IN THE SUPREME COURT
OF THE STATE OF DELAWARE

William Brehm and Geraldine Brehm, as Trustees and Custodians; Michael Grening; Richard Kaplan and David Kaplan, as Trustees; Thomas M. Malloy; Richard J. Kager and Carol R. Kager, as Joint Tenants; Michael Caesar, as Trustee for Howard Gunty, Inc. Profit Sharing Plan; Robert S. Goldberg, I.R.A.; Michael Shore, Michele DeBendictis; Peter Lawrence, I.R.A.; Melvin Zupnick; Judith B. Wohl, I.R.A.; James C. Hays; and Barnett Stepak,	)	No. 411, 2005
Plaintiffs-Below, Appellants,	)	Appeal from: Court of Chancery of the State of Delaware in and for New Castle County, Consol. C.A. No. 15452
v.	)	Chancellor William B. Chandler III
Michael D. Eisner, Michael S. Ovitz, Stephen F. Bollenbach, Sanford M. Litvack, Irwin Russell, Roy E. Disney, Stanley P. Gold, Richard A. Nunis, Sidney Poitier, Robert A.M. Stern, E. Cardon Walker, Raymond L. Watson, Gary L. Wilson, Reveta F. Bowers, Ignacio E. Lozano Jr., George J. Mitchell, Leo J. O'Donovan, Thomas S. Murphy and The Walt Disney Company,	)	
Defendants-Below, Appellees.	)	

ANSWERING BRIEF OF NON-OVITZ DEFENDANTS-BELOW, APPELLEES

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Dated: December 9, 2005

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MISCELLANEOUS

NATURE OF PROCEEDINGS

This is an appeal from a judgment of the Court of Chancery against plaintiffs and in favor of defendants on all counts entered on August 9, 2005, following the second-longest trial in that court's history. As recounted by the Chancellor: "The trial consumed thirty-seven days (between October 20, 2004 and January 19, 2005) and generated 9,360 pages of transcript from twenty-four witnesses. The court also reviewed thousands of pages of deposition transcripts and 1,033 trial exhibits that filled more than twenty-two 3½-inch binders. Extensive post-trial memoranda also were submitted and considered." *In re The Walt Disney Co. Derivative Litig.*, 2005 WL 2056651, at *1 (Del. Ch.).[1] At the conclusion of that exhaustive process, the Chancellor issued a 174 page opinion, including almost 100 pages of findings of fact "in a detailed manner and with abundant citations to the voluminous record." Op. at 5.

This action was commenced on or about January 8, 1997. By decision of October 7, 1998, the Court of Chancery dismissed the original complaint. *In re The Walt Disney Co. Derivative Litig.*, 731 A.2d 342 (Del. Ch. 1998). This Court affirmed in part and reversed in part that dismissal. *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (*en Banc*). After remand of the action to the lower court, plaintiffs filed their second amended complaint (the "Complaint") on January 3, 2002, and defendants moved to dismiss on April 19, 2002. On May 22, 2003, the Court of Chancery denied the motion holding that "a more complete factual record is necessary" to determine if -- as alleged by plaintiffs -- the defendant directors had breached their fiduciary duties. *In re The Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 278 (Del. Ch. 2003).

At trial, plaintiffs were given full opportunity to prove the allegations of their Complaint. The trial court permitted them virtually unrestricted cross-examination of each of the fact witnesses called by defendants. The trial court also reviewed all of the exhibits and deposition testimony offered by the parties, and excluded only a small number of trial exhibits and deposition excerpts after conclusion of the live testimony.

In their statement of the Nature and Stage of the Proceedings, plaintiffs attempt to portray the court below as arbitrarily depriving them of a fair trial, claiming the trial court gave only cursory review to

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[1] Citations to the trial court's Opinion and Order (attached to Appellants' Opening Brief) are hereinafter referred to as "Op. at __".

evidentiary issues. Appellants' Opening Brief at 1-2.[2] Nothing could be further from the truth. Instead, under a procedure stipulated to by the parties, rulings on evidentiary issues generally were deferred until the end of trial. *See* B44 at 249. However, objections were often raised and argued at trial, and no single exhibit consumed more trial time or argument time than PTE 147, a draft report issued by PriceWaterhouse LLP regarding Michael Ovitz's expense account. Contrary to plaintiffs' assertions, PB at 1-2, the ruling on PTE 147 was made after extended consideration.

Plaintiffs similarly distort what occurred in the face of a late production of certain files relating to Ovitz's performance as President of The Walt Disney Company ("Disney" or the "Company"). Plaintiffs claim the court did no more than adjourn the trial for two days, PB at 1, but the record shows that the Chancellor permitted plaintiffs to deal with those documents up to the final day of trial -- three months after production of the documents -- even allowing them to recall an expert after the conclusion of defendants' case specifically to address the documents. Op. at 97-98. *See* B32-33 at 6-7 (plaintiffs permitted to take depositions before or during trial); B39 at 48 (noting that plaintiffs' counsel had the subject documents for weeks and had reviewed them); B40 at 49 (permitting plaintiffs to recall experts at end of the case with weeks to reformulate their opinions).

Plaintiffs filed their Notice of Appeal on September 6, 2005, and filed their opening brief on October 24, 2005. This is the brief of all of the individual defendants other than Ovitz.

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[2] Citations to Appellants' Opening Brief will hereinafter be "PB at __".

SUMMARY OF ARGUMENT

1. Denied. The trial court made no errors, reversible or otherwise, in applying the relevant standards of review. In accordance with black-letter Delaware law, the trial court held that the actions of Disney's Board of Directors (the "Board") were entitled to the presumptions of the business judgment rule unless plaintiffs could prove that the directors violated their duty of care through gross negligence or acted in bad faith. After hearing the case for thirty-seven days, the Chancellor detailed his factual findings on the issues of due care and good faith -- findings appropriately based on his personal observation of the twenty-four witnesses and careful review of the extensive record. There was no deficiency in the trial or the court's analysis.

2. Denied. Plaintiffs' claim that the trial court "provided no analysis in its decision on the threshold question whether the business judgment rule had been rebutted by virtue of the directors' failure to be informed," PB at 3, reflects, at best for plaintiffs, a misreading of the trial court's Opinion. The court made explicit findings that the directors were informed, holding that plaintiffs had not proven that any of the directors acted in a grossly negligent manner. Because plaintiffs did not rebut the presumptions of the business judgment rule, the trial court, in accordance with fundamental principles of Delaware corporate law, did not apply the entire fairness standard.

3. Denied. Because the various directors had different roles in connection with the election of Ovitz, the approval of the terms of his employment agreement, his termination, and the payment of his termination benefits, the court correctly evaluated the potential liability of the directors on an individual basis.

4. Denied. This Court has unambiguously held that proof of a breach of the duty of care or the duty of loyalty or failure to act in good faith "sufficiently rebuts the business judgment presumption and permits a challenge to the board's action under the entire fairness standard." *Emerald Partners v. Berlin*, 726 A.2d 1215, 1221 (Del. 1999). The trial court held plaintiffs had not proven any breach of the duty of care. The court then provided plaintiffs another opportunity to rebut the business judgment rule by examining whether plaintiffs had proven that defendants acted in bad faith. Plaintiffs also failed to make that showing. Thus, contrary to plaintiffs' assertions, the trial court correctly applied standards clearly and repeatedly articulated by this Court.

5. Denied. Plaintiffs confuse the concepts of due care and good faith. The trial court suffered from no such confusion. The court held that due care requires directors to act with all reasonably available, material information. Op. at 112. The court held that fiduciaries act in good faith when they avoid "intentional dereliction of duty, a conscious disregard of one's responsibilities." Op. at 123. Those standards are fully supported by Delaware law. Plaintiffs' argument that courts reviewing issues of good faith are limited to "strictly procedural criteria," PB at 4, finds no support in Delaware law.

6. Denied. The trial court correctly held that Disney's Board was entitled to delegate to, and rely upon, its Compensation Committee to approve the terms of Ovitz's employment agreement (the "OEA"). That holding is entirely consistent with *Brehm*.

7. Denied. The Disney Board approved the election of Ovitz as President. It had the information necessary to determine that Ovitz, whose reputation in the entertainment industry was immense, should serve under Eisner as President of the Company. The Compensation Committee, which had the authority to approve the terms of the OEA, appropriately informed itself prior to doing so.

8. Denied. The Compensation Committee considered all aspects of the OEA, including the benefits Ovitz would receive if he were terminated without cause (a "Non-Fault Termination" or "NFT"). Plaintiffs' theory that the OEA had a "disincentivizing impact" on Ovitz, PB at 4, was correctly rejected by the Chancellor as "patently unreasonable," Op. at 131-32, based, in part, on observation of five days of Ovitz's testimony.

9. Denied. Plaintiffs do not dispute that Ovitz had to be terminated; they challenge only the decision to pay him his contractual termination benefits. The trial court correctly determined that the Board was not required to adopt a resolution approving Ovitz's termination. Consistent with the Company's practice, nothing in Disney's Charter or Bylaws or other corporate documents divested Eisner of the ability to terminate those officers who reported to him. The Board was informed of and fully supported the decision to fire Ovitz. Plaintiffs' claim that the trial court somehow disregarded *Brehm* is based on a misreading of either *Brehm* or the Opinion, or both. Nothing in *Brehm* states or implies that formal Board approval was required to pay Ovitz his contractual termination benefits.

10. Denied. The trial court appropriately applied the business judgment rule to the conduct of Eisner and Litvack in

connection with the Company's fulfillment of its obligations under the OEA and payment to Ovitz of the NFT benefits to which he was contractually entitled. Plaintiffs are incorrect in asserting that the business judgment rule does not apply to officers of a Delaware corporation and that considerations of good faith are only relevant to a Section 102(b)(7) defense.

11. Denied. The trial court applied long-settled Delaware law in determining that plaintiffs had not proven their waste claim. The court made extensive factual findings regarding Ovitz's performance at Disney that demonstrate the inability of the Company to fire Ovitz for cause. Plaintiffs' claim that the court's findings of fact were the result of "illogical deductions" (PB at 5) is baseless. The Chancellor fairly weighed trial testimony, deposition testimony and documentary evidence. Where conflicts between those forms of evidence existed, the court resolved them as a trier of fact is required to do, making credibility determinations when necessary.

12. Denied. Because the contentions set forth in paragraph 12 of plaintiffs' Summary of Argument are directed solely at Ovitz, Ovitz will respond thereto in his answering brief.

13. Denied. As the trial court found, Eisner and Litvack both were fully informed in connection with Ovitz's termination. They had worked with Ovitz on a daily basis for over one year. They knew his failings and failures, and their conclusion that Ovitz could not be fired for cause was informed and reasonable.

14. Denied. With respect to their waste claims, plaintiffs failed to prove that no person of sound judgment could have believed that the OEA or making termination payments to Ovitz pursuant to the OEA were in the interest of the Company. The OEA was designed to link Ovitz's financial success to that of the Company. When Ovitz's employment at the Company was no longer serving the interests of the Company and its stockholders, Eisner acted decisively to solve the problem. Ovitz received no more or less than that to which he was entitled under the OEA. As the trial court found, Eisner acted out of an overriding concern for the interests of the Company. Plaintiffs' claim that Eisner sacrificed the interests of the Company to benefit a friend was exposed as pure fantasy by the lengthy trial.

15. Denied. As the trial court held, "a fiduciary's duties do not change over time." Op. at 2. After carefully considering the extensive record, the court held that defendants complied with their duties.

STATEMENT OF FACTS

The factual findings of the trial court are summarized in the following statement of facts with some supplementation of factual detail consistent with the findings. In contrast, plaintiffs' statement of facts on virtually every page challenges and/or ignores the court's findings, even to the extent of urging this Court to reject findings which rest firmly on credibility determinations based on live testimony.

A. A Time of Triumphs and Challenges.

April 1994 through January 1997 was a time of great change at Disney. Disney found itself facing the challenges of the death of one of its leaders, the temporary incapacitation of its remaining leader, and the simultaneous doubling of Company resources, revenue, and responsibility. Op. at 6, 7, 14. Looking for the right person to aid the Company during this crucial time, Eisner and Disney's Board turned to Ovitz -- then known as one of the most powerful persons in Hollywood -- to help lead Disney to future triumphs. *See* Op. at 10, 25-26. Later, when it was perceived that Ovitz's performance as President was detrimental to the Company, he was promptly fired. Hiring Ovitz, a perfectly reasonable business decision, simply did not work out as planned. Op. at 3-4.

B. The Decision to Hire Michael Ovitz.

1. Initial Overtures.

In 1984, the Company's Board elected Eisner as Chairman and Chief Executive Officer and Frank Wells as President and Chief Operating Officer, each to report directly to the Board. Under their leadership, the Company experienced ten years of "remarkable success." Op. at 6; *see also* B47 at 839; B233-34 at 4131-33.

The Eisner/Wells team came to a tragic end at the height of its success: Wells died in a helicopter accident in April 1994. Shortly thereafter, Eisner underwent heart by-pass surgery. While Eisner regained his good health, the combination of Wells' sudden death and Eisner's sudden surgery created great pressure on Disney to identify a successor for Wells and a potential successor for Eisner. Op. at 7 citing B237-38 at 4150-52.

During the next year, Eisner and the Board "discussed the need to identify Eisner's successor." Op. at 7. There were no viable inside candidates. Op. at 6 citing B226 at 3997-99; B360 at 6025. Eisner

discussed with the directors at various times on an individual basis the possibility of hiring Ovitz. Op. at 7 & n.6, citing B196-98 at 3665-76 (Gold); B226 at 3997-99 (R. Disney); B305 at 4699-700 (Eisner); B349 at 5913-14 (Bowers); B447 at 7125 (Poitier); B462-63 at 7628-29 (Lozano); B495 at 8142 (Stern); B1741 at 183-85, 192 (Bowers); B1768 at 54-56 (Lozano); B1770-71 at 17-19 (Mitchell); B1810 at 44-45 (Wilson); B1811 at 48-49 (Wilson). The need for a new President became all the more urgent when Disney announced in July 1995 that it would acquire Capital Cities/ABC, Inc., doubling the size of the Company. Op. at 14; B125 at 2414; B245 at 4190-91; B246 at 4193-94.[3]

2. The Agency Career of Michael Ovitz.

Ovitz formed Creative Artists Agency ("CAA") in 1974 with four former colleagues from the William Morris Agency. Op. at 8-9. In 1995, Ovitz was the dominant partner in CAA. Ovitz's business model had transformed the agency business, pioneering the concept of package deals for movies (*i.e.*, presenting film studios with CAA clients pre-committed to direct and star in particular projects). Op. at 9. Ovitz also served as a consultant to Japanese corporations acquiring U.S. entertainment companies. *See* Op. at 10. By 1995, he was earning an annual income of $20 million. Op. at 10; *see also* B1746 at 128.

3. Eisner Approaches Ovitz and the Negotiations Begin.

Although Eisner and Ovitz had discussed "joining ranks" and working together from time to time, Op. at 7, the subject received renewed attention in the spring of 1995, when it was learned that Ovitz was in negotiations with Music Corporation of America ("MCA"). Op. at 10-12; B103 at 2314-17; B199 at 3679-80; B242 at 4173-75. Those talks ultimately were not successful, but Ovitz and two of his CAA partners who were to join him at MCA were offered a package valued in excess of $300 million. Op. at 10-11; B1776 at 85. Eisner asked Irwin

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[3] At a Board meeting on April 25, 1994, Disney's Bylaws were amended to reflect that the new President (when hired) would report to Eisner, rather than directly to the Board:

> The President shall be the Chief Operating Officer of the Corporation *and shall report and be responsible to the Chairman of the Board.*

B1099 (emphasis added).

Russell, a director and Chairman of the Compensation Committee, to keep in touch with Ovitz's advisor Bob Goldman, in case a hitch developed in the MCA negotiations. B104 at 2319. Eisner and Russell understood the basic terms that MCA was offering to Ovitz and knew that Disney could not match them. Op. at 13 citing B242-43 at 4175-77; s*ee also* Op. at 14 n.24 citing B156 at 2630-31. Nevertheless, after consulting with the Company's largest individual shareholders (Sid Bass and Roy Disney) in May 1995 about trying to hire Ovitz and receiving their support, Eisner approached Ovitz. Op. at 13; B109 at 2345; B227 at 4000-01; B242 at 4175; B243 at 4177-79; B1145. Contrary to plaintiffs' assertion, PB at 8, it was not Eisner and Ovitz's "longstanding friendship [that] motivated Eisner to recruit Ovitz." Eisner decided to recruit Ovitz because he believed Ovitz could be an effective executive at Disney, and Eisner did not want to face the prospect of having Ovitz work for a competitor. Op. at 7-8, 12, citing B242 at 4173-75.

Within a few weeks, it was clear that the MCA negotiations had ended. From that point until late July, Russell had numerous conversations with Goldman. B110-11 at 2346-52; B114-15 at 2363-68; B117 at 2378; B123-24 at 2407-09; B125 at 2414-15. Based upon those discussions, Russell came to understand that Ovitz was making $20-$25 million per year from CAA and owned 55% of CAA. Op. at 14 citing B161 at 2755; *see also* B1186.

From the start of the negotiations between Ovitz and Disney, Ovitz made it clear to Disney that he would not give up his 55% ownership in CAA without "downside protection." *See* Op. at 14 citing B73 at 1277-78; B100 at 2175-77. During the same period, Russell considered various components of a possible compensation package consistent with the pay-for-performance compensation philosophy that had been adopted at Disney with the arrival of Eisner and Wells. Op. at 16-18 citing A210-14; B1803-04 at 108-10; B115-16 at 2367-72; B121 at 2396-99; B1180; B1182; B1183-84; B1185; B1196-1200; B606-07; B608. Along with fellow Compensation Committee member Ray Watson,[4] Russell spent time analyzing the possible yield of the options that might be granted to Ovitz. Op. at 19-20.

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[4] Watson's input was especially valuable as he was also a past Chairman of Disney's Board as well as one of the men who designed Eisner's and Wells' compensation structure. Op. at 19, 145-46. Actor, producer, director and writer Sidney Poitier also served on the Compensation Committee. The final member of the Compensation

Early on in the parties' discussions about a possible compensation package for Ovitz, and consistent with Disney's pay-for-performance philosophy, it was agreed that Ovitz's annual salary would be $1 million and that he would have a performance-based discretionary bonus. Eisner and Russell refused (consistent with Company practice) to offer a signing bonus. Op. at 16; B250 at 4208-09; B178 at 3273. Thus, the continuing discussions related primarily to the stock options, especially the number, strike prices, vesting schedules and possible downside protection. Op. at 15-16; B1008; B125 at 2415. Ovitz asked for options on eight million shares, the same number that Eisner had received on a split-adjusted basis. Op. at 16; *see also* B1008; B125 at 2414-15; B246-47 at 4195-96. Eisner and Russell believed that Ovitz should not be offered options on eight million, or even five million, shares for the first five years of his contract. Op. at 16 citing B125-27 at 2415-21; B248-49 at 4203-04; *see also* B957-59. Instead, using both Eisner's and Wells' contracts "as a template," they agreed that Eisner should propose a contract for a five-year term with options on three million shares vesting one third at the end of each of the third, fourth and fifth years (the "A options"). Op. at 16 citing B119-20 at 2391-92; *see also* B1179; B1181.[5] The A options would be granted with a strike price at 100% of the then-current market trading price. The parties also initially agreed that if the options on the three million shares had not appreciated by $50 million by the end of the five-year term, the Company would pay Ovitz the difference. Op. at 16.

Finally, they also agreed that, in the event that Ovitz was terminated by Disney without cause (an NFT), the A options would become immediately exercisable. If he resigned, he would forfeit anything he was entitled to under the contract. Op. at 17. The language

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Committee was Ignacio Lozano, the publisher of the largest Spanish-language newspaper in the United States.

[5] Eisner and Russell also decided to offer Ovitz the possibility of obtaining options on an additional two million shares subject to agreement on a two year contract extension at the end of the initial five year term (the "B options"). Op. at 16-17. The B options would have a strike price of 115% of the market price at the time of the grant. By fixing a strike price for the B options in 1995, Eisner and Russell would provide Disney with negotiating leverage at the end of the contract term -- if Ovitz was considering leaving the Company to pursue some other endeavor, he would have to decide whether to leave on the table the options on those two million shares, which might at that time be substantially in-the-money. B135-36 at 2473-76; B861-65.

defining "cause" ("gross negligence" or "malfeasance") was standard in Disney's contracts for senior executives. Op. at 28 n.81; *see also* B203 at 3695-96.

4. Compensation Committee and Expert Analysis.

Eisner and Russell enlisted the help of Graef "Bud" Crystal to provide advice on the proposed employment agreement, once it became sufficiently concrete. Op. at 18-19, 157; B817; B866-82; B967-68; B175 at 3258-60; B176-77 at 3265-66; B426 at 7826.[6] On August 10, 1995, Russell and Watson spent a full day with Crystal discussing proposed terms for Ovitz's contract. Op. at 19; B177 at 3267-68; B476 at 7827; B866-82. Crystal had amassed an extensive electronic library of compensation information, including comparables, that he carried with him on his laptop computer. Op. at 19; B179 at 3275. He also was familiar with the Black-Scholes formula which he used to analyze various combinations of variables. *See* Op. at 19. During the day, the three men "worked with various assumptions and manipulated inputs in order to generate a series of values that could be attributed to the OEA." Op. at 19-20. They reviewed together the results generated by Crystal's programs as well as Crystal's information on comparables. Op. at 19-20; B866-82; B164 at 2765-66; B178 at 3271-73; B476-77 at 7827-30.

Watson had independently generated his own spreadsheets showing the possible proceeds of option exercises at various times and different stock prices, which he shared with the others. Op. at 20; B1161-71; B1175-7; B191 at 3535-36; B476-77 at 7827-29; B1793 at Russell 351-52. At the end of their day-long discussion, Crystal, Russell and Watson agreed that Crystal should do a draft report and fax it to the other two, and that they would reconvene by phone to discuss his written analysis. Op. at 20; B128 at 2434; B861-65.

On Saturday, August 12, Crystal faxed a draft of his letter analyzing the proposed Ovitz contract. Op. at 20; A220-24; B129 at 2441-42; B180 at 3280. Crystal concluded that the combined salary,

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[6]Plaintiffs assert that Crystal was not an "expert" (PB at 9), but the trial court rejected that assertion. Op. at 19 and n.41. Crystal, who previously headed the Towers Perrin compensation practice, had been providing advice to the Company on compensation issues since before Eisner had come to the Company. Op. at 19 citing B160 at 2714-15; B173-74 at 3253-54; B174-75 at 3257-60; B476 at 7826-27; *see also* Op. at 157.

bonus, option and guarantee provisions had an approximate value of $23.6 million per year for the five-year contract, and $23.9 million per year if the contract was renewed for an additional two years. Op. at 20; A220-24. Crystal noted that those figures approximated what he understood Ovitz was earning at CAA. Op. at 20; A220-24.

That evening, Russell, Watson and Crystal had a telephone conversation to discuss Crystal's draft letter. Op. at 20-21 & n.47 citing B130 at 2444-45; B132 at 2452; B1438; B861-65; *see* also B189 at 3485-86. At the conclusion of their Saturday night conference call, Russell asked Crystal to revise his letter to set forth more accurately some of the deal points that had been agreed to by the parties. Op. at 20-21; B130 at 2444-45.

Rather than sending Russell the revised letter he had requested, on August 15 Crystal sent Russell a letter expressing concern about his understanding of how the proposed $50 million guarantee relating to the appreciation of the options would work. Op. at 21 citing A225-28. Russell called Crystal and cleared up Crystal's misunderstanding. Op. at 21 citing B857-60; B133-34 at 2458-60; *see also* B181-82 at 3289-90. With that false alarm resolved, Crystal revised his first August 12 letter and replaced it with a second version which he subsequently faxed to Russell. Op. at 21. In the definitive letter, Crystal revised his calculation of the value of the total package to approximately $23.6 million per year for the first five years and $24.1 million per year if the contract was renewed for the additional two years. Op. at 22; B976-78.

Poitier and Lozano were informed of the proposed contract and reacted positively. Op. at 24-25; B865. Russell discussed the subject in two telephone calls with Poitier. Op. at 24 citing B447 at 7125-26; B130 at 2445-47; B861-65. Watson discussed the matter in a long telephone conversation with Lozano. Op. at 25 citing B465 at 7637-38 and B861-65; *see also* B478 at 7833-34. Both Poitier and Lozano concurred in the approach and conclusions reached by Russell and Watson. Op. at 25; B865. On August 18, Russell sent a memorandum to Eisner summarizing the events of the past several days, the factors considered and the conversations with Crystal, Watson, Poitier and Lozano. *See* Op. at 25 n.70 citing B861-65.

5. Eisner, with the Concurrence of the Directors, Makes a Deal with Ovitz -- and the Stock Market Reacts Positively.

Over the weekend of August 11-13, 1995, Eisner and Ovitz reached agreement on the terms of Ovitz's hire. Eisner gave Ovitz a

"take-it-or-leave-it offer." Op. at 22 citing B247 at 4196-98. That offer was based on the research of Russell, Watson and Crystal and on Eisner's knowledge of the marketplace in the entertainment industry. *See* Op. at 22; B246-47 at 4194-97. Ovitz accepted the terms. Op. at 22. Eisner told Ovitz that he would not be offered the title of Chief Operating Officer, and Ovitz agreed that he would just be President. Op. at 22.

Eisner spoke to all directors for their concurrence; he discussed with the directors the "impending deal" and "his friendship with Ovitz, and Ovitz's background and qualifications." Op. at 25-26 citing B1491-1502; B251-52 at 4215-16; B204 at 3704; B329 at 5388; B332 at 5582-83; B343 at 5802; B469 at 7658; B495-96 at 8141-43; *see also* B228 at 4006; B357 at 5964. Ovitz was well known to Disney's directors, and they all viewed his hiring as a great coup for the Company. *See, e.g.,* B228 at 4005-06; B321 at 5277; B367 at 6053-54. The directors believed that the friendship between Eisner and Ovitz would allow them to work as an effective team. B200 at 3682; B343 at 5804; B349 at 5914-15; B435 at 6831; B465 at 7638-39; B496 at 8143.

On Sunday night, August 13, Eisner held a meeting at his house with Ovitz, Stephen Bollenbach (Disney's CFO), and Sanford Litvack (Disney's general counsel), as well as Russell. Op. at 22-23. Bollenbach and Litvack -- while holding positive opinions about Ovitz -- said they were not happy to see a new executive join Disney's management at a level above them because they believed the current management team worked well together. Op. at 23 citing B364 at 6040; A1109 at 6045-47. They both made clear to Ovitz that they would not report to him. Op. at 23 citing B320-21 at 5274-76; B366 at 6048-49. Eisner and Ovitz caucused, and Ovitz ultimately agreed that he, Bollenbach and Litvack would all report to Eisner. Op. at 23-24. With that reporting issue resolved, both Bollenbach and Litvack expressed their support for the hiring of Ovitz as President. B320-21 at 5275-76 (Bollenbach); B366-67 at 6050-52 (Litvack).

The next morning, on August 14, Eisner and Ovitz signed a letter agreement (the "OLA"), which outlined the basic terms of Ovitz's proposed compensation. Op. at 24 citing B592-96. The OLA specified that it was subject to the approval of the Compensation Committee and the Board. *Id.* Later that day, the Company announced that Ovitz would become Disney's President. Op. at 26; A414-16.

The public reaction to the announcement "was extremely positive." Op. at 26; B1274-1424; B1508 at 6; B205-06 at 3708-09. Disney "was applauded for the decision," and its stock increased 4.4%,

raising the market capitalization of the Company by more than a billion dollars *in a single day*. Op. at 26 citing B1541 at Ex. 4a; *see also* B457 at 7289-90.

6. The Company's Lawyers Draft the OEA.

Once the major terms had been negotiated and the OLA was signed, the parties began the process of preparing definitive documentation. Joseph Santaniello, a Vice President and Counsel in the Disney Legal Department who reported to Litvack and was responsible for preparing executive contracts for Disney, drafted the OEA. Op. at 26 citing B368 at 6055-56; B631-48; B669-91; A496-98.

After conferring with outside tax counsel, Santaniello and Russell concluded that the application of I.R.C. § 162(m) to the $50 million guarantee could have a negative impact on deductibility and that the guarantee would need to be eliminated. Op. at 26 citing B1797 at 48-49; *see also* B137 at 2484. Russell consulted with Eisner and Santaniello about what to propose to Ovitz in exchange for elimination of the guarantee. *See* Op. at 26-27 & n.76. Russell had separate conversations with Crystal and Watson to discuss the possible consequences of the proposed changes, which included extended exercisability of the options. Op. at 27 citing B137 at 2485-86. Crystal and Russell discussed Black-Scholes calculations related to the extended exercisability features, while Watson generated and discussed with Russell a spreadsheet that analyzed the possible impact of the extended exercisability. B960; B961-66; B1009-10; B979-80; B1153-56; B1157; B1158; B1159-60; B138 at 2489; B479-81 at 7836-46.[7]

7. The Compensation Committee Approves the Terms of the OEA.

On September 26, the Compensation Committee met and considered the proposed terms of Ovitz's contract. Op. at 27-29; A731-52. Under its Charter (which had been adopted by Disney's Board), the Compensation Committee was charged with the responsibility:

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[7] Santaniello circulated the first external draft of the contract to the Ovitz negotiators on September 23, 1995. The OEA was finalized and executed in December 1995. B783-803; B1762 at 527-28. Because Ovitz had been elected as President of Disney effective October 1, 1995, the OEA was made effective as of that date. B1764-64.1 at 528-29; *see also* A414-16. It was not "backdated," as plaintiffs suggest. PB at 6.

> [t]o establish the salaries of the Chief Executive Officer and the Chief Operating Officer, and to approve the salaries of those persons who report directly to the Chief Executive Officer and/or the Chief Operating Officer.

Op. at 142 citing B815-16. The directors understood the Compensation Committee's responsibility. *See, e.g.,* B205 at 3706; B225 at 3993-94; B350 at 5917; B471 at 7691. As President, Ovitz would report directly to Eisner, the Chairman and Chief Executive Officer; therefore, the Compensation Committee was responsible for approving his compensation.

Although Crystal did not attend the September 26 meeting, he was available by telephone to respond to questions if needed. Op. at 28; *see also* B140 at 2518. The members of the Compensation Committee -- already informed of proposed deal terms from prior discussions -- had in front of them a term sheet prepared by Santaniello that Russell reviewed in detail. Op. at 27; B978.20-978.22; B141-43 at 2520-29. Russell and Watson discussed the process they had followed over the prior several weeks, the information they had received and their consultations with Crystal. Op. at 27-28. Watson also presented and reviewed his spreadsheets examining possible yields of the options. Op. at 28 citing B482 at 7848; *see also* B143 at 2529; B490-91 at 8046-47.

The Compensation Committee then discussed the factors that had been considered in setting the proposed option size, with reference to the historical Eisner and Wells option grants as the most relevant comparables. *See* Op. at 28 citing B141 at 2522-23. Russell explained to the Compensation Committee that Ovitz was essentially walking away from any economic interest in the future success of CAA and needed to have meaningful protection for that loss. Litvack addressed further questions from the Committee members. *See* Op. at 28 & n.84. Poitier and Lozano, who had a high opinion of Russell's and Watson's abilities, were satisfied that they had sufficient information with which to make their decision and that approval of the proposed terms of the contract was in the Company's best interests. Op. at 29 citing B449-50 at 7136-37; B450 at 7140; B464 at 7636; B465 at 7639-40. Following Russell's presentation and discussion by Compensation Committee members, the Committee approved the terms of the OEA, subject to further negotiations within the framework of the approval. A734.

8. <u>The Board Elects Ovitz as Disney's President.</u>

Following the Compensation Committee meeting, the full Board met. At the beginning of the meeting, the executives other than Eisner

left the boardroom so that the remaining Board members could participate in executive session. Op. at 29-30 & n.90; *see also* B330 at 5443.

The Board was told about the salary, the bonus, and why the options were sized "to make it very attractive to Ovitz to be able to walk away from his company" and to compensate him for the loss of income from future CAA deals. B351 at 5921-22, *cited at* Op. at 30 n.91. There was also a discussion about comparables, although "following the CapCities/ABC merger with the Walt Disney Company, ... [resulting in] a huge entity ... it was hard to determine what the comparables would actually be." *See* B351 at 5924, *cited at* Op. at 30 n.91; *see also* B190 at 3497-98.

During the executive session, Watson described the work of the Committee on the OEA including his spreadsheet analyses, and he and Russell responded to questions from other members of the Board. Op. at 30 citing B144-45 at 2537-40; B210 at 3733-35; B229-30 at 4014-17; B309-11 at 4872-79; B333 at 5585-88; B350-52 at 5919-25; B482-83 at 7851-53; B490-91 at 8046-47; B496 at 8145-46; *see also* B359 at 5977; B492 at 8079.

With the full Board in attendance, Eisner turned back to the subject of the election of Ovitz as President of the Company. Although Ovitz's experience was known to everyone in the room, Eisner reiterated Ovitz's professional qualifications for the position. The members of the Board discussed the recommendation and unanimously elected Ovitz as President. Op. at 30 citing A718.

9. The Compensation Committee Grants Options to Ovitz.

The Compensation Committee could not grant Ovitz's stock options until he became an employee on October 1, 1995. The Compensation Committee also needed to consider and vote on the amendments to the current stock option plan, as well as the terms of the new option plan. Those subjects were taken up at a special meeting of the Compensation Committee held on October 16, 1995. Op. at 30 citing A753; B146 at 2546-47; B168 at 2971-72; B454-55 at 7228-29.

At the meeting, Litvack made a presentation regarding the stock option plans after which the new option plan and amendments to an existing plan were approved. Op. at 31 citing A754-56; A758-76; B370

at 6077-78.[8] The Compensation Committee then granted Ovitz his stock options with a strike price based on that day's market price (consistent with Disney's customary practice). Op. at 31 citing A757; B169 at 2979-81; B372 at 6083; B571; B572; B585-88; B953-56. Litvack then reviewed the proposed terms and conditions of the OEA, which were set forth in a written summary prepared by Santaniello, and responded to questions by the Compensation Committee members. Op. at 31; A756; B1762-63 at 464-65; B370 at 6077-78. The term sheet presented to the Compensation Committee that day noted that in the event of a Non-Fault Termination, vesting of the A options would accelerate. The term sheet also provided that if Disney's stockholders did not approve the option plan amendments, the parties would negotiate to provide alternate compensation. A777-78.

C. Ovitz's Performance.

1. Early Optimism.

Ovitz officially began his position as Disney's President on October 1, 1995. Op. at 32. Throughout Ovitz's tenure, Eisner maintained a continuing dialogue with members of the Board regarding Ovitz's performance and Eisner's efforts to transition him to the Company culture. B211 at 3746-47. Eisner's early reports to the Board regarding Ovitz were glowing. Op. at 32-35; B936-41; B211-12 at 3746-51; *see also* Op. at 32-34 citing B919-24; B258 at 4265-66.

Eisner remained optimistic about Ovitz's future at Disney throughout 1995, a period when Ovitz performed well in his foreign travels and importantly proposed a different arrangement for the entrance gate of the new California Adventure theme park. Op. at 32-35, n.119; *see also* B259-60 at 4278-80; B334-35 at 5591-93. However, Eisner started to have concerns about Ovitz beginning in January 1996. Those concerns intensified in May 1996 and, by the end of September 1996, led to a decision to secure Ovitz's departure from the Company.[9]

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[8] The Board subsequently acted by written consent to approve the new plan and amendments and the stockholders gave their approval at a meeting held on January 4, 1996. Op. at 31 citing A755; A473-93; B889-918; A789-95; B147 at 2548-49.

[9] Despite the extensive fact findings of the trial court supporting its conclusion that "Eisner believed Ovitz would be an excellent addition to the company throughout 1995," Op. at 132; *see also* Op. at 32-35, plaintiffs continue to argue the opposite. PB at 15. They fail to mention

2. Ovitz Fails to Perform at the Company.

At the core of the problem, Ovitz did not adapt to the Disney culture. *See* Op. at 36 ("A Mismatch of Culture and Styles"); B260 at 4281-82; B325 at 5292-93; B352 at 5926-27; B440 at 6973-76; B452 at 7145-46; B465-66 at 7640-41; B497 at 8147-48; B498 at 8153-54. For instance, in January 1996, Ovitz alienated many of his fellow senior officers during a management retreat. Op. at 36-37 citing B260 at 4280-4282; B325 at 5292-93. By May, as Eisner recalled it, Ovitz "was aggravating many employees," B264 at 4305, and "the senior management started to come to a halt." *Id.* at 4307; *see also* B261-63 at 4294-4302; A188-90.

During 1996, Eisner discussed the growing problems with Ovitz's performance at, or in connection with, Board meetings. *See, e.g.*, B224 at 3890-93. Eisner also had conversations with directors individually. Op. at 37 n.125, 126, 127 citing B148-49 at 2567-71; A1083 at 3751-54; B214 at 3758-59; B231 at 4021-22; B261 at 4294-95; B308 at 4733-34; B334 at 5593; B344 at 5810; B346-47 at 5851-54; B373-74 at 6095-99; B436-37 at 6836-38; B484 at 7855-57; B497 at 8147-48; A188-90; *see* B451 at 7141.

By the fall of 1996, "directors began discussing that the disconnect between Ovitz and the Company was likely irreparable, and that Ovitz would have to be terminated." Op. at 38 citing B270 at 4345-46; B272 at 4354-55; B273 at 4368; B459 at 7555-56; B498 at 8153-54. In addition, Ovitz's poor performance was well known as his struggles were extensively reported in the media, most particularly in a *Vanity Fair* article that many of the directors discussed at the November 25, 1996 board meeting. Op. at 38 citing A661-75; B544-46; B540-43; B804-10; A657-59; B925-27; B947-50; B1123-28; B1129; *see* B270 at 4345-46; B459 at 7555-56; B344 at 5810. While "the philosophical divide between Eisner and Ovitz" (Op. at 48) was significant to Ovitz's perceived failure, none of the reasons for Ovitz's failure to perform adequately had anything to do with any improper conduct while he was President. Op. at 38, 46-49. Because of the fundamental problems with Ovitz's performance, it was not feasible to simply transfer Ovitz to a

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that the note which they cite, A196, was written in November 1996 and was never sent, or that Eisner testified credibly at trial that the note was not accurate. Op. at 66 citing B274 at 4372.

different position within Disney. *See* Op. at 72 n.273; *see also* B342 at 5785-86; B438 at 6843-44; B484 at 7858.[10]

3. Attempts to Get Ovitz to Leave Voluntarily.

Litvack, with the approval of Eisner, had two meetings with Ovitz in September 1996 at which Litvack informed Ovitz that the relationship was not working and encouraged Ovitz to think about leaving the Company. Op. at 59 citing B272 at 4354-55; B307 at 4731-32; B374-75 at 6101-03. Those efforts failed.

In a further attempt to remove Ovitz at no cost to the Company, Eisner attempted to "trade" Ovitz to Sony. Op. at 60; *see also* B265 at 4319. After receiving written permission from Eisner, Ovitz entered into negotiations with Sony, but those discussions were unsuccessful. Op. at 61-62; A643-48. When Ovitz's discussions with Sony failed, he announced his firm intention to stay at the Company. A648. At no time did Ovitz desire to leave. Op. at 60 citing B1780.1 at 537; B79 at 1350-52; B375 at 6103. In fact, he repeatedly refused to listen to and accept the message that he should leave Disney, threatening instead to "chain himself to his desk." Op. at 60 citing B79 at 1352-53; *see also* A203; B273 at 4368-70.

4. Litvack Advises that there is No Basis to Terminate Ovitz for Cause.

In connection with the Sony negotiations, Eisner first asked Litvack whether there was any basis to terminate Ovitz for cause under the OEA in order to avoid the NFT payments. Op. at 68 citing B275-76 at 4379-80; B376-77 at 6110-11. Both individuals had an incentive to conclude that there was cause because they did not want the Company to have to pay anything to Ovitz. Op. at 68 citing B276 at 4380-81. In addition, Litvack disliked Ovitz such that if there was any way to avoid paying Ovitz a dime, Litvack would have found it. Op. at 70 n.269 citing B378 at 6115.[11]

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[10] In any event, such a transfer would have entitled Ovitz to all the benefits of a Non-Fault Termination under paragraph 12 of the OEA. *See* A466 ¶ 12(b).

[11] Plaintiffs ignore these findings by the trial court when they continue to assert -- as they did below -- that "Eisner and Ovitz Execute a 'Win-Win' Separation Strategy," PB at 18-19, and that "Eisner Pays Off His Friend." PB at 19. Those central allegations of plaintiffs' case were

With his legal background, and as general counsel and head of human resources at Disney, Litvack was more than knowledgeable about employment contracts and the standard needed to terminate employment for cause. Op. at 69 n.263; *see also* B377-78 at 6114-15. The trial court explained the steps Litvack took to determine the answer to Eisner's question. Litvack began by reviewing the OEA and refreshing his recollection about the meaning of the terms "gross negligence" and "malfeasance". Op. at 69 citing B377-78 at 6113-14. He then considered all of the events involving Ovitz over the previous thirteen or fourteen months. *Id.* Litvack believed that he had a complete understanding of the facts which were relevant to determining whether the termination of Ovitz should be with or without cause. Op. at 69 n.263; B378 at 6115-16. Litvack not only had the opportunity personally to observe Ovitz (since their offices were on the same floor), but he was also fully familiar with Eisner's experiences with Ovitz. B214 at 3761. Based on all of that information and experience, Litvack concluded that there was no basis under the OEA to terminate Ovitz for cause. Op. at 70; B377-78 at 6113-14.

Litvack believed that the decision was not a close one. Op. at 70; B378 at 6115. Many of the improper things Ovitz was thought to have done turned out simply not to be true. For example, Ovitz did, in fact, report the gifts he received. B385 at 6139-41; *see also* Op. at 58.[12] As the trial court found, no one (including the plaintiffs) could identify any meaningful misstatement by Ovitz, and certainly none that harmed the Company. Op. at 51 citing B155 at 2621-22; B213 at 3755-56; B229 at 4012-13; B327-28 at 5307-08; B344 at 5809; B355 at 5940; B430 at 6724; B439 at 6847; B452 at 7148; B458-59 at 7552-53; B468 at 7649; B486 at 7867; B500 at 8161; B1784 at 118-19.

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not proven at trial. *See, e.g.*, Op. at 60-61 ("Eisner favored the Sony 'trade' because, not only would it remove Ovitz and his personality from the halls of Disney, but it would also relieve Disney of having to pay Ovitz under the OEA" and it might also have secured for Disney valuable licensing rights.)

[12] Despite the record evidence, plaintiffs continue to argue that Ovitz did not report gifts. PB at 18. The Chancellor specifically found credible the overwhelming evidence to the contrary. *See* Op. at 56 citing B157 at 2632-33; B167 at 2892; B299 at 4578-80; B386 at 6145-46; B393-94 at 6171-78; B401 at 6362; B418 at 6533; B422 at 6604; B427 at 6692-93.

Towards the end of November, Eisner again asked Litvack if the Company had sufficient "cause to fire Ovitz and avoid the costly payment." Op. at 69 & n.261. Litvack took an even closer look at the issue, Op. at 69, and also consulted with Val Cohen, a member of the California bar and the co-head of Disney's litigation department, and with Santaniello. Op. at 69 n.264 citing B380 at 6119-21. Both Cohen and Santaniello agreed with Litvack that there was no basis to terminate Ovitz for cause. *Id.*

Litvack was also convinced that, absent any credible grounds for cause, Disney, which had hundreds of contracts, had to honor the OEA. Although he considered attempting to bluff, in the hope of paying Ovitz less than the OEA required, Litvack concluded that it was a bad idea to advance what would be obviously contrived grounds for cause because, among other reasons, it was unethical and would subject Disney to a wrongful termination suit. Op. at 71-72; B378-80 at 6118-19; B382 at 6129-30.

Eisner finally accepted the idea of a Non-Fault Termination for Ovitz only because he was advised there were no valid grounds for termination for cause. Op. at 71 citing B276 at 4380; *see also* Op. at 173. As the trial court found, Eisner and Litvack "were unable to manufacture the desired result." Op. at 71.

5. Eisner Keeps the Board Informed.

At the September 1996 Board meeting and retreat in Orlando, Eisner advised the directors that he was no longer attempting to rehabilitate Ovitz but was trying to arrange for Ovitz to leave Disney. Op. at 63 citing B170 at 3087-88; B222 at 3818; B231 at 4021-22; B271 at 4349-50; B306-07 at 4728-29; B335 at 5593-94; B338 at 5725-26; B344 at 5810; B436-37 at 6836-37.

The need for Ovitz to be terminated was further discussed in connection with the Board meeting on November 25. Op. at 74 citing B215 at 3772-73; B218 at 3785; B293 at 4551-52; B356 at 5950-52; B484-85 at 7859-7862; B499 at 8155-58; *see also* B340 at 5758-59; B353 at 5930-31. During a discussion immediately following the Board meeting, Eisner informed those directors present that it was still his belief that Ovitz had to go. Op. at 73. No director objected to the need to terminate Ovitz. *See* Op. at 85.[13]

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[13] While plaintiffs point to certain documents that were shared with only some of the directors, PB at 16, 17, the trial court found that

6. Disney Terminates Ovitz Without Cause and Honors Its Obligations.

On December 3, 1996, Eisner and Ovitz met to discuss Ovitz's departure. Op. at 77; A678-79; B277-78 at 4395-96. In order to save face, Ovitz requested several concessions. Op. at 78; A678-79; B278 at 4396. Eisner did not reject those requests immediately; instead, he asked Russell to discuss those issues with Ovitz's representatives. Op. at 78; A678-79. Eisner ultimately rejected the concessions sought by Ovitz. Op. at 79 citing B84 at 1379-80; B172 at 3228-29; B99 at 2098; B172 at 3227; B171 at 3224-25; B96 at 2063-64; B394-95 at 6178-79; *see also* B278-79 at 4397-4401. In fact, the Company did not pay Ovitz anything more than was required by the OEA. Op. at 79; B151-52 at 2578-80; B278-79 at 4397-4400. There were never any negotiations with Ovitz or his representatives regarding whether Ovitz would receive an NFT. Op. at 80 citing B83 at 1378; B159 at 2640-41; B289 at 4455; B396-97 at 6186-87; *see also* B282 at 4421; B292 at 4525.

On December 10, the Executive Performance Plan Committee (the "EPPC") met to consider annual bonuses for Disney's most highly-compensated executive officers for the fiscal year ending on September 30, including Ovitz. Op. at 80-81; *see also* B1443-44. Directors Gold, Russell, Poitier, Lozano, Litvack, Watson and Eisner attended. Op. at 80; A779-86. The directors discussed the fact that Ovitz was being terminated but that he was not going to be terminated for cause. Op. at 80 citing B152 at 2581-82; B218-19 at 3785-86; B284 at 4429-30.[14]

On December 11, Eisner and Ovitz met to discuss the language of a press release announcing Ovitz's termination and the Company's refusal to grant Ovitz anything that was not in his contract. Op. at 81-82 citing B279 at 4402-03; B302 at 4601. The next day, Eisner called each of the Board members and told them that Ovitz's tenure with Disney was over. Op. at 84-85 citing B1491-1502; B220 at 3802; B280 at 4405-06; B344 at 5810-11; B353-54 at 5932-33; B459-60 at 7556-57; B466 at

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Eisner kept the Board informed about Ovitz's performance. *E.g.*, Op. at 63, 73-74.

[14] There was a misunderstanding regarding whether Ovitz was entitled to a bonus for the prior fiscal year which led the EPPC initially to approve a bonus for Ovitz. Op. at 81; B152 at 2582-83. After further reflection, however, the EPPC rescinded the bonus ten days later. Op. at 89-91; *see also* B589-91. Thus, Ovitz received no bonus for his fourteen months of work at the Company.

7642-43; B500 at 8159-60; *see also* B1189.1-.2. None of the directors opposed the decision to terminate Ovitz, and, in fact, the directors thought that it was the appropriate action to take. Op. at 85 citing B217 at 3778; B232-232.1 at 4026-28; B280-81 at 4405-09; B344 at 5810-11; B354 at 5933-35; B429 at 6720; B451-52 at 7144-46; B459-60 at 7556-57; B466 at 7642-43; B499-500 at 8158-60; *see also* B1189.1-.27. This was so even though the directors knew the NFT payment would be significant. Op. at 87 citing B150-51 at 2574-76; B216-17 at 3775-78; B336 at 5597-98; B345 at 5813; B354 at 5933-34; B431 at 6781-82; B460 at 7557; B486-87 at 7867-68; B500 at 8160-61.

Ovitz's termination was memorialized in a letter dated December 12. Op. at 82 citing A698. Later that day, the Company issued a press release announcing the termination. Op. at 83 citing A685. Although the press release stated that Ovitz's departure was by "mutual agreement," both parties understood that Ovitz was not voluntarily resigning, but was being terminated by the Company. Op. at 83 citing A644; B97 at 2087-88; B150 at 2573; B292 at 4525. On that same day, copies of the press release and a letter from Eisner were sent to each of the directors. Op. at 85; B535-39; B1447; B1448; B280-81 at 4406-08.

No one from Disney's legal department advised that formal Board action was required to terminate Ovitz or to determine whether to honor his contract. Op. at 86. Litvack did not believe that a Board meeting was legally required because he believed that Eisner had the power and authority to terminate the employment of the President. Op. at 86 citing A1110 at 6149-51. The Company's Bylaws were amended in 1994 to provide that the President reported to the Chairman of the Board and not to the Board itself. *See* A811-12. There was nothing in the Company's Bylaws, Charter or any board resolution or statute that prevented Eisner from terminating Ovitz. Op. at 140 n.496. Furthermore, Litvack could not recall one instance during his tenure at Disney when the Board was asked to decide whether to terminate an officer. A1110 at 6150. The directors also believed that Eisner had the authority to terminate his subordinate, Ovitz. Op. at 86 citing B166-67 at 2889-92; B429-30 at 6720-21; B432 at 6785-86; B454 at 7227; B461 at 7561; *see also* A1110 at 6149-50; B400 at 6339-41; A1113 at 7067-69; B467 at 7646. Accordingly, no formal Board meeting was called in December 1996 to vote on the termination of Ovitz or on whether to pay him what was due under the OEA.[15]

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[15] The directors also believed that if a meeting was required to terminate Ovitz, Litvack would have advised them of that fact. Op. at 86

The parties superseded the December 12 letter by letter dated December 27. Op. at 91 citing A699. Ovitz's tenure as a director and officer ended on that date. The December 27, 1996 letter reflects the lump sum cash payment of $38,888,230.77 due under the contract, the immediate vesting of his A options, and a $1 million holdback, pending a review of Ovitz's expense reports. Op. at 91-92.[16] In addition, Ovitz executed a general release of all claims against Disney. B601-05; B395 at 6180.

The next regularly scheduled Board meeting was set for January 27, 1997. At that meeting, as Litvack testified, he repeated his earlier advice:

> It was my view that cause, which was specified in the contract, had not been satisfied or achieved. There was no gross negligence, there was no malfeasance; and that we had, in my judgment, again, been required to honor our contract, that we had no choice.

Id. at 6182; *see also* Op. at 93.

In the end, as the trial court correctly found, Ovitz received no more from the Company than the OEA required. Op. at 78-80.

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citing B153 at 2587; B339 at 5733-34; B430 at 6721; B461 at 7561; B501 at 8233. Plaintiffs bemoan the trial court's lack of examination into why the Board did not seek to invoke its concurrent authority to terminate Ovitz. PB at 34-35. Plaintiffs fail, however, to explain why the directors should have demanded a meeting to approve something they already knew was occurring, and which they supported.

[16] Of the $1 million withheld by the Company, $860,816 was ultimately returned to Ovitz. B1005-07. Of the $139,184 retained by Disney, $68,972 represented unamortized portions of capital improvements for a screening room and security system at Ovitz's home. Op. at 56; *see also* B393 at 6174-75. That number could not be computed until after Ovitz was terminated. B394 at 6175. The remaining $70,212 represented expense account items which lacked full documentation. B1460. Contrary to plaintiffs' aspersions, PB at 2 n.1, 18, there was never any finding, or a basis for any finding, that Ovitz intentionally violated any Disney policy. *See* Op. at 51-52, 58. B394 at 6175; *Id.* at 6178; B399 at 6275; B422 at 6604; B426-27 at 6691-92.

ARGUMENT

I. THE TRIAL COURT CORRECTLY HELD THAT PLAINTIFFS FAILED TO REBUT THE PRESUMPTIONS OF THE BUSINESS JUDGMENT RULE WITH RESPECT TO OVITZ'S ELECTION AS PRESIDENT OR APPROVAL OF HIS EMPLOYMENT AGREEMENT.

A. Standard and Scope of Review.

The Chancellor is "the sole judge of the credibility of live witness testimony." *Hudak v. Procek*, 806 A.2d 140, 151 n.28 (Del. 2002), *citing Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. 1972) ("When the determination of facts turns on a question of credibility and the acceptance or rejection of 'live' testimony by the trial judge, his findings will be approved upon review."); *see also Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 259 (Del. 1991) ("Where factual determinations turn on a question of credibility and the acceptance or rejection of testimony by the trier of fact, they will be accepted by this Court."). As to findings of the trial court which do not turn on the acceptance or rejection of "live testimony," this Court will accept such findings if they "are the product of an orderly and logical deductive process" even if this Court might have independently reached opposite conclusions. *Levitt,* 287 A.2d at 673. "It is only when the findings below are clearly wrong and the doing of justice requires their overturn that [this Court is] free to make contradictory findings of fact." *Id.* A finding based on a weighing of expert opinion "may be overturned only if arbitrary or lacking any evidentiary support...." *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1146 (Del. 1989). The legal rulings of the trial court are subject to *de novo* review by this Court. *Hudak*, 806 A.2d at 150.

Plaintiffs' statement of the standard of review (PB at 21) fails to acknowledge that this Court will accept findings of fact based on a trial court's acceptance or rejection of live testimony as this Court held in *Hudak* and *Alabama By-Products*, *supra.* It is, therefore, not surprising that plaintiffs' brief repeatedly ignores that settled rule of appellate review and challenges without any deference the credibility determinations of the trial court. *See, e.g.*, PB at 29 (challenging credibility determinations about September 26, 1995 board meeting where the trial court explicitly stated that it accepted the directors' trial testimony, Op. at 73 n.277). Far from crediting defendants' trial testimony in a "chronic" or "uncritical" fashion, PB at 39 n.40, 45, the Chancellor carefully and appropriately made findings of fact after considering the trial record, including the testimony of live witnesses.

See, e.g., Op. at 24 n.64; Op. at 28 n.82; Op. at 50 n.189; Op. at 56; Op. at 58; Op. at 73 n.277; Op. at 133.[17]

B. The Chancellor Correctly Concluded that Plaintiffs Had Failed to Rebut the Presumptions of the Business Judgment Rule by Proving Either Gross Negligence or Bad Faith in Connection with the Election of Ovitz or Approval of the OEA.

1. The Chancellor Correctly Described the Presumptions of the Business Judgment Rule.

In its Opinion, the Court of Chancery correctly observed that the business judgment rule "is a presumption that 'in making a business decision the directors of a corporation acted on an informed basis, . . . and in the honest belief that the action taken was in the best interests of the company [and its shareholders].'" Op. at 107-08 (quoting *Aronson v. Lewis,* 473 A.2d 805, 812 (Del. 1984)). The presumptions of the business judgment rule can be rebutted by a showing that the directors breached their duty of care or loyalty or acted in bad faith, and the burden then "shifts to the director defendants to demonstrate that the challenged transaction was 'entirely fair' to the corporation and its shareholders." Op. at 109 citing *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001); *see also Brehm,* 746 A.2d at 264 n.66 ("Thus, directors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available."). Because the duty of loyalty was not at issue as to the non-Ovitz defendants and plaintiffs failed to prove at trial either a breach of the duty of care or a lack of good faith, they failed to rebut the presumptions of the business judgment rule.

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[17] The cases cited by plaintiffs (PB at 24 nn.21, 22) merely hold that a trial court need not credit trial testimony when it finds other evidence more persuasive; the cases nowhere say that a trial court *must* discredit trial testimony even if it is arguably in conflict with prior deposition testimony or relevant documents.

2. The Chancellor Correctly Considered as Separate Issues Whether Plaintiffs Had Established by a Preponderance of the Evidence Either Gross Negligence or a Lack of Good Faith.

Notwithstanding the Chancellor's careful and sequential analysis, plaintiffs argue that he failed to make a "threshold determination" regarding gross negligence and "conflated" plaintiffs' burden to rebut the business judgment presumptions with an analysis of whether defendants' conduct fell within the good faith exception of Section 102(b)(7) of the General Corporation Law. PB at 21. That argument fails to recognize that the business judgment rule can be rebutted not only by proving gross negligence, but also upon a showing of bad faith. It also ignores the Chancellor's findings with respect to each member of the Board at the time of Ovitz's election as President (the "Old Board") that plaintiffs failed to demonstrate either gross negligence or bad faith. *See, e.g.*, Op. at 139-41 (as to Eisner); Op. at 141-45 (as to Russell); Op. at 145-47 (as to Watson); Op. at 147-58 (as to Poitier and Lozano); Op. at 159-61 (as to the remaining members of the Old Board).

This Court has set forth the required analysis in the same manner as was implemented by the Chancellor: "Procedurally, the initial burden is on the shareholder plaintiff to rebut the presumption of the business judgment rule. To meet that burden, the shareholder plaintiff must effectively provide evidence that the defendant board of directors, in reaching its challenged decision" breached the duty of care or loyalty or failed to act in good faith. *McMullin v. Beran*, 765 A.2d 910, 916-17 (Del. 2000). *Compare Emerald Partners*, 726 A.2d at 1221, *with* Op. at 107-09 and *In re The Walt Disney Co. Derivative Litig.*, 825 A.2d at 286 ("Plaintiffs may rebut the presumption that the board's decision is entitled to deference by raising a reason to doubt whether the board's action was taken on an informed basis or whether the directors honestly and in good faith believed that the action was in the best interests of the corporation."). Thus, plaintiffs' assertion that "'[g]ood faith' is only relevant to the Court's analysis when plaintiffs have met their burden on the due care claim, and defendants have failed to demonstrate the entire fairness of the challenged transaction," PB at 21, is directly contrary to Delaware law as established by this Court.

Moreover, plaintiffs' reliance upon *Smith v. Van Gorkom*, 488 A.2d 858, 889 (Del. 1985), and *Emerald Partners*, 787 A.2d at 93, to support their argument (PB at 22) that "good faith [is] irrelevant" to the business judgment rule is completely misplaced. In *Van Gorkom* the

defendants argued that "reversal may result in a multi-million dollar class award against the defendants for having made an allegedly uninformed business judgment in a transaction not involving any personal gain, self-dealing or claim of bad faith." 488 A.2d at 889. This Court rejected the defendants' argument, holding that good faith was not relevant to the threshold issue of determining whether directors were adequately informed. This Court did not hold that good faith, or lack thereof, is irrelevant to application of the business judgment presumption. Nor does *Emerald Partners* support plaintiffs' argument. In *Emerald Partners*, the Court held that when entire fairness is the applicable standard of review, an exculpatory charter provision becomes a proper focus of judicial scrutiny only *after* the basis for liability has been decided. 787 A.2d at 94. *Emerald Partners* did not hold that a court should not consider evidence of bad faith when a stockholder is attempting to rebut the presumptions of the business judgment rule.

3. The Chancellor Correctly Held that the Members of the Old Board Did Not Violate Their Duty of Care in Connection with Ovitz's Election or Approval of the OEA.

The Chancellor held that "due care requires that directors of a Delaware corporation 'use that amount of care which ordinarily careful and prudent men would use in similar circumstances,' and 'consider all material information reasonably available' in making business decisions, and that deficiencies in the directors' process are actionable only if the directors' actions are grossly negligent." Op. at 112 (footnote omitted).[18] After analyzing the care taken by the members of the Old Board, the Chancellor found that plaintiffs had not carried their burden of showing gross negligence.

a. Based Upon the Facts Established at Trial, the Chancellor Correctly Analyzed the Actions of the Directors on an Individual Basis.

In the Opinion, the Chancellor took note of this Court's analysis of the directors as a whole in *Van Gorkom*, cited Justice Jacobs' decision

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[18] Contrary to plaintiffs' argument (PB at 25 n.23), the quoted language was consistent with this Court's description of Delaware law "that, in making business decisions, directors must consider all material information reasonably available, and that the directors' process is actionable only if grossly negligent." *Brehm*, 746 A.2d at 259.

(while sitting as a Vice Chancellor) in *Emerging Communications* for the proposition that liability determinations must be made on a director-by-director basis, and observed that there was a "not insignificant degree of tension between these two positions, notwithstanding the procedural differences between the two cases." Op. at 109-10. Despite the fact that their own post-trial briefs made separate duty of care arguments with respect to the members of the Compensation Committee and the other members of the Old Board,[19] plaintiffs now argue that the trial court erred by not engaging in a collective analysis on the issue of due care. PB at 26. That argument is both precluded by Supreme Court Rule 8[20] and is otherwise without merit.

The evidence presented at trial demonstrated that the Old Board as a whole made the decision to elect Ovitz as the Company's President. The determination of Ovitz's compensation was delegated to the Compensation Committee, which was empowered to "'establish the salaries' of the Company's CEO and COO/President, together with benefits and incentive compensation, including stock options, for those same individuals." Op. at 142. Within the Compensation Committee, different directors had different levels of involvement. Finally, Eisner negotiated directly with Ovitz about the terms of his employment and the scope of his role. Since the various directors had different roles with respect to the events surrounding Ovitz coming to Disney, the trial court appropriately examined separately the acts of the differently situated directors.

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[19] *See, e.g.*, Plaintiffs' Post-Trial Reply Brief at 5, 7, 15 & 16. Unlike the positions taken by the parties in this case, which acknowledged the differing roles played by the directors in the election and compensation decisions, in *Van Gorkom* the Court was presented with a situation in which "all of the defendant directors, outside as well as inside, [took] a unified position" with respect to their action of approving the challenged cash-out merger such that the Court was "required to treat all of the directors as one as to whether they are entitled to the protection of the business judgment rule. . . ." 488 A.2d at 889. In *Cede II*, the Court also was presented with a cash-out merger, a transaction which 8 *Del. C.* § 141 requires be approved by the board as a whole, rather than by a committee of the board. *Cede & Co. v. Technicolor, Inc.* ("*Cede II*"), 634 A.2d 345, 370 (Del. 1993).

[20] Plaintiffs' argument that the trial court was required to examine collectively the defendants' compliance with their fiduciary duties was not asserted below and, accordingly, cannot be raised on appeal. *See* Supr. Ct. R. 8.

Even if it were legal error not to examine the directors collectively, that error would be harmless. Although plaintiffs assert that the Chancellor's approach "exacerbated" other supposed errors in the Opinion, PB at 26, plaintiffs nowhere identify how the approach prejudiced their case. Under the circumstances of this case, if each director individually did not breach his or her fiduciary duty of care with respect to the election of Ovitz and the determination of his compensation, then the collective actions of the directors could not constitute such a breach.

b. The Chancellor Was Correct that the Old Board Did Not Have to Approve the OEA.

Plaintiffs claim that the Chancellor "committed legal error by concluding that the Board as a whole did not have to approve the OEA," PB at 27, citing the following passage from this Court's earlier decision: "Certainly in this case the economic exposure of the corporation to the payout scenarios of the Ovitz contract was material, particularly given its large size, for purposes of the directors' decision-making process." *Id.* (citing *Brehm*, 746 A.2d at 259). Contrary to plaintiffs' suggestion, this Court made that observation in the context of whether the potential payout amounts would be the type of information a decision maker should consider. The statement did not address the question of whether it was the exclusive province of the full Board, as distinguished from a committee of the Board, to approve the terms of the contract.

Plaintiffs also criticize the Chancellor's comments that the financial magnitude of the OEA was immaterial to the Company. PB at 28. Once again, plaintiffs have misunderstood the court's analysis. In comparing the totality of the information known to and the amount of attention paid by the members of the Trans Union Corp. board (in *Smith v. Van Gorkom*) and the Disney Compensation Committee, the Chancellor observed that "it is beyond question that the $734 million sale of Trans Union was material and significantly larger than the financial ramifications to the Company of Ovitz's hiring." Op. at 151 (footnote omitted). It was in this context -- considering whether the amount of information known was reasonable -- that the Chancellor noted that "the proposition that Eisner, the Company's chief executive officer, entered into the OLA without prior board authorization, or that the compensation committee approved Ovitz's contract based upon a term sheet and upon less than an hour of discussion, seems eminently reasonable given the OEA's (relatively small) economic size." Op. at 151-52, n.533. *Compare favorably Brehm*, 746 A.2d at 260 n.49 ("One must also keep

in mind that the size of executive compensation for a large public company in the current environment often involves huge numbers.").

Plaintiffs suggest that "[t]aken to its logical conclusion, the trial court's immateriality analysis in this case would excuse virtually all executive compensation decisions from board consideration." PB at 28. There is no reason why, as a matter of Delaware law, compensation decisions must be made by the entire board. The General Assembly adopted Section 141(c) to permit boards of directors to appoint committees and delegate a broad range of responsibilities to them. Because Section 141(c) expressly permits (with exceptions not applicable here) directors to delegate decisions to a committee, the trial court appropriately considered the actions of the members of the Compensation Committee,[21] not the other directors, in assessing plaintiffs' due care challenge to the terms of the OEA.

c. The Members of the Compensation Committee.

The Chancellor correctly found that the members of the Compensation Committee were not grossly negligent in approving the terms of the OEA. This Court should affirm that finding which was based on the Chancellor's assessment of live testimony and was "the product of a logical and deductive reasoning process." *Cede II*, 634 A.2d at 360.

(1) Plaintiffs' Claims that the Members of the Compensation Committee Were Grossly Negligent Were Properly Rejected by the Chancellor.

Plaintiffs' claim that the members of the Compensation Committee were grossly negligent is based on their arguments that: not all of the members of the Compensation Committee reviewed a draft of the OEA; the minutes of the September 26, 1995 Compensation Committee meeting do not contain any description of a discussion of the

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[21] *See, e.g.*, 8 *Del. C.* § 141(c); *Scattered Corp. v. Chicago Stock Exchange, Inc.*, 1996 WL 417507, at *3 (Del. Ch.) ("The action properly subject to review is that of the Executive Committee, as opposed to the Special Committee or the full Board."); *Zapata v. Maldonado*, 430 A.2d 779, 785, 788-89 (Del. 1981) (focusing judicial review upon the special litigation committee and not on the board as a whole).

grounds for which Ovitz could receive a Non-Fault Termination; the members of the Compensation Committee did not consider any comparable employment agreements; the members of the Compensation Committee did not consider the economic impact of providing extended exercisability of the options being granted to Ovitz; Crystal did not attend the September 26, 1995 Compensation Committee meeting; the letters from Crystal were neither distributed to nor discussed with Poitier and Lozano; and Poitier and Lozano did not review the spreadsheets generated by Watson. PB at 11-12, 13, 30-31. These arguments were addressed by the trial court and properly rejected as either factually or legally unsound.

The trial court correctly concluded that the Compensation Committee members were not required to "review and discuss the then-existing draft of the full text of the OEA." Op. at 154 (citing *Smith v. Van Gorkom*, 488 A.2d at 883 n.25). In so concluding, the court found that the members of the Compensation Committee were informed about the substance of the OEA: "the compensation committee was provided with a term sheet of the key terms of the OEA and a presentation was made by Russell (assisted by Watson), who had personal knowledge of the relevant information by virtue of his negotiations with Ovitz and discussions with Crystal." Op. at 154.[22] That term sheet included a description of the consequences of a not-for-cause termination such as the one Ovitz ultimately received.[23]

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[22] Plaintiffs claim that because the term sheet presented to the Compensation Committee members at the September 26, 1995 meeting included the language "Discussion only. Options and agreement will be approved when finalized by unanimous written consent expected to be effective October 2, 1995," the Compensation Committee members did not actually approve the terms of the OEA at that meeting. PB at 11-12. However, as reflected in the meeting minutes, A734 at WD01170, and as found by the Chancellor, "the Committee unanimously voted to approve the terms of the OEA subject to 'reasonable further negotiations within the framework of the terms and conditions.'" Op. at 29.

[23] As to plaintiffs' challenge to the September 26 minutes, the Chancellor concluded that although "no one on the committee recalled any discussion concerning the meaning of gross negligence or malfeasance," the terms "were not foreign to the board of directors, as the language was standard, and could be found, for example, in Eisner's, Wells', Katzenberg's and Roth's employment contracts." Op. at 28 n.81.

The Compensation Committee members, contrary to plaintiffs' claim, did consider comparable employment agreements. As the Chancellor found, and as demonstrated by Russell's extensive notes, the comparable historical option grants that Russell analyzed and discussed at the September 26, 1995 Compensation Committee meeting were the Eisner and Wells grants. Op. at 27-28; B1179; B1181. Plaintiffs are also mistaken when they suggest that the members of the Compensation Committee did not consider the potential economic impact of the decision to provide extended exercisability for the options to be granted to Ovitz. The Chancellor found that "Russell . . . worked with Watson and Crystal to consider the possible consequences of the proposed changes. Russell and Crystal applied the Black-Scholes methodology to assess the value of the extended exercisability features of the options and Watson generated his own analysis to the same end." Op. at 27.[24] Those analyses of the effect of providing extended exercisability took place in the two weeks in September leading up to the September 26, 1995 Compensation Committee meeting, and Russell provided a summary of those analyses at that meeting. Op. at 27-28; B141 at 2522-23.[25]

Plaintiffs also overlook the fact that Crystal was available by phone in the event that the Compensation Committee members had questions that could not be answered by other participants in the meeting. B140 at 2518; B193 at 3601-02. As the court noted, "[n]or is it necessary for an expert to make a formal presentation at the committee

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[24] Crystal's work continued through September 22, 1995, including extensive advice concerning the termination package which replaced the back-end guarantee. B961-66; B967-68; B177 at 3266; B186 at 3313; B187-88 at 3321-23. Despite a complete lack of any evidence, plaintiffs suggest that this work was really focused on Eisner's contract -- insinuating a nefarious "linkage" between the two contracts. PB at 9-10. Crystal was clear that he did no substantial work on Eisner's contract in 1995. B177 at 3266; B180 at 3279; B192 at 3594. There was, in fact, no linkage between the terms of Ovitz's contract and the 1996 Eisner contract. B182-85 at 3293-3304.

[25] Plaintiffs' claim that the letter from Crystal was not "discussed" and that its contents were withheld from Poitier and Lozano (PB at 11) ignores the record. Russell told the Compensation Committee about the meetings that he and Watson had with Crystal, as well as Crystal's Black-Scholes calculations and evaluation of Ovitz's proposed compensation package, and that as a result, Russell and Watson "felt that this grant of options was ... a fair and ... appropriate amount...." B141 at 2522-23; B449 at 7136; B465 at 7637.

meeting in order for the board to rely on that expert's analysis, although that certainly would have been the better course of action." Op. at 154.

Plaintiffs go further and suggest that the Chancellor erred in finding that Poitier and Lozano could rely upon the work performed by Russell, Watson and Crystal during August and September 1995, without having seen all of the written materials generated during that process themselves or having participated in all of the discussions held during that time. However, the trial court correctly noted that:

> Poitier and Lozano [did not make] a decision [until] September 26, 1995 when they voted to approve the terms of [Ovitz's] contract. As a result, their level of knowledge or involvement before that date is only relevant insofar as it informs the Court as to their accumulated knowledge on September 26, 1995, when the business judgment was made.

Op. at 149 n.522. The trial court found that their accumulated knowledge included the fact that both had known for several weeks that the subject of the terms of Ovitz's proposed employment contract would be discussed at the meeting (Op. at 148-49; B130 at 2445-47; B131 at 2450-51; B465 at 7637-38; B478 at 7833-34; B492-93 at 8082-83) and the discussions by Russell and Watson at the meeting of the process followed over the prior several weeks, the information they had received,[26] their consultations with Crystal, Crystal's Black-Scholes calculations and evaluation of Ovitz's proposed compensation package, and Watson's spreadsheet calculations. Op. at 152-57; B141 at 2522-23; B142-43 at 2527-28; B117-18 at 2381-84; B119-20 at 2391-92; B140-43 at 2519-30; B448-49 at 7132-36; B465 at 7638; B470 at 7668; B482 at 7848-49; B489 at 8029-30; B490-91 at 8046-47; B1782 at 131.[27]

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[26] Plaintiffs' characterization of Crystal's August 15, 1995 letter as "highly critical", PB at 31, ignores the facts. As the Chancellor correctly found, the letter to which they refer was based upon Crystal's mistaken understanding about the formulation of the guarantee originally proposed as a feature of the stock options. Once Russell cleared up that misunderstanding, Crystal revised his original letter to comport with the facts and sent the revised letter to Russell and Watson. Op. at 21-22. They, in turn, described the revised letter's contents to Poitier and Lozano at the September 26, 1995 meeting.

[27] Plaintiffs' suggestion (PB at 9, 30) that the document authored by Russell titled "Case Study," which was not shown to Poitier and

Delaware law does not require that each director receive precisely the same amount of information about a particular subject on which a vote is to be taken. As the Chancellor found:

> The [C]ompensation [C]ommittee reasonably believed that the analysis of the terms of the OEA was within Crystal's professional or expert competence, and together with Russell and Watson's professional competence *in those same areas*, the committee relied on the information, opinions, reports and statements made by Crystal, even if Crystal did not relay the information, opinions, reports and statements in person to the committee as a whole.[28]

Op. at 156 (emphasis added). Indeed, the language of Section 141(e) is not so narrow as plaintiffs would suggest -- it gives protection to directors who rely "in good faith" upon information presented to them from various sources, including "committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation." 8 *Del. C.* § 141(e).

(2) The Chancellor's Conclusion that the Members of the Compensation Committee Could Rely on Crystal's Analysis Is Supported by this Court's *Brehm* Decision.

Plaintiffs mistakenly claim that the Chancellor's conclusion that Poitier and Lozano could rely upon information about Crystal's analysis provided by Russell and Watson is "completely in contradiction to this

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Lozano, was material information that they should have seen ignores the factual record. As Russell testified, the document was an early stage negotiating document he wrote with the intention of sending it to Ovitz and his negotiators to explain "the pros and the cons ... as well as some concrete aspects of this proposal." B121-22 at 2399-2400; B1789-91 at 135-43.

[28] The court's finding that Crystal's "work product was not distributed to the committee" (Op. at 28), related only to whether a copy of Crystal's *written* work product was given to Poitier and Lozano.

Court's holding in *Brehm*." PB at 31. Presumably plaintiffs are citing to this Court's discussion in *Brehm* of what would be necessary to "survive a Rule 23.1 motion to dismiss in a due care case where an expert has advised the board in its decisionmaking process...." 746 A.2d at 262. Applying the factors articulated in *Brehm* to the facts of this case as found by the Chancellor demonstrates why the Chancellor properly held that plaintiffs had not proven their claims:

Compare the Complaint must allege facts that would show "(a) the directors did not in fact rely on the expert" (*Brehm*, 746 A.2d 262)	With Op. at 156 ("the committee relied on the information, opinions, reports and statements made by Crystal");
"(b) their reliance was not in good faith" (746 A.2d 262)	Op. at 156 ("the [C]ompensation [C]ommittee... relied on Crystal in good faith");[29]
"(c) they did not reasonably believe that the expert's advice was within the expert's professional competence" (746 A.2d 262)	Op. at 156 ("The [C]ompensation [C]ommittee reasonably believed that the analysis of the terms of the OEA was within Crystal's professional or expert 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" (746 A.2d 262)	Op. at 157 ("Crystal appears to have been selected with reasonable care");
"(e) the subject matter [in this case the cost calculation] that	Op. at 156 (court concluded there was no reason for any member of

[29] Plaintiffs also claim that the Compensation Committee members could not have relied in good faith on Crystal because his "letters did not encapsulate the final OEA pay package." PB at 31. Russell had discussions with both Watson and Crystal in September before the Compensation Committee meeting about the potential financial consequences of the changed terms. Op. at 27. *See also* § I.B.3.c.1.

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" (746 A.2d 262) (parenthetical added).	the Compensation Committee to conclude or believe that "Crystal's analysis was inaccurate or incomplete.");
"(f) that the decision of the Board [here, the Compensation Committee] was so unconscionable as to constitute waste or fraud" (746 A.2d 262) (parenthetical added).	Op. at 133 ("defendants did not commit waste").

d. The Remaining Members of the Old Board.

The Chancellor correctly determined that, in accordance with the Company's Certificate of Incorporation and Bylaws, the sole responsibility of the full Board was to "elect (or reject) Ovitz as President of the Company." Op. at 159 citing n.528; B1461-65 at Article Tenth; B511-19 at Article Tenth; A807 at Article Tenth; *see also* § I.B.3.a, *supra*. The court specifically rejected plaintiffs' argument that the full Board was required to approve the OEA. Op. at 159-60. As a result, the trial court analyzed the actions of the remaining members of the Old Board[30] "in the context of whether they properly exercised their business judgment and acted in accordance with their fiduciary duties when they elected Ovitz to the Company's presidency." Op. at 160. The Chancellor concluded that, when electing Ovitz, the directors were informed of all material information reasonably available and therefore

[30] The members of the Old Board who were not on the compensation committee are: Bollenbach, Bowers, R. Disney, Eisner, Gold, Litvack, Mitchell, Nunis, Stern, Walker and Wilson.

The trial court expressly found that "Eisner was very much aware of what was going on as the situation developed", Op. at 139, and that plaintiffs could not demonstrate "that Eisner failed to inform himself of all material information reasonably available or that he acted in a grossly negligent manner." Op. at 139-40. Plaintiffs have not contested these findings in their brief.

were not grossly negligent. *Id.* That determination is overwhelmingly supported by the court's factual findings and the record.

First, well in advance of the September 26 Board meeting, the directors were fully aware of the Company's need -- "especially in light of the CapCities/ABC acquisition, Wells' death and Eisner's medical problems" -- to hire a "number two" executive and potential successor to Eisner. Op. at 7 citing B237-38 at 4150-52; Op. at 157-58 n.551; *see also* B194-98 at 3658-76; B332 at 5581-82; B349 at 5913-14; B447 at 7125; B462-63 at 7628-29; B495 at 8141-42. Indeed, there had been numerous discussions concerning that need and the potential candidates who could fill the role even before Eisner's decision to try to recruit Ovitz. B196-98 at 3665-76; B226 at 3997-99; B305 at 4699-700; B349 at 5913-14; B447 at 7125; B462-63 at 7628-29; B495 at 8141-42.

Second, the directors knew of Ovitz's reputation, skills and experience, which they believed to be "very valuable to the Company." Op. at 157 & n.551 (the Board knew that "Ovitz was a highly-regarded industry figure"); Op. at 25; *see also* B199-200 at 3680-81; B201-02 at 3687-89; B227 at 4000-01; B321 at 5277-79; B332 at 5582-84; B343 at 5802-03; B349 at 5915-16; B362 at 6031-33; B447 at 7127. As the trial court found, Eisner also individually discussed with each director before the September 26 Board meeting the possibility of hiring Ovitz, the impending deal with Ovitz, and Ovitz's background and qualifications.[31]

Third, the directors knew that "in order to accept the Company's presidency, Ovitz was leaving and giving up a very successful business, which would lead a reasonable person to believe that he would likely be highly successful in similar pursuits elsewhere in the industry." Op. at

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[31] Op. at 7 n.6 (Eisner "contact[ed] board members on an individual basis" to discuss the possibility of hiring Ovitz) citing B349 at 5913-14 (Bowers); B226 at 3997-99 (R. Disney); B196-98 at 3665-76 (Gold); B462-63 at 7628-29 (Lozano); B495 at 8142 (Stern); also citing B1741 at 183-85 (Bowers); B1742 at 192 (Bowers); B1768 at 54-56 (Lozano); B1770-71 at 17-19 (Mitchell); B1810 at 44-45 (Wilson); B1811 at 48-49 (Wilson); Op. at 13; Op. at 25-26 (Eisner contacted each director to discuss the impending deal with Ovitz and "described ... Ovitz's background and qualifications") citing B329 at 5388 (Bollenbach); B251-52 at 4215-16 (Eisner); B204 at 3704 (Gold) ("testifying that he received a call from Eisner and also spoke with Roy Disney"); B469 at 7658 (Lozano); B332 at 5582-83 (Mitchell); B343 at 5802 (Nunis); B495-96 at 8141-43 (Stern); B1491-1502 (Eisner's phone log); *see also* B201-02 at 3688-89; B242 at 4175; B243 at 4178.

157 n.551 & 158; Op. at 25; *see also* B103 at 2315; B256 at 4235; B447-48 at 7128-29.

Fourth, the directors were aware of the public's overwhelmingly positive reaction to the Ovitz announcement. As the Chancellor explained, the Company "was applauded for the decision, and [its] stock price increased 4.4 percent in a single day -- increasing [the Company's] market capitalization by more than $1 billion." Op. at 26 citing B1274-1424; B1503-45 at Ex. 4a; *see also* B569-70; B1201-73; B205-06 at 3708-10 (directors received on August 16, 1995, copies of an extensive number of press articles uniformly applauding the announcement and describing it as "seismic").

Fifth, the directors knew that Eisner and senior management supported the Ovitz hiring.[32] Op. at 157 n.551 & 158; Op. at 155 citing B321 at 5276-77 (Bollenbach); B343 at 5802-04 (Nunis); B364 at 6039-41 (Litvack); B367 at 6051-52 (Litvack). In fact, Eisner, who had long desired "to bring ... Ovitz within the Disney fold," consistently vouched for Ovitz's qualifications and told the directors that he could work well with Ovitz. Op. at 7-8; *see also* B200 at 3682-83; B227 at 4001; B348-49 at 5912-13; B496 at 8143-44.

Sixth, at the September 26, 1995 executive session (which Eisner and all non-executive directors attended), Watson explained his

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[32] Plaintiffs note that although the Board was informed about the reporting structure that had been agreed to, "no discussion of the discontent Litvack or Bollenbach expressed [initially] at Eisner's home was recounted" at the September 26 meeting. PB at 29, citing Op. at 29-30. There was, however, nothing to discuss with the members of the Board because any discontent had been resolved six weeks earlier. B320-22 at 5275-82; B367 at 6051-52. As the trial court found, the Company's senior management believed "Ovitz's hiring [w]as a boon for the Company, notwithstanding Litvack and Bollenbach's *initial personal* feelings" that were promptly resolved once the parties had agreed to the reporting structure. Op. at 155 (emphasis added) citing B367 at 6051-52 (Litvack testifying that once the "reporting issues were resolved at the [August] meeting" at Eisner's home, he "thought [Ovitz's hiring] was great ... Ovitz was a real talent"); B321 at 5276-77 (Bollenbach testifying that the reporting issue had been resolved at Eisner's house, and at the time he left that meeting, he viewed Ovitz "as an excellent choice" and "a really good hire for the Company, as did ... everybody else"). In fact, in July, 1995, Litvack had proposed to Eisner that Ovitz be hired as president of ABC. B362-63 at 6034-36.

compensation analysis and reviewed the key terms of the OEA (including Ovitz's salary, bonus and options), Russell reported on the Compensation Committee meeting that immediately preceded the executive session, and both Watson and Russell responded to questions by the Board. Op. at 29-30 citing B144-45 at 2537-40 (Russell); B210 at 3733-35 (Gold); B230 at 4014-17 (R. Disney); B309-11 at 4872-80 (Eisner); B333 at 5585-88 (Mitchell); B350-52 at 5919-25 (Bowers); B482-83 at 7851-53 (Watson); B496 at 8145-46 (Stern); Op. at 160; *see also* B605.1-.3; B207-09 at 3719-25. The directors were also informed of the reporting structure agreed to by Ovitz. Op. at 160. At the regular session, Eisner again reviewed Ovitz's qualifications and the Board further deliberated. Op. at 30 citing A716-30; Op. at 160.

Based on all this information, the directors unanimously elected Ovitz as the Company's President. Against this backdrop, the only argument that plaintiffs can muster is that the entire Board "breached its fiduciary duty of due care by failing to inform itself . . . with respect to Ovitz's *employment agreement*." PB at 3 (emphasis added). Specifically, plaintiffs contend that "(1) the Board did not review or discuss a spreadsheet showing the possible payouts to Ovitz in the event of an NFT; (2) no written materials were provided to the Board at all; (3) no compensation expert attended the meeting or provided any written or oral report or advice to the Board; (4) the Board had no idea that the OEA was then the richest pay package ever offered to a corporate officer ... ; and (5) the Board did not discuss the gross negligence or malfeasance standards in the OEA that would control Ovitz's receipt of an NFT payout." PB at 4, 30. As plaintiffs recognize, however, each of those purported facts relate to the approval of Ovitz's "employment agreement," a responsibility that was explicitly delegated to the Compensation Committee. Accordingly, the Chancellor appropriately addressed issues relating to that responsibility in the context of his discussion of the Compensation Committee members. *See* § I.B.3.c, *supra*. The remaining Board members were entitled to rely upon the Compensation Committee (8 *Del. C.* § 141(e)) and cannot be held liable for the Compensation Committee's approval of that agreement. *See Emerald Partners v. Berlin*, 2003 WL 21003437, at *42 (Del. Ch.) (holding that a director did not breach his fiduciary duties with regard to decisions in which he did not participate), *aff'd*, 2003 WL 23019210 (Del. Supr.) (TABLE).

4. The Chancellor Correctly Concluded that the Members of the Old Board Did Not Act in Bad Faith in Connection with the Election of Ovitz and Approval of the OEA.

a. The Chancellor Correctly Defined Good Faith.

In describing the business judgment rule, the trial court noted that Delaware law presumes that directors act in good faith, and that bad faith may be found when directors act "'for some purpose *other than* a genuine attempt to advance corporate welfare or [when the transaction] is *known to constitute* a violation of applicable positive law.'" Op. at 120 (emphasis in original) (quoting *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996)). Recognizing that the concept of good faith eschews an effort to "create a definitive and categorical definition of the universe of acts that would constitute bad faith," the Chancellor concluded that "the concept of *intentional dereliction of duty*, a *conscious disregard for one's responsibilities*, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith." Op. at 123-24 (emphasis in original).[33]

Plaintiffs claim that the Chancellor improperly defined "good faith," arguing that the trial court's earlier opinion denying defendants' motion to dismiss applied a different standard. PB at 23. It did not. To the contrary, the trial court's definition of bad faith after trial -- "intentional dereliction of duty, a conscious disregard for one's responsibilities," Op. at 123, is wholly consistent with its definition in 2003 -- "consciously and intentionally disregarded their responsibilities...." *Disney*, 825 A.2d at 289.

Plaintiffs also argue that the "trial court's formulation of the good faith standard wrongly incorporated substantive elements regarding the rationality of the decision under review *rather than being constrained, as in a due care analysis, to strictly procedural criteria.*" PB at 4 (emphasis

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[33] In addition, as the Chancellor noted, certain "moral failings" such as "greed, 'hatred, lust, envy, revenge, ... shame or pride'" that cause a director to act in a manner that is not in the best interests of the corporation may result in a finding of bad faith without gross negligence. Op. at 121-22 (citing *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)).

added); *see also* PB at 23.[34] Not surprisingly, they cite no authority for their novel interpretation of good faith -- being constrained to strictly procedural criteria -- because Delaware courts have held to the contrary. *See, e.g., Gagliardi*, 683 A.2d at 1051.

Plaintiffs also suggest that the trial court's definition of bad faith is a subjective standard that can never be met. PB at 24. That, of course, is not true. Courts resolve such questions of intent routinely. When questions of state of mind -- whether they involve good faith, "*scienter* or *mens rea*" (PB at 24) -- are raised in matters that are tried, trial courts observe the witnesses, compare their testimony to deposition testimony and documents, and make objective assessments of the facts and whether the plaintiffs have proven their case. That is exactly what the Chancellor did here.

b. The Chancellor Correctly Concluded that Plaintiffs Had Not Shown, by a Preponderance of the Evidence, Facts to Rebut the Presumption that the Members of the Old Board Acted in Good Faith with Respect to the Election of Ovitz.

As part of his analysis of whether plaintiffs had established sufficient evidence to rebut the presumptions of the business judgment rule, the Chancellor considered whether plaintiffs had shown that any of the members of the Old Board had acted in bad faith. His findings that they had not done so, set forth in indented text below, are fully supported by the record, as discussed below.

- **EISNER: "after carefully considering and weighing all the evidence, [I conclude] that Eisner's actions were taken in good faith. That is, Eisner's actions were taken with the subjective belief that those actions were in the best interests of the Company. . . ." Op. at 140-41.**

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[34] Plaintiffs' argument makes no sense as it completely conflates the concept of due care with good faith. If accepted, plaintiffs' definition of good faith would result in every breach of the duty of care also being deemed to have been in bad faith, effectively eviscerating the protections accorded to directors by the General Assembly's adoption of Section 102(b)(7), and rendering nonsensical this Court's careful distinctions in *Emerald Partners*. *See Emerald Partners*, 787 A.2d at 85.

The care taken in the Chancellor's consideration of Eisner is apparent in the Opinion, which takes into account "all of the legitimate criticisms that may be leveled at Eisner," Op. at 140, while retracing the actions he took. The Chancellor's ultimate conclusion is compelled by his findings of fact, including the repeated crediting of Eisner's testimony. *See, e.g.*, Op. at 7, 13, 22, 25-26, 32-35.

Eisner's efforts to recruit Ovitz had the support of Sid Bass and Roy Disney, two of Disney's largest shareholders (and, in the case of Roy Disney, a member of the Board). Op. at 13. Disney's Board had over the prior year discussed the need to find a successor for Eisner, and Eisner had contacted board members on an individual basis to discuss the possibility of having Ovitz come to the Company. Op. at 7 & n.6. Ovitz "would provide a legitimate potential successor to Eisner and provide the Company with one of the entertainment industry's most influential individuals." Op. at 145. The trial court expressly "found and concluded ... that Eisner believed Ovitz would be an excellent addition to the [C]ompany throughout 1995...." Op. at 132; *see also* n.9 *supra*. Moreover, plaintiffs failed to prove -- and the court did not find -- that Eisner's friendship with Ovitz had any adverse impact on what were arm's-length and substantial negotiations as described by the court. Op. at 15-17, 22.

Before the OLA was signed, Eisner called every member of the Board to inform them of the impending deal before any public announcement was made. Op. at 25; B1491-1502; B1748 at 191; B1750 at 390; B235-36 at 4141-44; B251-54 at 4215-24; B331 at 5574-75; B474 at 7817-18. While no Board meeting occurred before the OLA was signed, "Eisner was entirely convinced that the board would support him in this decision," Op. at 137 n.489, perhaps influenced by his "stellar track record" as Chairman and as CEO which "bolster[ed] his belief that his decisions generally benefit[ed] the Company and its shareholders." Op. at 141 n.497. The evidence failed to demonstrate that "Eisner actively took steps to defeat or short-circuit a decisionmaking process that would otherwise have occurred." Op. at 136. And although Bollenbach and Litvack initially "were not happy with the decision" to hire Ovitz, Op. at 23, Eisner was able to work out the reporting relationships in a way acceptable to Bollenbach, Litvack and Ovitz. Op. at 23-24.

After August 14, "Eisner's role in Ovitz's hiring lessened," Op. at 138, but Eisner did lead the discussion at the September 26 Board meeting about Ovitz's qualifications and the terms of Ovitz's employment prior to Ovitz's election as President. Op. at 29-30, 138, 160; B1172;

B257 at 4240-42. In sum, as the court found, "Eisner's actions were taken with the subjective belief that those actions were in the best interests of the Company. . . ." Op. at 141 (footnote omitted).

Plaintiffs' brief does not discuss or even acknowledge the findings of fact upon which the court found that Eisner acted in good faith. Instead, plaintiffs give prominent attention to certain observations by the court about Eisner's interaction with the Board generally, PB at 8, and about certain steps not taken in connection with the hiring of Ovitz. PB at 10. Unlike plaintiffs, the Chancellor weighed all of the evidence concerning Eisner and carefully explained how he came to the ultimate conclusion that Eisner acted in good faith.

- **RUSSELL: "Have plaintiffs shown by a preponderance of the evidence that...[Russell] acted in bad faith? No. I conclude that Russell...was doing the best he thought he could to advance the interests of the Company by facilitating a transaction that would provide a legitimate potential successor to Eisner and provide the Company with one of the entertainment industry's most influential individuals." Op. at 144-45.**

- **WATSON: "Watson was familiar with making executive compensation decisions at the Company. Nothing in his conduct leads me to believe that he took an 'ostrich-like' approach to considering and approving the OEA. Nothing in his conduct leads me to believe that Watson consciously and intentionally disregarded his duties to the Company. Nothing in his conduct leads me to believe that Watson had anything in mind other than the best interests of the Company when evaluating and consenting to Ovitz's compensation package. . . .In short, I conclude that plaintiffs have not demonstrated by a preponderance of the evidence that Watson...acted in anything other than good faith in connection with the hiring of Ovitz and the approval of the economic terms of the OEA." Op. at 146-47.**

- **POITIER and LOZANO: "neither of these men acted in...bad faith," but instead acted "in a manner that they believed was in the best interest of the**

corporation" and in "good faith in connection with Ovitz's hiring." Op. at 147, 158; *see also* Op. at 156.

Russell and Watson worked diligently in setting the proposed terms of Ovitz's compensation. They enlisted the services of Crystal to work through Black-Scholes calculations with them and considered a separate analytical tool as reflected in the spreadsheets Watson had generated. They knew that only a very substantial compensation package would lure Ovitz to the Company in light of his past successes, B107-08 at 2337-38; B475 at 7820-21; Op. at 14, 144, but also did not intend to abandon the Company's long–standing compensation practices of trying to align the economic interests of executives and stockholders by having the vast majority of compensation in the form of stock options and by refusing to pay signing bonuses. Op. at 16; B106 at 2331; B250 at 4208-09. As part of their consideration of the Company's practices, they looked to the most appropriate template available -- the prior contracts of Eisner and Wells. Op. at 16; B105-06 at 2329-33; B108 at 2339-41.

Once the basic terms of the OEA were negotiated, Russell and Watson brought them to the full Compensation Committee for their review and approval. At the meeting, Russell reviewed those terms in detail. All members of the Committee asked questions about the contract and all basic terms of the contract were discussed. B464-65 at 7635-37; B473 at 7789-90. Watson presented and reviewed his spreadsheets examining the options' potential values under different scenarios. B143 at 2529; B482 at 7848-49. Lozano and Poitier were satisfied with the information they received and that the matter had been given proper attention. B449-50 at 7136-37; B465 at 7637. As a result, it was appropriate for Lozano and Poitier to rely in good faith on Russell and Watson to inform them of the negotiated terms. *See* 8 *Del. C.* § 141(e). In the end, each member of the Compensation Committee believed entering into the OEA was in the best interests of the Company and its shareholders. B865; B450 at 7140; B465 at 7639; Op. at 29, 145, 146, 158.

- **REMAINING MEMBERS OF THE OLD BOARD: these directors "did not intentionally shirk or ignore their duty, but acted in good faith, believing they were acting in the best interests of the Company." Op. at 161.**

The Chancellor's finding that the remaining members of the Old Board when electing Ovitz "acted in good faith, believing they were

acting in the best interests of the Company," Op. at 161, is amply supported by the record. Indeed, as discussed above, § I.B.3.d., *supra*, when electing Ovitz, the directors were well aware of the Company's need to hire a number-two executive and knew of Ovitz's reputation, qualifications and enormous success at CAA, as well as the market's overwhelmingly positive reaction to the announcement of his coming to Disney. Each director therefore believed that electing Ovitz would benefit the Company and was the right, sound decision for Disney.[35] *See, e.g.*, B343 at 5803 (Nunis believed that at that time, "we couldn't pick a better person [than Ovitz]"), B227 at 4001; B228 at 4005-06 (R. Disney had no reservations and it was a "great coup for the company"); B207 at 3717 (Gold believed that he "was doing the shareholders a great service" by electing Ovitz); B1807-08 at 229-30 (hiring "promised a kind of second golden age"); B332 at 5583 (Mitchell); B433 at 6824 (Wilson); B369 at 6072 (Litvack believed that electing Ovitz "was a good thing for the Walt Disney Company").

* * *

Following established precedent, the Chancellor carefully evaluated all the evidence presented during the lengthy trial to determine whether plaintiffs had rebutted the presumptions of the business judgment rule by demonstrating gross negligence or bad faith in connection with the election of Ovitz and in connection with the approval of the OEA. Plaintiffs failed to meet their burden and, consistent with this Court's precedent, the Chancellor had no need to engage in an entire fairness analysis or to consider defendants' affirmative defense predicated upon the Company's Section 102(b)(7) charter provision. *See Emerald Partners*, 726 A.2d 1215, 1221 (Del. 1999).

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[35] Plaintiffs argue that the election of Ovitz was a "done deal" as of August 14 (PB at 10, 30), but they distort what the court actually found. While the Chancellor did find that Ovitz's election "as a practical matter" was a "done deal" as of August 14, the court was very careful to conclude that "legally" Ovitz's election was not a "done deal" as of August 14. Op. at 138; *see also* Op. at 149 n.522. Moreover, the terms of the OLA were not the final terms of the OEA. As recounted by the trial court, the final material terms of the OEA were reached only by September 23. Op. 26-27, 159 n.559; B139 at 2510. In any event, the members of the Old Board understood that they had the right, if reservations had been expressed, to vote against the election of Ovitz. B205 at 3708; B232.2 at 4041; B322 at 5280; B332-33 at 5584-85; B337 at 5663; B358 at 5966; B434 at 6827; B448 at 7131.

II. THE TRIAL COURT CORRECTLY HELD THAT PLAINTIFFS FAILED TO PROVE BY A PREPONDERANCE OF THE EVIDENCE THAT ANY OF THE DEFENDANTS BREACHED THEIR FIDUCIARY DUTIES IN CONNECTION WITH THE TERMINATION OF OVITZ OR HIS RECEIPT OF NFT BENEFITS.

A. Standard and Scope of Review.

Supra § I.A.

B. The Trial Court Did Not Err in Holding that Neither the Compensation Committee Nor the Board Were Required to Vote on Whether to Terminate Ovitz or to Pay Ovitz the NFT Benefits.

The Chancellor correctly determined that the Board as constituted upon Ovitz's termination (the "New Board") was not required to act in connection with Ovitz's termination. Op. at 162-69. The trial court also considered whether any action was required by the Compensation Committee and correctly concluded that there was not. Op. at 168, 170-71. Finally, the Chancellor properly concluded that the law of the case doctrine is inapplicable to the court's post-trial findings relating to Ovitz's termination. Op. at 168 n.577.

1. The Trial Court Correctly Interpreted the Company's Charter and Bylaws.

"The parties largely agree on the relevant language from the Company's [C]ertificate of [I]ncorporation and [B]ylaws". Op. at 162.[36] The court first considered Article Tenth of the Company's Certificate of Incorporation regarding officers, Op. at 162-63 (quoting A807 at Article Tenth),[37] and then considered certain sections of Article Four of the

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[36] Plaintiffs' footnoted argument regarding Ovitz's status as a member of the Disney Board (PB at 34 n.35) was not made to the trial court. In any event, it simply ignores the fact that Ovitz agreed in his December 27, 1996 letter agreement with the Company to resign as a director. *See* A699 ("Consequently, your signature confirms the end of your service as an officer, and your resignation as a director, of the Company and its affiliates."). There was, therefore, no need to remove him in that capacity.

[37] "The officers of the Corporation shall be chosen in such a manner, shall hold their offices for such terms and shall carry out such

Company's Bylaws. Op. at 163-64 quoting A811-12. Finally the trial court considered the language of the Board resolution electing Ovitz as President. Op. at 164 quoting A718.

From those documents the Chancellor appropriately concluded that:

- The Board has the sole power to elect officers of the Company;
- The Board has the sole power to determine the "duties" of the officers;
- The Chairman/CEO, subject to the control of the Board, has the power to direct management and supervise the business of the Corporation and its officers;
- The Board has the "non-exclusive" right, but not the duty, to remove officers;
- The Chairman/CEO (subject to the control of the Board) also possesses the right to remove officers.

Op. at 164-165.

Plaintiffs cannot point to anything in the governing documents that confers exclusive authority on the Board to terminate Ovitz. *See* PB at 33-35. Consistent with the non-exclusive nature of the Board's power, the Bylaws granted Eisner, as the Chairman and Chief Executive Officer, "general and active management, direction, and supervision over the business of the corporation and *over its officers*", including Ovitz. A812. Importantly, the Bylaws were amended in 1994 to provide that the President no longer reported to the Board, but instead to the Chairman -- Eisner. B1190-95.

Plaintiffs contend that the trial court's interpretation was erroneous because the Bylaw provision that mandated that Ovitz reported to, and was supervised by, Eisner cannot trump the Board's authority over the removal of officers. The Chancellor, however, appropriately harmonized all of the provisions, concluding that none trumped any

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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." A807 at Article Tenth.

other, but rather worked in unison to confer the power of removal on both the Chairman/CEO and the Board. Op. at 167.[38] The Chancellor's interpretation of the corporate instruments, moreover, "conformed to the Company's custom and practice," Op. at 166 n.571, which recognized the authority of the Chairman/CEO to remove subordinate officers. The directors and the general counsel of the Company all testified, and the trial court found, that the "New Board unanimously believed that Eisner, as Chairman and CEO, possessed the power to terminate Ovitz without board approval or intervention." Op. at 166-67 & n.572. As Litvack testified, numerous officers had been terminated without Board action, and Litvack could not recall a single instance when the Board formally approved the termination of an officer. A1110 at 6150-51 cited by Op. at 167 n.572.

2. The Trial Court Correctly Concluded that the Language of the OEA and Option Plan Did Not Require the Compensation Committee to Act with Respect to Ovitz's Termination.

In addition to asserting erroneously that the Disney Board had the "*sole authority*" to terminate Disney officers (such as Ovitz), plaintiffs also erroneously contend that the Option Plan made mandatory the Compensation Committee's "concurrent" approval of Ovitz's termination. PB at 35.[39] In support of their argument, plaintiffs rely on Section 4 of the Amended and Restated 1990 Stock Incentive Plan (the "Option Plan"). A770. Section 4, which is titled "Conditions to Exercise of Options," contains certain restrictions on the exercise of Disney options in the event that an employee is terminated, and provides that, "[f]or purposes hereof" [*i.e.*, the option exercise provisions in Section 4], the Compensation Committee shall have the sole power to make determinations regarding the termination of any participant's

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[38] The existence of concurrent power is entirely consistent with and permitted by Delaware law. *See, e.g.*, 8 *Del. C.* § 109 (concurrent power to amend bylaws); *Campbell v. Loew's, Inc.*, 134 A.2d 852, 856 (Del. Ch. 1957).

[39] Plaintiffs' interpretation would not be limited to the termination of Ovitz. Instead, if plaintiffs' argument were followed, no employee who received Disney options could be terminated without the approval of the Compensation Committee, which would transform that Committee into human resource managers required to evaluate the termination of any Disney employee with options.

employment, including, "the cause(s) therefor and the consequences thereof." *Id.*

Section 4 of the Option Plan is expressly limited by the language "or as otherwise may be provided by the [Compensation] Committee." A770. The Compensation Committee approved the OEA, which contained its own termination provisions and standards. Op. at 168. The OEA expressly addresses the possible causes for a fault termination and the consequences thereof. A453-72. Moreover, Section 11 of the OEA provides that "the Company" (defined as the "The Walt Disney Company") shall determine if cause exists for a termination and does not purport to grant sole authority to the Compensation Committee to make such a determination. *Id.*; *see also* A456 at ¶ (e); B424-25 at 6662-64.

Litvack and Santaniello reviewed the Option Plan in connection with Ovitz's termination and determined that, for the reasons set forth above, the Compensation Committee was not required to approve the termination. Op. at 171 & n.587; B381-82 at 6126-27; B423-24 at 6659-61. Plaintiffs presented no evidence in the voluminous record that the Compensation Committee ever took action with respect to terminations and nothing in the record indicated that they were on notice that they were required to do so.[40] The trial court found that Litvack's and Santaniello's determination was reasonable under the circumstances. Op. at 170-71.[41]

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[40] *Sanders v. Wang*, 1999 WL 1044880 (Del. Ch.), cited by plaintiffs, did not (as plaintiffs would have it) hold that any violation of an option plan was a violation of directors' fiduciary duties. PB at 35. The opinion in *Sanders* was decided on a motion for judgment on the pleadings; it expressly drew "no conclusion" as to any breach of fiduciary duty and involved an award of 20.25 million shares when the clear language of the plan authorized only 6 million shares. *Sanders*, 1999 WL 1044880 at *7, *10; *Landy v. D'Alessandro*, 316 F. Supp.2d 49, 64-66 (D. Mass. 2004) (applying Delaware law and distinguishing *Sanders* because it involved a clear and unambiguous violation).

[41] Although the trial court noted that the legal conclusion reached by Litvack and Santaniello is "questionable" given the ambiguous language of the Option Plan, Op. at 170-71, the trial court found that such conclusion was "not the product of an uninformed decision or bad faith." *Id.*

3. The Law of the Case Doctrine Does Not Compel a Holding that Only the Board Could Fire Ovitz.

Plaintiffs' contention that the Chancellor erred in his application of the law of the case doctrine, PB at 32, misses the mark. This Court has noted that the doctrine is "not inflexible" and that it:

> applies only to those matters necessary to a given decision and those matters which were decided on the basis of a fully developed record. Where, as here, this Court could not have envisioned the full factual posture of a particular claim, the prior ruling cannot be considered to be the law of the case.

Zirn v. VLI Corp., 681 A.2d 1050, 1062 n.7 (Del. 1996) (dictum from earlier Supreme Court decision not decided on the basis of a fully developed record was not law of the case).

After careful consideration of the evidence, the Chancellor found "that the NFT was not economically material to the Company." Op. at 168 n.577. Fully cognizant of prior statements from this Court in *Brehm*, as well as statements in his summary judgment decision, the Chancellor concluded that:

> previous judicial statements regarding materiality cannot properly be considered "law of the case" because those statements were made in the context of motions where plaintiffs were afforded all reasonable inferences in support of their arguments and without any factual basis. Now, upon a full factual record, and in my discretion as fact-finder (materiality is a question of fact), I conclude that the NFT payout, even at the inflated valuation by Professor Murphy, was not material to the Company.[42]

Id. The trial court's conclusion is correct for several reasons.

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[42] The trial court did not hold that the NFT payments were immaterial to the Company "whatever facts plaintiffs established," PB at 33, but rather at the inflated valuation of Professor Murphy. Plaintiffs' related assertion that the trial court never explained its findings that Professor Murphy's valuation was "inflated," PB at 33 n.32, simply ignores the trial court's explanation. Op. at 99 & n.383.

a. The Prior Statements Are Not Law of the Case.

First, the prior statements in *Brehm* and the summary judgment opinion are not law of the case. In *Brehm*, this Court considered, among other things, whether plaintiffs' first amended complaint stated a claim that the Old Board violated its fiduciary duties in "*[a]pproving* the Ovitz Employment Agreement." 746 A.2d at 259 (emphasis added). After considering plaintiffs' allegations with respect to the approval of the OEA, the Court ruled that the complaint, "as drafted, fails to create a reasonable doubt that the Old Board's decision in approving the [OEA] was protected by the business judgment rule. Plaintiffs will be provided an opportunity to replead on this issue." *Id.* at 262. In short, the Court did not discuss whether the Board needed to meet to determine whether to make the NFT payment and its statement regarding materiality was therefore not necessary to the Court's holding. Similarly, the dictum in the summary judgment opinion (which cited to this Court's statement in *Brehm*) was not necessary to the trial court's holding that there were "genuine issues of material fact regarding Ovitz's receipt of the NFT, and the use of his position to obtain the NFT...." *In re The Walt Disney Company Derivative Litig.*, 2004 WL 2050138, at *7 (Del. Ch.). Thus, the Chancellor correctly determined that the prior statements were not law of the case.

b. The Trial Court's Finding Is Not Inconsistent with this Court's Prior Decision.

Regardless of whether this Court's prior statements are law of the case, *Brehm* is entirely consistent with the Chancellor's subsequent factual finding that the NFT payment was not material to the Company. As this Court cautioned:

> One must also keep in mind that the size of executive compensation for a large public company in the current environment often involves huge numbers. This is particularly true in the entertainment industry where the enormous revenues from one "hit" movie or enormous losses from a "flop" place in perspective the compensation of executives whose genius or misjudgment, as the case may be, may have contributed substantially to the "hit" or "flop."

746 A.2d at 260 n.49. Here, with the subsequent development of a factual record, the trial court considered the very types of facts this Court referenced in *Brehm*. The facts not available to this Court in *Brehm* or to the trial court in conjunction with its summary judgment opinion include:

- In fiscal 1996, the Company had approximately $19 billion in revenues, and more than $3 billion in operating income;

- Roth, who was subordinate to both Eisner and Ovitz in the chain of command, had authority to budget feature films without board authorization, notwithstanding the cost of approximately $52 million per film and a 1996 budget for 30 feature films (for a total film budget of approximately $1.56 billion); and

- Between two motion pictures alone, Roth had the authority to spend almost $250 million.

Op. at 151-52 n.533. These factual findings, which are unchallenged by plaintiffs in this appeal, are based upon contemporaneous written documents and were further supported by trial testimony of two former CFO's of the Company, who each testified that the NFT payments were not material to the Company.[43] B323 at 5284; B435 at 6829.

C. In All Events the Financial Materiality of the NFT Does Not Matter.

Regardless of the financial materiality or immateriality of the NFT payment to the Company, once the decision was made to terminate Ovitz, the correctness of which plaintiffs do not challenge, the only question left for the Company was one of contract administration and legal judgment -- whether the Company was contractually obligated to make the NFT payment. The trial court found that the members of the Compensation Committee had already authorized, on behalf of the Company, payment of NFT benefits to Ovitz upon his termination:

> The board had delegated to the Compensation Committee *ex ante* the responsibility to establish and

[43] Contrary to plaintiffs' brief and the transcript citations it references, PB at 28 n.26, neither Professor Murphy nor "several other defendants" testified that the NFT payments were material to the Company.

> approve compensation for Eisner, Ovitz and other applicable Company executives and high-paid employees. The approval of Ovitz's compensation arrangements by the [C]ompensation [C]ommittee on September 26, 1995 included approval for the termination provisions of the OEA, obviating any need to meet and approve the payment of the NFT upon Ovitz's termination.

Op. at 168 (footnotes omitted).

The trial court found that the "New Board unanimously believed that Eisner, as Chairman and CEO, possessed the power to terminate Ovitz without board approval or intervention." Op. at 166-67. This belief, the Chancellor found, was consistent with "the Company's custom and practice." Op. at 166 n.571.

The trial court also found that "Litvack properly concluded that the Company did not have good cause under the OEA to terminate Ovitz. He also properly concluded that no board action was necessary in connection with the termination." Op. at 169. The legal question of whether Ovitz was entitled to the NFT under the OEA's terms was properly addressed by Litvack, the Company's general counsel, and the trial court "independently analyzed the record and conclude[d] that Litvack's decisions as to those questions were correct." Op. at 170. Material or not, the decision was made properly.

D. The Trial Court Correctly Applied the Business Judgment Rule in Analyzing the Actions of Eisner and Litvack in Connection with Ovitz's Termination and Receipt of NFT Benefits.

Plaintiffs argue that the trial court erred as a matter of law in applying the business judgment rule to actions that Eisner and Litvack took as officers of the Company. PB at 36. That belated argument is both procedurally barred and legally incorrect.[44]

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[44] Plaintiffs' *new* arguments that Russell is a "gratuitous agent" and that his standard of care is thereby heightened are wrong. PB at 36. Russell was not a gratuitous agent of the Company (let alone of Eisner). *See* Op. at 145 (holding that Russell was doing "the best he thought he could to advance the interests *of the Company*") (emphasis added). Plaintiffs have cited no cases refusing to apply the business judgment rule to a compensated director of a corporation acting with express

Plaintiffs' argument was not fairly presented below, and therefore, cannot now be presented for review on appeal.[45] Supr. Ct. R. 8. In direct contrast to their current contention, plaintiffs argued in the Court of Chancery that the conduct of Eisner and Litvack in connection with Ovitz's termination amounted to "gross negligence" and "bad faith" -- the standards required to rebut the presumptions of the business judgment rule. (Pl. Post-Tr. Op. Br. at 72-76). In his Opinion, the Chancellor acknowledged that the application of the business judgment rule was not contested, stating that "[t]he parties essentially treat both officers and directors as comparable fiduciaries, that is, subject to the same fiduciary duties and standards of substantive review." Op. at 172 n.588. Having failed to rebut the presumptions of the business judgment rule, plaintiffs are not permitted to advance an entirely new argument on appeal -- that the rule does not apply to the actions taken by Eisner and Litvack as officers of the Company.[46]

In addition to its procedural defects, plaintiffs' new argument is contrary to both the weight of the case law and public policy. Although

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authority from the corporation (as did Russell, Op. at 78) on the rationale that the compensated director was nevertheless a gratuitous agent of the corporation. Plaintiffs also do not explain why the standard of care for a gratuitous agent should be higher than that of a compensated director of a corporation -- it is not. *See* Restatement (Second) of Agency § 379(2) (1957) (a gratuitous agent is under a duty to act "with the care and skill which is required of persons *not agents performing similar gratuitous undertakings* for others") (emphasis added); *see also Allen v. Adams*, 140 A. 694, 697 (Del. Ch. 1928) (assuming *arguendo* that a gratuitous agent is held to a "gross negligence" standard).

[45] In the detailed Pre-Trial Stipulation and Order, B1-31, plaintiffs failed to assert their new argument that the presumptions of the business judgment rule do not apply to the actions of Eisner and Litvack as officers. The Second Amended Complaint also asserts only that the "directors" breached their fiduciary duties, and does not contain a separate claim that Eisner or Litvack breached their fiduciary duties as officers. No claims were ever asserted against Russell as a "gratuitous agent".

[46] Plaintiffs' belated attempt to assert a new claim against Eisner and Litvack in their capacity as officers also must be rejected because the Court of Chancery did not have jurisdiction over them in that capacity. 10 *Del. C.* § 3114 (as it existed in 1996). Therefore, plaintiffs cannot assert a separate claim against Eisner and Litvack for breach of their fiduciary duties as *officers*.

no Delaware court has squarely addressed whether the presumptions of the business judgment rule extend to officers, several opinions have described the rule as applying to both officers and directors. *See, e.g., Cede II*, 634 A.2d at 361 (Del. 1993); *Kelly v. Bell*, 266 A.2d 878, 879 (Del. 1970); *Pogostin v. Rice*, 1983 WL 17985, at *3 (Del. Ch.), *aff'd*, 480 A.2d 619 (Del. 1984); *Haber v. Bell*, 465 A.2d 353, 357 (Del. Ch. 1983).[47]

Moreover, the strong policy justifications for the business judgment rule mandate its application to officers. As the Chancellor explained, "[s]hould the Court apportion liability based on the ultimate outcome of decisions taken in good faith by faithful directors or officers, those decision-makers would necessarily take decisions that minimize risk, not maximize value." Op. at 4. There is no logical reason to afford directors the legal presumption that they acted in good faith and in an informed manner, but refuse to extend that same presumption to corporate officers such that the courts could "engage in *post hoc* substantive review of business decisions" made by corporate officers. Op. at 107. Furthermore, because many executive officers also serve their companies as directors, plaintiffs' position would create a complex evidentiary and factual quandary for trial courts, which would be forced to determine in each case whether a corporate decision-maker was acting as a director or an officer (or both) when the challenged decision was made. For example, here, the Bylaws required Eisner to be a director in order to be Chairman and, as Chairman, he automatically became CEO, thus illustrating the difficulty in determining whether specific conduct was taken as an officer or as a director. B1107-20; Op. at 163-64.

With both the legal authority and public policy squarely against them, plaintiffs misleadingly cite one Delaware case, *McMullin v. Beran*, 765 A.2d 910, 923 (Del. 2000), which did not hold or suggest that the business judgment rule was not available to officers. PB at 36. The only other case upon which plaintiffs rely is *Platt v. Richardson*, 1989 WL 159584 (M.D. Pa.), which cited no authority and provided no legal analysis for its erroneous conclusion that the business judgment rule does not apply to officers. *Id.* at *20; PB at 36 n.37. Aside from *Platt*, the

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[47] The relevant legal commentary also buttresses the conclusion that the business judgment rule applies to officers. *See, e.g.*, 1 *Folk on the Delaware General Corporation Law* § 142.6, n.20 (Supp. 2005); 3A Fletcher Cyc. Corp. § 1036 (Perm. Ed. 2002); A. Gilchrist Sparks, III & Lawrence A. Hammermesh, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 Bus. Law J. 865 (2005).

judicial authority in other jurisdictions is squarely against plaintiffs' position. *See, e.g.*, *TSG Water Res., Inc. v. D'Alba & Donovan Certified Pub. Accountants*, 366 F. Supp.2d 1212, 1226 (S.D. Ga. 2004); *AmeriFirst Bank v. Bomar*, 757 F. Supp. 1365, 1376 (S.D. Fla. 1991).[48]

In sum, the policy justifications for the business judgment rule and the vast majority of judicial decisions refute plaintiffs' belated argument. As with directors, officers' decisions are entitled to the presumptions of the business judgment rule, and gross negligence is the appropriate standard for reviewing the care taken by officers.[49]

Finally, even if the presumptions of the business judgment rule were deemed not to apply to officers, the trial court's decision still should be affirmed. Stripped of any presumptions in their favor, the issue is simply whether Eisner or Litvack breached their fiduciary duties as officers in connection with the termination of Ovitz. After considering the extensive record, the Chancellor found that both Eisner and Litvack were adequately informed and acted in good faith in connection with Ovitz's termination. Op. at 171 ("Litvack gave the proper advice and came to the proper conclusions when it was necessary. He was adequately informed in his decisions, and he acted in good faith for what he believed were the best interests of the Company."); *id.* at 174 ("Eisner knew all the material information reasonably available when making the decision [to terminate Ovitz], he did not neglect an affirmative duty to act (or fail to cause the board to act) and he acted in what he believed

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[48] *See also Gunter v. Novopharm USA, Inc.*, 2001 U.S. Dist. LEXIS 2117, at *34 (N.D. Ill.) (applying Delaware law); *Massaro v. Venitron Corp.*, 559 F. Supp. 1068, 1080 (D. Mass. 1983) (applying Delaware law); *Para-Medical Leasing, Inc. v. Hangen*, 739 P.2d 717, 720-22 (Wash. Ct. App. 1987).

[49] Plaintiffs' unsupported contention that the Court should apply an "ordinary negligence" standard with respect to actions by officers should be rejected. *See, e.g.*, 3A Fletcher Cyc. Corp. § 1031 (Perm. Ed. 2002) ("Generally, a corporate director or officer will not be held liable for mere negligent mismanagement untainted by self-dealing."). The relevant authorities are in agreement that the rules governing an officer's liability for breach of a fiduciary duty are the same as those for directors. *See, e.g., id.*; Model Bus. Corp. Act. § 8.42 cmt. at 8-263 to 8-265 (Supp. 1998/99); 1 *Principles of Corporate Governance: Analysis and Recommendations* § 4.01 (American Law Institute 1994); David A. Drexler, Lewis S. Black & A. Gilchrist Sparks, 1 *Delaware Corporation Law and Practice* § 14.02 (2004).

were the best interests of the Company ... ."). In fact, plaintiffs concede that it was appropriate to terminate Ovitz, and the Chancellor independently concluded (as had Litvack) that "Ovitz could not have been fired for cause under the OEA." Op. at 132, 169. The Chancellor's findings were based on his assessment of the credibility of the trial witnesses and were fully supported by the record. Thus, the trial court's decision should be affirmed regardless of whether or not Eisner or Litvack are afforded the presumptions of the business judgment rule.[50]

1. Litvack.

The Chancellor found that Litvack formed a legal opinion on whether Disney could terminate Ovitz for cause and thereby avoid paying Ovitz's contractual termination benefits. Op. at 169. After considering the OEA and Ovitz's conduct, Litvack concluded (and advised Eisner) that Disney did not have a basis to terminate Ovitz's employment for cause, and that it should comply with its contractual obligations. *Id.* citing B377-80 at 6113-19. As Litvack testified, he did not want to grant a Non-Fault Termination to Ovitz, but determined that the Company simply did not have a legal basis to terminate Ovitz for cause and that to assert falsely there was cause would be both unethical and harmful to Disney. B382 at 6127-30. The Chancellor independently reached the same conclusion, based on his factual findings and the expert reports of both Feldman and Fox. Op. at 132-33.

The Chancellor also found that Litvack properly believed that no Board action was required to terminate Ovitz. Op. at 169. Litvack testified that a special Board meeting was not required for two reasons:

> One is I believed, and continue to believe, that Michael Eisner, as the CEO, had the power and the authority to fire him by himself. Two, I understood and believed, and still believe, that each of the board members in fact knew and agreed with and had discussed the firing of

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[50] Plaintiffs' assertion that the trial court found that "defendants acted negligently," PB at 36, is both wrong and misleading. The referenced page of the Opinion provides that, in connection with the *hiring* of Ovitz, defendants "were at most ordinarily negligent...." Op. at 134. The court did not make a finding that either Eisner or Litvack was negligent. Moreover, the referenced portion of the court's opinion related solely to the hiring of Ovitz, but plaintiffs' new claim relates to the actions of Eisner and Litvack in connection with Ovitz's *termination*.

> Michael Ovitz. And so I did not believe that a formal board meeting was necessary.

B388 at 6151. This belief was consistent with past practices at the Company. Op. at 166 n.571. Litvack could not recall one instance in which the Disney Board formally approved the termination of an officer. A1110 at 6149-50.

The Chancellor found, based on the record, that Litvack "was familiar with the relevant factual information and legal standards...." Op. at 169. Plaintiffs have not disputed those findings.

2. Eisner.

The Chancellor concluded that "Eisner did not breach his fiduciary duties and did act in good faith in connection with Ovitz's termination and concomitant receipt of the NFT." Op. at 172. That conclusion is compelled, once again, by the trial court's findings of fact, including the repeated crediting of Eisner's testimony. *E.g.*, Op. at 37, 50 n.189, 56, 58, 60-61, 63, 66-68, 70-71, 74, 88-89.

Eisner began to discuss Ovitz's disappointing performance with directors beginning in January 1996, culminating in a discussion with directors on November 25, 1996 when Eisner informed them that he would be terminating Ovitz's tenure with the Company. Op. at 37 & n.126, 63, 167; *see also* B214 at 3759-61; B222 at 3818; B335 at 5593-94; B352 at 5926. The Board "supported Eisner's decision." Op. at 165-67 & nn.570, 572.

Among the critical but unproven allegations of the Complaint was plaintiffs' assertion that Eisner allowed Ovitz to receive an NFT payment as an act of friendship -- an allegation they still press. *See* PB at 18 ("Eisner And Ovitz Execute A 'Win-Win' Separation Strategy"); PB at 19 ("Eisner Pays Off His Friend"); *see also* PB at 6, ¶14. But the Chancellor found that Eisner did not want Ovitz to receive that payment. Op. at 71, 173.

When it became clear that "things did not work out as blissfully as anticipated," Eisner considered all available options. Op. at 172. Because Eisner did not want Ovitz to receive the NFT payments, he first unsuccessfully sought to "trade" Ovitz to Sony. Op. at 60-62, 173. When no "trade" occurred, Eisner repeatedly pressed Litvack on the issue of cause and also "'checked with almost anyone that [he] could find that had a legal degree....'" Op. at 71, quoting B276 at 4380; *see also* B1754 at 641. No one with whom Eisner conferred said cause existed. Op. at

71. On the contrary, Litvack (who was no friend of Ovitz) advised that cause did not exist and that the Company should honor its contractual obligations, and Eisner relied on that advice. Op. at 71, 173; B282 at 4420-21; B290 at 4476; B291 at 4479; B376-77 at 6110-14; B378 at 6117-18; B382 at 6127-28.

Eisner also relied on Litvack to advise him when a decision required a Board meeting or resolution. B283 at 4423; B303 at 4671. Litvack never told Eisner -- and Litvack did not believe -- that a Board vote was required to terminate Ovitz and to determine whether to honor the Company's obligations under the OEA. Op. at 169; A1110 at 6149-51; B400 at 6339-41.

In sum, as the Chancellor found: "Eisner, consistent with his discretion as CEO, considered keeping Ovitz as the Company's President an unacceptable solution." Op. at 172. Shunting Ovitz to a different role in the Company would have "almost certainly" entitled Ovitz to the NFT benefits plaintiffs challenge here. Op. at 173. Termination, Eisner concluded, was the "best alternative." *Id.* "Eisner knew all the material information reasonably available when making the decision, he did not neglect an affirmative duty to act (or fail to cause the Board to act) and he acted in what he believed were the best interests of the Company, taking into account the cost to the Company of the decision and the potential alternatives." Op. at 174.

E. The Trial Court Correctly Held that the Members of the New Board Did Not Proceed in Bad Faith with Regard to Ovitz's Termination or His Receipt of NFT Benefits.

The trial court held that because Eisner terminated Ovitz, the New Board was not required to act and the non-action was "in good faith". Op. at 167-169 & n.580. As the Chancellor correctly found, "most if not all [directors] thought [Ovitz's termination] was the appropriate move for Eisner to make." Op. at 85 & n.326. The directors believed in good faith that Eisner had full authority to terminate the employment of an officer who reported to him. *See* Op. at 86 & n.328, 166-69. As the trial record shows, the Board members believed that because Eisner was Chairman and CEO and did not have full confidence in his President, "he had not only the right, but, in effect, the obligation to make that decision." A1113 at 6720-21; *see also* B432 at 6785-86; B461 at 7561; B467 at 7646-47.

The directors also relied in good faith on the Company's legal department to tell them if a meeting was required to terminate Ovitz. *See*

Op. at 86 & n.329, 166-69; *see also* B1766 at 825-26 ("I think the board recognized that I was the general counsel and that's -- they looked to me to fulfill that role [with respect to what matters legally had to go to the Board]."); B153 at 2587; B339 at 5733; A1110 at 6149-50; A1113 at 6721; B461 at 7561; B501 at 8233. As discussed above, Litvack believed that Eisner had full authority to terminate Ovitz's employment and no director was ever told otherwise. *See* A1110 at 6151.

Although formal Board action was not necessary, all of the other directors supported the decision to terminate Ovitz in good faith reliance on the information given to them by Eisner and Litvack. The Chancellor found credible the directors' testimony that they believed that the Company would be better off without Ovitz. *See* Op. at 133. Plaintiffs themselves do not disagree with Eisner's decision to terminate Ovitz nor do they allege the disagreement of a single director. The Board members clearly fulfilled their fiduciary duties because they understood that appropriate action was being taken to terminate Ovitz.

F. The Trial Court Properly Determined that There Were No Grounds to Terminate Ovitz for Cause.

Wholly apart from testing Eisner and Litvack's decision to terminate Ovitz under the business judgment rule, the trial court properly determined that the Company could not have terminated Ovitz for cause pursuant to the OEA. *See* Op. at 132-33, 169. The trial court's determination in this regard involved questions of credibility and was based upon extensive trial testimony. Because the Chancellor's findings turned on questions of credibility and assessment of "live testimony," such factual findings "will be accepted by this Court." *Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 259 (Del. 1991); *accord Baynard v. Kent County Motors, Inc.*, 1988 WL 101220 (Del. Supr.) (recognizing "fact-specific context" of for cause determination).

1. The Trial Court Appropriately Resolved the Factual Question of Whether Ovitz Had Committed Misconduct Constituting Cause for Termination under the OEA.

The trial court "independently analyzed the record" and expressly found that "Ovitz could not have been fired for cause under the OEA." Op. at 132-33, 169-70. The court found that both Eisner and Litvack believed that Ovitz's termination was for the best, and that they wanted to avoid the NFT payments but were unable to manufacture cause where there was none. *See* Op. at 71, 131-33. Plaintiffs argue that

this finding is "incapable of meaningful appellate review" because the trial court failed to "link any facts to support its findings." PB at 5, 39. To the contrary, the trial court devoted nearly thirty pages of its Opinion (replete with abundant citations to the record) to explaining its detailed findings on this issue. *See* Op. at 32-58 (discussing Ovitz's performance as President and plaintiffs' allegations of conduct constituting good cause); *see also Dickerson v. Simpson*, 2002 WL 371866, at *1 (Del. Supr.) (TABLE) (affirming a lower court's conclusion when the basis for it was evident and supported by the record).

Plaintiffs then argue that the trial court failed to articulate its understanding of the standard for good cause termination (defined in the OEA as "gross negligence" or "malfeasance"). PB at 38-39. Again, to the contrary, the trial court gave considerable articulation to its understanding: (i) the trial court declined to accept the legal standard advanced by Ovitz's expert, Larry R. Feldman, Op. at 100-01; (ii) the trial court found the definitions advanced by the non-Ovitz defendants' expert John Fox to be of significant value, Op. at 101-03; (iii) the trial court found that the opinion advanced by plaintiffs' expert Professor John Donohue provided very little guidance because of, *inter alia*, Donohue's "zeal to crucify Ovitz," Op. at 97-98; and (iv) the trial court concluded that, under *all* the "myriad" definitions discussed by Donohue, Feldman, and Fox, Ovitz did not commit gross negligence or malfeasance.[51] Op. at 132-33.

Plaintiffs' argument misses the point -- the trial court found none of their specific allegations of misconduct constituted good cause under *any* legally valid definition of malfeasance or gross negligence. It is not error to refrain from deciding a legal issue not necessary to the disposition of a case, but rather a customary exercise in judicial economy. *See, e.g., In re Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *39 n.184 (Del. Ch.) ("The Court need not decide that definitional issue [of good faith], because under either definition, Raynor's conduct amounted to a non-exculpated breach of fiduciary duty.").

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[51] Plaintiffs argue that falsehoods need not be material to constitute good cause under the terms of the OEA. PB at 39 n.39. Yet plaintiffs cite to a portion of the report of their expert, Donohue, in which he references "Habitual lying;" nowhere does Donohue opine that non-material, isolated falsehoods could as a matter of law constitute malfeasance or gross negligence. PB at 39 n.39 (citing A857). Moreover, as noted above, the trial court found as a factual matter that Ovitz was not a "habitual liar." Op. at 51-52; § II.F.2., *infra*.

2. The Trial Court Appropriately Found No Material Falsehoods in the Course of Ovitz's Duties for the Company.

Notably, the trial court rejected plaintiffs' contention that Ovitz was a "habitual liar" and that plaintiffs' allegations of lack of veracity constituted good cause. Op. at 49-52. That finding was supported by the testimony of numerous witnesses that they were not aware of a material falsehood told by Ovitz. Op. at 51 n.192.[52] Fox stated that, upon review of the record and testimony, he could not find a dishonest statement by Ovitz that was materially harmful to the Company. B506-07 at 8766-69. Even plaintiffs' own expert, Donohue, could not identify at trial a single lie by Ovitz in the course of his duties for the Company. Op. at 51 n.193.

The Chancellor also carefully considered and discussed each of the documents which plaintiffs presented on the issue of Ovitz's veracity at trial. Op. at 50-51; PB at 41-42 (citing A196-202; A191-95). The Chancellor found credible Eisner's testimony that he "was not referring to any material falsehoods, but instead to Ovitz's salesmanship or, in other words, his 'agenting.'" Op. at 50-51.

Plaintiffs contend that "the trial court cannot explain why it chose to uncritically accept Eisner's testimonial, latter day characterizations of incriminating written evidence," asserting that "the trial court found that Eisner had actually lied to shareholders and the investing public at large" "[i]n at least two instances." PB at 42. Plaintiffs seem not to grasp that one essential function of a trial judge is to make credibility determinations. Here, the Chancellor explained several times why he credited the testimony of Eisner – a witness who was on the stand for five days, *see, e.g.*, Op. at 36 n.120, Op. at 50. To the extent that the court was critical of Eisner's conduct in the two cited incidents, plaintiffs overstate those criticisms and present them out of

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[52] Plaintiffs' statement that the trial court "failed to consider that there were specific examples of material falsehoods in the record" is wrong. PB at 42. To the contrary, the Chancellor considered plaintiffs' purported "falsehoods" and rejected them as (among other reasons) not misleading or not alleged to have occurred in the course of Ovitz's duties for the Company. *See* Op. at 52 n.193 (statements with respect to Ovitz's airplane ownership and a non-disparagement agreement were not made in the course of Ovitz's duties for the Company); 51-54 (Ovitz's disclosures regarding his earn-out with, and past income from, CAA were not false or materially misleading); 40 (Ovitz did not act improperly in dealings with a potential NFL franchise in Los Angeles).

context. *Compare* PB at 42 *with* Op. at 64, 82-84 & n.312. More importantly, the fact that the Opinion includes such criticisms reveals the care with which the court made its factual findings: the court weighed all of the evidence about Eisner before deciding to credit that testimony on each and every significant aspect of the case. *See, e.g.,* Op. 34 n. 113, 56, 63, 65-67, 70-71, 74, 89, 92 and 132.

Plaintiffs' related argument that the trial court rejected the testimony of Disney stockholder Sid Bass "because he did not appear at trial," PB at 16, 43, also mischaracterizes the Opinion. The trial court found that Bass' testimony of conversations he had with Eisner was vague as to both timeframe and content. Op. at 35-36 n.120; *see also* Op. at 50 n.189. The court noted that Bass' testimony conflicted with contemporaneous documents authored by Eisner as well as Eisner's trial testimony. Op. at 35-36 n.120. The Chancellor found, based upon the trial record "and my personal determination as to the credibility of the testimony presented at trial, . . . Eisner's account of Ovitz's performance together with the contemporaneous documents credible, and Bass' deposition testimony not credible." *Id.*[53] The Chancellor held Bass' testimony to be non-credible for many reasons and not because he did not attend trial; rather, the court simply speculated that "[h]ad I had the opportunity to observe Bass at trial, I might have reached a different conclusion as to the weight of his testimony . . . ." *Id.* Of course, the far more likely result would have been that Bass, faced with objective impeachment of the time frame of his conversations with Eisner (*see* note 53 *supra*) would have corrected his deposition testimony.[54]

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[53] Eisner's recollection of the timing and circumstances of his discussion with Bass about a concern that Ovitz might commit suicide were he to be terminated was corroborated by Eisner's contemporaneous written communications with Bass (A188-90); by Eisner's positive communications about Ovitz's performance of October 20, 1995 and November 10, 1995, respectively, to the Board, the Basses and his wife, Jane (B936-41) and his biographer (B942-46); and by the date of the news reports of the suicide of Admiral Jeremy Boorda. B1486-88 (May 17, 1996). In contrast, the court noted that, in deposition, Bass could only reply "Fall 95" when asked the "approximate date" of Ovitz's hiring, and that Bass was able to say he met with Ovitz in August 1995 only because someone had refreshed Bass' recollection. Op. at 35 n.120.

[54] As a separate matter, the trial court held that Bass' testimony would also have been hearsay against all defendants (other than Eisner). Op. at 35-36 n.120 (citing D.R.E. 801).

3. Ovitz's Lack of Success at the Company Was Not Due to Gross Negligence or Malfeasance, but Philosophical Differences with Disney Management.

While the trial court recognized that, in the end, Ovitz was not a success at the Company, it noted that Ovitz did make contributions to the Company while President. Op. at 43-46. The trial court concluded that Ovitz's efforts often failed to produce results not because Ovitz was grossly negligent or malfeasant, but "because his efforts reflected an opposite philosophy than that held by Eisner, Iger, and Roth." Op. at 47. The court emphasized that Ovitz's efforts -- albeit unsuccessful -- "demonstrate[] that Ovitz was attempting to use his knowledge and experience, which (by virtue of his experience on the 'sell side' as opposed to the 'buy side' of the entertainment industry) was fundamentally different from Eisner's, Iger's, and Roth's, to benefit the Company." Op. at 48.

The Chancellor's factual findings were informed by the testimony of Feldman and Fox, "whose factual assumptions [were] consonant with [the court's] factual findings." Op. at 132. The court found that Fox's report and testimony -- which "were very thorough, well-reasoned and informed by Fox's extensive practical experience as an employment law litigator and advisor" -- were of significant value and that his conclusions would be weighed accordingly in the trial court's determinations. Op. at 102-03. Fox testified at trial that he had reviewed the testimony of the witnesses and thousands of pages of documents in the discovery record but could not find evidence of alleged misconduct by Ovitz that even remotely justified termination for cause under the OEA. B1567-77 at Ex. D (consisting of a 53-page chart rebutting each of plaintiffs' claims of purported wrongdoing); B505-07 at 8764-69. The trial court relied on Fox's testimony and expert opinion, a conclusion that is entitled to deference. Op. at 103; *see Cavalier Oil Corp.*, 564 A.2d at 1146 ("A factual finding based on a weighing of expert opinion may be overturned only if arbitrary or lacking any evidential support.").

* * *

The finding of the Chancellor that no grounds existed to fire Ovitz for cause defeats several of plaintiffs' claims. First, plaintiffs' claim that the full Board was required to determine how to terminate Ovitz becomes irrelevant because, even if the Board had acted, it would have had no basis to do anything other than what was done -- fire Ovitz without cause. Second, regardless of the standard applied to the actions

of Eisner and Litvack, they had no factual basis to do what plaintiffs claim they should have done -- fire Ovitz for cause. Further, as discussed *infra*, it could not have been waste to provide Ovitz his contractual termination benefits when there was no basis to withhold them. Finally, though the court was not required to address entire fairness because plaintiffs did not rebut the presumptions of the business judgment rule, paying contractual obligations is both required of, and fair to, Delaware corporations. *See, e.g., Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 267-68, 276 (Del. Ch. 1989) (holding that grant of options was fair notwithstanding the inapplicability of the business judgment rule).

III. THE COURT OF CHANCERY CORRECTLY HELD THAT PLAINTIFFS DID NOT MEET THEIR ONEROUS BURDEN TO PROVE WASTE.

A. Standard and Scope of Review.

Supra § I.A.

B. Merits of Argument.

Plaintiffs' arguments specific to waste, rejected by the court below, Op. at 38-39, have been reduced to a footnote and a paragraph or two in plaintiffs' summary of argument. PB at 6, 48 n.46. The "stringent requirements" of waste only apply to an exchange "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." *Brehm*, 746 A.2d at 263 (quotations omitted). A claim of waste will usually only succeed where there is a "transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received." *Id.* Plaintiffs have not met that exacting standard.

1. The Approval of the OEA Was Not Waste.

The approval of the OEA was not waste. The OEA induced Ovitz to serve as the Company's President and he did in fact serve the Company full-time in that capacity. As a result of the announcement of the hiring of Ovitz as Disney's President, the market value of Disney's stock increased by more than a billion dollars. Op. at 26. The trial court also found that Ovitz had made valuable contributions to the Company as President. Op. at 43-44.

This Court had previously affirmed the Court of Chancery's ruling that plaintiff's argument that the OEA somehow incentivized Ovitz to leave the Company early did not, as a legal matter, meet the stringent requirements of waste. *Brehm*, 746 A.2d at 262-63. Regardless, after trial, the court rejected the argument's factual premises -- that either Ovitz would be able to procure an NFT for himself or Eisner had agreed to terminate Ovitz even before he was hired. *See* Op. at 131 (finding that the record did not support those illogical assertions "in any conceivable way").

Plaintiffs continue to press their claim that the OEA's terms "incentivized" Ovitz to seek an early end to his employment at Disney. PB at 14-15. That argument has always defied logic and now ignores the evidence. As the Chancellor correctly found, "Ovitz was never in a

position to determine if he would be terminated, and if so, whether it would be with or without cause.... I find it patently unreasonable to assume that Ovitz intended to perform just poorly enough to be fired quickly, but not so poorly that he could be terminated for cause." Op. at 131-32. Also, Ovitz testified unambiguously that until the day he was terminated he expected the relationship to work. B77 at 1305. The trial court found that testimony credible. Op. at 132 ("[N]othing in the trial record indicates to me that Ovitz intended to bring anything less than his best efforts to the Company."). Finally and notably, as a result of his Non-Fault Termination, Ovitz relinquished the opportunity to receive options on an additional two million shares.[55]

2. Ovitz's Receipt of NFT Payments Pursuant to the OEA Was Not Waste.

Nor was Ovitz's receipt of NFT payments pursuant to the OEA waste. Ovitz did not voluntarily resign, as plaintiffs alleged they would prove on their first appeal to this Court. *Brehm*, 746 A.2d at 264. To the contrary, Ovitz made clear to all until he was forced out that he was committed to succeeding at the Company. *See* Op. at 59-60. The only other means for Ovitz to forfeit his contractual right to termination payments would be to be fired for cause. As the Chancellor found, the Company had no grounds to fire Ovitz for cause. Op. at 132-33, 169, *supra* § II.F.

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[55] Plaintiffs cite stock option cases from 1952 and 1960 for the proposition that there should be some connection between an option grant and an anticipated benefit to the Company. PB at 4-5. There was here -- the stock options in question induced Ovitz to come to Disney. *See Kerbs v. Cal. E. Airways,* 90 A.2d 652, 656 (Del. 1952) (sufficient benefit from an option grant includes "retention of the services of an employee"). Unlike the *Kerbs* case plaintiffs cite, Ovitz's options were not self-granted. *See Beard v. Elster*, 160 A.2d 731, 735 (Del. 1960) (distinguishing *Kerbs* on that basis). In any event, the appropriate question under current case law regarding stock options granted consonant with fiduciary duties is, like any other business decision, only whether they constitute waste (and Ovitz's did not). *Brehm*, 746 A.2d at 262-63; *Zupnick v. Goizueta*, 698 A.2d 384, 386-87 (Del. Ch. 1997).

CONCLUSION

For the foregoing reasons, the Non-Ovitz Defendants respectfully request that this Court affirm the judgment of the Court of Chancery.

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