

RECENT DEVELOPMENTS IN THE LAW  
AFFECTING CORPORATE COUNSEL

*Fredrick H.L. McClure, Joshua S. Sohn, Rachel A. Gupta,  
and Chandana Ravindranath*

I. Electronic Discovery and the Federal Rules .....	334
A. Responses and Objections Should Comply with Rule 26(g).....	334
B. Form and Organization of Production .....	337
1. <i>White v. Graceland College Center for Professional             Development &amp; Lifelong Learning, Inc.</i> .....	337
2. <i>Suarez Corp. Industries v. Earthwise Technologies, Inc.</i> .....	339
C. Scope of Production and Retention of Documents.....	340
1. <i>Flagg v. City of Detroit</i> .....	340
2. <i>Nursing Home Pension Fund v. Oracle Corp.</i> .....	343
II. Secondary Liability Under the Federal Securities Laws Antifraud Provisions— <i>Stoneridge Investment     Partners, LLC v. Scientific-Atlanta, Inc.</i> .....	345
III. Privilege.....	348
A. <i>Ryan v. Gifford</i> .....	348
B. <i>In re Intel Corp. Microprocessor Antitrust Litigation</i> .....	349
IV. Corporate Governance.....	350
A. Exculpatory Provisions for Breaches of Fiduciary Duties .....	351
1. <i>Ryan v. Lyondell Chemical Co.</i> .....	351
2. <i>In re Lear Corp. Shareholder Litigation</i> .....	354
B. Interpretation of Bylaws .....	357
1. <i>JANA Master Fund, Ltd. v. CNET Networks, Inc.</i> .....	357
2. <i>Levitt Corp. v. Office Depot, Inc.</i> .....	359

---

---

*Fredrick McClure is a litigation partner in the Tampa office of DLA Piper LLP (U.S.).  
Joshua Sohn is a litigation partner and Rachel Gupta and Chandana Ravindranath are  
litigation associates in the New York office of DLA Piper LLP (U.S.).*

---

---

---

This article reviews the past year's significant cases relevant to in-house and outside counsel in the areas of private rights of action in securities cases, electronic discovery, attorney-client privilege, and corporate governance. Section I summarizes recent noteworthy federal decisions in the area of electronic discovery. Section II digests the Supreme Court's decision in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, which concerns the availability of private causes of action for aiding and abetting securities fraud. Section III addresses recent federal cases addressing waiver of the attorney-client privilege. Finally, Section IV summarizes recent Delaware decisions interpreting corporations' exculpatory provisions and advanced notice bylaws.

## I. ELECTRONIC DISCOVERY AND THE FEDERAL RULES

During the past year, federal courts have strictly interpreted discovery rules, rejecting attempts to narrow parties' discovery obligations. The cases summarized below illustrate courts' recent enforcement of requirements that counsel work cooperatively with one another, and to conduct discovery in a manner that promotes—rather than inhibits—the course of discovery and progress toward trial of civil cases. Courts will use their authority to impose sanctions to ensure that end is reached.

### A. *Responses and Objections Should Comply with Rule 26(g).*

*Mancia v. Mayflower Textile Services Co.*<sup>1</sup> is an instructive case for parties to consider when drafting and responding to discovery requests. Although many recent cases address the scope of electronic discovery and the treatment of electronic evidence,<sup>2</sup> *Mancia* focuses on the fundamentals of discovery: discovery requests and responses. This case provides a valuable lesson for counsel and a reminder of the importance of taking the time to analyze what is at stake in a case before commencing discovery so that the parties can work together in a manner that accomplishes the goals of discovery, without unnecessarily burdening each other.

*Mancia* concerns an action by employees against Mayflower Textile Services and other related entities (Mayflower) for declaratory and monetary relief under the Fair Labor Standards Act of 1938 (FLSA).<sup>3</sup> The employees alleged that Mayflower violated § 207(a) of the FLSA both by knowingly

---

1. 253 F.R.D. 354 (D. Md. 2008).

2. See, e.g., *White v. Graceland College Ctr. for Prof'l Dev. & Lifelong Learning, Inc.*, No. 07-2319-CM, 2008 WL 3271924 (D. Kan. Aug. 7, 2008).

3. *Mancia*, 253 F.R.D. at 355.

failing to compensate them for overtime work and by illegally deducting wages from their paychecks.<sup>4</sup>

The plaintiffs in *Mancia* alleged Mayflower improperly responded to their numerous interrogatories and document requests. Judge Grimm of the U.S. District Court for the District of Maryland, upon his initial review of the extensive briefing on a motion to compel, noted obvious violations by Mayflower of both Rule 33(b)(4), which requires that objections to an interrogatory be stated with specificity, and Rule 26(g)(1), which requires the responding party to conduct a “reasonable inquiry” before objecting to a discovery request.<sup>5</sup> At a court conference, Judge Grimm raised concerns about the defendants’ responses and objections, as well as concerns that the plaintiffs’ discovery requests themselves were “excessively broad and costly, given what [was] at stake in this case.”<sup>6</sup> In light of this, the court directed the parties to communicate and cooperate in an attempt to resolve the dispute on their own, but also issued a memorandum opinion, explaining his concerns, suggestions, rulings, and instructions on how counsel should respond should their dispute require additional intervention from the court.<sup>7</sup>

According to Judge Grimm, Rule 26(g) is one of the “most important, but apparently least understood or followed,” rules of discovery.<sup>8</sup> Rule 26(g) requires that every disclosure, request, response, and objection be signed by an attorney of record, or the client if *pro se*.<sup>9</sup> The signature certifies “that to the best of the person’s knowledge, information and belief formed after reasonable inquiry,” the disclosure is complete and correct at the time it is made and that a response or objection is (a) consistent with the rules of procedure and warranted by existing law; (b) “not interposed for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation”; and (c) “neither unreasonable nor unduly burdensome or expensive.”<sup>10</sup> If the rule is violated without substantial justification, the court, either on motion or *sua sponte*, must impose sanctions.<sup>11</sup>

In analyzing the advisory committee’s notes, Judge Grimm noted that Rule 26(g) imposes an affirmative duty on parties to conduct discovery in a reasonable manner, and was designed to curb abuse and deter improper discovery conduct.<sup>12</sup> “[T]he rule aspires to eliminate one of the

---

4. *Id.*

5. *Id.* at 356 (citing FED. R. CIV. P. 33(b)(4) and 26(g)(i)).

6. *Id.*

7. *Id.* at 356–57.

8. *Id.* at 357.

9. *Id.* (citing FED. R. CIV. P. 26(g)(1)).

10. *Id.* (citing FED. R. CIV. P. 26(g)(A)–(B)(iii)).

11. *Id.* (citing FED. R. CIV. P. 26(g)(3)).

12. *Id.* (citing FED. R. CIV. P. 26(g) advisory committee’s notes).

most prevalent of all discovery abuses: knee jerk discovery requests served without consideration of cost or burden to the responding party.”<sup>13</sup> The reality is, however, that “lawyers customarily serve requests that are far broader, more redundant and burdensome than necessary to obtain sufficient facts to enable them to resolve the case through motion, settlement or trial.”<sup>14</sup> While it is true that the parties may not initially have enough information to “narrowly tailor” their discovery requests, this can be remedied if the parties “approached discovery responsibly . . . and met and conferred before initiating discovery.”<sup>15</sup> According to Judge Grimm, if they did this, they would be able to discuss “what the amount in controversy is, and how much, what type, and in what sequence, discovery should be conducted” so that discovery correlates to what is at stake in the litigation and is cost-effective for all parties.<sup>16</sup>

Judge Grimm also noted that Rule 26(g) also serves to prevent baseless boilerplate objections to discovery requests.<sup>17</sup> Noting that an objection to a discovery request “may not be made until after a lawyer has ‘paused and consider[ed]’ whether, based on a ‘reasonable inquiry,’ there is a ‘factual basis [for the] . . . objection,”<sup>18</sup> the *Mancia* court criticized defendants for using “boilerplate objections that a request for discovery is ‘overbroad and unduly burdensome, and not reasonably calculated to lead to the discovery of material admissible in evidence.’”<sup>19</sup> Indeed, Judge Grimm stated that making this boilerplate objection “is *prima facie* evidence of a Rule 26(g) violation.”<sup>20</sup> Given the widespread invocation of these and other boilerplate objections, this opinion should serve as a warning to practitioners—especially in the District of Maryland.

Although the *Mancia* court recommended that the parties cooperate in an attempt to resolve their dispute without the court’s intervention, the court also noted that parties’ regular “failure to engage in discovery as required by Rule 26(g) is one reason why the cost of discovery is so widely criticized as being excessive.”<sup>21</sup> The court explained that the costs of discovery have become an impediment to the legal system’s proper function; parties do not commence meritorious actions because they are too expensive, while smaller cases involving baseless claims are settled rather than

---

13. *Id.* at 358.

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.* at 359.

18. *Id.* (citing Fed. R. Civ. P. 26(g)).

19. *Id.*

20. *Id.*

21. *Id.*

tried.<sup>22</sup> Judge Grimm blamed lawyers for this breakdown because of their failure to follow the “letter and spirit of the discovery rules” and urged them to work responsibly or face sanctions.<sup>23</sup>

### B. *Form and Organization of Production*

The Federal Rules of Civil Procedure allow a requesting party to dictate how the documents sought will be produced (i.e., paper, electronic native documents, or images). The rules, however, do not allow a requesting party to mandate how the documents are to be organized. Rather, the rules allow the producing party either to produce documents as they are maintained “in the usual course of business” or to “organize and label them to correspond to the categories in the requests.”<sup>24</sup> In its discretion, a court may order the producing party to provide some indication as to how the documents are organized.

#### 1. *White v. Graceland College Center for Professional Development & Lifelong Learning, Inc.*<sup>25</sup>

In a case regarding the production of electronically stored information (ESI), *White v. Graceland College Center for Professional Development & Lifelong Learning, Inc.*, Judge Waxse of the U.S. District Court for the District of Kansas ordered defendants to re-produce in native format certain documents that had previously been produced in hardcopy from portable document format (PDFs), finding that the defendants’ production did not comply with Rule 34 of the Federal Rules of Civil Procedure.<sup>26</sup>

Plaintiff White filed an action alleging that defendants terminated her employment in violation of the Family Medical Leave Act.<sup>27</sup> During discovery, White filed a motion seeking, in part, an order compelling defendants to produce certain documents, principally e-mails and e-mail attachments, in their native format, rather than in the paper format defendants provided.<sup>28</sup> These e-mails and e-mail attachments, although electronically stored, were converted to PDFs, printed, and produced by defendants as paper documents.<sup>29</sup>

Defendants objected to re-producing these documents, arguing that the plaintiff’s request for documents failed to specify that documents should

22. *Id.* at 359–60.

23. *Id.* at 360.

24. FED. R. CIV. P. 34(b)(2)(E)(i).

25. No. 07-2319-CM, 2008 WL 3271924 (D. Kan. Aug. 7, 2008).

26. *Id.* at \*1.

27. *Id.*

28. *Id.* at \*9.

29. *Id.*

be produced in native format, and that they had produced the documents in a “reasonably usable form” as required by Federal Rule 34(b)(2)(E)(ii).<sup>30</sup> That rule provides: “[i]f a request does not specify a form for producing electronically stored information, a party must produce it in a form or forms in which it is ordinarily maintained or in a reasonably usable form or forms.”<sup>31</sup> Under the rule, “[a] party need not produce the same electronically stored information in more than one form.”<sup>32</sup>

The plaintiff argued that the defendants’ converting the electronic documents and printing them out “changed the way they were kept in the ordinary course of [d]efendants’ business” in violation of Rule 34.<sup>33</sup> The plaintiff argued that the format in which the documents were produced made it impossible to tell when the documents were prepared, which was extremely important since the timetable of the termination of employment was critical to her case.<sup>34</sup>

The district court looked to the advisory committee notes to Rule 34, which explicitly state that the producing party’s “option to produce [documents] in a reasonably usable form does not mean that a responding party is free to convert electronically stored information from the form in which it is ordinarily maintained to a different form that makes it more difficult or burdensome for the requesting party to use the information efficiently in the litigation.”<sup>35</sup> The court then quoted from the advisory committee’s notes, which provide that “[i]f the responding party ordinarily maintains the information it is producing in a way that makes it searchable by electronic means, the information should not be produced in a form that removes or significantly degrades this feature.”<sup>36</sup> The court concluded that since the plaintiff failed to specify a form for production, defendants could either “produce the emails and attachments in the form (1) in which they are ordinarily maintained, or (2) ‘in a reasonably usable form.’”<sup>37</sup>

The court held that the defendants failed to do either and granted the plaintiff’s motion.<sup>38</sup> The court stated that “reasonably usable form” as described by Rule 34 does not give the defendants license to convert the ESI from the form in which it is ordinarily maintained to a different form that

---

30. *Id.*

31. FED. R. CIV. P. 34(b)(2)(E)(ii).

32. *Id.*

33. *White v. Graceland Coll. Ctr. for Prof'l Dev. & Lifelong Learning, Inc.*, No 07-2319-CM, 2008 WL 3271924, at \*9 (D. Kan. Aug. 7, 2008).

34. *Id.* at \*10.

35. *Id.* (citing FED. R. CIV. P. 34 (b) advisory committee’s notes (2006 amendments)).

36. *Id.*

37. *Id.*

38. *Id.* at \*11.

prevents the plaintiff's use of the information efficiently throughout the litigation.<sup>39</sup> Accordingly, the defendants were ordered to re-produce certain documents in native form.

Notably, in this opinion, the court relied heavily on the plain language of the rule and the advisory notes, and rejected the defendants' broad interpretation that would have enabled them to unilaterally limit discovery.<sup>40</sup> Further, the court expressed a similar sentiment as Judge Grimm in *Mancia* regarding cooperation among the parties, noting that the "discovery dispute is an example of one [in] which the re-production of discovery could have been altogether avoided had the parties adequately conferred at their Fed. R. Civ. P. 26(f) conference."<sup>41</sup>

## 2. *Suarez Corp. Industries v. Earthwise Technologies, Inc.*<sup>42</sup>

In another case addressing the manner in which documents were produced, Judge Bryan of the Western District of Washington held that while there is a right to specify the form of production of ESI, the requesting party does not have authority to "mandate the organization of the opposing party's production."<sup>43</sup>

The plaintiffs, Suarez Corporation Industries and MHE Corporation (collectively Suarez), served multiple sets of interrogatories and requests for production on the defendant, Earthwise Technologies, Inc. (Earthwise).<sup>44</sup> In response, Earthwise produced 55,000 e-mails, approximately 8,700 pages of PDF documents in paper, and nine CDs of data in native form.<sup>45</sup> Suarez claimed that Earthwise's production was unorganized and amounted to a "document dump."<sup>46</sup> Suarez argued that under Rule 34, it could request the manner in which documents were to be produced, and that Earthwise should either produce the responsive materials as they are kept in the ordinary course of business or organize its production and correlate the 55,000 e-mails to Suarez's 136 specific requests for production.<sup>47</sup> Suarez contended that the present production was neither, and instead constituted a "document dump without any cognizable organization."<sup>48</sup>

While the court acknowledged that pursuant to Rule 34 a requesting party may choose the form of electronic discovery it wants, the court

---

39. *Id.*

40. *See id.*

41. *Id.*

42. No. C07-5577RJB, 2008 WL 2811162 (W.D. Wash. July 17, 2008).

43. *Id.* at \*3.

44. *Id.* at \*1.

45. *Id.* at \*2.

46. *Id.*

47. *Id.*

48. *Id.*

rejected the idea that a requesting party can control the organization of the documents.<sup>49</sup> In support, the court cited the advisory committee notes, which define “form” as referring to the electronic format or other means for storing the information (i.e., PDF, native, or other electronic means), but do not refer to “form” as the manner in which a production is organized.<sup>50</sup>

Although the court rejected the plaintiff’s right to dictate the organization of the documents produced, the court ruled that the defendant had to give the plaintiff some indication as to how the produced documents were organized.<sup>51</sup> As a result, the court required, pursuant to its discretionary authority over litigants, “that Earthwise convey some information as to *how* documents were determined to be responsive or *how* the documents were kept in the normal course of business.”<sup>52</sup> The court therefore granted plaintiff’s motion to compel to the extent that Earthwise’s production did not conform to this standard.<sup>53</sup>

### *C. Scope of Production and Retention of Documents*

Under Federal Rule of Civil Procedure 34, a responding party must produce documents that are in its “possession, custody, or control.”<sup>54</sup> This includes individuals or entities that are within the responding party’s control, including agents, contractors, suppliers, or third-party providers. Further, a party also must take steps at the outset of litigation to ensure that all relevant documents are preserved and collected for production. Failure to fulfill these obligations may lead to sanctions, as shown in the two cases discussed in this section.

#### *1. Flagg v. City of Detroit*<sup>55</sup>

In *Flagg v. City of Detroit*, the issue was whether text messages stored by a nonparty service provider were discoverable.<sup>56</sup> In deciding the messages could be discovered, the court noted a party’s affirmative duty to seek information reasonably available to it from other sources within its control when responding to requests for production.<sup>57</sup>

The plaintiff claimed that the City of Detroit and individual employees took steps to delay and obstruct the investigation into his mother’s murder,

---

49. *Id.* at \*3.

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

54. FED. R. CIV. P. 34(a)(1).

55. 252 F.R.D. 346 (E.D. Mich. 2008).

56. *Id.* at 348.

57. *Id.* at 353.

thereby violating his constitutional right of access to the courts.<sup>58</sup> The City of Detroit moved to prevent the discovery of communications between particular city officials and employees exchanged through city-issued text-messaging devices.<sup>59</sup> The e-mail copies of those text messages were preserved by a nonparty service provider, SkyTel.<sup>60</sup> In a previous order, Judge Rosen denied the defendants' motion to quash subpoenas to SkyTel that sought the production of text messages of thirty-four city employees from the previous five years.<sup>61</sup> The court acknowledged that the text messages were potentially discoverable, depending on their subject matter, and ordered two magistrate judges to review the communications *in camera* to determine which messages were discoverable.<sup>62</sup>

The City and one individual defendant then filed a motion arguing that the court-ordered process violated the federal Stored Communications Act (SCA) because plaintiffs sought to obtain electronic communications retained by a nonparty service provider in civil litigation.<sup>63</sup> The SCA expressly prohibits a service provider such as SkyTel from "knowingly divulg[ing] . . . the contents of a communication" such as a text message while it is stored by that service provider.<sup>64</sup> The SCA permits the disclosure of the communications with consent.<sup>65</sup> Although the statute enumerates certain exceptions, there is no express exception permitting the service provider to disclose the text messages pursuant to court order or subpoena.<sup>66</sup> Accordingly, defendants argued that the court could not compel SkyTel to produce documents in response to plaintiff's subpoenas.<sup>67</sup>

The court rejected the defendants' interpretation of the SCA, stating that if the defendants' position were accepted, it would allow parties to prevent the production of electronically stored documents that would otherwise be subject to civil discovery under Rule 34 by turning them over to a third party.<sup>68</sup> In analyzing the question of whether the text messages were discoverable, the court first examined general discovery obligations under the federal rules and the scope of discoverable information. The court noted

---

58. *Id.* at 351.

59. *Id.* at 348.

60. *Id.*

61. *Id.*

62. *Id.* The documents were viewed *in camera* and the defendants were allowed to object to those messages that they deemed private or privileged. *Id.*

63. *Id.* (citing 18 U.S.C. §§ 2701–11).

64. *Id.* at 349 (citing 18 U.S.C. § 2702(a)(1), (a)(2)).

65. *Id.* at 350.

66. *Id.*

67. *Id.* at 347.

68. *Id.* at 351.

that under Rule 26(b)(1), “the universe of text messages that will ultimately be produced to [p]laintiff is narrowly confined to those that are found to be ‘relevant’ and ‘nonprivileged.’”<sup>69</sup> As a result, the court ruled the defendants’ general objections to the discoverability of the text messages based on privacy laws or privilege were without merit.<sup>70</sup> Rather, only those text messages that related to the parties’ claims or defenses were discoverable.<sup>71</sup> The review by the magistrate judges, as ordered by the court, would filter out irrelevant text messages.<sup>72</sup>

Because the information requested was subject to Federal Rule of Civil Procedure 34, the court looked to that rule’s provision providing that “a party may request the production of documents . . . that are ‘in the responding party’s possession, custody, or control.’”<sup>73</sup> Applying the Sixth Circuit’s interpretation of “control,” the court determined that documents are deemed to be within a party’s control if it “has the legal right to obtain the documents on demand.”<sup>74</sup> Accordingly, the court noted that “a party responding to a Rule 34 production request cannot furnish only that information within his immediate knowledge or possession; he is under an affirmative duty to seek that information reasonably available to him from his employees, agents, or others subject to his control.”<sup>75</sup> Exploring the body of cases on the subject, the court cited a recent District of Colorado case holding that a corporation had “control” of “electronic records maintained by a third party on the company’s behalf.”<sup>76</sup>

As a result, the court “readily conclude[d] that the Defendant City of Detroit ha[d] ‘control’ over the text messages preserved by third party Sky-Tel pursuant to its contractual relationship with the City.”<sup>77</sup> Accordingly, the court determined not only that the text messages that related to the parties’ claims and defenses were discoverable, but that the plaintiffs could obtain them through a Rule 34 request directed at the defendants, and use of nonparty subpoenas was unnecessary.<sup>78</sup>

Turning to whether SkyTel was permitted to disclose the text message under the SCA, the court determined that any production would be pursuant to a Rule 34 request to the defendant, City of Detroit, and the

---

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.* at 352.

73. *Id.*

74. *Id.* at 353 (citing *In re Bankers Trust Co.*, 61 F.3d 465, 469 (6th Cir. 1995)).

75. *Id.* (citing *Gray v. Faulkner*, 148 F.R.D. 220, 223 (N.D. Ind. 1992)).

76. *Id.* at 354 (citing *Tomlinson v. El Paso Corp.*, 245 F.R.D. 474, 477 (D. Colo. 2007)).

77. *Id.*

78. *Id.* at 357.

communications would be produced by SkyTel to the City of Detroit—its customer—who would, in turn, produce the documents to the plaintiff.<sup>79</sup> First, the court determined that the contractual relationship between SkyTel and Detroit must necessarily include some mechanism for retrieving the messages; otherwise, the service of archiving text messages would be of no value.<sup>80</sup> Second, the court concluded that the City had both the ability and the obligation to give any “lawful consent” required by the SCA to permit disclosure.<sup>81</sup>

Accordingly, based on this decision, a responding party should be mindful of its ability to exert control over its agents, representatives, third-party providers, and suppliers when responding to discovery requests.

## 2. *Nursing Home Pension Fund v. Oracle Corp.*<sup>82</sup>

*Nursing Home Pension Fund v. Oracle Corp.* was a class action brought by stockholders of Oracle Corporation against the company and individual officers for violations of §§ 10(b), 20(a), and 20A of the Securities Exchange Act of 1934 arising from allegedly false and misleading statements made by Oracle.<sup>83</sup> Judge Illston of the Northern District of California sanctioned defendants for failing to preserve thousands of e-mails, as required by the federal rules.<sup>84</sup>

According to plaintiffs, Oracle purportedly took a series of actions “that led to the failure to preserve or the affirmative destruction of evidence relevant to [the] lawsuit.”<sup>85</sup> The plaintiffs alleged that upon serving Oracle with notice of the action, the defendants only sent out preservation notices to approximately thirty of the company’s more than 40,000 employees.<sup>86</sup> Employees that were not included in the preservation attempts included those at the vice-president level, regional sales managers, and others plaintiffs contended possessed discoverable information.<sup>87</sup> The plaintiffs further alleged that the preservation process was inadequate because a high-ranking corporate officer who was a named defendant did not preserve hundreds of e-mails that related to the suit.<sup>88</sup> In addition, plaintiffs alleged that Oracle failed to preserve data from its online sales company and purged the

---

79. *Id.* at 358.

80. *Id.* at 357.

81. *Id.* at 359.

82. No. C 01-00988 SI, 2008 WL 4093497 (N.D. Cal. Sept. 2, 2008).

83. *Id.* at \*1.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

backup tapes four months *after* commencement of the litigation.<sup>89</sup> Finally, the plaintiffs argued that Oracle failed to preserve evidence that was in the possession of a third party, but under the control of Oracle, and that the evidence may have been destroyed *after* plaintiff had requested the information and filed a motion to compel.<sup>90</sup>

Upon motion by the plaintiffs for sanctions, the court analyzed the provisions of Rule 37(b)(2)(A), which authorizes imposing sanctions for discovery abuses, as well as the scope of its inherent power to regulate the conduct of litigants.<sup>91</sup> The court summarized the scope of available sanctions, the harshest of which “is to dismiss the claim of the party responsible for the spoliation.”<sup>92</sup> In determining what type of sanctions to order, the court considered (1) “the degree of fault of the party who altered or destroyed the evidence,” (2) “the degree of prejudice suffered by the opposing party,” and (3) “whether there is a lesser sanction that will avoid substantial unfairness to the opposing party.”<sup>93</sup> Applying this standard, the court concluded that sanctions were appropriate, but concluded that termination of the litigation was inappropriate because plaintiffs had not demonstrated the requisite degree of prejudice.<sup>94</sup> Rather, the plaintiffs had received a large volume of discovery and public policy favored deciding the case on the merits.<sup>95</sup>

The court did, however, conclude that adverse inferences in favor of the plaintiffs were warranted when deciding the parties’ summary judgment motions.<sup>96</sup> The court agreed the plaintiffs had met the governing test for gaining the inference, which required showing (1) at the time the evidence was destroyed, the parties in control of the evidence had a preservation obligation; (2) evidence was destroyed with a culpable state of mind, and (3) “the destroyed evidence was relevant to the party’s claim or defense such that a reasonable trier of fact could find that it would support that claim or defense.”<sup>97</sup>

The court denied the plaintiffs’ request for additional sanctions for the defendants’ alleged failure to adequately communicate document preservation notices to a number of its employees because the plaintiffs did not

---

89. *Id.* at \*2.

90. *Id.*

91. *Id.* at \*3.

92. *Id.* at \*4.

93. *Id.*

94. *Id.* at \*5.

95. *Id.* at \*4.

96. *Id.* at \*5.

97. *Id.* (citing *In re Napster, Inc. Copyright Litig.*, 462 F. Supp. 2d 1060, 1078 (N.D. Cal. 2006)).

identify specific lost documents or show that defendants' failure to preserve was willful.<sup>98</sup> With respect to individual employees who received a preservation notice but failed to preserve documents, however, the court found sanctions were appropriate.<sup>99</sup> In doing so, the court rejected the defendants' arguments that many of the e-mails were produced to the plaintiffs from the files of other employees and the plaintiffs were not entitled to multiple copies.<sup>100</sup> The court disagreed and held that "[i]t could have been helpful to plaintiffs to demonstrate that certain emails were discovered in [the named defendant employee's] files" because it could rebut an argument that he never received or read the e-mails.<sup>101</sup>

This case has implications on the steps a corporate litigant should take in ensuring that all relevant documents are preserved immediately upon receiving notification of litigation. Not only is a company required to instruct its employees to preserve information, it also has an obligation to ensure that its employees comply with these instructions. A company cannot turn a blind eye once its document preservation notice is sent—rather, it needs to be diligent in ensuring that relevant documents are collected and produced.

## II. SECONDARY LIABILITY UNDER THE FEDERAL SECURITIES LAWS ANTIFRAUD PROVISIONS — *STONERIDGE INVESTMENT PARTNERS, LLC V. SCIENTIFIC-ATLANTA, INC.*<sup>102</sup>

In *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, the Supreme Court held that secondary actors cannot be sued by private plaintiffs for aiding and abetting violations of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Unequivocally, the Court held that the private right of action permitted under § 10(b) and Rule 10b-5 did not extend to aiding and abetting a § 10(b) violation.<sup>103</sup>

*Stoneridge* was a class action filed in the U.S. District Court for the Eastern District of Missouri by Charter Communications, Inc. (Charter) shareholders against Charter; some of its officers; its independent auditor, Arthur Andersen LLP; and two of its suppliers and customers: Scientific-Atlanta, Inc. and Motorola, Inc.<sup>104</sup> The plaintiffs alleged that Charter engaged in fraudulent practices to satisfy revenue and cash-flow projections included

---

98. *Id.* at \*6.

99. *Id.*

100. *Id.*

101. *Id.*

102. 128 S. Ct. 761 (2008).

103. *Id.* at 769.

104. *Id.* at 766.

in quarterly reports.<sup>105</sup> The complaint alleged that when Charter realized it would fall short of the cash-flow projections by \$15 to \$20 million, it altered its then-existing arrangements with co-defendants Scientific-Atlanta and Motorola and entered into “sham” deals designed to help Charter “fix” its cash-flow situation.<sup>106</sup> In these sham deals, Charter purchased digital cable converter boxes from Scientific-Atlanta and Motorola at an inflated price;<sup>107</sup> and in return, Scientific-Atlanta and Motorola repaid Charter’s overpayment by purchasing advertising from Charter.<sup>108</sup> Charter then booked those advertising sales as revenue, which overstated its revenues by approximately \$17 million in violation of generally accepted accounting principles (GAAP).<sup>109</sup> As a result, plaintiffs argued, Charter misled its auditors—and investors—into believing it had met the previously disclosed financial projections.<sup>110</sup> By contrast, Scientific-Atlanta and Motorola both recorded the transactions in their own financial statements in accordance with GAAP—as washes.<sup>111</sup>

The plaintiffs filed a securities fraud class action on behalf of purchasers of Charter stock, alleging that all parties involved in the scheme, including Scientific-Atlanta and Motorola, should be held liable for violating the federal securities laws because they “knew or were in reckless disregard of Charter’s intention to inflate its revenues” and mislead investors.<sup>112</sup> Accordingly, the complaint alleged violations of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

The district court granted Scientific-Atlanta’s and Motorola’s motions to dismiss, and the U.S. Court of Appeals for the Eighth Circuit affirmed.<sup>113</sup> The Supreme Court granted certiorari on the issue of whether a shareholder may recover against a secondary actor under § 10(b) for aiding and abetting.<sup>114</sup> The Supreme Court held that to state a claim for § 10(b) liability, “[t]he conduct of a secondary actor must satisfy each of the elements or preconditions for liability.”<sup>115</sup> Accordingly, like the issuer, to be held liable Scientific-Atlanta and Motorola must have (1) made a material misrepresentation or omission, (2) with scienter, (3) in connection with the purchase

---

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at 767.

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

or sale of a security, (4) inducing reliance, (5) resulting in economic loss, and (6) with actionable loss causation.<sup>116</sup>

The Court determined that the shareholders' implied right of action to sue for securities fraud did not "reach the customer/companies because the investors did not rely upon their statements or misrepresentations" in that Scientific Atlanta and Motorola had no duty to disclose the alleged fraud to plaintiffs, and their deceptive acts were not directed to the public.<sup>117</sup> The lack of reliance was fatal to plaintiffs' claim because

[r]eliance . . . upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action . . . [and] for liability to arise, the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury exists as a predicate for liability.<sup>118</sup>

Scientific-Atlanta's and Motorola's actions, however, were not communicated to the public.<sup>119</sup> Accordingly, the investors could not have relied on their deceptive acts.<sup>120</sup>

The Supreme Court also specifically rejected the scheme-liability theory in cases brought by private plaintiffs—here, that Scientific-Atlanta and Motorola engaged in a scheme intended to misrepresent Charter's revenue, and that the financial statements released to the public with the inflated revenue was "a natural and expected consequence of respondents' deceptive acts."<sup>121</sup> The Court rejected the argument that investors rely not just on an issuer's statements made to the public, but also upon the transactions underlying the statements.<sup>122</sup> The Court refused to accept this argument, explaining that doing so would extend the private cause of action to "the realm of ordinary business operations"—an area that is sufficiently governed by state law.<sup>123</sup>

Similarly, the Court rejected the plaintiffs' interpretation of § 10(b) as contrary to Congress's purpose in adopting § 10(b), and held that any change to the law is for Congress to make, not the courts.<sup>124</sup> The Court stated that Congress amended the securities laws to provide for limited coverage of aiders and abettors, and that actions against aiders and abettors should be brought by the Securities and Exchange Commission (SEC), not

---

116. *Id.* at 768.

117. *Id.* at 769.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.* at 770.

122. *Id.*

123. *Id.*

124. *Id.* at 773.

private plaintiffs.<sup>125</sup> The Court noted that to allow private plaintiffs to bring these claims could have drastic implications—“extensive discovery and the potential for uncertainty and disruption in a lawsuit could allow plaintiffs with weak claims to extort settlements from innocent companies.”<sup>126</sup>

### III. PRIVILEGE

The attorney-client privilege is “the oldest of the privileges for confidential communications known to the common law.”<sup>127</sup> The sanctity of the attorney-client privilege serves “to encourage full and frank communication between attorneys and their clients.”<sup>128</sup> Recent decisions reinforce the importance of diligently preserving this privilege because it is not absolute and can be waived if privileged matters are disclosed to parties whose interests are adversarial.

#### A. *Ryan v. Gifford*<sup>129</sup>

*Ryan v. Gifford*, an options backdating case involving Maxim Integrated Products, Inc. (Maxim), addresses the waiver of privilege when information is shared between a special litigation committee, the board of directors, and individual board members who may be adverse to the company. The plaintiffs in *Ryan* sought to compel the production of all communications between Maxim’s special committee (Special Committee) and the committee’s counsel, Orrick Herrington & Sutcliffe LLP (Orrick), as well as all communications between Orrick and Maxim.<sup>130</sup> The Delaware Court of Chancery held that a Special Committee created by Maxim’s board to investigate concerns about stock option backdating waived the attorney-client privilege as to all communications between the Special Committee and its lawyers, and ordered the production of all communications relating to the investigation and report.<sup>131</sup>

Although, absent waiver or good cause, the attorney-client privilege typically protects communications between a special committee and its counsel, the privilege does not always apply to communications between a special committee’s counsel and the company itself.<sup>132</sup> The court found good cause to waive the privilege because the plaintiffs had alleged a “colorable”

125. *See id.* at 771.

126. *Id.* at 772.

127. *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

128. *Id.*

129. No. 2213-CC, 2007 WL 4259557 (Del. Ch. Nov. 30, 2007).

130. *Id.* at \*2.

131. *Id.* at \*3.

132. *Id.*

claim, the information at issue was unavailable from other sources, and the information sought was specifically identified.<sup>133</sup> Moreover, any privilege that did apply to communications relating to the investigation and report conducted by the Special Committee was waived by the presentation by the Special Committee to Maxim's board of directors because there was no joint privilege between the Special Committee and Maxim with the individual defendants, who were directors of Maxim's board.<sup>134</sup>

In concluding that there had been a waiver of the attorney-client privilege, the court noted that the Special Committee made a presentation of its report to Maxim's board of directors.<sup>135</sup> Attendees at that meeting included certain directors who were individual defendants in the litigation and those directors' counsel.<sup>136</sup> Because the Special Committee was formed to investigate the alleged wrongdoing of these directors as alleged in the litigation, the relationship between the Special Committee and these individual directors was adversarial.<sup>137</sup> Accordingly, the court determined that the presentation of the investigation and report was a voluntary waiver of privileged information to third parties "whose interests are not common with the client . . . [t]hus, there can be no doubt that the common interest exception is inapplicable to extend the protection of the attorney-client privilege to communications disclosed at the January board meetings."<sup>138</sup> Notably, the court determined that the waiver was not only of the presentation of the report, but also a complete waiver for all communications regarding this subject matter.<sup>139</sup>

As many corporations may rely on special committee practice where the end result is a presentation to the board of directors by the special committee, this ruling has significant implications on the applicability of the attorney-client privilege in those instances under Delaware law.

#### B. *In re Intel Corp. Microprocessor Antitrust Litigation*<sup>140</sup>

In *In re Intel Corp. Microprocessor Antitrust Litigation*, the defendant's voluntary production of summaries of witness interviews in response to allegations it had improperly preserved documents resulted in a waiver of the attorney-client privilege. The U.S. District Court for the District of Delaware concluded Intel waived the privilege because it made certain assertions

---

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.* at \*3.

140. No. 05-441-JJF, 2008 WL 2310288 (D. Del. June 4, 2008).

of truth that could only “be assessed by examination of the privileged communication[s].”<sup>141</sup>

The plaintiffs moved to compel Intel to produce its attorneys’ notes taken during and after employee interviews, meeting notices, and e-mails regarding the interviews conducted by Intel’s counsel, Weil, Gotshal & Manges (Weil), concerning compliance with Intel’s evidence preservation obligations.<sup>142</sup> The plaintiffs alleged that Intel failed to preserve potentially important documents, and in response Intel asserted “misunderstanding or errors by individual employees” that were not the result of “deliberate deletion to deny [plaintiffs] access to” responsive information.<sup>143</sup> Pursuant to an agreement with the plaintiffs’ counsel, Intel produced summaries of interviews that its counsel conducted of more than 1,000 Intel employees but refused to produce the underlying notes from those meetings, and other communications concerning those meetings.<sup>144</sup>

As a result of Intel’s defense and the facts it alleged in support of the defense, the Special Master concluded that the attorneys’ notes and the communications were no longer protected.<sup>145</sup> The court explained that a party may not selectively disclose privileged conversations, which was what Intel attempted to do by producing only the summaries of the interviews in support of its claim that there was no deliberate destruction of evidence.<sup>146</sup> The court concluded that to apply the privilege to the underlying notes or communications relating to the interviews would “effectively deny [the plaintiffs] the opportunity to fully test Intel’s positions . . . .”<sup>147</sup>

The court, however, recognized that although the attorney-client privilege was waived, the attorney-work product doctrine was not.<sup>148</sup> The court therefore ordered that “core work-product”—which contains attorney analysis that cannot be separated from pure fact—should be shielded from disclosure if discovered among the materials ordered to be produced.<sup>149</sup>

#### IV. CORPORATE GOVERNANCE

Recent decisions further confirmed that Delaware courts will strictly enforce provisions in a corporation’s charter and bylaws. This judicial policy

---

141. *Id.* at \*11.

142. *Id.* at \*1.

143. *Id.* at \*6.

144. *Id.* at \*2.

145. *Id.* at \*14.

146. *Id.*

147. *Id.*

148. *Id.* at \*14–15.

149. *Id.* at \*15.

---

sometimes benefits the corporation, in the case of charter provisions exculpating directors from liability for breaches of their fiduciary duty of care, but can favor shareholders in the case of advanced notice provisions in corporate bylaws.

A. *Exculpatory Provisions for Breaches of Fiduciary Duties*

1. *Ryan v. Lyondell Chemical Co.*<sup>150</sup>

In *Ryan v. Lyondell Chemical Co.*, the plaintiff, a shareholder of defendant Lyondell Chemical Company, challenged the company's approval of an unsolicited \$13 billion cash-for-shares merger with Basell AF and its subsidiary (collectively Basell) that was negotiated and approved by the board in less than seven days.<sup>151</sup> At the time it received the offer, Lyondell was not in financial trouble or actively seeking acquirers.<sup>152</sup> Before receiving the offer, the board had not evaluated the value of the company, and despite signals in Basell's SEC filings that it intended to possibly acquire Lyondell, the board had not made any effort toward Basell.<sup>153</sup> Rather, the board decided to see if other companies expressed any interest in the aftermath of the Basell filing indicating that the company was "in play."<sup>154</sup>

Basell Corporation thereafter made its best offer of \$48 per share, which to the board seemed too good to pass up.<sup>155</sup> The board made this decision, however, after doing very little to evaluate it.<sup>156</sup> The agreement to purchase came with protective measures, including a no-shop provision, matching rights, and a \$385 million break-up fee.<sup>157</sup>

The plaintiff challenged the planned merger, arguing that the directors breached their duties of loyalty. The plaintiff alleged that the directors were looking out for their own self-interests and that the process by which the merger was approved was flawed. First, the plaintiff alleged the board reviewed the transaction within only a seven-day period, which was an inadequate amount of time to fully inform itself as to the value of the company and to evaluate the benefits of the transaction.<sup>158</sup> Second, plaintiff alleged the board never attempted to see if it could obtain a higher price from another purchaser or if there was other market interest.<sup>159</sup> Third, the

---

150. No. 3176-VCN, 2008 WL 2923427 (Del. Ch. July 29, 2008).

151. *Id.* at \*1.

152. *Id.*

153. *Id.* at \*5.

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.* at \*1.

158. *Id.*

159. *Id.*

plaintiff alleged that the deal included protection devices that were unreasonable and “locked up” the transaction by precluding other bidders.<sup>160</sup>

The court rejected the plaintiff’s argument that the board was motivated by self-interest.<sup>161</sup> Although the directors’ stock options would vest early in connection with the merger, the court viewed this fact as insufficient to demonstrate a case of improper interest or disloyalty.<sup>162</sup> According to the court, “[t]he vesting of stock options in connection with a merger does not create a *per se* impermissible interest in the transaction.”<sup>163</sup> To find otherwise would be “irrational” and subject the directors to a “proverbial Catch-22 requiring them either to forego [sic] the options . . . or to accept their rightfully earned compensation and risk a breach of their duty of loyalty.”<sup>164</sup> Rather, a director may be self-interested only where he receives a benefit that the shareholders do not receive.<sup>165</sup> The vesting of the options was a legitimate part of the directors’ compensation plan and provided them with an incentive to seek the highest value per share—making their interests aligned with those of the stockholder.<sup>166</sup> The court agreed with the plaintiff’s second and third arguments, however, and found the process employed by the board in evaluating the merger potentially inadequate, and the merger’s protective measures draconian.<sup>167</sup>

The plaintiff’s allegations concerning the board’s inadequate evaluation implicated its performance of its fiduciary duties. Although the business judgment rule ordinarily protects the board of directors’ decision making, when a board approves a cash sale of the company, the decision receives heightened scrutiny involving “a judicial determination regarding the adequacy of the decision-making process employed by the directors” and “a judicial examination of the directors’ actions in light of the circumstances then existing.”<sup>168</sup> The burden is on the directors to prove the reasonableness of their actions.<sup>169</sup> Because Lyondell’s charter exculpated directors from liability for breaches of their fiduciary duty of care, pursuant to Delaware law, the plaintiff needed to demonstrate that the board either acted in bad faith or violated its duty of loyalty.<sup>170</sup> In this case, although at first glance the merger offering appeared to be at a substantial premium to market, the

---

160. *Id.*

161. *Id.* at \*10.

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.*

168. *Id.* at \*12.

169. *Id.*

170. *Id.* at \*11.

court determined that upon closer examination, the merger resulted from a “troubling board process.”<sup>171</sup>

Pursuant to Delaware law, the directors had a duty to engage “actively in the sale process,” but they need not prove the company sought multiple bidders.<sup>172</sup> Rather, “a sale to a single bidder without canvassing the market also is permissible where the board possesses ‘a body of reliable evidence with which to evaluate the fairness of the transaction.’”<sup>173</sup> In this case, the court concluded that the plaintiff pleaded sufficient facts to call into question the adequacy of the board’s knowledge and its process for evaluating the transaction.<sup>174</sup>

The court concluded that the amount of time in which the transaction materialized and was finalized—a mere seven days—raised questions about how much thought the board gave the transaction or Lyondell’s alternatives.<sup>175</sup> Similarly, the court questioned whether the board should have taken some action in response to Basell’s SEC filing to determine the company’s value or other potential interest from the market.<sup>176</sup> The court also believed that the board should have been consulted about the possible merger sooner—not after the best offer was given, but, rather, when serious negotiations commenced.<sup>177</sup> Moreover, there was no evidence that the board actively negotiated the terms of the merger or fought the protective measures.<sup>178</sup> Accordingly, the inadequacies in the process undertaken by the board implicated the “good faith aspect of the duty of loyalty” and therefore, the plaintiff’s claim fell outside Lyondell’s exculpatory provision.<sup>179</sup>

In light of what the court considered an inadequate process taken by the board to evaluate the transaction, the court was troubled by the protective measures, stating:

the problem lies primarily in the Board’s decision to tie its hands with a no-shop . . . under the circumstances of this case. In other words, where there is lingering doubt as to the Board’s efforts to ensure that it had secured the “best” transaction available to the Lyondell shareholders before it endorsed the transaction, the Court also should be skeptical of the wisdom of the Board’s decision to grant considerable deal protections, simply as a matter of

---

171. *Id.* at \*1.

172. *Id.* at \*12.

173. *Id.*

174. *Id.* at \*14.

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.* at \*15.

179. *Id.* at \*18.

course, that limited its ability to discharge proactively its fiduciary obligations after the fact.<sup>180</sup>

Accordingly, on summary judgment, the court could not exclude the possibility that the protective measures “served no purpose other than to squelch even the remotest possibility of a competing bid that might have increased the price for the stockholders.”<sup>181</sup> The court held that the plaintiff had pled sufficient facts to withstand defendants’ motion for summary judgment.<sup>182</sup>

## 2. *In re Lear Corp. Shareholder Litigation*<sup>183</sup>

In contrast to *Ryan v. Lyondell Chemical*, the Delaware Chancery Court in *In re Lear Corp. Shareholder Litigation* rejected the plaintiffs’ claim that a corporation’s decision to pay a bidder termination fee upon the shareholders’ vote against a merger amounted to a breach of the duty of loyalty or corporate waste.<sup>184</sup> As a result, because the company’s charter exculpated directors from liability from breaches of the duty of care, the court granted defendants’ motion to dismiss.<sup>185</sup>

Plaintiffs, stockholders of Lear Corporation (Lear), sought damages from the company for the board’s approval of a merger agreement that included a bidder termination fee payable in the event the shareholders voted against the merger.<sup>186</sup> This fee, \$25 million, was agreed to in exchange for an increase in bid price of \$1.25 per share.<sup>187</sup>

The merger arose out of negotiations between Lear’s chief executive officer, Robert Rossiter, and Carl Icahn, on behalf of his fund and subsidiaries.<sup>188</sup> In light of U.S. economic conditions, which affected Lear’s business of selling equipment to increasingly troubled U.S. automakers, Rossiter became concerned with Lear’s financial future, and, as a result, the future of his own wealth, much of which was tied up in the company.<sup>189</sup> Accordingly, when Icahn’s group approached Rossiter with the idea of acquiring Lear, Rossiter entertained the offer.<sup>190</sup> After brief negotiations, the parties reached an agreement whereby Icahn’s group would buy Lear for \$36 per share.<sup>191</sup> When news of the merger agreement became public, stockholders

180. *Id.* at \*17.

181. *Id.*

182. *Id.* at \*11.

183. No. 2728-VCS, 2008 WL 4053221 (Del. Ch. Sept. 2, 2008).

184. *Id.* at \*12–13.

185. *Id.* at \*10, \*14.

186. *Id.* at \*1.

187. *Id.*

188. *Id.* at \*2.

189. *Id.*

190. *Id.*

191. *Id.*

---

filed suit seeking an injunction.<sup>192</sup> The court did not grant an injunction, but did rule that Lear's proxy statement had failed to adequately disclose Rossiter's personal interest and motivation for the merger.<sup>193</sup>

After the court's ruling, but prior to the shareholder vote, Lear filed an amended proxy and encountered shareholder resistance, leading it to believe that the merger would not pass.<sup>194</sup> After receiving word from some of the company's largest stockholders that an increased bid of at least \$1.00 might get the deal approved, the company's Special Committee—formed for the purpose of assisting with the deal process—authorized the company's chairman, Larry McCurdy, and Rossiter to work together to negotiate an improved merger agreement.<sup>195</sup> After negotiating for more than a week, Lear was able to get Icahn's group to agree to increase its bid by \$1.25 in exchange for a termination fee of \$25 million that would be payable in the event the shareholders voted against the merger.<sup>196</sup> The shareholders voted against the merger, resulting in the claims against Lear and Icahn's group seeking damages.<sup>197</sup>

Prior to filing a derivative suit, the plaintiffs failed to make a demand on the board, and therefore, to receive damages, they were required to meet a heightened pleading standard under Delaware law.<sup>198</sup> Accordingly, plaintiffs had to allege facts demonstrating reasonable doubt that (1) the majority of the board was disinterested or (2) the merger agreement resulted from a valid business judgment.<sup>199</sup> Plaintiffs did not attempt to satisfy the first prong because the majority of the board was clearly independent.<sup>200</sup>

In order for the plaintiffs to satisfy the second prong, they had to prove a breach of fiduciary duty that was not covered by the director exculpation clause in Lear's charter.<sup>201</sup> Because Lear's charter included a provision exculpating directors from liability for breaches of the duty of care, allegations of gross negligence would not suffice.<sup>202</sup> Rather, the plaintiffs had to demonstrate a breach of the duty of loyalty supported by facts from which it could be inferred that "the directors consciously acted in a manner contrary to the interests of Lear and its stockholders."<sup>203</sup>

---

192. *Id.* at \*3.

193. *Id.*

194. *Id.*

195. *Id.* at \*4–5.

196. *Id.* at \*5.

197. *Id.* at \*6.

198. *Id.*

199. *Id.*

200. *Id.* at \*10.

201. *Id.* at \*6.

202. *Id.* at \*10, \*7.

203. *Id.* at \*7.

The plaintiffs argued that the directors acted in bad faith because they agreed to the termination fee despite knowing that an increased bid of \$1.25 would not pass a shareholder vote.<sup>204</sup> The plaintiffs argued, therefore, that the board entered into a transaction that “was tantamount to corporate waste.”<sup>205</sup> Moreover, the plaintiffs contended that the board was so disconnected from the stockholders’ views that in agreeing to the termination fee, the board exercised “no care.”<sup>206</sup>

The court rejected the plaintiffs’ arguments. In essence, the court viewed the plaintiffs’ arguments as nothing more than contesting the prudence of the directors’ decisions—decisions protected by the business judgment rule.<sup>207</sup> In addition, the court determined that none of the allegations in the complaint led to the conclusion that the board acted in bad faith or in violation of its fiduciary duties. First, the court concluded the board employed a rational process in considering the merger agreement.<sup>208</sup> It met regularly to discuss the merger, it sought advice of professional advisors, and the company “had been freely shopped” and no bidder had come with a better offer.<sup>209</sup> Moreover, the plaintiffs’ claim that Rossiter was self-interested and had his own financial incentives to approving the merger did not prove a breach of the duty of loyalty.<sup>210</sup> Rather, Rossiter did not negotiate the termination fee alone, but was assisted in the negotiations by the chairman of Lear’s special committee. In addition, Rossiter only had a financial benefit if the merger was approved—a failed merger did not advance Rossiter’s interest at all.<sup>211</sup>

The court further noted that the plaintiffs’ arguments were belied by their own allegations.<sup>212</sup> The complaint was rife with equivocations indicating that even the plaintiffs conceded that there was a chance the stockholders would vote in favor of the merger, making the directors’ belief of possible victory plausible.<sup>213</sup> Similarly, in support of their claims of bad faith or that the board acted with “no care,” the plaintiffs failed to plead any particularized facts.<sup>214</sup> Accordingly, the court held that the inflammatory conclusory allegations of wrongdoing were insufficient to withstand a motion to dismiss.<sup>215</sup>

---

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.* at \*9.

208. *Id.* at \*7.

209. *Id.* at \*8.

210. *Id.*

211. *Id.*

212. *Id.* at \*9.

213. *Id.*

214. *Id.* at \*10.

215. *Id.*

Finally, the court held that the plaintiffs' claim that the merger agreement was an act of corporate waste was unsupported by the facts as alleged. The court emphasized the stringent pleading standard required for corporate waste claims requires a plaintiff to plead "facts showing that no person of ordinary sound business judgment could view the benefits received in the transaction as a fair exchange for the consideration paid by the corporation."<sup>216</sup> The court concluded that "[t]o call it waste for the Lear board to grant that modest fee in exchange for a substantial price increase would require a radical revision of the waste concept, converting it from a rigorous test designed to smoke out shady, bad faith deals to a license for judicial scrutiny of arm's length bargains."<sup>217</sup>

### B. Interpretation of Bylaws

Delaware courts are hesitant to interpret corporation bylaws in a manner that would prevent or inhibit shareholders' rights to nominate or participate in annual elections. For example, the Delaware Chancery Court ruled in *JANA Master Fund, Ltd. v. CNET Networks, Inc.* that a corporation's advance-notice bylaw did not apply to all stockholder proposals to conduct business, but rather only those proposals the shareholder intended to include in the company's proxy materials pursuant to SEC Rule 14a-8.<sup>218</sup> Similarly, in *Levitt Corp. v. Office Depot, Inc.*, the chancery court ruled that unless the bylaws expressly and unambiguously required advanced notice for the nomination of directors for upcoming elections, no notice is required for a shareholder to make such nominations at the company's annual meeting.<sup>219</sup>

#### 1. *JANA Master Fund, Ltd. v. CNET Networks, Inc.*

In *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, plaintiff JANA, owner of approximately eleven percent of the common stock of defendant CNET, advised CNET's board of its intention to replace two CNET directors, expand the size of CNET's board, nominate individuals to fill the new positions at the upcoming annual meeting, and seek shareholder proxies in support of these changes.<sup>220</sup> CNET claimed that JANA's proposed proxy solicitation violated the company's bylaws because JANA had not owned sufficient common stock for at least one year prior to the annual election and had failed to provide the requisite 120-day advance notice.<sup>221</sup>

216. *Id.* at \*13.

217. *Id.* at \*14.

218. 954 A.2d 335, 339 (Del. Ch. 2008).

219. No. 3622-VCN, 2008 WL 1724244 (Del. Ch. Apr. 14, 2008).

220. *JANA Master Fund*, 954 A.2d at 337-38.

221. *Id.* at 338.

JANA sued for a declaration that the bylaws were inapplicable to JANA or that CNET's interpretation was incorrect.<sup>222</sup> JANA argued that the bylaws only applied to nominations or proposals to be included within the company's proxy materials pursuant to Rule 14a-8 of the federal securities laws, and that because it intended to finance its own proxy materials, the bylaw was inapplicable.<sup>223</sup> JANA alternatively argued that the bylaw violated Delaware law because it was unreasonably restrictive on shareholders' voting rights.<sup>224</sup>

CNET responded that the advance-notice bylaw was valid because the shareholders adopted it, and that the language of the bylaw applied to all proposals and was not restricted to only those proposals made under Rule 14a-8.<sup>225</sup> An advance-notice bylaw "requires stockholders wishing to make nominations or proposals at a corporation's annual meeting to give notice of their intention in advance of so doing."<sup>226</sup> Although they have been upheld by Delaware courts, "when advance notice bylaws unduly restrict the stockholder franchise or are applied inequitably, they will be struck down."<sup>227</sup> Here, the court agreed with JANA's arguments and ruled that the bylaw only applied to proposals made under Rule 14a-8 and, therefore, did not apply to JANA's proposed proxy solicitation.<sup>228</sup>

First, the express language of the bylaw that stated "shareholders *may seek* to transact other corporate business at the annual meeting" did not "make sense outside the context of Rule 14a-8."<sup>229</sup> Ordinarily, unless a shareholder wants to include its proposal in the company's proxy materials, it need not *seek* management's approval to solicit proxies that the shareholder independently finances.<sup>230</sup>

Second, the bylaw's language set a deadline for advanced notices that was tied to the release of the company's proxy form.<sup>231</sup> The advanced-notice provision required that a shareholder who intended to make a proposal inform CNET by written notice "received no later than 120 calendar days in advance of the state of the Corporation's proxy statement."<sup>232</sup> The court reasoned that this requirement did not make sense if the shareholder intended to independently finance its own proxy materials. Moreover, the

---

222. *Id.* at 337.

223. *Id.* at 338.

224. *Id.*

225. *Id.*

226. *Id.* at 344.

227. *Id.*

228. *Id.* at 339.

229. *Id.* at 340 (emphasis added).

230. *Id.* at 342.

231. *Id.* at 343.

232. *Id.*

court rejected CNET's contention that this bylaw acted as a general advance-notice bylaw.<sup>233</sup> The court noted that while it has previously upheld general advance-notice bylaws, it could not "find a single example of a permissible advance-notice bylaw that has set the notice required by reference to the release of the company's proxy statement."<sup>234</sup>

Third, the court concluded that the express language of the bylaw established that it was intended to apply only to Rule 14a-8 proposals and not to all shareholder proposals. The last sentence of the bylaw states, "[n]otwithstanding the foregoing, such notice must also comply with any *applicable federal securities laws establishing* the circumstances under which the Corporation is *required to include the proposal in its proxy* statement or form of proxy."<sup>235</sup> The court stated that the "applicable federal securities laws" referenced that "establish the circumstances" where the company must include shareholder proxy proposals "clearly refer to Rule 14a-8."<sup>236</sup>

The decision was recently affirmed on appeal by the Delaware Supreme Court, "on the basis of and for the reasons stated in" the opinion from the court of chancery.<sup>237</sup> Therefore, corporations intending to require advance notice for all shareholder proposals should ensure that their bylaws expressly and unambiguously so require.

## 2. *Levitt Corp. v. Office Depot, Inc.*

Consistent with Delaware precedent, the Chancery Court in *Levitt Corp. v. Office Depot, Inc.* ruled that unless a corporation's bylaws clearly and unambiguously require advance notice of a stockholder's intent to nominate directors at an annual meeting, no advance notice needs to be given.<sup>238</sup> In this case, although the corporation's bylaws required advance notice for any "business" to be conducted or considered at the annual meeting, this requirement was satisfied by the company's notice of the annual meeting that expressly indicated that elections would occur.<sup>239</sup>

Plaintiff Levitt Corporation (Levitt) sought a declaratory judgment permitting it to nominate two candidates for the election of the board of directors of Office Depot, Inc.<sup>240</sup> Office Depot sent out its notice of an annual meeting and listed as its first item of business "to elect twelve (12) members

---

233. *Id.* at 344.

234. *Id.*

235. *Id.* (emphasis added).

236. *Id.* at 344-45.

237. *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, 947 A.2d 335 (Del. 2008) (table).

238. No. 3622-VCN, 2008 WL 1724244, at \*4 (Del. Ch. Apr. 14, 2008).

239. *Id.*

240. *Id.* at \*1.

of the Board of Directors.”<sup>241</sup> Following the notice, Levitt filed its own proxy statement with the SEC seeking to nominate two candidates but did not provide the company with advance notice of its nomination. Office Depot, claiming that Levitt had failed to follow the company’s bylaws, refused to permit Levitt’s nominations.<sup>242</sup>

Office Depot’s bylaws provide, “At an annual meeting of the stockholders, only such *business* shall be conducted as shall have been properly brought before the meeting.”<sup>243</sup> Although Levitt argued that this provision excluded elections, the court disagreed and held that “business” meant any “affair” or “matter” and, therefore, necessarily included elections.<sup>244</sup> Levitt, however, was not precluded by the advanced notice requirement from nominating directors as part of the previously announced “business” of electing directors.<sup>245</sup> Rather, the “business” of the director elections, which the court read to include nominations as well as voting, was raised in the company’s notice of the annual meeting.<sup>246</sup> Accordingly, the court found that Levitt was entitled to make its nominations.<sup>247</sup>

---

241. *Id.*

242. *Id.*

243. *Id.* at \*5 (emphasis added).

244. *Id.*

245. *Id.*

246. *Id.*

247. *Id.*