IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

APPELLANTS' OPENING BRIEF

PART 3 of 11

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

OPINION AND ORDER

Date Submitted: April 28, 2005
Date Decided: August 9, 2005

Joseph A. Rosenthal, Norman M. Monhait and Carmella P. Keener of ROSENTHAL, MONHAIT, GROSS & GODDESS, P.A., Wilmington, Delaware; Seth D. Rigrodsky, of MILBERG WEISS BERSHAD & SCHULMAN LLP, Wilmington, Delaware; OF COUNSEL: Steven G. Schulman, Joshua H. Vinik, Jennifer K. Hirsh and John B. Rediker, of MILBERG WEISS BERSHAD & SCHULMAN LLP, New York, New York, Attorneys for Plaintiffs.

David C. McBride and Christian Douglas Wright, of YOUNG CONAWAY STARGATT & TAYLOR, LLP, Wilmington, Delaware; OF COUNSEL: Mark H. Epstein and Jason L. Haas, of MUNGER, TOLLES & OLSON LLP, Los Angeles, California, Attorneys for Defendant Michael S. Ovitz.

Andre G. Bouchard and Joel Friedlander, of BOUCHARD, MARGULES & FRIEDLANDER, P.A., Wilmington, Delaware, Attorneys for Nominal Defendant The Walt Disney Company.

Robert K. Payson, Stephen C. Norman and Kevin R. Shannon, of POTTER ANDERSON & CORROON LLP, Wilmington, Delaware, Attorneys for Defendant Sanford M. Litvack.

Jesse A. Finkelstein, Gregory P. Williams, Anne C. Foster, Lisa A. Schmidt, Evan O. Williford and Michael R. Robinson, of RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware, Attorneys for Defendants Stephen F. Bollenbach, Reveta F. Bowers, Ignacio E. Lozano, Jr., George J. Mitchell, Thomas S. Murphy, Richard A. Nunis, Leo J. O'Donovan, S.J., Sidney Poitier, Irwin E. Russell, Robert A. M. Stern, E. Cardon Walker, Raymond L. Watson and Gary L. Wilson.

A. Gilchrist Sparks, III and S. Mark Hurd, of MORRIS, NICHOLS, ARSHT & TUNNELL, Wilmington, Delaware; OF COUNSEL: Stephen D. Alexander and Fred L. Wilks, formerly of FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP, Los Angeles, California, Attorneys for Defendants Roy Disney and Stanley P. Gold.

Lawrence C. Ashby and Richard D. Heins, of ASHBY & GEDDES, Wilmington, Delaware; OF COUNSEL: Gary P. Naftalis, Michael S. Oberman, Paul F. Schoeman and Shoshana Menu, of KRAMER LEVIN NAFTALIS & FRANKEL LLP, New York, New York, Attorneys for Defendant Michael Eisner.

CHANDLER, Chancellor

TABLE OF CONTENTS

INTRODUCTION

This is the Court's decision after trial in this long running dispute over an executive compensation and severance package. The stockholder plaintiffs have alleged that the director defendants breached their fiduciary duties in connection with the 1995 hiring and 1996 termination of Michael Ovitz as President of The Walt Disney Company. The trial consumed thirty-seven days (between October 20, 2004 and January 19, 2005) and generated 9,360 pages of transcript from twenty-four witnesses. The Court also reviewed thousands of pages of deposition transcripts and 1,033 trial exhibits that filled more than twenty-two 3½-inch binders. Extensive post-trial memoranda also were submitted and considered. After carefully considering all of the evidence and arguments, and for the reasons set forth in this Opinion, I conclude that the director defendants did not breach their fiduciary duties or commit waste. Therefore, I will enter judgment in favor of the defendants as to all claims in the amended complaint.

As I will explain in painful detail hereafter, there are many aspects of defendants' conduct that fell significantly short of the best practices of ideal corporate governance. Recognizing the protean nature of ideal corporate governance practices, particularly over an era that has included the Enron and WorldCom debacles, and the resulting legislative focus on corporate governance, it is perhaps worth pointing out that the actions (and the failures to act) of the Disney board that gave rise to this lawsuit took place ten years ago, and that applying 21st century notions of best practices in analyzing whether those decisions were actionable would be misplaced.

Unlike ideals of corporate governance, a fiduciary's duties do not change over time. How we understand those duties may evolve and become refined, but the duties themselves have not changed, except to the extent that fulfilling a fiduciary duty requires obedience to other positive law. This Court strongly encourages directors and officers to employ best practices, as those practices are understood at the time a corporate decision is taken. But Delaware law does not—indeed, the common law cannot—hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices, any more than a common-law court deciding a medical malpractice dispute can impose a standard of liability based on ideal—rather than competent or standard—medical treatment practices, lest the average medical practitioner be found inevitably derelict.

Fiduciaries are held by the common law to a high standard in fulfilling their stewardship over the assets of others, a standard that (depending on the circumstances) may not be the same as that contemplated by ideal corporate governance. Yet therein lies perhaps the greatest strength of Delaware's corporation law. Fiduciaries who act faithfully and honestly on behalf of those whose interests they represent are indeed granted wide latitude in their efforts to maximize shareholders' investment. Times may change, but fiduciary duties do not. Indeed, other institutions may develop, pronounce and urge adherence to ideals of corporate best practices. But the development of aspirational ideals, however worthy as goals for human behavior, should not work to distort the legal requirements by which human behavior is actually measured. Nor should the common law of fiduciary duties become a prisoner of narrow definitions or formulaic expressions. It is thus both the province and special duty of this Court to measure, in light of all the facts and circumstances of a particular case, whether an individual who has accepted a position of responsibility over the assets of another has been unremittingly faithful to his or her charge.

Because this matter, by its very nature, has become something of a public spectacle—commencing as it did with the spectacular hiring of one of the entertainment industry's best-known personalities to help run one of its iconic businesses, and ending with a spectacular failure of that union, with breathtaking amounts of severance pay the consequence—it is, I think, worth noting what the role of this Court must be in evaluating decision-makers' performance with respect to decisions gone awry, spectacularly or otherwise. It is easy, of course, to fault a decision that ends in a failure, once hindsight makes the result of that decision plain to see. But the essence of business is risk—the application of informed belief to contingencies whose outcomes can sometimes be predicted, but never known. The decision-makers entrusted by shareholders must act out of loyalty to those shareholders. They must in good faith act to make informed decisions on behalf of the shareholders, untainted by self-interest. Where they fail to do so, this Court stands ready to remedy breaches of fiduciary duty.

Even where decision-makers act as faithful servants, however, their ability and the wisdom of their judgments will vary. The redress for failures that arise from faithful management must come from the markets, through the action of shareholders and the free flow of capital, and not from this Court. Should the Court apportion liability based on the ultimate outcome of decisions taken in good faith by faithful directors or officers, those decision-makers would necessarily take decisions that minimize risk, not maximize value. The entire advantage of the risk-taking, innovative, wealth-creating engine that is the Delaware corporation would cease to exist, with disastrous results for shareholders and society alike. That is why, under our corporate law, corporate decision-makers are held strictly to their fiduciary duties, but within the boundaries of those duties are free to act as their judgment and abilities dictate, free of *post hoc* penalties from a reviewing court using perfect hindsight. Corporate decisions are made, risks are taken, the results become apparent, capital flows accordingly, and shareholder value is increased.

Because of these considerations, I have tried to outline carefully the relevant facts and law, in a detailed manner and with abundant citations to the voluminous record. I do this, in part, because of the possibility that the Opinion may serve as guidance for future officers and directors—not only of The Walt Disney Company, but of other Delaware corporations. And, in part, it is an effort to ensure meaningful appellate review. Ultimately, however, it is for others to judge whether my effort here offers reasonable guidance to corporate directors, in general, on the subject of executive compensation and severance payments.[1] What follows is my judgment on whether each director of The Walt Disney Company fulfilled his or her obligation to act in good faith and with honesty of purpose under the unusual facts of this case.

---

[1] The subject of executive compensation itself has recently produced much thoughtful analysis and comment. *See, e.g.*, Lucian Bebchuk and Jesse Fried, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004) (describing how management influence distorts the compensation process); Stephen M. Bainbridge, *Executive Compensation: Who Decides*, 83 TEX. L. REV. 1615 (2005) (reviewing and critiquing Bebchuk and Fried's *Pay Without Performance*).

I. FACTS[2]

A. *Michael Ovitz Joins The Walt Disney Company*

1. Background

The story of Michael Ovitz's rise and fall at The Walt Disney Company ("Disney" or the "Company") begins with the unfortunate and untimely demise of Frank Wells. Before his death, Wells served as Disney's President and Chief Operating Officer, and both he and Michael Eisner, Disney's Chairman and CEO, enjoyed ten years of remarkable success at the Company's helm. In April 1994, a fatal helicopter crash ended Wells' tenure at Disney and forced the company to consider a decision it was not properly prepared or ready to make.[3]

Disney's short list of potential internal successors produced, for one reason or another, no viable candidates.[4] Instead, Eisner assumed Disney's presidency, and for a brief moment, the Company was able to stave off the need to replace Wells. Within three months, however, misfortune again struck the Company when Eisner was unexpectedly diagnosed with heart

---

[2] To be consistent with the parties' submissions, the trial transcript will be cited as "Tr. ####," and at relevant times will indicate the particular witness by including that witness' name in parentheses. Deposition testimony will be cited as "[Deponent] ####." Plaintiffs' trial exhibits will be cited as "PTE" and Defendants' trial exhibits will be cited as "DTE." Finally, for the sake of clarity, the Court will refer to Roy Disney as such.

[3] *See* Tr. 4148:11-4150:5.

[4] Tr. 3997:24-3999:4; *see also* 6025:7-19.

disease and underwent quadruple bypass surgery. The unfortunate timing of Eisner's illness and operation set off an "enormous amount of speculation" concerning Eisner's health and convinced Eisner of the need to "protect[] the company and get[] help."[5] Over the next year, Eisner and Disney's board of directors discussed the need to identify Eisner's successor. These events were the springboard from which Eisner intensified his longstanding desire to bring Michael Ovitz within the Disney fold.[6]

By the summer of 1995, Michael Ovitz and Michael Eisner had been friends for nearly twenty-five years. These men were very well acquainted, both socially and professionally. Over time, this relationship engendered numerous overtures, by which Eisner and Ovitz flirted with the idea of joining ranks and doing something together.[7] As Eisner put it: "I had been trying to hire him forever. . . . I couldn't do business with him . . . he was too tough, so I thought he would be better . . . on our side."[8] But until Eisner had

---

[5] *See* Tr. 4150:20-4152:8.

[6] Eisner never called a board meeting for the specific purpose of discussing the possibility of hiring Ovitz, but at various times Eisner did contact board members on an individual basis. *See* Tr. 3665:1-3676:20 (Gold); 3997:6-3999:4 (Roy Disney); 4699:19-4700:24 (Eisner); 5913:23-5914:10 (Bowers); 7125:2-18 (Poitier); 7628:19-7629:2 (Lozano); 8142:2-8 (Stern); *see also* Bowers 183:13-185:6; 192:8-25; Lozano 54:13-56:14; Mitchell 17:23-19:14; Wilson 44:22-45:23; 48:14-49:2.

[7] Tr. 1105:12-1106:13 (Ovitz) ("[O]ver the years, he had asked me, and we had talked many times about doing something together from the time he [Eisner] was with ABC, then at Paramount and then when he went to Disney.").

[8] Eisner 111:3-112:2.

offered Ovitz Disney's presidency, Ovitz had never seriously considered any of Eisner's offers and, according to Ovitz, there was good reason.

Michael Ovitz's interest in the entertainment industry was kindled during his high school years and, from that time through college, Ovitz held different posts at Universal Studios and Twentieth Century Fox. After graduating college, Ovitz left the studios and gained employment in the mailroom of the William Morris Agency. At that time, William Morris was well regarded as the oldest and largest theatrical talent agency in the world.[9] Ovitz worked for William Morris for six years, and had worked his way up to become a talent agent within the agency's television department. Here, Ovitz began to question the company's direction and its approach to representing its clients. Despite several colleagues' attempts to address their discontent with management, their efforts were not well received and, eventually, these philosophical disagreements led to an impasse. Ovitz and four other William Morris agents left, and Creative Artist Agency ("CAA") was born.

---

[9] Tr. 1091:6-10.

CAA had a modest beginning and, from 1974 to 1979, the company's revenues were barely sufficient to meet its expenses.[10] During this period, most of CAA's business focused on the television industry, because CAA was self-financed and television revenues were more certain than revenues from feature films.[11] It was not until late 1979 that CAA branched off into the motion picture industry, and another four or five years later, the company moved into the music and consulting businesses. Ovitz attributes CAA's rise, in part, to a business model that he dubbed: "packaging."[12] As Ovitz explained, before CAA, it was Hollywood studios, distributors or networks that controlled the talent "either contractually or by virtue of the fact that they had all of the distribution capability."[13] CAA revolutionized this system by grouping various talents, whether they were actors, directors or writers. These "packaged" talents could then coordinate their efforts to best exploit their leverage and maximize the economics of any given deal.[14] The effect of Ovitz's business model was clear. By 1995, CAA had

---

[10] CAA's beginnings were so modest that the wives of the five founding partners were needed on a rotating basis to answer the company's phones. Tr. 1093:1-5.

[11] Tr. 1094:20-1095:16.

[12] *Id.*

[13] Tr. 1093:8-24.

[14] During trial, Ovitz best explained the concept of packaging by way of example. After Warner Brothers had rejected the screenplay for the motion picture *Rain Man*, the screen writer, using CAA as a conduit, was able to pass his work on to Dustin Hoffman, who teamed up with Tom Cruise, another CAA client, and Barry Levinson, to produce a picture that went on to win 1989's Academy Award for Best Picture. Tr. 1094:2-19.

reshaped an entire industry and had grown from five men sitting around a card table to the premier Hollywood talent agency. When Ovitz joined Disney, he left behind 550 employees and an impressive roster of about 1400 of Hollywood's top actors, directors, writers and musicians—a roster that earned CAA approximately $150 million in annual revenues. In turn, this success translated into an annual income of $20 million for Ovitz and, for his part, he was regarded as one of the most powerful figures in Hollywood.

2. <u>Ovitz First Contemplates Leaving CAA But His Negotiations With MCA Fail</u>

In the spring of 1995, CAA was retained to facilitate negotiations between the Seagram Company and Matsushita where Seagram was to purchase eighty percent of Matsushita's holdings in Music Corporation of America ("MCA," now known as Universal Studios). During those negotiations, Edgar Bronfman Jr., Seagram's Chairman and CEO, who had known Michael Ovitz for a number of years, began to discuss with Ovitz the possibility of leaving CAA and joining MCA.

Bronfman's deal contemplated MCA purchasing CAA's consulting business from Ovitz, Ron Meyer and Bill Haber (the three remaining CAA founders and its only shareholders) in exchange for MCA stock. Ovitz, Meyer, and Haber would then sell their remaining CAA interest to a third party and use the proceeds to purchase more MCA stock.[15] If the deal were consummated, Ovitz would take MCA's reins as Chairman and CEO and would be paid handsomely for the job, including options for an additional 3.5 percent of MCA, $1.5 million in Seagram shares, and a seven-year contract (with a three-year renewal option) that paid a seven-figure salary with performance-based cash bonuses that could reach three to five times the base salary.[16]

By June 1995, it was apparent that Ovitz's deal with MCA would never materialize. Ovitz attributed this failure to his rising skepticism over his ability to improve "a company that had been flat for five [or more] years" in a culture unlikely "to support the effort of expansion, capital expenses, and changing overhead" that Ovitz perceived was needed.[17] Fueling Ovitz's skepticism was his perception that sudden changes to the terms of the CAA/MCA deal were not coming from Bronfman, but, in fact, were instigated at the behest of Bronfman's father and uncle, who were controlling shareholders in the Seagram Company. In the end, Ovitz

---

[15] If the fair market value of CAA's non-consulting business was less than $50 million, Ovitz, Meyer and Haber would be required to invest their personal assets to bring their collective investment in MCA up to $50 million. In return, MCA would provide Ovitz, personally, with ninety percent of the quantity of MCA restricted stock needed to bring the three CAA shareholders' collective stake in MCA equity up to six and a half percent. PTE 793.

[16] *Id.*

[17] Tr. 1280:14-1281:22.

remained unconvinced that Bronfman could deliver the things that he was promising to deliver.[18]

With the MCA deal falling apart, Ovitz returned to CAA and business continued as usual until Ovitz discovered that his close friend and number two at CAA, Ron Meyer, was leaving for MCA. This revelation devastated Ovitz, who had no idea Meyer was interested in leaving CAA, let alone leaving without Ovitz. Suddenly, the prospect of Ovitz remaining with the company he and Meyer built no longer seemed palatable, and Ovitz became receptive to the idea of joining Disney.

3. Ovitz Seriously Considers Joining The Walt Disney Company

Michael Eisner had been following Ovitz's talks with MCA closely and believed that now was the time to either talk to Ovitz seriously about joining Disney or face the possibility of having Ovitz at the helm of a major Disney competitor.[19] Thus, the informal overtures that had spanned the last

---

[18] *Id.*

[19] *See* Tr. 4173:24-4175:12 (Eisner) ("I saw a parade of horribles in front of me, which were resolved in a fairly, averagely managed company coming back to America. I saw a company that spent money pretty freely, wanting maybe to get Michael Ovitz to come manage it. And I was getting a little nervous about the prospect of … having Michael Ovitz work for us be usurped by MCA, and not only have him not work for us but be a competitor.").

two decades intensified and Eisner was "on a hunt"[20] to bring Ovitz to Disney.

Eisner's renewed efforts to recruit Ovitz received support from Sid Bass and Roy Disney (Roy Disney was also a director of the Company), two of the company's largest individual shareholders.[21] Hoping not to be outdone by MCA, Eisner and Irwin Russell (the chairman of Disney's compensation committee) reached out to Ovitz and attempted to convince him to join Disney. Both Eisner and Russell knew the basic terms and economics of MCA's offer and both knew that Disney would not match or exceed those terms. For this reason, the initial talks with Ovitz were unproductive and ended in short order. Eisner could not compete with the rich terms MCA was offering and he settled on the notion that Disney would have "to live with [Ovitz going to] a competitor because [Disney] could not match [MCA's terms]."[23] Within a few weeks, however, the tides changed and Eisner learned that Meyer was leaving CAA to join MCA. For the first time, Eisner's desire to hire Ovitz was aligned with Ovitz's desire to leave CAA.

---

[20] *Id.*

[21] From the beginning, Bass made clear that he would support Ovitz's hiring but that he would not support Ovitz sharing equal power with Eisner. *See* PTE 778 at MDE 000053.

[22] *See, e.g.*, Tr. 4175:13-4177:3.

[23] *Id.*