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Corporate Litigation:

Stockholder Derivative Litigation Update

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The Delaware Court of Chancery recently addressed a nearly unprecedented issue: the discovery and privilege implications of a special litigation committee's (SLC) decision to hand over control of a company claim to a stockholder derivative plaintiff who initiated the claim and survived a motion to dismiss. In *In re Oracle Derivative Litig.*, 2019 WL 6522297 (Del. Ch. Dec. 4, 2019), Vice Chancellor Sam Glasscock III determined that it would promote Oracle's best interests to have the derivative plaintiff "proceed with the litigation asset" with the benefit of the enhanced asset value created by the SLC's investigative work. The framework established by the court to provide the plaintiff with the benefit of the SLC's work has expansive disclosure aspects and important boundaries to be understood by practitioners.

Background

Oracle stockholders brought derivative fiduciary duty claims challenging Oracle's acquisition of NetSuite—a company approximately 40% owned by Lawrence Ellison, Oracle's founder, largest stockholder, and board Chairman. The stockholder Lead Plaintiff survived a motion to dismiss for failure to make pre-suit demand and to state a claim, prompting Oracle to form the SLC, which consisted of three independent directors, to consider whether pursuing the derivative claims was in Oracle's best interest. Pursuant to the framework of *Zapata v. Maldonado*, 430 A.2d 779 (Del. 1981), the SLC retained separate counsel and a financial advisor, and obtained a stay of the litigation while it investigated the claim. After a year-long investigation in which Oracle, individual defendants, and various third parties produced more than 1.4 million documents and the SLC conducted 34 interviews, the SLC informed the court that it had determined that it was the company's best interest to explore settlement through mediation. The court denied Plaintiff's request to participate in the mediation and obtain interim production of documents received by the SLC. After the mediation was unsuccessful, the SLC reported to the court that it had determined that, rather than pursue the litigation itself, the Lead Plaintiff should be allowed to proceed with the derivative litigation on behalf of Oracle.

The Plaintiff immediately served a subpoena on the SLC (a non-litigant) seeking everything the SLC obtained, considered, or prepared during its investigation, including the SLC's work product and privileged communications. The SLC objected, contending that its decision to cede control of the litigation to the Plaintiff obviated any need for the court or the parties to evaluate the SLC's independence, investigation, or determination, making discovery unnecessary. The SLC further asserted that the broad subpoena implicated a variety of privileged documents, including communications between the SLC and its counsel, and communications of third parties, including Oracle and other defendants.

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Decision

The court framed its analysis around two questions: (1) to which communications is a plaintiff who controls a corporate claim presumptively entitled? and (2) what communications may be withheld from production pursuant to valid objections? Addressing the first question, the court's touchstone was Delaware's regard of the control exercised by a corporate board over a corporate claim as control of a corporate asset. The value of a litigation asset, the court reasoned, "—like any other corporate asset—may be increased by the efforts of corporate fiduciaries." The court concluded that the SLC enhanced the value of the derivative claims through its evaluation and investigation of the claims, "was empowered to make a decision with respect to disposition of the litigation asset, and determined that Oracle's interests required it to be administered by the Lead Plaintiff on behalf of Oracle." Consequently, "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."

Next addressing the information that must be made available to the Plaintiff, the court adopted a relevance standard narrower than what Lead Plaintiff sought: everything provided to or created by the SLC. Instead, the court consulted the basic relevance standard for discoverability to conclude that, subject to certain privilege limitations, the Lead Plaintiff was presumptively entitled only to relevant documents actually reviewed and relied upon by the SLC or its counsel in forming its conclusions concerning pursuit of the derivative claim. In determining the contours of relevance for a production to a stockholder plaintiff, the court distinguished between the expansive information often provided to a special litigation committee composed of corporate directors and a litigation production to a stockholder. "Allowing complete discovery of all documents provided to or created by a special litigation committee in situations such as these, as requested by the Subpoenas, could chill candor and access and limit the effectiveness of special litigation committees going forward." The "actually reviewed and relied upon" standard "separated, presumably, the ore of relevance from the overburden of available but irrelevant material. Those documents so screened, or created therefrom, form a handy proxy for identifying relevant documents." Recognizing that the SLC and its counsel were in the best position to identify which documents and communications fit this criteria, the court allowed them to identify and produce those documents.

The court likewise entrusted the SLC to determine the scope of the attorney-client privilege and work product protection over its own documents and communications, reasoning that the SLC has business-judgment discretion, independent of Oracle, to withhold such material.

With respect to Oracle's privileged documents, however, the court held that they must be produced to the extent they were relied upon by the SLC and thus met the court's relevance test. The Lead Plaintiff had argued such a result was required by the *Garner* doctrine, a fiduciary exception to attorney-client privilege recognized by the Fifth Circuit and adopted by the Delaware Supreme Court in *Wal-Mart Stores v. Indiana Electrical Workers Pension Trust Fund IBEW*, 95 A.3d 1264 (Del. 2014). The *Garner* doctrine requires a stockholder seeking to prove breaches of fiduciary duty to demonstrate good cause to invoke an exception to the corporation's attorney-client privilege. The *Oracle* court distinguished "the typical *Garner* situation," in which the court—not the company—is charged with determining whether a stockholder suit is in the company's best interest. It nevertheless found the rationale for the doctrine, identity of interests between the company and its stockholder, instructive. Oracle established the SLC and provided it with privileged communications. In the court's view, Oracle failed to explain why disclosure of its privileged communications to the SLC was appropriate, but disclosure to Lead Plaintiff entrusted to litigate the claims endorsed by the SLC was not. In both situations, the harm of disclosure was outweighed by the company's interest in pursuing its litigation asset. The individual defendants, in contrast, could assert attorney-client privilege, as Plaintiff is not their fiduciary and they had not entrusted the litigation to Plaintiff.

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Conclusion

Oracle arises from a rare occurrence: a decision by a SLC to cede control of derivative litigation to a stockholder plaintiff. Under such circumstances, the court found that the balance of relevant interests—harm to the corporation of disclosing privileged communications versus the value to the company of pursuing the derivative claims—requires disclosure. Where the SLC has not determined, in its business judgment, that a stockholder should prosecute litigation on the company's behalf, the more limited *Garner* doctrine, requiring good cause to upset the usual attorney-client privilege, applies.

In exercising its business judgment and acting on its fiduciary responsibility to the company, however, the SLC cannot pre-determine at the outset of its investigation whether to pursue claims against the company and, if so, control the litigation itself. Given this unpredictability, company counsel should exercise care in providing an SLC with privileged communications upon which it could rely in recommending litigation.
