

**IN THE COURT OF THE CHANCERY OF THE STATE OF DELAWARE**

PUBLIC VERSION

DATED: April 23, 2008

In re Yahoo! Shareholders Litigation

Cons. C.A. No. 3561-CC

**PLAINTIFFS' EMERGENCY MOTION  
TO COMPEL ATTENDANCE AT DEPOSITION**

Plaintiffs respectfully move the Court, pursuant to Court of Chancery Rules 30 and 37, for an Order compelling defendant Arthur H. Kern to appear at a deposition at any time and place next week, as defendants are refusing to make him available until June 13, 2008.

**Preliminary Statement**

1. On March 3, 2008, this Court entered a Stipulation and Proposed Case Management Order calling for defendants to attempt to substantially complete non-electronic discovery by March 21, 2008, and electronic discovery by April 4, 2008. The director defendants have not yet produced a single document.

2. Plaintiffs have diligently pursued discovery, and have scheduled several depositions. Yet we have been stymied in our efforts to obtain any discovery from the director defendant at the center of the development and approval of the challenged change-in-control severance plans, Arthur Kern, Chairman of the Compensation Committee of the Board of Directors of Yahoo! Inc. ("Yahoo").

3. After pressing for documents since mid-March, we learned that although Kern possesses responsive documents, he has been away on vacation for an extended period of time and did not gather them until yesterday. After repeated requests to schedule Kern's deposition, we were told that Kern would be out of the country from

{BMP-W0091758.}

April 26 through June 9, 2008, and that he would not be made available for deposition prior to his departure. We noticed Kern's deposition for April 22, 2008 (Ex. A), and advised that we were willing to depose him for less than half a day at any time and location next week. Plaintiffs should be allowed to depose Kern next week, and not in mid-June.

#### **Status of the Litigation**

4. At a telephonic conference on March 24, 2008, this Court denied plaintiffs' request to set a trial date on plaintiffs' claim that Yahoo's change-in-control severance plans should be invalidated under *Unocal/Unitrin* as an unreasonable response to an unsolicited, premium merger proposal from Microsoft Corporation ("Microsoft"). The Court observed, based largely on the content of just-produced Yahoo board minutes and the arguments of Yahoo's counsel, that Microsoft apparently "doesn't care one w[h]it about the adoption of the severance plans" and that Microsoft had set aside funds for employee retention "in an amount far greater" than the estimated costs of the Yahoo severance plans. (Ex. B at 36, 37)<sup>1</sup>

5. Accordingly, the Court instructed that plaintiffs should continue "doing discovery in a deliberate and prudent manner" and that if plaintiffs "learn something in the discovery" about how the plans were "having the effect you are claiming it is having," then "you may come back to ask me to schedule it on an expedited basis then." (*Id.* at 37, 38)

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<sup>1</sup> Yahoo's counsel argued that the severance plans have "no impact whatsoever" on Microsoft, and that they "make[] sense for Microsoft." (Ex. B at 22, 23) (BMF-W0091758.)

6. From the limited information available since the March 24 teleconference, it is apparent that Microsoft and the stockholders of Yahoo are harmed by the challenged severance plans.

7. On April 5, 2008, Steven Ballmer, the CEO of Microsoft, sent a letter to the Yahoo Board that contradicts Yahoo's contention in this Court that the severance plans are benign. After recounting the Yahoo Board's refusal to fairly consider Microsoft's acquisition proposal while management has attempted to negotiate various alternatives, and in a clear reference to the challenged severance plans, Ballmer wrote: *"Finally, you have adopted new plans at the company that have made any change in control more costly."* (Ex. C at 1) (emphasis added). Ballmer stated that Microsoft "will be compelled to take our case directly to your shareholders" if a merger agreement is not negotiated within three weeks, and stated that they might do so at a lower price than previously proposed. (*Id.*)

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**REDACTED**

9. Microsoft has its own experience with this problem. Last year, as part of its negotiated acquisition of aQuantive, Inc., Microsoft agreed to a variety of retention incentives. Microsoft subsequently consented to the accelerated vesting of the stock options and restricted shares of executive officers immediately prior to the Merger. They did so "to eliminate the incentive for executives to terminate employment after the merger and claim 'good reason' in order to accelerate option vesting." (Ex. E at 10-11)

10. At Yahoo, all full-time employees are now incentivized to terminate their employment for "good reason" following a merger to obtain severance benefits, including accelerated equity compensation.

**REDACTED**

REDACTED

Given that

Yahoos' second-largest shareholder has publicly stated recently that an increase in Microsoft's proposal by \$1 per share for Yahoo's 1.34 billion shares could be outcome determinative (Ex. G), it is critical to shareholders whether Microsoft must reserve that same amount or more to pay the incremental cost of the severance plans to employees.

11. This information confirms the basic point made by plaintiffs' expert, James Reda, in his previously submitted Affirmation -- the highly unusual Yahoo severance plans adopted by the Yahoo Board in response to Microsoft's offer drive up the cost of any acquisition. These plans not only require that an acquirer pay severance benefits to all employees it terminates, the acquirer must also "contend with the possibility of a massive number of constructive terminations, [and] employees who decide to stay may exert leverage created by the Severance Plans to be 'made whole' for their waiver of termination rights . . . ." (Reda Aff. ¶ 14) (Ex. H)

12. Yahoo's Change in Control Employee Severance Plans should really be called "Change in Control *Walkout* Plans."

### The Importance of Kern's Deposition

13. Consistent with the Court's direction, plaintiffs are pursuing discovery, and are scheduling various depositions.<sup>2</sup> But in order to preserve our ability to seek an expedited trial, it is important that we not be delayed two months in deposing Arthur Kern, the director most knowledgeable about the creation and approval of the challenged severance plans.

14. Kern's central role respecting the severance plans is apparent from documents produced by Yahoo.

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15. As Chairman of the Compensation Committee, Kern was the director who stood at the center of the development of the retention program. He dealt with management, consultants, and fellow Board and Compensation Committee members. No other individual likely shares his multiple vantage points into the process. Deposing Kern is essential to understanding what he knew and what he did not know and, by extension, what the rest of the Board and the Compensation Committee knew or did not know about the process, terms and effects of the challenged severance plans.

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<sup>2</sup> Plaintiffs scheduled the depositions of two Yahoo human resources executives for April 29 and April 30, and an executive compensation consultant on May 1. We are scheduling the depositions of another executive compensation consultant in early May, and defendant Ron Burkle, a member of the Compensation Committee, for the week of May 12, the earliest time that he will make himself available.

16. Defendants propose making Kern available for a deposition on June 13, following his return from his honeymoon. (Ex. I) They refuse to make him available any time next week, even though we had been told that Kern himself advised that he had available time following a Yahoo Board meeting on April 25. Plaintiffs have offered to take a shortened deposition of Kern in order to obtain his testimony without a two-month delay. Otherwise, plaintiffs will be deprived of the opportunity to use the deposition testimony of the most central director for purposes of seeking an expedited trial, and we would not know his version of events until the time when an expedited trial may be scheduled.

17. A similar argument of unavailability was made last year on behalf of the lead director of the Caremark Board. Defendants in that case argued that the deposition of the director, who had just returned from an extended trip to New Zealand, should occur only at a location convenient for that director. This Court compelled the director's deposition on the east coast, given that "the inconveniences of a directorship are part of the job." *Louisiana Mun. Police Employees' Ret. Sys. v. Crawford*, C.A. No. 2635-N, *let op.* at 2, Chandler, C. (Feb. 1, 2007) (Ex. J) The present circumstance is more glaring, as an important director who just returned from an extended vacation is refusing to be deposed at a time and location at which he is actually available, and is further claiming unavailability over a period of months, "during an especially critical period in the life of the company on whose board he serves[.]" *Id.* at 1. Mr. Kern should be required to be deposed next Friday, at a time and location of his choosing, in a case in which the amount of the challenged severance benefits could very well affect the outcome of an ongoing control contest.

For all the foregoing reasons, plaintiffs respectfully request that the Court grant plaintiffs' motion to compel the deposition of Arthur Kern.

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Dated: April 18, 2008

/s/ Joel Friedlander

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# Exhibit

# D

**REDACTED IN ITS ENTIRETY**

# Exhibit

F

**REDACTED IN ITS ENTIRETY**

**Exhibit**

**H**

IN THE COURT OF CHANCERY IN THE STATE OF DELAWARE

In Re Yahoo! Shareholders Litigation

Consolidated C.A. No. 3561-CC

AFFIRMATION OF JAMES F. REDA

COUNTY OF Cobb )

STATE OF Georgia )

ss.

JAMES F. REDA, being duly sworn, hereby deposes and says as follows:

1. I am the Founder and Managing Director of James F. Reda & Associates, LLC, an executive compensation consulting firm located in New York City. I have been retained by Plaintiffs in the above-captioned action to advise on certain "Change in Control Employee Severance Plans" (the "Severance Plans") that were approved on February 12, 2008, by the Compensation Committee of Yahoo! Inc. ("Yahoo"). In particular, I have been asked to consider the impact of the Severance Plans on a potential acquiror of Yahoo.

2. For this report, I relied upon various materials, including but not limited to: (i) the Yahoo Change in Control Employee Severance Plan for Level I and II employees; (ii) Yahoo Change in Control Employee Severance Plan for Level III, IV and V employees; (iii) a Yahoo presentation labeled "Retention Program" dated February 12, 2008; (iv) a Yahoo "Q&A for Change in Control Employee Severance Plan" dated February 19, 2008; (v) and Securities and Exchange Commission ("SEC") filings, including Form 8-Ks filed by Yahoo on February 15 and February 19 of 2008.

**Preliminary Conclusions**

3. Based on my review and analysis of Yahoo's document production, I have reached the following preliminary conclusions:

a. On its face, the Severance Plans are atypical and unreasonable in that they cover every Yahoo employee, without regard to the value of that employee to the business. In my twenty years of work in the field of executive compensation consulting, I cannot recall ever having seen a severance plan cover all of a major corporation's employees.

b. The Severance Plans are not aligned with their stated purpose, as set forth in internal Yahoo documents. In addition, the Severance Plans are inconsistent with Yahoo's announcement, just weeks before the adoption of the Severance Plans, that Yahoo would reduce its headcount by as much as 1,000 employees.

c. The Severance Plans can be expected to impose a substantial economic cost on an acquirer of Yahoo.

REDACTED

d. The Severance Plans create substantial uncertainty and possible disruption for a potential acquirer, in addition to the direct costs of the benefits,

because of a constructive termination or "Good Reason" provision covering all employees. Vagueness in the defined terms under which employees are entitled to benefits makes it difficult to predict what kinds of changes in circumstances will be claimed to trigger the benefits -- an uncertainty increased by the number of employees granted such rights. As a result, an acquiror will not be able to predict with any degree of certainty which or how many employees will choose to leave, and how much the aggregate benefits will cost.

c. Given the inconsistency between the stated purposes of the Severance Plans and their actual provisions, I have serious questions about whether the stated purpose of the Severance Plans is a pretext. The circumstances suggest that the impact of the Plans on a potential acquiror is the purpose for which they were adopted, and not an unintended consequence.

4. The bases for these conclusions are set forth below. My conclusions are preliminary and are qualified by the fact that we have received very little information about the Severance Plans from Yahoo. I reserve the right to amend, modify or withdraw any or all of these opinions at any time.

### **My Qualifications**

5. I attach as Appendix A a description of my qualifications, which lists relevant publications I have authored over the past ten years. As can be seen from that description, I have extensive experience in the field of executive compensation, including expertise in change in control ("CIC") severance plans, senior executive employment arrangements, competitive compensation benchmarking and long-term and short-term incentive plan design.



6. In the course of my career, I have advised the compensation committees of public and private corporations as an independent advisor on matters of executive compensation for over twenty years. Throughout my career, I have assisted hundreds of publicly-traded companies, such as J.C. Penney Company, Inc., Starbucks Corporation, Tivo, Inc., International Paper Company, and King Pharmaceuticals, Inc., in reviewing and revising change in control severance or retention plans, to balance the retention of key employees with the maximization of shareholder value. In addition, I often serve as an expert witness on executive compensation issues in various litigation matters.

#### **Defective Plan Design**

7. In a February 12 presentation entitled "Retention Program," Yahoo identifies four "Broad Based Retention Goals." As stated in the presentation, they are:

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8. Rather than being targeted at REDACTED the Severance Plans are extended to all of Yahoo's 14,000 employees. The broad-based nature of the Severance Plans, in which all employees are covered, and the ability given to each employee to terminate for "Good Reason" and receive cash payments, stock awards and benefits, is something which I cannot recall ever having encountered in twenty years of executive compensation consulting. My experience covers hundreds of transactions, my own research, the review of numerous articles and surveys, speaking at conferences and roundtables, and writing articles and books on the subject of severance

plans.

9. The Severance Plans cover all employees from top to bottom, from Level I (the CEO and his direct reports) to Level V (including junior professionals and support staff). This results in a staggering number of implicit change-in-control agreements, which is extremely uncommon and unreasonable. Based on my experience and research, the number of employees covered by enhanced severance or retention programs is much lower. Participation is most often limited to senior executives and a few key managers alone. The work of these senior executives is most closely linked with the creation of shareholder value, unlike lower-level managers, junior professionals and support staff. Consequently, the common rationale for change in control severance or retention programs is to provide a measure of predictability for senior executives, which encourages them to seek transactions that are beneficial to shareholders, despite any added risk concerning their own employment situation.

10. The universal applicability of the Severance Plans is not aligned with the Severance Plans' stated objective of:

REDACTED

The implicit view that each of Yahoo's 14,000 employees is at odds with the Company's announced intent to reduce its head-counts by 1,000 (more than 7% of the total workforce).

11. In addition, the Severance Plans provide no incentives to remain in the job for those employees who may feel threatened by Yahoo's Strategic Workforce Realignment, as described in the January 29, 2008 Yahoo earnings call. The severance benefits vest only if Yahoo is first the subject of a change-in-control.

### **The Impact on an Acquiror**

12. There are substantial costs associated with covering more than the key employees by a change-in-control retention severance program. Under the Severance Plans, all employees are granted a constructive termination right, or "walk-away right," typically reserved for senior-level contracts. Specifically, employees are permitted to terminate their employment for "Good Reason," and to collect severance benefits. "Good Reason" is defined as including, among other things, "a substantial adverse alteration in the Eligible Employee's duties or responsibilities from those in effect immediately prior to the Change in Control," and "the relocation of the Eligible Employee's principal place of employment to a location more than 35 miles from the Eligible Employee's principal place of employment immediately prior to the Change in Control." In my experience, this type of "Good Reason" provision, if present at all, is reserved solely for the Chief Executive Officer and his or her direct reports, not all employees.

13. Since all employees are eligible for constructive termination, the Yahoo Severance Plans complicate any potential acquisition, as every Yahoo employee may allege "adverse alterations" in duties or responsibilities during the inevitable organizational change following a sale of the Company.

14. Not only do potential bidders have to contend with the possibility of a massive number of constructive terminations, but employees who decide to stay may exert leverage created by the Severance Plans to be "made whole" for their waiver of termination rights or underwater Yahoo incentive awards.

15. The post-transaction integration costs for an eventual acquiror of Yahoo will be onerous. Those costs include more than the cash pay-out that would become due.

16. An acquiror that would otherwise be able to create value by exploiting

synergies will be constrained in doing so. It would have to weigh the cost of terminating employees -- even at the lowest support staff level -- against the gain in efficiency that would result. The acquiror's ability to control who stays and who leaves is also seriously impaired as all employees will have a financial incentive to allege the occurrence of "Good Reason" and the triggering of the severance benefits.

17. In addition, there will be a substantial administrative burden over the 24-month period which the constructive termination period covers. The acquiror theoretically could have to keep track of and arbitrate disputes for all 14,000 employees worldwide. Overall, it is difficult to quantify the cost of these Severance Plans, because of the ripple effect and collateral damage that any reduction in force might have, when faced with 14,000 potential interpretations of "substantial adverse alteration."

### Conclusion

18. I find it difficult to reconcile the terms of the Severance Plans with the stated goals. The benefits are extended to all employees -- an atypical and unreasonable feature -- although the stated goal is to REDACTED The grant of change-in-control severance rights is inconsistent with the Board's almost contemporaneous conclusion that Yahoo is overstaffed and that headcount should be reduced by more than 7%.

19. The Severance Plans impose huge costs on a potential acquiror by forcing it to bear the expense associated with employees who terminate their employment, claiming "Good Reason" to do so. In addition, the Severance Plans create huge uncertainty by interfering with an acquiror's ability to control the integration of Yahoo's workforce and the harnessing of synergies between the entities.

20. Certainly, it is appropriate for Yahoo's Compensation Committee to consider some form of retention or severance program for senior executives and key managers, given the enhanced potential for a change in control. But the scope of these atypical Severance Plans greatly increases the complexity of the Company's compensation and benefit structure, such that any transaction beneficial to shareholders might be unduly compromised. Furthermore, the common rationale for such change in control programs seems absent in this instance. If these Severance Plans are not amended or removed, the value of Yahoo to a potential acquirer is likely to be severely and adversely affected.

21. I offer this Affirmation under threat of perjury this 17<sup>th</sup> day of March, 2008.

  
James F. Reda

Sworn before me this 17<sup>th</sup>  
day of March, 2008.

  
Notary Public

ANNOUNCE ELLIS  
Notary Public  
Fulton County  
State of Georgia  
My Commission Expires Jun 19, 2011



## CERTIFICATE OF SERVICE

I, Edward B. Micheletti, hereby certify that I caused to be served the Public Version of Plaintiffs' Emergency Motion To Compel Attendance At Deposition that was filed on April 18, 2008 and Public Version of Exhibits D, F and H thereto on this 23<sup>rd</sup> day of April, 2008 upon:

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