Notes on Special Litigation Committees and Derivative Suits October 21, 2023

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There have been some interesting developments involving SLCs at Oracle. In 2003, Leo Strine, then a VC, declined to grant a motion to dismiss after an Oracle SLC decided the litigation over claims 4 directors traded securities on inside information, selling shares before earnings information was fully disclosed was not in Oracle's interests.

Strine found the SLC was not independent because of ties between Oracle and Stanford University. The 2 person SLC comprised 2 Stanford Professors: Joseph Grundfest (previously an SEC Commissioner) and Hector Garcia-Molina. Strine wrote that the "ties among the SLC, the trading defendants, and Stanford are so substantial that they cause reasonable doubt about the SLC's ability to impartially consider whether the trading defendants should face suit."

Larry Ellison the founder of Oracle (and CEO until 2014 when he became Chairman and Chief Technology Officer) agreed to pay $100m to charity to settle the lawsuit (not to Oracle).

A subsequent derivative suit involving Oracle claimed that Larry Ellison arranged for Oracle to acquire and overpay for Netsuite, a company he had founded, in breach of his duties.

In 2018 VC Glasscock found that demand was excused. Tangential, non-material business ties and casual social relationships don't demonstrate a lack of independence but the ties alleged were substantial. There was a reasonable doubt that a majority of the board that would have considered a demand would be capable of bringing its business judgment to bear on the decision. There were particularized allegations about Ellison's domination; a biography of Ellison described Oracle as a cult; plaintiff alleged Ellison's control was demonstrated by "massive overcompensation" in the face of persistent objections by stockholders; Oracle was the only S&P 500 company to have failed 5 straight say-on-pay votes. Catz, who had an important role in the acquisition process was on record as saying her role was to make sure Ellison gets what he wants.

Oracle then set up a SLC with 3 members. Two of the committee members had not previously been on the Oracle board. The other was Leon Panetta, former US Defense Secretary, who had been a member of the transaction committee that approved the transaction and was originally named as a defendant in the litigation, and again in an amended complaint filed in 2019.

Generally SLCs decide that the litigation is not in the corporation's best interests. In this case the SLC thought it would be a good idea to settle the case but negotiations were unsuccessful. The SLC decided the litigation should proceed against Ellison, Catz and possibly other board members and that the original shareholder plaintiff should be able to bring the derivative litigation. The SLC would transfer the "litigation asset" back to the shareholder plaintiff.

In 2019 the Chancery court had to decide what would happen to the SLC's work: did documents etc the SLC acquired in its investigation remain with Oracle or should the plaintiff shareholder acquire them?

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Oracle argued that because the SLC members were Oracle directors Oracle provided them with information in a process that was nothing like a typical litigation, so the documents should not be turned over to the shareholder plaintiffs.

VC Glasscock said that litigation is a corporate asset and adversarial derivative litigation is a struggle for control of that asset. The value of the litigation asset is derived from the risk-adjusted recovery sought by the plaintiff. The work of the SLC, as a fiduciary, can increase the value of the asset.

The SLC was given broad authority by the board with respect to the lawsuit and what the SLC did enhanced the value of the litigation asset. The VC said that in the circumstances it would at least in part be against Oracle's interests for the lead plaintiff to get the litigation asset stripped of part of its value.

SLCs may have preferential access to information/documents because members are board members. Allowing discovery of all documents could chill candor and access and limit the effectiveness of SLCs in future.

So, the lead plaintiff is presumptively entitled to all documents and communications actually reviewed and relied on by the SLC or its counsel in forming its conclusions that (1) it would not be in Oracle's best interests to seek to dismiss the derivative claims and (2) 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.

Privileged communications given by Oracle to the SLC and relied on by the SLC in reaching its conclusions must be produced to the lead plaintiff: "Oracle has not advanced a single reason why, in its business judgment, the corporate interest in non-disclosure…to the lead plaintiff outweighs its interest in vindication of the asset."

The case proceeded to trial and after trial the Chancery court concluded that the trial evidence did not prove that Ellison controlled the acquisition and that the special committee that negotiated the acquisition hasd been fully empowered.

Some more thoughts on derivative litigation

In a recent article, Jessica Erickson wrote:

> Given the bedrock principle that corporate boards oversee the business and affairs of corporations, it is not surprising that courts have looked for ways to allow boards to exercise oversight over shareholder lawsuits, either through the adoption of new rules to govern these suits in corporate bylaws and charters or through procedures such as the demand requirement and special litigation committees (SLC). Yet the legal system has never fully grappled with the conflicts of interests that arise when directors' power extends to claims that may someday be filed against them....Over time, battered by procedural hurdles and empirical criticism, derivative suits largely faded from view. Their lackluster settlements rarely made the front pages of the financial press. Securities class actions stepped in to address many of the same types of claims that derivative suits had traditionally addressed. And the rise of institutional investors meant that larger shareholders did not need to resort to litigation because they had the economic

> clout to make their voices heard in the boardroom. In this new world of corporate governance, derivative suits play a minimal role in policing corporate managers. Today, when the scholarly literature mentions derivative suits, it often characterizes them as corporate law relics that are largely "dead" or "forgotten."[1]

Erickson notes the recent visibility of merger litigation, which increased in volume, leading the Delaware courts to take steps to limit the litigation, including In re Trulia Inc. Stockholder Litigation,[2] where Chancellor Bouchard said he would reject disclosure only settlements in class actions unless the disclosures were plainly material. These limiting actions in turn led to cases being filed as securities claims in federal court. But where claims are filed in many different courts this means that no one court system can control the litigation.[3]

We have, of course noticed that the Delaware courts have been faced with a number of oversight cases recently, which are derivative suits, although the volume of cases is nothing like the volume of merger related class actions in the relatively recent past.

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[1] Jessica Erickson, *The Lost Lessons of Shareholder Derivative Suits*, 77 WASH. & LEE L. REV. 113, 1135, 1143-1144 (2020) (footnotes omitted).

[2] 129 A. 3d 884 (Del. Ch. 2016).

[3] Erickson, at 1159. *Cf. id*. at 1165 ("if a significant number of fiduciary duty cases are filed in Delaware, they can respond to broader trends in a way that is difficult for a federal court that may only see one or two corporate cases a year.")