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In Re Dish Network Derivation Litig., 133 Nev. Adv. Op. 61 (Sept. 14, 2017)

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CIVIL APPEAL: BUSINESS LAW

Summary

The Court determined that the *Auerbach* test should be applied when a Special Litigation Committee (SLC) files a motion to defer a derivative claim. A derivative claim is dismissible if the SLC was independent and conducted a good faith investigation when it concluded litigation would not be in the company's best interest.

Background

From April 2012 to April 2013, Charles W. Ergen, Dish Network Corporation's CEO, purchased $690 million in LightSquared's secured debts with personal assets through an entity he owned called SP Special Opportunities (SPSO). Ergen informed Dish that it could obtain LightSquared assets through its bankruptcy. Ergen also disclosed to Dish's board that he bought LightSquared debt. Dish submitted a plan to acquire LightSquared, but Dish's Board terminated the bid.

Jacksonville, one of Dish's stockholders, brought a claim against Ergen for unjust enrichment, and against Ergen and Dish's board and officers for breach of loyalty. Jacksonville's claims arose from Ergen's purchase of LightSquared's debt under SPSO's entity; the Special Transaction Committee that Dish's board established to consider purchasing LightSquared; and Dish's bid for LightSquared secured debts. Dish's board created a Special Litigation Committee (SLC) to determine if it should pursue Jacksonville's claims. The SLC's members were Tom A. Ortolf and George R Brokaw, two longstanding board members and close friends to Ergen. Jacksonville filed a complaint with the court because of Ergen's close ties to Ortolf and Brokaw. The board added Charles M. Lillis to the SLC and approved a resolution that only allowed the SLC to act if Lillis approved the action.

Jacksonville filed a second complaint that added the SLC members after Dish terminated its bid for LightSquared's assets. The SLC determined pursuing litigation would not serve Dish's best interests. The SLC moved the court to defer to its decision to avoid litigation and dismiss Jacksonville's claims against Dish. The district court granted Jacksonville discovery after an initial hearing and briefing on the motion to defer. The district court granted SLC's motion to defer after supplemental briefing and oral arguments. Then, Jacksonville appealed.

The SLC filed its memorandum of costs, and Jacksonville filed a motion to retax. Jacksonville challenged SLC's costs for electronic discovery, photocopying and scanning, and teleconferences. Pursuant to NRS 18.005(17), the district court awarded the SLC $151,178.32 for costs because the costs were reasonable expenses regarding the discovery requests the court granted Jacksonville. Pursuant to NRS 18.005(12), the district court awarded the SLC costs for photocopying. Pursuant to NRS 18.005(13) the district court also awarded SLC costs for teleconference calls. Jacksonville timely appealed, and the Nevada Supreme Court consolidated the two appeals.

[1] By Joseph K. Fabbi.

Discussion

Jacksonville mainly took issue with the district court's granting deference to the SLC's decision to dismiss Jacksonville's derivative complaint. The Nevada Supreme Court used the *Auerbach* test to determine if a district court can grant an SLC's motion to defer to its decision. The *Auerbach* test determines whether an SLC is independent, and if its investigation was conducted in a good faith. The Nevada Supreme Court chose the *Auerbach* test over the more intrusive *Zapata* test because "Nevada's business judgment rule 'prevents courts from substitute[ing] [their] own notions of what is or is not sound business judgment.'"[2]

Under *Auerbach*, the district court should defer to the SLC's judgment when its members are independent, and if the SLC conducted a good faith investigation of the derivative claim.[3] The Nevada Supreme Court concluded that the district court can decide how it applies the standard, and its ruling should not be remanded on appeal unless it abused its discretion.

The district court did not abuse its discretion in deferring to the SLC's decision and dismissing the complaint

If a district court finds that an SLC was not independent or did not conduct a good faith investigation, the *Auerbach* standard instructs that a shareholder can proceed with a derivative claim after the SLC's motion to defer. Here, the Nevada Supreme Court held that the district court did not abuse its discretion when it granted the SLC's motion to defer and dismissed the complaint because (1) the SLC's voting structure required an independent member's affirmative vote to effect any decision which illustrated the SLC's independence, and (2) the SLC conducted a good faith investigation.

Independence

Jacksonville argued that the district court erred when it used a pre-suit demand futility case test that presumed the SLC's independence and good faith, and placed the burden of proof to overcome that presumption on Jacksonville. The Nevada Supreme Court held that the test's independence standard was also applicable to determine an SLC's independence. In the demand-futility context, the test requires courts to consider whether the board can exercise independent business judgment without being improperly influenced.[4] Similarly, when evaluating an SLC's business judgment, courts must consider whether improper influence impacted its decision not to pursue litigation. Conversely, the court may not presume independence or place the burden of proof on the plaintiff.

When evaluating independence, courts may consider a variety of factors. For instance, when the board has a potentially liable director may be unable to consider the problem at issue on its merits. Courts also consider if a majority of the board members were materially benefited or set back by the board's decision, but that the corporation and stockholders were not. Also, courts note that familial ties could show interestedness.

The Nevada Supreme Court held that the district court did not abuse its discretion when it used demand-futility context case law to show that the SLC was independent. The district court

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[2] Wynn Resorts, Ltd. v. Eighth Judicial Dist. Court, 133 Nev. Adv. Op. 52, 399 P.3d 334, 344 (2017).
[3] Auerbach v. Bennett, 393 N.E.2d 994, 996 (N.Y. 1979).
[4] Shoen v. SAC Holding Corp., 122 Nev. 621, 639, 137 P.3d 1171,1183 (2006).

did not apply a presumption in favor of the SLC, but "reached a conclusion irrespective of which party bears the burden."

Jacksonville argued that the district court erroneously concluded that the SLC was independent because two out of three members were not independent. The Nevada Supreme Court disagreed because Lillis was independent, and the SLC's voting structure was dependent upon Lillis' affirmative vote.

Good-faith and through investigation

Jacksonville argued that the district court erred when it determined the SLC conducted a good-faith, thorough investigation. The Nevada Supreme Court disagreed because there was no proof that the SLC investigated the claims in a "restricted scope" or executed a shallow investigation, in a half-hearted, shameful way inconsistent with business judgment doctrine. In fact, the SLC's investigation included monitoring LightSquared's bankruptcy; conducting interviews of sixteen people in twenty-one total interviews; reviewing documents which numbered hundreds of thousands of pages; and formally meeting seventeen times with additional informal and telephonic meetings.

The district court was within its discretion to award costs for electronic discovery and photocopying and scanning, but abused its discretion in awarding costs for teleconferences

Electronic discovery costs

Jacksonville argued that the district court mistakenly awarded the SLC costs for electronic discovery because under NRS 18.005, electronic discovery expenses are not costs.[5] The Nevada Supreme Court disagreed. The costs were "reasonable and necessary expense[s] incurred in connection with the action" because the Court required the SLC to produce the documents when it granted discovery to Jacksonville.[6] The SLC's electronic discovery expenses did not include any legal fee costs.

Costs for photocopying, scanning, and teleconferences

Jacksonville also argued that the district court mistakenly awarded the SLC with costs for photocopying and scanning under NRS 18.005(12), and claims that the SLC did not submit justifying documents to prove the photocopying and scanning were necessary. The Nevada Supreme Court disagreed because the SLC provided the district court with documents, including an itemized list of charges and a declaration of counsel that explained how the expenses were incurred, supporting the awards for photocopying and scanning costs.

Finally, Jacksonville argued that the district court mistakenly awarded SLC with costs for teleconferences under NRS 18.005(13) because the SLC did not provide proper documents that justify the costs. The Nevada Supreme Court ruled that the district court abused its discretion when it awarded costs for teleconferences because the documents that the SLC provided did not show how the fees were incurred, or if they were appropriate for discovery.

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[5] NEV. REV. STAT. § 18.005 (2017).

[6] NEV. REV. STAT. § 18.005(17) (2017).

Conclusion

The Nevada Supreme Court affirmed the district court's grant to the SLC's motion to defer, awarded costs for electronic discovery, photocopying, and scanning, and vacated the district court's awarded costs to the SLC for teleconferences because the SLC did not provide justifying information.

Pickering, J., concurring in part and dissenting in part:

Justice Pickering agreed with the majority that *Auerbach* is the better approach for Nevada, but did not agree with the majority's version of *Auerbach* because it was too deferential. Justice Pickering specifically dissented about the genuine issues of material fact present regarding the SLC's independence. Justice Pickering reasoned that before the board added Lillis to the SLC, Ortolf and Brokaw made the SLC's decisions regarding Jacksonville's derivative complaint. Pickering argues further that the SLC's independence should not merely hang on one member, in this case Lillis, but Ortolf's and Brokaw's disinterest and independence, too. As such, Pickering reasoned that there was a genuine issue of material fact regarding the SLC's independence and disinterestedness. Therefore, Pickering did not agree with the majority when it granted the SLC's motion to defer a derivative complaint, and did not agree that the SLC's recommendation to dismiss was based only on Dish's best interests.