

CLIENT ALERT

Oracle Revisited: Delaware Chancery Court Finds Board's Lack of Independence from Company's Founder Excuses Demand in Shareholder Derivative Action

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On March 19, 2018, the Delaware Chancery Court held that an Oracle stockholder had standing to bring a derivative action on behalf of the company in connection with Oracle's acquisition of competitor NetSuite, Inc., excusing pre-suit demand as futile.¹ The complaint alleged that the company's directors breached their fiduciary duties by agreeing to acquire NetSuite at an excessive and unfair price in order to benefit Lawrence J. Ellison, who co-founded both Oracle and NetSuite, is Oracle's largest blockholder, and, until the transaction in question, held directly and indirectly about 45% of NetSuite's outstanding stock. Vice Chancellor Glasscock concluded that the complaint failed to allege particularized facts sufficient to show that a majority of the Oracle Board faced a substantial risk of personal liability for their roles in approving the NetSuite acquisition. Demand was nonetheless excused because, although a "closer question," the court concluded that the complaint raised a reasonable doubt that a majority of the Board was sufficiently independent of Ellison to bring its "business judgment to bear." While each director's "entanglement" to Ellison might be insufficient to imply a lack of independence on its own, "taken together" those connections raised a reasonable doubt as to whether a majority of the directors could evaluate a demand to sue Ellison.

¹ *In re Oracle Corporation Derivative Litigation*, C.A. No. 2017-0337-SG (Del. Ch. Mar. 19, 2018).

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In his opinion, Vice Chancellor Glasscock assessed the two bases alleged by the plaintiff to demonstrate demand futility with respect to Oracle's 12-member board: (1) "the potential liability of the outside directors, particularly those serving on a special committee appointed to evaluate the conflicted transaction, as well as those on a standing conflicts committee tasked with evaluating transactions involving Ellison," and (2) "various relationships, business and personal, between a majority of the directors and Ellison" that showed lack of independence. With respect to the alleged risk of liability in connection with the NetSuite transaction, the court noted that because Oracle's charter exculpated the directors from monetary liability for breaches of the duty of care, the complaint must adequately plead that a majority of the board "breached the duty of loyalty by acting in bad faith in connection with the NetSuite transaction." Here, the plaintiff's attacks on the special committee's process and the independence committee's failure to proactively address conflicts of interest presented by the transaction were insufficient to support an inference of disloyalty or bad faith. Further, the complaint lacked particularized allegations showing that the three non-committee outside directors "played any role whatsoever in the NetSuite transaction," much less that they faced a substantial likelihood of liability in connection with the transaction. Accordingly, because plaintiff "failed to offer particularized factual allegations supporting a loyalty claim against any of the eight outside directors," demand was not excused as futile on that basis.

With respect to plaintiff's lack of independence argument, however, Vice Chancellor Glasscock found this to be a "closer question." A plaintiff may establish that a director lacks independence by alleging with particularity that the director is loyal to, beholden to, or otherwise influenced by an interested party so as to undermine the director's ability impartially to judge the matter on its merits. While acknowledging that "allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to" meet this standard, some professional or personal friendships, "which may border on or even exceed familial loyalty and closeness, may raise a reasonable doubt whether a director can appropriately consider demand." In the court's view, this was "such a case."

Here, the court found that three of Oracle's outside directors, including two of the three members of the special committee that had approved the acquisition, lacked independence because of their ties to Ellison, primarily relating to their role in setting his compensation. The complaint alleged that at every annual stockholder meeting from 2012 to 2016, a majority of Oracle's stockholders rejected the company's executive pay practices and that, in recent years, a majority of Oracle's non-Ellison stockholders withheld votes for Compensation Committee members in order to express disapproval of these directors' failure to address concerns about excessive compensation paid to Ellison. For example, in 2013, approximately 60% of non-Ellison votes withheld support for the three directors in question. The only reason these directors had not been forced to resign, therefore, was Ellison's continuing support. In addition, several additional alleged facts, viewed collectively, raised a reasonable doubt about the directors' ability to appropriately consider a demand:

- one director holds multiple high-level positions at a company that does substantial business with Oracle; is a major investor and director in a company for which the CTO is a senior executive at Oracle; is a partner in two venture capital firms focused on areas in which Oracle is an active acquirer and that have portfolio companies

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that rely on Oracle technology or are managed by former Oracle executives; and stands to lose almost half a million dollars in director fees if he agrees to sue Ellison;

- a second director serves on the boards of two portfolio companies that have substantial business relationships with Oracle; was determined by the Oracle Board in October 2017 to no longer be independent under the New York Stock Exchange's listing standards because she had been appointed CEO of a joint venture between Oracle and two other technology companies; and stands to lose over half a million dollars in director fees if she agrees to sue Ellison; and
- a third director founded two private sector companies whose events Ellison frequently attends and at which he often presents, garnering participation and support of other technology sector leaders for the companies; the director's husband published a book lauding Ellison and Ellison wrote a blurb that was included in the book; the director and her husband have known Ellison since the late 1980s and own two condos on a Hawaiian island in which Ellison owns a 98% stake along with a majority of the island's businesses and infrastructures; and, like the other two directors, the third director stands to lose close to half a million dollars in director's fees if she were to lose Ellison's support of her directorship.²

In light of these relationships, together with allegations as to Ellison himself (having stood on both sides of the NetSuite transaction), and three additional directors who were all senior Oracle officers and subject to Ellison's alleged "firm grip on Oracle's daily operations," the court determined that plaintiff alleged a "constellation of facts" with particularity that, taken together, were sufficient to create reasonable doubt that a majority of Oracle's 12-person board could impartially consider a demand. Vice Chancellor Glasscock therefore denied defendants' motion to dismiss the complaint for lack of standing under Delaware Chancery Rule 23.1.

The Chancery Court's opinion in *Oracle* builds on a developing line of recent Delaware precedent addressing challenges to director disinterestedness and independence. The current era of director independence cases stems from the Chancery Court's groundbreaking decision in another derivative litigation involving Oracle in 2003, in which then-Vice Chancellor Strine focused on the philanthropic (as opposed to economic) ties between directors in determining that Oracle's special litigation committee was "fraught" with "bias-creating relationships" that precluded a finding of independence.³ While Vice Chancellor Glasscock's opinion in *Oracle* does not create any new law, it is a timely reminder to both litigators and transaction planners alike that the Delaware courts will continue to give considerable scrutiny to directorial independence issues, whether in the derivative lawsuit context, or where director independence forms the basis for limiting judicial review of a corporate transaction to the deferential business judgment rule.

² *Id.* at 54-57.

³ *In re Oracle Corp. Derivative Litig.*, 2003 WL 21396449 (Del. Ch. June 17, 2003).

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