

**THE ORACLE THAT WASN'T:  
WHY FINANCIAL TIES HAVE REMAINED THE  
STANDARD FOR ASSESSING THE INDEPENDENCE OF  
CORPORATE DIRECTORS**

ROCKY DALLUM\*

**I. INTRODUCTION**

In the wake of the highly publicized scandals at the beginning of this decade involving malfeasance of corporate leadership, courts have increased the focus on outside director independence in derivative litigation.<sup>1</sup> This heightened scrutiny of outside directors has seemingly left significant ambiguity in the law regarding the standards that govern director independence.<sup>2</sup> This note examines the state of the law in Delaware regarding conflicts of interest and lack of independence in corporate litigation. An analysis of Delaware court decisions will show whether the law has actually become more protective of shareholders' right to bring derivative suits since the Enron and WorldCom scandals of the early 2000s.

This note surveys the decisions before and following the Delaware Chancery Court's 2003 decision in *In re Oracle Corp. Derivative Litigation (Oracle)*<sup>3</sup> as well as other derivative termination cases. The decision in *Oracle* expanded the inquiry of director independence from considerations of material economic ties between

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\* Counsel, Boise, Inc.; J.D., Willamette University, 2009; B.A., Linfield College, 2002. I appreciate the insights, advice, and feedback professors Peter V. Letsou and Terrance O'Reilly gave me while I was researching and writing this note. Generally, I thank the legal department at Boise, Inc., as the driving force in my transition from legal study to legal practice. On a personal note, I thank my dad for his encouragement as well as his financial contributions to my education. Most important is my gratitude to my wife, Becky, for her immense support and endless patience in all of my endeavors, including time spent composing this article.

1. Carl W. Mills, *Breach of Fiduciary Duty as Securities Fraud: SEC v. Chancellor Corp.*, 10 FORDHAM J. CORP. & FIN. L. 439, 467 (2005).

2. Elizabeth Cosenza, *The Holy Grail of Corporate Governance Reform: Independence or Democracy?*, 2007 BYU L. REV. 1, 40.

3. 824 A.2d 917 (Del. Ch. 2003).

a director and an interested party to personal, professional, philanthropic or social ties that might impede a director's exercise of independent judgment.<sup>4</sup>

In *Oracle*, the Chancery Court denied the motion of a special litigation committee (SLC) to dismiss the litigation.<sup>5</sup> As will be discussed below, an SLC's motion to dismiss is rarely denied, so *Oracle* is a noteworthy decision, not only for that reason, but also because the analysis used by the court focusing on personal and non-economic relationships seemed to create a new approach in evaluating the termination of derivative litigation.

The *Oracle* case ultimately favored the defendants, and therefore it was unnecessary for Delaware's highest court to review or overturn the analysis, meaning that the decision is still good law.<sup>6</sup> The opinion itself is worth examining not only because of its uncommon result, but also because of its geographic origin. Courts in other jurisdictions pay close attention to, and often follow, the corporate law decisions of Delaware courts, including the Court of Chancery.<sup>7</sup> For example, a Massachusetts Superior Court decision from 2006 relied on the Chancery Court's unreviewed opinion in *Oracle* in determining that state's standards for independence.<sup>8</sup>

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4. Cosenza, *supra* note 2, at 39–40.

5. *Oracle*, 824 A.2d at 948.

6. While the SLC's motion to terminate was denied in *Oracle*, the case was ultimately dismissed on a summary judgment motion. See *In re Oracle Corp. Derivative Litig.*, 867 A.2d 904, 906 (Del. Ch. 2004), *aff'd*, *In re Oracle Corp. Derivative Litig.*, 872 A.2d 960 (Del. 2005).

7. "Delaware's case law is cited constantly and relied upon in other jurisdictions. Every corporation law casebook for students is filled with Delaware decisions because it is the state where a great number of companies are organized and where there is the most corporate experience to draw upon." William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 671 (1974). For a discussion of the importance of judge-made corporate law in Delaware, see Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1591–97 (2005). The authors note:

In Delaware, judge-made law, to the virtual exclusion of statutory law, governs fundamental issues such as fiduciary duties of directors, officers, and controlling shareholders, the prerequisites for a derivative suit, and disclosure obligations. Even powers that the Delaware code explicitly accords to the board of directors are subject to a judicially created and interpreted duty not to use these powers for "inequitable purposes." Thus, judge-made, rather than statutory, law governs issues such as: . . . when a director is considered "independent[.]"

*Id.* at 1591 (citation omitted).

8. See *Blake v. Friendly Ice Cream Corp.*, No. Civ. 03-0003, 2006 WL 2714976, at \*1 n.3 (Mass. Super. Ct. Aug. 24, 2006).

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While *Oracle* appeared to be in line with the response to post-Enron scrutiny of Delaware corporate law, more recent cases have generated ambiguity as to the actual standards for determining director independence. The survey of cases in this note will help to more clearly explain the particular facts, relationships and interests that are sufficient to show a lack of independence when a corporation terminates derivative litigation.

Delaware courts are more closely examining cases where the corporation has dismissed a derivative action since the Enron and Worldcom scandals. However, an evaluation of the recent decisions following *Oracle* shows that the focus again centers on economic relationships as they did prior to *Oracle* when determining director independence. *Oracle* may be the high-water mark of protecting shareholders in derivative actions; the current state of Delaware law requires more than social relationships to establish that a board's decision to terminate is tainted.

Analyzing and synthesizing these cases is an important tool in determining the specific facts, relationships and conduct of directors and managers that will permit plaintiffs to go forward with derivative actions. It also gives some standards for understanding when a demand to review the proposed litigation by a board of directors may be excused or when an SLC may terminate litigation because its decisions are considered independent and therefore valid. This note aims to make sense of decisions regarding the Delaware law defining conflicts of interest in the termination of derivative suits.

This note focuses primarily on Delaware law, as Delaware is the most common state of incorporation of publicly traded companies and is also used as a secondary authority by other jurisdictions in developing corporate law.<sup>9</sup> Delaware is often criticized in its administration of corporate law for its "race to the bottom," which encourages incorporation within the state by accommodating the needs of directors and managers.<sup>10</sup> Conversely, many legal and economic scholars argue that the incentive for investment will cause corporations to avoid jurisdictions that are viewed as overly favorable

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9. Corporate litigation is brought most commonly in Delaware because the overwhelming majority of business entities, particularly publicly traded corporations, are incorporated in Delaware. For an explanation of this phenomenon, see Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749 (2006).

10. See Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 553–55 (2002).

to management because they provide fewer protections to shareholders.<sup>11</sup> These debates over the efficacy of Delaware's legal structure for public corporations involve the same underlying tension as the debate regarding derivative suits. Both reflect the competing interests between the needs of the corporation as an entity and the problems a shareholder faces in dealing with the separation of ownership and control.<sup>12</sup>

In the context of derivative litigation, Delaware jurisprudence traditionally deferred to the judgment of directors and SLCs in terminating derivative suits, so long as those parties were sufficiently "independent." Only an economic relationship involving some type of control or other financial interest could render a director "beholden" to the defendant in the proposed litigation.<sup>13</sup> Recently, however, the Delaware courts have expanded their inquiry into director independence to include non-economic relationships.<sup>14</sup> Part II of this note discusses the history of the law regarding derivative litigation including a detailed look at the facts and relationships that the courts evaluated prior to *Oracle*. Part III provides a survey of cases and an analysis of the factors, relationships and other circumstances that the Delaware courts have examined since *Oracle*. The analysis of these cases demonstrates that Delaware courts are examining director independence more closely. However, despite the decision in *Oracle*, non-economic relationships, and even economic ties beyond the control or the transaction at issue are not likely to create a sufficient lack of independence. Part IV discusses why the *Oracle* decision tips the balance unnecessarily in favor of litigants, exposing corporations to harmful suits, which ultimately costs other shareholders. Finally, I conclude that the *Oracle* court's approach is vague and difficult to define or apply.

## II. BACKGROUND

Derivative litigation emerged in the mid-1800s as a method for shareholders to seek remedies on the corporation's behalf for

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11. *See id.*

12. Meg Shevach, *Deciding Who Should Decide to Dismiss Derivative Suits*, 39 EMORY L.J. 937, 937 & n.3 (1990).

13. *See, e.g.*, Orman v. Cullman, 794 A.2d 5 (Del. Ch. 2002); Litt v. Wycoff, No. Civ.A. 19083-NC, 2003 WL 1794724 (Del. Ch. Mar. 28, 2003).

14. *See In re Oracle Corp. Derivative Litig.*, 824 A.2d 917 (Del. Ch. 2003).

mismangement by officers and directors.<sup>15</sup> "Derivative action" is defined by Black's Law Dictionary as "a suit asserted by a shareholder on the corporation's behalf against a third party (usu[ally] a corporate officer) because of the corporation's failure to take some action against the third party."<sup>16</sup> Derivative suits frequently arise after misconduct by a director or officer of the corporation, typically a breach of duty or loyalty, resulting in some damage to the value of the corporation. This misconduct is followed by a shareholder filing a derivative action in order to ensure that the corporation takes action against the party involved in the alleged misconduct. One specific example of such misconduct is when officers or directors approve transactions that benefit them personally but are detrimental to the corporation. It may also involve officers discovering business opportunities as part of their duty to the corporation and seizing them for their own interests, thereby denying the corporation the opportunity to profit from the transaction.

Criticism of derivative litigation stems from balancing "shareholders' need to protect the corporation from mismanagement or fraud and the corporation's need to prevent meritless or harmful litigation" where the harm done to the corporation outweighs the ultimate benefit.<sup>17</sup> Without derivative litigation, a shareholder's ability to enforce the fiduciary duties of managers may be nonexistent.<sup>18</sup> However, the intentions of plaintiffs in derivative actions and the motives of plaintiffs' attorneys have been questioned.<sup>19</sup> These questions fuel speculation that the motivation for initiating these suits is often either harassment or personal gain and not for the protection of the interests of the corporation itself.<sup>20</sup> Shareholders may bring these actions for any reason. Furthermore, the individual bringing the suit may own only a few shares, and therefore

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15. John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 261 (1981) (citing Foss v. Harbottle, (1843) 67 Eng. Rep. 189 (Ch.); Dodge v. Woolsey, 59 U.S. 331 (1855)).

16. BLACK'S LAW DICTIONARY 475 (8th ed. 2004).

17. See Shevach, *supra* note 12, at 937.

18. *Id.*; Joy v. North, 692 F.2d 880, 889 (2d Cir. 1982).

19. *North*, 692 F.2d at 887.

20. James D. Cox, *Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of Zapata and the ALI Project*, 1982 DUKE L.J. 959, 965 ("New York's security for expense statute, the forerunner of statutes enacted in other states, was a response to the popular conception of the derivative suit plaintiff as one who traffics in corporate causes of action and initiates suits for the sole purpose of harassment or personal gain.").

have virtually no interest in the outcome of the suit.<sup>21</sup> These suits are potentially extremely costly to the corporation: the time, expense, negative publicity and the risk of paying the attorneys' fees for both defendants and plaintiffs all can undermine the value of the corporation.<sup>22</sup>

This possibility of abuse by shareholders in asserting this right led legislatures to regulate the commencement of derivative litigation. Legislatures implemented the first hurdles to derivative suits by requiring security deposits for litigation expenses in order to limit "strike suits," which are filed largely for their nuisance value.<sup>23</sup> Similarly, standing requirements were created to ensure that only shareholders who were affected by the alleged misconduct could assert a right on behalf of the corporation.<sup>24</sup> The same policy of protecting management's right to deflect suits that harm the corporation provides a backdrop for the development of the law in Delaware regarding corporate directors' ability to terminate derivative litigation.

#### *A. Current Approaches to Termination of Derivative Litigation*

The "demand requirement" and the implementation of SLCs are the two mechanisms that allow boards of directors in Delaware the power to terminate litigation. Like the impediments to derivative actions that came before them, these two procedures have been criticized for tipping the balance of power away from shareholders towards directors and management. As the demand requirement and use of SLCs emerged in the 1970s, legal scholars pointed to each as fatal blows to derivative litigation.<sup>25</sup>

The demand requirement, under which shareholders must make a demand upon the corporation to take action against certain defendants at the commencement of the litigation, is an important hurdle for plaintiff shareholders in derivative suits. When this requirement is not excused, the board of directors is given the "business judgment presumption," that is, the decision not to take action against the party in question is respected as a valid exercise of the board's expertise

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21. *Id.* at 960.

22. *Id.* at 960 & n.5.

23. Coffee & Schwartz, *supra* note 15, at 261.

24. See FED. R. CIV. P. 23.1; DEL. CODE ANN. tit. 8, § 327 (2009).

25. Cox, *supra* note 20, at 959 ("[L]ike the heroine in a Saturday matinee, the derivative suit has repeatedly appeared to be at the cliffs of disaster.").

and authority.<sup>26</sup> As for cases where the demand requirement is excused, the SLC has been a powerful tool, because, prior to *Oracle*, termination of the litigation was the likely outcome and the courts did not deny SLC motions to dismiss.<sup>27</sup>

### *1. The Demand Requirement*

In order to commence a derivative action, a shareholder is required to make a written demand upon the corporation's directors to take action on behalf of the corporation against a third party who has harmed the corporation.<sup>28</sup> This is an important protection for directors and management because, typically, when the demand is made, the corporation decides to terminate the litigation.<sup>29</sup>

Delaware excuses demand when the plaintiff shows reason for failure to make the demand on the directors.<sup>30</sup> In its 1984 *Aronson v. Lewis* decision, the Delaware Supreme Court clarified the circumstances that would excuse demand, rejecting the Chancery Court's finding that the plaintiff shareholder raised a "reasonable inference" that directors' termination of a derivative suit was not protected by the business judgment rule.<sup>31</sup> The court developed a two-part test by which to evaluate demand excuse requests. First, plaintiffs must show that the board's decision not to sue on behalf of the corporation, pursuant to the demand, cannot be respected because of a lack of independence.<sup>32</sup> Second, plaintiffs must show that the original decision that is the subject of the action should not be given the presumption of the business judgment rule.<sup>33</sup> Each prong requires the plaintiff to establish a "reasonable doubt" that the board lacks independence.<sup>34</sup>

Most importantly, *Aronson* gave insight into the concept of independence. "Independence means that a director's decision is

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26. See *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1076 (Del. Ch. 1985).

27. Shevach, *supra* note 12, at 938 ("Not surprisingly, in all reported cases, SLCs have decided to dismiss derivative suits.").

28. AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS §7.03 (1994) [hereinafter CORPORATE GOVERNANCE]; MODEL BUS. CORP. ACT § 7.42 (1984).

29. Coffee & Schwartz, *supra* note 15, at 262.

30. See DEL. CH. CT. R. 23.1; CORPORATE GOVERNANCE, *supra* note 28, §7.03 cmt. a.

31. *Aronson v. Lewis*, 473 A.2d 805, 808 (Del. 1984).

32. *Id.* at 814.

33. *Id.*

34. *Id.*

based on the corporate merits of the subject before the board rather than extraneous considerations or influences.”<sup>35</sup> Such extraneous considerations or influences may exist when one director has the ability to control another. While an interest in the litigation by a board of directors can show that demand is futile, “courts have frequently disagreed over how to apply this principle.”<sup>36</sup> The number of directors with an interest, or directors named as defendants, required to excuse demand differs between jurisdictions.<sup>37</sup> Delaware simply requires that a majority of directors be interested in order for demand to be futile.<sup>38</sup> Furthermore, the particular relationships between directors and other defendants that create conflicts or lack of independence are also ambiguous.<sup>39</sup> It is this ambiguity that creates the difficulty in determining when a corporation may terminate derivative litigation.

The demand requirement is critical in cases where director independence is in question. Either prong of the *Aronson* test will trigger an inquiry into each director’s independence. These relationships are the basis for review by higher courts when a lower court determines that demand is required. The state of the law regarding independence will inform litigants whether a specific corporate decision is valid and cannot be challenged. It also determines whether a board is sufficiently independent to terminate a shareholder suit.

## 2. Special Litigation Committees

The other important tool allowing corporations to terminate derivative litigation, especially when there are issues of independence

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35. *Id.* at 816.

36. CORPORATE GOVERNANCE, *supra* note 28, §7.03 cmt. d.

37. *Id.* In contrast to the demand requirement, the American Law Institute’s *Principles of Corporate Governance: Analysis and Recommendations* and the Model Business Corporations Act suggest a requirement of demand in all cases known as “universal demand.” *Id.* at §7.03 cmt. e; MODEL BUS. CORP. ACT § 7.42 (1984). Universal demand allows a board to make a decision regarding the litigation before determining whether the board lacks sufficient independence. This gives the plaintiff the benefit of discovery before having to prove a lack of independence and avoids useless inquiries into board conflicts in situations where the board decides to let the action go forward.

38. *Beneville v. York*, 769 A.2d 80, 84 (Del Ch. 2000).

39. See *Blake v. Friendly Ice Cream Corp.*, No. Civ. 03-0003, 2006 WL 2714976, at \*1 & n.5 (Mass. Super. Ct. Aug. 24, 2006) (“As observed by other courts, the [Delaware] case law is not entirely free from ambiguity or inconsistent application.”); *Off v. Ross*, No. Civ. A. 3468-VCP, 2008 WL 5053448, at \*11 (Del. Ch. Nov. 26, 2008) (noting that “there is no bright line test for gauging director non-independence”).

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and conflicts of interest, is the special litigation committee. An SLC is a committee of independent or outside directors appointed by a corporation's board of directors specifically to determine whether the litigation is in the best interest of the corporation.<sup>40</sup> However, there is always some question of independence when a tainted board appoints a purportedly independent committee.

The concept of the SLC developed as "an evolutionary response to earlier, relatively inefficient and ineffective procedural devices designed to terminate derivative suits."<sup>41</sup> Prior procedures such as "security for expense" statutes, summary judgment motions, and out-of-court settlements had proven to be weak mechanisms for protecting corporations against unwanted litigation.<sup>42</sup> Security for expense statutes allow for a suit to be terminated when security cannot be posted, but because they do not allow for an adverse judgment against the plaintiff, corporations are still exposed to liability in other jurisdictions.<sup>43</sup> Summary judgment and other pretrial motions are equally ineffective because they only test the sufficiency of the pleadings, and will only be granted when there are no disputed factual issues.<sup>44</sup> In fiduciary duty cases, courts easily find material factual disputes, but such a finding does not ultimately address whether a decision was made independently. Finally, settlement is the closest mechanism to the SLC's power to terminate. However, the clandestine nature of settlements solves none of the structural problems created when directors cannot act independently from management or other directors.<sup>45</sup>

The evolutionary response to these mechanisms was the SLC. The SLC "provided a voice for the corporation even after the court has excused the demand requirement."<sup>46</sup> "The first case to recognize an SLC's power to terminate a derivative suit was *Gall v. Exxon Corp.*"<sup>47</sup> *Gall* was decided in 1976, and involved a suit against directors for using corporate funds for illegal bribes and political donations in a foreign country.<sup>48</sup> Exxon's board of directors passed a

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40. See Shevach, *supra* note 12, at 938.

41. Cox, *supra* note 20, at 960.

42. *Id.* at 964–72.

43. *Id.* at 965.

44. *Id.* at 966.

45. *Id.* at 969–72.

46. *Id.* at 961.

47. Shevach, *supra* note 12, at 939.

48. *Gall v. Exxon Corp.*, 418 F. Supp. 508, 509 (S.D.N.Y. 1976).

resolution creating a committee of disinterested directors to investigate and decide on the corporation's response to the suit.<sup>49</sup> The court gave what commentators call the "judicial blessing" to the use of an SLC in determining whether derivative litigation should be dismissed.<sup>50</sup> However, while the court found that a special litigation committee could be created and comprised of the non-defendant directors, it refused to dismiss the suit. The court allowed the plaintiff to "test the bona fides and independence of the Special Committee . . ."<sup>51</sup> This decision shows that the real inquiry in derivative litigation termination is the independence of the corporate entity that dismisses either the board itself or an SLC.

Following *Gall*, some questioned the independence of the SLC.<sup>52</sup> Again, a balance between the competing policies of protecting the corporation from suits lacking merit and maintaining shareholders' rights was needed. Courts examined the manner in which SLCs were appointed, the independence and qualifications of the members, and the independence of the directors who appoint them.<sup>53</sup>

Prior to the much publicized Enron and WorldCom scandals, the courts were highly deferential to the decisions of SLCs.<sup>54</sup> A primary case demonstrating this level of deference was *Zapata Corp. v. Maldonado*.<sup>55</sup> In *Zapata*, the Delaware Supreme Court aimed to balance the interests of the shareholder and the corporation, stating that

It thus appears desirable to us to find a balancing point where bona fide stockholder power to bring corporate causes of action cannot be unfairly trampled on by the board of directors, but the corporation can rid itself of derivative litigation.<sup>56</sup>

*Zapata* involved a derivative action for breach of fiduciary duty by the directors of a corporation. The directors exercised stock options in a manner that gave directors tax benefits, but cost the

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49. *Id.* at 510.

50. Shevach, *supra* note 12, at 939.

51. *Gall*, 418 F. Supp. at 520.

52. See Shevach, *supra* note 12, at 939 (citing James D. Cox & Donald E. Schwartz, *The Business Judgment Rule in the Context of Termination of Derivative Suits by Independent Committees*, 61 N.C. L. REV. 541 (1983)).

53. Shevach, *supra* note 12, at 939–40.

54. *Id.* at 938 (noting that "[n]ot surprisingly, in all reported cases, SLCs have decided to dismiss derivative suits").

55. See *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981).

56. *Id.* at 787.

corporation itself.<sup>57</sup> All of the directors of the company were named as defendants.<sup>58</sup> After some changes in board membership, the new board appointed two independent directors to investigate and evaluate the plaintiff's claim.<sup>59</sup> The court found that a tainted board may legally delegate authority to determine the future of a derivative action so long as the corporation meets the burden of showing that the decision was independent, in good faith, and reasonable.<sup>60</sup>

The Delaware Supreme Court further held that courts should apply a standard similar to the much applied "business judgment rule."<sup>61</sup> However, the standard from *Zapata* involved slightly more scrutiny. When an SLC terminates litigation, it (rather than the plaintiff) bears the burden of proving that there is no material issue of fact regarding the independence, good faith and reasonableness of the committee.<sup>62</sup> *Zapata* requires the court to make its own independent decision about the validity of terminating the litigation once it is satisfied that the SLC is sufficiently independent.<sup>63</sup> This decision is based on whether there was a reasonable basis for the SLC's motion to dismiss. While the aim was to protect shareholders' rights, the SLC was still given a relatively high level of deference, which revived speculation about the demise of derivative suits.<sup>64</sup>

In 1985, the Delaware Chancery Court again upheld an SLC's motion to dismiss in *Kaplan v. Wyatt* after reviewing the independence of a two-member SLC.<sup>65</sup> The case clarified the standard for establishing director independence. In *Kaplan*, the court rejected the plaintiff's assertion that there was a difference between a motion to dismiss a derivative action by an SLC and a board's determination not to go forward in cases requiring demand.<sup>66</sup> *Kaplan* highlights an

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57. *Id.* at 779.

58. *Id.* at 780.

59. *Id.* at 781.

60. *Id.* at 786–87.

61. *Id.* at 787.

62. *Id.* at 788–89.

63. *Id.*

64. Shevach, *supra* note 12, at 939–40 (citing Coffee & Schwartz, *supra* note 15; George W. Dent, Jr., *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U. L. REV. 96 (1980)).

65. *Kaplan v. Wyatt*, 499 A.2d 1184 (Del. Ch. 1985).

66. *Id.* at 1189, n.1. Characterizing the plaintiff's argument, the court wrote:

Kaplan contends that there is an important distinction between a motion to dismiss a suit made by a Special Litigation Committee and a determination by the Board of Directors after demand of whether it should bring the suit, because in the latter case

important point: namely, that the standard in Delaware for independence is the same in both the demand requirement context and the SLC termination context.<sup>67</sup> This point is critical when evaluating the cases based on independence.

### B. Pre-Enron Cases on Director Independence

Pre-*Oracle* decisions focusing on director and SLC independence show that non-economic relationships are not enough to create a lack of independence.<sup>68</sup> Further, there seems to be a dearth of cases denying an SLC's motion to dismiss.<sup>69</sup> This may be the best evidence that courts were unlikely to overturn an SLC's decision for lack of independence. Reviewing the relationships in question in the cases decided prior to *Oracle* show that the Delaware courts readily rejected a finding of lack of independence when SLC members merely had personal friendships or social relationships with the named defendants in the derivative suit.<sup>70</sup> These can be compared to the *Oracle* decision and subsequent cases to show how the law has evolved.

One early case where the court did find a lack of independence was *Lewis v. Fuqua*. In *Lewis*, the corporation in question appointed an SLC with only one member who was also a named defendant but had not participated in the underlying transaction that gave rise to the charge of breach of fiduciary duty.<sup>71</sup> The court found that the corporation failed to show that there was no material issue of fact regarding independence.<sup>72</sup> However, it did not specifically state which aspects of his relationships caused conflicts. The SLC member in question, Terry Sanford, "had numerous political and financial dealings" with the CEO and Chairman of the Board of Fuqua

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if the board rejects the demand the shareholder can still bring the suit, while in the former case the suit is terminated. This distinction is irrelevant to the director's ability to make an independent business judgment.

*Id.*

67. See *id.* at 1189.

68. See, e.g., Orman v. Cullman, 794 A.2d 5 (Del. Ch. 2002); Litt v. Wycoff, No. Civ.A. 19083-NC, 2003 WL 1794724 (Del. Ch. Mar. 28, 2003).

69. Shevach, *supra* note 12, at 938 n.9 ("Cases in which courts have denied the corporation's motion to dismiss similarly are lacking.").

70. *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 936 n.44 (Del. Ch. 2003); see *Crescent/Mach I Partners, L.P. v. Turner*, 846 A.2d 963, 980–81 (Del. Ch. 2000); *In re Walt Disney Derivative Litig.*, 731 A.2d 342, 354 n.18 (Del. Ch. 1998).

71. *Lewis v. Fuqua*, 502 A.2d 962, 965 (1985).

72. *Id.* at 967.

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industries, J.B. Fuqua.<sup>73</sup> While the court failed to state which relationships were dispositive, it also noted that Sanford was president of Duke University, which had received a \$10 million dollar donation from Fuqua, and that J.B. Fuqua was a trustee on the Duke University Board.<sup>74</sup>

*Lewis* is one of the few cases where a court found a material issue regarding the lack of independence in an SLC. Although it is unique because the SLC had only one member, it does implicate some factual similarities to *Oracle*, specifically that a corporation's ties to university officials affected the independence inquiry. In *Oracle* a court reasoned that a university president, dean, or development professional could be beholden to a defendant based on the pursuit of major donations.<sup>75</sup> Yet when looking retrospectively at *Lewis*, it seems that a position as university president does not raise issues of independence for reasons of social or long-standing business relationships. Instead, where the fundraiser at an institution may be beholden to the contributor based on the requirements of his or her job, independence may be questioned.<sup>76</sup> *Lewis* did not mention personal or social relationships, but merely Sanford's "political and financial dealings" which were sufficient to raise an issue of material fact about his independence.

Many cases following *Lewis* and prior to *Oracle* specifically stated that non-economic relationships were not enough to raise doubts of independence. In *In re Walt Disney Co.*, the court reviewed a decision of CEO Michael Eisner and the Walt Disney Board of Directors.<sup>77</sup> Disney President Michael Ovitz was given a large severance package as part of his contract.<sup>78</sup> In assessing Eisner's interest in the underlying contract, the court reviewed his long-standing personal relationship with Ovitz.<sup>79</sup> The court noted that Delaware law did not support any finding that long-standing personal relationships or business ties could raise a doubt about

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73. *Id.* at 966–67.

74. *Id.* at 967.

75. *Oracle*, 824 A.2d at 930 & n.21.

76. See also *In re Limited, Inc.*, No. CIV.A. 17148-NC, 2002 WL 537692, at \*6–\*7 (Del. Ch. Mar. 27, 2002) (finding material issues regarding independence where director was a university president and defendant made significant contributions to that university).

77. 731 A.2d 342, 350, 352 (Del. Ch. 1998).

78. *Id.* at 350.

79. *Id.* at 355.

independence.<sup>80</sup> In fact, citing earlier case law, the court actually explained that the mere fact that a director may have to sue “friends, family, and business associates” would not excuse demand.<sup>81</sup> The case law from *Walt Disney* was specifically rejected in *Oracle* along with other prior cases with similar factual situations.<sup>82</sup>

The case law in the years and months just prior to *Oracle* demonstrates how quickly the Delaware courts may have shifted the approach to personal and non-economic relationships. In *Orman v. Cullman*, the Chancery Court used the *Aronson* definition of “independence” when reviewing a corporation’s motion to dismiss litigation.<sup>83</sup> In doing so, it evaluated six directors in question.<sup>84</sup> The specific facts of those relationships are a good basis for evaluating the state of the law prior to *Oracle*. The Delaware courts require an “actual person” standard in determining the materiality of any particular director.<sup>85</sup> “Actual person” means the precise relationship at issue must be reviewed in context, and for this reason it is necessary to analyze each director in question, both in the case law and throughout the remainder of this note.

The court first addressed the independence of Directors Israel and Vincent, finding that long-standing business relationships with the corporation and the individual defendants were not enough to create a material issue of lack of independence.<sup>86</sup> The court specifically stated that “[t]he law in Delaware is well-settled on this point. . . . [A]llegations of a ‘long-standing 15-year professional and personal relationship’ between a director and the CEO and Chairman of the Board of his company were insufficient to support a finding of control.”<sup>87</sup>

The Court’s assessment of Director Lufkin was similar to that of Israel and Vincent. Lufkin seemed to have even greater financial ties, as his company underwrote the initial public offering for the corporation at issue.<sup>88</sup> Still, this relationship failed to raise issues of independence because as the court noted the pleading did not show

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80. *Id.*

81. *Id.* at 354 n.18 (citing *Abrams v. Koether*, 766 F. Supp. 237, 256 (D.N.J. 1991)).

82. *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 936 n.44 (Del. Ch. 2003).

83. 794 A.2d 5, 24 (Del. Ch. 2002).

84. *Id.* at 26–31.

85. *Id.* at 24.

86. *Id.* at 26–27.

87. *Id.* at 27 (citation omitted).

88. *Id.* at 28.

that Lufkin would “receive a personal financial benefit from [the] transaction that [was] not equally shared by the stockholders.”<sup>89</sup> This statement gives strength to the argument that personal or non-economic relationships are not enough to create a reasonable doubt regarding independence. It also implies that independence is only lacking when there is an actual economic benefit, which would exclude any control by way of personal or social relationships.

The court briefly disposed of Director Barnet’s interest by finding that his position as director for the surviving company, following the transaction at issue, did not create an interest material to his independence.<sup>90</sup> However, regarding Director Bernbach, a \$75,000 consulting contract with the remaining company was enough to raise a material issue of fact regarding his independence.<sup>91</sup> Similarly, a \$3.3 million dollar benefit from the underlying transaction also created a material issue regarding Director Solomon’s independence.<sup>92</sup>

The director-by-director analysis in *Orman* demonstrates that only economic relationships related to the corporation itself or the underlying transaction created questions of director independence. The case was very clear that long-standing business relationships, tenure on the board of directors, and certainly personal relationships do not make a director controlled by or “beholden” to the defendants.<sup>93</sup>

In *Litt v. Wycoff*, the Delaware Chancery Court also rejected personal friendships and even outside business relationships as reasons to doubt the independence of a director or SLC member.<sup>94</sup> *Litt* is an unpublished memorandum opinion involving the question of whether demand would be futile based on the lack of independence of the five corporate board members in question.<sup>95</sup> *Litt* is significant

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89. *Id.* (alteration in original) (quotations omitted).

90. *Id.* at 28–29.

91. *Id.* at 29–30.

92. *Id.* at 30–31.

93. However, interestingly, a footnote in the *Orman* decision seems to suggest the contrary. Although *Orman* was very clear about the types of relationships that taint independence, while defining independence the court stated that a director could “be controlled by another . . . through close personal or familial relationship[s].” *Id.* at 25 n.50. The decision itself was in line with prior independence inquiries, but is the perhaps the first mention that a personal relationship may be part of an independence inquiry.

94. *Litt v. Wycoff*, No. Civ.A. 19083-NC, 2003 WL 1794724, at \*4 (Del. Ch. Mar. 28, 2003).

95. *Id.* at \*3.

because it was decided only months prior to *Oracle* and, judging by the nature of the corporations involved, may have been a much lower profile decision.

The underlying cause of action in *Litt* involved a CEO and board chair named Wycoff.<sup>96</sup> The inquiry of independence focused on each board member's relationship with Wycoff.<sup>97</sup> Specifically, two board members, Directors Zarrilli and Tornetta, were alleged to have relationships that went beyond economic interests.<sup>98</sup>

The inquiry into Zarrilli included his business relationship with Progress and Wycoff.<sup>99</sup> Zarrilli owned shares in a company called USIT.<sup>100</sup> USIT borrowed a significant amount of money from Progress.<sup>101</sup> This economic relationship caused loans to be made in favor of USIT, which were indeed detrimental to Progress.<sup>102</sup> The court also found from the pleadings that Zarilli's membership on the Progress board overlapped with his time as an employee of USIT.<sup>103</sup> While this economic relationship seemingly could have raised some material issues of fact regarding a conflict of interest, the court found that it raised none, as the loans would not create any type of "owingness" to Wycoff.<sup>104</sup>

Secondarily, the plaintiff argued that Zarrilli's business relationship also created a long-standing personal relationship with Wycoff.<sup>105</sup> The court expressly rejected this argument, stating that "[n]either mere personal friendship alone nor mere outside business relationships alone, are sufficient to raise a reasonable doubt regarding a director's independence."<sup>106</sup>

In evaluating Director Tornetta's relationship with Wycoff, the court rejected the argument that Progress's business transactions with an LLC owned by Tornetta's family was enough to implicate a lack of independence.<sup>107</sup> First, the court held that Wycoff could not

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96. *Id.* at \*1.

97. *Id.* at \*4-\*5.

98. *Id.*

99. *Id.* at \*4.

100. *Id.* at \*1.

101. *Id.*

102. *Id.* at \*4.

103. *Id.*

104. *Id.*

105. *Id.* at \*1.

106. *Id.* at \*4 (citations omitted).

107. *Id.* at \*5.

personally break the contracts between Progress and the LLC.<sup>108</sup> As for Tornetta's family, the court found that plaintiff had failed to plead specific facts regarding the family relationship as well as a material economic relationship that raised serious concerns.<sup>109</sup> In dealing with family relationships, the court stated, "material financial interests of close family members may factor into the disinterest and independence analysis under the *Aronson* test."<sup>110</sup> Again, this evaluation of Tornetta's independence showed that mere family relationships would not be enough to raise a material issue regarding independence.<sup>111</sup> Instead, the plaintiff must show a close relationship that actually affects some economic interest.<sup>112</sup>

The factors and relationships in these decisions (and lack of decisions denying SLC motions to dismiss) demonstrate the difficult burden of raising a reasonable doubt regarding independence for non-economic reasons prior to *Oracle*. Simply put, prior to *Oracle*, a director or SLC member only lacked independence if he or she was beholden to the defendant through economic ties.

### III. ANALYSIS: FINDING THE LAW BY MAKING SENSE OF *ORACLE* AND ITS SUCCESSORS

The fallout from the Enron and WorldCom scandals created numerous changes in corporate law in many jurisdictions,<sup>113</sup> including a change in the way Delaware viewed corporate monitoring and shareholder protection. *In re Oracle Corp. Derivative Litigation* is the leading post-Enron case that shifted the standards for determining independence. The decision seemed to give life to new, non-economic approaches to determining the independence of a director or SLC member when terminating derivative litigation.

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108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. See James L. Buchwalter, Annotation, *Construction and Application of Whistleblower Provision of Sarbanes-Oxley Act*, 18 U.S.C.A. § 1514A(a)(1), 15 A.L.R. FED. 2d 315 (2006) ("In response to highly publicized corporate scandals, the Sarbanes-Oxley Act of 2002 was created, imposing broad new oversight and regulation of publicly-traded companies."); 68 Fed. Reg. 19,051-01 (Apr. 11 2003) ("The NYSE proposes to amend its Listed Company Manual ('Manual') to implement significant changes to its listing standards aimed at helping to restore investor confidence by empowering and ensuring the independence of directors and strengthening corporate governance practices.").

The analysis of the *Oracle* decision, and various cases following it, show that Delaware courts are examining SLC decisions and demand futility cases more closely than in the cases discussed above. Yet it appears that the courts are still requiring a showing of a material economic interest by directors or SLC members in order to deny the corporation's motion to dismiss the claim in the derivative action. *Oracle* may mark the high point of protecting shareholders in derivative actions, but current Delaware law still requires more than social relationships to establish that a decision to terminate is tainted. Perhaps these recent clarifications reflect the best and most appropriate balance between a shareholder's right to sue on behalf of the corporation and the corporation's ability to terminate frivolous and costly litigation.

#### A. The Facts and Analysis of Oracle

In *Oracle*, the court reviewed an SLC's recommendation to terminate litigation.<sup>114</sup> It examined the two SLC members' relationships with several named defendants as well as their shared ties to Stanford University.<sup>115</sup> As is the standard, the SLC was required to show that the "members were independent; . . . acted in good faith; and . . . had a reasonable basis for their recommendations."<sup>116</sup> The two SLC members were both tenured professors at Stanford.<sup>117</sup> Hector Garcia-Molina was chair of the school's computer science department and received undergraduate and graduate degrees from Stanford.<sup>118</sup> The other member, Joseph Grundfest, was also a prominent professor and department chair who acted as the lead investigator for Stanford Law School's Securities Litigation Clearinghouse.<sup>119</sup> Prior to joining Stanford, Grundfest had been a commissioner for the Securities and Exchange Commission.<sup>120</sup> Grundfest also attended graduate school at Stanford, from which he received his law degree.<sup>121</sup>

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114. *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 920 (Del. Ch. 2003).

115. *Id.* at 929–35.

116. *Id.* at 928 (citing *Zapata v. Maldanado*, 430 A.2d 779, 788–89 (Del. 1981)).

117. *Id.* at 923.

118. *Id.*

119. *Id.* at 924.

120. *Id.*

121. *Id.*

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The allegations by the plaintiffs in *Oracle* and the SLC's report regarding each director's ties to Stanford were significantly different.<sup>122</sup> The court evaluated the ties as they had emerged during discovery.<sup>123</sup> The court found that neither SLC member's financial well-being was threatened by the decision to proceed or terminate.<sup>124</sup> Similarly, neither member held a fundraising position that would create any "owingness" to the defendants.<sup>125</sup>

Despite the lack of an economic relationship that would render Garcia-Molina or Grundfest beholden to the defendants, the court examined the multiple ties between the defendants and Stanford University, and the relationship with the two professors on the SLC.<sup>126</sup> As to Director Boskin, he had taught Grundfest as a Ph.D. candidate and the two remained in contact regarding public policy up to the time of the litigation.<sup>127</sup> Both were steering committee members of the Stanford Institute for Economic Policy Research (SIEPR) and each published papers under that organization.<sup>128</sup>

As the SLC reported, Director Lucas contributed significantly to Stanford, and one such contribution was made in response to a speech Grundfest gave at the law school.<sup>129</sup> Grundfest used about half of these funds for his research.<sup>130</sup> The ties the SLC failed to report were more important to the court.<sup>131</sup> Lucas created a foundation that donated \$11.7 million to Stanford.<sup>132</sup> He was also an alumnus of Stanford, who donated personally to both SIEPR (which named its facility after Lucas) and Stanford Law School.<sup>133</sup> The court pointed out that both institutions were "important to Grundfest."<sup>134</sup>

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122. *Id.* at 929–30 ("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.").

123. *Id.* at 929–35.

124. *Id.* at 930.

125. *Id.* at 930.

126. *Id.* at 929–35.

127. *Id.* at 931.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.* at 931–32 ("But Lucas's ties with Stanford are far, far richer than the SLC report lets on.").

132. *Id.* at 931.

133. *Id.* at 931–32.

134. *Id.* at 932.

The final individual the court examined was Lawrence Ellison, the chairman, CEO and largest shareholder of *Oracle*.<sup>135</sup> Ellison's ties with Stanford were much deeper than Boskin and Lucas's ties. Ellison had created endowments at Stanford and was in discussions over a scholarship program, to be named after him, funded by a \$170 million donation.<sup>136</sup> These initiatives involved boards whose directors would be appointed in some combination by Ellison and Stanford.<sup>137</sup> There were indications from discovery that these programs might be directed in some part by Ellison, Boskin and Lucas, and that Grundfest might have played a role in teaching aspects of the programs.<sup>138</sup>

Undoubtedly, there were many financial relationships regarding contributions between the named defendants and Stanford University. The SLC members would have been active participants in the institutions that would receive these contributions. However, again, as the court found, neither member was part of the fundraising efforts for these donations.<sup>139</sup> As tenured professors, their livelihoods were not directly or indirectly threatened by Ellison, Lucas, or Boskin.<sup>140</sup> They were not under the control of the defendants, either in a financial sense or otherwise. However, the court reevaluated Delaware law regarding independence, applying new standards to these specific facts and the ties involved between the SLC, the defendants and Stanford.

As discussed above, prior to the decision in *Oracle*, Delaware courts were unlikely to question the decisions of SLCs based on conflicts of interest, especially for non-economic reasons.<sup>141</sup> The decision in *Oracle* recognized the longstanding precedent of deferral, but rejected the argument of the SLC, noting that "the SLC focuse[d] on the language of previous opinions of this court and the Delaware Supreme Court that indicate[d] that a director is not independent only if he is dominated and controlled by an interested party . . .".<sup>142</sup>

The *Oracle* decision abandoned precedent that required economic ties in order for a director to be "beholden" to a

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135. *Id.* at 921.

136. *Id.* at 933.

137. *Id.*

138. *Id.* at 933–34.

139. See *supra* text accompanying note 125.

140. See *supra* text accompanying note 124.

141. See *supra* notes 68–69 and accompanying text.

142. *Oracle*, 824 A.2d at 936.

defendant.<sup>143</sup> The court proposed a hypothetical involving two brothers in a derivative action, one a member of the SLC, and one involved in the underlying transaction.<sup>144</sup> According to the court, the law lacked sensibility because, based on a test of domination and control, one brother could still investigate the other.<sup>145</sup> The decision suggested that the prior economic test of independence was based on a “reductionist view of human nature that simplifie[d] human motivation on the lines of the least sophisticated notions of the law and economics movement.”<sup>146</sup> Furthermore, the court explained that “[w]e may be thankful that an array of other motivations exist that influence human behavior; not all are any better than greed or avarice, think envy to name just one.”<sup>147</sup>

Reviewing the then-existing state of the law at some length, the court admitted that prior case law gave little weight to social relationships when determining independence.<sup>148</sup> The court found some room in the *Aronson* definition that would allow a finding of lack of independence for social or familial reasons.<sup>149</sup> Applying this expanded definition of independence to the various ties between the directors named as defendants in the action, the court denied the SLC’s motion to terminate.<sup>150</sup>

The court found that the SLC might not be independent because its members were required to consider allowing legal action against their fellow professors.<sup>151</sup> Grundfest’s objectivity was in doubt because of his shared academic interests with Boskin.<sup>152</sup> Similarly, simply requiring him to assess the conduct of his former teacher could also have created the same problems.<sup>153</sup> The court noted that the

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143. *Id.* at 938.

144. *Id.* at 937.

145. *Id.* at 938 (“If the test is domination and control, then one brother could investigate the other. Does any sensible person think that is our law? I do not think it is.”).

146. *Id.* at 938 & n.47 (“Professor Lynn Stout has argued that there exists an empirical basis to infer that corporate directors are likely to be motivated by altruistic impulses and not simply by a concern for their own pocketbooks.” (citing Lynn A. Stout, *In Praise of Procedure: An Economic and Behavioral Defense of Smith v. VanGorkom and the Business Judgment Rule*, 96 NW. U. L. REV. 675, 677–78 (2002))).

147. *Id.* at 938.

148. *Id.* at 938–39.

149. *Id.* The court also found support for this view in *Orman v. Cullman*, 794 A.2d 5, 25 n.50 (Del. Ch. 2002), discussed *supra* note 93. *Id.*

150. *Id.* at 948.

151. *Id.* at 942.

152. *Id.*

153. *Id.*

specific contributions and shared board positions, though not positions of control, indeed raised issues of independence.<sup>154</sup> According to the decision, a professor's general awareness of a corporation's significant contributions to his university would create issues of independence; "by any measure, this was a social atmosphere painted in too much vivid Stanford Cardinal red for the SLC members to have reasonably ignored it."<sup>155</sup> Ultimately, to the court, the totality of the contributions, board positions and various relationships implicated a lack of independence based on "a general sense of human nature."<sup>156</sup>

*Oracle*, as noted not only by the court itself, but also by legal scholars, clearly departed from a purely economic analysis of conflicts of interest.<sup>157</sup> The case yielded speculation that the Delaware courts would consistently expand their inquiries into director and SLC independence to include non-economic relationships.<sup>158</sup> As opposed to earlier decisions fueling the argument that derivative litigation was dead, *Oracle* seemingly placed the balance back in favor of the shareholder and away from management. However, as more cases have been decided, this interpretation of *Oracle* has lost support.

#### B. Post-*Oracle* Decisions

In subsequent decisions, Delaware courts reverted back to the more narrow interpretation of director independence. However, they did so without specifically criticizing or limiting the decision in *Oracle*.<sup>159</sup> The year following the Delaware Chancery Court's decision in *Oracle*, the Delaware Supreme Court again reviewed the independence of directors in *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*.<sup>160</sup> Again, like *Oracle*, *Beam* was a high-profile case, watched closely by the legal community and the general public. However, this case seemed to contrast with the *Oracle* decision, because the court again focused primarily on economic relationships that would create a lack of independence.

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154. See *id.* at 942–43.

155. *Id.* at 947.

156. *Id.* at 943.

157. *Id.* at 936. Cf. Shevach, *supra* note 12, at 938.

158. Cosenza, *supra* note 2, at 40.

159. *Id.*

160. 845 A.2d 1040 (Del. 2004).

The court in *Beam* found that the plaintiff failed to raise a reasonable doubt that demand was futile because there was no material issue of fact regarding director independence.<sup>161</sup> The Delaware Supreme Court agreed after examining the relationships of board members with the defendant, Martha Stewart.<sup>162</sup> The underlying complaint, filed by shareholder Monica Beam, centered on Stewart's alleged breach of fiduciary duties when she sold ImClone stock.<sup>163</sup> Both courts found that Stewart and Sharon L. Patrick, an officer of the corporation who received substantial compensation, were interested parties.<sup>164</sup> The Delaware Supreme Court's inquiry focused on the remaining four directors, rejecting a number of claims by the plaintiff alleging a reasonable inference that the director in question lacked sufficient independence.

The first director in question was Director Seligman. Seligman, who was a long-time friend and business associate of Stewart's, had made calls to a third party in order to prevent negative publicity to Stewart.<sup>165</sup> This alone (and the lesser allegations regarding Director Martinez) did not raise any issues of independence.<sup>166</sup> The "closer call" according to the court was the relationship between Director Moore and Stewart, who had both attended the wedding of a mutual friend.<sup>167</sup> *Fortune* magazine had even written an article focusing on the close relationship of Moore and Stewart.<sup>168</sup>

In dealing with these relationships, the court stated that a director is unable to consider the demand only if the relationship is of a "bias-producing nature."<sup>169</sup> The court held that "[a]llegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director's independence."<sup>170</sup> The court then addressed the "structural bias" that is created because of the business and social relationships of

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161. *Id.* at 1046.

162. *Id.* at 1044.

163. *Id.*

164. *Id.* at 1044–45.

165. *Id.* at 1053.

166. *Id.*

167. *Id.* at 1053–54.

168. *Id.* at 1054.

169. *Id.* at 1050.

170. *Id.* (citing *Litt v. Wycoff*, No. Civ.A. 19083-NC, 2003 WL 1794724, at \*4 (Del. Ch. Mar. 28, 2003)).

particular individuals, further explaining that particularized facts were required in order to establish lack of independence.<sup>171</sup>

In addition to these personal relationships, the plaintiff alleged that Martha Stewart's 94% ownership of company stock would add to the inference that directors were not independent.<sup>172</sup> The ownership of stock in itself was not sufficient to raise issues of independence, because according to the court, there was not an allegation that the ownership rendered other directors "beholden" to Stewart.<sup>173</sup> The focus on whether the directors were "beholden" was again a seemingly obvious return to the pre-*Oracle* approach to independence. In *Oracle*, as explained above, the court admitted that the SLC members were not beholden to the defendants.

The court in *Beam* stated that coupling Stewart's large share of the corporation with the directors' common social circles, attendance at weddings, and business relationships prior to serving on the board of directors was not enough to render demand futile.<sup>174</sup> The court did recognize that "social relationships [c]ould become allegations casting reasonable doubt on independence."<sup>175</sup> It did not, however, explain any articulable facts or standard for finding such doubt.

*Beam* was a remarkable decision in the wake of *Oracle* because the relationships between Stewart and the directors in question were arguably much closer than the relationships between the Stanford professors and the director-defendants in *Oracle*. If the court was correct in *Oracle* regarding its assertion about "human nature" and its hypothetical regarding brotherhood, then close personal friendships should implicate the same questions of objectivity.<sup>176</sup> The Court in *Beam* addressed the differences briefly, distinguishing between the pre-suit demand context and the SLC context, and criticizing the process of the SLC in *Oracle*.<sup>177</sup> However, this analysis seems contradictory given that, in *Kaplan*, the Court clarified that the analysis is the same in either context.<sup>178</sup> Finally, the Court stated that the Stanford connection was "factually distinct from the relationships

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171. *Id.* at 1050–51.

172. *Id.* at 1054.

173. *Id.*

174. *Id.* at 1051.

175. *Id.* at 1054.

176. See Shevac, *supra* note 12, at 939–40.

177. *Beam*, 845 A.2d at 1055.

178. See *supra* notes 66–67 and accompanying text.

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present here.”<sup>179</sup> However, the Delaware Supreme Court, while noting the differences of the SLC process and merger cases, declined to explain specifically which facts created the potential bias in *Oracle*.

The *Beam* decision left open the possibility of a non-economic relationship creating a conflict of interest by acknowledging that “the balance could be tipped so that mere allegations of social relationships would become allegations casting reasonable doubt on independence.”<sup>180</sup> But *Beam* did not explain the standards for finding situations that tip the balance in a plaintiff’s favor; they were left for future cases. At a minimum, even if *Beam* was a departure from the non-economic approach in *Oracle*, it left the door open for plaintiffs to argue about specific non-economic relationships on a case-by-case basis. While this may not prove to give shareholders more practical flexibility in advancing derivative litigation, it counters the argument that the SLC and demand requirement are the death knell for derivative litigation in the post-Enron era. Conversely, the departure from the *Oracle* analysis gives credence to the argument that *Oracle* was merely a response to the post-Enron calls for more corporate oversight and shareholder protection that did not continue as a trend in Delaware corporate jurisprudence. This theory is supported by a further look into cases following *Beam*.

The decision regarding demand futility and the independence of outside directors in *In re J.P. Morgan Chase & Co. Shareholder Litigation* was an even greater departure from the analysis in *Oracle*, because the court found that even certain economic ties were insufficient to create a conflict that would excuse demand.<sup>181</sup> In *J.P. Morgan*, three directors had additional business relationships with the corporation involved.<sup>182</sup> The plaintiff alleged that this created a strong enough inference that there was a lack of independence.<sup>183</sup>

The closest parallel, factually, between *Oracle* and *J.P. Morgan* involved Director Futter and, to a lesser extent, Director Kaplan. Both were involved with the American Museum of Natural History, to which J.P. Morgan Chase contributed significantly.<sup>184</sup> Director Futter was also a trustee of the museum. The court found that plaintiffs

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179. *Beam*, 845 A.2d at 1055.

180. *Id.* at 1054.

181. *In re J.P. Morgan Chase & Co. Shareholder Litig.*, 906 A.2d 808, 812 (Del. Ch. 2005).

182. *Id.* at 822.

183. *Id.*

184. *Id.*

“never state[d] how [J.P. Morgan]’s contributions could, or did, affect the decision-making process of the president of one of the largest museums in the nation. Therefore, as alleged, the complaint [did] not demonstrate that Futter [was] not independent.”<sup>185</sup>

Contributions to a museum president (who likely participated in fundraising) would seemingly create the same concerns that existed for the professors in *Oracle* who cared about their university. The court disposed of this distinction, leaning heavily on the specific facts pleaded in *Oracle* as contrasted with those pleaded in *J.P. Morgan*. However, *Oracle* never explained how shared board memberships and contributions specifically created any type of “owingness.” Instead, it explained that the relationship was painted in “too much . . . Cardinal red.”<sup>186</sup> As the court noted, in *J.P. Morgan* the plaintiff depended on the “mere inference” that contributions affected the independence of the directors.<sup>187</sup>

Admittedly, one distinction between *Oracle* and both *Beam* and *J.P. Morgan* could be the specificity with which the particular relationships were pleaded or reviewed by the court. However, in *Oracle* it was not merely the specific facts that led to a possible lack of independence. “Human nature” created questions of independence, which also extended to relationships beyond a purely economic nature.<sup>188</sup> Seemingly, that same “human nature” could create a material issue regarding the independence of Martha Stewart’s longtime friends or the president of the American Museum of Natural History, who depended on the defendants for success of the institution.

However, the court in *J.P. Morgan* called the inference from the relationships of directors to the American Museum of Natural History “conclusory.”<sup>189</sup> Despite the fact that the specific amounts of the contributions at issue and the relationships of the *Oracle* directors to Stanford were more clearly explained by the plaintiffs in *Oracle*, the

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185. *Id.*

186. *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 947 (Del. Ch. 2003).

187. *J.P. Morgan*, 906 A.2d at 822 & n.48 (“Delaware courts have previously recognized that philanthropic relationships with institutions may give rise to questions about a director’s independence. But in those cases, the complaints had many more particularized facts about the materiality of the relationship in question that would create a reasonable doubt about the independence of the directors.” (citations omitted)).

188. See *supra* note 143–47 and accompanying text.

189. *J.P. Morgan*, 906 A.2d at 822.

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lack of an *actual* showing of a specific conflict means that the inferences made in that case were also conclusory.

If the logic in *Oracle* and dicta from *J.P. Morgan*<sup>190</sup> is to be followed by plaintiffs in later cases, pleading more specific details about the directors or SLC members is all that is necessary for an actual showing of lack of independence. However, it is difficult to see how the contributions made to the museum need more specificity to implicate the same issues as discussed in *Oracle*. *Oracle* explained that individuals involved in fundraising could be beholden to contributors based on the nature of their jobs.<sup>191</sup>

Again, as in *Beam*, there may not be an actual distinction between the facts of *J.P. Morgan* and *Oracle*. Instead, it may just be a shift back toward the long-standing rule requiring an economic relationship of control. The pleading distinction made by the court in *J.P. Morgan* may be a way for the court to allow dismissal without overturning *Oracle*. Ultimately, dismissal is a sign of reduced shareholder protection. This leaves plaintiffs in a difficult position. Even if the law under *Oracle* is favorable, the limited access to discovery (which would be available in other jurisdictions that have adopted the Model Business Corporation Act) creates difficulty in learning the nature of specific relationships that rise to the level of those in *Oracle*.

Despite the focus in the *J.P. Morgan* decision on pleadings, the factual similarity to the language of *Oracle* signals a departure from *Oracle*. The *J.P. Morgan* approach is less protective of shareholders, but leaves the door open for future factual reviews of the individual relationships of each director, to be examined by the courts on a case-by-case basis.

This case-by-case basis was used to determine demand futility in the 2007 decision of *In re infoUSA, Inc. Shareholders Litigation*.<sup>192</sup> *InfoUSA*, citing *Beam*, acknowledged that personal friendships could raise a reasonable doubt about independence, yet the case found no lack of interest on this basis.<sup>193</sup> Furthermore, *infoUSA* relied on *Orman* for the proposition that beyond personal or family relationships, a director must be beholden to the defendant to raise a

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190. *Id.* at 822–23 n.48.

191. See *supra* note 126–47 and accompanying text.

192. *In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963 (Del. Ch. 2007).

193. *Id.* at 985–94.

material issue regarding independence.<sup>194</sup> This is interesting, because like many other cases on independence, there is no cite to the analysis in *Oracle* that applied “human nature” to the particular facts when finding a lack of independence.

The *infoUSA* case had some seemingly relevant factual similarities to *Oracle*: it involved university contributions, board positions, and professors. In *infoUSA*, Vinod Gupta was a director, CEO, and 41% shareholder of *infoUSA*.<sup>195</sup> He was a substantial contributor to Creighton University.<sup>196</sup> In *infoUSA*, one director at issue in the independence inquiry, Raval, was a professor at Creighton University, chair of the accounting department, and a board member of the university.<sup>197</sup> Raval received a \$50,000 grant through the V. Gupta School of Business Administration. Director Reznicek was a former dean at the Creighton University College of Business Administration.<sup>198</sup> Director Haddix was a board member at Creighton and served on an advisory council to the school of business administration.<sup>199</sup> Haddix went on personal trips with Gupta on the *infoUSA* company jet.

Again, as in the previously discussed cases, the court analyzed the ties between each director and the defendant. The allegations raising questions of independence regarding Director Raval were: Raval’s salary as a board member was greater than the average salary of a professor at Creighton University, he had received a grant from the V. Gupta School of Business Administration, and defendants Haddix and Gupta had “professional ties with his employer.”<sup>200</sup> The court found a sufficient lack of independence, not because of the salary issue, but because there was a risk that defendant’s presence on other boards could affect Raval’s advancement.<sup>201</sup> Again, Raval’s relationship to Gupta was similar to the relationships in *Oracle*. However, the court did not distinguish or even reference *Oracle*.<sup>202</sup> At the same time, it relied on *Beam* and *Orman* for its standards in

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194. *Id.* at 985.

195. *Id.* at 980.

196. *Id.* at 979.

197. *Id.* at 974.

198. *Id.* at 979.

199. *Id.*

200. *Id.* at 992.

201. *Id.*

202. *See id.*

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determining independence.<sup>203</sup> This suggests a retreat from *Oracle*'s expansive view of independence.

In *infoUSA*, it was not Raval's involvement with Creighton University and grants from institutions funded or named for Gupta that caused an awareness of the effects on the institution (as was the case in *Oracle*).<sup>204</sup> Instead, the court used the traditional view of "control" finding that the risk of professional advancement raised an issue of independence. While the outcome may have been the same as in *Oracle*, the manner in which the court reached its conclusion was evidence that human nature and non-pecuniary relationships are not the applicable standards, or if they are, they only apply to an SLC.

Regarding Director Haddix, beyond the long-standing personal and business relationship with Gupta, Haddix received free office space in a building owned by *infoUSA*.<sup>205</sup> In its analysis, the court did not address the board membership at Creighton or the personal relationship, but only the recommendation from an *infoUSA* report, which had found that the office space could create a conflict.<sup>206</sup> Again, without even addressing the shortcomings of the allegations, the court seemed to disregard the type of issues that were so prevalent in *Oracle*.

Clearly, the plaintiff in *infoUSA* alleged facts that raised issues similar to those presented in *Oracle*. Perhaps the court's quick disposal of these issues signals the lack of deference Delaware courts give to the *Oracle* decision. Or perhaps the court found that the lack of director independence was sufficient to show demand futility and chose not to address relationships that were immaterial to the outcome of the case. Either way, one could interpret *infoUSA* as yet another decision chipping away at the shareholder protection that *Oracle* generated.

The actual similarities in *J.P. Morgan* and *infoUSA* are the greatest evidence that *Oracle* may be minimally persuasive to Delaware courts. In the nearly six years since *Oracle* was decided, three cases have distinguished it, all finding that the pleadings were

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203. *Id.* at 985.

204. *Id.* at 992 ("[S]uch allegations [of payment of director's fees], without more, do not establish any financial interest,' . . . [To hold otherwise] would be to discourage the membership on corporate boards of people of less-than extraordinary means." (alterations in original) (citation omitted)).

205. *Id.* at 979.

206. *Id.* at 993.

insufficient to demonstrate issues of independence.<sup>207</sup> Some courts have recognized the rule in *Oracle* that independence may be questioned for “any substantial reason.”<sup>208</sup> However, many of these decisions merely cited *Oracle*, and still found that the SLC or directors were sufficiently independent.<sup>209</sup>

Courts have even acknowledged the *Oracle* explanation that independence is “not tested merely on economics.”<sup>210</sup> In Delaware, however, even when citing *Oracle*, the courts are requiring a showing that a director is beholden to the defendant.<sup>211</sup> In *Sutherland v. Sutherland*, the court stated that the inquiry from *Oracle* is a “narrow one,” focusing solely on independence, and not the reasonableness or good faith of the SLC.<sup>212</sup> Ultimately, though citing *Oracle*, the court found that a single-member SLC was sufficiently independent.<sup>213</sup> The SLC member had performed significant accounting services for the defendant’s wife, had known the defendant and his wife socially for over fifteen years, and received payments for his role as an SLC even after his report was complete.<sup>214</sup>

*Biondi v. Scrushy*, decided in late 2003, provides some evidence that *Oracle* was not alone in the inferences to be drawn from non-economic relationships.<sup>215</sup> In *Biondi*, the court found an issue of

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207. See *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1054 (Del. 2004); *In re J.P. Morgan Chase & Co. S’holder Litig.*, 906 A.2d 808, 824 (Del. Ch. 2005); *In re Verisign, Inc. Derivative Litig.*, 531 F. Supp. 2d 1173, 1189 (N.D. Cal. 2007).

208. See *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 929–35, 938 (Del. Ch. 2003); *Sutherland v. Sutherland*, 958 A.2d 235, 239 (Del. Ch. 2008); *St. Clair Shores Gen. Employees Ret. Sys. v. Eibeler*, No. 06 Civ. 688 (SWK), 2008 WL 2941174, at \*7 (S.D.N.Y. July 30, 2008); *McSparran v. Larson*, No. 04-C-0041, 2006 WL 2052057, at \*3 (N.D. Ill. May 3, 2006); *Atl. Coast Airlines Holdings, Inc. v. Mesa Air Group, Inc.*, 295 F. Supp. 2d 75, 86 (D.D.C. 2003).

209. See *Sutherland v. Sutherland*, 958 A.2d 235, 239 (Del. Ch. 2008); Official Comm. of Unsecured Creditors of Integrated Health Serv., Inc. v. Elkins, No. 20228-NC, 2004 WL 1949290, at \*10 (Del. Ch. Aug. 24, 2004); *Atlantic Coast Airlines Holdings, Inc. v. Mesa Air Group, Inc.*, 295 F. Supp. 2d 75 (D.D.C. 2003).

210. *Integrated Health Serv.*, 2004 WL 1949290, at \*10; *In re Enivid Inc.*, 345 B.R. 426, 448 (Bankr. D. Mass. 2006).

211. See *Integrated Health Serv.*, 2004 WL 1949290, at \*10 (“[W]hile domination and control are not tested merely by economics, a plaintiff must allege some facts showing a director is *beholden* to an interested director in order to show a lack of independence.” (citations omitted)).

212. *Sutherland*, 958 A.2d at 239 (citing *Oracle*, 824 A.2d at 947).

213. *Id.* at 240.

214. *Id.* (alleging a “secret financial relationship” between SLC member and defendant).

215. 820 A.2d 1148 (Del. Ch. 2003).

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independence where the SLC members and the defendant, Scrushy, served together on boards for the National Football Foundation and College Hall of Fame, Inc.<sup>216</sup> Scrushy chaired one of those boards.<sup>217</sup> The College Hall of Fame had an award named for Scrushy's corporation, "suggesting that the company, under Scrushy's managerial leadership, [had] been quite generous with a cause very important to [the SLC member]."<sup>218</sup> The court found that the long-standing personal ties between the defendant and the SLC member and the fact that both contributed to "college sports programs in Alabama" demonstrated a lack of independence.<sup>219</sup>

*Biondi* seems to be a rare decision with a similar outcome to *Oracle*. The timing of *Biondi*, which was decided only months following *Oracle*, but prior to *J.P. Morgan, Beam*, and *infoUSA*, indicates that inquiries into independence expanded following the Enron scandal. The specific facts in those three cases seemingly would implicate the same issues of independence in *Biondi* and *Oracle*. These more recent decisions suggest that the more expansive definition of independence articulated in *Biondi* and *Oracle* are not a trend, let alone the law in Delaware.

When looking at the facts of these cases where independence was in question when terminating litigation, *Oracle* does not seem to be persuasive law. In *Beam*, Martha Stewart had close personal relationships with many of the directors. The link between her friends, as opposed to the donations and common Stanford ties in *Oracle*, were stronger relationships where "human nature" would likely threaten a truly independent review. However, the court in *Beam* found that demand was not excused, meaning that there were insufficient facts to raise a reasonable doubt regarding independence.

Similarly, the result in *J.P. Morgan* was at odds with the reasoning of *Oracle* in the same respects. Significant donations to the American Museum of Natural History are no different than significant donations to Stanford. Furthermore, Director Futter in *J.P. Morgan* was actually economically dependent on donations, considering his position as director of the museum. There were some additional ties alleged in *Oracle*, but if the personal friendships in *Beam* were not enough, and the inquiry is truly focused on "human nature," then

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216. *Id.* at 1157.

217. *Id.*

218. *Id.*

219. *Id.*

there is no reason why the demand requirement should be excused in *J.P. Morgan*, just as the SLC's determination in *Oracle* was not to be respected.

Finally, *infoUSA* is another clear demonstration of the departure from *Oracle*. Shared ties to Stanford created too much "Cardinal red," but strikingly similar ties to Creighton University in *infoUSA* did not even prompt the court to cite *Oracle*, let alone find a lack of independence on those same grounds. These cases discussed above involved relationships as close as or even closer than the ties at issue in *Oracle*, yet the courts found no lack of independence. It does not appear that decisions subsequent to *Oracle* were distinguishable because the relationships in question were weaker. If this were the case, then the courts should have or would have cited, compared, or distinguished *Oracle*. Reliance on *Oracle* would have demonstrated the decision's authority as law in Delaware. *Oracle*, however, stands as something of an anomaly.

*Oracle* seems to be inconsistent with decisions both preceding and following it. It may just be a high-water mark in finding a lack of independence. One thing is clear, however: other courts have struggled to determine what it actually means.<sup>220</sup> In 2006, a Massachusetts court noted that "[a]s observed by other courts, the [Delaware] case law is not entirely free from ambiguity or inconsistent application."<sup>221</sup> Even Delaware courts have recognized the ambiguity in testing independence, stating, "there is no bright line test for gauging director non-independence . . .".<sup>222</sup>

#### IV. CONCLUSION: STRIKING THE PROPER BALANCE AFTER *ORACLE*

Delaware courts have avoided repeating the *Oracle* analysis by granting motions to dismiss based on the pleadings, such as in *Beam* and *J.P. Morgan*. Perhaps *Oracle* has been flat-out ignored, even in strikingly similar factual circumstances like those in *J.P. Morgan* and *infoUSA*. At most, *Oracle* is used as a recent statement of the basic law regarding review of SLC determinations. In reviewing the case law before and after, it does not appear as if the standards for

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220. See, e.g., *Blake v. Friendly Ice Cream Corp.*, No. Civ. 03-0003, 2006 WL 2714976, at \*1 & n.5 (Mass. Super. Ct. Aug. 24, 2006).

221. *Blake*, 2006 WL 2714976, at \*1.

222. *Off v. Ross*, No. Civ. A. 3468-VCP, 2008 WL 5053448, at \*11 (Del. Ch. Nov. 26, 2008).

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determining independence have expanded since *Oracle*. This may again increase speculation that derivative litigation is either dead or under-protective of shareholders. The question remains whether the *Oracle* approach to determining independence is beneficial.

For shareholders, the benefit may be that courts are looking more closely at the particular facts and relationships between directors who terminate derivative suits and other corporate officers. However, based on the examination of the subsequent case law, even this may not be the case. Have corporate boards and SLCs maintained their pre-Enron power to terminate litigation? Or does *Oracle* give some hope to shareholders that the process will be examined more closely than in the past? SLCs may have judicial blessing, but they will not have unfettered control.

This section discusses two major problems with the approach in *Oracle*. First, finding a lack of independence based on circumstantial inferences and “human nature” strips corporations of their ability to eliminate litigation that is costly, ultimately harming the value of corporate shares. Secondly, the court’s departure in *Oracle* from an economic test of “beholden-ness” (as used in *Orman v. Cullman*<sup>223</sup>) creates a rule without any real standards to apply. If there had been an actual legal standard in *Oracle*, it would have been applied consistently in *Beam*, *J.P. Morgan*, and *infoUSA*. A contextual test based on “human nature” cannot be applied consistently and therefore cannot give guidance to corporations when creating SLCs to review derivative suits.

#### A. Oracle Is Under-Protective of a Corporation’s Ability to Terminate Derivative Suits

The creation of SLCs and the development of the demand requirement allow corporations to address derivative litigation in a manner that protects the corporation. These hurdles are the most recent protections in the long evolution of mechanisms that deter frivolous suits or suits based on a desire to harass or further a personal interest. The approach in *Oracle* would allow suits to go forward as long as a plaintiff could plead some type of professional, academic, or personal history between disinterested directors or SLC members and the named defendants.

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223. See generally *Orman v. Cullman*, 794 A.2d 5 (Del. Ch. 2002).

As discussed above, the court in *Oracle* found that limiting the independence analysis simply to economic interests reduces the sensible view of human nature.<sup>224</sup> First, adopting *Oracle*'s view would excuse demand or taint an SLC for nearly any relationship between a named defendant and another director or SLC member not involved with the transaction at issue. Practically any member serving on a corporate board will have some type of relationship, both personal and professional, with management or other members of the corporation's board. If the *Oracle* decision is correct, demand could be futile in any case because board members serving together will have a wide variety of past connections and personal or professional relationships. This is especially true in light of challenges in finding outside directors who have both some knowledge of a corporation's business or industry and are willing and financially able to serve.

As to SLC members, finding and locating members of a committee who can adequately review and assess proposed litigation requires knowledge of the particular industry and the specific corporation involved. Identifying members with no prior relationships which would implicate the motivations of "human nature" will not only be costly, but also likely impossible. Again, it is foreseeable that under the *Oracle* approach, no SLC determination would be respected. Instead of signaling the death of the derivative suit, the thirty-year history of the SLC and its use would be eliminated.

Following *Oracle*, a court could focus on any similarities with *Oracle* that extend beyond economic ties. This could include any prior ties to the same institution, regardless of whether those ties implicate "beholden-ness." Going forward, a director or SLC member who works for a university would lack independence if the defendant worked for that same institution or donated to it. Similarly, a prior relationship such as student to a professor would taint independence. The ramifications of this focus on "human nature" instead of direct economic relationships have likely been recognized in Delaware. Perhaps this is the reason why the same analysis did not apply to Martha Stewart's friends in *Beam*, Director Futter in *J.P. Morgan*, or Director Gupta in *infoUSA*. In those cases, the corporations at issue would have been powerless to dismiss the suits and save shareholders from paying litigation expenses.

The demand requirement and SLC mechanisms allow a corporation to decide for itself whether suing its directors or

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224. See *supra* text accompanying notes 137–42.

management is cost-effective. More importantly, the hurdle allows termination prior to reaching the summary judgment stage of litigation. While summary judgment is a valuable tool in disposing of non-meritorious suits, even getting to that phase can still be expensive and time consuming. The corporation itself bears these expenses, meaning that one shareholder can initiate a suit at the expense of all other shareholders. By simply alleging a personal or non-economic relationship, a plaintiff can forego the demand requirement or the SLC's recommendation. Again, the result is that a single shareholder can commence a frivolous suit for the purpose of harassment or furthering a personal interest against a particular individual in a corporate leadership role. This would be a return to the pre-SLC days and the ineffective procedures used in the past.<sup>225</sup>

Conversely, requiring that there be either an economic interest or beholden-ness would disqualify SLC members or excuse demand when appropriate. This strikes the correct balance. Anyone who stands to benefit financially or risks losing his livelihood or other pecuniary interests cannot make decisions independently. Admittedly, directors and SLC members have motivations based on personal relationships or even friendships that could affect their decisions. However, the position taken in *Oracle* ignores the fact that these same SLC members and directors have their own countervailing motivations such as professional and personal reputation, which would temper the desire to terminate litigation solely to protect friends and associates.

Interestingly, despite the approach in *Oracle*, which denied the SLC's recommendation because of a lack of independence by its members, the case was ultimately resolved for the defendants on a motion for summary judgment.<sup>226</sup> The outcome of the case is important because while it does not change the original decision, it demonstrates that eventually the court agreed with the SLC that the litigation should be terminated. According to the decision, the SLC lacked independence because of the numerous non-economic ties shared between the members, the defendants and Stanford University. However, according to the court's final affirmation of the trial court's decision, the SLC's recommendation was correct. By denying the recommendation based on "human nature" and "sensibility," which tainted the SLC decision, the court essentially required shareholders

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225. See *supra* text accompanying notes 23–27.

226. See *In re Oracle Corp. Derivative Litig.*, 867 A.2d 904, 906 (Del. Ch. 2004).

to foot the bill for additional litigation expenses to reach the same result. Although it is only one case, the result proved that the SLC was able to make the correct decision, despite prior personal and educational relationships with the defendants.

If the Delaware courts had continued to follow *Oracle* in cases such as *Beam*, *J.P. Morgan*, and *infoUSA*, it is possible that in those instances excusing demand and requiring the litigation to advance to the summary judgment phase would have also resulted in dismissal. Again, shareholders would be required to pay for non-meritorious suits because directors and defendants had personal relationships that implicated a lack of independence based on “human nature,” yet did not threaten any type of economic interest. By inferring that an individual lacks independence because of shared ties to institutions or long-standing personal relationships, courts would create a risk of drawing out suits and decreasing the value of shares. Alternatively, using the *Orman v. Cullman* test and requiring an actual economic interest ensures that plaintiffs get fair decisions by the SLC or directors, and also that corporations have some power to stop suits without bearing undue litigation expenses. The *Oracle* analysis, which seems to be the highest level of scrutiny for determining independence, exposes corporations to costly derivative suits without the ability to review and dismiss them at the appropriate stage. The *Oracle* approach should, and seemingly has been, disregarded by Delaware courts.

#### *B. Oracle Lacks a Clear Method and Factors for Determining a Lack of Independence*

Prior to *Oracle*, the well-settled principle for finding a lack of independence was based on “domination” and “control.”<sup>227</sup> Domination and control required a showing of some type of economic beholden-ness to the defendant in question. The test was clear and could be applied to any type of relationship or transaction. *Oracle* rejected that approach and expanded independence inquiries beyond economic ties.<sup>228</sup> However, other than identifying the specific relationships between the defendants and SLC members in *Oracle*, the court gave little guidance as to what precisely can taint

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227. See, e.g., *Orman v. Cullman*, 794 A.2d 5, 20 (Del. Ch. 2002).

228. See *Oracle*, 867 A.2d at 936.

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independence other than to “measure the SLC’s independence contextually.”<sup>229</sup>

A contextual approach to each case would suggest that there is no bright-line test for relationships that do not implicate domination and control. Instead, each case could be decided on its own facts. *Oracle* cited a number of relevant facts regarding the defendants’ relationship to the SLC member, none of which implicated direct economic consequences to the SLC members. However, after stripping away the relationships that subsequent cases disposed of, there are no clear factors left to use in applying the *Oracle* approach; all that remains are conclusory statements of there being “material factual question[s] about independence” in the case.<sup>230</sup>

Based on case law, personal relationships cannot be enough to implicate a lack of independence. In *Beam*, Director Moore had a close relationship with Martha Stewart; they both attended the wedding of friends and had their relationship featured in *Fortune*.<sup>231</sup> Based on the facts from each decision, no SLC member had as close a personal or social relationship with the defendants in question. This means that the weight of personal and social ties is a limited factor in the “contextual inquiry.”

Similarly, ties to an institution are not the main factor. While the *Oracle* court acknowledged that the social atmosphere was “painted in too much vivid Stanford Cardinal red[,]”<sup>232</sup> the exact same types of institutional ties and donations to the American Museum of Natural History in *J.P. Morgan* and Creighton University in *infoUSA* did not create a sufficient issue regarding independence. Therefore, contextually, institutional ties, donations, or alumni giving cannot be dispositive.

While the specific factors of each case are discussed in greater detail above in Part III, it is important to reiterate that, contextually, cases subsequent to *Oracle* give little or no weight to similar circumstances. Furthermore, these cases fail to give any weight to the *Oracle* decision because none of them cite *Oracle*’s rule that independence is a contextual inquiry. The contextual inquiry is a

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229. *Id.* at 941.

230. *Id.* at 942 (“Using the contextual approach I have described, I conclude that the SLC has not met its burden to show the absence of a material factual question about its independence.”).

231. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1053–54 (Del. 2004).

232. *Oracle*, 824 A.2d at 947.

difficult standard to apply, because it means each case is determined on its own facts. Secondly, the important factors in *Oracle* have diminished value because later cases have been decided to the contrary despite similar contexts. In that light, there is nothing left from *Oracle* that either can be or has been applied by the courts.

Lending support to the argument that *Oracle* was merely a response to the post-Enron criticisms of corporate operations and law, the court cited contemporary congressional enactments that endorsed a similar situational approach.<sup>233</sup> The *Oracle* decision definitely catered to criticisms of corporate law, yet by analysis of subsequent cases and factors, it seems to have been a one-time only approach. Calling it a “contextual inquiry” may be its best defense as law and the most convenient way to explain its anomalous analysis and outcome. Fortunately, this result also allows courts to avoid relying on *Oracle* because it lacked a clearly applicable rule and (as discussed above in Part IV.A) adopting its approach would result in greater exposure for corporations to costly and potentially frivolous litigation.

The Delaware courts have returned to focusing on the economic analysis stated in *Orman v. Cullman*.<sup>234</sup> A standard focusing on economic ties and domination and control not only makes sense legally because it reflects a true “interest” in the outcome of the litigation, but also because it is easier to apply. The *Oracle* approach would leave future courts the ability to infer issues of independence without stating the precise ties that taint independence. This gives courts too much flexibility and too little in the way of established principles. It gives no indication to corporations as to how to construct SLCs. As for the demand context, a corporation would be well-advised to find completely isolated directors so as not to implicate a lack of independence in the event of derivative suits. This would be the case regardless of whether the suits had merit or were baseless.

Under *Oracle* (without the subsequent decisions) courts must speculate about what factors actually should carry weight. Again, this ambiguity is not only a reason why *Oracle* should not be followed, but also is possibly a reason why subsequent decisions have ignored it and yielded seemingly contrary results on facts that were hardly distinct.

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233. *Id.* at 941 n.62.

234. See *supra* text accompanying notes 83–84; *Orman v. Cullman*, 794 A.2d 5, 24–31 (Del. Ch. 2002).

*C. Delaware Courts Have Properly Retreated from the Oracle Standard*

While the widely held belief is that the law in Delaware is ambiguous regarding independence in the context of derivative suit termination,<sup>235</sup> perhaps the law is clear in that *Oracle* will not be followed so closely again. There is no explicit indication from either the Delaware Court of Chancery or the Delaware Supreme Court that *Oracle* has been overturned. However, this review of the subsequent case law, the factual similarities and the seemingly obvious refusal of Delaware courts to cite *Oracle* for its independence analysis suggests that non-economic ties simply are not enough to taint the independence of an SLC or excuse the demand requirement.

While the propositions discussed above in Parts IV.A-B are two reasons that *Oracle* may not be the proper approach to independence inquiries, there is no case law specifically explaining why the Delaware courts have departed from it. The long held standards of deferring to SLCs and the history of allowing derivative litigation to be terminated (as discussed in Part II) are evidence of the prevailing policy: corporations should have the ability to deflect suits that do not ultimately benefit shareholders. An understanding of the history of Delaware law concerning derivative litigation, coupled with a survey of the facts of cases and relationships since *Oracle*, shows that the law is not ambiguous. Simply put, *Oracle* was a response to scandals like those involving Enron and WorldCom, but it has not maintained its persuasiveness.

*Oracle* may allow plaintiffs a greater opportunity to challenge the independence of a board or SLC. The *Oracle* approach creates a heightened scrutiny on director and SLC independence. However, ultimately, independence can only be tainted through economic ties, i.e., “domination and control,” and not merely by social relationships or “human nature.” This approach is the best way to balance the needs of corporate entities and shareholders. The standard is clear, it is well defined, and despite the belief that Delaware law has been ambiguous since *Oracle*, it is the method still employed by Delaware courts.

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235. See *supra* text accompanying notes 2, 220–22.

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