ALERT MEMORANDUM

Delaware Chancery Court Opinion Raises New Considerations for Special Litigation Committees

December 12, 2019

On December 4, 2019, Vice Chancellor Sam Glassock III issued a memorandum opinion in *In re Oracle Corporation Derivative Litigation*[1] finding that the Lead Plaintiff in a shareholder derivative suit against Oracle's board of directors had the right to subpoena documents relied upon by the corporation's Special Litigation Committee (SLC) in making its determination as to whether litigation against Oracle should be allowed to proceed, including privileged documents Oracle had produced to the SLC. While the procedural posture of this case was unusual—the SLC had decided 1) that claims against its founder and chairman should proceed, and 2) that the Lead Plaintiff should be the one to prosecute those claims—the Court's decision has potential ramifications for SLCs in the future. SLCs should, therefore, be cognizant of these potential ramifications when they collect and prepare documents in connection with an investigation.

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[1] C.A. No. 2017-0337-SG (Del. Ch. Dec. 4, 2019).

Background:

In July 2016, Oracle announced that it would be acquiring Netsuite, a cloud computing company. Lawrence J. Ellison, the co-founder and chairman of Oracle and a 35% shareholder in it, was also the co-founder and a 39% shareholder of Netsuite. The transaction closed in November of that year.

Shareholder derivative litigation predictably followed the announcement of the transaction. Specifically, in July 2017, Firemen's Retirement System of St. Louis (the "Lead Plaintiff") filed a derivative action, alleging that the acquisition unfairly benefitted Ellison at the expense of Oracle's other shareholders, and that Ellison, the other directors of Oracle, a Netsuite co-founder and director, and a Netsuite executive breached their fiduciary duties in effecting the transaction. The defendants filed a motion to dismiss for failure to meet the demand-futility requirement and for failure to state a claim upon which relief may be granted. However, in 2018, the Court rejected the demand-futility argument, finding that a majority of the Oracle board could not impartially consider a litigation demand because it was reasonably conceivable that they were not independent of Ellison.[2] The Court also denied the motion to dismiss for failure to state a claim as to Ellison and Oracle CEO Safra Catz, concluding that it was a reasonable inference that Ellison, standing on both sides of the transaction, manipulated the sales process to benefit himself at the expense of the other Oracle stockholders, and that Catz helped him do so.[3]

Following the Court's decision to allow the claims against Ellison and Catz to proceed, in May 2018, the Oracle board of directors formed a SLC consisting of three independent board members to 1) investigate and evaluate the Lead Plaintiff's claims, and 2) take any actions related to the lawsuit that the committee deemed to be in the best interest of the corporation.[4] After the Court granted its motion to stay in July 2018, the SLC began its work. Over the course of its year-long investigation, the SLC both requested and created an enormous number of documents. In total, the SLC requested documents from seventeen individuals and entities, including Oracle; the nondefendant Oracle directors; Oracle's Special Transaction Committee (which had previously evaluated the fairness of the acquisition), its counsel, and its financial advisors; and Netsuite's counsel and financial advisors.[5] From Oracle alone, the SLC received 1.4 million documents.[6] It had also interviewed forty witnesses, including two senior Oracle marketing employees, one senior Netsuite marketing employee, the Special Transaction Committee's counsel, the nondefendant Oracle directors, an Oracle executive, and former Netsuite executives.[7]

In August 2019, the SLC found that it would be in the corporation's best interest for the litigation to proceed, and—in a surprising move—determined that the litigation asset would be best monetized if the Lead Plaintiff were allowed to continue with its claim (as opposed to the SLC itself prosecuting the action).[8] Following the SLC's announcement of its determination, the Lead Plaintiff subpoenaed the SLC and its counsel, requesting all documents and communications that were produced to the SLC or that the SLC "obtained, reviewed, considered, created or prepared" during its investigation and "all documents and communications concerning this Action or the Special Litigation Committee."[9] In other words, the Lead Plaintiff did not want to have to duplicate the SLC's work by recollecting all the documents the SLC relied upon itself, and wanted to have access to the SLC's own work product.

The SLC objected. Responding to the Lead Plaintiff's request, the SLC noted that because it had allowed the

[2] *In re Oracle Corp. Derivative Litig.*, 2018 WL 1381331, at *16.
[3] *Id.* at *21, *22.
[4] *Supra* n. 1, at *18.
[5] *Id.* at *21, *27.
[6] *Id.* at *27.
[7] *Id.* at *22, *27.
[8] *Id.* at *25-26.
[9] Subp. Duces Tecum Served on The Special Litig. Comm. of the Bd. of Dirs. of Oracle Corp., D.I. 167, at 15-16; Subp. Duces Tecum Served on Potter Anderson & Corroon LLP, D.I. 167, at 15-16.

litigation to proceed, there was no need for the Lead Plaintiff to evaluate its independence, investigation, or determination; therefore, the Lead Plaintiff was not entitled to the subpoenaed materials.[10] The SLC and Oracle also argued that some of the subpoenaed material was privileged and should not be subject to discovery.[11]

As a result of this dispute, the Court was presented with the following questions:

1. When a SLC transfers the litigation asset to a Lead Plaintiff in a shareholder derivative suit, does it also transfer the right to access documents made available to or relied upon by the SLC during its investigation?[12]
2. If the SLC does transfer such a right, to what extent, and subject to which privileges?[13]

The Decision:

The Court began its analysis by noting the unusual procedural posture of the case. In the typical case, where a SLC recommends discontinuation of litigation, the putative derivative plaintiff is entitled to discovery of material sufficient to test whether the SLC has applied its business judgment in the best interest of the entity. *In re Oracle* presented the atypical case: the SLC determined that the case should go forward and that the Lead Plaintiff should pursue it. Accordingly, there was no need to challenge the business judgment of the SLC.[14] The question, rather, was whether the Lead Plaintiff could obtain access to the documents and information that the SLC received in the course of deciding *not* to discontinue the case, as well as its work product, for the Lead Plaintiff's use in prosecuting the case against Ellison and Catz. The Court framed the issue as whether the Lead Plaintiff—like a relay racer—should be entitled to receive the "baton" of work from the SLC to complete the race[15] or whether, on the other hand, the SLC should be viewed as a third party hitting the "pause" button while it investigated the claims, at the conclusion of which it hit the "play" button to allow the Lead Plaintiff to proceed. Under the latter view, which was advocated by the SLC, the Lead Plaintiff would be permitted to continue the litigation but without the benefit of the information accumulated and the work done by the SLC in the interim.[16]

Ultimately, the Court substantially sided with the Lead Plaintiff, ruling that the Lead Plaintiff would be entitled to "all documents and communications actually reviewed and relied upon by the SLC or its counsel in forming its conclusions that (i) it would not be in Oracle's best interests to seek to dismiss the derivative claims and (ii) it was in Oracle's best interests to allow the Lead Plaintiff (rather than the SLC) to proceed with the litigation on behalf of Oracle."[17] The Court reasoned as follows: under Delaware law, a derivative claim's value is determined primarily by the risk-adjusted recovery the plaintiff seeks, and such recovery increases as facts unfavorable to the defendant are uncovered.[18] The SLC, through its thorough investigation and conclusion that the Lead Plaintiff's claim should proceed, added value to the litigation asset as it increased the chances that the plaintiff would succeed in convincing a trier of fact of the defendants' liability.[19] Given these circumstances, "it would be, at least in part, *against* Oracle's best interests to allow the Lead Plaintiff to proceed with the litigation asset stripped of all value created by the SLC."[20]

The Court noted that these considerations "do not exist in a vacuum."[21] The SLC was required to fully and thoroughly investigate and evaluate shareholder claims and to pursue every avenue and investigate all theories of recovery.[22] Moreover, as directors of Oracle with a

[10] *Supra* n. 1, at *29-30.
[11] *Id.* at *30.
[12] *Id.* at *1.
[13] *Id.* at *1.
[14] *Id.* at *36-37.
[15] *Id.* at *37.
[16] *Id.* at *38.
[17] *Id.* at *47.
[18] *Id.* at *41, *42.
[19] *Id.* at *42.
[20] *Id.* at *45.
[21] *Id.* at *45.
[22] *Id.* at *45

broad mandate from the board resolutions creating the SLC, the SLC had virtually unfettered access to Oracle's information, including potentially privileged information.[23] Thus, for example, when the SLC requested documents, the company simply provided them without questioning their relevance to the claims at issue or screening them for privilege.[24] Of course, a typical derivative plaintiff would not have comparable access to company information.[25] Accordingly, the Court did not grant the Lead Plaintiff's request that the SLC produce "all" documents that it collected, but rather limited production to relevant documents and communications.[26] The Court defined "relevant" documents as those "actually reviewed and relied upon by the SLC" in making its determination.[27]

The Court then proceeded to the second issue presented: whether the SLC should be required to produce relevant attorney-client privileged and work product documents or communications.[28] The Court first looked to the *Garner*[29] doctrine, pursuant to which shareholders can for good cause and under "narrow and exacting conditions" obtain privileged documents of the corporation in order to assert a derivative claim.[30] Recognizing that *Garner* itself did not apply (because the SLC already had determined that it was in the Company's interest to pursue claims against Ellison), the Court held by analogy that because Oracle had already determined to produce privileged documents to the SLC and the SLC had determined—based in part on those documents—that the derivative claim should be pursued, those same documents should be made available to the Lead Plaintiff (who, the Court noted, was also a fiduciary of Oracle).[31]

The Court reached a somewhat different conclusion with respect to documents that the individual defendants claimed were subject to an individual privilege and documents that the SLC claimed were subject to its own privilege. With respect to the privilege claim of the individual defendants, the Court noted that arguments could be made that the individual defendants' production of otherwise privileged communications to the SLC constituted a privilege waiver and that the individual defendants' emails on Oracle's email servers were not privileged to begin with.[32] However, it held that the question of privilege and whether the individual defendants had waived it was "necessarily fact-specific" and would have to be determined based on a privilege log produced by the individual defendants after a review of the documents intended to be produced by the SLC to the Lead Plaintiff.[33]

As to the SLC itself, the Court upheld the claim of privilege. It reasoned that the SLC is a distinct entity from Oracle and that the SLC had "determined in its business judgment not to share such privileged and protected documents with the Lead Plaintiff," a judgment which the Court found no reason not to honor.[34] The Court rejected the argument that the Lead Plaintiff was entitled to the SLC's privileged and work product documents under the common-interest doctrine on the theory that it did not compel the production of documents.[35] In the Court's words, the common-interest doctrine "is a shield to waiver—not a sword to obtain production[.]"[36] It also rejected the Lead Plaintiff's claim that it should be entitled to privileged and work product documents on efficiency grounds, finding that no such exception exists in Delaware law.[37] The Lead Plaintiff suggested that the SLC's withholding of privileged and work product documents may constitute a breach of fiduciary duty; while the Court declined to rule on this question, it did note that the SLC had to produce a privilege log to the

[23] *Id.* at *45-46.
[24] *Id.* at *35-36.
[25] *Id.* at *45-46.
[26] *Id.* at *47.
[27] *Id.* at *47.
[28] *Id.* at *49.
[29] *Garner v. Wolfinbarger*, 430 F.2d 1093, 1101 (5th Cir. 1970).
[30] *Supra* n.1, at *52.
[31] *Id.* at *43, *53.
[32] *Id.* at *56-57.
[33] *Id.* at *58-59
[34] *Id.* at *59-60.
[35] *Id.* at *60.
[36] *Id.* at *60.
[37] *Id.* at *60-61.

Lead Plaintiff.[38] Thus, the Court held that privileged or work product documents of the SLC itself need not be produced even if deemed relevant.[39]

Finally, the Court held that mediation materials prepared and used by the SLC (which had unsuccessfully attempted to settle the claims against Ellison and Catz before concluding that the claims should be pursued by the Lead Plaintiff) were generally exempt from discovery under the Chancery Rules protecting settlement materials, except to the extent that such materials would not be protected under such Rules (e.g., factual documents exchanged in connection with settlement discussions).[40]

Key Takeaways:

In re Oracle arises under unusual circumstances. In many cases, a company faced with a derivative claim that has survived motions will decide to settle the matter. In others, the SLC will recommend discontinuation of the litigation. It is not typical that the outcome of a SLC investigation is a recommendation that the company pursue its officers or directors, much less that it decides that a stockholder-plaintiff should be the one to do so. That said, SLC investigations are broad; by law, the SLC must be independent and cannot approach its work with a preconceived judgment as to the conclusion it will reach. Because neither the SLC nor those interacting with the SLC can know the outcome of the investigation until it is concluded, *In re Oracle* offers some important lessons and reminders:

1. A careful SLC will exercise judgment in choosing the documents that it requests and the procedures it follows for organizing them so as to reduce the burden on it and the cost to the corporation should it be compelled to produce them in the future. The *Oracle* court drew a distinction between documents that the SLC reviewed and relied upon in making its determination and all of the other documents it collected in the course of its investigation. However, the *Oracle* SLC—like many SLCs will do in reliance on their broad mandate and authority as directors of the corporation—collected more than a million documents. While a SLC cannot and should not neglect its obligation to conduct a good faith investigation of reasonable scope and to explore all relevant facts and sources of information, *Oracle* is a reminder that it should do so with care. A request that is too broad or goes beyond what is reasonably necessary to investigate the facts at issue could increase costs and burdens for the corporation in the future.
2. Likewise, care should be exercised by SLCs with respect to requests for otherwise privileged information and by management in determining how to respond to a request for privileged information. The authority of a SLC is typically broad and includes the right to request all relevant documents. In some instances, those relevant documents will include privileged documents. In cases, however, where privileged documents would not be relevant, the SLC and management together might consider whether the prudent course would be to weed out readily-identifiable privileged documents at the outset, rather than having to review them and potentially produce them later in response to a subpoena.
3. Officers, directors, and other individuals who might be subject to a SLC request should give careful consideration to the decision of whether to turn over information and when to assert personal privilege claims. It may be that, in many instances, there will be little discretion: the SLC wants the information, and the officer and director cannot refuse. But where there is discretion either over which documents to produce or how to produce them, officers and directors should bear in mind that, if the SLC decides litigation should be pursued, such documents could be used against them. This is particularly true for documents as to which an individual officer or director has a

[38] *Id.* at *61.
[39] *Id.* at *61.
[40] *Id.* at *61-62.

colorable claim of personal privilege (e.g., a privilege separate from that of the entity). While a SLC presumably would not have the power to compel a director or officer to produce such documents, if she were to nonetheless do so, a court may later find that the SLC must turn over such documents to a stockholder-plaintiff even over the officer or director's objection.

4. Finally, the Court's separate analysis of the privilege enjoyed by officers and directors suggests a last word about so-called *Upjohn* warnings. These are the warnings provided by company or SLC counsel to an interview subject informing the subject that the privilege attached to the interview belongs to the company. Typically, counsel will also inform the subject that the company which enjoys the privilege may choose to waive it. *Oracle* suggests that counsel might add an additional line to the warning in the case of a SLC, informing the officer or director that the "company or the SLC may choose to waive the privilege or take actions which would result in privileged information being disclosed." Officers and directors who do not receive such a warning and who can credibly claim that they believed that counsel for the company or the SLC were representing them may have an additional argument against production of the interview notes in the circumstance where such notes might otherwise be discoverable from the company.[41]

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[41] This Alert Memorandum was prepared with the assistance of Rebecca Prager.