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The Oracle Cases Settlement: Too Charitable to Ellison and the Plaintiffs' Attorneys?

Steven D. Frankel*

I. INTRODUCTION

Allegations that Larry Ellison, CEO of Oracle Corporation, had engaged in insider trading of the company's shares to the tune of close to a billion dollars made headlines in 2001.¹ More recently, what has made headlines is a settlement that Ellison, Oracle, and a group of plaintiff shareholders reached to end a lawsuit based on these allegations in California state court.² A judge approved the proposed settlement after the parties modified it so that Ellison rather than Oracle would be responsible for paying millions of dollars in plaintiffs' attorneys' fees.³ Descriptions of the settlement have included "novel,"⁴ "the first of its kind,"⁵ and "extremely unusual."⁶ Rather than provide any direct benefit to Oracle, as is typically the case with damages in shareholder derivative lawsuits, the main settlement provision requires Ellison to give \$100 million to charity on Oracle's behalf and in its name.⁷ Past settlements have required the defendant to contribute some money to charity; however, Ellison's settlement is the first to provide that the recovery will go solely to charity.⁸ Several commen-

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1. Peter Burrows, *The Lords of Tech: What Were They Thinking?*, BUS. WK., Mar. 19, 2001, at 40. See also Kelly Zito, *Oracle Hits Its Revised Profit Call*, S.F. CHRON., Mar. 16, 2001, at B1.

2. Michael Liedtke, *Oracle CEO to Pay \$122 Mil. In Stock-Trade Suit*, CHI. SUN TIMES, Nov. 23, 2005, at 80. See also Bloomberg News, *Oracle Chief to Pay Millions in Legal Fees*, N.Y. TIMES, Nov. 22, 2005, at C6.

3. Judgment of Dismissal, Oracle Cases, No. CIV417511, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005).

4. *California Judge Nixes Oracle CEO's Offer to Pay \$100M to Charity to Settle Suit*, 21 No. 7 ANDREWS CORP. OFF. & DIRECTORS LIAB. LITIG. REP. 2, Oct. 3, 2005.

5. *Id.*

6. Benjamin Pimentel, *Ellison to Settle Suit with \$100 Million Deals Needs Court OK, Could Affect Pending Lawsuit*, S.F. CHRON., Sept. 13, 2005, at D1 (quoting John Coffee, a law professor at Columbia University).

7. *Id.*

8. *California Judge Nixes Oracle CEO's Offer to Pay \$100M to Charity to Settle Suit*, *supra* note 4. See Michael Bazeley & Deborah Lohse, *Three Executives Settle Lawsuit Over IPO 'Spinning'*, SAN JOSE MERCURY NEWS, Apr. 29, 2005; see also Stipulation and Agreement of Compromise, Settlement and Release of Claims, *In re* EBay, Inc. S'holders Litig., 2005 WL 1046779 (Del. Ch. Apr.28 2005). Several executives at EBay were sued derivatively for their receipt of

tators have criticized the settlement for not providing damages directly to Oracle, whose shareholders, as owners of the company, were ultimately but indirectly harmed by the alleged insider trading.⁹

Courts must strike a balance between two competing objectives when deciding whether to approve a proposed settlement of a shareholder derivative lawsuit. On one hand, public policy generally favors the settlement of litigation as a means of avoiding unnecessarily protracted lawsuits. A settlement should reflect a fair assessment by each party of the relative merits of its case and the chances of achieving a favorable outcome, making a settlement possible once the parties' assessments converge. This is likely to be achieved when the settlement is the product of arms-length bargaining. On the other hand, the policy of resolving litigation should not come at the cost of encouraging unfair settlements. Unfair settlements resulting from collusive behavior between the parties are a big concern with shareholder derivative litigation, as will be further explained later in this Note. This concern is particularly acute when the value of the settlement is difficult to determine, such as with non-pecuniary settlements, or, as here, when the settlement consists mainly of a charitable donation. Therefore, in light of this concern, the primary issues are whether a charitable donation can possibly be an adequate settlement in a derivative lawsuit, and, if so, what framework a court should use to assess whether such a settlement is fair and reasonable rather than the product of collusive behavior.

Part II of this Note will provide a brief discussion of shareholder derivative lawsuits, with a highlight on the settlement of such lawsuits. This section will also give an overview of the statutory and case law that deals with charitable donations by corporations. The focus will be on California law, given its applicability to the Ellison settlement, and Delaware law, given the importance of that state's corporate law. This Note will also reference illustrative case law from other jurisdictions. Part III will outline the Oracle lawsuit and settlement in more detail. Part IV will contend that courts should allow, and in fact en-

initial public offering shares from investment bankers trying to drum up investment banking business. *Id.* The executives settled the lawsuits for \$3 million, with half of the settlement going to charities, including the Boys and Girls Club of Northern California. *Id.*

9. See Pimentel, *supra* note 6, (quoting Columbia University Professor John Coffee, who questions "whether the plaintiffs' attorneys are entitled to be charitable with other people's money."). See also Mike Langberg, *Did Ellison's Insider Trading Settlement Benefit Oracle?*, SAN JOSE MERCURY NEWS, Sept. 16, 2005 (wondering whether the Oracle Cases settlement was a way for Ellison to "game the system," particularly in light of Ellison's already substantial philanthropic activities); see generally Floyd Norris, *When Charity Stems from a Lawsuit*, N.Y. TIMES, Sept. 16, 2005, at C1 (asking whether the proposed settlement would really benefit Oracle shareholders).

courage, settlements of shareholder derivative lawsuits that mainly provide for charitable donations in the company's name, subject, of course, to the same inquiry always made in such lawsuits to make sure that the settlements are fair and not the result of collusion. As part of this inquiry, the court should be required to find that the charitable donation comprising such a settlement provide at least some direct or indirect benefit to the corporation. Moreover, the fact that the settlement calls for the company to pay attorneys' fees should not necessarily result in the court rejecting the settlement. This section will then analyze the Oracle Cases settlement and the judge's rejection of the original settlement and approval of the revised settlement. Next, Part V will explore the impact of the Oracle Cases settlement. Finally, Part VI will provide a conclusion to this Note.

II. BACKGROUND

A. *The Basics of Shareholder Derivative Lawsuits*

In order to understand why the Oracle Cases settlement is so unusual and why settlements of shareholder derivative lawsuits can be problematic (which this Note will explain later), this section will briefly review the basics of the shareholder derivative lawsuit. A shareholder may file two different types of lawsuits; one type is a direct action and the other type is a derivative action.¹⁰ A shareholder's claim is either a direct action or a derivative action; the two types of actions are mutually exclusive.¹¹ The core differences between direct and derivative actions are: 1) to whom the cause of action belongs (i.e., who suffered the alleged harm) and 2) who, as a result, is entitled to the benefit of any recovery.¹²

In a direct action, the company or its officers are alleged to have committed a direct harm to the shareholder interest of a specific shareholder (or class of shareholders).¹³ Only the harmed shareholder is entitled to recovery and the recovery goes directly to that shareholder.¹⁴ In contrast, the purpose of a shareholder derivative lawsuit is to allow a shareholder (or shareholders) to rectify a wrong committed against the corporation on which the corporation fails to act.¹⁵ The cause of action belongs to the harmed corporation rather

10. *Schuster v. Gardner*, 25 Cal. Rptr. 3d 468, 473 (Cal. Ct. App. 2005).

11. *Id.*

12. *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).

13. *Shuster*, 25 Cal.Rptr.3d at 473.

14. *Id.*; *Tooley*, 845 A.2d at 1036.

15. *McDermott, Will & Emery v. Superior Court*, 99 Cal. Rptr. 2d 622, 625 (Cal. Ct. App. 2000).

than the shareholder as an individual.¹⁶ For instance, in the recently decided case of *Schuster v. Gardner*, the court explained that, under California law, “[a]n action is derivative if ‘the gravamen of the complaint is injury to the corporation, or to the whole body of its stock or property without any severance of distribution among individual holders. . . .’”¹⁷ In *Schuster*, the court found that the claim was derivative under both California and Delaware law¹⁸, relying in part on the Delaware Supreme Court’s holding in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*¹⁹ In *Tooley*, the court noted that a claim is derivative rather than direct if, in order to obtain a favorable outcome, the shareholder must demonstrate an injury to the corporation.²⁰

The nature and purpose of a derivative action has several implications—two of which are particularly important to the focus of this Note.²¹ First, several key parties are necessarily part of the litigation of a shareholder derivative claim.²² These include: 1) the plaintiff shareholder, whom is only nominally the plaintiff since the corporation is the real party of interest; 2) the wrongdoer defendants, which are often officers, directors, or agents of the corporation; and 3) the corporation itself, which is nominally a defendant but which, as stated above, is actually akin to the plaintiff in practice.²³ Although of course not technically a party to the litigation, another important participant one should not overlook, for reasons given in the next section, is the plaintiff shareholder’s attorneys.

Second, because the wrongdoer harmed the corporation rather than the shareholder plaintiffs, any recovery belongs to the corporation.²⁴ The corporation may receive any remedy to which it would have been entitled, had the corporation itself sued.²⁵ The possible remedies in-

16. *Id.*

17. *Schuster*, 25 Cal. Rptr. 3d at 473 (citing *Jones v. H.F. Ahmanson & Co.*, 81 Cal. Rptr. 592, 598 (Cal. 1969)).

18. *Id.*

19. 845 A.2d 1031 (Del. 2004).

20. *Id.* at 1039.

21. The following are two other implications that arise based on the nature and purpose of a derivative action. First, the shareholder seeking to file such a lawsuit must satisfy a “demand requirement” that the shareholder first ask the company to take action and the company refuse to do so. 13 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 5963 (2006). Second, since the shareholder is suing on behalf of the corporation, the shareholder must own the stock at the time the alleged wrongdoing occurred and must remain a shareholder during the course of the litigation. *Id.* § 5972.

22. *Id.* §§ 5994-5998.

23. *Id.*; *Schuster v. Gardner*, 25 Cal. Rptr. 3d at 473.

24. FLETCHER *supra* note 21, § 6038; *Tooley*, 845 A.2d at 1036.

25. FLETCHER *supra* note 21, § 6027.

clude damages, injunctions, or an accounting.²⁶ When the recovery is in the form of monetary damages, the defendant wrongdoers usually pay these directly to the corporation. This second point is the primary reason why the Oracle Cases settlement at issue here is considered to be so unusual, with the recovery being given to charity in the name of Oracle Corporation—the de facto plaintiff—rather than to the company itself. Some of the criticism of the Oracle Cases settlement, in particular, and the more general issue as to whether courts should approve such settlements is based on the unusual nature of such settlements.²⁷

B. Settlement of Shareholder Derivative Lawsuits

1. Potential Concerns with Shareholder Derivative Lawsuit Settlements

While the terms of the settlement in the Oracle Cases may be unusual or novel, settlements in shareholder derivative lawsuits are hardly out of the ordinary.²⁸ In fact, one study found that litigants settled nearly 65% of all derivative suits.²⁹ This is despite only a 6% success rate for plaintiffs in cases that the parties fully adjudicated.³⁰ Many of these settlements did not provide for monetary damages but instead called for non-pecuniary measures such as corporate governance or corporate structure changes.³¹ In contrast, the vast majority of these settlements provided the plaintiffs' attorneys with fee awards, regardless of the terms of the settlement.³²

The high settlement rate and the other findings of the study point to two distinct but related concerns with derivative lawsuit settlements. The first is the “strike suit,” where the shareholder plaintiff and his or her attorneys bring a non-meritorious action in order to try to procure a settlement.³³ The second concern is a collusive settlement, where a claim has merit but the parties settle for less than what is fair given the

26. *Id.* § 6029.

27. See *supra* note 9 and accompanying text.

28. See Tim Oliver Brandi, *The Strike Suit: A Common Problem of the Derivative Suit and the Shareholder Class Action*, 98 DICK. L. REV. 355, 385 (2001) (noting that some studies have shown that settlement rates in shareholder litigation tend to be higher than in other civil litigation).

29. Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 60 (1991).

30. *Id.*

31. *Id.* at 61.

32. *Id.*

33. Brandi, *supra* note 28, at 357.

strength of the shareholder's claims.³⁴ Both of these potential problems stem from the same source—the nature of the derivative lawsuit and the resulting incentives to the various litigants.

The easiest way to explain how the nature of the derivative lawsuit leads to the problem of strike suits and collusive settlements is to explore the incentives that each of the litigating parties has to settle, even if the resulting settlement is unfair to that litigant. Foremost, there is the plaintiff shareholder, or more realistically, the plaintiff shareholder's attorneys. Because of the relatively small stake that any individual shareholder has in any recovery in a derivative action, which belongs to the defendant company, and the costs of monitoring the attorneys, the shareholder's attorneys are likely to determine when to settle and what the settlement terms will be.³⁵ Therefore, the incentives that drive the decision of whether and how to settle are those of the attorneys rather than the shareholder—a classic agency problem.³⁶ The ability to collect attorneys' fees gives the attorneys reason to settle.³⁷ Not surprisingly, when the claim has little merit and the chances of losing at trial are high, the attorney would prefer to settle and collect attorneys' fees based on that outcome.³⁸ If the claims do have merit, the attorney still has an incentive to settle, even if the settlement is unreasonably low. This is because settling the claim obviates the risk that the shareholder will lose at trial despite the lawsuit's merits, thus giving the attorneys no fee award.³⁹ In addition, the amount of the attorneys' fee award primarily is based on the number of hours billed rather than the size of the recovery, so there is really no incentive to reject a low monetary or non-pecuniary settlement.⁴⁰

The wrongdoer defendant, on the other hand, has an obvious incentive to agree to an unduly meager settlement of a meritorious derivative action. However, even if the plaintiff's case is weak, the wrongdoer defendant still has reason to settle. One reason for this is that the wrongdoer defendant may be adverse to even a small risk of losing the litigation and the potential for a large judgment; paying a smaller amount or agreeing to non-pecuniary measures in a settlement

34. Matthew Anderson, *An Intervention Requirement Provides Greater Benefit to the Corporation When Nonparty Shareholders Appeal Derivative Action Settlements: Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998), 79 NEB. L. REV. 171, 193 (2000).

35. *Id.* at 192-193.

36. *Id.*

37. Brandi, *supra* note 28, at 389.

38. *Id.* at 390-391.

39. *Id.*

40. *Id.*

is likely to be preferable.⁴¹ Moreover, directors' and officers' liability insurance and indemnification by the company typically will cover the wrongdoer defendant for a settlement but not for a final judgment against the defendant that finds him or her to have engaged in wrongdoing.⁴²

Finally, the company is likely to acquiesce in any settlement reached between the plaintiff shareholder and the wrongdoer defendant. Even if the claim has merit and the agreed settlement is too low, the corporation may wish to avoid the hassle or potential embarrassment of litigation.⁴³ Also, the wrongdoer defendant may exert enough control over the company to make the acceptance of too low a settlement likely. With a non-meritorious claim, the company may still be driven by a desire to not litigate and its status as the beneficiary of any recovery.

2. Court Approval of Settlements

The risk of strike suits or collusive settlements has resulted in the requirement that a court approve any settlement of a shareholder derivative action. In the federal courts and in some state courts, a statute or rule has codified the court approval requirement.⁴⁴ In Delaware, Chancery Court Rule 23.1 mandates that, with regard to derivative actions by shareholders, "the action shall not be dismissed or compromised without the approval of the Court."⁴⁵ California does not have a similar codified rule, but several cases have explicitly stated that court approval is necessary for settlement of derivative actions.⁴⁶

Once parties to a derivative action have concluded settlement negotiations, a trial court will conduct a hearing to determine whether it should approve the proposed settlement. In order to make this determination, the court looks at the discovery record in an attempt to evaluate the relative strengths of the claims and defenses put forth by the parties; the court, however, does not decide contested facts.⁴⁷ The court then is to "exercise an informed judgment whether the proposed

41. *Id.* at 386-387.

42. *Id.* at 387-388.

43. Andrew J. Sockol, *A Natural Evolution: Compulsory Arbitration of Shareholder Derivative Suits in Publicly Traded Corporations*, 77 TUL. L. REV. 1095, 1104 (2003).

44. *See, e.g.*, FED. R. CIV. P. 23.1; N.Y. BUS. CORP. LAW § 626(d) (McKinney 2003); COLO. R. CIV. P. 23.1.

45. DEL. CH. CT. R. 23.1.

46. *E.g.*, Gaillard v. Natomas Co., 219 Cal. Rptr. 74, 79 (Cal. Ct. App. 1985); Ensher v. Ensher, Alexander, & Barshoom, Inc., 9 Cal. Rptr. 732, 734 (Cal. Ct. App. 1960).

47. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d. 959, 961 (Del. Ch. 1996).

settlement is fair and reasonable in the light of all relevant factors.”⁴⁸ Some of the relevant factors include:

- (1) the probable validity of the claims, (2) the apparent difficulties in enforcing the claims through the courts, (3) the collectibility of any judgment recovered, (4) the delay, expense and trouble of litigation, (5) the amount of the compromise as compared with the amount and collectibility of a judgment, and (6) the views of the parties involved, pro and con.⁴⁹

The court must gauge the “adequacy of the consideration offered to the corporation in exchange for the release of all claims made or arising from the facts alleged.”⁵⁰ When exercising this judgment the court is supposed to protect the best interests of the corporation—the real party of interest to the lawsuit—and the corporation’s non-litigant shareholders, who will be barred from future claims if the court approves the settlement.⁵¹ Given the risk of collusion and the effect on future litigation, the proponents of the settlement bear the burden of persuasion to demonstrate that the settlement is in fact fair and reasonable.⁵² Finally, in *Maher v. Zapata Corporation*, the court stated that the judge “must reject a settlement agreement no matter how acceptable it may otherwise be, if it is not free from collusion or fraud.”⁵³

The strong incentives for collusion in derivative action settlements make the court’s job difficult even when the settlement is entirely pecuniary. The court’s task becomes even more difficult in the case of a settlement involving hard-to-measure non-pecuniary benefits.⁵⁴ In *Bell Atlantic Corp. v. Bolger*, a group of shareholders brought a derivative action for breach of fiduciary duty when Bell Atlantic Corp. agreed to pay \$40 million in refunds to customers after the Pennsylvania Attorney General made allegations of consumer fraud by one of Bell Atlantic’s subsidiaries.⁵⁵ The shareholders and the company reached a settlement to the derivative action, with the company agreeing to: 1) disclose information about the consumer fraud claims in its proxy statement and 2) adopt new procedures to monitor its sales and marketing programs out of which the consumer fraud allegations arose.⁵⁶ In analyzing the settlement, the court first acknowledged the

48. *Id.* at 966.

49. *Polk v. Good*, 507 A.2d 531, 536 (Del. 1986).

50. *In re Caremark*, 698 A.2d at 961.

51. *Id.* at 966.

52. *Id.* at 967.

53. *Maher v. Zapata Corp.*, 714 F.2d 436, 457 (5th Cir. 1983).

54. Sockol, *supra* note 43, at 1102.

55. *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1306 (3d Cir. 1993).

56. *Id.* at 1306-07.

potential problems with a non-pecuniary settlement, observing that “nonmonetary relief may be used to mask an unfair settlement that benefits individual defendants and plaintiffs’ counsel but not the corporation.”⁵⁷ The court envisioned a situation in which the parties, in reliance on the “valuation problem” presented by non-pecuniary relief, collude to exchange merely cosmetic measures for plaintiff’s attorneys’ fees.⁵⁸ Despite this caveat, the court held the settlement to be fair and reasonable.⁵⁹ The court reasoned that the settlement terms, which included measures to prevent future consumer fraud by the company’s employees, conferred a benefit to Bell Atlantic.⁶⁰ While this benefit might have been small, according to the court, it was adequate consideration given the weakness of the shareholder claims of breach of fiduciary duty.⁶¹ The application of the business judgment rule, a provision in Bell Atlantic’s charter shielding company directors from liability for negligence, and the fact that lower level employees of a subsidiary perpetrated the alleged consumer fraud reduced the probability of the shareholders succeeding in their derivative action.⁶² Finally, only a small percentage of Bell Atlantic shareholders objected to the proposed settlement.⁶³

Similarly, in *In re Caremark International Inc. Derivative Litigation*, the Delaware Chancery Court approved a settlement that called only for non-pecuniary governance and corporate structure changes.⁶⁴ In *Caremark*, the company agreed to pay \$250 million in a plea agreement to resolve government charges that the company had violated a law prohibiting payments made to secure the referral of Medicaid and Medicare patients.⁶⁵ Shareholders filed a derivative action, alleging that Caremark’s directors had breached their fiduciary duty of care and, therefore, should be liable to the company for the \$250 million.⁶⁶ The shareholder plaintiffs, the defendant directors, and Caremark’s Board came to a settlement of the derivative action.⁶⁷ The settlement provided no monetary damages, instead requiring Caremark to undertake to prevent payments for referrals, change the way it interacts with physicians and hospitals, and form a Compliance and Ethics

57. *Id.* at 1314.

58. *Id.* at 1311-12.

59. *Id.* at 1318.

60. *Bell Atlantic Corp.*, 2 F.3d at 1312.

61. *Id.* at 1314.

62. *Id.* at 1312-14.

63. *Id.* at 1313-14.

64. *In re Caremark*, 698 A.2d 959 (Del. Ch. 1996).

65. *Id.* at 960-61.

66. *Id.* at 964.

67. *Id.* at 965.

Committee to ensure compliance with the law.⁶⁸ The court approved the settlement despite the “very modest benefits.”⁶⁹ The court determined that the “consideration appears fully adequate” given the lack of evidence that the directors had failed to properly oversee the actions of lower-level employees and the resulting weakness of the shareholders’ claims.⁷⁰

3. Plaintiffs’ Attorneys’ Fees

As noted above, the vast majority of settlements in shareholder derivative cases result in the plaintiff’s attorney receiving a fee award.⁷¹ The corporation is typically the payor of such a fee award since the plaintiff shareholder has brought the claim on the corporation’s behalf and the corporation is supposed to be the beneficiary of any recovery.⁷² A court may not approve a settlement with a provision for attorneys’ fees unless the corporation receives a benefit.⁷³ Under the common fund doctrine, the settlement awards attorneys’ fees out of a common fund created or preserved by the litigation, through either a final judgment or a settlement.⁷⁴ A common fund is created as the result of a monetary settlement.⁷⁵ Still, a non-monetary settlement does not preclude an award of fees to the plaintiff’s attorneys.⁷⁶ With settlements only involving non-pecuniary provisions, a settlement may award attorneys’ fees under the substantial benefit doctrine.⁷⁷ The substantial benefit doctrine allows the settlement to provide for attorneys’ fees if the settlement confers a substantial benefit on the corporation; the benefit must be “actual and concrete.”⁷⁸

Under both doctrines, when the parties negotiate the attorneys’ fees as part of a settlement, the court must assess the negotiated fees as part of its inquiry into the fairness and reasonableness of the settlement.⁷⁹ The negotiated fees do not have to be exactly what the court itself would have awarded had there been no provision for attorneys’

68. *Id.* at 966.

69. *In re Caremark*, 698 A.2d at 972.

70. *Id.* at 971.

71. Romano, *supra* note 23, 61.

72. 13 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 6044 (2006).

73. Sockol, *supra* note 43, at 1102.

74. *Cziraki v. Thunder Cats, Inc.*, 3 Cal. Rptr. 3d 419, 422-23 (Cal. Ct. App. 2003).

75. *Id.*

76. Sockol, *supra* note 43, at 1102.

77. *Cziraki*, 3 Cal. Rptr. 3d at 423.

78. *Robbins v. Alibrandi*, 25 Cal. Rptr. 3d 387, 393 (Cal. Ct. App. 2005).

79. *Id.* at 394-95.

fees, but the negotiated fees must be within the same range.⁸⁰ The court has to be wary of any signs of collusion evident from the amount of the attorneys' fees or the circumstances that led up to the proposed settlement.⁸¹ The most important factor in assessing whether the negotiated fees are fair is that they "bear a reasonable relationship to the value of the attorney's work."⁸² Bearing on the value of the attorneys' work are variables such as number of hours spent and the complexity of the litigation.⁸³ The court must also assure that the payment of the negotiated fees will not be unduly burdensome to the corporation, as might be the case if the cost of the settlement to the corporation were to vastly outweigh the value of the settlement to the corporation.⁸⁴

C. *The Power of Corporations to Make Charitable Donations*

1. Statutory Law

All fifty states (plus the District of Columbia) statutorily authorize corporations to donate to charitable, scientific, and educational causes and institutions.⁸⁵ The Delaware corporate donations statute is representative of the statutes in a large number of states.⁸⁶ The Delaware statute provides that corporations have the power to "make donations for the public welfare or for charitable, scientific or educational purposes. . . ."⁸⁷ California's statute, while worded differently, gives corporations the same leeway, if not more, to make donations. The statute provides that corporations have the power to "[m]ake donations, regardless of specific corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic or similar purposes."⁸⁸ However, a quick reading of their language

80. *Id.* at 396.

81. *Id.* at 395.

82. *Id.* at 396.

83. *Robbins*, 25 Cal. Rptr. 3d at 394.

84. *Id.* at 395.

85. R. Franklin Balotti & James J. Hanks, Jr., *Giving at the Office: A Reappraisal of Charitable Contributions by Corporations*, 54 BUS. LAW. 965, 970 (1999).

86. *Id.* The authors note that corporate donations statutes fall into one of three general categories. A handful of states, including California, explicitly require no corporate benefit. The remainder of states split about evenly between single-provision statutes similar to Delaware's and statutes that have two separate provisions. In the latter states, the first provision is similar to Delaware's single provision, while a second provision specifically provides for donations made to further the interest of the corporation so long as the donations are otherwise lawful. *Id.*

87. DEL. CODE ANN. tit. 8, § 122(9) (2005). Similar to the Delaware statute is the current version of the Revised Model Business Corporations Act. See MODEL BUS. CORP. ACT § 3.02(13) (2005) ("Unless its articles of incorporation provide otherwise. . . (13) to make donations for the public welfare or for charitable, scientific, or educational purposes. . .").

88. CAL. CORP. CODE § 207(e) (2005).

makes it clear that these statutes offer scant guidance to courts as to what standard should govern the propriety of a given corporate donation. In most states, the corporate philanthropy statutes are unrestrictive.⁸⁹

2. Case Law: What Standard Governs Corporate Charitable Donations?

There has been little litigation over the propriety of specific corporate donations.⁹⁰ The two most recent of only four cases since 1950 dealing with corporate charitable donations directly have both taken place in Delaware.⁹¹ Given the influence of Delaware corporate law, these two cases are likely to have a significant amount of persuasive authority in other jurisdictions.

Theodora Holding Corporation v. Henderson, the first of the Delaware cases, sought to announce an express standard for corporate charitable donations.⁹² In *Theodora*, a minority shareholder of Alexander Dawson, Inc. sued the defendant, a controlling shareholder, who had committed the company to a \$528,000 donation of company stock to the Alexander Dawson Foundation.⁹³ The foundation, a charitable trust run by the defendant, was to use the funds in question to operate a western camp for under-privileged boys.⁹⁴ The minority shareholder alleged that the donation was improper.⁹⁵ Significantly, the \$528,000 donations represented less than three percent of the corporation's annual income of over \$19 million.⁹⁶ The court applied a test of reasonableness to determine whether the charitable gift made

89. Balotti & Hanks, *supra* note 85, at 972. However, a couple states do include restrictions in their corporate donations statute. Massachusetts' corporate donations statute limits donations by corporations with capital stock to one-half of one percent of its capital and surplus at the end of the preceding fiscal year unless stockholders approve a greater amount. For corporations without capital stock, donations are limited to one-half of one percent of the surplus at the end of the preceding fiscal year unless the members of the corporation approve a greater amount. MASS. GEN. LAWS ANN. ch. 155, § 12C (West 2005). See also VA. CODE ANN. § 13.1-627(A)(12) (2005).

90. See Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 605 n.101 (1997).

91. See *id.* One of the two non-Delaware cases directly dealing with corporate donations is *A.P. Smith Mfg. Co. v. Barlow* 98 A.2d 581 (N.J. 1953). The other is *Union Pacific R.R. v. Trustees, Inc.*, 329 P.2d 398 (Utah 1958). This Note focuses on the Delaware cases because they were the first and only cases to adopt an express standard for corporate donations. While not expressly addressing the standard for corporate charitable donations, it is also interesting to note that the Supreme Court of California did allude to a test of reasonableness in *Memorial Hosp. Ass'n of Stanislaus County v. Pacific Grape Prod. Co.* See 290 P.2d 481, 483 (Cal. 1955).

92. *Theodora Holding Corp.*, 257 A.2d 398 (Del. Ch. 1969).

93. *Id.* at 400-01.

94. *Id.* at 402.

95. *Id.*

96. *Id.* at 405.

pursuant to the Delaware statute was proper or not.⁹⁷ The court noted that, at 2.7% of the corporation's annual gross income, the donation was less than the 5% limit for federal tax deductions of charitable donations.⁹⁸ The court explicitly said that the Internal Revenue Code provided a guidepost against which courts could size up the reasonableness of a corporate charitable donation.⁹⁹ The court also pointed out that the donation reduced the corporation's capital gains taxes and was a small price to pay to help ameliorate social tensions arising from "large private holdings" over the longer term.¹⁰⁰ Given the above reasons, along with the fact that providing money to the youth camp was in line with public policy, the court determined that the donation was reasonable.¹⁰¹ Based on this determination, the Chancery Court held that the charitable donation to the foundation was proper.¹⁰²

A second and more recent Delaware case, *Sullivan v. Hammer*, followed the test of reasonableness set forth in *Theodora*.¹⁰³ In *Sullivan*, a Special Committee of Occidental Petroleum Corporation had approved a corporate donation for the construction of an art museum adjacent to its California headquarters and other financial support for the museum.¹⁰⁴ The museum was to be named The Armand Hammer Museum of Art and Cultural Center, after Armand Hammer, the Chairman of Occidental's Board.¹⁰⁵ Several shareholders sued to challenge the donation after the company announced the gift, claiming that the donation was improper.¹⁰⁶ The plaintiff shareholders and the defendants agreed to settle the matter, but several shareholders whom had filed separate claims objected to the settlement.¹⁰⁷ The Court of Chancery approved the settlement, concluding that the plaintiffs' claims were weak since the donation met the test of reasonableness.¹⁰⁸ The Supreme Court of Delaware affirmed the lower court's

97. *Theodora*, 257 A.2d at 405.

98. *Id.* The Internal Revenue Code deduction limitation for charitable donations is currently set at 10% of the company's taxable income for the year. 26 U.S.C. § 170(b)(2)(2005).

99. *Theodora*, 257 A.2d at 405.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Sullivan v. Hammer*, No. CIV.A.10823, 1990 WL 114223, at *6 (Del. Ch. Aug. 14, 1990).

104. *Id.* at *1.

105. *Id.*

106. *Id.*

107. *Id.* at *2. The terms of the settlement allowed the museum plan to go forward with several conditions. These conditions included naming the building the "Occidental Petroleum Cultural Center Building" and recognizing the company as the museum's corporate sponsor in advertising materials. *Id.* at *3.

108. *Sullivan*, 1990 WL 114223, at *5.

approval of the settlement.¹⁰⁹ The Supreme Court of Delaware noted its agreement with the Court of Chancery in *Theodora* that the correct test was one of reasonableness, informed by the Internal Revenue Code's provisions dealing with deductions for corporate donations.¹¹⁰ Further, the Supreme Court of Delaware wrote, "The Court of Chancery recognized that not every charitable gift constitutes a valid corporate action. Nevertheless, the Court of Chancery concluded, given the net worth of Occidental, its annual net income before taxes, and the tax benefits to Occidental, that the gift to the Museum was within the range of reasonableness established in *Theodora*."¹¹¹

3. Types of Corporate Donations: Must There Be a Benefit to the Corporation?

Professors Balotti and Hanks identify three distinct types of corporate donations—1) "personal aggrandizement/pet-charity" donations, 2) "altruistic" donations, and 3) "business-benefit" donations.¹¹² The first two types do not involve any "demonstrable benefit" to the corporation.¹¹³ For the "personal aggrandizement/pet-charity" donation, the motivation for the donation is the personal preferences of the company official making the donation; the donation is either to a pet charity or in some other way for the personal aggrandizement of the official.¹¹⁴ As its name implies, the motivation for an "altruistic" donation is entirely altruistic.¹¹⁵ Finally, there is the "business-benefit" corporate donation, where the charitable contribution confers a "demonstrable benefit" on the corporation.¹¹⁶ Potential benefits to the corporation arising from corporate charitable donations may include use of donations as a marketing and advertising tool, generation of goodwill for the corporation, and attraction of shareholders by emphasizing the corporation's "social responsibility."¹¹⁷ In many cases,

109. Kahn v. Sullivan, 594 A.2d 48, 63 (Del. 1991).

110. *Id.* at 61.

111. *Id.*

112. Balotti & Hanks, *supra* note 85, at 968.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. Balotti & Hanks, *supra* note 85, at 967. See also Kahn, *supra* note 90, at 662-674. While locating source materials outlining the theoretical benefits to corporations of making charitable donations was easy, empirical evidence of such benefits proved harder to come by. One of the only sources found was a telephone survey by Cone, Inc., a marketing and public relations firm that specializes in "cause-related" marketing. Press Release, Cone, Inc., Multi-Year Study Finds 21% Increase in Americans Who Say Corporate Support of Social Issues is Important in Building Trust (Dec. 8, 2004), available at http://www.coneinc.com/Pages/pr_30.html. Among the survey's findings was that a large majority of those responding would switch to a similar product

the extent of the benefit to the corporation, or whether there is actually a benefit at all, depends on such factors as the publicity that the donation gets and the reactions of the relevant parties (such as consumers) to the donations.¹¹⁸

The permissive standard of reasonableness adopted by the Delaware courts does not put much restraint on corporate donations. Is there any requirement that a charitable donation confer a benefit on the corporation in addition to meeting the reasonableness test? Most of corporation law is based on principles of profit maximization; however, corporate donations law has often been justified on the grounds of “social responsibility” and public policy.¹¹⁹ As long as corporate donations law is not based on profit maximization theory, then a benefit is not necessarily required. Addressing the question expressly, the California corporate donations statute provides that corporations may make donations “regardless of specific corporate benefit.”¹²⁰ It is not, however, entirely certain whether or not there is any requirement of a benefit to the corporation in other states with statutes similar to Delaware’s statute.¹²¹

The Delaware case law, at the very least, recognizes that a court may properly consider any benefit to the corporation as an important factor when analyzing the reasonableness of a given corporate donation. For instance, in *Theodora*, the court takes into account that the “relatively small loss of immediate income. . . is far out-weighted by the overall benefits flowing from the placing of such gift in channels where it serves to benefit those in need of philanthropic or educational support, thus providing justification for large private holdings, thereby benefiting plaintiff in the long run.”¹²² As stated earlier, the court’s assessment of reasonableness also included the reduction in the company’s capital gains taxes resulting from the donation.¹²³ Perhaps even going further, the *Kahn* court agreed with the lower court

based on the company supporting a cause. *Id.* Of course, a single report is not nearly enough to draw any firm conclusions.

118. Balotti & Hanks, *supra* note 85, at 967.

119. *Id.* at 978-980. See also Kahn, *supra* note 90, at 625-30 (defining “corporate social responsibility” as the idea that, based on corporate ability, social necessity and morality, public corporations, especially large ones, have “an obligation to contribute to the betterment of society in a manner distinct from the maximization of corporate profit and obedience to the law.”).

120. CAL. CORP. CODE § 207(e) (2005). It is also clear that there is no benefit requirement in states with two separate provisions for charitable donations. See Balotti & Hanks, *supra* note 85, at 977. Since the second of the provisions deals specifically with donations that confer a benefit, by implication, the first provision does not require a corporate benefit. *Id.*

121. Balotti & Hanks, *supra* note 85, at 976-978.

122. *Theodora Holding Corp. v. Henderson*, 257 A.2d 398, 405 (Del. Ch. 1969).

123. *Id.*

that the business judgment rule likely would have protected the Special Committee's decision to make the donation from claims of breach of duty of care.¹²⁴ As Balotti and Hanks point out, the business judgment rule is based on principles of profit maximization—principles under which a corporate benefit would be required.¹²⁵ Despite the opinion of the *Kahn* court, with no concrete decision on this point to date and a dearth of litigation concerning corporate donations, the question of whether there is a corporate benefit requirement in states like Delaware is still up in the air.

III. THE ORACLE LAWSUIT AND SETTLEMENT

A. *Factual Background, Lawsuits Filed, and Procedural History*

In early 2001, Larry Ellison, the CEO of Oracle Corporation¹²⁶ and owner of approximately one quarter of the company's stock, sold 29 million of his shares.¹²⁷ This sale, conducted over the course of one week, netted Ellison nearly \$900 million at an average price of \$30.76 per share.¹²⁸ On March 1, 2001—one month after Ellison completed his stock sales—Oracle announced its earning results from the just-ended fiscal quarter.¹²⁹ The earnings failed to live up to Wall Street expectations.¹³⁰ The news of the missed earnings resulted in Oracle's stock price dropping precipitously; by mid-March, the stock was trading at just one-half of the price at which Ellison had sold his shares.¹³¹ Oracle shareholders proceeded to allege insider trading based on Ellison's sale of stock before the unfavorable earnings report. Shareholders filed what became three separate derivative lawsuits—one in Delaware state court that was dismissed on summary judgment,¹³² one in federal court that is pending,¹³³ and the one in the Superior Court of California that is at issue here.¹³⁴

124. *Kahn v. Sullivan*, 594 A.2d 48, 61 (Del. 1991).

125. Balotti & Hanks, *supra* note 85, at 977-978.

126. Oracle Corporation is incorporated in Delaware and headquartered in California.

127. Jonathan D. Glater, *Oracle's Chief in Agreement to Settle Insider Trading Lawsuit*, N.Y. TIMES, Sept. 12, 2005, at C1.

128. Langberg, *supra* note 9.

129. Glater, *supra* note 127.

130. *Id.*

131. Langberg, *supra* note 9.

132. *In re Oracle Corp. Derivative Litig.*, 867 A.2d 904, 955 (Del. Ch. 2004), *aff'd* 872 A.2d 960 (Del. 2005). The court based the dismissal on the failure of the plaintiffs to meet Delaware's pleading requirements for scinter. *Id.*

133. *In re Oracle Corp. Sec. Litig.*, No. C-01-0988-MJJ (N.D. Cal. 2005).

134. *In re Oracle Cases* (Chairman of the Judicial Council JCC 4180), No. CIV417511 (Cal. Super. Ct. 2005).

Plaintiff Alan Pierce filed the first lawsuit in San Mateo County Superior Court of California, alleging, inter alia, breach of fiduciary duty, constructive fraud, and unjust enrichment in connection with Ellison's sale of the 29 million Oracle shares.¹³⁵ Five other shareholders filed separate lawsuits based on the same stock sales.¹³⁶ The courts consolidated the six actions in San Mateo County Superior Court.¹³⁷ After the filing of a consolidated complaint, the court dismissed several defendants and claims.¹³⁸ The remaining defendants were Larry Ellison and Oracle Corporation.¹³⁹ The remaining claims were actions under California Corporations Code sections 25402 and 25502.¹⁴⁰ The court scheduled the trial to begin in late September 2005.¹⁴¹

B. *The Original Settlement: Negotiations, Terms, and Court Rejection*

Two months before the scheduled trial date, the parties began settlement negotiations.¹⁴² Retired judge Daniel Weinstein mediated these negotiations.¹⁴³ On September 20, 2005, the parties filed their original proposed settlement.¹⁴⁴ Ellison, the shareholder plaintiffs, and Oracle's board of directors, including three independent directors, all approved this proposed settlement.¹⁴⁵

The main provision of the original proposed settlement called for Ellison to donate \$100 million to charity in Oracle's name over a period of five years.¹⁴⁶ While Ellison was to select the charity, Oracle

135. Stipulation and Agreement of Settlement, Oracle Cases (Chairman of the Judicial Council JCCP 4180), No. CIV417511, 2005 WL 2396788 (Cal. Super. Ct. Sept. 20, 2005).

136. *Id.*

137. *Id.*

138. Stipulation and Agreement of Settlement, Oracle Cases (Chairman of the Judicial Council JCCP 4180), No. CIV417511, 2005 WL 2396788 (Cal. Super. Ct. Sept. 20, 2005).

139. *Id.*

140. *Id.* Section 25402 prohibits insider trading. CAL. CORP. CODE § 25402 (2005). Section 25502 states that a party who violates Section 25402 is liable for damages to the injured party. CAL. CORP. CODE § 25502 (2005).

141. Stipulation and Agreement of Settlement, Oracle Cases (Chairman of the Judicial Council JCCP 4180), No. CIV417511, 2005 WL 2396788 (Cal. Super. Ct. Sept. 20, 2005).

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.* Oracle outlines its charitable giving program on its website. For instance, Oracle lists its charitable giving for the fiscal year 2005 as \$7 million in cash donations and \$162 million of in-kind software donations. Oracle Corporation, *Summary of Oracle's Commitment* (2006), available at http://www.oracle.com/corporate/community/cr_summary.pdf. One area of focus for Oracle's charitable giving is education initiatives, particularly for science and technology education. *Id.* See also Oracle Corporation, *Oracle's Commitment* (2006), available at <http://www.oracle.com>.

had to approve the choice.¹⁴⁷ It is unclear by the settlement terms whether Ellison or Oracle would be entitled to deduct the charitable donations for tax purposes.¹⁴⁸ Moreover, the settlement required Oracle to make several changes to its corporate governance.¹⁴⁹ These changes included allowing Oracle executives to have pre-planned stock selling plans, establishing restricted trading windows before the end of a quarter and immediately after the company releases earnings reports, and tightening the company's policy of pre-clearing stock trades by its employees.¹⁵⁰ In regards to plaintiffs' attorneys' fees, the settlement requested that Oracle pay approximately \$24 million in fees.¹⁵¹ However, the settlement stated that failure of the court to agree to the requested attorneys' fees "shall not operate to terminate or cancel the Stipulation [and Agreement of Settlement] or affect its terms. . ."¹⁵² Finally, the proposed settlement made clear that Ellison would admit to no wrongdoing in connection with his stock sales in 2001.¹⁵³

At a September 26, 2005 hearing, Judge John Schwartz of the San Mateo County Court rejected the original proposed settlement.¹⁵⁴ Judge Schwartz rejected the settlement after Oracle shareholder Donald Titus filed an objection to the payment of the plaintiffs' attorneys' fees by the company.¹⁵⁵ The judge agreed with Titus that the problem was that, while the settlement proceeds would go to charity, the parties wanted Oracle to foot the bill for \$24 million in plaintiffs' attorney

com/corporate/community/Oracles_Commitment.pdf. Larry Ellison has also given significant amounts to charity; in particular, Ellison donated \$100 million to form the Ellison Medical Foundation, which helps to finance "aging research." Press Release, American Federation for Aging Research, Oracle CEO Larry Ellison and Pfizer Honored for Contributions to Ageing Research (Nov. 15, 2004), available at <http://www.afar.org/dinner-press-release.html>. See also Langberg, *supra* note 9 (stating that Larry Ellison is "already giving away \$30 million to \$40 million a year" to charity).

147. Stipulation and Agreement of Settlement, Oracle Cases (Chairman of the Judicial Council JCCP 4180), No. CIV417511, 2005 WL 2396788 (Cal. Super. Ct. Sept. 20, 2005).

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. Stipulation and Agreement of Settlement, Oracle Cases (Chairman of the Judicial Council JCCP 4180), No. CIV417511, 2005 WL 2396788 (Cal. Super. Ct. Sept. 20, 2005).

153. *Id.*

154. *California Judge Nixes Oracle CEO's Offer to Pay \$100M to Charity to Settle Suits*, *supra* note 4.

155. *Id.*

fees.¹⁵⁶ The judge remarked, "It's a very good settlement, but I don't see the corporation paying for it."¹⁵⁷

C. *The Revised Settlement: Terms and Court Acceptance*

In response to the judge's rejection of the original proposed settlement, the parties resumed negotiations, once again mediated by retired judge Daniel Weinstein.¹⁵⁸ The parties reached a revised settlement, with the terms substantially the same as in the rejected original settlement.¹⁵⁹ The major change was that Ellison would now pay up to \$22 million in plaintiffs' attorneys' fees as opposed to Oracle paying up to \$24 million under the original settlement.¹⁶⁰ On November 22, 2005, Judge Schwartz approved the revised settlement and the attorneys' fees, as required.¹⁶¹ Based on his acceptance of the revised settlement, Judge Schwartz dismissed the consolidated action with prejudice.¹⁶²

IV. ANALYSIS

This section will contend that courts should allow and, in fact, encourage settlements of shareholder derivative actions that primarily provide for charitable donations, as long as the court is able to determine that such a settlement is fair, reasonable, and non-collusive.¹⁶³

156. *Id.*

157. Jonathan D. Glater, *Judge Delays Oracle Suit Settlement, Citing Legal Fees*, N.Y. TIMES, Sept. 27, 2005, at C3.

158. Supplemental Declaration of the Honorable Daniel Weinstein (Ret.) in Support of Motion for Approval of Revised Proposed Settlement and Motion for Award of Attorneys' Fees and Reimbursement of Expenses, Oracle Cases, No. CIV417511, 2005 WL 3279791 (Cal. Super. Ct. Nov. 17, 2005).

159. Judgment of Dismissal, Oracle Cases, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005) (No. CIV417511). See also Bloomberg News, *Oracle Chief to Pay Millions in Legal Fees*, N.Y. TIMES, Nov. 22, 2005, at C6.

160. Bloomberg News, *supra* note 159, at C6.

161. Judgment of Dismissal, Oracle Cases, No. CIV417511, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005). See also Order Granting Plaintiffs' Motion for Award of Attorneys' Fees and Costs, Oracle Cases, No. CIV417511, 2005 WL 3278775 (Cal. Super. Ct. Nov. 22, 2005).

162. Judgment of Dismissal, Oracle Cases, No. CIV417511, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005). On February 16, 2006, an appeal by an Oracle shareholder of the settlement approval was voluntarily dismissed and the lower court disposition became final. Docket, People v. Oracle Corp., No. A112891 (Cal. Ct. App. 2006).

163. Other articles propose reforms to the settlement stage of derivative litigation, calling for improvement in preventing collusive settlements over the current court approval mechanism. See generally Tim Oliver Brandi, *The Strike Suit: A Common Problem of the Derivative Suit and the Shareholder Class Action*, 98 DICK. L. REV. 355 (2001); Andrew J. Sockol, *A Natural Evolution: Compulsory Arbitration of Shareholder Derivative Suits in Publicly Traded Corporations*, 77 TUL. L. REV. 1095 (2003); Mathew Anderson, *An Intervention Requirement Provides Greater Benefit to the Corporation When Nonparty Shareholders Appeal Derivative Action Settlements: Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998), 79 NEB. L. REV. 171 (2000). Proposals for such

First, this Note will present the legal argument in support of allowing both settlements calling for charitable donations and provisions requiring the corporation to pay reasonable attorneys' fees in conjunction with such settlements. Second, taking into account the law dealing with the power of corporations to make charitable donations, a couple of issues that the courts will need to consider when they determine whether to approve such settlements will be outlined. Next, policy arguments will offer the reasons why courts should not only allow but also encourage litigants to consider charitable donations provisions during their settlement negotiations, particularly when the plaintiff shareholder's claims appear weak. Finally, the Oracle Cases settlement and its approval will be analyzed in terms of the legal framework and policy goals presented in the earlier sub-sections.

A. *How Courts Should Treat Settlements Providing Primarily for Charitable Donation*

1. Case Law Supports Allowing Charitable Donation Based Settlements

Given the novelty of the Oracle Cases settlement, there is no prior case law dealing specifically with settlements primarily providing for charitable donations by the defendant in the name of the injured corporation. Even so, the general treatment that courts should accord to such settlements may be analogized to case law dealing with settlements providing solely for non-pecuniary measures. A court should approve a proposed settlement of a shareholder derivative action as long as its proponents demonstrate that the settlement is fair and reasonable under the circumstances.¹⁶⁴ The ultimate consideration is whether the value of the consideration proffered justifies the release of all claims on the corporation's behalf stemming from the alleged facts.¹⁶⁵ Despite the difficulty that this presents in the evaluation of settlements providing for non-pecuniary measures, which are difficult to place a value on, courts like those in *Bell Atlantic*¹⁶⁶ and *Caremark*¹⁶⁷ have not had a problem approving these settlements in cases where the plaintiff's claims were weak. In fact, only one-half of

reforms, however, are outside the scope of this Note. This Note will deal with charitable donations settlements in the context of the current court approval mechanism for derivative lawsuit settlements.

164. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 966 (Del. Ch. 1996).

165. *Id.* at 961.

166. *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1314 (3d Cir. 1993).

167. *In re Caremark*, 698 A.2d at 972.

approved derivative action settlements include any provision for monetary damages.¹⁶⁸

There is no reason for why the basic view of courts concerning settlements providing for charitable donations should be any different from the view of courts about settlements that call for non-pecuniary measures. To be sure, charitable donations present the problem of being hard to value. However, this is the same potential criticism of non-pecuniary settlements. Arguably, though still difficult, a charitable donation of a certain dollar amount is likely to be easier to put a value on than non-pecuniary measures with no dollar amount or other quantitative measurement attached. The judge deciding whether to approve a settlement does not need to be exacting; the judge is merely required to make a reasoned judgment as to whether the settlement is fair and reasonable.¹⁶⁹ Making a reasoned judgment is no more problematic with charitable donations settlements than with non-pecuniary settlements.

Likewise, the court should treat the award of attorneys' fees in a settlement providing for charitable donations in a way analogous to the award of attorneys' fees resulting from non-pecuniary settlements. In both cases, since there is no monetary damages provision to create a common fund, the fee awards will fall under the substantial benefit doctrine.¹⁷⁰ In *Robbins v. Alibrandi*, the court, while holding that the trial court had erred in finding the negotiated attorneys' fees to be fair, stated that under the substantial benefit doctrine "the benefit need not be pecuniary."¹⁷¹ As long as the corporation receives an actual benefit from a charitable donation provided for in a settlement, the corporation as real party of interest in the derivative litigation should have to pay fair plaintiff's attorneys' fees that are either negotiated as part of the settlement or awarded after a petition to the court.

2. Charitable Donations Settlements in Light of Corporate Donations Law

The intersection of the law concerning the approval of shareholder derivative lawsuits and the law dealing with the power of corporations to make charitable donations presents a couple of important issues with which the courts will need to deal. The first and most straightforward of these two issues is the application of the reasonableness test

168. Romano, *supra* note 29, at 61.

169. *In re Caremark*, 698 A.2d at 961.

170. *Cziraki v. Thunder Cats, Inc.*, 3 Cal. Rptr. 3d 419, 423 (Cal. Ct. App. 2003).

171. 25 Cal. Rptr. 3d 387, 393 (Cal. Ct. App. 2005).

announced in *Theodora*.¹⁷² The court should not approve a settlement that provides for a charitable donation made in the name of the company that the company could not have made directly under the reasonableness standard that governs corporate charitable donations in general. Therefore, the court should impose an additional requirement and assess the reasonableness of the company making such a donation in and of itself in addition to the inquiry made into the fairness of the overall settlement. If, for instance, the donation mandated by the terms of the settlement exceeds the current 10% of annual taxable income limit for federal tax deductions of charitable donations,¹⁷³ the court should reject the settlement regardless of the fairness and reasonableness of the settlement value in consideration of terminating the lawsuit.

The second issue—whether there should be a requirement that the settlement donation confer a benefit on the corporation—is more complicated. This Note contends that courts should require that charitable donations in the derivative lawsuit settlement context provide a demonstrable benefit, whether direct or indirect, to the corporation. Even after taking into consideration several arguments for concluding otherwise in the non-settlement context, courts should conclude that such a requirement is both necessary and workable. The issue of whether to have a benefit requirement is complicated for two main reasons.

First, as mentioned in the Background section, corporate donation law in the non-settlement context clearly requires no benefit to the corporation to result from a charitable donation in states with statutes similar to the one in California¹⁷⁴ and is uncertain as to whether there is any benefit required in states with statutes similar to the one in Delaware¹⁷⁵. Moreover, it follows that a company receiving monetary damages as the result of a derivative lawsuit could then turn around and donate that money to charity, presumably without receiving a benefit; the final result would be identical to the result if a settlement provided for a charitable donation conferring no benefit on the corporation. However, a settlement cannot be fair and reasonable if there is inadequate consideration given by the wrongdoer defendant in exchange for the plaintiff terminating his or her claim.¹⁷⁶ With a settlement providing for a “personal aggrandizement” or “altruistic”

172. *Theodora Holding Corp. v. Henderson*, 257 A.2d 398, 405 (Del. Ch. 1969).

173. 26 U.S.C.A. § 170(b)(2) (2005).

174. CAL. CORP. CODE § 207(e) (2005).

175. DEL. CODE ANN. tit. 8, § 122(9) (2005).

176. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 961 (Del. Ch. 1996).

charitable contribution by the defendant, the consideration would have no value to the corporation, and, therefore, could not possibly be fair unless there was no merit to the plaintiff's claim; such a non-meritorious lawsuit should be dismissed rather than settled. Only if the charitable donation provided for in the settlement confers a "demonstrable benefit" can it be adequate consideration to support the end to litigation by settlement. A requirement that the court approving the settlement find such a benefit helps to guard against a collusive settlement.

Second, Professors Balotti and Hanks express concern that a rule requiring a benefit for charitable contributions in the non-settlement context would present problems of both determining what exactly the benefit might be and ignoring the corporate social responsibility and public policy justifications for allowing altruistic corporate donations to charity.¹⁷⁷ However, the concerns of Professors Balotti and Hanks do not resonate the same way when a benefit requirement is limited to the settlement context. The court would assess the benefits of the donations but would not have to be exact.¹⁷⁸ Moreover, since a benefit requirement would apply only in the context of settlements, this would not undermine altruistic corporate donations but would be applying the requirement for the limited purpose of lessening the risk of collusion in derivative action settlements.

3. Policy Arguments for Encouraging Charitable Donation Based Settlements

The main policy argument in favor of not only allowing but also encouraging, under the right circumstances, derivative lawsuit settlements that provide for charitable donations by the defendant is the generally favorable view that the legal system accords to negotiated settlements. Public policy generally favors the voluntary settlement of litigation as a means of avoiding unnecessarily protracted lawsuits.¹⁷⁹ This public policy is especially applicable to shareholder derivative litigation. The court in *Maher v. Zapata Corp.* emphasized this, noting that "[s]ettlement of shareholder derivative actions are particularly favored because such litigation is 'notoriously difficult and unpredictable' (citation omitted)."¹⁸⁰ The *Maher* court stated that, because of this policy preference, courts do not "lightly reject" negotiated settlements of derivative litigation.¹⁸¹ Also indicative of the policy favoring

177. Balotti & Hanks, *supra* note 85, at 991.

178. *In re Caremark*, 698 A.2d at 961.

179. *Neponsit Inv. Co. v. Abramson*, 405 A.2d 97, 100 (Del. 1979).

180. *Maher v. Zapata Corp.* 714 F.2d 436, 455 (5th Cir. 1983).

181. *Id.*

the settlement of derivative litigation is that, while the adequacy of the settlement consideration balanced against the strength of the shareholder plaintiff's claims is the primary factor in analyzing the fairness of a settlement, courts have acknowledged that the avoidance of unnecessary expense is also an important factor supporting the approval of a settlement.¹⁸²

Of course, given the risk of unfair settlements of derivative actions stemming from collusive dealing between the parties, courts have sought to strike a balance between allowing settlements and preventing abuse of the settlement process. The balance that courts have struck has been to remain amenable toward the settlement of derivative litigation for the aforementioned reasons but also, pursuant to the court approval requirement, to assess independently that the settlement is fair, reasonable, and the product of non-collusive bargaining. Thus, the *Maher* court, immediately after indicating the preference for ending litigation by settlement, proceeds to review the criteria for court approval.¹⁸³

The above policy of favoring settlement of derivative litigation is as equally applicable to charitable donation settlements as it is to settlements providing for monetary damages or non-pecuniary measures. The argument for encouraging charitable donations settlements is particularly compelling when a shareholder plaintiff's claims appear to be weak. Once a court has found that such a settlement is fair, reasonable and non-collusive, the general policy favoring settlement moves to the forefront. This policy dictates that it is preferable to settle a claim that is not very strong but does not warrant dismissal with a charitable donation than it is to undergo further expensive, time-consuming, and distracting litigation. The solution to the issues arising from charitable donations settlements is not to go to the extreme of proscribing such settlements but to strike the same balance between the competing goals of promoting voluntary settlement and ensuring fairness in the settlement process that the legal system has found sensible with other types of settlements.

A second policy justification for the approval of charitable donations settlements is that such settlements help to fulfill the primary purposes of shareholder derivative litigation, albeit, as is the case with

182. *Lewis v. Anderson*, 81 F.R.D. 436, 439 (S.D.N.Y. 1978) (finding the termination of the derivative litigation—thus avoiding further expense, distraction of company management, and uncertainty—to be the “most persuasive” of the purported benefits of the proposed settlement at issue). See also *Robbins v. Alibrandi*, 25 Cal. Rptr. 3d 387, 396 (Cal. Ct. App. 2005)396; see also *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1314 (3d Cir. 1993).

183. *Maher*, 714 F.2d at 455.

all settlements, to a lesser extent than a plaintiff victory at trial. A debate among commentators as to whether derivative litigation serves the purpose of compensating the harmed corporation or the purpose of deterring wrongful conduct remains unsettled.¹⁸⁴ Most derivative lawsuit recoveries, however, will serve both of these purposes.¹⁸⁵ This is the case with a charitable donation settlement conferring a “demonstrable benefit” to the corporation, assuming that the settlement is free from collusion. The deterrence objective is satisfied by the need for the wrongdoer defendant to contribute to charity because of his or her wrongdoing. Some of the commentators who were critical of the Oracle Cases settlement expressed the concern that the settlement would provide little punishment for Ellison, who already donates significant sums to charity¹⁸⁶; indeed, Ellison could merely donate less in his own name to balance out the amount of money that he must donate in Oracle’s name. While this may reduce the punishment in the Oracle Cases settlement, the deterrent effect will still hold in many other situations where the wrongdoer defendant does not already make large charitable donations. Moreover, there remains the compensation objective of derivative lawsuits. The compensation objective is satisfied by the benefit to the corporation that results from the charitable donation in the corporation’s name.

A final policy reason that lends support to the case for allowing derivative lawsuit settlements that provide for charitable donations by the wrongdoer defendant is the beneficial impact this could have on charitable giving.¹⁸⁷ To be sure, such settlement-driven charitable donations, even if they were to go from being unusual to much more commonplace, would still represent only a small portion of both overall charitable donations and charitable donations by corporations.¹⁸⁸ However, from the perspective of the individual charities that receive donations provided for in settlements, the impact could be large; the \$100 million called for in the Oracle cases settlement, for instance, could have a substantial positive benefit for the selected charities. The above policy argument fits in well with the idea that corporate charitable donations, even when providing a benefit to the corpora-

184. *When Should Courts Allow the Settlement of Duty-of-Loyalty Derivative Suits?*, 109 HARV. L. REV. 1084, 1088 (1996). “The Delaware courts have declined to declare an open allegiance to either the compensation or the deterrence rationale.” *Id.* at 1090.

185. *Id.* at 1088.

186. *See* Langberg, *supra* note 9.

187. Of course, the impact of a charitable settlement on total charitable giving depends on whether the defendant reduces his or her own charitable contributions in response.

188. *See* American Association of Fundraising Council, *Giving USA 2005*, available at http://www.aafr.org/press_releases/index.cfm?pg=trustreleases/tsunamigifts.html.

tion, also can be justified on the grounds of “corporate social responsibility.”¹⁸⁹ The idea of corporate social responsibility states that “in light of pressing social needs, the vastness of corporate wealth and power, and evolving ethical norms, corporate America should make increased social expenditures.”¹⁹⁰ To the extent that allowing charitable donations settlements increases charitable giving, such settlements further the end of corporate social responsibility. While most of corporate law is driven by ideas of profit-maximization and economic efficiency, the idea of corporate social responsibility has gained acceptance in both “public policy discourse” and in the law.¹⁹¹ Thus, while this may be a fairly minor policy point in favor of settlements providing for charitable donations, it should not be totally dismissed.

B. *Analysis of the Oracle Cases Settlement*

This Note will now apply the above general discussion of settlements providing for charitable donations to the settlements negotiated between Oracle Corporation, Larry Ellison, and the Oracle shareholders who brought the derivative suit based on the insider trading allegations. First, the factors that could potentially weigh for or against the approval of the settlement will be discussed. Second, Judge Schwartz’s rejection of the original proposed settlement and subsequent approval of the revised settlement will be analyzed.

1. Factors Favoring and Disfavoring Approval of the Proposed Settlement

The difficulty that a court faces when assessing the fairness and reasonableness of a proposed settlement is apparent from listing some of the factors that weigh for and against settlement of the Oracle lawsuit. The first factor among those that could possibly weigh in favor of approval of settlement in the instant case is the potential benefit to Oracle from the main charitable donations provision and the other mandated changes in company policy to help prevent future insider trading.¹⁹² In addition, the Delaware courts dismissed litigation on summary judgment brought in that state based on the same allegations, calling into question the strength of the plaintiff shareholders’

189. Kahn, *supra* note 90, at 625-26.

190. *Id.* at 630.

191. *Id.* at 632. For example, Congress has indicated its support for the idea of corporate social responsibility through corporate tax deductions for charitable contributions, including increasing the ceiling on the deduction in 1981 from 5% to 10% of annual profits. *Id.* at 633.

192. See Judgment of Dismissal, Oracle Cases, No. CIV417511, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005).

claims.¹⁹³ Other factors favoring approval include that: 1) a former judge acted as a mediator during the settlement negotiations;¹⁹⁴ 2) Oracle has to approve the donee of the settlement donation;¹⁹⁵ 3) all the parties expressed views that the settlement was fair, including independent directors on the Oracle board;¹⁹⁶ and 4) the litigation had already lasted for four years and would continue without settlement.¹⁹⁷

However, there are also several factors weighing against approval of a settlement of the derivative claims against Ellison. First, the donees of the charitable donations arising out of the settlement were not named in the settlement, making it impossible to discern whether there would be any “demonstrable benefit” to the corporation.¹⁹⁸ Second, Ellison owns approximately 25% of outstanding Oracle stock, giving him substantial control over the company;¹⁹⁹ this presumably includes the settlement decision. Finally, the settlement did not clear up whether Oracle would be entitled to claim the tax deductions from the donations provided for in the settlement.²⁰⁰

2. Judge’s Rejection of the Original Settlement and Approval of the Revised Settlement

Fully analyzing Judge Swartz’s decision with respect to both the original proposed Oracle Cases settlement and the approved revised settlement is difficult given a limited record and no full written opinion by the judge. Still, one minor and two larger potential flaws in the judge’s decisions concerning the Oracle settlement are discernable. The potential minor flaw is that no reasonableness analysis pursuant to *Theodora* was undertaken. This omission, however, is minor because the charitable donations provided for in the settlement are not likely to fail this test. The settlement calls for \$20 million donations in each of five years; in any of the fiscal years between 2001 and 2005,

193. See *In re Oracle Corp. Derivative Litig.*, 867 A.2d 904, 955 (Del. Ch. 2004), *aff’d* 872 A.2d 960 (Del. 2005).

194. Supplemental Declaration of the Honorable Daniel Weinstein (Ret.) in Support of Motion for Approval of Revised Proposed Settlement and Motion for Award of Attorneys’ Fees and Reimbursement of Expenses, Oracle Cases, No. CIV417511, 2005 WL 3279791 (Cal. Super. Ct. Nov. 17, 2005).

195. Judgment of Dismissal, Oracle Cases, No. CIV417511, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005).

196. *Id.*

197. *Id.*

198. *Id.*

199. Glater, *supra* note 127, at C1.

200. See Judgment of Dismissal, Oracle Cases, No. CIV417511, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005).

this would represent less than 1% of Oracle Corporation's net income.²⁰¹ Since this is well below the 10% limit for tax deductions for charitable donations, a court would likely find the donations provided for in the Oracle settlement to be reasonable.

A more substantial problem with the Oracle settlement is that it does not name the specific donations that Ellison will make pursuant to the settlement. Instead, the settlement merely provides for Ellison to pick the recipients subject to approval by Oracle's board of directors.²⁰² The problem with this is that, despite the safeguard of having Oracle approve the donees, there is no way for a court to discern whether a benefit will be conferred on Oracle by the settlement donations. As such, Judge Schwartz could not possibly have considered whether the charitable donation would provide a "demonstrable benefit" in his approval of the revised settlement.

In addition, the judge rejected the original proposed settlement in this case and approved a revised settlement with the only change being that, instead of Oracle paying the plaintiffs' attorneys' fees, Ellison would be responsible for paying millions of dollars in fees.²⁰³ The judge said the original proposed settlement was "very good" but rejected it because of attorneys' fees that it asked Oracle to pay.²⁰⁴ However, assuming that the judge finds a substantial benefit, then the court should award fees under the substantial benefit doctrine. These fees should be payable by Oracle rather than Ellison, as "[t]he obligation to reimburse expenses to a shareholder who brings a successful derivative action should be the obligation of the corporation and not an obligation of the defendants."²⁰⁵ Under the American Rule, courts only shift fees to defendants in rare situations.²⁰⁶ As such, in corporate litigation, such as this, fee shifting is an "exception, rather than the rule."²⁰⁷ There is no equitable reason for fee shifting in the Oracle settlement. Even if the judge determined that the negotiated fees were too high, the settlement specifically stated that if the judge lowered the fee award, this would not negate the other settlement

201. See Oracle Corporation, Form 10-K, available at http://www.oracle.com/corporate/investor_relations/10k_2005.pdf.

202. Judgment of Dismissal, Oracle Cases, No. CIV417511, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005).

203. Bloomberg News, *supra* note 159, at C6.

204. Glater, *supra* note 127, at C3.

205. 13 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 6044 (2006).

206. *Id.*

207. *Id.*

terms.²⁰⁸ Therefore, the judge could have ordered Oracle to pay less than the negotiated amount of plaintiffs' attorneys' fees if he felt this was too high given the work done by the attorneys and the outcome of the case.

V. IMPACT

The impact of the Oracle Cases settlement is difficult to gauge. Given the novelty of the settlement in the instant case, how far-reaching and influential it will be remains uncertain; previous settlements, such as in the EBay settlement, have only provided for part of the damages to go directly from the defendant to charity.²⁰⁹ Despite these uncertainties over the impact of this settlement, there are a couple possibilities.

On one hand, the Oracle settlement may be an anomaly or an example of what will become a rare phenomenon in derivative litigation, either because parties do not negotiate settlements providing mainly for charitable donations or because courts refuse to approve such settlements. The commentators who were critical of the Oracle settlement, besides disapproving of Oracle having to pay millions of dollars in the ultimately rejected original proposed settlement, were more widely concerned that charitable donations settlements will not really benefit the corporation and its shareholder and is merely an example of a corporate defendant trying to "game the system."²¹⁰ If the arguments of these critics win out, the Oracle settlement may remain the lone or rare example of this type of settlement.

On the other hand, given the benefits of settling derivative litigation and the court approval requirement already used to determine whether a settlement is fair, courts and litigating parties might find settlement involving charitable donations to be an attractive option, especially when the plaintiff's claims are not very strong. However, while the court in this case did approve the settlement, there are clearly some unresolved issues with this type of settlement should it become more prevalent, including how the court should handle the awarding of attorneys' fees and how stringent any benefit requirement should be.

208. See Judgment of Dismissal, Oracle Cases, No. CIV417511, 2005 WL 3438589 (Cal. Super. Ct. Nov. 22, 2005).

209. *California Judge Nixes Oracle CEO's Offer to Pay \$100M to Charity to Settle Suit*, *supra* note 4.

210. See *supra* note 9 and accompanying text.

VI. CONCLUSION

Despite some potential flaws, the novel settlement in the Oracle Cases posits a new avenue for parties negotiating an end to time-consuming and costly derivative litigation. Courts should both allow and encourage settlements that provide solely or primarily for charitable donations by the defendant in the name of the corporation, as long as the courts determine that such settlements are fair, reasonable, and reached in the absence of collusive behavior. Courts should treat charitable donation settlements similarly to non-pecuniary settlements, which are also difficult to value. As further assurance that a charitable donations settlement is non-collusive and fair, courts should: 1) apply the *Theodora* reasonableness test and 2) require that a “demonstrable benefit” to the corporation result from the donations. In addition, policy reasons for encouraging such settlements include: 1) our legal system’s preference for the voluntary settlement of litigation, 2) the fulfillment of the main objectives of derivative litigations, and 3) the potential benefit of such settlements to individual charities. It will now be interesting to observe whether the novel settlement in the Oracle Cases becomes more commonplace or whether it is merely a blip in the history of derivative litigation settlements.