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Lessons Learned: Martin Marietta Materials vs. Vulcan Materials

By Derek Stoldt and Joel I. Greenberg, Partners of Kaye Scholer LLP

As explained in the next article, the Delaware Court of Chancery recently issued a lengthy and detailed opinion in *Martin Marietta Materials, Inc. v. Vulcan Materials Company,* a case that primarily deals with contractual confidentiality obligations. There are several important lessons to be learned from this decision:

- ***Contractual Prohibitions on Unsolicited Acquisition Proposals are Enforceable***

  The Court rejected the argument that the interests of Vulcan's stockholders required that they not be denied the opportunity to consider and accept Martin Marietta's offer, recognizing that public companies would be less likely to engage in discussion of potential business combinations if "confidentiality and other agreements that control the downside risks of such engagement will not be respected." Although this case involved the remedy for breach of a confidentiality agreement that did not contain a standstill, the Court's reasoning clearly signals that it would be willing to enforce an express standstill agreement.

- ***The Words Matter; Choose them Carefully***

  This case reads as a lecture from Chancellor Strine on the importance of choosing each word in a confidentiality agreement (and any agreement for that matter) very carefully; small variations can have major consequences.

- ***Permitted Uses of Confidential Information***

  The Court found that limiting the use of confidential information to evaluating a "possible business combination between" the parties was ambiguous and accordingly considered external evidence in determining whether it could be used to evaluate a hostile offer. Adding one word and limiting use to evaluating a "possible negotiated business combination between the parties"—the approach suggested by a ABA model merger agreement cited by the Court—would have eliminated the ambiguity and clearly prohibited use of the information for a hostile offer.

  In contrast, an agreement that limited use to evaluating "a possible transaction involving the parties" would appear to permit the use of the information for a hostile offer.

TABLE OF CONTENTS

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- ***The Legal Requirements Exception: External Demands?***

  Chancellor Strine recognized two possible standards under which otherwise prohibited disclosures would be permitted because of legal compulsion—one limited to disclosures that were required by what the Court termed an "External Demand" ("oral questions, interrogatories, requests of information or documents in legal proceedings, subpoena, civil investigative demand or similar process") and the other including both External Demands and generally applicable legal requirements such as the federal securities laws. The parties are free to choose which standard will apply if they do so clearly.

  Chancellor Strine observed that many confidentiality agreements, including the agreement at issue in this case, are less clear about the standard that applies to confidential deal information (e.g., the fact that discussions have taken place) than they are about the standard that applies to confidential business information (e.g., customer lists, cost and pricing data). It may also be advisable for parties to specifically address the treatment of legal requirements caused by the voluntarily action of the party receiving the information, such as disclosure requirements triggered by the registration of securities or launch of a tender offer.

- ***Beware of Other Implied Restrictions***

  While the implied remedy in this case was a standstill, it is not difficult to imagine a situation in which a court would rely on non-use provisions to imply a non-compete agreement, non-solicitation of employees, customers or vendors, or other similar restrictive covenant. It is critical for the parties to make their intentions with respect to these issues clear.

- ***Consider Informational Firewalls and Taking Only the Information You Need***

  The Court would not have enjoined the offer for breach of the non-use restriction if it had not made a finding that Martin Marietta had used Vulcan's confidential information to make its offer. A party that wants to preserve its freedom to make a hostile offer should consider requesting and accepting only the minimum amount of information necessary while discussions between the parties are proceeding and limiting access to that information to personnel who could be excluded from involvement in the consideration of any hostile offer—an approach that may not be practical.

Delaware Chancery Enjoins Hostile Bid Based on Confidentiality Agreement Breach

By J.D. Weinberg and Andrew Lutes, a Partner and Associate of Covington & Burling LLP

On May 4, after a full trial, Chancellor Strine of the Delaware Court of Chancery issued a lengthy and detailed opinion in Martin Marietta Materials, Inc. v. Vulcan Materials Company, granting a four month injunction halting Martin Marietta's hostile bid against Vulcan Materials. Strine held that, in spite of the lack of an express agreement prohibiting a hostile bid—a so-called standstill agreement—Martin Marietta violated its contractual confidentiality obligations with Vulcan by going hostile when merger talks fizzled. The opinion contains a detailed analysis of language commonly used in confidentiality agreements and provides useful drafting guidance to practitioners.

Background

In December 2011, Martin Marietta made an unsolicited exchange offer for rival Vulcan Materials and commenced a proxy contest to replace the directors currently up for re-election on Vulcan's staggered board. These actions followed failed discussions regarding a possible business combination. During those discussions, the companies exchanged confidential information pursuant to a customary non-disclosure agreement (the "NDA") and, for antitrust-related information, a joint defense agreement (the "JDA"). Neither agreement contained a standstill provision expressly barring an unsolicited public takeover proposal, and the court found that at no time in the process of drafting the confidentiality agreements did the companies even discuss the inclusion of a standstill. Both agreements are expressly governed by Delaware law.

In the litigation over the confidentiality agreements that immediately ensued, Vulcan argued that Martin Marietta breached the agreements by (i) using confidential information obtained from Vulcan in formulating and planning Martin Marietta's bid and (ii) publicly disclosing, including in Martin Marietta's SEC filings made in connection with the exchange offer and proxy contest, both confidential information obtained from Vulcan and confidential "transaction information"—e.g., that the parties had merger discussions and shared information. Martin Marietta claimed that it did not use confidential information in formulating the bid, that the lack of a standstill provision showed that the agreements did not preclude a hostile bid and that its disclosures to the SEC were permitted under the agreements under an express exception allowing for "legally required" disclosures.

Strine concluded that the evidence revealed that Martin Marietta did use confidential information obtained in merger discussions in forming its hostile bid. The Chancellor found several instances of material information that Martin Marietta used that could only have obtained from the merger talks—most notably, elements of the potential synergies that were expected to arise from the combination and the companies' joint antitrust analysis. Strine also found that the efforts that Martin Marietta made to cabin off information it received pursuant to the confidentiality agreements fell short and were probably impractical in any event.

Interpreting the Agreements

Vulcan argued that Martin Marietta breached the confidentiality agreements in four key ways:

- Martin Marietta could not use the confidential information—the "evaluation material"—in the aid of a hostile offer because the confidentiality agreement expressly limited the use of such information for a *business combination transaction between* the parties, which Vulcan argued meant only a consensual transaction.
- Vulcan could not publicly disclose the companies' merger discussions—the "transaction information"—because the express exception for "legally required" disclosure in the confidentiality agreements only applied to "external demands", as Strine labeled them.
- Even if Vulcan was permitted to disclose information pursuant to the "legally required" exception, Martin Marietta went well beyond what was required in its SEC filings.
- In any event, through its "push pieces", investor calls and interactions with journalists, Martin Marietta went beyond any conceivable view of a legal requirements exception, even if such information was contained in the SEC disclosures filed by it.

Business Combination Between the Parties. With respect to Martin Marietta's claim that its use of the confidential information was permissible because a merger effected through hostile exchange constituted a "business combination transaction" that would be "between" the parties, Strine could not conclude that the phrase was unambiguous on its face, though he listed several textual arguments in favor of Vulcan's position that a hostile exchange was not "between" the parties.

Accordingly, Strine looked to extrinsic evidence of intent. He emphasized that when the NDA and JDA were negotiated, Martin Marietta was the party pushing for stronger confidentiality protections, fearing that it itself would be the subject of a hostile takeover attempt by Vulcan or a third party. Indeed, the language requiring that the transaction be "between" the parties was a change made by Martin Marietta's general counsel during drafting; without that change, the proposed draft would have covered transactions "involving" the parties, a broader standard according to Strine and, seemingly, to Martin Marietta. As market conditions changed and Martin Marietta began to consider going hostile, it itself behaved as if the NDA and JDA prohibited a bid. Notably, a draft press release explicitly prepared by Martin Marietta stated that it was keeping its bid confidential because of the NDA. Strine also looked at industry practice with respect to confidentiality agreements, citing treatises advising generally that, in the absence of an explicit standstill, confidentiality agreements can create a "functional" standstill by narrowly defining the permitted use of information.

Interestingly, Strine noted that Martin Marietta's counsel, who drafted the "between the parties" language, must have been aware of the Ontario case of *RIM v. Certicom*, a widely-publicized case recently decided at the time of the drafting of the NDA. In *Certicom*, the Ontario court enjoined a hostile offer, based on a finding that it was made in breach of a confidentiality agreement without a standstill, focusing, similarly, on the notion that a hostile bid could not constitute a business combination "*between*" the parties.

Legal Requirements Exception. Chancellor Strine rejected Martin Marietta's contention that its SEC disclosures were allowable under exceptions permitting disclosure when "legally required". First, Strine conducted a textual analysis of the exceptions in question to find that the definition of a legal requirement was narrowed by its express terms to an externally driven legal requirement such as a subpoena or CID—an "external demand" as Strine called it. As such, Strine rejected Martin Marietta's argument that the disclosures were legally required, characterizing the purported legal requirements as being triggered solely by an entirely voluntary solicitation by Martin Marietta. Strine also noted that Martin Marietta continued to disclose information outside of the SEC context, and he could find no basis to hold that initial disclosure to the SEC created any right to "open the floodgates" and make these further disclosures, even where they were disclosures already made in Martin Marietta's SEC filings.

Extent of Disclosure. Finally, Strine noted that the disclosures made in the SEC filings went far beyond those required by law (as is customary in hostile bids), including by disclosing cherry-picked facts designed to make Martin Marietta's bid look more attractive and Vulcan look worse. Strine also held that the evidence showed that Martin Marietta failed to comply with the procedural obligations tied to the legal requirements provisions, which would have required notice and vetting by Vulcan prior to disclosure being made.

The Injunction

In fashioning a remedy, Chancellor Strine noted that the parties expressly agreed in the NDA and JDA that money damages would not be a sufficient remedy for breach and that the non-breaching party should be entitled to an injunction. Strine cited Delaware law's strongly pro-contractarian public policy, generally respecting parties' bargained-for agreements to injunctive relief in contracts. While Strine admitted some difficulty in determining whether an injunction would do more harm than good, he concluded that the value of upholding confidentiality obligations in the M&A context, for the sake of protecting future arrangements inducing the sharing of sensitive information and the benefits that flow therefrom by facilitating transactions, outweighed any perceived harm.

Having decided on an injunction, Strine turned to the issue of its length. Because there had been four months remaining on the confidentiality obligations under the NDA at the time of the December bid, Strine issued an injunction of four months—the "temporally reasonable" period sought by Vulcan, tailored to the amount of time Martin Marietta should have been precluded from making its hostile bid. The JDA, which was also breached, had no expiration date. Notably, the four-month injunction period carries past the scheduled date of the board election with respect to which Martin Marietta was waging its proxy contest. Further, the injunction was issued the day after the expiration of the NDA, which some observers speculated would be used as an excuse for the court to avoid issuing an injunction.

Conclusion

The opinion left open one important question that many would have liked answered. Strine expressly declined to address what he noted to be an "interesting ...[and] plausible argument" — that a backdoor standstill obligation might be imposed in a confidentiality agreement that contained a "legal requirements" exception not narrowly limited to responses to "external demands." Under that argument, a broader legal requirements disclosure exception in a confidentiality agreement could be unavailable when triggered by the bidder's voluntary action, such as a hostile tender offer requiring SEC disclosure. In a footnote, Strine cited Vulcan's pre-trial brief, where it cited "Corbin on Contracts for the proposition that doctrine that 'a legal prohibition preventing performance is not a defense if the situation leading to the prohibition is attributable to the acts of the party asserting the defense.'"

In dealing with confidentiality agreements, practitioners are often faced with many of the interpretive questions addressed in *Martin Marietta*, which appears to be the first significant Delaware case to tackle them in a detailed fashion. In Strine's review of the relevant treatises and model agreements, he found a lack of consistency and precision, underscoring the need for careful drafting in preparing an essential document that can sometimes be overlooked as mere boilerplate. Strine ended his opinion with an admonishment to any future Martin Mariettas: "transactional lawyers are advised that restricting the scope of legally required disclosures to those that arise in the context of some sort of discovery obligation or affirmative legal process may have the effect of creating a backdoor standstill restriction." Sometimes, boilerplate matters.

The JOBS Act: Implications for Private Company Acquisitions and M&A Professionals

By Mischa Travers, a Partner of Davis Polk & Wardwell LLP

On April 5, President Obama signed into law the Jumpstart Our Business Startups Act (the "JOBS Act"), which as has been widely noted significantly loosens restrictions around the IPO process and post-IPO reporting obligations. While most of the commentary on this legislation has focused on its impact on capital markets matters, there are implications for private company mergers and acquisitions as well.

Late-stage private companies contemplating an M&A or IPO exit often undertake so-called "dual-track" processes in which they simultaneously file an IPO registration statement with the SEC and hold discussions with prospective acquirors. The IPO side of the process effectively becomes a stalking horse for M&A discussions and may motivate prospective acquirors that might otherwise not move as quickly as the target would like. The publicly filed registration statement serves as a marketing vehicle that both attracts attention and provides prospective acquirors with a sort of first-stage diligence that theoretically helps encourage bids.

Under the JOBS Act, emerging growth companies or "EGCs" now have the ability to submit IPO registration statements confidentially, so long as the confidential drafts are ultimately released at least 21 days before the road show. Confidential submissions have quickly become the norm since the passage of the Act, including for some issuers who were in the midst of the traditional public registration process when the Act became effective.

In effect, most companies are making the judgment that the competitive and other advantages of keeping early drafts of registration statements confidential outweigh the publicity and employee-related benefits of the traditional IPO process. The occasional exceptions will likely be companies that want to maximize the value of the process as a branding event that assures prospective customers of the organization's stability and a recruiting opportunity in which prospective employees have one last chance to receive pre-IPO equity. For those issuers, a hybrid approach is possible in which the issuer submits registration statements confidentially but uses a Rule 135-compliant press release to announce the intended offering. For everyone else, the optionality that confidential submissions create may be hard to resist: A company that submits confidentially and does not announce it's going public can now pull its deal without the stigma associated with withdrawing a publicly filed registration statement.

The ability to submit confidentially creates another sort of optionality for a company undertaking a dual-track process, in that it can now conduct both sides of the process outside the public eye. A buyer that thought it was participating in a standalone M&A process may now find out that it is competing not only with other buyers but with a credible IPO as well. The fact that a draft registration statement is confidential does not prevent a target from providing it to prospective buyers (or for that matter anyone else), which opens up the possibility of surprising a buyer with a registration statement that has already been through multiple rounds of SEC review. Used judiciously, this sort of tactic could potentially be a powerful tool both for price negotiations and in controlling the pace at which buyers move forward, which is often one of the most challenging aspects of dual-track processes.

For prospective buyers of private companies that are plausible IPO candidates, it may be worth asking a few questions about IPO registration status to reduce the chance of these sorts of surprises. Targets would be well-advised to remember that these tactics will generally work only once per buyer, if that, and that the optimal number of surprises to deploy in many M&A processes will be zero.

Before selecting the confidential submissions approach, dual-track targets should also consider that there may be advantages to making their IPO filings fully visible, including the possibility of attracting bidders that might not otherwise have been aware of the company and facilitating the process by making their diligence easier. For a dual-track candidate there will likely be a bit of strategy in this decision and much will depend on the universe of prospective buyers. As practice evolves, the relative frequency of confidential versus non-confidential IPO processes may also be important in the sense that if confidential processes continue to be the norm, a non-confidential filing may come to be seen as signaling a dual-track process.

Although most companies that use the confidential approach will probably shift to public filings at the point when the SEC review process is finished or nearly finished, they can always do so earlier if they choose. Generally there will be no benefit to doing that, but a dual-track candidate that wishes to communicate to prospective buyers that it's close to going public may perceive an advantage in switching to public filings. A registration statement that has been through multiple drafts will tend to suggest to prospective buyers that the company is close to going on the road and is filing publicly to start the 21-day clock, regardless of the company's actual intent. As a result, dual-track candidates should think carefully about when they switch to public filings as doing so may set expectations that a road show is soon to follow. If for whatever reason one does not, prospective buyers may take the view that the company's bluff has been called and conduct themselves accordingly.

Lastly, the relaxation of restrictions on "test the waters" pre-marketing has implications for private targets regardless of whether they undertake a dual-track process or a standalone M&A process. The JOBS Act permits EGCs and their financial advisers to meet with qualified institutional buyers and institutional accredited investors to gauge interest in their securities, which theoretically creates an additional avenue for conducting a market check for a company that has an acquisition offer in hand – or for that matter, even one in the midst of price negotiations.

After the JOBS Act: The Increased Need for Common Sense

By Vince Pisano, Partner of Troutman Sanders LLP

Now that every law firm in America has sent out it's memo summarizing the provisions of the JOBS Act, it is time to implore all lawyers who advise investment banks and bankers to strive to slow down the race to the bottom. Congressional interference in the details of what constitutes proper disclosure does not change the need to exercise sound, independent professional judgment on the adequacy of disclosure in registration statements and prospectuses.

As we know, the JOBS Act provides, among many other things, that emerging growth companies, those with annual gross revenues in their last fiscal year of less than $1 billion, need disclose only two years of audited financial information instead of three years and need not disclose selected financial information in their annual or quarterly reports for prior years. The SEC has advised that in light of those requirements, selected financial information for years prior to those audited will not be required in registration statements either.

Prior to the JOBS Act, rules and regulations of the SEC required disclosure of three years of audited financial information and five years of selected financial information. Rule 144A offering memoranda—in a disclosure "requirement" determined by lawyers and investment bankers—generally include three years of audited financials and five years of selected financial data.

Why? There are those who believe that a financial history actually discloses important information about trends in a business. That a management's discussion and analysis comparing only the two most recent fiscal years might not be enough. We've believed that significant enough that in offerings for newer companies we have included a risk factor that indicates that one of the risks to an investor is that the issuer has not been in business for a long enough period to evaluate trends or for the issuer to have experienced different economic environments and competitive challenges. Congress and the President have decided that older information is not automatically material and the savings to issuers offset increased risks to investors because those savings will bring more issuers to market and somehow create more jobs. It is likely that all those premises are incorrect.

The SEC has long informed the legal profession that we are the gatekeepers to securities law compliance and therefore a fair and efficient market. We are generally drafters of registration statements and we issue 10b-5 letters, without which initial public offerings will not close, indicating that no facts have come to our attention that lead us to believe that the registration statement or prospectus contains an untrue of a material fact or omits to state a material fact required to make the information contained therein not misleading.

We of course carve out the registration statements because those are expertised and we are unqualified to opine on them. That carve out, however, only relates to the contents of registration statements. Whether or not additional financial information should be contained in a registration statement is a matter of professional judgment.

In thirty-five years of practice, there have been numerous instances where underwriters have required more information that demanded by the SEC for the purpose of adequately informing investors on the history and prospects of an issuer. Five years history can demonstrate steady growth, or incrementally significant growth. It can also demonstrate, however, false starts, significant problems and inability to react to economic or competitive pressures.

Until now, we as securities lawyers did not need to fight our clients on disclosure of those negative events because the disclosure was explicitly required. Who else is going to fight for that disclosure now—disclosure that the SEC may or may not continue to believe is material and which, as the agency empowered to oversee disclosure, was overruled by Congress?

There was a period when investment banks' engagement letters for private equity financing actually had as a condition of funding that there not be a material adverse change in the target companies' financial condition or results of operations or general credit worthiness. Loan documents contained significant covenants, designed to protect lenders and investors, that were drafted and in part negotiated by lawyers. Over time, the conventional belief that a lender cannot continue to lend to a borrower who at the time of lending is a serious credit risk and that those covenants are necessary to protect the lenders and investors were drowned out by competitive pressures and the rewards associated with sponsor financing.

That at least was a business decision. The question of what should be included in or omitted from a registration statement cannot be decided by Congress. There is no safe harbor built into the JOBS Act. Historical financial information is likely to continue to be relevant, audited or not. Disclosure discipline will have to come from the lawyers and our banking clients and if not, characterizing our 10b-5 letters as negative assurance letters and not opinions will be irrelevant.

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6. "Getting the Vote In: The Proxy Solicitors Speak"
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Groping for Gold: $305 Million in Plaintiff Attorney Fee Awards Under *Grupo México*

By Ralph Ferrara, Noelle Francis and Rosanna Neil of Dewey & LeBoeuf LLP*

Given that M&A litigation is one of the hottest deal topics right now, the latest developments in plaintiff attorney fee awards in such cases are worth noting. Last year, on December 20, 2011, the Delaware Court of Chancery awarded plaintiff's counsel a staggering $305 million in fees for counsel's work in bringing a shareholder derivative lawsuit against certain directors and a controlling stockholder of Southern Peru Copper Corporation, a mining company.

Grupo México, S.A.B. de C.V., which owned a controlling stake in Southern Peru, had proposed in 2004 that Southern Peru purchase Grupo México's 99.15% stake in Minera México, S.A., a non-public mining company, for $3.05 billion in Southern Peru stock.[1] After the deal was approved on October 21, 2004, shareholders brought a derivative suit against the Grupo México subsidiary that owned Minera, together with Grupo México, S.A.B. de C.V. ("Grupo México"), the Grupo México-affiliated directors of Southern Peru and the members of the Special Committee of independent directors tasked with evaluating Grupo México's offer, alleging that the deal was entirely unfair to Southern Peru and its minority stockholders.

On October 14, 2011, seven years after the deal closed, Chancellor Strine of the Delaware Court of Chancery held in *In re Southern Peru Copper Corp. Shareholder Litigation* that Grupo México and the Grupo México-affiliated directors of Southern Peru breached their duties of loyalty to the corporation in approving the deal. The problem was that Minera, which was non-public and therefore had no market-tested value, was worth hundreds of millions of dollars less than $3.05 billion. Instead of negotiating down Grupo México's offering price, the independent directors tasked with evaluating the offer and their financial advisor jumped through hoops to justify the deal using a valuation method that improperly discounted the cash value of Southern Peru's stock.[2] By the time the deal was approved, the Southern Peru stock to be delivered to Grupo México had appreciated in value to $3.75 billion. Thus, Grupo México received more in value than it had requested.

Chancellor Strine found that the amount owed to Southern Peru was $1.347 billion. He stated that Grupo México could satisfy the judgment by returning to Southern Peru the number of its shares necessary to satisfy the remedy. With pre-judgment interest, the damages totaled $2 billion.[3] On the issue of attorneys' fees, plaintiff's counsel requested 22.5% of the judgment.[4] The defendants argued that plaintiff's counsel should receive no more than four times their hourly billing rate, which would result in a fee award of no more than $13.88 million.[5]

Chancellor Strine awarded 15% of the total judgment, which amounted to $305 million, or an hourly fee of $35,000. The chancellor acknowledged that the fee award was large (and that the defendants would likely appeal), but stated that the fee was reasonable because the plaintiffs had "battled through trial," taken risks, and worked hard to obtain real benefits for the company instead of settling the case early for nominal benefits and a fee. Chancellor Strine stated that there was reason to award an even higher fee, but that he gave a "conservative" fee award because of plaintiffs' delay in prosecuting the case. The gargantuan fee award, which may be the largest ever awarded in a shareholder derivative lawsuit, has received significant media attention. An overview of the Delaware law on awarding attorneys' fees is warranted.

* Ralph C. Ferrara is Vice Chair, and N. Noelle Francis and Rosanna Neil are Associates, of Dewey & LeBoeuf LLP. Reprinted with the permission of the publisher and copyright holder from *Shareholder Derivative Litigation: Besieging the Board* by Ralph C. Ferrara, Kevin T. Abikoff and Laura Leedy Gansler, copyrighted by ALM Properties, LLC. and published by Law Journal Press a division of ALM Media, LLC. Copies of the complete work may be ordered online at www.lawcatalog.com.

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1 *In re S. Peru Copper Corp. S'holder Deriv. Litig.*,—A.3d—, 2011 WL 6440761, at *3 (Del. Ch. Oct. 14, 2011) (revised Dec. 20, 2011).

2 Despite their role in approving the deal, the independent directors, members of the Special Committee were dismissed from the case on the grounds that they were exculpated from liability pursuant to Southern Peru's corporate charter and 8 Del. C. § 102(b)(7) and the plaintiff presented no evidence supporting a non-exculpated breach of their fiduciary duty of loyalty.

3 *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 2011 WL 6382006, at *1 (Del. Ch. Dec. 20, 2011).

4 *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, C.A. No. 961-CS, at 9 (Del. Ch. Dec. 19, 2011) (TRANSCRIPT).

5 *AMC Defendants' Answering Brief in Opposition to Plaintiff's Petition for Attorneys' Fees and Expenses* at 17, *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 2011 WL 5883257 (Nov. 11, 2011).

Attorneys' Fees in General

Plaintiffs often seek to recover legal expenses they incurred in bringing securities actions. The Delaware courts adhere to the American Rule, pursuant to which litigants are responsible for paying the full costs of their own legal representation.[6] The courts recognize an exception to the American Rule, however, where the litigation brought by the plaintiff has conferred benefits upon shareholders or the corporation.[7] Under the common fund doctrine, a litigant who confers a common monetary benefit upon an ascertainable class is entitled to an allowance for fees and expenses to be paid from the fund or property that his efforts created.[8]

The corporate benefit doctrine provides that a court may order the payment of counsel fees and related expenses to a plaintiff whose efforts resulted in the conferral of a corporate benefit.[9] The "purpose underlying these fee-shifting doctrines is to balance the equities to prevent 'persons who obtain the benefit of a lawsuit without contributing to its cost [from being] unjustly enriched at the successful litigant's expense.'"[10]

To determine the amount of fees to which plaintiffs are entitled, the Delaware courts apply the factors set forth in *Sugarland Industries, Inc. v. Thomas*. Those factors include:

> (i) the amount of time and effort applied to the case by counsel for the plaintiffs; (ii) the relative complexities of the litigation; (iii) the standing and ability of petitioning counsel; (iv) the contingent nature of the litigation; (v) the stage at which the litigation ended; (vi) whether the plaintiff can rightly receive all the credit for the benefit conferred or only a portion thereof; and (vii) the size of the benefit conferred.[11]

In determining the appropriate fee award, the Delaware courts also consider the "lodestar" method of determining attorneys' fees. The lodestar method "requires a court to calculate the product of an attorney's reasonable hours expended on the litigation and reasonable hourly rate to arrive at the 'lodestar.'"[12] That lodestar calculation can then be adjusted using a "multiplier" or fee enhancer to account for additional factors, such as: "(1) the contingent nature of the expected compensation for services rendered; (2) the consequent risk of non-payment viewed as of the time of filing the suit; (3) the quality of representation; and (4) the results achieved."[13] Courts within the Second Circuit, for example, "regularly award lodestar multipliers from two to six times lodestar."[14] The lodestar may be used by the court as a "backstop check" to assess the reasonableness of a fee award based on the Sugarland factors.[15]

Courts will award to plaintiffs only "reasonable" attorneys' fees and expenses. The amount of attorneys' fees awarded is within the sole discretion of the trial court, which must balance the public policy interests in encouraging meritorious derivative litigation while protecting the corporation's shareholders, who bear the ultimate burden of paying for the litigation.

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[6] *Goodrich v. E.F. Hutton Grp., Inc.*, 681 A.2d 1039, 1043-44 (Del. 1996).

[7] *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 391-97 (1970); *Seinfeld v. Coker*, 847 A.2d 330, 333 (Del. Ch. 2000) ("This Court consistently has held that, in class and derivative actions, plaintiffs' counsel are entitled to an award of attorney's fees and expenses where their efforts achieve a benefit for the corporation or its shareholders.").

[8] *Korn v. New Castle County*, 922 A.2d 409, 412 (Del. 2007).

[9] *Alaska Elec. Pension Fund v. Brown*, 988 A.2d 412, 417 (Del. 2010).

[10] *Korn v. New Castle County*, 922 A.2d at 412 (quoting *Dover Historical Society, Inc. v. City of Dover Planning Comm'n*, 902 A.2d 1084, 1090 (Del. 2006)).

[11] *Sugarland Indus., Inc. v. Thomas*, 420 A.2d 142, 149-50 (Del. 1980).

[12] *Goodrich v. E.F. Hutton Grp.*, 681 A.2d at 1046. A court using the lodestar approach must make a "dual inquiry" into reasonableness: first, whether it was reasonable for counsel to expend the number of hours claimed, and second, whether the hourly rate sought by counsel is reasonable. *Goodrich v. E.F. Hutton Grp.*, 681 A.2d at 1046 n.8.

[13] *Johnson v. Brennan*, 2011 WL 4357376, at *20 (S.D.N.Y. Sept. 16, 2011); *See also Goodrich v. E.F. Hutton Grp.*, 681 A.2d at 1046.

[14] *Johnson v. Brennan*, 2011 WL 4357376 at *20.

[15] *In re Abercrombie & Fitch Co. S'holders Deriv. Litig.*, 886 A.2d 1271, 1274 (Del. 2005).

As the Delaware Court of Chancery explained in *Seinfeld v. Coker*,[16] courts grant fee awards to incentivize stockholders to bring meritorious lawsuits and litigate such lawsuits efficiently. The "greater and more certain the fee, the greater the incentive for plaintiffs' lawyers to bring meritorious suits. If the fee is large enough to cover both their lost opportunity costs and the risks associated with bringing the suit, as well as provide a premium, it should induce meritorious behavior." The award of large fees, without regard to hours invested, also provides incentives for lawyers to litigate efficiently, resolve the litigation at an early stage, and move on to the next best opportunity. "There is a point, however, at which 'incentives' are unnecessary, and anything above that point is a windfall." The determination of reasonable attorneys' fees is, at least in part, an attempt to estimate that point.[17]

Uncontested fee applications receive the same level of scrutiny as those that are disputed. "The fact that a fee is negotiated . . . does not obviate the need for independent judicial scrutiny of the fee because of the omnipresent threat that plaintiffs would trade off settlement benefits for an agreement that the defendant will not contest a substantial fee award."[18] Although, in theory, the awards for both contested and uncontested fee applications should be the same, the Delaware Court of Chancery has noted that, in reality, courts reviewing an uncontested fee application "suffer[] from an informational vacuum created when the adversity of interests that drives the common law process dissipates."[19]

The most important factor considered by the Delaware courts in determining an award of attorneys' fees is the benefit conferred.[20] As the Delaware Court of Chancery explained in *In re Emerson Radio Shareholder Derivative Litigation*,[21] when "the benefit [achieved] by the litigation is quantifiable, such as where the plaintiff's litigation secured a significant financial benefit for the corporation that they probably could not have achieved otherwise, courts typically apply a 'percentage of the benefit' approach." The Delaware Court of Chancery "award[s] lower percentages of the benefit where cases have settled well before trial." When a case settles early, "the Chancery Court tends to award 10-15% of the monetary benefit conferred."

However, "[w]hen a case settles after the plaintiffs have engaged in meaningful litigation efforts, typically including multiple depositions and some level of motion practice, fee awards range from 15-25% of the monetary benefits conferred." When "derivative and class actions settle for both monetary and therapeutic consideration [, the fee award] is approximately 23% of the monetary benefit conferred; the median is 25%." The Court of Chancery awards higher percentages "when cases progress further or go the distance to a posttrial adjudication." Thirty-three percent is "'the very top of the range of percentages' that the Court of Chancery will grant."

Courts in various jurisdictions also have held that a plaintiff who brought a derivative action may recover attorneys' fees and expenses from the corporation even when the benefits conferred are non-monetary, so long as the benefits conferred to the corporation and its shareholders are substantial.[22] The Delaware courts follow this approach.[23] The substantial benefit may take the form of remedial corporate action to rectify the alleged wrongdoing, or prophylactic measures to prevent future wrongdoing.

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[16] *Seinfeld v. Coker*, 847 A.2d 330 (Del. Ch. 2000).

[17] *Seinfeld v. Coker*, 847 A.2d at 334. *See also San Antonio Fire & Police Pension Fund v. Bradbury*, 2010 WL 4273171, at *12 (Del. Ch. Oct. 28, 2010) ("[T]he amount of the award should incentivize stockholders (and their attorneys) to file meritorious lawsuits and prosecute such lawsuits efficiently without generating any unnecessary windfall."); Wright, *et al.*, 7C Federal Practice & Procedure § 1841 (3d ed. 2008) ("In determining what amount is a reasonable award, the court is faced with competing considerations. Certainly, allowances should be liberal enough to compensate lawyers adequately so that use of the derivative action to police corporate management will be encouraged. But awards should not be so generous as to foster strike suits.").

[18] *Brinkerhoff v. Tex. E. Prods. Pipeline Co.*, 986 A.2d 370, 396 (Del. Ch. 2010) (internal citation omitted); *see also Goodrich v. E.F. Hutton Grp.*, 681 A.2d at 1045-46 (holding that when awarding fees, the Court of Chancery "must make an independent determination of reasonableness").

[19] *In re Sauer-Danfoss Inc. S'holders Litig.*, 2011 WL 2519210, at *18 (Del. Ch. Apr. 29, 2011).

[20] *In re Cox Commc'n, Inc. S'holder Litig.*, 879 A.2d 604, 639 (Del. Ch. 2005) (citing *Sanders v. Wang*, 2001 WL 599901, at *2 (Del. May 29, 2001)); *In re Anderson Clayton S'holders Litig.*, 1988 WL 97480, at *3 (Del. Ch. Sept. 19, 1988).

[21] *In re Emerson Radio S'holder Deriv. Litig.*, 2011 WL 1135006 (Del.Ch. Mar. 28, 2011).

[22] *Mills v. Elec. Auto-Lite Co.*, 396 U.S. at 391-97 (citing examples).

[23] *Frank v. Elgamal*, 2011 WL 3300344, at *2 (Del. Ch. Jul. 28, 2011) (noting that "the litigation need not achieve a pecuniary benefit . . . ; rather, a plaintiff may be entitled to a fee award if the lawsuit produces a substantial benefit to the corporation or its stockholders").

Courts may make an interim award of attorneys' fees prior to the termination of the litigation. Under Delaware law, a trial court may grant interim fees as a consequence for discovery abuse, as a sanction for making frivolous legal arguments or engaging in bad-faith litigation tactics, as a remedy for contempt of an interlocutory court order, or under specific statutory authority.[24] In *Louisiana State Employees Retirement System v. Citrix Systems, Inc.*,[25] the Delaware Court of Chancery stated that "interim fee awards may be appropriate where a plaintiff has achieved the benefit sought by the claim that has been mooted or settled and that benefit is not subject to reversal or alteration as the remaining portion of the litigation proceeds." Interim fees are disfavored, however, on the grounds that judicial economy and the orderly conduct of litigation are usually better served if applications for attorneys' fees are considered after a lawsuit has concluded.[26] The Delaware Court of Chancery has observed that "[p]rocessing fee applications will generally delay the processing of the remaining substantive claims. Moreover, piecemeal consideration of attorneys' fee applications presents added risk that the Court's fee determination effort may generate even less confidence."[27]

Making Plaintiff's Counsel Earn their Fees

The Delaware courts have placed increased emphasis on the time and effort spent by plaintiffs' counsel. According to the Court of Chancery in *In re Sauer–Danfoss Inc. Shareholders Litigation*,[28] "[t]he time and effort expended by counsel serves [as] a cross-check on the reasonableness of a fee award." This factor "has two separate but related components: (i) time and (ii) effort." The "time (*i.e.*, hours) that counsel claim to have worked is of secondary importance." In *In re Del Monte Foods Co. Shareholders Litigation*,[29] the Court explained further that "[m]ore important than hours is effort, as in what plaintiffs' counsel actually did."

Accordingly, the Delaware courts have awarded higher attorneys' fees when plaintiffs' counsel had done significant work during litigation, and awarded lower fees when plaintiffs' counsel had used their time inefficiently. In *Del Monte Foods*, shareholders filed a putative class action challenging a merger transaction involving the purchase of Del Monte Foods Company (Del Monte) by private equity firms. After the completion of discovery in connection with plaintiffs' motion to enjoin the transaction, Del Monte issued disclosures that mooted plaintiffs' claims. The supplemental disclosures revealed Barclays Capital Inc.'s conflict of interest in providing buy-side financing while also acting as Del Monte's sell-side advisor.

After considering the *Sugarland* factors, the Delaware Chancery Court granted an interim award of $2.75 million to plaintiff's counsel. In granting this award, the court found that plaintiffs' counsel did "quite a bit." According to the court, "Lead Counsel fully litigated an expedited injunction application. They engaged in thorough and diligent discovery, obtained documents from approximately a dozen third parties, and fully briefed their motion for preliminary injunction. Indeed, it was only through the effective use of discovery that the plaintiffs were able to 'disturb[ ] the patina of normalcy surrounding the transaction.'" The court further acknowledged plaintiffs' counsel's significant investment of time in the case and "demonstrated commitment to pursuing their claims."

The Delaware Court of Chancery awarded lower fees in *Sauer-Danfoss*, however, where the court found that plaintiffs' counsel had not done sufficient work to justify a larger award. In *Sauer-Danfoss*, shareholders filed suit after Sauer-Danfoss Inc.'s controlling stockholder announced a plan to launch a tender offer for the Sauer-Danfoss minority shares. After the plaintiffs amended their complaint to allege that the defendants had failed to make certain disclosures, Sauer-Danfoss and the controlling stockholder voluntarily disclosed the information. The controlling stockholder subsequently withdrew its tender offer, rendering the litigation moot. Plaintiffs' counsel requested an award of $750,000 for conferring a corporate benefit in the form of supplemental disclosures. The court granted an award of $75,000. In granting this award, the court considered the seven *Sugarland* factors. On the issue of "[w]hat did the plaintiffs

[24] *See Kurz v. Holbrook*, 2010 WL 3028003, at *1 (Del. Ch. July 29, 2010) (citing authorities).

[25] *Louisiana State Emp. Ret. Sys. v. Citrix Sys., Inc.*, 2001 WL 1131364 (Del. Ch. Sept. 17, 2001).

[26] *In re Novell, Inc. S'holder Litig.*, 2011 WL 4091502, at *5 (Del. Ch. Aug. 30, 2011).

[27] *Frank v. Elgamal*, 2011 WL 3300344, at *3 (Del. Ch. July 28, 2011).

[28] *In re Sauer–Danfoss Inc. S'holders Litig.*, 2011 WL 1632336 (Del. Ch. Apr. 29, 2011).

[29] *In re Del Monte Foods Co. S'holders Litig.*, 2011 WL 2535256 (Del. Ch. June 27, 2011).

do?" the court's answer was, "[n]ot much." According to the court, plaintiffs "filed fast, and then shifted into retirement mode. They conducted no adversarial discovery and obtained only the standard package of documents that defendants routinely provide to facilitate a disclosure-only settlement. Then they bargained for insubstantial disclosures."

In *In re Cox Communications, Inc. Shareholder Litigation*,[30] the Delaware Court of Chancery chided plaintiffs' counsel for the inefficient use of their time. In that case, plaintiffs' counsel requested $4.95 million in fees for their effort in obtaining a higher price in a bid by Cox Communications Inc.'s controlling stockholder for the public's shares in the company. According to the court "the hours put in by the plaintiffs' attorneys seem excessive given the work that they actually did" and that "the original complaints were hastily drafted throw-aways . . . ." The court stated that "given that the hours worked on the matter are excessive in relation to what was usefully done, involved an inefficient allocation between partners and associates, and involved work done on poorly crafted complaints and organizational infighting, I do not credit the full amount of hours submitted as being reasonable. For these reasons and others, the court ultimately awarded $1.275 million.

Attorneys' Fees where Defendants' Action Renders the Litigation Moot

Consider a situation in which a derivative action alleging wrongdoing is filed and the corporation subsequently takes action consistent with the objectives of the derivative action, thereby rendering the derivative action moot. Plaintiffs' counsel then request an award of fees for causing the corporation's beneficial action. With respect to plaintiffs' counsel's request for fees under these circumstances, the issue is whether the pendency of the derivative action was the proximate cause of the corporation's action.

The Delaware Supreme Court addressed this issue in *Chrysler Corp. v. Dann*.[31] In *Dann*, the court held that to recover attorneys' fees where the defendants' conduct has rendered the litigation moot, plaintiffs must show: (1) that the action had merit at the time it was filed; and (2) that they had some factual basis for making the charges. A claim is meritorious under *Dann* if (1) it can withstand a motion to dismiss and (2) the plaintiffs possess knowledge of provable facts that hold out some reasonable likelihood of success. Subsequently, in *Allied Artists Picture Corp. v. Baron*,[32] the Delaware Supreme Court rejected the argument that the plaintiffs need not show that the claims were meritorious, so long as the pendency of the litigation caused benefits to the corporation or its shareholders. The court adhered to the merit requirement to deter baseless litigation.

More recently, in *Alaska Electrical Pension Fund v. Brown*,[33] the Delaware Supreme Court has articulated the standard as follows: "In order to be entitled to an award of fees under the corporate benefit doctrine, an applicant must show, as a preliminary matter, that: (i) the suit was meritorious when filed; (ii) the action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved; and (iii) the resulting corporate benefit was causally related to the lawsuit." Once the plaintiffs have met their burden, the burden shifts to the defendants to rebut the presumption that their actions to moot the suit were caused by the pending lawsuit. According to the Delaware Supreme Court, "[t]his rule insures that, even without a favorable adjudication, counsel will be compensated for the beneficial results they produced . . . ."

In *Cox Communications*, the Delaware Court of Chancery declined to permit shareholders who would not be injured by the grant of attorneys' fees to challenge an award of fees as non-meritorious, and therefore non-payable, under *Dann*, when the paying party did not object to the fee. In *Cox Communications*, Cox's controlling stockholder agreed to pay any attorneys' fees awarded rather than to permit those fees to be paid by the alleged beneficiaries of the plaintiffs' efforts, the minority shareholders. The court observed that "[i]n every previous case under *Dann*, the meritoriousness inquiry has arisen because an objection has been raised by a party that would suffer an economic injury if the fee was granted—such as the corporation in a derivative suit when the corporation is to be the source of the fee or class members when the fee is to be paid out of the common fund." The court concluded that the shareholders' argument

[30] *In re Cox Commc'n, Inc. S'holder Litig.*, 879 A.2d 604 (Del. Ch. 2005).

[31] *Chrysler Corp. v. Dann*, 223 A.2d 384 (Del. 1966).

[32] *Allied Artists Picture Corp. v. Baron*, 413 A.2d 876 (Del. 1980).

[33] *Alaska Elec. Pension, Fund v. Brown*, 988 A.2d 412 (Del. 2010).

"goes too far and seeks to extend a practical doctrine designed to govern a very different context in a way that is unnecessary to ensure the integrity of the representative litigation process and that is likely to generate excessive litigation costs." The court noted that the shareholders' interests were adequately protected by the requirement that the court examine the substantive fairness of the proposed settlement and the court's consideration of what fee to award.

A related issue in the derivative context is whether attorneys' fees and costs may be awarded when a shareholder makes a demand that produces real benefit to the corporation without the necessity for litigation. In *Kaufman v. Shoenberg*,[34] decided before *Dann*, the Delaware Court of Chancery stated that the answer to this question is "yes," provided that the plaintiff "is able to substantiate his contention factually." The court reasoned that "substantially the same benefit accrues to the corporation whether it be as a result of the demand or of successful litigation. To grant a fee based upon legitimate investigation expenses in connection with a successful demand is to discourage litigation and yet encourage stockholder vigilance, without unduly prejudicing the general corporate welfare."

Relying on *Kaufman* and *Dann*, the Court of Chancery subsequently held, in *Bird v. Lida, Inc.*,[35] that a plaintiff may recover attorneys' fees when his demand produces benefit to the corporation without the necessity for litigation, so long as the demand was made concerning a meritorious legal claim. Thus, the test for determining whether a shareholder who made a demand upon the board, but did not file a derivative suit, is nevertheless entitled to attorneys' fees is whether: (1) the shareholder makes a demand on the board asserting a meritorious claim; (2) the shareholder expends funds or credit in investigating the claim; and (3) as a result of the shareholder's demand, the board takes action that confers a quantifiable financial benefit to the corporation.

Allocating Attorneys' Fees among Plaintiffs' Counsel

With the rise in multi-jurisdictional litigation, courts are now increasingly faced having to allocate one award of attorneys' fees and expenses among various plaintiffs' firms that have brought similar derivative actions on behalf of the same company in different jurisdictions, based on the same alleged wrongdoing. In *In re Infinity Broadcasting Corp. Shareholders Litigation*,[36] the Delaware Supreme Court upheld the Chancery Court's denial of attorneys' fees to New York counsel where class action lawsuits had been filed in both New York and Delaware. The lawsuits challenged the fairness of a tender offer by Viacom Inc. for the shares of Infinity Broadcasting Corporation (Infinity) that Viacom did not own.

The Delaware plaintiffs entered into a global settlement with Infinity on behalf of a class of Infinity shareholders and the Chancery Court awarded $2.25 million in fees to counsel appearing in the Delaware action. Counsel in the New York litigation argued in the Delaware Supreme Court that the Chancery Court wrongly denied them a share of the fee award. The Delaware Supreme Court found that "the New York litigation neither promoted or influenced the global settlement in any meaningful way nor resulted directly in any benefit to the shareholder class."

The court stated that "because [New York counsel] failed to participate in the Delaware litigation in any meaningful way, any evidence of a benefit must result from the impact of the New York litigation itself." The court further stated: "When determining the amount and distribution of an award, the mere pendency of litigation alone does not establish the causal connection between counsel's efforts and changes in the merger terms that benefit the shareholder class. In this appeal, the record is devoid of evidence that the New York litigation in any way influenced the settlement approved by the Court of Chancery."

In another case, *Sanders v. Wang*, [37] the Delaware Chancery Court explained that the issue was "the extent to which each participating firm's efforts directly resulted in what portion of the sizable benefit conferred." According to the court, "[t]he first question that must be addressed asks what each firm respectively contributed to the Delaware litigation that led to the settlement. The second question is what effect did the New York litigation have on the settlement of the Delaware litigation. Finally, I must ask

[34] *Kaufman v. Shoenberg*, 91 A.2d 786 (Del. Ch. 1952), and *Kaufman v. Shoenberg*, 33 Del. Ch. 282, 92 A.2d 295 (Del. Ch. 1952).

[35] *Bird v. Lida, Inc.*, 681 A.2d 399, 401 (Del. Ch. 1996).

[36] *In re Infinity Broad. Corp. S'holders Litig.*, 802 A.2d 285 (Del. 2002).

[37] *Sanders v. Wang*, 2001 WL 1131353, at *1 (Del. Ch. Sept. 18, 2001).

what of plaintiffs' counsel's efforts should I should consider in applying any secondary (non-benefit-based) factors." The court also considered the *Sugarland* factors—although it did not cite the case—in deciding the appropriate fee allocation.

Conclusion

Given that the defendants have appealed the award in *Southern Peru Copper*, it is not clear at this time whether Chancellor Strine's fee award will stand. The Delaware Supreme Court will review Chancellor Strine's award for abuse of discretion.[38] Of course plaintiffs could well argue that the award should be upheld: fifteen percent of the quantifiable benefit conferred is well within the range of percentages of benefit ordinarily given to plaintiffs' counsel when they have taken a case to trial.[39] Even under this highly deferential standard, however, there remains a chance that the outlandish fee award will be reversed. In *Seinfeld v. Coker*,[40] Chancellor Chandler explained the dual incentives that fee awards seek to produce: (1) the incentive for the attorneys to bring meritorious lawsuits, and (2) the incentive for plaintiffs to litigate such lawsuits efficiently.

If Chancellor Chandler was correct, then Chancellor Strine's award seems to run afoul of the second incentive because plaintiff's counsel were given a massive fee award despite their delayed prosecution of the case. Chancellor Chandler also stated in *Seinfeld* that "if a fee of $500,000 produces [the proper] incentives in a particular case, awarding $1 million is a windfall, serving no other purpose than to siphon money away from stockholders and into the hands of their agents." It is difficult to argue that the incentives Chancellor Strine sought to produce - for plaintiffs' attorneys to litigate meritorious cases vigorously with the goal of obtaining real benefits for their clients instead of settling cases for marginal benefits and fees—could not have been obtained with a fee award substantially less than $305 million.

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[38] *William Penn P'nship v. Saliba*, 13 A.3d 749, 758 (Del. 2011) ("[The Delaware Supreme Court] review[s] awards of attorneys' fees for abuse of discretion. We do not substitute our own notions of what is right for those of the trial judge if that judgment was based upon conscience and reason, as opposed to capriciousness or arbitrariness." (footnotes omitted)).

[39] *See In re Emerson Radio S'holder Deriv. Litig.*, 2011 WL 1135006 at *3 ("When a case settles after the plaintiffs have engaged in meaningful litigation efforts, typically including multiple depositions and some level of motion practice, fee awards range from 15-25% of the monetary benefits conferred").

[40] *Seinfeld v. Coker*, 847 A.2d 330 (Del. Ch. 2000).

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