COURT OF CHANCERY
OF THE
STATE OF DELAWARE

JOHN W. NOBLE
VICE CHANCELLOR

417 SOUTH STATE STREET
DOVER, DELAWARE 19901
TELEPHONE: (302) 739-4397
FACSIMILE: (302) 739-6179

August 8, 2008

Carmella P. Keener, Esquire
Rosenthal, Monhait & Goddess, P.A.
919 Market Street, Suite 1401
Wilmington, DE 19801

Scott M. Tucker, Esquire
Chimicles & Tikellis LLP
One Rodney Square
Wilmington, DE 19801

S. Mark Hurd, Esquire
Morris, Nichols, Arsht & Tunnell LLP
1201 N. Market Street
Wilmington, DE 19801

Catherine G. Dearlove, Esquire
Richards, Layton & Finger, P.A.
One Rodney Square
Wilmington, DE 19801

David C. McBride, Esquire
Young Conaway Stargatt & Taylor, LLP
1000 West Street, 17th Floor
Wilmington, DE 19801

R. Bruce McNew, Esquire
Taylor & McNew LLP
2710 Centerville Road, Suite 210
Wilmington, DE 19808

Re: In re William Lyon Homes Shareholder Litigation
Consolidated C.A. No. 2015-VCN
Date Submitted: August 7, 2008

Dear Counsel:

Plaintiff-Intervenor Alaska Electrical Pension Fund ("Alaska") has moved to compel the production of three emails between Defendant General William Lyon, (together with Defendant, William H. Lyon, the "Lyon Defendants") and his

attorneys regarding conversations with one of Alaska's attorneys. The Lyon Defendants have withheld the emails under the attorney-client privilege.[1] Alaska concedes that the emails would ordinarily be protected by the privilege but argues that, under these circumstances, the emails fall within the so-called "at issue" exception and must be produced.

The only issue remaining in this shareholder class action is a determination of whether, and to what extent, if any, Alaska caused the increase in the final consideration paid in connection with settlement of this action challenging the efforts of the Lyon Defendants to acquire all of the publicly held stock of Nominal Defendant William Lyon Homes, a Delaware corporation (the "Company"), and, thus, is entitled to an award of attorney's fees. Alaska begins with a rebuttable presumption of causation.[2] The Lyon Defendants maintain, however, that Alaska's then-pending lawsuit in California (the "California Action") did not, in any way, contribute to their decision to increase the price of their underlying tender offer from $100 to $109 per share (the "Final Price Increase").

[1] The Lyon Defendants also assert the work product doctrine in their effort to withhold two of the three emails.
[2] *Alaska Elec. Pension Fund v. Brown*, 941 A.2d 1011, 1016 (Del. 2007).

Discovery on the issue of causation is ongoing, and Alaska now seeks to compel production of three privileged emails. Alaska contends that what the Lyon Defendants knew and thought about the risks posed by the California Action at the time of the Final Price Increase is "at issue" in this phase of the litigation, and, thus, it claims that the attorney-client privilege has been waived with respect to any communications reflecting how the Lyon Defendants may have assessed that action. The Lyon Defendants respond that they have carefully structured their challenge to Alaska's presumption of causation in such a way as to avoid placing the advice of their legal counsel at issue (thereby waiving the privilege). Instead, they are relying solely upon objective, non-privileged facts about their negotiations with Chesapeake Partners, L.P. ("Chesapeake"), a large shareholder of the Company whose shares, ultimately, were necessary to meet the "Majority of the Minority" condition of the underlying tender offer, and upon their objective, non-privileged knowledge of the California Action.

After considering the matter and the parties' arguments, the Court concludes that the Lyon Defendants have not put their attorney-client communications at issue, and, therefore, they have not waived attorney-client privilege. The necessary corollary to their refusal to produce the privileged communications, however, is

that they may not rely upon those communications or other privileged communications from their attorneys to rebut Alaska's presumption of causation and to support their contention that the California Action had no impact on the Final Price Increase; that, however, is their tactical choice and one, of course, that they are free to make. Accordingly, because the Lyon Defendants have thus far successfully tip-toed around placing attorney-client privileged communications "at issue," Alaska's motion to compel will be denied.

I. BACKGROUND

A brief review of the relevant background facts is necessary to place Alaska's motion to compel in context.

On March 17, 2006, General Lyon commenced a tender offer to purchase all the outstanding shares of the Company for $93 per share, subject to a non-waivable "Majority of the Minority" condition (the "Tender Offer"). Shortly thereafter, three purported shareholder class actions—two in Delaware (consolidated, the "Delaware Action") and the California Action—were filed alleging various disclosure and fiduciary duty claims. The Delaware Action moved forward on an expedited schedule, and the Lyon Defendants and the California court consistently urged Alaska to coordinate with or participate in the Delaware Action.

On April 10, 2006, the parties in the Delaware Action executed a memorandum of understanding memorializing terms of a settlement agreement resulting in an increase in the price of the Tender Offer to $100 per share (the "Original Settlement"). Confirmatory discovery in support of the Original Settlement continued throughout the month of April. Meanwhile, in California, Alaska declined to join in the Original Settlement and continued to maneuver in an effort to advance its claims there. Those efforts met with limited, if any, success.

Notwithstanding the increase in the price of the Tender Offer, as of April 24, 2006, the date the Tender Offer was set to expire, General Lyon had not yet received a sufficient number of tendered shares to satisfy the "Majority of the Minority" condition of the offer. Accordingly, he extended the deadline for the Tender Offer to April 28, 2006, but he remained concerned that he might not be able to complete the Tender Offer as planned. Thus, that same day, General Lyon consulted with his financial advisor, Lehman Brothers ("Lehman"), and developed a strategy to seek out the non-tendering common stockholders of the Company, including Chesapeake, and to convince them to tender. Lehman contacted Chesapeake, and, on April 27, 2006, Chesapeake agreed to tender its shares for $109 per share. On May 1, 2006, General Lyon announced that he was increasing

the price of the Tender Offer to $109 per share for all the Company's stockholders who tendered their shares before the expiration of the Tender Offer (i.e., the "Final Price Increase").

The Original Settlement in the Delaware Action was revised to reflect the Final Price Increase. In addition, in the final stipulation of settlement in the Delaware Action, the Lyon Defendants agreed not to object to an award not exceeding $1.2 million in attorneys' fees to the plaintiffs' attorneys. The Lyon Defendants and Alaska then agreed to stay the California Action, and Alaska intervened in the Delaware Action to submit its application for an award of attorneys' fees.

II. THE PARTIES' CONTENTIONS

Because Alaska did not enter into the Original Settlement in the Delaware Action, and because the Final Price Increase occurred while the California Action was the only pending lawsuit, Alaska is presumed to have caused (or at least contributed to) the increase in the settlement consideration paid to the plaintiff shareholder class.[3] The Lyon Defendants challenge that presumption and argue that the Final Price Increase was attributable solely to the negotiating leverage of

[3] *Alaska Elec. Pension Fund*, 941 A.2d at 1016.

Chesapeake in connection with the "Majority of the Minority" condition of the Tender Offer. Alaska takes the position, however, that with the Lyon Defendants' argument that the Final Price Increase is attributable solely to Chesapeake, then they also are arguing that they placed no value on the claims in the California Action and were not motivated by its pendency; in seeking to ascertain whether and *why* the Lyon Defendants did not consider the California Action in negotiating the Final Price Increase, Alaska assumes that they relied on advice of their attorneys, which necessarily places certain attorney-client communications at issue.

The three emails that are the subject of Alaska's motion to compel were exchanged among the Lyon Defendants and their attorneys and are plainly subject to the attorney-client privilege. Given the timing of the emails—in the interim between the Original Settlement and the announcement of the Final Price Increase—Alaska seeks to discover whether those emails contain any advice or other information regarding the Lyon Defendants' consideration and valuation of the California Action. The Lyon Defendants resist production of the privileged communications on the grounds that they have not placed the advice of counsel

with respect to their consideration of the California Action "at issue," and, therefore, they contend they have not waived attorney-client privilege.

III. ANALYSIS

The attorney-client privilege generally protects confidential communications between a client and his attorney acting in her professional capacity.[4] The privilege can be waived, however, where, for example, a party places an otherwise privileged communication "at issue" in the litigation. Thus, the so-called "at issue" exception to the attorney-client privilege applies where either "(1) a party injects the privileged communications themselves into the litigation, or (2) a party injects an issue into the litigation, the truthful resolution of which requires an examination of confidential communications."[5] The "at issue" exception is grounded on notions of fundamental fairness and recognizes that "a party cannot take a position in litigation and then erect the attorney-client privilege in order to shield itself from discovery by an adverse party who challenges that position."[6]

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[4] *Moyer v. Moyer*, 602 A.2d 68, 72 (Del. 1992).

[5] DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 7.02[c][2], at 7-28 (2008).

[6] *Id.* (quoting *Sealy Mattress Co. of NJ, Inc. v. Sealy Inc.*, 1987 WL 12500, at *6 (Del. Ch. June 19, 1987); *see also Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254, 259 (Del. 1995) ("The courts of this State have refused to allow a party to make bare, factual allegations, the veracity of which are central to resolution of the parties' dispute, and then assert the attorney-

In attempting to rebut Alaska's presumption of causation, the Lyon Defendants have not relied upon the specific emails Alaska seeks to discover, nor have they directly injected those specific communications into this litigation, in support of their substantive arguments to rebut the presumption.[7] The debate here centers around whether the Lyon Defendants' challenge to Alaska's presumption of causation, and their reliance exclusively on objective, non-privileged evidence of their negotiations with Chesapeake in support thereof, implicitly and necessarily places at issue their consideration *vel non* of the California Action in determining the Final Price Increase. In other words, in a zero-sum construct where, by definition, the Final Price Increase can be attributed only to two possible sources of causation—Chesapeake or Alaska—if the Lyon Defendants position is, "We only considered Chesapeake," then, by implication, they also are saying, "We did not consider Alaska." In order to establish the veracity of that statement and to ascertain the reason *why* the Lyon Defendants did not consider Alaska to be a factor in Final Price Increase, one would expect the advice of an attorney to surface eventually.

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client privilege as a barrier to prevent a full understanding of the facts disclosed." (citations omitted)).

[7] *See generally* General Wm. Lyon and Wm. H. Lyon's Supp. Br. re: Alaska Elec. Pension Fund's App. For an Award of Atty. Fees and Expenses.

The Lyon Defendants nevertheless have adopted a particular tactic and strategy—exclusive reliance on objective, non-privileged facts—in their challenge to Alaska's presumption of causation in order to avoid placing directly "at issue" any advice they may have received from their attorneys regarding the California Action. Candidly, the line they seek to walk here is very fine and a line about which one may readily harbor considerable doubt about whether they will maintain it successfully. That said, however, at present, by relying exclusively upon objective, non-privileged facts about their negotiations with Chesapeake and the Lyon Defendants' objective, non-privileged knowledge of the California Action in seeking to rebut the presumption of causation, the Lyon Defendants have not placed their attorney-client privileged communications regarding the California Action directly "at issue," and the Court finds no persuasive reason to ignore that tactical choice and preclude assertion of the attorney-client privilege.

The more difficult aspect of the parties' debate is whether the Lyon Defendants' challenge to Alaska's presumption of causation is one that raises an issue in the litigation "the truthful resolution of which requires an examination of confidential communications." The Lyon Defendants have contended that they did not "inject" any such issue into this litigation. Because the increase in share price

was caused either by California or Alaska (or both in whatever proportion), however, the Lyon Defendants are necessarily, either explicitly or implicitly, arguing that they were not motivated at all by the existence of the California Action. That, of course, is an inevitable contention in the face of a rebuttable presumption of causation in cases of this nature.[8] Thus, the issue of whether or not the Lyon Defendants were in any way induced by the pendency of the California Action is an issue which must be deemed to have been injected by them into this litigation. Although an examination of the Lyon Defendants' communications with their attorneys undoubtedly would be helpful in resolving that question, access to such communications cannot be said to be "required" in order to achieve a "truthful resolution" of the factor(s) motivating them to increase their offer.

Alaska has an upcoming opportunity to depose the Lyon Defendants and their defense counsel. Through those depositions, Alaska will be able to probe the extent of the witnesses' objective knowledge regarding the California Action and,

[8] Under Alaska's view of the "at issue" exception, it would always (or, perhaps, almost always) be applicable in these circumstances. Indeed, Alaska has suggested that, because this is litigation about litigation, an accurate observation as far as it goes, the attorney-client privilege will have to give way in order to gain access to the "truth." The attorney-client privilege—as with any privilege—can always be seen as impairing access to the "truth." That avoiding the protection of the privilege would be beneficial for resolving a dispute does not constitute a reason for denying a party the benefit of the privilege.

presumably, the basis for the Lyon Defendants' asserted non-consideration of the California Action in arriving at the Final Price Increase. If the Lyon Defendants can continue to execute their strategy and can answer Alaska's proper questions regarding the Final Price Increase without placing the advice of their attorneys concerning the California Action "at issue," then they are entitled to do so and to continue to protect from discovery the privileged attorney-client communications.

A necessary consequence of the Lyon Defendants' strategy, however, is that they will not be able to rely upon privileged communications from their attorneys to rebut the presumption that Alaska was a cause behind the Final Price Increase.[9] In other words, they cannot now assert the attorney-client privilege as a shield to protect from disclosure any privileged communications regarding the California Action, and later use those or similar communications as a sword in an effort to prove that at the time of the Final Price Increase they did not consider the California Action and, therefore, that Alaska was not a cause. Thus, in light of their tactical choice, whether the Lyon Defendants will be able to rebut Alaska's presumption of causation in the Final Price Increase without resorting to attorney-

[9] See WOLFE & PITTENGER, *supra* note 5, § 7.02[c][2], at 7-32 (2008) (citing *Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, Del. Ch. C.A. No. 16584 & 16588 (Oct. 23, 1998), Bench Ruling at 505).

client privileged communications is an open question, but it is a risk they appear to be choosing to run.

IV. CONCLUSION

For the foregoing reasons, the Court concludes that the Lyon Defendants have not waived their attorney-client privilege by placing the three emails "at issue."[10] Accordingly, Alaska's motion is denied.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-K

[10] With this conclusion, it is not necessary to address separately the Lyon Defendants' work product doctrine contentions.