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

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Plaintiffs respectfully submit this Reply Brief in further support of their appeal.

ARGUMENT

I. THE TRIAL COURT COMMITTED LEGAL ERROR IN CONCLUDING THAT THE BOARD DID NOT HAVE A DUTY TO APPROVE OVITZ'S FULL NFT PAYOUT

A. Ovitz's NFT Payout Was Material And Required The Board's Approval As A Matter Of Law

The law of this case is that the approval of the OEA and the decision to grant Ovitz a full NFT payout were "material" and required the Board's approval. *See, e.g., Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000). The clear language in *Brehm* negates defendants' argument that this Court's holding on the materiality issue was merely dictum. Non-Ovitz Appellees' Answering Brief ("DB") at 50-52. Indeed, the trial court previously understood *Brehm* to have established the law of the case on materiality. *See In re Walt Disney Co. Derivative Litig.*, 2004 Del. Ch. LEXIS 132, at *35 n.64 ("*Disney IV*") (NFT payout was "material"); *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 278 (Del. Ch. 2003) ("*Disney II*") (approving the OEA with an NFT payout possibility was "material"). Defendants cannot credibly rely on *Zirn v. VLI Corp.*, 681 A.2d 1050 (Del. 1996) ("*Zirn II*"), to justify the trial court's decision to abandon the law of the case. DB at 50. In *Zirn II*, this Court turned aside its prior ruling that certain disclosure claims fell outside the protection of 8 *Del. C.* § 102(b)(7). The Court ruled that the law of the case doctrine was not applicable due to intervening changes in the law and because the Court's prior decision was rendered before a sufficient factual record existed to assess whether the alleged misstatements were made in good faith. *Id.* at 1062 n.7.

In this case, by contrast, there has been no subsequent development in the law. Unlike the situation in *Zirn II*, the factual record developed at trial did not introduce any new evidence that could possibly detract from the conclusion that the NFT payout was material to Disney. *See* Appellants' Opening Brief ("PB") at 32-33. The financial consequences of an NFT payout were demonstrated in a way which precisely mirrored plaintiffs' pleadings as analyzed in the prior decisions in this case. Am. Compl. ¶¶ 54-56, 59-67; *see, e.g., Brehm*, 746 A.2d at 250, 252-53; *Disney II*, 825 A.2d at 282-83. In *Brehm*, this Court understood that an NFT payout was not nearly as large as the funds Disney could lose on film projects (746 A.2d at 260 n.49) and that Disney -- one of the most well-known entertainment conglomerates in the world -- was a "large public company" with

a large market capitalization. *Id.* In fact, the trial record is replete with instances in which the Board acted to approve financial commitments substantially less than the NFT payout.[1]

1. Consideration And Approval Of The OEA And The NFT Payout Could Not Be Delegated To A Committee Or Usurped By The CEO

Because the successive decisions to approve the OEA and give Ovitz a full NFT were material to Disney, the Board was obligated to act and to exercise due care. *See generally* 8 *Del. C.* § 141(a); *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1291 (Del. 1998) ("*Quickturn*"). The duty to supervise the business of the corporation included the decisions to hire a new President -- the second-in-command and potential successor to Eisner -- with a compensation package worth more than any other non-CEO president to that point in time, and then grant him a full NFT payout worth approximately $130 million and end his employment. *See Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1284 (Del. 1989) (finding a breach of the duty of care where the board abandoned its oversight functions). These decisions were so vital to the Company that they could not be delegated to either a committee or to Eisner acting exclusively in his capacity as CEO. As recently stated by former Chief Justice E. Norman Veasey: "Statutory law provides that the corporation shall be managed by or under the direction of the board of directors. That means the directors are in charge! They are not merely advisors to the CEO. They are the people who hire and fire the CEO." E. Norman Veasey, *Speech: Corporate Governance and Ethics in the Post-Enron Worldcom Environment*, 38 Wake Forest L. Rev. 839, 842 (2003); *see also Carmody v. Toll Bros., Inc.*, 723 A.2d 1180, 1992 (Del. Ch. 1998); *Quickturn*, 721 A.2d at 1291-92.

Defendants claim that the Board did not need to meet and approve Ovitz's termination or the NFT payout because the Board had purportedly delegated to the Compensation Committee *ex ante* the responsibility of approving Ovitz's contractual termination rights in 1995. DB at 52-53. Defendants' argument misconstrues the law. Due to their materiality, these decisions were not delegable

[1] The fact that the Board "considered" and "approved" a $250,000 payment to Russell for his work *in hiring Ovitz* (A717-18) cannot be squared with the trial court's holding that the NFT payout itself -- a term Russell negotiated -- was immaterial as a matter of law. The Compensation Committee also approved hundreds of option grants worth hundreds of thousands of dollars to numerous Disney officers at the same meeting it purportedly discussed the OEA. A731-52.

by the Board and, in fact, were never delegated to Eisner or Litvack in their roles as officers, or *ex ante* to the Compensation Committee.

B. Disney's Stock Option Plan Expressly Vested The Compensation Committee With The Responsibility To Determine The Terms Of Ovitz's Termination

The 1990 Amended Stock Option Plan (the "Plan") made *mandatory* the Compensation Committee's concurrent approval of Ovitz's NFT in light of the fact that the NFT payout consisted mostly of vested stock options.[2] The Plan was subject to and received full Board and shareholder approval. *See* A797. Bypassing the Compensation Committee in connection with Ovitz's termination thus violated the plain, binding terms of the Plan.

In contradiction of the plain terms of the Plan, defendants argue, relying exclusively on the trial testimony of Litvack, that the OEA superseded the Plan. DB at 48-49. It defies logic that the Plan, which was approved by the Compensation Committee, the Board, and Disney's shareholders, could be overridden by a term in an employment agreement.[3] Additionally, the OEA expressly states that it is subject to the Plan. A456. Indeed, there is no reference to any such intent in the: (1) Compensation Committee minutes (A753-78); (2) the memorandum to the Board soliciting its written consent to approve the Plan amendments (A473-93); or (3) the proxy statement soliciting the shareholders' approval of the modification. A790-95.

The OEA incorporated the Plan by reference except as "*expressly* provided" in the OEA. *Id.* at § 5(e) (emphasis added). While the OEA sets the standards for

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[2] *See, e.g.*, A770 ("[T]he Committee shall have the *sole power* to make all determinations regarding the termination of any participant's employment, including, but not limited to, . . . the cause(s) therefore and the consequences thereof.") (emphasis added); *see also* A769 ("in the event of termination of employment or discharge of a participant for cause, as determined by the Committee in its *sole discretion*") (emphasis added).

[3] The trial court credited Litvack's testimony on this topic despite finding it was "certainly questionable." Op. at 170. Illustrative of many similar errors, the trial court flatly ignored Litvack's equivocal and evasive deposition testimony on this topic. AR 238-39 at 480:13-483:8 (Litvack deposition testimony). Santaniello, the Disney attorney with whom Litvack claimed to have discussed whether the OEA superseded the Plan (Op. at 170-71), offered no corroborating testimony at his deposition. Defendants did not call Santaniello to testify at trial.

the determination as to whether or not Ovitz could be terminated for cause, no provision in the OEA purports to "expressly" override the unequivocal language in the Plan. The OEA confers on the "Company" the power to effectuate an NFT and does not contain specific language shifting the locus of decision-making authority on that aspect of the decision from the Compensation Committee to anyone else. Indeed, as discussed below, defendants previously conceded to this Court that "the terms of the employment agreement gave *the Board alone* the power to determine whether a Non-Fault Termination had taken place and, accordingly, if the options would be exerciseable." DB at 27 (emphasis added).

C. Disney's Bylaws And Charter Did Not Excuse The Board From Acting On The NFT Payout

As discussed in Appellants' Opening Brief at Section II(B)(1), Disney's charter and bylaws granted to the Board the sole authority to hire *and* terminate the President. Unable to refute the clear language of the charter and bylaws, defendants resort to the argument that the Board and Eisner had "concurrent" power of removal -- arguing that the operative bylaws did not require the Board to terminate Ovitz, but merely gave the Board the "non-exclusive" power to terminate him and that Eisner had sufficient parallel power to terminate Ovitz. DB at 47-48. Defendants base this supposition on provisions of the bylaws giving Eisner, as CEO and Chairman, general authority to "supervise" Disney's officers, and which stated that the President "reports" to the Chairman. *Id.*[4]

These general and non-specific provisions did not, and could not, trump the specific provisions cited in plaintiffs' Opening Brief, that the President held his office for such term as determined *solely* by the Board, and that the Board had the authority to remove any officer with or without cause. *See* PB at 34-35. Ignored by defendants is that by saying that "terms" are set "solely" by the Board, the charter and bylaws exclude the possibility of removal by the CEO. If the CEO has the power to unilaterally fire the President, as defendants erroneously argue, then the CEO has the power to set the terms of office -- an express violation of the charter and bylaws.

In addition, defendants argue that the Board, not Eisner exclusively, hired Ovitz. Defendants cannot have it both ways. If, as defendants purport, Ovitz was hired by the Board, then only the Board could terminate his employment. *See* 2 William Meade Fletcher et al., *Fletcher Cyclopedia of the Law of Private*

[4] Even if this argument was persuasive, defendants fail to explain why the Board failed to even consider exercising its own purported "concurrent" authority or at least question why it was appropriate for Eisner to have acted unilaterally.

Corporations § 466.10, 467 (rev. ed. 1998) (where an "officer is hired by the board of directors, only the board of directors has the authority to terminate the particular . . . officer"); Rodman Ward, Jr. et al., *Folk on the Delaware General Corporation Law* § 142.4 (4th ed. 2004). Defendants' reliance on Disney's "custom and practice" of not seeking Compensation Committee intervention (DB at 48, 53) makes a mockery of corporate governance documents approved by Disney's shareholders and/or the collective Board.

In fact, defendants previously admitted that it was ultimately the Board's responsibility to consider and determine Ovitz's termination under the OEA. In their briefing to this Court in *Brehm*, defendants stated that, "*[t]he Board* controlled whether Ovitz received a Non-Fault Termination, which is the only relevant fact." DB at 9 (emphasis added). Defendants acknowledged that the "option to pursue [the termination of Ovitz with or without cause, sue for breach of contract, or allow him to continue serving as Disney's President] was *solely within the province of the Board's business judgment. Id.* at 32 (emphasis added). Defendants also told this Court that "[t]here is no way, short of Mr. Ovitz's death, that Mr. Ovitz could part with all of the termination benefits *unless the board of directors of Disney acted affirmatively. There has to be an affirmative action by the board of directors* to enable Mr. Ovitz to depart with all of the benefits." Del. Sup. Ct. Oral Arg. at 24 (emphasis added).

II. THE TRIAL COURT ERRED AS A MATTER OF LAW BY APPLYING THE BUSINESS JUDGMENT RULE TO EISNER, LITVACK AND RUSSELL

A. The Business Judgment Rule Does Not Extend To Officers Or Gratuitous Agents

The trial court found that Eisner and Litvack acted as *officers* in effectuating Ovitz's departure from the Company. *See* PB at 36. Russell, although not an officer, assumed the responsibility of a "gratuitous agent" acting on Disney's behalf in negotiating Ovitz's departure. As such, the trial court should not have allowed Eisner, Litvack and Russell to invoke the business judgment rule.

Defendants do not challenge the fact that Eisner and Litvack were acting in their capacity as officers in effectuating Ovitz's departure. Instead, they argue that the business judgment rule should be extended to cover the actions of officers. DB at 54-56.[5] Both sides agree that this is an issue of first impression. DB at 54-55.

Defendants argue that an extension of the business judgment rule is justified because officers should be encouraged to take risks. DB at 55. However, the policy rationale for risk-taking deference as applied to directors is based on the

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[5] Supr. Ct. R. 8 does not bar plaintiffs' argument because the issue only arose *after* the trial court ruled that the Board did not have to act and applied the business judgment rule to Eisner, Litvack and Russell in their capacity as officers. Contrary to defendants' claim (DB at 54), on pp. 7, 8, 15, 16 and 22 of the Pre-Trial Stipulation and Order, and ¶¶ 3, 16, 19, 20, 26, 46 and 106(B) of the Second Amended Complaint, plaintiffs identified Eisner and Litvack as officers and Russell as Eisner's representative. Even assuming, *arguendo*, that the issue was not presented to the trial court, the interests of justice require review, because otherwise, this important and potentially dispositive issue would evade review. *See* Supr. Ct. R. 8; *Candlewood Timber Group, LLC v. Pan Am. Energy, LLC*, 859 A.2d 989, 1004 (Del. 2004), *cert. denied*, 125 S. Ct. 1314 (2005). Defendants further argue that 10 *Del. C.* § 3114 prevented the Court of Chancery from exercising jurisdiction over Eisner and Litvack in their capacity as officers. Plaintiffs obtained jurisdiction over all individual defendants in their capacity as directors, but no defendant thereafter entered a limited appearance, and Eisner and Litvack repeatedly relied on their officer status to defend the legitimacy of their conduct, as well as justify the remaining defendants' conduct. Thus, *in personam* jurisdiction exists over all defendants regardless of their corporate title.

assumption that directors have relatively small stockholdings and lack incentive compensation which gives them little of the "upside" gains on investment projects. A similar concern motivated the enactment of 8 *Del. C.* § 102(b)(7).[6]

Courts can and should more closely scrutinize officer conduct due to the agency relationship officers have with the corporations they serve. Directors are vested with specific *oversight* duties. An officer does not have this broad oversight duty; rather officers' responsibilities are *task-oriented* and they act under the aegis of the board. Officers are compensated for performing specific functions. Directors, but not officers, are elected and can be removed by stockholders; officers are appointed and can be removed only by, or under a grant of authority from the board. Indeed, neither the board as a body, nor individual directors, are agents of either the stockholders or of the corporation. Officers are agents of the corporation.[7] Officers work for the company full-time, should possess extensive knowledge and skill concerning corporate affairs and have access to considerably more and better information than do directors. Officers oversee day-to-day operations. The culmination of these factors and the differences in incentives between directors and officers all weigh heavily in favor of denying the extension of the business judgment rule to officers.[8]

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[6] 8 *Del. C.* § 102(b)(7) is limited to directors and does not apply to Eisner or Litvack for their action taken as officers or, in Russell's case, as a gratuitous agent. *See* PB at 37.

[7] Revised Model Business Corporation Act § 8.42, Official Comment ("Consistent with the principles of agency, which generally govern the conduct of corporate employees, an officer is expected . . .").

[8] Defendants wrongfully argue that Russell was not a gratuitous agent of the Company and had "express" authority to effectuate Ovitz's departure from the Company. DB at 53-54 n.44. To support their supposition, defendants rely on the trial court's recitation of a note from Eisner to Russell which stated that, "I met with Michael Ovitz today who wants to bring our discussions to a conclusion this week, wants you and Bob Goldman to settle out his contract immediately and sign it by week[']s end." Op. at 78; DB at 53-54 n.44. Eisner's note cannot possibly substitute for an actual express delegation from the Board, and in fact, demonstrates that Russell was acting as the personal agent of Eisner.

B. Eisner, Litvack And Russell's Conduct Must Be Measured Against Concepts Of Ordinary Negligence

Defendants argue that the rules governing an officer's liability for breach of a fiduciary duty are the same as those for directors. DB at 56 n.49. Defendants misstate the law. Because Eisner, Litvack and Russell are not entitled to the protections of the business judgment rule as officers and agents of the Company, they cannot qualify for the heightened gross negligence standard set forth in *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985).[9]

If this Court were to conclude that a negligence standard applied to Eisner, Litvack and Russell's conduct in arranging for Ovitz's receipt of a full NFT payout, the record and findings below would emphatically dictate a determination of personal liability. Numerous findings by the trial court support finding that they each acted negligently:

1. Eisner

The trial court found that Eisner was a "Machiavellian" and "imperial" CEO (Op. at 135), who "enthroned himself as the omnipotent and infallible monarch of his personal Magic Kingdom." *Id.* at 140. Eisner alone was found to be "responsible for the failings in process that infected and handicapped the board's decisionmaking abilities." *Id.* at 135. He was "the most culpable of all the defendants." *Id.* at 134. "He was pulling the strings; he knew what was going on." *Id.* The trial court found that "[h]is lapses were many. He failed to keep the board as informed as he should have. He stretched the outer boundaries of his authority as CEO by acting without specific board direction or involvement." *Id.* at 140.

The trial court also found that "Eisner never sat down at a full board meeting to discuss the persistent and growing Ovitz problem" (*id.* at 63), that he never shared the contents of highly critical writings regarding Ovitz's veracity and performance with members of the Board other than Russell and Watson (*id.* at 65, 67), that he never informed the whole Board that he had given Ovitz permission

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[9] Eisner, Litvack and Russell could have acted collegially with the Board instead of acting unilaterally. Had the Board actually met and in good faith discussed and approved Ovitz's termination and the NFT payout, Eisner, Litvack and Russell could theoretically have invoked the protection of the business judgment rule. Since they consciously and negligently acted without enlisting the Board, they forfeited any such protection. *See* Restatement 2d Agency § 379 and Official Comment (agents are liable for negligence).

to negotiate with Sony (*id.* at 62), and that he never shared with the entire Board either the December 12, 1996, (*id.* at 83) or December 27, 1996 letters ending Ovitz's employment with the Company. *Id.* at 92. As an officer and agent, Eisner had a duty to keep the Board informed and aid the directors in understanding the significance of any information provided. *See Macmillan*, 559 A.2d at 1282-83 (A fiduciary's duty of candor requires "[a]t a minimum," that fiduciaries "not use superior information or knowledge to mislead others in the performance of their own fiduciary obligations.").

Even assuming (as did the trial court), that Eisner had the authority as Disney's CEO to act unilaterally, his decision to grant Ovitz an NFT was, as the very least, negligent. Eisner wrote numerous detailed memos concerning Ovitz's lack of veracity, failure to follow directives and violations of Company expense and gift policies. *See* PB at 15-18. Moreover, Eisner maintained an "OM" file (*see* PB at 15) and engaged Litvack, Bollenbach and Russell to monitor Ovitz's actions. *Id.* The record shows that Eisner never shared all information with the full Board and carefully managed the information flow to individual directors as he saw fit. These facts show enough knowledge on the part of Eisner that he could not dispense with a thorough investigation or the advice of outside legal counsel.

2. Litvack

The trial court found that Litvack was not "an infallible source of legal knowledge." Op. at 170. Litvack "did not do any legal research in answering the cause question" (*id.* at 69), nor did he "order an outside opinion to be authored" to support his contention that there was no cause to terminate Ovitz. *Id.* In fact, the trial court found that Litvack "produced no written work product or notes . . . that would explain or defend his conclusion, and because he did not ask for an outside opinion to be authored, there was *no written work product at all*." *Id.* at 70 (emphasis added).

Litvack did not "order an outside investigation to be undertaken" to determine whether there was cause to terminate Ovitz. *Id.* at 69. He did not assemble all the information known by disparate parties into one file. Litvack assumed that he knew all relevant information without objectively verifying that to be the case. Moreover, despite the fact that Litvack was responsible for overseeing the PW Audit of Ovitz's expenses (A639; AR253 at 5157:7-23; Op. at 92), he never discussed the Audit with the Board or any committee thereof. A1077; A1103-04; A1107-08; A1122; A1125; A1130; A1136.

The trial court repeatedly questioned the soundness of Litvack's decision-making. The trial court found that Litvack's conclusion regarding the potential conflict between the OEA and the terms of the 1990 Plan was "certainly questionable." *Id.* at 170. Litvack never advised the Board that a meeting was unnecessary to terminate Ovitz (A1110 at 6150:21-6151:11) and admitted at his deposition that he never gave any thought to the issue at the time. AR238-39 at 480:13-483:8. The trial court found that Litvack's:

> [S]ilence at the December 10, 1996 EPPC meeting, when Russell informed the committee that Ovitz's bonus was contractually required, was *unquestionably curious*, and some might even call it *irresponsible. His excuse* that he did not want to embarrass Russell in front of the committee is, in a word, *pathetic.* Litvack *should have exercised better judgment* than to allow Russell to convince the committee that a $7.5 million bonus was contractually required.

Op. at 170 (emphasis added). Under these circumstances, the trial court's finding that Litvack must have done a full investigation because he was motivated to punish Ovitz by denying him a full NFT payout (Op. at 71) is inexplicable -- the trial court drew a favorable inference despite the total absence of any tangible evidence.

3. Russell

The trial court found that Russell held back Crystal's letters evaluating the terms of the OEA (*id.* at 21, 28) and the "Case Study" he authored, which noted that Ovitz's compensation would be greater than any other non-CEO Presidents and would raise strong criticism, from all board members other than Eisner. *Id.* at 18. The trial court also concluded that, like Eisner, Russell was privy to the fact that Ovitz had been give permission to negotiate with Sony (*id.* at 62), but did not share that information with the rest of the Board.

Moreover, Russell was engaged by Eisner to monitor Ovitz's expense-related issues (A206; A635; A636; *cf.* A1125 at 6926:13-17), and to monitor his gift-giving and gift-receiving. A208-09; A206-07; A636. Russell also received two Eisner-authored missives regarding Ovitz's lack of veracity and deficient performance which he failed to share with the Board. *Id.* at 65, 67. The content of these withheld letters, and the expense-related information Russell alone was privy to, demonstrate Russell's negligence in collaborating in Ovitz's termination without cause.

III. THE TRIAL COURT'S LEGAL CONCLUSION THAT OVITZ COULD NOT BE TERMINATED FOR "CAUSE" WAS ERRONEOUS

A. The Record Supports A Finding That A Rational Basis Existed To Terminate Ovitz For Cause And To Deny Him An NFT

There is ample support in the record for a rational basis to terminate Ovitz for cause. PB at 38-45. Defendants' arguments to the contrary make the same mistake as the trial court made -- they analyze Ovitz's performance solely from the perspective of plaintiffs' alternate waste claim, incorrectly shifting to plaintiffs the burden of proving that Ovitz could have been fired for cause. DB at 60-61; Answering Brief of Appellee Michael Ovitz ("OB") at 23.

Both the trial court and defendants wrongly presuppose that the cause issue can fairly be addressed "without invoking any concepts of burden of proof." OB at 24 n.13. Because defendants did not exercise any business judgment by failing to act in connection with the decision to grant Ovitz an NFT, under an entire fairness analysis, the burden should be placed on defendants to prove that there was no rational basis upon which the Board could have made a business judgment to terminate Ovitz for cause. *See Unitrin, Inc. v. Am. Gen. Corp. (In re Unitrin, Inc. S'holders Litig.)*, 651 A.2d 1361, 1373 (Del. 1995).

Numerous contemporaneous documents authored by Eisner and shared with certain other defendants state that Ovitz was "not truthful," "a psychopath," "erratic," "pathological," "devious," and "doesn't know right from wrong." PB at 16-17, 41-42. These documents cast doubt on whether Ovitz reported gifts as required by Company policy (PB at 18), and state that Ovitz failed to heed the directives of Eisner with respect to Company business. *See, e.g.*, A196-203; A188-190; AR217; AR220; A1015 at 76:9-77:25; AR241. The fact that Eisner attempted to discredit his own contemporaneous writings at trial, when he had every incentive and motive to do so (DB at 62-63; OB at 24-25), does not negate their obvious reflection of his true views at the time.[10] In addition, the PW Audit

[10] Defendants insist that it was within the trial court's discretion to interpret evidence and that the trial court did not abuse its discretion in making this conclusion and refusing to rely on Eisner's contemporaneous statements. DB at 62-63. Any such exercise of the trial court's discretion to interpret evidence must, however, be sufficiently supported by the record and be the product of an orderly and logical deductive process. *Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. 1972). Failing to credit the plain meaning of numerous contemporaneous documents at all, which consistently sounded the theme of lack of veracity, at a point in time when there was no motive to mislead, is neither orderly nor logical. *See* PB at 16-17.

identified Ovitz's expenditures totaling thousands and thousands of dollars that had no discernible business purpose which the Company was caused to reimburse. The PW Audit showed that Ovitz used Company money to lavish gifts, entertainment and meals on personal friends and business associates. PB at 2, 39-41. In their totality, these materials were sufficient to have afforded the Board a rational basis to terminate Ovitz for cause.[11]

Defendants heavily rely on the trial court's finding that the record evidences no "material falsehoods" during the relevant time. However, no legal authority has been cited under Delaware or California law (gross negligence and malfeasance must be construed under California law pursuant to the OEA) (A471) as support for the theory that the veracity of an employee is to be tested under a "material falsehood" test. *Cf.* A813. The record does show that, during the relevant time, Eisner was aware that Iger, Bass, Litvack, Russell and Watson, among others, criticized Ovitz's veracity and were aware of many examples of his lies. PB at 42-43. It is unremarkable that defendants could not, and would not, identify during cross-examination any of the examples they freely admitted in contemporaneous written documents given their self-interest in the outcome of the trial and the inevitable fading of memories. *See* AR246 at 360:13-361:11 In any event, plaintiffs have shown material falsehoods made by Ovitz at the time of his employment. *See* PB at 16-18; 42-43.

1. The Trial Court Failed To Articulate The Standard It Employed In Finding That Ovitz Could Not Be Terminated For Cause

The trial court failed to articulate its understanding of the standard for a good cause termination under the OEA. Defendants argue that it is sufficient that the trial court stated that, "under any one of the myriad of legally valid definitions of malfeasance or gross negligence proffered by the three expert witnesses, Ovitz could not be terminated for cause." DB at 61. The trial court's holding that Ovitz could not be terminated for cause, however, is a legal determination subject to *de novo* review by this Court. *Kahn v. Lynch Commc'ns Sys.*, 669 A.2d 79, 84 (Del. 1995). Such review requires that the trial court specify the legal standard by which it made its determination. Without an articulation of

[11] By comparison, Thomas Coughlin, former Vice-Chairman of Wal-Mart, has recently agreed to plead guilty to criminal charges for misappropriating approximately $350,000 of Wal-Mart funds even though he received millions in compensation. *See* James Bandler, *Former No. 2 at Wal-Mart Set to Plead Guilty*, Wall St. J., Jan. 7-8, 2006.

the legal standard used, this Court does not have the means by which to review the trial court's holding. *See Macmillan*, 559 A.2d at 1279.

Also, the trial court failed to link any of its factual findings to its legal determinations on cause. Defendants argue that it is adequate for the trial court to make factual findings completely distinct from its legal conclusions. DB at 61. Contrary to defendants' assertion, legal holdings must be specifically linked to factual findings so as to allow for meaningful review. Without so doing, this Court has no means to review whether the factual findings and record do indeed support the legal conclusions made, or to the contrary, refute them.

B. The Trial Court Incorrectly Excluded The PW Audit

The trial court incorrectly excluded the PW Audit as hearsay in a one-line holding, bereft of any legal analysis, and issued hours after the completion of detailed evidentiary submissions. PB at 40-41. As explained more fully in Appellants' Opening Brief at 39-41, the PW Audit is either not hearsay or falls under a number of exceptions to the hearsay rule.

Defendants argue that the PW Audit cannot be included under the business record exception because "PriceWaterhouse did not make post-termination investigations of expenses as part of their regular business activities, *nor was it Disney's regular practice to have such reports prepared.*" OB at 26 (emphasis added). Defendants cannot have it both ways. If the hiring of PW to conduct an audit of Ovitz's spending, purchasing, and gift-giving was highly unusual, the fact that such an audit was commissioned demonstrates that Eisner and/or Litvack were concerned about Ovitz's spending of Company money. Both individuals were obligated to report their concerns to the rest of the Board, and ensure that the PW Audit was finalized and distributed to the rest of the Board for its review -- instead of ordering PW not to finalize the audit (A637-39) and concealing its existence from the majority of the Board. PB at 39. If such an audit was not unusual and, instead, formed a regular business record, it should have been admitted under D.R.E. 803(6).

Defendants incorrectly argue that the PW Audit is not admissible under D.R.E. 801(d)(2)(D) because PW was not acting as an agent. OB at 27. An agency relationship exists when a declarant is hired by a party and works on matters in which the party is actively involved or a party directs a declarant's work on a continuing basis. Jack B. Weinstein & Margaret A. Berger, *Weinstein's Federal Evidence*, § 801.3(2)(b) at 801-74 (2005). *See also* Restatement 2d of Agency, § 220. PW was hired and directed by Eisner and Litvack for Disney to scrutinize Ovitz's expenditures, an undertaking which Eisner, Litvack and Disney's

accounting department were actively involved in and continually directed. *See generally United States v. Chappell*, 698 F.2d 308 (7th Cir. 1983) (holding that statements made by a defendant's accountant were admissible under Rule 801(d)(2)(D)).

Defendants also argue that the PW Audit is not admissible as a statement affecting an interest in property. OB at 27. Defendants cannot credibly argue that the PW Audit, which had direct implications for the one million dollar holdback, was not a document affecting an interest in property. Despite defendants' argument to the contrary, the one million dollar holdback was not specified in Ovitz's contract nor was his right to said funds a matter of contract.[12]

[12] Defendants argue that the requirements of the residual exception were not met. OB at 27. No more probative evidence existed in the record on the issue of Ovitz's spending of Company funds than the PW Audit. The only document defendants cite to substantiate their argument that such evidence existed is A539-632. *Id.* The expense reimbursement forms contained within A539-632 fail to indicate the business purpose (or otherwise) or specific expenditures for gifts or Ovitz entertainment expenses, whereas the PW Audit is as complete a study as possible. Additionally, the PW Audit covers Ovitz's full tenure at Disney, whereas A539-632 is only a partial compilation.

IV. THE TRIAL COURT APPLIED ERRONEOUS LEGAL STANDARDS

A. The Trial Court Erroneously Combined And Conflated Plaintiffs' Burden Of Rebutting The Business Judgment Rule With The Bad Faith Showing Relevant To A Section 102(b)(7) Defense

Defendants structure their answering briefs on the mistaken notion that as part of their *prima facie* case, appellants must prove *both* a due care violation and a good faith violation in order to rebut the presumptions of the business judgment rule. DB at 26-27. Defendants misstate the law. Whether the business judgment rule can be rebutted by a showing of bad faith is irrelevant to determining whether it can be rebutted by a showing of gross negligence. *See, e.g., Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 371 (Del. 1993) ("*Cede II*"); *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*"). Due care claims and bad faith claims must be analyzed separately as they require different evidentiary thresholds to rebut the presumption of the business judgment rule.

Defendants argue that the trial court analyzed plaintiffs' due care and bad faith claims separately. DB at 26. Defendants' claim is belied by the Opinion. The trial court flatly stated that in order to overcome the presumption of the business judgment rule, "a *plaintiff must prove* an act of bad faith by a preponderance of the evidence." Op. at 124 (emphasis added). Nowhere in the Opinion did the trial court systematically analyze whether gross negligence had been demonstrated as distinct from whether plaintiffs had demonstrated bad faith. *See* PB at 21-22.

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

The business judgment rule applies to *board* conduct and a board's conduct must be assessed collectively. *Van Gorkom*, 488 A.2d at 889. Ignoring *Van Gorkom's* holding and citing *Emerging Communications*,[13] defendants argue that because different directors had different roles and levels of involvement with respect to the events surrounding Ovitz's joining Disney, it was correct for the trial court to separately assess the acts of the directors. DB at 28.[14] Defendants'

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[13] *In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 Del. Ch. LEXIS 70.

[14] Defendants do not dispute that the Court of Chancery's director-by-director analysis in *Emerging Communications* applies solely to assess application of the "good faith" defense provided in Section 102(b)(7). DB at 28.

argument is insupportable. Regardless of the different roles and involvement of individual directors, a board cannot properly function unless all directors are privy to the same information and deliberate collectively. *See Macmillan*, 559 A.2d at 1282-83.

C. The Trial Court Incorrectly Defined Bad Faith

Without any intervening change in the law, the trial court wrongly changed its definition of what constitutes bad faith. PB at 23-24. The trial court's definition of good faith in its motion to dismiss decision was logically tied to board decision-making under the duty of care. *Disney II*, 825 A.2d at 289 (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."). If directors made decisions in conscious or deliberate disregard of material information, they could have been found to have acted in bad faith. *Id.* The definition of good faith in the trial court's post-trial opinion requires that there first be a separate "duty to act." Op. at 123. Defendants spuriously claim that this new definition is "wholly consistent with [the court's] definition in 2003." DB at 40. However, this later definition of bad faith fails to hold directors responsible for deficient investigation, where such deliberate and conscious disregard would be adequate to demonstrate bad faith under the Court's 2003 opinion. Essentially, this later definition now allows directors to sit by passively "with their heads in the sand" as material decisions are made.

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

Gross negligence, the legal standard for rebutting the business judgment rule, is proven by a showing that the board failed to consider "all material information reasonably available." *Cede II*, 634 A.2d at 367; *see also Brehm*, 746 A.2d at 259. In contradiction of this bedrock principle, the trial court held that the informational component is separate and distinct from gross negligence: "[P]laintiffs have failed to meet their burden to demonstrate that the directors acted in a grossly negligent manner *or* that they failed to inform themselves of all material information reasonably available when making a decision." Op. at 160 (emphasis added); *see also* Op. at 126-27. Defendants argue that this is consistent with this Court's description of gross negligence in *Brehm*. DB at 27 n.18. On its face, however, defendants' interpretation defies the plain language utilized by this Court. This Court has made clear that proving that the directors failed to inform themselves of all reasonably available information is sufficient to rebut the presumptions of the business judgment rule. *Brehm*, 746 A.2d at 259. Nothing more is required.

V. THE TRIAL COURT ERRONEOUSLY CONCLUDED THAT THE COMPENSATION COMMITTEE COULD INVOKE THE PROTECTION OF 141(e)

Defendants wrongly claim that the trial court was correct in holding that Compensation Committee can invoke the protection of 141(e) (DB at 34-35), despite the fact that the trial court found that Crystal never made a report to the entire Committee (Op. at 28) and his highly critical letters were never distributed to the entire Committee. Op. at 21, 28. In order to sustain this argument, defendants rely on an incomplete quote from the Opinion: "the committee relied on the information, opinions, reports and statements made by Crystal." DB at 35; Op. at 156. However, the trial court continued that "even if Crystal did not relay the information, opinions, reports and statements in person to the committee *as a whole*." Op. at 156 (emphasis added). Defendants' interpretation defies the plain language of the statute which requires that the directors "did in fact rely on the expert" (8 *Del. C.* § 141(e)), in order to invoke such protection. *See also Brehm*, 746 A.2d at 262. Moreover, while a board may rely in good faith upon experts, "it may not avoid its active and direct duty of oversight" in significant matters. *Macmillan*, 559 A.2d at 1281.

Furthermore, even assuming *arguendo* that Crystal's information was conveyed to and analyzed by the members of the Committee, Crystal's analysis was incomplete. Defendants miss the point by arguing that there was "no reason for any member of the Compensation Committee to conclude or believe that 'Crystal's analysis was inaccurate or incomplete.'" DB at 35-36 (quoting Op. at 156). What is obvious from the face of Crystal's writings is that he never compared the cost of the OEA or evaluated its structure in light of the pros and cons of hiring Ovitz as Disney's President and second-in-command. Thus, there could not be any reliance on the advice of an expert as to the decision Disney's directors were called upon to make. In addition, by Crystal's own admission, he never performed an analysis of the exposure to Disney in the event of an NFT and was not asked to do so. A691; *see also* PB at 12.

Not only are defendants not entitled to the protection of Section 141(e), but the fact that Crystal's letters were available but were not distributed (Op. at 21, 28) and that Crystal was supposedly waiting by the phone during the September 26, 1995 meeting, but not called (DB at 32), proves that there was material information reasonably available of which defendants did not avail themselves (or, in the alternative, there was material information reasonably available that was withheld). This demonstrates gross negligence.

VI. THE COMPENSATION COMMITTEE MEETING CANNOT SERVE AS A PROXY FOR THE DEFICIENT BOARD MEETING THAT IMMEDIATELY FOLLOWED

A. The Compensation Committee Process Was Grossly Negligent

As explained above in Section I(A), the material nature of the OEA decision mandated Board consideration and approval and the decision could not be delegated to the Compensation Committee. Even assuming, *arguendo*, that the Committee meeting could hypothetically supplant the necessity for Board decision-making, here, the evidence proves that the Committee was grossly negligent.

Defendants argue that the Compensation Committee was not grossly negligent for a number of reasons. First, defendants claim that the Compensation Committee did not need to review and discuss the draft of the OEA, arguing that it was sufficient that a short summary term sheet was reviewed. DB at 31. A term sheet cannot encapsulate the true terms of an integrated employment agreement worth in excess of a hundred million dollars. Nor is there any reason why the Committee could not have considered both a copy of a then-existing draft and a term sheet. Then existing drafts of the OEA were available, and the information contained within those drafts was material.

Second, defendants argue that the Compensation Committee did not need to discuss the meaning of gross negligence or malfeasance because, supposedly, the terms were included in the employment contracts of Eisner, Wells, Katzenberg and Roth. DB at 31 n.23. Neither Wells, Katzenberg nor Roth's contracts, however, are in the record and there is no evidence to suggest that they had the same gross negligence and malfeasance language that was in the OEA. Eisner's contract was originally approved before either Poitier or Lozano were on the Board. There is no record of any prior occasion where the Compensation Committee members had any reason to consider the application of those terms. Moreover, even if those contracts had the same language, it was imperative that the Committee discuss these terms in the context of the contract which they were reviewing so as to comprehend the full economic ramifications of an NFT.

Third, defendants argue that the Compensation Committee did consider comparable employment agreements, those of Eisner and Wells. DB at 32. However, Eisner's contract was not comparable to Ovitz's. Eisner served as Disney's CEO, a position of much greater responsibility and authority. Eisner was also a known commodity with a successful track record. Well's contract was not comparable either. The OEA was worth many times more than Well's contract

and included other different, more valuable features like the extended exercisability feature of Ovitz's options. A890-91; AR247-48 at 779:2-784:22. Moreover, both Lozano and Poitier admitted at trial that there was no discussion concerning Crystal's observations that there were no comparables of non-CEO presidents of public companies that could justify Ovitz's pay package. Op. at 80 n.28; AR257-58 at 7181:21-7182:1; A1126 at 7701:4-10; A1105 at 5826:8-16.

B. Ovitz's Hiring Was A "Done Deal" Before The September 26th Board And Compensation Committee Meetings

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.*

Op. at 136-37 (emphasis added). The Board also received an invitation *in August* to attend a lunch celebrating Ovitz's hiring to be held following the upcoming September 26, 1995 Board meeting. A229-30. Thus, Board members correctly understood that Ovitz's hiring was already a "done deal." AR233 at 124:20-125:4; AR234 at 140:10-22; AR235 at 126:20-127:8; AR231 at 84:4-8; AR252 at 2807:5-23; AR261 at 7693:19-7694:6; AR264 at 8198:5-21; *see also* Op. at 138. Defendants cannot credibly claim that the Board was free to vote against Ovitz. The press release announcing Ovitz's hiring in August 1995 "placed significant pressure on the board to accept Ovitz and approve his compensation package in accordance with the press release." Op. at 140. Once Ovitz had been announced as the new President of Disney, it would have been nearly impossible for the Board to fail to elect him or seriously second-guess his already heavily-negotiated employment agreement. *See Van Gorkom*, 488 A.2d at 884 (finding that a premature press release had the effect of locking in the board).

VII. PLAINTIFFS DEMONSTRATED THAT THE BOARD WAS GROSSLY NEGLIGENT

Defendants claim that the Board did not have to consider the NFT provisions arguing instead that their *sole responsibility* was to elect Ovitz as President. DB at 36.[15] The Board could not have made a rational business judgment to either approve the OEA or elect Ovitz as President without understanding the value and structure of his pay package and how the contract terms compared to other similarly-situated executives. A1057 at 777:24-779:1; A1082 at 3384:18-3386:14. In other words, the Board had to determine whether Ovitz was worth the unprecedented amounts of money he would receive under the OEA and its NFT provisions. [16]

Defendants argue that they were informed of all material information required to elect Ovitz as President because they knew: (1) the Company needed to hire a "number two" and potential successor to Eisner; (2) Ovitz's reputation, background and qualifications; (3) that Ovitz was leaving and giving up a successful business; (4) that the public positively reacted to the announcement touting Ovitz's hiring; (5) that Eisner and senior management supported Ovitz's hiring; and (6) the key terms of the OEA and reporting structure agreed to by Ovitz as relayed to them at an executive session of the Board. DB at 36-39. Defendants' arguments are all baseless.

The necessity for the Company to hire a "number two" and potential successor due to the increase in the Company's size as a result of the CapCities merger and Eisner's heart condition should have increased the deliberation conducted by the Board, not lessened it. The circumstances should also have

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[15] Defendants do not dispute that (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 distributed to the Board; (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; 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. DB at 39.

[16] Defendants fail to respond to the discussion in Appellants' Opening Brief that in electing Ovitz as President, the Board had to conduct a competitive pay analysis before it could even make an informed decision to hire Ovitz (PB at 30) -- a proposition even defendants' so-called expert, Crystal, agreed with. A1057 at 777:24-779:1; A1082 at 3384:18-3386:14.

intensified the Board's consideration of the incentives, safeguards and loopholes contained in the OEA.

Second, it is not sufficient for the Board to have only considered Ovitz's reputation as a "powerful" man in Hollywood. Had the Board conducted even a cursory examination, it would have learned that Ovitz had never run a public company, had never served as a second-in-command, had signed a consent decree with the U.S. Department of Labor regarding his unauthorized use of CAA pension funds (AR210) and that the Sony and MCA transactions, touted as examples of Ovitz's qualifications in the August 14, 1995 press release (AR213), were financially unsuccessful and Ovitz's role was exaggerated.

Third, while Ovitz was leaving CAA to come to Disney, he was in no way "giving up" his earnings from CAA.[17] Ovitz sold his business to the "Young Turks" through a self-financed purchase *via* a series of earn-out agreements, contracts and leases (*see, e.g.*, AR107-40; AR141-98; B825-56) which netted Ovitz nearly $28 million during his short tenure at Disney alone. AR216.[18]

Fourth, the fact that the stock price went up on the same day as Ovitz's hiring did not absolve the Board of its failing to have met prior to that time. Moreover, the positive stock price reaction could have been the result of the fact

[17] Poitier testified at trial that any Ovitz earn-out agreement with CAA had to be structured in such a way as to avoid any "conflict of interest." B453 at 7205:14-20. Yet other than Russell, Eisner and Litvack, no member of the Compensation Committee was even aware that Ovitz had an earn-out agreement with CAA. B163 at 2761:9-15; B453 at 7206:22-7207:20; B472 at 7697:16-7699:2; B494 at 8095:19-8098:21. Nor was the Compensation Committee aware that Ovitz wanted, and had a vested interest in CAA doing well, even after his departure from CAA. AR249 at 1620:21-24.

[18] There was no discussion at either the Compensation Committee or Board meeting regarding the level of compensation Ovitz had been receiving at CAA, his earn-out agreement or his real and personal property leases with NewCo. A1139 at 8093:14-8094:7; A1139 at 8095:15-18; B161-62 at 2755:2-2756:1; B163 at 2761:9-15; B453 at 7206:22-7207:20; B472 at 7697:16-7698:5; B472 at 7698:24-7699:2; AR262 at 8066:6-10. In fact, defendants took the position in their post-trial evidentiary submission that Ovitz's CAA payouts were "not relevant." Letter to Chancellor Chandler from Individual Defendants at 13, Feb. 4, 2005 ("The amount of money that Mr. Ovitz ultimately received as a payout from his interest in CAA . . . was not considered by Disney's Compensation Committee in negotiating Mr. Ovitz's compensation.").

that a second-in-command and potential successor had finally been chosen after months of uncertainty, not a reaction to Ovitz *per se*. *See* AR260 at 7405:24-7407:15. In addition, the terms of the OEA were not disclosed in the press release which led to the stock price reaction (A414-16), and therefore, the stock movement does not indicate that the public approved of the OEA.

Fifth, senior management had not been supportive of the decision to hire Ovitz. Even by September 26, 1995, Eisner had deepening doubts about Ovitz's veracity and ability to serve as President (B230 at 4016:23-4017:3) and Litvack and Bollenbach had expressed concerns about hiring Ovitz. Op. at 29-30; B230 at 4017:12-20. Moreover, the Board was not informed of the fact that, despite being named President, Ovitz would not be receiving the title of COO (AR254 at 5701:4-11; AR255 at 5844:3-12; AR259 at 7216:3-18; AR263 at 8126:20-8127:9) -- a position mandated by the bylaws in effect at that time. B1099 at Art. IV, Sec. 4.

Sixth, the Board minutes say absolutely nothing about consideration of the OEA. While the minutes reference that the Board met in Executive Session during the meeting, no written record exists that even hints that Ovitz was discussed during this session, as the minutes reference only a discussion of the $250,000 payment to Russell for his services in hiring Ovitz. A717. Self-serving, after-the-fact trial testimony that is often conflicting (PB at 29), cannot supplant the plain face of the Board minutes evidencing the lack of any discussion.

In order to make an informed judgment, it is imperative that all members of the Board be privy to the same information. Whether a board was adequately informed, can only be assessed by the information presented and considered in board meetings. Individual, undocumented discussions between the Chairman CEO and certain board members concentrates even more power in the Chairman CEO and inevitably results in directors who are poorly and unequally informed.[19] Yet, defendants structure their briefs on the mistaken notion that it is acceptable

[19] The problems of individual, one-on-one discussions are even more relevant due to the trial court's factual findings that Eisner was a "Machiavellian" and "imperial" CEO (Op. at 135) who "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. The trial court also found that Eisner stacked the Board with "yes men" (*id.*), which led to defendants' "collective kowtowing in regard to Ovitz's hiring." *Id.*

for Board members to be informed by Eisner in just such a one-on-one manner. DB at 37. There is no written evidence to substantiate what, if anything, directors were told in these one-on-one discussions or even to indicate how long these supposed conversations lasted (if they even occurred). Eisner even testified that, to the extent he could remember the calls, their scope and content varied. *See, e.g.*, A1091-98 at 4939:17-4967:11.

Even assuming that these discussions took place, no written information was sent to the Board before, during or after these discussions so that the directors would be able to review for themselves the terms of the impending deal or Ovitz's qualifications. *See Van Gorkom*, 488 A.2d at 874. As a result, directors had greatly varying degrees of knowledge regarding Ovitz's hiring and the terms of the compensation package. For example, only Eisner and Russell were aware of the "Case Study" (Op. at 18) which highlighted the fact that the OEA was extraordinarily large and would raise criticisms. *See* PB at 9. Only Eisner, Russell and Watson had ever seen any of Crystal's letters and the issues and reservations noted by him. Op. at 21, 28. Only Eisner, Russell, Litvack and Bollenbach were aware of the meeting at Eisner's house where Litvack and Bollenbach expressed their discontent with Ovitz's hiring and refused to report to him. PB at 10. Only Eisner, Russell and Litvack ever saw drafts of the OEA. Op. at 27, 154.

While one-on-one information sharing may arguably be a supplement to better inform directors, it cannot serve as a substitute for collective discussions, unanimous written consent and for the enactment of board resolutions. *See* PB at 26. In fact, Disney's bylaws codified the basic legal principle that in order for the Board to act, there either had to be a board resolution or action by unanimous written consent. A810.

VIII. THE TRIAL COURT ERRONEOUSLY CONCLUDED THAT THE NFT PROVISIONS WERE NOT WASTE

The NFT provision in the OEA incentivized Ovitz to depart Disney prematurely and thus constituted waste. Defendants argue that the OEA did not incentivize Ovitz to leave the Company because he was not in a position to determine if he would be terminated, and if so, whether his termination would be with or without cause. DB at 66-67. Defendants further argue that Ovitz never wanted to leave Disney. DB at 67.

Ovitz's personal motivation is irrelevant. Under Delaware law, "[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." *Beard v. Elster*, 160 A.2d 731, 737 (Del. 1960); *accord Kerbs v. Cal. E. Airways, Inc.*, 90 A.2d 652, 656 (Del. 1952). Thus, "the key factor for the court to consider in determining the validity of the option plan is not whether the corporation can qualify the benefit, but *whether the plan itself* contains safeguards or circumstances to ensure that the corporation receives the benefit for which it bargained." *Byrne v. Lord*, 1995 Del. Ch. LEXIS 131, at **13-14 (emphasis added) (citation omitted).[20]

A plain reading of the OEA makes clear that it did not contain safeguards to ensure Ovitz remained at Disney for the full five-year term of his contract. Under the OEA, and given that Ovitz had no possible expectation of being rehired at the end of the initial five-year term (AR245 at 532:17-533:19), Ovitz was at all times better off with an NFT than staying, particularly during the first three years of the agreement, since he would then be entitled to a severance package equal to or greater than the benefits he would have received had he served out all five years. A907.[21]

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[20] Under Delaware law, judicial scrutiny of contractual provisions is an objective, not a subjective inquiry. *Sanders v. Wang*, 1999 Del. Ch. LEXIS 203, at *20.

[21] For example, Ovitz was guaranteed, in the event of an NFT, the present value of $7.5 million per year in bonus compensation though the remaining years of his contract (A464), where, under ordinary circumstances, he would only be entitled to a discretionary bonus with no guaranteed minimum. A454. In addition, if Ovitz received an NFT, he was also entitled to receive a one-time, $10 million contract termination payment that not discounted to present value. A461.

Defendants argue that the OEA was not waste because there was a connection between the option grant and an anticipated benefit to the Company, namely, that the stock options induced Ovitz to come to Disney. DB at 67 n.55. Again, defendants misstate the law. It is not sufficient that the option grant purportedly induced Ovitz to come to Disney. In order to pass muster, the option grant must not only have induced Ovitz to come to Disney, *but it must have secured his services throughout the term of the contract. Byrne*, 1995 Del. Ch. LEXIS 131, at **13-14. The OEA's incentive structure perversely achieved the opposite.

Defendants' argument that the NFT payout was not waste is predicated on the incorrect determination that Ovitz could not be dismissed for cause. DB at 67. As discussed above in Section III, the Company could have made a rational business judgment to terminate Ovitz for cause. Thus, the NFT payment to Ovitz amounted to an unnecessary transfer fostered by Eisner's friendship with Ovitz, and provided the Company no corresponding return.

Ovitz's argument goes one step further: Ovitz would have this Court believe that in order to prove waste, plaintiffs must show more than that Ovitz could have been terminated for cause. According to Ovitz, plaintiffs must prove that the evidence supporting a termination for cause was so strong that it was the only rational conclusion that could have been reached. OB at 34. That assertion is wrong. Under the OEA, it was the Company's prerogative to terminate Ovitz for cause if the standards in the contract were met. That decision, which had to be made by *the Board*, need only have constituted a rational decision and thus need not have excluded any other possibilities.

IX. OVITZ VIOLATED HIS FIDUCIARY DUTIES OF CARE AND LOYALTY

A. Ovitz Violated His Fiduciary Duties In Connection With His Role In Negotiating A Full NFT Payout

Ovitz argues that he did not violate his fiduciary duties of care or loyalty based on the alleged facts that he: (1) was terminated by Disney against his will; (2) took no actions to inject himself into or manipulate Disney's decision-making process regarding his termination; (3) could not have been terminated for cause; and (4) had no duty to demand a board meeting to be held to consider his termination. OB at 20-21. Ovitz's assertions, however, are contradicted by the contemporaneous written evidence and misstate the law.

First, contemporary written evidence proves that Eisner and Ovitz negotiated Ovitz's departure from Disney, not that Ovitz was unilaterally "fired." In October 1996, Eisner and Ovitz exchanged handwritten letters evidencing the strong, personal friendship bonds then still existing between them and their desire to make Ovitz's departure a "win-win" situation. A643-A645; PB at 18-19.

Additionally, Eisner claims to have needed to enlist Wilson to "convince" Ovitz to leave -- a proposition inconsistent with a unilateral "firing." PB at 12-13.[22] Eisner's contemporaneous notes of his conversation with Wilson on December 1, 1996, plainly show that Ovitz would accept nothing less than an *agreed-to settlement*. *See* A676-77. Wilson reported to Eisner that Ovitz was a "wounded animal in a corner" and a "loyal friend, devastating enemy." *Id.* Eisner understood Wilson to be communicating, "don't screw [Ovitz] financially and don't embarrass him in public." AR243 at 626:5-9. Eisner noted that Wilson reported that Ovitz was "*available to discuss settlement*" and Eisner had to be "magnanimous" with Ovitz. A676-77; *see also* AR243 at 627:3-10.

Defendants also ignore the typed note Eisner wrote to Russell on December 3, 1996. A678-79. The document shows that Ovitz wanted numerous substantial benefits in addition to an NFT. It would have been illogical for Eisner to put Russell in charge of "settling out" the OEA at the outset if the terms of Ovitz's departure required the mere mechanical application of the OEA's NFT provisions.[23]

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[22] This conversation took place aboard a yacht that defendant Wilson, Disney's former CFO, and Ovitz co-owned. AR256 at 7012:10-7013:24.

[23] Ovitz's *ex post* claim that he only received what he was "entitled" to under his contract, ignores the fact that *ex ante* the parties were prepared to discuss terms well outside what was contractually provided.

The December 12th and December 27th letters memorializing Ovitz's departure also flatly *disprove* the contention that Ovitz was "fired." A698-99; *see* PB at 38-41. Both letters contain carefully crafted language vetted by Ovitz's attorneys. B976-78.

Also ignored in defendants' briefs is the fact that Ovitz did not actually agree to leave until after he and Eisner met privately at Eisner's mother's apartment in New York, on December 11, 1996. PB at 20. On December 12, 1996, Disney issued a press release announcing that Ovitz was leaving by "mutual agreement" and would continue to serve as a consultant (A685) -- words that the trial court inexplicably refused to treat as binding admissions. Op. at 83. Eisner also secured from Ovitz a secret, non-disparagement deal. A679; *see also* PB at 19. Defendants say nothing about the fact that Ovitz's $7.5 million bonus awarded at the December 10, 1996 EPPC meeting, was not rescinded until Eisner perceived that Ovitz's severance package was creating a firestorm. PB at 19-20 n.16.

Eisner's own testimony also belies the assertion that Ovitz was unilaterally fired. Eisner stated that Ovitz "wouldn't accept being fired. I mean, I know that sounds ridiculous but he would not here [sic] it." A987 at 610:22-25. He further testified that he could not just "throw" Ovitz out, but, instead, had to get his "consent" to leave. B292 at 4525:3-16. Despite defendants' argument to the contrary (OB at 21), the evidence compels the conclusion that Ovitz's protest that he was "chained to his desk" was, in reality, a lawyer-designed strategy designed to prevent his forfeiture of an NFT payout by resigning. A privilege log produced by Ovitz's attorneys in this litigation shows that Ovitz was receiving legal advice at least as early as October 1996 regarding how to handle his impending departure from Disney. A711; AR251 at 2039:1-10.

Third, as discussed above in Section III, the record evidences that a rational basis existed for the Board to give Ovitz a for-cause termination which would have been protected by the business judgment rule. Yet, there is not a shred of evidence that Eisner or Litvack ever contemplated or stated an intention to terminate Ovitz for cause.

Fourth, Ovitz did have a duty, like the other directors, to assure the occurrence of a board meeting to consider his receipt of an NFT. It is the law of the case that Ovitz had an affirmative duty to take steps to ensure proper Board deliberation regarding his termination. *Disney II*, 825 A.2d at 290-91. Ovitz could not fulfill his fiduciary duties by *assuming* that the necessary Board action had taken place especially when no contemporaneous documents showed that such a meeting occurred. *Compare* OB at 31. Defendants' argument, based on the trial court's opinion that a fiduciary cannot (or should not) act against his own self-interest

(OB at 31), is contrary to the entire body of Delaware corporate law. *See generally Guth v. Loft*, 5 A.2d 503 (Del. 1939). Being a fiduciary requires that an individual put the interests of the corporation above his own interests. *See, e.g., Zirn v. VLI Corp.*, 621 A.2d 773, 781 (Del. 1993) ("*Zirn I*") (Fiduciaries must "act in the best interests of the corporation and not of themselves.").

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

Ovitz argues that the trial court's grant of partial summary judgment should be sustained because Ovitz purportedly did not owe fiduciary duties to Disney prior to October 1, 1995, and that there were no material changes to the OEA on or after October 1, 1995. OB at 15.

As a legal matter, the trial court's conclusion that an incoming executive cannot have fiduciary duties until "the bright-line" of that person's formal investiture in office has passed would eviscerate the *de facto* fiduciary doctrine. *Disney IV*, 2004 Del. Ch. LEXIS 132, at *18. In this case, Ovitz admitted that he started work before his official start date (AR250 at 1991:1-14), and contemporaneous written evidence shows that Ovitz had substantial contact with third parties in which he held himself out as a representative of Disney, received extensive confidential Disney information and memoranda prior to October 1, 1995, and submitted requests for reimbursement which were paid. PB at 11.

The trial court's conclusion, and Ovitz's assertion, that all "material" terms had been resolved by September 23, 1995 (*Disney IV*, 2004 Del. Ch. LEXIS 132, at *28), has no grounding in contract law. The parties intended to bind themselves by a definitive written agreement and continued to exchange drafts, wherein changes were made, through and including the execution of the contract in mid-December 1995. A496-506; B649-779; AR1-106. Throughout that period, Ovitz was serving as President, and undeniably was a fiduciary even under the trial court's reasoning. That the OEA was made retroactively effective to October 1, 1995, is simply a matter of form that cannot override the fact that it was not completed or signed until December.

Accordingly, genuine issues of fact did exist as to whether Ovitz should be held culpable for the flaws in the formation and structure of the OEA, for which the defendants should be held jointly and severally liable. Assuming that the Board did breach its fiduciary duties in connection with Ovitz's hiring, Ovitz must be included as a culpable defendant.

CONCLUSION

For all the foregoing reasons, and for the reasons set forth in their Opening Brief, plaintiffs respectfully request this Court to reverse the trial court's adverse judgments and provide such other relief it deems appropriate.

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Respectfully submitted,

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