IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

JAMES FORSYTHE and ALAN TESCHE, individually and derivatively on behalf of CIBC EMPLOYEE PRIVATE EQUITY FUND (U.S.) I, L.P., Plaintiffs, v. ESC FUND MANAGEMENT CO. (U.S.), INC., PETER H. SORENSEN, DEAN A. CHRISTIANSEN, VERNON L. OUTLAW, ORLANDO FIGUEROA, ALBERT FIORAVANTI, CIBC ESC ADVISORS, LLC, CIBC ESC SLP, LLC, and CANADIAN IMPERIAL BANK OF COMMERCE, Defendants, and CIBC EMPLOYEE PRIVATE EQUITY FUND (U.S.) I, L.P., Nominal Defendant.	C.A. No. 1091-VCL

<u>MEMORANDUM OPINION</u>

Date Submitted: November 27, 2012
Date Decided: February 6, 2013

Seth D. Rigrodsky, Brian D. Long, Gina M. Serra, RIGRODSKY & LONG, P.A., Wilmington, Delaware; Herbert E. Milstein, Joshua S. Devore, Joshua M. Kolsky, COHEN MILSTEIN SELLERS & TOLL PLLC, Washington, District of Columbia; *Attorneys for Plaintiffs.*

Stephen C. Norman, Kevin R. Shannon, Timothy R. Dudderar, Daniel A. Mason, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; *Attorneys for Defendants CIBC ESC Advisors, LLC, CIBC ESC SLP, LLC, and Canadian Imperial Bank of Commerce.*

Kenneth J. Nachbar, Megan Ward Cascio, Kevin M. Coen, MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Wilmington, Delaware; *Attorneys for Defendants ESC Fund Management Co. (U.S.), Inc., Peter H. Sorensen, Dean A. Christiansen, and Vernon L. Outlaw*.

Stephen E. Jenkins, Richard L. Renck, ASHBY & GEDDES, Wilmington, Delaware; Steven G. Mintz, Steven W. Gold, Scott A. Klein, MINTZ & GOLD LLP, New York, New York; *Attorneys for Objectors*.

Henry E. Gallagher, Jr., Ryan P. Newell, CONNOLLY GALLAGHER LLP, Wilmington, Delaware; *Attorneys for Nominal Defendant CIBC Employee Private Equity Fund (U.S.) I, L.P*.

Gregory P. Williams, Rudolf Koch, Kevin M. Gallagher, RICHARDS LAYTON & FINGER, Wilmington, Delaware; *Attorneys for non-party Burford Capital Limited.*

LASTER, Vice Chancellor.

On the eve of trial, plaintiffs' counsel and the defendants reached a settlement in this long-running derivative action. The proposed settlement contemplated that in return for the defendants receiving a global release, (i) nominal party CIBC Employee Private Equity Fund (U.S.) I, L.P. (the "Fund") would receive $10.25 million in cash and (ii) defendants would forego claims for indemnification from the Fund with a face value of $3 million (collectively, the "Settlement"). The named plaintiffs and certain other limited partners in the Fund objected to the Settlement.

In a May 2012 decision, I found that the Settlement fell "within a range of fairness, albeit at the low end." *Forsythe v. ESC Fund Mgmt. Co. (U.S.), Inc.*, 2012 WL 1655538, at *1 (Del. Ch. May 9, 2012) (the "May Decision"). Because fairness was a close call, I gave the objectors the opportunity to present a superior alternative and take over the case. The objectors now have proposed to litigate the case to trial with the Fund's interests secured by (i) $1.35 million in cash contributed by certain objectors and (ii) a litigation bond in the amount of $11.9 million that Burford Capital Limited procured from Travelers Casualty and Surety Company of America, a licensed surety in Delaware (the "Competing Proposal"). I refer to Burford and those objectors who are putting up cash as the "Capital Providers." If the objectors fail to obtain a recovery for the Fund equal to or greater than $13.25 million, then the Fund will collect the difference from the security.

The defendants have assailed the Competing Proposal with a volley of arguments, several of which are fairly litigable. The vigor with which they have advanced these positions reinforces my suspicion that they believe they extracted a quite favorable deal from fatiguing plaintiffs' counsel. Nevertheless, passing over all but one of their contentions, I find that although the Competing Proposal is superior to the Settlement in the important sense that it offers the Fund the potential for a greater recovery, the objectors have not carried their burden of demonstrating that the terms on which they would proceed are reasonable from the standpoint of the Fund.

The failure of the objectors to carry their burden confirms the reasonableness of the Settlement. The objectors' motion to take over the case is denied. My earlier, conditional ruling approving the Settlement is now final. The case is dismissed.

I. LEGAL ANALYSIS

The settlement of a derivative action requires Court approval. *See* Ct. Ch. R. 23.1(c). "[T]he Court of Chancery must . . . play the role of fiduciary in its review of these settlements . . . ." *In re Resorts Int'l S'holders Litig. Appeals*, 570 A.2d 259, 266 (Del. 1990). In describing the standard that this Court applies when acting as a fiduciary, the Delaware Supreme Court has used interchangeably concepts of fairness, reasonableness, and business judgment.[1] When applied to decisions made by fiduciaries

[1] *See In re Infinity Broad. Corp. S'holders Litig.*, 802 A.2d 285, 289 (Del. 2002) ("Any decision of the Court of Chancery regarding the fairness of a proposed settlement is within the discretion of that court and requires an application of its own business judgment.") (footnote omitted); *Alabama By-Products Corp. v. Cede & Co. ex rel. Shearson Lehman Bros., Inc.*, 657 A.2d 254, 260 (Del. 1995) ("The unique fiduciary nature of the class action requires the Court of Chancery to participate in the consummation of any potential settlement to determine its intrinsic fairness."); *Kahn v. Sullivan*, 594 A.2d 48, 59 (Del. 1991) (describing trial court's determination as whether the settlement is "fair and reasonable"); *Resorts*, 570 A.2d at 266 (explaining that "[i]n essence, the trial court's function is to exercise its business judgment in deciding whether the settlement is reasonable in light of the factual and legal circumstances of the case"; calling on trial court to consider "[a]ll challenges to the fairness of the settlement" when

in other contexts, each concept is associated with a different standard of judicial review, corresponding respectively with the entire fairness test, the intermediate standard of enhanced scrutiny, and the business judgment rule. The burdens on the parties and the

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"deciding whether the settlement is reasonable"; further stating that the Supreme Court reviews deferentially the trial court's determination of "the reasonableness of the settlement" and that the Supreme Court does not independently judge "the intrinsic fairness of the settlement"); *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1284 (Del. 1989) (stating that "when the Court of Chancery reviews the fairness of a settlement, it must evaluate all of the circumstances of the settlement by using its own business judgment"; noting that "the Court of Chancery's most important yardstick of a settlement's fairness is its business judgment"; describing the trial court's task as evaluating "the fairness of the settlement" and stating that the Supreme Court does not "evaluate independently the intrinsic fairness of the settlement"); *Nottingham P'rs v. Dana*, 564 A.2d 1089, 1102-03 (Del. 1989) (stating that "[t]he reasonableness of a particular class action settlement is addressed to the discretion of the Court of Chancery, on a case by case basis, in light of all of the relevant circumstances"; also stating that the Court of Chancery must determine whether to approve the settlement "as reasonable through the exercise of sound business judgment"); *Polk v. Good*, 507 A.2d 531, 536 (Del. 1986) (stating that the trial court must determine whether the settlement is "fair and reasonable"; explaining that the trial court "exercises a form of business judgment to determine the overall reasonableness of the settlement"; noting that the Supreme Court does not independently "determine the intrinsic fairness of the settlement"); *Fins v. Pearlman*, 424 A.2d 305, 308-09 (Del. 1980) (stating that "the Court of Chancery is to use its own business judgment to determine whether the settlement is intrinsically fair" and that "[t]he Court of Chancery's responsibility and function is to examine the proposed settlement's intrinsic fairness"); *Neponsit Inv. Co. v. Abramson*, 405 A.2d 97, 100 (Del. 1979) ("In determining whether or not to approve a proposed settlement of a derivative stockholders' action in these circumstances, the Court of Chancery is called upon to exercise its own business judgment."); *Rome v. Archer*, 197 A.2d 49, 53-54 (Del. 1964) (stating that "[b]ecause of the fiduciary character of a class action, the court must participate in the consummation of a settlement to the extent of determining its intrinsic fairness"; further stating that the court discharges its function by determining if the settlement is "reasonable"; citing factors for trial court to consider "through the exercise of sound business judgment"; noting that on appeal the Supreme Court does not "determine the intrinsic fairness of the settlement in the light of [its] own business judgment").

Court would vary greatly depending on which standard of judicial review applied. Moreover, some have criticized the notion of "judicial business judgment."[2]

As I understand it, this Court's role when acting as a fiduciary in the settlement context is to determine whether the settlement falls within a range of results that a reasonable party in the position of the plaintiff, not under any compulsion to settle and with the benefit of the information then available, reasonably could accept. In this sense, the Court's task is analogous to that of an attorney (also a fiduciary) who is asked by a client whether a settlement seems reasonable. The ultimate decision whether or not to settle rests with the client—indeed, it falls within the client's "business judgment"—but the lawyer appropriately can apply legal knowledge and experience to make an assessment of the likely outcomes so as to advise the client on whether the settlement is one that the lawyer believes the client legitimately could accept. The resulting judicial inquiry is most akin to range-of-reasonableness review, and the submissions and

[2] *See, e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 39 (1991) ("[T]he idea that a trial court can exercise 'business judgment' is anomalous. Trial judges are not businesspeople; they do not possess the practical experience and exposure to the special needs of the corporation that characterizes the business judgment of corporate managers."); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 Nw. U. L. Rev. 913, 941 (1982) ("[T]he whole notion of a court exercising business judgment flies in the face of one of the most basic premises of corporation law—that courts are unable to make business decisions.") (footnote omitted); John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and A Proposal for Legislative Reform*, 81 Colum. L. Rev. 261, 329 (1981) (noting that "boards, and not courts, are entitled to exercise business judgment"); *see also In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 928 (Del. Ch. 2003) (referring to the Court's "oxymoronic judicial 'business judgment'").

presentations received by the Court in a settlement hearing are consistent with that standard.

In the May Decision, I found that the Settlement fell within a reasonable range, albeit at the low end, and in this sense was "fair." But it is also a fundamental and longstanding aspect of fiduciary duty law that "a fiduciary cannot sell for less when more is available on similar terms." *City Capital Assocs. Ltd. P'ship v. Interco Inc.*, 551 A.2d 787, 802 (Del. Ch. 1988) (Allen, C.) (footnote omitted).[3] When evaluating the

[3] Although the value-maximizing principle is typically associated with *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), it is not unique to that context. *See In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 999 (Del. Ch. 2005) (noting that the obligation to maximize stockholder value "is rooted in old trust principles"); *Paramount Commc'ns Inc. v. Time, Inc.*, 1989 WL 79880, at *25 (Del. Ch. July 14, 1989) (Allen, C.) ("*Revlon* was not a radical departure from existing Delaware, or other, law (*i.e.*, it has 'always' been the case that when a trustee or other fiduciary sells an asset for cash, his duty is to seek the single goal of getting the best available price) . . . ."), *aff'd*, 571 A.2d 1140 (Del. 1989); *Freedman v. Rest. Assocs. Indus., Inc.*, 1987 WL 14323, at *6 (Del. Ch. Oct. 16, 1987) (Allen, C.) ("The bedrock principle that a board owes a duty to shareholders to act only in pursuit of their interests is the principle that explains *Revlon*. Where the company is to be sold, it cannot be in conformity with that obligation to defeat a higher offer in favor of a lower one regardless of other considerations. So understood, *Revlon* is consistent with a very long line of cases."); *see also* Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 Bus. Law. 919, 927 n.25 (2001) (stating that the "[t]he *Revlon* principle grows out of the traditional principle that fiduciaries must sell trust assets for their highest value" and citing *Wilmington Trust Co. v. Coulter*, 200 A.2d 441, 448 (Del. 1964), and *Robinson v. Pittsburgh Oil Refining Corp.*, 126 A. 46, 49 (Del. Ch. 1924), as demonstrating that principle). What changes under *Revlon* is not the universal and loyalty-based standard of conduct that obligates a fiduciary to strive to maximize value for the beneficiary, but rather the standard of review that a court uses when reviewing the fiduciary's decisions, which narrows from rationality to range-of-reasonableness. *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 192 (Del. Ch. 2007) ("What is important and different about the *Revlon* standard is the intensity of judicial review that is applied to the directors' conduct. Unlike the bare rationality standard applicable to garden-variety decisions subject to the business judgment rule, the *Revlon* standard contemplates a judicial examination of the reasonableness of the board's

Settlement, the Court was asked to approve a sale of the Fund's claims by the plaintiffs and their counsel. The operative question was therefore not only whether the consideration fell within a reasonable range, but also whether more was available to the Fund on similar terms.[4] The May Decision provided an opportunity for the objectors or anyone else who wished to take over the litigation to demonstrate that more was available on similar terms.

In an effort to keep the terms for the Fund as similar as possible, the May Decision required that any alternative provide "security for the benefit of the Fund in the amount of $13.25 million . . . ." *Forsythe*, 2012 WL 1655538, at *8. The security requirement sought to force the objectors and their counsel "to internalize the downside of not taking the proposal currently on the table . . . ." *Id.* at *7. This strategy attempted to use the objectors' enlightened self-interest to test the Settlement's value. If the Settlement materially underpriced the Fund's risk-adjusted recovery, then the objectors and their counsel should have been able to go out-of-pocket to secure a bond and still come out ahead. If the objectors and their counsel declined to pay for a bond, then their behavior

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decision-making process.") (footnote omitted); *accord In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573, 596 n.170 (Del. Ch. 2010) (quoting *Netsmart*).

[4] *Cf. In re First Boston, Inc. S'holders Litig.*, 1990 WL 78836, at *7 (Del. Ch. June 7, 1990) (Allen, C.) (explaining that directors who serve on a special committee to evaluate an interested transaction are expected not simply to assess fairness but rather "to approve only a transaction that is in the best interests of the public shareholders, [and] to say no to any transaction that is not fair to those shareholders and is not the best transaction available"); *In re Trans World Airlines, Inc. S'holders Litig.*, 1988 WL 111271, at *5 (Del. Ch. Oct. 21, 1988) (Allen, C.) (describing special negotiating committee members who understood their obligation was only to determine fairness and not to get the "highest possible price" as having an "imperfect appreciation of the proper scope and purpose of such a special committee").

would tend to confirm that the Settlement offered the Fund a recovery that was not unreasonably slight, taking into account both the prospects for recovery and transaction costs.

The objectors have now come forward with the Competing Proposal, which provides the Fund with security having a face amount of $13.25 million. The defendants point out that the Competing Proposal does not fully secure the Fund, because the dollar value of the defendants' indemnification claims will increase and not be capped at $3 million under the Competing Proposal. The objectors point out that the $13.25 million face value afforded by the Settlement is high, because it gives full dollar credit for the $3 million in indemnification claims, without any discounting, and because if the objectors prevail on the merits, the defendants likely will not have a right to indemnification. There is sufficient force to both arguments that, with respect to the amount of security, the Settlement and the Competing Proposal are "on similar terms." *Interco*, 551 A.2d at 802.

Under the Competing Proposal, if the objectors obtain greater than $13.25 million, then the Capital Providers will recover, *pro rata*, 43% of the first $10 million excess plus 33⅓% of any additional amounts. The Fund therefore will receive 57% of the first $10 million excess, plus 66⅔% of any additional amounts. To account for the time value of money, the $10 million threshold will increase by $50,000 per month starting eighteen months after the posting of the bond. Any attorneys' fee award will come out of the Fund's portion. If the lawyers get 33⅓%—a reasonable estimate in the event of post-trial success—then the Fund's net recovery drops to 38% of the first $10 million excess and 44% of any additional amounts.

With respect to the potential for recovery, the Competing Proposal is superior. Put simply, it gives the Fund the chance to get more. Under the Settlement, the Fund receives $13.25 million in value and gives up any possibility of upside on its claims. Under the Competing Proposal, the Fund secures $13.25 million in value and keeps the possibility of upside. A chance to get more is better than no chance at all.

The focus therefore turns to the terms on which the Capital Providers have offered the Fund a chance to get more. I originally anticipated that the objectors and their counsel would have to decide whether to go out-of-pocket for the cost of the bond without the potential for extra upside, a choice that would force them to assess whether the risk-adjusted potential for a greater recovery made the cost of the bond worthwhile. This did not mean that the objectors and their counsel had to have cash on hand; they could have borrowed the money for the bond. But I expected them to use their own assets, internalize the risk, and make the decision about whether it made sense to pay for the bond. Under that scenario, I would not have had to address the reasonableness of the financing's terms.

By proposing to fund the security with a portion of the Fund's recovery, the objectors and their counsel cleverly sidestepped the choice that the May Decision tried to foist upon them. Rather than internalizing the cost, they seek to socialize it on the Fund. This proposal tosses back to me the task of determining whether the terms of the financing are reasonable.

Assuming economic rationality, the Fund should not care what the Capital Providers charge for the opportunity to get more, because anything more is better than nothing more. Even under a 99-to-1 split, the Fund should prefer the Competing Proposal, because even if the Capital Providers receive 99 cents from every dollar, the Fund still gets another penny. The Court, however, is not only concerned with economic rationality.

> The law comprises more than the determination of contested facts and the unmediated application of principles of economic efficiency to [resolve] disputes arising from those facts. This is true even of corporation law, which may be thought to be especially concerned with facilitating the realization of benefits from efficient forms of organization. In determining the rule of decision in a specific case, courts apply law. While notions of economic efficiency will appropriately play a role in the myriad instances in which common-law courts shape the law [interstitially], case by case, courts do tend to look first, and often last, not to calculation of (contestable) efficiency effects, but to concerns more directly affecting legal values.

Bird v. Lida, Inc., 681 A.2d 399, 403 (Del. Ch. 1996) (Allen, C.).

One such legal value manifests itself in an insistence on reasonable terms and a resistance to disproportionate outcomes, an intuition which appears widely shared. *See, e.g.*, Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, 59 J. Bus. S285, S289-92 (1986) (discussing experiments in which participants reward fairness and penalize those who seek outsized shares of gains at the expense of value-maximizing outcomes). When evaluating the portion of recovery appropriate for the provider of legal services, for example, Delaware decisions have not blindly deferred to economic rationality and an iron rule of marginal return. If they did, then a lawyer who pursued a claim on behalf of a plaintiff otherwise unable to litigate could demand and receive the proverbial 99% fee, invoking the economic argument (previewed above) that anything for the client is better than nothing. But our law has not taken that approach, and this Court has topped out at awarding one-third of the economic benefit to counsel. *See Thorpe v. CERBCO, Inc.*, 1997 WL 67833, at *6 (Del. Ch. Feb. 6, 1997) (Allen, C.) (describing award of "one-third" of the recovery as the "very top of the range of percentages that this [C]ourt grants"), *aff'd*, 703 A.2d 645 (Del. 1997); *see also* Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 9.05[b], at 9-225 (2012) (discussing ranges of fee awards).

In this case, the objectors have not created a record that provides me with any assurance of the reasonableness of the splits. It is clear that if the Competing Proposal were approved, it would contemplate a percentage recovery for the Fund, net of litigation freight, ranking among the lowest net recoveries ever approved by this Court.

Perhaps the percentage of the upside extracted by the Capital Providers is a market rate that falls within a range of reasonableness. It may be, but I cannot make that determination because the Capital Providers declined to permit any discovery into the negotiation of the splits and did not otherwise support their terms. I do not even know what Travelers charged Burford for the bond.

Under other circumstances, the negotiation between Burford and the objectors' counsel might have provided some assurance of arm's length pricing, because the objectors' counsel will receive one-third of the post-financing recovery and therefore would have an incentive to minimize the Capital Providers' share. But the objectors' counsel's clients include those objectors who are putting up cash and who will receive a *pro rata* share of the litigation financing split. The objectors' counsel therefore owed a duty to parties with an interest in having the Capital Providers receive a greater share of the recovery, undermining the confidence that the negotiation might have inspired.

Further complicating matters, Burford has represented that it made its underwriting decision to promote the market for litigation finance. Taken at face value, this representation suggests that a competing proposal would not have emerged without Burford's business development subsidy and that the market therefore does not support continuing the litigation.

The record thus leaves me unpersuaded that the terms on which the objectors propose to assume the case, while superior to the Settlement from the perspective of offering the Fund a chance at more, are reasonable from the standpoint of the Fund. I am therefore unable to accept the Competing Proposal.

II. CONCLUSION

The objectors' motion is denied, and the Settlement is formally approved. An implementing order has been entered.