contractual and related documents should be considered even at the level of analysis of examining the four corners of the Debenture because Section 5 of the Debenture itself specifically refers to the Securities Purchase Agreement and incorporates it by reference into the Debenture and because the other documents referred to are exhibits thereto.

There are also other items of extrinsic evidence in the record, such as: (i) the term sheet, (ii) a Form 8-K filed by the Company contemporaneously with the sale of the Debenture, and (iii) a Form S-3 registration statement filed by Strategic in December as part of its obligations under the Registration Rights Agreement. There is also a Form 10-Q filed by the company that discusses the sale of the Debenture. These are all outside the four corners of the Debenture. They are extrinsic evidence which I would consult secondarily, not to discern any ambiguity but to resolve any ambiguity found or, as here, merely to confirm my conclusion that the contract language is unambiguous, evidencing, as these documents do, the shared intent of the parties, at the time the Debenture was issued, to permit only cash redemptions.

Other extrinsic evidence I could examine, if I found the language of the Debenture to be ambiguous, would be testimony about the course of negotiations. In this regard, I only note that the negotiations over the terms relevant to the matters at issue were unremarkable. There were no discussions between the parties during the negotiation over the language of the Debenture about whether or not the Company had the right to redeem the Debenture for stock. There was one change made in the second paragraph of the first page of the Debenture which produced the language cited earlier, upon which Strategic rests its contention that it has the right to redeem the Debenture for stock. That change is one which, if the Company is correct, varied the terms of the term sheet in a significant way. Yet, there is no evidence that there were any discussions or negotiations between the parties about the change or any intent on the part of Strategic thereby to vary the terms of the deal in so important a way. In contrast, there is testimony that there were significant negotiations between the parties with respect to other important deal points in this negotiation and, in particular, when other significant items addressed in the term sheet were varied.

I also refer to the Delaware Supreme Court case of Eagle Industries Inc. v. DeVilbiss Health Care, Inc., Del. Supr., 702 A.2d 1228 (1997) for the proposition that I should not rely on extrinsic evidence to create an ambiguity. In Eagle, the Supreme Court stated, "[i]f a contract is unambiguous, extrinsic evidence may not be used to interpret the intent of the parties, to vary the terms of the contract or to create an ambiguity." Eagle at 1232. I also note that at Footnote 7 the Court addresses itself to the fact that there may be occasions when it is appropriate for the trial court to
consider some undisputed background facts in order to place the contractual provision in its historical setting without violating this principle, but that a court must be careful in entertaining background facts to avoid encroaching on the basic principles set forth in the opinion. See id. at 1232 n.7. Because this matter was tried, there is evidence in the record concerning the background of the parties' agreement to the sale and purchase of the Debenture. As I have already discussed, I do find those background facts to be helpful in putting the terms of the contract in context. But, I will avoid relying on it in determining whether or not there is an ambiguity in the contract.

The issue between the parties derives principally from the fact that there is language in the second paragraph on the first page of the Debenture, cited supra, which the Company argues to mean that it has the right, at its option, to redeem the Debenture for stock or for cash. That language differs from the draft of the contract. In the original draft, the holder (i.e., Supermex) had the option to choose between cash or common stock. There was a change made during the exchange of drafts of the Debenture to change the word "Holder" to "Issuer," and then from "Issuer" to "Company." The last change was made simply to conform the usage to the rest of the document.

As I have said, the language of this provision in paragraph 2 itself is expressly made "subject to" Section 4 of the contract. And it is on Section 4 that Supermex relies to support its position that the Debenture is convertible only for cash. The language in Section 4C which deals with redemption, was not changed in any material respect from the time the first draft of this contract was prepared by Supermex's counsel and submitted to Strategic for its review and comment until the final document was executed.

At trial, Mr. Palmarella, the General Counsel of Strategic, conceded that Section 4C, standing alone, requires the Company to pay cash when it redeems the Debenture. When asked to look at the original draft of the document, Mr. Palmarella testified that under the terms of that draft of the document, the redemption option of the Company was exercisable only for cash. He then agreed that the language in Section 4 pertaining to the redemption of the Debenture did not change in any material way from that first draft to the final document.

Even without considering the force of this concession, I view Section 4C by itself as requiring the Company to redeem for cash. I also find that the language in paragraph 2 is trumped or sublimated by the provisions of Section 4C, so that the cash redemption required by that section overcomes whatever right to pay "principal and interest" in cash is otherwise created by the terms of paragraph 2.
First, I note my disagreement with one of Supermex's interpretative arguments. Supermex argues that the use of the word "sum" in Section 4C(i) mandates that I interpret Section 4C to require a cash payment in any redemption. I do not accept this argument because I find that, in Section 4C(i), the word "sum" is being used as a reference to an arithmetical function, not as a reference to cash or money. In this sense, the operative word in Section 4C(i) is "amount," not "sum." As it is used, I find that the "amount" described in Section 4C(i) must be read to refer to an amount of cash.

Section 4C(i) says that the Company may redeem the Debenture for an amount, which is then defined as the Redemption Amount, equal to the arithmetical result of adding the outstanding principal on the Debenture, the unpaid but accrued interest and the Redemption Premium, which is also a defined term. Thus, the amount that the Company must pay is defined as the sum of three amounts of money. The sum of three amounts of money, is necessarily, itself an amount of money. Indeed, I note that the notice of redemption given by Strategic first stated the Redemption Amount as an amount of money.

What is missing from Section 4C, but needed to support Strategic's position, is some provision that would describe how to convert that dollar value of the Redemption Amount into a number of shares of stock. The facts in this case themselves demonstrate the significance of the absence of such a provision because, while purporting to redeem the Debenture for stock, Strategic chose a method for doing so by reference to a provision of the Debenture relating to the conversion feature, and derived a share amount which was incorrect and which deprived Supermex of the full economic value it bargained for.

Strategic's construction of the Debenture also runs afoul of 4C(iii), which, I find, makes no sense if one were to conclude that Strategic had a right to redeem for stock. Certainly, Section 4C(iii), which gives Supermex the right to avoid a redemption by electing to convert the principal amount so redeemed, would be written differently if such a right existed. A discussion of section 4C(iii), also leads to an observation about the timing of issuance of stock. As the Company interprets the Debenture, it had ten days to issue the share certificate in payment of the Redemption Amount. However, where the Debenture expressly contemplates the issuance of shares — that is, in Section 4A in the case of shares issued upon conversion — it requires that the shares be delivered in three business days. There was testimony at trial that where Supermex thought it was to receive or understood that it was to receive stock, it wanted the stock immediately. The reason for this was so that it could immediately turn around and sell the stock. Nevertheless, Section 4C(iii) allows the Company 10 days to pay the
Redemption Amount. If it is true that the Redemption Amount may be payable in stock, this 10-day period would be substantially inconsistent with the 3 business day provision governing the issuance of shares on conversion.

I now turn back to the language in the second paragraph on the introductory page. As I stated previously when quoting that language, it begins by saying that it is "subject to the provisions of Section 4." There is recent Delaware Supreme Court authority addressing the question of what it means when a provision of a contract says that it is subject to other terms of the contract. That authority substantially clarifies the interplay between the language found in paragraph 2 and the provisions of Section 4.

[10] In *Penn Mutual Life Insurance Co. v. Oglesby*, Del. Supr., 695 A.2d 1146 (1997), the Court concluded that where the words "subject to all provisions of this policy" preface a term of a contract it means that inconsistent terms to which reference is made will trump the provision so preaced. *Penn Mutual* at 1150. In this case, if I read Section 4C as being inconsistent with the right of the Company to redeem the Debenture for any consideration other than cash, than the provisions of Section 4C will trump the language found in paragraph two on the first page. Indeed, I do conclude that section 4C is inconsistent with any such right.

[11] Thus, notwithstanding the right of the Company pursuant to paragraph 2 to issue shares in payment for principal and interest, I conclude that the contract unambiguously requires cash redemptions. I find this to be true because the language "subject to the provisions of Section 4 below," which appears in paragraph two on the first page, sublimates the right of the Company to issue shares in payment of principal or interest to the provisions of Section 4 which, as Mr. Palmarella conceded, and as I in any event conclude, requires a cash payment in the event of redemption.

I also note that it is reasonable to read the language in paragraph two on the first page as, in any event, not referring to redemptions, since the language refers only to the payment of principal and interest and does not refer to payment of the Redemption Amount, which is a defined term used later in this document and which includes an element of Redemption Premium that is neither principal nor interest. Strategic's counsel argues that I should interpret this to mean that the Company can pay part of the Redemption Amount in stock under paragraph two on the first page, but is required to pay the Redemption Premium portion of it in cash. That is a construction of the contract which I reject. There is nothing to suggest that the Redemption Amount, which is a defined aggregation of elements, can be disaggregated for purposes of calculating the method of payment.

Looking beyond the language of the contract, the provisions of the Stock Purchase Agreement and the Registration Rights Agreement, which are incorporated by reference into the Debenture contract, confirm the
conclusion that the mutual understanding of the parties at the time the Debenture was entered into is that it was not redeemable for stock. The Stock Purchase Agreement contains a provision which was important to Supermex, and perhaps Strategic, that before the Maturity Date of the Debenture, Supermex never become the holder of 5 percent or more of the common stock of Strategic. Thus, the Securities Purchase Agreement limits Supermex's right to convert in order to accomplish that objective. This carefully structured limitation would be utterly vitiated if, as Strategic contends, it has the right to redeem the Debenture for stock. Illustratively, in this case, Strategic purported to issue 38.8 percent of its stock to Supermex in redemption of the Debenture, which not only would put Supermex in a filing position under Section 13(d), but would make it the largest stockholder of Strategic by far.

The provisions of the Registration Rights Agreement also confirm the Court's construction of the Debenture. That agreement requires that Strategic file a registration statement under the Securities Act of 1933 covering the shares that are issuable upon conversion of the Debenture by Supermex or upon its exercise of the Warrant. The agreement, however, says nothing about registration of shares issuable upon redemption. It is a striking omission. One would have to conclude that while Supermex was interested in having all the other shares that it might acquire registered, to be free to trade them, it did not seek the registration of the large number of shares issuable upon redemption. This omission strongly supports the conclusion that the parties never contemplated the issuance of shares on redemption.

Similarly, Mr. Palmarella's firm gave an opinion letter in connection with the transaction at issue, the form of which was an exhibit to the Securities Purchase Agreement. On page 3 of that letter, an opinion is given as to the validity of the issuance of shares of common stock upon conversion of the security. Again there is no mention in his letter of the issuance of shares upon redemption. Certainly, had the parties contemplated the issuance of shares upon redemption, Mr. Palmarella would have been asked to give the same opinion as to those shares. All of these points, I think, strongly confirm the view that the Debenture does not permit, and is not ambiguous with respect to the right of the Company, to redeem for stock. Even if I were to conclude that the Debenture contract was ambiguous, the extrinsic evidence submitted in connection with the trial of this matter would lead me to conclude that the contract must be interpreted as Supermex contends. The Company filed a registration statement or Form S-3 in December of 1997. This was the registration statement contemplated by the Registration Rights Agreement. The registration statement does not cover shares issuable upon redemption. Rather, it states that it relates to a certain
number of shares of common stock that are issuable in connection with the conversion of the Debenture and the exercise of the Warrant to purchase 40,000 shares of common stock issued to Supermex in connection with the transaction.

When the Company sought to redeem the Debenture for stock, it asked the transfer agent to issue a certificate pursuant to the registration statement. The transfer agent refused to do that. Thereafter the Company filed an amendment to its Form S-3, specifically to amend the language in Form S-3 to cover the issuance of shares pursuant to the redemption. This amendment was not required by the Registration Rights Agreement and simply underscores the impropriety of the January 19th redemption.

I also note that on page 5 of the S-3, there is discussion of risk factors. Described on that page is a particular risk factor concerning the possible delisting of the common stock from the NASDAQ system due to Strategic's weak equity position. It is not necessary to describe the problem in detail. What is noteworthy, Supermex contends, is that in its discussion of the problem, Strategic stated that "the Company cannot require holders of the Debentures to convert the Debentures until October 1999." This language strongly suggest that, at the time Strategic filed this S-3, it did not believe it had the right to redeem the Debentures for stock. If it thought it had that right, Strategic would surely have said so in connection with this risk factor discussion. That is so even if Strategic had not yet formulated an intention to redeem the Debenture for stock. Rather, a right to do so would itself have been a material disclosure in that connection.

There are also relevant statements made by Strategic in a Form 8-K prepared by Mr. Palmarella's office and filed on November 17, 1997, and in the Form 10-Q for the period ending September 30th. Both of those filings contain descriptions of the Debenture, including detailed descriptions of the conversion feature. Neither of them contains any reference to the Company's right to redeem the Debenture for stock. Again, these omissions corroborate the Court's conclusion that the shared intention of the parties at the time they entered into this contract was to permit redemption only for cash.

The only extrinsic evidence that is offered to the contrary is testimony given by Mr. Cadigan, CEO of Strategic, and Mr. Palmarella. That testimony is to the effect that Strategic formed a view, at the time the change was made in paragraph 2 of the Debenture, that such change gave Strategic the right to redeem for stock. The testimony is clear, and I think unambiguous and uncontradicted, that accepting the truth of this testimony, Strategic never communicated this understanding to Supermex in the course of the negotiations. There is clear testimony that the term sheet contemplated a cash redemption. The term sheet was signed by Mr. Cadigan. It was signed on behalf of Supermex. The initial draft of the
document prepared by Supermex's attorneys provided for a cash redemption. There's no argument about that. Mr. Palmarella so testified. Nevertheless, the argument is made that Strategic's undisclosed understanding of the change in the language in paragraph 2 is key to the interpretation of this contract and has the effect of overcoming all the prior shared understanding of the parties and, indeed, all of the subsequent manifestation by the parties of a different shared understanding.

[12] It is the law of Delaware that subjective understandings of a party to a contract which are not communicated to the other party are of no effect. They are irrelevant to the interpretation of the contract and should not and will not be given any weight. See Bell Atlantic at 13 n.4 (and cases cited therein). In this case, the failure of Strategic to communicate its claimed understanding that the amendment to paragraph 2 radically altered an important element of the transaction fatally undermines its position.

Strategic does not offer any proof that Supermex was even aware of this undisclosed understanding. To the contrary, the trial testimony of Mr. Nussbaum, Supermex's counsel who reviewed the change in the language in paragraph 2, was that he did not understand the change to give Strategic the right to redeem for stock. Mr. Nussbaum's testimony was clear and credible. He understood that the pertinent language in paragraph 2 was expressly "subject to" Section 4 and that Section 4 required cash redemptions. Some other draftsman might have questioned the meaning of Strategic's proposed right to pay principal in cash and have required language clarifying the status of Strategic's obligation to pay cash in the event of redemption. Mr. Nussbaum, relying on his understanding of Section 4 and the prefatory language in paragraph 2, and being ignorant of Strategic's secret understanding, did not. In the circumstances, it would do substantial violence to the shared intent of the parties, as manifested by all the objective evidence, to read the Debenture to permit Strategic to deliver stock in payment for redemption. I also note that, "Redemption Amount" is a defined term in this contract. If Strategic believed at the time it proposed a change in the language of paragraph 2 that the change would give it the right to redeem for stock, it very simply could have proposed to amend paragraph 2 to include the words "Redemption Amount." That, at least, would have communicated unmistakably its understanding of the change and would have alerted Supermex to the need to object.

In sum, all of the evidence of shared intent derived from the documents signed the same day and the related public filings is inconsistent with the position that Strategic now takes. Everything (other than Strategic's claimed uncommunicated understanding) points to the conclusion that the contract does not permit the redemption of the debenture for stock, and I so find.
For these reasons, I will enter an order, declaring that the Debenture is not redeemable for stock and that the redemption that was noticed on January 19, 1998 by Strategic was a nullity. That brings me to some final issues.

First, plaintiff also challenged certain bylaw amendments passed by the Strategic Board of Directors at or about the same time that the board determined to redeem the Debenture for stock. The record reflects that, in response to this litigation, those amendments have all been rescinded. Thus, I find it unnecessary and inappropriate to comment further on their adoption, and will not enter any order with respect to those bylaws other than to note that they have been rescinded and to dismiss the claims with respect to them as moot for that reason.

There are two other issues to be addressed. The first is the contention by Supermex that, under Section 4C(iii) of the Debenture, the failure of the Company to deliver the Redemption Amount within ten days of the notice of redemption caused Strategic to forfeit its right in the future to call the Debenture or any part of it for redemption. I reject this argument.

Section 4C(iii) clearly was not written in contemplation of a redemption of the Debenture for stock, but rather was written to deal with the situation where the Company calls the Debenture for redemption and then fails to pay the Redemption Amount within the 10 day time period provided. Here the Company acted on the belief that it had a right to redeem this Debenture for stock and, within ten days, presented a share certificate which by its calculations represented the Redemption Amount. While I conclude that Strategic was mistaken in believing it had a right to do so, I do not find that Strategic's action was undertaken in bad faith. There is a dispute as to whether the number of shares represented by that share certificate was the correct number of shares. I understand that the difference amounts to something less than 5 percent of the total, which I regard as immaterial to the issue. Thus, while I find that the redemption was ineffectual, I do not find that the failure of the Company to deliver either cash or exactly the correct number of shares is such a failure as to deprive it of its right to engage in redemptions for cash in the future. To this extent I will deny the relief requested by the plaintiff.

The final issue concerns the plaintiff's January 29th notice of conversion. Under the terms of the Securities Purchase Agreement, when notice of conversion is given, the Company is obligated to deliver the shares within three business days, and any failure to do so subjects the Company to late delivery charges. At the time the plaintiff gave the January 29th conversion notice, it had the right to do so and the failure of the Company to perform violated its obligations under the Debenture. Thus, I conclude
that Strategic is liable for the amount of the late payment fees that are defined by the Securities Purchase Agreement.

It was suggested at trial that Supermex could have engaged in self-help by taking the certificate it received in the redemption and breaking it into two different certificates, one representing the shares due on the conversion. This is not a realistic suggestion. First, the share certificate Supermex received was one it believed, correctly, it was not entitled to. Second, that certificate was restricted and not freely tradeable. In all events, it was incumbent upon the Company to make arrangements to have a certificate in the appropriate amount and form issued to Supermex in conformity with the terms of the Debenture. The fact that the Company had taken a position that rendered it difficult for it to do so explains, but does not excuse its failure of performance.

As of the date of trial, the penalty was $92,000. The exact amount now owing is a matter of computation, and I direct the parties to agree on an amount that is due as of April 23, 1998. For these reasons I will enter an award of the late fee in the appropriate amount.

For all of the foregoing reasons, the Court has, as of the date of this written opinion, entered the Judgment Order in the form submitted by the parties.

JUDGMENT ORDER

This 1st day of May, 1998, for the reasons stated in this Court's Memorandum Opinion of May 1, 1998, IT IS HEREBY ORDERED:

1. Judgment is hereby entered in favor of Plaintiff and against Defendant Strategic Solutions Group, Inc. ("Strategic") in accordance with the terms of this Order;
2. It is hereby declared that Strategic's 6% Convertible Subordinated Debenture (the "Debenture") due October 1999, is redeemable for cash only and is not redeemable for shares of Strategic Common Stock;
3. Strategic's issuance to Plaintiff of Certificate No. PA 00447 for 1,052,624 shares of Common Stock is hereby declared null and void;
4. Strategic retains its right to redeem the Debenture for cash;
5. It is hereby declared that Plaintiff's January 29, 1998 Notice of Conversion is valid and effective, and Plaintiff is entitled to 90,465 shares of Strategic Common Stock;
6. Plaintiff is hereby awarded $105,800.00 in late delivery fees, pursuant to Section 5(c) of the Stock Purchase Agreement between Plaintiff and Strategic, against Strategic. Simple interest at the rate of ten percent (10%) per annum shall accrue from April 23, 1998 until payment of the late delivery fee is made; and
7. Plaintiff's claims in Count V against all individual defendants with respect to certain amendments to Strategic's By-laws are dismissed as moot.

IN RE TALLEY INDUSTRIES, INC. SHAREHOLDERS LITIGATION

No. 15,961 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

April 9, 1998

Plaintiff stockholders of Talley Industries challenged the propriety and validity of the completed two-step acquisition of Talley by Carpenter Technology Corporation. Plaintiffs' amended complaint alleged: (1) that defendant directors had breached their fiduciary duty to act reasonably to maximize value in the sale of the company, and (2) that the tender offer materials were false and misleading. During the course of expedited proceedings, the parties agreed to settle the claims asserted. The settlement agreement was before the court for approval. Two large stockholders of the acquired corporation, Talley, objected to the proposed settlement.

The court of chancery, per Vice-Chancellor Lamb, concluded that the proposed settlement was fair, reasonable, adequate, and in the best interests of the class, and approved the settlement because: (1) the plaintiffs were properly certified as a class; (2) the board of directors informed themselves adequately and acted reasonably in the sale of the company and were thus protected by the business judgment rule; (3) the plaintiffs' failure to file and prosecute a disclosure claim alleging misconduct was not a valid ground upon which the objectors could object to the proposed settlement; (4) the plaintiffs faced inherent difficulties in proving damages to the class as a result of defendants' alleged misconduct in light of the superior nature of the acquiror's offer; and (5) there was no reason to withhold approval of the proposed settlement to protect the objectors' ability to proceed in another court. Vice-Chancellor Lamb awarded attorneys' fees and expenses to the plaintiffs' counsel because the class did receive benefit from plaintiffs' efforts.
1. Compromise and Settlement  2, 4.5, 57, 63, 67

As a general proposition, Delaware law favors voluntary settlements; however, settlement of class actions is unique because the fiduciary nature of class actions requires the court of chancery to participate in consummation of settlement to the extent of determining intrinsic fairness.

2. Compromise and Settlement  56, 57, 63, 67

The court of chancery, in deciding whether to approve settlement of a class or derivative action, must balance policy preference for settlement against need to insure that interests of the class have been fairly represented; it must carefully consider all challenges to fairness of settlement without actually trying issues presented.

3. Compromise and Settlement  57, 63, 67

Court's function in considering proposed settlement of class action is to consider the nature of the plaintiffs' claim, the legal and factual circumstances of the case, the possible defenses thereto, and the exercise of its own business judgment to determine the overall reasonableness of the settlement.

4. Parties  35.31, 35.39

Chancery rule regarding procedures for maintenance of class actions first requires determination of whether action is properly maintainable as class action prior to examination of proposed settlement, not at some later stage of litigation. DEL. CH. CT. R. 23.

5. Parties  35.5, 35.11, 35.13, 35.17, 35.31

Rule 23(a) sets out four general requirements for a class to be certified: numerosity, commonality, typicality, and adequacy of class representative. DEL. CH. CT. R. 23(a).

6. Parties  35.11, 35.31

Plaintiffs satisfied numerosity requirement of Rule 23(a) where proposed class was comprised of hundreds of stockholders who owned in excess of 14 million shares of corporation's stock and joinder of all members was not practical. DEL. CH. CT. R. 23(a).
Commonality requirement for class certification is met if questions of law and fact linking class members is substantially related to resolution of litigation even though class members are not identically situated; stockholders met commonality requirement through claim alleging that defendant breached fiduciary duties in connection with merger to detriment of the class.

All class members faced some injury as a result of defendants' conduct in connection with merger; thus, class representatives met typicality requirement that the legal and factual position of the class representative not be significantly different from the members of the class.

Representative plaintiffs met the burden of persuading court that plaintiffs were adequate class representatives when they established that they owned common stock on the date the merger was announced, they continued to own stock through the date of the merger, and there was no conflict of interest between the named plaintiff and other class members. Del. Ch. Ct. R. 23.

Representative plaintiffs were adequate class representatives when there was evidence that class counsel diligently and thoroughly prosecuted action and engaged in meaningful discovery on behalf of class.

Actions challenging exercise of fiduciary responsibility in corporate merger transaction are properly certified under Rules 23(b)(1) and (2); because action challenged board's action regarding sale of company, requirements of (b)(1) and (2) were satisfied. Del. Ch. Ct. R. 23.
12. Corporations 307, 310(1)

Generally, there is no single blueprint in Delaware that a board authorizing the sale of a corporate enterprise must follow to fulfill its fiduciary duties.

13. Corporations 310(1)

Board's actions concerning sale of corporate enterprise must be evaluated in light of relevant circumstances to determine if they were undertaken with due diligence and in good faith; if no breach of duty is found, the board is entitled to the protection of the business judgment rule.

14. Corporations 182.4, 310(1)

Fact that board informed themselves adequately by retaining investment banker to furnish strategic financial advice regarding proposed sale of company indicated that board acted reasonably and was entitled to protection of business judgment rule.

15. Corporations 310(1)

Plaintiffs' Revlon claim was not meritorious; director defendants were entitled to protection of business judgment rule because there was no foundation in the record for objectors' arguments: that directors solicited merger agreement to further their own interests; that greater value could have been achieved by selling company in pieces; or that the price per share in the merger was diminished by claims arising out of improper severance agreement.

16. Corporations 310(1)

Board of directors' duty of disclosure does not oblige them to characterize their conduct in such a way as to admit wrongdoing; board is not required to engage in self-flagellation and draw legal conclusions implicating itself in breach of fiduciary duty from surrounding facts and circumstances prior to formal adjudication of the matter.

17. Compromise and Settlement 57, 63, 67

Evidence in proceeding for approval of class action supported conclusion that terms of settlement were fair, reasonable, and adequate to the
class, when corporate directors acted in good faith in sale of the company and plaintiffs would have had difficulty proving damages to the class as a result of defendant directors' alleged misconduct.

18. Compromise and Settlement ⇔ 1, 66

Where claims arising out of the same nucleus of operative facts are pending in both state and federal court, and a proposal is made to settle the state action on terms which would preclude pending federal court litigation, a court may refuse to approve a settlement because state claims being settled have little or no value, terms of the settlement provide meager consideration to the class, and federal claims have at least arguable merit and therefore significant value.

19. Compromise and Settlement ⇔ 65

Simple disclosure claims were not precluded from litigation in state court by exclusive jurisdiction of federal courts over claims brought under the Securities Exchange Act of 1934; thus, approval of proposed settlement was not to be withheld to preserve objectors' ability to proceed in another court.

20. Corporations ⇔ 214
Costs ⇔ 194.12

Where litigation efforts on behalf of a corporation or its stockholders result in the creation of a common fund or the conferring of a benefit, the court may, in its discretion, award fees and expenses.

21. Corporations ⇔ 214
Costs ⇔ 194.12

In determining the amount of fees to award, the courts have generally accorded the greatest weight to the benefit achieved as a result of the litigation; other factors considered are the time and effort applied to the matter by plaintiff's counsel and the difficulty of the litigation, the contingent nature of the litigation, and the standing of counsel.
Terms of settlement requiring publication and dissemination of supplemental disclosure provided substantial benefit to members of class; such disclosure constituted adequate consideration for the settlement of the claims asserted and supported award of fees requested.

Fees sought were reasonable where services rendered by plaintiffs' counsel were of high quality, the action was prosecuted diligently, and counsel's efforts were undertaken on purely contingent basis.


Martin P. Tully, Esquire, Alan J. Stone, Esquire, and David J. Teklits, Esquire, of Morris, Nichols, Arsh & Tunnell, Wilmington, Delaware, for defendants Jack C. Crim, Alex Stamatakis, Donald J. Ulrich, Paul L. Foster, Joseph A. Orlando, Fred Israel, John W. Stodder, David Victor, and Talley Industries, Inc.


Arthur G. Connolly, Jr., Esquire, and Arthur G. Connolly, III, Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware; Matthew J. Ferretti, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Robert M. Krasne, Esquire, George A. Borden, Esquire, and Stacey M. Bosshardt, Esquire, of Williams & Connolly, Washington, D.C., of counsel, for Saad A. Alissa and Ralph A. Rockow.
INTRODUCTION

This consolidated litigation arises out of the recently completed two-step acquisition of Talley Industries, Inc. ("Talley") by Carpenter Technology Corporation ("Carpenter") and its wholly owned subsidiary, Score Acquisition Corporation, all Delaware corporations. In both the tender offer and the second step merger, the common stockholders of Talley received $12.00 per share in cash for their Talley stock.

The initial complaint in this matter was filed on September 26, 1997, the day the transaction was announced. During the course of expedited discovery proceedings undertaken in anticipation of a motion for preliminary injunction, the parties reached an agreement in principal to settle the claims asserted. Following further discovery, that agreement was incorporated into the January 23, 1998 Stipulation and Agreement of Compromise, Settlement and Release, which is now before the Court for approval.

Two large stockholders of Talley, Saad A. Alissa and Ralph A. Rockow (who was also a director of Talley) (together "Objectors"), appearing through counsel, have raised objections to the proposed settlement, both in writing and orally at the hearing held March 20, 1998 to consider the settlement proposed. For the reasons discussed herein, I conclude that the objections raised are not well-founded and must be overruled. Moreover, I conclude that the settlement proposed is fair, reasonable and adequate and in the best interests of the class; for these reasons it should be approved in the form submitted. Finally, I conclude that the plaintiffs' application for attorneys' fees and costs is reasonable and appropriate and should be approved.

BACKGROUND

Talley is, or was, a Delaware corporation with its principal place of business in Phoenix, Arizona. Talley is a diversified manufacturer of a wide range of proprietary and other specialized products for defense, industrial and commercial applications.

A. The 1997 Annual Meeting Contest

Objector Saad Alissa first began to accumulate shares of Talley common stock in 1994. Eventually, his holdings exceeded 5 percent of the class of common shares; thus, he became obligated to report his holdings on Schedule 13D. In early 1997, Mr. Alissa, as the head of a dissident group
of Talley stockholders calling itself the Shareholders' Committee to Remove Entrenched and Arrogant Management ("SCREAM"), announced publicly that it was considering engaging in a proxy contest to elect directors at the Tally 1997 Annual Meeting. In early February, Mr. Alissa notified Talley that he intended to nominate at least two candidates, including Messrs. Robert Craig and Ralph Rockow, and further intended to present a series of shareholder proposals recommending that the Talley board take certain actions (including the hiring of an investment banking firm for the purpose of evaluating the Company) designed to weaken or eliminate the Company's antitakeover protections.

The 1997 Annual Meeting was held on May 8, 1997, at which Mr. Alissa's two nominees, Craig and Rockow, were elected. Their election was certified on May 27, 1997, at which time it was also announced that all of the precatory proposals sponsored by Mr. Alissa and SCREAM had been approved by the stockholders.

B. The Mallender Settlement

On June 3, 1997, Mr. William Mallender, who had been defeated for reelection, resigned as Chairman and Chief Executive Officer of Talley. Admiral Paul L. Foster, a member of the Board of Directors, was named Chairman and CEO. Thereafter, the Executive Committee of the Talley board undertook to negotiate a settlement of Mr. Mallender's compensation package with him. The minutes of the June 16, 1997 meeting of that committee, of which Rockow was a member, reflect the wide variety of issues considered by its members. Ultimately, the Executive Committee recommended a settlement package to the Board of Directors which considered that recommendation at a special meeting held on June 18-19, 1997. The minutes of the meeting of the Board of Directors also reflect a wide range of subjects considered in regard to the Mallender settlement. The board voted 8 to 2 to approve the recommendation made by the Executive Committee. Messrs. Craig and Rockow specifically expressed their agreement with the financial terms of the recommended severance package but voted against the Executive Committee's recommendation solely because "they did not agree that there should be a mutual release between the Company and Mr. Mallender."

C. The Board's Search for Alternatives

At its meeting on March 4, 1997, the Talley board of directors unanimously determined to retain the services of an investment banking firm for the purpose of providing the company strategic advice. After some
investigation, the board retained J.P. Morgan Securities Inc. ("J.P. Morgan") as its banker. The board specifically instructed J.P. Morgan to investigate all alternatives available to Talley at the time for a new strategic direction, including, *inter alia*, a "sale, merger, consolidation, joint venture, or any other business combination or extraordinary transaction, in one or a series of transactions, involving all or a material portion of the stock, assets, or business of the Company."

On June 19, 1997, J.P. Morgan presented its initial findings to the Board. J.P. Morgan described various alternatives including a "stay the course" strategy, a sale or spin-off of certain of the Company's businesses, or the sale or liquidation of the Company. The directors postponed until their next meeting a decision on how best to proceed. Meanwhile, on June 12, 1997, the Company received an indication of interest in the purchase of one of the Company's subsidiaries in the government service and products segment. The Company responded to the person making the proposal, stating that it would not consider any proposals until it had concluded its strategic review.

The Board of Directors met again on July 22 and 23, 1997 to resume its consideration of strategic alternatives and to hear further from J.P. Morgan about the results of its work. The Board of Directors unanimously determined to pursue a sale of the Company as a whole and voted to retain J.P. Morgan to explore such a transaction and to advise the directors in connection therewith. Alternative proposals to sell or spin-off one or more units were rejected because tax and other considerations made them less valuable and attractive than a sale of the Company as a whole. Craig and Rockow, Alissa's two board designees, participated in these meetings and agreed with the determination that a sale of Talley as a whole was the value maximizing alternative.

On August 1, 1997, Talley received from Carpenter a non-binding indication of interest to purchase all of Talley's outstanding common stock for $10 per share, including a stated willingness to increase the proposed price after receipt of additional information about one segment of Talley's business. Following consultation with the Board of Directors, J.P. Morgan and senior management, Admiral Foster rejected this offer but agreed to enter into a confidentiality agreement with Carpenter for the purpose of sharing non-public information about Talley. On August 7, 1997, having reviewed additional information, Carpenter raised its offer to $12 per share, subject to further due diligence. Talley agreed to Carpenter's request for a 45 day due diligence period and to a limited form of exclusivity during that time. The confidentiality agreement provided that Talley would not initiate, solicit, or encourage other offers for Talley during this period, but that Talley was free to participate in discussions or negotiations with, and provide
confidential information to third parties if Foster determined in good faith, after receiving advice from J.P. Morgan, that such third party had submitted a bona fide proposal or indication of interest that was, or could reasonably be expected to lead to, an acquisition proposal that was financially superior to Carpenter's $12 per share proposal.

During the month of August and until the execution of the merger agreement on September 25, 1997, Talley and J.P. Morgan received a number of inquiries from third parties concerning possible transactions involving Talley as a whole, or certain of its businesses. None of these contacts ripened into a proposal superior to the $12 per share Carpenter proposal.

D. The Board of Directors Accepts Carpenter's Merger Proposal

On September 25, 1997, the Board of Directors met to consider the terms of the proposed transaction with Carpenter. Craig and Rockow made a motion at the meeting to adjourn for two weeks to afford additional time to review and consider the Carpenter proposal. They also delivered a written memorandum to the Board of Directors ("September 25 Memorandum"), setting forth the reasons for their motion and, thus, their opposition to the Carpenter transaction. The motion to adjourn was defeated by a vote of 8 to 2. Thereafter, J.P. Morgan delivered its oral opinion to the Board that the proposed Carpenter transaction was fair to the stockholders of Talley from a financial point of view. The transaction was then approved by a vote of 8 to 2, Craig and Rockow dissenting.

Craig and Rockow voted against the transaction for the reasons expressed in the September 25 Memorandum. On October 1, 1997, Mr. Rockow's Arizona attorneys wrote to Admiral Foster raising concerns about the disclosures already made in connection with the public announcement of the merger with Carpenter and to be made in a tender offer or proxy soliciting materials. That letter concluded by stating that, if adequate disclosure was made (including the reasons he and Craig dissented on the vote approving the merger) Mr. Rockow "is willing to let the stockholders decide whether to accept the Carpenter terms."

E. The Litigation

The Board's approval of the Carpenter merger proposal was announced on September 26, 1997. Carpenter began its first step, any and all cash tender offer on October 2, 1997. The defendants' Schedules 14D-1 and 14D-9 were disseminated to Talley stockholders at that time.
The first of the six lawsuits to challenge the merger was filed September 26, 1997. After their receipt and review of the tender offer materials, the plaintiffs updated and expanded their allegations of wrongdoing in an amended complaint filed October 8, 1997. Among other things, the amended complaint alleges that the defendant directors failed to fulfill their fiduciary duty to act reasonably to maximize value in the sale of the Company and that the tender offer materials were false and misleading, inter alia, in their failure to disclose the reasons given by Craig and Rockow (in the September 25 Memorandum) for voting against the merger.

After filing their amended complaint, the plaintiffs moved for a preliminary injunction and began discovery, obtaining documents from the defendants and J.P. Morgan. According to the March 16, 1998 affidavit of the plaintiffs' lead counsel, Stanley D. Bernstein ("Bernstein Affidavit"), plaintiffs also sought from Alissa, Craig and Rockow any information that would help in prosecuting the case. In a conversation held on October 7, 1997, Robert Krasne, of Williams & Connolly, Alissa's lawyers, told Bernstein that the Board of Directors of Talley had improperly favored a sale of the Company as a whole, rather than a division by division transaction, in order to insulate themselves from liability for past conduct. When Bernstein inquired about the facts supporting this claim, Krasne pointed only to the terms of the merger agreement dealing with the continuation for a period of six years of Talley's directors and officers liability insurance coverage and associated provisions in Talley's charter and bylaws, which he claimed were unusual and suggested an improper motivation on the part of the Talley directors.\(^1\) Based on his prior experience, Bernstein told Krasne that such provisions are commonplace and do not suggest any improper motivation on the part of directors.

Bernstein contacted counsel for Rockow in an effort to learn whether or not there were facts to support Alissa's suggestion that a division by division transaction would yield greater value. Rockow's attorney advised Bernstein that Rockow's goal was for Talley's shareholders to be advised of

\(^1\)The record before the Court establishes that the merger agreement terms regarding, exculpation, indemnification and insurance are typical of those commonly found in transactions of this type. The Talley Certificate of Incorporation contained a provision exculpating Talley directors from personal liability to Talley or its stockholders to the fullest extent authorized by 8 Del. C. § 102(b)(7). The Talley bylaws also contained provisions mandating indemnification of the Talley directors "to the fullest extent permitted or authorized by the General Corporation Law of the State of Delaware." There also existed between Talley and each of its directors, contractual provisions regarding the procedures for claiming a right to indemnification.

Section 5.5 of the Talley/Carpenter merger agreement requires the surviving corporation to assume the pre-existing exculpation and indemnification obligations of Talley to its officers and directors, to honor those obligations for a period of six years and (subject to a cost limitation) to maintain directors and officers liability insurance on terms and amounts no less favorable than those preexisting the merger.
the substance of his opposition to the Carpenter transaction, as set forth in the September 25 Memorandum.2

Craig was interviewed on the record on October 15, 1997. In his interview, he stated that he and Rockow were displeased "with the pace at which [the Board] was proceeding," and felt that it would be better to "stay the course" in order to realize the long term values in the Company. Craig stated, in his interview, that these were the only two objections either he or Rockow had to the merger with Carpenter. Rockow resisted appearing.

On October 16, 1997, the plaintiffs entered into a memorandum of understanding providing for substantial additional disclosure by the defendants in connection with the tender offer and merger. Importantly, the supplemental disclosure includes the content of the September 25 Memorandum, together with information concerning other possible bidders for Talley, including the dollar amounts of other proposals, and an analysis of the liquidation value of Talley. Plaintiffs tentatively agreed to settle the action in consideration of this additional disclosure after their initial discovery raised serious questions about the validity of their claims attacking the process followed by the Board of Directors in reaching the agreement to merge with Carpenter.

After the memorandum of understanding was signed, plaintiffs' counsel undertook further, limited discovery to assure themselves that the terms of the proposed settlement were fair, reasonable and adequate. In this regard, they continued to press for Rockow's testimony. On October 29, 1997, Rockow's lawyer rejected a request that Rockow, who resides in Arizona, appear in response to a subpoena issued out of this Court. Rather, Rockow's counsel wrote seeking to delay Rockow's appearance until an arrangement could be made for the payment by Talley of his attorneys' fees and expenses. This same letter acknowledges an awareness that the deposition was needed to confirm the adequacy of the proposed settlement. Finally, on November 11, 1997, Rockow's attorney wrote Bernstein as follows:

With respect to your request for a telephonic interview or deposition of Ralph Rockow, please be advised that, at this point, he is disinterested in the lawsuit or perpetuating the

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2The September 25 Memorandum is Exhibit B to the Bernstein Affidavit. In addition to expressing concerns about the timing of the Board's consideration of the Carpenter merger proposal, that memorandum also complained, at page 2, as follows: the entire Board has not been advised about, or had the opportunity to evaluate, other inquiries which might result in superior proposals for Talley and the stockholders and we are concerned that the $6 million termination fee could create a significant impediment to other viable proposals.
litigation. You should reconsider whether you need his deposition. (Emphasis added)

F. The Settlement

Plaintiffs' counsel then concluded their confirmatory discovery and entered into the final stipulation and agreement of settlement on January 23, 1998. The supplemental disclosures, made in accordance with the terms of the memorandum of understanding, form the essence of the consideration flowing to the class as a result of the settlement of the action. The class is proposed to be certified pursuant to Rules 23(b)(1) and (b)(2), as is usual in actions challenging the exercise of fiduciary responsibility in corporate merger transactions, and does not contemplate the ability of class members to "opt out." See Hynson v. Drummond Coal Co., Del. Ch., 601 A.2d 570, 575 (1991). Moreover, as is usual in matters of this sort where no other litigation is pending in any federal or state court, the terms of the settlement provide for the dismissal of the action and the release of all claims which have been or could have been asserted in the action, or which arise from or relate to the events described in the action. Thus, if the settlement is approved, the proposed judgment would preclude all members of the class from litigating in any other court claims arising out of the merger, including claims arising under the Securities Exchange Act of 1934 ("1934 Act") over which the federal courts have exclusive jurisdiction. Matsushita Electrical Indus. Co., Ltd. v. Epstein, 516 U.S. 367 (1996).

III. THE OBJECTION

A. The Threat of Litigation

Before turning to an analysis of their legal merit, I find it necessary to discuss events leading to the lodging of the objections by Alissa and Rockow. Alissa claims that he is entitled to be reimbursed by Talley for more than $700,000 in fees and expenses incurred by him in connection with the 1997 proxy contest. The record before me strongly suggests that the decision to lodge objections to the Settlement was related to Alissa's efforts to force the payment or settlement of that claim. For the reasons discussed herein, this suggested connection necessarily colors the Court's consideration of the objections.

In accordance with this Court's order of January 26, 1998, directing the giving of notice of the proposed settlement, all objections thereto were to be filed by March 10, 1998. On February 26, 1998, Mr. Krasne, of
Williams & Connolly, Alissa's counsel, wrote to John R. Welty, Vice President, General Counsel and Secretary of Carpenter as follows:

This firm represents Saad A. Alissa, an individual who has been a shareholder in Talley Industries, Inc. ("Talley"). As you may be aware, Mr. Alissa held discussions with the former management and Board of Talley over an extended period of time concerning a variety of issues that he identified concerning the operations and management of Talley. After being rebuffed repeatedly by Talley's management, Mr. Alissa took his case to the shareholders of Talley, who, in conjunction with the 1997 Talley Annual Meeting, voted to end the reign of William Mallender as Talley's Chairman and chief executive officer.*

Mr. Alissa has repeatedly requested that Talley reimburse him for the expenses he incurred in conjunction with the 1997 Talley proxy contest. Notwithstanding suggestions to the contrary, we are aware of no meaningful action taken by the Talley Board to address his request. Mr. Alissa believes that the actions he took with respect to the proxy contest inured to the benefit of Talley and its shareholders. Because no action has been taken concerning his request for reimbursement of his proxy expenses, he feels compelled to file the enclosed draft complaint.

Mr. Alissa also has concerns about the conduct of Talley's Board, and, in particular, its failure to disclose adequately a variety of significant issues and decisions of import to the Talley shareholders. The Talley Board's disclosure failures give rise to liability for which we understand the Board is indemnified by Carpenter Technology Corporation ("Carpenter") under the terms of the Talley/Carpenter merger agreement.

Because Carpenter may ultimately be responsible for these matters under the terms of Talley's merger with Carpenter, Mr. Alissa is advising you of his intention to file the two enclosed complaints and to pursue his lawful remedies.** If Carpenter or Talley are aware of any reason why Mr. Alissa should not file these complaints, please contact me within the next ten days to advise me of the basis for such belief.
Very truly yours,

Robert M. Krasne

*Indeed, in conjunction with that proxy contest, Mr. Alissa announced his intention to place a number of proposals before the Talley shareholders, including the question of whether Talley should engage an investment banker to review Talley's circumstances. That announcement prompted Talley to engage J.P. Morgan and began a series of events that ultimately led to the sale of Talley.

**In addition, Mr. Alissa has directed me to advise you of his intention to file with the Delaware Chancery Court objections to the proposed settlement. Mr. Alissa also intends to be represented at the March 20 hearing.

Attached to this letter were drafts of the two complaints Alissa was said to "intend" to file, although, at least as of the March 20 hearing, neither complaint had been filed. The first of these drafts is captioned in the United States District Court for the District of Arizona and relates only to Alissa's claimed entitlement to reimbursement of his proxy expenses. Talley is the only named defendant. That draft complaint is of relevance to the Court's consideration of the proposed settlement and the objections because it reveals an ulterior motive behind the objection to the settlement and contradicts a fundamental premise of the objection by repeatedly and strenuously alleging that the Talley/Carpenter merger was a substantial benefit to the Talley shareholders. For example, the following is alleged:

- Alissa's 1997 proxy solicitation "directly led to a change in management and subsequently to the sale of the Company for the benefit of all shareholders . . ." (¶1)
- Talley "would not have entertained any offers for the sale of its stock nor entered an agreement to permit the acquisition of the Company if plaintiff had not been successful in his proxy contest." (¶34)

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3Only the second of these draft complaints, purporting to allege substantive claims against the Board regarding the Talley/Carpenter merger, is attached to the Notice of Intent to Appear and Object filed by Alissa and Rockow in this Court.
The expenses Alissa incurred "accrued benefit to the shareholders and the Company by directly and/or indirectly causing and/or enabling Carpenter to offer and the Company to accept the merger proposal whereby shareholders were able to surrender their stock for $12.00 per share." (¶42)

- Alissa's proxy solicitation activities "provided substantial benefit to the Company and its shareholders by directly and/or indirectly leading to the acquisition of the Company by Carpenter." (¶52)

The second draft complaint reflects a rather different view of the Talley/Carpenter merger. This draft is captioned in the United States District Court for the District of Delaware and purports to make claims against Talley directors (other than Craig and Rockow) under the federal securities laws and Delaware fiduciary duty law. The complaint is a hodgepodge of allegations of mismanagement or misconduct by Mallender or the Talley Board. The complaint claims that the Schedule 14D-9 and the merger proxy statement, both of which were issued after Craig and Rockow had been directors for some months, were false and misleading as the result of the omission or misrepresentation of the information about this alleged misconduct and that, as a result, Alissa was "forced to sell his shares at a price substantially below" their true value. (¶101)

The gist of this draft complaint is found in a series of allegations that Mallender, during his tenure as Chairman and Chief Executive Officer, engaged in illegal or fraudulent conduct (including alleged insider trading) which, eventually, became known to the Board of Directors and which is said to have violated the terms of Mallender's employment agreement. The draft complaint alleges in conclusory terms that the directors: (i) failed to initiate action against Mallender on account of his misdeeds, but rather authorized the expenditure of corporate funds in opposition to Alissa's proxy contest and in support of Mallender's reelection, (ii) improperly authorized the settlement of Mallender's severance compensation claims when, if alleged, they knew that Mallender was in breach of his employment contract and that no amounts were due thereunder, (iii) failed to disclose either Mallender's misdeeds or their own misconduct in either the Schedule 14D-9 disseminated in connection with the tender offer or the merger proxy statement. It is alleged that the Board "knew of Mallender's liability (and their own) prior to issuing the Schedule 14D-9 on October 2, 1997." (¶98h) And, it is further alleged that "[b]y concealing a cause of action on behalf of Talley of which they knew, and which would be extinguished by ratification
of the merger agreement, [the defendant directors] failed to disclose an asset of Talley worth $6,000,000 [roughly the amount of the Mallender severance payment] of which they were aware." (¶99)

Surprisingly, in light of Alissa and Rockow's lack of cooperation with the plaintiffs' counsel in this case, the draft complaint (¶¶66-67) claims that the charges against Mallender of alleged insider trading were communicated to Admiral Foster on July 7, 1997 by a person acting on behalf of Alissa with an explicit threat "to sue the Board in connection with these allegations." The draft then makes the following conclusory allegations without acknowledging or discussing Rockow and Craig's agreement to the financial terms of the Mallender severance agreement:

68. Despite this information, the Board did nothing to recover the handsome severance package that had been given to Mallender, or to inform shareholders of Talley that the company had a potential cause of action worth at least $6,000,000.

69. Instead, motivated by the threat of litigation, the Directors negotiated to sell the company whole and to obtain from the purchaser -- Carpenter -- an indemnification clause in the sales contract that would ensure their own immunity from suits arising from their breaches of their fiduciary duties.

Ultimately, the only claims asserted in the draft complaint are for alleged failures of disclosure variously alleged as violations of Section 14(a) and 14(e) of the 1934 Act and of the defendants' Delaware law based disclosure duties.

B. The Asserted Grounds for Objection

The nub of the objection to the settlement is the argument, advanced on page 8 of the Objectors' legal memorandum, and purportedly substantiated by their second draft federal court complaint, as follows:

As established in In re MCA, Inc. Shareholders Litig., Del. Ch., 598 A.2d 687 (1991), a settlement should not be approved where, for minimal consideration, it would cut off meritorious federal-law claims that were not raised in Chancery court. This is precisely the situation here. The defendants are getting their broad release far too cheaply.
The Objectors also make a series of attacks on the adequacy and thoroughness of the work undertaken by plaintiffs' counsel. Finally, as previously discussed, the Objectors argue that the Talley directors did not adequately consider a sale of the individual subsidiaries because they wished to obtain some greater right to indemnification and insurance coverage from the sale of the Company to Carpenter as a whole.

IV. DISCUSSION


The [Court of Chancery] must balance the policy preference for settlement against the need to insure that the interests of the class have been fairly represented. *Rome v. Archer*, Del. Supr., 197 A.2d 49, 53 (1964). Thus, the Court of Chancery must carefully consider all challenges to the fairness of the settlement but without actually trying the issues presented. 'Under *Rome*, the [C]ourt's function is to consider the nature of the claim, the possible defenses thereto, the legal and factual circumstances of the case, and then to apply its own business judgment in deciding whether the settlement is reasonable in light of these factors.'

(quotting *Polk*, 507 A.2d at 535).

A. Class Certification Issues

[4] Before examining the merits of the proposed settlement, I must first determine whether this action is maintainable as a class action under Chancery Court Rule 23. *Prezant v. De Angelis*, Del. Supr., 636 A.2d 915 (1994). Plaintiffs move for class certification pursuant to Rule 23(b)(1) and (2), thus, in addition to determining whether the requirements of Rule 23(a)
have been satisfied, I must also determine whether the plaintiff has satisfied the class certification requirements encompassed in one of these subsections.

[5] Rule 23(a) sets out four general requirements for a class to be certified: (i) numerosity, (ii) commonality, (iii) typicality, and (iv) adequacy of class representatives. Alissa and Rockow have raised objections to class certification only with regard to the adequacy of the class representation, and, in particular, the adequacy of the litigation efforts undertaken by class counsel. As I find that the other elements are readily satisfied, the focus of the discussion will be directed toward this element.

1. **Numerosity, Commonality and Typicality**

[6-8] As of June 30, 1997, Talley had in excess of 14 million shares outstanding, which are owned by hundreds of stockholders. As such, it would not be practical to join all potential plaintiffs before the court. See *Leon N. Weiner & Assoc., Inc. v. Krapf*, Del. Supr., 584 A.2d 1220, 1225 (1991) (stating test is not impossibility of joinder but rather practicality). Accordingly, the plaintiffs satisfy the numerosity requirement of Rule 23(a).

As to the commonality requirement, class certification is proper if the plaintiffs have questions of law and fact in common. *Weiner*, 584 A.2d at 1225. The amended complaint alleges that the defendants breached their fiduciary duties in connection with the Talley/Carpenter merger to the detriment of the class and/or aided and abetted in such wrongs. As this question similarly affects each stockholder, the commonality requirement is also satisfied. See *id.* (stating requirement satisfied where question of law linking class members is substantially related to resolution of litigation even though class members are not identically situated). In order to satisfy the typicality requirement, the representative plaintiffs' claims must be the same as those of other Talley stockholders. Because all Class members face the same injury flowing from the defendants' conduct in connection with the merger, the typicality requirement is satisfied. See *id.* at 1226 (stating representative's claim sufficient if it arises from same event or course of conduct giving rise to claims of other class members and is based on same legal theory).

2. **Adequacy of Class Plaintiffs**

[9] The record before the Court contains affidavits of several named plaintiffs establishing that they owned Talley common stock on September 26, 1997 (the same day the merger was announced) and continued to own the stock through the date of the merger. Moreover, the record shows the absence of a conflict of interest between those named
plaintiffs and other Class members. For these reasons I find that the representative plaintiffs are adequate Class representatives.

3. Adequacy of Class Counsel

The Objectors' argument against class certification seems to be based primarily on two grounds. First, the Objectors assert that the plaintiffs' counsel engaged in grossly inadequate discovery when prosecuting this action, and further, that after entering into the memorandum of understanding with the defendants, class counsel undertook only a small amount of pro forma discovery. Second, the Objectors assert that class counsel ignored certain disclosure violations giving rise to federal and state claims, viz, (i) Mallender's misconduct and the defendants' complicity with the wrongful conduct, (ii) the circumstances surrounding Mallender's severance package, and (iii) the board's alleged desire for an indemnification provision, all of which, the Objectors contend, give rise to breach of fiduciary duty claims.

[10] I am satisfied from my review of the record that class counsel diligently and thoroughly prosecuted this action, and that they are adequate class representatives. The record is devoid of any facts evincing a failure on the part of class counsel to either (i) adequately prosecute this action, or (ii) to engage in meaningful discovery. To the contrary, the record, including the Bernstein Affidavit, shows that class counsel undertook appropriate discovery into the claims asserted in the amended complaint and sought information relating to those and other potential claims in evaluating the claims and the proposed settlement terms. Among other things, class counsel made repeated attempts to obtain testimony from Rockow. These efforts only ceased when Rockow's counsel sent a letter stating "please be advised that, at this point, [Rockow] is disinterested in the lawsuit or perpetuating the litigation." Thus, there is more than a little irony in Rockow's attack on the plaintiffs' litigation efforts.

The adequacy of class counsels' efforts is also evidenced by the fact that the "claims" Objectors now propose to litigate all appear to be makeweight, asserted only to add force to Alissa's demands to be paid his $700,000 in proxy expenses. The substance of these claims will be addressed, infra. At this point, I only note in passing that plaintiffs' counsel cannot be faulted for not having addressed these claims earlier in the litigation. The record is replete with evidence demonstrating class counsel's attempts to procure information from Alissa and Rockow giving rise to any potential claims which could be asserted against Talley, or any reasons why the settlement should not proceed. Apart from suggesting implausibly that the indemnification provisions of the merger agreement, by themselves, suggested improper motivation, neither Alissa nor Rockow was
forthcoming. In the circumstances, their attacks on class counsels' diligence ring hollow.

4. **Rule 23(b) Requirements**

[11] Having concluded that the requirements of Rule 23(a) have been satisfied, I turn to an analysis of whether class certification is proper under Rule 23(b). This Court has held that actions challenging the exercise of fiduciary responsibility in corporate merger transactions are properly certified under Rule 23(b)(1) and (2). See *Hymson*, Del. Ch., 601 A.2d at 575. Because this action challenged the board's action regarding the sale of the company, it satisfies the requirements of (b)(1) and (2).

* * *

The record before me supports the conclusion that this action is maintainable as a class action. Class counsel has established that all of the requirements of Rule 23 have been fully satisfied. Contrary to the assertions of the objectors, class counsel have demonstrated that they are adequate class representatives. Thus, I find that class certification in this action is proper and will be granted. I turn now to an analysis of the settlement terms.

B. **The Nature of the Claims and Difficulties of the Litigation**

The amended complaint makes two general claims. First, that the defendant directors failed to maximize value in the sale of Talley and did not adequately pursue other value-maximizing alternatives, all in breach of their duties under *Revlon* v. *MacAndrews & Forbes Holdings, Inc.*, Del. Supr., 506 A.2d 173 (1986). Second, that the disclosures made in the Schedule 14D-9 and otherwise in connection with the merger were incomplete, false and misleading, in violation of the directors' fiduciary duties.

1. **The Revlon Claims**

[12-13] It is clearly the law of Delaware that there "is no single blueprint" that a board authorizing a sale of the corporate enterprise must

*The assertion that the board improperly sought a sale of the company as a whole rather than in parts because of its desire to obtain an indemnification provision in order to protect themselves from liability is particularly jejune. The indemnification provisions evince no sinister motive on the part of the board. Rather, they are of the type normally found in these situations. The mere existence of this provision without substantial additional evidence is insufficient even to raise an inference that the defendants acted with an improper purpose.*
follow to fulfill its fiduciary duties. Barkan, 567 A.2d at 1286. "Rather a board's actions must be evaluated in light of relevant circumstances to determine if they were undertaken with due diligence and in good faith. If no breach of duty is found, the board's actions are entitled to the protections of the business judgment rule." Id. (citing Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946, 954-55 (1985)).

[14] The record before the Court quite strongly suggests that, even assuming that the Talley/Carpenter merger implicates the duties discussed in Revlon and other similar cases, the Board of Directors informed themselves adequately and acted reasonably in connection with the sale of the Company. Thus, they would appear to be entitled to the protection of the business judgment rule. Paramount Communications, Inc. v. QVC Network, Inc., Del. Supr., 637 A.2d 34 (1994) (stating that in the context of a change of control directors must act in accordance with their fundamental duties of care and loyalty).

The Board began the process of exploration in March when the directors unanimously voted to retain an investment banker to furnish strategic financial advice to the Company. J.P. Morgan was chosen for this role by a committee of three outside directors and was instructed to examine all alternatives, including "a sale, merger, consolidation, joint venture, or any other business combination or extraordinary transaction, in one or a series of transactions, involving all or a material portion of the stock, assets, or business of the Company."

Between March and June, J.P. Morgan performed a detailed review and, at meetings held in June and July, outlined the various available strategic alternatives, including a sale of the Company, in whole or in pieces. At the July Board meeting, the Talley directors, including Rockow and Craig, considered an offer from Carpenter to purchase only Talley's steel subsidiary. At the meeting, the Board, with the advice of J.P. Morgan, determined that it was not in the best interests of Talley and its stockholders to sell the steel business alone. This decision was based, among other things, on the tax liability of approximately $30 million that would have resulted from a sale of the steel subsidiary and the inability of Talley to replace the cash flow that would be lost from the sale of that subsidiary. At the end of these meetings, the Board of Directors unanimously determined to pursue a sale of the Company as a whole as the best way to maximize shareholder value.

This conclusion was reaffirmed in September, before the Board approved the Carpenter offer, when Admiral Foster asked J.P. Morgan to perform a liquidation analysis of the value, on an after tax basis, to be obtained from a sale of the subsidiaries on an individual basis. This analysis,
which is unchallenged, demonstrated that the Carpenter offer provided greater value. As Admiral Foster testified:

[A]fter J.P. Morgan's analysis, it was evident that while individually some of these numbers look attractive, when you look at the whole package on an after tax basis it was not an alternative which would maximize shareholder value. It was considerably less than the $12 per share that was on the table.

Moreover, discovery showed that the consideration the Board obtained was the highest obtainable in the circumstances. Carpenter was unwilling to go higher, and no one else came close to meeting the Carpenter offer. Once the terms of the agreement with Carpenter were announced, no one emerged with a higher offer. Craig, in his interview, stated that he was unaware of anyone prepared to offer more. The Objectors offer no evidence of any higher alternative transaction.\(^5\) Indeed, Alissa, in his first draft federal complaint takes full credit for the merger and claims that its terms were very beneficial to the Talley stockholders.

\[15\] Considering all of the circumstances, it seems likely that the so-called Revlon claim asserted in the amended complaint was not meritorious, or, to put it differently, that the director defendants would have been entitled to the protection of the business judgment rule and would have succeeded in their defense of that claim. This conclusion is not altered by any argument advanced by the Objectors. Specifically, I reject as lacking in any foundation in the record the Objectors' arguments that: (i) the Talley directors solicited and approved the Talley/Carpenter merger agreement to further their own interest in continued indemnification; (ii) greater value could have been achieved by selling the Company in pieces; or (iii) the $12 per share price paid in the merger was improperly diminished by the putative value of claims arising out of the Mallender severance settlement.\(^6\)

2. The Disclosure Claims

As a result of the litigation and the settlement, substantial supplemental disclosures were made to the Talley stockholders, both in the tender offer and the merger. The supplemental disclosure includes the

\(^5\)Objectors do suggest that a sale of the Company in pieces would have yielded greater value, but this suggestion is made without analysis, is contrary to all the record evidence and would appear to be utterly untenable.

\(^6\)In this last regard, it is noteworthy that Craig and Rockow both expressed their approval of the financial aspects of that settlement and that neither Alissa nor Rockow chose to dissent from the merger or pursue their statutory appraisal remedy.
September 25 Memorandum and other information about other possible bidders for Talley, including the dollar amounts of other proposals, together with the J.P. Morgan liquidation analysis of Talley. The disclosures made as a part of the settlement responded completely to the claims maintained by the plaintiffs in connection with their preliminary injunction application. Before agreeing to the settlement, the plaintiffs sought assurance from Alissa, Rockow and Craig that there were no other claims to litigate. Craig assured them there were none. Rockow avoided giving testimony and, in the end, communicated that he was "disinterested in the lawsuit or perpetuating the litigation." Alissa's counsel evidently had nothing to contribute beyond their complaint about the indemnification provisions of the merger agreement.

Alissa and Rockow now claim that there are other disclosure issues left to litigate. Even if these claims are asserted in good faith (and there is ample reason to doubt that they are), they do not appear to raise substantial, litigable issues. Without deciding the matter, there is at least a serious doubt that the Objectors' purported federal disclosure claims, if ever filed, would or could survive a motion to dismiss. Those claims appear to be no more than Delaware law based claims of waste or mismanagement dressed up in the language of federal disclosure law, not actionable under federal law. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977). In *Santa Fe*, the Supreme Court made clear that it will not countenance the federalization of state law claims of mismanagement or waste by reference to federal disclosure statutes or rules. *See also Field v. Trump*, 850 F.2d 938, 946 (2d Cir. 1988), *cert. denied*, 489 U.S. 1012 (1989) (stating that allegation that management should have disclosed its purported failure to take steps to maximize value during the course of a tender offer was merely a state claim for breach of fiduciary duty).

[16] These claims fare no better under Delaware law. It is well established that corporate directors need not "engage in self-flagellation ... implicating [themselves] in a breach of fiduciary duty from surrounding facts and circumstances prior to formal adjudication of the matter." *Stroud v. Grace*, Del. Supr., 606 A.2d 75, 81 n.1 (1992) (citation and internal quotation marks omitted). *See also Loudon v. Archer-Daniels-Midland Co.*, Del. Supr., 700 A.2d 135, 145 (1997); *Brody v. Zaucha*, Del. Supr., 697 A.2d 749, 754 (1997). Objectors' asserted claims about Mallender's misconduct, the directors failure to rectify it and the allegedly improper payment to Mallender of $6 million in severance benefits all fall squarely in the category of "self-flagellation." None of the underlying allegations of misconduct has been the subject of a formal adjudication. Indeed, none of it has even been the subject of a filed compliant. In the circumstances, it seems clear that the plaintiffs' failure to file and prosecute a disclosure claim relating to such
alleged misconduct is not a valid ground for objecting to the proposed settlement.  

* * *

[17] For all of the foregoing reasons, and in the exercise of my independent business judgment, I conclude that the terms of the settlement are fair, reasonable and adequate to the Class. In doing so, I also take into consideration the inherent difficulties the plaintiffs would have faced in proving damages to the Class as a result of the defendants' alleged misconduct in light of the superior nature of the Carpenter proposal.

3. Issues of Federal/State Relation

[18] Finally, I will comment briefly on Objectors' efforts to fit themselves into the paradigm discussed in In re MCA, Inc. Shareholders Litig., Del. Ch., 598 A.2d 687 (1991), where claims arising out of the same nucleus of operative facts are pending in both state and federal court and a proposal is made to settle the state court action on terms which would preclude the litigation of the action pending in federal court. In that case, then Vice Chancellor (now Justice) Hartnett refused to approve a settlement where the state court claims being settled had little or no value, the terms of the settlement provided meager consideration to the class, and the federal claims had "at least arguable merit and therefore . . . significant value." Id. at 690.

There are at least two notable differences between MCA and the situation presented here. First, the federal litigation was pending in MCA and is merely threatened here. This is a real difference. Because the Objectors have chosen not to initiate suit, there is no other forum available for the assessment of the merits of the federal claim asserted by them. Second, the federal claim asserted in MCA was for the alleged violation of a substantive federal tender offer rule having no Delaware state law correlative. Thus, the legal issues presented by that federal claim, while sharing certain factual predicates with the state law claims, were distinctly federal in nature. The "federal" claims the Objectors threaten to file are, by contrast, simple disclosure claims, akin to those alleged in the amended complaint in this matter and routinely considered by this Court. Thus, the exclusive jurisdiction of the federal courts over claims brought under the

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7Of course, as Objectors' counsel conceded at the hearing, the accomplishment of the Talley/Carpenter merger has eliminated the standing of any former Talley stockholder to sue derivatively to recover any of the monies Objectors' claim were improperly paid to Mallender.
1934 Act would not, as a practical matter, preclude litigation of those disclosure claims in this Court. [19] For these reasons, I have neither occasion nor reason to withhold approval of the proposed settlement or to tailor the scope of the proposed release to preserve the Objectors' ability to proceed in another court. MCA does not hold or suggest otherwise. Indeed, in a subsequent decision in that matter, the Court approved a modified version of the same settlement (including a $2 million payment to the class) after it appeared that the federal district court had entered summary judgment in favor of the defendants, notwithstanding that an appeal was pending before the Ninth Circuit. In Re MCA, Inc. Shareholders Litig., Del. Ch., Cons. C.A. No. 11740, Hartnett, V.C. (Feb. 16, 1993). Exercising his business judgment, then Vice Chancellor Hartnett found the terms of the settlement adequate, reasoning that the district court's entry of summary judgment showed that the federal claims "now have minimal economic value" and that, if he rejected the settlement, the $2 million benefit would be lost. Id. at 11-12.

V. THE FEE PETITION

Plaintiffs' counsel seek an award of attorneys' fees in the amount of $330,000.00, inclusive of expenses, for their efforts in prosecuting the litigation. They point out that they worked on a fully contingent basis and argue that the settlement achieved by them favorably resolves the issues raised in the amended complaint. Other than Alissa and Rockow, no member of the class has voiced any objection to the fee request. [20] The law in Delaware governing the award of attorneys' fees in corporate litigation is well established. Where litigation efforts on behalf of a corporation or its stockholders result in the creation of a common fund or the conferring of a benefit, the Court may, in its discretion, award fees and expenses. Tandycrafts, Inc. v. Initio Partners, Del. Supr., 562 A.2d 1162, 1164 (1989).

[21] In determining the amount of fees to award, the courts have generally accorded the greatest weight to the benefit achieved as a result of the litigation. In the Matter of the Appraisal of Shell Oil Co., Del. Ch., C.A. No. 8080, Hartnett, V.C., (Oct. 30, 1992), In re Maxxam Group, Inc. Stockholders Litig., Del. Ch., C.A. No. 8636, Allen, C. (Apr. 16, 1987), slip op. at 31. Other factors considered are the time and effort applied to the matter by the plaintiffs' counsel and the difficulty of the litigation, the contingent nature of the retainer, and the standing of counsel. Sugarland Indus., Inc. v. Thomas, Del. Supr., 420 A.2d 142 (1980).

[22] I am satisfied that the terms of the settlement requiring the publication and dissemination of the supplemental disclosure provided a substantial,
although nonmonetary and unquantifiable, benefit to the members of the class. Indeed, the timely disclosure of the information in the supplement was presumably of greater value to the class than any potential award of damages based on the failure to disclose the same information, as such information is of the greatest utility when it is available in a timely manner to inform the stockholders' decision making process. Considering all the circumstances presented, I have no difficulty concluding that the disclosures made here constitute adequate consideration for the settlement of the claims asserted and adequately support the fee requested.

While not necessarily unusual for expedited corporate litigation of this type, the services rendered by plaintiffs' counsel were of high quality and, it is fair to say, could not have been rendered by lawyers inexperienced at prosecuting stockholder litigation. The action was prosecuted diligently, in the context of expedited proceedings designed to lead to a hearing on plaintiffs' motion for a preliminary injunction. Plaintiffs' counsel, who together devoted in excess of 700 hours of attorney time to this matter, pursued their case vigorously and engaged in successful efforts to settle those claims which appeared meritorious. Their efforts were undertaken on a purely contingent fee basis, a factor which may justify a higher fee than would be awarded to an attorney who works on an hourly fee or modified hourly fee basis. See Chrysler Corp. v. Dann, Del. Supr., 223 A.2d 384, 389 (1966).

[23] For all of these reasons, I conclude that the fee sought is a reasonable one and should be allowed. I will also allow an award of expenses in the amount sought.

VI. CONCLUSION

For all of the foregoing reasons, I will approve the settlement, award fees and overrule the objections. Counsel for plaintiffs should submit a form of order in conformity with this opinion.
United Vanguard Fund, Inc. v. Takecare, Inc.

No. 13,343

Court of Chancery of the State of Delaware, New Castle

June 8, 1998

Plaintiffs brought a fee petition seeking $4.8 million in attorney's fees and expenses for purportedly conferring a benefit on stockholders of a corporation that resulted from their initiation of litigation which was later rendered moot by defendant board's actions. Plaintiffs originally claimed that the board impeded bidding for acquisition of the company by entering into a letter of intent with one bidder. Plaintiffs also claimed the directors breached their duties of care and loyalty by not fully informing themselves of another offer to buy the company and by not conducting a fair auction. Defendants countered that plaintiffs' claim was not meritorious when filed and the complaint was prematurely filed because the bidding process was ongoing; therefore, no breach of fiduciary duties occurred.

The court of chancery, per Vice-Chancellor Lamb, concluded that defendants failed to rebut the common corporate benefit doctrine presumption that there was a causal connection between the litigation and the corporate benefit conferred upon the company. Further, the court concluded that the lawsuit was meritorious when filed and awarded attorney's fees to plaintiffs. Plaintiffs were not entitled to the full amount of the award requested, however, for failing to prove that counsel was entitled to a success bonus per the original fee agreement.

1. Attorney and Client

When corporate defendant, after complaint is filed, takes action that renders claims asserted in complaint moot, Delaware law imposes on it a burden of persuasion to show that no causal connection existed between initiation of suit and any later benefit to shareholders in order to avoid an award of attorney fees to litigants initiating suit.

2. Attorney and Client

In Delaware, the common corporate benefit doctrine is the basis for awarding attorney's fees and expenses in corporate litigation.
3. Attorney and Client Corporations

As a preliminary matter, in order to be entitled to award of attorney fees under corporate benefit doctrine, applicant must show that suit was meritorious when filed, that action producing benefit to corporation was taken by defendants before judicial resolution was achieved, and that resulting corporate benefit was causally related to lawsuit.

4. Attorney and Client Corporations

Under the common corporate benefit doctrine, Delaware law entitles plaintiffs to the presumption that a causal connection existed between the initiation of litigation and benefit later conferred on corporation in situation where actions taken by defendant after filing of complaint render asserted claims moot.

5. Attorney and Client Costs

Under the corporate benefit doctrine, a claim is meritorious when filed within the rule authorizing an award of counsel fees if the claim can withstand a motion to dismiss on the pleadings and the plaintiff possesses knowledge of provable facts which holds up some reasonable, albeit not absolute assurance, of likelihood of ultimate success.

6. Administrative Law and Procedure

In assessing defendant's claim that suit was not meritorious under corporate benefit doctrine, court did not give SEC No Action Letter same effect as judicial ruling on a motion to dismiss.

7. Attorney and Client

Where defendants failed to establish complete absence of any causal relationship between the litigation and their actions rendering plaintiffs' claim moot, court found defendant failed to overcome the causal connection presumption of the corporate benefit doctrine.
8. Attorney and Client 155, 157

Where plaintiff's litigation resulted in company entering into final sale agreement higher than would have been the case without the lawsuit, court found benefit was conferred upon shareholders under an application for attorney's fees within meaning of corporate benefit doctrine.

9. Attorney and Client 155
Corporations 214

Under common corporate benefit doctrine, litigant who confers common monetary benefit upon ascertainable stockholder class is entitled to award of counsel fees and expenses for its efforts in creating such benefit.

10. Attorney and Client 155, 157

Corporate benefit doctrine is premised on theory that all stockholders who have benefitted from plaintiff's actions should have to share in the costs of achieving that benefit.

11. Attorney and Client 166

Nonlitigation related fees, such as provision of investment banking advice where no evidence is in the record showing any substantial services were furnished in connection with litigation, are not reimbursable to plaintiffs under the corporate benefit doctrine.

12. Costs 172

In determining the amount of an award of fees in a given case, the court considers: (1) the amount of time and effort applied to the case by counsel for the plaintiffs; (2) the relative complexities of the litigation, including skill applied to their resolution by counsel; (3) the standing and ability of petitioning counsel; and (4) the contingent nature of the litigation.

13. Corporations 214

Allowance of fees in a stockholder's derivative action is a discretionary act and is ascertained solely by reason of the benefit conferred on shareholders by reason of the litigation.
14. Costs 161, 171

In suit for fees and expenses, party is entitled to reimbursement only for those fees and expenses incurred while prosecuting the litigation and not for time expended on nonlitigation activities before or after the filing of the complaint.

15. Costs 163, 171

A fee agreement does not preclude plaintiffs' counsel from recovering an amount in excess of their hourly fee if (1) the right to petition fees was the basis on which plaintiffs' counsel agreed in writing with plaintiffs at the beginning of the representation; (2) the written retention agreement contemplated legal services not only for plaintiffs but for the benefit of all stockholders; and (3) since benefit to all shareholders was an objective of counsel and since the contemplated benefit achieved was within the scope of the fee contract, it would be patently unfair to deprive petitioners of compensation based on the advantage which their efforts secured for all stockholders.

16. Attorney and Client 155, 157

Where the court cannot attribute the whole or any particular part of the claimed benefit to the results of the stockholder class litigation, fees will be awarded on a quantum meruit basis.


Kenneth J. Nachbar, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Michael Joseph, Esquire and Joseph 0. Click, Esquire, of Dyer Ellis & Joseph, Washington, D.C., of counsel, for defendants TakeCare, Inc.

LAMB, Vice-Chancellor
I. INTRODUCTION

This fee petition is before the Court on remand following the decision of the Delaware Supreme Court reversing an earlier ruling granting the defendants' motion for summary judgment. The underlying action was brought in January 1994, by the holders of approximately 22% of the common stock of TakeCare Inc. ("TakeCare" or the "Company"), a Delaware corporation, to enjoin the sale of TakeCare to FHP International Corp. ("FHP") and to compel a "fair auction" of the Company. After the defendants' actions mooted the lawsuit, the plaintiffs brought this fee petition seeking $4.8 million in attorney's fees and expenses for purportedly conferring a benefit on the stockholders of the corporation.

In late 1993, the directors and substantial stockholders of TakeCare, a health maintenance organization, decided that TakeCare should be sold. After engaging in a search for potential acquirers, TakeCare received two offers: (i) an all stock offer from United HealthCare Corp. ("United") valued at $65 per share; and (ii) a cash-and stock offer from FHP valued at $62 per share. On January 9, 1994, after discussing the merits of both offers, the Board entered into a letter of intent with FHP. On January 17, TakeCare received an unsolicited offer from a new bidder, Foundation Health Corp. ("Foundation"), proposing an all-stock transaction valued at $72 per share.¹ The next day, January 18, the plaintiffs filed suit seeking to set aside the letter of intent which was set to expire by its terms on February 7, 1994. Ultimately, FHP acquired TakeCare for $80 per share.

In their complaint, the plaintiffs alleged, inter alia, that TakeCare impermissibly favored FHP in the bidding process, and also that a 1% breakup fee in the letter of intent precluded United, as well as other potential bidders, from treating a potential acquisition as a "pooling of interest," thus effectively preventing a "fair auction" of the Company. On January 19, 1994, the Court held a hearing on the plaintiffs' expedited discovery motion. Because Foundation had entered the bidding with its $72 per share offer, and because the bidding process was ongoing, the Court denied the plaintiffs' request for immediate expedited discovery on their preliminary injunction application, postponed all discovery until after the expiration of the letter of intent on February 7, and set a hearing date for March 1, 1994. At a hearing held on February 18, the Court suspended all discovery and vacated the March 1 hearing date.

Ultimately, the Company was acquired by FHP in a cash and stock deal valued at $80 per share. These events, which occurred after the filing

¹On January 30, a fourth bidder, PacifiCare Health Systems, made an offer valued at $68.50 per share consisting of cash, common stock and subordinated debt.
of the litigation, mooted the plaintiffs' claims. Plaintiffs argue, however, that the litigation conferred a substantial benefit on TakeCare and its shareholders, resulting in the creation of a $271 million common fund, representing the entire difference in value between the initial $62 proposal and the final $80 merger transaction.

II. PROCEDURAL POSTURE

On April 8, 1994, the plaintiffs and their counsel filed a motion for an award of attorney's fees and expenses for $4.8 million. Thereafter, the parties filed cross-motions for summary judgment on the plaintiffs' fee application. By Memorandum Opinion dated November 8, 1996, this Court denied the plaintiffs' motion for summary judgment, and granted the defendants' cross-motion for summary judgment. United Vanguard Fund v. TakeCare, Inc., C.A. No. 13343, Allen, C. (Nov. 19, 1996). In his Opinion, then Chancellor Allen held that there was no causal connection between the filing of the lawsuit and the monetary benefit conferred upon TakeCare's shareholders. Beginning with the indisputable premise that Foundation's entrance into the bidding process on January 17, 1994, had nothing to do with the later filed litigation, the Court concluded, as a matter of law, that the benefit claimed by the plaintiffs (i.e. the higher price that was ultimately obtained) was caused by Foundation's $72 bid, and not by the litigation.

Plaintiffs appealed the Court's decision and the Supreme Court of Delaware reversed and remanded. On appeal, the Supreme Court stated that:

[w]here, as here, a corporate defendant, after a complaint is filed, takes action that renders the claims asserted in the complaint moot, Delaware law imposes on it the burden of persuasion to show that no causal connection existed between the initiation of the suit and any later benefit to the shareholders.

United Vanguard Fund v. TakeCare, Inc., 693 A.2d 1076, 1080 (1997). The Supreme Court stated that the reason for placing this rebuttable presumption on the defendants is because it is "the defendant, and not the plaintiff, who is in a position to know the reasons, events and decisions leading up to the defendant's actions." Id. The Supreme Court found that

2Pursuant to a stipulation entered into by the parties, $4.8 million was withheld from the total consideration paid in FHP's acquisition of TakeCare and set aside in a fund to pay any award that the Court might grant.

3On November 19, 1996, the Court issued a revised opinion.
Chancellor Allen's opinion had failed to address the plaintiffs' argument that, notwithstanding Foundation's pre-lawsuit $72 bid, the litigation nevertheless paved the way for the increased bidding by removing four specific impediments to bidding that the defendants had allegedly erected: (i) certain management bonuses that TakeCare's chairman intended to recommend be paid to the Company's chief executive and chief financial officers; (ii) the 1% breakup fee that TakeCare agreed to pay FHP if TakeCare merged with another acquirer; (iii) a stock option that TakeCare's chairman had given FHP to purchase TakeCare shares that he and his wife personally owned; and (iv) the letter of intent's provision that the definitive agreement would not contain a fiduciary out clause. Thus, the Supreme Court remanded the case to this Court for a determination as to whether the defendants had met their burden of rebutting the presumption of causation favoring the plaintiffs by demonstrating that the lawsuit "did not in any way cause their action." *Id.* (quoting *Allied Artists Pictures Corp. v. Baron*, Del. Supr., 413 A. 2d 876, 880).

On March 3-4, 1998, the Court held an evidentiary hearing on the plaintiffs' fee petition. This is the post-hearing and post-briefing decision on the plaintiffs' petition. For the reasons set forth, *infra*, I find that the defendants have failed to rebut the presumption that there was a causal connection between the litigation and the corporate benefit conferred upon the Company. Further, I conclude that the lawsuit was meritorious when filed. I conclude, however, that the plaintiffs are not entitled to the full amount of the award requested.

### III. BACKGROUND

Many of the relevant background facts in this action are set forth in the prior opinions of the Supreme Court, *United Vanguard Fund v. TakeCare, Inc.*, Del. Supr., 693 A.2d 1076 (1997), and this Court, *United Vanguard Fund v. TakeCare, Inc.*, Del. Ch., C.A. No. 13343, Allen, C. (Nov. 19, 1996). Therefore, I will limit the factual exposition in the opinion to facts not previously addressed or ones particularly relevant to my resolution of this matter on remand. Further, because I conclude that the plaintiffs are entitled to some award of fees and expenses, I will discuss the facts surrounding the plaintiffs' counsel's fee arrangements.

#### A. Letter of Intent

By mid-December, 1993, TakeCare had received bids, from FHP and United, in response to its efforts to find a buyer. The initial FHP bid, received December 17, 1993, was for a combination of cash, preferred stock
and common stock valued at approximately $60 per TakeCare share. The United proposal was to exchange .84 shares of its common stock, valued at approximately $65 per TakeCare share as of December 17, for each share of TakeCare common stock.

On December 18, 1993 and January 5, 1994, the TakeCare Board met to consider the FHP and United bids. At the January 5 meeting, the Board was told that FHP had submitted a new bid valued at $62 per share together with a proposed letter of intent. The letter of intent provided that TakeCare grant FHP a thirty (30) day exclusive negotiation period during which the parties would formalize and execute a definitive agreement. The proposal also contained two "lock-up" fee provisions, including one intended to become effective upon the execution of the letter of intent. This first lock-up fee provision would trigger if the letter of intent terminated: (i) without the execution of a definitive merger agreement and (ii) the Company was acquired by a third party within one year. If triggered, TakeCare would be required to pay FHP 1% of the value of the proposed transaction, or approximately $8 million. The second lock-up fee provision would be included in the definitive merger agreement, and would require the Company to pay FHP 2% of the transaction, or approximately $16 million, if the merger was not consummated because of a breach by TakeCare or the existence of an alternative proposal. The letter of intent also provided for the payment of transaction bonuses totaling $7.5 million in cash to Jessup and Dennis Gates, TakeCare's CFO.

The FHP proposal made several other demands. First, FHP required Jack Anderson, TakeCare's CEO, to grant it an option to purchase over one million shares of TakeCare stock, personally owned by him and his wife, at a price of $62 per share if: (i) there was a breach of the letter of intent, or (ii) TakeCare accepted a bid from another party at a price of $68 per share or less ("Anderson Option"). Second, FHP required that the definitive merger agreement contain no "fiduciary out" provision. Third, as mentioned above, TakeCare had to agree to negotiate exclusively with FHP until the expiration of the letter of intent on February 7, 1994.

At the January 5 meeting, Kidder Peabody & Co. ("Kidder"), the investment banker retained by TakeCare, and Alex, Brown & Sons, Inc. ("Alex Brown"), the investment banker retained by Hillman, made presentations analyzing the two bids. As of the meeting, neither banking firm was prepared to give a fairness opinion based only on their analyses of publicly available information. Kidder's analysis (subject to due diligence)

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4At the time of United's acquisition of TakeCare, the TakeCare Board consisted of the following individuals: Jack R. Anderson, R. Judd Jessup, Richard M. Burdge, George E. Bello, Robert W. Jampilis, Russell Ayres, V. Gordon Clemons and Richard M. Johnston.

5Neither Kidder nor Alex Brown had access to non-public information regarding TakeCare
was that under certain circumstances the FHP proposal "approached" the United proposal in value. Alex Brown, representing Hillman, voiced concerns about the value and liquidity of the preferred stock offered by FHP and presented data demonstrating that United consistently outperformed FHP in terms of earnings and growth. After the presentation, the Board, by a five-to-three vote, voted to authorize TakeCare to enter into a letter of intent with FHP.

B. SEC No Action Letter

Plaintiffs' Complaint asserted importantly that the 1% breakup fee would "blow" pooling of interest accounting treatment, thus preventing any potential bidder seeking such a transaction from making an offer for TakeCare. On February 1, 1994, after the filing of the Complaint, and after consultation with the Company's accountants, the defendants wrote to the SEC, Office of Chief Accountant, requesting advice regarding whether:

in the event the Company is ultimately acquired by United or another company desiring pooling accounting, and assuming all other requirements for pooling accounting are satisfied, the staff would not, in light of the facts and circumstances described below, object to pooling accounting treatment on the basis of the Company's payment of the agreed termination fee to FHP.6

On February 18, based on the representations made by the defendants in the February 1, 9 and 14 letters, the SEC Staff issued a "no action letter" ("No Action Letter"), advising that it would not object to pooling of interest accounting treatment for a business combination between TakeCare and a third party other than FHP.

On February 18, the same day the SEC issued its No Action Letter, the Court held a second conference with counsel for the parties. During this teleconference, TakeCare's counsel requested that all discovery be suspended and that the hearing date, scheduled for March 1, on the plaintiffs' preliminary injunction motion be vacated. Plaintiffs opposed termination of the proceedings due to the perceived threat the Anderson Option and the

or the two bidders.

6Defendants sent additional letters on February 9 and 14. The February 9 letter was sent in response to a request for information concerning the pending stockholder suit filed against TakeCare. The February 14 letter provided additional information regarding the lawsuit and the termination fee as well as other issues which were addressed in discussions between TakeCare's accountants, Ernst & Young, and SEC staff members.
transaction bonuses continued to pose to a pooling of interests transaction. During the conference, FHP's counsel agreed that the Anderson Option would be exercisable only if the deal price fell back below $68 per share, thereby eliminating any risk that FHP could "bust" pooling by claiming a breach of the letter of intent. Further, the defendants' counsel agreed that they would not require the payment of transaction bonuses if it would impede pooling of interests accounting treatment. After these representations were made, the Court vacated the March 1 hearing date and suspended all discovery.

C. Plaintiffs' Counsel's Fee Arrangement

The evidence in the record pertaining to plaintiffs' counsel's fee arrangement in this action is sparse, consisting mostly of the testimony of Barry Shalov, Esquire, of the firm of Gordon Altman Butowsky Weitzen Shalov & Wein ("Gordon Altman"). Shalov, who specializes in mergers and acquisitions, was in charge of Gordon Altman's representation of Hillman in connection with the TakeCare transaction. He is not a litigator, nevertheless he testified that he often employs litigation as a tactic in transactional work and gives advice in that respect.

Shalov testified that he was retained in mid-December by H. Vaughan Blaxter, III, Hiflman's Vice-President and General Counsel, and Russell W. Ayres, Hillman's Associate General Counsel and one of its two nominees on the TakeCare Board of Directors. At the time, they expressed to him their concern that the conduct of the process of selling TakeCare was not one best designed to obtain the highest value for TakeCare stockholders. Rather, they conveyed to Shalov their understanding that the defendants were engaging in a very limited auction without obtaining the advice of professionals (i.e. investment bankers) and were favoring a transaction with FHP for inappropriate reasons. Shalov understood that his firm's role would be to help Hillman foster or promote a process designed to achieve maximum value for the shareholders.

Shalov testified that, consistent with his usual practice, he did not obtain a written fee arrangement from Hillman. His expectation, based on a single prior representation of Hillman, was that Gordon Altman would be paid time plus a success fee, determined by Hillman. Shalov did not testify

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7Shalov testified that he also had no written fee arrangement with the other plaintiffs that he came to represent in the case. Further, Shalov testified that when Potter Anderson & Corroon was retained as Delaware counsel in the action, he told them what his expectation was and understood that they had the same expectation.

8Blaxter testified, however, that no such success fee was ever paid to the Gordon Altman firm in regard to that prior matter.
that, before settlement negotiations began, there was any discussion with Blaxter or Ayres on the subject of a "success fee" or that there was any mutual understanding on that point.9

After the parties began to discuss settlement of their differences, Gordon Altman sent two different computer generated printouts representing the legal fees and expenses of plaintiffs' counsel in pursuing the litigation. The first is accompanied by a cover letter dated March 14, 1994 and is addressed to Blaxter. The bill is for fees and expenses in the amount of $1,670,965.51. Included in this amount is $750,000 representing an "agreed upon 'success fee.'" The testimony regarding this first bill is that Blaxter told Shalov to bill at his premium rate and to include a success fee. As indicated across the top of the cover letter, this bill was sent only for the purpose of settlement negotiations. The second bill, dated April 4, 1994, is also accompanied by a cover letter addressed to Blaxter. This revised bill provides for only regular billing rates as opposed to premium billing rates. It provides for fees and expenses in the amount of $804,491.84. Further, in lieu of the $750,000 success fee, the bill states that the success fee would be "such amount as plaintiffs, in their reasonable discretion determine to be appropriate or, if plaintiffs determine to petition the court for reimbursement of costs, such amount as may be determined by the court." Ultimately, the Hillmans made fee payments based on regular hourly rates and which did not include a success fee.

IV. DISCUSSION

[2-4] Delaware courts have long acknowledged the "common corporate benefit," doctrine as a basis for awarding attorney's fees and expenses in corporate litigation. See Goodrich v. E.F. Hutton Group, Inc., Del. Supr., 681 A.2d 1039 (1996). The principle underlying this doctrine is that where a litigant has conferred a common monetary benefit upon an identifiable class of stockholders, all of the stockholders should contribute to the costs of achieving that benefit. Weinberger v. UOP, Inc., Del. Ch., 517 A.2d 653, 656 (1986). As a preliminary matter, however, in order to be entitled to an award of fees under the corporate benefit doctrine, the petitioner must demonstrate that: (i) the suit was meritorious when filed; (ii) the action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved;10 and (iii) the resulting corporate benefit

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9In his deposition, Blaxter testified that he did not recall whether there was any discussion of a success bonus prior to his requesting an invoice from Gordon Altman. He also testified that he did not recall Shalov suggesting that a success bonus would be appropriate.

10After the Board, including one of the two Hillman Board representatives, eventually voted to approve the sale of TakeCare to FHP, no judicial resolution was ever reached in this action.
was casually related to the lawsuit. *TakeCare*, 693 A.2d at 1079. Further, as discussed *supra*, Delaware law entitles the plaintiffs to a presumption that a causal connection existed between the initiation of litigation and a benefit later conferred on the corporation in a situation where actions taken by the defendant after the filing of the complaint render asserted claims moot. *Id.* at 1080. Thus, in the present situation where the plaintiffs claim that the litigation caused the defendants to take action which mooted their claims but which created a common fund or other corporate benefit, fees will be awarded upon a showing that these elements have been satisfied. *Allied Artists Pictures Corp. v. Baron*, Del. Supr., 413 A.2d 876, 878 (1980).

A. *Lawsuit was Meritorious when Filed*

[5] In assessing whether a lawsuit was meritorious when filed, the standard the Court will look to is whether the claim would have been able to withstand a motion to dismiss. *Chrysler Corp. v. Dann*, Del. Supr., 223 A.2d 384, 387 (1966). Further, at the time of filing the complaint the plaintiffs must have possessed knowledge of provable facts which held out some reasonable likelihood of ultimate success. *Id.* There need not be an absolute assurance of ultimate success, rather, only that there be some reasonable hope. *Id.*

Plaintiffs' principal claims were two-fold: (i) that the 1% breakup fee in the letter of intent entered into between TakeCare and FHP impeded certain bids based upon pooling-of-interests accounting; and (ii) that the defendant directors breached their duties of care and loyalty by not fully informing themselves regarding the FHP offer and by not conducting a "fair auction" of TakeCare. The defendants argue that the No Action Letter determined that the breakup fee in the letter of intent did not preclude bids based on pooling of accounting and, therefore, the claim that it did was not meritorious when filed. As to the breach of fiduciary duty claim, the defendants assert that at the time the complaint was filed the bidding process was ongoing, the directors were endeavoring to attract other bidders, and therefore, that the complaint was prematurely filed.

1. *Breakup fee*

Defendants assert that the SEC No Action Letter vindicated their position that, as a matter of law, the termination fee had no impact on the ability of parties to engage in a pooling of interest transaction. Thus, they argue, the claim regarding the impact of the termination fee on pooling of

Therefore, an analysis of this element is unnecessary.
interest accounting could not have survived a motion to dismiss. Plaintiffs do not meet this argument directly. Instead, they contend that the lawsuit caused the defendants to seek clarification from the SEC on the effect of the termination fee. Because the SEC no action letter provided significant comfort to potential bidders about the availability of pooling of interest accounting treatment in a transaction competing with FHP, the plaintiffs argue they were responsible for opening up the bidding process.

[6] Initially, I note that the defendants never filed a motion to dismiss the Complaint at any point in the litigation. Moreover, the No Action Letter cannot be given the same effect as a judicial ruling on a motion to dismiss. See Margolies v. Pope & Talbot, Inc., Del. Ch., C.A. No. 8244, Hartnett, V.C. (Dec. 23, 1986) (citing Koss v. Securities and Exchange Comm., 364 F. Supp. 1321 (SDNY 1973) (stating that no action letter not res judicata and therefore not binding on Court)). Indeed, an SEC no action letter merely expresses a conclusion that, assuming the truthfulness, accuracy and completeness of the factual matters represented in the letter(s) requesting such advice, the staff of the SEC responding to the request (in this case, the Office of the Chief Accountant) will not recommend the commencement of enforcement action by the Commission.

Moreover, in issuing its letter, the SEC staff necessarily relied on the representations made in the letters of request sent to them. Most significantly, the February 1 letter to the SEC states:

[the facts and circumstances under which the obligation to pay the termination fee arose show that it was not in contemplation of a business combination with another party. In fact, it was undertaken in part to discourage transactions other than the proposed transaction with FHP. Although the obligation was undertaken with reference to some subsequent business combination . . . the parties' expectation at the time it was undertaken was, of course, that there would be no such third-party transaction.]

(emphasis supplied).

Consistent with this representation, defendant Jessup testified in deposition that, as of the January 5 Board meeting, it was his view that the search for an acquiror was ended and that the process had been successful in eliciting FHP and United's best offers.

Defendants' position in opposing the fee petition is different. For example, Michael Joseph, Esquire, the defendants' attorney who drafted the February 1, 9 and 14 letters to the SEC, and who appeared as a witness at the