ESSAY

HOW MUCH IS A $30 MILLION SETTLEMENT WORTH?

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The Delaware Court of Chancery has traditionally calculated attorneys' fees to class counsel as a percentage of the settlement fund paid to the class. The Court, however, is increasingly looking beyond the face value of the settlement fund when awarding fees. When evaluating the appropriate fee, the Court has observed that the true economic value of a settlement may not equal the settlement payment to the class. Thus, a new paradigm is emerging for calculating fee awards, as shown in two recent instances.

First, the Court has determined that the economic benefit to the class is greater when defendants pay plaintiffs' counsel's fees *on top* of the settlement fund, rather the class paying those fees *from* the settlement fund. Consequently, where defendants pay fees on top of the fund, the Court calculates plaintiffs' counsel's fees based on a percentage of the gross amount paid by defendants, *i.e.*, the sum of the monetary fund and the fee award. This method results in larger fee awards for the same-size settlement than does a percentage-of-the-fund-only fee calculation.

Second, in a stock-for-stock merger, class members continue to hold stock in the combined company after the merger closes. As a result, when the post-merger company is responsible for paying a settlement to the class, the class members indirectly absorb part of that cost through a reduction of value of their equity in the combined company. Here, the Court has expressed support for "looking through" the face value of the settlement to determine the settlement's true economic value. Under the "look through" method, defendants may be able to reduce the fee award by establishing that the real economic value of the settlement to the class is less than its face value.

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"Grossing Up" The Settlement When Fees Are Paid On Top Of The Fund

Traditionally, class counsel is paid from the settlement fund. The Court of Chancery typically awards attorneys' fees based upon a "reasonable percentage" of that fund.[1] For cases that settle quickly, the Court often awards 10-15% of the settlement fund.[2] For cases that settle after "meaningful litigation efforts, typically including multiple depositions and some level of motion practice," the award ranges from 15-25%.[3] For cases that advance to trial and beyond, 33% is at "the very top of the range."[4] Some recent settlements, however, have required the defendants to pay the fee award on top of the settlement fund. Under such a settlement, the fees paid to class counsel do not reduce the proceeds available for distribution to the class members.

The Court of Chancery has embraced this settlement structure because it subjects the plaintiffs' counsel's fee award to an adversarial process in which defendants have an incentive to object to unreasonable fee petitions. In contrast, where fees are paid from the fund itself, defendants have no economic interest in the fee award; the onus then falls upon the Court, unaided by the adversarial process, to decipher whether the fee petition is fair and reasonable. For example, in *In re Jeffries Group S'holder Litig.*, Chancellor Bouchard noted that while defendants are usually indifferent as to the amount of a negotiated fund awarded to plaintiffs' counsel, when the fees are paid on top of the fund defendants have an incentive to manage their total financial exposure by objecting to unreasonable fee requests.[5] Chancellor Bouchard found that "[f]rom a policy perspective, it would be beneficial in my view for fee applications to be subject to adversarial inquiry to provide the Court with a better record with which to evaluate the *Sugarland* factors,[6] in particular the quality of the benefit achieved in the proposed settlement and the relative complexity of the case."[7] In another stockholder class

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[1] *See* Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1253 (Del. 2012).

[2] *Id.* at 1259.

[3] *Id.* at 1259-60.

[4] *Id.* at 1259.

[5] 2015 WL 3540662, at *2 n. 5 (Del. Ch. Jun. 5, 2015).

[6] In Sugarland Industries, Inc. v. Thomas, 420 A.2d 142 (Del. 1980), the Delaware Supreme Court identified the following factors as relevant when examining the appropriate amount of attorneys' fees: (i) the amount of time and effort applied to the case by counsel for the plaintiffs; (ii) the relative complexities of the litigation; (iii) the standing and ability of petitioning counsel; (iv) the contingent nature of the litigation; (v) the stage at which the litigation ended; (vi) whether the plaintiff can rightly receive all the credit for the benefit conferred or only a portion thereof; and (vii) the size of the benefit conferred.

[7] *Id.*

action, *In re Globe Specialty Metals, Inc. S'holder Litig.*, Vice Chancellor Glasscock voiced similar approval: "I think that there's a tremendous advantage to the Court [when the fees are paid on top of the fund] as opposed to the case where that fee would come out of the payment to the class, in that I get [a] full discussion of what the appropriate fee is. I think . . . it is much easier for us to function as a court where we have an adversarial presentation."[8]

Not surprisingly, plaintiffs' attorneys expect compensation for structuring a settlement in a way that both benefits the class and aids the Court in its fact-finding mission. Because a settlement fund in any amount is worth more to the class when the fund is not reduced by the payment of plaintiffs' fees, plaintiffs' attorneys argue that their fees should reflect the net benefit received by their clients. For example, if plaintiffs' attorneys would have traditionally received 25% of a $40 million settlement fund (based on the stage at which the case settled), their fees would have been $10 million and the net benefit to their clients would have been $30 million. Alternatively, if plaintiffs' attorneys negotiate a $30 million settlement fund that goes entirely to their clients, with attorneys' fees to be paid on top of that fund, then their fees ought to be the same $10 million. In essence, plaintiffs' attorneys argue that they should receive equivalent fees for achieving equivalent results.

Therefore, plaintiffs' attorneys argue that the reasonableness of their fees should be evaluated based on the gross payment made by defendants. In the above example, defendants paid $40 million ($30 million fund and $10 million fees) and attorneys' fees of $10 million are 25% of the total payment. If instead the Court awarded attorneys' fees by applying 25% only to the $30 million settlement fund, the resulting fees would be $7.5 million and class counsel would be earning less for achieving the same net benefit for its client. Thus, plaintiffs' attorneys argue that the only way to fairly evaluate their fee request is to compare their fees to the "grossed up" amount of the defendants' payments. The Court of Chancery has recognized the inconsistency of awarding class counsel different fees for the same net benefit to the class, and has begun basing fee awards upon the gross amount paid by defendants, *i.e.*, a percentage of the sum total of the settlement fund and attorneys' fees.[9]

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[8]No. 10865-VCG, at 73 (Del. Ch. Feb. 10, 2016) (Transcript at 73).

[9]*See, e.g.*, *Jeffries*, 2015 WL 3540662, at *2 (granting fees based on a percentage of "the gross settlement value"); *Globe*, No. 10865-VCG, at 73 ("[W]here the agreement is that the fee is going to be paid by the defendants and is not going to come from the class, [] the actual amount of the benefit has to include that fee."). *See* also *In re* GSI Commerce, Inc. S'holder Litig., CA No. 6346-VCN, at 23-24 (Del. Ch. Nov. 6, 2014) (Transcript) ("If we look at it under what I think is a more traditional fashion where we would add the attorneys' fees and expenses to the recovery and then use that as the denominator for finding a percentage of

Parties should consider the impact of this jurisprudence when formulating their negotiating strategies. Defendants should negotiate knowing that a reviewing Court will likely evaluate the reasonableness of plaintiffs' counsel's fees based on the "grossed up" value of the settlement. Consequently, defense attorneys must explain this fee calculation scheme to their clients and lay the foundation for those clients to understand the likely outcome of the plaintiffs' fee petition. Described algebraically, the fees resulting from a grossed up settlement can be derived using the following formula:

Fees = (Settlement Fund + Fees) * Reasonable Percentage

If defendants have a general idea of the amount the case will settle for and the reasonable percentage the Court is likely to award (based primarily on the stage of the litigation), the likely fee award can be estimated by plugging those numbers into the equation and solving for "x." Alternatively, if the parties have engaged in settlement talks and the defendant has an idea of where the settlement amount and fees might end up, it can plug those numbers into the formula to determine if they yield a percentage the Court is likely to find reasonable. Doing so provides attorneys with a useful planning tool when advising clients on potential "grossed up" settlement values and outcomes.

"Looking Through" The Payment To Account For Equity Diminution

In contrast to "grossing up" the settlement and awarding fees based on a benefit to the class that is greater than the face value of the settlement fund, another scenario exists where the net economic benefit to the class is less than the face value of the settlement fund. This situation will occur when, as the result of an obligation to indemnify its officers and directors, the corporation is responsible for paying a cash settlement or damages award to the plaintiff class. When the corporation makes a cash payment, its enterprise value is reduced by the value of that payment. The stockholders of the company therefore suffer a corresponding pro rata diminution in the value of their equity. It follows

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the fees and expenses . . . "); *In re* Talecris Biotherapeutics Holdings S'holder Litig., CA No. 5614-VCL, at 1-2 (Dec. 5, 2011) (Order) (awarding fees of 25% of the sum of the additional merger consideration and fees); *In re* Arthrocare Corp. S'holder Litig., CA No. 9313-VCL, at 34-35 (Del Ch. Nov. 6, 2014) (Transcript) (applying a percentage to both the monetary benefit achieved for plaintiffs as well as the fee award being paid on top of the fund to calculate the total fee award).

that when class members are also stockholders of the corporation, those class members are indirectly absorbing the cost of the settlement payment to the extent of their equity in the corporation.[10] In such a case, the Court should "look through" the nominal amount of the settlement fund and base the plaintiffs' fee award on the net benefit received by the class members after taking into account the pro rata equity reduction in the value of the class members' stock.

The Court of Chancery first addressed this issue in *Gatz v. Ponsoldt.*[11] In that derivative case, plaintiffs brought suit against individuals indemnified by the company. Plaintiffs' counsel sought a fee of 33% of the $3 million settlement fund. The Court, however, raised a concern that because of an indemnification agreement between the company and its director defendants, the burden of paying the settlement fund was essentially born by the company's stockholders, *i.e.*, the class.[12] The Court stated that such an arrangement "would not amount to any real benefit to the shareholder class because they would, essentially, be paying themselves."[13] In other words, because the $3 million cash payment would lead to a corresponding $3 million reduction in the class members' equity in the company, the net benefit of the payment to the class would be zero. Ultimately, the court found that its concern was unwarranted in that particular case because seven years had passed since the actions at issue and 93% of the stock was no longer owned by the class members when the settlement payment was made.[14] Thus, there *was* an economic benefit from the settlement payment because the class members were not indirectly funding that payment.

More recently, the Court of Chancery addressed this issue again in the *Globe* stockholder litigation, where the parties agreed to settle a class-action lawsuit for a $32.5 million payment to the class, to be paid by the newly-combined entity, Ferroglobe PLC, after the merger closed.[15] Defendants argued that because the class owned approximately 38% of the outstanding shares of Ferroglobe, the settlement payment by

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[10] *See, e.g.*, James J. Park, *Shareholder Compensation as Dividend*, 108 MICH. L. REV. 323, 324 (2009) ("[W]hen a corporation compensates shareholders for securities fraud, the payment is seen as a circular transfer from shareholders to themselves ... ."); Daniel R. Fischel, *The Law and Economics of Dividend Policy*, 67 VA. L. REV. 699, 703-04 (1981) (finding that a dividend payout lowers the post payout price of the stock).

[11] 2009 WL 1743760, at *4 (Del. Ch. Jun. 12, 2009).

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *In re* Globe Specialty Metals, Inc., Stockholders Litigation, Consol. C.A. No. 10865-VCG (Del. Ch. Feb. 15, 2016).

Ferroglobe resulted in a pro rata reduction of the class members' equity in Ferroglobe. Specifically, the $32.5 million payment reduced the enterprise value of Ferroglobe by $32.5 million, and the class members who owned 38% of the outstanding shares of Ferroglobe would indirectly absorb 38% of that cost, or $12.4 million. Therefore, the net benefit of the settlement payment to the class, defendants argued, was $20.1 million: the $32.5 million settlement fund minus the $12.4 million diminution in the class members' equity in Ferroglobe.

Defendants further argued that, unlike in *Gatz* where seven years had passed between the transaction at issue and the settlement payment, only two months had passed since the Ferroglobe merger had closed. Further, because the $32.5 million settlement payment was publicly announced before the deal closed, any subsequent turnover in the stockholder base during those two months was irrelevant for the purposes of measuring the payment's economic impact—the market price of the stock when the merger closed would have already reflected the publicly announced settlement payment and thus the class members would have already borne the diminution to their Ferroglobe equity.

Vice Chancellor Glasscock agreed with defendants' reasoning that the face value of a settlement fund may not reflect its real value to the class. At oral argument he stated that one of the questions he faced was whether to reduce the face value of the settlement when calculating plaintiffs' attorneys' fees under what he termed the "look-through theory," because part of the settlement payment was "really coming out of the equity value that is held by the class."[16] And indeed the Court observed that "it believe[d] in the look-through theory and its efficacy" because "it makes sense to look at the real number and not a facial number if that number doesn't represent real value to the class."[17] Thus, the Court agreed with defendants that, for the purpose of calculating attorneys' fees, the value of the settlement fund should be adjusted to reflect its true economic value to the class.

But, although the Court approved of defendants' "theory," it concluded that it was the defendants' burden to prove facts sufficient to establish that the class would suffer the equity dilution that the theory predicted. Specifically, Vice Chancellor Glasscock explained that such evidence should include establishing that the defendant corporation is actually responsible for making the payment. For example, there would be no corresponding diminution to class members' equity for amounts paid by insurers or co-defendants. The Court held that the evidentiary

[16] No. 10865-VCG, at 73 (Del. Ch. Feb. 10, 2016) (Transcript at 71).
[17] *Id.*

burden to establish these facts was appropriately placed on defendants because they were in the best position to know who would make the payment and to offer the necessary supporting evidence. Additionally, the Court expressed the need to better understand "the relationship between the payment and the equity value," suggesting that defendants would perhaps be required to offer expert testimony establishing the causal link between the cash payment and the corresponding diminution in enterprise value and stockholders' equity.

Two important practice points emerge from the *Gatz* and *Globe* cases. First, in the context of stock-for-stock mergers in which the class will continue to be stockholders of the merged entity, defendants can and should argue that plaintiffs' attorneys should not get fee credit for any portion of the settlement that creates a corresponding diminution to the class members' equity. Second, defendants carry the burden of proving whether and to what extent the settlement payment will be made by the corporation, as opposed to its insurers or co-defendants. Defendants should also consider whether to bolster their argument with an expert declaration explaining how the cash payment translates into a reduction in enterprise value and which portion of that reduction is borne by the class. To the extent they are able to provide the necessary evidence, defendants will have a valuable tool for opposing excessive fee requests.

Analyzing Two Sides Of The Same Coin To Determine Actual Value

Taking these recent Delaware law developments together, it is clear that the Court is receptive to hearing arguments from both plaintiffs and defendants that the actual value of a settlement payment may be more or less than its nominal cash value. Plaintiffs argue that when their fees are paid on top of the settlement fund, the actual value of that fund is higher than the traditional "all in" settlement fund in which the class would have to give part of its award to its counsel. Defendants likewise argue that when the class is indirectly responsible for funding its own settlement fund, the actual value of that fund is lower than the face amount. Taken together, these arguments are two sides of the same coin. They both ask the Court to set aside the appearance of value and to instead determine real value. The recent decisions by the Delaware Court of Chancery indicate that the Court is willing to engage in that analysis.

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