours of these filings, the trial court issued a four-page letter ruling that summarily excluded, without

any stated rationale, substantial evidence plaintiffs had extensively used at trial.[1] The parties then submitted post-trial briefs.

On August 9, 2005, the trial court issued its 174-page Opinion and Order absolving defendants of all liability. *In re Walt Disney Co. Derivative Litig.*, 2005 Del. Ch. LEXIS 113.[2] On September 6, 2005, plaintiffs filed their Notice of Appeal from the proceedings below. This is plaintiffs' Opening Brief.

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[1] When Ovitz left Disney, the Company reserved $1 million of the NFT payout due to lingering questions about the validity of Ovitz's expenditures charged to Disney. Pursuant to an initiative termed "Project Ovitz [Michael S. Ovitz]," Disney engaged its regular outside auditor, Price Waterhouse LLC, to assess Ovitz's compliance with Disney's corporate expense and gift-giving policies and appropriateness of various of other of his expenditures. A637-39. PW then completed a "draft" 117-page "full audit" ("PW Audit"). Op. at 92 n.356 (citing A71-187). The PW Audit identified Ovitz's expenditures totaling thousands of dollars that had no discernible business purpose for which the Company paid. Among other things, Ovitz had given many gifts to his personal friends and former business associates. The PW Audit also showed that Ovitz had flown on Disney's corporate plane at Company expense *after* he had been terminated (A187), and lavished gifts like firearms (A187) and art (*id.*) on personal friends and advisors (A103-07; A111-12) and charged Disney for meals and entertainment with such individuals. These expenditures had all been defrayed or reimbursed by Disney, but many appeared to be purely personal in nature. *See, e.g.*, A90 (dinner with Ovitz's personal financial advisor). The trial court, however, did not consider the PW Audit in making its decision because it ruled, without explanation or analysis, that it was entirely "hearsay." *In re Walt Disney Co. Derivative Litig.*, 2005 Del. Ch. LEXIS 28, at *3. As explained herein, this ruling alone merits reversal, because the trial court disregarded evidence highly material to Ovitz's performance and defendants' compliance with their fiduciary duties of due care and good faith in affording him a full NFT payout.

[2] Citations to the Opinion and Order which is the subject of this Appeal (attached hereto), are referred to as "Op. at ___."

SUMMARY OF ARGUMENT

1. The trial court made critical, reversible errors in formulating and applying the relevant burdens and standards of proof. As an initial matter, the trial court was required to determine whether plaintiffs presented sufficient evidence of defendants' gross negligence to rebut the presumption afforded by the business judgment rule. Gross negligence is established by the directors' failure to inform themselves of all material information reasonably available in making a business decision.

2. If the Court determines that the business judgment rule is rebutted, then it must turn to an analysis of whether the challenged transaction comports with entire fairness. *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001). In this case, plaintiffs established that the presumption was rebutted because the Disney Board breached its fiduciary duty of due care by failing to inform itself of all material information reasonably available with respect to Ovitz's employment agreement. The trial court, however, provided no analysis in its decision on the threshold question whether the business judgment rule had been rebutted by virtue of the directors' failure to be informed. Defendants were thus wrongly relieved of their burden of demonstrating entire fairness.

3. The trial court erred in evaluating the liability of the director defendants on a one-on-one basis rather than determining whether the Board, acting collectively and as a whole, had violated its fiduciary duty of due care. The trial court should not have engaged in a director-by-director analysis to assess whether defendants were entitled to the presumption of the business judgment rule and breached their fiduciary duty. Such an analysis eviscerates this Court's seminal ruling in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), which unmistakably ruled that the business judgment rule applies to collective board action. *Id.* at 889.

4. The trial court wrongly conflated the fiduciary duty of due care and the standards for good faith used in determining whether a breach of the duty of due care can be exculpated under the affirmative defense afforded by 8 *Del. C.* § 102(b)(7). Under Delaware law, considerations of bad faith lie beyond the threshold issue whether directors collectively exercise informed business judgment. *See Van Gorkom*, 488 A.2d at 889. As a result, the trial court imposed upon plaintiffs a more stringent standard for establishing their affirmative case than the law requires and wrongly imposed on plaintiffs the burden of rebutting an affirmative defense it was defendants' burden to establish.

5. In subjecting plaintiffs' evidence to an overarching good faith standard, the trial court also committed reversible error in imparting to that standard a degree of stringency that is unsupported in Delaware law. The trial court incorrectly held

that good faith must be proven by "deliberate indifference and inaction in the face of a duty to act." Op. at 123. The trial court's formulation of the good faith standard wrongly incorporated substantive elements regarding the rationality of the decision under review rather than being constrained, as in a due care analysis, to strictly procedural criteria. *Brehm*, 746 A.2d at 264. The trial court incorrectly suggested that "ignorance" attributable to a litany of "moral failings" could constitute bad faith. Such an expansive and ultimately amorphous standard for assessing directorial conduct, which imposes a great deal more than the gross negligence standard adopted in *Van Gorkom*, all but eliminates the possibility of enforcing fiduciary duties of due care. It is no answer to suggest, as did the court below, that free flows of capital in the equity markets provide the requisite discipline. Despite this Court's well-established recognition that corporate directors should be afforded reasonable latitude in formulating policies and making decisions, this Court has never adopted such a *laissez-faire* approach.

6. The trial court erred by ruling that Disney's Board did not have to approve the terms of Ovitz's employment agreement, because it ignored this Court's prior ruling in *Brehm* that the financial terms and potential costs of the OEA, particularly with respect to its Non-Fault Termination provisions, were material to Disney and thus necessitated board approval. 746 A.2d at 259. The trial court's contrary analysis and rejection of *Brehm*, if allowed to stand, would practically carve executive compensation decisions out of the purview of board responsibilities.

7. Plaintiffs met their burden of rebutting the presumption of the business judgment rule because the Disney Board failed to satisfy the informational requirements of its decision-making before approving Ovitz's election as President at the September 26, 1995 board meeting. The one paragraph the trial court devoted to this meeting, and the trial record, show that, among other things, the Board was not fully informed of all reasonably available material information, because: (1) the Board did not review or discuss a spreadsheet showing the possible payouts to Ovitz in the event of an NFT; (2) no written materials were provided to the Board at all; (3) no compensation expert attended the meeting or provided any written or oral report or advice to the Board; (4) the Board had no idea that the OEA was then the richest pay package ever offered to a corporate officer in the United States; and (5) the Board did not discuss the gross negligence or malfeasance standards in the OEA that would control Ovitz's receipt of an NFT payout.

8. The Board failed to consider the disincentivizing impact of Ovitz's employment agreement given that, under its terms, he could receive as much or more compensation by receiving a Non-Fault Termination than serving and meeting expectations throughout the full term of the agreement. *See generally Beard v.*

Elster, 160 A.2d 731, 737 (Del. 1960) ("[a]ll stock option plans must be tested against the requirement that they contain conditions or that surrounding circumstances are such, that the corporation may reasonably expect to receive the contemplated benefit from the grant of the options"); *accord Kerbs v. Cal. E. Airways, Inc.*, 90 A.2d 652, 656 (Del. 1952).

9. The trial court erred in ruling that the Board had no duty to decide whether Ovitz should be terminated and receive a full NFT payout. It is the law of the case however, that the full NFT payout was material to Disney and required Board approval. *Brehm*, 746 A.2d at 259-60. Similarly, Disney's charter, bylaws and other corporate documents clearly mandated Board approval. Instead, the trial court, disregarding the law of the case and Disney's internal regulations, wrongly concluded that Eisner as CEO had sufficient, "non-exclusive" authority to effect Ovitz's termination and grant him a full NFT payout. This legal ruling improperly absolved the director defendants from any and all liability for failing to meet, consider and approve the terms of Ovitz's departure.

10. The trial court erred as a matter of law by applying the presumption of the business judgment rule to assess the conduct of Eisner, Sanford Litvack ("Litvack") and Irwin Russell ("Russell"), individually and separately, who the trial court found to have acted in their capacities as corporate officers or their equivalents, not as directors, in connection with Ovitz's receipt of a full NFT payout. No Delaware court has specifically ruled that the business judgment rule should apply to protect the conduct of non-directors, which, when they are sued for corporate wrongs, is measured by an ordinary negligence standard – a standard the trial court found that plaintiffs had met. *See, e.g.*, Op. at 134. Additionally, considerations of good faith are only relevant as part of a defense predicated on Section 102(b)(7), which by its terms, only applies to directors.

11. The trial court erred as a matter of law by ruling, in the context of addressing plaintiffs' alternative claim for waste, that Ovitz could not be dismissed for cause, thus placing the burden of such a showing on plaintiffs rather than on defendants as part of their burden of establishing entire fairness. The trial court also failed to articulate any clear legal standard, or to link any facts to support its findings, in arriving at its conclusion that Ovitz could not be terminated for cause. Moreover, the trial court's adverse determination was based upon numerous erroneous applications of the evidence and illogical deductions which cause its rulings to be clearly erroneous and contrary to the weight of the evidence. Among other things, the court was consistently willing to credit defendants' self-interested trial testimony over both contrary prior deposition testimony and the plain meaning of contemporaneously written documents by Eisner and other well-placed observers,

including correspondence among certain Board members detailing Ovitz's observed proclivity for lying and failure to comply with Disney's expenditures and gift-giving policies.

12. The trial court committed legal error in ruling that Ovitz did not violate his fiduciary duties of care and loyalty. Ovitz actively negotiated the terms of his departure with Eisner as evidenced by the contemporary written record. As a director participating in a self-interested transaction, Ovitz was no less obliged than the other directors to secure independent Board approval, which he did not. The trial court's pre-trial decision to grant Ovitz's motion for summary judgment was also legally erroneous. Ovitz claimed he was never a fiduciary when the challenged terms of the OEA were being negotiated. Plaintiffs showed, however, that Ovitz had at least acquired the status of a *de facto* fiduciary when he assumed presidential or apparent authority on or about August 14, 1995, after his hiring was publicly announced. The OEA went through several material changes from that time forward to mid-December 1995, when Ovitz and Disney finally signed and backdated the OEA to October 1, 1995, the date of Ovitz's formal investiture in office. The Board never reviewed or approved the final contract.

13. Had the Disney Board properly investigated and sought to obtain all material information reasonably available regarding Ovitz's infractions, lack of veracity and abysmal performance, the evidence in the record establishes that it would have had, at a minimum, reasonable grounds to terminate Ovitz for cause and deny him a full NFT payout then worth approximately $130 million, or seek to pursue some less costly alternative. Eisner, Litvack and Russell, by assuming the responsibility for effectuating Ovitz's termination, are separately liable as officers for such lack of due care in addition to their wrongful displacement of the Board's role and responsibility to act.

14. The trial court erred as a matter of law in denying plaintiffs' waste claims. The Ovitz employment agreement does not pass muster under Delaware precedents requiring that executive compensation primarily or significantly structured as stock options be structured to secure the services of the executive for the full life of the contract. Furthermore, the grant to Ovitz of a full NFT payout was not a rational business judgment because the Company was entitled under its contract to terminate Ovitz for cause. Eisner's privately negotiated settlement with Ovitz was motivated not by either executive's concerns for the best interests of the corporation, but flowed from their deep and abiding friendship and desire to achieve a "win-win" outcome for both of them irrespective of the cost.

15. The trial court harshly criticized all aspects of the Board's performance, but nonetheless found under the stringent standard that it erected, that no breach of fiduciary duty was committed. The trial court seemed to base its ruling in part on the perception that plaintiffs were seeking to impose 21st century standards of corporate governance on last century conduct. That is false. Plaintiffs never argued for the retroactive application of any sort of 21st century standards of corporate governance. Plaintiffs proved their case through contemporaneous evidence and admissions that established liability under the unchanging fiduciary duties this Court has always enforced.

STATEMENT OF FACTS

A. Eisner's "Personal Magic Kingdom"

The trial court found that, as Disney's CEO, Eisner "enthroned himself as the omnipotent and infallible monarch of his personal Magic Kingdom." Op. at 140. According to the trial court, "[b]y virtue of his Machiavellian (and imperial) nature as CEO, and his control over Ovitz's hiring in particular, Eisner to a large extent is responsible for the failings in process that infected and handicapped the board's decision-making abilities." *Id.* at 135. The trial court found that "Eisner stacked his (and I intentionally write 'his' as opposed to 'the Company's') board of directors with friends and other acquaintances who were certainly more willing to accede to his wishes and support him unconditionally than truly independent directors" (*id.* at 135-36), and who exhibited "sycophantic tendencies." *Id.* at 136 n.488.[3] Eisner's stacking of the Board with "yes men" (*id.*) led to defendants' "collective kowtowing in regard to Ovitz's hiring." *Id.* Further, according to Ovitz, Eisner regularly shared information preferentially, if not exclusively, with an "inner circle" of trusted confidantes. The "inner circle" included Sid Bass ("Bass"), then Disney's largest shareholder but not a director, and director defendants Russell, Gold, Murphy, Watson, and Litvack. A994-96 at 513:23-518:24.

According to the trial court, Eisner's "lapses were many. He failed to keep the board as informed as he should have. He stretched the outer bounds of his authority as CEO by acting without specific board direction or involvement." Op. at 140. In sum, Eisner created the "unwholesome boardroom culture at Disney." *Id.* at 96 n.373.

B. Eisner Unilaterally Hired His "Best Friend"

Eisner was Ovitz's "best friend" and "life partner." A1061-62 at 1392:13-1395:6; *see also* Op. at 7. When Eisner was hospitalized in 1994, Ovitz hurried to Eisner's bedside and "guarded" (A967-68 at 77:21-79:4; A1058 at 1106:14-1107:22; A1064 at 2016:3-12) Eisner's hospital room. A643-48. As discussed below (but ignored by the trial court), this specific act of friendship later took on pointed significance when the two friends negotiated Ovitz's departure from Disney.

Eisner and Ovitz's longstanding friendship motivated Eisner to recruit Ovitz to work at Disney. Op. at 7. Early on, while negotiating with Ovitz, Russell – Eisner's personal attorney whom Eisner put in charge of the discussions – authored and provided Eisner and Ovitz with a "Case Study" outlining the parameters for a

[3] According to the trial court, these included director defendants: Irwin Russell ("Russell") – Eisner's personal lawyer; George Mitchell ("Mitchell"); Reveta Bowers ("Bowers"); and Leo O'Donovan ("O'Donovan"). Op. at 136 n.488.

potential contract. A210-14; *see also* Op. at 17. Russell, on Eisner's behalf, was also then beginning to negotiate a new, richer employment agreement *for Eisner*. A231-33; A234-42. In the "Case Study," Russell noted that Ovitz's compensation would be at the "top level for any corporate officer" and "significantly above that of the CEO" and that the number of stock options then under consideration was "far beyond the standards applied within Disney and corporate America" and "will raise very strong criticism." A211; *see also* Op. at 18. The "Case Study" said that Disney should obtain "survey data" about executive compensation. A211-12. Neither Eisner, Russell nor Ovitz ever provided or discussed the "Case Study" with any other members of the Board or obtained or circulated any "survey data." Op. at 18.

C. No "Expert" Advised The Board

Eisner and Russell unilaterally enlisted Graef Crystal ("Crystal") to help out. Op. at 18-19. Crystal, who had done no outside consulting on an executive employment agreement since consulting on Eisner's 1989 contract renewal, agreed to work as "a favor" to Eisner. A687-92; A999 at 39:15-41:16. Crystal's contribution was limited. Crystal never produced an industry-standard Black-Scholes valuation which described the magnitude of possible payouts that Ovitz would receive in the event of an NFT. A1001 at 524:6-12; A1117 at 7167:23-7168:1; A1125a at 7668:3-13. In August 1995, Crystal wrote some letters received only by Eisner, Russell and Raymond Watson ("Watson") that expressed some concerns about Ovitz's prospective pay package. A215-19; A220-24; A225-28; *see also* Op. at 21.[4] For example, Crystal wrote, echoing the Case Study, "there really is no precedent for offering a non-CEO the sum of $25 million per year" (A223), and "there is only one executive – Sandy Weill – who can provide anything in the way of fighter cover" (*id.*) and "there is no real comfort to be had from looking at . . . 'comparables'." *Id.*

Shortly after his first letter, Crystal wrote a second letter, stating in pertinent part: "[A]bsolutely none of my advice concerning Mr. Ovitz was taken. In effect, I became a calculator for the Compensation Committee, and, I am afraid to say, a high-priced calculator at that." A228. Critically, but ignored by the trial court, Crystal drew a direct link between Ovitz's compensation and the compensation Eisner could receive in the negotiations over his new contract. *Id.* ("I have earlier counseled that Mr. Eisner receive an option on no more than four million shares.

[4] Crystal's letters (A215-19; A220-24; A225-28) preceded a major reworking of key deal terms ultimately incorporated into the OEA, including, in particular, a substantial enhancement of Ovitz's rights if he were terminated without cause, including a significant extension of the exercisability period for the options. *See, e.g.*, A496-98.

But how can this happen if his Number Two executive has been granted five million shares?"). Crystal questioned whether he could further assist Disney given the "deep philosophical divide between what I believe should have been done for Mr. Ovitz and what was done and between what I believe ought to be done for Mr. Eisner and what seems likely will be done . . . ." *Id.* Following these protests, Russell had Crystal redraft his first letter in minor respects, but it was backdated to the date of the first letter. A215-19; *see also* A999a at 179:8-180:5.

D. Eisner's Hiring Of Ovitz Is A "Done Deal"

On August 11, 1995, while vacationing together, Eisner and Ovitz together agreed to the terms of Ovitz's hiring as Disney's President and Number Two. A989 at 138:12-19; A1096 at 4959:4-4961:10. Litvack – Disney's top legal officer and head of Human Resources – and Stephen Bollenbach ("Bollenbach") – Disney's CFO – expressed opposition to this move when Eisner then informed them of the hiring. Op. at 23, 141; A950 at 128:8-129:13 (confirming quotes in A661-75); A969 at 125:7-24; A1099 at 5270:9-17, 5271:17-21. At a contentious meeting held at Eisner's house on Sunday, August 13th (A1066 at 2453:19-2454:10), Litvack and Bollenbach insisted that they would continue reporting directly to Eisner and would not report to Ovitz. A1109 at 6048:7-6049:13. Eisner and Ovitz then talked, and Ovitz agreed to the arrangement. A977 at 246:4-248:17; *see also* A1059-60 at 1123:9-1125:5.

Ovitz's hiring was a "done deal." Op. at 138. On August 14th, Ovitz and Eisner signed a letter agreement ("OLA") memorializing the principal terms of their agreement. A417-18; *see also* Op. at 138. The OLA stated that it was subject to approval by the Compensation Committee and the Board. A417; *see also* Op. at 138 n.491. Also on August 14th, Disney publicly trumpeted the hiring of Ovitz in a "prematurely issued" (Op. at 140) press release. A414-16. The economic terms, still being negotiated, were not, however, alluded to in this press release. *Id.* As the trial court correctly noted, preceding any board action whatsoever, this press release "placed significant pressure on the Board to accept Ovitz and approve his compensation package in accordance with the press release." Op. at 140. According to the trial court:

> Eisner obtained no consent or authorization from the board before agreeing to hire Ovitz, before agreeing to the substantive terms of the OLA, or before issuing the press release. Indeed, outside of his small circle of confidantes, it appears that Eisner made no effort to inform the board of his discussions with Ovitz until after they were essentially completed and an agreement in principle had been reached.

Id. at 136-37.

Ovitz began working before August 14th and throughout the time leading to his formal election as President on September 26, 1995. As early as July 1995, Ovitz was provided confidential, internal Disney documents. *See, e.g.*, A245-310 (7/30/95); A356 (9/5/95); A410-13 (9/12/95); A323-55 (8/21/95); A386-94 (9/8/95); A395-409 (9/14/95); A358-82 (9/7/95).[5] Ovitz also started working on the Disney grounds (A990 at 162:21-163:7), scheduled meetings with high-level outsiders (A385; A311-22) and *submitted requests for reimbursement* which were paid. A632.

On August 28, 1995, Board members received an invitation to attend a lunch honoring Ovitz to be held immediately after the September 26, 1995, meeting at which Ovitz's preordained "election" as President was scheduled for a vote. A229; A230.

E. The Compensation Committee Ignores The Consequences Of An NFT

The Compensation Committee waited until its regularly scheduled meeting on September 26, 1995, to discuss the OEA which was one of several matters pending before it.[6] The Committee met for one hour, discussing topics including: (1) proposed terms of the OEA; (2) compensation packages for various Disney employees; (3) 121 executive stock option grants, (4) Robert Iger's CapCities ABC employment agreement; and (5) a special $250,000 payment to Russell for his work assisting Eisner in negotiating to hire Ovitz. Op. at 27. During the meeting, an actual draft of the OEA was not distributed (*id.* at 27, 154) despite the fact that drafts were available for review. *Id.* Crystal did not attend. *Id.* at 28. None of his letters were discussed or distributed. *Id.* at 21, 28.

The grounds for which Ovitz could be terminated "for cause" or receive a huge payout in the context of an NFT were not reflected in the minutes.[7] Neither Poitier nor Lozano remember Watson distributing spreadsheets assigning a value to the severance Ovitz would receive in the event of an NFT and the minutes record no such discussion. *Id.* at 28 n.82. The Compensation Committee did not formally approve the terms of the not-yet-finalized OEA at that time – or at any time. An exhibit to the minutes recites: "[a]ction to be taken: Discussion only.

[5] These documents came from the Ovitz "work files" belatedly produced on the eve of trial after discovery had concluded.

[6] Russell chaired the Committee which also included Raymond Watson ("Watson"), Sidney Poitier ("Poitier") and Ignacio Lozano ("Lozano").

[7] Not one of the Committee members remembered any discussion of this topic. A1001 at 524:13-22; A1071 at 2903:8-16; A1118 at 7198:14-20; A1126 at 7701:23-7702:12; A1127-28 at 7716:22-7717:3; *see also* Op. at 28 n.81.

Options and agreement will be approved when finalized by unanimous written consent expected to be effective October 2, 1995." A752.

F. The Board "Kowtows" To Eisner And Elects Ovitz

The Board, as scheduled, met immediately after the Compensation Committee's one-hour meeting. Op. at 29. The minutes recite that the Board met in "Executive Session" for a portion of the meeting (A717-18), but the attendees never received any advance notice that an executive session would take place. The minutes of the executive session refer only to a discussion of a $250,000 payment to Russell for his work in connection with Ovitz's hiring. *Id.* Eisner, Russell's client, participated in the decision to award Russell this compensation. A507-08. However, Russell had no records describing his actual time and efforts. A962 at 42:4-6; A975 at 18:14-19:6; A1068 at 2836:3-8. Litvack and Bollenbach, both of whom expressed concerns about Ovitz, were excluded from the Executive Session purportedly because of their status as "inside" directors even though both executives had attended the meeting at Eisner's house on August 13th, and Litvack had just attended the Compensation Committee meeting where the OEA was reportedly discussed. A731.

Plaintiffs' executive compensation expert, Professor Kevin J. Murphy ("K. Murphy"), and Crystal both agreed with the basic, and common-sense proposition that the Board would have to know how much Ovitz would be paid before deciding whether to elect him President. A1057 at 777:24-779:1; A1082 at 3384:18-3386:14. Nonetheless, the Board could not undertake this basic "cost-benefit" analysis on Ovitz's hiring because it did not receive any written materials about the OEA, including Crystal's August letters, drafts of the OEA, or any survey data or comparables of executive pay either before, during or after the meeting. A963 at 210:16-211:1; A1073 at 2960:12-18; A1085 at 3886:6-19; A1102 at 5443:4-9; A1119 at 7212:15-18. The Board did not review a spreadsheet, table, list of estimates or a Black-Scholes valuation which described the magnitude of possible payouts that Ovitz would receive in the event of an NFT. A1085 at 3885:10-19; A1127 at 7716:2-21. The financial impact of an NFT payout on Disney was not discussed, and no defendant requested information on the issue. A1002-03 at 556:22-557:2; A980 at 365:24-366:8. The Board did not discuss the definition of "malfeasance" or "gross negligence" – the terms by which Ovitz could be dismissed for cause pursuant to the OEA. A1102a at 5456:10-13; A1127-28 at 7716:22-7717:3. Nor did the Board discuss the potentially disincentivizing effect of the structure of the NFT terms in the OEA. The minutes simply state that Eisner reviewed Ovitz's "qualifications" and that Ovitz was elected to replace him as President. A731-52. The minutes nowhere refer to the OEA itself. *Id.* Crystal did not attend. *Id.* The trial court's Opinion, in fact, gives only brief mention to this meeting at all. Op. at 29-30.

G. The Board Facilitates Ovitz's Option Grant

On October 16, 1995, the Compensation Committee held a special meeting. A753-78; *see also* Op. at 30. During the meeting, the Committee adopted a resolution approving an amendment to Disney's 1990 Stock Option Plan that permitted an extension of the exercise period of Ovitz's options beyond the 24-month post-termination limitation then in the Plan. A755; *see also* Op. at 30-31. This amendment gave Ovitz until September 30, 2002, seven years from October 1, 1995, to exercise his options in the event of an NFT. Op. at 32. This length of post-termination exercisability was unprecedented at the time. *See* A903 ("Murphy Report"). Under Black-Scholes option pricing, the lengthening of the period of exercisability greatly added to the present value of the options if fully vested prior to September 30, 2002. *Id.* The Committee, however, did not address the increased value such an extension would confer on Ovitz (A1004 at 574:17-575:4; A1075 at 3005:12-16, A1112 at 6655:11-17), or the disincentive such an extension could have on Ovitz's remaining at Disney for the full five-year term. A1121 at 7231:6-10; A1129 at 7736:16-21. The Committee also adopted a resolution requiring the approval of both the Board and Disney's shareholders. A755; *see also* Op. at 31. Significantly, the Rules of the Stock Option Plan, attached to the minutes and incorporated in the amendments, expressly vested in the Committee the right and duty to determine the terms of any executive's termination with respect to the vesting of stock options. A760. The rules provided in significant part:

> For purposes hereof, the Committee shall have the sole power to make all determinations regarding the termination of any participant's employment, including, but not limited to, the effective time thereof for the purposes of this Plan, the cause therefore and the consequences thereof.

A770. In addition, the Plan states, " . . . in the event of termination of employment or discharge of a participant for cause, as determined by the Committee in its *sole* discretion . . . ." A769 (emphasis added). The Committee never discussed whether the OEA was intended to supersede the Plan Rules. A1074 at 2992:10-2994:12; A1123 at 7265:20-23; A1131-33 at 7779:9-7785:1; A1137-38 at 7992:17-7997:13. Instead, the OEA expressly recited that the option grants thereunder were subject to the Plan Rules. A454-55.

On October 26, 1995, Russell sent a memorandum to the Board seeking its approval of the 1990 Plan amendments. A473; A1006-07 at 616:3-617:5; A1067 at 2548:8-20. Among other things, the memorandum stated that the amendment included "a provision for extended exercisability under limited circumstances," but did not specifically refer to the impact on Ovitz's compensation. A474. Thus, the memorandum did not specify under what "limited circumstances" Ovitz

could take advantage of the extended exercise period. A473-93. No director asked to convene a meeting or raised any questions about the stock option extension. A1007-08 at 620:12-621:10.[8] On November 1, 1995, defendants, in lieu of a meeting, executed unanimous written consents approving the amended Plan. A509-38.

H. The OEA

Ovitz and Disney did not execute the OEA until mid-December 1995, but it was made "effective" as of October 1, 1995. A453-72. The Board neither reviewed nor approved the final deal.[9] The OEA provided Ovitz, *inter alia*, with a compensation package consisting of: (1) an annual salary set at $1 million, (2) a discretionary bonus at the end of each full year of service as Disney's President up to a maximum of $10 million and (3) a series of "A" options that allowed Ovitz to purchase three million shares of Disney common stock at an exercise price equal to their market price on October 16, 1995. The Class A options were scheduled to vest in one million share tranches at the end of Ovitz's third, fourth and fifth years of employment. *Id.* Importantly, the NFT provisions provided Ovitz with a package that would be worth at least as much, if not more, than if he stayed with Disney for the full term of the OEA with respect to each of the three core elements of his compensation. Of greatest importance, an NFT would cause the *immediate vesting* of all of Ovitz's three million Class A stock options. Professor Murphy opined

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[8] Similarly, no explanatory language was included in the Disney Proxy soliciting shareholder approval of the 1990 Plan Amendments and Rules. A790-95. Disney's shareholders approved the amendments and the Rules were effective at the time Ovitz left Disney.

[9] Ovitz received many other favorable deals that did not receive Board scrutiny including the purchase of his private plane at above-market prices (A1072 at 2915:5-24) and the purchase of his car at its purchase price instead of its depreciated market value. *Id.* at 2918:10-19. The trial court stated that "plaintiffs demonstrated that at no point were the following matters discussed in the Committee meeting: (1) the purchase of Ovitz's private jet for $187,000 over the appraised value; (2) the purchase of Ovitz's BMW at acquisition cost and not the depreciated market value; (3) the purchase of Ovitz's computers at replacement value instead of their lower book value; (4) any specific list of perquisites, despite Eisner already agreeing to provide Ovitz with numerous such benefits; and (5) that despite Ovitz's bonus being payable completely on a discretionary basis, Russell's memorandum to Ovitz indicating that the Board would likely approximate $7.5 million annually." Op. at 29 n.85. The trial court, however, found these side-deals to be "ultimately immaterial to [its] decision" (*id.*) even though they clearly evidenced Eisner's favorable treatment of Ovitz and evasion of board scrutiny.

that: "there were virtually no incentives for Mr. Ovitz to stay at Disney . . . [o]nce he developed a preference for leaving (or once he concluded there was little chance of having his contract renewed), the value of the non-fault-termination payment *significantly exceeded* the present value of remaining employed." A907 (emphasis added). Not surprisingly, the severance provisions garnered Ovitz's particular attention after the pivotal August 13th meeting at Eisner's house among Eisner, Litvack, Bollenbach and Ovitz. A496-98; A499-506; A1139 at 8092:12-8093:8.

I. Disney Monitored Ovitz From The Outset

Eisner maintained a file on Ovitz during his tenure as Disney's President designating its contents with the notation "MSO" (Michael S. Ovitz) or "OM." *See, e.g.*, A191-95; A196-202; A203; A204; A205; A641-42; A643-48; A649-50; A651-52; A653; A654-59; A660; *see also* A1140 at 8280:3-8281:7. This practice is routinely advised when a for-cause dismissal is deemed likely. A1141 at 8343:13-16; A1142 at 8519:24-8520:5. Except for sharing a few documents with selected confidantes, Eisner never shared the most critical documents concerning Ovitz with either Litvack or other Board members. Op. at 65 (withheld A191-95), 67 (withheld A196-202); A188-90 (addressed only to Watson and Russell).

Eisner engaged in unorthodox methods to monitor Ovitz. Litvack and Bollenbach oversaw the purchase of Ovitz's computers from his former employer, Creative Artists Agency ("CAA") on terms that proved quite favorable to Ovitz. *See* A633-34. Eisner engaged Russell, not Disney's internal accounting department, to monitor Ovitz's expense-related issues that had become increasingly apparent. A206; A635; A636; *cf.* A1125 at 6926:13-17.[10] Eisner again turned to Russell, acting in some undefined capacity, in early 1996 to tutor Ovitz on gift-giving, gift-receiving and other similar issues. A208-09; A206-07; A636.

J. Eisner Perceives That Ovitz Has Serious Veracity, Character, And Job Performance Deficiencies

Eisner knew about Ovitz's serious performance and character deficiencies immediately after his hiring. Eisner regretted his decision almost as soon as he hired Ovitz, commenting in a note that, "[b]y Labor Day I was wondering what it would cost in dollars *and embarrassment* to end our corporate partnership right away." A196 (emphasis added). Ovitz felt he had lost Eisner's support as early as August 13, 1995, when Eisner "made it clear that he wasn't going to back what I was going to do. And if I projected myself forward I knew that it was going to be

[10] Russell acknowledged that by policing Ovitz's expenses, he was acting outside the scope of his authority conferred by the Compensation Committee charter. A787-88; A1076 at 3015:15-3016:12. Litvack was unaware that Eisner had recruited Russell for this purpose. A1111a at 6361:21-6362:8.

an uphill fight . . . ." A997 at 533:11-19. By early November 1995, Eisner told Bass that he planned to fire Ovitz within twelve months but could not then do so because he was afraid that Ovitz would "commit suicide." A1016-17 at 88:13-90:16; A1017 at 92:18-93:7.[11]

In numerous contemporaneous documents sent to Russell, Watson and Bass, Eisner consistently wrote about his perception of Ovitz's lack of veracity. On May 26, 1996, Eisner wrote an e-mail to Bass stating that Ovitz had become a problem for ABC head Robert Iger. A188-90. Eisner forwarded this e-mail to Watson and Russell. A188. Eisner wrote that Iger "finally admitted he did not trust Michael [Ovitz] and gave me many examples." A190.[12]

On October 1, 1996, just one year into Ovitz's tenure as President, Eisner sent another letter detailing Ovitz lack of veracity, again, just to Watson and Russell. A191-95; *see also* Op. at 65. In this letter, Eisner wrote that Ovitz's "strength of personality together with his erratic behavior and pathological problems . . . is a mixture leading to disaster for this company. You [Watson] Irwin [Russell] and Sid Bass know this already and have many examples . . . Stanley Gold is aware of the problems as well. . . ." A191. Eisner continued: "Michael does not have the trust of anybody. I do not trust him . . . the biggest problem is that nobody trusts him, for he cannot tell the truth. He says whatever comes to hi[s] mind, no matter what the reality." A192. Eisner further wrote: "How does one tell *a friend* he is not truthful and nobody trusts him? . . . He does not seem to understand that he *stretches the truth, changes the truth, leaves out information as to bend the truth*." A193 (emphasis added).[13]

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[11] As discussed in Section II(B)(4), *infra*, the trial court largely discounted this important testimony by a well-placed and knowledgeable third-party witness with no apparent axe to grind.

[12] When questioned at trial and deposition, Eisner professed not to be capable of recalling specifically what Iger had said about Ovitz. Paradoxically, the trial court determined that Eisner's lack of recall supported a finding that Ovitz had not lied. *See* Op. at 50; *infra* at Section II(B)(4).

[13] While admitting that "it is entirely possible that his [Ovitz's] actions while at Disney and his general character led Eisner to believe that Ovitz was not completely honest" (Op. at 64 n.243), the trial court tried to diminish the significance of this contemporaneous evidence by relying on Eisner's after-the-fact, self-serving trial testimony that he was emotionally stressed and angry when he wrote the letter. *Id.* at 50, 64-65 (citing Eisner's direct trial testimony at 4436:14-4439:6). The trial court credits this trial testimony despite the fact that the letter begins, "As you know I started writing this letter several weeks ago . . . I decided to put i[t] down and let some time pass. I was particularly angry with Michael Ovitz and [I] did not

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Then, on November 11, 1996, Eisner wrote: "Most of our executives were out of step with you [Ovitz]. And that cadence problem basically was caused by lack of trust in you. *As we've discussed many times*, we all never knew when you were telling things the way they were. The truth was often hard to decipher." A197 (emphasis added). Eisner continued:

> I told you again that my biggest problem was that you played the angles too much, exaggerated the truth too far, manipulated me and others too much. I told you 98% of the problem was that I did not know when you were telling the truth, about big things, about small things. And while you were telling me that those dishonest days were over, you were deceiving me on a specific matter.

A201.[14] "Russell was the only director to receive this document and he did not share it or the matters it concerned with anyone else on the Board." Op. at 67.

On December 16, 1996, Eisner, after Ovitz's termination was announced, transmitted an e-mail to John Dreyer, Disney's head of public relations, complaining again about Ovitz's veracity. Eisner wrote: "Nobody has got the two main points. (1) He is a psychopath (Doesn't know right from wrong), cannot tell the truth. Basically he has a character problem, too devious, too untrustworthy to everybody, and only out for himself." A204.[15]

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want to commit anything to writing until additional time had passed . . . *I am [now] not a bit angry*." A191 (emphasis added). The trial court did not cite (and ignored) this section of the letter, which, in Eisner's own words and deeds, demonstrates "cooling of the blood" on his part.

[14] The trial court eschews this document, relying on Eisner's after-the-fact trial testimony that the letter was "not accurate, way exaggerated, silly" and "hyperbole." Op. at 66 (citing Eisner's direct trial testimony at 4372:5-19). The trial court, however, completely ignores the fact that at his deposition, Eisner admitted that the letter was "directionally correct." A986 at 607:9-15. Eisner explained that the letter represented his "duty and obligation to let Ovitz know seriously, not joking or trying to get him between phone calls, as to what we were really doing." A978 at 320:25-321:4. On November 13, 1996, Eisner had a long meeting with Ovitz to discuss these issues. A203. The trial court also ignores Eisner's deposition testimony that when he takes the time to put things in writing, it is a serious form of communication. *Id.* at 319:21-320:2.

[15] Similarly, the trial court endorsed Eisner's trial testimony explanation that this e-mail was an angry reaction by him to a series of articles allegedly planted by
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In addition to the instances highlighted in the PW Audit, numerous contemporaneous documents also showed that Eisner worried that Ovitz was misusing Company monies. In fact, the trial court found that "the record contains several examples of statements by Eisner where he believed that Ovitz's compliance with Company expense policies was questionable." Op. at 56. In a document containing Russell's handwritten notes between January and February 1996, Russell questioned Ovitz's use of Disney planes for personal family travel, his charging to Disney for personal watches, his giving of gifts to personal doctors, personal charities and personal talent relationships, his giving of gifts to Disney employees in violation of company policy and his using Company money for personal art gifts. A207. In addition, on June 24, 1996, eight months into Ovitz's tenure, Eisner wrote a note to Russell in which he stated that "Michael [Ovitz] is obviously not reporting gifts." A208-09.

K. Eisner And Ovitz Execute A "Win-Win" Separation Strategy

Without discussing it with the Board, Eisner and Ovitz began to discuss the idea of Ovitz moving to Sony. Op. at 60, 62. Only a limited number of directors, including Litvack, Watson, Russell, Stanley Gold ("Gold") and Roy Disney ("R. Disney") were told about these discussions. *Id.* at 62. Of these directors, only Litvack and Russell were ever asked for their opinions on the matter. *Id.*

On October 8, 1996, Ovitz wrote a note to Eisner about possibly joining Sony. A641-42. Stating that he "didn't want to leave [himself] open" and wanted to act with Eisner's "blessing," Ovitz wrote:

> . . . [I]f I make a deal we will work together to insure the best possible transition, timing and P.R. issues are taken into consideration for the benefit of the companies involved as well as you and I. As you said, we need to do this together and put the right face on it. . . . Since Sandy relayed his P.O.V. on the company and me I think I need you to acknowledge this note by signing it so that I do not end up in a problem which I do not want with the company *or my best friend.*

Id. (emphasis added). Without seeking the Board's approval, on October 9, 1996, Eisner hand-wrote a reply to Ovitz (A643-48), waiving Disney's rights under the OEA to Ovitz's exclusive services (A459-61) and affirming his desire to engineer Ovitz's departure so as to avoid:

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Ovitz after Ovitz left Disney. Op. at 89. The face of this document shows, however, that Eisner was not reacting to anything that had already been leaked by Ovitz, but that he "want[ed] to see what spin MSO puts on the whole thing." A204.

> . . . the "*Disney and MDE* [Michael D. Eisner] *embarrassment equation*" . . . I agree with you that we must work together to assure a smooth transition and deal with the public relations brilliantly. *I am committed to make this a win-win situation, to keep our friendship intact, to be positive, to say and write only glowing things. . . . Nobody ever needs to know anything other than positive things from either of us. This all can work out!*

A643-45 (emphasis added). In a passage the trial court ignored, Eisner, harkening back to the time when Ovitz came to his side, wrote: "You still are the only one who came to my hospital bed - and I do remember." A645. Eisner also wrote to Ovitz, "I am sure we are now both protected 'every way to and from Sunday'." A647.

L. Eisner Pays Off His Friend

Eisner and Ovitz met together on December 3, 1996, to negotiate the terms of Ovitz's departure. A678. Eisner memorialized this meeting in a note to Russell: "I met with Michael Ovitz today who wants to bring our discussions to a conclusion this week, wants you and Robert Goldman to *settle out* his contract immediately, and to sign it by weeks end." *Id.* (emphasis added). Ovitz specifically requested that Russell, *not* Litvack, negotiate his departure. A679. Ovitz made several demands which were not provided for in his contract. A678-79. Eisner did not immediately object to any of Ovitz's demands, except for his continued use of a Disney-owned car: "I don't want to nit pick here, but we are paying him a fortune." A678. Echoing his oft-stated desire to avoid criticism, Eisner noted to Russell that any agreement "that is one cent more than the contract" should include a provision that would cause Ovitz to forfeit his benefits if, during a five-month period, he "bad mouth[s] me or the Company. . . ." A679; *see also* A680; A1010 at 755:17-756:5. Eisner noted that Ovitz "wants it to be a total secret until Jan. 6," and despite everything, Eisner was still planning Ovitz's 50th birthday party. A679.[16]

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[16] On December 10th, Ovitz received a $7.5 million bonus for his "performance" in 1995 consistent with a questionable private deal, unreported to the Board, which he had struck with Russell the previous year. A494 ("[W]e have concluded that an annual bonus . . . would likely be not less than $7.5 M, but, on the other hand, not necessarily more than $7.5 M, depending on appropriate considerations."); Op. at 29 n.85. This bonus was later "rescinded" after Ovitz's departure was publicly announced, on the purported rationale that "Committee members cannot be asked to try to justify it [bonus] based on good performance." A686. The trial court never addressed why this self-evident explanation was not apparent when Disney first awarded the bonus on December 10, 1996, at a

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Russell and Eisner did not share their communications with the Board. *See* A1081 at 3139:19-3140:5. In fact, many directors were not even aware Russell had been designated to negotiate Ovitz's departure. *See, e.g.*, A1079-80 at 3104:23-3107:5; A1107 at 5771:10-22; 5882:3-23.

M. The Board Does Nothing As Ovitz Departs With Millions

On December 12, 1996, after a private meeting between Ovitz and Eisner in Eisner's New York apartment, Ovitz's separation from the Company was memorialized in a letter signed by Litvack at Eisner's instruction. Op. at 82-83. No director ever saw this letter or approved its terms. *Id.* at 83. Until this point, the Board never convened to vote on, or even discuss, the termination or severance. *Id.* at 86, 167. Also on December 12, 1996, Disney issued a press release announcing Ovitz's departure. A685; *see also* Op. at 83. The press release stated: ". . . Michael S. Ovitz, will leave the company *by mutual agreement* effective January 31, 1997." A685 (emphasis added). In addition, the press release explicitly stated that Ovitz would "continue to serve as an advisor and consultant to the company and the Board of Directors." *Id.* The trial court observed that this part of the press release was "either a deliberate untruth or an incredibly irresponsible and sloppy error on Disney's part." Op. at 84.

Eisner thereafter accelerated Ovitz's departure from January 31, 1997, to December 27, 1996, in a letter agreement of the same date. A699; *see also* Op. at 91. The second paragraph of the letter states that Ovitz's departure "will for all purposes of the Employment Agreement be treated as a 'Non-Fault Termination'," and confirmed that Ovitz would receive $38,888,230.77 cash compensation and the immediate vesting of 3 million stock options, a package worth approximately $130 million. A699. The Board never met to discuss whether Disney could terminate Ovitz for cause and avoid the NFT payout, or pursue some other cost-saving, alternative measure. Op. at 86, 87, 93. Aside from Eisner and Litvack, no member of the Board ever saw the December 27th letter before its execution. *Id.* at 92.

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Committee meeting attended by Eisner, Russell, Watson, Lozano, Poitier, Gold and Litvack. *See* Op. at 81; A779-86. Nor did they consider why the same concerns should not have triggered a full-scale investigation into Ovitz's entitlement to an NFT. In fact, at the meeting, Ovitz was awarded the largest bonus of any other executive, both absolutely and in relation to the maximum amount that could have been awarded. A785. This succeeded his having been nominated at the November 1996 board meeting for election to a full three-year term as a Disney director.

ARGUMENT

I. THE TRIAL COURT ERRONEOUSLY CONCLUDED THAT PLAINTIFFS FAILED TO REBUT THE PRESUMPTION OF THE BUSINESS JUDGMENT RULE IN CONNECTION WITH THE BOARD'S APPROVAL OF THE OEA

A. Standard Of Review

This Court's review of legal rulings "is plenary and requires no deference." *Kahn v. Lynch Communications Sys.*, 669 A.2d 79, 84 (Del. 1995). The formulation of the duty of loyalty and duty of care involves questions of law which are subject to *de novo* review by this Court. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993) ("*Cede II*"). This Court will accept the trial court's factual findings only "[i]f they are sufficiently supported by the record and are the product of an orderly and logical deductive process." *Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. 1972). This Court may substitute its own findings of fact where "the findings below are clearly wrong and the doing of justice requires their overturn." *Id.*

B. Merits Of Argument

1. The Trial Court Erred As A Matter Of Law By Failing To Make A Threshold Determination That The Board's Gross Negligence Rebutted The Presumption Of The Business Judgment Rule

The trial court erroneously combined and conflated plaintiffs' burden of rebutting the presumption of the business judgment rule with the bad faith showing relevant to a Section 102(b)(7) defense. The business judgment rule is "a presumption that directors making a business decision, not involving self-interest, act on an informed basis, in good faith and in the honest belief that their actions are in the corporation's best interest." *Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988), *overruled in part by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *see also Cede II*, 634 A.2d at 360. To rebut this presumption, plaintiffs need only establish that the board acted with gross negligence. *See Van Gorkom*, 488 A.2d at 872-73; *see also Cede II*, 634 A.2d at 371; *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Plaintiffs do not have to demonstrate bad faith. *See Cede II*, 634 A.2d at 371; *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001); *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1162 (Del. 1995) ("*Cede III*"). "Good faith" is only relevant to the court's analysis when plaintiffs have met their burden on the due care claim, and defendants have failed to demonstrate the entire fairness of the challenged transaction.

> [W]hen entire fairness is the applicable standard of judicial review, . . . injury or damages becomes a proper focus only *after* a transaction is determined *not* to be entirely fair. *A fortiori*, the exculpatory effect of a Section 102(b)(7) provision only becomes a proper focus of judicial scrutiny after the directors' potential personal liability for the payment of monetary damages has been established.

Emerald Partners, 787 A.2d at 93; *see also Van Gorkom*, 488 A.2d at 889 (holding that considerations of good faith are irrelevant when directors have collectively exercised an informed business judgment). Moreover, by effectively placing emphasis on the content of a board's decision, the trial court ignored this Court's admonition in *Brehm* that the concept of "'substantive due care' . . . is foreign to the business judgment rule." 746 A.2d at 264.

In contravention of the above bedrock principles, the trial court held: "the presumption of the business judgment rule creates a presumption that a director acted in good faith. In order to overcome that presumption, a *plaintiff must prove* an act of bad faith by a preponderance of the evidence." Op. at 124.[17] Thus, the trial court was not only "premature" in its examination of good faith, but also incorrectly placed the burden of persuasion on plaintiffs. Instead, the trial court should first have determined whether the presumption of the business judgment rule was rebutted based on a showing that the Board had acted with gross negligence. Once gross negligence is established, it then becomes incumbent on the trial court to scrutinize the challenged transaction for entire fairness. If the transaction is not deemed entirely fair, then the trial court can evaluate a defendant's affirmative defense under Section 102(b)(7) that no "bad faith" or any other exception negates its exculpation of solely duty of care violations. *Disney II*, 825 A.2d at 286. On its face, the trial court's decision is bereft of any such step-by-step analysis.

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[17] *See also* Op. at 139 ("In order to prevail, therefore, *plaintiffs must demonstrate* by a preponderance of the evidence that Eisner was either grossly negligent or acted in bad faith in connection with Ovitz's hiring and the approval of the OEA.") (emphasis added); *id.* at 147 (" . . . I conclude that *plaintiffs have not demonstrated* by a preponderance of the evidence that Watson . . . acted in anything other than good faith in connection with the hiring of Ovitz and the approval of the economic terms of the OEA.") (emphasis added); *id.* at 174 ("I conclude that *plaintiffs have not demonstrated* by a preponderance of the evidence that Eisner . . . acted in bad faith in connection with Ovitz's termination and receipt of the NFT.") (emphasis added).

The trial court also erroneously anchored its analysis on the statement that the business judgment rule is merely an evidentiary presumption and not a substantive rule of law. Op. at 107. The law is exactly to the contrary. *Cede II*, 634 A.2d at 360 (citation omitted) ("The rule operates as both a procedural guide for litigants and a substantive rule of law.").

2. The Trial Court Erred As A Matter Of Law In Defining Bad Faith

Putting aside its error regarding the order of proof, the trial court wrongly formulated "good faith." The trial court had earlier held that bad faith could be established by a showing that defendants "*consciously and intentionally disregarded their responsibilities*, adopting a 'we don't care about the risks' attitude concerning a material corporate decision." *Disney II*, 825 A.2d at 289. Under this formulation, directors violate their duty of good faith if they are making material decisions without adequate information and without adequate deliberation. *Id.* Without any intervening change in the law or modified guidance from this Court, the trial court changed its opinion of what does not constitute good faith, holding in its post-trial decision that "[d]eliberate indifference and inaction in the face of a duty to act is . . . conduct that is clearly disloyal to the corporation." Op. at 123.[18] While the trial court's original definition of good faith was logically tied to board decision-making under the duty of care, its newly-minted reformulation relates to an amorphous "duty to act" that is seemingly unconnected to the sufficiency of a board's investigation *per se*.

The trial court also wrongly subsumed gross negligence within intentional misconduct or bad faith, and held that gross negligence is "reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are 'without the bounds of reason'." Op. at 114.[19] The trial court even went so far as to say that "[t]he presumption of the business judgment rule creates a presumption that a director acted in good faith. *In order to overcome that presumption, a plaintiff must prove an act of bad faith by a preponderance of the evidence.*" *Id.* at 124 (emphasis added).

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[18] *See Cede & Co. v. Technicolor, Inc.*, 875 A.2d 602, 613-14 (Del. 2005) ([R]eview of an "application of the law of the case doctrine is *de novo*.").

[19] The trial court's definition of gross negligence wrongly relies upon failure to supervise cases such as *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996); *Graham v. Allis-Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963); and *Tomczak v. Morton Thikol, Inc.*, 1990 Del. Ch. LEXIS 47, which are inapposite here. Op. at 114 n.429.

Defendants shaped their testimony in the apparent hope that such a highly permissive standard would be applied. Thus, the subjective, latter-day testimonials given on the stand were permitted to displace the objective circumstantial evidence or admissions supplied by contemporaneous written documents and other hard information.[20] Yet, as the trial court had ruled in a prior opinion, "Delaware law, however, has always taken an objective approach to determining fiduciary duties." *Disney III*, 2004 Del. Ch. LEXIS 132, at *31.[21] The trial court's soft, subjective approach would make it virtually impossible to prove a good faith violation – or, for that matter, any offense or crime involving *scienter* or *mens rea*. Moreover, in the same vein, the trial court should have, but repeatedly failed, to turn aside from trial testimony that contradicted prior deposition testimony or time-relevant statements or admissions reflected in original notes, memoranda, correspondence and the like.[22]

[20] The trial court's decision shows that even a board that decides to take an "ostrich-like" approach to making a business decision is immune from monetary liability if the director defendants testify that they acted in that manner in "good faith."

[21] Delaware courts critically assess defendants' own exculpatory trial testimony. *See, e.g., Faraone v. Kenyon*, 2004 Del. Ch. LEXIS 26, at **29-30 (failing to give credibility to a defense predicated on self-serving testimony); *Rudnitsky v. Rudnitsky*, 2001 Del. Ch. LEXIS 159, at *12 (failing to give credibility to uncorroborated, self-serving testimony); *Williams v. Spanagel*, 2000 Del. Ch. LEXIS 123, at **8-9 (failing to give credibility to self-serving testimony because it was the only evidence proffered and was contradictory and inconsistent at several points), *aff'd*, 787 A.2d 101 (Del. 2001); *Technicorp Int'l II, Inc. v. Johnston*, 2000 Del. Ch. LEXIS 81, at **4-5 (failing to accept the fiduciary defendants' uncorroborated and self-serving testimony without documentary evidence).

[22] *See also E.I. Dupont De Nemours & Co. v. Monsanto Co.*, 903 F. Supp. 680, 749 (D. Del. 1995) (finding that a witness lacked credibility because his testimony at trial differed from that of his deposition), *aff'd without an opinion*, 92 F.3d 1208 (Fed. Cir. 1996); *McGrory v. Schiavo*, 1997 U.S. Dist. LEXIS 19218, at *9 (E.D. Pa.) (finding that a plaintiff lacked credibility because his "story changed beginning with the allegations in his complaint to his deposition testimony to his trial testimony"); *Hoffman v. United States*, 23 T.C. 569, 575 (1954) (refusing to credit self-serving testimony over documentary evidence); *McCammond v. Oxford Bank & Trust*, 1998 U.S. Dist. LEXIS 15796, at *14 (N.D. Ill.) (finding self-serving testimony outweighed by unrebutted documentary evidence); *Hall v. Gary Cmty. Sch. Corp.*, 298 F.3d 672, 676 (7th Cir. 2002) (holding that a plaintiff's subjective, self-serving testimony is not sufficient to contradict a well-documented history of poor job performance).

3. The Trial Court Improperly Formulated The Legal Standard For Rebutting The Business Judgment Rule

Compounding its legal error set forth above, the trial court misinterpreted the requirements for rebutting the presumption of the business judgment rule. Gross negligence is the test: nothing more, nothing less. *Van Gorkom*, 488 A.2d at 873. Gross negligence is proven by a showing that the board failed to inform itself "of all material information reasonably available." *Cede II*, 634 A.2d at 367; *see also Brehm*, 746 A.2d at 259 (same). The trial court, however, seems to have assumed that the informational component of the due care analysis is a separate and distinct element from gross negligence.[23]

In addition, the trial court incorrectly held that the scope and extent of the duty of due care varies depending upon the nature or size of the underlying transaction and whether a statute mandates board action. *See* Op. at 150. The trial court, however, overlooked Section 141(a) providing that directors are charged with management of corporate business and affairs. In discharging this statutory obligation, directors are charged with a fiduciary duty of care. *Guth v. Loth, Inc.*, 5 A.2d 503, 510 (Del. 1939); *Aronson*, 473 A.2d at 811; *Van Gorkom*, 488 A.2d at 872; *Mills Acquisition Co. v. MacMillon, Inc.*, 559 A.2d 1261, 1280 (Del. 1989); *Cede II*, 634 A.2d at 360. Compliance with the fiduciary duty of care requires board diligence throughout the decision-making process and consideration of "all material information reasonably available to [the board]." *Cede II*, 634 A.2d at 367 (citing *Aronson*, 473 A.2d at 812).

Moreover, while circumstances may differ, the basic duty of due care, if triggered, remains the same. There is no authority for a "flexible" duty of care, which transmutes the question whether care was properly exercised under the circumstances into a threshold determination of whether a duty even exists, or if so, to what extreme.

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[23] *See, e.g.*, Op. at 160 ("Again, plaintiffs have failed to meet their burden to demonstrate that the directors acted in a grossly negligent manner *or* that they failed to reasonably inform themselves of all material information reasonably available to them when making a decision.") (emphasis added); *id.* at 126-27 ("[T]he presumption of the business judgment rule does not apply either because the directors breached their fiduciary duties, acted in bad faith *or* that the directors made an 'unintelligent or unadvised judgment,' *by reason of failing to inform themselves of all material information reasonably available to them before making a business judgment.*") (emphasis added).

4. The Trial Court Erroneously Assessed Plaintiffs' Due Care Claims Director-By-Director

The trial court's analytical errors were exacerbated by its erroneously analyzing the application of the presumption of the business judgment rule director-by-director, instead of collectively. *See* Op. at 133-61. This Court held in *Van Gorkom* that the business judgment rule applies to *board* conduct only and that the board's conduct must be assessed collectively (488 A.2d at 889) – a requirement the trial court even acknowledged in its Opinion, but failed to observe. Op. at 109.[24]

Practically overturning *Van Gorkom*, the trial court erroneously relied on the Court of Chancery's decision in *Emerging*. *Id.* at 109-10. The individualized analysis the Court of Chancery employed in *Emerging*, however, applied solely to assessing application of the "good faith" defense provided in Section 102(b)(7). *See In re Emerging Communications, Inc. S'holders Litig.*, 2004 Del. Ch. LEXIS 70. Application of a director-by-director analysis to assess plaintiffs' due care claims violates the core principle that the business judgment rule exists to protect collective board action. *Van Gorkom*, 488 A.2d at 889; *Cede II*, 634 A.2d at 370. Indeed, the trial court overlooked Disney's bylaws which codified the basic legal principle that in order for the Board to act, there either had to be a board meeting or action by unanimous written consent. A810.

5. Discussions Outside The Context Of A Board Meeting Are Irrelevant In Assessing The Informational Component Of Fiduciary Duty

For a Board to make an informed judgment, directors, acting collectively, must consider all reasonably available information. *See supra* at Section I(B)(4). As Professor DeMott testified, and as cited by the trial court in its Opinion:

> [I]ndividualized one-on-one discussions between management and directors can lead to directors who are "unequally or unevenly informed with regard to significant matters" and "have the effect of vitiating, sapping, the board's ability as an institution to function together collectively and collegially and deliberatively."

Op. at 96 n.373 (citing A1025-26 at 43:4-46:15; A1027 at 83:12-84:6). This is exactly what happened here. Eisner did not discuss any details of the OEA during

[24] *See also Cede II*, 634 A.2d at 370 ("The question presented in this case is whether the defendant directors, *meeting as a board*, satisfied the rule's presumption of board due care in meeting to consider for the first time a proposed sale of the company under terms negotiated exclusively by its chairman.") (emphasis added).

the purported one-on-one calls the trial court cites in its Opinion. Op. at 25-26.[25] Eisner testified that the scope and content of his private, undocumented one-on-one communications with the Board, to the extent he could even remember them with any specificity, varied. *See, e.g.*, A1091-98 at 4939:17-4967:11. In the absence of a single shred of written contemporaneous evidence showing just what, if anything, the directors discussed, the trial court was obligated to find that no such discussions occurred.

In any event, the trial court should have disregarded this post-hoc reconstruction of calls that might have occurred and that were not recorded in any minutes, as legally irrelevant. The informational component of a board's responsibilities is assessed by what is provided to the board and considered collectively in the recognized setting of boardroom discussion. The trial court's contrary decision to allow self-serving testimony regarding undocumented individual meetings to embellish the sparse discussions recorded in contemporaneous minutes is untenable.

6. The Trial Court Committed Legal Error By Ruling That The Full Board Did Not Have A Duty To Consider And Approve The OEA

The trial court also committed legal error by concluding that the Board as a whole did not have to approve the OEA. In so doing, the trial court ignored the central holding in *Brehm* that the Board had a duty to approve the OEA because of its materiality. 746 A.2d at 259 ("Certainly in this case the economic exposure of the corporation to the payout scenarios of the Ovitz contract was material, particularly given its large size, for purposes of the directors' decision-making process."). This Court held that "the sheer size of the payout to Ovitz . . . pushes the envelope of judicial respect for the business judgment of directors in making compensation decisions." *Id.* at 249.

In the Opinion, the trial court attempted to avoid the law of the case by ruling that *Brehm* involved a review of a motion to dismiss where plaintiffs were "afforded all reasonable inferences in support of their arguments and without any factual

[25] The only evidence after discovery concluded regarding these alleged calls is a handwritten phone log produced by defendants. DTE 413. There are no contemporaneous documents indicating what was discussed during these calls. Furthermore, even after trial, it is not clear whether or not Eisner actually spoke to all of the directors, as opposed to simply trying to reach all the directors prior to the announcement and execution of the OLA. *See* A1096-97 at 4961:20-4963:1; A1097-98 at 4965:15-4966:2; DTE 413 at WD07477, 7481 (demonstrating that there is no indication that a call was ever completed).

basis." Op. at 168 n.577. This distinction is not tenable. The materiality of the NFT was upheld as a *matter of law* at the pleading stage based on the *same operative facts* about the economic impact of the NFT evidenced in the trial record.[26] Confirming the materiality of the Ovitz transaction, the opening paragraph of the OLA executed on August 14, 1995, states that the terms of Ovitz's employment were subject to Board approval (A417), and even the Case Study created by Russell explicitly assured that Board approval would be needed. A210.

Because Disney officers could apparently commit the Company to movie projects or other deals involving dollar amounts greater than the OEA without concomitant Board approval, the trial court concluded that it could treat the OEA as immaterial. Op. at 151-52 n.533. In Fortune 500, publicly-listed corporations, senior vice-presidents or operational heads often commit the company to business transactions that tower in size over even the most lucrative executive compensation packages of senior officers. Taken to its logical conclusion, the trial court's immateriality analysis in this case would excuse virtually all executive compensation decisions from board consideration.[27]

7. The Evidence Shows That The Board Was Grossly Negligent

The process employed by the Board in connection with Ovitz's hiring was grossly negligent. The trial court devoted *one paragraph* of its 174-page Opinion to the board meeting held on September 26, 1995 – the only Board meeting where Ovitz's hiring was discussed at all. Op. at 29-30. The trial court's factual findings about the meeting constitute the following:

> In executive session, the Board was informed of the reporting structure that Eisner and Ovitz agreed to, but no discussion of the discontent Litvack or Bollenbach expressed at Eisner's home was recounted.

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[26] The trial court appears to have credited the trial testimony of defendant Wilson, a non-expert, who testified that the NFT payout was immaterial from an accounting perspective. Op. at 158 n.558. Wilson conceded, however, that he is neither an expert in accounting on the concept of materiality, nor an expert in materiality as it is applied to Delaware law. A1116 at 7074:17-7075:15. Moreover, plaintiffs' expert, Professor Murphy, and several other defendants testified that the NFT payout was material. *See, e.g.*, A1055-56 at 748:22-749:13 (K. Murphy); A1083 at 3753:21-3754:4 (Gold referring to the payout as a "boatload" of money).

[27] Moreover, the size and structure of the OEA, particularly as it related to the lucrative NFT provisions in the contract, not only affected Ovitz's incentives, an important factor given the significance of his service as President, but also set parameters that could impact on other levels of the organization as well. A224.

> Eisner led the discussion regarding Ovitz, and Watson then explained his analysis and both he and Russell responded to questions by the Board. Upon resuming the regular session, the Board deliberated further, then voted unanimously to elect Ovitz as President.

Id.

Having made these limited findings, the trial court's decision contains no factual predicate whatsoever for the conclusion that the Board "was informed" about the "key terms of the OEA." Op. at 160; *see Candlewood Timber Group, LLC v. Pan Am. Energy LLC*, 859 A.2d 989, 1000-01 (Del. 2004), *cert. denied*, 2005 U.S. LEXIS 1911. Moreover, the trial court's factual findings *do* establish that Eisner, Russell, Litvack and Bollenbach failed to communicate the "discontent" Litvack and Bollenbach had expressed about Ovitz's hiring or the compromise that was reached. Op. at 29-30. The Board minutes say nothing about consideration of the OEA. A716-30. Defendants' attempt to fill in the blanks nine years later with self-serving and revived (yet selective) recollections is predictably and hopelessly confused, generalized and often conflicting. Op. at 73 n.277.[28] *See Van*

[28] *Compare* A951 at 159:11-160:18 (Bollenbach at his deposition having no memory of the September 26, 1995 board meeting), *with* A1000-01 at 5436:18-5437:17 (Bollenbach remembering at trial the September 26, 1995 board meeting); *compare* A1005 at 585:16-25; A1009 at 736:3-10 (Russell at his deposition stating that there were no discussions of the terms good cause, non-fault termination, gross negligence or malfeasance at any board meeting through January of 1997), *with* A1071 at 2903:4-2904:21 (Russell "not recalling" at trial whether such terms were discussed); *compare* A965 at 140:8-16 (Gold at his deposition not remembering whether the Compensation Committee made a presentation to the Board), *with* A1084-85 at 3882:21-3883:12 (Gold remembering at trial that a "partial report" was made by Russell and Watson to the Board); *compare* A980 at 365:24-366:15 (Eisner at his deposition having no memory whether or not the Board had ever assigned monetary value to Ovitz's contract at the executive session of the September 26, 1995 Board meeting), *with* A1089-90 at 4880:2-4884:23 (Eisner remembering at trial an effort to put a dollar value on the contract); *compare* A953 at 130:11-14 (Poitier at his deposition testifying that he did not remember the Board discussing the OEA at the September 26, 1995 board meeting), *with* A1120 at 7218:1-17 (Poitier remembering at trial such a discussion); *compare* A973 at 59:11-18 (Nunis testifying at his deposition that he did not remember the Board discussing Ovitz's hiring at the September 26, 1995 meeting), *with* A1106 at 5840:14-21 (Nunis at trial testifying that Ovitz's hiring was the "topic of conversation" all day: "pre-lunch and through lunch").

Gorkom, 488 A.2d at 878-79 (Court discredits events which directors claimed after-the-fact occurred when minutes failed to reflect such events occurred); *In re Prime Hospitality, Inc. S'holders Litig.*, 2005 Del. Ch. LEXIS 61, at **41-42 (same).

As the trial court found, Ovitz's hiring was a "done deal" by the time the Board met. Op. at 138. The Board blindly "kowtowed" to Eisner. *Id.* at 136 n.488. No documents, spreadsheets, or comparables were ever provided to the Board in advance of the September 26, 1995 meeting. *Id.* at 28. The "Case Study," Crystal's letters critical of Ovitz's pay package, and drafts of the OEA, though reasonably available, were withheld by Eisner, Russell and Watson.[29] The Board did not discuss the NFT provisions, concepts of fault, gross negligence or malfeasance, or payouts that would be made to Ovitz under the OEA if he were terminated under different scenarios. *Id.* at 86. Crystal, who did not attend the Board meeting, was supposedly "available" by phone, but was never contacted (if reliance on an expert in this way were even permitted). *Id.* at 28. Although the OLA had been executed, and a recent draft of the proposed OEA was available, neither of these documents was distributed nor discussed. A419-34; A435-52 (drafts of the OEA which existed and had been sent to Russell). The complete lack of any Board deliberation, let alone informed deliberation, constitutes both gross negligence and an "ostrich-like" abdication of duty warranting at least a threshold finding of gross negligence. *Disney II*, 825 A.2d at 288.

8. The Compensation Committee "Deliberations" Provided No Defense

The trial court's focus on the September 26, 1995 Compensation Committee meeting cannot serve as a proxy for the deficient Board meeting that immediately followed. The material nature of the OEA decision mandated *Board* approval. Indeed, in electing Ovitz President, the Board had to conduct a competitive pay analysis before it could even make an informed decision to hire Ovitz – a proposition Crystal agreed with. A1057 at 777:24-779:1; A1082 at 3384:18-3386:14. Moreover, whatever its significance, the evidence shows that the Committee was grossly negligent. The trial court did not consider that the Committee never approved the OEA, discussed the meaning of an NFT under the terms of the OEA, or analyzed the financial consequences to Disney in the event of an NFT. *See infra* at Statement of Facts Section E. No comparable employment agreements were examined. Op. at 28 n.80; A1105 at 5826:8-16.

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[29] *See, e.g.*, Op. at 18 (Case Study withheld); *id.* at 21, 28 (Crystal letters withheld); *id.* at 27, 154 (OEA drafts withheld).

The trial court erroneously concluded that the Compensation Committee could invoke Section 141(e) despite the fact it also found that Crystal never made a report to the full Committee (Op. at 28) and his highly critical letters were never distributed to the full Committee (*id.* at 21, 28). According to the trial court, Crystal's advice was orally "relayed" to Poitier and Lozano by Russell and Watson. *Id.* at 156-57.[30] This conclusion is legally erroneous and completely in contradiction to this Court's holding in *Brehm*. *See* 746 A.2d at 259-62.

The trial court did not, and could not cite any case for the proposition that Section 141(e) applies where, as found here, instead of relying directly on an expert or an expert report, directors are told by another director what an expert supposedly said. Such a finding ignores the requirement of a board functioning as such and not being permitted to be picked off selectively, with second and third-hand information where actual data and other information is reasonably available.

In addition, even assuming, *arguendo*, that the Committee could in fact rely upon Crystal, such reliance was not in good faith given that Crystal's letters did not encapsulate the final OEA pay package (A453-72; A750-52) and his analysis did not discuss the cost to Disney of an NFT (*see generally* A215-19; A225-28), despite the fact that such information was material and reasonably available. *See Brehm*, 746 A.2d at 262. The trial court thus erred in concluding that Crystal performed an "analysis" on which the full Compensation Committee reasonably relied. Op. at 155-57.[31]

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[30] In contrast to the letters Crystal wrote about a potential Ovitz pay package, Crystal wrote a formal fairness opinion on Eisner's new compensation package in 1996 (A234-42) and that opinion was explicitly referenced in the minutes of the September 30, 1996 Board meeting where formal board approval was given. A244. The trial court gave no explanation why it disregarded such assumed "custom and practice" (or lack of evidence thereof) at Disney while citing other such "customs and practices" against plaintiffs. *See*, *e.g.*, Op. at 171 n.587.

[31] If this Court agrees that the presumption of the business judgment rule was rebutted with respect to Ovitz's hiring and the formation of the OEA, then an entire fairness analysis comes into play. Plaintiffs established below that the unfair dealing and unfair pricing and structure embodied in the OEA dictates a finding in their favor. It is within this Court's authority to address the entire fairness and the liability issues on the extensive record it already has before it if there is a reversal.

II. THE TRIAL COURT COMMITTED REVERSIBLE LEGAL ERROR IN ABSOLVING DEFENDANTS FROM LIABILITY IN CONNECTION WITH OVITZ'S RECEIPT OF A FULL NFT PAYOUT

A. Standard Of Review

See Section I.A.

B. Merits Of Argument

1. The Trial Court Committed Legal Error In Concluding That The Board Did Not Have A Duty To Approve The 1996 Termination And Full NFT Payout

The record is undisputed that the Board never collectively considered or approved Ovitz's termination, the terms of his departure, what Ovitz was going to receive or any alternatives to a full NFT payout. Op. at 87, 167, 168 n.580. According to the trial court, "the Disney directors had been taken for a wild ride, and most of it was in the dark." *Id.* at 86. Nonetheless, the trial court, ignoring the law of the case that the NFT payout decision was "material" and necessitated board action and purportedly relying on a construction of Disney's charter and bylaws, held that the Board could not have violated its fiduciary duty of due care in connection with Ovitz's termination as a matter of law because it *had no duty to approve the terms of Ovitz's departure. Id.* at 162-69. These legal conclusions are clearly erroneous.

The trial court's materiality decision cannot be logically squared with *Brehm* and the trial court's prior conclusion that "some action would be necessary." *Disney III*, 2004 Del. Ch. LEXIS 132, at *34 n.64 (citing *Brehm*, 746 A.2d at 259). In *Brehm*, this Court plainly assumed that the Board was vested with the power to remove Ovitz and the Board's deliberations in this regard were presumptively protected (at that stage) by the business judgment rule. 746 A.2d at 261, 266. The trial court concluded, however, that it was not bound by *Brehm* (Op. at 168 n.577) or its own earlier rulings in the case (*id.*) on the issue of the NFT's economic materiality and the Board's corresponding duty to act: "The previous judicial statements regarding materiality cannot properly be considered 'law of the case' because those statements were made in the context of motions [to dismiss]." *Id.* Holding that materiality was a question of fact, the trial court determined that the NFT payout was not "material to the Company." *Id.*

The trial court was not free to ignore the law of the case. The materiality of the NFT was upheld as a matter of law at the pleading stage based on the same operative facts evidenced in the trial record. The size and structure of the OEA and the nature and impact of its NFT provisions were demonstrated at trial in a way which precisely mirrors plaintiffs' allegations regarding these matters in the

operative complaint and as reflected in prior decisions. While there was conflicting testimony at trial regarding the true cost to Disney of the NFT payout, the trial court concluded that the NFT payout, "even at the inflated valuation calculated by Professor Murphy, was not material to the Company." Op. at 168 n.577.[32] That is a conclusion of law and not a finding of fact, since it held true whatever facts plaintiffs established.

Furthermore, Section 141(e) does not absolve the Board for its purported "reliance" on Litvack in his capacity as legal counsel in connection with his purported view that a meeting and separate board deliberations were unnecessary. *Id.* at 169. There is no contemporaneous evidence that anyone at Disney ever gave any thought to the issue at the time. Indeed, Litvack testified that he never advised the Board that a meeting was unnecessary. A1110 at 6150:21-6151:11. Nor is there any evidence that the Board even collectively made any business judgment not to meet or defer to Eisner. If the trial court's Opinion were affirmed, it would allow directors to rely on the absence of affirmative guidance as a defense to their liability for not acting in accordance with their duties as fiduciaries under Section 141(a). *See, e.g.*, A1113 at 6721:11-14 (O'Donovan testifying that he never considered whether the Board was required to meet). Delaware has never endorsed such a passive view of directors' duties.

Even if the NFT payout was not "material," the trial court erred by ruling that Disney's bylaws and charter excused the Board from any duty to act. In its decision, the trial court reasoned that Disney's operative bylaws did not require the Board to terminate Ovitz but merely gave the Board the "non-exclusive" power along with Eisner to terminate Ovitz. Op. at 140 n.496, 162-68. The trial court purportedly based this conclusion on certain provisions of the bylaws giving Eisner, as CEO

[32] The trial court's characterization of Professor Murphy's valuation calculations as "inflated" ignores that: (1) he summarized three methodologies as valid approaches to valuation in the executive compensation industry, his specialty; and (2) his calculations, even at the upper end, were not so vastly different from Dunbar's calculations which were credited by the court. *Compare* A910-13 *with* DTE 428 ("Dunbar Report") at 13; *see also* A1124 at 7323:7-13 (Dunbar's testimony). In the face of this evidence, the trial court never explained its criticism of Professor Murphy's analysis. A factual finding based on the weighing of expert opinion is reversible error if arbitrarily made and lacking in evidential support. *See Cede & Co. v. Technicolor, Inc.*, 875 A.2d at 611.

and Chairman, general authority to "supervise" Disney's officers, and which stated that the President "reports" to the CEO. *Id.* at 164. The trial court's decision is legally erroneous.[33]

Disney's charter and bylaws granted to the Board the sole authority to hire *and* terminate the President. Article Tenth of Disney's Certificate of Incorporation states that the "officers of the Corporation . . . shall hold their offices for such terms . . . as are determined *solely* by the Board of Directors, subject to the right of the Board of Directors to remove any officer or officers at any time with or without cause." A807 at Article Tenth (emphasis added).[34] This article does not say "subject to the right of the Board or *the CEO* to remove. . . ." The only limitation to officers serving full terms, as initially set for them, by the Board is that of the Board removing the officer.[35]

To conclude that the Board's right is non-exclusive, the trial court appears to rely on the fact that the first part of the charter provision uses "solely" and the second part does not. Op. at 164-65. However, that is not the logical interpretation. By saying that the "terms" are set "solely" by the Board, the article already excludes the possibility of removal by the CEO. If an officer can be removed by the CEO, the officer's term of service might not be set by the Board but also the CEO, *i.e.*, by removing the officer, the CEO can set the end point of the officer's term of service. Thus, the first part already rules out the possibility of the CEO's removing

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[33] When construing charter and bylaw provisions, courts must give effect to the intent of the parties as revealed by the language of the charter or bylaw and the circumstances surrounding its creation and adoption. *See Waggoner v. Laster*, 581 A.2d 1127, 1134 (Del. 1990). The rules used to interpret contracts are applicable when construing corporate charters and bylaws. *Centaur Partners IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 926 (Del. 1990); *Gentile v. SinglePoint Fin. Inc.*, 788 A.2d 111, 113 (Del. 2001). The construction or interpretation of a corporate certificate or bylaw is a question of law subject to *de novo* review.

[34] Even assuming that the Board's authority was not exclusive, the trial court does not explain why the Board failed to seek to invoke its authority to make the decision.

[35] The trial court failed to consider that Ovitz was also a member of the Board. Disney's charter sets forth the procedures for removal of board members, none of which give the CEO that authority. A805-06 at Article Fifth. The trial court also failed to consider that the Board had just nominated Ovitz to a new three-year term during its November 25, 1996 meeting. A778b. Procedures for removal of a nominated director also were not followed. A806 at Article Sixth.

an officer elected by the Board. Any other interpretation would undermine the proposition that the terms are solely determined by the Board. *See Cede III*, 663 A.2d at 1171 (courts are required to "respect and enforce the literal language of the constitutional documents of a corporation") (citation omitted).

Disney's bylaws similarly granted to the Board the sole authority to hire and terminate the President. *See* A807; A811. Under Art. IV, Sec. 2 of the bylaws, the President shall be chosen by the Board, and the President "shall hold [his] office[] for such terms . . . as shall be determined from time to time *solely* by the Board of Directors." A811. Disney's bylaws continued, "[a]ny officer elected to the Board of Directors may be removed at any time by the Board of Directors with or without cause." In addition, and in accord with the bylaws and charter, the Board resolution approving Ovitz's hiring at the September, 26, 1995 Board meeting unequivocally stated that Ovitz was elected to serve as Disney's President by the Board, and served in the capacity of President of Disney "at the pleasure" of the Board. A718; *see* A955-56 at 153:20-154:23 (testifying that his [Lozano's] interpretation of the phrase "at the pleasure" of the Board is that Ovitz "could be terminated as president by the board of directors, and by no one else. That is, as an officer of the corporation.").

In addition, the 1990 Amended Stock Option Plan (the "Stock Option Plan" or "Plan") made mandatory the Compensation Committee's concurrent approval of Ovitz's termination, particularly in light of the fact that the lion's share of Ovitz's severance was in the form of immediately vested stock options. A770; *see supra* Statement of Facts Section G. The Compensation Committee approved the Stock Option Plan at a special meeting of the Compensation Committee on October 16, 1995. A753-78. The Board approved the Stock Option Plan by unanimous written consent. A509-38. The Stock Option Plan was also subject to shareholder approval, which was obtained by a shareholder vote. *See* A797. The bypassing of the Compensation Committee in connection with Ovitz's termination violated the plain terms of the Option Plan Rules. *See Sanders v. Wang*, 1999 Del. Ch. LEXIS 203 (the terms of an option plan are to be construed liberally, and directors' failure to abide by the terms of an option plan violate their fiduciary duties).[36]

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[36] According to the trial court, the rules of the stock option plan have no weight or do not mean what they say because of the apparent lack of custom and practice in enforcing them. *See* Op. at 171 n.587. There is no evidence that any Disney executive was terminated with the concomitant vesting of a stock option package other than Ovitz himself, and the trial court lacked the predicate for a finding of custom and practice, or, for that matter, the lack thereof. In all events, any such extrinsic matter cannot overcome the plain meaning of binding corporate instruments.

2. The Trial Court Erred As A Matter Of Law By Applying The Business Judgment Rule To Eisner, Litvack And Russell

Even assuming, *arguendo*, that Eisner, Litvack and Russell could effect Ovitz's receipt of the NFT payout without seeking Board approval, the legal analysis that properly applies to these three defendants as an outgrowth of its conclusions vastly differs from that applied by the trial court. Eisner and Litvack, instead of having acted in their capacities as directors, were found by the trial court to have acted as *officers* in effectuating Ovitz's departure from the Company. *See, e.g.*, Op. at 172 ("Eisner, consistent with his discretion as CEO . . ."); *id.* at 169 ("Litvack as an officer of the corporation and as its General Counsel . . ."). The trial court also makes explicit that Eisner and Litvack, having determined to proceed without the authorization of the Board and not acting in their capacities as members of the Board, were acting under the assumed authority they possessed as *officers* to effect Ovitz's removal. *Id.* at 167-69. Russell, who did not serve as an officer, nonetheless assumed the responsibility of a "gratuitous agent" acting on Disney's behalf in negotiating Ovitz's departure. Restatement 3d Agency § 1.03(4); A1077-78 at 3022:6-3024:5.

Eisner, Litvack and Russell can be divested of the immunization and protections ordinarily made available to corporate directors under Delaware law because the business judgment rule does not apply to Eisner or Litvack acting as officers or to Russell acting as Eisner's personal "gratuitous agent." *McMullin v. Beran*, 765 A.2d 910, 923 (Del. 2000) (the substantive protections of the business judgment rule can only be claimed by disinterested directors).[37] Accordingly, Eisner, Litvack and Russell's conduct must be measured against concepts of ordinary negligence. The trial court's finding that defendants acted negligently (Op. at 134) should have resulted in a judgment for plaintiffs. Moreover, even if Eisner, Litvack and Russell's misfeasance and nonfeasance were protected by the business judgment rule, their

[37] The trial court assumed, without any analysis, that the business judgment rule applied to Eisner, Litvack and Russell. No Delaware court, however, has explicitly ruled that the business judgment rule applies to corporate officers for their conduct as officers. *See Platt v. Richardson*, 1989 WL 159584, at *2 (M.D.P.A. June 6, 1989); Lyman P.Q. Johnson, *Corporate Officers and The Business Judgment Rule*, 60 Bus. Law. 439, 440-41 (2005). Inexplicably, the trial court cited and relied upon the Johnson article (Op. at 172 n.588), but failed to apprehend its focal point. *See also Cede III*, 663 A.2d at 1162 (although stating that the rule applies to the decisions of both officers and directors, the rationale for its application only involves directors: "If the rule is rebutted, the burden shifts to the *defendant directors*, the proponents of the challenged transaction . . . .") (emphasis added) (citation omitted).

outright disdain for the processes of the Board and utter failure to perform a proper investigation, *see infra* at Section II(B)(4), constituted gross negligence.

Furthermore, having solely acted in their capacities as *officers*, they are without the protection of Section 102(b)(7). *See Arnold v. Soc'y for Sav. Bancorp., Inc.*, 650 A.2d 1270, 1288 (Del. 1994) ("[W]here a defendant is a director and officer, only those actions taken solely in the defendant's capacity as an officers are outside the purview of Section 102(b)(7).") (citing R. Franklin Balotti & Jesse A. Finkelstein, Del. Law of Corp. & Business Org. § 4.19, at 4-335 (Supp. 1992)). Because Section 102(b)(7) does not protect the conduct of corporate officers, consideration of Eisner, Litvack and Russell's "good faith" was irrelevant.

3. The Trial Court's Legal Conclusion That Ovitz Could Not Be Terminated For "Cause" Was Erroneous

As discussed above in Section I(B)(4), the Board had a duty to collectively decide whether Ovitz should receive the NFT payout. Since the Board failed to collectively make any such decision, (Op. at 167, 168 n.580), it is not entitled to the presumption of the business judgment rule, and the burden shifts to defendants to prove entire fairness. *See Emerald Partners*, 787 A.2d at 91.

The trial court, however, incorrectly held that no board decision was necessary and thus failed to undertake an entire fairness analysis. Op. at 167. Consequently, the trial court analyzed Ovitz's performance solely from the perspective of plaintiffs' alternative waste claim, shifting to plaintiffs the burden of proving that Ovitz could have been fired for cause. Had the trial court properly found that plaintiffs had rebutted the presumption of the business judgment rule, it would have been unnecessary for the Court to analyze Ovitz's performance under the rigorous standards for waste. Because plaintiffs have successfully rebutted the presumption of the business judgment rule in connection with the decision to terminate Ovitz and grant him an NFT, due to the Board's knowing, conscious and culpable failure to act in defiance of their clear duties to do so, the trial court should have shifted the burden to defendants to prove entire fairness.

A sufficient record exists to support a finding by this Court that defendants cannot meet their heavy burden of proving entire fairness. In order to prove entire fairness, the *defendants* must prove that Ovitz's NFT payout was the product of fair dealing and fair price. *See Cede II*, 634 A.2d at 361; *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983). In a case like this one, the Court must scrutinize how the defendants discharged their responsibilities with respect to each of these components. *See Cede III*, 663 A.2d at 1172. This is not a bifurcated analysis but one which should be "examined as a whole since the question is one of entire fairness." *Id.* at 1163 (citation omitted). *See also Nixon v. Blackwell*, 626 A.2d

1366, 1376 (Del. 1993); *Solomon v. Armstrong*, 747 A.2d 1098, 1113 n.39 (Del. Ch. 1999) ("entire fairness review invokes a standard so exacting that it ordinarily, but not invariably, results in a finding of liability"), *aff'd*, 746 A.2d 277 (Del. 2000). The Board did not engage in *any* process in approving Ovitz's receipt of a full NFT payout, reflecting a conscious abdication of duties that so widely varies from minimal standards as to bespeak bad faith. No defendant ever requested a meeting to discuss Ovitz's termination, its treatment, its cost, or the Company's alternatives to paying a full NFT, including the possibility of firing Ovitz for cause or attempting to negotiate a lesser amount. *See* Op. at 167; *see also* A1101 at 800:12-23. The Board's failure to make any decision with regard to Ovitz's termination and the terms of his departure means that the Board cannot make any showing of fair process, and any attempt by defendants to satisfy their already significant burden to prove fair price thus became suspect. *See, e.g., Kahn v. Tremont Corp.*, 694 A.2d 422, 432 (Del. 1997) ("[T]he process is so intertwined with price that under *Weinberger's* unitary standard a finding that the price negotiated by the Special Committee might have been fair does not save the result."); *Bomarko, Inc. v. Int'l Telecharge, Inc.*, 794 A.2d 1161, 1183 (Del. Ch. 1999), *aff'd*, 766 A.2d 437 (Del. 2000) (unfairness of process infects fairness of the price); *Metro. Life Ins. v. Aramark Corp.*, 1998 Del. Ch. LEXIS 70, at *7.

4. The Record Supports A Finding That A Rational Basis Existed To Terminate Ovitz For Cause And Deprive Him Of Any NFT Benefits

The OEA provided for a mechanism which allowed the Company to terminate Ovitz for cause and avoid a costly buyout of his contract in the event that Ovitz was either "grossly negligent" or "malfeasant" in carrying out his duties as President, issues that were never considered or determined by the Board. A463 at Sec. 11(a)(iii). California law governs the definition of gross negligence or malfeasance as used in the OEA. A471. Three experts submitted hundreds of pages of analysis in their reports and offered lengthy testimony at trial regarding the definitions of malfeasance and gross negligence. *See* A813-82 and A943-48 (Expert and Supplemental Reports of Professor John J. Donohue, III); DTE 430 (Expert Report of John C. Fox); DTE 408 (Expert Report of Larry R. Feldman).[38] The trial court

[38] In sharp contrast, Litvack, an antitrust specialist with no expertise in employment law, concluded that the cause issue was a "no-brainer," did no analysis or legal research at all, and failed to produce a single piece of paper to corroborate any purported "advice" on the issue. Op. at 69-71. In its Opinion, the trial court deemed that Litvack was not an infallible source of legal knowledge (*id.* at 170) and that aspects of his conduct could only be described as "pathetic." *Id.*

failed to articulate which, if any, of the differing interpretations of gross negligence and malfeasance it relied upon. Op. at 132-33; *see, e.g.*, A829-30; A1143 at 9039:19-22 (malfeasance does not require intent); *see Nixon*, 626 A.2d at 1378 n.15 ("In order for this Court to discharge its appellate responsibilities it must be supplied with the bases for the decision of the trial court. A decision without reasons borders on the arbitrary and is not subject to meaningful review.") (citation omitted).[39] The trial court's decision is also incapable of meaningful appellate review because it failed to articulate which facts it relied upon to conclude that Ovitz could not be dismissed for cause. *See* Op. at 133.

In reaching its decision, the trial court also completely failed to take into consideration the PW Audit. Standing alone, the PW Audit provides more than ample evidence that Ovitz could have been dismissed for cause. The PW Audit, part of something called "Project MSO," was addressed to the Board (A71-187), reviewed by Litvack (A639), and authorized by Eisner as part of his decision to hold back $1 million from Ovitz's termination payout. A981 at 454:25-455:14.[40] The PW Audit, however – which was not even undertaken until after Ovitz's termination – never saw the light of day. A1077 at 3021:8-20; A1103 at 5610:7-5613:21; A1107-08 at 5885:5-5887:2; A1122 at 7258:10-7260:16; A1125 at 7584:23-7585:16; A1130 at 7774:15-7775:7; A1136 at 7909:13-7910:15. It was never sent to the Board, and following the filing of this lawsuit, Disney ordered PW not to finalize the audit. A637-39. Defendants even sought to initially avoid its production on a subsequently abandoned claim of work product privilege. A1156-57.

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[39] For instance, Professor Donohue opined that a lack of honesty could be considered grossly negligent or malfeasant behavior. A857-63; A1028 at 260:5-262:3; A1029-30 at 287:24-288:11. Professor Donohue also testified extensively as to numerous specific instances of Ovitz's dishonesty that, if considered by the Board, would have provided justification for a for-cause dismissal under California law. A1031-32 at 328:1-332:21; A1032-34 at 333:3-340:9; A1034 at 341:3-342:8; A1034-35 at 343:17-385:8. The trial court incorrectly required plaintiffs to prove that Ovitz told "material falsehoods" while at Disney in order to demonstrate that Ovitz could have been fired for cause. Op. at 50-51. Professor Donohue opined that Ovitz could be terminated for less.

[40] The trial court credited Eisner's trial testimony that he did not know about PW's retention without reference to his conflicting deposition testimony cited above. Op. at 92 n.356. This was symptomatic of the trial court's chronic refusal to discount defense witnesses' testimony despite open-court impeachment through the proffer of prior inconsistent deposition testimony.

PW's mandate in performing its audit was clear. The PW Audit plainly states that it was intended to assess whether Ovitz's expenses and gift-giving during the terms of his employment at Disney "were in compliance with Company policy and contractual terms of the [OEA]." A71-187.[41] The PW Audit notes that Ovitz was responsible for $4.8 million of expenditures during his brief 14-month tenure. A84. Of that amount, the PW Audit notes that only approximately $690,000 actually complied with spending guidelines Disney supplied PW. *Id.* Among other things, PW observed that Ovitz appeared to have violated Disney's gift-giving limits on over 100 occasions. A103-12. On approximately 100 occasions, according to PW, Ovitz charged Disney for items having no identifiable business purpose. *Id.* For example, the PW Audit shows that Ovitz traveled on Disney's corporate jet *after* he left the Company (A88) in December 1996, and he lavished gifts and meals at Disney's expense on his personal business associates and friends (A87-92; A103-13) – going so far as to send a gift of a *firearm* to a former client. A103. It is beyond dispute that many executives have suffered censure, dismissal and even criminal penalties for such infractions. *See, e.g.*, A832-40.[42] Accordingly, the PW Audit was an important part of plaintiffs' case. Plaintiffs' expert, Professor Donohue, cited the PW Audit at length in his report and during the trial. *See generally* A813-82; A1045-54 at 386:1-420:7. Plaintiffs questioned numerous defendants about the PW Audit at their depositions and during trial. *See, e.g.*, A981-85 at 454:25-468:21; A970-71 at 276:21-279:5; A1069-70 at 2880:13-2883:12; A1086-87 at 3942:15-3944:22.

At the conclusion of the trial, the trial court announced that it wanted the parties to simultaneously exchange written challenges to record evidence and would thereafter be prepared to issue a ruling in a matter of hours. A1144-49 at 9339:1-

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[41] The trial court relied on Litvack's trial testimony that Disney withheld $1 million because, like other executives who left the Company, Ovitz was merely delinquent in submitting documentation for his expenses. Op. at 57. The scope and substance of the PW Audit bely that assertion, as does the fact that no such audit was conducted on either Litvack or Bollenbach. A1111 at 6242:5-6243:9.

[42] *See, e.g.*, Ann Zimmerman and Kris Hudson, *Wal-Mart Sues Ex-Vice Chairman - Complaint Accuses Conghlin of Fraud, Seeks to Recoup Bonuses and Expenses*, Wall St. J., July 28, 2005 (Vice Chairman forced to resign and sued due to "bogus" expenses, unauthorized use of company gift cards and spending company money on personal items); Albert Salvato, *Ohio Governor Fined Over Unreported Gifts*, N.Y. Times, Aug. 19, 2005 (Governor of Ohio fined by a court for failing to report less than $6,000 in gifts).

9358:19. Within four hours after the parties filed their evidentiary submissions, the trial court issued a four-page letter ruling dealing with hundreds of evidentiary issues. *In re Walt Disney Co. Derivative Litig.*, 2005 Del. Ch. LEXIS 28. In that letter ruling, despite plaintiffs' contrary substantive arguments, the trial court held, without explanation or analysis, that the PW Audit constituted "hearsay." *Id.* at *3. The trial court's conclusory ruling on this important piece of evidence was legally erroneous and by itself merits reversal.

The trial court did not take into consideration that, in the absence of a jury, hearsay objections can be handled less rigorously. In fact, the trial court, inconsistently, did not exclude several other documents relating to the PW Audit as hearsay. *See, e.g.*, A637-39; A640. Moreover, the trial court did not exclude several other expense and report-related documents in the record. Op. at 55-56 n.207; *see, e.g.*, A539-632. As an "audit," the PW Audit was a business record (record of regularly conducted activity) and thus is expressly excepted from the hearsay rule. *See* D.R.E. 803(6). As Disney retained PW at Eisner's request, the PW Audit is admissible as a statement by an agent offered against a principal concerning a matter within the scope of the agency. D.R.E. 801(d)(2)(D). In the alternative, even if it is hearsay, the PW Audit is still admissible under certain hearsay exceptions. Under D.R.E. 803(15), the report is admissible as a statement affecting an interest in property. A981-82 at 455:16-456:4 (i.e., the portion of the $1 million holdback retained or released to Ovitz pending the results of the investigation into his expenses). For the reasons discussed above, the PW Audit is also admissible under the residual exception of the hearsay rule, D.R.E. 807. Pursuant to duly issued subpoenas, plaintiffs deposed the two key PW witnesses, none of whom contested the accuracy of PW's findings. These witnesses thus validated both the authenticity and foundation for their report. Notably PW, a Big Four giant of the profession, had served as Disney's only outside auditor during its entire history as a publicly-listed company. A1114 at 6872:11-6873:18. At a minimum, the fact and existence of the PW Audit and related post-termination investigation were relevant to the Board's abdication of its duty of due care irrespective of the report's contents.

Compounding this legal error, as discussed in the Statement of Facts, the trial court reached its "no cause" ruling by repeatedly crediting Eisner's self-serving trial testimony to explain away the plain meaning of his written, contemporaneous negative observations about Ovitz's veracity. *See infra* at Statement of Facts Section J. For example, uncritically keying on Eisner's (Op. at 50 n.188) and Litvack's (*id.* at n.189) trial testimony, the trial court concluded that Ovitz was not a habitual liar but was engaged in something called "agenting." *Id.* at 50. While Eisner

repeatedly observed in his writings that Ovitz was "not truthful" (A191-95; A196-202), a "psychopath" (A204), "erratic" (A191-95), "pathological" (*id.*), "devious" (*id.*) and "doesn't know right from wrong" (A204), the word "agenting" never appeared.[43] Moreover, the trial court failed to consider those portions of his contemporary written statements in which Eisner specifically stated that there were numerous examples of Ovitz's untruthfulness. *See, e.g.*, A190 ("he [Iger] finally admitted he did not trust Michael [Ovitz] and gave me many examples."); A191 ("You Irwin and Sid Bass know this already and have many examples . . ."); A199 ("He [Litvack] gave me example after example, of your not telling the truth, of 'handling' him and others, of the continuing problem."). The trial court also failed to consider that there were specific examples of material falsehoods in the record. *See, e.g.*, A202 (Eisner writing that Ovitz lied to him about his negotiations with Sony); A1088 at 4607:7-14 (Eisner testifying that Ovitz lied about hiring a PR agent to "advertise and exaggerate" the circumstances under which he left Disney and money he received for leaving the Company.); A1013-14 at 44:17-46:11 (Bass testifying that Ovitz lied about owning an airplane that the CAA partnership owned when trying to get Disney to purchase it); A1015 at 76:17-77:25 (Bass testifying that Ovitz wanted to lie about the possibility of Disney owning an NFL franchise). *Compare* A696 (Ovitz obscuring and concealing his lucrative earn-out agreement in signed ethics form given to Disney), *with* A694 *and* A697.

In at least two instances, the trial court found that Eisner had actually lied to shareholders and the investing public at large: by issuing a false press release announcing that Ovitz would continue to serve as a consultant to Disney after his departure (Op. at 84), and by making false statements about Ovitz's standing at Disney during a joint national television appearance on the "Larry King Live" television show. *Id.* at 64. Given these observations, the trial court cannot explain why it chose to uncritically accept Eisner's testimonial, latter-day characterizations of incriminating written evidence or why it held Eisner's apparent failure to recall specific instances of Ovitz's lying to constitute proof that Ovitz did not do so. *See id.* at 50. Clearly, the "public" Eisner is prone to misstate or mischaracterize, as the trial court has acknowledged.

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[43] The trial court never took into consideration the possibility that a corporate second-in- command who repeatedly "agents" – whatever the term means – could reasonably be deemed grossly negligent or malfeasant.

In stark contrast, the trial court completely debunked the deposition testimony of Sid Bass (*id.* at 35-36 n.120, *id.* at 50-51 n.189), who unambiguously testified that Ovitz had a veracity problem and that Eisner had decided to fire Ovitz before Disney and Ovitz executed the OEA in December 1995, but did not do so because of concern that Ovitz would "commit suicide." A1016-17 at 88:13-90:16; A1017 at 92:18-93:7. Unlike Ovitz, Eisner or the other defendants, Bass had no interest in the outcome of this lawsuit. Bass is still one of Eisner's friends (A1018 at 116:21-117:10; A1022 at 180:6-12) and as Ovitz testified, was "like a brother" to Eisner in 1995-1996. A995 at 514:10-13. He was also Disney's largest shareholder and was even included by Eisner on written communications that he sent selectively to such directors as Russell or Watson. A1021 at 176:4-13 (testifying that he received A196-202); A986 at 605:22-606:7 (same); A188-90 ("[T]his is a note I write to Sid Bass. . . ."). Although the trial court claims that Bass may have been mistaken as to the timing of certain of Eisner's statements (Op. at 35-36 n.120), it failed to note that all defendants' counsel attended Mr. Bass's deposition and chose not to ask him any questions about the suicide testimony or any other aspect of his recollections. A1019-24 at 167:1-188:4.

The trial court's decision to discredit Bass because he did not appear at trial (Op. at 35-36) cannot be sustained. Bass could not have been compelled to attend the trial. The trial court, in accord with Chancery Court practice, subject to evidentiary rulings, admitted all deposition testimony into the record.

Failing to credit testimony of a third-party compelled to appear for deposition by subpoena, but incapable of being compelled to appear at trial, is arbitrary. Without explanation, in contrast, the trial court fully credited the deposition testimony of other third-party witnesses, under defendants' actual or practical control, who did not appear for trial. *See* Op. at 42 n.146 (crediting the deposition testimony of Robert Iger); *id.* at 44 n.155; *id.* at 47 n.179; *id.* at 51 (crediting the deposition testimony of Joe Roth); *id.* at 26 n.75; *id.* at 27 n.76; *id.* at 30 n.94; *id.* at 103 n.396 (crediting the deposition testimony of Joseph Santaniello); *id.* at 30 n.94 (crediting the deposition testimony of Mitchell Schultz).

Similar to its decision to draw negative inferences against plaintiffs from defendants' memory lapses as described above, the trial court also failed to draw any inference against defendants for their production lapses in contravention of proper procedure, much less did it exact any penalty. For instance, the trial court prejudicially refused to delay commencement of the trial after Disney unconscionably produced Ovitz's "work files" on the eve of trial. *See* A1151-53. Plaintiffs were prejudiced because they were not offered the opportunity to use these documents at the depositions of the prime witnesses, including Ovitz himself.

Additionally, trial court's findings which were unfavorable to plaintiffs relied on these documents.[44] The trial court committed legal error in failing to take account of these circumstances when using or relying on these materials – particularly when making findings adverse to plaintiffs. *See generally Klonoski v. Mahlab*, 156 F.3d 255 (1st Cir. 1998).

In its Opinion, the trial court said nothing about the prejudicial destruction of evidence. It was not disputed that Disney, after the commencement of this suit, deleted its electronic hard drives containing e-mails. A958-60 at 46:19-55:14. Watson's laptop computer hard-drive purportedly containing financial data regarding the OEA was also "lost." A1134-35 at 7902:17-7908:3. Ovitz also claims to have "lost" his meticulously kept Day-Timer (A1063 at 1417:6-18) which would have corroborated his alleged work output and expenses incurred at Disney. A991-92 at 200:2-202:17.

Disney lost seemingly very important letters that Eisner and Ovitz exchanged in mid-1996 (A1171-74) that were referenced in a document Eisner later wrote that was highly critical of Ovitz. A196-202. Just days before the trial ended, however, an article written by Pulitzer-Prize winning author James B. Stewart quoted the letters which showed that Ovitz was not performing as Disney's President and may even have indicated his willingness to leave the Company voluntarily long before December 1996. A1159-70. The trial court's Opinion never mentions Disney's failure to produce these documents or their content as referenced in the *New Yorker*. Although this matter was brought to the trial court's attention, it took no umbrage and disregarded any of the implications in making its decision.

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[44] PTE 545 (Op. at 39 n.133); PTE 558 at WD08652 (Op. at 151 n.533); PTE 563 at WD08721 (Op. at 159 n.563); PTE 587 at WD10767, 10772 (Op. at 151-52 n.533); PTE 606 (Op. at 46 n.175); PTE 621 (Op. at 41 n.138); PTE 622 (Op. at 39 n.133; Op. at 46 n.175); PTE 626 (Op. at 46 n.174); PTE 629 (Op. at 46 n.175); PTE 631 (Op. at 41 n.138); PTE 638 (Op. at 46 n.170); PTE 654 (Op. at 40 n.135); PTE 742 (Op. at 39 n.133); PTE 744 at WD09336-37 (Op. at 45 n.162); PTE 747 (Op. at 45 n.167); PTE 749 (Op. at 45 n.167); PTE 755 (Op. at 43 n.149); PTE 768 (Op. at 46 n.175); PTE 778 at MDE 000053 (Op. at 13 n.21); PTE 780 at WD13842 (Op. at 46 n.174); DTE 188 (Op. at 40 n.137); DTE 189 (Op. at 41 n.138); DTE 190 (Op. at 39 n.133; Op. at 46 n.175); DTE 191 (Op. at 41 n.138); DTE 192 (Op. at 39 n.133); DTE 193 (Op. at 39 n.133); DTE 194 (Op. at 42 n.145); DTE 207 (Op. at 46 n.170); DTE 224 (Op. at 39 n.133).

In sum, the trial court uncritically credited contrary trial testimony over unambiguous written documents from the relevant time. The trial court also accepted, at face value, the testimony of defendants whose credibility was at least dubious, even in instances when the trial testimony was impeached by prior deposition testimony, or documents written by them. The trial court also failed to draw negative inferences against defendants in instances where they destroyed, lost, or misplaced key evidence. Instead, the trial court drew negative inferences against plaintiffs for the absence of positives – such as candid memories of Ovitz's lies, which no defendant had any interest in recollecting. These cumulative errors, which appear throughout the Opinion, merit complete reversal.

III. THE TRIAL COURT COMMITTED LEGAL ERROR IN FINDING THAT OVITZ DID NOT VIOLATE HIS FIDUCIARY DUTIES OF CARE AND LOYALTY

A. Scope Of Review

This Court reviews summary judgment decisions *de novo*. *See Texlon Corp. v. Meyerson*, 802 A.2d 257, 262 (Del. 2002); *see also* Section I.A.

B. Merits Of Argument

1. The Trial Court Committed Legal Error In Partially Granting Ovitz's Summary Judgment Motion

In its pre-trial summary judgment decision, the trial court dismissed plaintiffs' claims against Ovitz in connection with the OEA and denied the motion as to his termination and plaintiffs' waste claims. *Disney III*, 2004 Del. Ch. LEXIS 132, at *3. Plaintiffs contended that Ovitz assumed fiduciary duties before he was elected to office on September 26, 1995. *See Blish v. Thompson Automatic Arms Corp.*, 64 A.2d 581, 594 (Del. 1948). However, as the trial court found *at trial*, in the summer of 1995, Ovitz was conducting Disney business and reviewing confidential company information. Op. at 39-41. Under these circumstances, plaintiffs contend that Ovitz was at least a *de facto* fiduciary. The post-summary judgment, eve-of-trial production of Ovitz's "work files" bolsters these conclusions.[45] As early as July, Ovitz received highly confidential internal Disney documents (*see, e.g.*, A245-310 (7/30/95); A356 (9/5/95); A410-13 (9/12/95); A323-55 (8/21/95); A386-94 (9/8/95); A395-409 (9/14/95); A358-82 (9/7/95), penned memoranda on Disney letterhead (A357; A385), initiated a $2 million renovation of his palatial Disney office (PTE 476, DTE 110) and met with high level outside executives, including NFL Commissioner, Paul Tagliabue (A311-22; A357; A385) on the Company's behalf.

The trial court nevertheless devised a "bright-line" rule with respect to when Ovitz acquired fiduciary status, holding that Ovitz became a fiduciary upon his "official" October 1st, 1995 start date, so as to avoid "uncertainty." *Disney III*, 2004 Del. Ch. LEXIS 132, at *18. Delaware law, however, recognizes the concept of "apparent authority" in connection with corporate conduct. *See Italo-Petroleum Corp. of Am. v. Hannigan*, 14 A.2d 401 (Del. 1940). Ovitz's substantial contacts with third parties and his receipt of confidential Disney information before

[45] Defendants' failure to produce these documents before Ovitz filed his motion, much less before Ovitz was deposed, and the trial court's refusal to allow plaintiffs a reasonable opportunity to take discovery on these materials constitutes highly prejudicial error.

October 1st show that Eisner and Disney had already vested him with at least apparent authority prior to his formal investiture in office. Accordingly, no "uncertainty" was possible. Eisner and his senior officers, media insiders and even the investing public at large saw that Ovitz was acting as Disney's President as soon as his hiring was announced with great fanfare on August 12th.

Even if Ovitz did not assume fiduciary duties until October 1st, he still can be held liable for the NFT provisions in the OEA. Contrary to the trial court's decision, the OEA was not final on October 1st. No binding contractual obligation arose until Ovitz and Disney signed the OEA in December 1995. A469-70. In all events, the trial court ignored the fact that substantial negotiations and substantive redrafting continued between the parties after October 1st, including a major rewrite of Section 10 of the OEA in December 1995. A496-98; A499-506. At a minimum, there are genuine issues of fact on all these intertwined issues that precluded the trial court's grant of partial summary judgment regarding Ovitz's liability with respect to the formation and negotiation of the OEA.

2. The Trial Court Committed Legal Error In Concluding That Ovitz Did Not Violate His Fiduciary Duties In Connection With His Departure

The trial court found that Ovitz did not violate his fiduciary duty of loyalty because he "played no part" in the termination decision and was unilaterally fired. *See* Op. at 129. This finding was erroneous because the trial court ignored contemporaneous evidence showing that Ovitz was not "fired," but rather acted to "settle out his contract." A678. The trial court uncritically credited Ovitz's testimony that, victimized, he departed from Disney against his will and thus did not negotiate his exit. The evidence shows, however, that Ovitz executed all the pressure that was needed (if any) to assure that his good friend Eisner gave him his full NFT payout when leaving. When Eisner asked Litvack to communicate Eisner's desire for Ovitz to leave the Company, Ovitz, understanding that he would lose everything if he simply resigned, "wouldn't accept being fired." A987 at 610:22-25. After the breakdown of the Sony negotiations, Ovitz wrote a note to Eisner emphasizing that he was committed to succeed at Disney, which Eisner noted "sounds like a legal letter to me." A660; *see also* A700-15 (MTO privilege log indicating Ovitz's communications with his lawyers starting in October 1996, the time of the Sony negotiations). Eisner's notes of a discussion he had with Wilson over Thanksgiving using the phrases "must be magnanimous" and "dangerous enemy" are not indicative of an executive expecting to stay at the Company or passively accepting his being "fired." A676-77. The numerous letters Disney's and Ovitz's attorneys exchanged carefully documenting the terms of Ovitz's departure, as well as notes of

conversation discussing his departure, evidence that Ovitz was not fired. A678-79; A680; A681-84; A698; A699. He was very much an integral participant in bringing about the end result.

In its motion to dismiss opinion, the trial court held that Ovitz had an affirmative duty to take steps to convene a meeting of the Board to discuss his departure. *Disney II*, 825 A.2d at 290-91. The trial court ignored its own ruling, on this issue of law and the law of the case (*Cede*, 875 A.2d at 611), stating that Ovitz need not have convened a meeting and, indeed, *ought not* to have done so. Op. at 130. As he testified, however, Ovitz "forgot to make [the] suggestion" (A1065 at 2078:12-22) to call a board meeting in compliance with his fiduciary duties, and in the process, breached them.[46]

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[46] The trial court erroneously denied plaintiffs' alternative claims for waste. In *Brehm*, this Court dismissed plaintiffs' waste claim finding that the complaint failed to adequately allege that "no reasonable business person would have made *the decision that the New Board made under the circumstances*." 746 A.2d at 266 (emphasis added). Because, as discussed above, Disney could reasonably have terminated Ovitz for cause, defendants can be held liable for payment of what amounted to a gift of corporate assets to Ovitz from his close friend Eisner. At the front end, Disney was caused to enter into an employment agreement which, through its NFT exposure, disincentivized Ovitz to remain. *See Beard*, 160 A.2d at 737 ("[a]ll stock option plans must be tested against the requirement that they contain conditions, or that surrounding circumstances are such, that the corporation may reasonably expect to receive the contemplated benefit from the grant of the options"); *accord Kerbs*, 90 A.2d at 656. Consistent with these principles, plaintiffs submitted credible expert testimony that the NFT provisions incentivized Ovitz to depart Disney prematurely and to seek a full NFT payout as part and parcel thereof. A907.

CONCLUSION

For all the foregoing reasons, plaintiffs respectfully request this Court to reverse the Court of Chancery's judgment against plaintiffs in full.

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