

DELAWARE CORPORATE LAW BULLETIN

Chancery Court Finds that Adverse Directors Not Entitled to Privileged Board Communications Concerning a Potential Merger

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Determines that interested directors not entitled to certain privileged communications with outside counsel relating to a potential merger with an affiliated company

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INTRODUCTION

The Delaware Court of Chancery (“*Chancery Court*”) has recognized in *Kalisman v. Friedman*, C.A. No. 8447–VCL, 2013 WL 1668205, at *3–4 (Del. Ch. Apr. 17, 2013) (“*Kalisman*”), that a “director’s right to information is essentially unfettered in nature. The right includes equal access to board information. A company cannot pick and choose which directors will receive which information.”

At the same time, the *Kalisman* Court identified three circumstances under which a board of directors may limit this unfettered right:

1. Pursuant to “an *ex ante* agreement among the contracting parties.”
2. In connection with appointment of a special committee, “which is free to retain separate legal counsel, and its communications with that counsel would be properly protected, at least to the extent necessary for the committee’s ongoing work, such as . . . negotiating an interested transaction.”
3. “[O]nce sufficient adversity exists between the director and the corporation such that the director could no longer have a reasonable expectation that he was a client of the board’s counsel.”

When the third circumstance is at issue, the board must employ “appropriate governance procedures,” according to *SBC Interactive, Inc. v. Corporate Media Partners*, No. Civ.A. 15987, 1997 WL 770715, at *6 (Del. Ch. Dec. 9, 1997) (“*SBC Interactive*”), to put specified directors on notice they are being segregated from certain deliberations.

This very circumstance recently arose in *In re CBS Corporation Litigation*, Consol. C.A. No. 2018-0342-AGB, 2018 WL 3414163 (Del. Ch. July 13, 2018) (“*CBS Litigation*”). Chancellor Andre G. Bouchard’s letter ruling in *CBS Litigation* provides a useful analysis how a board should proceed in preventing adverse directors from obtaining certain privileged information with outside legal counsel. This decision strikes a balance between protecting the board from disclosing privileged

information to potentially adverse directors while protecting individual directors from being unknowingly excluded from such information.

I. FACTUAL BACKGROUND

A. *The Relationship Between CBS and Viacom*

The two mass media behemoths, CBS Corporation (“CBS”) and Viacom Inc. (“Viacom”) were part of a single company “before they were split into standalone entities in 2005” (the “*Split*”). Both are effectively controlled by Sumner Redstone and his daughter Shari through their ownership of National Amusements, Inc. (“NAI”). CBS has two classes of stock: Class A common stock with voting power and Class B stock without voting power. Through its ownership of Class A common stock, NAI effectively controls 79.7% of the voting power of CBS, versus approximately 10.3% of the economic stake. CBS has 14 directors, 3 of whom (including Ms. Redstone) are affiliated with NAI (the “*NAI Affiliated Directors*”). The Redstones enjoy a similar control position at Viacom.

Since 2006, the law firm Wachtell, Lipton, Rosen & Katz (“*Wachtell Lipton*”) has served as outside counsel to CBS, as well as to key governance committees of the CBS board of directors (the “*Board*”). In this connection, Wachtell Lipton has represented CBS in a variety of matters, some that involve NAI and some that do not. With regard to the former category, on several occasions, the Board sought advice from Wachtell Lipton “arising from concern that National Amusements and its principals might take actions that were not in the best interests of CBS and its stockholders.”

On September 27, 2016, NAI’s outside counsel sent Wachtell Lipton “a draft of a letter from NAI requesting that CBS consider a potential combination with Viacom.” Among other things, the letter stated: “In light of [NAI’s] controlling interest in each of [CBS] and [Viacom], we expect that each company will establish a special committee to evaluate, explore, consider and, if they determine advisable, negotiate a potential combination[.]” Two days later, the Board adopted resolutions authorizing a special committee of independent directors (“*2016 Special Committee*”) to consider, negotiate, and oversee the potential transaction. The Board resolutions required that the “directors, officers, and agents of CBS cooperate with [the 2016 Special Committee] so that it could carry out its duties.” The 2016 Special Committee finished its work in December 2016 but merger talks did not proceed.

In January 2018, Ms. Redstone formally approached the CBS and Viacom boards to press for a combination. On February 1, 2018, the

Board adopted resolutions forming a second special committee (“*2018 Special Committee*” and, together with the 2016 Special Committee, the “*Special Committee*”). The 2018 Special Committee received substantively the same delegation of authority to consider a merger with Viacom as did the 2016 Special Committee, including a mandate for the “full cooperation of directors, officers, employees, and agents of CBS” with the 2018 Special Committee.

In mid-May, the 2018 Special Committee determined a combination with Viacom was not in the best interests of CBS or its non-NIA related stockholders. The 2018 Special Committee also recommended that the Board issue a dividend of Class A voting stock to all CBS stockholders to effectively reduce NAI’s voting power from approximately 80% to 20%, but leaving its economic interest intact (the “*Stock Dividend*”).

In response, just three days later, NAI executed a written consent of stockholders purporting to amend CBS’s bylaws “to require approval of 90% of the directors then in office at two separate meetings held at least twenty business days apart in order to declare a dividend” (the “*90% Bylaw*”). Nevertheless, the Board approved the Stock Dividend the next day by a vote of 11–3, with only the NAI Affiliated Directors dissenting.

B. Litigation Ensues

Not surprising, litigation followed in the Chancery Court as to the validity of both the Stock Dividend and the 90% Bylaw. While awaiting trial, NAI filed motions seeking to compel production to NAI and the Redstones (collectively, the “*NAI Parties*”) of two categories “of privileged materials involving communications with CBS Counsel from before May 14, 2018”:

1. “Communications with and between CBS counsel and any officer or director of CBS.” (“*CBS Communications*”)
2. “Communications between (i) members of the special committees of the CBS board formed to consider a potential CBS/Viacom transaction or committee counsel, on the one hand, and (ii) CBS Counsel, on the other hand.” (“*Special Committee Communications*”)

In both cases, “CBS Counsel” refers to both CBS in-house counsel as well as its outside counsel, Wachtell Lipton.

NAI contends the NAI Affiliated Directors are entitled “to unfettered access to any legal advice rendered to CBS or other members

of its Board as joint clients of CBS Counsel.” CBS raises four arguments in response:

1. The NAI Affiliated Directors “could not have reasonably expected that they were represented by CBS’s outside counsel,” post-Split, concerning the “use or abuse of NAI control.”
2. The NAI Affiliated Directors have no right to communications regarding the merger proposals because adversity existed when NAI “placed itself across the negotiating table from CBS” beginning in 2016.
3. The Special Committee is protected from turning over privileged documents to the NAI Affiliated Directors because the Special Committee was “explicitly authorized to work with and direct ‘directors, officers, employees, and agents’ of CBS.”
4. Even if NAI Affiliated Directors are entitled to the privileged documents, the NAI Parties are not because NAI “lacks the contractual designation rights required to access such information.”

II. CHANCELLOR BOUCHARD’S ANALYSIS

Chancellor Bouchard addressed the NAI Parties’ motion to obtain CBS Counsel communications in a letter ruling issued on July 13, 2018, well in advance of the expedited trial to consider the validity of the Stock Dividend and the 90% Bylaw. At this preliminary stage, the Chancellor was not in a position to rule on all the issues before him. For instance, he deferred the NAI Parties’ motion seeking pre-2016 communications with CBS Counsel, explaining the record was too underdeveloped and directing the NAI Parties to develop the necessary facts during pre-trial discovery. The Chancellor also denied CBS’s request that any privileged information required to be produced to the NAI Affiliated Directors not similarly be made available to the NAI Parties. As a practical matter, the Chancellor explained, it would be unrealistic to believe any information provided to Ms. Redstone, in her capacity as an NAI Affiliated Director, “could be segregated from her thought process as an adversary of CBS” in her capacity as a stockholder.

On the other hand, Chancellor Bouchard was not so constrained from ruling on the NAI Parties’ motion relating to communications during the period from 2016 to 2018. The Chancellor’s thought process in this regard was informed by his conclusion that, once “the NAI

Parties placed themselves across the negotiating table from CBS” by asking the Board to consider a CBS/Viacom combination, they “created sufficient diversity with CBS such that the NAI Affiliated Directors could not . . . have a reasonable expectation that [they were] a client of the *board’s counsel* . . . with respect to’ matters delegated to the Special Committees.” Against this backdrop, the Chancellor turned to the NAI Parties’ request to obtain the CBS Communications and the Special Committee Communications from 2016 to 2018.

A. Directors’ Right of Access to Privileged Board Information

Returning to the *SBC Interactive* discussion of the third limitation on directors’ access laid out in *Kalisman*—that is, when “sufficient adversity exists”—Chancellor Bouchard explained that a board of directors must employ “appropriate governance procedures,” which can include “openly form[ing] a special committee,” to “ensure that the director involved had no reasonable expectation that he was a client of the board’s counsel.” Absent such procedures, where the existence of adversity is concealed, the director may reasonably, albeit mistakenly, believe he or she is “being treated identically with the other directors thus entitling that director to access the privileged information provided to the other directors.” In this connection, Delaware courts place “the burden to establish when sufficient adversity existed” on the corporation seeking to limit director access.

B. Are the NAI Affiliated Directors Entitled to the Requested Information?

Applying these principles, Chancellor Bouchard denied the NAI Affiliated Directors access to the Special Committee Communications and, to a more limited extent, to the CBS Communications, in each case for the period from 2016 to 2018.

1. Special Committee Communications

Once NAI created “sufficient adversity” with CBS by asking the Board to consider a CBS/Viacom combination, the NAI Affiliated Directors lost any “reasonable expectation that [they were] a client of the *board’s counsel* or the *Special Committee’s counsel* with respect to’ matters delegated to the Special Committees.” At this point, the Chancellor found, the Board employed “appropriate governance procedures” by forming the Special Committees, thereby putting the NAI Affiliated Directors on notice they would be segregated from the CBS side of deliberations. Thereafter, the Board was “entitled to

deliberate—and receive legal advice—in confidence and without having to share that advice with the director[s] whose interests are adverse[.]’ ”

While conceding they were not entitled to access to advice from counsel *specifically retained* by the Special Committee, the NAI Parties argued they were nonetheless entitled to communications between the Special Committees’ counsel and CBS Counsel. Chancellor Bouchard responded that “adversity should have been equally manifest to the NAI Affiliated Directors in this situation as well,” inasmuch as the Special Committee’s counsel needs to confer with CBS Counsel “to discharge their duties in an informed and responsible manner.” In particular, “Wachtell Lipton possessed extensive historical knowledge about CBS and its relationship with NAI from having represented CBS virtually from the date it became a separate public company.”

In fact, as the Chancellor explained, the Board’s resolutions forming the Special Committee specifically require “ ‘that the directors, officers, employees, and agents of the Corporation’ must cooperate with the Special Committees and their advisors so that they could carry out their duties.” And in this regard, “agent” plainly includes outside counsel—that is, Wachtell Lipton. Allowing exposure of this information to adverse parties—that is, the NAI Affiliated Directors and, by extension, the NAI Parties—would render this aspect of the Special Committee resolutions useless. The Chancellor did not believe any of this should come as a surprise to NAI or its agents or designees.

2. CBS Communications

Employing the same analysis, Chancellor Bouchard held that communications between CBS, on the one hand, and CBS Counsel, on the other, should be accorded comparable privileged treatment, but in this case *only to the extent* “undertaken in aid of the process of either of the Special Committees.” By contrast, the Chancellor recognized no factual basis to support the notion that NAI Affiliated Directors were made aware they would be separated from the other CBS directors “with respect to any matter *other than the matters falling within the purview of the Special Committees for which CBS Counsel provided assistance.*” On this basis, the NAI Parties’ motion was granted in part and denied in part.

CONCLUSION

Chancellor Bouchard’s letter ruling in the *CBS Corporation Litigation* provides guidance to legal advisors seeking to inform board of directors and their special committees how to protect privileged information from directors designated by an influential stockholder

whose interests may not be aligned with those of stockholders generally. The Chancellor strikes what appears to be an appropriate balance:

- *First*, limiting the general rule that directors are entitled to all privileged information protects a corporation from situations that may jeopardize the best interests of the corporation and its stockholders.
- *Second*, requiring “sufficient adversity” prevents a board of directors from inappropriately withholding privileged information from individual directors.
- *Third*, requiring “appropriate governance procedures” puts potentially conflicted directors on notice when they are being excluded.

It certainly will be interesting to see what other guidance emerges from the high profile CBS-NAI litigation as the conflict wends its way through the Delaware judicial system.