69

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

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

OPENING BRIEF IN SUPPORT OF DEFENDANT MICHAEL S. OVITZ'S MOTION TO DISMISS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

INTRODUCTION 1

FACTUAL AND PROCEDURAL BACKGROUND 2

ARGUMENT 4

I. MR. OVITZ BREACHED NO FIDUCIARY DUTIES IN NEGOTIATING AND SIGNING HIS EMPLOYMENT AGREEMENT 4

A. Even If Mr. Ovitz Owed Fiduciary Duties To Disney While Negotiating His Compensation, He Could Not Have Breached Such Duties As A Matter Of Law. 5

B. The Contract Terms Did Not Change Materially After Mr. Ovitz Started Working At Disney. 7

II. MR. OVITZ DID NOT BREACH HIS FIDUCIARY DUTIES BY OBTAINING BENEFITS GUARANTEED TO HIM BY HIS EMPLOYMENT AGREEMENT. 10

III. IF THE COURT FINDS THAT THE COMPLAINT STATES A CLAIM UNDER 12(b)(6), IT MUST NEVERTHELESS DISMISS THE COMPLAINT FOR FAILURE TO EXCUSE PRE-SUIT DEMAND TO DISNEY'S BOARD OF DIRECTORS UNDER COURT OF CHANCERY RULE 23.1. 14

CONCLUSION 16

TABLE OF AUTHORITIES

Cases **Pages**

Brehm v. Eisner,
746 A.2d 244 (Del. 2000).....*passim*

Church Point Wholesale Beverage v. Voitier,
706 So.2d 1015 (La. App. 3 Cir. 1998).....6

Cochran v. Stifel Financial Corp.,
Del. Ch., C.A. No. 17350, 2000 Del. Ch. LEXIS 179,
Strine, V.C. (Dec. 13, 2000).....5

Gagliardi v. TriFoods Intern., Inc.,
683 A.2d 1049 (Del. Ch. 1996).....6, 11

Haber v. Bell,
465 A.2d 353 (Del. Ch. 1985).....5

In re The Walt Disney Co. Deriv. Litig.,
731 A.2d 342 (Del. Ch. 1998), *aff'd in part and reversed in part*,
Brehm v. Eisner, 746 A.2d 244 (Del. 2000).....*passim*

Jacobson v. American Tool Companies, Inc.,
588 N.W.2d 67 (Wisc. App. 1998).....12

Kaufman v. Beal,
Del. Ch., C.A. Nos. 6485, 6526, 1983 Del. Ch. LEXIS 391,
Hartnett, V.C. (Feb. 25, 1983).....12

Kleinsasser v. McNamara,
18 P.2d 423 (1 Cal. App. 1933).....6

Orban v. Field,
Del. Ch., C.A. No. 12820, 1997 Del. Ch. LEXIS 48,
Allen, C. (Apr. 1, 1997).....12

Parnes v. Bally Entertainment Corp.,
Del. Ch., C.A. No. 15192, 1997 Del. Ch. LEXIS 70,
Chandler, V.C. (May 12, 1997).....11

Rabkin v. Philip A. Hunt Chemical Corp.,
498 A.2d 1099 (Del. 1985).....4

Rales v. Blasband,
634 A.2d 927 (Del. 1993),.....14, 15

Sorenson v. Overland Corp.,
142 F. Supp. 354 (D. Del. 1956).....5

Telxon Corp. v. Bogomolny,
Del. Ch., 792 A.2d 964, 2001 Del. Ch. LEXIS 131,
Lamb, V.C. (Oct. 29, 2001).....10

Wilderman v., Wilderman,
351 A. 2d 610 (Del. Ch. 1972).....11

Yaw v. Talley,
Del. Ch., C.A. No. 12882, 1994 Del. Ch. LEXIS 35,
Jacobs, V.C. (Mar. 2, 1994).....11

Other Authorities

8 *Del. C.* § 220.....3

INTRODUCTION

This case raises two questions: (1) whether a person owes a fiduciary duty to his employer or prospective employer *not* to bargain for the best employment contract possible, and (2) whether (having obtained a contract) a corporate executive owes his employer a fiduciary duty *not* to enforce the contract's terms. The answer to these questions is intuitively obvious: no such duty exists. Absent fraud or self-dealing, there is, quite simply, nothing wrong with a corporate executive seeking to negotiate the deal most beneficial to his interests. Because plaintiffs' claims against Mr. Ovitz are based entirely upon premises contrary to settled Delaware law, and for the additional reasons set forth in Disney's brief filed on April 19, 2002, the Second Amended Consolidated Derivative Complaint (D.I. 66) (the "Complaint" or "Compl.") fails to state a claim upon which relief may be granted against Mr. Ovitz and should be dismissed with prejudice.

FACTUAL AND PROCEDURAL BACKGROUND

In 1995, the Walt Disney Company ("Disney" or the "Company") recruited Michael Ovitz to be its President, reporting directly to its Chairman and Chief Executive Officer, Michael Eisner. (Compl. at ¶¶ 3, 30.) Mr. Ovitz was, at the time, the Chairman and founder of Creative Artists Agency ("CAA"), the nation's leading talent agency (Compl. at ¶ 17(b)), and (as plaintiffs alleged in their prior complaint) said to be "the most powerful man in Hollywood." (Stockholders' Derivative Complaint (D.I. 1) at ¶20.) To accept the job at Disney, Mr. Ovitz had to relinquish his position with and ownership of CAA. *In re The Walt Disney Co. Deriv. Litig.*, 731 A.2d 342, 362 (Del. Ch. 1998) (hereafter "*Disney I*"), *aff'd in part and reversed in part, Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

Mr. Ovitz decided to accept Disney's offer and join the Company. Prior to doing so, however, he and the Company negotiated the essential terms of his employment contract. (Compl. at ¶¶ 31, 32.) Those terms reflected the substantial sacrifice Mr. Ovitz was making by leaving CAA as well as his substantial new responsibilities as the Company's second highest ranking executive. On October 1, 1995, after the Compensation Committee of Disney's Board of Directors (the "Board") approved the contract's essential terms (Compl. at ¶ 46), and after Disney sent a proposed agreement to Mr. Ovitz, Mr. Ovitz left CAA and began working at Disney (Compl. at ¶ 51). The final contract was signed on December 16, 1995 and was effective "as of" October 1, 1995. (Compl. at ¶ 52.) Under the terms of the contract, if Disney terminated Mr. Ovitz other than for a contractually defined cause (a "Non Fault Termination"), Mr. Ovitz would be entitled to substantial termination benefits. (Compl. at ¶¶ 60-65.)

Unfortunately, things did not work out as everyone had hoped, and by the latter part of 1996, Disney and Mr. Ovitz were discussing a mutually agreeable termination of Mr. Ovitz's employment. (Compl. at ¶¶ 69-71.) As a result of those discussions, Mr. Ovitz left Disney on December 27, 1996 with the Company's permission – a procedure provided for in the contract as being equivalent to a Non Fault Termination – and Disney paid the contractually required termination benefits to Mr. Ovitz. (Compl. at ¶ 85-87.) Plaintiffs then brought a derivative claim against the defendants herein, including Mr. Ovitz. They did not make a demand on the Board, however, claiming instead that such demand would be futile and was therefore excused.

In 1998, defendants filed a motion to dismiss the complaint for failure to make a pre-suit demand on the Board, which this Court granted. *Disney I*, 731 A.2d at 362. The Delaware Supreme Court upheld this Court's dismissal for failure to comply with Court of Chancery Rule 23.1's demand requirement, but held that the dismissal should be without prejudice so as to give plaintiffs a limited opportunity to amend their complaint. *Brehm v. Eisner*, 746 A.2d 244, 262 (Del. 2000) (hereafter "*Disney II*").

On January 3, 2002, following an inspection of Disney's books and records pursuant to 8 *Del. C.* §220, plaintiffs filed the Complaint. On January 25, 2002, Mr. Ovitz moved to dismiss the Complaint for failure to state a claim upon which relief may be granted and for failure to make a pre-suit demand on the Board. This is the opening brief in support of Mr. Ovitz's motion.

ARGUMENT

The standard for dismissal of a complaint under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief may be granted is well-settled. A complaint should be dismissed whenever it appears "with reasonable certainty . . . [that] a plaintiff would not be entitled to the relief sought under any set of facts which could be proven to support the action." *Rabkin v. Philip A. Hunt Chemical Corp.*, 498 A.2d 1099, 1104 (Del. 1985). Plaintiffs in this action have been given ***three*** chances to state a claim against Mr. Ovitz and, as set forth below, have failed to articulate a viable cause of action every single time. The claims against Mr. Ovitz should therefore be dismissed with prejudice.

I. MR. OVITZ BREACHED NO FIDUCIARY DUTIES IN NEGOTIATING AND SIGNING HIS EMPLOYMENT AGREEMENT.

Plaintiffs' first claim against Mr. Ovitz is that he breached his fiduciary duty to Disney when he entered into his employment contract. Plaintiffs recognize, as they must, that Mr. Ovitz owed Disney no fiduciary (or other) duty prior to October 1, 1995, when he started work at the Company. Indeed, in their prior complaints, plaintiffs did not even allege a breach of duty against Mr. Ovitz regarding the contract's formation.

To get around this obvious obstacle, plaintiffs assert that Mr. Ovitz "substantially" changed the deal between the time he started work and the time when the written contract was formally signed. Plaintiffs' claim fails for two independent reasons: it is legally wrong and it is factually unsupported by any well-pleaded allegations in the complaint.

A. Even If Mr. Ovitz Owed Fiduciary Duties To Disney While Negotiating His Compensation, He Could Not Have Breached Such Duties As A Matter Of Law.

Absent fraud or self dealing, corporate officers are free to negotiate the best terms of employment they can with their employers, and no "fiduciary duty" requires them to "roll over" in the negotiation. Thus, it is well-settled that a corporation's directors have the authority to set the compensation of corporate officers, and their decisions are protected by the business judgment rule. *Haber v. Bell*, 465 A.2d 353, 359 (Del. Ch. 1985). Such a decision by a board of directors is accorded great deference, as both this Court and the Delaware Supreme Court recognized earlier in these proceedings. *Disney I*, 731 A.2d at 362; *Disney II*, 746 A.2d at 263. By allocating such authority to directors, employees are released from the untenable position of trying to balance their personal interests in seeking a favorable contract with their duty to the corporation to forego such an agreement. *See Cochran v. Stifel Financial Corp.*, Del. Ch., C.A. No. 17350, 2000 Del. Ch. LEXIS 179, at *20-21, Strine, V.C. (Dec. 13, 2000); *Sorenson v. Overland Corp.*, 142 F. Supp. 354, 358 (D. Del. 1956), *aff'd*, 242 F.2d 70, 72 (3d.Cir. 1957). It is, therefore, incumbent on those negotiating on the corporation's behalf to look out for the corporation's interest. The corporate executive – who is on the other side of the table – is free to negotiate the best deal possible for himself. *Cf. Cochran*, 2000 Del. Ch. LEXIS 179, at *18 (noting that "when a person signs an employment agreement with . . . the corporation he serves, he is, one would think, acting as an individual").

Plaintiffs advance a different theory. They allege that a corporate officer, negotiating his own contract with the company, still has a fiduciary duty to insure that the resulting contract is in the company's best interest. This position has no basis in

Delaware law, which, as noted above, holds that an employee is not required to place the company's interest above his or her own in the bargaining process. *See Gagliardi v. TriFoods Intern., Inc.*, 683 A.2d 1049, 1051 (Del. Ch. 1996) ("No allegations concerning [the defendant former president's] control, domination or fraudulent manipulation of the corporate process that fixed his compensation is made...," and therefore the court had no reason not to apply business judgment rule and dismiss the count for failure to state a claim); *Church Point Wholesale Beverage v. Voitier*, 706 So.2d 1015, 1020-1021 (La. App. 3 Cir. 1998) (no breach of duty when corporate executive negotiated employment contract but did not vote to approve the contract, the contract was approved by disinterested persons, and no evidence of coercion); *Kleinsasser v. McNamara*, 18 P.2d 423, 427 (1 Cal. App. 1933) (Corporate officers may contract with their employers without breaching their duties as long as there is no fraud, self-dealing or "inequitable circumstances"). Plaintiffs' proposed rule, in addition to being contrary to settled Delaware law, would put executives in the completely untenable position of having to bargain against themselves during the negotiation process, making negotiations between corporate officers and their employers effectively impossible. Such, plainly, is not the law, and no court of which Mr. Ovitz is aware has ever adopted plaintiff's novel position.[1]

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[1] Of course, the situation is different when self-dealing is involved. If the executive is setting his or her *own* compensation, then courts are freer to review the unilaterally imposed contract for overall fairness to the company. *See Wilderman v. Wilderman*, 315 A.2d 610, 615 (Del. Ch. 1974). The instant case, however, does not involve self-dealing. Mr. Ovitz bargained with disinterested parties at all times. *Disney II*, 746 A.2d at 258. He did not, and could not, unilaterally impose or approve his own contract on Disney's behalf.

Plaintiffs have not even attempted to overcome this defect in their claim by alleging fraud or self-dealing by Mr. Ovitz. Moreover, the Delaware Supreme Court conclusively held that the Board (and thus its Compensation Committee) was disinterested in the transaction. *Disney II*, 746 A.2d at 258. Indeed, the most plaintiffs have alleged is that Messrs. Ovitz and Eisner were longstanding friends (Compl. at ¶ 29), but such an allegation – alleged in the prior complaint – is of no legal moment, for the law does not require that corporate executives or directors be strangers to one another.

For all of these reasons, Mr. Ovitz had no fiduciary duty not to bargain for the best employment contract he could obtain, even after he started working for the Company.

B. The Contract Terms Did Not Change Materially After Mr. Ovitz Started Working At Disney.

Even assuming, *arguendo*, Mr. Ovitz had some fiduciary duty not to change the terms of his contract once he started working at Disney, plaintiffs' claim would still fail because no such change occurred. Indeed, plaintiffs admit that "much of the [Employment Agreement] had already been formulated" as of September 26, 1995, before Mr. Ovitz commenced his employment at Disney. (Compl. at ¶ 32.)

Plaintiffs themselves allege only two "changes" that they claim give rise to liability. Plaintiffs first claim that the definition of a "Non Fault Termination" was expanded from situations where Mr. Ovitz was wrongfully terminated in breach of contract, to include situations where Mr. Ovitz was terminated for any reason other than gross negligence or malfeasance. (Compl. at ¶ 54.) The problem with plaintiffs' assertion is that it is comparing apples to oranges. The proper stick by which to measure

any alleged change is between Disney's September 23, 1995 proposal to Mr. Ovitz and the final contract.[2] Such a comparison readily reveals that the gross negligence or malfeasance was part of the contract prior to Mr. Ovitz starting work at Disney. (*Compare* Ex. 1, ¶ 11(a)(iii) *with* the Ovitz Employment Agreement ¶ 11(a)(iii).) Rather than compare those documents, though, plaintiffs improperly compare the Compensation Committee's "term sheet" – which they assert equated a non-fault termination with a breach of contract by Disney – with the final contract. But plaintiffs do not allege (nor can they) that Mr. Ovitz controlled the Compensation Committee process, or that he knew or approved the papers the Committee reviewed. Thus, he cannot be held to have "changed the deal" based on those papers and those papers are simply irrelevant here. Rather, Mr. Ovitz can only be expected to know what was in the proposal Disney made to him, and as to that, Mr. Ovitz made no material changes to the provisions regarding non fault terminations.[3]

Plaintiffs' second claimed "change" is that Mr. Ovitz was given "in the money" stock options rather than market price options. Plaintiffs do not allege, however, that the number of options changed or that the vesting terms changed. (Compl. at ¶¶ 55, 56.) Instead, the gist of plaintiffs' theory is that the option price should have been renegotiated to reflect market prices on the day the final contract was physically signed or the options were formally granted, rather than remaining at the price agreed upon (i.e. the market price on the trading day after Mr. Ovitz started work). Plaintiffs provide no

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2 The September 23, 1995 proposal is attached hereto as Exhibit 1.

3 Moreover, for the reasons set forth in Disney's brief, the Compensation Committee gave due consideration to all of the salient terms of the deal.

support for that odd notion. The agreement, *as proposed by Disney* prior to October 1, provided that the option price would be set at the market price as of October 2, 1995 – the first trading day after Mr. Ovitz started work. (Compl. at ¶ 56.) This term never materially changed.[4] That there was some delay in formalizing the contract or issuing the options does not change the parties' agreement or mutual intent. The point of the option price date was to tie the price to the time Mr. Ovitz started working at Disney – October 1995. By that point, he had given up his interest in CAA, and, like other Disney executives, was devoting his efforts to the Company. There is no logical reason (and plaintiffs suggest none) why the price should instead be judicially tied to the date the contract was formally executed or the options formally issued.

* * *

In sum, Mr. Ovitz owed Disney no duty, fiduciary or otherwise, in the negotiation of his own contract, even after he started working at the Company. Moreover, even were this Court to find such a duty, the duty was not breached because Mr. Ovitz did not materially change the contract terms after he started work. Thus, plaintiffs have stated no claim against Mr. Ovitz relating to the formation of his contract. As such, those aspects of the Complaint should be dismissed with prejudice.

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[4] The actual exercise price was re-set by the Compensation Committee to the market price on October 16, 1995 due to a change in Disney's overall stock plan. Plaintiffs concede, however, that the October 16 price "was roughly the same as that of October 2, 1995." (Compl. at ¶ 56.)

II. MR. OVITZ DID NOT BREACH HIS FIDUCIARY DUTIES BY OBTAINING BENEFITS GUARANTEED TO HIM BY HIS EMPLOYMENT AGREEMENT.

Plaintiffs' second broad claim is that Mr. Ovitz's acceptance of contractually-mandated termination benefits negotiated at arm's-length somehow breached a "fiduciary duty" he owed to Disney (or that he colluded in others' breach of their own fiduciary duties), because the payment (by Disney) and acceptance (by Mr. Ovitz) of those benefits constituted a waste of Disney's assets. Plaintiffs' argument fails for three reasons. *First*, this Court and the Delaware Supreme Court have both already found that both Mr. Eisner and the Board were disinterested. Absent self-dealing or fraud, disinterested Company approval of Mr. Ovitz's termination benefits is, in and of itself, fatal to plaintiffs' claim of breach of duty by Mr. Ovitz. *Second*, plaintiffs' bare allegations of "collusion" with Mr. Eisner – even were such allegations relevant – are not supported by any particularized allegations of wrongdoing by anyone. *Finally*, plaintiffs utterly fail to support their claim for waste.

Generally, an employee has no duty, fiduciary or otherwise, to eschew the benefits of a bargained-for contract. Indeed, in every case in which a derivative claim for excessive compensation has been permitted to go forward against an employee, the courts have found allegations of fraud, self-dealing, or compensation over and above that provided in the contract. *See, e.g.*, *Telxon Corp. v. Bogomolny*, 792 A.2d 964, 2001 Del. Ch. LEXIS 131, at *22, Lamb, V.C. (Oct. 29. 2001) (breach of fiduciary duty claims against former CEO/director based on self-dealing stated a claim when all but one other director were financially beholden to him); *Parnes v. Bally Entertainment Corp.*, Del. Ch., C.A. No. 15192, 1997 Del. Ch. LEXIS 70, at *11-12, Chandler, V.C. (May 12,

1997) (complaint stated a claim for waste when CEO allegedly demanded extra contractual payments to permit merger to proceed and board allegedly acquiesced); *Yaw v. Talley*, Del. Ch., C.A. No. 12882, 1994 Del. Ch. LEXIS 35, at *27-28, Jacobs, V.C. (Mar. 2, 1994) (excusing pre-suit demand when director/officer defendants were specifically alleged to have engaged in self-dealing); *Wilderman v., Wilderman*, 351 A. 2d 610, 615 (Del. Ch. 1972). None of those factors are present here.

First, Mr. Ovitz received nothing beyond the Non Fault Termination benefits set forth in his contract. Plaintiffs do not allege to the contrary.

Second, there is no fraud. Plaintiffs do not, and cannot, allege that Mr. Ovitz deceived or defrauded Mr. Eisner (or Disney) in any way. In fact, the Complaint shows that Messrs. Ovitz and Eisner were very open with each other. (Compl. at ¶¶ 77, 80, 82.) Nor do plaintiffs allege that Mr. Ovitz exerted any undue influence over Mr. Eisner. The most they allege is that Messrs. Ovitz and Eisner were friends – a circumstance that this Court has already held falls far short of wrongdoing. *Disney I*, 731 A.2d at 355. In fact, as set forth in greater detail in Disney's brief, far from "colluding" with Mr. Ovitz, Mr. Eisner at all times put the Company's interests above any personal friendship.

Third, there is no self-dealing. Mr. Ovitz did not, of course, approve the Non Fault Termination on Disney's behalf. Further, Mr. Eisner and the Board were independent and disinterested with regard to the Non Fault Termination payment. *See Disney I*, 731 A.2d at 361; *Disney II*, 746 A.2d at 258. Such a finding, in the absence of fraud or self-dealing by Mr. Ovitz, is sufficient to dismiss the claim against Mr. Ovitz. *See Gagliardi*, 683 A.2d at 1049 (holding allegations of excessive compensation failed to state a claim when there were no allegations of self-dealing or improper motive by the

officer or of bad faith or interest by the board); *Kaufman v. Beal*, Del. Ch., C.A. Nos. 6485, 6526, 1983 Del. Ch. LEXIS 391, at *27, Hartnett, V.C. (Feb. 25, 1983) (dismissing excessive compensation claim for failure to excuse demand because compensation approved by independent board).

Accordingly, Mr. Ovitz was entitled to insist on the benefit of his bargain. *See Orban v. Field*, Del. Ch., C.A. No. 12820, 1997 Del. Ch. LEXIS 48, at *31-32, Allen, C. (Apr. 1, 1997) (summary judgment on claim that executive improperly received a severance payment when his employment contract provided for such payment); *Jacobson v. American Tool Companies, Inc.*, 588 N.W.2d 67, 73 (Wisc. App. 1998) ("[a]s an employee [the defendant former CEO] cannot be faulted for seeking compensation commensurate with promises contained in his employment contract").

Perhaps implicitly conceding the legal insufficiency of their claims against Mr. Ovitz, plaintiffs resort to accusing Mr. Ovitz of "colluding" with Mr. Eisner to breach Mr. Eisner's fiduciary duties to Disney. But these accusations fail in two critical respects. *First*, plaintiffs are unable to explain what purportedly improper action Mr. Ovitz allegedly took to convince Mr. Eisner to supposedly breach his fiduciary duties to Disney. The most plaintiffs have alleged is that two colleagues and friends put the best face on a difficult situation, thereby avoiding protracted litigation and negative publicity. (Compl. at ¶¶ 77-85.) That hardly amounts to wrongful conduct. *Second*, plaintiffs have failed to allege adequately how *Mr. Eisner* breached his duty to Disney. There was no breach of Mr. Eisner's duty of loyalty because, as this Court found, Mr. Eisner did not lack disinterest. Nor do plaintiffs allege that Mr. Eisner was not fully informed concerning his decision to grant Mr. Ovitz a Non Fault Termination. *Finally*,

plaintiffs admit that the Board was aware of the negotiations regarding Mr. Ovitz's departure from Disney (Comp. at ¶¶ 92, 93), and there is no particularized allegation that any pertinent information was withheld from the Board. Thus, all that is left is plaintiffs' after-the-fact critique of the Company's decision. That Mr. Eisner and Disney chose to honor a contract rather than to breach it (and thereby expose the Company to expensive and protracted litigation), however, is not the stuff of a lawsuit.[5]

All that remains, then, is plaintiffs' untenable waste claim. Again, however, no such claim lies against Mr. Ovitz, or, for that matter, against any other defendant. As set forth in greater detail in Disney's brief, the allegations in the instant complaint fall well short of those necessary to state a claim for waste. Indeed, Mr. Ovitz is aware of no case allowing a waste claim to proceed against an employee receiving only previously bargained-for compensation, at least in the absence of particularized allegations of fraud or self-dealing.

Plaintiffs' fundamental claim thus boils down to this: without engaging in fraud or self-dealing, Mr. Ovitz somehow breached his fiduciary duty to Disney simply because he accepted the benefits of an employment contract that he had previously negotiated with Disney on an arm's-length basis, and that the Company's decision to honor the contract somehow constitutes waste. Such conduct does not breach any fiduciary duty,

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5 The lack of any adequate allegations as to Mr. Eisner is more fully demonstrated in the Disney brief.

and the Complaint therefore fails to state a claim for which relief can possibly be granted.[6]

* * *

In sum, plaintiffs' claims regarding Mr. Ovitz's departure fall short on every possible theory. The claims against Mr. Ovitz must be dismissed with prejudice.

III. IF THE COURT FINDS THAT THE COMPLAINT STATES A CLAIM UNDER 12(b)(6), IT MUST NEVERTHELESS DISMISS THE COMPLAINT FOR FAILURE TO EXCUSE PRE-SUIT DEMAND TO DISNEY'S BOARD OF DIRECTORS UNDER COURT OF CHANCERY RULE 23.1.

The Complaint must be also dismissed as to Mr. Ovitz because plaintiffs failed to make a pre-suit demand on the Board. None of the allegedly wrongful acts attributed to Mr. Ovitz were taken by him in his capacity as a member of the Board, and plaintiffs do not attempt to allege otherwise. Since the challenged acts *by Mr. Ovitz* were not part of a decision by Disney's Board, to excuse demand here plaintiffs must satisfy the test set forth in *Rales v. Blasband*, 634 A.2d 927 (Del. 1993), as this Court recognized in analyzing plaintiffs' earlier claim against Mr. Ovitz for breach of contract (*Disney I*, 731 A.2d at 379). The *Rales* test requires the plaintiffs to allege facts that would create a reasonable doubt that the Board could have exercised disinterested and independent judgment in responding to a demand to bring claims against Mr. Ovitz – that is, plaintiffs must satisfy the first prong of the *Aronson* test. This Court has already found that

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[6] Plaintiffs also appear to allege that Mr. Eisner lacked the power to authorize a Non-Fault Termination, although this claim is less than clearly articulated. (Compl. at ¶ 89.) Nothing in the contract so requires, however, and surely Mr. Ovitz was entitled to rely on the authority of Mr. Eisner and Mr. Litvak (Disney's CEO and General Counsel, respectively) to act on behalf of their employer.

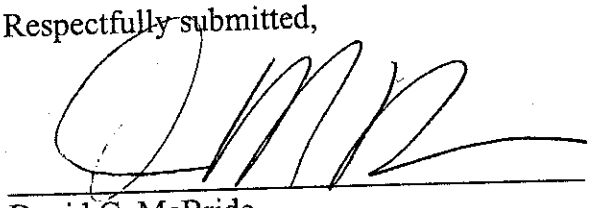
plaintiffs cannot meet this burden (*Disney I*, 731 A.2d at 379), and the Delaware Supreme Court explicitly held that "that part of plaintiffs' Complaint raising the first prong of *Aronson* . . . has been dismissed with prejudice. Our affirmance of that dismissal is final and dispositive of the first prong of *Aronson*." *Disney II*, 746 A.2d at 258 (emphasis added). Because the first prong of *Aronson* is the only prong at issue pursuant to *Rales*, the claims against Mr. Ovitz must be dismissed for failure to excuse demand under Court of Chancery Rule 23.1.

Additionally, even were the *Rales* test not applicable here, plaintiffs still have failed to allege facts sufficient to excuse demand. In this regard, Mr. Ovitz joins in and incorporates the arguments set forth in Disney's brief.

CONCLUSION

For the reasons stated herein, and for those set forth in Disney's brief, Mr. Ovitz respectfully requests that the Second Consolidated Amended Complaint be dismissed with prejudice.

Respectfully submitted,



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