87

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

REPLY BRIEF OF THE WALT DISNEY COMPANY AND THE DIRECTOR DEFENDANTS IN SUPPORT OF THEIR MOTION TO DISMISS AND ANSWERING BRIEF IN OPPOSITION TO THE MOTION TO STRIKE

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

OTHER AUTHORITIES

PRELIMINARY STATEMENT

Plaintiffs have been given one last chance to try to state a claim concerning Disney's employment of Michael Ovitz and the termination of that employment. In affirming this Court's dismissal of plaintiffs' Amended Complaint (which had been based on publicly available information), the Delaware Supreme Court allowed plaintiffs another opportunity to replead certain of their claims -- *but only if* documents they might obtain pursuant to Section 220 provided a basis to do so "consistent with Chancery Rule 11." Brehm v. Eisner, Del. Supr., 746 A.2d 244, 266 (2000). As demonstrated in the opening brief of Disney and the Director Defendants, the documents plaintiffs obtained from Disney do not support a claim, and plaintiffs know it. That is why, in an effort to avoid dismissal, plaintiffs ask this Court not to consider any of the actual documents on which plaintiffs rely, but instead to accept plaintiffs' mischaracterizations and selective quotations of those documents.

Given that the Supreme Court said any new pleading would stand or fall based on the documents plaintiffs might get from Disney, clearly, to weigh the sufficiency of this last complaint, the Court should look at the documents. But whether it does or not, as will be shown below, the plaintiffs are not entitled to proceed since the current complaint cannot survive a motion to dismiss. First, defendants have moved to dismiss for plaintiffs' failure to comply with Rule 23.1 of the Rules of the Court of Chancery. The allegations of the Second Amended Complaint fail to contain particularized facts to demonstrate why the decision of whether to pursue any alleged claims should be taken away from the Disney board of directors. The first prong of the Aronson test has been foreclosed by the prior ruling of the Delaware Supreme Court, and the facts of the Second Amended Complaint have not

demonstrated why the challenged transactions were not otherwise the product of a valid exercise of business judgment.

Ultimately, however, the Court may not even need to decide the Rule 23.1 motion since Disney's board of directors and stockholders adopted an exculpatory charter provision pursuant to Section 102(b)(7) of the General Corporation Law of the State of Delaware (the "GCL"). Even though plaintiffs acknowledge that they must plead facts alleging "breaches of the duty of loyalty or bad faith misconduct" (PAB 57), they have not done so. The Second Amended Complaint alleges no new fact or indeed any fact, that in any way suggests that the directors acted other than in the best interests of Disney or engaged in anything other than a good faith effort to advance the interests of Disney, both in hiring Ovitz, and in later deciding that honoring his contract through the mechanism of a non-fault termination was an appropriate means of ending a relationship that had not worked out as expected.

Despite the fact that the Section 102(b)(7) provision is dispositive of the motion to dismiss, this brief first discusses the 23.1 motion since the plaintiffs have devoted so much of their brief to it. Also, much of the same analysis applies to both motions and both should be granted.

It is, therefore, time for all of plaintiffs' claims to be dismissed with prejudice.

I. PLAINTIFFS HAVE FAILED TO SATISFY THE REQUIREMENTS OF COURT OF CHANCERY RULE 23.1.

Plaintiffs' latest complaint -- their third -- must satisfy the requirements of Rule 23.1 to avoid dismissal. Attempting to compensate in length for what they lack in substance, plaintiffs have submitted yet another "prolix complaint larded with conclusory language," Brehm v. Eisner, Del. Supr., 746 A.2d 244, 254 (2000), instead of the required "particularized factual statements that are essential to the claim." Id. As a result of their failure, and for the last time, this Court should dismiss plaintiffs' derivative claims for failure to comply with Rule 23.1.

A. Plaintiffs' Argument That Demand Was Excused Because the Board Was Interested and Lacked Independence Has Already Been Litigated, and in Any Event Is Meritless.

Plaintiffs had so little confidence in their arguments about disinterestedness and independence of the New Board with respect to the challenged transactions that they did not even bother appealing that aspect of this Court's earlier decision. Nevertheless, plaintiffs now try to revive that argument. Their attempt is futile for at least two reasons: (1) the Supreme Court affirmed that aspect of this Court's ruling with prejudice, and (2) the only "new" fact upon which plaintiffs rely in challenging disinterestedness and independence comes from a public filing available five years ago.

1. Plaintiffs Are Barred from Relitigating the Disinterest and Independence of Eisner and the New Board.

Plaintiffs argue that they are not precluded from relitigating whether the members of the New Board are disinterested and independent. (PAB 53). They suggest that the Supreme Court's dismissal with prejudice of "that part of plaintiffs' Complaint raising the first prong

of Aronson," Brehm, 746 A.2d at 258, was limited only to the portion of the complaint alleging "that a majority of the Board was beholden to Eisner." (PAB 54).

Plaintiffs' wishing does not make it so. The Supreme Court's language could hardly be more clear:

> 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.

Brehm, 746 A.2d at 258 (footnote omitted). In a footnote, the Court continued:

> This issue is not one that plaintiffs shall be permitted to relitigate if they elect to file an amended complaint setting forth particularized facts relating to the second prong of Aronson.

Id. at 258 n.42. That language not only constitutes the law of the case, but also deprives this Court of jurisdiction to revisit an issue that was not remanded: "While the mandate does not control a trial court as to matters not addressed on appeal, the trial court is bound to strictly comply with the appellate court's determination of any issues expressly or impliedly disposed of in its decision." Ins. Corp. of Am. v. Barker, Del. Supr., 628 A.2d 38, 40 (1993). In Barker, the Supreme Court found that its "decision and mandate deprived [the] Superior Court of any authority to permit [plaintiff] to replead any claim previously raised against" the defendant. Id. at 42. Therefore, this Court properly dismissed that portion of plaintiffs' complaint, and they may not relitigate the issue.

Notwithstanding that clear ruling, plaintiffs claim that the "law of the case" doctrine only applies to "litigated issues." (PAB 54). That argument fails, because the issues of whether Eisner and the New Board were interested or lacking independence with respect to the challenged transactions were plainly litigated. Brehm, 746 A.2d at 257, 258.

As a fallback, plaintiffs seek to invoke an exception to the rule, which applies only when there has been an "important change in circumstances, in particular, the factual basis for issues previously posed." (PAB 55) (quoting Weedon v. State, Del. Supr., 750 A.2d 521, 527-28 (1990)) (emphasis added by plaintiffs). The cases plaintiffs cite have no bearing here. Kenton v. Kenton, Del. Supr., 571 A.2d 778 (1990), involved a petition to modify a child support order, an inquiry for which the relevant facts "are never static." Id. at 784. And in Weedon, a principal witness against the defendant had recanted his testimony, raising "a serious question whether other evidence is strong enough to support the defendant's conviction." 750 A.2d at 528 n.5.[1]

Here, the underlying facts have not changed at all. Plaintiffs just waited years before getting around to looking for them. Plaintiffs filed their original complaint on January 8, 1997. After reviewing the brief in support of defendants' motion to dismiss the original complaint, plaintiffs voluntarily decided to amend the complaint. In so doing, plaintiffs ignored a series of opinions by the Supreme Court encouraging shareholder plaintiffs to use the "tools at hand" to seek books and records pursuant to 8 Del. C. § 220. Plaintiffs elected to stand on the facts as alleged in the amended complaint, which were found deficient, and, in their appeal to the Delaware Supreme Court, plaintiffs did not even brief the first prong of Aronson. Having ignored an avenue open to them years ago, and having received an "unusual" leave to replead certain issues in an amended complaint that had been dismissed, Brehm, 746 A.2d at 267, plaintiffs should not be heard to argue that they are allowed to

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[1]Plaintiffs' discussions of res judicata and collateral estoppel (PAB 56-57) are irrelevant, because those doctrines do not apply when considering the effect to be given to earlier rulings in the same litigation.

relitigate an issue that has been expressly foreclosed, based on facts that plaintiffs simply chose not to discover earlier.[2]

2. No Well-Pled Allegations Cast Doubt on the Director Defendants' Independence and Disinterest With Respect to the Decision to Approve Ovitz's Compensation Package.

In their Opening Brief, Disney and the Director Defendants argued that even if plaintiffs are allowed to relitigate the issues of director disinterest and independence – issues embraced by the first prong of the Aronson standard, as to which dismissal was "final and dispositive," Brehm, 746 A.2d at 258 – plaintiffs have failed to allege any particularized facts

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[2]Plaintiffs' only avenue to revisit the Supreme Court's ruling in Brehm would be by filing a motion pursuant to Rule 60(b), which they have not done. Plaintiffs could not hope to succeed on a Rule 60(b)(2) motion premised on "newly discovered evidence" (PAB 54 n.29), because they cannot contend that such evidence "could not, in the exercise of reasonable diligence, have been discovered for use" in the earlier proceeding. Poole v. N.V. Deli Maatschappi, Del. Ch., 257 A.2d 241, 243 (1969). A party's lack of diligence in obtaining available information is sufficient to deny relief under Rule 60(b)(2). See Fitzgerald v. Cantor, Del. Ch., C.A. No. 16297, slip op. at 5-6, Steele, J. (Jan. 10, 2000); In re U.S. Robotics Corp. S'holders Litig., Del. Ch., C.A. No. 15580, slip op. at 20, Strine, V.C. (Mar. 15, 1999). Given plaintiffs' failure to request books and records prior to an explicit affirmance of a dismissal with prejudice, and their failure to move under Rule 60(b), plaintiffs can hardly rely on the unusual facts of Levine v. Smith, Del. Supr., 591 A.2d 194 (1991), in which the Supreme Court deferred to a discretionary finding that plaintiffs had acted in good faith in filing a tardy Rule 60(b) motion. Id. at 203.

Presumably, plaintiffs do not intend to suggest that Ovitz's signing a document in 1996 which released the members of the New Board from liability relating to the Non-Fault Termination constitutes "newly-discovered evidence." See PAB 54 ("[T]he facts set forth in the Complaint, which support a finding of demand futility pursuant to the first prong of Aronson, are based on newly uncovered facts entirely different from those alleged in 'that part' of the plaintiffs' prior complaint which the Supreme Court dismissed with prejudice."). The release in question was contained in the Form 10-Q for the quarter ended December 31, 1996, which the Company filed with the Securities and Exchange Commission on February 14, 1997. (Affidavit of Anne C. Foster Exhibit A (filed contemporaneously herewith)). Whether plaintiffs failed to read this public document before filing their May 28, 1997 first amended complaint, or read it and chose not to include it, does not turn this old public fact into new evidence.

impugning the independence and disinterest of any of the Director Defendants with respect to the approval of the OEA. (DOB at 26 n.8).

Plaintiffs have tacitly conceded this fundamental point. Nowhere in their 60-page answering brief do plaintiffs argue that the Director Defendants were interested or lacked independence respecting the decisions to hire Ovitz and approve his proposed compensation package.[3] In a footnote, plaintiffs incorrectly contend that this Court previously determined that Irwin Russell and Sanford Litvack "lacked independence." (PAB 39 n.22) In fact, this Court determined only that plaintiffs had raised a reasonable doubt as to their independence *from Eisner*. In re The Walt Disney Co. Derivative Litig., Del. Ch., 731 A.2d 342, 357, 360 (1998), aff'd in part, rev'd in part sub nom. Brehm v. Eisner, Del. Supr., 746 A.2d 244 (2000). That is completely irrelevant given this Court's determination, affirmed by the Supreme Court, that "no reasonable doubt can exist as to Eisner's disinterest in the approval of the Employment Agreement, as a matter of law." Id. at 356 (emphasis added). The Supreme Court held "that the Complaint fails to create a reasonable doubt that Eisner was disinterested in the Ovitz Employment Agreement." Brehm, 746 A.2d at 258. Therefore, plaintiffs have not alleged facts sufficient to cast doubt on the disinterestedness or independence of the Director Defendants with respect to the approval of Ovitz's employment contract.

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[3]In the Complaint itself, plaintiffs allege that Eisner was "conflicted" with respect to approval of the Ovitz compensation package "because of Ovitz's status as Eisner's 'best friend.'" (Compl. ¶ 106.B). This Court has already found that "[t]his argument . . . finds no support under Delaware law." In re The Walt Disney Co., 731 A.2d at 355.

3. Plaintiffs Fail to Allege Facts Casting Doubt on the Disinterest and Independence of the New Board With Respect to the Grant of the Non-Fault Termination.

As discussed above, plaintiffs are barred from relitigating the disinterest and independence of the New Board. But even if the issue were open, plaintiffs' only pertinent factual allegation is that Ovitz signed a

> general release from all claims (the "Release") . . . *running to Disney* and, inter alia, all of its officers and directors, including all claims relating to or arising from the OEA, the Non-Fault Termination and his tenure with Disney. The Release conferred a tangible benefit on each of the members of the New Board.

(Compl. ¶ 97) (italics added).

This allegation of a "tangible benefit" is deficient. Plaintiffs fail to allege whether Ovitz had any basis to assert a claim against any member of the New Board relating to the OEA, the Non-Fault Termination or his tenure at Disney. Indeed, plaintiffs allege that Ovitz received all that he was owed under the OEA for a Non-Fault Termination, and that he acceded to the Non-Fault Termination. (Compl. ¶ 77). Plaintiffs cite no law for the notion that a generic release, standing alone, constitutes a material, disabling self-interest for all persons covered by that release.[4]

Plaintiffs claim they have discovered "new" facts supporting an argument that demand is excused under the first prong of the Aronson test. First, with respect to Eisner, plaintiffs simply have rehashed the fact that Eisner and Ovitz were close friends. (PAB at 51, 56). Plaintiffs do not respond to the points made in the opening brief, and therefore

[4]Plaintiffs cite only a footnote in Orman v. Cullman, Del. Ch., 794 A.2d 5, 25 n.50 (2002), in which the Court outlined the differences between the concepts of "interestedness" and "independence." (PAB 53).

conceded the following facts -- which, when placed in context through allegations from plaintiffs' own complaint -- demonstrate Eisner's loyalty:

- Months after Ovitz was hired, Eisner allegedly wrote to Watson acknowledging that Eisner had "made an error in judgment" in hiring Ovitz, and urging that Ovitz not be promoted in the event of Eisner's death. (DOB 34; Compl. ¶ 70).

- Ovitz's October 8, 1996 note to Eisner demonstrates that Eisner had been encouraging Ovitz to obtain other employment, thereby seeking to "arrange Ovitz's exit on terms whereby Sony would effectively absorb the cost." (DOB 34-35; Compl. ¶¶ 77, 80, 85).

Thus, rather than alleging facts that cast doubt on Eisner's ability to consider the demand independently, plaintiffs have actually set forth facts showing Eisner's loyalty to the Company.

Plaintiffs also argue that because they claim to have alleged new facts supporting their contention that the members of the New Board failed to engage in a valid exercise of business judgment with respect to the Non-Fault Termination, those directors were interested in the transaction. The cases plaintiffs cite for that proposition are inapposite. (PAB 52-53). Kohls v. Duthie involved what this Court described as "a highly unusual set of facts that color [the] decision on this motion" -- specifically, that a member of a board of directors considered acting in his personal capacity to take advantage of what was alleged to be an opportunity belonging to the corporation. Kohls v. Duthie, Del. Ch., 791 A.2d 772, 782 (2000). In Rales v. Blasband, the Supreme Court found that the Third Circuit's preexisting conclusion that plaintiff had "pleaded facts raising at least a reasonable doubt that [the board's action] was a valid exercise of business judgment" meant that the potential for liability was raised to a "substantial likelihood" and, therefore, led to a disqualifying financial interest. Rales v. Blasband, Del. Supr., 634 A.2d 927, 936 (1993).

Here, as discussed below, plaintiffs have not alleged any facts to support the claim that "the New Board faces a substantial and legitimate threat of liability." (PAB 53). As a result, this Court should be guided by the established principle that allegations that directors would have to sue themselves, without more, do not establish a disqualifying interest. Pogostin v. Rice, Del. Supr., 480 A.2d 619, 625 (1984). Furthermore, this Court has recognized that directors' abilities to evaluate potential litigation disinterestedly will be actually enhanced where, as here, they are protected from personal liability by a charter provision adopted pursuant to Section 102(b)(7). In re Baxter Int'l S'holders Litig., Del. Ch., 654 A.2d 1268, 1270 (1995).

B. Plaintiffs Have Failed to Allege Particularized Facts Showing That the Challenged Transactions Were Not Otherwise the Product of a Valid Exercise of Business Judgment.

On the prior motion to dismiss, this Court found that the allegations of the Amended Complaint were insufficient to satisfy the requirements of the second prong of the Aronson test. This Court's finding was affirmed on appeal. What the Supreme Court did was to give plaintiffs leave to try a third time to file a complaint containing sufficiently particularized facts to state a claim. Instead of doing so, however, plaintiffs have just recycled the numerous deficient allegations from the prior complaint. To the extent they allege a few facts that did not appear before, those facts, if anything, support defendants' arguments, not plaintiffs'.

1. Disney's Exculpatory Charter Provision Raises the Pleading Burden Under the Second Prong of *Aronson* to Particularized Factual Allegations of Disloyalty or Bad Faith.

The existence of an exculpatory charter provision adopted pursuant to 8 Del. C. § 102(b)(7) renders moot allegations that the challenged transactions were not the product of a valid exercise of business judgment because the Director Defendants purportedly breached their duty of care. In the post-Brehm decision of Malpiede v. Townson, Del. Supr., 780 A.2d 1075 (2001), the Delaware Supreme Court held that "if a shareholder complaint unambiguously asserts only a due care claim, the complaint is dismissable once the corporation's Section 102(b)(7) provision is properly invoked." Emerald Partners v. Berlin, Del. Supr., 787 A.2d 85, 91 (2001) (citing Malpiede, 780 A.2d at 1093). As the Court further explained in Emerald Partners: "The effect of our holding in Malpiede is that, in actions against the directors of Delaware corporations with a Section 102(b)(7) charter provision, a shareholder's complaint must allege well-pled facts that, if true, implicate breaches of loyalty or good faith." Id. at 92.

This Court should consider Disney's exculpatory charter provision when evaluating whether the shareholder plaintiffs have pled demand futility with particularity. In Brehm, the Supreme Court incorporated Section 141(e) into its analysis of demand futility under the second prong of Aronson, holding that plaintiffs must allege "particularized facts" that the protection of Section 141(e) is unavailable in order 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. Under Brehm, and the post-Brehm decisions in Malpiede and Emerald Partners, it stands to reason that plaintiffs must similarly allege why the protections of Section 102(b)(7) are inapplicable if they wish to survive a Rule 23.1 motion. Thus, in Baxter

International Shareholders Litigation, Del. Ch., 654 A.2d 1268, 1270 (1995), this Court considered an exculpatory charter provision when evaluating whether a shareholder plaintiff had pled demand futility with particularity.[5]

Apparently recognizing that Article Eleventh of Disney's charter eliminates liability for breaches of the duty of care, plaintiffs' arguments about why the second prong of Aronson is satisfied are littered with words like "recklessness" and "bad faith." Take those away and the actual allegations of the Second Amended Complaint do not even support a showing of a breach of the duty of care, much less any more exacting standard.

The statute contains limited exceptions for cases of "breach of the director's duty of loyalty" and "acts or omissions not in good faith." 8 Del. C. § 102(b)(7). Delaware courts have not, strictly speaking, viewed the duty of good faith as a separate duty under Delaware law. As this Court has previously stated, "Because the duty to act 'in good faith' is merely a subset of a director's duty of loyalty," consideration of duty of loyalty claims "necessarily includes a consideration of whether the facts pled suggest that the defendants did not act in good faith with regard to their duty of loyalty." Orman v. Cullman, Del. Ch., 794 A.2d 5, 14 n.3 (2002). In another decision, this Court noted:

> Bad faith conduct . . . would seem to be other than loyal conduct. See Webster's Ninth New Collegiate Dictionary 446 (1987) (indicating that: the primary definition of 'faith' is 'allegiance to duty or a person: LOYALTY'; the primary definition of 'faithless' is 'not true to allegiance or duty: TREACHEROUS, DISLOYAL'; 'loyal' is a synonym for 'faithful'; and 'disloyal' is a synonym for 'faithless').

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[5]Indeed, plaintiffs themselves rely on the decision of the Sixth Circuit Court of Appeals in McCall v. Scott, 250 F.3d 997 (6th Cir. 2001), in which the court applied a Section 102(b)(7) analysis "in deciding a motion to dismiss for failure to make pre-suit demand." Id. at 1000. McCall was construed in the subsequent decision of Salsitz v. Nasser, 208 F.R.D. 589 (E.D. Mich. 2002), in which the court granted a Rule 23.1 motion based on an exculpatory charter provision.

In re ML/EQ Real Estate P'ship Litig., Del. Ch., C.A. No. 15741, slip op. at 9 n.20, Strine, V.C. (Dec. 21, 1999). See also Gagliardi v. TriFoods Int'l, Inc., Del. Ch., 683 A.2d 1049, 1051 (1996) (lack of good faith requires a showing that defendants "lacked an actual intention to advance corporate welfare").

"Recklessness" may be viewed as equivalent to gross negligence, for which liability has been eliminated pursuant to Article Eleventh. See William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., "Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law," 56 Bus. L. 1287, 1300 (Aug. 2001) ("gross negligence ... involves a devil-may-care attitude or indifference to duty amounting to recklessness"). This Court has held that "[r]ecklessness requires 'a conscious indifference to the decision's foreseeable results.'" Wolf v. Magness Constr. Co., Del. Ch., C.A. No. 13004, slip op. at 9, Chandler, V.C. (Dec. 20, 1994) (citation omitted). See also Capano Mgmt. v. Transcontinental Ins., 78 F. Supp. 2d 320, 329 (D. Del. 1999) (Delaware pattern jury instructions define recklessness as "a knowing disregard of a substantial and unjustifiable risk. It amounts to an 'I don't care attitude.' Recklessness occurs when a person, with no intent to cause harm, performs an act so unreasonable and so dangerous that he or she knows, or should know, that harm will probably result.").

Whether the test is good faith or recklessness, either requires a showing of some conscious act by the directors to the detriment of the stockholders, whether it be conscious indifference, lack of intent to advance the corporate welfare, or conscious disregard of a risk. Under any of these formulations, none of the facts alleged by plaintiffs suggest that the Director Defendants had anything other than the best interests of the stockholders in mind

with respect to the approval of the Ovitz Employment Agreement and the decision to grant a Non-Fault Termination.

a. There Are No Well-Pled Allegations that Any Member of the Old Board Ignored Any Supposed "Red Flags" Respecting Ovitz's Compensation Package.

The Second Amended Complaint makes the conclusory allegation that "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. ¶ 106.B). According to plaintiffs, "red flags" consisted of "[a]n internal Disney document created on or about July 7, 1995" and "a letter from Crystal to Russell dated August 12, 1995," both of which are only partially quoted in the Second Amended Complaint. (Id. ¶¶ 33, 35). The Second Amended Complaint further alleges that "Graef Crystal . . . had communications with Russell relating to the negotiations and development of the OEA." (Id. ¶ 45).

In their Opening Brief, Disney and the Director Defendants quoted from the entirety of the two documents, which actually explained the reasons why Ovitz's proposed compensation package took the form that it did. The Opening Brief also observed that Russell, the Chairman of the Compensation Committee, must have been fully aware of the contents of the two documents and must have informed the other members of the Compensation Committee about Crystal's assessment of the proposed compensation package. (DOB 9-12, 31-32). Tellingly, plaintiffs responded by seeking to strike the full text of the alleged "red flags" from the record.[6]

[6]Absurdly, plaintiffs also question whether either document actually refers to Ovitz's proposed compensation. (PAB 18, 39). See Mot. to Strike at 10 ("As with the Case Study, this document [the letter from Crystal to Russell] does not expressly refer to Ovitz by

It is eminently proper for the Court to consider the actual text of the alleged "red flags" in deciding this motion to dismiss. A document extrinsic to a complaint may be considered when deciding a Rule 12(b)(6) motion if the document is "integral to a plaintiff's claim and incorporated into the complaint." Vanderbilt Income & Growth Assocs. v. Arvida/JMB Managers, Del. Supr., 691 A.2d 609, 613 (1996). As this Court has previously found, "[t]he fact that [parties] chose to describe [a document] in their complaint but not to attach it should not preclude consideration of its clear terms. To hold otherwise would be to encourage the filing of misleading complaints that strategically omit crucial information and to subject defendants to the substantial burdens of pre-trial discovery in cases that, if pled straightforwardly, can be resolved on a motion to dismiss." Midland Food Servs., LLC v. Castle Hill Holdings V, LLC, Del. Ch., 792 A.2d 920, 925-26 n.5 (1999).[7]

If plaintiffs contend that the partially-quoted July 7, 1995 Disney document and Crystal's letter of August 12, 1995 are "red flags" that the Old Board improperly "failed to heed" (Compl. ¶ 106.B), they cannot in good faith dispute that those documents are integral to the complaint and incorporated into it. If the documents are not integral to the complaint, then in what sense can they be deemed "red flags" that can create liability if ignored? Similarly, a document must be read in its entirety to know whether it is a "red flag." If one

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name."). The timing and text of the documents leaves no reason to doubt that the subject under discussion is the potential hiring of Ovitz as President of Disney. See Friedlander Aff. Exs. B, C. Moreover, if the documents referred to someone other than Ovitz, Disney would not have produced them in response to plaintiffs' Section 220 demand.

[7]Unlike the New Valley case cited by plaintiffs, In re New Valley Corp. Derivative Litigation, Del. Ch., C.A. No. 17649, Chandler, C. (Jan. 11, 2001), in this case, as discussed above, the Supreme Court gave plaintiffs a limited opportunity to replead only if they were able to allege particularized facts based upon documents they might obtain pursuant to a Section 220 demand.

sentence, ripped out of context, appears "red," but the rest of the document demonstrates that the whole is green, there is no "red flag" at all. A director -- and, indeed, the Court -- could only know by reading the entire document. Plaintiffs cannot conjure up "red flags" by drawing inferences that are not warranted from the entire text of the document. In addition, as discussed above, the Supreme Court carefully limited plaintiffs' opportunity to replead certain claims. For this Court to be able to determine whether plaintiffs have complied with this limitation, it must be able to consider the text of the documents upon which plaintiffs relied in drafting the complaint.

In any event, even if the Court does not read the documents, the factual allegations of the Second Amended Complaint do not support plaintiffs' claim that "red flags" were disregarded in bad faith. The internal document of July 7, 1995 is quoted as stating that the "[n]umber of stock options is far beyond standards applied in Company [sic] and in corporate America and will raise very strong criticism." (Compl. ¶ 33). Plaintiffs do not allege that any member of the Compensation Committee was unaware of the number of stock options in the OEA. Nor do plaintiffs allege that the number of stock options in the proposed compensation package is out of line with more relevant standards -- what Ovitz would otherwise expect to earn if he remained as Chairman of Creative Artist Agency, and what amount and form of compensation was necessary to motivate Ovitz to abandon the business he founded, ran and owned, and to accept a position as second-in-command to Eisner at Disney.

The August 12, 1995 letter from Crystal to Russell is quoted as saying that the deficiencies of a "large signing bonus" are that "the cost is borne immediately, and it is borne in full even though the executive, for one reason or another, fails to serve his full

employment term." (Id. ¶ 35). Plaintiffs do not allege, however, that the OEA contained a "large signing bonus," or indeed any signing bonus. Moreover, the safeguards built into the OEA *reflect* Crystal's advice concerning the problems with giving an employee a "large signing bonus." Under the OEA, if Ovitz decided on a given day to leave Disney "for one reason or another" (Id.), he was entitled only to whatever portion of his $1 million annual salary and his discretionary annual bonus that he had already earned. The OEA contains a vesting schedule, pursuant to which Ovitz would not receive any stock options if he decided to quit within the first three years of his employment at Disney. (Compl. Ex. A § 5). Unlike the "large signing bonus" described by Crystal, the vesting schedule for Ovitz's stock options in the OEA is accelerated only in the event that Ovitz died, suffered a total and permanent incapacity, or received a "Non-Fault Termination" as defined in the OEA, which would not include his being terminated for "gross negligence or malfeasance." (Id. §§ 5, 11).

The only permissible inference to be drawn from plaintiffs' minimalist pleading respecting Crystal's letter and his involvement in the "negotiations and development of the OEA" (Compl. ¶ 45) is that Crystal was waving a "green flag," not a "red flag," regarding the structure of Ovitz's proposed compensation package. Cf. Ash v. McCall, Del. Ch., C.A. No. 17132, slip op. at 25, Chandler, C. (Sept. 15, 2000) (finding that the juxtaposition of alleged "red flags" with actual "green flags" only permits inference of good faith). Certainly, plaintiffs have not alleged that the Old Board acted in a manner *contrary* to the advice that they admit Crystal provided to Russell. Nothing about the July 7, 1995 or August 12, 1995 documents casts doubt on the good faith of any of the members of the Old Board. Indeed, nowhere have plaintiffs alleged any facts to suggest that the members of the Old Board, who made the decision to elect Ovitz as President of Disney and permitted the properly

constituted Compensation Committee to approve the details of his employment agreement, took any actions demonstrating a lack of concern for Disney's best interests.

b. The Compensation Committee Possessed the Power to Approve the OEA.

Plaintiffs also criticize the fact that the OEA was approved by Disney's Compensation Committee, rather than the entire Old Board. According to plaintiffs, Section 141(a) of the GCL required a vote of the full board "due to the materiality of Ovitz's hiring as Disney's second-in-command and the Company's potentially large financial exposure in the event of Non-Fault Termination." (PAB 37).[8] Plaintiffs also rely on a statement in Eisner's letter to Ovitz dated August 14, 1995 that their agreement was subject to formal approval by Disney's Board and its Compensation Committee. (Compl. ¶ 32). Plaintiffs' statutory attack on the approval of the OEA is demonstrably wrong.

Contrary to plaintiffs' suggestion, "8 Del. C. § 141(c) permits a board of directors to pass a resolution designating one or more committees that may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation." Scattered Corp. v. Chicago Stock Exch., Del. Supr., 701 A.2d 70, 75 (1997).[9] In Scattered, the Supreme Court rejected the argument that an Executive Committee lacked the authority to refuse a stockholder demand, even though the full Board had initially acted on the demand by referring it to a special committee for investigation. The Court found

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[8]Plaintiffs concede that the full Board voted on whether to elect Ovitz as President of the Company. (PAB 19).

[9]The statute excepts certain fundamental corporate acts, such as amending the certificate of incorporation, adopting a merger agreement, recommending the sale of all or substantially all assets, and recommending dissolution. See 8 Del. C. § 141(c)(1). None of the statutory exceptions remotely relates to the issue of approving an employment contract.

compliance with Section 141(c): "The Exchange has done this by appointing the Executive Committee and by allowing that committee to review the investigation by the Special Committee and to decide whether or not to refuse plaintiffs' pre-suit demand." Id. The Scattered Court expressly affirmed this Court's ruling that it was "neither logically nor legally permissible, and in any event not a reasonable inference" that the full Board had reserved to itself the job of responding to the demand by having taken the initial step of appointing the special committee. Id. at 76 (quoting Scattered Corp. v Chicago Stock Exchange, Inc., Del. Ch., C.A. No. 14010, 1997 WL 187316, at *4 (Apr. 7, 1997)). See also Cirrus Holding Co. v. Cirrus Indus., Inc., Del. Ch., 794 A.2d 1191, 1208 & n.36 (2001) (finding little likelihood of success on breach of contract claim where contract called for decision by the "Board" and decision was rendered by Finance Committee of the Board of Directors, because Section 141(c) "permits delegation of duties to committees" and Finance Committee frequently "consider[ed] business items of this nature"). Here, it cannot even be alleged that obtaining approval of the Compensation Committee, as opposed to the full Board, constituted a breach of any agreement, as Eisner's August 14, 1995 letter to Ovitz was superseded by the OEA. (Compl. Ex. A § 20(a)).

Plaintiffs do not allege any facts calling into question that the Compensation Committee was duly established and authorized pursuant to Section 141(c).[10] Clearly, the full Disney Board allowed the Compensation Committee to make the decision to enter into the OEA, and plaintiffs allege no facts to suggest that the Old Board acted wrongfully in so doing. And the Board was plainly informed. As plaintiffs allege, a meeting of the Old Board

[10]Indeed, they never even requested such documents in their Section 220 demand.

"took place on September 26, 1995, immediately following the meeting of the Compensation Committee," and Ovitz was elected President at that meeting. (Compl. ¶ 47).[11]

Plaintiffs' reliance on cases discussing the abdication or improper delegation of board powers or duties to others is misplaced. (PAB 37-38). Although Grimes does include the uncontroversial language plaintiffs quote in a parenthetical (PAB 37), it in no way stands for the proposition urged by plaintiffs that "the Old Board could not have properly delegated its duty to assess the OEA and consider various payout scenarios in the case of a Non-Fault Termination without violating its fiduciary duties." (PAB 37). In fact, the Grimes Court found that an employment agreement which allowed the employee unilaterally to declare a constructive termination without cause if he determined that the board had "unreasonably interfered" with his general management of the affairs of the corporation did not constitute abdication. As the Court recognized, "[t]he Board of DSC retains the ultimate freedom to direct the strategy and affairs of the Company. If [the employee] disagrees with the Board, the Company may or may not (depending on the circumstances) be required to pay him a substantial sum of money in order to pursue its chosen course of action." Grimes v. Donald, Del. Supr., 673 A.2d 1207, 1215 (1996). Chapin involved a situation where the Court concluded that member-trustees of a non-stock corporation could not commit themselves in advance to filling board vacancies with particular individuals.

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[11] Although they describe and rely upon the minutes of the September 26, 1995 board meeting, plaintiffs have nevertheless moved to strike that document. For the reasons discussed below, plaintiffs should not be able to have it both ways, and the Court should consider the minutes. (Friedlander Aff. Ex. F).

c. Plaintiffs Have Not Alleged Facts to Demonstrate That the Compensation Committee Members Acted Recklessly or In Bad Faith.

Plaintiffs also contend that the members of the Compensation Committee acted recklessly and in bad faith in approving the OEA. This argument has no basis in fact, as demonstrated by the allegations of the Second Amended Complaint and the documents plaintiffs relied upon in drafting it. Although plaintiffs devote many pages of their Second Amended Complaint and answering brief to the decision-making process of the Compensation Committee on September 26, 1995 (Compl. ¶¶ 36-46; PAB 16-19, 38-42), virtually everything that plaintiffs have to say about that meeting of the Compensation Committee comes from a single document, the minutes of the meeting. (See Friedlander Aff. Ex. E). Plaintiffs subject that document to the most extreme textual analysis in their Second Amended Complaint, commenting on its length, the number of lines devoted to particular topics, and its tone, while purporting to summarize the summary of the terms and conditions of the OEA that is attached to those minutes. (Compl. ¶¶ 38-41, 46).

This Court has held that a document is "integral" to a complaint if it is the source of the facts pled in the complaint. Orman v. Cullman, Del. Ch., 794 A.2d 5, 16 (2002). The minutes certainly qualify. Nonetheless, again wanting to have it both ways, plaintiffs have moved to strike the minutes from the record, and thereby prevent the Court from considering the "undisputed facts" contained therein. Id. at 16 n.9. Thus, plaintiffs do not want the Court to read the actual text of the document that was provided to the members of the Compensation Committee summarizing the principal terms and conditions of the OEA, and the report of who attended and who spoke at the meeting. No legitimate ground exists for

hiding these facts from the Court, especially considering that the Section 220 demand is plaintiffs' sole basis for repleading.

But even if the Court's analysis is confined to the text of the Second Amended Complaint, its factual allegations do not support an inference that any aspect of the process involved conduct that was not designed to consider the Company's best interests. The Second Amended Complaint itself states that at the September 26 meeting of the Compensation Committee, Russell, the Committee's Chairman, reviewed the terms of the OEA and answered questions, and that a summary of the OEA was distributed to members of the Committee. (Compl. ¶¶ 39, 41). Litvack, Disney's general counsel, also attended the meeting. (Id. ¶ 36).[12] The subject matter of the meeting would not have been a surprise to the attendees. Eisner and Ovitz had countersigned a non-binding letter agreement weeks earlier. (Id. ¶ 31).[13] Litvack and Russell had been the first to know that Eisner wanted to hire Ovitz, before the letter agreement was signed. (Id. ¶ 30). Russell had been acting in a legal capacity on Disney's behalf for weeks, and had worked with Crystal to develop and negotiate the OEA. (Id. ¶¶ 35, 38, 45). By the time the Compensation Committee met, much of the OEA had been formulated in arm's length negotiations between Disney and Ovitz. (Id. ¶ 32) Disney had sent a draft of the complete OEA to Ovitz's lawyers three days earlier. (Id. ¶ 40)

On the merits of hiring Ovitz as President, it is hardly "bad faith misconduct" for the members of the Compensation Committee to consider Eisner's views, even if Eisner did not

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[12]As discussed above, the fact that the Supreme Court found that Russell and Litvack were not independent from *Eisner* has no bearing on the Compensation Committee's good faith in acting upon Ovitz's employment contract.

[13]Plaintiffs have moved to strike that letter, which even they characterize as "memorializing the principal terms of Ovitz's prospective employment by Disney." (Compl. ¶ 31).

make a presentation at the Committee's meeting. (PAB 41). Ovitz was being hired to become Eisner's second-in-command. It must be reasonably inferred that members of the Compensation Committee could and did consider facts that, as plaintiffs allege, were widely known at the time -- Disney had been criticized for being without a second-in-command since the tragic death of Frank Wells; Ovitz was a person of high stature in Hollywood; Eisner and Ovitz had been friends for over 25 years; and Eisner strongly favored hiring Ovitz as Disney's President, even over the initial objection of three directors.[14] (Compl. ¶¶ 25-27, 29-30). The members of the Compensation Committee had at least six weeks to think about the subject of hiring Ovitz and entering into an employment contract prior to their meeting on September 26, 1995. It is more than reasonable to assume that they had thought and talked about that decision long before the meeting began.

The only specific term alleged to be missing from the summary of terms provided to the Compensation Committee on September 26, 1995 is the exercise price of the options. (Id. ¶ 41). However, the Compensation Committee met for a second time with respect to the OEA on October 16, 1995, and plaintiffs allege that the Committee set the exercise price for Ovitz's options at the stock price that day, which was also roughly the same as the stock price on October 2, 1995, the first trading day after Ovitz's first day of work. (Compl. ¶ 56)

Plaintiffs do not allege that the members of the Compensation Committee were uninformed about the basic framework of the OEA – the amount of salary, the form of bonus, the number of stock options, the vesting schedule of the options, the effect of terminating the

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[14]The fact that a director might initially oppose a transaction does not prevent business judgment rule review from applying to a later decision by that same director to support the transaction. See Paramount Communications v. Time, Inc., Del. Supr., 571 A.2d 1140, 1143-44, 1152 (1989) (discussing evolution in board's thinking toward Time-Warner merger).

contract after its initial five-year term, the acceleration of the vesting of the options upon a Non-Fault Termination, or the determination of the amount of cash payments for a Non-Fault Termination at any given time. Given the approximate one-hour length of the Compensation Committee meeting on September 26, it is not reasonable to infer -- as plaintiffs do -- that Russell lacked enough time to explain the OEA's principal terms, even if other items were on the agenda. In short, plaintiffs present no reason why the members of the Compensation Committee are not "fully protected in relying in good faith" upon Russell's report concerning the principal terms of the OEA. 8 Del. C. § 141(e). It is plaintiffs' burden to plead facts to demonstrate why Section 141(e) would not apply to Russell's report, and plaintiffs have not done so. Brehm, 746 A.2d at 262.

With respect to the financial aspects of the OEA, no allegation is made that the Compensation Committee did not comprehend the cash aspects of the compensation package. Plaintiffs focus on the Compensation Committee's knowledge concerning the "magnitude of possible payouts that Ovitz would receive in the event of a Non-Fault Termination at various points in time." (Compl. ¶ 42). Again, the cash aspects of the payouts are readily calculable, as they essentially consist of the net present value of the future salary and expected bonuses for the remainder of the contract term. (See Compl. Ex. § 11(c)). The only remaining item is the value of the stock options that would vest upon the date of a Non-Fault Termination.

Moreover, the members of the Compensation Committee cannot be deemed to have acted recklessly or in bad faith for allegedly not having at their fingertips various estimates of the cash value of Ovitz's options on three million shares of Disney stock as of any possible future date of a Non-Fault Termination for the following reasons:

First, Crystal, the expert who had been advising Disney, had not seen fit to create such a spreadsheet, and plaintiffs do not suggest that he exhibited a lack of concern for Disney's welfare when he "did not at the time intervene to cause the simple and easy steps needed to remedy the utter failure to inform the decision-making process of the magnitude of compensation involved" if Ovitz were fired. (Compl. ¶ 43). Any failure by Eisner, Litvack, Russell, or any member of the Compensation Committee to ask Crystal to make a spreadsheet showing possible future payouts in the event Ovitz was fired at any time cannot fairly be deemed evidence of indifference to the Company's best interests.[15]

Second, it had to be apparent to any observer that under the OEA, Ovitz stood to obtain substantial value if he succeeded at Disney, and that he stood to obtain substantial value in the unfortunate circumstance of a Non-Fault Termination.[16] The risk of a large payout in the event of a Non-Fault Termination is inherent in the contracting process. Disney needed the freedom to compel a Non-Fault Termination if circumstances warranted, while

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[15]The pertinent analysis is whether the directors acted "in good faith," not strict liability for failing to correct an oversight by a professional advisor. See Ash v. McCall, Del. Ch., C.A. No. 17132, slip op. at 25, Chandler, C. (Sept. 15, 2000) ("What would plaintiffs have the McKesson board do in the course of making an acquisition other than hire a national accounting firm and investment bank to examine the books and records of the target company? Nothing in the pleadings otherwise casts doubt on the good faith of the McKesson directors."). Plaintiffs repeatedly state that Crystal did not make any presentation to the Compensation Committee or the Old Board. Nonetheless, plaintiffs concede that "Crystal had communications with Russell relating to the negotiations and development of the OEA," and it cannot be assumed that Russell did not tell the other members of the Compensation Committee of that fact. (Compl. ¶ 45). Retaining Crystal to help negotiate and develop the OEA is the functional equivalent of retaining an investment bank or accounting firm to help evaluate a prospective merger. It evidences the Old Board's good faith, and vitiates plaintiffs' conclusory allegations of bad faith.

[16]In any event, to generate a spreadsheet showing the value of the options under various scenarios, the company's expert would have to have known the *future* trading prices of the Company's stock, information that is inherently unknowable.

Ovitz needed protection so that Disney would have no incentive to breach the OEA and deprive Ovitz of the benefits of his contract. As the Delaware Supreme Court has specifically recognized, a board may determine that "the market for senior management . . . demands significant severance packages [that] inevitably limit [the corporation's] future range of action." Grimes v. Donald, Del. Supr., 673 A.2d 1207, 1215 (1996). The acceleration of stock option vesting in the event of termination "without cause" is judicially accepted as an enforceable obligation. Scribner v. Worldcom, Inc., 249 F.3d 902 (9th Cir. 2001). The acceleration of vesting for certain of the options may create additional value,[17] but the magnitude of that benefit is related to the number of option shares, which was itself a matter of arm's length negotiation. The constraints of contracting hardly suggest irrationality or bad faith.

* * *

No well-pled allegations in the Second Amended Complaint, and no argument in plaintiffs' answering brief, call into question the significant facts that disinterested and independent members of the Compensation Committee were being asked to approve a proposed compensation package that had been negotiated at arm's length between Eisner and his subordinates and Ovitz. It is difficult to conceive how Eisner or any member of the Compensation Committee can be found to lack good faith respecting the negotiation and approval of an arm's length transaction. After all, "arm's-length negotiation provides 'strong evidence that the transaction meets the test of fairness.'" Cinerama, Inc. v. Technicolor, Inc.,

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[17]Acceleration of vesting would apply only to the options for the initial 3,000,000 shares, not the 2,000,000 share option for years 6 and 7, which would be irretrievably lost. (Compl. Ex. A ¶ 5(g)).

Del. Supr., 663 A.2d 1156, 1172 (1995) (quoting Weinberger v. UOP, Del. Supr., 457 A.2d 709-10 n.7 (1983)).

The Compensation Committee was informed of the basic terms of the proposed OEA. It approved Ovitz's hiring on those terms, with the details to be finalized by the negotiators. The Compensation Committee met a second time to consider the principal terms of the OEA as they stood on October 16, 1995, the date when the stock options were granted with an exercise price set at the then-market price. Nothing about the manner in which the OEA was approved remotely supports a claim that the decision was irrational or that the process did not involve concern for the Company's best interests.

d. Plaintiffs Have Alleged No Facts Demonstrating Recklessness or Lack of Good Faith in the Decision to Grant a Non-Fault Termination.

Despite the fact that they themselves allege that Ovitz's tenure as Disney's President was not a resounding success, plaintiffs are critical of the fact that after attempting unsuccessfully to help Ovitz obtain employment elsewhere and thereby avoid any termination costs to the Company, Eisner concluded that Ovitz would have to be given a Non-Fault Termination. They challenge this result despite having alleged no facts to suggest how the Company could have terminated Ovitz without having to pay severance costs required by his employment agreement. Nor have they alleged a single particularized fact to support a contention that the members of the New Board, including Eisner, had anything other than the best interests of the Company at heart in connection with granting the Non-Fault Termination.

(1) The Prior Decisions Do Not Compel the Conclusion That the New Board Was Required to Consider and Approve the Grant of the Non-Fault Termination.

Plaintiffs claim that their complaint "pleads the exact allegation that this Court and the Supreme Court ruled would be sufficient to state a claim and excuse demand, namely 'that the Board did not consider the pertinent issues surrounding Ovitz's termination.'" (PAB 47). That portion of the Supreme Court's decision, which quoted directly from this Court's ruling on the motion to dismiss, related to a conclusion this Court had drawn based upon the allegations of the then-operative complaint. Plaintiffs had alleged that the members of the New Board had "rubber stamped" Eisner's decision to give Ovitz a Non-Fault Termination. Based on that allegation, both courts concluded that "[t]he Board made a business judgment to grant Ovitz a Non-Fault Termination." It was with respect to that affirmative "business decision" that the Court observed that there had been no allegation "that the Board did not consider the pertinent issues." In re The Walt Disney Co., 731 A.2d at 364.

This time, plaintiffs allege conclusorily that the members of the New Board "made the decision to stand aside," and knew that Eisner was arranging the Non-Fault Termination but were "supine." Plaintiffs' attack against the members of the New Board is wholly procedural. According to plaintiffs, the New Board was compelled to meet formally and to resolve whether to grant Ovitz a Non-Fault Termination, regardless of whether any plausible alternative existed, and regardless of whether each member of the New Board knew about Ovitz's poor performance at Disney, knew that the Non-Fault Termination was about to occur, and supported that outcome in good faith. In support of their claim that the members

of the New Board were obligated to make a decision about the Non-Fault Termination, plaintiffs argue first that the "'sheer size' of the $140 million Non-Fault Termination payout to Ovitz" required some affirmative action to be taken by the Board. (PAB 49).[18] This argument is meritless on its face. The Company, through its subsidiaries, makes big-budget motion pictures that are "greenlit" without Board approval; the approvals necessary for those types of authorizations would be governed by internal corporate policies, rather than by the GCL.[19] Similarly, the decision whether to grant a Non-Fault Termination pursuant to an existing contract was one that Eisner, in his capacity as Chairman of the Board, could make as part of his "general and active management, direction, and supervision over the business of the Corporation and over its officers." (Friedlander Aff. Ex. I; DOB 37 n.12).[20]

Plaintiffs' other rationale for why the Board had to make an affirmative decision about the Non-Fault Termination is based upon statements made in prior submissions and arguments by the defendants. As described above, however, plaintiffs' prior complaint

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[18]Although plaintiffs suggest that the Supreme Court already "ruled" that the size of the Non-Fault Termination payment "merited the directors' consideration" (PAB 49), the cited portions of the Supreme Court's opinion presumed that the facts as alleged in the prior complaint were true--that the New Board had made a business decision to approve the Non-Fault Termination. Because plaintiffs' allegations have changed, that statement has no application here.

[19]As the Supreme Court recognized, "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.'" Brehm, 746 A.2d at 259 n.49.

[20] As noted in the Opening Brief, 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. Plaintiffs respond by going outside the record to make a different point, that "the documents defendants have produced show that the *New Board* never met and considered Ovitz's departure before he was granted a Non-Fault Termination." (PAB 49 n.27) (emphasis added). Again, plaintiffs nowhere suggest that Eisner did not attend a meeting of a *committee* of the New Board respecting Ovitz.

alleged that the Board had made a decision on whether to grant the Non-Fault Termination, and in making their prior responses, defendants were required to assume that that alleged fact was true.

(2) Plaintiffs Have Not Alleged Facts to Demonstrate That Eisner Acted in Bad Faith With Respect to the Non-Fault Termination.

In their answering brief, plaintiffs argue that "Eisner acted in bad faith" and "allowed his friendship [with] and sense of commitment towards Ovitz to impact and affect his business judgment" in connection with the decision to grant a Non-Fault Termination. (PAB 51). The factual allegations in the Second Amended Complaint belie this charge.

Plaintiffs' own pleading shows that Eisner subordinated his friendship with Ovitz to the best interests of Disney. Plaintiffs allege that, in a memo to director Watson, Eisner forthrightly acknowledged that he "had made an error in judgment in who I brought into the company," and that he "did not want to leave a legacy of my mistake." (Compl. ¶¶ 70). Plaintiffs' allegations about Eisner's subsequent conduct show that Eisner acted to protect Disney from the legacy of his prior mistake.

The entirety of the October 8, 1996 memo from Ovitz to Eisner (which plaintiffs have not moved to strike) makes clear that *it was Eisner's idea that Ovitz look for a new job, and that Eisner encouraged Ovitz to negotiate with Sony*:

> 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.

(Friedlander Aff. Ex. H). Eisner's actions show, in plaintiffs' own words, that Eisner had "sought to arrange Ovitz's exit on terms whereby Sony would effectively absorb the cost." (Compl. ¶ 85). Plaintiffs cannot object to that, given their contention that "Ovitz's performance as Disney's President was undistinguished and counter-productive." (Id. ¶ 69). Eisner's willingness to "work together to assure a smooth transition and deal with the public relations brilliantly," his desire to avoid embarrassment to Disney and himself, and his commitment "to make this a win-win situation, to keep our friendship intact" is altogether sensible. (Id. ¶ 80). Plaintiffs do not suggest any bad faith that was contrary to Disney's best interests.

Unfortunately, negotiations between Sony and Ovitz on a contemplated "five-year, $100 million contract" did not succeed (id. ¶ 84), and Eisner concluded that Ovitz's employment would have to be terminated.

2. Neither the Approval Nor the Termination of the Ovitz Employment Agreement Constituted Waste.

As plaintiffs themselves concede, the requirements to allege waste are extremely difficult to satisfy, necessitating a showing of "an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." (PAB 42, quoting Brehm, 746 A.2d at 263). See also Glazer v. Zapata Corp., Del. Ch., 658 A.2d 176, 183 (1993) (plaintiffs must allege that transaction "is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration"). The facts alleged in the

Second Amended Complaint show that a reasonable business person could easily have concluded that both transactions were appropriate.[21]

a. The Approval of the Ovitz Employment Agreement.

In the Opening Brief, Disney and the Director Defendants observed that the Delaware Supreme Court has already affirmed this Court's finding 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 Supreme Court equated with "unconscionable cases where directors irrationally squander or give away corporate assets." (DOB 32, quoting Brehm, 746 A.2d at 263). Plaintiffs cannot satisfy this test merely by adding now that the transaction was "unreasonably risky." White v. Panic, Del. Supr., 783 A.2d 543, 554 (2001). Not a single particularized fact in the Second Amended Complaint suggests that the decision to bring on board someone as powerful in Hollywood as Ovitz was irrational.

Plaintiffs respond to defendants' arguments by recycling their previously rejected theories. Multiple pages of the answering brief argue that the terms of the OEA incentivized Ovitz to get himself fired without cause, as if any rational person would have understood that Ovitz's decision to leave behind his immensely profitable and powerful position "as a virtual kingpin" at CAA (Compl. ¶ 26), and take on a new, highly visible role at Disney, was actually a scheme by which Ovitz hoped to enrich himself through public failure. (PAB 22-25, 43-46). In plaintiffs' view, this Court should find that the approval of the Ovitz Employment Agreement constituted waste because the Second Amended Complaint "pleads

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[21]Plaintiffs misconstrue defendants' opening brief by claiming that it suggested that "the Supreme Court barred plaintiffs from reasserting waste." (PAB 42 n.23). Defendants simply noted that to the extent plaintiffs were merely reasserting the same allegations already presented to the Supreme Court, the Court had concluded that those facts did not support a claim of waste.

facts which demonstrate that the OEA failed to secure for Disney the benefit of its bargain" and gave Ovitz "significant financial incentives to prematurely leave Disney." (PAB 43-44).

These very arguments have already been made--see, e.g., Amended Complaint ¶¶ 22 (Ovitz's compensation package "provided him with substantial incentive to exit Disney as soon as possible"); 53; 59; 60-61; 266 ("no conditions were set forth in the Ovitz Employment Agreement to ensure that Disney would receive the services for which it bargained. In fact, the Ovitz Employment Agreement called for the stock options to vest under circumstances where Disney could (and did) receive nothing of value in return, facts which were known to the Individual Defendants from the outset."). With these same allegations in the record before it, the Supreme Court concluded that the Court of Chancery "correctly dismissed [plaintiffs'] theory" that "the 1995 Ovitz Employment was a 'wasteful transaction for Disney ab initio' because it was structured to 'incentivize' Ovitz to seek an early non-fault termination." Brehm, 746 A.2d at 262-63. This finding is the law of the case and may not be relitigated.

Plaintiffs' other theory for why approving the OEA constituted waste is that the members of the Old Board failed to assess the potential payouts associated with a Non-Fault Termination and were not aware of the circumstances under which a Non-Fault Termination would be triggered. (PAB 43). Thus, plaintiffs argue, the decision to approve the agreement was "irrational" and did not include any "assessment of the corporation's best interests." (PAB 43). These claims have no basis in fact, as discussed in detail above.

b. The Decision to Grant a Non-Fault Termination.

In affirming the dismissal of the waste claim concerning the decision to grant a Non-Fault Termination, the Brehm Court held that the prior pleading "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." 746 A.2d at 266.[22] As alleged in the Second Amended Complaint, the decision to grant the Non-Fault Termination was made by Eisner, and the members of the New Board chose not to interfere with that decision. (Compl. ¶ 92). Absent a challenge to a business decision made by the New Board, Rales v. Blasband dictates that a finding that plaintiffs have failed to allege facts sufficient to satisfy the first prong of the Aronson test requires dismissal of the claim. Rales v. Blasband, Del. Supr., 634 A.2d 927, 934 (1993).

Even if the Court concludes it must analyze the allegations of the Second Amended Complaint concerning the grant of the Non-Fault Termination to determine if they allege waste, plaintiffs have failed to satisfy the "no reasonable business person" standard. To deflect attention from the fact that they have reasserted previously rejected theories, plaintiffs claim simply that the facts they have alleged do not show that the New Board made a "good faith judgment" that the grant of the Non-Fault Termination was "worthwhile" to Disney and thus, that is sufficient to show waste. (PAB 48).

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[22]Plaintiffs claim this ruling was based upon defendants' statements to the Court that the board had to approve the grant. (PAB 7-8, 50). Again, for motion purposes, defendants had to accept as true the facts as pleaded in the Amended Complaint. The Amended Complaint claimed that the New Board "rubber-stamp[ed]" Eisner's decision to grant a Non-Fault Termination (Am. Compl. ¶ 8); and "approv[ed] the payment of Ovitz's full severance package." (Am. Compl. ¶ 9). These were plaintiffs' assertions, not defendants'.

The only logical inference that can be drawn from the facts alleged is that after Eisner was unsuccessful in his efforts to help Ovitz find another job, he decided that Ovitz should be terminated pursuant to the terms of the OEA. Moreover, the only pertinent documents quoted in the Second Amended Complaint and in plaintiffs' answering brief are handwritten notes that undermine plaintiffs' prior theory that Ovitz had been negotiating with Sony in violation of the OEA. (PAB 26-27).

Plaintiffs complain, nevertheless, that Eisner chose to grant Ovitz a Non-Fault Termination pursuant to the OEA.[23] Plaintiffs say the decision constituted waste because "the New Board did not consider any of its other possible options in dealing with Ovitz's departure, including firing him for cause, suing for breach of contract or allowing him to continue serving as Disney's President." (PAB 47-48). Plaintiffs fail to explain, however, how the termination decision reflected lack of concern for Disney's best interests. Unlike plaintiffs' prior pleading, the Second Amended Complaint does not (1) suggest that Disney had any superior alternative, (2) allege that Ovitz resigned, (3) allege that Ovitz breached the OEA by negotiating with Sony, or (4) allege any new facts to show why Disney had any claim that Ovitz committed "gross negligence or malfeasance" under the OEA, much less a claim so strong that Eisner and Disney were required to risk litigation with a person then described in the New York Times as "one of the most formidable power brokers in Hollywood." (Compl. ¶ 76). Plaintiffs do not try to allege that Disney would have been better off had Ovitz remained as its President.

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[23]The answering brief ignores altogether the argument set forth in defendants' opening brief about why Ovitz was not "removed." (See DOB 37 n.12). Instead, plaintiffs devote three pages to an irrelevant discussion of who theoretically would have had the power to remove Ovitz. (PAB 49-51).

This utter void in the Second Amended Complaint is remarkable in light of plaintiffs' pleading requirement under Brehm:

> [T]he 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.

Brehm, 746 A.2d at 266. Plaintiffs failed to allege why *any* reasonable business person in Eisner's circumstances would have chosen differently.

3. Plaintiffs Have Not Alleged Facts Sufficient to Demonstrate That the Decisions Concerning the OEA Were the Result of a Breach of the Duty of Care.

For the same reasons discussed above about why there are no particularized allegations that any member of the Old or New Boards failed to act in good faith, no such allegations exist that any member of the Old or New Boards acted with gross negligence.

Plaintiffs claim that the Old Board did not exercise "proper reliance" on an expert with respect to the potential payouts pursuant to the OEA, and that therefore, according to Brehm v. Eisner, the members of the Old Board were not entitled to the presumptions of the business judgment rule. Remarkably, plaintiffs assert that these facts are "contrary to the Supreme Court's factual assumptions urged upon it by defendants." (PAB 35; see also PAB 6-7, 19). In fact, the basis for the Supreme Court's "factual assumptions" was *plaintiffs' own prior complaint*, which alleged that the Ovitz Employment Agreement was approved by the full Board and that Crystal advised the full Board in connection with its approval. See, e.g., Amended Complaint ¶¶ 4, 6, 22, 57, 251(d). Plaintiffs also know that defendants were required to accept those allegations as true for purposes of the prior motion to dismiss; that is why their prior briefing and argument contained those allegations. Thus, the Supreme

Court's opinion did *not* conclude that the Old Board was required to so act. Instead, the Court's finding was limited to a factual circumstance in which, based upon plaintiffs' own allegations, it was assumed that the Old Board took action upon the agreement.

On the present Rule 23.1 motion, the pertinent standard is whether plaintiffs have alleged that the Old or New Boards are not entitled to exculpation for breach of the duty of care under the charter provision adopted pursuant to Section 102(b)(7). Even if exculpation under Section 102(b)(7) is not deemed part of the Rule 23.1 analysis, Disney's exculpatory charter provision provides an independent basis for dismissal, as discussed below.

II. DISNEY'S EXCULPATORY CHARTER PROVISION MANDATES DISMISSAL.

Plaintiffs acknowledge the existence of Disney's exculpatory charter provision, and concede that Section 102(b)(7) "was enacted to exculpate directors from liability for monetary damages for duty of care violations but not breaches of the duty of loyalty or bad faith misconduct." (PAB 57).

A. Plaintiffs Have Not Alleged Facts to Establish Lack of Good Faith in the Decision to Approve the OEA or Grant a Non-Fault Termination.

As discussed above, plaintiffs have failed to allege particularized facts to support a finding that the Director Defendants failed to act in good faith with respect to the OEA or the decision to grant a Non-Fault Termination. Under those circumstances, even if the Court finds that demand was excused, liability has been eliminated pursuant to Article Eleventh. Ash v. McCall, Del. Ch., C.A. No. 17132, slip op. at 29 n.31, Chandler, C. (Sept. 15, 2000) (Court relied on the independent ground of an exculpatory charter provision to dismiss a claim that directors failed to heed "red flags" where the complaint "fail[ed] to allege adequately either pre-merger or post-merger bad faith or disloyalty"). See also Zirn v. VLI

Corp., Del. Supr., 681 A.2d 1050, 1061-62 (1996) (The Supreme Court found that directors had acted in "good faith" and were shielded from liability where the record showed they "lacked any pecuniary motive to mislead the VLI stockholders intentionally and no other plausible motive for deceiving the stockholders has been advanced.").

In support of their argument that Article Eleventh should not apply, plaintiffs cite the non-controlling decision of the Sixth Circuit Court of Appeals in McCall v. Scott, 250 F.3d 997 (6th Cir. 2001). The McCall court observed that the "[p]laintiffs' claims of reckless or intentional breach of the duty of care do not fit easily into the terminology of Delaware corporate law." Id. at 1000 (internal quotations omitted). In ruling that the exculpatory charter provision did not support dismissal, the McCall court reasoned that because the plaintiffs accused the directors "not merely of 'sustained inattention' to their management obligations, but rather of 'intentional ignorance of' and 'willful blindness' to 'red flags' signaling fraudulent practices throughout [the company]," plaintiffs had alleged "a conscious disregard of known risks, which conduct, if proven, cannot have been undertaken in good faith." Id. at 1001.

The high pleading hurdle set forth in McCall was discussed in the subsequent decision of Salsitz v. Nasser, 208 F.R.D. 589 (E.D. Mich. 2002). The Nasser court distinguished McCall, observing that in McCall, the plaintiffs had alleged facts

> demonstrating that the board must have been aware of the [wide-spread and systematic health care fraud by Columbia's hospitals, home health agencies, and other facilities], including (1) audit discrepancies between cost reports submitted to the government and secret reserve reports; (2) improper acquisition practices in which at least one of the directors personally was involved; (3) a qui tam action alleging a widespread strategy to engage in violations of federal law; and (4) an extensive criminal investigation that included raids on thirty-five Columbia facilities in six different states. . . . Given the McCall defendants' prior experience [as directors or managers of

> health care organizations that were acquired by Columbia], the [McCall] court was persuaded that the failure to react to the criminal investigation and other "red flags" created a strong inference of intentional or reckless disregard.

Id. at 598. Here, as in Nasser, there are no comparable "allegations of criminal or civil investigations that plainly put the Board on notice of illegal behavior," or even any allegations of "specific facts demonstrating 'a sustained or systematic failure of the board to exercise oversight–such as an utter failure to attempt to assure a reasonable information reporting system exists.'" Id. (quoting McCall, 250 F.3d at 999 (quoting In re Caremark Int'l Deriv. Litig., Del. Ch., 698 A.2d 959, 971 (1996))).

B. The Finalization of the OEA Is No Basis for Any Claim of Breach of the Duty of Loyalty.

As discussed above, the Supreme Court has already found that plaintiffs failed to state a claim for breach of the duty of loyalty based upon the facts asserted in the Amended Complaint. The Second Amended Complaint alleges no new facts regarding the duty of loyalty with respect to the members of the New and Old Boards (other than Eisner). Therefore, the exception contained in 8 Del. C. § 102(b)(7)(i) does not operate to deny them exculpation from liability.

With respect to plaintiffs' allegations that Eisner breached his duty of loyalty by colluding with Ovitz to grant him unwarranted benefits in the final terms of the OEA, they have not alleged facts to support that claim.[24] (DOB 18-20, 33-34). Indeed, plaintiffs do not

[24]Plaintiffs' arguments that the OEA was "backdated" (Compl. ¶ 51) and that Ovitz breached his duty of loyalty by entering into the contract while already a member of the board of directors are meritless. The materials terms of the contract were already agreed upon before Ovitz commenced his employment, and dating a contract "as of" a particular date is a routine corporate practice.

argue that the alleged collusion is a valid basis for avoiding exculpation of Eisner under Section 102(b)(7). Nonetheless, plaintiffs repeat their insufficient allegations. (PAB 20-22).

The summary terms of the OEA provided to the Compensation Committee on September 26, 1995 and October 16, 1995 defined a Non-Fault Termination as something that would arise in the event that Ovitz died, became disabled, or if "Disney 'wrongfully' terminated Ovitz's employment." (Compl. ¶ 54). Although plaintiffs inexplicably seek to bar the Court from reading the actual language of the summary term sheet, it is apparent from even that brief description that a "wrongful" termination in this context is a termination that is not for good cause.[25] The longer and more detailed OEA defines "good cause" as being "limited to gross negligence or malfeasance by Executive in the performance of his duties under this Agreement or the voluntary resignation by Executive prior to expiration of the Term." (Compl. Ex. A ¶ 11(a)(iii)). Nothing whatsoever is alleged to suggest that the definition of "good cause" in the OEA was changed in any fashion from the initial draft created by Disney prior to the first meeting of the Compensation Committee to the final version executed by the parties. Nor is the definition of "good cause" in the OEA remarkable in any way. Plaintiffs' allegations of collusion or concealment are wholly unsupported.

Nor is there any basis for the conclusory allegation that the stock options in the OEA "were materially more in-the-money than they were supposed to be." (Compl. ¶ 55). (emphasis in original). Plaintiffs allege that the first draft of the OEA contemplated that the

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[25]The pertinent section of the term sheet, which is certainly "integral" to the Second Amended Complaint in light of this claim and others, reads as follows: "In the event that Executive's employment is terminated in first five years by death or disability, or Company wrongfully terminates Executive's employment (a "Non-Fault Cause") . . . . In the event of termination for cause, all stock options will terminate three months after such termination with no further vesting after such date." (Friedlander Aff. Ex. E at DI 0037-38).

exercise price of Ovitz's stock options would be set as of October 2, 1995, the first trading day after the anticipated effective date of the OEA. (Compl. ¶ 56). Plaintiffs further allege that when the Compensation Committee met on October 16, 1995, it set the exercise price for the stock options at the then-market price "(which was roughly the same as that of October 2, 1995)." (Id.). The signed version of the OEA reflects that reality, by stating that the exercise price of the "A" options "shall be equal to the fair market value (determined in accordance with the applicable provisions of the Plan) of Company's common stock on the date of grant, which date shall be October 16, 1995." (Compl. Ex. A ¶ 5(a)). Those events are internally consistent and do not suggest any form of collusion or advantage to Ovitz.

Plaintiffs' argument is based on a hypothetical that has absolutely no basis in fact. Plaintiffs argue that because the OEA was not actually signed until December 12, 1995, "Ovitz could have insisted that Disney reduce the exercise price to a lower figure" if the price of Disney stock had dropped between October 16 and December 12. (PAB 21). Plaintiffs offer no support for that assertion and there is none. The fact is that Ovitz began work on October 1, 1995, and the exercise price of the stock options was set by the Compensation Committee on October 16, 1995. (Compl. ¶¶ 51, 56). Plaintiffs do not explain how either Ovitz or Disney had any right under any body of law to undo history and demand that the exercise price of the stock options be reset as of the arbitrary date on which the OEA happened to be executed. Needless to say, plaintiffs do not cite any actual documents or events evidencing that "Eisner enabled Ovitz to play a win-win game at Disney's expense." (PAB 22). Once again, plaintiffs have failed to allege facts showing disloyalty.

With respect to plaintiffs' suggestion that Eisner breached his duty of loyalty in connection with the grant of the Non-Fault Termination, that argument lacks merit, as discussed above.

C. **Article Eleventh Eliminates Any Liability for Breach of the Duty of Care.**

As discussed above, the existence of an exculpatory charter provision adopted pursuant to Section 102(b)(7) renders irrelevant allegations that the Director Defendants breached their duty of care. Under those circumstances, therefore, the Court should dismiss the Second Amended Complaint.

CONCLUSION

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

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