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I. Introduction

Ralph Waldo Emerson, in his preface to *Parnassus*, stated that "[p]oetry teaches the enormous force of a few words, and, in proportion to the inspiration, checks loquacity." Perhaps because Emerson was untrained in the law, he could not imagine what "enormous force" excessive language can create. The recent case of *Zirn v. VLI Corp.* serves as an appropriate example. The Delaware Supreme Court, through loquacious analyses, has authored an opinion which may create far-reaching implications for future disclosure-related corporate litigation.

The supreme court in *Zirn* first examined the materiality of the stock market crash of 1987 to a decision to merge VLI Corporation (VLI) and American Home Products Corporation (AHP). Writing for the court, Justice Walsh reaffirmed Delaware's adherence to the United States Supreme Court's objective materiality standard, set forth in *TSC Industries, Inc. v. Northway, Inc.* In doing so, the court reversed the court of chancery's subjective interpretation and application of the materiality standard. Accordingly, the case was re-

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2. 621 A.2d 773 (Del. 1993).
3. See infra notes 242-52 and accompanying text.
5. *Zirn*, 621 A.2d at 779. The court found the vice-chancellor's materiality analysis had erred in two ways. *Id.* The first error occurred when the court of
manded for the application of "an objective standard calculated to
determine what information a reasonable VLI shareholder should
possess in order to gauge the motivation for the price reduction." 6
This comment argues that the court, while declaring a preference
for an objective materiality standard, intimated that the failure to
disclose the effect an event has on directors' subjective motivations
may result in liability.7 Specifically, the court explained that "[t]he
test [for materiality was] whether AHP's decision to seek, and VLI's
decision to accept, a reduction in the per share price was influenced
by the market crash and, if so, whether that information 'would
have assumed actual significance in the deliberations of a reasonable
shareholder.' "8

The Zirn court's second ruling dealt with the effects of a corpo-
ration's partial disclosure of the legal advice provided by its patent
attorney to the Securities and Exchange Commission (SEC).9 The

chancery interpreted the standard of materiality as requiring an analysis of "the
VLI director's [sic] subjective views and motivations, without addressing what a
reasonable stockholder would consider." Id. The supreme court noted that the
chancery decision made only one reference to what a "reasonable shareholder might
dean relevant." Id. The balance of Vice-Chancellor Hartnett's decision was based
on the subjective views of VLI's directors. See id.

The second error, according to the court, occurred in the vice-chancellor's
application of the materiality standard. Id. Vice-Chancellor Hartnett suggested that
had Zirn "proven that the market crash was the primary reason for the VLI
directors' approving the revision of the Merger Agreement, she might have estab-
lished a breach of the VLI directors' fiduciary duty of disclosure." Zirn v. VLI
Corp., No. 9488, 1992 Del. Ch. LEXIS 127, at *16-17 (Del. Ch. June 10, 1992),
that the veracity of the directors' subjective beliefs was not an issue. Zirn, 621 A.2d
at 779. "'[I]f an omission is immaterial, the fact that it was made by a party with
some incentive to be less than candid cannot render the omission material.' " Id.
(quoting Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1288 (Del. 1989)). The
court further noted that "a material omission is not rendered immaterial simply
because the party making the omission honestly believes it insignificant." Id.
6. Zirn, 621 A.2d at 780.

7. See infra text accompanying notes 275-81. This comment contends that
the directors' motivation for agreeing to the price reduction would not be subject
to disclosure, provided all relevant facts pertaining to the price reduction were fully
disclosed. See infra note 290. The market crash of October 1987, had international
repercussions and received a corresponding measure of publicity. See infra note 291
and accompanying text. Thus, under any formulation of the facts, "a reasonable
VLI shareholder" would have possessed knowledge of the market's decline and
would have incorporated this knowledge into a decision of whether to oppose the
merger's price reduction. See infra note 292 and accompanying text.
8. Zirn, 621 A.2d at 779 (emphasis added) (quoting Rosenblatt, 493 A.2d at
944).
9. See id. at 781-82.
supreme court concluded that, in addition to a showing of "good cause" by plaintiff, partial disclosure of the attorney's advice to the SEC waived assertion of the attorney-client privilege. Additionally, the court, relying on its attorney-client waiver analysis, concluded that the same partial disclosure to the SEC waived protections afforded by the work product doctrine. This comment argues that these rulings contradict the policy aims of the two concepts.

The Delaware Supreme Court's third holding in Zirn denied section 102(b)(7) protection to directors for breaches of their duty of loyalty. The court noted that the duty of loyalty "embraces the

10. Id. at 781. Because the court, in its analysis, disagreed with the trial court's good cause determination, the court's conclusion that partial disclosure waived the attorney-client privilege may have been unnecessary. See infra note 295 and accompanying text. As a result of this "strict waiver" portion of the Zirn decision, Delaware has joined other jurisdictions in concluding that disclosure of information, pursuant to the SEC's regulations, serves to waive the protections afforded by the attorney-client privilege and work product doctrine. See infra note 298 and accompanying text.

11. Zirn, 621 A.2d at 782. Therefore, VL1 was precluded from shielding itself from further discovery requests seeking disclosure of the corporation's patent attorney's advice. See id.

12. Section 102(b)(7) of the Delaware General Corporation Law provides, in pertinent part:

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:

... (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. All references in this paragraph to a director shall also be deemed to refer to a member of the governing body of a corporation which is not authorized to issue capital stock.


13. Zirn, 621 A.2d at 783. The court also explained that § 102(b)(7) "does not shield directors from liability for equitable fraud." Id.
duty of disclosure that is at issue here." This ruling, as the court explained, was addressed summarily "[i]n the interest of completeness and in anticipation of a rehearing upon remand." This comment suggests that the Delaware Supreme Court's language may be read to imply that the duty of disclosure is related exclusively to the duty of loyalty. Unless clarified, this interpretation could undermine the Delaware Legislature's attempt to enable corporations to limit director liability for certain negligent conduct.

This comment discusses the background of each of the court's rulings. The decisions of the court of chancery and supreme court are also analyzed. Finally, this comment evaluates the possible consequences of each of the supreme court's rulings and offers alternative analyses, where applicable.

II. BACKGROUND

A. Materiality

The definition of materiality for corporate disclosure liability has plagued the courts for more than three decades. The prevailing view, as set forth in TSC Industries, Inc. v. Northway, Inc., defines materiality as that which creates "a substantial likelihood that a reasonable shareholder would consider [the fact] important in deciding how to vote." This test, according to the United States Supreme Court, describes materiality "as a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts."

Certainly, the most common situation for applying the materiality test occurs in the federal securities arena, where materiality

14. Id. The court, however, failed to indicate which of the plaintiffs' disclosure claims implicated the duty of loyalty. See infra text accompanying note 313.
15. Zirn, 621 A.2d at 783.
16. See infra note 312 and accompanying text. But see 2 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 22.10, at 22-18 (1993) (stating that "[t]he requirement that directors disclose to stockholders all material facts bearing upon a stockholder vote arises under the directors' duties of care and loyalty") (emphasis added).
17. See infra note 318 and accompanying text.
18. See infra notes 27-77 and accompanying text.
20. Id. at 449.
21. Id. at 450.
is the cornerstone of liability. The Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted after the 1929 stock market collapse to regulate securities through stringent disclosure guidelines. Virtually all of the disclosure requirements of the Securities Acts are concerned with the concept of "materiality" in determining which facts require disclosure.

1. Early Definitions

The Seventh Circuit was the first United States Court of Appeals to define materiality in the disclosure context of the securities laws. Judge Swygert, in Kohler v. Kohler Co., explained that a fact is material and requires disclosure if, "in reasonable and objective contemplation[,] it might affect the value of the corporation's stock or securities and [the fact is one] which the insiders should reasonably believe [is] unknown to the outsider." Obviously, this "might" test was highly pro-disclosure and was later abandoned in favor of a more exacting standard.

28. 319 F.2d 634 (7th Cir. 1963).
29. Id. at 642 (emphasis added).
30. See Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1302 (2d Cir. 1973). The Gerstle court explained that "[w]hile the difference between 'might' and 'would' may seem gossamer, the former is too suggestive of mere possibility, however unlikely." Id.
31. See TSC Indus., 426 U.S. at 449.
In 1965, the Second Circuit explained that "'[t]he basic test of 'materiality' . . . is whether 'a reasonable man would attach' importance [to the fact misrepresented]." 32 Three years later, this test was modified by the same court in SEC v. Texas Gulf Sulphur Co.33 The Texas Gulf court required a showing that the allegedly material information "may affect the desire of investors to buy, sell, or hold the company's securities."34

The United States Supreme Court unwittingly entered the definitional thicket in Mills v. Electric Auto-Lite Co.35 In Mills, the Mergenthaler Linotype Company had agreed to merge with the Electric Auto-Lite Company.36 The plaintiffs in Mills alleged that the defendants had failed to disclose that "Auto-Lite's directors were nominees of Mergenthaler and were under the 'control and domination of Mergenthaler' " at the time the merger decision was made.37 The

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32. List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.) (emphasis added), cert. denied, 382 U.S. 811 (1965) (quoting Restatement of Torts § 538(2)(a) (1938)). Curiously, the court quoted Kohler in the subsequent paragraph for the proposition that "'[m]ateriality' encompasses those facts 'which in reasonable and objective contemplation might affect the value of the corporation's stock or securities.'" Id. (quoting Kohler, 319 F.2d at 642) (emphasis added).
34. Id. at 849. The Texas Gulf court, deciding an action brought under Rule 10b-5, 17 C.F.R. § 240.10b-5 (1991), developed a "'probability-magnitude' test for determining the materiality of "'soft information.'" Id. See infra note 65 and accompanying text for the full text of Rule 10b-5. "'Soft information' encompasses such things as "'forecasts of earnings, revenues, budgets for capital expenditures, future dividend policies, management analyses of financial statements, and any other forward looking information. . . . In contrast, hard information includes historical and objectively verifiable data such as current or past financial information.'" Robert B. McIntosh, Note, Disclosure of Soft Information in Tender Offers After Flynn v. Bass Brothers Enterprises, Inc., 42 Wash. & Lee L. Rev. 915, 917-18 (1985) (emphasis added). The court in Texas Gulf explained that whether "'those facts which affect the probable future of the company'" are material "'depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'" Texas Gulf, 401 F.2d at 849. This "'probability-magnitude' test for soft information was adopted recently by the Supreme Court in Basic Inc. v. Levinson, 485 U.S. 224, 238-39 (1988). See infra note 76 and accompanying text.
36. Id. at 377.
37. Id. at 378. The plaintiffs had brought an implied private right of action under § 14(a) of the 1934 Act. Id. at 377. The issue for adjudication before the Court was whether the plaintiffs had established the "'causal relationship'" between the false or misleading statement and the merger required to state a cause of action under the Act. Id.
merger proxy statement had indicated only that the Electric Auto-
Lite board recommended the approval of the merger.38

Although the Supreme Court stated in an early footnote that it
would not consider the question of materiality,39 Justice Harlan
referenced, in dicta, the highly pro-disclosure "might" standard.40
The Court explained that a material fact is that which is "of such
a character that it might have been considered important by a rea-
sonable shareholder who was in the process of deciding how to
vote."41 The next sentence in Mills, however, indicated that in order
to be material the fact must have a "significant propensity to affect"
the decision of a reasonable, prudent investor.42 Based, in part, on
this passing reference to the materiality standard, the Supreme Court
held that the plaintiffs had established the causal relationship required
for a cause of action under section 14(a) of the 1934 Act.43

2. TSC Industries, Inc. v. Northway, Inc.

The Supreme Court, in TSC Industries, Inc. v. Northway, Inc.,44
was faced squarely with defining materiality in an action brought
for alleged violations of section 14(a)45 of the 1934 Act.46 In TSC

38. Id. at 378.
40. See id. at 384; see also Gerstle, 478 F.2d at 1302 (stating that "[w]e think
that, in a context such as this, the 'might have been' standard mentioned by Mr.
Justice Harlan [in Mills] sets somewhat too low a threshold").
41. Mills, 396 U.S. at 384 (emphasis added). Two years later, the Court
used, in dicta, the "might" language of Mills in a Rule 10b-5 misrepresentation
claim. See Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-54,
reh'g denied, 407 U.S. 916 (1972).
42. Mills, 396 U.S. at 384.
43. See id. at 385.
44. 426 U.S. 438 (1976).
45. Section 14(a) of the 1934 Act provides:
It shall be unlawful for any person, by the use of the mails or by any
means or instrumentality of interstate commerce or of any facility of a
national securities exchange or otherwise, in contravention of such rules
and regulations as the Commission may prescribe as necessary or approp-
riate in the public interest or for the protection of investors, to solicit or
to permit the use of his name to solicit any proxy or consent or authorization
in respect of any security (other than an exempted security) registered
pursuant to section 78l of this title.
15 U.S.C. § 78n(a) (1989). Section 78l, to which § 14(a) refers, pertains to the
general requirements for registration of securities with the SEC. Id. § 78l.
46. TSC Indus., 426 U.S. at 441.
Industries, National Industries, Inc. (National) had acquired thirty-four percent of TSC Industries' voting shares in February of 1969.\textsuperscript{47} Subsequently, five National nominees were appointed to TSC's board of directors.\textsuperscript{48} The TSC board, with the recent appointees abstaining, approved a proposal to sell all of TSC's assets to National.\textsuperscript{49} TSC and National, on November 12, 1969, issued a joint proxy statement, recommending the proposal's approval.\textsuperscript{50} The proxy solicitation was approved by the shareholders and TSC was liquidated and dissolved pursuant to the proposal.\textsuperscript{51}

Northway, a TSC shareholder, instituted suit against TSC and National, alleging that the joint proxy statement had materially misled TSC's shareholders.\textsuperscript{52} Central to Northway's claim was that TSC and National had failed to disclose: (1) that National's 1969 acquisition of TSC had placed National in control of TSC\textsuperscript{53} and (2) the degree to which National controlled TSC.\textsuperscript{54}

The Supreme Court explained that "[t]he question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor."\textsuperscript{55} The Court indicated that the problem of defining materiality arose from variations in describing "how certain it must be that the fact would affect a reasonable investor's judgment."\textsuperscript{56}

\textsuperscript{47} Id. at 440.
\textsuperscript{48} Id.
\textsuperscript{49} Id. at 440-41.
\textsuperscript{50} TSC Indus., 426 U.S. at 441.
\textsuperscript{51} Id.
\textsuperscript{52} Id.
\textsuperscript{53} Id. at 441-42.
\textsuperscript{54} TSC Indus., 426 U.S. at 442.
\textsuperscript{55} Id. at 445.
\textsuperscript{56} Id. The TSC Industries Court, however, failed to expound upon the definition of a "reasonable investor." The disclosures disseminated to equity investors are directed towards disparate audiences. There are individual investors (sophisticated and unsophisticated) as well as institutional investors of all sizes. In Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544 (E.D.N.Y. 1971), the court attempted to resolve this issue by explaining that

\textsuperscript{56} The objectives of full disclosure can be fully achieved only by complete recitation of facts which would be material to the sophisticated investor or the securities professional not just the average common shareholder. But, at the same time, the prospectus must not slight the less experienced. They are entitled to have within the four corners of the document an intelligible description of the transaction.

\textsuperscript{Id.} at 566 (emphasis added). Cf. Gould v. American-Hawaiian S.S. Co., 535 F.2d 761, 774 (3d Cir. 1976) (finding the proxy statement deficient because it did not sufficiently emphasize certain conflicts of interest); Gerstle, 478 F.2d at 1297 (ex-
The Court found the Seventh Circuit's reliance on Mills v. Electric Auto-Lite Co. to be misplaced, noting that "[t]he references to materiality [in Mills] were simply preliminary to our consideration of the sole question in [that] case . . . . Mills did not intend to foreclose further inquiry into the meaning of materiality." The TSC Industries definition, which followed, took a less liberal approach than the Mills dicta.

TSC Industries defined a material fact as that which creates "a substantial likelihood that a reasonable shareholder would consider [the fact] important in deciding how to vote." The Court justified its new

plaining that "it is not sufficient that overtones [in a proxy statement] might have been picked up by the sensitive antennae of investment analysts"). But see Smallwood v. Pearl Brewing Co., 489 F.2d 579, 602 (5th Cir.), cert. denied, 419 U.S. 873 (1974) (concluding that "[i]t is enough that proxy statements be complete and not misleading in light of the circumstances existent and reasonably anticipated at the time distributed").


58. TSC Indus., 426 U.S. at 447. The Court also diminished its passing reference to materiality in Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972). TSC Indus., 426 U.S. at 447 n.9. The language in Affiliated Ute Citizens upon which the Seventh Circuit relied "was not necessary to articulate a precise definition of materiality, but only to give a 'sense' of the notion." Id.

59. Id. at 449 (emphasis added). The Court quoted with approval language from Judge Friendly's opinion in Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281 (2d Cir. 1973), which explained "that the 'might' formulation is 'too suggestive of mere possibility, however unlikely.' " TSC Indus., 426 U.S. at 449 (quoting Gerstle, 478 F.2d at 1302). Justice Marshall took great pains to clarify the TSC Industries' definition of materiality, stating it in alternative fashion:

[Materiality] does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

Id. Although the TSC Industries opinion contains language which might limit the definition of "materiality" to actions under Rule 14a-9, "[t]he better view . . . is that the Court was just being careful not to exceed the scope of the issue presented by the facts in the case." James O. Hewitt, Developing Concepts of Materiality and Disclosure, 32 Bus. Law. 887, 900 (1977). The recent decision of the Court in Basic Inc. v. Levinson has reinforced the idea that the materiality standard in TSC Industries should apply to all corporate disclosure-related causes of action. See Basic, 485 U.S. at 240 n.18 (citing several cases for the proposition that varying standards of materiality should not be formulated). But see infra note 76 (explaining Delaware's adoption of a bright-line test for materiality in preliminary merger negotiations).
definition based, in part, on the fact that "[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good."60 This new test, according to the Court, describes materiality "as a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts."61 Employing this definition, the Court held that none of the alleged material omissions violated Rule 14a-9.62

3. Basic Inc. v. Levinson: Further Supreme Court Guidance

The Supreme Court again considered the concept of materiality in Basic Inc. v. Levinson,63 a suit based on section 10(b)64 of the 1934 Act and Rule 10b-565 promulgated by the SEC.66 Representatives of

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60. TSC Indus., 426 U.S. at 448. The Court continued:
The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.

Id. at 448-49.

61. Id. at 450.

62. Id. at 463.


64. Section 10 of the 1934 Act provides:
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
   (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
   (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.


65. Rule 10b-5 provides:
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
   (a) To employ any device, scheme, or artifice to defraud,
   (b) To make any untrue statement of a material fact or to omit
Basic Inc. (Basic) and Combustion Engineering, Inc. (Combustion Engineering) held negotiations for fifteen months regarding a possible merger of the two companies. During the time Basic was negotiating with Combustion Engineering, however, Basic publicly denied that merger negotiations were taking place on three separate occasions. Furthermore, Basic denied any knowledge of corporate developments which would explain the stock's heavy trading activity.

After the merger was announced, persons who sold their common stock in Basic between October 21, 1977, and December 18, 1978, brought a class action suit under section 10(b) and Rule 10b-5. Plaintiffs alleged that they had sold their shares in reliance upon Basic's public statements denying corporate developments which would account for the stock's increased trading activity. Additionally, plaintiffs asserted that Basic's statements were false, misleading, and material because the company was involved in merger negotiations.

The Supreme Court, in Basic, reaffirmed the TSC Industries materiality test, expressly extending the test to preliminary merger negotiations. Justice Blackmun explained that "materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information." Thus, the Court was obliged to eschew a bright-line test for determining materiality of "soft

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67. Id. at 227.
68. Id.
69. Id. at 227-28 n.4.
70. Basic, 485 U.S. at 228.
71. Id.
72. Id.
73. Id.
74. Basic, 485 U.S. at 236. Preliminary merger negotiations are often characterized as "soft information" because they involve future, uncertain events. See supra note 34.
75. Basic, 485 U.S. at 240.
Because the Court explicitly adopted the materiality standard of *TSC Industries*, the case was remanded "for reconsideration of the question whether a grant of summary judgment [was] appropriate on [the] record."

4. Delaware’s Adoption and Application of *TSC Industries*

The Delaware Supreme Court implicitly adopted the *TSC Industries* materiality standard in *Lynch v. Vickers Energy Corp.* Lynch was a former shareholder of TransOcean Oil, Inc. (TransOcean), which was acquired by Vickers Energy Corporation (Vickers) in

76. See id. at 236. The *Basic* Court adopted the probability-magnitude test, first formulated by the Second Circuit in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969). *Basic*, 485 U.S. at 238-39. For an explanation of the “probability-magnitude test, see *supra* note 34. The Supreme Court steered away from a bright-line test, explaining that [a] bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress’ policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or under-inclusive.

*Basic*, 485 U.S. at 236. The Delaware Supreme Court, however, has adopted a bright-line test for materiality when companies are engaged in preliminary merger negotiations. The court considers preliminary negotiations immaterial, “as a matter of law, until the firms have agreed on the price and structure of the transaction.” Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 847 (Del. 1987). See also Greenfield v. Heublein, Inc., 742 F.2d 751, 756 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985) (reasoning that preliminary negotiations are immaterial as a matter of law, until “an agreement in principle” is reached, i.e., an agreement on price and structure). Accordingly, until the Delaware Supreme Court adopts the reasoning in *Basic*, the materiality of ongoing merger negotiations in Delaware will differ substantially from the standard applied under the disclosure requirements of the federal securities laws.

77. *Basic*, 485 U.S. at 240-41. On remand, the Sixth Circuit concluded that “[m]ateriality is a question of fact to be determined in the court below. It is a function of the probability that the transaction will be consummated and its significance to the issuer of the securities.” Levinson v. Basic, Inc., 871 F.2d 562, 564 n.1 (6th Cir. 1989). The court stated that “[b]ased upon the facts of this case, it is difficult for us to see how Basic’s multiple public statements denying merger talks which substantially affected the activity of the stock were not material.” Id.

78. 383 A.2d 278, 281 (Del. 1977) (requiring disclosure of all “germane” facts which “a reasonable shareholder would consider important in deciding whether to sell or retain stock”).
1974.79 Plaintiff sued Vickers to recover damages, alleging that the defendant failed to fully disclose certain facts surrounding TransOcean's acquisition.80 According to plaintiff, this lack of disclosure caused the minority shareholders "to sell their respective shares for a grossly inadequate price."81

The supreme court, agreeing with the court of chancery, found that the defendant had a duty to disclose all relevant facts concerning the tender offer.82 The court disagreed, however, with the court of chancery's application of the law to the facts.83 Noting that the defendants were required to disclose all facts "in their possession germane to the transaction in issue,"84 the supreme court found that

the tender offer failed to disclose fully two critical facts: (1) that a "highly qualified" petroleum engineer, who was a member of TransOcean's management, had calculated the net asset value to be worth significantly more than the minimum amount disclosed in the offer; and (2) that Vickers' management had authorized open market purchases of TransOcean's stock during the period immediately preceding the $12 per share tender offer for bids up to $15 per share.85

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79. Id. at 279.
80. Id. Plaintiff alleged that defendants had violated their fiduciary duties by making "less than a full and frank disclosure in the tender offer of the value of TransOcean's net assets." Id. According to the supreme court, the Tender Offer Circular contained the following statement concerning TransOcean's net asset value:

Management of the Company [TransOcean] has informed the Offeror [Vickers] that, based on a calculation of discounted present value of the Company's reserves and values attributable to the Company's management to the Company's undeveloped acreage and other assets, management of the Company estimates that at this date the Company's net asset value adjusted for such factors is not less than $200,000,000 (approximately $16.00 per share) and could be substantially greater.

Id. at 280. When this circular was distributed to TransOcean's shareholders, management was aware that one of the company's vice presidents, Forrest Harrell, a petroleum engineer, had fixed "the net asset value [of TransOcean] at $250.8 million, which computes to approximately $20 per share, and from which one could conclude that the value could be as high as $300 million." Id.
81. Id. at 279.
82. Lynch, 383 A.2d at 279.
83. Id.
84. Id. at 281. The court continued, stating that "by 'germane' we mean, for present purposes, information such as a reasonable shareholder would consider important in deciding whether to sell or retain stock." Id.
85. Id. at 280 (citation omitted).
The Supreme Court of Delaware did not expressly adopt the TSC Industries materiality standard until 1985 in Rosenblatt v. Getty Oil Co. The plaintiffs alleged, inter alia, that defendants' "proxy statement failed to disclose the secrecy of [DeGolyer and MacNaughton]'s (D & M) methods in valuing the respective companies' reserves, and that the proxy statement misled Skelly's minority shareholders into believing that Skelly and its investment banker had carefully reviewed D & M's subsurface valuation."98

Addressing plaintiffs' disclosure claim, the supreme court applied the "germane" standard from Lynch.99 The court, after explaining that the Lynch standard of "'germane' has no well-accepted meaning in the disclosure context," stated that "it is clear from the Delaware cases that the materiality standard of TSC Industries, Inc. v. Northway, Inc., applies."90 The court "conclude[d] that Skelly fully met its duty of complete candor."91

86. 493 A.2d 929, 944 (Del. 1985).
87. Id. at 931.
88. Id. at 936. Getty Oil Company (Getty) and Skelly Oil (Skelly) met in July of 1976 to discuss the possibility of the companies' merger. Id. at 933. The parties agreed to use D & M and various investment banking firms to help in the valuation of the companies' surface assets and their subsurface oil, gas, and mineral reserves. Id. at 933-34.

The parties soon agreed on the valuation of the surface assets, but arrived at an impasse regarding their respective subsurface reserves. Id. at 935. Skelly and Getty agreed to delegate calculation of their respective reserves to D & M. Id. D & M, as a prerequisite to accepting the task of valuating the subsurface assets, required that its valuation methods not be divulged to the parties. Id. After extensive negotiations, the parties agreed on a stock exchange ratio of 0.5875 Getty shares for each share of Skelly. Id. at 935-36.

89. See id. at 944.
90. Rosenblatt, 493 A.2d at 944 (citation omitted) (citing Field v. Allyn, 457 A.2d 1089, 1100 (Del. Ch.), aff'd, 467 A.2d 1274 (Del. 1983); Kaplan v. Goldsamt, 380 A.2d 556, 565-66 (Del. Ch. 1977)). The court then quoted extensively from the TSC Industries opinion. See id.
91. Id. at 945. The court reasoned that "in deciding whether to vote to approve the merger, a reasonable shareholder would not consider the delegation to D & M or the confidentiality of its methods to be material." Id.

The Delaware Supreme Court has since suggested in Stroud v. Grace, 606 A.2d 75 (Del. 1992), that it would be "more appropriate for [the Delaware] courts to speak of a duty of disclosure based on a materiality standard rather than the unhelpful terminology that has crept into Delaware court decisions as a 'duty of candor.'" Id. at 94. The court explained that

the term "duty of candor" does not import a unique or special rule of disclosure. It represents nothing more than the well-recognized proposition
The supreme court, in 1992, applied the *TSC Industries* standard in *Stroud v. Grace*. Plaintiffs, in *Stroud*, brought an action against defendant Milliken & Company, a closely-held Delaware corporation, alleging that Milliken's directors had inadequately disclosed and misled Milliken's shareholders concerning the notice of a meeting at which certain amendments to Milliken's charter were made.

The court succinctly stated the materiality standard as adopted from *TSC Industries*: "Delaware law imposes upon a board of directors the fiduciary duty to disclose fully and fairly all material facts within its control that would have a significant effect upon a stockholder vote. The board is not required to disclose all available information." Applying this test, the court concluded that Milliken's "board complied with its statutory duty and included with its notice both the certificate of incorporation and the proposed amendments."

The *TSC Industries-Rosenblatt* standard was also recently applied by the Delaware Supreme Court in *Shell Petroleum, Inc. v. Smith*. A class of former minority shareholders of the Shell Corporation sued Shell's majority shareholder for alleged damages arising from a short-form merger. Plaintiffs maintained that defendants had materially misrepresented Shell's oil and gas reserves. The miscalculation of these reserves "resulted in an understatement of [Shell's] discounted future net cash flows of approximately $993 million to $1.1 billion or $3.00 to $3.45 per share."

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that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action.

_Id._

92. 606 A.2d 75, 84 (Del. 1992).
93. _Id._ at 78.
94. _Id._ at 85 (citations omitted).
95. _Id._ at 87.
96. 606 A.2d 112 (Del. 1992).
97. _Id._ at 113. For the applicable statute governing the use of short-form mergers in Delaware, see Del. Code Ann. tit. 8, § 253 (1991). The purpose of a short-form merger is to give the parent corporation a way to eliminate the minority stakeholders' interests in the enterprise. In _re Delaware Racing Ass'n_, 213 A.2d 203, 209 (Del. 1965). The majority stockholders, however, continue to be bound by their fiduciary duties. See Coleman v. Taub, 638 F.2d 628, 635 (3d Cir. 1981). For a brief discussion of directors' fiduciary duties, see _infra_ notes 155-61 and accompanying text.
98. *Shell Petroleum*, 606 A.2d at 113. An error in calculating the gas reserves was apparently caused by a computer error. _Id._
99. _Id._ The undisclosed reserves constituted approximately 295 million barrel equivalents of oil and gas. _Id._
The court, in Shell Petroleum, explained that a majority shareholder has the burden of disclosing "all material facts relevant to a minority shareholders' [sic] decision whether to accept the short-form merger consideration or seek an appraisal."\(^{100}\) The court reiterated the TSC Industries materiality standard, as adopted in Rosenblatt.\(^{101}\) Attempting to clarify further how definitely the information would have to affect a reasonable shareholder's decision, the court noted that "the question is not whether the information would have changed the stockholder's decision to accept the merger consideration, but whether 'the fact in question would have been relevant to him.'"\(^{102}\) The court affirmed the trial court's determination that defendant's billion dollar understatement of Shell's oil and gas reserves was a material fact under the TSC Industries-Rosenblatt standard.\(^{103}\)

5. A "Last" Word on Materiality

Basic Inc. v. Levinson\(^{104}\) has the likely effect of ensuring that the TSC Industries materiality test is applied uniformly in all federal, disclosure-related causes of action.\(^{105}\) Furthermore, Basic solidifies the TSC Industries standard as "the definition" of materiality, even in state law claims.\(^{106}\) The natural deficiencies of language continue to prevent a general, bright-line test for materiality in all circumstances, without simultaneously abandoning the goals of disclosure.\(^{107}\) Thus,

100. Id. at 114 (citations omitted).
101. Id.
103. Id. at 116. The court explained that it could not "agree that a billion dollar understatement of the value of Shell's reserves would have been anything but highly relevant and material to a reasonable shareholder." Id. at 115.
105. See id. at 240 n.18 (citing several cases for the proposition that varying standards of materiality should not be formulated).
107. See Basic, 485 U.S. at 236.
the question of materiality, as TSC Industries has defined it, is an objective, fact-intensive inquiry, requiring case-by-case analysis.\footnote{108}

B. Attorney-Client Privilege and Work Product Doctrine

1. The Attorney-Client Privilege Generally

At English common law, the attorney-client privilege arose from the code of honor of the English barrister who refused to testify against his client.\footnote{109} The honor of the English barrister, however, soon gave way as the countervailing policy of the search for truth prevailed.\footnote{110} As a result, the rationale for maintaining the protections of the attorney-client privilege shifted toward the more modern justification of encouraging an open dialogue between attorneys and their clients.\footnote{111} Modern theory posits that encouraging open and frank conversations between an attorney and his client is necessary to promote justice.\footnote{112}

The attorney-client privilege has been assumed, apparently without substantial challenge, to apply to corporate clients.\footnote{113} The question of whether to apply the privilege frequently arises because of the peculiar legal fiction which surrounds a corporation.\footnote{114} A natural

\begin{footnotesize}


\footnotetext{109}{See 8 John H. Wigmore, Evidence in Trials at Common Law \$ 2290 (J. McNaughton rev. ed. 1961).}


\footnotetext{111}{Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 348 (1985).}

\footnotetext{112}{Id. But see James J. Dalessio, Comment, Evidentiary Privileges and the Exclusion of Derivative Evidence: Commentary and Analysis, 26 San Diego L. Rev. 625, 631, 636-38 (1989) (reasoning that privacy is the \"more modern\" justification for the attorney-client privilege).}


\footnotetext{114}{See Commodity Futures Trading Comm'n, 471 U.S. at 348. Cf. Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819) (explaining that a corporation \"possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence\").}

\end{footnotesize}
person, in a client capacity, has the ability to invoke the protection of the attorney-client privilege.\textsuperscript{115} A corporation’s officers and directors, however, do not maintain a personal "attorney-client privilege with regard to communications made in their role as corporate officials."\textsuperscript{116} The corporation’s current directors, or the current officers to whom management power is delegated, are the only persons who may invoke or otherwise waive the privilege.\textsuperscript{117} These officers’ or directors’ use of the privilege is governed, in turn, by their fiduciary duties, which govern all management decisions.\textsuperscript{118}

Assuming the question of who might invoke the privilege is clear, difficulties frequently arise in determining which corporate communications are subject to protection.\textsuperscript{119} The corporation seeking the privilege’s protection generally bears the burden of proving that the communication is protected.\textsuperscript{120} Professor Gergacz explains that, just like human clients,

not every confidential corporate communication with counsel is protected by the attorney-client privilege. Some communications may involve business plans and thus fail because they lack the requisite legal advice element. Management may circulate a memo summarizing the communication, thus raising questions about whether it was intended to be in confidence.\textsuperscript{121}

Moreover, the relationship of the parties can have a substantial impact on application of the attorney-client privilege. The Fifth Circuit, in the seminal case of \textit{Garner v. Wolfinbarger},\textsuperscript{122} held that a corporation was prevented from claiming attorney-client privilege in a derivative suit brought by a minority shareholder who shows good

\begin{itemize}
  \item \textsuperscript{115} See \textit{Wigmore}, supra note 109, § 2321.
  \item \textsuperscript{116} \textit{In re Bevill}, Bresler & Schulman Asset Management Corp., 805 F.2d 120, 125 (3d Cir. 1986).
  \item \textsuperscript{117} \textit{Commodity Futures Trading Comm’n}, 471 U.S. at 348.
  \item \textsuperscript{118} Id. at 349; see infra notes 155-61 and accompanying text (discussing directors’ general fiduciary duties of care and loyalty).
  \item \textsuperscript{119} See, e.g., \textit{Upjohn Corp.}, 449 U.S. at 394-97 (analyzing whether communication between corporate counsel and non-management employees regarding an internal bribery investigation was protected by the attorney-client privilege).
  \item \textsuperscript{120} \textit{In re Grand Jury Subpoena}, 788 F.2d 1511, 1511 (11th Cir. 1986).
  \item \textsuperscript{121} \textit{Gergacz}, supra note 113, § 3.01.
\end{itemize}
"cause why it should not be invoked in the particular instance."123 The court based its ruling on the fiduciary obligations of directors to the corporation's shareholders.124 Subsequent cases have opined that social utility is better served when the courts prefer directors' fiduciary obligations to their shareholders over the corporate attorney-client relationship.125 Thus, courts, with relatively few exceptions,126 have tended to follow the reasoning of Garner.127

2. The Attorney-Client Privilege and Waiver

Separate from the concept of good cause, courts recognize as "hornbook law that the voluntary disclosure or consent to the disclosure of a communication, otherwise subject to a claim of privilege, effectively waives the privilege."128 Moreover, a client may not selectively invoke the attorney-client privilege so as to "pick and choose" when communications are waived and when communications

123. Id. at 1103-04. The Garner court set forth an illustrative list of good cause factors, including
the number of shareholders and the percentage of stock they represent; the bona fides of the shareholders; the nature of the shareholders' claim and whether it is obviously colorable; the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources; whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality; whether the communication related to past or to prospective actions; whether the communication is of advice concerning the litigation itself; the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing; the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.

Id. at 1104. Like most lists used to clarify a legal concept, the list in Garner is not exhaustive. See Keith W. Johnson, Evidence: Fausek v. White: The Sixth Circuit Garners Support for a Good Cause Exception to the Attorney-Client Privilege, 18 U. DAYTON L. REV. 313, 343 (1993).

124. Garner, 430 F.2d at 1102.


126. See, e.g., Shirvani v. Capital Investing Corp., 112 F.R.D. 389, 390 (D. Conn. 1986) (characterizing the Garner "good cause" exception as "ill-defined in origin and . . . troublesome in application").

127. See Stephen A. Saltzburg, Corporate Attorney-Client Privilege in Shareholder Litigation and Similar Cases: Garner Revisited, 12 Hofstra L. Rev. 817, 844 (1984) (observing the number of decisions that have followed Garner).

are protected by the privilege. To allow otherwise would permit a client to make disclosures that might tend to distort the overall picture in which the legal advice was given.

Therefore, once a client discloses a privileged communication with his attorney, the client waives any privilege the communication might otherwise have possessed. Accordingly, courts have held that the concept of partial disclosure attaches to situations where a corporation discloses communications to the general public.

Competing public policies arise, however, when a corporation discloses information to the government, pursuant to statutory or regulatory provisions. Specifically, disclosure of information to the SEC has presented the courts with the difficult task of choosing between the need for confidential corporate attorney-client communications and the need for compliance with SEC disclosure requirements. The courts, naturally, are in conflict over which policy prevails.

129. Gergacz, supra note 113, ¶ 5.03[4][a], at 5-47 (quoting Permian Corp. v. United States, 665 F.2d 1214, 1221 (D.C. Cir. 1981)); see Bank of the West v. Valley Nat'l Bank of Ariz., 132 F.R.D. 250, 259 (N.D. Cal. 1990) (opining that "[t]he pattern of selective disclosures of significant portions of confidential material that is evident in this record is fundamentally at odds with basic notions of fairness").

130. Cf. IBM v. Sperry Rand Corp., 44 F.R.D. 10, 13 (D. Del. 1968) (narrowly reading the scope of waiver in order to "foster the free disclosure which the privilege is designed to encourage while protecting against misuse of the privilege to distort or mislead").

131. See In re John Doe Corp., 675 F.2d 482, 489 (2d Cir. 1982). "Once a corporate decision is made to disclose [confidential communications] for commercial purposes, . . . the privilege is lost, not because of voluntariness or involuntariness, but because the need for confidentiality served by the privilege is inconsistent with such disclosure." Id. (footnote omitted).

132. See, e.g., United States v. Jones, 696 F.2d 1069, 1073 (4th Cir. 1982) (finding that a corporation which "publicized portions of the legal opinions in brochures and other printed material" waived any attorney-client privilege which may have applied).

133. See Gergacz, supra note 113, ¶ 5.03[4][a].

134. See, e.g., Schnell v. Schnall, 550 F. Supp. 650, 652-53 (S.D.N.Y. 1982) (concluding that public policy in favor of voluntary disclosure is paramount); Byrnes v. IDS Realty Trust, 85 F.R.D. 679, 688 (S.D.N.Y. 1980) (holding that "voluntary disclosures to agencies should be encouraged rather than requiring that agency requests or subpoenas be fought to the hilt").

135. In re Steinhardt Partners, L.P., 9 F.3d 230 (2d Cir. 1993). The court, in its discussion, noted the conflict among the circuits with the following comparison: compare Westinghouse Elec. Corp. v. Republic of the Philippines, 951 F.2d 1414 (3d Cir. 1991) (finding that waiver of attorney-client privilege occurred because of voluntary disclosure of information to the SEC) and In re Subpoenas Duces Tecum, 738 F.2d 1367 (D.C. Cir. 1984) (finding both the attorney-client privilege and the
3. The Work Product Doctrine Generally

The protection afforded by the work product doctrine merits a separate analysis from the protection afforded by the attorney-client privilege.\(^{136}\) The leading case of Hickman v. Taylor\(^{137}\) sets forth the concept of the work product doctrine.\(^{138}\) Generally, the doctrine grants an attorney a certain degree of privacy within which to prepare for litigation.\(^{139}\) The doctrine also allows the attorney to perform his work without undue interference from opposing counsel.\(^{140}\) Finally, the work product doctrine discourages the idle lawyer from discovering the fruits of his adversary’s labor.\(^{141}\) Rule 26(b)(3)\(^{142}\) of the

work product doctrine to have been waived after voluntary disclosure to the SEC) with Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 611 (8th Cir. 1977) (en banc) (concluding that only a limited waiver of attorney-client privilege occurred because disclosure was voluntary and produced in response to an informal inquiry).

136. See United States v. Nobles, 422 U.S. 225, 238 n.11 (1975) (stating that “the work-product doctrine is distinct from and broader than the attorney-client privilege”).

137. 329 U.S. 495 (1947).

138. See generally id. at 510-13 (discussing the origins and protections of the attorney’s “work product”); Jeff A. Anderson et al., Note, The Work Product Doctrine, 68 CORNELL L. REV. 760 (1983) (discussing extensively the work product doctrine, including types, temporal factors, theories, and policies underlying the work product immunity).

139. Hickman, 329 U.S. at 510. “Work product” is defined as “documents and tangible things otherwise discoverable . . . and prepared in anticipation of litigation or for trial by or for another party or by or for that other party’s representative (including the other party’s attorney, consultant, surety, indemnitor, insurer, or agent).” Fed. R. Civ. P. 26(b)(3). For the full text of Rule 26(b)(3), see infra note 142 and accompanying text.


141. See id. at 516 (Jackson, J., concurring) (“Discovery was hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary.”).

142. Rule 26(b)(3) reads in pertinent part as follows:

(b) DISCOVERY SCOPE AND LIMITS. Unless otherwise limited by order of the court in accordance with these rules, the scope of discovery is as follows:

(3) TRIAL PREPARATION: MATERIALS. Subject to the provisions of subdivision (b)(4) of this rule, a party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (b)(1) of this rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party’s representative (including the other party’s attorney, consultant, surety, indemnitor, insurer, or agent) only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party’s case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials
Federal Rules of Civil Procedure has since codified the Supreme Court's findings in *Hickman.*

As with the attorney-client privilege, the work product doctrine applies when the client is a corporation. Unlike the attorney-client privilege, however, the discovering party has the burden of proving that he has "substantial need" for the materials and that he is unable "without undue hardship to obtain the substantial equivalent . . . by other means." One commentator has noted that

[w]hile the test for discovering work product materials may sound similar to the good cause test developed in *Garner* to defeat a claim of attorney-client privilege, differences in the analytical methodologies exist. The attorney-client privilege covers only communications between clients and counsel. The work product doctrine, on the other hand, includes the attorney's mental processes in evaluating the communications. Plaintiffs bear a higher burden in attempting to discover work product material than other *Garner* materials.

Furthermore, whereas the work product doctrine focuses on the attorney, the attorney-client privilege is more concerned with the status of the client. The rationale underlying the work product doctrine is that it promotes the efficiency of the adversary system. Work product material can always be discovered if the plaintiffs can demonstrate substantial hardship. On the other hand, the attorney-client privilege may only be defeated by the plaintiffs' categorization of their particular case into a narrow exception to

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143. *Anderson,* supra note 138, at 783 ("Instead of leaving the question of *Hickman*'s relevance to the Committee notes, a new rule 26(b)(3) purported to codify *Hickman,* and to describe the showing *Hickman* required for discovery of trial preparation materials.") (footnote omitted).

144. *In re Grand Jury Proceedings,* 473 F.2d 840, 842 (8th Cir. 1973).

the privilege. In short, the policies that drive the work product doctrine and the attorney-client privilege are vastly different. *Garner* was created to serve as a limited exception to the [attorney-client] privilege, not the work product doctrine.\footnote{146}

A discovering party may make a showing of substantial need by demonstrating that a "critical issue" in the case is implicated by the disputed work product.\footnote{147} Conversely, substantial need is not shown when a party merely wants or desires the work product to bolster his case.\footnote{148} Additionally, assuming "substantial need" is shown, the discovering party must also show that he "is unable without undue hardship to obtain the substantial equivalent of the materials."\footnote{149}

4. The Work Product Doctrine and Waiver

Waiver of the attorney-client privilege does not automatically relinquish the protection provided by the work product doctrine.\footnote{150} The focus for waiver of the work product doctrine does not center on the attorney-client privilege's aim of confidentiality, but on the work product doctrine's objective of keeping trial preparation materials from opponents.\footnote{151} Generally, the protection afforded by the work product doctrine will be waived if the disclosure of the work product has "substantially increase[d] the opportunities for potential adversaries to obtain the information."\footnote{152}

One court has explained that "[t]he work product privilege should not be deemed waived unless the disclosure is inconsistent with maintaining secrecy from possible adversaries."\footnote{153} Therefore, some courts have concluded that disclosure of an attorney's advice

\begin{footnotes}
\item[146] Johnson, *supra* note 123, at 351-52 (citations, footnotes, and internal quotations omitted).
\item[148] See United States v. Lipshy, 492 F. Supp. 35, 47 (N.D. Tex. 1979) (holding disclosure of attorney work product items "is not permitted merely to aid opposing counsel to help prepare himself and to make sure that he has overlooked nothing").
\item[149] Fed. R. Civ. P. 26(b)(3).
\item[151] Shields v. Sturm, Ruger & Co., 864 F.2d 379, 382 (5th Cir. 1989).
\end{footnotes}
to the SEC serves to waive any future assertion of the work product doctrine.\(^{154}\)

C. **Section 102(b)(7)**

A corporation’s directors owe to the corporation’s shareholders the duty of care and the duty of loyalty.\(^{155}\) The duty of care requires a director first to exercise an informed business judgement.\(^{156}\) Directors meet this requirement when they have informed themselves of all material information which is reasonably available to them.\(^{157}\) Once reasonably informed, the duty of care dictates that the director act carefully when directing and monitoring corporate management.\(^{158}\)

The duty of loyalty, on the other hand, requires that directors refrain from placing their personal interests before the interests of the corporation.\(^{159}\) The theory behind the duty of loyalty is that, because shareholders are unable to exert any meaningful control over a corporation’s management, independent directors must take responsibility for protecting shareholder investment in the corporation.\(^{160}\) "Directors may be found liable for breaching their duty of loyalty where corporate decisions reflect a kind of self-interest currently referred to as ‘entrenchment’ by many courts."\(^{161}\)

1. **Smith v. Van Gorkom** and the Director Liability Crisis

Many commentators view the services of independent directors as critical to the proper governance of corporate affairs.\(^{162}\) The Del-

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154. See, e.g., Westinghouse Elec. Corp., 951 F.2d at 1429 (holding "that Westinghouse’s disclosures to the SEC . . . waived the protection of the work-product doctrine because they were not made to further the goal underlying the doctrine"). But see infra note 303 and accompanying text.


156. Cede II, 634 A.2d at 367.

157. Id.

158. Id.

159. Id. at 361.


162. See, e.g., William F. Kennedy, The Standard of Responsibility for Directors,
aware Supreme Court’s decision in *Smith v. Van Gorkom* resulted in anxiety over the depletion of qualified, independent directors and a simultaneous rise in premiums for, or outright unavailability of, director and officer liability insurance.

The Delaware Supreme Court, applying a gross negligence standard, found Trans Union’s directors liable for a breach of their fiduciary duty of care. The court found that the directors had not availed themselves of all information reasonably necessary to make an informed decision. This finding of liability by the court was thought by some to signal the willingness of the court “to impose staggering personal liability upon directors for actions that involved breaches of their fiduciary duties to shareholders.”

The Delaware legislature, in response to *Van Gorkom* and the perceived director liability crisis, sought to maintain Delaware’s ability to attract incorporation fees by passing section 102(b)(7) of

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52 GEO. WASH. L. REV. 624, 635 (1984) (characterizing outside directors as “critical reviewers of management decisions” with a power of rejection”).

163. 488 A.2d 858 (Del. 1985).


166. Id. The effect of this conclusion was to deny the directors the judicial deference afforded to business decisions through the “business judgment rule.” See id. at 893. For an extensive discussion of the business judgment rule, see Bartley A. Brennan, *Current Developments Surrounding the Business Judgment Rule: A “Race to the Bottom” Theory of Corporate Law Revised*, 12 WHITTIER L. REV. 299 (1991).

167. *Van Gorkom*, 488 A.2d at 874. The court based its finding on the following: The directors (1) did not adequately inform themselves as to [the chairman and chief executive officer] Van Gorkom’s role in forcing the “sale” of the Company and in establishing the [$55] per share purchase price; (2) were uninformed as to the intrinsic value of the Company; and (3) given these circumstances, at a minimum, were grossly negligent in approving the “sale” of the Company upon two hours’ consideration, without prior notice, and without the exigency of a crisis or emergency.

Id.


169. This effort by Delaware has frequently been termed the “race for the bottom.” See generally Brennan, *supra* note 166, at 301, 307-24 (tracing recent case law applications of the business judgment rule and the enactment of § 102(b)(7) as they relate to a reformulation of the business judgment rule and a return to a “race to the bottom” theory of corporate law); William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) (suggesting that Delaware’s corporation law system is geared toward increasing the revenue of the state through the fees collected from corporations incorporating there). But see generally Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes* 61 FORDHAM L. REV. 843, 858 (1993) (concluding that, in the takeover context,
the Delaware General Corporation Law.\textsuperscript{171} Section 102(b)(7), in short, empowers a corporation’s shareholders to restrict the monetary liability that the corporation’s directors face for breaching the duty of care.\textsuperscript{172}

2. The Limits of Section 102(b)(7)

Section 102(b)(7) does not preclude a court from granting equitable relief.\textsuperscript{173} Furthermore, the statute does not allow directors immunity from various derelictions of their duties, including a breach of the duty of loyalty.\textsuperscript{174} Therefore, a plaintiff-shareholder in Delaware need only phrase the suit “in terms of the duty of loyalty rather
than broad fiduciary duty or duty of care’’ to secure a trial on the merits.\(^{175}\)

Unfortunately, the Delaware legislature has avoided differentiating the duties of care and loyalty.\(^ {176}\) Thus, there is some ambiguity in section 102(b)(7) regarding what specific directorial activities are afforded protection.\(^ {177}\) The Delaware courts, therefore, are left with the task of drawing the proverbial lines on a case-by-case basis.\(^ {178}\)

III. Analysis

A. Procedural Posture

Marilyn Zirn (Zirn), a shareholder of the VLI Corporation, instituted an action against VLI’s Board of Directors and others\(^ {179}\) for their alleged failure to disclose material information concerning a merger of VLI and AHP.\(^ {180}\) Zirn also alleged that the defendants committed equitable fraud in the merger of VLI and AHP.\(^ {181}\)

The Delaware Court of Chancery, per Vice-Chancellor Hartnett (now a Justice of the Delaware Supreme Court), held that the defendants were not liable for equitable fraud as a result of failing to disclose certain facts about the proposed merger.\(^ {182}\) Moreover, the chancery court held that the defendants did not violate their duty

\(^{175}\) Groessl, supra note 160, at 435; see also Pease, supra note 164, at 94 (predicting that complaints will be drafted alleging breach of the duty of loyalty rather than the duty of care).

\(^{176}\) See generally Del. Code Ann. tit. 8, §§ 141-145 (1991) (failing to define the parameters of either the duty of care or the duty of loyalty).

\(^{177}\) See Groessl, supra note 160, at 441 (noting that “[t]he Delaware legislature appears to have drafted (§ 102(b)(7)] ambiguously to allow the judiciary to decide the specific parameters of directors’ duties’’); see also Balotti & Gentile, supra note 155, at 16 (pointing out that “it is unclear whether section 102(b)(7) would protect a director against liability for reckless acts”).

\(^{178}\) Groessl, supra note 160, at 434.


\(^{180}\) Zirn v. VLI Corp., 621 A.2d 773, 775 (Del. 1993).

\(^{181}\) Id.

to disclose material facts concerning the merger of the two companies. Zirn appealed, seeking to reverse the court of chancery.

B. Factual Background

VL1 obtained a United States patent in 1983 for a female contraceptive known as the Today® Vaginal Contraceptive Sponge (Sponge). The Sponge also received protection from the Food and Drug Administration under the FDA’s New Drug Approval Program. By 1985, however, VL1’s management had determined that the company required a large infusion of capital to remain economically viable and began to search for potential buyers. After a two year search, representatives of VL1 and AHP met in late August 1987 to discuss the merger of the companies. AHP made VL1 a $7 per share tender offer for VL1’s outstanding shares.

Subsequent to this tender offer, VL1 learned that its patent on the Sponge had expired because of the company’s inadvertent failure to pay a maintenance fee. This fact was disclosed to AHP on August 28, 1987, and as a result, AHP, on August 30, 1987, changed its acquisition offer from a tender offer/merger to a merger.

AHP also required reinstatement of the patent as a condition for completion of the transaction. The amount offered for the shares, however, remained at $7 per share.

183. Id.
184. Zirn, 621 A.2d at 775.
185. Id.
186. Id.
187. Id.
188. Zirn, 621 A.2d at 775.
189. Id.
190. Id.
191. Id. Patent counsel for VL1 sought reinstatement of the Sponge’s patent from the United States Patent and Trademark Office. Id. The Patent Office, however, denied VL1’s petition on September 21, 1987. Id. VL1 retained new patent counsel who petitioned for reconsideration of the patent’s denial on October 21, 1987. Id. Despite this last ditch effort, VL1’s new patent counsel maintained “that there was a ‘significant possibility’ that the petition for reconsideration would be unsuccessful.” Id. at 775-76.
192. Zirn, 621 A.2d at 775.
193. Id.
194. Id.
195. Id. VLI’s Board approved the merger proposal on August 30, 1987, after obtaining an investment banker’s opinion that $7 per share was a fair price. Id. An announcement concerning the proposed merger was made the following day. Id.
AHP had substantially completed a due diligence review of VLI by September 30, 1987, but VLI’s financial reports for the third quarter of 1987 were still unavailable to AHP. Less than a month later, on October 19, 1987, the Dow Jones Industrial Average fell more than 500 points. When AHP received VLI’s third quarter information on October 22, 1987, it revealed a larger than expected decline of twenty-two percent in VLI’s Sponge sales.

On October 27, 1987, AHP concluded that the August 30th merger agreement should be renegotiated. The new merger proposal included the “elimination of the patent reinstatement condition, a change in the form of the acquisition to a merger from a tender offer/merger and a reduction in the purchase price from $7.00 per share to $6.25 per share.”

The VLI Board of Directors met on November 3, 1987, to discuss AHP’s new merger proposal. The VLI Board received an investment banker’s opinion that $6.25 per share was fair to its shareholders and accepted AHP’s modified proposal. Once AHP’s $6.25 per share offer was accepted, the VLI Board began to recommend to shareholders that “they tender their shares to AHP.” Along with its recommendation, VLI’s Board provided to shareholders “(i) a letter from VLI’s Chief Executive Officer, announcing the $6.25 per share tender offer; (ii) the Schedule 14D-9 filed with

197. *Id.* VLI made a partial announcement concerning its third quarter results on October 8, 1987. *Id.* VLI reported a net income of $.04 per share, a net increase of $.32 per share from the previous third quarter. *Id.*
199. *Zim*, 621 A.2d at 776. The plaintiff asserted at trial that AHP’s Board of Directors learned of the drop in Sponge sales in November 1987. *Id.*
200. *Id.*
201. *Id.*
202. *Id.*
204. *Id.* VLI’s Board also considered “the lack of any other suitor, VLI’s continuing need for an infusion of capital, the turmoil in the financial markets due to the October crash and the possibility that the patent would not be reinstated.” *Id.*
205. *Id.*
the Securities and Exchange Commission by VLI; and (iii) AHP's Offer to Purchase." 206

On November 17, 1987, Zirn requested that VLI sue its "original patent counsel, general corporate counsel and those responsible for overseeing the maintenance of VLI's patents." 207 The VLI Board, in response to Zirn's demands, created a special committee (Committee) "to investigate the patent lapse and respond to Zirn's demand." 208 The Committee conducted an investigation and "recommended to the VLI Board that it take no action over the failure to pay the maintenance fee." 209 Zirn was informed of the Committee's recommendation by letter. 210

By December 9, 1987, the date on which AHP's second offer expired, 211 approximately 94.8% of VLI's outstanding shares had been tendered to AHP. 212 VLI's remaining shares were acquired by AHP on December 31, 1987, through a "short-form merger." 213

Two weeks earlier, Zirn had instituted suit in the Delaware Court of Chancery, "seeking rescissory and compensatory damages from VLI, its individual directors and AHP." 214 The plaintiff, as

206. Id. AHP, in its effort to receive shareholder backing, explained, "AHP's purpose in making the tender offer was to 'facilitate the acquisition of [VLI] by AHP,' and the purpose of the subsequent cash-out merger was 'to acquire all outstanding shares not tendered and purchased pursuant to the Offer, thereby completing the acquisition of all the Shares.'" Id. VLI filed a Schedule 14D-9 in which the company discussed why the board had accepted AHP's $6.25 per share offer. Id. In its 14D-9, VLI explained to its shareholders that

[in order to eliminate unsatisfied and uncertain conditions to the August 30 Merger Agreement, which are unsatisfied, to resolve uncertainty, reduce potential delay and increase the prospects that [VLI] will in fact be acquired by [AHP], [VLI's] Board of Directors after consultation with [VLI's] financial and legal advisors, determined to accept AHP's proposal.

207. Zirn, 621 A.2d at 776.

208. Id. The Special Committee consisted of three non-management directors of VLI. Id.

209. Id. Counsel for the Committee, in support of the Committee's conclusion, "quoted VLI's new patent counsel as having told the Special Committee that there was a 'sound factual basis for claiming that the failure to pay the maintenance fee was unavoidable.'" Id. at 776-77.

210. Id. at 776.

211. Zirn, 621 A.2d at 777.

212. Id.

213. Id. Eight days later, "AHP sent the non-tendering shareholders a Notice of Merger, which informed them that their shares had been converted into a right to receive $6.25 per share and notified them of their appraisal rights." Id.

214. Id. Zirn alleged in her complaint
part of her suit, sought inspection of documents which AHP and VLI had asserted were protected under the attorney-client privilege or work product doctrine. The subsequent trial consumed four days, culminating in a judgment for defendants on all claims. Zirn appealed, seeking to reverse the decision of the court of chancery.

C. The Court of Chancery Decisions

Vice-Chancellor Hartnett addressed Zirn's requests for discovery in a pre-trial decision. Zirn's disclosure claims were disposed of at the conclusion of the trial and were reported in a separate opinion.

1. The Materiality Standard

Vice-Chancellor Hartnett began his analysis of the plaintiff's disclosure allegations by noting that, "as an arm's-length third party tender offeror, [AHP] owed no fiduciary duty of disclosure to the

that one or more of the defendants: (1) breached their fiduciary duty of candor and entire fairness to VLI Corporation's stockholders, (2) aided and abetted the breach of fiduciary duties owed to the shareholders of VLI Corporation, (3) engaged in illegal insider trading, (4) wrongfully converted the VLI Corporation stock of plaintiff and the class, (5) fraudulently induced VLI Corporation's shareholders to permit American Home to acquire VLI Corporation, and (6) conspired to defraud plaintiff and the class of their stock in VLI Corporation.

Zirn, No. 9488, 1989 Del Ch. LEXIS 83, at *3-4, reprinted in 15 Del. J. Corp. L. at 795. Plaintiff's claims of insider trading and conversion against all defendants were dismissed by the court of chancery in July of 1989. Zirn, 621 A.2d at 777. Vice-Chancellor Hartnett, however, declined to dismiss Zirn's other claims for breach of duty to disclose and equitable fraud. Id. Moreover, on February 15, 1991, the court granted Zirn leave to amend her complaint and certified her suit as a class action. Id. The class was to consist of those shareholders, with certain exceptions, who owned VLI stock as of November 16, 1987. Id.

215. Zirn, 621 A.2d at 780. Zirn also sought answers to deposition questions which defendants had refused to answer under the attorney-client privilege. Id. Defendants turned over particular documents after Zirn filed a motion to compel. Id. Defendants, however, continued to claim that the attorney-client and work product privileges applied to approximately 65 other documents. Id.

216. Id. at 777.

217. Id. at 775.


stockholders of VLI."220 The court of chancery explained that the plaintiff's "claim of inadequate disclosure [against AHP] is necessarily limited to her allegation that AHP's Offer to Purchase mentions the removal of the patent reinstatement condition as the reason for the revision of the Merger Agreement."221

The vice-chancellor cited his previous holding in Zirn v. VLI Corp.,222 in which he held that AHP, as an arm's-length third-party tender offeror, did not owe a fiduciary duty of disclosure to the VLI stockholders.223 The court noted that AHP could have been liable for equitable fraud if an omission in its offer to purchase "misled the stockholders who thereafter detrimentally relied on the inadequate information."224 The court of chancery concluded, however, that Zirn had misread the offer to purchase.225 The language on which

220. Zirn, No. 9488, 1992 Del. Ch. LEXIS 127, at *11, reprinted in 18 Del. J. Corp. L. at 811. Zirn maintained that "AHP was merely taking advantage of the unstable stock market conditions created by the [market] decline in order to lower the consideration to be paid to VLI's stockholders." Id. at *9, reprinted in 18 Del. J. Corp. L. at 810. The court of chancery pointed out that Zirn had disregarded the difference between a third-party offeror and the target company's directors. Id. at *10, reprinted in 18 Del. J. Corp. L. at 810. Vice-Chancellor Hartnett explained that this difference was critical "to determine if a duty of disclosure was even owed to the stockholders of VLI; only then can the question of a breach of such a duty (if any) be addressed." Id.

221. Id. at *10, reprinted in 18 Del. J. Corp. L. at 810-11. Zirn alleged that AHP's "primary motivation behind the revision" was the turbulent market during October of 1987. Id. at *11, reprinted in 18 Del. J. Corp. L. at 811. Therefore, according to the plaintiff, "AHP breached a duty of disclosure by failing to include that fact in its Tender Offer." Id.


224. Id. at *11-12, reprinted in 18 Del. J. Corp. L. at 811. Zirn alleged that AHP's omission of the role which the market decline played in its decision to alter the merger offer "left the VLI stockholders with the mistaken impression that [AHP's] only motivating factor in revising its offer was the removal of the patent reinstatement condition." Id. at *12, reprinted in 18 Del. J. Corp. L. at 811. The court quoted the language in the Tender Offer upon which plaintiff relied to support her claim for equitable fraud:

On or about October 27, 1987, representatives of AHP contacted representatives of [VLI] to propose revisions to the August 30 Agreement, including, but not limited to, the waiver of the condition to the proposed merger with respect to the reinstatement of [VLI's] patent referred to above, as well as certain other conditions included in the August 30 Agreement.

Id. at *10-11, reprinted in 18 Del. J. Corp. L. at 811.

225. Id. at *12, reprinted in 18 Del. J. Corp. L. at 811.
plaintiff relied "merely describe[d] the changes to the terms of the original Merger Agreement that AHP proposed during the renegotiations." Therefore, Vice-Chancellor Hartnett held that the "plaintiff's claim that AHP made only a partial, misleading disclosure is without merit." 227

The plaintiff next alleged failure of the VLI Board to disclose material facts in its Schedule 14D-9.228 Once again, Zirn relied upon alleged omissions concerning the stock market's decline and its influence on the merger negotiations.229

226. Id. No language in AHP's second offer indicated AHP's motivations. Id. "The only stated 'purpose' contained in the Tender Offer [was] 'to facilitate the acquisition of [VLI] by AHP.' This is not a statement of motivation, but rather a description of AHP's desired result for the tender offer." Id. (citation omitted).

227. Zirn, No. 9488, 1992 Del. Ch. LEXIS 127, at *12-13, reprinted in 18 Del. J. Corp. L. at 812. "Even if AHP had somehow been under a duty to disclose its motives for proposing the revised agreement, the evidence adduced at trial demonstrated that the market decline was not the primary factor in making that decision." Id. at *13, reprinted in 18 Del. J. Corp. L. at 812. Zirn also alleged that AHP had violated its fiduciary duty of disclosure in its Notice of Merger sent to minority stockholders. Id. According to plaintiff, the Notice of Merger failed to "discuss the role the stock market decline played in the revised agreement." Id. The court of chancery relied once more on its conclusion that Zirn had misunderstood the significance of the market's decline in AHP's conclusion to alter the merger agreement. Id. at *14, reprinted in 18 Del. J. Corp. L. at 812. The court thus dismissed Zirn's second claim against AHP which alleged that AHP had failed to disclose the market decline in its Notice of Merger "[b]ecause the decline was of minor significance, at best, to AHP's decision." Id.


On or about October 27, 1987, representatives of AHP contacted representatives of [VLI] to propose certain revisions to the August 30 Merger Agreement, including, but not limited to, the waiver of certain conditions precedent including the reinstatement of the Patent, the institution by [AHP] of the Offer, and the reduction of the consideration payable in the transaction. In order to eliminate unsatisfied and uncertain conditions to the August 30 Merger Agreement, which are unsatisfied, to resolve uncertainty, reduce potential delay and increase the prospects that [VLI] will in fact be acquired by [AHP], [VLI's] Board of Directors after consultation with [VLI's] financial and legal advisors, determined to accept AHP's proposal.

Id. at *14-15, reprinted in 18 Del. J. Corp. L. at 813 (quoting VLI's Schedule 14D-9 at 3). Zirn contended that this statement indicated "the importance the directors placed on the patent reinstatement" which, in turn, had a direct correlation
The court of chancery reasoned that, if the plaintiff had established that the market decline was the principal ground for VLI’s approval of AHP’s merger proposal, “she might have established a breach of the VLI directors’ fiduciary duty of disclosure.” The court ruled, however, that the plaintiff had only succeeded in proving “that the market decline was a ‘background factor’ of much lesser significance than other considerations.”

2. Attorney-Client Privilege and Work Product Doctrine

Defendants AHP and VLI argued at trial that their patent reinstatement discussions with counsel were protected by the attorney-
The defendants argued, alternatively, "that even if the failure to disclose the market decline was a material omission, they are

232. Rule 502(b) of the Delaware Uniform Rules of Evidence, which codifies the attorney-client privilege, reads as follows:

(b) 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 himself or his representative and his lawyer or his lawyer's representative, (2) between his lawyer and the lawyer's representative, (3) by him or his representative or his 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.

Del. Unif. R. Evid. 502(b).


234. Id. at 97,295, reprinted in 16 Del. J. Corp. L. at 1714.


237. Id. at 97,297, reprinted in 16 Del. J. Corp. L. at 1718. The vice-chancellor rebuffed Zirn's contention that defendants had waived the work product doctrine through references to the patent advice in the disclosure documents. Id. at 97,296-97,297, reprinted in 16 Del. J. Corp. L. at 1718.
insulated from liability by Article Ninth of VLI's Certificate of Incorporation.\textsuperscript{238} The trial court, however, did not address the issue of section 102(b)(7)’s protection for corporate directors because the materiality ruling was in favor of the VLI directors.\textsuperscript{239}

D. The Delaware Supreme Court Decision

The Delaware Supreme Court began its opinion by explaining that "the trial court, with Zirn’s consent, [had] dismissed all counts of the amended complaint except the disclosure claims and equitable fraud claims relating to the market crash and the patent lapse."\textsuperscript{240} The court went on to note that the record was unclear regarding the trial court’s disposition of Zirn’s patent disclosure claims.\textsuperscript{241}

1. The Materiality Standard

The court next turned its attention to the vice-chancellor’s decision regarding the standard for materiality.\textsuperscript{242} The court framed the issue as "whether AHP’s decision to seek, and VLI’s decision to accept, a reduction in the per share price was influenced by the market crash and, if so, whether that information ‘would have assumed actual significance in the deliberations of a reasonable shareholder.’"\textsuperscript{243} The court also observed that, although adequate disclosure is a combined issue of law and fact,\textsuperscript{244} the supreme court’s "review of the formulation of the materiality standard by the lower court . . . is de novo."\textsuperscript{245} Furthermore, the court noted its "‘authority to review the entire record and to make its own findings of fact in a proper case.’"\textsuperscript{246}

\textsuperscript{238} Zirn, No. 9488, 1992 Del. Ch. LEXIS 127, at *16, reprinted in 18 Del. J. Corp. L. at 813. This Article of VLI’s incorporation was probably enacted pursuant to § 102(b)(7) to prevent monetary liability from attaching to the corporation’s directors for breach of their fiduciary duty of care.

\textsuperscript{239} Zirn, 621 A.2d at 783 n.6.

\textsuperscript{240} Id. at 777.

\textsuperscript{241} Id. The court concluded that "[i]n any event, in view of our ruling, infra, that the trial court’s restriction of discovery on the patent disclosure claim requires a retrial on that claim as well, it is unnecessary to address the claimed omission." Id.

\textsuperscript{242} Id.

\textsuperscript{243} Zirn, 621 A.2d at 779 (quoting Rosenblatt, 493 A.2d at 944). The court explained that a director’s duty to disclose "all material facts bearing upon a merger vote arises under the duties of care and loyalty." Id. at 778 (citing Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)).

\textsuperscript{244} Id. at 777.

\textsuperscript{245} Id.

\textsuperscript{246} Id. at 778 (quoting Shell Petroleum, Inc. v. Smith, 606 A.2d 112, 114 (Del. 1992)).
After briefly reviewing the approach taken by the court of chancery, the Delaware Supreme Court examined the recent history of the materiality standard in Delaware.\textsuperscript{247} The court cited the leading case of Rosenblatt \textit{v. Getty Oil Co.},\textsuperscript{248} which adopted the United States Supreme Court's definition of materiality in \textit{TSC Industries}.\textsuperscript{249} The court found the \textit{TSC Industries} definition to be "an objective one, measured from the point of view of the reasonable investor."\textsuperscript{250}

The court explained that the vice-chancellor's application of the materiality test was erroneous because it placed upon Zirn "the burden of proving that the market decline was the primary factor in rescission of the merger agreement."\textsuperscript{251} The court stated that "[t]he consideration given by the VLI directors to a variety of factors, including the market crash, may be relevant to this inquiry but does not control it."\textsuperscript{252}

2. Attorney-Client Privilege and Work Product Doctrine

The supreme court recognized that its materiality ruling would give the discovery issue "added significance in the event of a re-

\begin{footnotesize}
\textsuperscript{247} Zirn, 621 A.2d at 778-79.
\textsuperscript{248} Rosenblatt, 493 A.2d at 929 (Del. 1985).
\textsuperscript{249} Zirn, 621 A.2d at 778. In \textit{Rosenblatt}, the court stated that [a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

\textit{Rosenblatt}, 493 A.2d at 944 (quoting \textit{TSC Indus.}, 426 U.S. at 449).
\textsuperscript{250} Zirn, 621 A.2d at 779. The court went on to explain that the standard of materiality "does not contemplate the subjective views of the directors, nor does it require that the information be of such import that its revelation would cause an investor to change his vote." \textit{Id}. According to the court, the standard imposes upon directors the duty to "provide to shareholders all the information which a reasonable shareholder 'would consider important in deciding whether to sell or retain stock.' " \textit{Id}. (quoting \textit{Rosenblatt}, 493 A.2d at 944). "While it need not be shown that an omission or distortion would have made an investor change his overall view of a proposed transaction, it must be shown that the fact in question would have been relevant to him." \textit{Id}. (quoting \textit{Barkan}, 567 A.2d at 1289).
\textsuperscript{251} \textit{Id}. at 780.
\textsuperscript{252} \textit{Id}. The chancery court was directed, upon remand, to "apply an objective standard calculated to determine what information a reasonable VLI shareholder should possess in order to gauge the motivation for the price reduction." \textit{Id}.
\end{footnotesize}
hearing on the role that the patent reinstatement played in the process leading to the revision of the merger agreement between VLI and AHP." Additionally, the court noted its "de novo authority to review the application of the attorney-client privilege."254

Zirn contended that the trial court had improperly limited the scope of discovery so that Zirn could not learn the full context of the legal advice received by the defendants.255 The court framed Zirn's discovery issue as "whether a corporation may invoke the attorney-client and work product privileges regarding information deemed material to a shareholder's decision to tender stock in the face of partial disclosure of such advice."256

The court briefly reviewed the intent and background of the protection afforded by the attorney-client privilege.257 The court cited Upjohn Co. v. United States258 for the proposition that a client-corporation seeking legal guidance enjoys the protection afforded by the attorney-client privilege.259 The court explained, however, that an inherent conflict is created when a defendant-corporation seeks to invoke the privilege against a plaintiff-shareholder.260

Under this scenario, the court noted both that the attorney-client privilege "is not absolute,"261 and that a corporation's power to invoke the attorney-client privilege is limited to the corporation's officers and directors.262 Furthermore, these agents of the corporation

253. Id.
254. Zirn, 621 A.2d at 780 (emphasis added) (citing Citadel Holding Corp. v. Roven, 603 A.2d 818, 825 (Del. 1992)).
255. Id.
256. Id. at 781.
257. Id. The court, in its review of the attorney-client privilege, stated that [t]he attorney-client privilege is intended to encourage full and frank communication between clients and their attorneys. The privilege was recognized at common law but received formal promulgation in Delaware through the adoption of the Delaware Rules of Evidence. Rule 502 of the Delaware Rules of Evidence is consistent with previous Delaware jurisprudence in extending the privilege to all communications, whether written or oral, made for the purpose of facilitating the rendition of professional legal services.
259. Zirn, 621 A.2d at 781.
260. Id.
261. Id. "[I]f the legal advice relates to a matter which becomes the subject of a suit by a shareholder against the corporation, the invocation of the privilege may be restricted or denied entirely." Id. (citation omitted).
262. Id.
"must 'exercise the privilege in a manner consistent with their fiduciary duty to act in the best interests of the corporation and not of themselves as individuals.'"263

The Delaware Supreme Court disagreed with the vice-chancellor's conclusion that Zirn failed to show "good cause based on director conflict of interest."264 The reversal of the trial court, however, was based on the defendants' waiver of the attorney-client privilege through partial disclosure, and not on the plaintiff's showing of good cause.265

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263. Zirn, 621 A.2d at 781 (quoting Commodity Futures Trading Comm'n, 471 U.S. at 349).
264. Id. The court cited the Fifth Circuit's opinion in Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970), cert. denied sub nom. Garner v. First Amer. Life Ins. Co., 401 U.S. 974 (1971), for the factors pertaining to a plaintiff's burden of showing "good cause." Zirn, 621 A.2d at 781. The court stated that at least four of the Garner factors were present:

First, the plaintiff class [members] have asserted an obviously colorable claim of breach of the fiduciary duty of candor. Second, in order to counter defendants' partial disclosure of the advice given by its new patent counsel as part of the mix of disclosed information supporting the merger revision, Zirn is entitled to examine that advice in full context. Third, in view of the general applicability of the attorney-client privilege, there appears to be no alternative source for discovering such information. Finally, since the patent has now been reinstated, there appears little risk of revelation of trade secrets or other information in which the corporation has a confidential interest.

Id. at 782-83 (footnote omitted).
265. Id. at 781. The court explained that VLI's inclusion of its patent counsel's advice in its 14D-9 demonstrated that VLI had deemed the information "material to the shareholders' decisions to sell their stock." Id. VLI, in its 14D-9, revealed that its new patent counsel suggested that "a significant possibility" existed that the petition for reconsideration filed with the Patent and Trademark Office would fail. Id. The court ruled that "[s]uch partial disclosure 'of the contents of a privileged communication surrenders the privilege as to those communications.'" Id. (quoting Citadel Holding Corp., 603 A.2d at 825). The court explained that

[t]he purpose underlying the rule of partial disclosure is one of fairness to discourage the use of the privilege as a litigation weapon in the interest of fairness. A party should not be permitted to assert the privilege to prevent inquiry by an opposing party where the professional advice, itself, is tendered as a defense or explanation for disputed conduct. VLI introduced portions of the advice of its new patent counsel in support of its claim that the disclosures concerning the prospect of the patent reinstatement were adequate given the uncertainty surrounding that issue. It would be manifestly unfair to permit selective utilization of these portions and at the same time assert the attorney-client privilege to shield any inquiry into the totality of counsel's advice and its factual basis.

Id. at 781-82 (citations omitted).
The court next addressed the defendants’ claim that the work product privilege protected counsel’s documents concerning VLI’s patent reinstatement. The court explained that work product immunity “seeks to strike a balance between the full disclosure spirit of modern discovery rules and the adverse effect the fear of disclosure might have on the lawyer’s efforts to advance his client’s cause.” To qualify for protection under the immunity, the “materials [must] be written specifically in preparation for threatened or anticipated litigation.” The court found that “the same principle of partial disclosure which governed communication with VLI’s new patent counsel applied to documentation prepared in connection with the patent reinstatement.” Even absent this partial disclosure, the court concluded that Zirn had, nevertheless, met her burden of showing “good cause” for the documents in question.

3. Section 102(b)(7) Protection

The court began its summary analysis of the defendants’ section 102(b)(7) argument by explaining that VLI’s Certificate of

266. Id. at 782. The court noted that, although the attorney-client and work product privileges both involve the attorney-client relationship, the work product privilege “raise[s] concerns separate from those implicated by the attorney-client privilege.” Id. The court noted further that “[t]he work product privilege . . . serves a different purpose, one related to the adversary system of litigation—the protection of an attorney’s private files and recorded impressions from discovery by opposing counsel.” Id.

267. Zirn, 621 A.2d at 782. The court noted the vice-chancellor’s recognition of “the relevancy of the patent reinstatement problem to the merger revision.” Id. at 782 n.4. The vice-chancellor had stated: “Clearly, documents regarding the reinstatement of the patent are relevant to the plaintiff’s claim that the lapse, and ultimate reinstatement, of the patent provided [AHP] with an excuse for reducing the consideration paid to [VLI’s] stockholders.” Id. (quoting Zirn, [1990 Transfer Binder] Fed. Sec. L. Rep. ¶ 95,447, at 97,295, reprinted in 16 Del. J. Corp. L. at 1714).


269. Id. The supreme court explained that the vice-chancellor’s “broad reading of the ‘anticipation’ standard” would not foreclose Zirn’s claim. Id. Vice-Chancellor Hartnett had reasoned that because Zirn’s claim for breach of fiduciary duty was pertinent to the patent’s reinstatement, those documents prepared by VLI’s new patent counsel could be interpreted as having been prepared “in anticipation of litigation.” See Zirn, [1990 Transfer Binder] Fed. Sec. L. Rep. ¶ 95,447, at 97,296, reprinted in 16 Del. J. Corp. L. at 1717.

270. Zirn, 621 A.2d at 782.

271. The Delaware Supreme Court explained that “[i]n the interest of completeness and in anticipation of a rehearing upon remand” defendant’s § 102(b)(7) defense was addressed summarily. Id. at 783.
Incorporation did not protect VLI’s directors from claims for equitable fraud, even though it shielded directors from claims for breaches of their fiduciary duty of care. Furthermore, the court cited the legislative history of section 102(b)(7) as indicating “that corporations are empowered to shield directors from breaches of the duty of care, not the duty of loyalty, which also embraces the duty of disclosure that is at issue here.” Accordingly, the court concluded that section 102(b)(7) failed to permit VLI’s Certificate of Incorporation to protect the VLI directors from disclosure liability.

IV. Evaluation

A. The Materiality Standard

Zirn’s disclosure allegations against VLI’s directors centered on the fact that the directors had failed to disclose the extent to which the market decline affected their decision to accept AHP’s second offer at $6.25 per share. The court explained that, in this case, “[t]he test [for materiality was] whether AHP’s decision to seek, and VLI’s decision to accept, a reduction in the per share price was influenced by the market crash and, if so, whether that information ‘would have assumed actual significance in the deliberations of a reasonable shareholder.’” Thus, the court, while espousing the preference for an objective test, simultaneously injected the effect that the stock market crash played on the subjective decision-making processes of the defendant directors.

Zirn’s disclosure claims were remanded to the chancery court for application of “an objective standard calculated to determine what information a reasonable VLI shareholder should possess in order to gauge the motivation for the price reduction.” The court seemed to suggest that disclosure of material information is required only insofar as it allows an investor to “gauge” a director’s moti-

272. Id.
273. Id.
274. Zirn, 621 A.2d at 783.
275. See id. at 777. Zirn’s disclosure claims against AHP also centered on the market decline. See id.
276. Id. at 779 (emphasis added) (quoting Rosenblatt, 493 A.2d at 944).
277. See id. The court explained that “[t]he TSC materiality standard is an objective one, measured from the point of view of the reasonable investor. It does not contemplate the subjective views of the directors.” Id. (emphasis added).
278. Id. at 780.
vation.\textsuperscript{279} Paradoxically, the court explained in the next sentence that "[t]he consideration given by the VLI directors to a variety of factors, including the [1987 stock] market crash, may be relevant to this inquiry but does not control it.\textsuperscript{280} This paradox is all the more apparent when juxtaposed with the court's earlier explanation that the materiality standard "does not contemplate the subjective views of the directors.\textsuperscript{281}"

This comment suggests that the extent to which the market crash influenced the VLI Board's decision to accept AHP's offer is immaterial, as a matter of law, for purposes of disclosure liability.\textsuperscript{282} A "reasonable shareholder\textsuperscript{283} would have possessed knowledge of the market's decline and "could [have] reach[ed] his own conclusions as to the risks of the transaction."\textsuperscript{284} "[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information."\textsuperscript{285} VLI's Board neither withheld nor misrepresented the fact that the stock market fell 508 points on October 19, 1987.\textsuperscript{286}

\textsuperscript{279} Zirn, 621 A.2d at 780.

\textsuperscript{280} Id. Requiring disclosure of the influence that a particular event played on a director's decision-making process will necessarily require the trial court to engage in a subjective inquiry.

\textsuperscript{281} Id. at 779.

\textsuperscript{282} See infra notes 290-92 and accompanying text. Assuming that VLI's directors had misrepresented or omitted the role of the market crash in their decision, the Delaware Supreme Court has recognized that even "if an omission is immaterial, the fact that it was made by a party with some incentive to be less than candid cannot render the omission material." Barkan, 567 A.2d at 1288.

\textsuperscript{283} See supra note 56 and accompanying text (describing the difficulty inherent in defining the "reasonable investor").

\textsuperscript{284} Sable v. Southmark/Environ Capital Corp. 819 F. Supp. 324, 335 (S.D.N.Y. 1993); see also SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969) (explaining that "access to material information . . . requires nothing more than the disclosure of basic facts so that outsiders may draw upon their own evaluative expertise in reaching their own investment decisions") (emphasis added); Richland v. Crandall, 262 F. Supp. 538, 554 (S.D.N.Y. 1967) ("[C]orporations are not required to address their stockholders as if they were children in kindergarten.").

\textsuperscript{285} Basic, 485 U.S. at 240 (emphasis added).

\textsuperscript{286} Stroud, 606 A.2d at 85 ("The board is not required to disclose all available information."); see also Lynch, 383 A.2d at 281 (explaining that directors are required to disclose all facts "in their possession 'germane' to the transaction in issue"). When VLI's Board began to consider AHP's second merger proposal, the market crash was nearly two weeks old. See Zirn, 621 A.2d at 776. Thus, the fact that the market crashed was public knowledge. Assuming, arguendo, that VLI's directors were required to disclose the fact that the market crashed (as distinguished from disclosing the effect the market crash had on their respective decisions), the United States
Requiring disclosure of subjective director motivations could rapidly overcome an investor in an "avalanche of information," a situation which the United States Supreme Court has sought to avoid. An event which influences one director to support a merger (e.g., dropping the requirement that a lost patent be reinstated) may differ from another director's motivation (e.g., a twenty-two percent drop in the sales of the company's flagship product) which may, in turn, differ from another director's reasons (e.g., the instability in the capital markets). Depending on the circumstances surrounding the transaction, these differences could bury an investor with excessive information.

The Zirn decision creates a dilemma for corporate directors. Zirn concludes that a quintessential public event, such as the 1987 stock market crash, may be material insofar as it sheds light on the subjective motivations of corporate directors' decisions concerning a contemplated merger. Other decisions, however, rejected this theory and found that, even where a defendant fully discloses all of the facts pertaining

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Supreme Court requires that "there . . . be a substantial likelihood that the disclosure of the omitted fact would have . . . significantly altered the 'total mix' of [the] information made available." TSC Indus., 426 U.S. at 449. Based on the exhaustive media coverage afforded the market crash of 1987, the board's "disclosure" of the crash would not have altered the "total mix." See infra note 291.

287. See TSC Indus., 426 U.S. at 448 (stating that "management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information").

288. See Zirn, 621 A.2d at 780. The vast majority of cases conclude, however, that the standard of materiality does not require disclosure of the subjective motivations of directors. See, e.g., Golub v. PPD Corp., 576 F.2d 759, 764-65 (8th Cir. 1978) (holding that the true motivation of those selling assets of a company to a new company, when management would receive bonuses for staying on, need not be disclosed in proxy materials); Dixon v. Ladish Co., 597 F. Supp. 20, 32 (E.D. Wis. 1984) (holding tax motivation nor desire for corporate control required disclosure); Morrissey v. County Tower Corp., 559 F. Supp. 1115, 1122 (E.D. Mo.), aff'd, 717 F.2d 1227 (8th Cir. 1983) (holding directors need not disclose subjective motives behind anti-takeover proposals); Bank & Trust Co. of Old York Rd. v. Hankin, 552 F. Supp. 1330, 1336 (E.D. Pa. 1982) (holding management need not disclose motives, particularly when motives are obvious); Goldman v. Lexington Ave. & 42nd St. Corp., [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,189, at 95,877-95,878 (S.D.N.Y. 1987) (holding alleged failure to disclose the "true and sole purpose" of reduction of directors as preventing minority representation not material); see also, e.g., TSC Indus., 426 U.S. at 448 (explaining that "[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good"). At least one court has suggested, however, that subjective motivations may require disclosure so as to enable shareholders to obtain injunctive or other relief under state law. See, e.g., SEC v. Parklane Hosiery, 558 F.2d 1083, 1088 (2d Cir. 1977).
to a particular event, liability may still attach because the reasonable investor was inundated with information. 289

The preferred analysis would be to determine whether the material facts surrounding the directors’ decision to merge were adequately disclosed. 290 Given the quintessential public nature of the stock market crash of 1987, its “disclosure” is a foregone conclusion. 291 Therefore, under any formulation of the facts, “a reasonable VLI shareholder” would have possessed knowledge of the market’s decline and would have incorporated this knowledge into the decision of whether to oppose the merger’s price reduction. 292

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289. See, e.g., Gould, 535 F.2d at 774 (finding material deficiency when facts were “rather buried in the lengthy proxy statement”).

290. See Thomas Lee Hazen, The Law of Securities Regulation 490-92 (2d ed. 1990). Professor Hazen explains that non-disclosure of the directors’ motivation for supporting or opposing a particular transaction is not a material omission of fact so long as there has been full disclosure of all relevant facts surrounding the transaction in question . . . . Once a merger agreement has been reached, the materiality requirement does not call for disclosure of every detail relating to the negotiations.

Id. (footnotes omitted). But see William H. Painter, Civil Liability Under the Federal Proxy Rules, 64 Wash. U. L.Q. 425, 459 (1986) (suggesting that requiring disclosure of subjective motivations is no more difficult than “in other areas of the law in which subjective motivation is important”).


292. See Diamond v. Arend, 649 F. Supp. 408, 416 (S.D.N.Y. 1986) (concluding that the court would “not require . . . restate[ment of the obvious]” when “[a]ny reasonable shareholder would realize that [the parties] acceded to [their] agreements in order to motivate the other party to enter into the Merger Agreement”) (citing Raybestos-Manhattan, Inc. v. Hi-Shear Indus., Inc., 503 F. Supp. 1122, 1131 (E.D.N.Y. 1980); Richland v. Crandall, 262 F. Supp. 538, 554 (S.D.N.Y. 1967)). See also Roger J. Dennis, Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix, 25 Wm. & Mary L. Rev. 373, 390 n.78 (1984) (stating that “[b]ecause all public information is part of the total mix, the position or emphasis given to a fact is irrelevant”).
The supreme court was correct to reverse and remand the case for application of an objective materiality standard. The court, however, should have limited its decision to reversing the court of chancery on its subjective application of the materiality standard and remanded the case solely for a determination of the materiality of the defendants' alleged omissions concerning the reinstatement of the Sponge's patent.293

B. Attorney-Client Privilege and Work Product Doctrine

The Delaware Supreme Court found that the plaintiff class had shown “good cause” to overcome VLI’s assertion of its attorney-client privilege.294 This finding was clearly sufficient to reverse the court of chancery.295 The supreme court, however, preceded this analysis with a superfluous examination of whether partial disclosure would serve to waive the attorney-client privilege protection.296 The court concluded that partial disclosure of information to the SEC constitutes waiver of the protections afforded by the privilege.297 This “strict waiver” conclusion, however, frustrates the United States Supreme Court’s policy approach which encourages corporate compliance with government regulations.298 Thus, the court should have

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293. See Zirn, 621 A.2d at 782 & n.4 (discussing the “patent reinstatement problem”).
294. Id. at 782-83; see supra note 264.
295. See id. at 782. The court noted that “[a]part from [the] reasons of partial disclosure, . . . we are satisfied that Zirn has demonstrated ‘good cause.’” Id.
296. Id. at 781-82.
297. Zirn, 621 A.2d at 781.
298. Gergacz, supra note 113, ¶ 5.03[4][a], at 5-50. As Professor Gergacz explains, this strict waiver theory elevates the confidentiality aspect of the [attorney-client] privilege . . . over its general policy of promoting the fair and efficient administration of justice in the public interest. Large, publicly traded corporations are heavily regulated by the government. Their activities are monitored by numerous government agencies which are charged with carrying out some public purpose. Agency budgets are limited, so cooperative regulation through corporate self-policing should be encouraged in the interests of economy and efficiency. The strict waiver cases[, which Zirn follows,] discourage this corporate policing activity (or at least sharing its results with the relevant agency) for fear that the privileged nature of some of those unfavorable reports may be lost in some future litigation challenge.

Id. The “strict waiver cases” to which Professor Gergacz refers are epitomized by In re Subpoenas Duces Tecum, 738 F.2d 1367 (D.C. Cir. 1984). The corporation in Subpoenas disclosed information to the SEC according to the Commission’s regulatory disclosure requirements. Id. at 1368. The D.C. Circuit, however, opined
limited its reasoning to whether Zirn had met her burden of showing "good cause."

The Delaware Supreme Court properly set out to conduct a separate analysis of the defendants' assertion of the work product doctrine.299 The court, however, appeared to confuse the Garner "good cause" analysis with VLI's claim of work product protection.300 Nonetheless, apart from this confusion, waiver of an attorney's advice through partial disclosure merits a distinct analysis.301

Waiver of the work product doctrine occurs when disclosure of information substantially increases the opportunity that an adversary will obtain the disclosed information.302 The same inherent conflict occurs with waiver of the work product doctrine that occurs with waiver of the attorney-client privilege when government regulations require disclosure. A rule which assumes that the work product doctrine is waived when a corporation follows regulatory requirements is contrary to the public policy of encouraging cooperation with government agencies.303

that the disclosure was influenced by the corporation's desire to avoid a formal SEC investigation. Id. at 1373. The court explained that "[a] client cannot waive [the attorney-client] privilege in circumstances where disclosure might be beneficial while maintaining it in other circumstances where non-disclosure would be beneficial." Id. at 1370.

299. See Zirn, 621 A.2d at 782.
300. See id. The court explained that "[a]part from reasons of partial disclosure, however, we are satisfied that Zirn has demonstrated 'good cause' for production of documents prepared in anticipation of the patent litigation." Id. (emphasis added). As explained earlier, discovery of work product requires the discovering party to show that he has a "substantial need" for the materials and that he is unable "without undue hardship to obtain the substantial equivalent . . . by other means." Fed. R. Civ. P. 26(b)(3); see supra text accompanying note 145. Nevertheless, the ostensible willingness of the court to find "good cause" on the record compels the conclusion that reversal of the court of chancery was possible without a "waiver" analysis.

301. See supra text accompanying note 152. While the court of chancery applied a liberal analysis of the "prepared in anticipation of litigation" requirement, see Fed. R. Civ. P. 26(b)(3), the Delaware Supreme Court opted to apply its attorney-client privilege "waiver" analysis to dispose of defendants' claim of work product protection. Zirn, 621 A.2d at 782. The court held that VLI's partial disclosure of the attorney's advice waived any protection afforded by the work product doctrine. Id.

303. See United States v. American Tel. & Tel. Co., 642 F.2d 1285, 1301 (D.C. Cir. 1980) (finding that the countervailing policy of maximum disclosure does not, by itself, require work product disclosure). The AT&T court did suggest that a showing of "substantial need" could allow discovery of the materials at issue. Id. at 1302. Other courts, however, have found unpersuasive such a public policy exception to waiver of the work product doctrine. See, e.g., In re Worlds of
This comment suggests that the supreme court should have limited its analysis to whether Zirn had shown "substantial need" for the documents she sought and an inability to obtain elsewhere the substantial equivalent of the materials.\(^{304}\)

Where the critical issue in a shareholders' suit is . . . the corporate defendants' reliance upon the "advice of counsel" in undertaking certain actions alleged to have been in breach of the defendants' fiduciary duties, . . . the advice of counsel [is] directly at issue and [therefore] the need for production of counsel's work-product [is] compelling.\(^{305}\)

The court, in its opinion, had explained that Zirn was entitled to the materials because the defendants relied upon the partially disclosed information to support its decision to accept the merger's renegotiated terms.\(^{306}\) Furthermore, there was "no alternative source for discovering such information."\(^{307}\) Because Zirn, as a stockholder challenging the decision of the VLI Board, required the full context of the legal advice and could not obtain this information elsewhere, she showed "substantial need" and an inability to obtain the substantial equivalent of the materials elsewhere.

**C. Section 102(b)(7) Protection**

Because of the clear language of section 102(b)(7),\(^{308}\) the supreme court's cursory discussion that the statute does not apply to the duty of loyalty is neither surprising nor groundbreaking. What could hold significance for future disclosure litigation is the court's statement

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\(^{304}\) See Fed. R. Civ. P. 26(b)(3).

\(^{305}\) Panter, 80 F.R.D. at 726.

\(^{306}\) Zirn, 621 A.2d at 782.

\(^{307}\) Id. at 782-83.

\(^{308}\) See supra note 12 for the full text of § 102(b)(7).
that "the duty of loyalty ... also embraces the duty of disclosure
that is at issue here."309 The supreme court addressed VLI's section
102(b)(7) defense "[i]n the interest of completeness and in anticipation
of a rehearing upon remand."310 The section 102(b)(7) defense,
however, was rendered moot by Vice-Chancellor Hartnett's ma-
teriality decision.311 Therefore, the court should have remanded the
case to the court of chancery for a determination of whether the
section 102(b)(7) defense was applicable under the facts in Zim.
Instead, the court simply found that the duty of disclosure at issue
in Zim fell within the duty of loyalty, not the duty of care.312

The court's indication that the duty of loyalty encompasses the
duty of disclosure presents at least two difficulties for future litigants.
First, in a manner inconsistent with its earlier loquacity, the court
failed to identify which disclosure issue—the stock market crash or
the patent reinstatement—was encompassed by the duty of loyalty.313
The duty of loyalty prevents a director from placing his or her
interests before those of the corporation.314 Neither the failure to
disclose the role which the market crash played in the decision to
accept the $6.25 per share offer315 nor the failure to disclose the full
context of the legal advice surrounding the patent reinstatement316

309. Zim, 621 A.2d at 783 (emphasis added).
310. Id.
311. Id. at 783 n.6.
312. See id. at 783. This action by the court appears to support the argument
made by some commentators that courts, in an effort to get around § 102(b)(7),
could enlarge the duty of loyalty to consume the duty of care. See, e.g., Leo Herzel
313. See Zim, 621 A.2d at 783.
314. See supra text accompanying note 159.
315. As fully explained earlier, this comment argues that the role that the
stock market played in the individual director's decision to accept the $6.25 per
share offer is immaterial as a matter of law and, therefore, it does not require
disclosure. See supra notes 282-85 and accompanying text. Even if the impact of the
stock market on the directors' decision required disclosure, it does not follow that
its omission constitutes a violation of the duty of loyalty. Nothing in the supreme
court's opinion suggests that the exclusion of the stock market's decline unjustly
benefitted VLI's directors to the detriment of the corporation's stockholders. On
the contrary, the instability in the equity markets, created by the 508 point decline,
appears to reinforce the VLI board's desire to obtain an infusion of capital for the
company. Zim, 621 A.2d at 775-76. Nevertheless, the question of whether this stock
market omission violated the duty of loyalty was an inquiry best left to the court
of chancery upon remand.

316. The patent disclosure issue was not fully analyzed by the court of chancery.
See Zim, 621 A.2d at 777 n.2.
appears, on its face, to place any interests of the directors before those of the corporation.

The second difficulty for potential litigants is the interpretation of the court's use of the phrase "the duty of loyalty . . . embraces the duty of disclosure that is at issue here." If the supreme court intended to have the duty of loyalty fully embrace the duty of disclosure in Delaware, the court has undermined the central focus of section 102(b)(7). The duty of disclosure can involve the duty of care and, simultaneously, not implicate the duty of loyalty. Likewise, the duty of disclosure can implicate the duty of loyalty, without a concurrent breach of the duty of care. Under the Zirn analysis, the legislature's statutory effort to shield directors from duty of care liability potentially could be undermined.

Conversely, litigants could interpret the court's language as limiting Zirn to its facts. A defendant-director might argue that the phrase "the duty of disclosure that is at issue here" was meant to suggest that the duty of loyalty only embraced the duty of disclosure at issue based on the facts of Zirn. This may be the more plausible interpretation of the court's vernacular. Therefore, under this interpretation, an article of incorporation passed pursuant to section 102(b)(7) would continue to afford directors protection for that portion of the duty of disclosure which falls under the duty of care.

317. Id. at 783.

318. The central focus of § 102(b)(7) was to provide corporations with the means by which their directors could be protected from exposing themselves to monetary liability for breaches of their duty of care. See Del. Code Ann. tit. 8, § 102(b)(7) (1991); see also Herzel, supra note 312 (explaining that courts, in an effort to get around § 102(b)(7), could enlarge the duty of loyalty to consume the duty of care).

319. For example, a director could neglect to inform herself of the information required to make a business decision. Having failed to familiarize herself with the requisite information, the director could not place herself in a position to inform the corporation's shareholders of the information they need to contest the transaction. This would involve a clear violation of the duty of care and would not result in personal liability for the director under a § 102(b)(7) charter provision.

320. For example, were a director to fully inform himself of the information needed to make an informed business decision and to act "carefully" in making that decision, he would pass the duty of care standard. Having met his duty of care, however, the same director could withhold the facts from stockholders in order to advance a transaction personally benefitting the director. This would involve a clear violation of the duty of loyalty and would result in personal liability for the director, despite a § 102(b)(7) charter provision.

321. At one point the court explained that a director's duty to disclose "all material facts bearing upon a merger vote arises under the duties of care and loyalty." Zirn, 621 A.2d at 778 (emphasis added).
As stated earlier, the Delaware legislature has avoided differentiating the duties of care and loyalty.\footnote{322} Moreover, the supreme court’s reasoning that the duty of disclosure falls partially under the duty of loyalty and partially under the duty of care necessarily muddies already murky waters. The resulting case-by-case analysis, however, is essential to the fact-intensive inquiry required for an alleged breach of a director’s fiduciary duties.

V. Conclusion

The Delaware Supreme Court, in \textit{Zirn v. VLI Corp.}, made several important decisions relating to a corporate director’s duty of disclosure in a merger or tender offer setting. Each of these decisions has potentially far-reaching implications for future disclosure-related causes of action in Delaware. Because of these implications, this comment has questioned the court’s loquacious tendencies and has offered alternative analyses.

As the Delaware Supreme Court’s opinion in \textit{Zirn} is written, the court has suggested several foreboding conclusions for corporations which become engaged in a disclosure-related suit. First, the \textit{Zirn} opinion intimates that directors may be required to disclose what effect a public event had on their \textit{subjective motivations} for recommending or opposing a particular course of action. This comment has suggested that the role of the October 1987 crash in the VLI Board’s acceptance of AHP’s offer is immaterial, as a matter of law, for purposes of the VLI Board’s disclosure liability. What required disclosure was the fact that the market crashed; this was accomplished \textit{ad absurdum} via the mainstream media. This comment agrees that the Delaware Supreme Court should have reversed the court of chancery’s application of the materiality standard. The supreme court, however, should have remanded the case solely for consideration of the plaintiffs’ patent disclosure allegations.

Second, the Delaware Supreme Court has suggested that partial disclosure of an attorney’s advice to the SEC serves to waive invocation of the attorney-client privilege and work product doctrine. This comment suggests that the supreme court should have limited its reversal of the trial court’s rulings to the issues of “good cause” and “substantial need,” respectively. By expanding its decision to the issue of waiver, the Delaware Supreme Court has contradicted

\footnote{322. \textit{See supra} text accompanying note 176.}
the policy aims of the attorney-client privilege and work product doctrine. Had the court limited its reasoning, the same result could have been achieved without the concomitant repercussions that the decision, as written, is likely to bring.

Finally, the Delaware Supreme Court has implied that the duty of disclosure is governed exclusively by the duty of loyalty. If this was the court’s intention, a corporation’s section 102(b)(7) charter provision will not shield a director from liability in a disclosure-related cause of action. This would undermine the Delaware legislature’s attempt to limit director liability for certain negligent conduct. The more likely, and the more logical, conclusion is that the court intended that the duty of loyalty govern the duty of disclosure in the Zirn case. Inconsistent with its earlier loquacity on the materiality, attorney-client privilege, and work product doctrine issues, the court failed to identify which disclosure issue implicated the duty of loyalty.

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