never even been to the offices of Hollywood Records on the lot at Disney. PTE 24 at DD2453. Litvack responded to Eisner that "there are a *host* of open issues, Hollywood Records being one of the important ones. If MSO is really working on HR, I don't know about it." PTE 780 at WD13842 (emphasis in original).

ARGUMENT

I. DEFENDANTS OWED FIDUCIARY DUTIES TO DISNEY IN CONNECTION WITH OVITZ'S HIRING AND TERMINATION

A. Defendants' Fiduciary Duties

It is undisputed that as directors, defendants owed Disney a fiduciary duty to supervise and manage its affairs. 8 *Del. C.* § 141 (2004)[40]; *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) ("*Brehm*"); *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275 (Del. Ch. 2003) ("*Disney I*"). In discharging these obligations, defendants owed Disney duties of care, loyalty, and good faith.[41] *Id*; *see, e.g., Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994) ("*Cede*"); *Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001).

A director's duty of care requires the director to, *inter alia*, obtain, consider and evaluate all reasonably available material information prior to approving or taking action. *Brehm*, 746 A.2d at 259; *Smith v. Van Gorkom*, 488 A.2d 858, 878 (Del. 1985); *In re Emerging Communications, Inc. S'holders Litig.*, 2004 Del. Ch. LEXIS 70, at *153 n.192. As a corollary, a director's duty of care incorporates a duty of inquiry and reasonable investigation when circumstances indicate that reasonably available information would be overlooked if such steps were not taken — for example, ensuring that a "reasonable information and reporting system

[40] All references to the Delaware General Corporation Law are hereinafter referred to as "Section" or "§___."

[41] *In re Walt Disney Co. Derivative Litig.*, 2004 Del. Ch. LEXIS 132, at *14 ("*Disney II*") (good faith "may or may not be subsumed under the duty of loyalty").

exists." *Saito v. McCall*, 2004 WL 3029876, at *6 (Del. Ch.). *See generally Van Gorkom*, 488 A.2d at 858; *Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins*, 2004 Del. Ch. LEXIS 122, at *46.

Delaware law and applicable corporate governance standards require that directors act collectively on significant matters. *See* PTE 462 ("DeMott Report") ¶ 9. As the exception which emphatically proves the rule, § 141(f) specifically states that board action without a meeting requires unanimous written consent. *See Solstice Capital II, Ltd. P'ship v. Ritz*, 2004 Del. Ch. LEXIS 39, at *3 (holding that a CEO was not properly terminated or removed as a director since the board had failed either to hold a meeting or obtain unanimous written consent). Section 141(f) "comports with the notion that directors should participate actively and engage in discussion before voting at meetings." *Id.*, at *4. Moreover, a director in possession of material information must disclose it to the other directors so that the board can collectively make informed decisions.[42]

The fiduciary duties of officers overlap with those of directors. *See Disney II*, 2004 Del. Ch. LEXIS 132, at *14. Moreover, negotiating the terms of an employment agreement and/or severance, a corporate fiduciary is obligated to ensure that the process is "impartial and fair." *See Disney I*, 825 A.2d at 291. As with directors, officers also have duties of candor.[43] Consistent with their fiduciary duties, corporate officers must comply with the corporate

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[42] *See Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 441-42 (Del. 1996) (stressing the importance of duty to be candid with fellow directors); *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1283 (Del. 1989) ("[F]iduciaries . . . may not use superior information or knowledge to mislead others in the performance of their own fiduciary obligations.").

[43] *Mills Acquisition*, 559 A.2d at 1283 ("As the duty of candor is one of the elementary principles of fair dealing, Delaware law imposes this unremitting obligation not only on officers and directors, but also upon those who are privy to material information obtained in the course of representing corporate interests.").

organizational structure and act within the scope of their position in the hierarchy — an issue of substantial concern that Eisner and Russell discussed before hiring Ovitz. Tr. 2769:3-2772:17 (discussing PTE 194).

In addition to what Eisner had told Ovitz, Disney's governing documents made it clear that Ovitz reported to Eisner. The bylaws existing as of October 1, 1995 provided that the President "shall be the Chief Operating Officer of the Corporation and shall report and be responsible to the Chairman of the Board." PTE 497 at Art. IV, Section 4. Ovitz was ultimately responsible to the Board. According to the charter: "The officers of the Corporation shall be chosen in such a manner, shall hold their offices for such terms and shall carry out such duties 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." *See* DTE 185 (Restated Certificate of Incorporation of The Walt Disney Company) at Article Tenth.

B. Defendants Owed Disney Fiduciary Duties In Connection With The "Material" Decisions To Hire And Terminate Ovitz

Defendants were obligated to exercise their independent business judgment in order to fulfill their fiduciary duties regarding matters material to Disney. *Brehm*, 746 A.2d at 259; *Disney I*, 825 A.2d at 289; DeMott Report ¶¶ 7, 9. Defendants were also obligated to act in compliance with the charter, bylaws, Board Committee charters and other internal governing instruments of the corporation.[44] It is conclusively presumed that directors (and officers) are

[44] *See H.F. Ahmanson & Co. v. Great W. Fin. Corp.*, 1997 Del. Ch. LEXIS 55, at *9 ("Where the shareholders or the directors, by adopting a by-law, command the performance of a certain act, to hold that coercive relief cannot be had to enforce that command would violate basic concepts of corporate governance" as well as the corporation's electoral process.); *Russell v. Morris*, 1990 Del. Ch. LEXIS 39, at *14-15 (rejecting defendants' contention that waiving five-day notice requirement for a special meeting in the bylaws constituted amendment by implication). *See also Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) ("Corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules

knowledgeable about the provisions of such internal governing instruments, rules and regulations and thus comprehend the duties thereunder. *See* 8 William Meade Fletcher et al., *Fletcher Cyclopedia of the Law of Private Corporations* § 419 (2001) ("Fletcher") (directors and officers presumed to know the provisions of the bylaws, and the presumption is incapable of being rebutted from want of knowledge).

Here, it is the law of the case that the approval of the OEA and decision to grant Ovitz a full NFT payout were sufficiently "material" to Disney's business to require the Board's attention and approval. *Brehm*, 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' decisionmaking process."). The Supreme Court also stated 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. Moreover, as this Court held: "Allegations that Disney's directors abdicated all responsibility to consider appropriately an action of *material importance* to the corporation puts directly in question whether the board's decisionmaking processes were employed in a good faith effort to advance corporate interests." *Disney I*, 825 A.2d at 278 (emphasis added).

Accordingly, defendants, consistent with their fiduciary duties and Disney's internal governance rules, were required to act collectively with due care, loyalty, and in good faith

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of contract interpretation are held to apply."); *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1077-78 (Del. Ch. 2004) ("In general, there are two types of corporate law claims. The first is a legal claim, grounded in the argument that corporate action is improper because it violates a statute, the certificate of incorporation, a bylaw or other governing instrument, such as a contract. The second is an equitable claim" for the breach of fiduciary duty.); *Liese v. Jupiter Corp.*, 241 A.2d 492, 497 (Del. Ch. 1968) ("The charter of a corporation and its by-laws are the fundamental documents governing the conduct of corporate affairs. These documents establish norms of procedure for exercising rights and all stockholders have a right to rely on them as to notice and other procedural requirements stated therein.").

regarding the approval of the OEA and Ovitz's receipt of his NFT payout. As demonstrated below, the trial record shows by more than a preponderance of the evidence that defendants intentionally, knowingly or recklessly violated their fiduciary duties such that any protection afforded by the business judgment rule is eliminated, and the grounds established for the joint and several liability of each and every defendant.

II. PLAINTIFFS HAVE REBUTTED ANY PRESUMPTION AFFORDED BY THE BUSINESS JUDGMENT RULE WITH REGARD TO THE HIRING AND FIRING OF OVITZ

A. Business Judgment Rule

The business judgment rule is a procedural guide for litigants and a substantive rule of law. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Delaware Courts have consistently held, in applying the business judgment rule, that: "[T]he business judgment rule is but 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 [-] threshold requirements for invoking the rule." *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*, 634 A.2d at 360. It is well-established that the business judgment rule does not "irrevocably shield[] the decisions of corporate directors from challenge." *Gimbel v. Signal Cos.*, 316 A.2d 599, 609 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974). Under the business judgment rule, there is no protection for directors who have made "an unintelligent or unadvised judgment." *Van Gorkom*, 488 A.2d at 872 (citation omitted). Considerations of bad faith lay beyond the threshold issue whether directors collectively exercised informed business judgment. *Id.* at 889.

To rebut the presumption afforded by the business judgment rule, the plaintiff, in challenging business decisions not involving directorial self-interest, assumes the burden of providing evidence that the directors acted with gross negligence. *See Van Gorkom*, 488 A.2d at

872-73. Assuming the plaintiff provides evidence of directors' gross negligence, the burden of proof shifts to defendants. *See Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1164 (Del. 1995). Likewise, defendant directors who "*consciously and intentionally disregarded their responsibilities*, adopting a 'we don't care about the risks' attitude concerning a material corporate decision" do not get the protection of the business judgment rule. *Disney I*, 825 A.2d at 289.[45]

The business judgment rule affords no protection to "directorial self-compensation decisions" which have not been made subject to affirmative, properly informed board approval by non-interested directors. *Id.* at 290. As this Court found in connection with Ovitz's termination, "'directorial self-compensation decisions lie outside the business judgment rule's presumptive protection, so that, where properly challenged, the receipt of self-determined benefits is subject to an affirmative showing that the compensation arrangements are fair to the corporation.'" *Id.* at 290-91 (quoting *Telxon Corp. v. Meyerson*, 802 A.2d 257, 265 (Del. 2002)).

Once a plaintiff rebuts the business judgment rule, or it is shown that the business judgment rule does not attach, the burden shifts to the defendants to prove that the challenged transaction was entirely fair to the corporation. *Cede*, 634 A.2d at 361.

B. The Business Judgment Rule Does Not Apply Here Because The Evidence Establishes That Defendants Acted With Gross Negligence And Bad Faith In Approving The OEA

1. The Old Board Failed To Approve The OEA

The record demonstrates that the Old Board recklessly and faithlessly ignored its fiduciary responsibilities by failing properly to assess the terms of the OEA before hiring Ovitz.

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[45] Such bad faith determination would also have adverse consequences for the directors' attempted reliance on the protection afforded by § 102(b)(7) or indemnification rights afforded by § 145(b). *See* Argument Section IV.

In fact, the Board's misconduct went far beyond mere inattentiveness to its duties or gross negligence. As addressed in Argument Section I.B., the decision to enter into the OEA was material and required the Board's consideration and approval. In addition to the large financial commitments being undertaken, the decision to hire Ovitz was material because Ovitz would be taking on the position of President, a highly influential and important executive position, whose importance was magnified by the recognized need to increase Disney's "bench strength" and put in place a possible successor to Eisner. Tr. 47:6-48:17; *see also* PTE 266; DeMott Report ¶ 9.

Moreover, Disney's own charter, bylaws and internal documents confirm the necessity of Board action. As Professor DeMott testified, norms of corporate governance require that a Board make informed decisions about significant matters, including matters for which the corporation's bylaws require action. Tr. 47:6-48:17. The bylaws in effect in 1995 specifically stated that "the officers [including the President] of the Corporation shall be *chosen by the Board of Directors*." PTE 497 at Art. IV, Section 1 (emphasis added). The Board could not simply shirk this duty and allow Eisner to arrogate this authority to himself alone. Corporate custom and practice dictated that the Old Board engage in collective deliberation and free exchange of information so that all sides of the decision were independently and objectively analyzed, and the decisionmaking process was not distorted by one-on-one lobbying or disparate degrees of information or influence among the directors. *See* DeMott Report ¶ 7; Tr. 41:20-42:6. The Old Board failed to observe those standards and, instead, in meekly acquiescing to Eisner's wishes, preempted the collective deliberative process which was required. Indeed, any Board processes allegedly devoted to these matters were either too little too late or simply cosmetic in nature.

Certain of Disney's directors recognized that Board approval was required of the OEA. Russell wrote a note that stated that the OEA was "subject to approval of Board." DTE 33. Yet,

he admitted at trial that no such board approval was sought at the September 26, 1995, Board meeting where Ovitz's hiring as President was purportedly discussed. Tr. 2960:22-2961:1; *see also* Tr. 5455:14-16; 6074:9-13. Additionally, the OLA signed by both Eisner and Ovitz, written by Litvack, and seen by Russell, clearly set out that the OEA was "[s]ubject to the formal approval of the Company's Board of Directors. . . ." PTE 33. The Case Study which provided the baseline for the ultimate negotiations (Tr. 2127:10-2130:5) specifically stated that the OEA would need to be approved by the Board. *See* PTE 64. Exhibit C, the summary of the OEA, purportedly discussed at the September 26, 1995, Compensation Committee meeting also recognized that Board approval was necessary. It states: "Action to be taken: Discussion only. Options and agreement will be approved when *finalized* by Unanimous Written Consent." PTE 370 at WD1188 (emphasis added). Furthermore, the Compensation Committee resolution approving the Option Plan amendments clearly show that the effective award of options to Ovitz – consistent with the minutes of the September 26th meeting – was subject to further approval:

> RESOLVED, that in view of the fact that, as set forth in Exhibit C hereto, certain provisions of Mr. Ovitz's hereinabove-granted stock options are based on amendments of the 1990 Stock Incentive Plan which must be approved by the Board of Directors of the Corporation and by the shareholders of the Corporation, it is hereby provided that (i) such provisions shall *not be effective until the approvals of the Board of Directors and the shareholders of the Corporation have been obtained* . . . .

PTE 41 at WD122 (emphasis added); *see also* PTE 30; 149; 265; 371; 372 at DD1773; Tr. 2548:1-4.

All of these documents and resolutions clearly demonstrate that Board approval of the terms of the OEA was required. The Board failed to ever issue such approval and, as such, acted with gross negligence and in bad faith. The record is bereft of any Board involvement at the critical time when Eisner agreed to hire Ovitz on August 11, 1995 and negotiated material terms of his employment, as reflected in the OLA and then publicly announced as a *fait accompli* on

August 14th. At the September 26, 1995, meeting, the minutes reflect no Board consideration of the prospective terms of the OEA at that stage of the negotiations. When the OEA was physically executed by Eisner and Ovitz on or about December 19, 1995, (PTE 353), no prior Board review or approval of the definitive contract was sought or obtained.

2. Defendants Violated Their Fiduciary Duties With Regard To Adoption Of The OEA

The Old Board treated Ovitz's hiring and approval of the OEA as mere formalities. The Old Board never convened a meeting to approve Ovitz's hiring before that fact was presented internally within Disney and externally to the investing public as a *fait accompli* in the press release announcing his hiring on August 14, 1995, (Tr. 3867:13-16; 5823:17-20; 7679:21-24) — precisely one day after Disney's two most senior executives, and members of the Old Board, expressed to Eisner their opposition to Ovitz's hiring.[46] In fact, Eisner made the decision on his own, in spite of the reservations of Bass and Russell — two of his closest confidants. Bass 42:2-25; Tr. 2701:3-11. Eisner's conduct stands in marked contrast to the input and active participation of Disney's Board in the decision to hire him and Wells in 1984. *See generally* Tr. 3645:1-3646:4; 3648:23-3649:4; 4122:24-4124:14; 7809:4-5; 7810:6-12; 8021:4-24.

Known to some defendants but apparently unknown to others, documents produced on the eve of trial show Ovitz began to receive confidential Disney documents in early August 1995 as if he were already "hired" as President. *See* Statement of Facts Section I.G. Some such late-produced documents show that Ovitz was vested with presidential authority and held himself out to the public as such at least as early as August 14, 1995. PTE 621; 631; DTE 189. At that time, Ovitz also began working at Disney headquarters (Ovitz 162:21-163:3), and construction began

[46] Indeed, Bollenbach testified that he did not even know that Ovitz would definitely be hired when he left the meeting at Eisner's house on the evening of August 13, 1995. Tr. 5422:10-19.

on his palatial new office. *See* PTE 476; DTE 110. On August 28, 1995, the members of the Old Board received an internal memorandum notifying them of a lunch scheduled to "honor" Ovitz after the scheduled board meeting when his election was to be "considered." PTE 216. Old Board members understood that the decision to hire Ovitz was "a done deal" in August (Litvack 126:20-127:8; Lozano 124:20-125:4; 140:10-22; Stern 84:4-8; Tr. 2807:5-23; 7693:19-7694:6; 8198:5-21) — Ovitz's later scheduled election, at best, a formality.[47]

The Compensation Committee gave the OEA only the most cursory scrutiny and consideration. Russell, admittedly acting beyond the scope of his authority under the Compensation Committee charter, negotiated the terms of the OEA for months without saying a word to Watson, Lozano or Poitier. *See* Statement of Facts Section I.C. Russell brought Watson into the fold only as a deal was imminent and to the exclusion of Poitier and Lozano. On or about August 12, 1995, Watson and Russell discussed Ovitz and Eisner's contracts with Crystal, an obvious conflict for Russell. Neither thought to invite Lozano or Poitier to attend. *See* Statement of Facts Sections I.C. and I.D. At that point, anything Russell, Watson, and Crystal discussed was irrelevant – Eisner had already orally agreed to terms with Ovitz on August 11th. The oral agreement was then memorialized in the August 14, 1995, OLA, which neither Watson, Lozano, nor Poitier ever saw or reviewed. *See* Statement of Facts Section I.E.

Although, as discussed above, Ovitz began working at Disney even before August 14th, and had signed the OLA, the Compensation Committee waited for its regularly scheduled meeting held on September 26, 1995, to collectively "discuss" the OEA. No documents were

[47] The Nominating Committee similarly abdicated its duty to "develop and review background information for candidates" as its charter required. DTE 182 at 13. None of the Nominating Committee members – Mitchell, Bowers, Wilson, or Gold – requested any information on Ovitz, interviewed Ovitz, held a meeting to discuss his qualifications, spoke to his colleagues and employees, nor conducted a background check on him. *See* Statement of Facts Section I.F.

circulated to Lozano or Poitier before the meeting regarding the OEA even though Watson and Russell had done rough-market value calculations showing that both Eisner and Ovitz stood to reap potentially hundreds of millions of dollars in options profits. PTE 346; Russell 524:24-526:6; 549:18-550:3; Watson 194:25-195:3. Watson and Russell also failed to copy Crystal's letters to either Poitier or Watson. PTE 58; 59; 215. In fact, Russell never bothered to copy either Poitier or Lozano on his memorandum purportedly memorializing the Committee's involvement in the process. PTE 218; Tr. 2805:8-19.

The Committee met for only one hour on September 26, 1995, and during that abbreviated session, as reflected in the minutes, purportedly discussed numerous other topics in addition to the thirteen items mentioned in the OEA summary attached to the minutes. *See* Statement of Facts Section I.H. Neither Crystal nor any other consultant or expert attended the session. *Id.* A spreadsheet showing the financial consequences to Disney of an NFT as measured by the industry standard Black-Scholes method was not handed out or discussed. *Id.* The Committee did not discuss or consider the meaning of "cause" or the definitions of either "negligence" or "malfeasance" as existing drafts of the OEA were not distributed or requested at the meeting. *Id.* The Committee ignored the industry standard of examining comparable pay of similarly situated executives so that it could intelligently assess the relative value of the pay package and then consider whether Ovitz was worth the money. *Id.* No such discussion was possible anyway as the Committee did not consider Ovitz's qualifications. *Id.*

The Committee adopted a resolution allowing Eisner to finalize the terms of the OEA purportedly within the "parameters" of the contract summary attached to the minutes. *Id.*[48] The

[48] As discussed above, only the Old Board had the authority to approve the OEA because of its "material size" and the plain terms of the charter and bylaws. Even assuming *arguendo* it could

Committee did nothing to ensure that Eisner complied with its directive. In fact, the Committee was not told, and was unaware, that Eisner, Litvack, and Russell had already approved, without its consent, several side deals with Ovitz including the above-market price purchases of his airplane and car. *Id.* Further, although the contract summary and existing drafts of the OEA termed Ovitz's annual bonuses to be "discretionary," Russell later transmitted a memorandum to Ovitz reflecting an "understanding" between them that Ovitz would presumably receive $7.5 million annual bonuses in his first two years. PTE 226.

As reflected in the minutes, the Old Board convened a meeting on September 26, 1995, at 10:00 a.m. PTE 29. During the meeting, the Old Board purportedly went into Executive Session to discuss the terms of Ovitz's hiring even though the minutes reference only a discussion of Russell's pay.[49] *See* Statement of Facts Section I.I. Litvack was unnecessarily excluded from the session as he knew about Ovitz's hiring and knew the terms of his hiring. *Id.* Bollenbach was also excluded. *Id.* Neither Bollenbach nor Litvack expressed, or asked to express, their critical assessment of Ovitz's experience and the negative impact his hiring would have on the Company's management team already in place. Eisner failed to mention his own doubts about Ovitz's veracity and ability to function in a public company which, just weeks earlier, had caused Eisner to wonder "what it would cost in dollars and embarrassment to end our corporate partnership right away." PTE 24 at DD2624.

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do so, the Old Board never passed a resolution delegating this authority to the Committee. Properly interpreted in context, the Committee's charter did not reflect any such general delegation of authority. PTE 465; Tr. 172:6-175:5.

[49] Defendants' claim that the Old Board considered the terms of the OEA during the Executive Session contradicts their contention that only the Compensation Committee had that authority.

Even if Ovitz was discussed at the Executive Session, the Old Board abdicated its duty to adequately inform itself. The Old Board could not have made a rational business judgment to either approve the OEA or to elect Ovitz as President without first knowing the value of his pay package and how that value compared to other similarly-situated executives — the so-called "competitive pay" analysis a board was expected to undertake before hiring a top executive. Tr. 777:24-779:1; 3384:18-3386:14.

The Old Board failed to take even the slightest action to acquire the most minimal information necessary to make an informed business decision on Ovitz's hiring. The Old Board did not have information about the "cost" side of the analysis. As with the Compensation Committee, at the Old Board meeting, there was: (i) no attendance by a compensation consultant (*see* PTE 29; Tr. 2960:19-21; 5704:23-5705:6; 5843:10-12; 7728:14-7729:4); (ii) no compensation consultant report or analysis (*see* Watson 210:16-211:1; Tr. 2960:12-18; 3886:6-19; 5843:4-9); (iii) no knowledge regarding what the standard Black-Scholes valuation of Ovitz's stock option grant was (Tr. 3885:10-19; 7729:5-9); (iv) no analysis of possible option payouts for Ovitz in the event of an NFT (Tr. 3885:10-19; 5455:2-5; 5842:14-17; 7593:14-23; 7716:12-18; 7734:3-7); and (v) no comparables (Tr. 5826:8-12) or survey data that Russell had warned would be necessary (*see* PTE 64 at DD1936-DD1937). The Old Board, like the Compensation Committee, had no idea and made no attempt to inform itself that the compensation package on the table was worth more than any non-CEO President in the United States had yet received. Murphy Report at 7. Even if the Compensation Committee had adequately assessed the costs of the proposed agreement, the minutes do not show that the Compensation Committee made any presentation to the Old Board of any information, opinion, report, or statement about the value of Ovitz's pay. *See* PTE 29. Accordingly, the Old Board

could not reasonably rely on the Compensation Committee's prior actions at all. *See* Statement of Facts Section I.H.

The Old Board was equally in the dark on the "benefit" side of the analysis — *e.g.*, was Ovitz worth it? The Old Board had no idea that Eisner, Russell, Bollenbach, Litvack, and Disney's then largest individual shareholder, Sid Bass, all had serious reservations about Ovitz. *See* Statement of Facts Sections I.C. and I.D. The Old Board did nothing to ascertain Ovitz's checkered employment history as no written materials were distributed at, or prior to, the meeting regarding Ovitz's qualifications. R. Disney 102:25-103:5; Tr. 5443:3-5; 7212:15-18. The Old Board did nothing to learn about how financially unsuccessful the Sony and MCA transactions touted in the August 14, 1995 press release turned out to be or about Ovitz's tangential role in those deals. PTE 315 at DD2328; Tr. 2966:10-13; 7214:10-7215:4; 7699:3-10. Even though it was a matter of public record, the Old Board did not inform itself about Ovitz's settlement with the U.S. Department of Labor regarding his unauthorized use of CAA pension funds. PTE 315 at DD2328; Tr. 2968:7-11; 5699:6-10; 7215:5-9.

Further, although he was going to earn much more than Frank Wells ever did, the Old Board also failed to discuss why Ovitz would not be receiving the same COO title Wells held as President. Tr. 5701:4-15; 5844:3-12. This failure is even more egregious considering the fact that Disney's bylaws mandated at the time that the President hold the COO position. *See* PTE 497 at Art. IV, Section A.

Many directors testified that Ovitz was worth the money because he was the "most powerful man in Hollywood" (Tr. 5820:5-25; 7630:3-7) even though the term was a manufactured press spin Ovitz himself described as "one of the silliest things" he had ever heard. Tr. 1462:22-1463:2. Other directors testified that it was necessary to pay Ovitz huge sums of

money to lure him away from CAA because he was supposedly abandoning a lucrative business. No defendant, however, did anything to ascertain the truth — Ovitz did not earn at CAA what his negotiator was telling Russell, and Ovitz gave up nothing; he sold his business to the CAA "Young Turks" through a self-financed purchase *via* a series of contracts and leases with NewCo. *See* Statement of Facts Section I.B. These deals netted Ovitz over $27,960,570 during his short tenure at Disney alone. PTE 369. Because it did nothing to inform itself, the Old Board did not know that Ovitz did not need special financial incentives to leave CAA. Unlike Eisner and Russell, the Old Board did not know about Ovitz's expressed desire to leave the agency business, the revolt brewing at CAA, Ovitz's "crazed" reaction and humiliation at being left at the altar by Bronfman in favor of his partner, Meyer, and the retirement of his other CAA day-to-day partner/manager, Haber.

The Old Board's torpor extended throughout the process leading to the execution of the OEA in December. The Compensation Committee convened a special meeting on October 16, 1995, at Ovitz's request, to lock in the strike price of his options (Santaniello 98:4-99:19) and to amend the existing 1990 Stock Option Plan to increase to September 30, 2002, the post-termination exercise period of the options. *See* Statement of Facts Section I.J. Again, as to the "cost" side of the analysis, Crystal did not attend the meeting, nor did the Compensation Committee discuss the value of the extension or the possible payouts to Ovitz in the event of an NFT. *Id.* The Compensation Committee was not aware of and made no effort to learn that the post-termination option exercise extension being considered was then the longest such period for any executive in the United States. Murphy Report at 19.

Even if they understood the unprecedented costly benefit they were about to confer on Ovitz, the Compensation Committee did not consider whether their actions would benefit

Disney. In fact, had they performed minimal due diligence instead of rubber-stamping Eisner's decisions, the Compensation Committee would have learned that its actions were sure to hurt the Company. By October 16th, Ovitz knew that his tenure at Disney would be short as he perceived himself to have been undermined by Eisner and Disney's senior management before he even started working at Disney. *See* Statement of Facts Section I.E. Ovitz and his team of lawyers and negotiators subsequently began to focus particular attention on the NFT provisions. Ovitz 273:19-277:15; 8092:12-8093:8; *see also* PTE 125. Eisner also knew that Ovitz would be leaving soon — he thought about the issue during Labor Day (PTE 24) and, just a few weeks after the Compensation Committee meeting, decided to fire Ovitz within a year. Bass 89:18-90:10.

Nonetheless, the Compensation Committee did not discuss the NFT provisions at the meeting. *See* Statement of Facts Section I.H.6. Accordingly, the Committee was unaware that if Ovitz received an NFT, he would earn as much, if not more, than the amounts he would earn by staying at Disney for a full five years — at that point a non-existent probability. Murphy Report at 23. The NFT provisions gave Ovitz a powerful incentive to get out as soon as possible, but that topic was not discussed at the meeting. *See* Statement of Facts Section I.H.6. At the conclusion of the meeting, the Compensation Committee ratified the option extensions, subject to board and shareholder approval, thus perversely giving an individual with one foot out the door, an even stronger incentive to leave as soon as he could with a multi-million dollar payout garnering no benefit to Disney at all.

On November 1, 1995, once again displaying a blindly indifferent attitude for the best interests of the Company, each member of the Old Board executed a written consent approving the amendment of Disney's 1990 Option Plan which further extended the post-termination

exercise period of Ovitz's options. PTE 265. The Old Board acted without a meeting, without expert consultation, without knowledge of the cost in the event of an NFT, and without knowing the overwhelming incentives it would place on Ovitz to leave the Company as early as possible. *See* Statement of Facts Section I.I. The only information provided to the Old Board before each member executed a written consent was a short memorandum from Russell, inexplicably written on Disney Legal Department letterhead, saying only that the proposed amendments to the 1990 Stock Option Plan would facilitate the extension of the post-termination provisions of Ovitz's options under "limited circumstances." PTE 30. No member of the Old Board questioned the meaning of "limited circumstances" or followed up on the issue even when, just two weeks later, an article appeared in the press quoting Crystal as saying that Ovitz's options were worth $110 million and were "excessive . . . by the standards of all the other companies in America, but this is Hollywood. This is what passes for compensation down in La-La Land." PTE 351.

In sum, the Old Board and Compensation Committee abdicated their fiduciary duty to consider material, critical, and reasonably available information and failed to take into account pertinent doubts and fears of senior executives and directors regarding Ovitz's fitness to serve as President. Nor could the Old Board rely on the Compensation Committee to have performed such review, given the Old Board's responsibility to discuss and approve "material" matters and the abject deficiencies in the Compensation Committee processes, and the lack of any formal report by the Committee to the Board with it elected Ovitz as President. Accordingly, defendants cannot be afforded the protection of the business judgment rule with regard to their purported consideration and approval of the OEA.

3. The Director Defendants Cannot Rely On Any Disney Officers Or Experts

While directors may, in certain circumstances, rely upon information provided to them by experts and corporate officers (*see* § 141(e)), in this case the Supreme Court has specifically held that a board *may not* be protected *if* it is shown that:

> (a) the directors did not in fact rely on the expert; (b) their reliance was not in good faith; (c) they did not reasonably believe that the expert's advice was within the expert's professional competence; (d) the expert was not selected with reasonable care by or on behalf of the corporation, and the faulty selection process was attributable to the directors; (e) the subject matter (in this case the cost calculation) that was material and reasonably available was so obvious that the board's failure to consider it was grossly negligent regardless of the expert's advice or lack of advice; or (f) that the decision of the Board was so unconscionable as to constitute waste or fraud.

Brehm, 746 A.2d at 262. In addition, the information must be actually presented to the board and "must be pertinent to the subject matter upon which a board is called to act, and otherwise be entitled to good faith, not blind, reliance." *Van Gorkom*, 488 A.2d at 875; *see also Cinerama*, 663 A.2d at 1174.

Defendants are not entitled to claim reliance on an expert in connection with their participation in the OEA approval process. The selection of Crystal, a retired compensation consultant, was not made by the Old Board or the Compensation Committee, nor was it made with reasonable care. Eisner unilaterally selected Crystal in the middle of August 1995 to work with Russell and Watson on Ovitz's pay package. *See* PTE 10 at DD1100; Crystal 39:15-41:16; Tr. 3258:10-3261:12; 7687:19-7688:2. Disney had been Crystal's only client for over 6 years (*see* PTE 10; Crystal 19:4-14; 39:1-41:16; Tr. 3422:17-24) and he decided to assist on the Ovitz pay package as a "favor" to Eisner (Tr. 3265:3-4), on whose contract he had previously advised in both 1984 and 1989. Tr. 3440:13-19. In fact, Crystal never even signed a written retainer. Tr. 2719:13-16; 3265:13-18. Neither the Board nor the Compensation Committee were asked their opinion as to whether Crystal would be an appropriate consultant (*see* Tr. 2715:6-9; 7787:19-7688:2), nor were they even informed that he was working with Russell and Watson on

a pay package for Ovitz. *See* Tr. 5706:10-14. Neither the Compensation Committee nor the Board reviewed Crystal's resume or discussed his recent experience — or rather lack thereof — in compensation consulting. *See* Tr. 7688:9-18. No other compensation consultants were even considered, despite the fact that Crystal had clearly not been involved in evaluating compensation packages for many years. *See* Tr. 8053:22-8054:6.

Additionally, defendants did not rely on Crystal, as he did not communicate with the Old Board or the Compensation Committee directly or indirectly. *See* Tr. 3602:18-21. Crystal never rendered an opinion, written or otherwise, to either the Compensation Committee or the Old Board on the fairness or reasonableness of the OEA. Tr. 3534:2-15. Rather, Crystal met with Russell and Watson for two days to go over the terms of Ovitz's proposed contract. *See* Tr. 3483:10-13. Their work was apparently still ongoing when Eisner and Ovitz had reached their oral agreement in Aspen in August 1995. No other members of the Compensation Committee nor the Old Board dealt with Crystal (*see* Tr. 2778:7-15; 2786:16-2787:5; 3487:11-16; 3602:18-21) or were aware that such work was being done. *See* Tr. 2787:23-2788:6. Crystal was never given a copy of the proposed contract; Russell told him what the terms would be. *See* Tr. 3601:4-19. Additionally, Crystal was not informed that Ovitz was in the process of negotiating an earn-out and property lease agreement with CAA, which was expected to pay him considerably over the course of his contract term with Disney (*see* Tr. 3541:15-3542:6), nor was he told how much Ovitz was currently making at CAA. *Id.*

Crystal drafted a letter to Russell on August 12, 1995, criticizing Ovitz's pay package due to the fact that: (1) "there really is no precedent for offering a non-CEO the sum of $25 million per year"; (2) "there is only one executive - Sandy Weill - who can provide anything in the way of fighter cover"; and (3) "there is no real comfort to be had from looking at . . . 'comparables.'"

PTE 366 at DD1878. Russell was unhappy with the letter and asked Crystal to re-write it. *See* Tr. 3286:2-7. Crystal wrote a second letter to Russell on August 15, 1995, but did not change his assessments. Instead, Crystal further criticized Ovitz's pay package as giving Ovitz "the best of both worlds, *i.e.*, low risk and high reward." PTE 59 at DD1391. Crystal lamented that "absolutely none of my advice concerning Mr. Ovitz was taken" and specifically noted that the planned size of Ovitz's contract undermined his efforts to convince Eisner to reduce his compensation demands. *Id.* at DD1392. On August 17th, Crystal's work with Disney regarding Ovitz effectively terminated (*see* Crystal 180:21-25), even though the agreement terms subsequently changed. *See* PTE 353; *see also* PTE 373 (discussing 162(m)). Crystal testified that his letters did not analyze the value of the OEA to Ovitz in the event of an NFT. Tr. 3528:23-3529:3. In all events, Crystal's letters were not formal opinion letters such as those Crystal gave the New Board in connection with Eisner's employment agreements in 1984, 1988, and 1996. *See, e.g.*, PTE 362.

Russell, Watson, and Eisner withheld Crystal's letters from the rest of the Compensation Committee and the Old Board. *See* Tr. 2790:11-14; 7666:20-7668:13; 7707:21-7708:3.[50] Poitier never spoke with Crystal (*see* Tr. 7179:9-14), nor did he ever ask to speak with him regarding the terms and costs of the OEA. *See* Tr. 2790:22-24. Lozano did not receive Crystal's letters nor did he ask for them to be provided. *See* Lozano 80:9-14; Tr. 7666:20-22; 7667:14-16. Lozano did not speak with Crystal (Tr. 7687:6-10) or ask to speak with him. *See* Tr. 2518:22-24.

Moreover, at the Compensation Committee meeting on September 26th, the first time the entire Compensation Committee purportedly discussed the OEA, Crystal did not participate

[50] Crystal's letters were addressed only to Russell and cc'd only to Watson. Russell forwarded them only to Eisner. *See* PTE 58; 59; 218.

(PTE 370; Russell 515:25-516:3; Tr. 2518:9-24), his letters were not distributed, his criticisms were not discussed (Tr. 7707:21-7708:3), and no member of the Committee requested to speak with him. *See* Tr. 2518:22-24; 2910:17-19). There was no discussion of the lack of comparables as Crystal had previously informed Watson and Russell. *See* Tr. 7181:21-7182:1; 7701:4-6.[51]

Similarly, at the September 26th Old Board meeting, Crystal did not make any presentations or participate (*see* PTE 29; Tr. 2960:19-21; 5704:23-5705:6; 5843:10-12; 7728:14-7729:4), his letters were not distributed (*see* Watson 210:16-211:1; Tr. 2960:12-18; 3886:6-19; 5843:4-9), his criticisms were not discussed (Tr. 3735:1-5; 5707:9-5708:7; 5924:3-9; 7729:2-4), and no member of the Old Board requested to speak with him. *See* Tr. 3602:18-21. Crystal not only did not attend, but neither his opinions nor criticisms were discussed at the October 16th "special" meeting of the Compensation Committee as well. *See* Russell 571:8-13; Schultz 88:25-89:3; Tr. 2972:11-17.

Thus, the Old Board and Compensation Committee cannot claim reliance on Crystal under § 141(e). Defendants' attempted (or presumed) reliance on this "safe-harbor" is, therefore, misplaced and inappropriate. Indeed, the Board's failure to obtain expert advice regarding the OEA, the Ovitz stock option grant, the extended exercisability of his options and the cost to Disney of an NFT, is itself a knowing or reckless disregard of reasonably available information and a bad faith breach of fiduciary duty.

C. The Director Defendants Acted With Gross Negligence And In Bad Faith In Granting Ovitz the NFT

1. The New Board Was Required To Approve The Terms of Ovitz's Departure

[51] No member of the Compensation Committee or the Old Board asked him to provide a spreadsheet or other type of table which utilized the industry standard Black-Scholes methodology to value the option package and the cost of an NFT. Tr. 3537:11-3541:5.

As discussed above, the decision to give Ovitz a full NFT payout was material to Disney, requiring Board consideration and approval. *See* Argument Section I.B. The New Board was thus under a duty to obtain, consider, and evaluate all material information reasonably available to it prior to deciding to grant Ovitz an NFT. In addition, Disney's bylaws and internal governing documents confirmed the necessity of board action under the circumstances presented in this case.

Disney's bylaws and charter granted to the Board the sole authority to hire and terminate the senior officers of the Company. *See* PTE 498 at WD7100; DTE 185 at 9. Under Article IV, Section 2 of the bylaws, the President shall be chosen by the Board, and the President "shall hold [his] office[] for such terms and shall exercise such powers and perform such duties as shall be determined from time to time *solely* by the Board of Directors." PTE 498 at WD7100 (emphasis added). Disney's bylaws continued, "[a]ny officer elected by the Board of Directors may be *removed* at any time by the Board of Directors with or without cause."[52] Disney's charter also provided that officers held their positions for such terms and perform such duties as "solely" determined by the Board, and "subject to the right of the Board of Directors to remove any officer or officers at any time with or without cause." DTE 185 at 9. 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. PTE 29 at WD1196; Lozano 153:20-154:23.

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[52] In contrast, the provisions of Disney's bylaws, which set forth the Chairman of the Board/Chief Executive Officer's powers and responsibilities, while granting to the CEO supervisory authority, did not grant the CEO the right to terminate or remove senior executives appointed by the Board. *See* PTE 498 at WD7100-WD7101.

In addition, the Stock Option Plan made the Compensation Committee's approval of Ovitz's termination necessary, particularly given that the lion's share of Ovitz's severance was payable in the form of immediately vested stock options. PTE 41 at WD135.[53] The Compensation Committee approved the Stock Option Plan at a special meeting of the Compensation Committee on October 16, 1995. PTE 41. The Board approved the Stock Option Plan by unanimous written consent. PTE 265. The Stock Option Plan was also subject to shareholder approval, which was obtained by a shareholder vote. *See* DTE 145. By bypassing the Compensation Committee in connection with Ovitz's termination, the Board 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 literally, and directors' failure to abide by the terms of an option plan was a violation of their fiduciary duties).

Moreover, in prior proceedings in this case, defendants fully admitted that it was ultimately the Board's responsibility to consider and determine Ovitz's termination under the OEA. In their briefing to the Delaware Supreme Court, defendants stated that "[t]he Board controlled whether Ovitz received a Non-Fault Termination, which is the only relevant fact." *See* Indiv. Defs. Appellees' Br. at 9. Defendants also stated, "[A]s the Court of Chancery found, 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 exercisable." *Id.* at 27. Defendants acknowledged that the "option to pursue [the termination of Ovitz with or

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[53] "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(s) therefore and the consequences thereof." PTE 41 at WD135. 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. . . ." *Id.* at WD134.

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. Finally, defendants stated, "There 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 had to be an affirmative action by the board of directors to enable Mr. Ovitz to depart with all of the benefits." Del Supr. Ct. Oral Arg. at 24.[54] Contrary to defendants' representations that the Board had to, and did act on Ovitz's termination, the trial evidence shows that the New Board made no decision, but rather supinely acquiesced in Eisner's decision to grant Ovitz an NFT.

2. Defendants Acted With Gross Negligence And In Bad Faith In Connection With Ovitz's Receipt Of A Full NFT Payout

The Board never met or discussed as a body the terms of Ovitz's departure. Instead, they deferred to Eisner to negotiate Ovitz's severance without any formal delegation. Defendants abdicated their duties despite the fact that there was material information readily available to them indicating available grounds to terminate Ovitz for cause, or warranting further investigation, which could have provided reasonable grounds for avoiding the severance payment to Ovitz under the NFT provision.

a. Eisner Fails To Disclose Material Information To The Board

Eisner's failure to disclose material information to the other directors was both grossly negligent and in bad faith. Eisner was aware of problems with Ovitz from the beginning, and he considered terminating him almost immediately after Ovitz started work, long before the OEA

[54] In reliance on these representations, this Court initially dismissed plaintiffs' derivative complaint in part based on its assumption that the board had met and conferred to consider Ovitz's termination and the Court could not engage in substantive reconsideration of such a business judgment (*In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 363-4 (Del. Ch. 1998) — a board decision which in fact was never made.

was even executed. *See* PTE 24 at DD2449 ("By Labor Day I was wondering what it would cost in dollars and embarrassment to end our partnership right away."); Bass 76:9-77:25; 88:13-90:16.

Eisner blatantly violated his fiduciary duties by failing to share and discuss with all the other director defendants material information regarding Ovitz's repeated problems with veracity, fulfillment of responsibilities, failures to obey the directives of Eisner, his alienation of top executives at Disney due to his lack of attention to Disney business, and inability or unwillingness to comply with various Company policies. *See, e.g.*, PTE 20; 24; 67; 79. Many of these observations involved serious problems involving Ovitz that, when considered individually or collectively, indicated grounds for the Board to terminate Ovitz for cause. *See, e.g.*, PTE 17; 24; 67; 79; 318; 378.[55]

From late September 1996 when Eisner allegedly first began to inform board members that Ovitz was going to be terminated, he never disclosed to the other directors the full extent of his knowledge regarding Ovitz's misconduct. For instance, Eisner selectively shared his October 10, 1996 memorandum and his May 26, 1996 email to Sid Bass regarding Ovitz with Russell and Watson, excluding the other directors. *See, e.g.*, T. Murphy 91:4-20; Tr. 3814:23-3815:2; 5730:23-5731:13; 7575:17-7576:5. Eisner may have shared his November 11, 1996 letter to Ovitz with Russell, but no other directors were ever made aware of its existence, nor did Eisner ever choose to discuss its contents with the other directors. *See, e.g.*, Gold 183:6-14; O'Donovan 182:10-20; Tr. 3818:22-3819:11; 5025:17-5026:11; 5731:14-5733:2. Eisner acted in bad faith,

[55] Eisner's memoranda, such as PTE 24, also reference other memoranda which were not produced in this case and which apparently contain further discussions regarding Ovitz's repeated failures as President and which were available at that time. *See, e.g.*, PTE 24 at DD2449-DD2450, DD2452-DD2454; 79 at DD2625.

with gross negligence and in breach of his duty of candor when he chose not to share this material information with the Board.[56]

Furthermore, although he allegedly asked Litvack for an opinion as to whether or not Ovitz could be terminated for cause, Eisner failed to give to Litvack *any* of his contemporaneous documents detailing Ovitz's misconduct, and there is no evidence that Eisner discussed with Litvack the details contained in those documents. *See* Litvack 643:2-11; Tr. 6143:3-9; 6378:18-6379:9. Eisner therefore knew that whatever opinion he solicited from Litvack could not have rested on a fully informed basis.

b. Russell, Litvack, And Watson Received Material Information From Eisner Or Other Sources Regarding Ovitz's Presidency Which They Failed To Disclose To The Other Director Defendants

Russell and Eisner acted in bad faith and were grossly negligent when they failed to disclose to the other directors Ovitz's alleged violations of Company rules and guidelines, as well as other performance failures. For instance, Eisner assigned Russell to review Ovitz's expense reporting, as well as to investigate whether Ovitz had violated Company policies regarding gift-giving and the receipt of gifts. *See, e.g.*, PTE 17; 318; 378. Russell was asked to review instances of Ovitz buying gifts with Disney money, which he kept in a "gift stock," and then giving these gifts to personal acquaintance often with no business purpose. PTE 378; Tr. 3049:18-3061:6. It is unclear if Ovitz ever reimbursed the Company, even after being told he

[56] In addition to the referenced memos, Eisner maintained files on Ovitz which contained documents relating to Ovitz's trustworthiness and failures to carry out directives and observe Company policies. *See* Tr. 4553:1-16; 8280:3-8281:7; *see also* Affidavit of Edward Nowak at ¶ 3. However, when it came time to decide if Ovitz could be fired for cause, Eisner did not share these files with any of the other defendants. Indeed, to this day, Eisner incredibly denies that such files, designated "OM," and of which he was overwhelmingly identified as the source in defendants' own source logs and submissions, were ever maintained or existed.

needed to do so by Russell. Tr. 3053:12-19. Russell was also asked to look into a situation involving Ovitz's personal financial advisors buying Disney stock. PTE 17. Throughout the fall of 1996, Russell and Eisner failed to disclose to the other directors any of these alleged incidents implicating problems with Ovitz's veracity and performance as President. *See, e.g.*, Tr. 3943:10-18; 5729:12-5730:22; 5953:7-22; 7061:5-9; 7600:17-20; 7968:17-24. For his part, Russell testified that, by the time Ovitz was terminated, he did not believe that Ovitz had come into compliance with expense guidelines Russell had addressed with him. Tr. 2883:24-2885:21. Again, Litvack was unaware that Eisner had recruited Russell to investigate Ovitz's expense reporting, Ovitz's gift-receiving, or Ovitz's purchase of Disney stock when he purportedly made his determination that Ovitz could not be fired for cause under the OEA. Litvack 276:16-20, 621:3-22; Tr. 6361:21-6362:8; 6438:21-6439:3.

Litvack, however, was aware of certain problems with Ovitz's veracity and performance as well. Although he tried to temper his in-court testimony, Litvack testified that Ovitz repeatedly lied and was considered untrustworthy. *See* Tr. 6132:11-6133:5; 6374:21-6377:2. Litvack was also aware of Ovitz's failure to manage Hollywood Records, after Eisner had asked him repeatedly to address its operations. *See* PTE 780 at WD13842; Tr. 6135:5-17. Moreover, Litvack lectured Ovitz about the impropriety of giving gifts to Company employees. *See, e.g.*, Ovitz 243:8-15; Tr. 1253:9-24. Litvack never shared any of this information with the other directors during the fall of 1996. In fact, there is no indication that Litvack ever told any of the directors other than Eisner that he would leave Disney if Ovitz remained and that he had discontinued communicating with Ovitz in May 1996. *See, e.g.*, Tr. 7573:17-7574:4.

Watson received two of Eisner's memos detailing Ovitz's performance problems. *See* PTE 67; 79. Yet Watson never questioned whether the Board should investigate to determine

whether cause existed to terminate Ovitz and avoid paying him under the NFT provisions of the OEA. *See* Tr. 7916:7-14. Moreover, Watson never informed his fellow board members that he was aware of the concerns Eisner had shared with him. Tr. 7881:10-7887:3 (Watson admitting that he did not think it was important to share contents of PTE 79 with other board members); 7972:23-7973:23. Watson viewed Eisner's transmission of information to him about Ovitz to be treated as "confidential." Tr. 7885:10-7887:3.

c. All Directors Were Grossly Negligent And Acted In Bad Faith When They Consciously And Intentionally Disregarded Their Duties To Act

By the fall of 1996, most of the directors were aware that Ovitz was having problems at Disney that went far beyond him being a "bad fit."[57] Problems with Ovitz at Disney were widely reported in the press in 1996, some of which should have prompted concern by all directors as to Ovitz's fitness for office. *See, e.g.*, PTE 8; 85; 303; 507. For instance, a discussion of Tom Murphy's reactions to Ovitz's problems at Disney, which occurred at a dinner with Bob Iger and top ABC news people, appeared as a part of a larger article discussing Ovitz's problems at Disney.[58] *See* PTE 507. A *Vanity Fair* article authored by Kim Masters featured strong criticism of Ovitz's performance while President at Disney, including quotes from former CFO Steven Bollenbach (which he confirmed at trial), who had left Disney, in part, because of his inability to work with Ovitz. *See* PTE 8 at DD2123, DD2125; Tr. 5399:7-5401:4; 5412:18-5413:9; 5471:22-5472:6. Eisner, Litvack, O'Donovan, Murphy, Watson, and Bowers all received this article or testified that they read the article prior to the execution of Ovitz's

[57] Stern testified at trial that Ovitz was "destructive to the core values of the company," and Thomas Murphy stated that Ovitz was "like a cancer in the organization." Tr. 7556:11-16; 8160:15-24.

[58] Thomas Murphy also testified that he continued to hear that Ovitz was having trouble at Disney through press reports. Tr. 7553:20-7556:2.

termination letter of December 12, 1996. *See* PTE 89; Bowers 285:23-288:9; O'Donovan 176:22-177:19; Tr. 5199:20-5200:23; 5929:7-15; 5930:2-13; 5962:4-10; 6580:13-15; 6757:14-21; 7574:10-14; 7916:23-7917:3. Furthermore, some articles chronicled allegations that Ovitz had concocted a sexual harassment scheme to lure an executive to Disney (Tarses) (*See* PTE 85; 303), as scheme which had lasting adverse effects on Disney with competitors and about which Eisner expressed his disappointment. *See* PTE 24 at DD2449; 85; 303; Bass 123:7-125:5; Ohlmeyer 80:18-81:25.

Ovitz's first termination letter was executed on December 12, 1996. PTE 13. Eisner claims to have called each of the directors on a one-on-one basis on the same day to notify the directors that Ovitz had been terminated. DTE 413. Many of the defendant directors testified that this is how they first learned that Ovitz had been terminated. *See, e.g.*, Tr. 3802:6-16; 5868:16-20; 5932:7-13; 7556:3-6; 7763:4-12. It was clearly the Board's obligation to determine the nature and consequences of Ovitz's termination, but the Board failed to comply with its own resolutions, bylaws, and other governing documents by allowing Eisner and Ovitz to make the determination that Ovitz would receive an NFT. Furthermore, defendants abdicated their duty of care to obtain, consider and evaluate all reasonably available material information prior to Ovitz's termination. *Brehm*, 746 A.2d at 258-9. Defendants ignored their duty to inquire and investigate when there was information reasonably available to them which could affect the determination whether there was "cause" to fire Ovitz pursuant to the OEA and avoid granting an NFT payout. *See id.*; *Van Gorkom*, 488 A.2d at 875. Despite the fact that Eisner and Ovitz had a continuous dialogue regarding Ovitz's departure purportedly from September 21, 1996 until the first termination letter of December 12, 1996, the directors never once convened a

meeting to discuss any issues implicated in Ovitz's termination prior to the execution of the termination letter on December 12, 1996 or thereafter.[59]

3. The New Board Cannot Rely On Disney Officers Or Experts In Connection With The Decision To Grant Ovitz An NFT

Litvack never discussed the concepts underlying a termination for cause under the OEA with the members of the New Board until at least the January 27, 1997 board meeting, long after Ovitz had been terminated pursuant to the NFT provision in the OEA and after this action had already been commenced. *See* Tr. 6226:12-16; 6286:23-6288:10. Litvack never discussed the concepts of "gross negligence" or "malfeasance" with the full New Board prior to Ovitz's termination. Tr. 7614:10-19. Moreover, Litvack never provided to the New Board, either prior to or after Ovitz's termination, any information, opinion, report or statement discussing whether Ovitz could be terminated for cause under the OEA.[60] Tr. 6130:4-7. *See also* Tr. 3120:10-13; 3920:6-18; 5608:24-5609:14; 6130:1-7; 7247:19-7248:2; 7765:1-5. Accordingly, the New Board could not have reasonably relied on any opinion Litvack purportedly reached. § 141(e); *Brehm*, 746 A.2d at 261-2.

No employment law attorney or expert was consulted or retained by the Old Board to render an opinion as to whether Ovitz could be terminated for cause under the OEA, either before or after Ovitz's termination. *See, e.g.*, Tr. 3120:10-21; 5879:1-10; 7614:10-19; 7764:12-16. The Old Board never considered whether it was possible to negotiate a settlement for less

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[59] Eisner's self-serving testimony that he regularly briefed the directors in one-on-one conversations beginning in September 1996 regarding the likely firing of Ovitz if credited (as it should not be), would only accentuate the directors' gross abdication of duty by failing to act on facts that were allegedly being reported to them.

[60] Moreover, Litvack never advised the Board that no meeting was necessary to discuss Ovitz's termination or the NFT (Tr. 6339:22-6343:19), and the directors clearly had the authority to call a meeting on their own. PTE 498 at Art. II, Section 3.

money or if there were alternatives to paying Ovitz the full amount under the NFT provisions of the OEA. *See, e.g.*, Tr. 4105:18-4106:20; 5784:2-5787:11; 5881:11-14; 6002:17-6003:24; 6795:18-6796:10; 7053:15-23; 7245:16-19; 7606:19-7607:3; 7765:6-10. None of the attorney directors independently investigated as to whether Ovitz could be terminated for cause under the OEA or made lawyerly inquiry of Litvack as to the nature of his analysis (if any). *See, e.g.*, Tr. 3145:8-3148:10. Moreover, the Board did not retain either a compensation expert or consultant to value what the payout to Ovitz would be if he was granted a non-fault termination under the OEA.

Defendants completely abdicated their fiduciary responsibility to make an informed decision as to whether and on what terms Ovitz was to be terminated. At a minimum, the New Board had an opportunity to intervene after the December 12, 1996 announcement of Ovitz's termination and payout effective on December 27th. The silent record proves the New Board's supine acquiescence while a storm of controversy erupted after December 12th regarding the generous payment that Eisner was conferring on Ovitz.

III. THE DIRECTOR DEFENDANTS CANNOT SATISFY THEIR BURDEN OF PROVING ENTIRE FAIRNESS

A. Legal Standards

Plaintiffs have rebutted the presumption of the business judgment rule and the burden thus shifts to defendants to prove entire fairness by a preponderance of the evidence. Defendants must prove that the OEA and Ovitz's NFT payout were the products of fair dealing and fair price. *See Pereira v. Cogan*, 294 B.R. 449, 526-27 (S.D.N.Y. 2003); *Cede*, 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 Cinerama*, 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 Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993) ("Because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation") (citation omitted); *Solomon v. Armstrong*, 747 A.2d 1098, 1113 (Del. Ch. 1999), *aff'd*, 746 A.2d 277 (Del. 2000) (The "burden of proving entire fairness is often a daunting task," involving a "standard so exacting that it ordinarily, but not invariably, results in a finding of liability.").

The "fair dealing" aspect of entire fairness essentially deals with whether or not the transaction came about as a result of a fair process. The fair dealing aspect requires the Court to evaluate the timing of the transaction, initiation, structure, negotiation, and disclosure to the board as well as how director (and shareholder) approval was obtained. *See Weinberger*, 457 A.2d at 711; *Emerging*, 2004 Del. Ch. LEXIS 70, at *116. In this case, the same facts plaintiffs use to demonstrate the directors' gross negligence and bad faith as a means of rebutting the presumption of the business judgment rule and various affirmative defenses equally establishes that the defendants cannot satisfy their burden of demonstrating that the hiring and firing of Ovitz were the product of fair dealing.

"Fair price" relates to the financial and economic aspects of the challenged transaction. *Cinerama*, 663 A.2d at 1162-63; *Weinberger*, 457 A.2d at 711. In a case such as this, involving alleged breaches of fiduciary duties relating not to the "price" received (as in, for example, a freeze-out merger transaction (*see, e.g., Weinberger*)), but to executive compensation and severance, the "fair price" element necessarily transmutes into an assessment of whether the contracts or transactions at issue were substantively "fair" to the corporation when authorized or

permitted, an analysis which, of course, remains intertwined with an assessment of the process by which the challenged matters were approved.[61]

B. The Director Defendants Cannot Meet Their Heavy Burden Of Showing That The OEA Was "Entirely Fair" To Disney

For the same reasons discussed in Argument Section II.B., the process in approving the OEA was not entirely fair as the Old Board violated its fiduciary duties and acted in bad faith in connection with approving the OEA. Eisner unilaterally put Russell in charge of the negotiations, specifically excluding the head of human resources (Litvack), even though Russell was not an officer and had no authority to negotiate under the Compensation Committee charter. PTE 465; Tr. 2677:15-2678:15. Russell did not negotiate at arm's length as he repeatedly accepted Goldman's self-serving statements about how much Ovitz was making at CAA and how much Ovitz would be "giving up" to come to Disney. Tr. 2755:2-22; 2757:6-10. Russell, as Eisner's personal lawyer, had an ethical duty to represent him without conflict (Tr. 2662:20-2663:4) — and Eisner and Russell understood from Crystal that a large pay package for Ovitz would provide "fighter-cover" for a new contract for Eisner then being discussed. PTE 58 at WD431.[62]

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[61] *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).

[62] The inherent unfairness of the process in connection with the OEA and Ovitz termination was manifest in defendants' total abandonment of collective deliberation of those "material" issues. Defendants testified about one-on-one, undocumented conversations between themselves and Eisner and discussions during "informal" meetings of directors. *See, e.g.*, Bowers 183:13-184:12; Lozano 54:13-56:5; Mitchell 17:23-20:7; Tr. 3802:6-16; 5868:16-20; 5932:7-13; 6565:8-19; 7556:3-6; 7763:4-12. These discussions, to the extent they ever occurred, cannot substitute for the deliberative process that is the hallmark of informed business judgment. DeMott Report ¶ 7.

Because the process was unfair, the Court should accord little, if any, weight to the arguments regarding "fair price." As the Court held in *Bomarko,* 794 A.2d at 1183, and *Metropolitan Life Insurance Co. v. Aramark Corp.,* 1998 Del. Ch. LEXIS 70, at *7, because the process/price inquiries are necessarily intertwined, a showing of unfair process makes any attempt at proving fair price inherently suspect. In any event, and as shown below, defendants cannot meet their heavy burden of proving "fair price." The NFT was excessive under the circumstances and its termination provisions did not comply with Delaware law and, in fact, constituted waste.

1. The Unprecedented Size Of The OEA Was Not "Entirely Fair"

Prior to making an offer of employment to an executive, it is incumbent upon the board to establish a "market price" for the services expected. Murphy Report at 6. Such information sets a critical benchmark that should guide the board in deciding how much to offer a prospective executive. *Id.* The Old Board completely eschewed this imperative step, instead choosing to offer Ovitz a compensation package that plaintiffs' expert determined was well above the maximum observed for any other president in the media and entertainment industries, (*id.* at 7), and far in excess of that received in 1995 by any non-CEO president in the *S&P 500. Id.* at 8. Ovitz's compensation package was *ten times higher* than the median pay in the S&P 500 (and eight times higher than the 75th percentile) (*id.*), while his total compensation (including the grant date value of his stock options) was *70 times higher* than the median total pay (and 40 times higher than the 75th percentile). *Id.* at 9. In addition, the value of Ovitz's 1995 option grant was *more than double* the value of options granted to any other executive (including CEOs) during any year prior to 1996. *Id.* at 10.

Moreover, on a provision-by-provision basis, Ovitz's "severance arrangements were unusually generous" in virtually all regards. *Id.* at 23. In particular, his employment term (five

years) was higher than is typically observed (*id.* at 12-13), his effective target bonus of 7.5 times base salary was far in excess of any other observed target bonus (*id.*), and his initial option grant was orders of magnitude larger than the signing-grants received by other executives. *Id.* at 13-14. As a result, in all respects, Ovitz's compensation package was clearly excessive and unreasonable when measured relative to the going rate for individuals in the marketplace who, unlike Ovitz, had the proven skills and experience required to manage the operations of large complex publicly-traded corporations. *Id.* at 11.[63]

Defendants likely will argue that the amount of compensation Ovitz earned as a partner at CAA justified Disney offering him such an excessive and exorbitant pay package. There is no record evidence, however, that shows how much Ovitz actually made while at CAA. In fact, the only demonstrative proof of how much Ovitz was making at CAA, was a W-2 from 1995, in which he reported compensation of $17,802,293.01. PTE 200; Tr. 1507:15-23 (agreeing that compensation reported in W-2 was "a lot less than [$]25 million"). Also significant was the fact that Ovitz was not actually giving up any of that income steam by coming to Disney because he had negotiated a lucrative earn-out that would extend for up to four yeas. PTE 206.

While deviating from the "market price" to a certain extent is acceptable in order to attract individuals who are particularly well-suited and appropriate for the position or who are

[63] Professor Murphy is not alone in his assessment that there were no comparables to Ovitz's pay package within the industry, and that the OEA was "excessive." Russell, the chief negotiator of the OEA, wrote that the "[b]ase salary is top amount for any corporate officer, and significantly above CEO, and others at highest level. . . . Incentive bonus . . . in excess of previous office holder and based on Company projections should yield total compensation package at highest levels of corporate America. . . . Number of stock options is far beyond standards applied in Company and in corporate America and will raise very strong criticism." PTE 64 at DD1936. Additionally, Crystal, the Compensation Committee's purported consultant, wrote that "there really is no precedent for offering a non-CEO the sum of $25 million per year;" that "there is only one executive – Sandy Weill – who can provide anything in the way of fighter cover;" and that "there is no real comfort to be had from looking at . . . 'comparables.'" PTE 58 at WD430.

difficult to lure to a new Company, such was not the case with respect to Ovitz. Ovitz had never worked at a publicly-traded company before, nor for that matter, a company even close to the size and market-capitalization of Disney. Tr. 1114:17-19; 2701:20-23. He had no experience managing a diverse entertainment conglomerate, running theme parks, overseeing hotels, producing movies, or serving as a number two. Ovitz's entire work history was at CAA, a talent agency that had only three partners, 25 senior executives, and 150 agents, and was housed within a single office building. Ovitz 24:22-25:23. While at CAA, Ovitz, although the majority owner, was not even responsible for running the day-to-day business operations or office management. Ovitz 22:3-6; Tr. 2117:18-21. Moreover, Ovitz had no experience whatsoever in serving as an officer or director of a publicly-listed company (Tr. 1114:17-19) — a problem Bollenbach identified at the August 13th meeting. Bollenbach 128:8-19; Tr. 5285:9-11. Ovitz's lack of experience and absence of necessary skill sets certainly did not warrant such an excessive deviation from appropriate benchmarks within either the industry or the S&P 500.

Furthermore, substantial questions about Ovitz's veracity and ethics existed in Eisner's mind before Disney hired Ovitz. Bass 43:23-46:11, 48:6-49:8; Russell 158:2-160:24. Eisner questioned Ovitz's ability to focus and mental stability. PTE 194 at DD1931. Eisner and Russell questioned whether Ovitz's personality was suited to working in a public company. *Id.* at DD1930. These traits not only necessitated that the Board be extremely careful in considering whether he would be an appropriate individual to serve as Disney's President, but that they ensure that his compensation package be commensurate with his level of experience. Focused scrutiny on the contract's severance provisions also became even more critical.

Additionally, there was no need to "lure" Ovitz away from CAA, which might have explained a *slight* upward deviation from the "market price." He had already decided to move

into the public arena. Ovitz 96:11-15. In his own words, he had a "desire to move on and to try to become a bigger fish in a bigger pond." Tr. 1257:16-21; 2705:8-12; 4696:11-19. Ovitz had identified MCA's Universal Studios and Disney as the most appropriate and interesting prospects for his move. Ovitz 96:8-18. However, Ovitz failed in his attempt to go to MCA's Universal Studios, becoming damaged goods. Bronfman 28:13-31:19. Bronfman hired Ron Meyer, Ovitz's partner at CAA, a turn of events that "crushed" Ovitz and left him without anyone to run and manage CAA. Tr. 1285:6-17. In addition, during the same time period, Bill Haber, Ovitz's other partner at CAA, withdrew from the agency business entirely. Ovitz 165:12-16; Tr. 2120:16-2121:5. Meyer's move to MCA's Universal Studios and Haber's transition led Ovitz to decide that he "just didn't want to continue in the service side of life." Ovitz 103:16-19. The adulation Meyer received at the Sun Valley Conference for his new position at MCA's Universal Studios left Ovitz humiliated and "crazed" and open to Eisner's overtures. PTE 195; Tr. 2773:23-2774:6.

2. The NFT Provisions Were Not "Entirely Fair"

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 quantify 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.

That the OEA provided Ovitz with a disincentive to remain in his position at Disney is apparent upon a plain reading of its terms. Under that agreement, and given Ovitz's lack of any

expectation of being rehired at the end of the initial five-year term, Ovitz was at all times better off with an NFT than working, 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 if he served out all five years of the agreement.[64] Murphy Report at 23. Given the generous severance terms in his employment contract, there were virtually no incentives for Ovitz to stay at Disney (especially since there was no mitigation clause or non-compete agreement that would limit his opportunities on the outside market). *Id.* Once he developed a preference for leaving or could not expect to be rehired (which occurred virtually concurrently with announcement of his hiring), the value of the NFT payment significantly exceeded the present value of remaining employed. *Id.* For example, Ovitz was guaranteed, in the event of an NFT, the present value of $7.5 million per year in bonus compensation through the remaining years of his contract, whereas, under ordinary circumstances, he would only be entitled, under the OEA, to a discretionary bonus with no guaranteed minimum. In addition, if Ovitz received an NFT, he was also entitled to receive a one time $10 million contract termination payment that was not discounted to present value to account for early receipt. PTE 7 at WD210.

Moreover, under Delaware's specially tailored rules and principles governing executive compensation, particularly as those rules and principles are applied to the granting of stock options, the OEA represented a wasteful transaction for Disney *ab initio*. No reasonable person of ordinary sound business judgment (*see, e.g.*, *Grobow*, 539 A.2d at 189) would have approved a compensation package that was, through its structure, a disincentive to continue employment,

[64] There was no discussion whatsoever of the dis-incentivizing effect of the NFT provisions with the OEA at either the Compensation Committee meeting on September 26, 1995 (Tr. 7704:11-20) or at the October 16, 1995 "Special" meeting of the Compensation Committee (Tr. 7231:6-10; 7736:16-21), much less at any meeting of the Board.

when that very employee/officer already had a strong incentive to depart as soon as possible and could not have entertained any serious doubt when signing the contract that not only was he unlikely to be rehired, he was likely to be fired within the foreseeable future.[65] *See Brehm*, 746 A.2d at 264 (suggesting that "[i]rrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith"); *Saxe v. Brady*, 184 A.2d 602, 610 (Del. Ch. 1962) ("what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth what the corporation has paid").

The record shows that Ovitz was already disgruntled as early as the conclusion of the meeting at Eisner's house on August 13, 1995, and could not reasonably expect to be rehired at the end of five years, much less last that long. Ovitz testified that he had lost Eisner's support from "the day that I walked into his house in the meeting with . . . Sandy and Mr. Bollenbach. . . . he [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 was going to be an uphill fight and that was the beginning for me of the uphill fight. It was a difficult position." Ovitz 532:17-533:19. Thereafter, Ovitz and his attorneys paid particular attention to the NFT provisions of the then circulating OEA drafts. Ovitz 273:19-277:15; Tr. 8092:12-8093:8. At Ovitz's insistence, the Compensation Committee accelerated the date by which Disney set the option strike price. Santaniello 98:19-99:19. Ovitz also insisted that the *post-termination* exercise period of the options be extended past the 24 month limit then existing. Watson 322:3-7. Ovitz also changed the termination provisions in the OEA as late as December 1995. PTE 125.

[65] The OEA, although effective as of October 1, 1995, was actually executed in mid-December. *See* PTE 353.

Additionally, virtually from the moment Ovitz was hired, Eisner was regretting the decision and had decided by November 1995 to fire Ovitz, choosing to delay that action for approximately one year to avoid any adverse repercussions arising from Ovitz's emotional instability and to protect Eisner from the professional embarrassment of dismissing his newly-hired Number Two so soon after being hired. *See* PTE 24 ("By Labor Day I was wondering what it would cost in dollars and embarrassment to end out corporate partnership right away."); *accord* PTE 79 at DD2623-DD2624; Bass 88:23-89:13 ("I insisted on firing him immediately and Michael said that if he did Ovitz would commit suicide.").

Eisner and Ovitz shared the view that a termination for "gross negligence" or "malfeasance" required scandalous or quasi-criminal conduct that it was all but "impossible" to satisfy. Tr. 1308:17-1309:4; 4919:4-4920:11; 6114:11-19. Of course, Eisner had no incentive to construe the OEA language more broadly because his employment agreement contained the same definitions of "cause." Given their claimed understanding of a highly restrictive definition of cause, and the friendship that continued to exist between Eisner and Ovitz, there can be no real doubt that when Eisner and Ovitz inked the OEA in December 1995 both men knew that it was only a question of when Ovitz would receive his full NFT payouts, not if. As such, the circumstances that existed immediately prior to the execution of the OEA in December 1995 removed any doubt that the NFT provisions, if anything, motivated Ovitz to leave and thus constituted waste.

C. The Defendants Cannot Meet Their Heavy Burden Of Showing That Giving Ovitz An NFT Was "Entirely Fair" To Disney

As detailed in Argument Section II.C., the New Board did not engage in *any* process in approving Ovitz's receipt of a full NFT payout, reflecting a conscious abdication of its fiduciary responsibilities amounting to bad faith. Under these circumstances, the New Board cannot make

any showing of fair process and any attempt by it to meet its already significant burden to prove fair price is inherently suspect. *See Bomarko,* 794 A.2d at 1183; *Metro. Life Ins.*, 1998 Del. Ch. LEXIS 70, at *7.

Here, it is seemingly defendants' argument that even had the New Board engaged in a "fair process" of determining whether or not Ovitz could have been terminated for cause, by doing a full investigation and collectively deliberating, the New Board would have concluded that Ovitz could not have been fired for cause, that there was no choice but to give him an NFT, and that, therefore, giving an NFT to Ovitz was "entirely fair." However, defendants have come nowhere close to meeting their burden of showing, by a preponderance of the evidence, that the New Board could *not* have reasonably concluded that Ovitz could have been terminated for cause under the OEA.

The OEA was governed under California law. PTE 7 at WD220. Gross negligence and malfeasance are not defined in the OEA or in California court decisions in the employment law context. Gross negligence, however, can reasonably be interpreted under then existing California law to constitute reckless indifference or deliberate disregard of duties. *See* Donohue Report at 10-12. Gross negligence differs from ordinary negligence and lies somewhere between ordinary inadvertence or inattention, but less than conscious indifference to the consequences. *See* Tr. 260:5-262:3.

As with gross negligence, there are no reported decisions in California which interpret "malfeasance" in the context of an employment agreement. Donohue Report at 17-18. Malfeasance could be interpreted to mean the excessive exercise of the powers of president of a public corporation or in violation of specific duties of office. *Id.* at 11. Wrongful acts can constitute malfeasance. Tr. 9039:19-22 (malfeasance does not require intent).

If Disney had investigated, and terminated Ovitz for cause, it would have likely emphasized the habitual nature of Ovitz's various transgressions. Ovitz's repeated violations of Company policies, when coupled with his habitual lying, constituted wrongful acts, with reckless disregard. Donohue Report at 45-51. To support its determination, Disney could have and would have contemporaneously compiled all relevant documentary and testimonial evidence of Ovitz's performance failures, including the evidence in the "OM" file(s), and contemporaneous statements that any special counsel retained to investigate the matter could readily have obtained from Disney's employees, who would have been duty-bound and willing to cooperate in their employer's investigation. Since, in violation of defendants' fiduciary duties, such facts were never gathered, defendants cannot claim that no grounds existed for Ovitz's termination. *See Bomarko*, 794 A.2d at 1183.

Even if properly considered, facts existed showing that Ovitz repeatedly failed to follow Eisner's directives. Eisner clearly and consistently directed Ovitz to work on various core operations of the Company, which Ovitz failed to do. *See, e.g.*, PTE 24; 267. Instead, Ovitz chose to pursue acquisitions that Eisner eschewed and neglected Disney operations that he was assigned to oversee, resulting in significant monetary losses in these divisions. *See, e.g.*, PTE 24 at DD2453 ($100 million loss at Disney Interactive); 550 at WD8269; 755 at WD9868 (noting that the $100+ million losses in film/studio were a disaster and driving Disney "out of business"). Furthermore, Ovitz ignored Eisner's instructions that he meet regularly with Bollenbach to educate himself regarding Disney's operations. PTE 8 at DD2123; Bollenbach

175:7-24. Ovitz's repeated and deliberate failures to follow Eisner's directives went beyond mere unsatisfactory performance to the violation of legal duties of office.[66]

There was also substantial evidence available to Disney that Ovitz was suspected of repeatedly violating company guidelines and policies. These included violations of guidelines regarding gift-giving and receiving, violations of expense reporting guidelines, and guidelines regarding the personal purchase of Disney stock. *See* Statement of Facts Section II.A.; Argument Section II.C.2.b. Importantly, Litvack admitted that the giving of gifts to the advantage of the gift given and not the Company could be grounds for gross negligence or malfeasance. *See* Tr. 6432:3-15. Some of these suspicions resulted in a PW investigation Disney commissioned *after* Ovitz was fired. PTE 147; 394. Disney held back $1,000,000 from Ovitz's payout because of these suspected transgressions, and Disney ultimately kept approximately $140,000 even after "negotiations" on the issue commenced after plaintiffs filed this lawsuit. Tr. 6419:2-11. *See also* PTE 385 at WD5152; 403 at WD1995. The obvious conclusion is that Disney determined that Ovitz violated Company guidelines and policies by at least $140,000. It is beyond contradiction that effectively stealing $140,000 from Disney — or even the $70,000 that purportedly relating only to non-capital items — would have been enough for the Board to have fired Ovitz for cause.

There is also substantial evidence that Ovitz was a habitual liar from the time he began serving as President of Disney and his deceits were not merely casual or tangential to the Company's business. Ovitz's persistent pattern of untruthful behavior as perceived in Eisner's

[66] Ovitz's failure to apply himself to the divisions he was assigned to oversee is reflected in his comments during his appearance with Eisner on the Larry King show over one year after he began serving as Disney's President that he knew "about one percent of what I need to know." PTE 323 at 7.

repeated observations, including Ovitz's frequent lying to fellow executives, led Eisner to conclude that Ovitz had created an atmosphere of mistrust detrimental to Disney. *See, e.g.*, PTE 20; 24; 79; *see also* Donohue Report at 45 (habitual lying by a senior executive rises above mere negligence and is willful and intentional wrongdoing affecting the basic operations of a company). PW's observations put Disney on reasonable notice of possible expense account abuse sufficient to provide grounds for a termination for cause. *See* PTE 147; *see also* DTE 159 at WD5096, WD5170. Litvack and defendants' experts all admitted that lying can be grounds for gross negligence or malfeasance. Tr. 6428:15-19; 8467:7-19; 9087:7-9088:9; *see, e.g.*, *Chic by H.I.S., Inc. v. Luehrs*, 2000 U.S. Dist. LEXIS 1744 (S.D.N.Y.).[67]

Finally, if the Board had engaged in a reasonable inquiry and determined in good faith to terminate Ovitz for cause, a jury in a hypothetical wrongful termination suit by Ovitz could only be instructed, under California law, to scrutinize the Board's decisionmaking as to whether it was honestly taken and well-informed. *See Cotran v. Rollins Hudig Hall Int'l, Inc.*, 948 P.2d 412 (Cal. 1998). Thus, any jury considering whether or not Disney would be liable for firing Ovitz without severance would *not* be permitted to engage in a *de novo* review of the Board's decision — which is directly contrary to Fox's and Feldman's premise that a jury would be called upon to determine and assess the actual underlying facts and could even second-guess the judgment of the Board. *Id.* In any event, the highly speculative expert testimony defendants sought to introduce hypothesizing on what a California jury might have concluded had Ovitz brought such a suit should not be given any evidentiary weight. *See Hart v. Resort Investigations & Patrol*,

[67] Plaintiffs do not have to prove that Ovitz lied as they do not bear the burden of proof under the entire fairness standard. The record in this case contains numerous unbiased observations of Disney's CEO and others that Ovitz was a habitual liar. Defendants' failure to specifically recall these incidents years after the fact under hostile questioning says nothing about how the record would have looked if Ovitz sued Disney in 1996. Tr. 318:2-17.

2004 Del. Super. LEXIS 292, at *12 (excluding an expert's testimony because it was based on pure speculation and conjecture). For these reasons, among others, defendants' speculation on a result of a jury trial which never occurred, should simply be rejected.

The cumulative and injurious nature of Ovitz's wrongdoing, much of which was commented upon by Eisner and other defendants at the time, and which has also been elucidated through the discovery process, demonstrates that the Disney Board, had it exercised its authority at the time and made a business judgment, did, in fact, have at its disposal information which could and would have provided reasonable grounds to terminate Ovitz for cause under the OEA. Defendants have not carried their burden of showing by a preponderance of the evidence that had the Disney Board properly investigated and exercised its fiduciary responsibilities at that time, it could not have rationally terminated Ovitz for cause. Accordingly, the "fair price" element necessary to defendants' overcoming plaintiffs' rebuttal of the business judgment rule, has not been established by the requisite preponderance of the evidence.

IV. DEFENDANTS CANNOT RELY ON A § 102(B)(7) AFFIRMATIVE DEFENSE

A. Section 102(b)(7) Does Not Apply

When, as here, entire fairness is the applicable standard of judicial review, the application of a § 102(b)(7) provision "'can be made only *after the basis* for [defendants'] liability has been decided.'" *Emerging*, 2004 Del. Ch. LEXIS 70, at *103 (citation omitted). Also, once the defendants have failed to establish the entire fairness of the transaction, it is their burden to establish that the breaches of fiduciary duties for which they are liable do not fall within any of the three exceptions to § 102(b)(7). *See id.*, at *145-46. As this Court recognized, in denying defendants' motions to dismiss:

> plaintiffs' claims are based on an alleged knowing and deliberate indifference to a potential risk of harm to the corporation. Where a director consciously ignores his or her duties to the corporation, thereby causing economic injury to its

> stockholders, the director's actions are either "not in good faith" or "involve intentional misconduct." Thus, plaintiffs' allegations support claims that fall *outside* the liability waiver provided under Disney's certificate of incorporation.

Disney I, 825 A.2d at 290 (footnote omitted). Here, the evidence establishes "knowing and deliberate indifference" amounting to a conscious abdication of the directors' duties. *Id.* Abdication of a director's duties can also constitute a violation of the fiduciary duty of loyalty. *See Pereira*, 294 B.R. at 528 (interpreting Delaware law); *Cede*, 634 A.2d at 363. Moreover, Ovitz's receipt of NFT payments constituted an improper personal benefit which additionally precludes him from any reliance on § 102(b)(7) and, in any event, those provisions are protective only of acts taken by a director in his capacity as a director, not as an officer.

B. Each Director Falls Outside The Protection Of Disney's Liability-Limiting Charter Provisions

In assessing the culpability of each defendant and to what extent, if any, the charter's liability-limiting provisions should apply, the Court should consider, among other things:

(1) **Defendants with access to day-to-day information regarding Ovitz's failures to acclimate to a public company environment**: At the very least, Eisner, Litvack, Russell, Gold, R. Disney, and Bollenbach were privy to the day-to-day conflicts and failures which should have been relayed in an open, honest manner to the Board. Eisner, Litvack, Bollenbach, and Russell also knew of, but failed to disclose to the remaining directors, their concerns regarding Ovitz.

(2) **Specialized knowledge and/or experience**:[68] Russell, Litvack, Gold, and Mitchell were all attorneys. At the very least, each of them was aware or consciously disregarded, internal rules and regulations mandating that the Compensation Committee and Board pass on

[68] *See Emerging*, 2004 Del. Ch. LEXIS 70, at *143-44 (director defendant held liable primarily by virtue of his background and experience as an investment banker, which placed him on notice of the risks of the transaction).

Ovitz's receipt of an NFT, and that a valid legal determination regarding whether Ovitz could have been fired for cause could not take place without investigation and legal research and collective board deliberation.

(3) **Committee memberships**: The Compensation Committee, consisting of Russell, Watson, Poitier, and Lozano, engaged in the preliminary review of Ovitz's compensation package but did not discuss any of the factors raised by Crystal, which, among other things, should have led them to an understanding that there were no comparables. Indeed, the evidence shows that comparables were simply not discussed by the Compensation Committee, despite the fact that comparables are arguably a leading metric. The evidence also shows that Russell and Watson, with Eisner's complicity, hid from the other Compensation Committee members Crystal's observations and criticisms regarding the lack of comparables. Nor did the Compensation Committee consider calling a meeting to discuss whether Ovitz should be dismissed for cause, a responsibility the Stock Option Plan imposed on them. Russell, Gold, Poitier, and Lozano, as members of the EPPC approved a bonus two days before Litvack sent Ovitz his first termination letter, knowing Ovitz's performance had been poor. None of these Board members at this time thought to call a meeting to discuss the grant of an NFT.

(4) **Lack of participation in board processes for the hiring and firing of Ovitz**: Each and every board member is charged with knowledge of his or her responsibility to seek all reasonably available information that was material to these decisions and, thus, is liable for fully abdicating his or her duties in both of these events. This abdication of responsibility precludes any director from the § 102(b)(7) shield. Common to all directors is their bad faith failure to assure any meaningful deliberation, review or approval of the terms of the OEA, including its

liberal severance provisions, and their utter failure to take any action with regard to the grant of an NFT despite their knowledge and opportunity to act.

(5) **Disney Officers**: Eisner, Litvack, and Ovitz had an independent duty as officers of Disney, apart from their duties as directors, to ensure that the process by which Ovitz was given his NFT was "impartial and fair" to Disney. *Disney I*, 825 A.2d at 291. Eisner's acquiescence in Ovitz's wishes to keep the termination negotiations away from Litvack, Eisner's failure to inform the Board of material information with regard to Ovitz's misconduct, Litvack's failure to perform any legal research or factual investigation, Eisner's compete failure to ensure that the Board was fully advised and involved in the decision to grant Ovitz an NFT, and Ovitz's neglect of the need to obtain board approval of his NFT, all were bad faith breaches by these senior officers of their duties to the Company.

(6) **Ovitz's self-interest**: As a director and officer who was self-interested in the receipt of an NFT, Ovitz must show that his receipt of an NFT was entirely fair. Ovitz cannot objectively show (*see Disney II*, 2004 Del. Ch. LEXIS 132, at *30) that his involvement with the NFT was consistent with his fiduciary obligations. Ovitz was obliged to ensure that the processes by which he negotiated and obtained his NFT were at arm's-length and fair. *Disney I*, 825 A.2d at 291.[69] Ovitz's insistence that he not negotiate his termination with Litvack but only with Russell, Ovitz's complete failure to ensure that the Board was advised and involved in the process of approving his receipt of an NFT, and Ovitz's successful attempt to get the very best deal he could possibly get for himself without any consideration of supervening responsibilities to the Company, were bad faith breaches by Ovitz of his fiduciary duties to the Company.

[69] Ovitz failed to take any steps to avail himself of the potential safe-harbor provisions of § 144. *See Disney II*, 2004 Del. Ch. LEXIS 132, at *31-33.

V. THE DIRECTOR DEFENDANTS ARE JOINTLY AND SEVERALLY LIABLE FOR MONETARY DAMAGES AND PRE- AND POST-JUDGMENT INTEREST

The unrebutted expert report of Professor Murphy valued the cost to the Company of granting the NFT to Ovitz at $129,816,000.00. Murphy Report at 28. This includes the sum total of the Black-Scholes value of the options at $90,947,000 as of the date they vested plus the $38,869,000 cash severance per the NFT provisions of the OEA. *Id.* at 27-28. Professor Murphy explains that the cost of the options can similarly be understood in the following ways: (1) "the amount that Disney would have to pay an outside investor to accept the financial liability of the options granted" to Ovitz; (2) "the amount Disney could have raised if it had sold the options to an outside investor rather than giving them" to Ovitz; or (3) "the *expected* cost (measured as of the grant date) Disney would incur if it intended to go to the market to purchase stock whenever the options were ultimately exercised." *Id.* at 27.

Pre-judgment interest is available "as a matter of right" in breach of fiduciary duty cases. *Trans World Airlines, Inc. v. Summa Corp.*, 1987 Del. Ch. LEXIS 373, at *2; *see Smith v. Nu-West Indus.*, 2001 Del. Ch. LEXIS 8, at *1-2. Courts calculate pre-judgment interest from the date the company was wrongfully deprived of its funds as a result of the fiduciary breach. *Summa Corp. v. Trans World Airlines, Inc.*, 540 A.2d 403, 409-10 (Del. 1988). The rate of interest is generally the legal rate of five percent over the Federal Reserve discount rate as of the applicable date. 6 *Del. C.* § 2301(a) (2004). Here, plaintiffs seek an award of damages in the amount of $129,816,000.00, plus pre-judgment interest in the amount of $132,454,876.45, plus post-judgment interest, as allowed by law.[70]

[70] Attached hereto is a spreadsheet showing how the pre-judgment calculation was performed. The calculation was measured from the day of Ovitz's termination, December 27, 1996, to March 6, 2005. This captures the amount of interest on $129,816,000.00 at a rate of 5% over the

CONCLUSION

For the foregoing reasons, plaintiffs respectfully request that judgment be entered against all defendants, jointly and severally, in the total amount of $262,270,876.45, together with post-judgment interest until such damages are paid in full, and such other relief as the Court may deem appropriate under the circumstances.

Date: March 6, 2005

Respectfully submitted,

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Federal Discount Rate (§ 2301), compounded monthly. *See Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 173 (Del. 2002).