# RECENT DEVELOPMENTS IN DELAWARE CORPORATE LAW

## Table of Contents

<table>
<thead>
<tr>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994 Statutory Amendments to the Delaware General Corporation Law</td>
<td>477</td>
</tr>
<tr>
<td>Delaware’s New Mandate in Class Action Settlements: Expanding the Scope and Intensity of Settlement Review</td>
<td>496</td>
</tr>
<tr>
<td>Beyond Aronson: Recent Delaware Cases on Demand Futility</td>
<td>535</td>
</tr>
<tr>
<td>Kahn v. Lynch Communication Systems, Inc.: A Major Step Toward Clarifying the Role of Independent Committees</td>
<td>564</td>
</tr>
<tr>
<td>Mendel v. Carroll: When Must a Board of Directors Dilute a Controlling Shareholder?</td>
<td>588</td>
</tr>
<tr>
<td>Jackson v. Turnbull: Is Statutory Compliance the Threshold to Fair Dealing?</td>
<td>608</td>
</tr>
<tr>
<td>Compaq Computer Corp. v. Horton: A Straight Forward, Clarifying, Statutory Interpretation of Section 220(b) and (c)</td>
<td>622</td>
</tr>
<tr>
<td>Nonprofit Corporations: Conversion to For-Profit Corporate Status and Nonprofit Corporation Members’ Rights — Farahpour v. DCX, Inc.</td>
<td>635</td>
</tr>
</tbody>
</table>

475
RECENT DEVELOPMENTS IN
DELAWARE CORPORATE LAW

PRACTITIONERS COMMITTEE

CHAIRMAN

The Honorable Andrew G.T. Moore II

MEMBERS

Thomas C. Grimm, Esquire                Lisa A. Schmidt, Esquire
Stephen E. Jenkins, Esquire             Bruce I. Silverstein, Esquire
Michael M. Ledyard, Esquire             Andrew J. Turezyn, Esquire
Elizabeth M. McGeever, Esquire          Gregory P. Williams, Esquire
1994 STATUTORY AMENDMENTS
TO THE DELAWARE GENERAL CORPORATION LAW

Ever vigilant in its efforts to preserve Delaware's position as the country's leading state of incorporation, the Delaware General Assembly and judiciary made three important contributions to the development of the Delaware General Corporate Law (DGCL) in 1994. First, effective April 1, 1994, Delaware created summary proceedings, a hybrid form of adjudication for commercial disputes which bridges the gap between arbitration and traditional litigation. Second, the legislature amended section 145 of the DGCL, pertaining to indemnification of corporate directors, officers, employees, and agents, in several important respects. Finally, the General Assembly revised the statutory treatment of voting trusts to reflect the changing attitudes about their utility to Delaware corporations. This article discusses the changes and their implications on corporate affairs governed by Delaware law.

I. SUMMARY PROCEEDINGS

A. Background

In response to growing concern over the increasing costs of major commercial and business litigation, the Delaware Superior Court recently amended its rules creating an expedited procedure known as "summary proceedings." The reform, spearheaded by Governor Carper, began on

5See Gregory P. Williams, Summary Procedures Enacted In Delaware for Major Commercial Litigation, INSIGHTS, Aug. 1994, at 31 (noting that "major commercial litigation too often is characterized by staggering expense and inordinate delay"). Indirect costs associated with commercial litigation have been estimated at nearly $300 billion. Jay W. Eisenhofer, Delaware's New Summary Procedure for Business Disputes Could Reduce Legal Costs, LEGAL OPINION LETTER, Sept. 9, 1994, at 2. Corporations estimate that the discovery process accounts for 80% of their legal expenses. Id.
6S. Res. 28, 137th Gen. Assembly (1994) (enacted). Senator Sharp explained the
May 20, 1993, with the establishment of the Commission on Major Commercial Litigation Reform. 7 For a six-month period, the Commission, focusing on cost and time, studied the existing problems plaguing business litigation. 8 In addition, the Commission solicited responses from approximately 150 local and national corporate counsel on the issue of business litigation reform. 9 "The Commission also worked closely with . . . the Delaware judiciary . . . [which] in fact suggested the use of an administrative directive of the Supreme Court" to provide the legal framework for institution of summary proceedings. 10

The Delaware General Assembly adopted the Commission's recommendations on January 26, 1994, when it passed Joint Resolution 28. 11 On February 28, 1994, Chief Justice Veasey signed Administrative

reasons for enacting "summary proceedings":

Delaware's corporate, banking, partnership and commercial laws, as well as the quality, responsiveness and fairness of the Delaware judiciary in interpreting these laws, have made Delaware the leader in the development of the nation's business laws. These factors have also played a major role in Delaware becoming the state of organization for thousands of corporations and thousands of other business entities which, through taxes, fees and other direct and indirect means, contribute substantially to the State's revenues.

For many years Delaware's business citizenry — as well as most of America's business — has been concerned about the cost and delay of civil litigation. Other states, such as New York and Pennsylvania, have recently created or proposed creation of special commercial courts to expedite the resolution of business litigation. The Governor's Commission on Major Commercial Litigation Reform was formed in May of 1993 to address the concerns expressed by Delaware's business citizenry regarding litigation cost and delay.

Id. at 2.

1See S. Res. 28, 137th Gen. Assembly (1994) (enacted). The Governor's Commission on Major Commercial Litigation Reform was created by Executive Order No. 7.

2Id. at 2.

3Id.

4Id. at 3.

5S. Res. 28, 137th Gen. Assembly (1994) (enacted). The applicable portions of Senate Resolution No. 28 read as follows:

RELATING TO EXPEDITED PROCEDURES AS RECOMMENDED BY THE COMMISSION ON COMMERCIAL LITIGATION REFORM.

WHEREAS, the State of Delaware is the state of incorporation of a majority of America's "Fortune 500" corporations and state of organization for many financial institutions, partnerships, limited liability companies and other business entities, a sustained and increasing trend which is attributable in large measure to the quality of Delaware's courts and the responsiveness of these courts to the need for swift and predictable judicial action; and

WHEREAS, Delaware businesses and other citizens of this State and Nation are increasingly concerned with the high costs and delays attendant to
Directive Number 96\textsuperscript{12} implementing the joint resolution and directing the superior court to adopt "such interim rules as may be necessary to carry out th[e] Administrative Directive."\textsuperscript{13} Thereafter, the superior court all litigation, including business and commercial litigation;

WHEREAS, a Commission on Major Commercial Litigation Reform (the "Commission") was created by Executive Order No. 7, dated May 20, 1993;

WHEREAS, as one alternative, the Commission has recommended that a special expedited procedure be established pursuant to Administrative Directives, Rules of the Delaware Superior Court, Court of Chancery and Supreme Court;

WHEREAS, the special expedited procedure would be available in the Superior Court for major commercial and business cases where the amount in controversy exceeds one million dollars and involves at least one party which is a Delaware corporation or other Delaware citizen or entity whereby each such case may be individually assigned to a judge of the Superior Court or, by designation pursuant to Article IV, §13 of the Delaware Constitution, the Court of Chancery;

WHEREAS, the Commission further recommended that the Rules governing the expedited procedure should require the parties to consent to such an expedited procedure, with discovery and motion practice limited and accelerated, without a jury trial and without punitive damages;

WHEREAS, the Judiciary of the State desires to cooperate with the Governor's initiative by implementing a program, pursuant to the authority of Article IV, §13 of the Delaware Constitution;

WHEREAS, additional judicial resources may have to be provided to the courts in the future if the Commission's recommended procedure is substantially employed by commercial and business litigants;

NOW, THEREFORE:

BE IT RESOLVED by the Senate and the House of Representatives of the 137TH General Assembly of the State of Delaware, with the approval of the Governor, that such proposal is endorsed as an important public policy initiative of the State.

\textit{Id.}

\textsuperscript{12} Administrative Directive No. 96, Veasey, C.J. (Del. Feb. 28, 1994). It is significant that summary proceedings were created through an administrative directive. Chief Justice Veasey noted that this "gives incredible flexibility to the process. It is not frozen into a statute." \textit{Quick and Clean: Delaware's Experiment; Summary Procedure Expedites Litigation, CORP. LEGAL TIMES,} Aug. 1994, at 31, 34 [hereinafter \textit{Quick and Clean}].

\textsuperscript{13} Administrative Directive No. 96, \textit{supra} note 12, at 3. The applicable portions of the Administrative Directive No. 96 read as follows:

NOW, THEREFORE, IT IS DIRECTED, with the unanimous approval of the Justices of the Supreme Court (Del. Const. art. IV, § 13), that:

A. The Judiciary hereby implements the Joint Resolution until this Administrative Directive shall have been amended or superseded.

B. The guidelines for rules governing summary procedures for commercial disputes annexed hereto as Attachment B (the "Guidelines") are hereby adopted and promulgated to take effect contemporaneously with the adoption of Superior Court Rules as set forth in subparagraph C hereof.
issued an "Order Adopting Interim Rules For Summary Procedures For Resolving Commercial Disputes and Amending Rule 77(h) of the Superior Court Rules of Civil Procedure." This order set forth the rules governing summary proceedings.

B. Elements of a Summary Proceeding

1. Scope

Generally, summary proceedings are available to any matter within the subject matter jurisdiction of the superior court, excluding claims for personal, physical, or mental injury. Furthermore, restrictions designed to control the number of cases utilizing summary proceedings limit the availability of the expedited procedure. The amount in controversy must exceed $1 million, exclusive of interest and costs. The rules governing the proceedings do, however, grant some flexibility to the courts to expand the number of disputes utilizing summary proceedings. For example, under Rule 124(c) a court may hear an action where the amount in controversy does not exceed $1 million provided judicial resources are available. In order to employ summary proceedings, at least one party must be a Delaware citizen, corporation, or other business entity. Importantly, neither punitive damages nor jury trials are available in summary proceedings.

C. The Superior Court is directed to review its Rules and, subject to review by the Supreme Court in accordance with customary practice, to adopt, on or before March 31, 1994, such interim rules as may be necessary to carry out this Administrative Directive.

Id. at 2-3.


Superior Court Rules 124 through 131 set out the mechanics of a summary procedure.

Id.

Sup. Ct. Civ. R. 124(b). The exclusion of personal injury claims further demonstrates the commercial purpose of the new procedure. See Williams, supra note 5, at 31.


Id. 124(c).

Id. 124(b).

Id. The removal of jury trials and punitive damages lessens the uncertainty of damages which hovers over litigation in other forums. As one Delaware lawyer has stated, "The idea was that this procedure should be for parties that have an honest business dispute to resolve, not for parties trying to win the lottery and come away with a huge verdict." Quick and Clean, supra note 12, at 31 (quoting Jay W. Eisenhofer, a corporate and commercial litigator with Skadden, Arps, Slate, Meagher & Flom, in Wilmington, Delaware).
Although these restrictions limit the availability of summary proceedings, the consent requirement provides the defining prerequisite of the expedited procedure. The mutual consent of the parties may be evidenced in one of three contexts. First, the parties may consent by written agreement in advance of litigation. Second, the parties may stipulate their willingness to avail themselves of summary proceedings in the course of the pleadings. Finally, the parties may agree to have an action pending in another court, whether or not within Delaware, transferred to the superior court so long as the action could have originally have been brought as a summary proceeding in Delaware. Moreover, litigation already commenced in a Delaware superior court may be transferred upon the consent of both parties.

2. Pleadings

To avail themselves to summary proceedings, the consenting parties must meet strict pleading requirements. "The complaint must state prominently on the first page that [s]ummary [p]roceedings are requested." The rules require that the complaint also include: (1) the amount in controversy; (2) an affirmation that one of the parties is a Delaware citizen, corporation, or business entity; and (3) an averment that the defendant has agreed to submit to the court's jurisdiction for the proceedings. The complaint must then be sent next-day delivery to the defendant. Additionally, a maximum $5,000 filing fee is required to commence the proceedings.

---

22 Id. Some expect that once the business community becomes aware of the procedure, parties will include provisions in their contracts mandating the use of summary proceedings. Williams, supra note 5, at 31.
24 See id.
25 Id. 125(a)(3).
26 Id. 125(a)(2).
27 Sup. Ct. Civ. R. 131(a)(2). Rule 131(a)(2) reads as follows:
(2) Superior Court Civil Rule 77(h) is amended by adding the following:
Complaints Subject To Summary Proceedings for Commercial Disputes:

The filing fee for complaints subject to Summary Proceedings for Commercial Disputes shall be .005 times the amount in controversy, but not less than $125.00 nor more than $5,000.
The defendants must answer the complaint’s averments and plead any compulsory counterclaims within thirty days of service. Cross-claims, permissive counterclaims, and third-party claims are not permitted unless agreed to by both parties. In lieu of an answer, a party may move to dismiss. Such a motion will be heard on an expedited basis. Motions to dismiss carry the following requirements:

An opening brief must be filed at the same time the motion to dismiss is filed, an answering brief is due 15 days thereafter and a reply brief is due 10 days thereafter. Thus, within 55 days after service of the complaint, briefing on the motion to dismiss will be completed.

These requirements ensure the expedited nature of summary procedures will not be derailed.

3. Depositions and Discovery

The rules governing summary proceedings severely restrict discovery in order to eliminate costly discovery wars which escalate expenses to force a settlement. Interrogatories, generally considered the most abused device in the discovery process, are limited to ten per party. Requests for admissions are also limited to ten. Depositions may be taken of any person on the other party’s witness list; however, non-party depositions are limited to four.

Additionally, a mandatory disclosure provision applies to both parties. Within seven days after the filing of the answer, the plaintiff

Id.

Sup. Ct. Civ. R. 126(a). While this time period exceeds the 20 day limit normally available in superior court, one commentator predicts that the extensions often granted will be much more scarce in summary proceedings. See Williams, supra note 5, at 31.

Id. 126(b).

Id. 126(c).

Id.

Williams, supra note 5, at 31-32 (citing Sup. Ct. Civ. R. 126(e)).

Eisenhofer, supra note 5, at 2.

See Sup. Ct. Civ. R. 127(b); Quick and Clean, supra note 12, at 31 (stating that interrogatories are the most abused means of discovery).


Id. 127(d).

See id. 127(a). See also Williams, supra note 5, at 32 (explaining the mandatory disclosure provision in the summary procedure rules is similar to the newly proposed
must provide the defendant with a copy of each document they intend to rely on at trial, a list of trial witnesses, and "a list of all persons consulted or relied upon in connection with [the] preparation of the complaint." A defendant must then reciprocate with similar disclosures within thirty days of the filing of the answer.

Finally, the timetable for the completion of the discovery process is drastically reduced. Where traditional commercial litigation may take years to complete, summary proceedings cut off discovery within 180 days after the filing of the last answer. The discovery provisions balance the desire to focus the parties on the most important issues of the case with the need to provide access to adequate information in anticipation of trial.

4. Summary Judgment Replaced by Briefing

Significantly, summary proceedings explicitly prohibit summary judgment motions. Summary judgment motions, primarily employed in the hope of a quick win, comprise an expensive and time-consuming facet of traditional litigation. In reality, however, most summary judgment motions fail and litigants waste valuable time and money. To alleviate

amendment to the Federal Rules of Civil Procedure, which aims to "avoid the cat and mouse games that often plague the discovery process"); Quick and Clean, supra note 12, at 35 (explaining that the major criticism of federal mandatory disclosure is subjectivity, "leav[ing] a lot of room for debate as to what facts are alleged with particularity in the complaint"). In particular, Justice Scalia noted that it "runs counter to our traditions and obligations as attorneys" to provide your opponents with helpful documents. Id. Proponents of Delaware's version of mandatory disclosure rules argue that its "standard for disclosure . . . is much more objective. It requires disclosure of names of people consulted or relied upon in preparation of the complaint or the answer. You either consulted or relied upon a person or you didn't. There's no guesswork." Id.

41 Id.
42 Sup. Ct. Civ. R. 127(h). Delaware judges and practitioners pride themselves on a "long and rich history of adjudicating business disputes." Quick and Clean, supra note 12, at 34. Delaware courts have a strong interest in servicing the business and corporate community and thus are willing to experiment with new procedures. Chief Justice Veasey feels that the Delaware courts are particularly aware of discovery abuse which adds cost and delay to major commercial litigation and as such are trying to remedy the situation. Id.
43 Eisenhofer, supra note 5, at 2.
45 Williams, supra note 5, at 32.
46 Id. (explaining most summary judgment motions are denied because material issues of fact exist). Elimination of summary judgment seems particularly appropriate in light of the
this problem, summary proceedings offer a "briefing option" as an alternative to a motion for summary judgment which "arguably captures the benefits of those motions while avoiding the burdens." This "briefing option" permits the parties, at the close of discovery, to proceed at trial without live testimony. Each party simply submits briefs, affidavits, and presents oral argument. The court then makes factual findings on the record within one week after the close of briefing. Consequently, optional briefing eliminates the costly burden of presenting live testimony while retaining the benefit of a quick decision on the merits.

5. Trial

If parties choose not to employ the "briefing option," a trial will begin thirty to sixty days after the close of discovery. Parties must provide the court with a pre-trial order including a summary of the claims and defenses, a list of expected witnesses, and a description of disputed evidence and facts. The summary proceeding rules limit the trial to five days. The court must issue its decision within thirty days of the filing of the final brief or final oral argument. Thus, from the filing date of the complaint, a summary proceeding should be completed within approximately one year.

limited discovery process. In an attempt to defeat a motion for summary judgment, the common argument that more discovery is needed would forestall the expedited procedure.

41Id.
42Sup. Ct. Civ. R. 129. Electing to proceed at trial without live witnesses drastically reduces the expenses associated with preparing and presenting live testimony. Williams, supra note 5, at 32.
44Id.
45Id. 130(b).
46Id.
47Sup. Ct. Civ. R. 130(b). The trial is limited to five days absent a contrary court order. Id.
48Id. 130(c). Notably, as in traditional Delaware litigation, parties may take on appeal directly to the Delaware Supreme Court. See Quick and Clean, supra note 12, at 34.
49A sample timetable of an action litigated under summary proceedings would be as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>6/1/94</td>
<td>Complaint filed and served.</td>
</tr>
<tr>
<td>7/1/94</td>
<td>Answer due.</td>
</tr>
</tbody>
</table>
Defendant files and serves motion to dismiss and accompanying brief.

7/21/94 Plaintiff's brief in opposition to motion to dismiss due.

8/5/94 Defendant's reply brief in support of motion to dismiss due.

9/6/94 The Court's decision on defendant's motion to dismiss due. Court denies motion.

9/20/94 Defendant's answer due.

9/29/94 Plaintiff's required expedited discovery due.

10/20/94 Defendant's required expedited discovery due.

Cut-off day for parties to serve interrogatories, document requests and requests for admissions.

11/9/94 Responses to interrogatories and requests for admissions due.

11/21/94 Responses to document requests due.

Cut-off for service of first deposition notice by a party.

1/18/94 Cut-off for depositions (must be scheduled and completed by this day).

3/20/94 Final discovery cut-off.

4/19/95 Pre-trial order due.

5/19/95 - 5/25/95 Trial

6/9/95 Post-trial briefs due.

7/10/95 Court decision due.

Memorandum by Christopher S. Sontchi, Esquire, associate with Ashby and Geddes,
C. Distinguishing Delaware's Summary Proceedings
From Similar Procedures Available in Other Jurisdictions

Although various forms of alternative dispute resolution have come into vogue in a number of jurisdictions, no single proposed or existing scheme offers all of the benefits available in Delaware's summary proceedings. Private arbitration has the advantage of being quick and cost effective but suffers from the absence of a guaranteed right of appeal. Moreover, private arbitrators in the United States are not required to adhere to the rules of law or evidence. In contrast, because summary proceedings are a creation of the Delaware courts, the parties retain the ability to appeal directly to the Delaware Supreme Court. Furthermore, because summary proceedings make use of the Delaware courts, cases will be decided under Delaware's well-developed body of business law and the rules of evidence will apply.

The primary characteristic which sets Delaware's summary proceedings apart from private dispute resolution and the courts of most other jurisdictions is the quality of Delaware's judiciary. In many jurisdictions the courts do not regularly deal with business disputes and are ill-equipped to handle complex business matters, especially when such disagreements must be resolved on an expedited basis. As Chief Justice Veasey has noted, Delaware courts have developed "a long and rich history of adjudicating business disputes." Businesses have recognized the value of conducting their litigation in Delaware because of "the stability of the corporation law and judicial decisions." Summary proceedings take full advantage of these resources by utilizing judges drawn from a panel of four superior court judges and four chancellors.

Wilmington, Delaware, 14-15 (on file with The Delaware Journal of Corporate Law).


57 See Eisenhofer, supra note 5, at 2.

58 See Quick and Clean, supra note 12, at 32.


60 See infra text accompanying notes 61-64.


62 Quick and Clean, supra note 12, at 34.

63 Id.

D. Conclusion

Implementation of summary proceedings establishes a procedure that combines the benefits of both arbitration and litigation while reducing the burdens of each. This response by the legislature and judiciary attempts to keep Delaware business disputes in the courtroom rather than in arbitration proceedings. Whether the business community will embrace this new procedure and whether it will alleviate the problems associated with traditional commercial litigation, however, remain to be seen.

II. AMENDMENTS TO DELAWARE GENERAL CORPORATION LAW

A. Section 145 of the Delaware General Corporation Law

Section 145 generally permits indemnification of directors, officers, employees, and agents who are parties to litigation by reason of their position in the corporation. The Delaware General Assembly amended this provision in two significant aspects. First, the legislature modified section (d) to eliminate the requirement of a quorum of disinterested directors before a board may grant indemnification. Second, the legislature added subsection (k) providing for summary treatment in the court of chancery for actions to determine a corporation’s obligation to

---

63 Eisenhofer, supra note 5, at 2; see also Quick and Clean, supra note 12, at 36-37 (discussing the problems associated with arbitration and the benefits of litigation).
64 Quick and Clean, supra note 12, at 37.
66 See S. 323, 137th Gen. Assembly (1994) (enacted). Prior to the 1994 amendment, § 145(d) read as follows:
   (d) Any indemnification under subsections (a) and (b) of this section (unless ordered by a court) shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in subsections (a) and (b) of this section. Such determination shall be made (1) by the board of directors by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding, or (2) if such a quorum is not obtainable, or, even if obtainable a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, or (3) by the stockholders.
advance expenses before the final resolution of litigation involving an indemnified individual.69

Section 145(d)70 outlines the procedural requirements for the ultimate determination of entitlement to indemnification.71 Prior to amendment, subsection (d) required that the determination of indemnification be made by "a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding."72 The subsection now requires only a majority vote of disinterested directors, regardless of whether a quorum exists.73 This change was made for two reasons. First, the requirements of subsection (d) were inconsistent with the provisions of section 144 relating to the validity of transactions between the corporation and its directors, officers, or an entity in which they have an interest.74 Because section 145(d) also involves an

---

71Entitlement to indemnification is determined on a case-by-case basis by the corporation and is therefore not automatic. Subsection 145(d) requires a determination of whether the director, officer, employee, or agent is entitled to indemnification because they have met the applicable standards set out in subsections (a) and (b). See 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations and Business Organizations § 4.14, at 4-304 to -305 (2d ed. 1990 & Supp. 1993). Subsection (a) and (b) require that the party seeking indemnification must act "in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation." Del. Code Ann. tit. 8, § 145(a)-(b) (1991).
73S. 323, 137th Gen. Assembly (1994) (enacted). The applicable portions of Senate Bill No. 323 read as follows:

Section 1. Amend Section 145(d), Chapter 1, Title 8, Delaware Code, by deleting the second sentence thereof in its entirety and inserting in lieu thereof as follows:

"Such determination shall be made (1) by a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum, or (2) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (3) by the stockholders."

Id. (emphasis added).
74See Del. Code Ann. tit. 8, § 144 (1991). The applicable portion of § 144 reads as follows:

(a) No contract or transaction between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the contract or transaction, or solely because his or their votes are counted for such purpose, if:
interested director transaction, the amendment brought the two sections into conformity, requiring only a majority vote of disinterested directors.

Second, the revision responds to the reality that a large portion of board members are often named as defendants in the same litigation. As a consequence, a quorum of disinterested directors is rarely attainable because only a few directors may not actually be parties to the litigation. Subsection (d) places the power to decide indemnification with three groups; directors, independent legal counsel, or the stockholders may make the determination. The amendment, therefore, favors the least costly and time consuming of the three alternatives by making it easier for the board to make the decision.

The addition of subsection (k) represents perhaps the most noteworthy modification to section 145. Subsection (k) is significant in

---

(1) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

Id. (emphasis added).

75See, e.g., Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (noting that all 10 members of the board of directors were named defendants in action for breach of duty of care).


77In most circumstances, a corporation will prefer the determination of indemnification be made by the directors. See Diane H. Mazur, Indemnification of Directors in Actions Brought Directly by the Corporation: Must the Corporation Finance its Opponents Defense?, 19 J. Corp. L. 201, 221 (1994) (noting that shareholder approval of indemnification is unlikely due to the prohibitive cost). The expense of employing independent legal counsel is not desirable. Also, most corporations are even more reluctant to allow determination of indemnification to go to the stockholders. "That method, understandably, is rarely used. Moreover, if it were invoked, there are very interesting procedural questions." 1 Balotti & Finkelstein, supra note 71, § 4.14, at 4-305.

78S. 323, 137th Gen. Assembly (1994) (enacted). The applicable portions of Senate Bill No. 323 read as follows:

Section 2. Amend Section 145, Chapter 1, Title 8, Delaware Code, by adding new subsection (k) as follows:

"(k) The Court of Chancery is hereby vested with exclusive jurisdiction to hear and determine all actions for advancement of expenses or indemnification brought under this section or under any bylaw, agreement, vote of stockholders or disinterested directors, or otherwise. The Court of Chancery may summarily determine a corporation's obligation to advance expenses (including attorneys'
two respects. First, it vests the court of chancery with exclusive jurisdiction to hear actions for indemnification or advancement of expenses.\textsuperscript{79} Second, the amendment provides summary treatment for actions under section 145.\textsuperscript{80}

The court of chancery possesses exclusive jurisdiction to hear section 145 actions for several reasons. Initially, the amendment was proposed to conform section 145 to other sections of the DGCL which turned to the chancery court to handle disputes.\textsuperscript{81} These provisions include section 220\textsuperscript{82} (inspection of books and records) and 225\textsuperscript{83} (contested election of directors; proceedings to determine validity). The switch from the superior court to the chancery court centered on judicial economy.\textsuperscript{84} The court of chancery, Delaware's "business court,"\textsuperscript{85} is better equipped to deal with expediting corporate litigation. The move, however, entails a trade-off because punitive damages are no longer available.\textsuperscript{86} In the long-run, the drafters of the new amendment felt the

\textsuperscript{79}Id.

\textsuperscript{80}Id.

\textsuperscript{81}See S. 323, 137th Gen. Assembly (1994) (enacted) (explaining in synopsis that "[t]he provision is consistent with a number of other sections of the Delaware General Corporation Law that grant exclusive jurisdiction to the Court of Chancery").


\textsuperscript{84}The shift from the superior court to the court of chancery was not prompted by concerns about the quality of the decisions produced by the superior court. Instead, the drafting committee merely believed that the move to the chancery court would open up additional judicial resources to secure the speedy resolution of these actions. Interview with John Small, Esquire, chairman of the General Corporation Law Section of the Delaware Bar Association, in Wilmington, Delaware (Oct. 24, 1994).

\textsuperscript{85}Quick and Clean, supra note 12, at 31 (explaining that the court of chancery is Delaware's "business" court and possesses special expertise in dealing with business litigation, while the superior court is the general court in Delaware).

\textsuperscript{86}The court of chancery operates under rules prohibiting awards of punitive damages. See Quick and Clean, supra note 12, at 31. The elimination of punitive damages in § 145 actions proved to be a point of contention during the drafting of § (k). Several members of the drafting committee felt that punitive damages formed an important part of § 145 litigation. Interview with John Small, Esquire, chairman of the General Corporation Law Section of the Delaware Bar Association, in Wilmington, Delaware (Oct. 24, 1994). For an example of a recent decision in which the availability of punitive damages was central to the outcome, see Salaman v. National Media Corp., No. 92C-01-161, 1994 Del. Super. LEXIS 353 (Del. Super. Ct. July 22, 1994) (allowing a jury award of $1.5 million in punitive damages arising out of a former director's claim under the corporation's bylaws for advancement of attorneys' fees and expenses).
importance of expediting indemnification litigation outweighed the benefits of a punitive damage award. 87

Finally, amended subsection 145(k) employs summary treatment of actions seeking a determination of whether a corporation is obligated to advance expenses prior to the final disposition of litigation. 88 The chancery court routinely resolves actions brought under sections 220 and 225 of the DGCL through expedited statutory summary proceedings. 89 The amendment to section 145(k) conforms this section with section 220 and section 225 of the DGCL by vesting exclusive jurisdiction in the court of chancery 90 and allowing the court to decide these issues summarily. 91

III. AMENDMENTS TO SECTION 218

Section 218 92 of the DGCL addresses voting trusts and other voting agreements. Two important changes were made to section 218. 93 First, subsection (a) was amended to clarify the number of stockholders

87 Interview with John Small, Esquire, chairman of the General Corporation Law Section of the Delaware Bar Association, in Wilmington, Delaware (Oct. 24, 1994).
89 Edward P. Welch & Andrew J. Turezyn, The Delaware Court of Chancery’s Use of Summary Proceedings in Three Cases Shows That Complex Issues Can be Decided Quickly, NAT’L J., Oct. 10, 1994, at B4. As mentioned, summary proceedings are frequently used to expedite litigation under §§ 220 and 225. Such action usually results in the completion of these actions within one or two months after the filing of the complaint. "The prompt handling of such disputes helps to assure the smooth management of the affairs of Delaware corporations and provides stockholders with a readily available means of discovering and addressing corporate misconduct." Id.
90 See supra text accompanying notes 69-71.
91 Welch & Turezyn, supra note 89, at B8 (stating “Delaware practitioners expect that the new summary proceeding will be used by officers, directors, and corporations to gain a prompt determination as to a corporation’s obligation to advance expenses before the final disposition of litigation”).
93 See S. 326, 137th Gen. Assembly (1994) (enacted). Prior to the 1994 amendment, § 218(a) read as follows:
   (a) One or more stockholders may by agreement in writing deposit capital stock of an original issue with or transfer capital stock to any person or persons, or corporation or corporations authorized to act as trustee, for the purpose of vesting in such person or persons, corporation or corporations, who may be designated voting trustee, or voting trustees, the right to vote thereon for any period of time determined by such agreement

required to establish a voting trust.\textsuperscript{94} Confusion about whether one stockholder could in fact establish a voting trust resulted from the existing language of section 218(a).\textsuperscript{95} Therefore, this amendment simply provides that either a single stockholder or a group of stockholders are permitted to form a voting trust.\textsuperscript{96} 

Significantly, the second amendment to section 218\textsuperscript{97} eliminates the

\textsuperscript{94}See S. 326, 137th Gen. Assembly (1994) (enacted). The applicable portion of Senate Bill No. 326 reads as follows: "Section 1. Amend Section 218(a), Chapter 1, Title 8, Delaware Code, by deleting the words 'One or more stockholders' appearing at the beginning thereof and inserting in lieu thereof the words 'One stockholder or two or more stockholders.'" Id. (emphasis added).

\textsuperscript{95}See id. The synopsis to S. 326 explains that the amendment "clarifies that a voting trust may be established by a single stockholder alone or by two or more stockholders together." Id.

\textsuperscript{96}Id.

\textsuperscript{97}Del. Code Ann. tit. 8, § 218 (1991). Prior to the 1994 amendment, the applicable parts of § 218 read as follows:

(a) One or more stockholders may by agreement in writing deposit capital stock of an original issue with or transfer capital stock to any person or persons, or corporation or corporations authorized to act as trustee, for the purpose of vesting in such person or persons, corporation or corporations, who may be designated voting trustee, or voting trustees, the right to vote thereon for any period of time determined by such agreement, \textit{not exceeding 10 years}, upon the terms and conditions stated in such agreement.

(b) At any time within 2 years prior to the time of expiration of any voting trust agreement as originally fixed or as last extended as provided in this subsection, 1 or more beneficiaries of the trust under the voting trust agreement may, by written agreement and with the written consent of the voting trustee or trustees, extend the duration of the voting trust agreement \textit{for an additional period not exceeding 10 years} from the expiration date of the trust as originally fixed or as last extended, as provided in this subsection. The voting trustee or trustees shall, prior to the time of expiration of any such voting trust agreement, as originally fixed or as previously extended, as the case may be, file in the registered office of the corporation in this State a copy of such extension agreement and of his or their consent thereto, and thereupon the duration of the voting trust agreement shall be extended for the period fixed in the extension agreement; but no such extension agreement shall affect the rights or obligations of persons not parties thereto.

(c) An agreement between 2 or more stockholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as provided by the agreement, or as the parties may agree, or as determined in accordance with a procedure agreed upon them. \textit{No such agreement shall be effective for a term of more than 10 years}, but, at any time within 2 years prior to the time of the expiration of such agreement, the parties may extend its duration for as many additional periods, each not to exceed 10 years, as they may desire.

(d) The validity of any such voting trust or other voting
ten year limitation previously applicable to voting trusts and voting agreements. Implicit in the decision to eliminate the ten-year cap on voting trusts and agreements is a recognition that modern corporate law generally views these devices much differently than did common law. Historically voting trusts were viewed as suspect and therefore warranted the need for scrutiny and specific limitations on their duration. The amendment of section 218 is a recognition by the Delaware legislature that the trend is to view voting trusts as serving valuable corporate

agreement, otherwise lawful, shall not be affected during a period of 10 years from the date when it was created or last extended by the fact that under its terms it will or may last beyond the 10-year period.

(e) This section shall not be deemed to invalidated any voting or other agreement among stockholders or any irrevocable proxy which is not otherwise illegal.

Id. (emphasis added).

58S. 326, 137th Gen. Assembly (1994) (enacted). The appropriate portions of Senate bill No. 326 read as follows:

Section 2. Amend Section 218(a), Chapter 1, Title 8, Delaware Code, by deleting the clause "not exceeding 10 years," appearing in the first sentence thereof.

Section 3. Amend Section 218(b), Chapter 1, Title 8, Delaware Code, by deleting such subsection in its entirety and inserting in lieu thereof the following: "(b) Any amendment to a voting trust agreement shall be made by a written agreement, a copy of which shall be filed in the registered office of the corporation in this State."

Section 4. Amend Section 218(c), Chapter 1, Title 8, Delaware Code, by deleting the second sentence thereof in its entirety.

Section 5. Amend Section 218, Chapter 1, Title 8, Delaware Code, by deleting subsection (d) thereof in its entirety.

Section 6. Amend Section 218, Chapter 1, Title 8, Delaware Code, by relettering subsection (e) thereof to become subsection (d) thereof.

Section 7. This Act shall become effective on July 1, 1994, provided that it shall not apply to any voting trust agreement or voting agreement entered into, or any amendment thereto entered into, prior to such effective date unless and only to the extent that (i) such voting trust agreement, voting agreement or amendment thereto, as the same may have been extended, has not expired as of such effective date, and (ii) such voting trust agreement, voting agreement or amendment thereto provides that it will or may last beyond the 10 year period formerly permitted under § 218 and expressly indicates that the parties intended to be bound by changes in the law increasing the permitted duration of such agreement or amendment.

Id.

purposes. Therefore, the elimination of the ten year limitation is simply a step toward further acceptance of the voting trust. Delaware was not the first state to recognize the trend toward easing voting trust durations. Pennsylvania and New Jersey amended

100 Although the voting trust is capable of being abused, it has legitimate application in situations where a particular stockholder group needs to retain control. A few of these legitimate uses include:

Where a corporation had defaulted on its bonds and the bondholders were willing to withhold foreclosure proceedings only if a management was installed and maintained in control which the bondholders had confidence; or where the corporation had been reorganized on the basis of the creditors taking long-term paper for their debts and the creditors insisted on a permanent management satisfactory to them until the indebtedness to them had been paid. Voting trusts are also used in amalgamations, where two or more corporations merge or consolidate and each group of new stockholders is anxious that the control of the corporation be unified for the benefit of all and that each group have representation on the board of directors rather than that the control and management be taken over by whichever side can control the most votes.

There is often a demand for a voting trust when a new corporation is organized. The stockholders making the demand may be the original organizers who believe that the successful implementation of their concept requires the making and carrying out of a consistent plan of operation. They may be potential investors who are asked to make substantial investments in the corporation, for less than a majority of the stock and who may insist, as a condition of their subscriptions, that all the stock of the corporation be placed in a voting trust.


(a) Voting trusts. — One or more shareholders of any business corporation may, by agreement in writing, transfer all or part of their shares to any person for the purpose of vesting in the transferee voting or other rights pertaining to the shares upon the terms and conditions and for the period stated in the agreement.

Id.


(1) One or more shareholders of a corporation may confer upon a trustee or trustees the right to vote or otherwise represent his or their shares, for a period not to exceed 21 years, by entering into a written voting trust agreement specifying the terms and conditions of the voting trust, by filing an executed counterpart of the agreement at the registered office of the corporation and by depositing his or their shares of an original issue with, or by transferring his or their shares to, such trustee or trustees for the purposes of the agreement.

Id.
their corporate codes to extend or eliminate the ten year limitation. Thus, Delaware’s elimination of the ten year restriction can be viewed as an effort to keep pace with neighboring states’ corporate codes and keep Delaware’s business law in the forefront of change.

C. Conclusion

The statutory amendments to sections 145 and 218 of the DGCL should help preserve Delaware’s position as the repository of much of the nation’s business law. The changes to section 145 enhance the clarity of Delaware law on the issue of indemnification and promotes the speedy resolution of disputes in this area. The amendments to section 218 refine Delaware’s law on voting trusts and agreements and evidence the state’s commitment to keep in step in this developing area of the law.

*Brenda G. Houck*
DELAWARE'S NEW MANDATE
IN CLASS ACTION SETTLEMENTS: EXPANDING THE SCOPE
AND INTENSITY OF SETTLEMENT REVIEW

I. INTRODUCTION

The Delaware courts have long recognized that the class action mechanism occupies a unique position in the law of Delaware. The class action is distinct from nearly all other forms of adjudication because the suit not only determines the rights of the named parties but also may bind an extensive class whose interests are not individually represented. Cognizant of the heightened potential for abuse and mismanagement inherent in this form of litigation, the Delaware Chancery Court, in Chancery Court Rule 23, provides for a more active judicial role in the resolution of class actions.

When faced with a potential class action, a court must be mindful to protect the absentee class from the inherent dangers of representative litigation. Further, it must guard against the risk that the settlement is the product of collusion between the plaintiff and defense counsel. This judicial task is made even more daunting by the fact that the purported adversaries, having already privately resolved their differences, present the court with a uniform front in support of the settlement proposal.


3See Wied v. Valhi, Inc., 466 A.2d 9, 15 (Del. 1983), cert. denied, 465 U.S. 1026 (1984) (stating "Rules 23 and 23.1 are intended to guard against surreptitious buy-outs of representative plaintiffs, leaving other class members without recourse"). This is not to suggest that the class action is a hopelessly flawed form of adjudication. To the contrary, the class action has remained an important part of both Delaware and national jurisprudence because of the substantial benefits it confers on both the parties and the court. For instance, the class action allows plaintiffs, who individually would not have the means to seek a remedy, to combine their claims in a single suit. See Lazos, supra note 2, at 311.

4See, e.g., Kahn v. Occidental Petroleum Corp., No. 10,808, 1989 Del. Ch. LEXIS 92, at *8, 9 (Del. Ch. July 19, 1989), reprinted in 15 Del. J. Corp. L. 654, 660 (1990) (opining "I increasingly suspect that in some cases plaintiffs' counsel seem to be primarily motivated by the huge counsel fees now being generated in class and stockholder derivative actions and that defendant corporations are often willing to pay the fees to obtain a res judicata bar to claims against the corporation").

is in this context that the court of chancery must evaluate the settlement's "intrinsic fairness." 6

The response of the Delaware courts has traditionally been to engage in a factually intensive review of the available record and then to compare the strength of the plaintiffs' claims against the proposed consideration. 7 While this analysis still commands the bulk of the courts' attention in its review of proposed settlements, 8 several recent cases demonstrate that the courts are also directing increased scrutiny to the process which produces the settlement proposal.

This note examines the Delaware courts' recent trend toward expanding the scope of the judicial role in shareholder class action settlements. Parts II and III probe the aspects of the chancery court's increased scrutiny of the processes which yield the proposed settlements. Specifically, Part II addresses the chancery court's focus on the adequacy of the record as a precursor to evaluating the fairness of a proposed settlement. That section concludes with a review of the court's recent decision in Lewis v. Hirsch. 9 Part III examines the class action certification process under the Delaware Court of Chancery Rules. Part IV discusses the role of class certification in both the litigation and settlement contexts and ends with an evaluation of Delaware's position on the use of temporary settlement classes announced in Prezant v. De Angelis. 10

---

7See Polk v. Good, 507 A. 2d 531, 536 (Del. 1986). Evaluating the substantive fairness of the settlement itself involves application of the court's business judgment to determine the settlement's overall reasonableness. Id. To this end the court considers:
(1) the probable validity of the claims, (2) the apparent difficulties in enforcing the claims through the courts, (3) the collectibility of any judgment recovered, (4) the delay, expense and trouble of litigation, (5) the amount of the compromise as compared with the amount and collectibility of a judgment, and (6) the views of the parties involved, pro and con.
8Id. For an overview of this analysis applied in some recent Delaware decisions, see Theresa L. Kelly, Comment, J.L. Schifman & Co. v. Standard Industries, Inc. and Other Recent Settlement Proposal Cases, 19 DEL. J. CORP. L. 448 (1994).
10636 A. 2d 915 (Del. 1994).
II. ADEQUACY OF THE RECORD

A. Recent Decisions Addressing Adequacy of the Record

The adequacy of the record presented to the chancery court by the proponents of a settlement bears directly upon the court's ability to evaluate the settlement. Traditionally, the court has required in all cases that the settlement proponents provide it with sufficient information to reach a "fair and informed decision" concerning the reasonableness of the proposed settlement.\footnote{Fins v. Pearlman, 424 A.2d 305, 308 n.4 (Del. 1980). The burden of demonstrating such reasonableness rests on the parties seeking approval of the settlement. \textit{Id.} at 308.}

Delaware courts have considered an adequate record crucial in evaluating the fairness of the proposed settlement. In \textit{In re Amsted Industries, Inc. Litigation},\footnote{521 A.2d 1104 (Del. Ch. 1986).} the court articulated the substantive questions that both the party-proponents of the settlement and the court must answer before evaluating the fairness of any proposed settlement:

1. does one know enough about the strengths and weaknesses of the claims and about any defenses to sensibly and competently evaluate the value of the claims and
2. does the proposal being evaluated represent a fair and reasonable judgment concerning the value of those claims, given what one knows.\footnote{See \textit{Amsted}, 521 A.2d at 1107. The chancellor stated: That is, the trial court will have already determined that the representative party satisfies the standards of Rule 23(a) and, thus, it may safely conclude that any settlement proposed by such a plaintiff, if negotiated in good faith, represents at least one rational view of a fair and reasonable settlement. \textit{Id.} The validity of this assumption may be questionable where provisional certification has been permitted for the purposes of settlement. See discussion \textit{infra} part III.B.-C.}

Both questions must be answered when the representative plaintiff and the court possess less than full information.\footnote{See \textit{In re Amsted Indus., Inc. Litig.}, No. 8224, 1988 Del. Ch. LEXIS 116, at \textit{*3} (Del. Ch. Aug. 24, 1988), \textit{reprinted in} 14 Del. J. Corp. L. 611, 614 (1989), \textit{aff'd sub nom.} Barkan v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989) (noting that court's judgment as to the fairness and adequacy of the settlement must necessarily be made on incomplete information).} While on its face the burden seems imposing, the chancellor required that when confronting these issues, the court previously determine that the representative plaintiff fulfilled the requirements of certification.\footnote{\textit{See Amsted}, 521 A.2d at 1107. The chancellor stated: That is, the trial court will have already determined that the representative party satisfies the standards of Rule 23(a) and, thus, it may safely conclude that any settlement proposed by such a plaintiff, if negotiated in good faith, represents at least one rational view of a fair and reasonable settlement. \textit{Id.} The validity of this assumption may be questionable where provisional certification has been permitted for the purposes of settlement. See discussion \textit{infra} part III.B.-C.} Thus, the court may defer,
to a certain extent, to the good faith judgment and competence of the representative party and his counsel who, ostensibly, have resolved the above questions in favor of the decision to settle.\textsuperscript{16}

From this reasoning, the chancellor formulated the general rule that:

\begin{quote}
[i]f a representative party's determination to negotiate and recommend a settlement is made (1) in good faith and (2) upon competent information then such a proposed settlement should ordinarily be approved if (3) it appears fair and reasonable to the court based upon what the representative plaintiff and his counsel knew about the claims and defenses at the time the settlement accord was reached (or when it became binding on the representative).\textsuperscript{17}
\end{quote}

Conspicuously absent from this rule is any mention of adequacy of the record as a component in evaluating the fairness of the settlement itself.\textsuperscript{18}

However, Amsted suggests two prerequisites for determining whether a settlement is fair and reasonable. First, the named party's choice to begin negotiations and, ultimately, to accept the settlement must be the product of his judgment exercised in good faith.\textsuperscript{19} Second, these decisions must be made by the representative party "upon competent information."\textsuperscript{20} The former requires a showing that the class representative and class counsel "have proceeded in good faith, with the single goal of protecting class interests."\textsuperscript{21} This first condition spawns from Rule 23(e)'s purpose to "guard against surreptitious buy-outs of representative plaintiffs, leaving other class members without recourse."\textsuperscript{22} The latter requirement mandates that the named party act competently in exercising his judgment to begin settlement negotiations and recommend a settlement.\textsuperscript{23} This requirement serves to protect absent class members.\textsuperscript{24}

\textsuperscript{16}\textit{See Amsted,} 521 A.2d at 1107-08.
\textsuperscript{17}\textit{Id.} at 1108.
\textsuperscript{18}\textit{Id.} Instead, it appears from the rule itself that the court recognized the record is to some degree incomplete because, as the italicized portion of the above quotation indicates, the rule evaluates the fairness of the settlement in light of the information available to the representative plaintiff at the time the settlement was reached. \textit{Id.}
\textsuperscript{19}\textit{Id.}
\textsuperscript{20}\textit{Amsted,} 521 A.2d at 1108.
\textsuperscript{21}\textit{Id.}
\textsuperscript{22}\textit{Wied,} 466 A.2d at 15.
\textsuperscript{23}\textit{Amsted,} 521 A.2d at 1107-08.
\textsuperscript{24}\textit{Id.} at 1108.
Typical objectors' challenges to the adequacy of the record have disputed both the settling plaintiffs' good faith and competency. *In re Mobile Communications Corp. of America, Inc.*\(^\text{25}\) is a specific example of such an occurrence. Objecting class members contended that the barren state of the record demonstrated inadequate investigation of their claims.\(^\text{26}\) Specifically, objectors argued that the settling plaintiffs' willingness to compromise such large claims on so little information demonstrated their bad faith.\(^\text{27}\) In addition, the non-settling plaintiffs maintained that settlement approval was inappropriate because the representative plaintiffs and the court lacked sufficient information to evaluate the strengths and weaknesses of the claims.\(^\text{28}\)

The chancery court rejected both challenges to the adequacy of the record. As to the claims of bad faith, the court stated that it could "find no basis to infer inappropriate selfish motivations."\(^\text{29}\) Regarding objectors' claims of incompetence, the chancellor indicated that wide deference would be given to a plaintiffs' decision to settle.\(^\text{30}\) Moreover, the chancellor offered an alternate explanation for plaintiffs' decision to settle. Both the circumstances surrounding plaintiffs' claims and the state of the litigation indicated that the plaintiffs had little chance of obtaining a favorable and early resolution.\(^\text{31}\)

In *In re Republic American Corp. Litigation*,\(^\text{32}\) the chancery court reached a different result while addressing similar objections to the settlement of litigation arising out of a proposed merger.\(^\text{33}\) In so doing, the court appeared to set minimum standards of representative plaintiff competence that must be reflected in the record. At a minimum, the record must include "identification of the claims to be settled and an identification of the consideration to be paid" before the representative


\(^{26}\) Id. at 92,572, reprinted in 17 Del. J. Corp. L. at 317.

\(^{27}\) Id. Objectors cast this bad faith as an early settlement designed only to secure attorneys' fees rather than to protect the class interests. Id.

\(^{28}\) Id.


\(^{30}\) Id. at 92,573, reprinted in 17 Del. J. Corp. L. at 319.

\(^{31}\) Id. at 92,573, reprinted in 17 Del. J. Corp. L. at 319-20.


\(^{33}\) Id. at *2, reprinted in 15 Del. J. Corp. L. at 216.
plaintiff, his counsel, or the court can accurately evaluate the fairness of the settlement.34

The court initially indicated that the record adequately identified the consideration offered in settlement of the claims.35 Likewise, the chancellor found that he could identify the underlying claim as alleging that the defendant-directors had breached their fiduciary duty to the corporation by approving the merger at an inadequate price.36 The chancellor also pointed out that the gaps in the record would not have been material had the directors’ decision been protected by the business judgment rule.37 However, in this case, the plaintiffs’ claims appeared stronger because the board’s merger decision fell outside the rule’s protection.38 Settlement proponents had neither secured an expert witness nor obtained deposition testimony addressing the applicability of the rule.39 Therefore, the court found the record wanting because the proponents of the settlement had offered insufficient evidence to permit a determination of whether the settlement represented a fair compromise of these stronger claims.40

Interestingly, In re First Boston, Inc. Shareholders Litigation41 indicates that a record can be considered inadequate without attributing the cause to bad faith or incompetence of the settling plaintiffs. The plaintiffs asserted numerous claims involving breaches of fiduciary duties and disclosure violations arising out of a "going private" transaction.42 The court first addressed the value of the majority of these claims relative to the consideration offered for their release and found that the record supported approval of the settlement.43 However, with respect to two of the claims, purporting disclosure violations, the chancellor concluded that

---

34Id.
35Id. at *3-4, reprinted in 15 Del. J. Corp. L. at 216.
37Id. at *5, reprinted in 15 Del. J. Corp. L. at 217.
38Id. at *5-6, reprinted in 15 Del. J. Corp. L. at 217-18.
39Id. at *6, reprinted in 15 Del. J. Corp. L. at 218. Thus, the court lacked any indication whether the settlement contemplated the business judgment rule’s inapplicability. Id.
42Id. at 96,539.
43Id. at 96,539-96,542.
the court was unable to evaluate the fairness of the settlement. Significantly, the court indicated that these lapses might not be the fault of the parties but, rather, the court’s inability to draw the necessary conclusions from what was present in the record. As a result, the chancellor did not reject the settlement outright even though the parties had not technically met their burden of demonstrating its fairness. Instead, the chancellor stayed the motion pending additional briefing on the issues and raised the possibility of additional discovery.

This sampling of chancery settlement approval decisions demonstrates that the court will usually frame the issue of adequacy of the record as reflecting upon the representative plaintiffs’ good faith and competence. This scrutiny will be directed at both the representative’s decision to begin settlement negotiations and the decision to accept a particular settlement offer. Moreover, the decisions indicate that such scrutiny of the record must occur as a precursor to the court’s evaluation of the settlement for its overall fairness. Lastly, it appears that for the record to be found sufficient it must identify the claims to be compromised and the settlement consideration offered with enough specificity to allow the court to meaningfully evaluate the fairness of the proposed settlement.

B. Lewis v. Hirsch: Further Defining the Adequacy of the Record

1. The Facts

The underlying claim in this action initially arose as a stockholder derivative action against United States Surgical Corporation and its directors. The complaint, as originally filed in April 1992, asserted only claims of excessive compensation paid to certain defendant-directors. Following the initiation of this suit, an additional action was filed in

---

44 Id. at 96,542.
46 Id.
47 Id.
49 Id. Such "grossly excessive compensation" was alleged to have taken the form of cash, bonus payments, and stock options. Id. This compensation scheme was recommended by a committee comprised mostly of disinterested outside directors with expert advise and was subsequently approved by a majority of U.S. Surgical’s stockholders. Id. at 90,616.
Delaware and two actions were filed in the Connecticut United States District Court. The Delaware action asserted insider trading, and the federal action contained allegations of federal securities law violations.

Following initiation of these actions, plaintiffs and defendants in the original Lewis action reached a settlement which was approved by U.S. Surgical’s board on December 17, 1993. The proposed settlement provided for compromise of the claims in exchange for a reduction in the time for the exercise of the directors’ stock options from ten to seven years. U.S. Surgical’s board of directors approved the proposed settlement with the defendant-directors abstaining.

On December 27, 1993, after negotiating the proposed settlement, the Lewis plaintiffs amended their complaint to include insider trading claims. These claims alleged that between May 1991 and April 1993 the defendant-directors were aware of adverse business conditions and changes at U.S. Surgical and sold large amounts of their stock at high prices before the general public had access to such information. Specifically, the assertions centered around the directors’ involvement in and knowledge of U.S. Surgical’s implementation of a Just in Time Inventory Program (JIT). The decline in company sales and in the price of the company stock was largely attributed to the use of the JIT program.

2. The Objectors’ Arguments

At the hearing on the proposed settlement, two groups of objectors, the Chanoff objectors and the DiCicco objectors, challenged the settlement. The objectors offered numerous arguments in opposition to
the settlement’s approval. These arguments challenged primarily the
terms of the settlement and the approval process used by U.S. Surgical’s
board of directors.\textsuperscript{62} Significantly, the objectors maintained that the
Lewis plaintiffs had failed to adequately investigate the insider trading
claims before reaching settlement.\textsuperscript{63}

Furthermore, the objectors contended that Lewis failed to make use
of and develop evidence already in the record. In particular, they alleged
that Lewis had failed to contact them regarding the insider trading
allegations made in their Connecticut complaint.\textsuperscript{64} Moreover, the
objectors maintained that the Lewis plaintiffs had failed to depose or, in
cases where depositions were taken, to develop the testimony of principal
defendants regarding the schedule for the introduction of the JIT
program.\textsuperscript{65} Finally, the objectors contended that Lewis failed to obtain
documents that would have shed light on the corporation’s schedule for
implementing the JIT scheme.\textsuperscript{66}

Lewis countered by asserting that he acted competently in
investigating the insider trading claims\textsuperscript{67} and by raising several defenses
to the underlying claims of insider trading.\textsuperscript{68} These arguments focused

\begin{itemize}
\item[62] Specifically, the objectors first disputed the scope of the release of claims included
in the settlement as it related to the federal claims. \textit{Id.} Second, they maintained that the
settlement as it pertained to the excessive compensation claims afforded an insignificant benefit
to the corporation. \textit{Id.} at 90,617. Third, they alleged that the board of directors’ approval of
the settlement was improper because defendant-directors comprised a majority of the board.
\textit{Id.} Fourth, the objectors asserted that the insider trading claims should not have been included
within the settlement because the board approved the settlement before those claims were added
to the settlement. \textit{Id.} Fifth, they contended that the settlement’s provision indemnifying
directors against the cost of attorneys’ fees was improper. \textit{Id.}

\item[63]\textit{Id.}

\item[64]\textit{Hirsch, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, 90,617. The Chanoff complaint contained allegations that one of the defendants had stated that the company had begun the JIT system in the first quarter of 1992 and that it was operating ineffectively by the end of 1992. \textit{Id.} The objectors maintained that this statement indicated that the defendant possessed knowledge that would serve as an inducement to unload U.S. Surgical’s stock before the problems with the JIT program became public knowledge. \textit{Id.}

\item[65]\textit{Id.} at 90,617-90,618. Among the depositions Lewis had failed to obtain was that of
U.S. Surgical’s president and chief executive officer who had made over $78 million by
exercising the company’s stock options during the period covered by the complaint. \textit{Id.} at
90,618.

\item[66]\textit{Id.}

\item[67]\textit{Id.} Specifically, Lewis claimed that he had promptly begun investigation when the other Delaware action was filed, obtained copies of every one of the company’s press releases, and reviewed pertinent internal documents of the company. \textit{Id.}

primarily on demonstrating the difficulty in proving a claim of insider trading.

3. The Chancery Court's Decision

The court felt the settlement consideration was appropriate when compared to the difficulty the plaintiffs would encounter in attempting to prove the excess compensation claims. In addition, the court found that any improprieties in the decision of U.S. Surgical's board to accept the settlement were insufficient to prevent approval of the settlement which otherwise appeared fair and reasonable. The chancellor concluded by stating that "[i]f the excessive compensation claims were the only claims being compromised, the proposed settlement would be approved as being fair and reasonable in light of all the circumstances."

The court next turned to the objectors' arguments that Lewis had failed to adequately investigate the insider trading claims. The chancellor ruled the settlement could not be evaluated for its fairness on the present record because Lewis had failed to demonstrate adequate investigation of the insider trading claims.

The chancellor determined that Lewis' efforts were misdirected because he had failed to focus on the primary issues pertinent to the insider trading claims. Specifically, the court indicated that Lewis had failed to address:

---

Lewis argued, inter alia, that (1) the decline in the stock price was caused by publicly available information; (2) several of the defendants engaged in a regular program of stock transactions unrelated to insider trading; (3) such stock sales were proper under the Securities and Exchange Commission's "same day rule" making it legal to sell the stock on the same day the options were exercised; (4) the stock sales themselves were known to the public; and (5) for various reasons, the defendants did not have access to information regarding the JIT program or could not have anticipated the decline in stock price it would cause. Id.

Id. at 90-616. The court recognized that decisions pertaining to executive compensation usually fall within the protection of the business judgment rule and, therefore, Lewis had little chance of successfully arguing this point. Id.

Id. at 90,617. The court, however, mentioned that it would have been more desirable had a committee of outside, non-defendant directors considered the settlement proposal. Id.

Hirsch, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,618. In deciding this issue, the court seemed to dwell on the deficiencies in the record relating to both the direction and thoroughness of Lewis's investigation of the insider trading claims. Id. at 90,618-90,619.

Id.
(1) at what point did the individual defendants know that increased competitive pressures and implementation and increased use of the JIT program would have adverse effects on Company sales and the price of U.S. Surgical stock; (2) whether the individual defendants delayed advising the other stockholders of this adverse information; and (3) whether the defendants sold their stock based on this inside information before the public was informed of these developments and adverse effects, thereby making huge profits for themselves before the price of U.S. Surgical stock plummeted.74

As a result, even Lewis’s completed investigation of the claims was not useful to the court.75

The court further indicated that Lewis had failed to adequately utilize discovery to develop relevant information. In particular, the court remarked that Lewis had not obtained or pursued one of the defendant’s allegedly conflicting statements which appeared in the Chanoff complaint.76 In addition, the court found the record wanting because Lewis had not detailed what documents he had examined or what relevant information, if any, they contained.77

The court also recognized that the defenses raised by Lewis would render moot the dubious aspects of the record if they operated as absolute bars to the insider trading claims.78 Nevertheless, the court determined that these defenses could be defeated at trial by evidence bearing on the issues the chancellor had identified.79 As a result, the court was unable to assess the strength of the insider trading claims and, thus, the fairness of the settlement.

4. Evaluation

Placed in the context of the chancery court’s earlier decisions addressing the adequacy of the record, *Lewis v. Hirsch*80 suggests increasing wariness of potential abuses in the settlement process.

---

74 Id.
75 Id. at 90,618.
77 Id.
78 Id.
79 Id.
Moreover, by closely examining the adequacy of the record, the court found a mechanism by which it can deter settlement proposals without explicitly challenging the adequacy of representation or asserting overt collusion in the settlement process.

While the Delaware Chancery Court has long recognized that an inadequate record may signify a settling plaintiff’s bad faith or incompetence, it traditionally has accorded significant deference to the plaintiff’s decision to settle. For instance, in In re Mobile Communications Corp. of America, Inc., the court, refusing to entertain objectors’ arguments of inadequate investigation, characterized the plaintiffs’ decision that they possessed enough information to settle as a "professional judgment[] . . . which will necessarily be made on imperfect information."

In contrast, in Lewis v. Hirsch, the deficiencies in the record were not immediately apparent. Plaintiff Lewis possessed information indicating that significant defenses could be raised against his claims. Moreover, the court seemed to suggest that the Lewis plaintiff should have contacted the plaintiffs in the separately brought Connecticut federal actions in order to develop testimony relating to the inside trading allegations. Such an expectation appears to rise above the level of scrutiny the court has historically applied in such a situation.

This increased scrutiny is derived from the court’s reluctance to characterize settlements as collusive or to find that plaintiffs are inadequate class representatives. Even in the most extreme cases the court has declined to rule that the settlement was collusive or that the named plaintiff was an inadequate representative. For example, in Stepak v. Tracinda Corp., the consideration offered in settlement of class claims represented only 4.5¢ per share in cash and a distribution of several B-Movie videotapes. The court held that

81See Amsted Indus., 521 A.2d at 1107-09 (stating settlements, if fair and reasonable, should normally be approved absent evidence of plaintiff’s bad faith or incompetence in the record at the time the settlement was reached).
83Id. at 92,573, reprinted in 17 DEL. J. CORP. L. at 319.
85Id. at 90,619.
87Id. at *13-14, reprinted in 15 DEL. J. CORP. L. at 759. The defendants argued that the tapes were worth over $6 million, but the court concluded that the tapes had "so little value to the members of the class as to hardly merit serious consideration." Id. at *14, reprinted in
approval of such a proposal would . . . threaten to hold the class action mechanism up to justifiable scorn and to charges . . . that the stockholder class action mechanism represent[s] nothing so much as a device for lawyers to enrich themselves while serving no practical interest of those for whom they are charged to act.  

However, despite its obvious displeasure with the settlement, the court stopped short of disqualifying the class representative or explicitly calling the settlement collusive.  

In comparison, in Lewis v. Hirsch, the settlement contained significant consideration leading the court to state that the settlement represented a fair compromise of some of the claims. However, some hints of collusive behavior were present. Significantly, the Lewis plaintiffs only added the insider trading claims to their complaint after reaching a settlement with the defendants. While the court considered this conduct immaterial in light of the settlement consideration offered, it did imply such claims could be properly added only before reaching the settlement agreement.  

Nonetheless, the court in Lewis rendered unnecessary any lengthy consideration of the propriety of this arrangement in light of its close scrutiny of the record. Had the insider trading claims been included only as an afterthought to secure settlement, scrutiny of the record would have revealed that the Lewis plaintiffs had not adequately investigated leads pertinent to these claims. Thus, the court avoided a possibly suspect settlement without the need to directly confront the issues of collusion and inadequate representation.

15 Del. J. Corp. L. at 760.

95Id. at *19, reprinted in 15 Del. J. Corp. L. at 762.

96See id. at *16-19, reprinted in 15 Del. J. Corp. L. at 762. Instead, the chancellor evaluated the overall fairness of the settlement consideration and found it grossly inadequate to support a compromise of the class claims. Id. at *12-19, reprinted in 15 Del. J. Corp. L. at 759-62.


98Id. at 90,617.

99Id. at 90,615.

99Id. at 90,617.

III. Class Certification in Adversarial Litigation and Settlement

A. Formal Class Certification

1. Generally

The decision whether to certify a shareholder suit as a class action under Rule 23(c)(1)\textsuperscript{95} is widely recognized as "the single most important issue in the case."\textsuperscript{96} Moreover, the certification proceedings offer the single best opportunity for the judge to familiarize himself with an often complex action.\textsuperscript{97} Thus, the importance of the certification decision in the class action cannot be overstated.

The import of the certification issue derives from the very nature of the class action procedure. The class action has developed as an invention of equity to enable it to proceed to a decree in suits where the number of those interested in the litigation was too great to permit joinder. The absent parties would be bound by the decree so long as the named parties adequately represented the absent class and the prosecution of the litigation was within the common interest.\textsuperscript{98}

To ensure fairness, the certification decision primarily focuses on whether the interests of the vicariously represented class will be served by maintaining the suit as a class action.\textsuperscript{99} Thus, class certification is mandated by both Constitutional due process considerations\textsuperscript{100} and the plain language of Rule 23(c)(1).\textsuperscript{101}

\textsuperscript{95}Chancery Court Rule 23(c)(1) provides: "As soon as practicable after the commencement of an action brought as a class action, the Court shall determine by order whether it is to be so maintained. An order under this paragraph may be conditional, and may be altered or amended before the decision on the merits." \textit{Del. Ch. Ct. R. 23(c)(1)}.


\textsuperscript{97}See \textit{id.} at 12-13. Professor Arthur Miller instructs that certification proceedings allow the judge to "make a realistic appraisal as to how merit discovery can be managed, the legal and factual issues, the quality of the lawyers, and the motivation of the parties and attorneys." \textit{Id.} at 13.


\textsuperscript{100}Id. at *4, \textit{reprinted in} 8 Del. J. Corp. L. at 629.

\textsuperscript{101}See \textit{Del. Ch. Ct. R. 23(c)(1)} (requiring determination of whether suit can be
Although the court will likely learn much about the case from the certification proceedings, the inquiry should not center on the merits of the case. Ideally, certification insures that the class action procedure will address the merits of the case in a manner that is in the absentee class’s best interests. A representative plaintiff must fulfill seven requirements to secure class certification. The court must first find that class exists and that the representative plaintiff is a member of that class. In addition, the representative plaintiff must demonstrate that the four requirements of Chancery Court Rule 23(a) are satisfied. These requirements include

maintained as class action as soon as practicable after commencement of the suit). In addition, as a practical matter, a class must be properly certified to protect the settling defendant from further liability. Any judgment or settlement which purports to bind an uncertified or improperly certified class may be subject to successful collateral attack on due process grounds. See 2 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations and Business Organizations § 13.16 (2d ed. 1990 & Supp. 1992) (stating that when adequate representation, one of the requirements of certification, is not demonstrated then the class judgment becomes subject to collateral attack).


Miller, supra note 96, at 15, 17-18. Delaware courts have often implicitly made these determinations while addressing other elements of certification. See, e.g., Van de Walle, No. 7046, 1983 WL 8949, at *3, reprinted in 8 Del. J. Corp. L. at 627-28 (addressing whether named plaintiff must show support from members of purported class in context of Rule 23(a)(3) typicality requirement). See also Zimmerman, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,435, at 97,224, reprinted in 16 Del. J. Corp. L. at 1694-96 (considering defendant’s argument that plaintiff had not satisfied the Rule 23(a)(3) typicality requirement because plaintiff alleged not to be a member of the class). For purposes of clarity, these requirements are addressed independently of the Rule 23(a) requirements in this article. See infra notes 110-13 and accompanying text.

Chancery Court Rule 23(a) provides:

One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.


Nottingham Partners v. Dana, 564 A.2d 1089, 1094-95 (Del. 1989).
numerosity, commonality, typicality, and adequacy of representation.\textsuperscript{103} If such a showing is successfully made, the class plaintiff must then establish that the action subscribes to one of the three accepted forms under subsection (b) of Chancery Court Rule 23.\textsuperscript{109} After a representative plaintiff has affirmatively demonstrated these seven requirements, formal certification of the class is proper.

The two judicially created prerequisites to certification are usually easily satisfied in the shareholder context. First, in order to qualify as a class, the group identified must be objectively discernable based on the definition of the class found in the complaint.\textsuperscript{110} Once the existence of

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{103}See supra note 106.
\item \textsuperscript{109}Nottingham Partners, 564 A.2d at 1095. Chancery Court Rule 23(b) states: An action may be maintained as a class action if the prerequisites of paragraph (a) are satisfied, and in addition:
\begin{enumerate}
\item The prosecution of separate actions by or against individual members of the class would create a risk of:
\begin{enumerate}
\item Inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or
\item Adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests;
\end{enumerate}
\item The party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or
\item The Court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the finding include:
\begin{enumerate}
\item The interest of members of the class in individually controlling the prosecution or defense of separate actions;
\item The extent and nature of any litigation concerning the controversy already commenced by or against members of the class;
\item The desirability or undesirability of concentrating the litigation of the claims in the particular forum;
\item The difficulties likely to be encountered in the management of a class action.
\end{enumerate}
\end{enumerate}
\end{enumerate}
\end{footnotesize}
the class is established, the plaintiff is under no additional obligation to
demonstrate visible support from the class.\textsuperscript{111} Second, the named plaintiff
must show that he is a member of the purported class.\textsuperscript{112} This task is also
easily accomplished by examining ownership records to determine if the
plaintiff had an interest at the time the alleged wrong occurred.\textsuperscript{113}

The first statutory requirement, numerosity, is satisfied when the
representative party proves that joinder of the individual plaintiffs to be
included in the class is impractical.\textsuperscript{114} There is no "magic number" which
seems to automatically warrant certification. Instead, the court inquires
into the relevant circumstances of the case.\textsuperscript{115}

The second statutory requirement necessitates that the class plaintiff
demonstrate that "there are questions of law or fact common to the
class."\textsuperscript{116} Like numerosity, this requisite to certification usually presents
little difficulty to the potential class representative.\textsuperscript{117} The rule requires
only a showing that common issues are present; such questions need not be "important or controlling."\textsuperscript{118}

Next, Chancery Court Rule 23(a)(3) requires that the "claims or
defenses of the representative parties are typical of the claims or defenses
of the class."\textsuperscript{119} The Delaware courts appear to have read the rule in the
context of the commonality requirement.\textsuperscript{120} Thus, where the issues and

\textsuperscript{111}Van de Walle, No. 7046, 1983 WL 8949, at *3, reprinted in 8 DEL. J. CORP. L. at 628 (stating that requiring plaintiff to demonstrate class support would conflict with the class action's purpose of providing a mechanism to address wrongs that plaintiffs might not address individually).

\textsuperscript{112}Miller, supra note 96, at 17-18.

\textsuperscript{113}See, e.g., Citron v. Fairchild Camera & Instrument Corp., No. 6085, 1985 WL 206533 (Del. Ch. Jan. 21, 1985), reprinted in 10 DEL. J. CORP. L. 633 (1986) (reviewing stock records to determine whether named plaintiff had transferred stock interest to son-in-law before challenged tender offer was made).

\textsuperscript{114}Zimmerman, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) \# 95,435, at 97,223, reprinted in 16 DEL. J. CORP. L. at 1692 (applying Rule 23(a)(1)).

\textsuperscript{115}Id. at 97,223, reprinted in 16 DEL. J. CORP. L. at 1692-93. The factors considered by the court include:

- geographical [sic] diversity of the class members, the nature of the action, the
- size of the individual claims, . . . whether personal jurisdiction can be
- obtained over some members of the class[,] . . . whether the class members
- can be easily identified and located, [and] the type of relief sought by the
- named plaintiffs.

\textsuperscript{116}DELAWARE JOURNAL OF CORPORATE LAW [Vol. 20

\textsuperscript{117}See Miller, supra note 96, at 25.

\textsuperscript{118}Id. at 24.

\textsuperscript{119}DELAWARE JOURNAL OF CORPORATE LAW [Vol. 20

\textsuperscript{120}See, e.g., Van de Walle, No. 7046, 1983 WL 8949, at *3, reprinted in 8 DEL. J.
injuries alleged by the representative plaintiff are substantially like those of the purported class, this requirement is satisfied.

The final statutory requirement, adequacy of representation, is the most difficult to satisfy and the most important of the rule’s requisites. Adequacy of representation deserves intense scrutiny in any certification inquiry because of Rule 23’s potential to bind an entire class based on the actions of one or a few of its members. As one commentator has noted, "[A]dequacy of representation is the quintessence of due process in class actions." Because of the magnitude of the adequacy of representation issue, no attempt will be made to compress it into this overview of certification requirements. Instead, adequacy of representation is given broader treatment below.

Once all of the requirements of Rule 23(a) are satisfied, the class plaintiff must demonstrate that the action is maintainable within the contours specified in Chancery Court Rule 23(b). This task involves several due process issues pertaining to notice requirements, the opportunity to be heard, and the right to opt out of a class. Although detailed discussion of these aspects of certification is beyond the scope of this note, it is important to understand generally how Rule 23(b) distinguishes the different forms of class actions and the class members’ right under each.

The Delaware Supreme Court in Nottingham Partners v. Dana undertook the task of examining Rule 23(b) to identify what types of class actions are properly maintainable under the three categories provided by the rule. The court noted that Rule 23(b)(1) was aimed at class actions involving a threat to either the class members, or the class opponents, of being bound by conflicting obligations under multiple

---

120Rule 23(a)(4) requires that "the representative parties will fairly and adequately protect the interests of the class." Del. Ch. Ct. R. 23(a)(4).
123See discussion infra part III.A.2.
124See generally MILLER, supra note 96, at 40-41 (discussing Fed. R. Civ. P. 23(b)).
125564 A.2d 1089 (Del. 1989).
126Id. at 1094-101. However, it should be added that in Nottingham the court’s analysis was dicta because "the applicability of [Rule 23(b)(1)] had not been raised as an issue in [that] appeal." Id. at 1095 n.6.
judgments. In contrast, a Rule 23(b)(2) class action applies to class
claims made primarily for injunctive or declaratory relief. For
certification under this form, "[h]omogeneity in the rights and interests of
the class" is required.

Finally, the court in Nottingham Partners addressed class actions
certifiable under Rule 23(b)(3). This form of action is distinguishable
from the previous two in that it is primarily concerned with actions
requesting monetary, as opposed to equitable, relief. Certification
under 23(b)(3) is proper when "questions of law or fact common to the
members of the class predominate over any questions affecting only
individual members," and the "class action is superior to other avail-
able methods."

Rule 23(b) becomes even more important when evaluating the due
process rights of the class members upon entry of a judgment or approval
of a settlement. According to the United States Supreme Court's mandate
in Phillips Petroleum v. Schutts, due process requires that, in the
settlement of any class action certified under Rule 23(b)(3) as one
primarily for damages, class members must be provided with the
opportunity to withdraw from the class prior to settlement. By
withdrawing or opting out, the class members can preserve the right to
pursue on their own the same claims being settled by the rest of the
class.

2. Rule 23(a)(4) Adequate Representation

Rule 23(a)(4)'s requirement of adequate representation warrants
separate treatment from the other aspects of certification both because it
is one of the most frequently disputed certification issues and because of

128 Id. at 1095. A Rule 23(b)(1) class action might be employed in a case where the
class members pressed claims against a defendant with insufficient resources to satisfy all the
claims. 2 BALOTTI & FINKELSTEIN, supra note 101, § 13.18.
130Nottingham Partners, 564 A.2d at 1095.
131Id. at 1096.
133Id.
135Id. at 811-13.
136Cf. id. at 812 (rejecting argument that due process requires that class members
affirmatively opt in to settlement on basis that class members will usually only opt out if they
wish to pursue their claims independently).
its great importance in the overall certification inquiry.\textsuperscript{137} It is the special vicarious nature of the class action suit which makes adequacy of representation so important.\textsuperscript{138} Because the class action binds absent class members, due process mandates that the class representative act in the interest of all the members of the class.\textsuperscript{139} Without adequate representation, any judgment obtained through the class action becomes subject to collateral attack.\textsuperscript{140}

The Delaware courts have defined an adequate representative as one who is "qualified to serve in a fiduciary capacity as a representative of a class, whose interest is dependent upon the representative's adequate and fair prosecution."\textsuperscript{141} Implicit in this definition are the notions that the class representative will be free from economic or other conflicts with the absentee class and that the representative will vigorously prosecute the action for the class's benefit.\textsuperscript{142} In application, this means that "in . . . cases where the class action mechanism works well . . . relatively substantial investors act[] as real parties to the litigation and real clients to the attorneys prosecuting the suit."\textsuperscript{143}

The Delaware courts, in assessing the adequacy of representation, have focused on the good faith and competence of both the named plaintiffs\textsuperscript{144} and the class counsel.\textsuperscript{145} The inquiry into the good faith and competence of the named plaintiff is designed primarily to insure that the class representative has "an independent role even though, as a practical matter, it is the attorneys who handle the litigation and thus protect the interests of the class."\textsuperscript{146} This check is needed because the attorney's interest in obtaining fees might conflict with those of the class.\textsuperscript{147}

\textsuperscript{137} See Miller, supra note 96, at 27-28.

\textsuperscript{138} See Lazos, supra note 2, at 311. "[I]n class action suits, unlike traditional litigation, the plaintiffs do not act individually to protect their interests; rather, members of the absentee class rely on the class attorney and representative to pursue their interests vigorously." Id.

\textsuperscript{139} See, e.g., Van de Walle, No. 7046, 1983 WL 8949, at *4, reprinted in 8 DEL. J. CORP. L. at 629 (quoting duPont v. Wyly, 61 F.R.D. 615, 621 (D. Del. 1973)).

\textsuperscript{140} See 2 Balotti & Finkelstein, supra note 101, § 13.16.

\textsuperscript{141} Youngman v. Talmoush, 457 A.2d 376, 379 (Del. Ch. 1983).

\textsuperscript{142} See 2 Balotti & Finkelstein, supra note 101, § 13.16.


\textsuperscript{145} See, e.g., Van de Walle, No. 7046, 1983 WL 8949, at *5, reprinted in 8 DEL. J. CORP. L. at 631.

\textsuperscript{146} Tanzer v. Cavenham Ltd., No. 5349, 1980 WL 6428, at *2 (Del. Ch. May 2, 1980).

To insure that the named plaintiff is an adequate class representative, Delaware courts have focused on nearly every characteristic of the class representative. The chancery court in *Katz v. Plant Industries, Inc.*\(^{148}\) outlined a list of considerations that have since served as a guide to Delaware courts in evaluating the adequacy of the named plaintiff. These factors include:

"[1] economic antagonisms between [the] representative and class; [2] the remedy sought by plaintiff in the derivative action; [3] indications that the named plaintiff was not the driving force behind the litigation; [4] plaintiff's unfamiliarity with the litigation; [5] other litigation pending between the plaintiff and defendants; [6] the relative magnitude of plaintiff's personal interests as compared to his interest in the derivative [or class action] itself; [7] plaintiff's vindictiveness toward the defendants' and, [8] finally, the degree of support plaintiff was receiving from the shareholders he purported to represent."\(^{149}\)

The Delaware courts appear to have focused the inquiry primarily on whether the representative has conflicting interests to those of the class,\(^{150}\) whether the named plaintiff is the true interested party,\(^{151}\) and whether the plaintiff has knowledge of the claim.\(^{152}\)

The second part of the inquiry examines the fitness of the plaintiff's attorney for the position of class counsel. Generally, the


\(^{149}\)Id. at *2 (quoting David v. Comed, 619 F.2d 588 (6th Cir. 1980)). The court will combine these considerations in determining whether the plaintiff is an adequate representative; however, an excessive deficiency in one factor might be sufficient to disqualify a class representative. See *Youngman*, 457 A.2d at 379-80.

\(^{150}\)See, e.g., *Youngman*, 457 A.2d at 381 (requiring the defendant to show "a substantial likelihood that the derivative action is not being used as a device for the benefit of all stockholders" in order to disqualify the representative).

\(^{151}\)See, e.g., *Citron v. E.I. DuPont de Nemours & Co.*, No. 6219, 1983 WL 18002 (Del. Ch. May 18, 1983). If the named plaintiff is not the true interested party in the litigation, it may also indicate a conflict of interests between the representative and the class. See, e.g., *Field v. Allyn*, No. 5951, 1980 WL 6439 (Del. Ch. Sept. 25, 1980) (considering defendants' allegation that the class representative should have had a conflict of interest because he was actually a "stooge" for his stock broker).

\(^{152}\)See, e.g., *Joseph v. Shell Oil Co.*, No. 7450, 1985 WL 21125, at *2 (Del. Ch. Feb. 8, 1985) (finding representative "need not have read the complaints prior to the filing in order to be an adequate representative").
inquiry centers on the attorney's experience and skill in managing complex class action litigation, as well as the relationship between the attorney and the class representative. The court has usually resisted attempts to disqualify the class attorney because of a past history of involvement in shareholder class action suits. Likewise, even when the court has been presented with strong evidence pointing to an improper relationship between the representative plaintiff and attorney, its usual practice has been to grant certification.

This is not to suggest that the Rule 23(a)(4) adequacy of representation analysis is completely without teeth. While defendants bear a heavy burden in demonstrating that the class plaintiff and his counsel are inadequate class representatives, the scrutiny does effectively screen out plaintiffs who are overtly unfit to serve the interests of the class. Moreover, the court may exercise its discretion under Rule 23(d)(3) by requiring the representative party to make additional showings of his suitability to act on behalf of the class. However, on

153See, e.g., Lewis v. Fuqua Indus., No. 6534, 1982 WL 8783, at *5 (Del. Ch. Feb. 16, 1982), reprinted in 7 DEL. J. CORP. L. 478, 485 (1983) (stating that "[t]he lead counsel are well known for their representation of plaintiffs in suits of this nature. All interests therefore appear to have been adequately represented in the settlement negotiations").

154See, e.g., Citron, No. 6219, 1983 WL 18002, at *2-3 (addressing arrangement between plaintiff and counsel whereby the plaintiff had served as class representative in seventeen previous class and derivative actions).

155See Van de Walle, No. 7046, 1983 WL 8949, at *5, reprinted in 8 DEL. J. CORP. L. at 631 (stating that "[a]lthough I, Vice-Chancellor Hartnett, am aware that there appears to exist a sophisticated 'class action industry', it would be unreasonable to deny class action status on the grounds that the trial counsel is too experienced").

156See Citron v. E.I. DuPont de Nemours & Co., No. 6219, 1983 WL 18002 (Del. Ch. May 18, 1983) (granting class certification despite defendants' allegations that the plaintiff and her counsel "have been guilty of barratry and chancertous conduct over the past several years").

157Although the initial burden of proof for certification rests with the plaintiff, it has, in at least some respects been shifted to the defendant. For example, in the case of disqualifying a plaintiff on the basis of a conflict of interest where the plaintiff has otherwise demonstrated that he is an adequate class representative the chancery court has required that "a defendant show that a serious conflict of interest exists, . . . and that the plaintiff cannot be expected to act in the interests of the others because doing so would harm his other interests." Youngman, 457 A.2d at 381.


159DEl. CH. CT. R. 23(d)(3). Rule 23(d)(3) provides that "[If]n the conduct of actions to which this rule applies, the Court may make appropriate orders: . . . (3) imposing conditions on the representative parties or on intervenors." Id.

160Household Acquisition, No. 6293, 1982 WL 8778, at *6, reprinted in 7 DEL. J.
balance it does appear that the protection offered to the class is incomplete, a conclusion which has lead some commentators to call for a revamping of the class action structure. 161

B. Temporary Settlement Classes

Temporary certifications for the purpose of settlement represent a departure from the lengthy, sometimes ineffective, process of formal certification. Temporary certification results from the parties’ stipulations to the composition of the class 162 and that the suit is to "be maintained as a class action for the purpose of settlement only." 163 The temporary certification is most often made at the preliminary hearing at which time notice of the proposed settlement is sent to class members. 164 As this process suggests, temporary certification, unlike formal certification, does not usually occur until after the parties have initiated negotiations or reached settlement.

Certification obtained in this fashion is contingent on the parties reaching a settlement that receives the court’s approval. 165 Defendants waive their right to oppose certification of the class only if the settlement is subsequently approved. 166 Moreover, a judgment entered on a settlement after temporary certification can bind the class members and achieve the res judicata effect inherent in a judgment after formal certification. 167

Much of the discussion about temporary settlement classes has centered around their appropriateness and desirability. The Delaware courts and most commentators have accepted the premise that courts have

---

161 See Lazos, supra note 2, at 326 (suggesting that the court use its power under Rule 23(d) to appoint a third party as a guardian of the absentee class members’ interests).

162 See Solovy et al., supra note 110, at 344.

163 See 2 NEWBERG & CONTE, supra note 123, § 11.27.


165 See 2 NEWBERG & CONTE, supra note 123, § 11.27.

166 Id.

167 Id. The power of a judgment produced through temporary certification is referred to in terms of its potential binding and res judicata effect on the class. As discussed below and addressed in Prezant v. De Angelis, 636 A.2d 915 (Del. 1994), deficiencies in the way the temporary certification process is carried out can make the judgment subject to attack, collaterally or on appeal. See infra discussion part III.C.
the power under Rule 23 to employ temporary settlement classes.\textsuperscript{163} Both sides in the debate over temporary settlement classes can find literary support. One side is most vocally represented by the \textit{Manual for Complex Litigation} (the \textit{Manual})\textsuperscript{169} and the \textit{Manual for Complex Litigation Second} (the \textit{Manual, Second}).\textsuperscript{170} The other side finds support in \textit{Newberg on Class Actions} (\textit{Newberg}).\textsuperscript{171} The \textit{Manual} initially opposed the use of temporary classes\textsuperscript{172} and the \textit{Manual, Second} still remains skeptical of their value.\textsuperscript{173} In contrast, \textit{Newberg} has taken a more positive position on settlement classes, largely because of their ability to foster settlement.\textsuperscript{174}

The debate focuses primarily on three factors which distinguish temporary certification from formal certification. First, the courts and commentators have disputed the timing of the certification proceedings in relation to the settlement. Second, and closely related to the timing issue, concerns have been raised over the amount of information available during certification of a settlement class. Third, discussion has addressed the scope and intensity of the inquiry made to certify a temporary class.

The \textit{Manual} expressed serious concerns over the risk that negotiations producing a settlement without prior formal certification might be tainted by collusion because the adequacy of the representative had not yet been determined.\textsuperscript{175} Furthermore, the \textit{Manual} maintained that

\begin{itemize}
  \item \textsuperscript{163}Prior to the Delaware Supreme Court’s recent decision in Prezant v. De Angelis, 636 A.2d 915 (Del. 1994), Delaware courts seemed to have implicitly accepted this premise simply by making use of temporary certification without any meaningful discussion of whether the practice was permitted by Rule 23. \textit{See}, e.g., \textit{Vitalink Communications}, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) \S 96,585, at 92,737-92,738, \textit{reprinted in} 17 \textit{Del. J. Corp. L.} at 1322-23. \textit{But see} \textit{Manual for Complex Litigation} \S 1.46 (CCH ed. 1978) (arguing that temporary settlement classes are prohibited because not expressly provided for in Rule 23).
  \item \textsuperscript{169}\textit{Manual for Complex Litigation} (CCH ed. 1978).
  \item \textsuperscript{170}\textit{Manual for Complex Litigation Second} (West ed. 1983).
  \item \textsuperscript{171}\textit{Newberg \\& Conte}, \textit{supra} note 123, \S\S 11.27-28.
  \item \textsuperscript{172}\textit{See} \textit{Manual for Complex Litigation}, \textit{supra} note 168, \S 1.46, at 32 (stating that “tentative classes for the purposes of settlement . . . should not be formed”).
  \item \textsuperscript{173}\textit{See} \textit{Manual for Complex Litigation Second}, \textit{supra} note 170, \S 30.45 (permitting settlement class but only with “great caution”).
  \item \textsuperscript{174}\textit{See generally} \textit{Newberg \\& Conte}, \textit{supra} note 123, \S\S 11.27-28 (noting that temporary classes produce benefits as a result of a general judicial policy favoring settlements). \textit{See also} \textit{Rome}, 197 A.2d at 53 (explaining that “[t]he law, of course, favors settlement of contested issues”).
  \item \textsuperscript{175}\textit{See} \textit{Manual for Complex Litigation}, \textit{supra} note 169, \S 1.46, at 32. The risk of collusion arises out of the fact that when no class has been certified prior to initiating settlement negotiations, a defendant may be free to pick and choose among several unofficial class representatives. This acts contrary to the interests of the class because the threat that the defendant will negotiate with another party weakens the class’s bargaining position and,
\end{itemize}
the failure to utilize formal certification decreases the opportunity for objectors to challenge or opt out of the settlement. Critical of these positions, Newberg counters that the court's oversight throughout the litigation and its role in evaluating the fairness of any settlement presented to it are sufficient to protect the class. Newberg also asserts that objectors are satisfactorily protected by their opportunity to appear at the fairness hearing and by retaining their opt-out rights when a Rule 23(b)(3) class is utilized.

An example of Delaware's experience in this regard is highlighted in Kahn v. Occidental Petroleum Corp. Separate plaintiffs brought class and derivative actions against the corporate defendant. The risk of collusive pre-certification settlements became apparent to the court upon learning that the plaintiffs in the second action had furtively negotiated a settlement with the defendants which excluded the plaintiffs in the first action. The court handled this problem by insuring the excluded plaintiff the opportunity to object at the fairness hearing.

The second point producing division among the courts and commentators is whether the parties or the court will possess enough information to evaluate the fairness of the settlement and the adequacy of representation if temporary certification is permitted. The concern, as expressed in the Manual, is that the absentee plaintiffs would be bound to the class created on the basis of insufficient information. In his text, Newberg again responds that the Manual's position ignores the reality that temporary certification often does not occur until well into the case, allowing for substantial discovery and investigation.

Therefore, the benefits the class receives. See Kahn, No. 10,808, 1989 Del. Ch. LEXIS 92, at *8-9, reprinted in 15 Del. J. Corp. L. at 660.

176See MANUAL FOR COMPLEX LITIGATION, supra note 169, § 1.46, at 32. This reduced opportunity results, in part, from the fact that the class has an opportunity to appear only in conjunction with notice of the settlement. Id. But cf. Lewis, No. 6534, 1982 WL 8783 at *4-5, reprinted in 7 Del. J. Corp. L. at 484-85 (holding that sending notice of certification with notice of settlement was not improper if there was no prejudice to defendants or class).

177Newberg & Conte, supra note 123, § 11.27, at 11-42 to -43.

178Id. at 11-43 to -44.


180Id. at *3-5, reprinted in 15 Del. J. Corp. L. at 657-58.

181Id. at *7-9, reprinted in 15 Del. J. Corp. L. at 659-60.

182Id. at *11-12, reprinted in 15 Del. J. Corp. L. at 661.

183See MANUAL FOR COMPLEX LITIGATION, supra note 169, § 1.46, at 32. For example, incomplete information could pertain to the class composition, the strength of the claims, and the potential damages. Id.

184See 2 Newberg & Conte, supra note 123, § 11.27, at 11-43 to -44.
The final disputed issue relates to the certification inquiry for purposes of settlement as opposed to such an inquiry in the context of adversarial litigation. Within the context of a settlement, the dynamics change from an adversarial relationship between plaintiffs and defendants to one where former opponents are working together to secure approval of a settlement.\footnote{See Jonathan R. Macey & Geoffrey P. Miller, The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. Chi. L. Rev. 1, 46 (1990) (stating that "settlement hearings are typically pep rallies jointly orchestrated by plaintiffs' counsel and defense counsel").}

On this account, the \textit{Manual} continues to reject temporary settlement classes.\footnote{\textit{MANUAL FOR COMPLEX LITIGATION}, supra note 169, \S 1.46, at 33.} The \textit{Manual} maintains that the court would possess insufficient information to evaluate both the fairness of the settlement and whether class interests were protected because it would not have the benefit of discovery made on an adversarial basis.\footnote{Id.} Moreover, it has been argued that not only is the information lacking, but also that the absence of an adversarial relationship leads the court to minimize the Rule 23(a) elements of the certification analysis.\footnote{2 \textit{NEWBERG \& CONTE}, supra note 123, \S 11.25, at 11-50; cf. Ace Heating \& Plumbing Co. v. Crane Co., 453 F.2d 30, 33 (3d Cir. 1971) (cautioning that "when the settlement is not negotiated by a court designated class representative the court must be doubly careful in evaluating the fairness of the settlement to plaintiff's class").}

\textit{Newberg} accepts the argument that the level of scrutiny at settlement does not match the level placed on formal certification proceedings.\footnote{Id. at 11-52 to -53.} However, \textit{Newberg} maintains that this relaxed standard does not leave the class's interests unprotected.\footnote{Id. at 11-54 to -55.} \textit{Newberg} reasons that "[c]lass action determinations are made in the context of all the circumstances of the case as it is then postured."\footnote{Id. \S 11.28, at 11-57.} Therefore, according to \textit{Newberg}, a less intensive certification inquiry at settlement merely reflects on the fact that the factual and legal issues have become less complex.\footnote{\textit{Rome}, 197 A.2d at 53.}

Whatever the disadvantages of utilizing temporary settlement classes, they must be viewed in conjunction with the policy of strongly favoring settlement.\footnote{See 2 \textit{NEWBERG \& CONTE}, supra note 123, \S 11.27, at 11-53.} In addition to promoting settlement,\footnote{2 \textit{NEWBERG \& CONTE}, supra note 123, \S 11.27, at 11-53.} there is
general agreement as to the other advantages of temporary settlement classes. First, settlement classes reduce both the costs and the delay involved in formal certification. Second, they serve the interests of the absentee class in Rule 23(b)(3) class actions by protecting their opt-out rights. As a result, despite its risks and drawbacks, the temporary settlement class has become widely used in class actions.

C. Prezant v. De Angelis: Defining Delaware’s Position on Temporary Settlement Classes

1. The Facts

On October 9, 1991, Salton/Maxim Housewares, Inc. (Salton) issued a prospectus pursuant to a fully subscribed initial public offering of 2,300,000 shares of stock. In this prospectus, Salton stated that its revenues had increased 100% in each of the two previous years. Shortly thereafter, on November 27, 1991, Salton revealed that its revenues for the current quarter were expected to be no higher than those for the same quarter in the previous year.

Two days after Salton’s announcement, the first of nine class action suits was filed in the United States District Court for the Northern District of Illinois. The Illinois plaintiffs alleged that Salton violated federal securities laws by failing to disclose material information in its prospectus. Thereafter, the Illinois plaintiffs initiated settlement

---

195 See MANUAL FOR COMPLEX LITIGATION SECOND, supra note 170, § 30.45, at 242-43.
196 See id. When formal certification is applied in lieu of the parties’ stipulation that the action is maintainable under Rule 23(b)(3), there is a risk the court might determine certification should be made under Rule 23(b)(1) or 23(b)(2) in which no right to opt out of the settlement is afforded. Cf. id.
197 See Solovy et al., supra note 110, at 378 (“The use of the ‘settlement class’ device has become commonplace.”).
198 Salton, a Delaware corporation with its headquarters in Illinois, engaged in the design and marketing of a variety of small home and personal appliances. Prezant, 636 A.2d at 917.
199 Id. The issue price of the offering was $12 per share. Id.
200 Id.
201 Id.
202 Prezant, 636 A.2d at 917-18. On the day of the announcement, Salton’s stock dropped $3 to $6 per share. Id. at 918.
203 Id. at 918. These actions were consolidated by the District Court on April 27, 1992. Id.
204 Id. The complaint alleged two instances of disclosure deficiencies. First, the Illinois plaintiffs alleged that Salton’s prospectus overstated the value of its backlog of unfulfilled
negotiations with the Salton defendants. However, the Illinois plaintiffs claimed that these discussions broke down soon after they rejected defendants' initial settlement offer.

On January 6, 1992, the first of two class actions was filed on behalf of Joseph De Angelis in the United States District Court for the Eastern District of Pennsylvania. Within a short time, however, De Angelis's counsel learned of the Illinois action and, fearing that his action would be transferred to Illinois, sought to voluntarily dismiss the action without court approval. Such an attempt violated Rule 23(e).

Finally, on January 28, 1992, De Angelis's counsel filed an action in the Delaware Chancery Court, listing De Angelis as the sole named plaintiff. This suit initially included only state law fraud claims but was later amended to include claims substantially similar to those in the Illinois consolidated actions. After learning of this action, certain Illinois plaintiffs also filed suit in Delaware and moved to have all of the actions consolidated with counsel for the Illinois plaintiffs serving as lead counsel for the consolidated suit. Although consolidation was permitted, De Angelis's counsel remained lead counsel in the case.

Prior to the entry of the Illinois plaintiffs, De Angelis's counsel had begun settlement negotiations which continued under De Angelis's

orders by $23 million. Id. Second, the complaint contained allegations that Salton failed to disclose that it lacked adequate funding for product development and inventory maintenance during the upcoming Christmas season. Id.

Id. The Illinois plaintiffs and Salton disputed whether the settlement offer was for $1.2 million, as the Illinois plaintiffs claimed, or less than $1 million, as Salton claimed. Id.


Id. at 918. This Delaware filing and the previous decision to dismiss the federal claims were undertaken by De Angelis's counsel without consultation with De Angelis. Id.

Id. In addition, De Angelis's Delaware complaint contained a false allegation. De Angelis alleged that he had held shares in Salton throughout the entire class period. Id. However, later discovery revealed that De Angelis had, in fact, disposed of his shares before the making of the announcement that prompted this litigation. Id.

Id. at 919.

Id. See also De Angelis v. Salton/Maxim Housewares, Inc., Nos. 12,420, 12,554-12,556, 1992 WL 161799 (Del. Ch. June 29, 1992) (noting that consolidation and motion designating Illinois counsel as lead counsel sought to prevent De Angelis from negotiating any settlement that excluded the Illinois plaintiffs).
lead following the consolidation.\footnote{Prezant, 636 A.2d at 919.} Despite the fact that De Angelis's counsel conducted no formal discovery,\footnote{Id. at 918. De Angelis's counsel, in lieu of sworn depositions, merely interviewed certain Salton personnel. Id. In addition, the major underwriter for the offering was not interviewed until after formal settlement was reached some six months later. Id. Furthermore, De Angelis made no attempt to obtain documents from Salton beyond those that the company had voluntarily provided. Id.} an agreement was reached in principle with Salton on May 11, 1992,\footnote{Id. The original amount of the settlement was $1,290,000; however, this amount was subsequently reduced to $1,225,000 after Salton's insurer took exception to the initial settlement consideration. Id. Furthermore, De Angelis's counsel allowed three months to pass following the signing of the agreement in principle before seeking the services of a damages expert to determine if the settlement was fair. Id. at 918-19.} and a formal stipulation of settlement was entered on September 4, 1992.\footnote{Id. at 919.} Significantly, without leave of the court, De Angelis's counsel also made an additional amendment to the complaint following the formal stipulation of settlement.\footnote{Prezant, 636 A.2d at 919. De Angelis added an additional class representative and tacked federal securities law claims onto the complaint. Id. The amendment was notable because it, like the rest of De Angelis's pleadings, encountered no opposition from the defendants. Id. The court went on to note that this result stood in stark contrast to the Illinois action which the defendants had actively opposed. Id.}

The final settlement presented to the court provided for Salton's payment of $1,225,000 to be used for the benefit of the shareholder class.\footnote{Id.} In addition, the settlement was designed to bar the claims in both the Delaware and Illinois actions.\footnote{Id.} Finally, the settlement also permitted De Angelis's counsel to make an unopposed request for attorneys' fees amounting to twenty-five percent of the settlement fund.\footnote{Id.}

At the formal fairness hearing on the settlement, several objectors challenged both the proposed settlement and the application for attorneys' fees.\footnote{Id. The settlement did, however, allow for class members to retain their claims if they exercised their opt out rights. Id.} The objectors raised three arguments against approval of the settlement. First, they claimed that the settlement provided grossly inadequate compensation for compromise of the claims.\footnote{Id.} Second, the non-settling plaintiffs maintained that the defendants had impermissibly
engaged in forum shopping. Lastly, the objectors argued that "the process by which the settlement was reached was fatally tainted."223

2. The Chancery Court Decision

As an initial matter, the chancery court examined Delaware class action law to determine its role in reviewing the fairness and reasonableness of any proposed settlement under Rule 23(e).226 The court went on to note that "[n]ot only must the terms of the settlement be carefully examined, but [the] court must also scrutinize the process by which the settlement is procured."227 If this inquiry disclosed indications of unfairness in the settlement process, the court stated that it would examine the settlement "with heightened scrutiny and an enhanced standard of review."228

Applying its test to the De Angelis settlement proposal, the court found several deficiencies in the settlement process warranting "the closest scrutiny."229 In reaching this decision, the court focused on De Angelis's decision to bring the action in Delaware and how that decision affected the relationship between De Angelis's counsel and the defendants throughout the settlement process.230

The court first noted that, in light of the Illinois federal action already pending, the defendants could easily have obtained a stay of the Delaware action but did not.231 Second, the court recognized that De Angelis's claims as originally filed contained only state law fraud claims which are not maintainable as a class action.232 The court remarked that defendants could have rid themselves of this action by seeking dismissal but did not.233 Third, the court considered it significant that the defendants had not opposed De Angelis's temporary certification as the

---

224 Id.
225 Id.
226 De Angelis, 641 A.2d at 838.
227 Id.
228 Id.
229 Id.
230 De Angelis, 641 A.2d at 838.
231 Id. The court appreciated that in such an environment, "De Angelis could not realistically have hoped to try this Delaware case but could have only hoped to settle it. Accordingly, De Angelis'[s] bargaining position with defendants was necessarily significantly less than the bargaining position of the plaintiffs in the already pending federal suits." Id.
232 Id.
233 Id.
class representative.\textsuperscript{234} Finally, the court took note of De Angelis’s willingness to assuage the defendants’ concerns through his haphazard discovery and ready acceptance of a pared down settlement.\textsuperscript{235} These findings, viewed in contrast to the vigorously contested Illinois action, led the court to determine that the parties’ conduct "gives the unfortunate impression that defendants preferred De Angelis as a foe."\textsuperscript{236}

The court, applying heightened scrutiny to determine whether the settlement was worthy of judicial approval, next focused on the proposed settlement itself.\textsuperscript{237} Despite the objectors’ vigorous resistance to the settlement and the abundant evidence of procedural improprieties, the court determined that, even under heightened scrutiny, the settlement warranted approval.\textsuperscript{238}

To reach this determination, the court utilized the six factors that Delaware courts have generally relied upon in order to assess a settlement’s overall fairness.\textsuperscript{239} Considerations weighing against further litigation included the relative weakness of De Angelis’s disclosure claims,\textsuperscript{240} the substantial cost and delay to the class of pursuing the litigation,\textsuperscript{241} the likelihood that any judgment in excess of the settlement amount would be uncollectible,\textsuperscript{242} the small number of shareholders who

\textsuperscript{234}De Angelis, 641 A.2d at 838.
\textsuperscript{235}Id. at 838-39.
\textsuperscript{236}Id. at 838.
\textsuperscript{237}Id. at 839-40.
\textsuperscript{238}De Angelis, 641 A.2d at 839-40.
\textsuperscript{239}Id. at 839. The Delaware Supreme Court in Polk v. Good specified the factors that the chancery court, applying its own business judgment, was to consider in determining the fairness of a proposed settlement. These factors are:
- (1) the probable validity of the claims,
- (2) the apparent difficulties in enforcing the claims through the courts,
- (3) the collectibility of any judgment recovered,
- (4) the delay, expense and trouble of litigation,
- (5) the amount of the compromise as compared with the amount and collectibility of a judgment,
- and (6) the views of the parties involved, pro and con.

Polk, 507 A.2d at 536.

\textsuperscript{240}De Angelis, 641 A.2d at 839. The court indicated that De Angelis’s complaint suffered from serious weaknesses with respect to establishing liability and damages. The defendants had presented evidence, which, if true, indicated the company’s financial troubles were unrelated to the alleged nondisclosure of the adverse information. Id. Likewise, defendants deflated the objectors’ assertions that the actual damages amounted to nearly $7 million. Id. According to the defendants, if this was the case the entire $3 decrease in stock price would have to be attributable to the defendants’ failure to disclose. Id.

\textsuperscript{241}Id.

\textsuperscript{242}Id. The refusal of Salton’s insurer to provide additional coverage and the company’s history of financial frailty indicated that there was little additional money available to satisfy the claims. Id.