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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

PLAINTIFFS' ANSWERING BRIEF IN OPPOSITION TO THE WALT DISNEY COMPANY'S AND THE DIRECTOR DEFENDANTS' MOTION TO DISMISS

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Plaintiffs submit this brief in opposition to the motion of defendants The Walt Disney Company ("Disney" or the "Company") and the Director Defendants to dismiss plaintiffs' Second Amended Consolidated Derivative Complaint (the "Complaint") pursuant to Court of Chancery Rules 12(b)(6) and 23.1.[1]

INTRODUCTION

The Complaint alleges that defendants violated their fiduciary duties by acting recklessly and in bad faith and without obtaining all requisite material information reasonably available in (1) approving an employment agreement with defendant Ovitz (the "OEA") and then (2) passively supporting the dealings of Disney's Chief Executive Officer with Ovitz regarding his "Non-Fault Termination." The Complaint seeks recission and/or damages from defendants and Ovitz to recoup all damages sustained by Disney and disgorgement of Ovitz's unjust profits, plus interest.

The Complaint is much different in several, critical respects from the pleading this Court previously dismissed on October 7, 1998. In re The Walt Disney Co. Deriv. Litig., 731 A.2d 342 (Del. Ch. 1998). Following the Supreme Court's decision in Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (en banc), plaintiffs unearthed documents heretofore unknown to them, and in defendants' sole possession, pursuant to a §220 demand for books and records. These newly discovered facts negate key factual assumptions and arguments defendants previously urged upon

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[1]Disney and the Individual Defendants (excluding defendant Michael S. Ovitz ("Ovitz")) are hereinafter referred to as "defendants." Defendants' Opening Brief is hereinafter cited as "Def. Br."

this Court and the Supreme Court and now establish the exact claims the Supreme Court determined would be actionable and sufficient to excuse demand.[2]

Defendants previously asserted that the Disney Board of Directors at the time of Ovitz's hiring (hereinafter the "Old Board") properly considered and approved the OEA in consultation with Graef Crystal ("Crystal"), an executive compensation expert. Defendants claimed that Ovitz signed the OEA on October 1, 1995, the same day Ovitz began working for Disney. Defendants also argued that Disney's Board of Directors at the time of Ovitz's severance fourteen months later (hereinafter the "New Board") retained the sole, ultimate authority to grant Ovitz a Non-Fault Termination (as defined in the OEA) and had duly considered the issue (and all other alternatives) before making that decision.

The Supreme Court found that plaintiffs had not established that the Old Board had violated its fiduciary duties or committed waste in approving the OEA because it assumed, at defendants' urging, that the Old Board relied on Crystal for advice and, for that reason, had made an informed business decision to approve the OEA. Id. at 261. Nonetheless, the Supreme Court gave plaintiffs leave to amend their complaint to adduce facts sufficient to rebut defendants' reliance on 8 Del. C. §141(e), including facts showing that Crystal did not advise the Old Board. Id. at 262. The Supreme Court also ruled that the New Board had not violated its fiduciary duties or committed waste in approving Ovitz's Non-Fault Termination because it assumed that the New Board had considered the Non-Fault Termination, as well as other alternatives, and had

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[2]The Supreme Court reviewed this Court's decision de novo, thereby superceding this Court's findings. Id. at 254.

reached an informed decision when it purposefully decided to grant Ovitz a full $140 million severance payout. Id. at 266. Again, the Supreme Court gave plaintiffs leave to amend their pleading regarding the New Board's claimed decision to approve the Non-Fault Termination payout. Id.

Despite these findings, the Supreme Court still noted that "this is potentially a very troubling case on the merits," finding that even the facts as previously alleged indicated that "the processes of the boards of directors in dealing with the approval and termination of the [OEA] were casual, if not sloppy and perfunctory." Id. at 249. Indeed, the Court characterized this action, in its previous iteration, as a "close case." Id. In a separate concurring opinion, Justice Hartnett expressed his view that plaintiffs had stated claims, among others, as to whether "Ovitz had actually resigned before he struck his termination deal." Id. at 268 (Hartnett, J., concurring). Ultimately, given the "unusual nature" of this case, even as then pled, the Supreme Court granted plaintiffs leave to amend their complaint with the aid of discovery through the "tools at hand" by making a books and records demand under 8 Del. C. § 220. Id. at 266-67.

The new facts plaintiffs have unearthed through their § 220 document demand overwhelmingly tip this already "close case" in plaintiffs' favor and are more than sufficient to state valid claims for relief and excuse demand under both "prongs" of the formula set out in Aronson v. Lewis, 473 A.2d 805 (Del. 1984). As alleged in the Complaint, defendant Eisner, Disney's CEO, unilaterally decided to hire his dear friend Ovitz and, without the Old Board's oversight, negotiated and finalized the terms of the OEA with Ovitz after Ovitz became Disney's President. Neither Crystal nor any other expert or consultant ever advised the Old Board or its

Compensation Committee. Before hiring Ovitz, the Old Board, in dereliction of its fiduciary duties, never: (1) reviewed any version of the OEA; (2) heard or reviewed any report, study, opinion or recommendation about the OEA; or (3) deliberated about the OEA at all.

Thereafter, when Ovitz's abbreviated tenure at Disney drew to its inevitable end, Eisner unilaterally negotiated a Non-Fault Termination with Ovitz without consulting or informing the New Board. The New Board affirmatively abdicated its sole and express authority over the Non-Fault Termination decision: The New Board never: (1) consulted with Crystal or any other expert or consultant; (2) reviewed any report, study, opinion or recommendation about Ovitz's severance; (3) considered any alternatives to a full Non-Fault Termination payout to Ovitz, including firing Ovitz for cause; or (4) otherwise considered the costs and consequences of Non-Fault Termination. In fact, shockingly, the New Board never even convened a meeting to address the matter.

As discussed herein, all of these facts demonstrate that defendants patently violated their fiduciary duties. The Old Board failed to consider that the OEA irrationally provided Ovitz with severance compensation in the event of a Non-Fault Termination that was at least as valuable, if not more so, than if he remained in Disney's employ throughout his term. The Old Board could have detected this fundamental flaw in the OEA with minimal diligence including a comparative assessment of the magnitude of the benefits provided to Ovitz in the event of a Non-Fault Termination as compared to full-term service. Accordingly, the Old Board acted in an uninformed manner and approved a wasteful contract, with perverse and counter-productive effects on Ovitz's performance, lacking adequate safeguards to secure his full, five-year term of

employment. Such scrutiny was particularly mandated under the circumstances given the admitted importance of Ovitz's hiring by Disney.

Toward the end of Ovitz's brief employment by Disney, the New Board abdicated its fiduciary duties to review and decide whether to grant Ovitz a Non-Fault Termination. Instead, the entire matter was left to Ovitz and Eisner to work out in concert. At the time, the New Board was obligated to consider whether to elect alternatives to a Non-Fault Termination; i.e., a termination for cause or to cause Ovitz to submit his resignation and receive no benefits. Choosing among these alternatives invoked the New Board's business judgment, and the task could not be delegated to a single corporate officer -- especially Eisner, who had a well-known, longstanding friendship with Ovitz. However, the New Board never exercised any business judgments about the Non-Fault Termination at all. Despite the huge costs to Disney and the requirement that it be involved in the process, the New Board, without investigation, deliberation or even discussion, chose to go along with Eisner's decision to accommodate Ovitz by affording him the full benefits of a Non-Fault Termination.

Forced to confront the truth, defendants ignore the four corners of the Complaint and have invented their own self-serving version of events from documents extrinsic to the Complaint. This tactic violates the rule in Delaware prohibiting consideration of extrinsic documents for evidentiary purposes in support of a dismissal motion and is, therefore, subject to plaintiffs' separate motion to strike the documents. See In re New Valley Corporation Derivative

Litig., 2001 WL 50212 at *5-6 (Del. Ch.).[3] Defendants' reliance on these extrinsic documents, produced from their own files, is particularly inappropriate and troubling because the contents of these documents frequently clash with defendants' prior representations to this Court and the Supreme Court.

The Complaint asserts valid causes of action sufficient to excuse demand in compliance with the Supreme Court's guidance in Brehm. Accordingly, plaintiffs respectfully request the Court to deny defendants' motion in its entirety.

NATURE AND STAGE OF THE PROCEEDINGS

A. Defendants' Prior Representations

Plaintiffs commenced this action on January 7, 1997. On May 28, 1997, plaintiffs filed their Amended Stockholders' Derivative And Class Action Complaint ("First Amended Complaint"). On June 11, 1997, defendants moved to dismiss the First Amended Complaint. Throughout the course of the proceedings before this Court, and eventually the Supreme Court, defendants, ostensibly building on the allegations in the First Amended Complaint, proferred their own version of the facts and aggressively used it to support their dismissal motion. The principal factual positions to which they then committed themselves include the following:

- **Consideration And Ratification Of The OEA:**

  "The determination as to whether a high-powered executive should be hired at a high price was a classic decision within the business judgment of the Board." Def. Ch. Ct. Br. at 22.

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[3]Plaintiffs' brief in support of their motion to strike is hereinafter referred to as "Pls. Motion To Strike Br." with all its contents incorporated herein.

"The manner in which an incentive should have been structured [for Ovitz in the OEA] was a business judgment for the Board. Here, the Board exercised its business judgment to structure the incentive in the form of stock options that Ovitz would receive if he stayed at Disney or if he was granted a Non-Fault Termination by the Board." Individual Defendants' Supr. Ct. Br. at 26-27.

"The Board -- which included a majority of independent directors as independence has traditionally been understood -- approved the [OEA]." Id. at 5.

- **Board Retention Of An Expert:**

"It speaks volumes that Mr. Crystal – the executive compensation expert whom the Board consulted regarding the Employment Agreement and whose expertise plaintiffs acknowledge – did not find it necessary at the time to quantify the potential cost of an early, not-for-cause termination." Def. Ch. Ct. Br. at 19.

"In connection with the consideration of the terms of the [OEA], the Board members obtained advice from Graef Crystal, a compensation consultant." Individual Defendants' Supr. Ct. Br. at 5

- **Ovitz Signed The OEA Before He Began Working For Disney:**

"At the time Mr. Ovitz entered into that contract, he was not an employee of Disney. He owed no fiduciary or other duties to Disney. Accordingly, plaintiff is quite correct in not pleading that Mr. Ovitz can in any way be held like [sic] liable for anything having to do with the entry into the employment contract. I wish plaintiff had been equally careful with regard to the remainder of his complaint." Supr. Ct. Oral Argument Tr. at 30-31.

- **Board's Exclusive Authority To Grant A Non-Fault Termination:**

"[T]he Board controlled whether Ovitz received a Non-Fault Termination, which is the only relevant fact. . ." Individual Defendants' Supr. Ct. Br. at 9.

"As the Court of Chancery found, the terms of the [OEA] gave the Board alone the power to determine whether a Non-Fault Termination had taken place and, accordingly, if the options would be exercisable." Id. at 27.

"Which option to pursue [fire Ovitz for cause or without cause, sue for breach of contract or allow him to continue serving as Disney's President] was solely within the province of the Board's business judgment." Individual Defendants' Supr. Ct. Br. at 32. (emphasis added).

"There is no way, short of Mr. Ovitz's death, that Mr. Ovitz could part with all of the termination benefits unless the board of directors of Disney acted affirmatively. There had to be an affirmative action by the board of directors to enable Mr. Ovitz to depart with all of the benefits." Compl. ¶90 (quoting Del. Supr. Ct. Oral Arg. at 24) (emphasis in complaint).

- **The New Board's Decision To Grant Ovitz A Non-Fault Termination:**

"The decision to honor the Company's contractual commitments to Mr. Ovitz falls well within the reasonable discretion of directors exercising their business judgment. Indeed, it is hard to see an argument that they properly could have reached any other decision." Def. Ch. Ct. Br. at 22-23.

"On December 27, 1996, Sanford M. Litvack, Disney's chief legal officer at the time, sent a termination letter to Ovitz which stated that his termination would be treated as a Non-Fault Termination. This determination had been reached by the Board." Individual Defendants' Supr. Ct. Br. at 7 (citations omitted).

"The Grant of a Non-Fault Termination Was a Business Judgment of the Board." Individual Defendants' Supr. Ct. Br. at 31.

As discussed in detail below, defendants have now abandoned these positions. The facts plaintiffs uncovered through their books and records demand and alleged in the Complaint demonstrate that what actually occurred is almost totally at variance with defendants' account of the events. What remains relevant, however, is that the prior positions to which defendants committed themselves, as set forth above, were necessary and indispensable to this Court's and the Supreme Court's determination that the First Amended Complaint failed to state a claim. Those underpinnings are no longer available to defendants. Plaintiffs have demonstrated in the post-remand Complaint that the Disney Board's conduct both in approving the OEA and then allowing Ovitz to receive the full benefits of a Non-Fault Termination are not entitled to any protection under the business judgment rule or the presumptions of regularity which the rule sanctions.

B. This Court's Dismissal Of The First Amended Complaint

This Court granted defendants' dismissal motion based upon defendants' version of the facts as discussed above. In re The Walt Disney Co. Deriv. Litig., 731 A.2d 342, 362 (Del. Ch. 1998). Plaintiffs had alleged that Crystal failed to perform a spread-sheet analysis of the possible payouts to Ovitz in the case of a Non-Fault Termination at different time intervals during the OEA's five-year term. This Court, however, assumed it was possible that the Old Board did consider the various payout scenarios even if Crystal had not done so, and in any event, Crystal's failure to perform a spread-sheet analysis reflected his thinking at the time that such an analysis was not necessary. Id. at 361-62. Thus, this Court concluded:

> Because the Board's reliance on Crystal and his decision not to fully calculate the amount of severance lack "egregiousness," this is not that rare case. I think it a correct statement of law that the duty of care is still fulfilled even if a Board does not know the exact amount of a severance payout but nonetheless is fully informed about the manner in which such a payout would be calculated.

Id. at 362 (emphasis added).

In granting defendants' motion, this Court ruled that "[a] board is not required to be informed of every fact, but rather is required to be reasonably informed" and thus plaintiffs had failed to raise "a reasonable doubt" that the Old Board was reasonably informed about the OEA before approving it. Id. This Court also found that the Complaint did not state a claim of waste against the Old Board because this Court assumed that the Old Board had exercised a business judgment in structuring the terms of the OEA and the compensation Ovitz was to be paid. Id. ("Here the former Board determined that in order to attract Ovitz to Disney, Disney would have to offer him a highly attractive compensation package").

Similarly, this Court dismissed plaintiffs' claims against the New Board in connection with Ovitz' Non-Fault Termination based on the assumption that it actually made that decision. Id. at 363 ("[T]he board elected to grant Ovitz a Non-Fault Termination"). The Court assumed that "[s]ometime during Ovitz's tenure at Disney, the current board determined that it would not be in Disney's best interest for Ovitz to remain as Disney's president." Id. The Court understood that the New Board had "several options in deciding how to handle" Ovitz including: (1) doing nothing; (2) terminating him for cause; (3) suing Ovitz for breach of contract; or (4) granting him a Non-Fault Termination. Id. at 364. The Court held that:

> The Board made a business decision to grant Ovitz a Non-Fault Termination. Plaintiffs may disagree with the Board's judgment as to how this matter should have been handled. But where, as here, there is no reasonable doubt as to the disinterest of or absence of fraud by the Board, mere disagreement cannot serve as the grounds for imposing liability based on alleged breaches of fiduciary duty and waste. There is no allegation that the Board did not consider the pertinent issues surrounding Ovitz's termination.

Id. (Emphasis added).

C. The Supreme Court's Decision On Appeal

Plaintiffs appealed this Court's judgment. The Supreme Court affirmed in part and reversed in part. Brehm v. Eisner, 746 A.2d 244, 249 (Del. 2000) (en banc). The Supreme Court characterized plaintiffs' prior complaint as pleading "potentially a very troubling case on the merits," noting that it was (as of then) "a close case" with respect to "the processes of the two Boards, and the waste test. . . ." Id. at 249. The Supreme Court especially noted:

> [T]he processes of the boards of directors in dealing with the approval and termination of the Ovitz Employment Agreement were casual, if not sloppy and perfunctory . . . . [T]he processes of the Old Board and the New Board were hardly paradigms of good corporate governance practices. Moreover, the sheer

> size of the payout to Ovitz, as alleged, pushes the envelope of judicial respect for the business judgment of directors in making compensation decisions.

Id. at 249. In fact, Justice Hartnett opined in a separate concurring opinion that the First Amended Complaint stated valid claims including, among other things, whether "Ovitz had actually resigned before he struck his termination deal." Id. at 268 (Hartnett, J., concurring).[4]

Applying a de novo standard of review (Id. at 253-54), the Supreme Court disagreed with this Court's reasoning that the calculation of various payout scenarios to Ovitz in a Non-Fault Termination was either immaterial to Crystal, or that the Old Board may have done the calculations itself even though Crystal did not do so. Id. at 261. The Supreme Court understood that the "economic exposure of the corporation to the payout scenarios of the Ovitz contract was

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[4]Justice Hartnett disagreed with the Supreme Court's decision to reject plaintiffs' contention that Ovitz had actually resigned from Disney in violation of the OEA and therefore was not entitled to any compensation, making the payments to him waste. Brehm, 746 A.2d at 268; see Compl. Exh. A at 11 (DI 0212) (Disney could terminate Ovitz for "good cause" in the event, among other things, of his "voluntary resignation"). Going beyond the complaint during oral argument, Ovitz's counsel stated: "Nor did Mr. Ovitz ever use the term 'resign.' Nor can there be any reasonable basis to believe that he did formally resign." Supr. Ct. Tr. at 32. Nonetheless, Justice Hartnett opined that the complaint had alleged sufficient facts to create a reasonable doubt as to whether "Ovitz had actually resigned before he struck his termination deal." Id. at 268 (Hartnett, J., concurring). Justice Hartnett's expressed reluctance to apply a "too-high standard of pleading" to facts "not [in the] public knowledge" proved prescient despite Ovitz's counsel's contrary admonitions . Id. Now, years later, and speaking freely, Ovitz is quoted in a major article which appeared in the August 2002 edition of Vanity Fair, based on the author's interviews of Ovitz, that "[Ovitz] resigned from Disney and went home to his family, unemployed but with a severance package valued at about $140 million." [Emphasis added.] Ovitz Agonistes, Brian Burrough, Vanity Fair, Aug. 2002, at 172. Ovitz is quoted as stating, "'I decided to retire,' . . . 'I'm devoted to my family. I've been working since I was nine years old. I'd just turned 50. Judy [Ovitz's wife] said, 'this is ridiculous – let's just retire and goof off.'" [Emphasis added.] Id. Although plaintiffs elected not to attempt to replead the resignation issue after remand, plaintiffs reserve the right to seek discovery on this issue in the event the Complaint is sustained, given Ovitz's activities with respect to the Non-Fault Termination detailed supra. See Delaware Uniform Rules of Evidence 801(d)(2).

material, particularly given its large size . . . ," and therefore important to the directors' deliberative process. Id. at 259. The Supreme Court also held that such information was reasonably available to the Old Board. Id. at 260.

The Supreme Court concluded, however, that this Court's findings about the Old Board's deliberations constituted "harmless error" because the Supreme Court had assumed that Crystal "was the Board's expert ex ante for purposes of advising the directors" about the OEA. Id. at 261-62. The Supreme Court also assumed that the Old Board had exercised business judgment in deciding to offer Ovitz a very lucrative pay package to induce him to work for Disney (Id. at 263) and had considered the terms of the OEA with Crystal's advice before approving it. Id. at 260-64.

The Supreme Court went on to say that the ultimate "question here is whether the directors are to be 'fully protected' (i.e. not held liable) on the basis that they relied in good faith on a qualified expert under Section 141(e) of the Delaware General Corporation Law." Id. at 261 (emphasis added). The Supreme Court stated that "[t]he Old Board is entitled to the presumption that it exercised proper business judgment, including proper reliance on the expert." Id. at 261. It held, however, that a subsequent pleading could survive a Rule 23.1 dismissal motion if it alleged facts that met any of several tests necessary to rebut application of Section 141(e) including, among others, that "the directors did not in fact rely on the expert." Id. at 262. Hence, the Supreme Court's affirmance of the dismissal was without prejudice.

Turning to plaintiffs' waste allegations (without invoking the well-settled tests for assessing waste claims in the context of option grants like those provided in the OEA), the

Supreme Court observed that the question whether the Old Board had committed waste in approving the OEA turned on whether "there [was] any substantial consideration received by the corporation, and if there [was] a good faith judgment that in the circumstances the transaction is worthwhile . . . ." Id. at 263 (citation omitted) (emphasis added). The Supreme Court rejected plaintiffs' waste claims based on its assumption that the Old Board had made such a business judgment in good faith. Id. However, the Supreme Court did "not foreclose the possibility that a properly framed complaint could pass muster." Id. at 263.

The Supreme Court also determined, as did this Court, that plaintiffs' claims against the New Board for its conduct in connection with Ovitz's Non-Fault Termination were not actionable based on its assumption that the New Board had actually deliberated and considered the issue. The Supreme Court held:

> But 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. We agree with the Court of Chancery: "The Board made a business decision to grant Ovitz a Non-Fault Termination. . . . There is no allegation that the Board did not consider the pertinent issues surrounding Ovitz's termination."

Id. at 266 (quoting In re The Walt Disney Co. Deriv. Litig., 731 A.2d at 364) (emphasis added). Nonetheless, the Supreme Court gave plaintiffs "another opportunity" to replead and allege "particularized facts creating a reasonable doubt that the New Board's decision regarding the Ovitz non-fault termination was protected by the business judgment rule." Id.

D. Plaintiffs' Post-Remand Discovery Efforts

In accord with the Supreme Court's directive concerning a §220 demand (id. at 266-67), on March 1, 2000, plaintiffs made a demand on Disney to produce documents relevant to this action. Thereafter, following negotiations between the parties, Disney produced responsive documents. These documents included highly material information which demonstrate that the core factual assumptions defendants had trumpeted to this Court and the Supreme Court in support of their dismissal motion were not accurate and that the facts more directly supported plaintiffs' contention that the Disney Board had failed to exercise requisite business judgment, viz: (1) the Old Board neither retained an expert nor received expert advice regarding the OEA; (2) the Old Board never considered, reviewed or discussed the OEA before deciding to hire Ovitz; (3) the OEA was executed after Disney hired Ovitz and then backdated; and (4) the New Board never considered, reviewed or discussed the Non-Fault Termination before Disney gave Ovitz a $140 million severance payout.

Plaintiffs filed the Complaint on January 3, 2002, which, as discussed below, included these (and other) newly uncovered facts. Defendants moved to dismiss the Complaint on January 17, 2002 and filed their opening brief on April 19, 2002. This is plaintiffs' brief in opposition to defendants' dismissal arguments, which Ovitz has joined.

COUNTER-STATEMENT OF FACTS[5]

A. The Old Board Did Not Recruit Ovitz Or Exercise Any Oversight Over The Negotiation Of His Compensation

Eisner handled Ovitz's hiring and all negotiations over his compensation without the involvement of the Old Board or its Compensation Committee. Compl. ¶ 30.[6] Eisner made the decision to recruit and hire Ovitz as Disney's President following the departure of several high-level Disney executives. Compl. ¶¶ 27, 30. On or about August 13, 1995, during a discussion at his home, Eisner informed three of the fifteen Old Board members, defendants Bollenbach, Litvack and Russell, that he had already decided to hire Ovitz. Compl. ¶ 30.

Up until that time, neither the Old Board nor the Compensation Committee had considered or discussed Ovitz as a candidate for the President's post. Compl. ¶ 31. In fact, demonstrating how far the negotiations had proceeded without the Old Board or the Compensation Committee, on or about the day after the August 13, 1995 meeting at his home, Eisner sent Ovitz a letter memorializing material terms of the OEA. Id. However, Eisner's letter

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[5]This Court must disregard defendants' improper reliance on the truth of purported facts and inferences arising from documents extrinsic to the Complaint, produced pursuant to plaintiffs' §220 demand, to propound a purported "Statement of Facts" at extreme variance with the facts specifically alleged in the Complaint. Plaintiffs incorporate herein the arguments set forth in their separate motion to strike these documents and to direct defendants to file a revised brief deleting all references thereto.

[6]The Old Board consisted of defendants Eisner, Stephen F. Bollenbach ("Bollenbach"), Sanford M. Litvack ("Litvack"), Irwin Russell ("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.

confirmed that Disney could not formally hire Ovitz (and thus ratify the OEA), without the approval of the Compensation Committee and the Old Board. Compl. ¶ 32.

B. Disney's Compensation Committee Failed To Adequately Assess The OEA

Disney's Compensation Committee waited until September 26, 1995 to address Ovitz's employment -- over a month after Eisner sent his letter to Ovitz setting out the terms of his employment agreement. Compl. ¶ 36. At that time, the Compensation Committee consisted of defendants Lozano, Poitier, Watson and Russell, the latter of whom also served as its Chairman. Id. In violation of their fiduciary duties, the members of the Compensation Committee did not consider the impact of the OEA and its Non-Fault Termination clause on Disney at all.

The Compensation Committee did not receive any materials in advance of or during the meeting -- whether in the form of a spreadsheet, tables, a list of estimates, or any other form -- that described the magnitude of possible pay-outs that Ovitz would receive in the event of a Non-Fault Termination at any time during his tenure with Disney. Compl. ¶ 42.[7] Accordingly, the Compensation Committee did not possess the most general sense or notion of the amount of compensation Ovitz would receive in the event of a Non-Fault Termination -- much less any

[7]Thus, among other things, the Compensation Committee never learned about an internal Disney document created on or about July 7, 1995, which raised concerns about the huge number of options that were being negotiated for Ovitz: "[n]umber of stock options is far beyond standards applied in Company [sic] and in corporate America and will raise very strong criticism. We should collect survey information to be prepared to answer if it becomes necessary. [Emphasis added]." Compl. ¶ 33.

precise or even estimated quantification of the value of the severance package that Ovitz would receive under a variety of scenarios that could come into play. Id.

The Compensation Committee meeting lasted approximately one hour. Compl. ¶ 37.[8] Consideration of the decision to hire Ovitz was one of three agenda items for discussion at the meeting, which included the award of $250,000 to Russell in connection with Ovitz's hiring. Id. at ¶ 37. The Compensation Committee devoted far more of its attention to the other agenda items and focused as little as ten minutes on the subject of Ovitz's employment. Id.

During its meeting, the Compensation Committee did not review a draft of the OEA, even though Disney personnel had transmitted to Ovitz's attorneys a draft dated September 23, 1995. Compl. ¶ 40. Instead, the Compensation Committee reviewed an incomplete summary of the OEA's terms, which among other things, failed to include the exercise price of the options

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[8]Plaintiffs have not "presumed" that the Compensation Committee meeting lasted, at most, one hour, as defendants claim. Def. Br. at 16 n.7. To the extent the Court considers the contents of board minutes not cited in the Complaint, in derogation of the rule prohibiting such reference on a motion to dismiss (see Pls. Mt. to Strike Br.), it should note that the Compensation Committee meeting commenced at 9:00 a.m. (DI 0032) and the full Old Board meeting started at 10:00 a.m. (DI 0040); Compl. ¶ 37. Contrary to defendants' contention, the Court cannot assume that the Compensation Committee spent any more time discussing the OEA than the other two subjects the Committee also considered. Compl. ¶ 37. Thus, assuming no breaks, the Committee spent a maximum of 20 minutes on the OEA. Based upon the correlation between the number of pages and lines of the minutes devoted to each of the three topics on the agenda, it is reasonable to conclude that the Compensation Committee only spent ten minutes on the OEA. Compl. ¶¶ 37-38. In all events, there is no possible way for this Court to conclude, as a matter of law, that during its truncated and hasty meeting, the Compensation Committee accomplished all of the things defendants have assumed: (1) reviewed the two and a half pages of the OEA's summary terms and understood them fully; (2) listened to Russell's purported presentation and engaged in a "discussion;" (3) performed the calculations necessary to understand how much Disney would owe Ovitz if he received a Non-Fault Termination at different stages of his tenure; and (4) discussed and reached definitive conclusions about the OEA.

included in the OEA. Compl. ¶ 41. The Compensation Committee did not receive any other written materials either at or before its meeting. Compl. ¶ 42.

Moreover, neither the Compensation Committee nor the Old Board retained Crystal or any other consultant or expert to advise the directors about the OEA. Compl. ¶ 45. Consequently, Crystal did not attend the Compensation Committee's meeting (or any other relevant Compensation Committee or Board meeting), and did not prepare a written analysis, report or opinion concerning the OEA for distribution to the Compensation Committee or the Old Board. Id. Thus, the Compensation Committee did not possess the material information needed (and reasonably available to it) to determine (i) whether the OEA contained adequate safeguards to secure Ovitz's future services and (ii) the financial consequences of a Non-Fault Termination. This failure was particularly egregious because Crystal had previously warned Russell -- the Compensation Committee Chairman -- that Disney should avoid paying a "large signing bonus" because the "deficiencies of this approach 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" -- a defect similar to the flaws plaintiffs allege infected the Non-Fault Termination provisions of the OEA. See Compl. ¶ 35.[9] The Compensation Committee adopted a

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[9]Defendants' reliance on Crystal's August 12, 1995 letter to establish (by inference) Russell's purported diligence is improper (see Pls. Mt. To Strike Br. at 11-12), and in all events creates the opposite inference. First, the letter nowhere refers to Ovitz by name, does not address the issue of Non-Fault Termination at all, and reflects other potential terms which were never incorporated into the OEA. DI 0388-DI 0391. Second, the letter does not express any opinion or recommendation but merely reflects Crystal's general thoughts on compensation issues. Third, Crystal's letter makes clear that, after analyzing the top 900 corporations in terms of market capitalization, "there really is no precedent for offering a non-CEO the sum of $25 million per year [his estimate of the expected value of Ovitz's compensation package]" and that only one

resolution approving the general terms and conditions of the OEA and gave Eisner the authority to continue the negotiations and finalize the OEA. Compl. ¶ 46.

C. The Old Board Did Not Consider The OEA At All

The Old Board convened immediately after the Compensation Committee's September 26, 1995 meeting adjourned. Compl. ¶ 47. Despite the fact -- as defendants argued in the opening phase of this litigation -- that it was charged with the duty to approve the terms of Ovitz's hiring -- a fact also confirmed in Eisner's August 12, 1995 letter to Ovitz (Compl. ¶ 32) -- the Old Board failed to consider the OEA at all. Neither Crystal nor any other compensation expert or consultant attended the meeting. Neither the Compensation Committee nor any of its members made a presentation or recommendation to the Old Board about the OEA. Compl. ¶ 49. The Old Board did not receive any materials about the OEA, including any draft or summary of the OEA. Nonetheless, without the OEA having been executed at that time, or knowing how Ovitz would be compensated in the event of a Non-Fault Termination, the Old Board approved Disney's hiring of Ovitz effective immediately. Compl. ¶ 50.[10]

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executive, Sandy Weill of the Travelers, who earned $35.9 million, could provide public relations "fighter cover." DI 0390. Thus, if anything, Crystal's letter highlights the importance of devoting substantial time and diligence to the issue of Ovitz's compensation -- a task the Compensation Committee passed on, in an uninformed manner, for only ten minutes at one meeting and the Old Board completely ignored. In all events, Crystal's involvement, at most, was peripheral and informal because, from the content of his letter, it appears as though Crystal was retained to consider Eisner's compensation. Whatever Crystal's role, neither his letter nor any other of defendants' extrinsic documents indicate that Russell told the Compensation Committee or the Old Board that he had even communicated with Crystal.

[10]If the Court considers the contents of Disney's Board minutes as defendants urge in violation of settled precedents of this Court (see Pl. Mt. To Strike Br., citing New Valley, among other authorities), then it should also consider the fact that the Compensation Committee minutes

D. Ovitz and Eisner Finalize the OEA Without The Old Board's Oversight

Ovitz began serving as Disney's President on October 1, 1995 but, after continuing negotiations (Compl. ¶52), Ovitz executed the OEA in his capacity as a Disney "Executive" many weeks later on December 12, 1995. The OEA, was backdated to October 1, 1995 and there is no way from the face of the OEA to discern that it had been executed months later. Compl. ¶ 52; see Compl. Exh. A.[11] During this interim period, Eisner and Ovitz continued to negotiate the terms of the OEA without the Old Board's input or consultation. The upshot was that the final version of the OEA proved to be substantially more favorable to Ovitz than the summary terms reviewed by the Compensation Committee. Compl. ¶ 53.

The OEA summary terms presented to the Compensation Committee on September 26, 1995 defined a Non-Fault Termination as Disney's "wrongful" termination of Ovitz's employment (or that Ovitz died or became disabled). Compl. ¶ 54. The same definition was included in the OEA summary terms and conditions presented to the Compensation Committee during its October 16, 1995 meeting. However, the OEA Ovitz executed on December 12, 1995 provided a broader, less precise definition of Non-Fault Termination which would give him

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of its September 26, 1995 meeting seem to indicate that either it or the Old Board had to specifically approve the OEA terms before hiring Ovitz. Under the heading "Action To Be Taken," the minutes recite: "Discussion only. Options and agreement will be approved when finalized by Unanimous Written Consent, expected to be effective October 2, 1995." DI 0039. However, neither the Compensation Committee nor the Old Board ever did so.

[11]The Complaint alleges the exchange of five drafts of the OEA between October 1, 1995 and December 12, 1995. Compl. ¶ 52. The Stock Option Agreement to accompany the OEA was not executed until November 15, 1996, at which time Ovitz was already in discussions with Eisner about leaving the Company! Compl. ¶ 53.

massive benefits as long as he did not engage in misconduct defined as "gross negligence" or "malfeasance." Id.[12]

Eisner also favored Ovitz by causing Disney to grant Ovitz options that were materially more "in-the-money" than they were supposed to be. Compl. ¶ 55. The OEA draft dated September 23, 1995 contemplated that Disney would set the price of Ovitz's "A" options (as described below) as of October 2, 1995 -- the first trading day after Ovitz began to work at Disney (also presumably after executing the OEA). Compl. ¶ 56. Thereafter, at its meeting held on October 16, 1995, the Compensation Committee set the exercise price of Ovitz's A options as of that date to an exercise price that was roughly the same as it was on October 2, 1995. Id. The parties waited until December 12, 1995 to execute the OEA but did not then also change the exercise price from the original reference date of October 16, 1995 to December 12, 1995.

By waiting until December 1995 to execute the OEA, Ovitz knew through 20-20 hindsight that the A options priced on October 16th were "in-the-money." Because he had not yet signed the OEA, had the market price of Disney's shares declined during the period between October 16th and December 12th, Ovitz could have insisted that Disney reduce the exercise price to a lower figure. Such a move proved unnecessary because the market price of Disney's shares

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[12]Defendants attempt to disprove this allegation by citing the September 23, 1995 draft version of the OEA, which like the final version, defined Non-Fault Termination to mean termination for reasons other than Ovitz's "gross negligence" or "malfeasance." Def. Br. at 33. To the extent the Court permits defendants to use a document extrinsic to the Complaint for its purported truth, plaintiffs are entitled to the inference that a comparison of the September 23, 1995 draft to the OEA summary term sheet (Compl. ¶ 54) demonstrates that the Compensation Committee was misinformed and violated its fiduciary duties by endorsing the wrong definition of Non-Fault Termination -- a critical term of the OEA.

rose during the relevant period to the extent that when he signed the OEA, Ovitz's A options were already worth $5.125 per option. Compl. ¶ 55. Thus, by waiting until December to execute the OEA and then backdating it, Eisner enabled Ovitz to play a win-win game at Disney's expense - - if the market had fallen between October 16th and December 12th, Ovitz had the freedom to demand a downward adjustment to the exercise price of his options, if the market moved up during that same period, as it did, Ovitz would receive "in-the-money" options. Compl. ¶ 58.

The Compensation Committee met on October 16, 1995, more than two weeks after Ovitz began serving as Disney's President, but like its first meeting, failed to exercise even the most minimal due diligence regarding the OEA. Compl. ¶ 50. The Compensation Committee did not review any documentation except a substantially similar summary of the terms it had reviewed at the September 26, 1995 meeting. Id.[13] As was the case at the September meeting, the Compensation Committee did not receive or review any report, advice or recommendation from any expert (or anyone else) regarding the OEA and was not called upon to review the decision to hire Ovitz. Id.

E. The OEA Did Not Assure Disney The Benefit Of The Bargain: Ovitz's Employment For The Full, Five-Year Term Of The OEA

The final version of the OEA had a five-year term commencing on October 1, 1995, and among other things, required Ovitz to devote his time and best efforts exclusively to Disney.

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[13]This version of the OEA summary still contained the narrower definition of Non-Fault Termination included in the summary distributed at the September 26, 1995 Compensation Committee meeting. Compl. ¶ 54.

Compl. ¶ 59. The OEA provided Ovitz with generous compensation consisting of: (1) an annual salary of $1 million, (2) a discretionary bonus at the end of each full year of service as Disney's President up to $10 million, and (3) a series of "A" options that allowed Ovitz to purchase 3 million shares of Disney common stock at an exercise price equal to the market price of Disney stock on October 16, 1995. Id.[14] Despite this seemingly rich compensation package, the stock option and severance elements of the OEA provided Ovitz with a package that would be worth at least as much, if not more, than if he stayed with Disney for the full term of the OEA with respect to each of the three elements of his compensation. Compl. ¶ 60. As Crystal later remarked: "the contract was most valuable to Ovitz the sooner he left Disney." Compl. ¶ 68.

1. Salary:

The OEA provided that in the event of a Non-Fault Termination, Ovitz would immediately receive the full value of the total salary payments projected for the full five-year contract (Compl. ¶ 61) discounted to present value at a risk-free rate that would not reflect the risk that Ovitz might be terminated or leave before the end of the term. Id. Accordingly, the accelerated salary payment was greater than it would (or should) have been had Disney applied an appropriate discount rate reflecting the risk that Ovitz might not serve out the whole term. Id.

[14]The OEA also provided that if Ovitz completed the entire five-year term and then entered into a new contract with Disney, he would receive a second set of stock options, the "B options," for two million additional shares. Compl. ¶ 66. Disney, however, did not have to offer Ovitz a new employment agreement after his term expired. Id.

2. **Bonuses:**

A Non-Fault Termination would pay Ovitz $7.5 million per remaining year on his contract, reflecting 75% of the $10 million maximum annual bonus provided in the OEA discounted to present value at a risk-free interest rate keyed to Disney's borrowing costs. Compl. ¶ 62. This provision rewarded Ovitz for leaving because, if he served his entire term, Ovitz risked receiving no bonus or a lesser bonus than $7.5 million -- a distinct possibility given Ovitz's lack of familiarity with Disney's business. Id. Thus, the base amount of bonus compensation for purposes of the severance pay-out was very high, while the discount rate applied to converting that amount to present value was unrealistically low. Id.

3. **Options:**

If he received a Non-Fault Termination, Ovitz would receive as many A options as he would have obtained by serving out his full five-year contract term but sooner and in one block. Compl. ¶ 64. This would eliminate the risks that the market price of Disney stock would decline below the exercise price during the five-year term, or that Disney might terminate Ovitz for fault and deprive him of entitlement to any future A options. In contrast, if Ovitz served out his full five-year term, the options would vest in increments of one million shares on September 30 of each year commencing on September 30, 1998 through September 30, 2000. Compl. ¶ 63. In addition, the exercise price of the A options was extended until the later of 24 months after the date of a Non-Fault Termination, or September 2002. Thus, instead of giving Ovitz an incentive to promote Disney's success and growth by conditioning the options on performance milestones

or even his continued tenure, the A option payout provided incentives for Ovitz to secure a Non-Fault Termination. Id. at ¶ 64.

Another benefit arising from the premature termination of the OEA was that the OEA also called for Ovitz to receive a "termination payment" of $10,000,000 in the event of a Non-Fault Termination. Compl.¶ 65.

In short, the OEA actually undermined the goal of retaining Ovitz and securing his diligent performance during his five-year tenure as Disney's President. Compl. ¶ 67.

F. Ovitz Decides To Leave The Company

Ovitz did not enjoy a distinguished career with Disney. Ovitz clashed with senior Disney officers and adopted an "imperious" management style. Compl. ¶ 71. Ovitz refused to meet with defendant Bollenbach, then Disney's CFO, to learn the business (Compl. ¶ 72), precipitating Bollenbach's resignation from the Company. Bollenbach subsequently commented: "The point was, Michael Ovitz didn't understand the duties of an executive at a public company and he didn't want to learn." Compl. ¶ 73. Ovitz openingly conceded his shortcomings; almost a year after he was hired, Ovitz publicly acknowledged that "I probably know about 1% of what I need to know." Compl. ¶ 74. Ovitz's indifference and shortcomings were soon made evident to Eisner. Just months after hiring Ovitz, Eisner admitted in a memorandum addressed to defendant Watson that he "had made an error in judgment in who [Eisner] had brought into the company." Compl. ¶ 70.

Less than a year after joining the Company, Ovitz began a highly-publicized search for a new job despite his contractual and fiduciary obligations to "devote his full time and best efforts

exclusively to the Company." Compl. ¶¶ 75-76. In particular, Ovitz was interested in landing a top post with Sony Corporation of America ("Sony"). Id.

G. Eisner Orchestrates Ovitz's Receipt Of A Non-Fault Termination Without Consulting The New Board

Ovitz knew that if he resigned and took another job at Sony or a like enterprise, he would recover nothing under the Non-Fault Termination provisions of the OEA and might have to pay damages to Disney. Compl. ¶ 77. Ovitz candidly expressed his concerns in a letter he wrote to Eisner on October 8, 1996:

> If I get an offer I assume that you, Sandy [Litvack] 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. . . . I will try to do this in the next few weeks. If I cannot, then I guess you are stuck with me until I can find something to do that works for the both of us. . . . 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.

Compl. ¶ 77 (emphasis added). Eisner immediately responded by writing Ovitz a letter expressing Eisner's personal willingness to preserve Ovitz's full financial benefits while avoiding any personal embarrassment from Ovitz's rapid departure:

> I read your note, and I really appreciate the spirit in which it is written -- in 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 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. I agree with you that we must work together to assure a smooth transition and deal with the public relations brilliantly. I am committed to make this a win-win situation, to keep our friendship intact, to be positive, to say and write only glowing things . . . . Nobody ever needs to know anything other than positive things from either of us. This all can work out! You still are the only one who came to my hospital bed -- and I do remember.

Compl. ¶ 80. To further alleviate his friend's concern, Eisner wrote a letter to Sony authorizing it to negotiate with Ovitz without fear of retribution from Disney and then sent a copy of the letter along with a note to Ovitz stating: "I am sure we are now both protected 'every way to and from Sunday.'" Compl. ¶ 82. Ovitz's negotiations with Sony were not successful. Compl. ¶ 84. This correspondence from Eisner vividly displays Eisner's sense of "owningness" to Ovitz. In Re Ply Gem Industries, Inc. Shareholders Litigation, 2001 WL 1192206, at *1 (Del. Ch.).

After the Sony deal fell through, Eisner unilaterally agreed to let Ovitz leave Disney with all of the benefits of the Non-Fault Termination provisions of the OEA. Compl. ¶ 85. On December 11, 1996, defendants Eisner, Litvack and Ovitz met at Eisner's apartment to finalize the deal giving Ovitz a Non-Fault Termination from Disney. Id. The deal was memorialized in a letter defendant Litvack sent to Ovitz on December 27, 1996. Compl. ¶ 87.[15] The letter stated that: (1) Ovitz's employment with Disney would "end at the close of business today. Consequently, your signature confirms the end of your service as an officer, and your resignation as a director, of the Company and its affiliates;" (2) "this letter will . . . .be treated as a 'Non-Fault Termination' [and,] by mutual agreement, the total amount payable to you . . . is $38,888,230.77, net of withholding; [and] (3) . . . the option to purchase 3,000,000 shares of [Disney] Common Stock granted to you pursuant to Option A . . . will vest as of today and will expire in accordance with its terms on September 30, 2002." Compl. ¶ 87. Litvak, who was no longer a board member at the time, was the only signatory to the letter on Disney's behalf. Id.

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[15]This letter replaced a prior version of a letter sent to Ovitz on December 12, 1996, correcting a perceived shortcoming in that earlier draft which granted Ovitz all the benefits of a Non-Fault Termination "as though" there had been a Non-Fault Termination. Compl. ¶ 86.

In addition to the cash payout outlined in Disney's December 27, 1996 termination letter to Ovitz, the acceleration and vesting of Ovitz's 3 million "A" options brought him huge gains. The options were priced at the market price of Disney's shares as of October 16, 1995, approximately $57 per share. Compl. ¶ 101. Based on the closing price of Disney's shares of $71.25 on December 27, 1996 -- the official date of Ovitz's departure -- the cash value of his options was $42 million. Id. The true value of the options, however, should be calculated by their then present value using commonly-accepted techniques such as the Black-Scholes pricing model. When calculated under that model, using reasonable assumptions as set forth in the Complaint, the value of Ovitz's shares at the end of November 1996 was $101.5 million. Id. at ¶ 102. Accordingly, Ovitz's severance benefits exceeded $140 million -- approximately $10 million for each month of his employment at Disney in addition to his salary already received. Compl. ¶ 104.

The sheer size of Ovitz's Non-Fault Termination package required Board scrutiny. Compl. ¶ 106. Moreover, as a matter of law, the New Board retained sole authority to give Ovitz a Non-Fault Termination.[16] Disney's Bylaws provided, in pertinent part, that: "[a]ll officers of the corporation shall hold office until their successors are chosen and qualified, or until their earlier resignation or removal. Any officer elected by the Board of Directors may be removed at any time by the Board of Directors with or without cause." Compl. ¶ 89. Ovitz's Non-Fault

[16]The New Board consisted of defendants Eisner, Ovitz, Russell, Litvack, Roy E. Disney, Stanley P. Gold, Richard A. Nunis, Sidney Poitier, Robert A.M. Stern, E. Cardon Walker, Raymond L. Watson, Gary L. Wilson, Reveta F. Bowers, Ignacio E. Lozano, Jr., George J. Mitchell, Leo J. O'Donovan and Thomas S. Murphy.

Termination constituted his "removal", thus necessitating Board approval. Id.[17] Indeed, defendants' own counsel recognized this fact, stating during oral argument before the Supreme Court:

> The board retained the ability to determine whether or not Mr. Ovitz would leave under a fault or no-fault termination. There is no way, short of Mr. Ovitz's death, that Mr. Ovitz could part with all of the termination benefits unless the board of directors of Disney acted affirmatively. There had to be an affirmative action by the board of directors to enable Mr. Ovitz to depart with all of the benefits.
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> * * * *
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> number two; the company received assurance that he [Ovitz] would work for the company unless the board -- unless the board determined otherwise during the five-year term of that agreement.

Del. Supr. Ct. Oral Arg. 24, 28-29; Compl. ¶ 90.

Despite its affirmative obligation to consider and approve the terms of Ovitz's departure, the New Board, with knowledge that Eisner and Ovitz were working out arrangements for Ovitz's separation, made an uninformed decision to go along with the decision to grant Ovitz a Non-Fault Termination. Compl. ¶ 88. The New Board had plenty of time to act if it wanted to. The facts became publicly known at least as of December 12, 1996, when Ovitz and Disney entered into the letter agreement and Disney publicly announced the move. Id. at ¶¶ 88, 93, 95. The New Board also could have acted when Litvack, at Eisner's request, accelerated Ovitz's removal

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[17]To the extent the Court considers extrinsic documents like Board minutes, it must also consider the text of the resolution that the Old Board adopted at its September 26, 1995, meeting, which stated that Ovitz was "to serve in such capacity [President] at the pleasure of this Board of Directors." DI 0042. Thus, as further discussed below, because Ovitz served at the Board's "pleasure," the Board retained final authority to approve a Non-Fault Termination.

and Non-Fault Termination payout date from January 31, 1997 to December 27, 1996. Compl. ¶ 96.

But the New Board failed to take such action. The New Board did not consult with an expert (Compl. ¶ 94), review any documentation or engage in any discussion at all regarding the Non-Fault Termination. Compl. ¶ 91. As a consequence, the New Board never assessed its options in dealing with Ovitz short of giving him a Non-Fault Termination with full benefits. Compl. ¶ 94. In connection with the Non-Fault Termination, Ovitz gave a full release to Disney and all of its officers and directors of all claims arising from his employment, the OEA and the Non-Fault Termination. Compl. ¶ 97.

ARGUMENT

I. LEGAL STANDARDS

In the context of a Rule 12(b)(6) motion to dismiss, plaintiffs are entitled to all reasonable inferences that logically flow from the facts alleged in the Complaint. See Brehm v. Eisner, 746 A.2d 244, 255 (Del. 2000) (en banc). Where, under any state of facts consistent with the factual allegations of the complaint, plaintiffs would be entitled to judgment, the complaint may not be dismissed as legally defective. See Lewis v. Vogelstein, 699 A.2d 327, 338 (Del. Ch. 1997). As set forth in detail in plaintiffs' brief in support of their motion to strike, the Court should not consider the content of documents outside the four corners of the Complaint when they are not integral to plaintiffs' claims and incorporated by reference into the Complaint. Orman v. Cullman, 794 A.2d 5, 15-16 (Del. Ch. 2002). In all events, the Court should not permit

defendants to use documents outside the Complaint to prove the truth of their arguments in favor of dismissal. Id. at 15.

To sustain their claims for purposes of a Rule 23.1 motion, plaintiffs need not plead evidence. Brehm, 746 A.2d at 254. The pleader must set forth specific factual allegations that support the claim. Id. Such facts are sometimes referred to as "ultimate facts," "principal facts," or "elemental facts." Id.

Demand is excused when a complaint contains factual allegations raising a reasonable doubt that either: (1) "the directors are disinterested and independent" or (2) "the challenged transaction was otherwise the product of a valid exercise of business judgment." Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984). Demand is excused if plaintiffs satisfy either of these disjunctive requirements. Id. at 15.

As more fully discussed below, the Complaint states valid claims against defendants and demand is excused as futile because:

1. The Old Board did not retain an expert or consultant or rely on the advice, opinion or recommendation of an expert or consultant concerning the OEA. Therefore, pursuant to the Supreme Court's decision in Brehm, the Complaint raises a reasonable doubt that the New Board's decision to approve Ovitz's hiring was the product of a valid exercise of business judgment and demand is excused under the second prong of Aronson.

2. The members of the Old Board acted recklessly and in bad faith, in violation of their fiduciary duty of care, by failing to consider the OEA in any respect before agreeing to hire Ovitz. The Old Board could not have properly delegated this task due to its fundamental importance to Disney. Because the members of the Old Board recklessly, and in bad faith, violated their fiduciary duty of due care, the Complaint raises a reasonable doubt that their decision to approve the OEA was the product of a valid exercise of business judgment and demand is excused under the second prong of Aronson.

3. The OEA itself constituted a waste of Disney's assets. The members of the Old Board did not make a good faith judgment to approve the OEA or its accompanying option package. The OEA (and defendants' dereliction of duty) deprived Disney of any reasonable expectation that it would receive the benefit of its bargain with Ovitz -- five years of productive service -- because the OEA awarded Ovitz with severance benefits in the event of a Non-Fault Termination at least as valuable, if not more so, than if he remained in Disney's employ throughout his contract term.

4. The members of the New Board acted recklessly and in bad faith in connection with Ovitz's receipt of a Non-Fault Termination. Members of the New Board made no effort to inform themselves about the Non-Fault Termination and failed to consider Disney's other options in dealing with Ovitz, although they had the indisputable, affirmative obligation to do so. Accordingly, the Complaint gives rise to a reasonable doubt that the New Board's actions were the product of valid business judgment. Moreover, in the absence of any good faith judgment assessing the benefit to Disney of a Non-Fault Termination, the New Board members' decision to endorse it constituted waste.

5. The New Board members' reckless and bad faith conduct in connection with the Non-Fault Termination exposes them to liability to Disney, branding them with a personal financial interest in this action and giving rise to a reasonable doubt that they could consider a demand impartially. This proposition is reinforced by the fact that Ovitz conferred a tangible benefit on the members of the New Board, not shared by other shareholders, by giving each New Board member a general release from liability in connection with Ovitz's Non-Fault Termination.

II. THE COMPLAINT PLEADS PARTICULARIZED FACTS WHICH STATE VALID CLAIMS FOR RELIEF AND DEMONSTRATE THAT DEMAND IS EXCUSED

A. A Reasonable Doubt Exists That The Old Board Exercised Valid Business Judgment In Entering Into The OEA Under The Second Prong Of Aronson

It is well-established that directors of Delaware corporations owe shareholders unremitting fiduciary duties of due care, loyalty and good faith. See Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998). The business judgment rule is a presumption that, "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest

belief that the action taken was in the best interests of the company." Emerald Partners v. Berlin, 787 A.2d 85, 90-91 (Del. 2001). Therefore, in order to invoke the protection of the business judgment rule, directors must first inform themselves, prior to taking action, of all material facts reasonably available to them and must then act with the requisite care and good faith. Aronson, 473 A.2d at 812.

It is well-established that the business judgment rule does not "irrevocably shield[] the decisions of corporate directors from challenge." Gimbel v. The Signal Companies, Inc., 316 A.2d 599, 609 (Del. Ch.), aff'd, 316 A.2d 619 (Del. 1974). The business judgment rule does not protect directors who have made "an unintelligent or unadvised judgment." Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985). To rebut the presumptive applicability of the business judgment rule at the pleading stage, a shareholder plaintiff must raise a reasonable doubt that the directors, in reaching the challenged decision, violated their fiduciary duties.

As discussed below, the well pleaded allegations of the Complaint raise the requisite reasonable doubt as to whether the formation and terms of the OEA were the product of the Old Board's exercise of valid business judgment under the second prong of Aronson because: (1) the Old Board, acting recklessly and in bad faith, failed to inform itself of all material information and violated its fiduciary duty of care; and (2) also committed waste by approving the OEA.

B. The Old Board Violated Its Fiduciary Duty of Care in Approving The OEA

The Complaint pleads facts demonstrating that the members of the Old Board violated their fiduciary duty of care by failing to assess any of the terms of the OEA before hiring Ovitz. Indeed, the facts demonstrate that the members of the Old Board recklessly and faithlessly

ignored their fiduciary responsibilities, i.e., their misconduct went far beyond mere inattentiveness to their duties or gross negligence.[18]

In this case, the Supreme Court has already determined that the quantification of the potential financial exposure resulting from a Non-Fault Termination was reasonably "available" and "material" to Disney and required the Old Board's attention:

> [T]he economic exposure of the corporation to the payout scenarios of the Ovitz contract was material, particularly given its large size, for purposes of the directors' decisionmaking process. [Similarly], those dollar exposure numbers [relevant to the OEA] were reasonably available because the logical inference from plaintiffs' allegations is that Crystal or the New Board could have calculated the numbers. Thus, the objective tests of reasonable availability and materiality were satisfied by this Complaint.

Brehm, 746 A.2d at 259-60 (emphasis added) (footnote omitted).[19] The Supreme Court understood that plaintiffs' prior complaint had pled that the Old Board did not consider the various payout scenarios in the case of a Non-Fault Termination but nonetheless assumed that the Old Board relied on Crystal's advice. Id. at 261 ("the question here is whether the directors are to be 'fully protected' (i.e. not held liable) on the basis that they relied in good faith on a qualified expert under Section 141 (e) . . ."). Accordingly, the Supreme Court found that "[t]he Old Board is entitled to the presumption that it exercised proper business judgment, including proper reliance on the expert." Id. The Supreme Court, however, determined that an amended

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[18]Of course, to establish futility of demand, plaintiffs' allegations need only give rise to a reasonable doubt that defendants exercised due care.

[19]The Supreme Court defined materiality to mean, under these circumstances, "relevant and of a magnitude to be important to directors in carrying out their fiduciary duty of care in decisionmaking." Id. at 259 n.49.

pleading would "survive a Rule 23.1 motion to dismiss" if it alleged, among other things, that "the directors did not in fact rely on the expert." Id. at 262.

In accord with the Supreme Court's guidance, the Complaint now raises valid claims and pleads facts sufficient to excuse demand under the second prong of Aronson because, contrary to the Supreme Court's factual assumptions urged upon it by defendants, the Old Board did not rely on expert advice and did not make an informed decision to approve the OEA.

1. Demand Is Excused Because the Old Board Did Not Rely On The Advice Of An Expert In Approving The OEA

Demand is excused in this case because Crystal did not advise the Old Board or the Compensation Committee. Compl. ¶¶ 7, 45. Crystal did not prepare any written analysis or opinion regarding the OEA that was submitted to the Old Board or the Compensation Committee. Compl. ¶ 49. Crystal did not make any oral presentation to the Compensation Committee or the Old Board, nor did he participate in any meeting at which the directors discussed Ovitz's hiring. Id. The Compensation Committee and the Old Board also did not receive any advice or opinion from any other expert or consultant. Compl. ¶ 50. Thus, in accord with the Supreme Court's holding in Brehm, Section 141(e) does not "protect[ ]" defendants and demand must be excused as futile. 746 A.2d at 261.

2. Demand Is Excused Because The Old Board Recklessly, And In Bad Faith, Failed To Consider The OEA

Absent reliance on an expert, the Old Board is not otherwise entitled to the protection of the business judgment rule because its "consideration" of the OEA was not just "sloppy and perfunctory" (Brehm, 746 A.2d at 249) -- it was non-existent. As alleged in the Complaint, the

Old Board did not review or consider the OEA at all, let alone make any attempt to understand the "material" financial impact of an Ovitz Non-Fault Termination under various payout scenarios. Compl. ¶ 47. The Old Board's decision to hire Ovitz without any understanding of the terms of his employment agreement amounts to reckless misconduct and bad faith.

Defendants' brief is silent with respect to these facts as defendants have apparently abandoned their previously-asserted, but now proven false, contention that:

> the Board exercised its business judgment to structure the incentive in the form of stock options that Ovitz would receive if he stayed at Disney or if he was granted a Non-Fault Termination by the Board.

Individual Defendants' Supr. Ct. Br. at 27; see also Def. Ch. Ct. Br. at 22 ("[t]he determination as to whether a high-powered executive should be hired at a high price was a classic decision within the business judgment of the Board.") Instead, defendants now argue that the Old Board did not violate its fiduciary duties because it purportedly delegated its authority to the Compensation Committee, which defendants contend adequately considered the OEA. Def. Br. at 29-32. Defendants' claim fails on every count because as demonstrated below: (1) the decision to approve the OEA was "material" to Disney's business and affairs and could not be delegated as a matter of law; (2) even if it could be delegated, the Complaint does not plead that the Old Board delegated its authority, let alone adopted a formal resolution doing so; and (3) the Compensation Committee's perfunctory review of the OEA was patently inadequate.

a. The Old Board Could Not Delegate Its Authority To Approve The OEA As A Matter Of Law

Approval of the OEA was committed to the Old Board's exclusive authority to manage Disney's business and affairs 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. See 8 Del. C. § 141(a); Brehm, 746 A.2d at 259-60 n. 49. Directors of Delaware corporations are charged with the affirmative obligation to "protect and defend those interests entrusted to them. Officers and directors must exert all reasonable and lawful efforts to ensure that the corporation is not deprived of any advantage to which it is entitled." Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989) (emphasis added). Thus, 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. Grimes v. Donald, 1995 WL 54441, *9 (Del. Ch.), aff'd, 673 A.2d 1207 (Del. 1996) ("[t]he board may not either formally or effectively abdicate its statutory power and its fiduciary duty to manage or direct the management of the business and affairs of this corporation").[20] As Eisner set forth in his letter to Ovitz dated August 14, 1995, Disney could not hire Ovitz without the prior approval of the Old Board. Compl. ¶ 32.

[20] See Chapin v. Benwood Foundation, Inc., 402 A.2d 1205, 1210 (Del. Ch. 1979), aff'd sub nom. Harrison v. Chapin, 415 A.2d 1068 (Del. 1980) ("the directors of a Delaware corporation may not delegate to others those duties which lay at the heart of the management of the corporation").

b. The Old Board Did Not Delegate Its Authority

Even if the Old Board could have delegated its authority, defendants must still demonstrate that the Old Board made an informed judgment to delegate the "material" task of evaluating the financial impact of the OEA on Disney. See Grimes, 1995 WL 54441, *9 (emphasis added) (the board may "delegate such powers to the officers of the company as in the board's good faith, informed judgment are appropriate"). Defendants cannot make such a demonstration here because the Complaint does not plead that the Old Board made any decision to delegate its authority over the OEA. Further, even if such a delegation of authority did take place (and none did), there is no record that the Compensation Committee ever made a recommendation or reported any findings to the Old Board before the Old Board approved Ovitz's hiring. Compl. ¶ 46-47.

c. The Compensation Committee Acted Recklessly And In Bad Faith

Even assuming, contrary to fact and law, that the Old Board properly delegated its duty to consider the OEA, the Complaint pleads facts which demonstrate that the Compensation Committee itself acted recklessly and in bad faith. The Compensation Committee deliberated once (before Disney hired Ovitz) for approximately one hour and discussed two other topics besides the OEA. Compl. ¶¶ 37-38. The Compensation Committee only reviewed an incomplete summary of the OEA, which contained an already superseded definition of Non-Fault Termination and omitted critical facts such as the exercise price of Ovitz's options. Compl. ¶¶

41-42.[21] Despite the "materiality" of these clauses, 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 described the magnitude of possible payouts that Ovitz would receive in the event of a Non-Fault Termination. Id.

Defendants cannot rehabilitate the Compensation Committee's glaring lack of diligence by referring to supposition and inferences contrary to the facts alleged in the Complaint. Defendants' contention that the Compensation Committee properly relied on Russell and Litvack (Def. Br. at 30) presupposes, contrary to the allegations in the Complaint, that these individuals actually presented a detailed, adequate analysis of the OEA.[22] Similarly misplaced is defendants' self-serving speculation that the Compensation Committee was aware that "Russell had been advised by" Crystal (Def. Br. at 31).

The Complaint alleges that the other members of the Compensation Committee had no contact with Crystal whatsoever. Compl. ¶ 45. Further, defendants' own documents seriously call into question whether Crystal provided any "advice" to Russell about the OEA -- Crystal's August 12, 1995 letter to Russell: (1) does not refer to Ovitz by name; (2) does not discuss the issue of Non-Fault Termination; (3) reflects other potential terms never included in the OEA; and

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[21]Defendants cannot explain why the specialized "Compensation Committee" had to rely on a purportedly "reader-friendly" summary OEA (Def. Br. at 29-30), when a version of the entire 16-page OEA was available to them at the time.

[22]Moreover, defendants' assertion that the Compensation Committee could, in good faith, rely on Litvack and Russell disregards this Court's prior determination that plaintiffs had adequately alleged that both defendants lacked independence. In re The Walt Disney Co. Deriv. Litig., 731 A.2d at 357, 360.

(4) expresses no opinion or recommendation, and in fact, is not styled as an opinion or report. DI 0388-DI 0391; see supra note 9. Given the ambiguous nature and equivocal content of Crystal's memorandum, it cannot qualify as a "report" sufficient to invoke the protection of Section 141(e) for Russell, let alone any other member of the Compensation Committee. See Smith v. Van Gorkom, 488 A.2d 858, 875 (Del. 1985) ("[a]t a minimum for a report to enjoy the status conferred by § 141(e), it must be pertinent to the subject matter upon which a board is called to act, and otherwise be entitled to good faith, not blind reliance.")

Defendants' claim that the Compensation Committee could rely on the purported "arm's-length negotiations" involving Ovitz (Def. Br. at 31) must be ignored because it squarely contradicts the allegations in the Complaint that the discussions between Ovitz and Eisner were not at "arm's-length." Compl. ¶¶ 52-56. The same is true about defendants' claim that the Compensation Committee purportedly relied on Eisner's "assessment" of Ovitz's hiring because of Eisner's financial stake in Disney (Def. Br. at 31). There is nothing in the Complaint to suggest that the Compensation Committee made any "assessment" of Eisner's thought processes on Ovitz's hiring or the impact of Eisner's Disney holdings, and even if they did so, such reliance is inadequate as a matter of law as shown below.

Directors of a Delaware corporation cannot passively "rely" on the purported "assessment" of senior officers when called upon to exercise a business judgment -- the contrary rule defendants apparently assert eliminates any need for directors or their business judgment. It is bedrock law in Delaware that a director has a duty to independently "inform himself in preparation for a decision [which] derives from the fiduciary capacity in which he serves the

corporation and its stockholders." Smith, 488 A.2d at 872 (citation omitted); see Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989). Pursuant to Section 141(e), directors can rely on others, including corporate officers, to help them fulfill their fiduciary duties of care to act in a fully-informed manner, but only when they rely "in good faith on reports made by [such] officers." Smith, 488 A.2d at 875 (quoting Michelson v. Duncan, 386 A.2d 1144, 1156 (Del. Ch. 1978), aff'd in part, rev'd in part, 407 A.2d 211 (Del. 1979)) (emphasis added). The officer's report "must be pertinent to the subject matter upon which a board is called to act, and otherwise be entitled to good faith, not blind, reliance." Smith, 488 A.2d at 875. Here, Eisner made no report or presentation either to the Compensation Committee or to the Old Board and Section 141(e) cannot apply. Compl. ¶¶ 45, 49.

Absent such report, the Compensation Committee's supposed assumption (advanced only now as a litigation ploy) that Eisner knew what he was doing and was acting in good faith, amounts to reckless and bad faith misconduct. Even in Van Gorkom, where the Supreme Court found the directors had acted with "gross negligence" and had violated their fiduciary duties of care, the company's CEO, Van Gorkom, had made a presentation to the board, and the board considered the merger transaction requiring its approval on three separate occasions. In contrast, here, Eisner never addressed either the Compensation Committee or the Old Board about the OEA, the Old Board never considered the issue, and the Compensation Committee did so in a wholly inadequate manner. Defendants' contention that the directors could have made the calculations regarding the financial impact of a Non-Fault Termination on Disney if they wanted to (Def. Br. at 18), like their other defenses, improperly substitutes what might have been done

for what should have been done, and which the Complaint alleges was not done. Moreover, it is hard to imagine that even if they were inclined to make the calculations, the Compensation Committee members could have done so in the few minutes they spent considering the OEA. Compl. ¶ 37. In sum, the Compensation Committee failed to review critical, reasonably available and material information sufficient to invoke business judgment rule protection. Brehm, 746 A.2d at 259-60. For this reason as well, the Old Board's conduct in connection with the OEA was fatally uninformed.

C. The Old Board Committed Waste In Approving The OEA

Demand is excused under the second prong of Aronson because the Complaint also states valid claims against the Old Board for committing waste by recklessly and in bad faith entering into the OEA with Ovitz.[23] In Brehm, the Supreme Court stated that "waste entails an exchange of corporate assets for consideration so disproportionally small as to lie beyond the range at which any reasonable person might be willing to trade." Brehm, 746 A.2d at 263 (citation omitted). The Supreme Court analyzed waste within the business judgment rule construct, stating that "[i]rrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business

[23]Defendants' contention that the Supreme Court barred plaintiffs from reasserting waste claims flies in the face of its holding that "we do not foreclose the possibility that a properly framed complaint [alleging waste] could pass muster." Brehm, 746 A.2d at 263, 267 (reversing this Court's dismissal with prejudice of plaintiffs' claims for "breach of fiduciary duty and waste, as set forth in Counts I and II of the amended complaint . . .").

judgment rule." Id. at 264.[24] Thus, the Supreme Court found that "there should be no finding of waste" when "there is any substantial consideration received by the corporation, and if there is a good faith judgment that in the circumstances the transaction is worthwhile. . . " Brehm, 746 A.2d at 263 (quoting Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997)) (emphasis in original). Defendants' conduct fails this test.

The Supreme Court dismissed plaintiffs' waste claim without prejudice only because it assumed that by making such a claim, plaintiffs were disagreeing "with the Old Board's judgment in evaluating Ovitz's worth vis a vis the lavish payout to him." Id. (emphasis added). Plaintiffs have cured this perceived pleading defect because the Complaint alleges that the Old Board acted in bad faith and irrationally approved Ovitz's hiring without any assessment of the various payouts to Ovitz in a Non-Fault Termination. As discussed above, the Old Board had no idea what Disney had agreed to pay Ovitz in the event of a Non-Fault Termination, let alone what events could trigger a Non-Fault Termination. See Compl. ¶ 47. Because defendants made no "assessment of the corporation's best interests" in ratifying the OEA (White, 783 A.2d at 554, n.36), they are liable for waste for entering into such an unstable and one-sided agreement.

The Complaint pleads facts which demonstrate that the OEA failed to secure for Disney the benefit of its bargain. Thus, if for any reason Ovitz might have developed a desire to leave Disney's employ, the contract would not deter him, and, in fact, would afford him significant

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[24]The Supreme Court echoed and amplified this observation in a subsequent decision which held that "[t]o 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"). White v. Panic, 783 A.2d 543, 554 n.36 (Del. 2001) (emphasis added).

financial incentives to prematurely leave Disney. In the event of a Non-Fault Termination, Ovitz would earn the same, if not more, than what he would have earned if he had served out his full five-year term. Compl. ¶¶ 60-67. The Old Board could have learned this from a spread-sheet analysis of various payout scenarios to Ovitz in the case of Non-Fault Termination. Such an analysis was never done.

The Old Board's failure to consider the issue also violated the specially tailored rules which define the parameters of any decision to award stock options, like those included in the OEA and received by Ovitz in the Non-Fault Termination. It is well-settled that in considering a stock option grant to corporate officers and directors, careful consideration must be given to ensure "that they contain conditions, or that surrounding circumstances are such, that the corporation may reasonably expect to receive the contemplated benefit from the grant of the options." Beard v. Elster, 160 A.2d 731, 736-37 (Del. 1960); Kerbs v. California E. Airways, Inc., 90 A.2d 652, 656 (Del. 1952). Thus, "the key factor" for a court, and thus a board, to consider in assessing the validity of an option plan is "whether the plan itself contains safeguards or circumstances to ensure that the corporation receives the benefit for which it bargained." Byrne v. Lord, 1995 WL 684868 at * 5 (Del. Ch.); see Lewis v. Vogelstein, 699 A.2d at 337-38 ("a reasonable board could conclude from the circumstances that the corporation [might] reasonably expect to receive a proportionate benefit").

Consequently, if a company plans to issue stock options, as here, to secure an executive's continued employment, directors approving such option plans must inform themselves to ensure that the contemplated consideration "will in fact pass to the corporation." Kerbs, 90 A.2d at 656

(invalidating options because there was, inter alia, no showing that they were granted to induce the optionee to remain with the company) (citation omitted); Sandler v. Schenley Indus., Inc., 79 A.2d 606 (Del. Ch. 1951). Furthermore, if by granting stock options, the corporation "expects that it will retain key personnel, then the plan must provide terms, or circumstances, that ensure that the personnel are employed by the corporation when they exercise the options." Byrne, 1995 WL 684868, at *5 (citing Kerbs).

Here, contravening these authorities, the Old Board made no assessment as to whether the OEA would or could secure the purported "benefit" of Ovitz's five-year service. The Old Board failed to consider that a Non-Fault Termination would earn Ovitz the immediate vesting of his 3 million "A" options, garnering him instant millions without the same risks he would have assumed if he obtained the options in due course during his five-year term. Compl. ¶¶ 63-64. Accordingly, under the terms of the OEA, Ovitz was at all times better off in the event of a Non-Fault Termination than if he remained as an executive employee, particularly during the first three years of the OEA, because he would then be entitled to a severance package equal to or greater than the benefits he would have received if he served out all five years of the OEA.[25]

Thus, because the Old Board did not make a valid business judgment and failed to assure itself that the OEA would secure the bargained-for benefit of Ovitz's five-year employment with

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[25] As noted supra, other features of the OEA, such as the bountiful treatment of his projected bonuses on early termination of his employment, motivated Ovitz to sever his relationship with Disney without serving the full five-year term, thus underscoring the absence from the OEA and the option grant of any assurance that Disney would enjoy the benefit of its bargain.

Disney, demand is excused as futile under the second prong of Aronson because the Old Board committed waste.

D. Demand Is Excused As Futile As To Plaintiffs' Claims Against The New Board In Connection With Ovitz's Non-Fault Termination

In affirming dismissal of plaintiffs' claims against the New Board for acting in bad faith and committing waste in connection with its decision to grant Ovitz a Non-Fault Termination, the Supreme Court assumed that the New Board had actually deliberated and made an informed business decision:

> But 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. We agree with the Court of Chancery: "The Board made a business decision to grant Ovitz a Non-Fault Termination. . .. There is no allegation that the Board did not consider the pertinent issues surrounding Ovitz's termination."

Brehm, 746 A.2d at 266 (quoting In re The Walt Disney Co. Derivative Litig., 731 A.2d at 364) (emphasis added). The Supreme Court understood that "[t]o rule otherwise would invite courts to become super-directors, measuring matters of degree in business decisionmaking and executive compensation." Id. (emphasis added). The Supreme Court noted in its opinion that "the sheer size of the payout to Ovitz, as alleged, pushes the envelope of judicial respect for the business judgment of directors in making compensation decisions." Id. at 249 (emphasis added). Thus, the Supreme Court permitted plaintiffs to file an amended complaint adding facts giving rise to "a reasonable doubt that the New Board's decision regarding the Ovitz non-fault termination was protected by the business judgment rule." Id. at 266.

As discussed below, the Complaint states valid claims for violations of due care and waste sufficient to excuse demand under both prongs of Aronson because the New Board did not deliberate and did not make an informed decision to award Ovitz a Non-Fault Termination. Instead, the New Board recklessly, and in bad faith, acceded to the Non-Fault Termination and let Eisner handle the negotiations without Board oversight.

1. The Complaint Gives Rise To The Requisite Reasonable Doubt As To Whether The New Board's Conduct In Connection With Ovitz's Non-Fault Termination Was A Valid Exercise Of Business Judgment

The 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." Brehm, 764 A.2d at 266 (quoting In re The Walt Disney Co. Derivative Litig., 731 A.2d at 364). As alleged in the Complaint, the New Board made a reckless and bad faith judgment to accede to the Non-Fault Termination without reasonably informing itself of all material facts. Compl. ¶ 88. The New Board did not consult with an expert (Compl. ¶ 94), review any opinion, report, study or documentation or engage in any discussion at all about the Non-Fault Termination despite several opportunities to do so. Compl. ¶¶ 91, 93, 95. In short, despite Ovitz's self-admitted failures as Disney's President (Compl. ¶¶ 69-76), 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. Compare Brehm, 746 A.2d at 265; In re The Walt Disney Co. Derivative. Litig., 731 A.2d at 364.[26]

Having failed to deliberate and reasonably inform themselves about material events requiring their scrutiny, the New Board could not have made "a good faith judgment that in the circumstances the transaction [was] worthwhile" to Disney. Brehm, 746 A.2d at 263 (citation omitted). In fact, the only apparent benefit Disney received in paying Ovitz $140 million was a release he gave defendants for any claims arising out of his employment, the OEA or the Non-Fault Termination. Compl. ¶ 97. Because the Complaint pleads facts demonstrating that the New Board agreed to pay Ovitz $140 million without making "a good faith judgment" to ensure that Disney received something "worthwhile" in exchange for the Non-Fault Termination, plaintiffs have stated valid causes of action against the New Board for acting recklessly, in bad faith derogation of its duty of care, and for waste. Id.; see White, 783 A.2d at 554, n.36. These claims are sufficient to rebut the presumption of the business judgment rule and to excuse demand pursuant to the second prong of Aronson. See Brehm, 764 A.2d at 266.

Defendants' ill-founded reliance on Eisner's dealings with Ovitz and the New Board's purported "support" (Def. Br. at 4) for those negotiations cannot cure the New Board's misconduct as a matter of law. Def. Br. at 34-37. The Complaint does not allege that the New Board appointed Eisner to act as its representative nor does it allege that the New Board met with

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[26]The Court must disregard defendants' unfounded and unsupported factual assertion, contrary to the allegations of the Complaint, that the New Board affirmatively "declined to instigate a legal and public relations war by terminating (or threatening to terminate)" Ovitz. Def. Br. at 35. See Brehm, 746 A.2d at 255 (a court must accept the truth of facts pled in the complaint and draw all reasonable inferences in plaintiffs' favor).

Eisner (or anyone else) to review his decision to give Ovitz a Non-Fault Termination.[27] Moreover, given the "material" impact of the Non-Fault Termination, the New Board could not have legitimately delegated its core managerial duties to Eisner even if it chose to do so. See, e.g., Grimes v. Donald, 1995 WL 54441 at *9 (Del. Ch.), aff'd, 673 A.2d 1207 (Del. 1996).

The New Board had an affirmative obligation to carefully scrutinize and then approve any decision to grant Ovitz a Non-Fault Termination. Compl. ¶ 106. As the Supreme Court ruled in Brehm, the "sheer size" of the $140 million Non-Fault Termination payout to Ovitz merited the directors' consideration. Brehm, 746 A.2d at 249, 259-60 & n. 49. Moreover, the Board retained the exclusive authority to approve the Non-Fault Termination and to remove Ovitz because it had hired him, and Ovitz served "at the pleasure" of the Board. DI 0042; see 2 Fletcher, Cyclopedia Corporations § 466.10, at 467 (1998 ed.) (where an "officer is hired by the board of directors, only the board of directors has the authority to terminate that particular . . . officer"); Fournier v. Fournier, 479 A.2d 708, 711 (R.I. 1984) ("[i]t is the prevailing view that the power to remove officers and agents of a corporation resides in the body that appointed or elected them") (citations omitted). Significantly, Disney's Bylaws expressly vest the Board with the authority to approve the President's removal. Compl. ¶ 89; see Fletcher § 357, at 178 ("where the power to remove an

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[27]There is absolutely no merit to defendants' suggestion that the Complaint purposefully fails to allege that Eisner attended a meeting where "Ovitz's departure and Non-Fault Termination were discussed." Def. Br. at 23. Nor should the Court infer from defendants' rather coy suggestion that such a meeting may have occurred. In fact, 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. As a consequence, the Complaint rightly and unambiguously pleads that the New Board never discussed Ovitz's departure and a Non-Fault Termination before Ovitz left the Company on December 12, 1996. Compl. ¶¶ 91-97 (emphasis added).

officer is vested in the directors, action by them is necessary to constitute a removal"); Keil v. Fred Medart Mfg. Co., 46 S.W.2d 934, 935 (Mo. App. 1921) ("the rule is that the removal of an officer of a corporation must be by the body authorized in the first instance to elect or appoint him . . .")

Despite defendants' claims, the Disney Bylaw which conferred on Eisner "general and active management, direction and supervision" of the company's business and its "officers" (Def. Br. at 37 n.12) did not divest the New Board of its duty to consider and approve Ovitz's Non-Fault Termination. Defendants' argument is contradicted by their prior admission that "[t]here had to be an affirmative action by the board of directors to enable Mr. Ovitz to depart with all of the benefits." Compl. ¶ 90 (quoting Del Supr. Ct. Tr. at 24).

Even if the Court could consider it, the above-mentioned Bylaw could not have conferred on Eisner the New Board's exclusive authority to approve Ovitz's departure from Disney. It is well-settled that a bylaw must explicitly confer on corporate officers those functions generally reserved for the board. Fensterer v. Pressure Lighting Co., 85 Misc. 621, 626, 149 N.Y.S. 49 (City Ct. NY 1914) (delegation of authority to remove a corporate officer could not be inferred "from less than a clear expression of the legislative intent and an explicit provision of the by-laws and resolution"); see Fletcher § 357, at 179. A corporate bylaw, just like the one defendants rely on, which delegates "the full powers of the full board of directors as to the 'management of the business and affairs,'" does not give others the power to "remove from office statutory officers of the company who have themselves been elected for prescribed tenure by the full board of directors." Id. Disney's By-laws give effect to that proposition by designating the Board as the

corporate agency to remove Ovitz. Compl. ¶ 89. That specific designation trumps the generalized authority the By-laws delegate to the Chief Executive Officer.

Even assuming (contrary to Disney's By-Laws and accepted principles of corporate governance) that the New Board could have delegated such responsibility to Eisner, the Complaint alleges that Eisner acted in bad faith and violated his fiduciary duties. Eisner allowed his friendship and sense of commitment towards Ovitz to impact and affect his business judgment. As alleged in the Complaint, Eisner clearly acknowledged these feelings in a letter he sent to Ovitz after Ovitz expressed his desire to leave Disney: "I am committed to make this a win-win situation, to keep our friendship intact, to be positive, to say and write only glowing things . . . . Nobody ever needs to know anything other than positive things from either of us. This all can work out! You still are the only one who came to my hospital bed -- and I do remember." Compl. ¶ 80. Although a mere generalized allegation of personal friendship is insufficient to excuse demand (Orman v. Cullman, 794 A.2d at 27 n.55), facts which demonstrate "an obligation or debt (a sense of 'owingness')" of the type Eisner expressed to Ovitz, can raise "a reasonable doubt as to a director's loyalty to a corporation. . . . " In re Ply Gem Industries, Inc. Shareholders Litig., 2001 WL 1192206, at *1 (Del. Ch.)) (quoting In re New Valley); see Orman, 794 A.2d at 27, n. 55 ("it may be possible to plead additional facts concerning the length, nature or extent of those previous relationships that would put in issue that director's ability to objectively consider the challenged transaction"). The Complaint states valid claims against Eisner for violating his fiduciary duty of loyalty, and accordingly, the Court must ignore

defendants' claim that Eisner acted in good faith or that the New Board could reasonably rely on Eisner.

Ovitz's and Eisner's self-interest in the Non-Fault Termination "negotiation" further demonstrates the New Board's bad faith. In Mills Acquisition Co. v. Macmillan, Inc., the Delaware Supreme Court condemned the decision of a board of directors to permit a financially interested director to conduct an auction for corporate control without board oversight. 559 A.2d 1261, 1280 (Del. 1989). The Court stated:

> The board was torpid, if not supine, in its efforts to establish a truly independent auction, free of Evans' interference and access to confidential data. By placing the entire process in the hands of Evans, through his own chosen financial advisors, with little or no board oversight, the board materially contributed to the unprincipled conduct of those upon whom it looked with a blind eye.

Id.; see Parnes v. Bally, 722 A.2d 1243 (Del. 1999) (complaint charging board of directors which allowed a self-interested director to run the corporate sales process stated claim for relief). Here, like the situation in Macmillan, the New Board was "torpid, if not supine" in allowing the two conflicted "best friends," Eisner and Ovitz, to arrange a Non-Fault Termination without any Board oversight. Compl. ¶¶ 89-97.

2. The Complaint Raises A Reasonable Doubt About The New Board's Disinterest In Connection With Ovitz's Non-Fault Termination

The same facts sufficient to raise a reasonable doubt that the New Board did not validly exercise business judgment in connection with the decision to award Ovitz a Non-Fault Termination also establish a reasonable doubt as to the Old Board's disinterest sufficient to excuse demand under the first prong of Aronson. When, like here, demand is excused under Aronson's second prong, the absence of business judgment protection strips a defendant of the presumed ability to impartially consider demand due to "his own interest in avoiding that

litigation." Kohls v. Duthie, 791 A.2d 772, 782 n.36 (Del. Ch. 2000). As this Court stated in Kohls:

> If those protections ["the protection from liability that exists when the business judgment rule stands unrebutted"] will not apply, the court will infer that the director will be unable to consider impartially the corporation's interest in bringing the litigation because of his own interest in avoiding that litigation.

As Vice Chancellor Lamb explained, a director's self-interest "in avoiding that litigation", thereby excusing demand, is the counterpart of the substantial threat of personal liability construct set forth in Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993).[28]

Here, as demonstrated above, the New Board faces a substantial and legitimate threat of liability because, for the reasons stated above, it is not entitled to the protection of the business judgment rule. In addition, the members of the New Board received a general release of liability from Ovitz in connection with the Non-Fault Termination -- a personal benefit not shared by Disney's shareholders. Compl. ¶¶ 97, 106H; Orman v. Cullman, 794 A.2d at 25 n.50. Accordingly, demand is excused under the first prong of Aronson as well.

3. The Supreme Court Did Not Bar Plaintiffs From Challenging The New Board's Disinterest And Independence

The Supreme Court's decision in Brehm does not preclude plaintiffs from asserting breach of loyalty claims and demonstrating demand futility under the first prong of Aronson. The Supreme Court carefully worded its opinion to dismiss with prejudice "that part of plaintiffs' [prior] Complaint raising the first prong of Aronson." Brehm, 746 A.2d at 258 (emphasis

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[28]Here, of course, defendants insist they decided - i.e., made a business judgment - to grant Ovitz a Non-Fault Termination (Def. Br. at 4) so defendants' position takes this case out of Rales.

added). The "part" of the prior complaint to which the Supreme Court made reference was "plaintiffs' central allegation that a majority of the Board was beholden to Eisner" who, plaintiffs had claimed, was interested in facilitating Ovitz's Non-Fault Termination to protect Eisner's own financial interest. Id. at 257. As discussed above, the 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.[29]

Defendants cannot sustain their contention that the law of the case doctrine bars plaintiffs' claims. Pursuant to the law of the case doctrine, "findings of fact and conclusions of law by an appellate court are generally binding in all subsequent proceedings in the same case in the trial court or in a later appeal." Insurance Corp. of America v. Barker, 628 A.2d 38, 40 (Del. 1993) (citations omitted). However, the law of the case doctrine only applies to "litigated issues." Id. at 41, n. 5. See also Marine v. State, 624 A.2d 1181, 1184, n. 5 (Del. 1993) ("Previous holdings of an appellate court constitute the law of the case and are conclusive as to litigated issues decided on remand and subsequent appeal.") (citations omitted) Here, the Supreme Court could not have made any factual findings or legal conclusions regarding the New Board's interest and inability to address a demand impartially by virtue of being stripped of

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[29]Plaintiffs would be entitled to overcome the earlier judgment with "newly discovered evidence" in any event. See Court of Chancery Rule 60(b); Grobow v. Perot, 1990 WL 146 at *4 (Del. Ch.), aff'd sub nom. Levine v. Smith, 591 A.2d 194 (Del. 1991) (plaintiffs permitted to assert claims in a second amended complaint based on new evidence after the Court granted a Rule 60(b) motion to amend following final dismissal of the claims).

business judgment rule protection. This is so because the pertinent facts were not known to plaintiffs (or the Supreme Court) at the time.

Nonetheless, even if this Court were to determine that the parties had litigated the issue defendants seek to bar, law of the case would not apply because there is a new factual basis for the issues. The "law of the case" is established when a specific legal principle is applied to an issue presented by facts which remain constant throughout the course of the litigation. Kenton v. Kenton, 571 A.2d 778, 784 (Del. 1990). Law of the case is a doctrine founded on principles of stability and respect for court processes and precedent. However, law of the case is a flexible doctrine, and there are exceptions so that it is not an absolute bar to reconsideration of a prior decision. Gannett Co. v. Kanaga, 750 A.2d 1174, 1181-82 (Del. 2000).

One of these exceptions is when there has been an "important change in circumstances, in particular, the factual basis for issues previously posed." Weedon v. State, 750 A.2d 521, 527-528 (Del. 2000) (emphasis added). A party seeking to avoid application of the law of the case doctrine "must demonstrate newly discovered evidence, a change in law, or a manifest injustice." E.I. du Pont de Nemours v. Admiral Ins. Co., 711 A.2d 45, 55 (Del. 1995) (citations omitted). See also Nebel v. Southwest Bancorp, 1999 WL 135259 at *5 (Del. Ch.) ("[T]o avoid dismissal under the law of the case doctrine, the plaintiffs must submit some new information or allegations that would serve to revitalize the claims that were previously raised, adjudicated, and

found deficient.").[30] This exception is especially applicable where the newly discovered facts were not "known" at the time of the ruling. Id. at *7 n.24.[31]

Because plaintiffs uncovered new factual evidence, which now establishes demand futility pursuant to the first prong of Aronson, the law of the case doctrine cannot bar plaintiffs from challenging the New Board's disinterest. Similarly, plaintiffs are not barred from challenging Eisner's independence in connection with his interaction with Ovitz about the Non-Fault Termination. Def. Br. at 34. The friendship between Eisner and Ovitz may not be a "new fact" (Def. Br. at 34 n.11), but the Complaint's breach of loyalty claims against Eisner are based on facts plaintiffs obtained from their § 220 document demand, which demonstrate that that friendship and Eisner's sense of "owingness" to Ovitz directly influenced Eisner's dealings with Ovitz.

Similarly, the judicial doctrine of collateral estoppel is inapplicable here. It is well-settled that collateral estoppel can only apply if "a question of fact essential to the judgment [was] litigated and . . . determined." Messick v. Star Enterprise, 655 A.2d 1209, 1211 (Del. 1995).

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[30] The cases cited by defendants in their Motion to Dismiss do not involve situations where new facts were uncovered. Rather than discover new facts, the plaintiff in Insurance Corp. of America v. Barker, 628 A.2d 38, 40 n.2 (Del. 1993), merely "added detail" to her amended complaint. In Aronson v. Lewis, 473 A.2d 805 (Del. 1984), the law of the case doctrine is not even mentioned.

[31] The plaintiffs in Nebel found new information upon further discovery and filed a second amended complaint raising claims that had been previously dismissed by the Court because they did not state a legally valid cause of action. The Court refused to dismiss all but one of the claims in the second amended complaint which had previously been dismissed because plaintiffs had developed that claim more fully based on information "unknown" at the time of the earlier ruling. Id.

The New Board's failure to meet and the directors' resultant exposure to liability from the inapplicability of business judgment rule protection was not knowable or pleaded before. The facts now alleged in the Complaint regarding Eisner's and Ovitz's close friendship and how Eisner allowed that friendship to directly impact his judgment were also not previously known to plaintiffs and thus not presented to the Court.

Res judicata does not bar plaintiffs' loyalty claims as they also arise from a different factual nexus than previously alleged. Satterfield v. Pharmacia Corp., 2002 WL 1358751 at * 1 n. 4 (Del. Ch.) (quoting Maldonado v. Flynn, 417 A.2d 378, 381 (Del. Ch. 1980)). Claim preclusion also does not impact the breach of loyalty claims pleaded anew in the Complaint because res judicata finality precludes the reassertion of a substantially similar claim in a second litigation. The Complaint presently before this Court represents a later stage of the same litigation.

E. Disney's Exculpatory Charter Provision Does Not Bar Plaintiffs' Claims

Disney's liability limiting charter provision does not warrant dismissal of the Complaint as a matter of law. Section 102(b)(7) of the General Corporation Law, on which Disney patterned its liability limiting charter, 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. See Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001). A complaint that pleads facts implicating loyalty violations and bad faith misconduct cannot be dismissed, as a matter of law, based upon a liability limiting charter provision. Id; see O'Reilly v. Transworld Healthcare, Inc., 745 A.2d 902, 915-16 (Del. Ch. 1999) (§ 102(b)(7) found inapplicable where

directors' violations of their duty of care were coupled with self-interest and thus violated their duty of loyalty); HMG/Courtland Properties, Inc. v. Gray, 749 A.2d 94, 121 (Del. Ch. 1999) (§ 102(b)(7) found inapplicable where negotiations were undertaken by and among interested directors while concealing information from the rest of the board).[32] As discussed above, plaintiffs have stated valid causes of action against defendants for violating their fiduciary duties by acting recklessly and in bad faith.

In allowing Disney to enter into the OEA without any investigation and consideration of all material information reasonably available to the Old Board, and without consulting an expert or any other consultant, the members of the Old Board, recklessly and in bad faith, violated their fiduciary duties of good faith and due care which they owed to Disney. Compl. ¶ 108. The members of the Old Board failed to consider that the OEA provided Ovitz with severance benefits through a Non-Fault Termination at least as valuable, if not more so, than his compensation if he remained in Disney's employ throughout his term. The OEA (and the accompanying option grant) did not assure Disney the benefit of its bargain or comply with the most elemental requirements of an option grant as it gave Ovitz a powerful incentive to seek a

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[32]A complaint like this one which pleads facts demonstrating that the defendant directors acted recklessly -- meaning a form of conscious conduct "more culpable" than gross negligence involving a conscious disregard of known risks -- states claims tantamount to allegations of bad faith sufficient to overcome a Rule 12(b)(6) and 23.1 dismissal motion based upon an exculpatory charter provision. See McCall v. Scott, 250 F.3d 997, 1000 (6th Cir. 2001). See also Brehm, 746 A.2d at 267 (Harnett, J. concurring) ("Chancery Rules 23.1 and 12(b)(6) are predicated on the Federal Rules of Civil Procedure. The federal precedents therefore carry great weight"); 2 R. Balotti, J. Finkelstein, Delaware Corporations § 4.29, at 4-116 (Sup. 2002) ("[t]o the extent that recklessness involves a conscious disregard of a known risk, it could be argued that such an approach is not one taken in good faith and thus could not be liability exempted under the new statute").

Non-Fault Termination and not fulfill his agreement to work at Disney for at least five years. Accordingly, defendants' bad faith and reckless misconduct constituted waste.

The New Board acted recklessly and in bad faith by abandoning its fiduciary duties to diligently review and approve Ovitz's Non-Fault Termination instead of merely supporting Eisner's dealings with Ovitz. The New Board was obligated to consider alternatives to a Non-Fault Termination, but did not do so. Choosing among these alternatives required the New Board's business judgment, and the task could not be delegated to a single corporate officer -- especially Eisner who had a well-known, long-standing friendship with Ovitz.

In connection with the Non-Fault Termination, the members of the New Board passively supported Eisner's dealings with Ovitz while failing to inform themselves about all material information reasonably available to them, thereby recklessly and faithlessly violating their fiduciary duty of care. Compl. ¶¶ 91-92, 94-96; 116. The New Board failed to intervene in the process despite its duty to do so. Compl. ¶¶ 91-92.

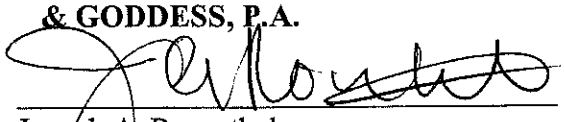
Ovitz received a huge personal benefit from the Disney Board members' fiduciary duty violations as well as his own disloyal conduct when he received the $140 million payout. Compl. ¶¶ 107-111, 114. Eisner violated his fiduciary duty of loyalty by agreeing to the OEA and its terms heavily favoring Ovitz and by arranging a Non-Fault Termination for Ovitz out of an "owing" sense of personal gratitude and to avoid personal embarrassment. Compl. ¶¶ 52-56, 80, 89-97.

In sum, defendants cannot invoke § 102(b)(7) to cause dismissal of the Complaint at this stage of the litigation.

CONCLUSION

For all of the reasons set forth herein, plaintiffs respectfully submit this Court should deny defendants' motion to dismiss in its entirety.

ROSENTHAL, MONHAIT, GROSS & GODDESS, P.A.

By: 

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