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Key Takeaways From Del. Chancery's Oracle Toss

By **Gail Weinstein, Steven Epstein and Brian Mangino** (June 5, 2023, 6:02 PM EDT)



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In the recent In re: Oracle Corp. Derivative Litigation, certain former stockholders of Oracle Corp. brought a derivative suit claiming that Oracle had overpaid when, in 2016, it acquired NetSuite Corp. for $9.3 billion.

The plaintiffs contended that Larry Ellison — the founder and a major stockholder of both Oracle and NetSuite — had used his outsized influence at Oracle to cause Oracle to overpay, which advantaged him because he owned a larger percentage of NetSuite than of Oracle. The transaction did not require, or involve, an Oracle stockholder vote.

On May 12, following a 10-day trial, the Delaware Chancery Court found that Ellison likely could have controlled the transaction had he wanted to, but, critically, that he had not tried to.

The court therefore **concluded that** Ellison was not a controller and thus business judgment review, rather than entire fairness, applied — and the court held in favor of the defendants.

Key Points

Controllers and Entire Fairness

The court held that a challenged transaction involving a conflicted nonmajority stockholder who had the ability to control the transaction but did not attempt to do so will be reviewed under the business judgment rule, rather than entire fairness.

The court emphasized that Ellison had absented himself from the process, and that a special committee that was independent of him had functioned effectively to consider and negotiate the transaction.

Critical Role of the Independent Special Committee

The decision underscores the advantages of a board's use of an independent special committee to lead the process for a potentially conflicted transaction.

The court emphasized that the committee's members and advisers were independent and experienced; the committee had conducted extensive due diligence on NetSuite; and the committee and Oracle's CEO, Safra Catz, had negotiated hard on Oracle's behalf, including having been willing to walk away from the deal and ultimately having obtained agreement for a price below the maximum the committee had decided Oracle should pay.

Business Judgment Review at Trial

In an earlier, pleading-stage decision, the court, applying plaintiff-friendly inferences — as it is required to do at that stage of litigation — had concluded that Ellison may have been a controller with respect to the transaction and therefore, due to his conflict based on being on both sides of the transaction, the entire fairness standard of review would apply.

At trial, however, the court found that the record established that Ellison was not a controller, and it applied business judgment review.

The decision thus underscores the importance of a board's establishing a record as to a potential controller's actions with respect to a transaction — and, also, in the event the transaction is challenged, how the record potentially could be used at the pleading stage to increase the likelihood of avoiding trial, which in this case continued for over six years.

Open Questions

The court did not address whether, if the court finds that a person was a controller with respect to a transaction, the effective functioning of an independent special committee would cleanse a non-squeeze-out merger transaction that did not require a stockholder vote.

The court also did not address whether there might be circumstances under which a person with the ability to control a transaction could, by virtue of his or her general influence and clout, be deemed to have controlled a transaction even if he or she had been fully absented from the process.

Background

Ellison founded Oracle in 1977 and NetSuite in 1998. He served on Oracle's board and was CEO until 2014, when he resigned to become the chief technology officer and executive chairman of the board, and Catz became CEO.

Over many years, Oracle had pursued a strategy of growth through the acquisition of other companies. Ellison had long advocated that, at the right time, Oracle should acquire NetSuite.

In early 2016, when NetSuite was struggling financially and Ellison allegedly believed that it could not survive competitively, Oracle began to consider seriously an acquisition of NetSuite. At this time, Ellison owned 28.4% of Oracle common stock and 39.8% of NetSuite stock.

The board established a special committee to consider and negotiate the acquisition. The committee determined that $110 per share would be the price above which an offer would no longer be accretive.

The parties ultimately agreed on a price of $109 per share. The committee received a fairness opinion at that price. The transaction was structured as a tender offer with a back-end merger.

The tender offer was conditioned on at least a majority of the shares unaffiliated with Ellison being tendered. T. Rowe Price — Oracle's largest stockholder other than Ellison — refused to tender, insisting on a price of $133 per share.

Oracle decided twice to extend the tender offer but did not increase the price. Ultimately, the tender offer closed with 53.2% of the unaffiliated shares tendered. In the acquisition, which closed in November 2016, Ellison received about $3.48 billion for his NetSuite shares.

In 2017, the plaintiffs brought suit. In a pleading-stage decision issued in March 2018, Vice Chancellor Sam Glasscock III noted that Ellison allegedly maintained "a firm grip on Oracle's day-to-day operations, and [had] shown a willingness to remove directors and officers who cross him."

The vice chancellor thus found it reasonable to infer that a majority of the Oracle board was not independent of Ellison and that entire fairness review would apply.

In 2019, after a yearlong investigation by a special litigation committee, the Oracle board authorized the stockholders to pursue the derivative case on behalf of the company. In this recent post-trial decision, the vice chancellor found that Ellison was not a controller and that a majority of the special committee members were independent of Ellison.

Applying business judgment review, the vice chancellor ruled in favor of the defendants.

Discussion

Ellison had the ability to control the transaction.

He was Oracle's founder, director, past long-time CEO, chief technology officer, key creative force and public face, and largest stockholder.

The court found that he had significant clout and was a potent force at the company, and that he was "so closely identified with Oracle that [his] insistence on a particular policy or result had the potential to sway the business judgment of the directors and the [Oracle] executives."

The court concluded that he likely could have controlled the transaction had he wanted to. However, Vice Chancellor Glasscock wrote:

> 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, as I understand it.

Ellison did not generally control Oracle.

The court noted that, at the time Oracle began to seriously consider the acquisition of NetSuite, Ellison was the CTO, and the record did not show that he had controlled the day-to-day function of the company nor dictated the operation of the company to the board.

The court pointed to an instance in which the board had forced Ellison to fire a senior member of his team over his strong objection. Similarly, the court concluded that Ellison's ideas received a respectful hearing from senior management, but that the executives "did not appear cowed or overawed by him."

The court noted a time when Catz had determined it was not in Oracle's best interests to continue to pursue a certain project with Microsoft, and after she shut the program down, it took Ellison in his capacity as CTO a year to convince her to change her mind.

Ellison did not try to control the transaction.

The directors and management knew that, "[a]s far as Ellison was concerned, the question was when, not if, the acquisition should occur."

The court observed, however, that Oracle's serious consideration of the acquisition began in 2015, after Ellison was no longer the CEO.

Also, and critically, once the board was considering the acquisition:

- Ellison did not indicate his favor or opposition;
- He absented himself from the board discussions about the acquisition, including with respect to establishing the special committee;
- The board established the committee, which was independent of Ellison;
- Ellison had no contact with the committee; and
- The committee functioned effectively.

Ellison did not try to control the transaction through Catz.

Although there was evidence that Catz was strongly loyal to Ellison, the court found that:

- The special committee and its advisers, not Catz, ran the negotiation process;
- The committee deliberated only after management had left its meetings;
- The committee questioned management's assumptions; and
- That "[d]uring negotiations, Catz showed herself to be a tough negotiator on behalf of Oracle, who was prepared to let the deal die if it was not in Oracle's best interests to pursue."

Throughout the process, the court stressed, Catz "agitated for Oracle to pay the lowest price possible, [with] her advice [leading] to several stalls that jeopardized the transaction."

The special committee functioned effectively.

The committee met 15 times in the eight months between its being established and the closing of the acquisition. The court noted that the committee:

- Was fully empowered to consider and negotiate an acquisition of NetSuite;
- Was comprised entirely of members who were independent and experienced — namely, Renee James, a former CEO of Intel; Leon Panetta, a CIA director and U.S. secretary of defense; and George Conrades, a business executive with 61 years of experience;
- Was guided by legal and financial advisers who were independent and experienced;
- Was walled off from and had no contact with Ellison during the process;
- Had "investigated alternatives and the prudence of the acquisition itself";
- Conducted extensive due diligence;
- Had "negotiated in a hard-nosed fashion" — including having concluded that $110 per share would be the price above which the acquisition would no longer be accretive and having initially offered $100 per share, to which NetSuite countered with $125 per share and, the court emphasized, having been prepared at times to let the deal die rather than agree to a higher price; and
- Succeeded in obtaining NetSuite's agreement to a price per share that was $1 below the committee's ceiling price.

Entire fairness does not apply where a potential controller does not actually control.

The court posited the question whether its finding — that Ellison was "a holder of potential control over a transaction in which he was interested" — mandated entire fairness review.

Referring to the Delaware Supreme Court's 2014 Kahn v. M & F Worldwide Corp. decision, the Chancery wrote: "[I]f Ellison was a controller, and if the protections of MFW … were not in place, entire fairness review must result."

The vice chancellor wrote that, based on the record established at trial:

> [Ellison] neither possessed voting control, nor ran the company de facto. He likely had the potential to control the transaction at issue, but … scrupulously avoided influencing the transaction. In addition, the transaction was negotiated by a special committee of independent directors who hired independent advisors. The Special Committee vigorously bargained for price and demonstrated a willingness to walk away from the transaction. I find, in light of these facts, that this is not a controlled transaction.

Practice Points

Potential Controllers

A conflicted nonmajority stockholder with outsized influence, such that he or she is a potential controller, should consider seeking to frame the transaction to meet the prerequisites for application of business judgment review under MFW.

Or, if a stockholder vote of the acquiring company's stockholders is not required and not desired, then they should consider having the process led by an independent special committee.

If a potential controller scrupulously avoids involvement in the transaction, and if the committee is independent and functions effectively, business judgment review should apply.

Notably, as plaintiff-friendly inferences are drawn at the pleading stage, the court may find at that stage that a potential controller likely was a controller — creating pressure on the putative controller to settle the case even though it may be able to prove at trial that it in fact was not a controller.

Special Committees

A special committee should:

- Be fully empowered to consider and negotiate a transaction — including considering alternatives and doing no transaction;
- Be comprised of independent, experienced members;
- Retain independent, experienced advisers;
- Be walled off from the possible conflicted controller;
- Conduct appropriate due diligence; and
- Negotiate hard on behalf of the company, including by being willing to let the deal die rather than agree to an inappropriate price.

It is critical that a special committee creates a record — for example, in meeting minutes — establishing the foregoing. In addition, a special committee should consider adopting rules of recusal requiring that:

- A potential controller be prohibited from discussing the potential transaction with anyone other than the committee;
- Officers and employees working on the transaction be informed of the potential controller's recusal, and
- Officers and employees be forbidden from being involved in the transaction except with the committee's knowledge and at its direction.

Director Independence

In Oracle, the plaintiffs asserted that the chair of the special committee had violated her fiduciary duties by conspiring with Ellison and Catz to control the acquisition process to advantage Ellison, with whom she allegedly wanted to curry favor so that he would use his influence in the tech industry to help her secure a future CEO position.

Vice Chancellor Glasscock wrote that the evidence at trial did not support this theory — and, in a

footnote, he commented that the plaintiffs' arguments "had some odor of denigrating the abilities of women executives to succeed based on their merits."

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