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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE THE WALT DISNEY COMPANY DERIVATIVE LITIGATION	))	CONSOLIDATED C.A. No. 15452

OPENING BRIEF OF THE WALT DISNEY COMPANY AND THE DIRECTOR DEFENDANTS IN SUPPORT OF THEIR MOTION TO DISMISS

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PRELIMINARY STATEMENT

When the plaintiffs last attempted to maintain a lawsuit against the directors of The Walt Disney Company ("Disney" or the "Company") concerning the hiring and firing of Michael Ovitz as its President, the Delaware Supreme Court affirmed this Court's dismissal of the plaintiffs' amended complaint, which the Court noted was a "pastiche of prolix invective." Brehm v. Eisner, Del. Supr., 746 A.2d 244, 248 (2000). In affirming the dismissal of the Amended Complaint pursuant to Rules 23.1 and 12(b)(6) of the Rules of the Court of Chancery, the Court held:

- "The Court of Chancery held that 'no reasonable doubt can exist as to [Disney Chairman and CEO Michael] Eisner's disinterest in the approval of the Employment Agreement, as a matter of law,' and similarly that plaintiffs 'have not demonstrated a reasonable doubt that Eisner was disinterested in granting Ovitz a Non-Fault Termination.' Plaintiffs challenge this conclusion, but we agree with the Court of Chancery and we affirm that holding."

- "Because we hold that the Complaint fails to create a reasonable doubt that Eisner was disinterested in the Ovitz Employment Agreement, we need not reach or comment on the analysis of the Court of Chancery on the independence of the other directors for this purpose."

- "In this case, therefore, that part of plaintiffs' Complaint raising the first prong of *Aronson*, even though not pressed by plaintiffs in this Court, has been dismissed with prejudice. Our affirmance of that dismissal is final and dispositive of the first prong of *Aronson*."

Id. at 258. Because all the issues relating to the first prong of the Aronson test have been resolved, plaintiffs are precluded from arguing that demand should be excused as a result of any perceived interest or lack of independence on the part of any of the individual defendants with respect to the challenged transactions. As for the second aspect of the Aronson test, the Supreme Court found as follows:

- Plaintiffs' allegations about what compensation consultant Graef Crystal "*now* believes *in hindsight* that he and the Board *should have done* in 1995" were insufficient to "create a

reasonable doubt that the Old Board's decision in approving the Ovitz Employment Agreement was protected by the business judgment rule."

- "We agree with the analysis of the Court of Chancery that the size and structure of executive compensation are inherently matters of judgment. . . . To be sure, there are outer limits, but they are confined to unconscionable cases where directors irrationally squander or give away corporate assets. Here, however, we find no error in the decision of the Court of Chancery on the waste test" as applied to the decision to enter into the employment agreement.

- "The Complaint does not allege facts that would show that Ovitz had, in fact, resigned before the Board acted on his non-fault termination."

- "The Complaint fails on its face to meet the waste test because it does not allege with particularity facts tending to show that no reasonable business person would have made the decision that the New Board made under these circumstances" to grant a Non-Fault Termination. . . . "To rule otherwise would invite courts to become super-directors, measuring matters of degree in business decisionmaking and executive compensation. Such a rule would run counter to the foundation of our jurisprudence."

Id. at 261-62, 263-64, 264, 266. (emphasis in original). The Court did allow, though, for the possibility that a Section 220 inspection might yield information that would allow plaintiffs to meet the pleading standard for breach of the duty of care and waste, and gave plaintiffs the opportunity to file an amended complaint "in accordance with the rulings of this Court as set forth in this opinion." Id. at 267.[1]

The only matters that plaintiffs may attempt to replead, therefore, relate to whether "the challenged transaction was otherwise the product of a valid exercise of business judgment." Id. at 253. As delineated by the Supreme Court, plaintiffs were granted leave to try to state a claim with

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[1]The Delaware Supreme Court did not address the applicability of Disney's exculpatory charter provision passed pursuant to Section 102(b)(7) of the General Corporation Law of the State of Delaware (the "General Corporation Law"), an issue that had not been raised on appeal. The Court subsequently ruled that this Court may take judicial notice of such an exculpatory provision for purposes of deciding a Rule 12(b)(6) motion to dismiss a derivative complaint. Malpiede v. Townson, Del. Supr., 780 A.2d 1075, 1090-92 (2001). Disney's charter documents are attached as Exhibit A to the Transmittal Affidavit of Joel Friedlander, which is cited herein as "Friedlander Aff. Ex. __".

respect to the following: (1) the Old Board's decision in approving Ovitz's employment agreement; (2) possible waste in connection with the approval of Ovitz's employment agreement and (3) possible waste in connection with the grant of a Non-Fault Termination. The new pleading, however, is not so limited, nor does it allege any new particularized facts that would establish the basis for any of the claims for which the Supreme Court allowed plaintiffs the opportunity to replead.

The new complaint quotes little from the various documents plaintiffs obtained from Disney pursuant to 8 Del. C. § 220. Moreover, the very language of the quoted documents refutes plaintiffs' conclusory allegations that Disney's board breached its fiduciary duties and committed waste when approving Ovitz's employment agreement and in connection with the termination of his employment. As discussed below, the documents make clear that Ovitz's hiring was approved after a months-long process in which Disney personnel, acting in consultation with Greaf Crystal, a nationally renowned executive compensation expert and critic, and negotiating at arm's length with Ovitz, created a compensation package of a size and structure necessary to entice Ovitz to leave his fabulously lucrative business and accept a position at Disney. Disney's Compensation Committee met on two separate occasions during the course of the negotiations to review and approve the key terms under discussion, including the severance provisions. The cited documents also make clear that, in an unsuccessful effort to arrange Ovitz's departure on terms that would avoid any cost to Disney, Eisner suggested that Ovitz look for a new job. In short, plaintiffs have offered nothing to contradict the reasonableness of terminating Ovitz pursuant to the bargained-for terms of his contract.

The record created by plaintiffs' incorporation of documents obtained pursuant to Section 220 shows how Disney's Compensation Committee approved a carefully constructed compensation

package founded on the reasonable belief that hiring Ovitz would create value for Disney and its stockholders. When the situation did not work out as expected, the record shows that Eisner, with the support of the Board of Directors, prudently intervened. Delaware law does not permit a dissident stockholder to second guess such judgments. As the Delaware Supreme Court noted in its opinion, Rule 23.1 "does not permit a stockholder to cause the corporation to expend money and resources in discovery and trial in the stockholder's quixotic pursuit of a purported corporate claim based solely on conclusions, opinions or speculation." Brehm, 746 A.2d at 255. It is time for plaintiffs' remaining unfounded allegations of directorial wrongdoing to be dismissed with prejudice.

NATURE AND STAGE OF THE PROCEEDINGS

This derivative action was initially filed on January 7, 1997 by plaintiffs William and Geraldine Brehm, allegedly on behalf of the Company. The Brehms claimed that twelve present or former members of Disney's board of directors (the "Board") breached their fiduciary duties by (a) approving the comprehensive employment and compensation arrangement required to attract defendant Michael S. Ovitz, then acknowledged to be "Hollywood's most powerful man," to leave the successful talent agency he had founded and become the President of Disney, and then (b) honoring the terms of the employment agreement upon Ovitz's termination from Disney.

On January 28, 1997, the defendants answered the initial complaint and moved for judgment on the pleadings on the ground that plaintiffs had failed to comply with Court of Chancery Rules 12(b)(6) and 23.1. On May 28, 1997, plaintiffs filed an "Amended Stockholders' Derivative And Class Action Complaint" (the "Amended Complaint"). On June 11, 1997, all defendants moved to dismiss the Amended Complaint.

This Court granted defendants' motions to dismiss the Amended Complaint pursuant to Rule 23.1 and for failure to state a claim upon which relief could be granted. In its opinion, the Court held that the well-pleaded allegations of the Amended Complaint did not create a reasonable doubt either that the Board was disinterested and independent or that the decisions challenged in the Amended Complaint were otherwise the product of a valid exercise of business judgment by the Board.[2]

On appeal, the Delaware Supreme Court affirmed the dismissal of the Amended Complaint. However, the Court allowed plaintiffs to attempt to replead certain of the claims that had been

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[2]This Court also dismissed certain disclosure claims asserted by plaintiffs. Plaintiffs did not appeal from that aspect of the dismissal, and they have not attempted to replead any such disclosure claims.

dismissed. On January 3, 2002, plaintiffs filed the Second Amended Consolidated Derivative Complaint (the "Second Amended Complaint"). Despite having now had the opportunity to file a third complaint with this Court, plaintiffs have yet to state nonconclusory facts that support their allegations. As discussed below, the very documents plaintiffs obtained in response to a demand pursuant to 8 Del. C. § 220 and which they quote in the Second Amended Complaint demonstrate that their claims have no merit.

This brief is submitted on behalf of defendants Michael D. Eisner, Stephen F. Bollenbach, Reveta F. Bowers, Roy E. Disney, Stanley P. Gold, Sanford M. Litvack, Ignacio E. Lozano, Jr., George J. Mitchell, Thomas S. Murphy, Richard A. Nunis, Leo J. O'Donovan, Sidney Poitier, Irwin E. Russell, Robert A. M. Stern, E. Cardon Walker, Raymond L. Watson, Gary L. Wilson and the Company in support of their motion to dismiss.

STATEMENT OF FACTS[3]

A. Disney and Its Independent Board of Directors.

The Walt Disney Company is a diversified international entertainment company. (Compl. ¶ 15) At all relevant times, Michael Eisner served as Disney's Chairman and Chief Executive Officer. (Id. ¶ 16)

Michael Ovitz was employed by Disney as its President from October 1, 1995 through December 27, 1996. (Id. ¶¶ 17(a), 51) Immediately prior to that time, Ovitz was the Chairman of Creative Artists Agency ("CAA"), a talent agency that he had founded. (Id. ¶ 17(b)) In December 1996, The New York Times described Ovitz as "one of the most formidable power brokers in Hollywood." (Id. ¶ 76)

At the time of Ovitz's hiring, the board of directors of Disney consisted of Eisner, 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., and George J. Mitchell (collectively, the "Old Board"). (Id. ¶ 21) The Compensation Committee consisted of outside directors Lozano, Poitier, Russell and Watson. (Id. ¶ 36) At the time of Ovitz's departure, the board of directors of Disney (excluding Ovitz) consisted of Eisner, Litvack, Russell, Disney, Gold, Nunis, Poitier, Stern, Walker, Wilson,

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[3]This Statement of Facts is derived from the factual allegations of the Second Amended Complaint, as well as certain documents quoted in that pleading. See Orman v. Cullman, Del. Ch., __ A.2d __, C.A. No. 18039, slip op. at 5, Chandler, C. (Feb. 26, 2002, revised Mar. 1, 2002) (attached as Exhibit A) (considering undisputed facts in proxy statement, a document that was "integral" to the complaint and "the source for the merger-related facts as pled in the complaint"). "If a plaintiff's complaint alleges a fact that is unambiguously contradicted by an integral document incorporated into the complaint *and* there are no other facts in that document supporting the allegation, the Court need not accept as true the fact as alleged in the complaint." Id. at 5 n.9 (emphasis in original).

Bowers, Lozano, Mitchell, Leo J. O'Donovan and Thomas S. Murphy (collectively, the "New Board").[4] (Id. ¶ 22)

Apart from a long-time personal friendship between Eisner and Ovitz, none of the Director Defendants is alleged to have had any personal or business relationship with Ovitz. (Id. ¶ 3) The only member of the Old Board who is alleged to have had any personal financial interest relating to the hiring of Ovitz is Russell, a practicing lawyer with a solo practice who was awarded $250,000 by the other members of the Old Board for having spent many hours over a period of months to effectuate Ovitz's hiring. (Id. ¶¶ 3, 48) No Director Defendant is alleged to have had any personal financial interest in the terms or timing of Ovitz's termination.

B. The Effort to Structure a Compensation Package that Would Entice Ovitz to Leave His Commanding and Highly Remunerative Position at CAA.

As of the summer of 1995, Disney had a need for a new President who would function in a supporting role to Eisner and potentially succeed him someday as CEO. The position had gone unfilled since 1994, when Eisner lost his second-in-command, Frank Wells, in a fatal helicopter crash. (Id. ¶ 27)

Eisner focused his attention on attracting Ovitz away from his position as Chairman of CAA to become the new second-in-command at Disney. (Id. ¶¶ 25, 33) Personnel at Disney worked on devising a compensation package to propose to Ovitz for that purpose. That effort is apparent from an "internal Disney document created on or about July 7, 1995," that has been partially quoted by plaintiffs. (Id. ¶ 33)

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[4]The New Board and Old Board are referred to collectively as the "Director Defendants."

The July 7, 1995 document quoted by plaintiffs[5] is a clear-eyed analysis of the constraints that existed in designing a compensation package that would be mutually acceptable to Ovitz and Disney. It states that its objective is as follows:

> To create a compensation package to induce a highly successful and unique entrepreneur to accept an exceptional corporate executive opportunity under guidelines that do not violate company standards, will be approved by its Board, and will not be unduly criticized by institutional investors, Wall Street analysts, and compensation "experts".
>
> It must be assumed that every element of the package will be intensely examined.

(Friedlander Aff. Ex. B at DI 0380)

This document notes two "Special Circumstances" that needed to be taken into account, given Ovitz's highly remunerative position at CAA:

> (a) *It is necessary and appropriate to provide Executive with downside protection and upside opportunity to compensate to the extent feasible for present and future values of the very successful business he will abandon*;
>
> (b) Similarly, Executive requires consideration to assist in the adjustment in life style resulting from the lower level of cash compensation from a public corporation in contrast to the availability of cash distributions and perquisites from a privately held enterprise.

(Id.) (emphasis added). The "downside protection and upside opportunity" under consideration to compensate Ovitz for leaving CAA took the form of a grant of stock options for five million shares of Disney common stock to vest over five years beginning after the third year, together with a contractual guarantee that if the option shares did not appreciate in total value by at least $100 million during the five-year period of the proposed contract, Disney would pay Ovitz up to $50 million. (Id. at DI 0381)

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[5]Plaintiffs selectively quote the July 7, 1995 document and mischaracterize it as a supposed "red flag" concerning the "magnitude and counter-productive nature" of the stock options under consideration for Ovitz. (Compl. ¶ 106.B; see id. ¶ 33)

The document makes clear that the magnitude of the stock option grant being considered was thought necessary to induce Ovitz to leave CAA and motivate him to try to earn more at Disney:

> Number of stock options is far beyond standards applied in Company and in corporate America and will raise very strong criticism. We should collect survey information to be prepared to answer if it becomes necessary.
>
> *Justification is that the large award of stock options is the best mechanism to reward Executive's performance with the Company, to motivate him* to apply the same extraordinary skills, ingenuity and success as an entrepreneur to his task as a corporate executive, *and concomitantly to compensate him for the value of the business he is abandoning.* In effect we are making the award extraordinary because *the Executive must be given the chance to earn greater awards by virtue of the change, than he would likely have earned in his own business, in order to induce him to make the change.*

(Friedlander Aff. Ex. B at DI 0381-82) (emphasis added).

The same document also makes clear that Disney was considering that Ovitz be afforded "downside protection" that, at worst, would guarantee him $50 million from the stock options by requiring Disney to pay him up to that amount if the option shares themselves did not appreciate by at least $100 million:

> Contractual guarantee wraps up the package by providing Executive with downside protection if the stock price fails to appreciate as projected. Hopefully, this will become academic. The guarantee has been set to trigger after his 5.0 M shares have already appreciated by $10 per share (or $50.0 M). In other words, the first $50.0 M of profit on the shares does not wipe out the guarantee; it is applied against the second $50.0 M of profit.

(Id. at DI 0382)

The document discusses an alternative mechanism for compensating Ovitz that was deemed less desirable and thus not proposed:

> A signing bonus was carefully considered but is not suggested. Signing bonuses have rarely and only been used where the sacrifice being made by a new hire can be clearly identified and quantified, and the amount of the bonus is directly

> related thereto. Otherwise, it will be subject to severe criticism as arbitrary and unjustified. Unless the amount of a signing bonus can be directly related to a sacrifice not otherwise covered in the package described above, it may well prove to be cancerous to the entire package. The contractual guarantee seems more tailored and legitimately responsive to the special circumstances discussed above.

(Id. at DI 0382)

Disney's negotiators were not assembling this compensation package in a vacuum. To the contrary, Graef Crystal was advising Russell, the Chairman of the Compensation Committee. In a five-page, single-spaced letter to Russell, dated August 12, 1995, only snippets of which are quoted by plaintiffs (Compl. ¶ 35), Crystal begins by stating:

> You have asked me to evaluate a possible pay package for a new President of The Walt Disney Company (hereafter called the Company).

(Friedlander Aff. Ex. C at DI 0427) Crystal then calculated the present value of the proposed package. According to Crystal, as of August 12, the package contained the following elements:

- base salary of $1 million annually;
- annual discretionary bonus that Crystal assumed to be $9 million per year;
- an option to purchase 5,000,000 shares of Disney; 3,000,000 shares would be exercisable in one-third cumulative annual installments beginning at the end of the third anniversary of employment; 1,000,000 shares would be exercisable on the sixth anniversary of employment if Ovitz was offered and accepted a renewal of his employment for at least one year after year five; 1,000,000 shares would be exercisable on the seventh anniversary of employment if Ovitz was offered and accepted a renewal of his employment for at least two years after year five; and
- a cash payment after five years in the amount of the excess, if any, of $50 million minus Ovitz's "option profits" from the exercise of the first 3,000,000 option shares.

(See id. at DI 0427-28) Crystal calculated that the first five years of the compensation package had a present value of $117.9 million, or an average of $23.6 million annually. (Id. at DI 0429)

In his letter, Crystal made several comments concerning the compensation package. First, "The value of the pay package would seem to approximate what Michael Eisner told me were the approximate annual earnings of the President in his current capacity." (Id.) Crystal further observed that the $50 million guarantee was justified by viewing it from the perspective of what Ovitz would lose by leaving CAA:

> *[W]ere the President to leave his current employment, one might assume that the residual value of his business would drop sharply.* Therefore, we have here not the normal case of keeping what one already has and then accepting new earnings opportunities at another employer. Rather, *we have here an unusual case of losing a good deal of what one already has and then accepting new earnings opportunities at another employer.*

(Id.) (emphasis added). Crystal compared the $50 million guarantee favorably to the alternative of paying Ovitz a signing bonus, even though "[m]any companies routinely offer a key executive a large signing bonus." (Id. at DI 0430)

Crystal closed his letter to Russell by saying that he was looking forward to a scheduled "phone conference" for later that day. (Id. at DI 0431)

C. Eisner and Ovitz Reach an Agreement Subject to Board Approval and Definitive Documentation.

On or about August 13, 1995, Eisner advised directors Bollenbach, Litvack and Russell that he had hired Ovitz. (Compl. ¶ 30) Plaintiffs allege that the three directors initially protested the decision, although all three presumably knew that discussions regarding a compensation package for Ovitz had been ongoing for weeks.[6]

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[6]Bollenbach was the Chief Financial Officer of Disney; Litvack was General Counsel. (Compl. ¶¶ 18-19) They would have known as much as the outside director Raymond Watson, who was explicitly mentioned in Crystal's letter of August 12 to outside director Russell. (Friedlander Aff. Ex. C at DI 0430) Plaintiffs chose not to relate events chronologically in the Second Amended Complaint, in an apparent -- but unfounded -- attempt to make it appear that Eisner decided to hire Ovitz out of the blue. (See Compl. ¶¶ 11-12)

On or about August 14, 1995, Eisner sent Ovitz a letter "memorializing the principal terms of Ovitz's prospective employment by Disney." (Compl. ¶ 31) Plaintiffs do not specify those "principal terms" set forth in the letter. (Friedlander Aff. Ex. D at DI 0001-02)

In fact, the basic terms outlined in the August 14 letter closely tracked those found in the memo of July 5 and Crystal's letter to Russell of August 12. Ovitz would become President for a five-year term and would report to the Chairman and Chief Executive Officer. He would have a base salary of $1 million and be eligible for a discretionary annual bonus to be determined by the Compensation Committee. He would receive options to purchase 5,000,000 shares of Disney stock, according to a vesting schedule whereby 1,000,000 shares would vest after each of years three, four and five, and 2,000,0000 shares would vest 1,000,000 per year after years six and seven, but only if his contract was renewed for at least an additional two years. If the first 3,000,000 shares did not appreciate in value to a total of $50 million by the end of year five, Disney would pay Ovitz the difference between the total appreciation of those options and $50 million. (Id.)

The letter specified that Ovitz was slated to become President for a five-year term "beginning October 1, 1995," and that the stock options for the first 3,000,000 shares "shall be granted at the market price of the stock as of the day of the grant but no later than October 1, 1995." (Friedlander Aff. Ex. D at DI 0001, 0002) The letter also specified that the options for the first 3,000,000 shares "shall vest immediately" should Ovitz die or become totally and permanently disabled, or if his "employment is terminated by the Company without cause." (Id. at DI 0002)

In the letter, Eisner expressly stated that Ovitz's hiring was "[s]ubject to the formal approval of the Company's Board of Directors and its Compensation Committee." (Id. at DI 0001; see

Compl. ¶ 32) The letter contemplated that the parties would "proceed to prepare definitive documentation for execution." (Friedlander Aff. Ex. D at DI 0002)

D. On Two Separate Occasions, Disney's Compensation Committee Approves the Major Terms of Ovitz's Employment Agreement, Including the Compensation Ovitz Would Receive in the Event of a Non-Fault Termination.

In the weeks following the signing of the two-page August 14, 1995 letter agreement, the parties began negotiating what became a twenty-page employment agreement (the "Ovitz Employment Agreement" or "OEA"), which itself contemplated a future Stock Option Agreement, and began preparing for Ovitz to begin working at Disney on October 1, 1995. (See Compl. ¶ 51, Ex. A) A first draft of the OEA prepared by Disney's lawyers was sent to Ovitz's lawyers on September 23, 1995. (Id. ¶ 40) The OEA was not finalized and executed until approximately December 12, 1995. (Id. ¶ 52) The Stock Option Agreement was not executed by Disney until April 2, 1996. (Id. ¶ 53)

1. The Committee Meeting of September 26, 1995.

The proposed major terms of the OEA were first presented to Disney's Compensation Committee on September 26, 1995. That meeting, and the minutes from it, are discussed at length by plaintiffs. (Compl. ¶¶ 36-46) Attending the entirety of the meeting were all four members of the Committee – Lozano, Poitier, Russell and Watson – as well as three officers of Disney – Litvack, Mitchell Schultz, Vice President-Corporate Compensation, and Marsha L. Reed, Corporate Secretary. (Friedlander Aff. Ex. E at DI 0032)

A significant portion of the meeting was devoted to a detailed review of the proposed major terms of the OEA, which were summarized in a two-and-a-half page, single-spaced outline distributed to the Committee. (See id. at DI 0035, 0037-39) The minutes relate the deliberative

process undertaken by the Committee, which culminated in the approval of a resolution approving the basic framework of the OEA, subject to the future negotiation of specific terms within that framework that may be approved by the Chief Executive Officer:

> *Mr. Russell then reviewed in great detail the terms and conditions of the proposed employment agreement* between Michael Ovitz and the Corporation to which Mr. Ovitz would serve as President of the Corporation. *Discussion ensued during which Messrs. Russell and Litvack responded to questions regarding the contract.* Mr. Russell mentioned that Mr. Ovitz's stock option grant would be delayed until final contract details were worked out between Mr. Ovitz and the Corporation. Thereafter, and upon motion duly made, seconded and unanimously carried, the following resolution was adopted:
>
> > RESOLVED, that *the terms and conditions of the proposed employment agreement between Michael Ovitz and The Walt Disney Company, as described in Exhibit C attached hereto, be, and it hereby is, approved,* subject to such reasonable further negotiations within the framework of the terms and conditions described in Exhibit C attached hereto as may be approved by the Chief Executive Officer of The Walt Disney Company.

(Id. at DI 0035) (emphasis added).

The summary of the terms and conditions of the proposed OEA contains certain basic compensation terms that closely resembled the terms considered at the outset of the negotiations – a $1 million annual salary, an annual discretionary bonus, and stock options for 5,000,000 Disney shares according to a vesting schedule whereby options for 3,000,000 shares would vest in three annual increments of 1,000,000 shares each beginning on September 30, 1998, and options for the other 2,000,000 shares would vest at the rate of 1,000,000 shares per year, but only if Ovitz's contract was renewed for the sixth and seventh years. (Id. at DI 0037-38) Unlike the August 14 letter agreement, the proposed OEA did not contemplate any contractual guarantee that Ovitz would make at least a $50 million profit from his stock options.

The summary of the OEA expressly stated what would happen if Ovitz did not serve out the five-year term of the contract for certain specified reasons. The summary outline specified "Special Termination Payments" that Ovitz would receive in the event of termination for a "Non-Fault Cause," described as death, disability or if Disney "wrongfully terminates Executive's employment." (Id.) In such circumstances, Ovitz would receive (in lieu of all other claims) the following payments: "(i) net present value of remaining salary payments through term of agreement; (ii) net present value of bonuses through term of agreement at assumed value of $7,500,000; and (iii) $10,000,000 contract termination payment." (Id. at DI 0038) The outline also specified that in the event of a termination for a Non-Fault Cause, the stock options for the first 3,000,000 shares would accelerate, while the options for the remaining 2,000,000 shares would be forgone. (Id. at DI 0037-38)

Plaintiffs have no basis for suggesting that the above terms were not reviewed and discussed at the committee meeting, as stated in the minutes of the meeting.[7]

Immediately following the September 26 meeting of the Compensation Committee, a meeting was held by the full Board of Directors, at which Eisner resigned as President effective October 1, 1995, and Ovitz was elected to serve as President of Disney effective October 1, 1995. (Compl. ¶¶ 47-48) Based on an analysis of the length of the meeting minutes, plaintiffs suggest that the Board of Directors did not spend sufficient time "considering Ovitz's employment" and the terms of the

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[7]Plaintiffs make the unreasonable and utterly unsubstantiated inference that only 10 minutes were spent reviewing the proposed OEA, based on the presumed hour length of the meeting, the length of the meeting minutes, and the proportionate amount of space devoted to the OEA in those minutes. (Compl. ¶ 38) This imaginary re-creation of the committee meeting ignores the length of the written summary of the OEA, which was "reviewed in great detail," ignores the fact that the proposed OEA is described as having been the subject of "[d]iscussion" and "questions," and improperly assumes that other subjects addressed in the meeting minutes required similar detailed review, discussion and questioning. (Friedlander Aff. Ex. E at DI 0035, 0037-39)

proposed OEA. (Id. ¶¶ 32, 47-49) The board minutes make clear, however, that the Board of Directors was actually implementing the resolution already approved by the Compensation Committee respecting Ovitz's hiring as President. (Friedlander Aff. Ex. F at DI 0041-42)

2. The Committee Meeting of October 16, 1995.

Over the following weeks, numerous drafts of the OEA were exchanged. (Compl. ¶ 52) Amidst that process, a special meeting of the Compensation Committee was held on October 16, 1995. (Id. ¶ 50) The plaintiffs have elected to say almost nothing about what transpired at the meeting, except that "the Compensation Committee agreed to set the exercise price of Ovitz's options at Disney's stock price as of October 16, 1995 (which was roughly the same as that of October 2, 1995)." (Id. ¶ 56) The plaintiffs have also chosen not to engage in any textual analysis of the minutes of the meeting, except to state that the members of the Compensation Committee were provided with "a similar summary and incomplete account of the main terms and conditions of the OEA that they received in their meeting of September 26, 1995." (Id. ¶ 50)

E. The Continuing Behind-the-Scenes Role of Graef Crystal.

Graef Crystal never made any oral or written presentation to the Compensation Committee. (Compl. ¶ 45) Plaintiffs concede, however, that Crystal "had communications with Russell relating to the negotiations and development of the OEA." (Id.) Indeed, Crystal provided advice respecting the severance arrangements adopted by the Compensation Committee that are the subject of this lawsuit. The full paragraph of the article in which Crystal bemoans his failure to have "made a spreadsheet" -- a remark highlighted by plaintiffs (Compl. ¶ 43) -- clearly indicates his behind-the-scenes support for the package adopted by the Compensation Committee, including its severance provisions:

> Instead [of a large one-time front-end grant of free stock or signing bonus], to provide the comfort needed to induce Ovitz to give up his marvelous career as an agent, the compensation committee offered him a severance agreement. This seemed a far cheaper–indeed probably costless–alternative to a front-end bonus. Of course, the overall costs of the package would go up sharply in the event of Ovitz's termination (and I wish now that I'd made a spreadsheet showing just what the deal would total if Ovitz had been fired at any time). But the probability of that happening was deemed to be exceedingly low. After all, if you think the person can't make it, why hire him in the first place.

(Friedlander Aff. Ex. G at 2)

Given the documentary record of the materials presented to the Compensation Committee, and Crystal's absence from their meetings, Crystal's failure to "ma[k]e a spreadsheet" is without significance. On two separate occasions, the Compensation Committee was given summary term sheets that clearly specified the "Special Termination Payments" to which Ovitz would be entitled if he received a Non-Fault Termination at any time during his five-year term. (Friedlander Aff. Ex. E at DI 0038; Compl. ¶ 50) The arithmetic is readily performed by any reader of the term sheets. In the face of this documentary record, plaintiffs cannot properly infer from Crystal's remark that the members of the Compensation Committee "did not receive any materials – whether in the form of a spreadsheet, tables, a list of estimates, or any other form – that could provide its members with some sense of the magnitude of possible pay-outs that Ovitz would receive in the event of a Non-Fault Termination at various points in time." (Compl. ¶ 42; see id. at ¶¶ 49, 50)

F. The Finalization of the OEA.

The amounts of compensation and severance benefits set forth in the ultimate form of the OEA, which was executed on or about December 12, 1995 and dated "as of" October 1, 1995, closely track the term sheets provided to the Compensation Committee at its meetings of September 26 and October 16, 1995. (Compare Compl. ¶¶ 52, 59-66 & Ex. A with Friedlander Aff. Ex. E at

DI 0038-39) Nonetheless, plaintiffs allege that the final terms of the OEA are "substantially more favorable toward Ovitz than the general terms and conditions approved by the Compensation Committee at its September 26, 1995 meeting (and again at its October 16, 1995 meeting)." (Compl. ¶ 53)

According to plaintiffs, Eisner "exceeded" his delegated authority and "favored Ovitz." (Compl. ¶¶ 54, 55) However, the two supposed examples offered by plaintiffs are unsupported by the documents quoted in the Second Amended Complaint.

Plaintiffs observe that the summary of the proposed OEA distributed at the meeting of the Compensation Committee on September 26 and October 16 stated that Ovitz would obtain the benefits of a Non-Fault Termination if Disney "wrongfully" terminated Ovitz's employment (i.e., in the language of the term sheet, a "Non-Fault Cause," as compared to a "termination for cause"). (Id. ¶ 54; Friedlander Aff. Ex. E at DI 0037-38) Plaintiffs compare that description to the OEA, which provides that Ovitz may be terminated for "good cause" if he commits "gross negligence" or "malfeasance." (Compl. ¶ 54, Ex. A ¶ 11(a)(iii))

The OEA simply specifies what level of misconduct can justify a "termination for cause." It cannot be reasonably inferred that the greater specificity in the OEA was attributable to subsequent misconduct by Eisner. If plaintiffs were serious in seeking to show that Eisner had unilaterally decided to loosen the standards for Ovitz's benefit, it would be incumbent on them to compare the executed version of the OEA with the earlier drafts, especially the draft of September 23, 1995 (see Compl. ¶ 40), which pre-dated the first meeting of the Compensation Committee. Plaintiffs, however, have chosen not to undertake that exercise.

Plaintiffs next allege that "Eisner favored Ovitz" by causing Disney to grant Ovitz stock options "that were materially more in-the-money than they were supposed to be." (Compl. ¶ 55) (emphasis in original). Plaintiffs observe that the OEA entitled Ovitz to be granted stock options with an exercise price equal to the market price on October 16, 1995, rather than the higher market price on December 12, 1995, the date on which the OEA happened to be executed. (Id.) But as plaintiffs allege in the very next paragraph, it was not Eisner, but "the Compensation Committee," which had agreed at its meeting on October 16, 1995, "to set the exercise price of Ovitz's options at Disney's stock price as of October 16, 1995 (which was roughly the same as that of October 2, 1995)." (Id. ¶ 56) Thus, the Eisner-executed OEA was simply complying with the direction of the Compensation Committee. Moreover, the 8% rise in Disney's stock price from October 16 to December 12, 1995 had occurred on Ovitz's watch, as he had begun serving as President of Disney on October 1, 1995. (Id. ¶¶ 51, 57)

G. Ovitz's Tenure as Disney's President.

Plaintiffs allege that Ovitz's performance as President of Disney was "undistinguished." (Id. ¶ 69) Within months, Eisner reportedly confided in certain directors at Disney that he had "made an error in judgment" and a "mistake" in bringing Ovitz to Disney, and that he did not believe that Ovitz should succeed him as CEO. (Id. ¶ 70) Ovitz reportedly clashed with certain top executives at Disney, including the Chief Financial Officer, Bollenbach, who left Disney only four months after Ovitz started, in part because of Eisner's choice of Ovitz as his second-in-command, and because Ovitz reportedly angered Bollenbach by canceling scheduled meetings with him. (Id. ¶¶ 71-73)

H. Eisner and Ovitz Attempt To Arrange a Departure for Ovitz that Would Have No Negative Repercussions for Disney.

In September 1996, Ovitz learned of a possible job opportunity with Sony Corporation of America ("Sony"), to become the head of its entertainment business. (Id. ¶ 75) Because Sony was contemplating paying Ovitz a very large sum, $100 million over five years (id. ¶ 84), that job opportunity for Ovitz was also an opportunity for Disney to avoid the costs of a Non-Fault Termination. As the plaintiffs put it, Eisner "sought to arrange Ovitz's exit on terms whereby Sony would effectively absorb the cost." (Id. ¶ 85)

The OEA posed an impediment to that goal. Ovitz did not necessarily have the right to seek outside employment, because he was required to "devote his full time and best efforts exclusively to the Company." (Id. § 2) Section 11(a)(iii) of the OEA did allow Ovitz to voluntarily resign as an employee of Disney without Disney's prior written consent, which would be deemed a termination by Disney of Ovitz's employment "for cause." (Compl. Ex. A § 11(a)(iii))

On October 8, 1996, Ovitz wrote a note to Eisner (partially quoted by plaintiffs (Compl. ¶ 77)), in which he sought permission to talk to Sony. The note indicates that, in Ovitz's view, Eisner perceived Ovitz's possible departure as beneficial for Disney:

> *AFTER MY CONVERSATION WITH SANDY [LITVACK] AND THE MANY SUBSEQUENT DISCUSSIONS WITH YOU, IT SEEMS TO ME THAT YOU WOULD BE MUCH HAPPIER IF I WERE NOT WITH THE COMPANY.*
>
> *TO THAT END, I GUESS I SHOULD TRY TO EXPLORE OTHER POSSIBILITIES, PARTICULARLY THE ONE YOU AND I HAVE DISCUSSED.* I DO NOT KNOW IF I WANT IT, OR IF IT IS REAL, HOWEVER, I GUESS I NEED YOUR PERMISSION TO LISTEN TO AN OFFER, EVEN THOUGH, I AM NOT SURE THAT ONE IS FORTHCOMING.
>
> IF I GET AN OFFER I ASSUME THAT YOU, SANDY AND/OR THE COMPANY WILL NOT RAISE ANY CLAIMS AGAINST ME OR THE OTHER COMPANY UNDER MY EMPLOYMENT CONTRACT OR, IF I MAKE A DEAL

> THAT THE SAME APPLIES. . . . AS YOU SAID, WE NEED TO DO THIS TOGETHER AND PUT THE RIGHT FACE ON IT.
>
> . . . .
>
> P.S. SINCE SANDY RELAYED HIS P.O.V. ON THE COMPANY AND ME I THINK I NEED YOU TO ACKNOWLEDGE THIS NOTE BY SIGNING IT SO THAT I DO NOT END UP IN A PROBLEM WHICH I DO NOT WANT WITH THE COMPANY OR MY BEST FRIEND.

(Friedlander Aff. Ex. H at DI 0397-398) (emphasis added).

Eisner's favorable response, dated October 9, 1996, clearly indicates that Eisner saw the Sony opportunity as a way to advance Disney's interests vis-a-vis Ovitz:

> [I]n light of all our conversations, I am sure you realize that I do not object to your trying to work out a deal for yourself with Sony. And if Sony replaces Disney's financial obligations to you so that you come out the same or better, and if Sony handles the "Disney and MDE [Michael D. Eisner] embarrassment equation" by making some strategic deal with us, then we certainly would not stand in the way of your closing your deal.

(Compl. ¶ 80) (emphasis in original). A week later, Eisner wrote a note to Ovitz enclosing a note from Eisner to Sony's Chairman giving his permission for Ovitz to negotiate with Sony. (Compl. ¶ 82)

Unfortunately for Disney, Ovitz's negotiations with top executives at Sony for a $100 million, five-year contract ultimately failed. (Id. ¶¶ 83-84)

I. Eisner and Litvack Terminate Ovitz's Employment, With the Full Knowledge of Disney's New Board.

Ovitz's lack of success in reaching an agreement with Sony left Disney with the choice of retaining Ovitz or terminating him pursuant to the OEA. (See id. ¶ 85) Disney chose the latter course.

On December 11, 1996, Eisner, Litvack and Ovitz met to finalize Ovitz's Non-Fault Termination from Disney. (Id.) The following day, December 12, 1996, Litvack sent Ovitz a

termination letter that was to become effective on January 31, 1997 and which was to be "given the same effect as though there had been a 'Non-Fault Termination.'" (Id.) Ovitz's departure was publicly announced on December 12. (Id. ¶ 88) On December 27, 1996, Litvack sent Ovitz a new letter, counter-signed by Ovitz, superseding the letter of December 12. (Id. ¶ 87) The December 27 letter declared that Ovitz's employment was terminated and that a Non-Fault Termination had occurred as of December 27. (Id. ¶ 87) By countersigning, Ovitz confirmed the end of his service as an officer and his resignation as a director and agreed to the amount of money made payable to him. (Id. ¶ 87) That same day, Ovitz executed a general release in favor of Disney. (Id. ¶ 97)

Plaintiffs allege that Disney's New Board knew about Eisner's decision to grant Ovitz a Non-Fault Termination on December 12, and acquiesced in that decision without taking any formal board action or undertaking any investigation of whether Ovitz could have been terminated for cause or not paid the full amount owed under the OEA for a Non-Fault Termination. (Id. ¶¶ 91-96) Plaintiffs do not articulate what grounds existed for possibly terminating Ovitz "for cause," whether the assertion of any such grounds could have withstood legal challenge from Ovitz, whether a purported "for cause" termination would have been beneficial to Disney's public relations and employee relations, or whether threatening to terminate Ovitz "for cause" would have been anything but a dangerous bluff.

Plaintiffs make the carefully worded allegation that Disney has no record that "Eisner reported to the New Board or to any of its committees, either in writing or orally in a Board meeting, the process leading to Ovitz's departure and his receipt of a Non-Fault Termination." (Id. ¶ 88) Plaintiffs do not allege that Disney has no record of Eisner having *attended* a committee meeting at which Ovitz's departure and Non-Fault Termination were discussed.

ARGUMENT

PLAINTIFFS HAVE FAILED TO ALLEGE PARTICULARIZED FACTS THAT CREATE A REASONABLE DOUBT THAT THE ACTIONS OF THE DIRECTOR DEFENDANTS ARE PROTECTED BY THE BUSINESS JUDGMENT RULE.

The sufficiency of plaintiffs' latest derivative complaint, their third pleading in this litigation, must be analyzed in light of three decisions handed down by the Delaware Supreme Court in the time since this Court last heard this case: Brehm v. Eisner, Del. Supr., 746 A.2d 244 (2000), White v. Panic, Del. Supr., 783 A.2d 543 (2001), and Malpiede v. Townson, Del. Supr., 780 A.2d 1075 (2001). Individually and combined, these three decisions create pleading requirements that plaintiffs have not satisfied and cannot satisfy, given the prior dismissal of the Amended Complaint, the exculpatory provision in Disney's Restated Certificate of Incorporation, and the documentary record created by plaintiffs' Section 220 demand.

In Brehm, the Delaware Supreme Court rejected the arguments that Eisner, a "long-time friend" of Ovitz, was interested in either the approval of the Ovitz Employment Agreement or the decision to grant Ovitz a Non-Fault Termination. 746 A.2d at 249, 257-58. The Court also rejected the claim made under the first prong of the Aronson standard that a majority of the New Board was incapable, due to personal interest or domination, of objectively evaluating a demand, and barred plaintiffs from relitigating that issue. Id. at 258 & n.42.

As a consequence of those rulings, to avoid dismissal of the derivative claims pursuant to Chancery Court Rule 23.1 for failure to make a pre-suit demand, plaintiffs must "carry the 'heavy burden' of showing that the well-pleaded allegations in the complaint create a reasonable doubt that the board's decisions were 'the product of a valid exercise of business judgment.'" White, 783 A.2d at 551 (internal quotations omitted). The derivative complaint "must comply with stringent

requirements of factual particularity" by setting forth "particularized factual statements that are essential to the claim." Brehm, 746 A.2d at 254. In both White and Brehm, the Court ruled that plaintiffs had failed to meet the heightened pleading standards under the second prong of Aronson for waste and other breach of fiduciary duty claims, without reaching the applicability of charter provisions adopted pursuant to Section 102(b)(7) of the General Corporation Law. White, 783 A.2d at 552-55; Brehm, 746 A.2d at 258-66.

Plaintiffs' pleading burden is all the greater because Disney's stockholders have adopted an exculpatory charter provision. In Malpiede v. Townson, the Delaware Supreme Court made clear that where the facts alleged in a complaint fail to state a cognizable claim that a board breached its duty of loyalty and good faith, any residual due care claim must be dismissed in the face of a Section 102(b)(7) charter provision and a Rule 12(b)(6) motion. 780 A.2d at 1094. For the same reasons discussed below as to why plaintiffs have not pled particularized facts casting a reasonable doubt as to the good faith of the Director Defendants, plaintiffs have also failed to plead particularized facts of gross negligence, although the existence of Disney's exculpatory charter provision makes it unnecessary to reach that issue.

A. The Supreme Court Has Found That Plaintiffs Are Precluded From Asserting Any Further Claims Alleging a Breach of the Duty of Loyalty.

The Second Amended Complaint asserts that demand should be excused as futile. (Compl. ¶ 106) In support of that contention, plaintiffs allege:

- "Eisner was conflicted because of Ovitz's status as Eisner's 'best friend' and Russell was conflicted because he was Eisner's personal lawyer and was paid $250,000 for 'securing' Ovitz's services for the Company" (Compl. ¶ 106B);
- "Eisner, Ovitz and Russell also had conflicts of interest in connection with the execution of the OEA" (Compl. ¶ 106D); and

- "[T]he Release executed by Ovitz running to the Director Defendants conferred a tangible benefit on each of the members of the New Board in connection with Ovitz's receipt of a Non-Fault Termination and provided each of them with a conflicting interest in responding to a demand." (Compl. ¶ 106H)

However, on the appeal from this Court's dismissal of the Amended Complaint, the Supreme Court affirmed the dismissal with prejudice of the claims advanced by plaintiffs under the first prong of Aronson, noting that the dismissal was "final and dispositive." Brehm, 746 A.2d at 258; see also id. at 268 n.42 ("This issue is not one that plaintiffs shall be permitted to relitigate . . . ."). This ruling is the law of the case. Insurance Corp. of Am. v. Barker, Del. Supr., 628 A.2d 38, 40-41 (1993); Odyssey Partners, L.P. v. Fleming Cos., Del. Ch., 735 A.2d 386, 415 (1999). Plaintiffs are therefore precluded from claiming that "a reasonable doubt is created that: (1) the directors are disinterested and independent." Aronson v. Lewis, Del. Supr., 473 A.2d 805, 815 (1984). As a consequence of that limitation, plaintiffs cannot claim that the challenged transactions involve any breach of the duty of loyalty, because no such breach can be shown in the absence of any showing of self-interest. See Malpiede, 780 A.2d at 1085 (dismissing duty of loyalty claim where facts alleged did not "state a cognizable claim that directors acted in their own personal interests rather than in the best interests of the stockholders . . . .").[8]

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[8]Even if plaintiffs were permitted to make any argument about the alleged interest or lack of independence of the members of the Compensation Committee, no particularized facts have been asserted that impugn the disinterest and independence of any (much less a majority) of the four members of the Compensation Committee. See Aronson v. Lewis, 473 A.2d at 815. It was only after the Compensation Committee voted on September 26 to approve the proposed terms of the OEA that Eisner entered the meeting and recommended, in conjunction with Watson, that the Compensation Committee recommend to the full board that Russell be paid $250,000 for his time-consuming services on Disney's behalf. (Friedlander Aff. Ex. E at DI 0035-36) The full board approved that payment later that day (Friedlander Aff. Ex. F at DI 0041-42), a payment which was not conditioned on any subsequent board or committee action.

Indeed, the Supreme Court gave plaintiffs permission to attempt to state a claim that the Board did not validly exercise its business judgment with respect to only three subjects: (1) the decision to approve the Ovitz Employment Agreement; (2) possible waste in connection with approval of the Ovitz Employment Agreement; and (3) possible waste in connection with the grant of a Non-Fault Termination. As discussed below, the Supreme Court did not consider the effect of Disney's exculpatory charter provision on such claims, and, moreover, plaintiffs have failed to allege particularized facts to support their claims.

B. Plaintiffs Are Precluded By Disney's Charter from Asserting Any Claims Not Involving Breach of the Duty of Loyalty and Bad Faith.

Subpart B of Article ELEVENTH of the Restated Certificate of Incorporation of DC Holdco, Inc., dated September 21, 1995, provides: "A director of this Corporation shall not be liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except to the extent such exemption from liability or limitation thereof is not permitted under the GCL." (Friedlander Aff. Ex. A) The same language is found in subpart B of Article ELEVENTH of the Restated Certificate of Incorporation of The Walt Disney Company (the successor to DC Holdco, Inc.), dated February 20, 1996, which remained in effect at the time of Ovitz's departure. (Id.) This charter provision, adopted pursuant to Section 102(b)(7), "bars any claim for money damages against the director defendants based solely on the board's alleged breach of its duty of care." Malpiede, 780 A.2d at 1079. When a defendant raises a Section 102(b)(7) defense on a motion to dismiss, and it is found that "the complaint fails properly to invoke loyalty and bad faith claims," then the residual due care claim must be dismissed as a matter of law. Id. at 1094.

C. Plaintiffs Have Not Alleged a Reasonable Doubt that the Board of Directors Was Even Grossly Negligent in Approving the OEA and the Non-Fault Termination.

Plaintiffs assert that demand should be excused because the Board was grossly negligent in hiring and firing Ovitz. Specifically, plaintiffs allege:

- "A majority of the Board, at the time this action was commenced, consisted of members of both the Old Board and New Board. The members of the Old Board and the New Board were grossly derelict in discharging their fiduciary obligations to Disney in connection with Ovitz's hiring and Ovitz's receipt of a Non-Fault Termination. The particularized allegations of this Complaint create the requisite reasonable doubt that the members of the Old Board and the New Board fulfilled their duty of care in hiring Ovitz and allowing him to depart from Disney with a Non-Fault Termination" (Compl. ¶ 106A);

- "The members of the Compensation Committee and the Old Board were grossly negligent -- to the point of recklessness and/or bad faith -- in not taking readily available steps to ascertain the rough value of the payout to Ovitz if he were terminated without 'fault.' As set forth above, the members of the Old Board failed to heed "red flags" posted by Disney's staff about the magnitude and counter-productive nature of the stock option package which accompanied the OEA" (Compl. ¶ 106B);

- "In addition, the members of the Compensation Committee and the Old Board abdicated their responsibilities by simply granting to Eisner a general authorization to proceed with and complete the agreement with Ovitz, without reserving to themselves the power to scrutinize and approve its final terms. As one of the results thereof, the OEA substantially deviated in Ovitz's favor from the general guidelines that the directors had approved. The directors knew that Eisner was not independent of Ovitz but failed to insulate him from the process or oversee his activities" (Compl. ¶ 106C);

- "Similarly, the members of the New Board were grossly negligent -- to the point of recklessness and/or bad faith -- in connection with the termination of Ovitz's employment by Disney. As set forth in the preceding sections of this Complaint, the New Board abdicated its duties to decide whether Disney's President should be removed and whether he should be given the benefits of a Non-Fault Termination. They allowed Eisner, who they knew lacked independence from Ovitz, to arrange all aspects of Ovitz's removal. The New Board also made no effort whatsoever to inform itself about this important termination and about the severance payments, notwithstanding the tens of millions of dollars -- aggregating $140 million in value -- that Ovitz garnered for a brief and unproductive 14 months as an employee of Disney, despite ample opportunity to do so. The New Board's failure to convene and consider the terms of Ovitz's separation under circumstances where all Board

members were aware of the negotiations between Eisner and Ovitz was reckless and unconscionable." (Compl. ¶ 106F)[9]

As discussed above, the existence of the exculpatory charter provision precludes plaintiffs from obtaining a finding of liability on the part of the individuals based on a gross negligence theory. Yet, the plaintiffs have not even alleged particularized facts of gross negligence, much less any higher standard of wrongdoing.

1. The Actions Taken By the Compensation Committee in Approving the OEA.

On September 26, 1995, and then again on October 16, 1995, the four outside directors who constituted Disney's Compensation Committee -- Lozano, Poitier, Russell and Watson -- met, discussed and approved the key terms of the OEA. (Friedlander Aff. Ex. E; Compl. ¶¶ 50, 53, 56) Plaintiffs have alleged no facts that cast doubt on the good faith of their decision.

The committee minutes of September 26, 1995 reflect that Russell gave an oral presentation in which he "reviewed in great detail the terms and conditions of the proposed employment agreement," a written summary of which is attached to the minutes. (Friedlander Aff. Ex. E at DI0035) The minutes further state that a "[d]iscussion ensued during which Messrs. Russell and Litvack responded to questions regarding the contract." (Id.) It was entirely appropriate that the discussion be based on a reader-friendly summary of the key terms of the proposed contract, rather

[9]Plaintiffs' demand futility section also seeks to rely, impermissibly, on the mere recitation of conclusory principles of law, without any attempt to identify any supporting facts. See Compl. ¶ 106E ("Because the members of the Old Board violated their duties of care, good faith and loyalty in connection with the OEA, the execution of the OEA was not the product of properly informed business judgment, nor can defendants invoke the Business Judgment Rule to avoid judicial scrutiny of their actions for fairness. Pre-suit demand on defendants is, therefore, excused.").

than the first draft of the full contract, which had only been sent to Ovitz's counsel three days earlier. (See Compl. ¶ 40)

The members of the Compensation Committee could reasonably rely on Russell and Litvack to provide faithful and knowledgeable reports on the proposed terms of the OEA and the considerations and events that informed those proposed terms. According to the minutes, Russell had played a "key role" in bringing Ovitz to Disney, and had participated in "negotiations [that] involved numerous meetings" and had undertaken "many hours of research." (Id.) Litvack was Disney's General Counsel. (Compl. ¶ 19) Under Section 141(e) of the General Corporation Law, a member of a board committee "shall, in the performance of such member's duties, be fully protected in relying in good faith upon . . . such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees . . . ." Plaintiffs have not alleged any particularized facts as to why the members of the Compensation Committee could not rely in good faith on what they heard from Russell and Litvack. See Brehm, 746 A.2d at 261-62 (placing burden on plaintiffs to plead why directors cannot rely on a Section 141(e) report for purposes of meeting the second prong of the Aronson standard).

When voting at the meeting of September 26, the members of the Compensation Committee had the benefit of other sources of information apart from the written summary of the proposed contract terms and the oral reports of Russell and Litvack. They knew that Eisner, the Chief Executive Officer, had openly endorsed hiring Ovitz to become his second-in-command. (Compl. ¶¶ 30-31) Eisner had a large financial stake in the success of Disney, had a large personal stake in hiring a President with whom he believed he could work effectively, had a long personal track record with Ovitz, and, based on recent events, well understood the importance to Disney of hiring a

President who would be perceived as an effective second-in-command and possible successor. (Id. ¶¶ 27-29) As already found by the Delaware Supreme Court, plaintiffs are precluded from claiming that Eisner was interested in Ovitz's hiring, see Brehm, 746 A.2d at 257-58, nor have they pled any facts to indicate any lack of good faith on Eisner's part. The Compensation Committee could properly consider Eisner's assessment that hiring Ovitz was worth the price of his proposed compensation package.

The Compensation Committee could also consider in good faith the arm's-length nature of the negotiations between Disney and Ovitz. Ovitz was not an employee of Disney during the negotiation of the basic terms of the compensation package prior to September 26, 1995. He was not standing on both sides of the contract and was not in a position to exercise any control over Disney. The existence of arm's-length negotiations is not only strong evidence of the fairness of the transaction, Weinberger v. UOP, Inc., Del. Supr., 457 A.2d 701, 709-10 (1983), it provides an additional good-faith basis for the members of the Compensation Committee to conclude that the terms of the proposed OEA reflected the economic reality of what it took to induce Ovitz to leave CAA and accept the position of President at Disney.

It is also reasonable to infer that the members of the Compensation Committee were aware that Russell had been advised by compensation expert Graef Crystal concerning the size and structure of Ovitz's proposed compensation package. Russell had received Crystal's detailed written analysis of the size and structure of the proposed compensation package on August 12, 1995. (Friedlander Aff. Ex. C) Analysis of a proposed compensation package had begun no later than July 7, 1995. (Friedlander Aff. Ex. B) In exercising their good faith business judgment, the members

of the Compensation Committee (including Russell) could properly consider the expertise and input that had been provided by experts such as Crystal.

Finally, nothing about the terms of the proposed OEA, as described in the written summary attached to the meeting minutes of September 26, 1996, gives rise to a reasonable doubt as to the good faith of the committee members. The Delaware Supreme Court has already held that the amount of compensation and the incentives reflected in the final terms of the OEA do not meet the pleading threshold for waste, which the Court equated with "unconscionable cases where directors irrationally squander or give away corporate assets." Brehm, 746 A.2d at 263. See also White, 783 A.2d at 554 n.36 ("To prevail on a waste claim or a bad faith claim, the plaintiff must overcome the general presumption of good faith by showing that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests.").[10]

Nothing about the term sheet approaches that high pleading standard. The base salary is $1,000,000, hardly extraordinary, and the annual bonus is discretionary. The stock options for 3,000,000 shares are dispensed according to a vesting schedule that begins after the third year of employment and induces Ovitz to have his contract extended on "substantially equivalent" terms for an additional five years, or else forfeit the opportunity to obtain an additional 2,000,000 option shares. Disney is similarly induced to continue the relationship, because it must pay $10,000,000 to Ovitz if it decides not to offer such a five-year extension. (Friedlander Aff. Ex. E at DI 0037)

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[10]In their latest complaint, plaintiffs allege merely that "[t]he OEA constituted a waste of Disney's assets. While the OEA may have induced Ovitz to join Disney, the terms of the OEA, with the accompanying stock option package, deprived Disney of any reasonable expectation that it would receive the benefit of its bargain - - five years of productive service by Ovitz. No reasonable person, if fully informed and acting in his or her interest, would enter into such an agreement. Thus, demand is excused on this basis as well." (Compl. ¶ 106G) These arguments were already presented to, and rejected by, the Delaware Supreme Court.

The severance provisions are explicitly set forth in the summary term sheet. Only Disney can trigger a Non-Fault termination, by "wrongfully terminat[ing]" Ovitz, in which case it must pay Ovitz the net present value of the remaining salary payments, pay the net present value of the remaining bonuses at an assumed value of $7,500,000 per year, pay the $10,000,000 contract termination payment, and accelerate the vesting of his 3,000,000 option shares. (Id. at DI 0037-38) If Ovitz is terminated "for cause," then no options vest after such date. (Id. at DI 0038). The notion that a corporation can obligate itself to accelerate the vesting of stock options if it terminates an employee "without cause" is commonplace and judicially accepted. See, e.g., Scribner v. Worldcom, Inc., 249 F.3d 902 (9th Cir. 2001) (granting summary judgment against Worldcom for failure to allow immediate exercise of stock options following early termination of employee that was found to be "without cause").

The Compensation Committee's approval of a revised term sheet on October 16, 1995 as a basis for the negotiation of the final terms of the OEA is similarly unimpeached. Indeed, plaintiffs have chosen to say almost nothing about that meeting or its minutes. (Compl. ¶ 50)

2. The Actions Taken By Eisner, Ovitz and Russell in Finalizing the OEA.

Plaintiffs allege variously that "Ovitz and Eisner colluded with each other in causing the OEA to be signed," that the Old Board allowed Eisner and Russell "to arrange with Ovitz the terms on which he would be hired," and that Ovitz violated the fiduciary duties he assumed after October 1, 1995 in "negotiating, arranging and finalizing the terms of the OEA." (Compl. ¶¶ 109-11) These allegations are wholly baseless, as they reveal nothing more than plaintiffs' carelessness in reviewing the pertinent documents. As discussed in Section F of the Statement of Facts, supra, the final version of the OEA is consistent with the term sheet approved by the Compensation Committee on

September 26, 1995, and with the grant of options by the Compensation Committee on October 16, 1995.

3. The Actions Taken By the New Board Respecting Ovitz's Non-Fault Termination.

The Delaware Supreme Court has barred plaintiffs from relitigating its ruling that a majority of the New Board was disinterested and independent respecting the termination of Ovitz, a holding that was itself based on the Court's rejection of the argument that Eisner had a personal interest in the decision to grant Ovitz a Non-Fault Termination. Brehm, 746 A.2d at 257-58. Despite these holdings, plaintiffs allege that the New Board breached its fiduciary duties by allowing Eisner to grant Ovitz a Non-Fault Termination, a decision by Eisner that was allegedly "motivated by friendship and the desire to avoid personal embarrassment rather than undivided loyalty to Disney." (Compl. ¶ 118) This issue is barred.

Even if they are allowed to relitigate the issue, plaintiffs have adduced no new facts in support of their allegation that Eisner was improperly motivated in connection with Ovitz's departure.[11] Indeed, the particularized facts in the current pleading reveal that Eisner remained loyal to Disney, not to Ovitz. Plaintiffs cite a newspaper article in which Eisner is reported to have written a memorandum to Watson months after Ovitz was hired (and before any public controversy erupted) in which Eisner allegedly acknowledged that he "made an error in judgment" in bringing Ovitz to Disney, and advised Watson not to "expand my error and continue it" by promoting Ovitz in the event that Eisner died. (Compl. ¶ 70) Plaintiffs also cite Ovitz's note to Eisner of October 8, 1996, the text of which makes clear that Eisner had been encouraging Ovitz to seek other employment:

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[11]The long-time friendship of Ovitz and Eisner is not a new fact. Brehm, 746 A.2d at 249.

> AFTER MY CONVERSATION WITH SANDY [LITVACK] AND THE MANY SUBSEQUENT DISCUSSIONS WITH YOU, IT SEEMS TO ME THAT YOU WOULD BE MUCH HAPPIER IF I WERE NOT WITH THE COMPANY.

(Friedlander Aff. Ex. H) Eisner's response of October 9, 1996 makes clear that Eisner was willing to allow Ovitz to negotiate with Sony to try to resolve the situation on more favorable terms for Disney. (Compl. ¶ 80) As plaintiffs themselves admit, Eisner "sought to arrange Ovitz's exit on terms whereby Sony would effectively absorb the cost." (Id. ¶ 85)

When the Sony opportunity disappeared, Eisner decided that Ovitz should be terminated pursuant to the terms of the OEA. (Id.) Plaintiffs do not approach the heightened pleading standard, which requires particularized facts that Eisner and the rest of the disinterested New Board were acting disloyally or in bad faith when they declined to instigate a legal and public relations war by terminating (or threatening to terminate) "one of the most formidable power brokers in Hollywood" (id. ¶ 76) without paying him his bargained-for severance benefits.

Indeed, no facts have been alleged which support plaintiffs' improbable claim that Ovitz should have been terminated for "good cause." The OEA defines "good cause" for termination as "gross negligence or malfeasance" by Ovitz, or his voluntary resignation without prior written consent of Disney. (Compl. Ex. A. ¶ 11(a)(iii)) The correspondence between Eisner and Ovitz negates any argument that Ovitz had resigned or committed malfeasance when he pursued the job opportunity at Sony. In the absence of any resignation, therefore, plaintiffs must allege that Ovitz had committed gross negligence or malfeasance. Despite the fact that they have now filed their third complaint, which contains 44 pages and 122 paragraphs, the only specific allegation of fact contained that purports to satisfy that test is the claim recycled from their prior pleading -- reports

that, a year earlier, Ovitz had canceled meetings with a subordinate to review Disney's budget. (Compl. ¶¶ 72-73)

To maintain a claim for waste or bad faith on the part of the Disney directors for their decision to grant a Non-Fault Termination, plaintiffs must show that the decision "was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests." White, 783 A.2d at 554 n.36. The Delaware Supreme Court has already rejected a waste claim on a pleading that permitted more favorable inferences than are available on the present record, reasoning as follows:

> All this shows is that the Board had *arguable* grounds to fire Ovitz for cause. But what is alleged is only an *argument* – perhaps a good one – that Ovitz' conduct constituted gross negligence or malfeasance. First, given the facts as alleged, Disney would have had to persuade a trier of fact and law of this argument in any litigated dispute with Ovitz. Second, that process of persuasion could involve expensive litigation, distraction of executive time and company resources, lost opportunity costs, more bad publicity and an outcome that was uncertain at best and, at worst, could have resulted in damages against the Company.

Brehm, 746 A.2d at 265 (emphasis in original). Plaintiffs' claim must fare worse on the present record, because it is now known that Ovitz had express permission to look for other jobs as part of a failed effort to arrange his departure without Disney incurring financial or public relations costs.

Plaintiffs cannot cover up this substantive void in their pleading by diverting attention to the fact that the New Board did not pass any formal resolution authorizing a Non-Fault Termination. When a derivative plaintiff is not challenging a business decision by a board of directors, then the applicable test for demand excusal under Rule 23.1 is the first prong of the Aronson standard. Rales v. Blasband, Del. Supr., 634 A.2d 927, 933-34 (1993). Plaintiffs have already fallen short of that standard, and they are barred from relitigating it. Brehm, 746 A.2d at 257-58.

Moreover, plaintiffs concede that the New Board had full knowledge that Eisner, Litvack and Ovitz were working out a Non-Fault Termination whereby Ovitz agreed to release any claims he may have had against Disney, and that the New Board knowingly decided to allow that action to proceed. (Compl. ¶¶ 92-97) Assuming *arguendo* that the second prong of Aronson applies, it is plaintiffs' burden to plead particularized facts as to how the New Board's non-interference in the authorized Non-Fault Termination decision by Eisner, the Chief Executive Officer, constitutes waste or bad faith. Plaintiffs have adduced no such facts.[12]

[12]Plaintiffs argue instead that only the New Board could remove Ovitz, quoting language from Disney's bylaws regarding the terms of officers and their removal from office. (Compl. ¶ 89) The bylaws also provide, however, that "[t]he President shall report and be responsible to the Chairman of the Board" and that the Chairman of the Board "shall be the Chief Executive Officer of the Corporation" and "have general and active management, direction, and supervision over the business of the Corporation and over its officers." (Friedlander Aff. Ex. I at Art. IV, §§ 3, 4) A Chief Executive Officer with such powers "commands the power to 'do anything the corporation could do in the general scope and operation of its business.'" Schoonejongen v. Curtiss-Wright Corp., 143 F.3d 120, 128 (3d Cir. 1998) (internal quotations omitted). Plaintiffs have alleged no facts to suggest that a decision by Eisner to compromise possible claims and agree to a termination of Ovitz's employment was not within his scope of authority as CEO. Plaintiffs' suggestion that the Non-Fault Termination was somehow a "removal" is not only directly contrary to their previously-rejected argument that Ovitz "resigned," it is also incorrect. "Removal" involves the "[d]eprivation of office" or "dismissal from office," which is involuntary in nature. Black's Law Dictionary 1295 (6th ed. 1990). Ovitz's departure from Disney was clearly the result of a Non-Fault Termination, as he acknowledged by signing the December 27, 1996 letter. (Compl. ¶ 87)

CONCLUSION

For all the foregoing reasons, Disney and the Director Defendants respectfully request that plaintiffs' Second Amended Consolidated Derivative Complaint be dismissed with prejudice.

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