Harvard Law School Forum on Corporate Governance

Ruling Provides Roadmap For Navigating Transactions With Fiduciary on Both Sides

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The mere *potential* for a prominent, highly respected officer, director and minority holder to influence a board's decision to approve a deal where the minority holder sits on both sides is insufficient to confer controller status and invoke entire fairness review, the Delaware Court of Chancery held post-trial in *In re Oracle Corporation Derivative Litigation*.[1]

The May 2023 ruling by Vice Chancellor Glasscock also commends the robust process employed by a "well-functioning" independent special committee with independent advisors. Companies and corporate practitioners considering a potentially conflicted transaction can look to *Oracle* for guidance about how to successfully navigate such a transaction and avoid pitfalls.

Background

Between 2006 and 2015, Oracle Corporation closed over 100 strategic acquisitions. At a January 2016 meeting of Oracle's board of directors, Oracle management identified Netsuite Corporation as a potential takeover target. Before management's presentation, Larry Ellison — director, officer, founder and "face" of Oracle — left the room and recused himself from the discussion. Ellison, who also co-founded and served as a director of Netsuite, owned 39.8% and 28.4% of Netsuite and Oracle stock, respectively.

After discussion, the board decided to explore a potential transaction with Netsuite and authorized Safra Catz, Oracle's chief executive officer, to connect with Netsuite's executives to gauge interest. When word of the possible acquisition reached Evan Goldberg, Netsuite's other co-founder, he expressed his displeasure to Ellison. Ellison shared details of Oracle's strategy for Netsuite post-acquisition and reassured Goldberg that, in the event of a transaction, Oracle planned to retain Netsuite's management.

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[1] C.A. No. 2017-0337-SG (Del. Ch. May 12, 2023)

In March 2016, the board, minus Ellison, who recused, approved the creation of a special committee of independent directors to negotiate the potential Netsuite transaction. The special committee was empowered to assess alternatives, negotiate the transaction, and approve or reject the transaction. The special committee retained independent legal and financial advisors,[2] and implemented "rules of recusal" that "prohibited Ellison from discussing the Transaction with anyone but the Special Committee; required Oracle employees brought in to assess the Transaction to be made aware of Ellison's recusal; and forbade Oracle officers and other employees from participating in the negotiation process absent Special Committee direction." Over a seven-month span, the special committee met 15 times to evaluate the transaction.

In June 2016, the special committee and Netsuite exchanged multiple offers and counteroffers. Eventually, frustrated that Netsuite's counterproposals were not proportional to the special committee's moves, the special committee declined to counter and was "prepared to let the deal die." In mid-July 2016, negotiations resumed and the special committee communicated its best and final offer of $109 per share, one dollar less than the ceiling Oracle had set internally. Netsuite accepted the same day. The transaction closed in November 2016.

In 2017, stockholder plaintiffs initiated a lawsuit against the board and certain Oracle officers alleging that Oracle overpaid for Netsuite. Central to plaintiffs' complaint were allegations that Ellison used his outside influence to cause Oracle to acquire Netsuite at a premium. Over six years, the action took a "circuitous and procedurally complex path to trial" that involved, *inter alia*, the court's issuance of six memorandum opinions; the creation of a special litigation committee which in a "surprising" move declined to take over the derivative litigation or dismiss it; a motion to intervene; numerous amended complaints; and plaintiffs' voluntary dismissal of several defendants. At the time the court issued its post-trial decision, only Ellison and Catz remained as defendants.

Applicable Standard of Review

Though Ellison, as a director and officer, stood on both sides of the transaction, the court found that, throughout the process, he appropriately insulated himself from the board's discussion of the deal. Specifically, Ellison withdrew from Oracle's consideration of a Netsuite acquisition *before* management's initial presentation to the board and the remaining directors empowered an independent special committee to negotiate the transaction on Oracle's behalf.

By the time of trial, plaintiffs no longer contended that two of the three special committee members were dependent on Ellison or otherwise conflicted. After trial, plaintiffs dropped their challenge against the third committee member that was based on the member's "reliance" on Ellison to help her become a CEO in the technology industry. (The court described this failed theory as having "some odor of denigrating the abilities of women executives to succeed based on their own merits.")

Ultimately, the court held that the special committee process was adequate to cleanse Ellison's conflict. Thus, the court held that the transaction would be analyzed under the business judgment rule unless plaintiffs could prove either that: (i) Ellison was a "controller" on both sides of the deal

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[2] Skadden advised the special committee.

or (ii) Ellison on his own, and through Catz, misled the Oracle board and the special committee, thereby rendering the transaction a product of fraud.

No Controlling Stockholder

The court rejected plaintiffs' argument that Ellison was a controller, first observing that, with less than 30% of Oracle's voting stake, Ellison did not exert "hard" control over the company. Instead, the court focused on whether Ellison dominated Oracle's corporate conduct, and found that claim lacked merit, saying that Ellison did not exercise control generally in regard to Oracle's operations. Ellison had relinquished executive control years earlier when he stepped down as chief executive officer, and the board was not afraid to stand opposed to Ellison.

Nor did Ellison attempt to exert control over the Netsuite acquisition, even though, as the court remarked, he could have "if he had so desired." As a director and officer, Ellison "scrupulously avoided influencing the transaction." Additionally, the board (without Ellison), created a special committee fully empowered to negotiate an acquisition and consider alternatives, including not buying NetSuite. Ellison's lack of contact with the special committee coupled with the fact that the special committee "vigorously bargained" on price and "demonstrated a willingness to walk away" from the transaction lead the court to conclude that the transaction was not a controlled transaction; rather "[t]his transaction was negotiated at arm's length by a fully empowered Special Committee."

Plaintiffs argued that, nonetheless, Ellison wielded transaction-specific control because (i) he proposed the transaction; (ii) his Netsuite holdings were coercive in that Netsuite principals felt an obligation to sell; and (iii) he drove the deal through Catz, who acted as Ellison's "surrogate."

The court found assertions (i) and (iii) completely unsupported by the trial record. Though Ellison had been a long-time proponent of an eventual Oracle/Netsuite transaction, at the time management presented Netsuite as a target, Ellison did not advocate for or against the transaction. And, the court emphasized that the independent and disinterested special committee, aided by its "highly experienced" independent advisors, ran the transaction, not Catz. Catz, as Oracle's CEO, was "fundamental to the ultimate deal," but her actions "demonstrate[d] loyalty to the company, not Ellison's conflicted interest."

Finally, with respect to the claim that Ellison forced Netsuite to sell, the court found that any influence Ellison exerted at Netsuite did not amount to control over Oracle.

In short, the court acknowledged that, while Ellison was a "force" at Oracle, that did not translate in the context of this transaction to Ellison acting as a controller and did not warrant an entire fairness review solely because he had the *potential* to assert influence over the board: "The concept that an individual — without voting control of an entity, who does not generally control the entity, and who absents himself from a conflicted transaction — is subject to entire fairness review as a fiduciary solely because he is a respected figure with a potential to assert influence over the directors, is not Delaware law."

No "Fraud on the Board"

Plaintiffs also argued that Ellison and Catz perpetrated a "fraud on the board" by failing to disclose facts relating to Netsuite's value, as well as Ellison and Catz's purported interactions with Netsuite, tainting the special committee's decision-making process.

The court held that none of plaintiffs' alleged omissions were material. For example, it rejected plaintiffs' theory that Ellison misled the Oracle board by failing to disclose his belief that Oracle would "crush" Netsuite (its purported competitor) and depress its stock price unless Netsuite changed course based on Ellison's advice. Among other reasons, the court noted that Netsuite and Oracle were not significant competitors and that Netsuite was in the process of making changes based on Ellison's critiques.

Another claim grounded on Ellison's failure to disclose the phone call with Netsuite's Goldberg in which he mused that Oracle would retain Netsuite management was also rejected. The court held, based on the trial evidence, that this did not impact the special committee's process. Though the court acknowledged best practices dictate erring on the side of disclosure, Ellison's "non-committal statements" to Goldberg were consistent with and typical of Oracle's practice in past acquisitions.

The court also found claims that Catz mislead the special committee by failing to disclose preliminary discussions about price with Netsuite executives, and by creating artificially inflated projections, were not supported by the evidence at trial.

Ultimately, because the court rejected both of plaintiffs' theories as to why the transaction warranted entire fairness review, the court applied the business judgment rule and found in favor of Ellison and Catz.

Key Points

- The *Oracle* decision provides a roadmap for how to successfully navigate a situation where a founder, director and officer with a significant reputation and influence sits on both sides of a deal.
- The court took a very pragmatic approach to assessing control, concluding that plaintiffs fell short at trial of demonstrating that Ellison *actually* either dominated Oracle at the time of the transaction, or attempted to wield control specifically in connection with the Netsuite acquisition. Even assuming that Ellison "had the potential to influence the transaction," he did not attempt to, and did not interfere with the special committee's process. Indeed, the court emphasized Ellison's early and complete recusal from any aspect of the special committee's process as an important factor in its decision.
- In many respects, the *Oracle* decision turns on the integrity and effectiveness of the special committee process. Having a properly empowered special committee comprised of independent, disinterested directors was crucial. Moreover, the trial record clearly reflected an independent and robust process: In addition to considering alternatives to Netsuite, the special committee was prepared at one point "to let the deal die rather than increase Oracle's offer."
- The *Oracle* decision also underscores the importance of having experienced, independent advisors to assist with a special committee process, particularly when

dealing with founders or highly regarded business executives with significant influence in a particular industry, even where they hold less than mathematical control. The court commented favorably on how the special committee's process was run, including the special committee's decision early on to implement rules of the road governing recusals and to ensure any conflicted director or potential controller did not infect the committee's process. For this reason, and others, the court noted that "[t]he record…demonstrates that the special committee, aided by its advisors, negotiated in a hard-nosed fashion that reduced the deal price in a way that — given Ellison's greater interest in [Netsuite] than in Oracle — was against Ellison's interest."

- The focus of merger litigation is often on the "sell side" of the deal, with arguments focusing on the target company board's decision to enter into a merger.
  The *Oracle* opinion is a prime example of the plaintiff bar focusing instead on the "buy side," targeting Oracle as the acquiror, and being brought derivatively against Oracle directors and officers. Parties on the buy side of transactions, particularly with controllers or highly influential fiduciaries with a less-than-majority interest that may be on both sides of the deal, should be mindful that their buy-side process may be the subject of litigation.