COURT OF CHANCERY
OF THE
STATE OF DELAWARE

STEPHEN P. LAMB
VICE CHANCELLOR

New Castle County Court House
500 N. King Street, Suite 11400
Wilmington, Delaware 19801

Submitted: June 19, 2007
Decided: July 2, 2007

J. Travis Laster, Esquire
Abrams & Laster, LLP
Brandywine Plaza West
1521 Concord Pike, Suite 303
Wilmington, DE 19803

Robert S. Saunders, Esquire
Skadden Arps Slate Meagher & Flom, LLP
One Rodney Square
P.O. Box 636
Wilmington, DE 19899

A. Gilchrist Sparks, Esquire
Morris, Nichols, Arsht & Tunnell, LLP
1201 North Market Street
P.O. Box 1347
Wilmington, DE 19899

RE: Martha S. Sutherland v. Perry H. Sutherland, Todd L. Sutherland, and Mark B. Sutherland, and Dardanelle Timber Co., Inc. and Sutherland Lumber Southwest, Inc.
C.A. No. 2399-VCL

Dear Counsel:

The court has considered the arguments made in the parties' briefing and at oral argument regarding the nominal defendants' motion for a protective order to limit the scope of discovery in the above-referenced matter. For the reasons that follow, the motion will be denied in part and granted in part.

The plaintiff, Martha Sutherland, filed this derivative and double derivative action on behalf of Dardanelle Timber Company, Inc. and its wholly owned

subsidiary, Sutherland Lumber Southwest, Inc., seeking to recover damages for alleged breaches of fiduciary duty and waste. Dardanelle is a closely-held Delaware corporation, and Martha beneficially owns 25% of its common stock. Martha's brother, Dwight Sutherland, Jr., beneficially owns another 25% of Dardanelle's common equity, and supports her in bringing this action.

The three defendants are the directors and senior officers of Dardanelle and Southwest, and include Perry Sutherland and Todd Sutherland, Martha's twin brothers who beneficially own the remaining 50% of Dardanelle's common stock. Despite this even split of the common equity between familial factions, Perry and Todd have absolute voting control over Dardanelle and Southwest because Perry is the trustee for a trust holding shares of Dardanelle preferred stock that carry voting rights.

This lawsuit is not the first time that the Sutherland family has resorted to the Court of Chancery to resolve a dispute over the management of Dardanelle. Having been shut out from information regarding the company's operation and management, and suspecting that Perry and Todd had engaged in self-dealing transactions, on August 31, 2004, Martha filed a complaint pursuant to 8 *Del. C.* § 220 to inspect Dardanelle's books and records.[1] After trial, Master Glasscock determined, and this court subsequently agreed, that Martha unquestionably

[1] *Sutherland v. Dardanelle Timber Co.*, 2006 WL 1451531, at *1-5 (Del. Ch. May 16, 2006).

possessed a proper purpose for her section 220 action.[2] Perry's and Todd's employment agreements with the company, as well as other documents presented at trial, provided credible evidence of managerial misconduct detrimental to Dardanelle.[3] Therefore, although temporally limiting the requested scope of inspection, this court largely granted Martha the relief requested in her section 220 action.[4]

Relying upon the documentation she received as a result of the section 220 action, Martha filed this suit on September 6, 2006. Specifically, she claims Perry and Todd enjoyed excessive compensation and perquisites as a result of their employment with Dardanelle and Southwest, prompted Dardanelle to adopt an amendment to its articles of incorporation which improperly purports to insulate management from liability for past and future breaches of fiduciary duty, and caused Dardanelle to spend upwards of $500,000 to defend the section 220 action out of self-interested motivation to conceal their wrongdoing as officers and directors.

In response, the boards of directors of both Dardanelle and Southwest, each of which consists of the three named director-defendants in this action, amended the bylaws of the companies by unanimous written consent. The written consents

---

[2] *Id.* at *8-9.
[3] *Id.* at *8.
[4] *Id.* at *10-11.

increased the number of directors from three to four, appointed Bryan Jeffrey as a member of each board, and formed a special litigation committee consisting solely of Jeffrey, who was given final and binding authority with respect to the claims asserted in the September 6 complaint.

Following a hearing on December 18, 2006, during which the court voiced significant concerns about the lack of adequate disclosure of Jeffrey's background and *bona fides*, a stay of this action was granted while Jeffery conducted his investigation. On March 26, 2007, Jeffrey filed his report with the court. Dardanelle and Southwest, relying on the findings and conclusions contained in that report, then moved to dismiss the September 6 complaint.

On April 17, 2007, Martha served various interrogatories and document requests on the defendants. The document requests seek, among other things, production of all documents requested by, produced or delivered to, or reviewed by Jeffrey in connection with his investigation. Additionally, the interrogatories seek identification of each and every task Jeffrey performed or was charged with performing, as well as the documents which provide evidentiary support for the conclusions reached in the report. On April 23, Martha served a subpoena *duces tecum* on Jeffrey, RSM McGladrey, Inc. (the compensation consultant relied upon in the report), and JPMS Cox, PLLC (an accounting firm owned by Jeffrey)

seeking all documents relating to Jeffery's investigation and report, as well as all documents relating to communications on such topics.

On April 27, 2007, Southwest and Dardanelle moved for a protective order. Relying on *Zapata Corp. v. Maldonado*[5] and its progeny, the nominal defendants argue that Martha's discovery requests are impermissibly broad because they go to the underlying merits of her derivative claims. Essentially, Southwest and Dardanelle believe that the scope of Martha's discovery should be strictly limited to the issues of Jeffrey's independence and good faith. According to the nominal defendants, because Martha's requests are tantamount to an investigation of the full-blown merits of this case, the court should issue a properly tailored protective order to shelter the companies from having to comply with such burdensome discovery.

In response, Martha argues that her discovery requests fall squarely within the parameters established by the *Zapata* line of cases, and that the court should permit her requests if she is to have any meaningful opportunity to inquire into Jeffrey's independence, good faith, or work product. Given the most unusual circumstances of this case–namely, that the 50% stockholder-directors of a company have repeatedly thwarted the efforts of the other 50% stockholders to obtain information integral to vindicating their legitimate ownership interests, and

[5] 430 A.2d 779 (Del. 1981).

that those stockholder-directors formed a one-person special litigation committee to determine which course of action to pursue with regard to the claims of waste and breach of fiduciary duty leveled at them–Martha also contends that basic notions of fairness and common sense should prevent the nominal defendants from limiting and sanitizing the record upon which she can mount a challenge to their motion to dismiss.

The Delaware Supreme Court's instructions in *Zapata* control the scope of permissible discovery that a derivative plaintiff may take when a special litigation committee, following its investigation into the substance of the plaintiff's allegations, files a motion to dismiss a derivative complaint.[6] At that stage, the role of the court is to conduct both an inquiry into the independence and good faith of the committee's members, and an examination of the objective reasonableness of the conclusions that the committee ultimately reached in its report.[7] The derivative plaintiff's discovery requests, then, necessarily must focus on these somewhat limited areas; otherwise, the perceived efficiencies generated by a committee's investigation might be lost.[8]

---

[6] *Kindt v. Lund*, 2001 WL 1671438, at *1 (Del. Ch. Dec. 14, 2001); *Kaplan v. Wyatt*, 1984 WL 8274, at *2 (Del. Ch. Jan. 18, 1984).
[7] *Kaplan*, 1984 WL 8274, at * 2 (citing *Zapata*, 430 A.2d at 788).
[8] *Kindt*, 2001 WL 1671438, at *1 (citing *Abbey v. Computer & Commc'ns Tech. Corp.*, C.A. No. 6941, letter op. at 7 (Del. Ch. Apr. 13, 1983)).

In determining how to limit the scope of discovery on a *Zapata* motion, the court cannot ignore the substantive history of litigation between the parties and the other anomalous circumstances that exist in the case. Given the inherent equitable discretion of the Court of Chancery to tailor discovery to a given set of facts, and understanding that the exact place where a "limited discovery" line is drawn inevitably risks relevant information being withheld from the derivative plaintiff, the court is convinced, in this lawsuit, to adopt a more liberal view of "limited discovery" than might be appropriate in another context.

The facts here, at least inferentially, paint a vivid picture of two 50% owners of a closely-held family business determined to prevent the other 50% owners from ever having a voice in, or even obtaining essential information about, the basic operational affairs of the companies. Having waged and lost a futile, yet extremely expensive, campaign of attrition against this same plaintiff in a section 220 action only months earlier, the defendants again seek to limit Martha's access to critical information–this time under the auspice of work conducted by a one-person special litigation committee whose *bona fides* have not yet been subject to rigorous examination.[9] Under these circumstances, Martha should have ample opportunity

[9] See Tr. of Oral Arg. 30-32, Dec. 18, 2006 (wherein the court stated: "[Jeffrey] submitted an affidavit in which he didn't identify himself, he didn't say where he lived, he didn't say what he does. He didn't indicate in any way what it was–to his knowledge, anyway–that resulted in his being named as this one-person special litigation committee. There will be lots of inquiry into those sections. In fact, [the court] would have liked to see more about that today, so [the court] would have some more confidence in his ability to function in this capacity . . . .").

to objectively examine whether or not Jeffrey is, indeed, independent and whether or not the allegations in the derivative complaint are as meritless as he reports.[10]

To facilitate Martha's inquiry, the court will permit the following categories of discovery:[11] (1) the production of the same documents Jeffrey and his counsel or advisors reviewed during his investigation; (2) the production of documents relating to the selection, retention, and compensation of Jeffrey, as well as his attorneys and advisors; (3) the depositions of Jeffrey, RSM McGladrey, and representatives of the attorneys who advised Jeffrey in his work; and, (4) the responses to interrogatories concerning, and documents relating to, the general scope of Jeffrey's work or the substantive tasks which were entrusted to him. These items directly relate to Jeffrey's diligence and independence. To the extent the nominal defendants complain that this discovery is overly burdensome, the court disagrees, since the documentary production will merely require photocopying and delivering those papers which Jeffrey should have already segregated during his investigation.

---

[10] On prior occasions, this court has noted the requirement that the sole member of a one-person special committee meet unyielding standards of diligence and independence. *See, e.g.*, *Kahn v. Tremont Corp.*, 694 A.2d 422, 430 (Del. 1997) (quoting *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985) ("If a single member committee is to be used, the member should, like Caesar's wife, be above reproach.")).

[11] This, of course, is in addition to those items that counsel for the defendants agreed to produce following the hearing held on June 19, 2007.

The court will, however, sustain the nominal defendants' objection to certain of Martha's requests. Document request number 22, seeking any document contradicting or undermining the conclusions of Jeffrey's report, is unnecessarily subjective and thus improper. Moreover, memoranda and opinions circulated between Jeffrey and his counsel, as well as preliminary drafts of Jeffrey's final report, are subject to a claim of privilege, and discovery of those items would set dangerous precedent with the potential collateral effect of chilling communications between a special committee and its legal advisors. Additionally, the court finds that the interrogatories served on Dardanelle and Southwest (other than those mentioned in the preceding paragraph), as well as interrogatories 16, 18, 22, 23, 24, 25, and 28–all of which pertain only to the pure merits of the allegations in the derivative complaint–are overly broad in the context of a *Zapata* motion.

For the foregoing reasons, the nominal defendants' motion for a protective order is DENIED IN PART and GRANTED IN PART. Counsel for the parties are directed to confer and submit an appropriate form of order in accordance with this opinion within 10 days.

/s/ Stephen P. Lamb
Vice Chancellor