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Delaware Chancery Court Renders Important Decision On SLC Investigations

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It is commonplace for corporations to appoint special litigation committees in response to putative derivative lawsuits filed against their officers and directors under Delaware or other state law. The special litigation committee's conclusions with respect to putative derivative claims frequently have dispositive effect. If the SLC determines, after a thorough investigation, that the claims are meritless or their pursuit not in the corporation's best interest, the committee's motion to dismiss the lawsuit will be granted. If it determines that the lawsuit should be pursued, its motion to realign frequently will be granted. The Delaware courts often have emphasized, however, that for the SLC investigation to have dispositive effect, the investigation must be independent, conducted in good faith, and reasonable. In short, how the investigation is conducted is critical.

Over four years ago, in In re: Oracle Corp. Derivative Litig., 824 A.2d 917, 938 (Del. Ch. 2003), the Delaware Chancery Court issued an important decision on the "independence" requirement. Despite noting that nothing in the record led the Court to believe that either SLC member did "anything other than discharge their duties with fidelity," the Court denied the SLC's motion to terminate. The basis of this decision was the lack of independence of the two members of the SLC, both Stanford professors. During discovery, numerous ties emerged between Stanford, Oracle and several individual defendants, none of which were disclosed in the extensive report prepared by the SLC, and which the Court found "generate[d] a reasonable doubt about the SLC's impartiality[.]" In light of Oracle Corp. any company considering an SLC—and any counsel advising them—should take care to explore and to report in detail on any personal interests that members of the SLC may have in the disputed transactions, as well as the relationship of SLC members with the interested directors.

On May 5, 2008, in Sutherland v. Sutherland, C.A. No. 2399-VCL (Del. Ch. May 5, 2008), the Court issued a similarly important decision on the "good faith" requirement. Sutherland should be read closely by any corporation considering a SLC investigation, as well as by SLC members and counsel conducting such an investigation. Sutherland involved the good faith of an investigation conducted by a single-member SLC into transactions between a closely-held corporation and two of the three directors of that corporation. The SLC concluded that the transactions did not violate the directors' fiduciary duties and moved to dismiss. The court rejected that motion, finding that the SLC had not proved that its investigation was conducted in good faith.

At the beginning of his opinion, Vice Chancellor Lamb issued a reminder that the "SLC is not entitled to any presumptions of independence, good faith, or reasonableness" and that, in particular, "one-member SLCs are less insulated from the influence of interested directors, and are closely scrutinized." He then rejected the SLC report because: (1) the SLC had included exculpatory information about certain payments in its report while omitting any mention or analysis of large, possibly suspicious payments of similar character; (2) the interview memoranda prepared by counsel to the SLC were perfunctory and several of the most important interview summaries failed to record witnesses's answers at all; (3) counsel failed to prepare a plan of investigation or to keep notes of his investigation of certain company records; (4) the SLC report was "wholly devoid of citations to key documents or interview summaries"; and (5) the SLC did not enter any of the underlying documents, interview summaries or affidavits into the record.

Sutherland is an important reminder of the care that is required for the conduct of SLC investigation and for the preparation of SLC reports.

For more information, please contact Lewis Liman, Evan Davis or Mitchell Lowenthal in the Firm's New York office (212-225-2000), or any of your firm contacts.

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