illusory. The Groves had no more authority to unilaterally dissolve Heartfelt than the Browns did to seize it for themselves.[74]

Because I find that the merger was a nullity, the Browns and the Groves remain equal members of the original Heartfelt LLC.

B. *The Defendants' Counterclaims*

I now turn to the Browns' counterclaim that Larry and Marlene Grove breached their fiduciary duties by usurping a corporate opportunity of Heartfelt, and that the other individual Counterclaim Defendants-Timothy Grove, Michelle Grove, Shawn Grove, Angela Grove, and Anna Keithley-aided and abetted that breach.

1. Breach of Fiduciary Duty

First, I address the claims for breach of fiduciary duty against Marlene and Larry Grove. The Groves were managing members of Heartfelt at the time they organized Home DE and Home MD and owed fiduciary duties to the other members.[75] I find that the Groves violated those fiduciary duties by wrongfully taking for themselves the corporate opportunities of Heartfelt.

The corporate opportunity doctrine is a consequence of a fiduciary's duty of loyalty, and it exists to prevent officers or directors of a corporation-or, as in this case, a managing member of an LLC-from personally benefiting from opportunities belonging to the corporation. A corporate officer or director may not take a business opportunity as his own if:

> (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has

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[74] *See* 6 *Del.* C. § 18-801(a)(3) ("A limited liability company is dissolved and its affairs shall be wound up ... upon the affirmative vote or written consent ... by members who own more than two-thirds of the then-current percentage or other interest in the profits of the limited liability company."). Because the Operating Agreement is silent as to dissolution, the LLC Act controls.

[75] *See Feeley v. NHAOCG, LLC,* 62 A.3d 649, 663 (Del. Ch. 2012) (holding that, absent contrary language in an LLC agreement, managing members of an LLC owe default fiduciary duties to the other members of the LLC). Here, neither side disputes that all four members were "managing members," and both sides testified that all four played some role in the day-to-day management of Heartfelt. Both sides also agree that each member owed fiduciary duties to the LLC.

> an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation.[76]

Conversely, a director or officer *may* take personal advantage of a corporate opportunity if:

> (1) the opportunity is presented to the director or officer in his individual and not corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity.[77]

Generally, for a corporation to have an expectant interest in any specific property, "there must be some tie between the property and the nature of the corporate business."[78] An opportunity may be said to be in the corporation's line of business where the opportunity embraces "an activity as to which [the corporation] has fundamental know ledge, practical experience and ability to pursue, which, logically and naturally, is adaptable to its business, and ... consonant with its reasonable needs and aspirations for expansion."[79]

The determination of "[w]hether or not a director has appropriated for himself something that in fairness should belong to the corporation is 'a factual question to be decided by reasonable inference from objective facts.'"[80] The burden is on the fiduciary to show that he or she did not seize a corporate opportunity.[81] As the corporate opportunity doctrine stems from a director's fiduciary duty of loyalty to the corporation, the director bears the burden of demonstrating that there was no breach because either the corporation was presented the opportunity and rejected it, or because the

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[76] *Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148, 155 (Del. 1996) (citing *Guth v. Loft*, 5 A.2d 503, 509 (Del. 1939)).

[77] *Id.*

[78] *Johnston v. Greene*, 121 A.2d 919, 924 (Del. 1956).

[79] *Guth*, 5 A.2d at 514.

[80] *Johnston*, 121 A.2d at 923 (quoting *Guth*, 5 A.2d at 513).

[81] *Guth*, 5 A.2d at 512.

corporation was not in a position to take the opportunity.[82] For example, one way that a director may satisfy this burden is by formally presenting the opportunity to the corporation's board of directors and confirming the board's disinterest.[83]

Applying these principles here, I find that Larry and Marlene Grove, as managing members of a Delaware LLC, breached their fiduciary duty of loyalty by usurping the business opportunities of Heartfelt. The business of Home DE and Home MD is the type of business that, absent a waiver from Heartfelt, would qualify as a corporate opportunity. Heartfelt would surely have been financially capable of capitalizing on that opportunity. The business was highly profitable, and, if the experiences of the parties here are indicative, there are few, if any, barriers to entering the market for low-skilled or unskilled home health staffing. Both Home entities are unquestionably engaged in the same market as Heartfelt, thereby infringing on Heartfelt's business interests. Accordingly, the only remaining issue is determining whether Heartfelt disclaimed its interest in expanding to Maryland and other parts of Delaware.

I find that the Groves have not met their burden of demonstrating that Heartfelt disclaimed its right to pursue this corporate opportunity. The only evidence of waiver was self-serving testimony from Marlene Grove that:

> Our business was going well.... So I asked [the Browns] in January of 2011 if they would like to go into a business in Maryland with T.J. and Michelle and my family . . . . And Mr. Brown indicated to me that he's not really looking at doing anything in Maryland. He wanted to look more into the aspect of being in Delaware, and I totally understood that and I said and that is fine. And I told him that I was going to pursue it, to put things together to possibly being in Maryland. And Mr.

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[82] *See Field v. Allyn*, 457 A.2d 1089, 1099 (Del. Ch. 1996).

[83] The Delaware Supreme Court has recognized a "safe harbor" for a director to pursue a corporate opportunity without breach of his fiduciary duty where the officer presents an opportunity to the broad of directors and the corporation decides not to pursue the opportunity. *Broz*, 673 A.2d at 156. However, "[i]t is not the law of Delaware that presentation to the board is a necessary prerequisite to a finding that a corporate opportunity has not been usurped." *Id.*

> Brown stated to me, just to keep them informed of what was going on or how things were happening."[84]

Marlene also asserts that she followed up with Melba two more times, once in February and again in March of 2011. Marlene testified that Melba rebuffed her each time and told her "[n]o, we are not going to go into business in Maryland with you."[85] However, Marlene acknowledged that she did not actually tell the Browns about the existence of any of her family's health care companies before this litigation commenced.[86]

Hubert Brown disagreed with Marlene's characterization of their discussions. He provided testimony— as self-serving as that of Marlene Grove—that neither he nor Melba ever disclaimed the opportunity to expand to Maryland or other parts of Delaware, but rather they wanted to proceed prudently and not expand the company too quickly.

> We had plans to expand the company ... into Maryland. But this was a newly created company. We wanted to take our time to build the company. We were doing great. There wasn't any reason for us to be jumping and going to any other places, except for just planning what we were doing and just establishing a name for ourself [sic] right here in Delaware, before we could start to branch out and do all these other things."[87]

Melba, unsurprisingly, corroborated Hubert's testimony and said that she, Marlene, and Hubert discussed "practically every day" the possibility that Heartfelt would expand to Maryland and southern Delaware."[88] Melba also testified that Marlene had *never* disclosed that she planned to create the Home entities nor invited the Browns to be a part of them.[89] On the contrary, Melba asserted that Heartfelt was actively considering expanding its operations to cover Maryland and Sussex County, Delaware.[90] In support of this

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[84] Trial Tr. 64.
[85] Trial Tr. 66.
[86] Trial Tr. 637.
[87] Trial Tr. 155-56.
[88] Trial Tr. 307.
[89] Trial Tr. 345.
[90] Trial Tr. 306.

assertion, the Browns produced handwritten notes which purport to be records of member meetings that took place from 2009 through 2011.[91] The notes dated May 17, 2010 indicate that there was a discussion of Heartfelt's expansion into Maryland and southern Delaware.[92] The notes from February 21, 2011 similarly state: "3. Expansion of Heartfelt to ... MD, Kent & Sussex. Marlene stated that she will sell her house if this is done and move to Lewes Beach to manage the Heartfelt office in Lewes as was previously discussed in 201 0."[93] Although the meeting notes for both dates note that Marlene was in attendance and that all members present agreed on the notes, Marlene denied that she ever saw the notes or agreed to their accuracy.[94]

Though I find all testimony presented on this issue of questionable credibility, the weight of the evidence favors the Browns' position that there was no express grant of permission for Marlene Grove to open up competing businesses in any location. It is unclear to what extent Marlene's testimony, even if I accepted it as true, supports a finding that Heartfelt waived a corporate opportunity. Marlene did not testify that she presented the opportunity to expand to nearby markets to *Heartfelt*; she avers that she invited the Browns in their personal capacity to join her in creating new, competing entities. Presenting an opportunity to the Browns is not the same as presenting an opportunity to Heartfelt. And even if it were, Marlene's acknowledgment that she never actually told the Browns about the competing entities belies her testimony that the Browns gave her permission to create them. In any event, as mentioned above, the Groves have the burden of proving that they had the right to pursue opportunities which would otherwise belong to Heartfelt. I find that they have failed to meet that burden.

2. Aiding and Abetting

Finally, I reject the counterclaims for aiding and abetting because the Browns have failed to present any evidence that the Counterclaim Defendants knowingly participated in Marlene's and Larry's breaches of fiduciary duty. "Knowing participation in a ... fiduciary breach

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[91] Defs.' Ex. 137.
[92] Defs.' Ex. 137, at 0254.
[93] Defs.' Ex. 137, at 0253.
[94] Trial Tr. 635-36.

requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach."[95] The Counterclaim Plaintiffs have failed to argue, and the evidence at trial failed to produce, any evidence that the Counterclaim Defendants *knew* that Marlene and Larry owed fiduciary duties or that operation of the Home MD and Home DE entities would constitute a breach of those duties. Accordingly, the aiding and abetting counterclaims fail.[96]

C. *Remedy*

The final question is the appropriate remedy for this breach of the Operating Agreement. Both parties have taken for themselves benefits that should have been shared with the other. The Browns attempted to effectuate a merger contrary to the LLC Act, and Heartfelt has doubtless amassed profits belonging to all four owners thereafter. Likewise, the Groves usurped opportunities that should have belonged to Heartfelt. This Court has "broad latitude to exercise its equitable powers to craft a remedy."[97] I find that the appropriate remedy in this case is to order each side to account to Heartfelt (and thus to one another) for those profits which they have wrongfully kept for themselves. Specifically, the Browns must account for the profits earned by Heartfelt II since the purported merger, and the Groves must account for the profits earned by Heart-N-Hand, Home DE, and Home MD.[98] Though there is currently no application for dissolution under 6 *Del.* C. § 18-802, the bitterness and acrimony between these parties-though they once considered themselves friends-means that it is "not reasonably practicable to carry on the business in conformity with a limited liability company agreement."[99] Though I will not effectuate a judicial dissolution of this LLC *sua sponte,* I would hope that the parties could, in the interests of economy, present a petition for dissolution to be considered concurrently with the accounting. The parties could then divide their interests and

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[95] *Malpiede v. Townson,* 780 A.2d 1075, 1097 (Del. 2001).

[96] As previously noted, the Brown's counterclaims for breach of contract were waived at trial. Trial Tr. 26.

[97] *Hogg v. Walker,* 622 A.2d 648, 654 (Del. 1993).

[98] The accounting should also determine the extent of any unpaid capital contributions which the members may owe to Heartfelt.

[99] 6 Del.C. § 18-802.

pursue them separately. The parties should submit a form of order consistent with this decision.

IN RE CHINA AUTOMOTIVE SYSTEMS CONSOLIDATED INC. DERIVATIVE LITIGATION

No. 7145-VCN

In the Court of Chancery of the State of Delaware

August 30, 2013

Blake A. Bennett, Esquire of Cooch and Taylor P.A., Wilmington, Delaware, and William B. Federman, Esquire of Federman & Sherwood, Oklahoma City, Oklahoma, Attorneys for Plaintiffs.

Kurt M. Heyman, Esquire and Patricia L. Enerio, Esquire of Proctor Heyman LLP, Wilmington, Delaware; Neal R. Marder, Esquire, Micol O. Sordina, Esquire, and Ali R. Rabbani, Esquire of Winston & Strawn LLP, Los Angeles, California; and Jeffrey R. Burke, Esquire of Winston & Strawn LLP, New York, New York, Attorneys for Defendants.

NOBLE, *Vice Chancellor*

I. INTRODUCTION[1]

Plaintiffs Arthur Garnett and David J. Tearle (the "Plaintiffs") bring this derivative action on behalf of Nominal Defendant China Automotive Systems, Inc. ("China Automotive" or the "Company") alleging breaches of fiduciary duty, insider trading, and unjust enrichment against Defendants Hanlin Chen ("Chen"), Qizhou Wu ("Wu"), Bruce Carlton Richardson ("Richardson"), Robert Tung ("Tung"), and Guangxun Xu ("Xu") (collectively, the "Defendants"), the five members of China Automotive's board of directors (the "Board").[2]

Specifically, the Plaintiffs assert that the Board as a whole, as well as Richardson, Tung, and Xu as the members of the Company's Audit Committee, breached their fiduciary duties both by failing to maintain adequate accounting controls and by utilizing improper

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[1] The facts are taken from the Plaintiffs' Verified Consolidated Shareholder Derivative Complaint (the "Complaint" or "Compl.").

[2] Compl. ¶ 3.

accounting and audit practices, leading to the Company's issuance of false and misleading statements.[3] The Plaintiffs also contend that Chen and Wu breached their fiduciary duties by selling stock of the Company while in possession of material, non-public information.[4] In addition, the Plaintiffs allege that the Defendants were unjustly enriched by continuing to receive remuneration from the Company at the time of these fiduciary breaches,[5] and that Chen and Wu were further unjustly enriched by retaining the proceeds from their alleged insider trading.

The Defendants have moved to dismiss each of the Plaintiffs' derivative claims under Court of Chancery Rule 23.1 for failure to make a demand on the Board or to establish demand futility through allegations of particularized facts. They assert that the allegations of the Complaint fail to show that a majority of the Board would have been interested, lacked independence, or faced a substantial threat of personal liability in considering a stockholder demand. Alternatively, the Defendants have moved under Court of Chancery Rule 12(b)(6) to dismiss the Complaint for failure to state a claim.

Because the Court concludes that demand, which was not made, is not excused under Rule 23.1, this action must be dismissed.

II. BACKGROUND

A. *The Parties*

The Plaintiffs are, and have been at all relevant times, owners of China Automotive common stock.[6] A publicly traded company since 1999,[7] China Automotive is a Delaware corporation with its headquarters in Jingzhou City in the People's Republic of China (the "PRC").[8] The Company manufactures and sells power steering systems and other automotive components.[9]

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[3] *Id.* ¶¶ 109-15.
[4] *Id.* ¶¶ 119-23.
[5] *Id.* ¶¶ 116-18.
[6] *Id.* ¶¶ 12-13.
[7] *Id.* ¶ 2.
[8] *Id.* ¶ 14.
[9] *Id.* ¶¶ 1, 2, 14.

The Defendants are the current members of the Board.[10] Chen, who owns a majority of the Company's common stock along with his wife,[11] has been Chairman of the Board since March 2003.[12] Wu, who became Chief Executive Officer in September 2007, has served as a director since 2003.[13] Three directors—Richardson, Tung, and Xu—comprise the Company's Audit, Compensation, and Nominating Committees. Richardson, the chair of the Audit Committee, and Xu, the chair of the Nominating Committee, have served as directors since December 2009.[14] Tung, the chair of the Compensation Committee, has served as a director since September 2003.[15]

B. *The Alleged Misstatements*

The Plaintiffs complain of the Board's (and the Audit Committee's) failure to oversee accounting practices at China Automotive, insider trading by Chen and Wu, and the unjust enrichment of the Defendants during these alleged breaches of fiduciary duty. Central to these claims is how the Company accounted for convertible notes it issued on February 15, 2008, (the "Convertible Notes") in a series of annual and quarterly Securities and Exchange Commission ("SEC") reports filed by China Automotive from May 12, 2009, through October 23, 2012, the date the Complaint was filed (the "Relevant Period").[16] The Plaintiffs allege that these public disclosures were materially false and misleading because they:

(1) "improperly accounted" for the Convertible Notes;

(2) "failed to account properly for operating expenses and other charges against income";

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[10] *Id.* ¶¶ 15-19.

[11] *Id.* ¶¶ 43, 102. At times the Plaintiffs allege that Chen controls "almost 55.5%" of the common stock, *id.* ¶ 43, and at other times the Plaintiffs allege that Chen owns "approximately 64%" of the common stock. *Id.* ¶ 102. Although these allegations are inconsistent, each alleges that Chen had majority control of China Automotive's stock.

[12] *Id.* ¶ 15.

[13] *Id.* ¶ 16.

[14] *Id.* ¶¶ 18, 17.

[15] *Id.* ¶19.

[16] The Plaintiffs use this definition in the Complaint, *id.* ¶ 3, and the Defendants use this definition in their briefs. Opening Br. in Supp. of Defs.' Mot. to Dismiss the Consolidated Compl. 3 n.2.

> (3) failed to disclose "material deficiencies in [the Company's] internal controls";
>
> (4) incorrectly stated the Company's financial results;
>
> (5) failed to disclose "that the Company's financial results were not prepared in accordance with Generally Accepted Accounting Principles ("GAAP")"; and
>
> (6) failed to disclose that the Company's former auditor, Schwartz Levitsky Feldman LLP ("SLF"), a Canadian firm, "was not licensed to conduct audits" in the PRC.[17]

The alleged result of these misstatements and omissions was an "inflated" price of the Company's stock during the Relevant Period.[18]

C. *The Financial Statements*

On March 17, 2011, the Company announced that it would need to restate its financial statements for fiscal year 2009 and its unaudited financial statements for the first three quarters of 2010 to correct its accounting for the Convertible Notes.[19]

The Company reported that the "Convertible Notes contain an embedded conversion feature that allows for an adjustment to the conversion price in the event that the Company issues equity securities at a price lower than the original conversion price."[20] In its announcement, the Company explained that Accounting Standard Codification 815, which governed the accounting of the Convertible Notes:

> requires issuers [like the Company] to bifurcate the embedded conversion options from the convertible notes and, starting on January 1, 2009, to record such conversion options as derivative liabilities valued at fair

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[17] Compl. ¶ 4.

[18] *Id.* ¶ 5.

[19] *Id.* ¶ 68. China Automotive also stated that it would not file its Form 10-K annual report for fiscal year 2010 on time.

[20] *Id.*

> value. Thereafter, any gain or loss in the fair value of the derivative should be recorded in the company's income statement at the end of each reporting period.[21]

After a review, the Audit Committee concluded that "[d]ue to the complexities of the accounting treatment of [the Company's] convertible notes, the Company inappropriately accounted for the embedded conversion feature and the associated gain or loss on changes in fair value for the derivative."[22]

The necessary adjustments reduced China Automotive's net income for the year ending December 31, 2009, by $43 million, and increased its net income for the year ending December 31, 2010, by $19 million.[23] The Plaintiffs also allege that the eventual restatement contained additional corrections to operating expenses, "increasing costs and further reducing profits."[24] The initial disclosure on March 17, 2011, about the need to restate certain financial statements, according to the Plaintiffs, caused China Automotive's shares to fall that day by $1.42, or by approximately 14%, to close at $8.81.[25]

D. *Alleged Wrongdoing by the Defendants*

The Plaintiffs frame the accounting misstatements and omissions, at least in part, as a direct product of their allegations that SLF, the Company's auditor, was not licensed "to audit books and records"[26] in the PRC and that the Defendants knew it was not licensed.[27] The

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[21] *Id.*

[22] *Id.*

[23] *Id.* ¶¶ 10, 68.

[24] *Id.* ¶ 10.

[25] *Id.* ¶ 69. On March 18, 2011, the Company revealed that it had received a notification letter from NASDAQ, the stock exchange on which China Automotive common stock was traded, indicating that it was not in compliance with NASDAQ's Listing Rules requiring the timely filing of SEC periodic reports. *Id.* ¶ 70. The Company explained that it was "reviewing the complex accounting treatment" of the Convertible Notes and would file its annual report and amended quarterly reports within the 60-day period to regain compliance with NASDAQ Listing Rules. *Id.* ¶ 70. According to the Plaintiffs, on the first trading day following this additional disclosure, March 21, 2011, China Automotive's share price fell a further 20 cents to $8.61 per share. *Id.* ¶ 71.

[26] *Id.* ¶ 72.

[27] *Id.* ¶ 8. As alleged in the Complaint, SLF resigned as China Automotive's auditor in December 2010, *id.* ¶ 72, some three months before the Company announced in March 2011 that it would restate certain financial statements. *Id.* ¶ 68. This timeline undermines the Plaintiffs' claim that SLF resigned only after China Automotive disclosed its receipt of a

Plaintiffs assert that Richardson, Tung, and Xu, as members of China Automotive's Audit Committee, failed to maintain sufficient oversight of the Company's accounting practices, presumably including the auditing by SLF.[28] More specifically, the Plaintiffs contend that these three directors had knowledge of "confidential and proprietary information"[29] because of their positions on the Board and the Audit Committee. These positions also allegedly gave them the "power and influence to cause"[30] the Company to issue materially misleading financial statements, meaning that the Audit Committee's actions caused the Company to "fail[] to disclose material facts to shareholders during the Relevant Period."[31]

According to the Plaintiffs, the review of China Automotive's 2009 and 2010 financial statements in March 2011 by PricewaterhouseCoopers Zhong Tian CPAs Limited Company, which replaced SLF after its resignation in December 2010,[32] determined that SLF had failed to account properly for the cost of the conversion feature and change in fair value of the Convertible Notes as a charge against income.[33] For instance, in 2009, while China Automotive's stock price rose from approximately $2 per share to approximately $20 per share, the conversion price of the Convertible Notes allegedly remained fixed instead of reflecting the change in stock price.[34]

Collectively, the Defendants are alleged to have "either caused the issuance of materially misleading statements or failed to timely correct such statements" in breach of their fiduciary duties.[35] Individually, during the Relevant Period and while the Company's stock price was "inflated,"[36] two Defendants—namely, Board Chairman Chen and CEO Wu—allegedly sold part of their personal holdings of China Automotive stock.[37]

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notification letter from NASDAQ that purportedly revealed for the first time that SLF was not a licensed auditor in the PRC. *Id.* ¶ 72.

[28] *Id.* ¶¶ 79, 96-98.

[29] *Id.* ¶ 29.

[30] *Id.* ¶ 30.

[31] *Id.* at ¶ 97. The Plaintiffs further contend that Richardson, Tung, and Xu, as members of the Company's Compensation Committee, wrongfully "approved compensation and financial plans" with knowledge that the plans were "based on artificially inflated stock prices." *Id.* ¶ 99.

[32] *Id.* ¶ 72.

[33] *Id.* ¶ 73.

[34] *Id.* ¶ 73

[35] *Id.* ¶ 79.

[36] *Id.* ¶ 9.

[37] *Id.* ¶¶ 43, 81-82.

Whatever the actual sales figures,[38] the Plaintiffs allege that Chen and Wu "misrepresented the financial posture of the Company" to "sell personally held stock at artificially inflated prices."[39] In particular, Wu's positions as a director and as CEO allegedly provided him with "material adverse information about the Company" that, instead of disclosing, he used "to secure financial gains for himself."[40] But, although in one paragraph the Plaintiffs claim that the Defendants together sold over $40 million in Company stock,[41] nowhere in the Complaint are any allegations of particularized facts naming the other three members of the Board—Richardson, Tung, or Xu—as persons who sold stock in China Automotive during the Relevant Period.[42]

III. CONTENTIONS

The Plaintiffs plead three causes of action. First, the Plaintiffs allege the Defendants breached their fiduciary duties as directors of China Automotive through their inadequate oversight of the Company's accounting practices and their issuance of misleading financial statements that improperly valued the Convertible Notes.[43] According to the Plaintiffs, the Defendants knew, or should have known, that the Company's statements about its financial condition contained material misstatements or omissions; moreover, they did not act to correct these improper misrepresentations.[44] The Plaintiffs seek damages for the alleged breaches of fiduciary duty.[45]

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[38] The purported dollar amount of these sales by the named Chen and Wu varies widely throughout the Complaint—from an earlier claim that Chen and his wife sold almost $10 million of Company stock while Wu sold in excess of $13 million, *id.* ¶ 43, to a later allegation that Chen sold stock in excess of $596,000 while Wu sold approximately $4,804,865, *id.* ¶¶ 81-82.

[39] *Id.* ¶ 80.

[40] *Id.* ¶ 81.

[41] *Id.* ¶ 9.

[42] In contrast to the Court's reasonably inferring that the Complaint alleges insider trading by Chen and Wu, despite inconsistent allegations of how much common stock they sold, the Court now cannot reasonably infer, even when viewing the allegations of common stock sales amounting to $40 million by all Defendants in favor of the Plaintiffs, that the Complaint supports an allegation of insider trading against Richardson, Tung, or Xu.

[43] The Plaintiffs also allege a related, and subsidiary, breach of fiduciary duty by the Compensation Committee members, *id.* ¶¶ 99, 109-15, as well as a claim of failure to remedy, *id.* ¶ 85.

[44] *Id.* ¶ 112.

[45] *Id.* ¶ 114.

The Plaintiffs next claim that Chen and Wu breached their fiduciary duties by engaging in insider trading. The Plaintiffs claim that Chen and Wu sold Company stock on the basis of their knowledge of material, non-public information. Supporting this theory is the Plaintiffs' allegation that sales of the Company stock by Chen and Wu were "unusual in size and scope" compared to previous trading practices.[46] As a remedy, the Plaintiffs seek the imposition of a constructive trust over any profits obtained by the alleged insider trading.[47]

Finally, the Plaintiffs assert that the Defendants were unjustly enriched by continuing to receive compensation from the Company while in breach of their fiduciary duties. The Plaintiffs seek disgorgement of all profits, benefits, and other compensation that the Defendants wrongfully obtained.[48] In addition, the Plaintiffs claim that Wu was unjustly enriched "by his receipt and retention of proceeds that he received from sales of China Automotive [stock] during the Relevant Period," which, according to the Plaintiffs, also warrants disgorgement.[49]

In response, the Defendants moved to dismiss the Complaint under Court of Chancery Rule 23.1, asserting that the Plaintiffs have failed to plead with particularity facts which establish demand futility. The Defendants contend that the Complaint: (1) fails to allege particularized facts demonstrating that a majority of the Board faced a substantial threat of personal liability if suit were filed; and (2) fails to allege particularized facts demonstrating that a majority of the Board was either interested or lacked independence to be able to consider a demand.[50]

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[46] *Id.* ¶¶ 103, 105.

[47] *Id.* ¶ 123.

[48] *Id.* ¶ 118.

[49] *Id.* ¶ 85. The Plaintiffs do not specifically seek disgorgement of Chen's alleged insider trading profits.

[50] The Defendants alternatively and independently seek dismissal of the Plaintiffs' claims under Court of Chancery Rule 12(b)(6) for failure to state a claim. Because this ruling on the motion under Rule 23.1 is dispositive, the Court need not address the motion under Rule 12(b)(6).

IV. ANALYSIS

The Plaintiffs concede that they did not make a demand on the Board before filing their Complaint.[51] Court of Chancery Rule 23.1 requires in derivative actions that "[t]he complaint . . . allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors . . . and the reasons for the plaintiff's failure to obtain the action or for not making the effort." The Plaintiffs' pleadings "must comply with stringent requirements of factual particularity"—a complaint filled with "conclusory statements or mere notice pleading" is not enough.[52]

The Court's inquiry under Rule 23.1 is limited to "the well-pled allegations of the complaint,"[53] which are taken as true.[54] All reasonable inferences from non-conclusory allegations in the Complaint are to be drawn in favor of the Plaintiffs, but the Court does not have to accept conclusory allegations unsupported by particularized facts.[55]

If stockholders do not demand that the directors pursue a claim of the corporation, then the stockholders may only pursue a derivative suit to assert the claim if "pre-suit demand is excused because the directors are deemed incapable of making an impartial decision regarding the pursuit of the litigation."[56] Under Delaware case law, the test for whether demand is excused depends on whether the

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[51] *Id.* ¶ 89.

[52] *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

[53] *Guttman v. Huang*, 823 A.2d 492, 499 (Del. Ch. 2003).

[54] *See Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988).

[55] *See In re Nat'l Auto Credit, Inc., S'holders Litig.*, 2003 WL 139768, at *8 (Del. Ch. Jan. 10, 2003).

[56] *Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008). That stockholders pursuing a derivative claim do not make demand on the board of directors—*i.e.*, the complaint purports to allege particularized facts establishing demand futility—must be expected in meritorious derivative actions. As the "business judgment rule and demand excusal are 'inextricably bound,'" *Rattner v. Bidzos*, 2003 WL 22284323, at *7 (Del. Ch. Sept. 30, 2003) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)), plaintiffs in a derivative complaint who make a demand imply they are unable to allege with particularity that at least half of the directors are interested, not independent or facing a substantial threat of personal liability. In other words, actually making demand on the corporation indicates that the stockholder plaintiffs are unable to rebut the presumption of the business judgment rule, which shields the business decisions of the board from judicial second-guessing as a matter of director discretion. *Aronson*, 473 A.2d at 812 ("[The business judgment rule] is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.").

derivative complaint alleges that the current board of directors took wrongful action or wrongfully took no action.

Where "a derivative plaintiff challenges an earlier board decision made by the same directors who remain in office at the time suit is filed,"[57] the Court must decide under *Aronson v. Lewis* "whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[58]

On the other hand, where "the subject of the derivative suit is not a business decision of the board"—for instance, a claim of inadequate oversight of the corporation's accounting practices—the Court must determine under *Rales v. Blasband* "whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[59]

Delaware case law focuses on three circumstances in which a director is not entitled to deference when considering a demand: if the director is interested, if the director is not independent, or if the director faces a substantial threat of personal liability.[60] Because a "majority vote is required to prevail on a board motion to cause the corporation to accept a demand," the derivative complaint must allege with particularity that at least half of the directors do not pass the appropriate *Aronson* or *Rales* test, which would excuse demand.[61]

Directors are interested for the purposes of demand futility if they "appear on both sides of a transaction [or] expect to derive any personal financial benefit from it in the sense of self-dealing."[62] If there is no self-dealing, the alleged corporate action needs to provide a benefit or cause a detriment that is material to the director.[63]

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[57] *In re China Agritech, Inc. S'holder Deriv. Litig.*, 2013 WL 2181514, at *15 (Del. Ch. May 21, 2013).

[58] *Aronson*, 473 A.2d at 814.

[59] *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993).

[60] *See, e.g., Desimone v. Barrows*, 924 A.2d 908, 928 (Del. Ch. 2007); *see also China Agritech*, 2013 WL 2181514, at *16 (citing *Rales*, 634 A.2d at 934).

[61] *Beneville v. York*, 769 A.2d 80, 86 (Del. Ch. 2000) (identifying the key question in the board's ability to respond to a demand as whether "the impartial directors . . . have the power unilaterally to cause the corporation to act on the demand").

[62] *Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002) (quoting *Aronson*, 473 A.2d at 812).

[63] *Id.* (citing *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 363 (Del. 1993));

A director may lack independence in the demand futility context if the director is so "beholden"[64] to the interests of another—most commonly a large or controlling stockholder—that the independence of the director's "discretion would be sterilized."[65] The alleged existence of a controlling, majority stockholder itself does not establish demand futility, even if the director was first elected with the support of the controlling stockholder.[66] Instead, there must be a sufficient "nexus" between the alleged controller and controlled party such that, based on the allegations of particularized facts in the complaint, the court "can reasonably infer that the board members . . . are acting at the direction of the allegedly dominating individual or entity."[67]

In addition to excusal by alleging with particularity that half of the board is interested or lacking independence, so too can demand be excused by alleging with particularity that at least half of the directors "face[] a sufficiently substantial threat of personal liability as to the conduct alleged in the complaint to compromise their ability to act impartially on a demand."[68] "Except in 'egregious circumstances,' the 'mere threat' of personal liability does not constitute a disabling interest for a director considering a derivative plaintiff's demand."[69] But, showing a substantial threat of personal liability does not require a plaintiff "to demonstrate a reasonable probability of success on the claim,"[70] as the plaintiff "need only 'make a threshold showing, through the allegation of particularized facts, that [its] claims have some merit.'"[71] The particularity requirement embedded within Rule 23.1

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see also In re Gen. Motors Class H S'holders Litig., 734 A.2d 611, 617 (Del. Ch. 1999) (locating the test for materiality within "the context of the director's economic circumstances").

[64] *Aronson*, 473 A.2d at 815.

[65] *Rales*, 634 A.2d at 936.

[66] *See Aronson*, 473 A.2d at 815, 816, (explaining that "[i]t is the care, attention and sense of individual responsibility to the performance of one's duties, not the method of election, that generally touches on independence").

[67] *Heineman v. Datapoint Corp.*, 611 A.2d 950, 955 (Del. 1992); *see also Beam v. Stewart*,

845 A.2d 1040, 1050 (Del. 2004) (explaining that a director's independence may be challenged by particularized allegations suggesting "a relationship . . . of a bias-producing nature").

[68] *Desimone*, 924 A.2d at 928.

[69] *Rattner*, 2003 WL 22284323, at *9 (quoting *H-M Wexford LLC v. Encorp, Inc.*, 2003 WL 21254843, at *14 (Del. Ch. May 27, 2003)).

[70] *China Agritech*, 2013 WL 2181514, at *16.

[71] *Id.* (quoting *Rales*, 634 A.2d at 934).

ensures that "only derivative actions supported by a reasonable factual basis proceed."[72]

The *Rales* test for demand futility applies here because the Plaintiffs "do not challenge any particular business decision" by the Defendants.[73] Therefore, for demand to be excused, the particularized allegations of the Complaint must create a reasonable doubt that, at the time the action was filed, three of the five directors on the Board could not have acted impartially in considering a demand. The Plaintiffs have alleged insider trading by only Chen and Wu,[74] who also happen to be the only two directors who the Plaintiffs argue lacked independence because of their positions with China Automotive, which were purportedly their "principal professional occupations."[75] Even if these allegations show that Chen and Wu could not have considered demand impartially, which the Court need not address now, then the Plaintiffs would still be required to allege with particularity that one of the other three directors—Richardson, Tung, or Xu—was interested, lacked independence, or faced a substantial threat of personal liability. In other words, unless the Plaintiffs have alleged with particularity that at least one of these three directors could not have impartially considered a demand, then the Court must find that demand is not excused.

Since these three directors (along with the rest of the Board) are primarily implicated by their allegedly inadequate oversight of the Company's accounting practices (and their related actions on the Compensation Committee), the Court will address those claims in the Complaint first. The Court will then consider the insider trading claims, before concluding with the unjust enrichment claims.

A. *Accounting Oversight Claims*

The Plaintiffs assert that the Defendants breached their fiduciary duties by "failing to adequately manage and oversee" China Automotive's financial accounting and reporting procedures.[76] According to the Plaintiffs, each Defendant "faces a substantial likelihood of liability in this action because of [the] failure, as a director,

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[72] *In re Dow Chem. Co. Deriv. Litig.*, 2010 WL 66769, at *6 (Del. Ch. Jan. 11, 2010).

[73] *Guttman*, 823 A.2d at 499.

[74] Compl. ¶¶ 119-123.

[75] Pls' Answering Br. In Opp'n to Defs.' Mot. To Dismiss the Consolidated Compl. ("AB") 21.

[76] Compl. ¶ 90.

to assure that reliable systems of controls were implemented and functioning effectively to prevent the Company from issuing materially misleading statements."[77]

In addition, the Plaintiffs argue that Richardson, Tung, and Xu each face a substantial threat of personal liability from their roles on both the Audit Committee and the Compensation Committee. As members of the Audit Committee, those three directors were purportedly responsible "for preparing, reviewing, and discussing China Automotive's financial statements with management and independent auditors [and] . . . for discussing China Automotive's internal audit function and reviewing reports concerning the Company's operation of internal controls."[78] Because Richardson, Tung, and Xu were "directly involved in preparing or reviewing such materially false and misleading statements," according to the Plaintiffs, the Audit Committee directors breached their fiduciary duties, and thereby would have been subject to a substantial threat of personal liability, when they either "knowingly or recklessly issued materially false and misleading statements that conflicted with facts known by them at the time."[79]

At the heart of the Plaintiffs' allegations about these three directors is a *Caremark* claim[80]—a claim that the Board, particularly

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[77] *Id.* ¶ 93.

[78] *Id.* ¶ 96.

[79] *Id.* ¶ 97.

[80] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996). The Plaintiffs also contend that the Company's issuance of false and misleading financial statements during the Relevant Period was predicated upon the Audit Committee's decision to hire and retain SLF as the Company's auditor, which the Committee was allegedly "aware" was "not licensed by the PRC to conduct corporate audits in China." Compl. ¶ 8. According to the Plaintiffs, this lack of PRC license meant that "SLF could not provide comprehensive or complete audits on behalf of Chinese companies trading in markets in the United States." *Id.* ¶ 8. The Plaintiffs argue in their brief that this decision of the Board and Audit Committee, with knowledge of SLF's lack of license, was an "intentional disregard of Defendants' fiduciary duties" such that they have asserted a claim beyond the typical failure to monitor boundaries of *Caremark*. AB 26.

Accepting as true the Complaint's particularized allegations and viewing all reasonable inferences in favor of the Plaintiffs, the Court concludes that any non-*Caremark* claim about the Board's or Audit Committee's choice of auditor lacks merit. First, the Plaintiffs argue that SLF was "unqualified" to be China Automotive's auditor, AB 8, and that the Audit Committee knew SLF was "not capable[] [or] qualified," *id.* 23. But, in the Complaint, the Plaintiffs only allege that SLF failed to account properly for the Convertible Notes under GAAP. Compl. ¶¶ 4, 44, 67, 91. They do not allege that SLF was unqualified under GAAP or that any Defendants knew SLF was unqualified under GAAP, thereby removing these unalleged issues from the Court's consideration here. *See Guttman*, 823 A.2d at 499. This conclusion makes the Plaintiffs' claims about SLF's Chinese accounting expertise of little consequence. The issue instead appears to be SLF's qualification to account for the

the Audit Committee, failed to monitor adequately the Company's accounting practices. Because this theory of fiduciary duty breach requires a plaintiff to show that "the directors knew that they were not discharging their fiduciary obligations"—*i.e.*, bad faith—as a "necessary condition[] predicate for director oversight liability,"[81] it has been considered "possibly the most difficult theory in corporation law"[82] to support a stockholder derivative action. This prerequisite showing of bad faith can be made by alleging with particularity a "sustained or systematic failure of the board to exercise oversight,"[83] but this Court has provided additional guidance on more concrete ways in which a plaintiff may seek to plead a *Caremark* claim with particularity.

Convertible Notes under GAAP, and the Board's knowledge of its qualifications, which the Plaintiffs have not contested by any allegations of particularized facts.

Second, the Plaintiffs have not alleged with any particularity that the Company selected SLF because of how it would account for the Convertible Notes or with knowledge that SLF's intended accounting would be incorrect under GAAP. There are no particularized allegations of bad faith or an irrational decision-making process about the initial hiring or continued use of SLF, so those director decisions are matters of director discretion under the business judgment rule. *See Caremark*, 698 A.2d at 967; *see also Aronson*, 473 A.2d at 812.

It is also worth noting that, after arguing that the Plaintiffs have put the PRC's auditor licensing requirements at issue by attaching to their Answering Brief an opinion from a related federal securities lawsuit against China Automotive that discusses this issue, the Defendants offered an exhibit (a law firm memorandum) filed by SLF in that lawsuit and suggested that the Court here may take judicial notice of it as a "publicly filed document[]." Reply Br. in Further Supp. of Defs.' Mot. to Dismiss the Consolidated Compl. 7 n.4, (citing *In re Career Educ. Corp. Deriv. Litig.*, 2007 WL 2875203, at *9 (Del. Ch. Sept. 28, 2007)). The exhibit purports to show that the PRC changed its foreign auditor licensing requirements in March 2011, which would not only be well after the Company first hired SLF, but also after SLF resigned—indicating that, absent some alleged prescience by the Defendants, they would have been unable to know that SLF would one day be an unlicensed auditor in the PRC, let alone to have made that decision in bad faith. Because the Court has discretion to decline to take judicial notice of an adjudicative fact, D.R.E. 201(c), unless it is "requested by a party and supplied with the necessary information," D.R.E. 201(d), and because neither party here has requested that the Court take judicial notice of the PRC's auditor licensing requirements or provided sufficient documentation, the Court declines to take judicial notice of the proffered exhibit.

[81] *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006). *See also Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243, 244 (Del. 2009) (identifying a "vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties" such that a Delaware court's inquiry should not be whether directors "did everything that they (arguably) should have done" under their fiduciary duties, but should instead be "whether those directors utterly failed to attempt" to satisfy their fiduciary duties); *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006) (explaining that bad faith can be shown by, but is not necessarily limited to, situations "where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act").

[82] *Caremark*, 698 A.2d at 967.

[83] *Stone*, 911 A.2d at 372 (quoting *Caremark*, 698 A.2d at 971).

For example, in *Caremark* cases involving the board's oversight of the corporation's accounting practices, this Court has suggested demand might be excused if a plaintiff alleges particularized facts that at least half of the directors had knowledge of specific "red flags"—such as personal knowledge of a series of detailed, third-party reports "suggesting potential accounting improprieties."[84] Or, a plaintiff could plead particularized allegations of fact about the board's auditing system by claiming "that the company lacked an audit committee[] [or] that the company had an audit committee that met only sporadically and devoted patently inadequate time to its work."[85] Furthermore, the particularized allegations may introduce facts about the direct and personal "involvement in the preparation of the financial statements" by at least half of the directors.[86] By contrast, this Court has consistently found that just being a director on the committee where the alleged wrongdoing is "within [its] delegated authority" does not give rise to a substantial threat of personal liability under *Caremark* without supporting allegations of particularized facts showing bad faith.[87] These examples demonstrate how this Court has been proactive in articulating a framework for how a derivative *Caremark* complaint may have enough merit to survive scrutiny under a demand-futility analysis, and this guidance provides a lens through which the Court can now examine the particularized allegations of the Complaint. Equally important as what is alleged with particularity is what is not alleged with particularity.

As an initial matter, the Plaintiffs plead conclusory allegations that the Defendants knew "confidential and proprietary information" about the Company[88] and that, as directors, they had the "power and influence to cause" the issuance of allegedly misleading financial statements.[89] A mere statement that the Defendants "caused"[90] the filing of the allegedly misleading financial statements with the SEC is not, without more, a particularized allegation of fact.[91] Nowhere within the Complaint are

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[84] *Ash v. McCall*, 2000 WL 1370341, at *4, *15 (Del. Ch. Sept. 15, 2000).

[85] *Guttman*, 823 A.2d at 507.

[86] Rattner, 2003 WL 22284323, at *12.

[87] *South v Baker*, 62 A.3d 1, 17 (Del. Ch. 2012) (citing *In re Goldman Sachs Gp., Inc. S'holder Litig.*, 2011 WL 4826104, at *22-23 (Del. Ch. Oct. 12, 2011); *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 126-28 (Del. Ch. 2009); *Desimone*, 924 A.2d at 938; and *Rattner*, 2003 WL 22284323, at *12-13).

[88] Compl. ¶ 29.

[89] *Id.* ¶ 30.

[90] *See, e.g., id.* at ¶ 65.

[91] *See Citigroup Inc.*, 964 A.2d at 133 n. 88 ("Pleading that the director defendants 'caused' or 'caused or allowed' the Company to issue certain statements in not sufficient

allegations of particularized facts about the Defendants' knowledge of any "red flags."[92] Nothing is alleged about any specific deficiencies of the Company's or Audit Committee's internal financial controls during the Relevant Period. And, the Complaint lacks particularized allegations about any Defendant's conscious disregard of Board or Committee meetings or responsibilities.[93]

Even the purportedly particularized allegations suggesting that Richardson, Tung, and Xu face a substantial threat of personal liability as the Audit Committee are not much more than a conclusory statement of an alleged failure to carry out the Committee's responsibilities assigned in its charter.[94] The Plaintiffs do allege that all five directors attested to the misleading financial statements by signing one of the SEC filings at issue,[95] but these allegations of fact, even viewed in the light most favorable to the Plaintiffs, contain no particularized allegations that the directors knew the statements were wrong, or in some other way failed to secure adequate internal controls. Likewise, the Complaint does not allege with particularity any direct or personal involvement by the Defendants in the Company's preparation of its financial statements, in the Board's or Audit Committee's review of SLF's auditing of the financial statements,[96] or in any other capacity by

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particularized pleading to excuse demand under Rule 23.1.").

[92] *See Ash*, 2000 WL 1370341, at *15.

[93] *See Guttman*, 823 A.2d at 507.

[94] Compl. ¶¶ 25-26, 96. The Plaintiffs pled equally non-particularized allegations in support of their assertion that Richardson, Tung, and Xu face a substantial threat of personal liability as Compensation Committee members for their purported disregard of the responsibilities assigned to the Committee in its charter. *Id.* ¶¶ 27-28, 99. This theory is a type of *Caremark* claim because the Plaintiffs argue that the Compensation Committee took "no action to curtail or penalize their fellow Board members" for the alleged "illegal stock sales" that the Committee "could not have missed . . . given its size, scope, and blatancy." AB 25. The Plaintiffs did not allege with particularity facts showing bad faith by the Committee, a showing of which is a "necessary condition[] predicate" to personal liability under *Caremark*. Moreover, the Plaintiffs did not allege with particularity facts supporting any other theory of breach of fiduciary duty, so the Compensation Committee does not face a substantial threat of personal liability. *Stone*, 911 A.2d at 370.

[95] Compl. ¶ 94.

[96] The Plaintiffs suggested the Audit Committee as a whole, or at least Richardson as its chair and designated financial expert under Sarbanes-Oxley, should be held to a heightened standard of constructive knowledge about the Company's financial statements. *In re China Automotive Sys. Inc. Deriv. Litig.*, C.A. No. 7145-VCN, at 36 (Del. Ch. May 6, 2013) (TRANSCRIPT) ("Tr."). The Court declines to entertain this argument because it does not support a claim under Delaware corporate law. The Audit Committee's oversight of SLF's esoteric accounting for the Convertible Notes is not, as Plaintiffs argued, AB 24, equivalent to the "deliberate violation of a stockholder approved stock option plan" where the court inferred that the conduct alleged (backdating stock options) could not have been "anything but an act of bad faith." *Ryan v. Gifford*, 918 A.2d 341, 358 (Del. Ch. 2007). The Court here cannot infer bad faith from the non-particularized allegations of the Complaint; thus, the Court

which the Court could reasonably infer that a majority of the Defendants had any knowledge that their actions or inactions were harmful to the corporation or a breach of their fiduciary duties.[97] Mere membership on the Audit Committee is not enough for the Court to infer bad faith.[98]

> In sum, the Plaintiffs have not alleged particularized facts, in the manner prescribed by Court of Chancery Rule 23.1, showing bad faith or a "sustained or systematic failure of the board to exercise oversight."[99] Therefore, the Plaintiffs have not alleged a particularized *Caremark* claim that has merit.[100] And, the Plaintiffs have not alleged with particularity any other theory by which the Audit Committee members—Richardson, Tung, and Xu—may have faced a substantial threat of personal liability.

Absent a substantial threat of personal liability for Richardson, Tung, and Xu, the Plaintiffs could still show demand futility by particularized allegations that these three Defendants were unable to consider a demand impartially because they were interested or not independent. No allegations in the Complaint suggest that these three directors were interested or conflicted by receiving a material benefit.[101] The alleged insider trading was by Chen and Wu, not the other directors. Similarly, in broad conclusory allegations, the Plaintiffs claim that the entire Board is "beholden" to Chen because of his majority common stock ownership.[102] By itself, that Chen has majority control of China Automotive's stock alone does not demonstrate demand futility without particularized allegations that the Board acted at the control of Chen,[103] and the Complaint does not include such allegations of particularized fact.

Because the Plaintiffs have not alleged particularized facts showing that any of Richardson, Tung, or Xu were interested, not independent, or facing a substantial threat of personal liability at the time the derivative Complaint was filed,[104] these three directors—

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cannot characterize, as the Plaintiffs argued, the alleged "ignorance" as a "sustained or systematic failure of the Board to exercise oversight," AB 27.

[97] *See Rattner*, 2003 WL 22284323, at *12. Moreover, the Plaintiffs have not alleged with particularity why it was unreasonable for the Board or the Audit Committee to rely on SLF's auditing of China Automotive's financial statements under GAAP. *See* Tr. at 49.

[98] *See South*, 62 A.3d at 17.

[99] *Stone*, 911 A.2d at 372 (quoting *Caremark*, 698 A.2d at 971).

[100] *See Rales*, 634 A.2d at 934.

[101] *See Orman*, 794 A.2d at 23.

[102] Compl. ¶ 102.

[103] *See Heineman*, 611 A.2d at 955.

[104] The Complaint can be said to have a paucity of particularized facts. The Plaintiffs declined the opportunity to inspect China Automotive's books and records under 8

representing a majority of the Board—were entitled to consider demand. Therefore, under Rule 23.1, demand is not excused.[105]

B. *The Insider Trading Claims*

The Plaintiffs next allege a breach of fiduciary duty by Chen and Wu when they sold "personally held stock at artificially inflated prices"[106] with knowledge of "material adverse information about the Company."[107] Delaware courts have long been willing to recognize this type of insider trading as a breach of fiduciary duty.[108]

Independent of whether the Plaintiffs have pled with particularity that Chen, Wu, or both, engaged in insider trading (which the Court does not now consider), at no point have the Plaintiffs alleged or argued that Richardson, Tung, or Xu engaged in, or gained a material benefit from, any insider trading; therefore, they were not interested and did not face a substantial threat of personal liability for these claims. Moreover, there are no further allegations about a lack of independence for these claims. Thus, since none of Richardson, Tung, or Xu was interested, lacking independence, or facing a substantial threat of personal liability under the particularized allegations of the Complaint, a majority of the Board survives scrutiny under the demand futility analysis.

Del. C. § 220, suggesting at oral argument that "you don't get much of anything" from a § 220 request of a Delaware corporation with its headquarters in the PRC, although they recognized that the Company might be "different." Tr. at 48. This Court has recognized the possible value of a § 220 suit in providing the basis for allegations of particularized facts in a derivative action. *See, e.g.*, *South*, 62 A.3d at 17; *Rattner*, 2003 WL 2284323, at *14; and *Guttman*, 823 A.2d at 504; *see also* Donald F. Parsons, Jr. & Jason S. Tyler, *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, 70 Wash. & Lee L. Rev. 473, 514-24 (2013) (identifying how, in response to the race to the courthouse that typically produces a first- filed complaint filled with sparse allegations, this Court has suggested creative procedural approaches to encourage the use of a § 220 action before a stockholder plaintiff files a derivative complaint). The potential futility of a § 220 suit in a derivative suit where no preceding § 220 request was made does not make for a persuasive argument. Stockholder plaintiffs must remember that § 220 is by no means the only way by which they could seek to adduce that demand should be excused.

[105] For similar reasons as above, because the Plaintiffs have not alleged particularized facts showing that Richardson, Tung, or Xu were interested, not independent, or facing a substantial threat of personal liability in their capacity as members of the Compensation Committee, demand is also not excused for those claims. Accordingly, demand is not excused for the related failure to remedy claim.

[106] Compl. ¶ 80.

[107] *Id.* ¶ 81.

[108] *See Brophy v. Cities Service Co.*, 70 A.2d 5, 7-8 (Del. Ch. 1949).

Under Court of Chancery Rule 23.1, the Plaintiffs have not demonstrated that demand should be excused.

C. *The Unjust Enrichment Claims*

The Plaintiffs have not alleged with particularity that any of Richardson, Tung, or Xu was unjustly enriched from purported breaches of their fiduciary duties or other wrongful conduct. Instead, the unjust enrichment claims are premised on the purported misstatements, which do not support a *Caremark* or other breach of fiduciary duty claim, and the alleged insider trading, which implicates only a minority of the Board. Under the same analysis of demand futility for the preceding *Caremark* claim, the Plaintiffs have failed to allege under Rule 23.1 a reasonable doubt of the capacity of a majority of the Board to consider impartially a demand for pursuit of the unjust enrichment claims.

V. CONCLUSION

For the foregoing reasons, this action is dismissed as to the Plaintiffs with prejudice. An implementing order will be entered

IN RE INFORMATION MANAGEMENT SERVICES, INC. DERIVATIVE LITIGATION

No. 8168-VCL

In the Court of Chancery of the State of Delaware

September 5, 2013

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LASTER, *Vice Chancellor*

Trusts that own fifty percent of the common stock of nominal defendant Information Management Services, Inc. ("IMS" or the "Company") allege that two of the Company's three most senior officers mismanaged the Company in breach of their fiduciary duties. The executives consulted with their personal lawyers and advisors about the alleged mismanagement using their work email accounts. IMS gathered the emails but took no position on whether they should be produced. The executives invoked the attorney-client privilege. They did not rely on the work product doctrine. The trusts moved to compel, arguing that the attorney-client privilege does not apply because the Company reserved the right to monitor all email communications on IMS accounts, thereby eliminating any reasonable expectation of confidentiality. The motion is granted.

I. FACTUAL BACKGROUND

The facts for purposes of the motion to compel are drawn from the allegations in the pleadings and the exhibits and affidavits submitted in connection with the briefing on the motion. What follows are not formal factual findings, but rather how the court views the record for purposes of a discovery ruling. At this stage of the case, the court cannot resolve conflicting factual contentions.

A. *Information Management Services, Inc.*

IMS is a Delaware corporation with its principal place of business in Rockville, Maryland. The Company provides analytical software tools and other products used primarily to evaluate clinical trials for biomedical research.

The Burton family and the Lake family each beneficially own fifty percent of the Company's common stock. The Burton family owns its half through two trusts, the EB Trust and the IMS Trust. Evelyn Burton is the sole trustee of the EB Trust; Michael Burton is the sole trustee of the IMS Trust. The Lake family owns the other half through the William H. Lake Grantor Trust. Brothers William Lake, Jr. and Andrew Lake are co-trustees of the Lake trust. Their mother, Jean Lake, is a beneficiary of the Lake trust. To differentiate among the individuals, this decision uses their first names.

The Company's board of directors (the "Board") has four members, two from the Burton family and two from the Lake family. The Burton family representatives are Evelyn and Michael. The Lake family representatives are Jean and Andrew.

Effective control over day-to-day management of the Company currently rests with the Lake family. It was not always so. Robert Burton and William Lake, Sr., founded the Company and managed the business together for many years. Robert, now deceased, was Evelyn's husband and Michael's father. William Sr., now retired, is Jean's husband and William and Andrew's father.

William Sr. retired in 2007. Robert passed away in 2010. At the time of Robert's death, William held the positions of President, Secretary, CFO, and Treasurer. Andrew held the position of Executive Vice President. Non-party Janis Beach, who joined the Company in 1974, held the position of COO. Since then, William, Andrew, and Janis have remained the most senior executives at the Company.

B. *The Dispute*

The Burton trusts allege that in the first quarter of 2011, William permitted IMS to overdraw its revolving line of credit by approximately $80,000, forcing IMS to obtain an emergency increase to meet payroll and other outstanding obligations. William allegedly did not inform the Board concurrently of this event or the Company's financial position.

In October 2011, Michael joined IMS. Michael perceived problems from inside the Company including lack of growth, a general failure to market the Company's intellectual property, and poor employee morale.

In May 2012, the Burtons scheduled a meeting with William and Andrew to discuss their concerns. William and Andrew cancelled the meeting. In June, IMS informed Michael that his employment would be terminated.

The Burtons next retained Venture Advisors Financial and Strategic Services, LLC ("Venture Advisors") to review the Company's books and records. Venture Advisors also interviewed William, Andrew, and Nancy MacGillivary, a bookkeeper.

In a report issued on July 30, 2012, Venture Advisors criticized senior management on several grounds, including their failure to understand or comply with Generally Accepted Accounting Principles, Federal Acquisition Regulations, and the Fair Labor Standards Act (the "FLSA"). The report identified as issues an absence of professional accounting expertise, a lack of budgeting and financial planning, the use of unconventional compensation practices, and the failure to plan for the Company's "graduation" from Small Business Administration ("SBA") status.

During a special meeting of the Board on August 23, 2012, the directors discussed the Venture Advisors' report and the Burton family's concerns. The Burton representatives proposed to bring in professional managers to serve as the CEO and CFO. The Lake representatives declined, resulting in deadlock. The Board resolved to hire outside counsel to evaluate the Company's compliance with the FLSA. The Burtons complain that William picked the law firm himself and instructed the firm not to communicate with the Burtons or the Board before presenting its final report.

During a meeting of the Board on September 14, 2012, the Board resolved to hire a consultant to evaluate the SBA issues. The Board deadlocked over the selection of the consultant and the scope of work. In October 2012, the Company retained Rubino & Company, Chartered, a financial services company with a special focus on

government contracting, to review the Company's accounting practices and financial reporting.

On November 1, 2012, the Board met again. The Burton representatives proposed terminating William for cause, eliminating the Executive Vice President position held by Andrew, bringing in a CEO from outside the Company, and hiring Robert Dudley of Venture Advisors as CFO. The Lake representatives declined, resulting in deadlock. The Burtons then refused to approve any bonuses for senior management or staff. Over the ensuing weeks, the Burtons modified their position, rejecting only the bonuses for William and Andrew.

C. *The Litigation*

On December 31, 2012, the Burton trusts filed a complaint that charges William with breaching his fiduciary duties as an officer of IMS by mismanaging the Company and Jean and Andrew with breaching their fiduciary duties as directors of IMS by protecting William and enabling him to continue running the Company. In response, on January 28, 2013, the Lake trust filed a complaint of its own that charges Evelyn and Michael with breaching their fiduciary duties by denying bonuses to management, causing the Company to incur liability to reimburse the federal government for amounts tied to the unpaid bonuses, and publicly disseminating confidential information about the Company. The complaint alleges that Evelyn and Michael have taken these actions in an effort to generate leverage to force a sale of their stock or the Company as a whole. The two actions were consolidated, generating this proceeding.

D. *The Motion to Compel*

During discovery, IMS advised the plaintiffs that William and Andrew used their work email accounts both before and after the filing of the lawsuit to communicate with their personal attorneys and advisors. The Company collected the emails, and William and Andrew asserted the attorney-client privilege. They did not invoke the work product doctrine. The defendants prepared a privilege log that identified 362 emails and attachments sent between August 2012 and March 2013. The Burton trusts then moved to compel IMS to produce the emails, arguing that the attorney-client privilege did not apply because William and Andrew communicated using work email accounts maintained on the IMS servers.

The IMS Policy Manual notifies employees that IMS has unrestricted access to communications sent using Company computers and that personal use of IMS computers should not be considered private. Section 9.1 of the IMS Policy Manual states: "You should assume files and Internet messages are open to access by IMS staff. After hours you may use IMS computers for personal use, but if you want the files kept private, please save them offline." Motion to Compel Ex. A at 6. Both William and Andrew filed affidavits stating that IMS has never actually engaged in email monitoring.

It is not seriously disputed that William and Andrew knew about the policy. There is also evidence that William understood that his work email account was accessible. In one email, William wrote "I'm switching over to my commercial email, just so I don't leave any more tracks about Mike in my IMS box." Motion to Compel Ex. G. In another email, he told a colleague that he was "sending . . . this via commercial email because it is stated to be confidential." Motion to Compel Ex. H.

II. LEGAL ANALYSIS

Delaware Rule of Evidence 502 establishes the scope of the attorney-client privilege under Delaware law. *See Zirn v. VLI Corp.*, 621 A.2d 773, 781 (Del. 1993) ("The [attorney-client] privilege was recognized at common law but received formal promulgation in Delaware through the adoption of the Delaware Rules of Evidence."). Rule 502(b) states:

> **General rule of privilege.** A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client (1) between the client or the client's representative and the client's lawyer or the lawyer's representative, (2) between the lawyer and the lawyer's representative, (3) by the client or the client's representative or the client's lawyer or a representative of the lawyer to a lawyer or a representative of a lawyer representing another in a matter of common interest, (4) between representatives of the client or between the client and a representative of the client, or (5) among lawyers and their representatives representing the same client.

D.R.E. 502(b). The motion to compel asserts that because William and Andrew used their IMS email accounts, their emails were not "confidential communications." The motion does not otherwise dispute that the requirements for the attorney-client privilege are met. The opposition does not argue that Andrew should be treated differently because he is a director of the Company.

"The burden of proving that the privilege applies to a particular communication is on the party asserting the privilege." *Moyer v. Moyer*, 602 A.2d 68, 72 (Del. 1992). Rule 502(a)(2) states that "[a] communication is 'confidential' if not intended to be disclosed to third persons other than those to whom disclosure is made in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication." D.R.E. 502(a)(2). A party's subjective expectation of confidentiality must be objectively reasonable under the circumstances. *See Upjohn Co. v. United States*, 449 U.S. 383, 389, 395 (1981); Edward J. Imwinkelried, *The New Wigmore: A Treatise on Evidence: Evidentiary Privileges* § 6.8.1 (2013); 1 Paul R. Rice, *Attorney-Client Privilege in the United States* § 6 (2012).

Delaware courts have not addressed whether an employee has a reasonable expectation of privacy in a work email account.[1] In

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[1] A work email account is an employer-provided email account furnished to each employee in which the address usually appears as some version of the individual employee's name followed by "@" followed by some variation on the employer's business name. The account uses the employer's technology infrastructure, typically an enterprise software system that operates on the employer's email server. *See* Marc A. Sherman, *Webmail at Work: The Case for Protection Against Employer Monitoring*, 23 Touro L. Rev. 647, 654 (2007). A work email account differs from a personal, password-protected, web-based email account, also known as webmail, which the employee may obtain through Google, Hotmail, or other services. *See id.* at 652; *see also* Meir S. Hornung, Note, *Think Before You Type: A Look at Email Privacy in the Workplace*, 11 Fordham J. Corp. & Fin. L. 115, 133-34 (2005) (distinguishing between work email and webmail).

Courts have generally afforded greater privacy protection to webmail and have reached divergent conclusions when analyzing the attorney-client privilege if the employee and personal attorney communicated using webmail. *Compare Long v. Marubeni Am. Corp.*, 2006 WL 2998671, at *3 (S.D.N.Y. Oct. 19, 2006) (finding employee could not assert privilege for webmail sent from employer-furnished computer that was set up to automatically store temporary internet files of employee activity, including email images) *with Curto v. Medical World Comm'ns, Inc.*, 2006 WL 1318387, at *8 (E.D.N.Y. May 15, 2006) (finding employee who worked from home had reasonable expectation of privacy in webmail sent using employer-furnished computer that was not connected to employer's network), *and Stengart v. Loving Care Agency, Inc.*, 990 A.2d 650, 665 (N.J. 2010) (holding that even a company policy authorizing unlimited right to review webmail accessed over company system "would not be enforceable"). *See also Pure Power Boot Camp v. Warrior Fitness Boot Camp*, 587 F. Supp. 2d 548 (S.D.N.Y. 2008) (finding

one of the early decisions to consider the issue, the Bankruptcy Court for the Southern District of New York started from the proposition that an employee can have a reasonable expectation of privacy in a work email account. In re Asia Global Crossing, Ltd., 322 B.R. 247, 256 (Bankr. S.D.N.Y. 2005). The Bankruptcy Court explained that under United States Supreme Court precedent, an employee can have reasonable expectation of privacy in areas such as the employee's office, desk, and files, but that the "employee's expectation of privacy . . . may be reduced by virtue of actual office practices and procedures, or by legitimate regulation." *Id.* at 257 (quoting O'Connor v. Ortega, 480 U.S. 709, 717 (1987)) (internal quotation marks omitted). "Although e-mail communication, like any other form of communication, carries the risk of unauthorized disclosure, the prevailing view is that lawyers and clients may communicate confidential information through unencrypted e-mail with a reasonable expectation of confidentiality." *Id.* (collecting authorities). In the ordinary course of business, employees who send communications within the company over the employer's email system can reasonably expect that outsiders will not be able to access the system. *Id.* Consequently, "[a]ssuming a communication is otherwise privileged, the use of the company's e-mail system does not, without more, destroy the privilege." *Id.* at 251.

An employer's policies and procedures regarding work email can alter the employee's reasonable expectation of privacy. Most employers choose to monitor work email accounts, or at least reserve the right to do so, for a host of legitimate business reasons.[2] "In light of the variety of work environments, whether the employee has a reasonable expectation of privacy must be decided on a case-by-case basis." *Asia Global*, 322 B.R. at 257 (citing *Ortega*, 480 U.S. at 718).

> To guide the case-by-case analysis, the *Asia Global* court identified four factors:

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violations of federal and state law where former employer accessed webmail; distinguishing case from precedents involving work email). This case involves work email, not webmail.

[2] *See, e.g., TBG Ins. Servs. Corp. v. Superior Court*, 117 Cal. Rptr. 2d 155, 162 (Cal. Ct. App. 2002) (citing reasons for employer monitoring including legal compliance, legal liability, performance review, productivity measures, and security concerns); Hornung, *supra*, at 120-22 (same); Dion Messer, *To: Client@WorkPlace.com: Privilege at Risk?*, 23 J. Marshall J. Computer & Info. L. 75, 77-79 (2004) (same); Sherman, *supra*, at 657-660 (same).

> (1) does the corporation maintain a policy banning personal or other objectionable use, (2) does the company monitor the use of the employee's computer or e-mail, (3) do third parties have a right of access to the computer or e-mails, and (4) did the corporation notify the employee, or was the employee aware, of the use and monitoring policies?

Id. No one factor is dispositive. *Id.* at 258-59. The question of privilege comes down to "whether the [employee's] intent to communicate in confidence was objectively reasonable." *Id.* at 258.

Numerous courts have applied the *Asia Global* factors or closely similar variants when analyzing the attorney-client privilege.[3] Several of the *Asia Global* factors have been refined through subsequent application. In the current case, the *Asia Global* factors weigh in favor of production.

A. *The Corporation's Policies On Work Email And Monitoring*

As framed by the *Asia Global* court, the first factor is "does the corporation maintain a policy banning personal or other objectionable use?" 322 B.R. at 257. This factor has been refined to focus on the nature and specificity of the employer's policies regarding email use and monitoring. It has been held to weigh in favor of production when the employer has a clear policy banning or restricting personal use, where the employer informs employees that they have no right of personal privacy in work email communications, or where the employer advises employees that the employer monitors or reserves the right to

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[3] *See, e.g., Maxtena, Inc. v. Marks*, 2013 WL 1316386, at *5 (D. Md. Mar. 26, 2013); *In re High-Tech Employee Antitrust Litig.*, 2013 WL 772668, at *6 (N.D. Cal. Feb. 28, 2013); *United States v. Finazzo*, 2013 WL 619572, at *7 (E.D.N.Y. Feb. 19, 2013); *Goldstein v. Colborne Acquisition Co.*, 873 F. Supp. 2d 932, 937 (N.D. Ill. 2012); *Aventa Learning, Inc. v. K12, Inc.*, 830 F. Supp. 2d 1083, 1109 (W.D. Wash. 2011); *Hanson v. First Nat'l Bank*, 2011 WL 5201430, at *5 (S.D.W. Va. Oct. 31, 2011); *Kaufman v. SunGard Inv. Sys.*, 2006 WL 1307882, at *4 (D.N.J. May 10, 2006); *In re Royce Homes, LP*, 449 B.R. 709, 737-38 (Bankr. S.D. Tex. 2011), *appeal dismissed*, 466 B.R. 81 (S.D. Tex. 2012). Other courts have applied the *Asia Global* factors when analyzing the marital communications privilege, which also turns on a reasonable expectation of privacy. *See, e.g., In re Reserve Fund Sec. & Deriv. Litig.*, 275 F.R.D. 154, 159-61 (S.D.N.Y. 2011); *In re Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico, on April 20, 2010 (Deep Horizon)*, 2011 WL 1193030, at *2 (E.D. La. Mar. 28, 2011); *Sprenger v. Rector & Bd. of Visitors of Va. Tech*, 2008 WL 2465236, at *3 (W.D. Va. June 17, 2008); *United States v. Etkin*, 2008 WL 482281, at *4 (S.D.N.Y. Feb. 20, 2008); *Geer v. Gilman Corp.*, 2007 WL 1423752, at *3 (D. Conn. Feb. 12, 2007).

monitor work email communications.4 "[A]n outright ban on personal use would likely end the privilege inquiry at the start." Finazzo, 2013 WL 619572, at *8; accord Reserve Fund, 275 F.R.D. at 163 (collecting cases). But a complete ban on personal use is not required.[5] This factor

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[4] *See, e.g., Aventa Learning,* 830 F. Supp. 2d at 1108 (finding no reasonable expectation of privacy where "the company reserved the right to access and disclose any file or stored communication[s] [on its systems] at any time"); *Deep Horizon,* 2011 WL 1193030, at *2 (finding that employee could not have reasonable expectation of privacy in work email where "BP's policy announced that [employee's] emails could be monitored and accessed by BP"); *Miller v. Blattner,* 676 F. Supp. 2d 485, 497 (E.D. La. 2009) (holding that when "an employer has a rule prohibiting personal computer use and a published policy that emails on [the employer's] computers were the property of [the employer], an employee cannot reasonably expect privacy in their prohibited communications"); *Pure Power,* 587 F. Supp. 2d at 559-60 ("Courts have routinely found that employees have no reasonable expectation of privacy in their workplace computers, where the employer has a policy which clearly informs employees that company computers cannot be used for personal e-mail activity, and that they will be monitored."); *Sims v. Lakeside School,* 2007 WL 2745367, at *1 (W.D. Wash. Sept. 20, 2007) ("[W]here an employer indicates that it can inspect laptops that it furnished for use of its employees, the employee does not have a reasonable expectation of privacy over the employer-furnished laptop."); *Long,* 2006 WL 2998671, at *3 (finding employee had no reasonable expectation of privacy when aware of employer's policy which provided that "(a) use of MAC's automated systems for personal purposes was prohibited; (b) MAC employees 'have no right of personal privacy in any matter stored in, created, or sent over the e-mail, voice mail, word processing, and/or internet systems provided' by MAC; and (c) MAC had the right to monitor all data flowing through its automated systems"); *Thygeson v. U.S. Bancorp,* 2004 WL 2066746, at *21 (D. Or. Sept. 15, 2004) ("[W]hen, as here, an employer accesses its own computer network and has an explicit policy banning personal use of office computers and permitting monitoring, an employee has no reasonable expectation of privacy."); *Kelleher v. City of Reading,* 2002 WL 1067442, at *8 (E.D. Pa. May 29, 2002) (finding employee had no reasonable expectation of privacy in workplace email where the employer's guidelines "explicitly informed employees that there was no such expectation of privacy"); *Garrity v. John Hancock Mut. Life Ins. Co.,* 2002 WL 974676, at *1-2 (D. Mass. May 7, 2002) (finding no reasonable expectation of privacy where company reserved the right to monitor employee use of work email); *Royce Homes,* 449 B.R. at 717, 741 (finding employee had no reasonable expectation of privacy when policy warned that "personal communications may be accessed, viewed, read or retrieved by a company Manager or employee"); *see also Muick v. Glenayre Elecs.,* 280 F.3d 741, 743 (7th Cir. 2002) (Posner, J.) ("But Glenayre had announced that it could inspect the laptops that it furnished for the use of its employees, and this destroyed any reasonable expectation of privacy that Muick might have had and so scotches his claim."); *United States v. Simons,* 206 F.3d 392, 398 (4th Cir. 2000) ("Therefore, regardless of whether Simons subjectively believed that the files he transferred from the Internet were private, such a belief was not objectively reasonable after [his employer] notified him that it would be overseeing his internet use."); *Banks v. Mario Indus. of Va., Inc.,* 650 S.E.2d. 687, 695-96 (Va. 2007) (holding that existence of policy advising employee that there was no right of privacy when using employer-furnished computer eliminated reasonable expectation of confidentiality and permitted employer to recover and use employee's letter to attorney that was drafted on employer-furnished computer, then sent through regular mail).

[5] *See Aventa Learning,* 830 F. Supp. 2d at 1109 (finding no reasonable expectation of privacy where company "discouraged" personal use and advised that its systems "should generally be used only for [company] business"); *Hanson,* 2011 WL 5201430, at *2,

has been held to weigh against production if the employer does not have a clear policy or practice regarding personal use and monitoring.[6]

The policy manual that IMS provided to all employees contains a section entitled "Computer Privacy." It states: "You should assume files and Internet messages are open to access by IMS staff. After hours you may use IMS computers for personal use, but if you want the files kept private, please save them offline." This policy notified employees that although they could send personal emails using their work accounts, those emails would not be private and could be accessed by IMS. Although this policy is less detailed than some of the policies described in precedent decisions, it sufficiently put IMS employees on notice that their work emails were not private. The first *Asia Global* factor favors production.

B. *The Degree To Which The Corporation Acts In Accordance With Its Policies*

As framed by the *Asia Global* court, the second factor is "does the company monitor the use of the employee's computer or e-mail?" 322 B.R. at 257. This factor has been refined to focus on the extent to which the employer adheres to or enforces its policies and the employee's knowledge of or reliance on deviations from the policy. Although some decisions have held that if an employer reserves the right to monitor work email, then whether it actually does so is irrelevant,[7] the

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*6 (ordering production despite policy that permitted "[i]ncidental and occasional personal use"); *Reserve Fund*, 275 F.R.D. at 161 (finding policy sufficient which stated that "[e]mployees should limit their use of the e-mail resources to official business"); *Deep Horizon*, 2011 WL 1193030, at *2 (finding that employee could not have reasonable expectation of privacy in work email where "BP's policy announced that [employee's] emails could be monitored and accessed by BP"); *Royce Homes*, 449 B.R. at 717, 741 (finding no reasonable expectation of privacy even though policy permitted employees to "conduct limited, reasonable and appropriate personal communications on the company's electronic communication system with the understanding that personal communications may be accessed, viewed, read or retrieved by a company Manager or employee").

[6] *See Leventhal v. Knapek*, 266 F.3d 64, 74 (2d Cir. 2001) (finding reasonable expectation of privacy when there was no clear policy or practice regarding email monitoring or use; "the anti-theft policy [merely] prohibited 'using' state equipment 'for personal business' without defining further these terms"); *Maxtena*, 2013 WL 1316386, at *5 (finding reasonable expectation of privacy where "[t]here is no evidence here indicating that the [employer] maintained any sort of monitoring or use policy"); *DeGeer v. Gillis*, 2010 WL 3732132, at *9 (N.D. Ill. Sept. 17, 2010) (declining to order production where there was no evidence of a company policy).

[7] *See, e.g.*, *Chechele v. Ward*, 2012 WL 4481439, at *1-2 (W.D. Okla. Sept. 28, 2012) (disregarding lack of actual monitoring); *Etkin*, 2008 WL 482281, at *4 ("Thus, it is irrelevant that the Government has not established that [the employer] *actually* read [the

employer's actual conduct with respect to monitoring remains an appropriate factor to consider, particularly if the employer has made specific representations or taken specific actions inconsistent with the monitoring policy and the employee can show detrimental reliance.[8] If, however, the employer has clearly and explicitly reserved the right to monitor work email, then the absence of past monitoring or a practice of intermittent or as-needed monitoring comports with the policy and does not undermine it.[9] In that setting, "evidence of actual monitoring would make an expectation of privacy even less reasonable." *Finazzo*, 2013 WL 619572, at *9.

William and Andrew have submitted affidavits saying that IMS never in fact conducted email monitoring. Under its policy, IMS reserves the right to conduct email monitoring. The policy states expressly that employees "should assume files and Internet messages are open to access by IMS staff." The fact that IMS has not historically monitored emails does not conflict with its implicit reservation of the right to do so.

Building on the lack of historic monitoring, William and Andrew have contended that because they are the senior officers at IMS, they would decide whether or not IMS would monitor an employee's email.

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employee's] email."); *Royce Homes*, 449 B.R. at 739 ("[W]hether [the employer] actually reads an employee's e-mails is irrelevant.").

[8] *See, e.g.*, *High-Tech Employee Antitrust Litig.*, 2013 WL 772668, at *7 ("a company's failure to actually monitor employees' emails or to have an explicit policy of monitoring the emails may suggest to employees that their emails in fact remain confidential"); *United States v. Nagle*, 2010 WL 3896200, at *4 (M.D. Pa. Sept. 30, 2010) (considering degree of actual monitoring); *Haynes v. Office of Attorney Gen.*, 298 F. Supp. 2d 1154, 1161-62 (D. Kan. 2003) (same). *But see, e.g.*, *Finazzo*, 2013 WL 619572, at *10 (declining to give less weight to policy because employee believed company did not monitor email usage as it had not disciplined CEO for violating rules about personal use of email); *Reserve Fund*, 275 F.R.D. at 161-62 (rejecting argument that employer's choice not to enforce policy in certain circumstances rendered policy inapplicable).

[9] *See Finazzo*, 2013 WL 619572, at *9 ("Most courts have concluded such reservation of the right to review destroys any reasonable expectation of privacy, whether or not the employer routinely reviews . . . the e-mails."); *Hanson*, 2011 WL 5201430, at *6 (ordering production where corporation reserved the right to access and monitor email communications, but where there was no evidence of actual monitoring); *Reserve Fund*, 275 F.R.D. at 163-64 (finding no expectation of privacy where employer reserved the right to monitor work emails, but also told employees it would not engage in routine monitoring and would attempt to protect the employee's privacy interests); *Long*, 2006 WL 2998671, at *3 (finding no expectation of privacy in work email where employer reserved the right to monitor); *Holmes v. Petrovich Dev. Co.*, 119 Cal. Rptr. 3d 878, 898 (Cal. Ct. App. 2011) (holding that lack of actual monitoring was "immaterial").

In their view, this gives them a unique expectation of privacy in the IMS system.

Legally, William and Andrew are wrong. "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ." 8 *Del. C.* § 141(a). The board of directors, not senior management, has the final say on accessing any employee's email. Moreover, because of their statutory obligation to manage the business and affairs of the corporation and the concomitant fiduciary duties they owe to the corporation and its stockholders, individual directors have informational rights that are "essentially unfettered in nature." *Kalisman v. Friedman*, 2013 WL 1668205, at *3 (Del. Ch. Apr. 17, 2013); *accord Schoon v. Troy Corp.*, 2006 WL 1851481, at *1 n.8 (Del. Ch. June 27, 2006); *Intrieri v. Avatex Corp.*, 1998 WL 326608, at *1 (Del. Ch. June 12, 1998); *Belloise v. Health Mgmt., Inc.*, 1996 Del. Ch. LEXIS 127, at *36 (Del. Ch. June 11, 1996) (Allen, C.). If an individual director needed to access an employee's work email for a legitimate purpose, which the law presumes the director to have, then the director could do so. *See* 8 *Del. C.* § 220(d). William's and Andrew's expectations of privacy in their work email are no different from any other employee's.

Factually, William and Andrew did not have a different expectation of privacy. As shown by William's communications, he understood that his work email account was not secure. *See* Motion to Compel Ex. G ("I'm switching over to my commercial email, just so I don't leave any more tracks about Mike in my IMS box."); Motion to Compel Ex. H (writing to a colleague in another email, "I'm sending you this via commercial email because it is stated to be confidential.").

Particularly in light of William's emails recognizing that his work account was not confidential, the second *Asia Global* factor could be treated as favoring production. But because IMS never actually engaged in email monitoring, I treat the factor as neutral.

C. *Ease of Third Party Access*

As framed by the *Asia Global* court, the third factor is "do third parties have a right of access to the computer or e-mails?" 322 B.R. at 257. In a work email case, this factor largely duplicates the first and second factors, because by definition the employer has the technical ability to access the employee's work email account. *See Goldstein*, 873 F. Supp. 2d. at 937 (noting that in work email case, the third factor "is somewhat redundant of the first"); *Royce Homes*, 449 B.R. at

740 (noting that "third parties undeniably had access to [the employee's work] e-mails by virtue of their mere placement on [the employer's] server"). The third factor is most helpful when analyzing webmail or other electronic files that the employer has been able to intercept, recover, or otherwise obtain. This factor encompasses consideration of (i) steps the employee took to maintain the privacy of the files, such as password-protection, encryption, or deletion, and (ii) what the employer did to obtain the files, such as whether the employer used forensic recovery techniques, deployed special monitoring software, or hacked the employee's accounts or files.[10]

This is a straightforward case involving work email. IMS, a third party to the communication, had the right to access William's and Andrew's emails when they communicated using their work accounts. Although William and Andrew took the precautionary step of putting the phrase "subject to the attorney client privilege" in the subject line, they failed to take more significant and meaningful steps to defeat access, such as shifting to a webmail account or encrypting their communications. The third *Asia Global* factor favors production.

D. *The Employee's Knowledge Regarding The Company's Policies And Actions*

As framed by the *Asia Global* court, the fourth factor is "did the corporation notify the employee, or was the employee aware, of the use and monitoring policies?" 322 B.R. at 257. This factor has persisted relatively unchanged. If the employee lacked knowledge of the email policy and the party seeking production cannot show that the employee was notified of the policy, then this factor favors the existence of a reasonable expectation of privacy.[11] If the employee had

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[10] *See Finazzo*, 2013 WL 619572, at *10 (explaining that third factor should take into account "what sort of precautions the employee took, or whether obstacles hindered the employer in accessing the privileged communications despite having a policy or practice otherwise allowing the employer to do so"); *Curto*, 2006 WL 1318387, at *1, *8 (noting that employer used forensic consultant to restore portions of emails that employee deleted nearly two years earlier); *Asia Global*, 322 B.R. at 257 n.7 (citing password-protection or encryption as potentially relevant considerations).

[11] *See Convertino v. U.S. Dep't of Justice*, 674 F. Supp. 2d 97, 110 (D.D.C. 2009) (finding employee had reasonable expectation of privacy in emails sent to attorney using employer-furnished account where employee stated he was unaware of monitoring); *Sprenger*, 2008 WL 2465236, at *4 (finding employee had reasonable expectation of privacy where there was no showing that the employee "[was] notified of the Policy by a log-on banner, flash screen, or employee handbook"); *Mason v. ILS Technologies, LLC*, 2008 WL

actual or constructive knowledge of the policy, then this factor favors production because any subjective expectation of privacy that the employee may have had is likely unreasonable.[12] Decisions have readily imputed knowledge of an employer's policy to officers and senior employees.[13]

William and Andrew were two of the three most senior officers at IMS, and they do not deny knowing about the Company's policies. As discussed, William's communications demonstrate that he understood his work email was not secure. The fourth *Asia Global* factor favors production.

E. *The Potential For A Statutory Override*

Three of the four *Asia Global* factors point towards production and one is neutral. The *Asia Global* calculus therefore calls for granting

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731557, at *4 (Feb. 29, 2008) (W.D.N.C. Feb. 29, 2008) (finding employee had reasonable expectation of privacy where it was "hotly disputed whether [employee] was even aware of the policy" and employer could not show that employee had been notified of policy); *Asia Global*, 322 B.R. at 259-61 (finding employee had reasonable expectation of privacy where it was not clear that employees knew of employer policy; company did not appear to have a formal policy regarding use of computers and email); *see also United States v. Slanina*, 283 F.3d 670, 676-77 (5th Cir. 2002) (holding employee had reasonable expectation of privacy where policy did not prevent storage of personal information or inform employees that computer usage would be monitored), *cert. granted, judgment vacated*, 537 U.S. 802 (2002) (vacating and remanding for further consideration in light of *Ashcroft v. Free Speech Coalition*, 535 U.S. 234 (2002)); *Nagle*, 2010 WL 3896200, at *4 (holding that employee had reasonable expectation of privacy in file stored on employer-furnished laptop where employee policy only referred to internet and email); *Haynes*, 298 F. Supp. 2d 1154, 1161-62 (holding that employee had reasonable expectation of privacy (i) where employer had policy stating there would be no reasonable expectation of privacy but employees were given passwords and advised that unauthorized access to other users' email was prohibited and (ii) where employer had never engaged in monitoring).

[12] *See, e.g.*, *Long*, 2006 WL 2998671, at *3 (finding employees had knowledge of work email policy when one employee had helped prepare the employee handbook containing the policy, another was a senior vice president and general manager, and where the employer sent annual reminders about its policy); *Royce Homes*, 449 B.R. at 741 (finding that presence of policy memorialized in employee handbook provided sufficient notice).

[13] *See, e.g.*, *Goldstein*, 873 F. Supp. 2d at 937 ("That Defendants did not allege they were unaware of the policy is not surprising. They owned the company and were its officers. They likely cannot make that assertion with a straight face."); *Aventa Learning*, 830 F. Supp. 2d at 1107 (holding that senior level manager had constructive knowledge of company's policies because his job was to enforce them when supervising employees); *Long*, 2006 WL 2998671, at *3 (imputing knowledge of policy to senior vice president and general manager); *Royce Homes*, 449 B.R. at 741 (imputing knowledge to "key employee of the [company] . . . [who] surely knew what the [company's] Electronic Communications Policy stated").

the motion to compel, absent a statutory override that could alter the common law result. *Cf. Protecting the Confidentiality of Unencrypted E-mail*, ABA Formal Op. 99-413 (relying on protections afforded by the Electronic Communications Protection Act of 1986 (the "ECPA") when opining that attorneys could communicate ethically with their clients using unencrypted email). Delaware, for example, requires that before an employer conducting business in the First State can monitor work email lawfully, the employer must (i) provide notice to employees daily that it engages work email monitoring or (ii) obtain written consent from the monitored employees. 19 *Del. C.* § 705(b). Although the court need not reach the issue, it is possible that if a Delaware employer did not follow either statutory path, then a Delaware employee might have a reasonable expectation of privacy in light of the additional protection provided by the Delaware Code.[14]

The Delaware statute applies only to businesses operating in Delaware, not to Delaware entities who operate elsewhere but choose Delaware as their corporate home. *See Klig v. Deloitte LLP*, 36 A.3d 785, 797-98 (Del. Ch. 2011). In this case, IMS conducts its business in Maryland. IMS is only a Delaware citizen by virtue of having selected Delaware as its state of incorporation and maintaining a registered agent here. The federal government and the State of Maryland are the sovereigns whose law IMS must follow when dealing with its employees' email.

1. The Federal Wiretap Act

Title I of the ECPA amended the Federal Wiretap Act of 1968 by adding the term "electronic communications" to its prohibitions, thereby making it a crime for a person to"intentionally intercept[], endeavor[] to intercept, or procure[] any other person to intercept or endeavor to intercept, any wire, oral, or electronic communication." 18 U.S.C. § 2511(1)(a). Emails are electronic communications for purposes of the Federal Wire Tap Act. *See Steve Jackson Games, Inc. v. U.S. Secret Service*, 36 F.3d 457, 461-62 (5th Cir. 1994); *Healix Infusion*

[14] Delaware also has adopted state legislation modeled on the Federal Wiretap Act and the Federal Stored Communications Act. *See* 11 *Del. C.* §§ 2401-2412 (Delaware Wiretap Act); 11 *Del. C.* §§ 2421-2427 (Delaware Stored Communications Act). For the reasons discussed below, the Federal Wiretap Act and the Federal Stored Communications Act do not support a reasonable expectation of privacy in work email.

Therapy, Inc. v. Helix Health, LLC, 747 F. Supp. 2d 730, 743 (S.D. Tex. 2010).

The Federal Wiretap Act provides that if a communication was intercepted in violation of the statute, then "no part of the contents of such communication and no evidence derived therefrom may be received in evidence in any trial, hearing, or other proceeding in or before any court . . . of the United States [or] a State." 18 U.S.C. § 2515. On the issue of privilege, Section 2517(4) of the Federal Wiretap Act states that "[n]o *otherwise privileged* wire, oral, or electronic communication intercepted in accordance with, or in violation of, the provisions of this chapter shall lose its privileged character." *Id.* § 2517(4) (emphasis added).

There are at least four reasons why the Federal Wiretap Act does not affect the privilege analysis for work email. First, the Federal Wiretap Act only applies when a party intercepts a communication. *Conte v. Newsday, Inc.*, 703 F. Supp. 2d 126, 139 (E.D.N.Y. 2010); *Ideal Aerosmith, Inc. v. Acutronic USA, Inc.*, 2007 WL 4394447, at *4 (E.D. Pa. Dec. 13, 2007). To do so, a party must acquire the communication during transmission. *See, e.g., Fraser v. Nationwide Mut. Ins. Co.*, 352 F.3d 107, 113-14 (3d Cir. 2003) (collecting cases). Emails that have arrived at their destination, such as the corporate email server, are not within the scope of the Federal Wiretap Act. *Id.* An employer does not violate the Federal Wiretap Act by accessing stored work emails on its server, as IMS did here.

Second, an intercept requires the use of an "electronic, mechanical or other device." 18 U.S.C. § 2511(1)(b). The Federal Wiretap Act excludes from the definition of "device" the equipment or facility "being used by a provider of wire or electronic communication service in the ordinary course of its business." *Id.* § 2510(5)(a)(ii); *accord Healix Infusion*, 747 F. Supp. 2d at 744 (holding that intercepting requires use of some device other than the email system used to convey the message; "the drive or server on which an e-mail is received does not constitute a device for purposes of the Wiretap Act") (citation omitted); *Conte*, 703 F. Supp. 2d at 140-41 (same); *Crowley v. Cybersource Corp*, 166 F. Supp. 2d 1263, 1268-69 (N.D. Cal. 2001) (same). Because IMS obtained the emails through the ordinary operation of its email system, it did not use a device to intercept them.

Third, a private employer can intercept electronic communications lawfully "where such person is a party to the communication or where one of the parties to the communication has given prior consent to such interception." 18 U.S.C. § 2511(2)(d).

Consent can be express or implied. *Williams v. Poulos*, 11 F.3d 271, 281 (1st Cir. 1993). The presence of an email monitoring policy in an employee handbook or policy manual is sufficient to support a finding of implied consent to the monitoring of a work email account. *See Shefts v. Petrakis*, 758 F. Supp. 2d 620, 630-31 (C.D. Ill. 2010) (holding company president gave implied consent to corporate monitoring of his email and texts sent using company-furnished device); *Thygeson*, 2004 WL 2066746, at *20 (relying on "explicit policies set out in [defendant's] Employee Handbook"). The IMS policy on email use was sufficiently specific to establish William and Andrew's implied consent to email monitoring.

Fourth, it is not unlawful for the provider of an email account and the related technical infrastructure to "intercept, disclose, or use" a communication as part of "any activity which is a necessary incident to the rendition of his service or to the protection of the rights or property of the provider of that service." 18 U.S.C. § 2511(2)(a)(i). IMS provided William and Andrew with their work email accounts and the underlying technical infrastructure, and IMS therefore had the right to access their email communications as "a necessary incident to" providing the email service and for "the protection of the rights or property" of IMS. Employers monitor email (or reserve the right to do so) in large part to protect their property and to guard against potential liability. *See supra* note 2. IMS could monitor email legitimately for those purposes.

In light of these exceptions, the protections afforded by the Federal Wiretap Act do not give William and Andrew a reasonable expectation of privacy in their work email. The Federal Wiretap Act does not alter the common law privilege analysis.

2. The Federal Stored Communications Act

Title II of the ECPA enacted the Federal Stored Communications Act, which makes it a crime for a person to "intentionally access[] without authorization a facility through which an electronic communication service is provided" or to "intentionally exceed[] an authorization to access that facility" "and thereby obtain[] . . . access to a wire or electronic communication while it is in electronic storage in such system." 18 U.S.C. § 2701(a). By its terms, the Federal Stored Communications Act applies to work email stored on a corporate server. *See Fraser*, 352 F.3d at 115; *Pure Power*, 587 F. Supp. 2d at 555.

The Federal Stored Communications Act's prohibition against access does not apply to conduct authorized "by the person or entity providing a wire or electronic communications service." 18 U.S.C. § 2701(c)(1). This exception has been held to permit an employer to search email stored on a system that the employer administered. *See, e.g., Fraser*, 352 F.3d at 115. IMS administered its email system and qualifies for this exception. The Federal Stored Communications Act does not change the common law privilege analysis either.

3. The Maryland Wiretap Act

Maryland has enacted a state version of the Federal Wiretap Act. Md. Code, Cts. & Jud. Proc. §§ 10-401 to 10-414 (the "Maryland Wiretap Act"). Although the Maryland act differs in one significant way from the federal act (Maryland is a dual consent state), the Maryland version ultimately does not alter the common law privilege analysis.

The Maryland Wiretap Act generally parallels the Federal Wiretap Act. Like the federal statute, the Maryland statute makes it unlawful for any person to "[w]illfully intercept, endeavor to intercept, or procure any other person to intercept or endeavor to intercept, any wire, oral, or electronic communication." Md. Code, Cts. & Jud. Proc. § 10-402(a). Like the federal act, the Maryland Wiretap Act provides that if a communication was intercepted in violation of the statute, then "no part of the contents of the communication and no evidence derived therefrom may be received in evidence in any trial, hearing, or other proceeding." *Id.* § 10-405(a). It further provides that "[a]n otherwise privileged wire, oral, or electronic communication intercepted in accordance with, or in violation of, the provisions of this subtitle, does not lose its privileged character." *Id.* § 10-407(d).

Unlike the federal statute, it is only lawful under Maryland law "for a person to intercept a[n] . . . electronic communication where the person is a party to the communication *and where all of the parties to the communication have given prior consent to the interception.*" *Id.* § 10-402(c)(3) (emphasis added). By requiring consent from all parties to the communication, the Maryland Wiretap Act "has imposed stricter requirements for civilian monitoring than has federal law." *Adams v. State*, 406 A.2d 637, 642 (Md. Ct. Spec. App. 1979). The parties' submissions do not suggest that William's or Andrew's personal attorneys and advisors ever consented to IMS obtaining their communications. The dual consent requirement of the Maryland Wiretap Act therefore renders the consent exception inapplicable.

Despite the unavailability of the consent exception, it remained lawful for IMS to possess William's and Andrew's work emails. The Maryland statute, like the federal act, turns on the existence of an "intercept" made with a "device," and the one Maryland decision to address those terms interpreted them narrowly, consistent with federal law. *See Adams*, 406 A.2d at 642. The *Adams* decision indicates that under the Maryland Wiretap Act, an employer accessing work emails stored on its system would be neither using a "device" nor "intercepting" the communications for the same reasons that those concepts would not apply under the Federal Wiretap Act. The Maryland act also contains an ordinary-course-of-business exception comparable to the Federal Wiretap Act. *See* Md. Code, Cts. & Jud. Proc. § 10-402(c)(1)(i). The Maryland Wiretap Act therefore does not change the outcome of the motion.[15]

4. Maryland Stored Communications Act

Maryland also has enacted a state version of the Federal Stored Communications Act. Md. Code, Cts. & Jud. Proc. §§ 10-4A-01 to 10-4A-08 (the "Maryland Stored Communications Act"). The Maryland act generally parallels the federal act. Like the federal statute, the Maryland statute makes it unlawful for any person to "[i]ntentionally access[] without authorization a facility through which an electronic communication service is provided" or to "[i]ntentionally exceed[] an authorization to access a facility" and thereby "obtain . . . access to a wire or electronic communication while it is in electronic storage" in that system. Md. Code, Cts. & Jud. Proc. § 10-4A-02(a). Like the federal act, the Maryland act applies to work emails stored on a corporate server. *See Upshur v. State*, 56 A.3d 620, 625 (Md. Ct. Spec. App. 2012), *cert. denied*, 62 A.3d 732 (Md. 2013) (observing that the Maryland Stored Communications Act "mirrors its federal counterpart").

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[15] The Maryland Wiretap Act's prohibition on the use of intercepted communications literally applies only to proceedings in the Maryland courts. *See* Md. Code, Cts. & Jud. Proc. § 10-405(a) (referring to a court "of this State"). Because the existence of other exceptions means that IMS did not violate the Maryland Wiretap Act by obtaining William's and Andrew's email, I need not consider the forum limitation. If IMS had violated the Maryland Wiretap Act, then a strong argument could be made that even a non-Maryland court should respect the Maryland legislature's public policy determination regarding the scope of permissible email monitoring within that state.

The exceptions to the Maryland Stored Communications Act similarly parallel the federal act. They include an exception for conduct authorized "[b]y the person or entity providing a wire or electronic communications service." Md. Code, Cts. & Jud. Proc. §10-4A-02(c)(1). While no Maryland case has interpreted this exception explicitly, it likely permits an employer to search email stored on a system that the employer administered. *See Upshur*, 56 A.3d at 625 (noting that Maryland act "mirrors its federal counterpart"). IMS administered its email system and would qualify for this exception. Like its federal counterpart, the Maryland Stored Communications Act does not change the privilege analysis for work email.

F. *A Cautionary Note*

"It is the nature of the judicial process that [the court] decide[s] only the case before [it.]" *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 51 (Del. 1994). This decision has applied the *Asia Global* factors to hold that William and Andrew cannot invoke the attorney-client privilege for communications exchanged with their personal attorneys and advisors using their work email accounts. Although the case has been postured as a consolidated derivative action, it actually involves a dispute between two families, each possessing 50% of the stock and enjoying equal representation on the Board. It is far from clear whether a court would analyze privilege similarly in a more traditional derivative action involving a stockholder plaintiff with a relatively nominal stake and a board comprising individuals without any affiliation with the suing stockholder.

As the *Asia Global* case recognized, the premise that an employer's access to an employee's work email compromises the attorney-client privilege makes the most sense in litigation between the employer or its successor-in-interest and the employee. *See* 322 B.R. at 256 ("The Insiders used the debtor's e-mail system . . . and the communications apparently concerned actual or potential disputes with the debtor, the owner of the e-mail system."). Those outside the corporation cannot routinely access work email accounts, and laws like the Federal Wiretap Act and the Federal Stored Communications Act have teeth when they try. The corporation and its employees should be on different and stronger ground when those outside the corporation seek to compel production of otherwise privileged documents that employees have sent using work email. Admittedly, courts have applied the *Asia Global* factors and found no reasonable expectation of privacy in suits by outsiders, *see, e.g.*, *Deepwater Horizon*, 2011 WL 1193030

(suits by property owners injured by oil spill), and courts routinely find no reasonable expectation of privacy in actions brought by prosecutors and regulators. It is not clear to me, however, that the analysis translates so easily when the party trying to overcome the privilege is not the corporation or its successor-in-interest.

As previously discussed, the plaintiffs in this case are trusts affiliated with directors who possess essentially unfettered informational rights. A stockholder with a small stake and no director affiliation would not have similar default rights of access and would be limited to relying on Section 220(a) of the General Corporation Law. *See* 8 *Del. C.* § 220(a). The IMS Board also is split evenly between directors affiliated with the two families, making it virtually inevitable that either family would have stockholder standing to assert the corporation's claims derivatively against defendants affiliated with the other family. *See Benerofe v. Cha*, 1998 WL 83081, at *3-4 (Del. Ch. Feb. 20, 1998) (demand futile where board is split). In a more typical derivative action not involving a split board, a stockholder plaintiff does not have power to sue in the corporation's name unless and until the corporation chooses not to oppose the stockholder's suit (explicitly or implicitly) or the court determines that the stockholder can sue by denying a motion to dismiss brought pursuant to Rule 23.1.[16] Only then does the stockholder actually gain the power to sue on behalf of the entity. Before that point, Delaware law regards the interests of the corporation as aligned with those of individual defendants. *Scattered Corp. v. Chi. Stock Exch., Inc.*, 1997 WL 187316, at *6-8 (Del. Ch.

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[16] *See, e.g.*, *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993) ("Because directors are empowered to manage, or direct the management of, the business and affairs of the corporation, the right of a stockholder to prosecute a derivative suit is limited to situations where the stockholder has demanded that the directors pursue the corporate claim *and* they have wrongfully refused to do so *or* where demand is excused because the directors are incapable of making an impartial decision regarding such litigation.") (emphases added; citation omitted); *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d 726, 730 (Del. 1988) ("[P]re-suit demand under Chancery Court Rule 23.1, is an objective burden which must be met in order for the shareholder to have capacity to sue on behalf of the corporation. *The right to bring a derivative action does not come into existence until the plaintiff shareholder has made a demand on the corporation to institute such an action or until the shareholder has demonstrated that demand would be futile.*") (emphasis added); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 (Del. 1981) ("[W]here demand is properly excused, the stockholder does possess the ability to initiate the action on his corporation's behalf."). Even then, the corporation can reassert control over the derivative claims through a special litigation committee. *Zapata*, 430 A.2d at 785 (explaining that, "if the board determines that a suit would be detrimental to the company," the board "has the power to choose not to pursue litigation . . . so long as the decision is not wrongful").

Apr. 7, 1997), *aff'd on other grounds*, 701 A.2d 70 (Del. 1997).[17] These distinctions make it unclear whether a more typical derivative action plaintiff should be able to obtain otherwise privileged communications sent using a work email account during periods pre-dating the point when the stockholder gains standing to sue.

Moreover, equity historically has imposed other limitations on a stockholder plaintiff's ability to obtain corporate documents in a derivative action, even after the stockholder gains standing to sue on behalf of the corporation. For example, a stockholder seeking to penetrate the corporation's privilege had to show good cause under *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971). A stockholder plaintiff does not automatically acquire the unfettered ability to access anything sent or received over the work email system.

Finally, it is possible that the concept of selective waiver (as distinct from partial waiver) might apply in an appropriate case. *Cf. Saito v. McKesson HBOC, Inc.*, 2002 WL 31657622, at *6-7, *11 (Del. Ch. Nov. 13, 2002) (holding that selective waiver when documents were provided to the SEC under a confidentiality agreement did not result in global waiver of the work product doctrine; "[c]onfidential disclosure of work product during law enforcement agency investigations relinquishes the work product privilege only as to that agency, not as to the client's other adversaries," thereby "encourag[ing] cooperation with law enforcement agencies without any negative cost to society or to private plaintiffs"). It is also likely, as in *Saito*, that the

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[17] The Delaware Supreme Court affirmed the Court of Chancery's Rule 23.1 dismissal under an abuse of discretion standard. *Scattered Corp.*, 701 A.2d 70, 73 (Del. 1997), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). In *Brehm*, the Delaware Supreme Court overruled seven precedents, including *Scattered*, to the extent those precedents reviewed a Rule 23.1 decision by the Court of Chancery under an abuse of discretion standard or otherwise suggested deferential appellate review. *See Brehm*, 746 A.2d at 253 n.13, 254 (overruling in part on this issue *Scattered*, 1997 WL 187316; *Grimes v. Donald*, 673 A.2d 1207 (Del. 1996); *Heineman v. Datapoint Corp.*, 611 A.2d 950 (Del. 1992); *Levine v. Smith*, 591 A.2d 194 (Del. 1991); *Grobow v. Perot*, 539 A.2d 180 (Del. 1988); *Pogostin v. Rice*, 480 A.2d 619 (Del. 1984); *and Aronson v. Lewis*, 473 A.2d 805 (Del. 1984)). The *Brehm* Court held that going forward appellate review of a Rule 23.1 determination would be *de novo* and plenary. *Brehm*, 746 A.2d at 253-54. Neither the Delaware Supreme Court's ruling on appeal in *Scattered* nor its subsequent modification of the standard of review in *Brehm* altered the Court of Chancery's holding that no conflict of interest existed between the corporation and the individual director defendants at the motion to dismiss stage in a derivative action such that a law firm could represent all defendants without impropriety.

defendants in a more traditional derivative action would invoke the work product doctrine, which was not argued here.

None of these issues has been presented, and this opinion does not provide any opportunity to hazard a guess about the potential outcome of a case in which they were raised. I mention them only to emphasize that this decision does not purport to announce a rule applicable to all derivative actions, and it should not be interpreted as doing so.

III. CONCLUSION

The motion to compel is granted. Within three days, the defendants shall produce the emails and attachments otherwise protected by the attorney-client privilege that William and Andrew exchanged with their personal attorneys and advisors using their work email accounts.