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Re: California Public Employees' Retirement System
v. Coulter, et al.
C.A. No. 19191-NC
Date Submitted: August 21, 2003

Dear Counsel:

This letter opinion addresses three argued motions: (1) Plaintiff's motion to compel; (2) Defendants' cross-motion to compel; and (3) Plaintiff's motion to amend.

In this action, Plaintiff California Public Employees' Retirement System ("CalPERS") alleges that the Individual Defendants, current and former directors of Nominal Defendant Lone Star Steakhouse & Saloon, Inc. ("Lone Star"), breached their fiduciary duties to the company and its shareholders. At issue are certain repricings of options in 1998 and 2000, allegations of efforts by the Individual Defendants to entrench themselves in their comfortable positions as directors of Lone Star, and a challenge to Lone Star's acquisition of Coulter Enterprises, Inc. ("CEI"), an entity owned by Defendant Jamie Coulter.¹

A. *CalPERS' Motion to Compel*

The scope of discovery is framed by the familiar words of Court of Chancery Rule 26(b)(1), which provides in part:

Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter in the pending action. . . . It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.

¹ For a more detailed description of this litigation, see *California Public Employees' Retirement System v. Coulter*, 2002 WL 31888343 (Del. Ch. Dec. 18, 2002), which granted in part and denied in part various Defendants' motions to dismiss.

Thus, “[t]he scope of discovery pursuant to Court of Chancery Rule 26(b) is broad and far-reaching . . . [and] renders discoverable any information that ‘appears reasonably calculated to lead to the discovery of admissible evidence.’ Consequently, absent injustice or privilege, the Rule instructs the Court to grant discovery liberally.”² On the other hand, the Court is empowered to limit discovery if it is, for example, “unreasonably cumulative or duplicative” or “unduly burdensome and expensive, taking into account the needs of the case, the amount in controversy, limitations on the parties’ resources, and the importance of the issues at stake in the litigation.”³ This Court has “recognized that considerations of subject matter, time, and space are important to confine the scope of discovery to those matters that are truly relevant and to prevent discovery from evolving into a fishing expedition or from furthering purposes ulterior to the litigation.”⁴ In addition, “document discovery is limited in scope to production of documents . . . relevant to the subject matter of the litigation. . . .”⁵ With these broad principles in mind, I turn to the specific discovery disputes at issue.

² *Pfizer, Inc. v. Warner-Lambert Co.*, 1999 WL 33236240, at *1 (Del. Ch. Dec. 8, 1999).

³ Ct. Ch. R. 26(b)(1).

⁴ *Plaza Sec. Co. v. Office*, 1986 WL 14417, at *5 (Del. Ch. Dec. 15, 1986).

⁵ *Frank v. Engle*, 1998 WL 155553, at *1 (Del. Ch. Mar. 30, 1998).

1. Options Repricing

CalPERS seeks far-ranging discovery into the challenged option repricings. In the Amended Complaint, as tested in the Court's Memorandum Opinion⁶ of December 18, 2002, these repricings were attacked on a variety of grounds. Only two attacks survived: (1) a challenge to the 1998 director options repricing based on the *ultra vires* doctrine, and (2) a challenge to the 2000 employee options based on an allegation that the board failed to exercise any business judgment. The scope of allowable discovery, of course, is tied to the issues presented in the litigation. An *ultra vires* claim is a narrow endeavor focusing on the governing documents and the grants of the options. Wide-ranging discovery that goes beyond that necessary to address an *ultra vires* claim would serve no useful purpose. Similarly, where the board's decision as to the 2000 employee options is questioned because of an alleged failure to exercise any business judgment, the inquiry must focus on those facts which are related to that issue. That might include, for example, what information was available to the board, what information did it consider, what guidance from experts did it receive, and what process was followed. CalPERS certainly is entitled to discovery with respect to options repricing, including, but not

⁶ *Cal. Pub. Employees' Ret. Sys. v. Coulter*, 2002 WL 31888343 (Del. Ch. Dec. 18, 2002).

necessarily limited to, the factors identified. However, the currently pending requests are far too broad and far too burdensome. Thus, CalPERS' motion to compel as to these issues is denied, but it may propound more focused discovery aimed at eliciting information pertaining to the surviving option claims.

2. Request No. 4 – Purchase of CEI

Mr. Coulter's sale of CEI to Lone Star appears to be the most fact-intensive claim remaining. Accordingly, there are several disputes regarding discovery as to CEI's valuation and Lone Star's acquisition of it.

I start with the squabble regarding the scope of reasonable discovery requests and the scope of reasonable discovery responses. CalPERS seeks, for example, in Request No. 4, “[a]ll documents referring or relating to Lone Star's purchase of CEI in the fall of 1998.”

Defendants have provided documents in response but have limited the production to those documents which the Defendants have deemed relevant to CalPERS' fiduciary duty allegations. CalPERS, in turn, responds that its discovery cannot be limited to those documents which the Individual Defendants “understand to bear a reasonable relationship” to the claims it now asserts. A request to produce every document touching upon a complex transaction strains the limits of reasonableness. Yet, it is difficult to

minimize the importance of the CEI acquisition in the context of this proceeding. In order to assess fairly the limitations which the Defendants seek to place on their duty to produce documents relating to the CEI transaction, they first must describe or categorize the documents which they seek to withhold. Given the breadth of discovery and the clear relevance of the CEI transaction to this matter, it is Defendants' obligation to demonstrate why certain classes of documents should not be produced.

3. Request No. 7 – ADP Proposal

The fairness opinion supporting acquisition of CEI relied in part upon a bid submitted by ADP to perform services similar to those of CEI. Defendants do not resist CalPERS' inquiry with respect to any ADP proposal prior to consummation of the CEI transaction. They do, however, seek to limit the responses to the date of the CEI transaction. Evidence of subsequent ADP proposals for similar services may provide a basis for evaluating – albeit with the benefit of hindsight – the reasonableness of the proposal. It may not be a particularly revealing inquiry, but, at this time, it cannot be precluded. If certain Individual Defendants have no knowledge of the ADP proposal, then they should set that forth directly.

4. Interrogatory No. 9 – ADP

If various Individual Defendants have information responsive to this inquiry (knowledge about ADP proposals), they should provide it within the temporal limits addressed with respect to Request No. 7. Perhaps some of the Individual Defendants do not have knowledge; but, if they do, then that knowledge must be shared.

5. Interrogatory No. 7 – Board Documents

This interrogatory asks that the Defendants identify the documents reviewed by the board as part of the process of making its decision regarding the acquisition of CEI. If this has not been done, CalPERS is entitled to the identification of the documents considered.

6. Request Nos. 34 and 35 – Adams Proxy Contest, etc.

These requests seek documents relating to the Guy Adams proxy contest and a shareholder proposal presented by CalPERS. Defendants respond that all nonprivileged documents have been provided. If not already provided, Defendants are to develop and supply a privilege log.

7. Request No. 23, etc. – TENT

Request No. 23 asks for “all documents referring or relating to TENT [Total Entertainment Restaurant Corp.].” CalPERS’ claims, as alleged in its Complaint, directly

targeting TENT were dismissed. The underlying allegations retain some relevance because the benefits of the TENT transaction may have influenced certain directors to view Mr. Coulter more favorably. Thus, CalPERS' request, as framed, is far too broad and burdensome. A more carefully tailored inquiry may be pursued with respect to the TENT matter. This is also the appropriate approach for those other matters about which CalPERS has complained but which it is not directly challenging in this action.

8. Interrogatory No. 5 and Request No. 50 – Olshan Grundman's Fees

By Interrogatory No. 5 and Request No. 50, CalPERS seeks information relating to payment of fees by Lone Star, CEI and the Individual Defendants to Olshan Grundman, a partner of which is alleged to have been a long-standing associate of Defendant Coulter.

CalPERS summarizes its allegations regarding Olshan Grundman as follows:

Steven Wolosky, Esq., as a named partner in Olshan Grundman, is a central figure in this case. Mr. Wolosky was a long-time associate of Jamie Coulter, who has been instrumental in Lone Star's affairs and particularly in the acquisition of CEI. Not only did Wolosky represent Coulter's personal interests, but he purported to represent the Company and the Special Committee in the transaction as well. Wolosky advised the Board *not* to retain independent counsel to represent the Company in connection with the CEI deal because he – and Coulter – had already drafted a sale agreement for the Board to approve.⁷

⁷ Mem. in Supp. of Pls.' Mot. to Compel at 12 (citing Am. Compl. ¶¶ 50, 52).

Defendants, through Mr. Wolosky's affidavit, assert that, as a factual matter, Olshan Grundman did not represent either CEI or Mr. Coulter in the CEI transaction. However, for present purposes, I must assess the appropriateness of discovery in the context of the specific allegations of the Amended Complaint, drafted by CalPERS' counsel, subject *inter alia* to the standards of Court of Chancery Rule 11, that the firm had multiple roles in the CEI transaction, which lies at the core of the litigation as presently constituted. Discovery cannot be avoided merely by filing an affidavit to the effect that the other side has its facts wrong, particularly where the discovery sought may reveal what those facts are.

Thus, in general, CalPERS' request is calculated to lead to the discovery of admissible evidence. The discovery request, as drafted, however, is unduly broad. First, it seeks information about legal fees charged through the date of the filing of this action. No reason exists for gaining access to Olshan Grundman's fees after the filing of this action and Defendants' discovery responses may be limited accordingly. Second, the current status of this proceeding does not support a general review of Olshan Grundman's fees. Thus, the description of the firm's efforts may be redacted except to the extent that they involve CEI or any work performed related to the CEI acquisition. Third, discovery

of a lawyer's invoices may implicate the attorney-client privilege. A detailed review of legal bills, of course, can provide fascinating insights into the conduct of lawyer and client, and it can also give a careful and experienced reader an understanding of the strategies employed by counsel for the benefit of the client. To accommodate any assertion of privilege, the invoices may be redacted to delete those portions which reflect the thought processes of counsel, but the bills may not be redacted in such a fashion as to deprive the reader of knowledge that the time entries involved CEI or work related to CEI, including Lone Star's acquisition of CEI.

9. Interrogatory No. 14, etc. – Other Related Party Transactions

CalPERS is entitled to inquire into the financial relationships between Defendant Coulter and the other Individual Defendants. After all, these other interests are, as alleged by CalPERS, the basis for its contention that the various directors were not independent. However, the scope of CalPERS' request again is so broad as to be unduly burdensome. A more narrowly focused set of discovery requests may properly inquire into these circumstances.

The Individual Defendants initially placed their personal financial conditions in play by arguing in support of their motions to dismiss that the various matters were not material in the context of their personal finances. If they intend to continue to make such

arguments, then inquiry into their personal finances by CalPERS is both appropriate and necessary. If they now concede that the transactions should be considered material, then CalPERS need not address this issue during discovery. Accordingly, the Individual Defendants must confirm promptly whether or not they intend to assert that the transactions were not material to them in light of their individual financial conditions.⁸

10. Request No. 17, etc. – Stock Repurchases

CalPERS' entrenchment claim, as described in its pleadings, depends upon the change in control provisions adopted in early 2000. These requests, however, are addressed to stock repurchase programs in 1998 and 1999. The Individual Defendants contend that CalPERS, except for a general argument regarding course of conduct, has not demonstrated why these earlier events are "directly connected and relevant" to the existing entrenchment claim.⁹ The stock repurchase programs were implemented only shortly before the change in control provision was adopted. Thus, both subject matter and temporal linkages appear to exist, and a bar to discovery regarding these programs is

⁸ CalPERS has offered no cognizable basis for inquiring into Defendant Coulter's personal financial status.

⁹ See *In re Fuqua Indus., Inc. S'holders Litig.*, 1999 WL 959182, at *4 (Del. Ch. Sept. 17, 1999).

not appropriate. Such discovery, however, must be more focused than the overly broad formulation adopted by CalPERS.

B. Defendants' Cross-Motion to Compel

Certain Defendants have moved to compel CalPERS to provide documents which they contend will assist in the determination of whether CalPERS is an appropriate representative plaintiff for the derivative claims asserted in this action and an appropriate class representative for the class claims asserted in this action. CalPERS does not dispute that its ability to serve as a representative plaintiff is an appropriate subject of discovery; the parties do join issue as to the appropriate scope of such discovery.

The proper scope of discovery into the adequacy of a putative class representative or derivative plaintiff is framed generally by the nature of the inquiry. The class plaintiff must, of course, satisfy the Court of Chancery Rule 23 requirements of having claims typical of those of the class and having the capacity fairly and adequately to protect the interests of the class. Among topics that may require consideration in assessing the adequacy of a representative plaintiff are when did the plaintiff acquire stock in the nominal defendant and whether it has held an equity position continuously since then; whether the plaintiff has some sort of personal agenda unrelated to either the claims raised in the proceedings or the best interests of the nominal defendant and its

shareholders; and whether the plaintiff may be subject to any defenses not applicable to shareholders in general.

The documents which the Defendants have requested may be broken into four categories.

1. CalPERS' Ownership of Lone Star Stock

By Request No. 21, Defendants seek production of all documents relating or referring to "CalPERS' ownership, purchase or sale of or investment in any Lone Star stock, including . . . any Lone Star stock owned, purchased, sold, or invested in by any director, officer, manager, or agent of CalPERS."¹⁰ Defendants first argue that they are entitled to CalPERS ownership and investment history with respect to Lone Star stock in order to determine whether CalPERS held stock as of the first event upon which the Amended Complaint is based and has held stock continuously since then. CalPERS, of course, must provide sufficient documentation to demonstrate its standing as a shareholder. CalPERS represents that it has provided that information and, thus, argues that this aspect of the motion to compel is moot. The current problem appears to be one of interpreting the documents provided by CalPERS. Counsel shall confer and determine

¹⁰ Request No. 22 seeks substantially the same information regarding stock funds.

what additional supporting documentation is necessary to interpret the documents provided. Following receipt of that material, Defendants may renew their application if they remain without adequate documentation for this purpose.

Defendants next argue that the history of CalPERS' investment in Lone Star may bring into question the good faith of CalPERS' allegations regarding the alleged breaches of fiduciary duty. If, Defendants argue, CalPERS truly believed that Defendants were mismanaging Lone Star, it would not have continued to invest in the company. I am not persuaded that the production of these documents could lead to the discovery of any admissible (or relevant) evidence. Investment decisions are made for many reasons. Even if CalPERS believed that Lone Star had good prospects and, thus, was an appropriate investment, it would not follow (or would not tend to support the proposition) that wrongdoing was not occurring. It may be, for example, that the business has such a bright future that, even with suspect management whose deficiencies might be corrected, the company was a good investment. Moreover, CalPERS' investments appear to have been the function of an index approach that would not have involved a separate analysis of Lone Star's investment appeal.

In addition, the investment decisions made by directors, employees, and agents of CalPERS are so remote from any of those issues which might arise during an evaluation

of whether CalPERS is an appropriate representative plaintiff that Defendants' inquiry fails to meet the relatively low threshold for proper discovery and unnecessarily invades the privacy of the individuals associated with CalPERS. Thus, except for those documents which are necessary to demonstrate continuous ownership of Lone Star stock throughout the applicable period, Defendants' motion to compel with respect to Request Nos. 21 and 22 is denied.

2. CalPERS' Litigation History

Request Nos. 35 and 36 seek documents relating or referring to all litigation in which CalPERS has been a plaintiff or a defendant since January 1995. In addition, Request No. 37 requests documents relating to any claims asserted against any member of CalPERS' board since January 1995. The Defendants have subsequently limited their request to litigation involving corporate governance and control issues; that is, they concede that they have no legitimate cause for production of documents involving litigation relating to employment claims, personal injury claims, or the like. Inquiry into a representative plaintiff's litigation history has been characterized, without some showing of wrongdoing as a party in a case unrelated to the pending case, as a "whim [in

which the Defendants hope] that they may stumble upon something that would disqualify [the putative representative plaintiff].”¹¹

I am satisfied that Defendants’ requests are overly broad and unduly burdensome. Even when restricted to corporate governance litigation, the Defendants’ requests would, on their face, require what would amount to the production of entire litigation and ancillary files. Absent some additional showing as to why other documents would be appropriate, I will deny Defendants’ motions to compel with respect to Request Nos. 35 and 36, except that I will direct CalPERS to provide to Defendants a list of all litigation in which it has been involved since January 1, 1995, and which relates to corporate governance matters. This, of course, would include any derivative actions and any class actions brought on behalf of shareholders. As to Request No. 37, Defendants have made no showing of any purpose that might be served by requiring production of documents involving claims regarding members of CalPERS’ board. Thus, with respect to Request No. 37, Defendants’ motion to compel is denied.

¹¹ *In re Dairy Mart Convenience Stores, Inc.*, 1997 WL 732467, at *4 (Del. Ch. Nov. 13, 1997).

3. Corporate Governance Documents

Request Nos. 38 and 39 seek documents constituting or referring to communications between CalPERS and officers or stockholders of any public company where the communications involved corporate governance or corporate financial performance matters. Request Nos. 42-46 seek documents regarding CalPERS' corporate governance and financial performance matters.

CalPERS' pleadings tout its prominent role in corporate governance matters. This, Defendants argue, justifies a broad ranging inquiry into all of CalPERS' communications regarding corporate governance with any public company or its shareholders, as well as CalPERS' own internal governance practices. Defendants rely upon the fundamental precept that documents relating to a complaint's allegations are appropriate for discovery.

Ordinarily, where a plaintiff makes allegations, even if they are self-congratulatory, in its complaint, it has subjected itself to the burdens of discovery with respect to those allegations. Ordinarily, the simple answer is: if the party wanted to avoid discovery into those matters, it should not have made such allegations. Notwithstanding those general principles, I deny Defendants' cross-motion to compel as to Request Nos. 38-39 and 42-46. First, they are so broad as to be unduly burdensome. Second,

implicit in Defendants' argument is the notion that CalPERS (or any other entity that takes a strong position in the ongoing national debate about corporate governance) would necessarily be precluded from acting as a representative plaintiff because it suffers from some sort of split motivation or because its litigation constitutes an effort to "extort" corporate governance "reforms" as a price of reaching a resolution of the litigation.¹²

Third, I am not persuaded that allowing the broad scope of discovery sought by Defendants would carry any potential for the eventual uncovering of admissible evidence.

Despite their claims of CalPERS' "ulterior motives," Defendants have been unable to set forth what those motives may be, except for CalPERS' interest in corporate governance.

Defendants have provided no basis for concern that these interests, to the extent that they may motivate CalPERS in this proceeding, will cause CalPERS to take positions adverse

to the interests of the nominal defendant or its other shareholders. If Defendants have a basis for their belief that CalPERS' posture on corporate governance matters is pertinent to the inquiry into CalPERS' ability to function as a representative plaintiff, then that

¹² Similarly, Defendants assert that CalPERS, through this litigation and similar litigation, may be seeking to "intimidate" other public companies to adopt the corporate governance practices advocated by CalPERS.

information can be garnered through a discovery effort that is both more focused and less burdensome than the one which Defendants have pursued.¹³

4. Timing of the Filing of the Complaint

Through Request No. 47, the Defendants seek, *inter alia*, all documents which refer to the reasons why CalPERS did not file its original complaint in this action until October 2000. Defendants argue that these documents are relevant to its time-bar defenses. CalPERS asserts that there are no non-privileged documents that would be responsive to this request. There is no purpose here for ordering the production of that which does not exist, but CalPERS does need to supply a privilege log.

C. *CalPERS' Motion to Amend*

CalPERS seeks to add to its Complaint allegations (i) in the nature of usurpation of corporate opportunity involving the TENT transaction and (ii) relating to the Board's actions after the filing of this action in furtherance of, as CalPERS describes them, its entrenchment efforts. The first set of allegations properly is viewed as an amendment of the pleadings under Court of Chancery Rule 15(a); the second set of allegations involving

¹³ Defendants have failed to show how inquiry into CalPERS' internal management practices should be deemed to require the assistance of the Court. A pole, some line, and a little bait should suffice.

actions occurring after commencement of this proceeding is properly viewed as a supplementation of CalPERS' pleading under Court of Chancery Rule 15(d). Under Court of Chancery Rule 15(a), "leave [to amend] shall be freely given when justice so requires." Court of Chancery Rule 15(d) contains no similar instruction to the trial judge.

Significantly, the proposed new complaint, whether amended or supplemented, sets forth no new claims.¹⁴ In general, the allegations regarding the TENT transaction, if true, would serve to question the independence of the Board and the allegations regarding entrenchment, if true, would serve to show a continuing pattern on the part of the Board and the consequences of its previous entrenchment efforts.

The nature of the additional allegations avoids direct application of familiar principles employed to assess motions to amend. For example, futility analysis is not possible because there are no new claims to measure. Considerations of prejudice are not easily evaluated because factual allegations that do not directly add to a substantive allegation can hardly be prejudicial (other than possibly expanding the scope of discovery unnecessarily).¹⁵

¹⁴ One assumes that no new claim was brought because, by the time of the post-complaint conduct, a majority of the board was independent.

¹⁵ A ruling on a motion to amend (or supplement) is not the best platform for anticipating discovery disputes. It would, perhaps, be naïve not to foresee discovery problems, but

In these unique circumstances, I have turned to Court of Chancery Rule 8(a) which teaches that a complaint is to contain, *inter alia*, “a short and plain statement of the claim showing that the pleader is entitled to relief.” I will not dwell on whether our pleadings can satisfy the goal of being “short and plain,” but I, nevertheless, will focus on the purpose of articulating a “statement of the claim.” The allegations which CalPERS now seeks to incorporate into its pleadings add nothing to define more clearly the existing claims in the Complaint. The Complaint already alleges that the Board was dominated by Mr. Coulter, in part, because he had conferred financial benefits upon them. In addition, the events occurring after the filing of this action involved a board with a substantially different composition from the one that engaged in the conduct challenged in this action.

On the other hand, one cannot, at this stage of the proceedings, say that the additional allegations are irrelevant. Indeed, the factual allegations, if proved, may well inform the resolution of the existing claims. For example, they may demonstrate the consequences of the pre-litigation board’s “entrenchment” actions. Perhaps the additional allegations will serve no useful purpose, but that outcome cannot be predicted

they are best addressed within the framework established by the Rules for resolving discovery disputes.

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at this time. In light of the general policy favoring a party's right to revise its pleadings to set forth fairly the grounds for its claims, CalPERS' motion to amend will be granted.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC