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In re Oracle Corp. Derivative Litigation: Death of Special Litigation Committees?

Anna Panchenko*

I. INTRODUCTION

Shareholders' derivative suits are recognized under federal and state law as a method for shareholders to seek redress for injuries suffered by a corporation. The derivative suit enables a shareholder to institute litigation to enforce a claim that the corporation, acting through its directors and officers, failed to pursue itself.1 Historically, courts have been reluctant to disturb the business judgment of a corporation’s directors in evaluating the merits of a corporate claim.2

However, because the action of management itself is often brought into question in derivative litigation, special procedures govern management’s authority over derivative claims.3 The special litigation committee (“SLC”) is among these special procedures. An SLC is an independent committee appointed by a majority of the directors of a corporation that is charged with the task of determining the propriety of the corporation’s pursuit of a derivative action.4 Furthermore, an SLC is composed of directors whose conduct is not itself brought into question by the derivative suit.5 In order for an SLC to obtain for its decisions the broadest protection from judicial scrutiny, its members should be independent and disinterested in the subject matter of the challenged claim.6

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2. Id. The business judgment rule is the presumption that in making business decision the directors of a corporation acted on an informed basis, in good faith, and in honest belief that the directors’ actions are in the best interest of the company. See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).
3. Fairman, supra note 1, at 327.
5. Fairman, supra note 1, at 328.
In a recent Delaware Court of Chancery decision, *In re Oracle Corp. Derivative Litigation*, the court imposed a new stringent test for independence in the context of an SLC. The court found an SLC was not independent when its members had extensive social or institutional connections with interested directors. The decision evidences a heightening of judicial scrutiny on directors of corporations.

This article examines the Delaware Court's application of the new standard of independence for SLCs. Part II of the Article provides relevant background information regarding the origin and development of the concept of SLCs and discusses the case law that introduced SLCs into Delaware law. This section also provides a review of what constitutes the demand requirement. Part III analyzes the *Oracle* decision. Part IV of the article discusses the impacts that the *Oracle* decision has had on the definition of independence and on the future of SLCs.

II. BACKGROUND

In order to understand the standards that are applied to a decision made by an SLC, it is first necessary to understand the basic elements of a derivative suit. Rule 23.1 of the Federal Rules of Civil Procedure requires that the plaintiff demand the board of directors to pursue the litigation, unless the demand is shown to be futile. In such an event, the shareholder must state in his complaint the reasons for not complying with the demand requirement.

If the plaintiff fails to make a demand before filing a suit, he bears a heavy burden of demonstrating why the demand would have been futile. To justify excusing the demand, the plaintiff has to allege with particularity the facts that support a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment.

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8. *See id.* at 938.
9. *Id.* at 942.
    The complaint shall . . . allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors . . . and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort.
11. *See Fairman, supra* note 1, at 329; *see also* *William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Private Corporations* § 5965 (2004).
13. *See id.*
In *Aronson v. Lewis*, the court set forth a two-step demand futility analysis. The Court of Chancery must decide whether a reasonable doubt is created that 1) the directors are disinterested and independent, and 2) the challenged transaction was otherwise the product of a valid exercise of business judgment.

If the court determines that the pleaded facts create a reasonable doubt that a majority of the board could have acted independently, the court will excuse the demand as futile. The basis for claiming excusal would normally be that 1) a majority of the board has a material financial or familial interest; 2) a majority of the board is incapable of acting independently for some other reason, such as domination or control; or 3) the underlying transaction is not a product of a valid exercise of business judgment.

The directors' decision not to institute the derivative action, taken in the proper exercise of the directors' business judgment, generally will preclude the shareholder from continuing with the derivative suit. Thus, many jurisdictions logically adopted the view that the business judgment rule enables corporate boards to terminate derivative suits.

### A. Special Litigation Committees

In many instances, a shareholder's derivative suit challenges conduct that either involved or was approved by the present directors, and, consequently, often names the directors as defendants. When a majority of the directors themselves participated in the challenged conduct, or when the interested directors effectively control the board, the business judgment rule cannot shield the board's decision not to pursue the claim. In such a case, the board generally can delegate its power to terminate derivative litigation to an SLC.

In *Burks v. Lasker*, the United States Supreme Court approved the use of an SLC to terminate a shareholder derivative action. However, the Court cautioned that corporate boards may not use this pro-

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14. *Id.* at 805.
15. *Id.* at 814.
16. See generally *FLETCHER*, supra note 11, § 5965.
17. *See id.*
19. *Id.*
procedure if application of the state law would frustrate federal policy. Since *Burks*, use of an SLC has proven to be a valuable device for corporate defendants. An SLC provides the corporation with an important tool to rid itself of meritless or harmful litigation and strike suits at an early stage in the litigation. Appointment of an SLC may also buy time, as courts frequently stay discovery until an SLC completes its investigation. In addition, creation of an SLC may facilitate settlement negotiations. An SLC's investigation itself may provide a powerful incentive for parties to negotiate in good faith.

Despite the potential benefits of appointing an SLC, there are occasions when the use of an SLC may be unwise. For example, a court may refuse to allow dismissal of the certain types of claims based on an SLC's recommendation. There is also a possibility that the SLC's investigation may actually bolster the derivative plaintiff's case. For instance, it may provide the plaintiff with additional discovery or clarify the complexities of the facts and legal theories on the plaintiff's behalf.

An SLC can be formed for the purpose of evaluating a demand when initiated by a shareholder and prior to instituting a derivative suit. Also, SLCs are employed when a presuit demand has already been excused. In that case, a board of directors can form an SLC to review the claims raised and to determine whether to seek a dismissal on the basis that the action is not within the best interest of the corporation.

Critical to the success of an SLC are its formation and composition. An SLC's members should be independent and disinterested

24. *Burks*, 441 U.S. at 479. The issue in *Burks* was whether a committee of independent directors of a mutual fund could terminate a claim pursuant to the Investment Company Act of 1940. See id. at 473. After determining that the state law permitted the use of a special litigation committee, the Court examined the federal policy underlying the purpose and role of independent directors under 1940 Act. See id. 484-85. The Court warned that federal courts must be on guard against state law threats to "any identifiable federal policy or interest, and should apply state corporate law only where it is consistent with federal securities law. See id. at 479-80.


26. Id. at 726.

27. Id.

28. Id.

29. Id.

30. Id.

31. See Fairman, *supra* note 1, at 333.

32. Id.

33. Id.

34. Patricia R. Hatler et al., *Bulletproof Your Special Litigation Committee in Interested Fiduciary Transactions*, 19/4 A.C.C.A. DOCKET 36, 40 (2001), available at WL 19 No. 4 ACCADKT 36 (discussing the problems of the initial formation of SLC's).
in the subject matter of the challenged claim.\textsuperscript{35} Independence is most easily established when the members of an SLC were not members of the board at the time of the challenged transaction and were not named as defendants in a derivative suit.\textsuperscript{36}

There are two principal lines of authority establishing the standards by which a reviewing court should measure decisions of an SLC. One line of authority generally applies the business judgment rule in reviewing the decisions of disinterested directors to dismiss derivative suits.\textsuperscript{37} The Supreme Court of Delaware, in \textit{Zapata Corp. v. Maldonado},\textsuperscript{38} took another approach. According to this approach, the reviewing court has discretion to exercise its own independent business judgment in determining whether to dismiss an action, even if an SLC have been independent and disinterested.\textsuperscript{39}

Prior to the \textit{Oracle} decision, the Delaware courts generally viewed independence as an issue of economics.\textsuperscript{40} The focus was limited to whether a director could be harmed financially by taking action against another director or against a challenged transaction.\textsuperscript{41} The determination usually turned on whether the director was incapable of acting independently for reasons such as domination or control.\textsuperscript{42} Domination and control were premised on the existence of a controlling or dominating shareholder.\textsuperscript{43} Personal relationships alone were not ordinarily sufficient to rebut a finding of independence.\textsuperscript{44} The cases that follow further explain the approach that existed before \textit{Oracle}.

1. \textit{Zapata Corp. v. Maldonado}\textsuperscript{45}

In \textit{Zapata}, the plaintiff, William Maldonado, instituted a derivative action in Delaware on behalf of the corporation and against ten officers and directors of Zapata Corp. ("Zapata"), alleging various breaches of fiduciary duty.\textsuperscript{46} Maldonado claimed that the requisite

\textsuperscript{35} See Fairman, \textit{supra} note 1, at 334.
\textsuperscript{36} \textit{Id.} at 334-35.
\textsuperscript{37} See Rudolph & del Puerto, \textit{supra} note 4, at 48-49.
\textsuperscript{38} Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).
\textsuperscript{39} See Fairman, \textit{supra} note 1, at 338.
\textsuperscript{40} Eric Landau et al., \textit{Director Independence: Impartiality or Isolation}, 1418 \textit{Prac. L. Inst.} 111, 114 (2004).
\textsuperscript{41} \textit{Id.}
\textsuperscript{43} \textit{Id.}
\textsuperscript{44} Landau, \textit{supra} note 40, at 114.
\textsuperscript{45} Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).
\textsuperscript{46} \textit{Id.} at 780.
demand was futile in light of the fact that all the corporate directors were parties to the derivative action. 47 A number of years later, while the action was still pending, there occurred a change in the composition of Zapata's board of directors, with the dismissal of several original directors and with the appointment of two new outside directors. 48

The board of directors next resolved to create an "Independent Investigating Committee," consisting of the two new directors, who were not parties to the suit, to determine whether the corporation had to pursue any of Maldonado's claims. 49 At the end of the investigation, the committee concluded that the action should have been dismissed. 50 The Delaware Court of Chancery held that the business judgment rule did not operate to authorize a corporate board to dismiss a derivative action. 51 It was left to the Delaware Supreme Court to resolve the different interpretations. 52

The Delaware Supreme Court doubted that the business judgment rule could justify a corporate board's termination of a derivative action. 53 The court observed that the business judgment rule only became relevant in a defensive sense, once someone challenged the directors' actual decision to terminate a derivative suit. 54

The court in the case produced specific rules and procedures that a committee must observe to be entitled to dismiss derivative litigation. The independent committee had to conduct "an objective and thorough investigation of the derivative suit," at the conclusion of which the independent committee might cause its corporation to file a pre-trial motion to dismiss. 55 The motion was considered as a hybrid summary judgment motion for dismissal, 56 and the basis thereof "[was] the best interests of the corporation, as determined by the committee." 57

The motion itself was reviewed under a two-step test. 58 First, the court had to inquire into the independence and good faith of the com-

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47. Id.
48. See id. at 781.
49. Id.
50. Id. The Committee concluded that the action should be dismissed because "[its] continued maintenance is inimical to the Company's best interest . . . ." Id.
51. See Zapata, 430 A.2d at 781.
52. Id.
53. See id. at 782.
54. See id. The Delaware Supreme Court defined the issue in Zapata as whether a committee designated by the corporate board of directors can be permitted to cause the dismissal of litigation which was properly initiated by a derivative stockholder in his own right. Id. at 785.
55. Id. at 788.
56. Id. at 787.
57. Zapata, 430 A.2d at 788.
58. See id.
mittee and the basis supporting its conclusions.\textsuperscript{59} Limited discoveries might be ordered to facilitate such inquiries.\textsuperscript{60} The committee had the burden of proving independence and good faith, rather than presuming independence and good faith.\textsuperscript{61} Second, the court should have determined whether to grant the motion by applying the court's own business judgment to the issues raised by the corporation's motion.\textsuperscript{62} Thus, even when the corporation showed an absence of a genuine issue of material fact as to the committee's independence, a reviewing court still might not dismiss an action when the court's own business judgment suggested that it was not in the best interest of the corporation.\textsuperscript{63}

2. \textit{In re Walt Disney Co. Derivative Litigation}\textsuperscript{64}

In \textit{Walt Disney}, shareholders brought a derivative action against the directors, alleging breach of fiduciary duty by 1) approving the employment agreement by which Michael Ovitz ("Ovitz") joined the company as a president; and 2) granting Ovitz a non-fault termination and paying him generous severance benefits under the terms of the agreement.\textsuperscript{65} The directors moved to dismiss on the ground that, \textit{inter alia}, the shareholders had failed to make a demand on the Board.\textsuperscript{66}

With respect to the issue of the directors' independence, the shareholders alleged that the personal interrelationships among the directors rendered the directors interested in the disputed transaction. Also, the shareholders alleged that many of the directors were interested because they had received directors' benefits and stock options.\textsuperscript{67}

The court, applying the existing Delaware law, found that the demand was not excused just because directors would have to sue their friends, family, and business associates.\textsuperscript{68} It also held that the directors' longstanding personal and professional ties to Ovitz could not overcome the presumption of independence that all directors were af-

\textsuperscript{59} Id.
\textsuperscript{60} Id.
\textsuperscript{61} Id.
\textsuperscript{62} Id. at 789.
\textsuperscript{63} Rudolph & del Puerto, \textit{supra} note 4, at 53.
\textsuperscript{64} \textit{In re Walt Disney Co. Derivative Litig.}, 731 A.2d 342 (Del. Ch. 1998).
\textsuperscript{65} Id. at 351.
\textsuperscript{66} See id.
\textsuperscript{67} See id. at 355 n.18.
\textsuperscript{68} Id.
Those ties must have been coupled with an allegation of control.\footnote{\textit{Walt Disney}, 731 A.2d at 355 n.19.}


In \textit{Lewis}, a shareholder of Fuqua Industries, Inc. sued the Chief Executive Officer ("CEO") and fourteen of the company's directors, alleging the usurpation of corporate opportunity.\footnote{\textit{Id. at 964.}} In response to the allegation, the Board of Directors formed an SLC consisting of one person to review the merits of the claims.\footnote{\textit{Id.}} The single member of the SLC, although on the Board, had not participated in the alleged wrongdoing.\footnote{\textit{Id.}} Also, he had been a president of Duke University and a Governor of North Carolina.\footnote{\textit{Id.}} Through his affiliation with Duke University and his political career, the SLC member had numerous contacts with the CEO.\footnote{\textit{Id.}} In his turn, the CEO made several contributions to the university.\footnote{\textit{Id.}} After conducting an investigation, the SLC recommended not to pursue the litigation.\footnote{\textit{Id.}}

The court found that the SLC member was not independent. In reaching the conclusion, the court relied on the fact that the member had numerous political and financial dealings with the CEO, and that the university had recently received a $10 million pledge from the CEO.\footnote{\textit{Id.}} The court stressed that all of the facts had to be considered as a whole.\footnote{\textit{Id.}} Thus, even if the court took into account social or institutional connections, it still must find that an economic component was present.\footnote{\textit{Id.}} Furthermore, the court established a heightened requirement applicable to an SLC comprised of a single member. The court...
observed that "[i]f a single member [special litigation] committee is to be used, the member should, like Caesar's wife, be above reproach."\textsuperscript{82}

4. Crescent/Mach I Partners, L.P. v. Turner\textsuperscript{83}

In \textit{Crescent/Mach I Partners, L.P.}, minority shareholders of the merged company brought an action against the directors, alleging that they had breached their fiduciary duties of loyalty, care, and good faith in approving the merger.\textsuperscript{84}

The court stated that in the context of a merger, a breach of fiduciary duty analysis began with the presumption that a board of directors acted with loyalty and care.\textsuperscript{85} Unless the shareholders rebutted the presumption, the directors were entitled to the protection of the business judgment rule.\textsuperscript{86} In order to rebut the presumption, the plaintiff must demonstrate that a majority of the directors had a financial interest in the transaction, or were dominated or controlled by a materially interested director.\textsuperscript{87} The court concluded that, \textit{inter alia}, the shareholders' allegation of a fifteen-year professional and personal relationship between the materially interested director and the majority of the board did not in itself raise a reasonable doubt about the director's independence.\textsuperscript{88}

5. Abrams v. Koether\textsuperscript{89}

In \textit{Abrams}, shareholders brought a derivative action, alleging, \textit{inter alia}, that "[a]ll the defendants were linked together by a host of familiar, business, and other ties . . .," and that they were all involved in a network of interlocking and overlapping business relationship.\textsuperscript{90}

The federal district court, interpreting Delaware law, held that the shareholders could not compromise an SLC's independence just because the directors would have to sue their families, friends, family, and business associates.\textsuperscript{91} The court concluded that, to cast a doubt on independence, the shareholders had to allege that the directors

\textsuperscript{82. Id. at 967. The Delaware court in its subsequent decisions affirmed that this heightened standard was applicable only to a single-member SLC. \textit{See generally Hollinger Int'l v. Black}, 844 A.2d 1022, 1034 (Del. Ch. 2004).}
\textsuperscript{83. Crescent/Mach I Partners, L.P. v. Turner, 846 A.2d 963 (Del. Ch. 2000).}
\textsuperscript{84. Id. at 968.}
\textsuperscript{85. Id. at 979.}
\textsuperscript{86. Id.}
\textsuperscript{87. Id.}
\textsuperscript{88. See id. at 979-80.}
\textsuperscript{90. Id. at 240.}
\textsuperscript{91. Id. at 256 (citing Aronson v. Lewis, 473 A.2d 805, 818 (Del. 1984)).}
were directly and financially interested in the self-dealing transactions.92

B. Subject Opinion: In re Oracle Corp. Derivative Litigation93

In Oracle, the analysis of an SLC's independence received a sophisticated articulation. The court explicitly acknowledged that social and institutional connections among committee members and defendants might be so numerous and significantly interrelated that their thickness called the committee members' independence into question.94

In December 2000, Oracle Corp. ("Oracle") provided the market with earnings guidance for the third quarter of the company's fiscal year 2001.95 Oracle's earnings were due to be reported in March 2001.96 In January 2001, more than a month before the quarterly earnings release, four Oracle directors—Ellison, Henley, Lucas, and Boskin—sold their shares.97 According to the directors, there was no reason to believe that Oracle would not meet the guidance provided in December.98 On March 1, 2001, Oracle revealed that the company's earnings would be roughly twenty percent below the guidance the company had provided in December 2000. Oracle's stocks plummeted in response to the news.99

Plaintiff shareholders brought a Delaware derivative suit against the trading directors for breach of the duty of loyalty by misappropriating inside information and using it as the basis for their trades.100 According to the plaintiffs, each of the defendants possessed material, non-public information, demonstrating that Oracle would not meet the earnings and revenue guidance it had provided in December 2000.101 The plaintiff also alleged that the guidance was materially misleading and became even more so as early results for the quarter came in.102

92. Id.
95. Oracle, 824 A.2d at 921.
96. Id. at 922.
97. Id. At the time, Mr. Ellison was Oracle's chairman, and CEO, and largest individual shareholder. Id. at 921. Mr. Lucas was a director who chaired Oracle's executive committee and the finance and audit committee. Id. Mr. Boskin was a director who chaired Oracle's compensation committee and served on the finance and audit committee. Id.
98. Id.
99. Id.
100. Id. at 922-23.
101. Oracle, 824 A.2d at 921.
102. Id.
In response, the Oracle board formed an SLC, consisting of Hector Garcia-Molina ("Garcia-Molina") and Joseph Grundfest ("Grundfest"), two directors who joined the Oracle board more than six months after the Oracle's disappointing earnings announcement. Both of the members were accomplished scholars in their fields: Garcia-Monica in electrical engineering and computer science, and Grundfest in business, economics and corporate governance. Both were tenured professors at Stanford University, and had obtained graduate degrees from Stanford. Furthermore, both were recruited to the board primarily by defendant Lucas, with help from defendant Boskin.

The SLC retained an independent counsel to assist in its investigation of the lawsuit. The law firm representing the SLC performed a great deal of diligence. For instance, it interviewed seventy witnesses among whom were members of Oracle's management responsible for financial reporting and witnesses identified by the plaintiffs in the then-pending federal securities class action. The SLC met with its counsel thirty-five times during the course of investigation for a total of eighty hours.

The SLC compiled a massive 1,110-page report detailing its findings. In its report, the SLC found that even a hypothetical Oracle executive who possessed all information regarding the company's performance in December 2000 and January 2001 would not have possessed material, non-public information indicating that the company would fail to meet the earnings and revenue guidance it had provided in December. None of the many e-mails from various Oracle top executives in January 2001 regarding the quarter anticipated that the company would perform as it actually did.

Important to the SLC's conclusion was the finding that Oracle's quarterly earnings were subject to the so-called "hockey stick effect," whereby a large portion of each quarter's earnings came in right at the end of the quarter. The SLC concluded that the two trading de-
fendants with the most access to the inside information did not possess material, non-public information at the time of the trades.\textsuperscript{115} Based on its investigation and report, the SLC moved to terminate the derivative litigation.\textsuperscript{116}

The court first noted that to prevail on its motion to terminate the derivative action, the SLC bore the burden of proving that 1) its members were independent; 2) they acted in good faith; and 3) they had reasonable bases for their recommendations.\textsuperscript{117} The court then stated that, if there was a material factual question causing doubt on any of the three issues, the SLC's motion must be denied.\textsuperscript{118} The independence prong was the only one which the court addressed.

The following evidence of the SLC's independence was provided. Neither Grundfest nor Garcia-Molina received compensation from Oracle other than as directors.\textsuperscript{119} Neither Grundfest nor Garcia-Molina was on the Oracle board at the time of the alleged wrongdoing.\textsuperscript{120} Both Grundfest and Garcia-Molina were willing to return their compensation as SLC members if necessary to preserve their status as independent.\textsuperscript{121} Finally, there were no any material ties between Oracle, the trading defendants, and any of the other defendants, on the one hand, and the SLC's members, on the other.\textsuperscript{122}

However, through the course of discovery, the plaintiffs found that the members of the SLC, the trading defendants, and Oracle, all had extensive ties to Stanford University.\textsuperscript{123} Boskin was a Stanford professor and had taught Grundfest when he was a Ph.D. candidate.\textsuperscript{124} Lucas was a contributor to Stanford.\textsuperscript{125} He obtained both his undergraduate and graduate degrees at Stanford.\textsuperscript{126} Lucas also was a head of a foundation that had given to Stanford more that $11 million since its founding.\textsuperscript{127} Lucas donated $4.1 million of his own personal funds to Stanford.\textsuperscript{128} Ellison was the sole director of the Ellison Medical
Foundation, which granted Stanford nearly $10 million in funds. In 2000-2001, Ellison was considering donating several million dollars to Stanford to create the "Ellison Scholars Program." The plaintiffs seized upon the fact that those details were absent from the SLC's report. They argued that the absence of those details rebutted not only the SLC's independence, but also its competence, which rendered its report fundamentally flawed.

The SLC responded by noting that neither of its members' roles at Stanford involved fundraising, nor did Oracle or any of the trading defendant had the ability to deprive the SLC members of compensation or terminate their employment with Stanford. Due to their tenured status, Stanford itself could not deprive either of the SLC members of compensation or terminate their employment. Essentially, the defendants argued that the SLC members were independent unless they were subservient to the trading defendants—unless they were under the domination and control of the interested parties.

The court denied the SLC's motion, holding that the SLC members had not met their burden of establishing their independence. The court held that the ties among the SLC, the trading defendants, and Stanford were so substantial that they caused reasonable doubt about the SLC's ability to impartially consider whether the trading defendants should face the suit. The court rejected the SLC's argument that the test for independence should focus on more traditional notions of domination and control.

The court stated that most corporate directors were deeply enmeshed in social institutions. Therefore, it was very important to look not only at economic consequences, but also at social ones. The court also noted that non-economic motivations such as love, friendship, and collegiality might influence human behavior.

129. Id. at 932.
130. Id. at 933.
131. Oracle, 824 A.2d at 936-37.
132. Id. at 937.
133. Id. at 935-36.
134. Id. at 936.
135. Id. at 937.
136. Id. at 942.
137. Oracle, 824 A.2d at 942.
138. Id. at 938.
139. Id.
140. Id. at 938-39
The court adopted the following standard: "At the bottom, the question of independence turns on whether a director is, for any substantial reason, incapable of making a decision with only the best interests of the corporation in mind. That is, the Supreme Court cases ultimately focus on impartiality and objectivity." 142 The court stated that this standard was wholly consistent with the teaching of Aronson, which defined independence as meaning that "a director's decision [was] based on the corporate merits of the subject before the board rather than extraneous considerations or influences." 143

The court acknowledged that Delaware case law had been inconsistent in applying the general standards of independence. 144 However, the court relied on Mizel v. Connelly 145 to support the proposition that the Delaware courts recognized the importance of family relationship in analyzing the director's independence. 146

In Mizel, shareholders brought a derivative action, challenging a transaction between the nominal defendant President Casinos, Inc. ("President Casinos") and a corporation wholly owned by President Casinos' Chairmain, CEO, and the largest shareholder, John Connelly ("Connelly"). 147 Connelly and two of his management subordinates, one of whom was Connelly's grandson, comprised a majority of the board of directors of President Casinos. 148 The court held that the shareholders' demand was excused and denied the defendant's motion to dismiss. 149 In doing so, the court relied on the first prong of the Aronson's test. 150 The court found that the board of directors was not independent because Connelly had a considerable influence over the economic fates of the two subordinates: they both derived their principal income from their employment at President Casinos. 151 The court also found the fact that one of the subordinates was Connelly's grandson further supported the inability to consider a demand impartially. 152

However, the Oracle court also acknowledged that a majority of the case law concentrated on whether there were economical material ties

142. Id. at 938 (citing Parfi Holding AB v. Mirror Image Internet, Inc., 794 A.2d 1211, 1232 (Del. Ch. 2001)).
143. Oracle, 824 A.2d at 938 (citing Aronson v. Lewis, 473 A.2d 805, 816 (Del. 1984)).
144. Id. at 939.
146. Oracle, 824 A.2d at 939.
148. Id. at *1.
149. Id. at *5.
150. Id. at *3.
151. Id.
152. Id. at *4.
between the interested party and the director whose impartiality was questioned.\textsuperscript{153} Also, the court emphasized the fact that the outside directors' various ties to Stanford only emerged after the plaintiffs completed limited discovery.\textsuperscript{154} The SLC's report noted only that Boskin was a professor at Stanford and that the SLC members were aware that Lucas had made certain donations to Stanford, but the donations were presented as rather insubstantial.\textsuperscript{155} The court found that in the view of the modesty of those disclosed ties, "it was with some shock that a series of other ties among Stanford, Oracle, and the trading defendants emerged during discovery."\textsuperscript{156} The court gave little weight to the SLC's argument that it was unaware of just how substantial the directors' beneficence to Stanford had been.\textsuperscript{157} It did so for two reasons. First, it undermined confidence that the SLC had examined the trading defendants' ties to Stanford in preparing its report.\textsuperscript{158} The report's failure to identify those ties was important because it was the SLC's burden to show independence.\textsuperscript{159} Second, there were too many visible manifestations of directors' status as major contributors.\textsuperscript{160} The court also rejected the SLC's argument that contributions, while seemingly large, constituted a very small proportion of Stanford's endowment and annual donations, and, therefore, could not be materially important.\textsuperscript{161}

C. Beam v. Stewart Limited the Application of Oracle.

In Beam,\textsuperscript{162} shareholders brought a derivative action, alleging illegal insider stock sales by Martha Stewart ("Stewart"), a director of Martha Stewart Living Omnimedia, Inc. ("MSO").\textsuperscript{163} Count one of the plaintiff's complaint alleged that Stewart breached her fiduciary duties of loyalty and care by illegally selling her personal shares of an unrelated company, ImClone, in December 2001, and thereafter mishandling the media attention that ensued.\textsuperscript{164}

\begin{itemize}
  \item \textsuperscript{153} Oracle, 824 A.2d at 936 (citing Crescent/Mach I Partners, L.P. v. Turner, 846 A.2d 963, 980-83 (Del. Ch. 2000)).
  \item \textsuperscript{154} Id. at 929.
  \item \textsuperscript{155} Id.
  \item \textsuperscript{156} Id.
  \item \textsuperscript{157} See id. at 943.
  \item \textsuperscript{158} Id.
  \item \textsuperscript{159} Oracle, 824 A.2d at 943.
  \item \textsuperscript{160} Id. at 944.
  \item \textsuperscript{161} Id. at 945.
  \item \textsuperscript{162} Beam v. Stewart, 845 A.2d 1040 (Del. 2004).
  \item \textsuperscript{163} Id. at 1044.
  \item \textsuperscript{164} Id.
\end{itemize}
The Delaware Court of Chancery dismissed count one of the complaint for failure to plead particularized facts demonstrating presuit demand futility in accordance with the Delaware Chancery Court Rule 23.1.\textsuperscript{165} The Delaware Supreme Court affirmed, holding that the plaintiff had not pleaded sufficient facts to support a reasonable inference that a majority of the MSO directors were not independent.\textsuperscript{166}

The plaintiff alleged a personal relationship to support the lack of the director's independence.\textsuperscript{167} But the court found that the Delaware law required substantially more than that.\textsuperscript{168} The court noted that there was a presumption that the directors were independent, and to overcome that presumption, "a plaintiff must plead facts that would support the inference that because of the nature of a relationship or additional circumstances . . . the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director."\textsuperscript{169}

In \textit{Beam}, the court addressed \textit{Oracle}'s discussion of director independence in the SLC context. The court limited the implication of \textit{Oracle}.\textsuperscript{170} The court noted that, unlike demand-excusal context, where the board was presumed to be independent, the SLC had the burden of establishing its own independence.\textsuperscript{171} The court also observed that the SLC analysis contemplated not only a shift in the burden of persuasion, but also the availability of discovery into various issues, including independence.\textsuperscript{172} The court suggested that, while the definitions of director's interest and independence in the presuit demand and SLC contexts were nominally identical, the procedural differences between the two types of cases might, as a practical matter, make it impossible for an SLC to establish its independence.\textsuperscript{173}

\section*{III. Analysis}

This section scrutinizes the \textit{Oracle} opinion. First, it argues that the \textit{Oracle} court applied a standard for independence that the Delaware

\begin{footnotesize}
165. \textit{Id}.
166. \textit{Id.} at 1057.
167. \textit{Id.} at 1047.
168. \textit{Beam}, 845 A.2d at 1050.
169. \textit{Id.} at 1052.
170. \textit{Id.} at 1054-56.
171. \textit{Id.} at 1055.
172. \textit{Id}.
173. \textit{See id.} at 1055. "We need not decide whether the substantive standard of independence in an SLC case differs from that in a presuit demand case. As a practical matter, the procedural distinction relating to the diametrically-opposed burdens and the availability of discovery into independence may be outcome-determinative on the issue of independence." \textit{Id.} at 1055.
\end{footnotesize}
courts had not applied before. Second, it addresses the point that the extensive social and institutional connections were not the only reason for the court's decision; the section will also discuss the role that failure to disclose those connections and burden of proof played in the outcome of the case. Next, it discusses the *Beam* case that limited *Oracle* in holding that it may be impossible to establish independence in the SLC context.

A. Standard for Independence.

The *Oracle* court's analysis of independence was not a simple application of the principles established in *Zapata*. Unlike in *Zapata*, the analysis focused almost exclusively on non-financial influences. The decision opened the door to the consideration of such tenuous ties as those among a teacher and a student, fellow professors and committee members.\(^{174}\) The following arguments further explain that the *Oracle* analysis of independence was a novel one.

First, the court's analysis of independence took into account the individual circumstances of the people in question and was far more nuanced than a typical analysis of independence.\(^{175}\) The court noted that Delaware law should not be based on a reductionist view of human nature that simplified human motions on the lines of the least sophisticated notions of the law and economics movement.\(^{176}\) The court pointed to the fact that corporate directors were generally the sort of people deeply enmeshed in social institutions.\(^{177}\)

However, the court's analysis of human nature hardly explains the case holding. It is difficult not to agree with the court's statements. On the other hand, personal relationships always exist. And as the *Oracle* court correctly observed, the corporate directors are also humans. Directors do not come to a board as strangers; they must be elected.\(^ {178}\) Therefore, simply owning enough stock to elect a director should not rebut independence. Otherwise, a director will never be considered independent if, for example, there is a controlling shareholder group.\(^ {179}\) The formation of an SLC is always a difficult task.\(^ {180}\)

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174. *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 938 (Del. Ch. 2003). "But also think of motives like love, friendship, and collegiality, think of those among us who direct their behavior as best they can on a guiding creed or set of moral values." *Id.*


176. *Oracle*, 824 A.2d at 938.

177. *Id.*


179. *Id.* "The question of independence must focus on whether a director has the ability to dispassionately and independently render a decision, not on whether he hypothetically might be
Most of the times, it is almost impossible to compose an SLC of totally unknown persons. However, the Oracle court's focus on human nature makes formation of an SLC more difficult. Now, even a dinner with the co-workers can divest members of an SLC of independence.

Second, the Oracle approach to independence was expressly rejected by the Delaware court in its previous decisions. In Walt Disney, the court refused to find that the directors were not independent, even though there was a much more solid basis for such a finding than in the Oracle case. In doing so, the court expressly stated that it was not enough to be friends, business associates, or members of the family to overcome the presumption of independence. In Crescent/Mach I Partners, L.P., the court also stated that the allegation of a fifteen-year professional and personal relationship between a materially interested director and the majority of the board was not enough to raise a doubt about the director's independence. Moreover, the court held that the director's financial self-interest in the transaction did not preclude his ability to independently evaluate the fairness of the transaction. Furthermore, in Abrams, a federal district court, interpreting Delaware law, found that the shareholders could not compromise the directors' independence just because the directors would have to sue their families, friends, and business associates.

Third, although the Oracle court recognized that its analysis of independence was inconsistent with the majority of the existing case law, it failed to overrule the above-mentioned cases or to reconcile the controversy. It simply stated that it applied the independence inquiry that the Supreme Court had articulated in a manner that was faithful to its essential spirit. It also said that the formulation of independence that the court adopted was wholly consistent with the teaching of Aronson. Aronson defined independence as meaning that "a worried about his position or his compensation, an allegation which could easily be asserted in most instances." Id.

180. See Hatler, supra note 34, at 40.
181. Id. at 41.
182. In re Walt Disney Co. Derivative Litig., 731 A.2d 342, 361 (Del. Ch. 1998). For instance, the shareholders alleged not only the longstanding personal relationship, but also director's benefits and stock options. Id. at 355 n.18.
183. Id.
185. Id.
188. Id. at 938. "At the bottom, the question of independence turns on whether a director, for any substantial reason, incapable of making a decision with only the best interests of the corporation in mind. That is, the Supreme Court cases ultimately focus on impartiality and objectivity." Id.
director's decision is based on the corporate merits of the subject before the board rather than extraneous consideration or influences.\textsuperscript{189} However, this statement from \textit{Aronson} is very ambiguous and is open to many different interpretations. Thus, although it is true that "consideration or influences" can be of various sorts, including personal, it is also true that the Delaware court never interpreted them this way.\textsuperscript{190} Therefore, it is hard to see how the teaching from \textit{Aronson} supports the court’s position in \textit{Oracle}. With the same success, the court could cite this proposition to reach the opposite conclusion.

Fourth, the court’s reliance on \textit{Mizel v. Connelly}\textsuperscript{191} to support its position that the Delaware law recognized the bias producing potential of family relationships is, probably, unwarranted for the following reasons. The \textit{Mizel} case involved a close family relationship: grandfather and grandson. To the contrary, the \textit{Oracle} case involved only a social relationship: students and professors. Besides, in \textit{Mizel}, the court did not find the director independent solely on that ground. The court primarily relied on the fact that the members of the board, including the grandson, each derived their principal income from their employment at President Casinos.\textsuperscript{192} Therefore, the economic factor was still present.

On the other hand, the facts of \textit{Oracle} are more similar to the facts of \textit{Crescent/Mach I Partners, L.P. v. Turner}.\textsuperscript{193} In \textit{Crescent/Mach I Partner, L.P.}, the plaintiff minority shareholder alleged the longstanding professional and personal (but not family) relationship to support the director’s lack of independence. However, the court found that those allegations were not enough. They alone failed to support the allegation that the director could not exercise his independent business judgment in approving the transaction.\textsuperscript{194} Nevertheless, the \textit{Oracle} court refused to follow this precedent.

Finally, even if it is true that the \textit{Oracle} court applied the existing standard of independence, and that the social or institutional connections were the components that the courts always took into account, these components were not decisive ones. Indeed, courts that have considered social or institutional connections have often held that

\begin{itemize}
\item \textsuperscript{189} \textit{Aronson} v. \textit{Lewis}, 473 A.2d 805, 816 (Del. 1984).
\item \textsuperscript{191} \textit{Mizel} v. \textit{Connelly}, 1999 WL 5500369 (Del. Ch. 1999).
\item \textsuperscript{192} \textit{Id.} at *3.
\item \textsuperscript{193} \textit{Crescent/Mach I Partners, L.P. v. Turner}, 846 A.2d 963 (Del. Ch. 2000).
\item \textsuperscript{194} \textit{Id.} at 980-81.
\end{itemize}
there must also be some economic component to warrant a finding against independence.\textsuperscript{195} For instance, in \textit{Lewis v. Fuqua},\textsuperscript{196} the Court of Chancery held that a university president, who served on an SLC, was not considered independent where he had numerous political and financial dealings with the CEO, the CEO was a trustee of the university, and the university had recently received a $10 million pledge from the corporation and CEO.\textsuperscript{197} \textit{Oracle} is distinguishable from this case in several important aspects. In reaching its conclusion, the \textit{Oracle} court did not rely on the financial aspects of the transaction at all. To the contrary, it placed the whole emphasis only on the social aspect.\textsuperscript{198} Thus, it is difficult to agree with the court’s position that the standard applied is the standard that always existed and was consistent with the previous case law.

Furthermore, in \textit{Fuqua}, the SLC consisted of only one member.\textsuperscript{199} In that case, the court established a heightened requirement applicable to an SLC comprised of a single member.\textsuperscript{200} Thus, the \textit{Fuqua} decision gave force to the practical notion that a single-member SLC was more susceptible to external influences than an SLC balanced by multiple members.\textsuperscript{201} The Delaware court in its subsequent decisions affirmed that the heightened requirement was applicable only to a single-member SLC.\textsuperscript{202} However, the court had never applied the heightened standard to an SLC comprised of multiple members.\textsuperscript{203}

\textsuperscript{195} Landau, \textit{supra} note 40, at 115.
\textsuperscript{196} Lewis v. Fuqua, 502 A.2d 962 (Del. Ch. 1985).
\textsuperscript{197} \textit{Id}.
\textsuperscript{198} Although it is true that the \textit{Oracle} court pointed to the defendant’s substantial contributions to the university in which the SLC’s members were professors, it is also true that the court did not find that those contributions made the SLC’s members financially dependent. \textit{See Oracle}, 824 A.2d at 938-42.
\textsuperscript{199} \textit{Fuqua}, 502 A.2d at 965. “The Board of Directors named Terry Sanford as the single member Committee. Mr. Sanford, although a member of the Board of Directors of Fuqua Industries, had not participated in the purchase of the Triton stock.” \textit{Id}.
\textsuperscript{200} \textit{Id} at 967:
If a single member committee is to be used, the member should, like Caesar’s wife, be above reproach. Terry Sanford is, unfortunately, the sole member of the Committee. His past and present associations raise a question of fact as to his independence. This alone is grounds to deny the motion to dismiss under the first test set forth in Zapata. \textit{Id}.
\textsuperscript{201} Kistenbroker, \textit{supra} note 42, at 666.
\textsuperscript{202} Hollinger Int’l v. Black, 844 A.2d 1022, 1034 (Del. Ch. 2004) “Realizing that a single-member Special Committee was oxymoronic and unwise, the International board decided to add new directors who could join Paris on the Special Committee.” \textit{Id}.
\textsuperscript{203} Kistenbroker, \textit{supra} note 42, at 666-67:
In Martha Stewart, the Delaware Supreme Court ignored that the Chancery Court in \textit{Fuqua} was evaluating the independence of a single-member SLC and adopted this heightened standard for all SLC’s. Thus, according to the Delaware Supreme Court, “[u]nlike the demand excusals context, where the board is presumed to be independent,
For this reason, before *Oracle*, legal consultants typically advised the board that its SLC must comprise more than one member.\(^{204}\)

Besides, in *Oracle*, unlike in *Fuqua*, none of the SLC members were on the Board of Directors at the time of the alleged wrongdoing.\(^{205}\) Also, it is important to note that the positions the SLC members occupied outside of the corporation in *Oracle* were different from those of the SLC member in *Fuqua*. In *Fuqua*, the SLC member was a president of Duke University.\(^{206}\) In *Oracle*, they were just professors at Stanford University.\(^{207}\)

### B. Failure to Disclose

The social ties among the SLC's members, Oracle, and the director defendants were not the only factor contributing to the denial of the SLC's motion. Important was the fact that the SLC did not fully disclose those ties in its motion. The plaintiffs uncovered those ties in discovery after the SLC filed its Motion to Terminate. The SLC's report noted only that Boskin was a professor at Stanford and the SLC members were aware that Lucas had made certain donations to Stanford, but the donations were presented as rather insubstantial.\(^{208}\) The court found the disparity between the SLC's disclosure and the truth shocking:

In the view of the modesty of these disclosed ties, it was with some shock that a series of other ties among Stanford, Oracle, and the Trading Defendants emerged during discovery. Although the plaintiffs have embellished these ties considerably beyond what is reasonable, the plain facts are a striking departure from the picture presented in the Report.\(^{209}\)

A close reading of *Oracle* strongly suggests that the court drew an adverse inference from the SLC's failure to be completely honest with the court. Moreover, it seems possible that if the members of the SLC

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the SLC has the burden of establishing its own independence by a yardstick that must be 'like Caesar's wife'—'above reproach.'\(^\text{Id.}\) It is not clear whether the Delaware Supreme Court intended to heighten the burden for all SLC's or whether its comment was the result of imprecise drafting.

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\(^{204}\) Hatler, *supra* note 34, at 44. "The cases demonstrate that courts are often influenced by the number of members on a special committee. Thus, you should advise your board to select as many disinterested directors as possible to serve on a special committee." \(^\text{Id.}\)

\(^{205}\) *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 929 (Del. Ch. 2003).


\(^{207}\) *Oracle*, 824 A.2d at 930-31.

\(^{208}\) \(^\text{Id.}\) at 931-32.

\(^{209}\) \(^\text{Id.}\) at 929-30.
had fully disclosed the social ties in their report, the Oracle's holding would have been different.

While the disparity between the facts disclosed in the SLC's report and the reality might be considered significant now after the Oracle decision, it is understandable why the SLC's members failed to disclose the social ties that had existed among them and the directors. Given the state of then existing law that considered a personal relationship as insufficient to rebut a finding of independence, it was unlikely that any board or SLC would have viewed as material any of the connections that the Oracle court found compelling.

The court also was not satisfied with the explanation the SLC's members provided for their failure to disclose those social ties in the report. It gave little weight to the SLC's argument that it was unaware of just how substantial ties to Stanford had been. The court observed that the arguments only proved that the SLC had not examined the trading defendants' ties to Stanford in preparing the Report. Also, the absence of live testimony of the SLC's members to explain its failure to disclose could have influenced the court's decision. Indeed, after the plaintiffs uncovered the ties, the SLC's members should have presented their live testimony at the hearing to dispel the court's doubts. Some authorities argue that such a strategy may be inappropriate in all cases. For instance, it can bring a risk of turning the hearing into a burdensome proceeding as a derivative suit itself. However, in the cases analogous to Oracle, when an SLC has nothing to lose, this strategy may be the only way to support an SLC's motion to terminate.

Thus, it seems that the availability of the information that the SLC members claimed to not know may have been the key to the court's holding. The Oracle holding implies a duty upon an SLC to conduct due diligence into the independence of its members to present an accurate picture to the court. If the SLC has not fulfilled its due dili-

210. Id. at 943.
211. Id. at 943-44.
212. Kistenbroker, supra note 42, at 665 (quoting Oracle, 824 A.2d at 942):

[I]t is inescapable that a court must often apply to the known facts about a specific director a consideration of how a reasonable person similarly situated to that director would behave, given the limited ability of a judge to look into a particular director's heart and mind. . . . This is especially so when a special litigation committee chooses, as was the case here, to eschew any live witness testimony . . . . [W]ith that . . . choice came an acceptance of the court's need to infer that the special litigation committee members are persons of typical professional sensibilities.

Oracle, 824 A.2d at 942.
213. Kistenbroker, supra note 42, at 668.
gence obligation, it will nevertheless be held accountable for what it would have learned if it had conducted that inquiry.\footnote{214 See \textit{id.} at 665.}

On the other hand, an SLC's duty of full disclosure and due diligence may be the reason for not using an SLC at all. For instance, during its investigation, an SLC may uncover information that an unsophisticated plaintiff would not have assessed. Also, an SLC may discover corporate wrongdoing in addition to that alleged by a plaintiff. It will not cause harm if the court grants the SLC's motion to terminate the suit. However, it can be really problematic if the court refuses to follow the SLC's recommendation. In such an event, an SLC's investigation report will effectively operate to build a plaintiff's case or to provide a basis for claims by future plaintiffs.\footnote{215 See \textit{Saparoff}, supra note 25, at 733.}

C. Burden of Proof

In \textit{Beam}, the court addressed the \textit{Oracle} court's discussion of director's independence in the SLC context. It observed that unlike the demand-exculsual context, where the board was presumed to be independent, the SLC had the burden of establishing its own independence by a yardstick that must be "'like Caesar's wife'—'above reproach.'"\footnote{216 \textit{Beam} v. \textit{Stewart}, 845 A.2d 1040, 1055 (Del. 2004).} By saying this, the \textit{Beam} court may have made it almost impossible for SLCs to establish their independence. As previously mentioned, the \textit{Fuqua} court made the same statement regarding the independence of the SLC consisting of a single member. This observation established a heightened standard of independence applicable to an SLC comprised of a single member.\footnote{217 See \textit{Kistenbroker}, supra note 42, at 666-67.} In \textit{Beam}, the court ignored the holding of \textit{Fuqua} and adopted that standard for all SLCs. While it could appear to be the result of imprecise drafting, the rest of the \textit{Beam} holding supports the conclusion that the Delaware Supreme Court intentionally heightened the standard for all SLCs, not only those comprising of a single member. For instance, the \textit{Beam} court specifically mentioned that the SLC in \textit{Oracle} consisted of multiple members.\footnote{218 \textit{Beam}, 845 A.2d at 1055. "The Court of Chancery undertook a searching inquiry of the relationships between the members of the SLC and Stanford University. . . ." \textit{Id.}} In addition, it is unlikely that the court, directly referring
to this famous phrase, was unaware of the fact that the SLC in *Fuqua* consisted of one member.

Also, even before *Oracle* and *Beam*, many authorities recognized that in some instances the use of an SLC might be unwise. They provided the list of disadvantages associated with the SLC's use. For instance, the corporation runs some risk that an SLC's investigative work product will be disclosed to a derivative plaintiff. Besides, use of an SLC gives a plaintiff access to an additional discovery that he or she otherwise would not have. Furthermore, as previously discussed, this discovery may operate to build a plaintiff's case. However, the difficulty or impossibility of proving independence was never on this list. And the *Beam* court decided to correct this “omission.” It made a very important suggestion. The court refused to address the issue of whether the substantive standard of independence in the SLC context was different from that in the presuit demand context. However, it noted that availability of discovery in the SLC context, coupled with the stringent summary judgment standard, might be outcome determinative on the issue of independence. Therefore, it seems that the court suggested that it might be very difficult or even impossible for the SLC to establish its own independence. Indeed, as Oracle's experience shows, such a possibility is not without merit.

On the other hand, there can be another explanation for the *Beam*’s court express refusal to address the issue of substantive standard. The refusal suggests that the court might want to reserve the right to apply the new standard established in *Oracle* in a presuit demand context. Indeed, it is obvious that, in *Beam*, the court used the substantive standard of independence that always existed and that was different from that applied in *Oracle*. Unlike in *Oracle*, the *Beam* court specifically stated that allegations of personal relationships were not enough to defeat the director’s independence. The fact that the court refused to acknowledge that the substantive standard was different demon-

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220. Saparoff, supra note 25, at 731.

221. Id. at 731. “Use of an SLC, in some jurisdictions, may give a derivative plaintiff access to additional discovery that he or she would otherwise have been denied. In majority of jurisdictions, discovery is limited to whether the SLC acted independently and in good faith.” Id.

222. *Beam*, 845 A.2d at 1055. “[U]nlike the presuit demand context, the SLC analysis contemplates not only a shift in the burden of persuasion but also the availability of discovery into various issues, including independence.” Id.

223. See id.
strates that there is still a possibility that the court will apply the Oracle new stringent standard in the situations not involving SLCs.

D. Legal Advisor’s Independence

The court also examined the role that the SLC’s legal advisor played, even though the court ultimately concluded that a reasonable doubt had not been raised as to the counsel’s independence. The court did not consider material the fact that the law firm the SLC retained had been engaged to render services for Oracle in the past.224 The SLC also determined that the work the advisor had done previously was not material, and the plaintiffs had not challenged its determination.225 Such a detailed examination of the SLC advisor’s role should serve as a practical warning: a counsel must be prepared to establish his independence as well, in order to place the counsel’s advice and impartiality beyond doubt. Although courts have been critical of legal advisors chosen or recommended by interested managers or by a controlling shareholder before Oracle,226 it is quite possible that now legal advisors will be subject to even more increased scrutiny. For instance, courts may start evaluating the SLC legal advisor’s independence according to the requirements set forth for the SLC’s members themselves, taking into account personal and social connections.

IV. IMPACT

Oracle is important in several aspects. First, the court in Oracle imposed a stringent test for independence in the context of an SLC. Previously, a director was not considered independent if he or she had direct business dealings with any of the people being investigated. The new ruling includes those who might just indirectly benefit from their relationship with the defendants through charitable or nonprofit organizations. The Oracle court stated that it applied the standard for independence that always existed. However, previous case law suggests the opposite. Although the court recognized this inconsistency, it failed to explain it.

Second, although the Beam court limited Oracle’s holding to an SLC context, it is very suspicious that it refused to hold that the sub-

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225. Id.
226. Hatler, supra note 34, at 45. “Although an interested fiduciary can recommend advisors, this practice is generally not advisable. In the event that an interested party makes a recommendation to the special committee, the committee should carefully evaluate it before making a selection.” Id.
stantive standard of independence was different in a presuit demand context. Such a refusal might suggest that the court reserved the right to apply this new standard in the situations not involving SLCs. This is especially true when the whole Beam holding demonstrates that the court did, in fact, use the substantive standard of independence different from the one used in Oracle. The fact that the court refused to acknowledge it shows that the court left the door open for reconsideration of its position regarding the substantive standard of independence in a presuit demand context.

Third, the Oracle case made it clear that directors must make a careful evaluation of the individuals they chose to form an SLC, including new board members recruited to the board for purposes of forming an SLC. Even when the board recruits the SLC’s members after the allegedly wrongful conduct occurred, this may not be sufficient. Thus, in selecting an SLC, the board should choose directors without any connections to the corporation or management, even remote ones. However, this may be an impossible task. As Oracle demonstrates, there are no connections so tenuous that the court could not construe as giving rise to a reasonable doubt of an SLC member’s independence.

Fourth, anything less than the full disclosure of an SLC’s ties to the company or board of directors will raise doubts about the SLC’s independence. The emphasis the court placed on the fact that the director’s various ties to Stanford only emerged after the plaintiffs had completed limited discovery illustrates that the outcome of the case could have been different, had the SLC fully disclosed those ties itself. Thus, even if the new standard for independence was fatal in Oracle, it is possible that this standard will not play such a role in future cases’ outcomes if members of SLCs themselves advise the court of the existence of the social ties.

Finally, as the Beam decision indicated, the procedural distinction relating to the diametrically-opposed burdens and the availability of discovery into independence may make an SLC an ineffective tool for a corporate defendant. The use of an SLC was always time consuming and expensive. Besides, there was always a possibility of the court’s refusal to grant an SLC’s motion to dismiss. Now such a possibility is much more substantial. Under these circumstances, an SLC may stop its existence as a tool for terminating a derivative suit. This is espe-

228. Kistenbroker, supra note 42, at 668.
229. See Saparoff, supra note 25, at 726.
cially true since the *Oracle* and *Beam* decisions left some important questions open. As previously discussed, the court did not answer the question of whether the substantive standard of independence in the SLC context differs from that in a demand-excusal context. Also, it did not answer the question of whether the standard of independence is the same for a single-member SLC and a multi-member one. The court should respond to these questions to clarify the future of an SLC.\textsuperscript{230}

V. Conclusion

*Oracle* established a new more stringent standard for independence in the context of SLCs. This standard makes it very difficult, perhaps impossible, for an SLC to establish its independence. It appears that the only chance for an SLC to survive judicial scrutiny is to be composed of the members that are total strangers to a corporate defendant. If that is not the case, then it is clear that even the most insubstantial, ties that an SLC's members have with a corporate defendant should be fully disclosed to the court. Further, a corporate defendant should be careful when selecting an SLC's legal advisor. As *Oracle* indicates, Delaware courts may start evaluating the legal advisor's independence according to the standard they apply to an SLC's members. Therefore, all these restrictions suggest that an SLC may stop being used as a universal tool for termination of derivative actions.

\textsuperscript{230} Kistenbroker, supra note 42, at 669.