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.	)	C.A. No. 1091-VCL
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.	)	

MEMORANDUM OPINION

Date Submitted: April 3, 2012
Date Decided: May 9, 2012

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LASTER, Vice Chancellor.

This long-running derivative action has generated six written opinions.[1] Most recently, I granted in part the defendants' motion for summary judgment, ruling in their favor on one of three categories of claims. On the eve of trial, the parties settled the two remaining categories. In return for a global release, the defendants agreed to pay $10.25 million in cash to CIBC Employee Private Equity Fund (U.S.) I, L.P. (the "Fund"), on whose behalf the derivative claims were brought. The defendants also agreed not to pursue claims for indemnification against the Fund, a concession they value at approximately $3 million. The parties seek judicial approval of the settlement. Certain limited partners in the Fund, including the named plaintiffs, object to the settlement consideration as inadequate.

The current record convinces me that the settlement consideration falls within a range of fairness, albeit at the low end. The objectors say they can recover more on the two categories of claims headed for trial. Moreover, they say they can resurrect the category on which I granted summary judgment, which carried the largest potential

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[1] *See Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, 2010 WL 3168407 (Del. Ch. Aug. 11, 2010) (the "Summary Judgment Opinion" or "S.J. Op."); *Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, 2010 WL 1676442 (Del. Ch. Apr. 21, 2010) (decision on motion to strike expert testimony); *Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, 2007 WL 3262205 (Del. Ch. Oct. 31, 2007) (decision on motion to reargue part of ruling on motion to dismiss); *Forsythe v. ESC Fund Mgmt. Co. (U .S.)*, 2007 WL 2982247 (Del. Ch. Oct. 9, 2007) (decision on motion to dismiss); *Forsythe v. CIBC Empl. Private Equity Fund (U.S.) I, L.P.*, 2006 WL 846007 (Del. Ch. Mar. 22, 2006) (decision on redactions following merits ruling in related Section 220 proceeding); *Forsythe v. CIBC Empl. Private Equity Fund (U.S.) I, L.P.*, 2005 WL 1653963 (Del. Ch. July 7, 2005) (post-trial decision in related Section 220 proceeding).

damages award. If the objectors are correct, then the settlement consideration drops below the range of fairness.

Passing on the current settlement to seek more at trial carries substantial risk. The defendants have offered real money to settle the claims, and any future recovery could be substantially less favorable to the Fund, even nonexistent. Because the consideration falls within the range of fairness, I will approve the settlement unless the objectors make the equivalent of a topping bid. If they post a secured bond or letter of credit for the benefit of the Fund for the full settlement consideration of $13.25 million, then they may take over the case. If they later lose or obtain less than the full settlement amount, the Fund will be able to draw on the security and be made whole. If the objectors achieve a greater recovery, then both they and the Fund will benefit.

The objectors have sixty days from the date of this decision to make their election and post security. If they do not, then I will enter a final order approving the settlement and granting the fee award requested by plaintiffs' counsel.

I. FACTUAL BACKGROUND

In November 1999, Canadian Imperial Bank of Commerce ("CIBC") formed the Fund so that senior CIBC employees could co-invest with the bank in private equity opportunities. As a co-investment vehicle, the Fund was not permitted to search the financial universe for investment opportunities of its own; it only could invest side-by-side with CIBC in investments selected by CIBC's Investment Committee. Moreover, the Fund only could invest in the subset of CIBC investments that met the Fund's eligibility criteria. The offering documents for the Fund explained that its investment

portfolio would be divided into three categories: (i) Trimaran Investments, (ii) Fund-of-Funds Investments, and (iii) Merchant Banking Investments.

During its first two years, the Fund performed disastrously. Although eventually it got back into the black, the Fund posted an annual rate of return of only 2.13% through September 30, 2008. This performance left the Fund approximately $200 million below the returns generated by the lowest quartile of comparable funds.

The plaintiffs in this action asserted breach of fiduciary duty claims derivatively on behalf of the Fund. They sued (i) ESC Fund Management Co. (U.S.), Inc., the Fund's general partner (the "General Partner"), (ii) the individual directors of the General Partner, (iii) CIBC ESC Advisors, LLC, the Fund's investment advisor (the "Investment Advisor"), (iv) CIBC ESC SLP, LLC, the Fund's special limited partner (the "Special Limited Partner"), and (v) CIBC. Readers seeking additional factual background can consult this Court's prior opinions.

On March 14, 2011, one week before the scheduled trial, the parties engaged in the second of two mediation sessions with Judge Stephen P. Lamb, who presided over this case while a Vice Chancellor until retiring from the Court in 2009. The session produced a settlement pursuant to which (i) the Fund will receive $10.25 million in cash from CIBC, the Investment Advisor, the Special Limited Partner, and Liberty Mutual Insurance Company, the insurer for the General Partner and the individual defendants, and (ii) the defendants will forgo claims for indemnification from the Fund in the amount of approximately $3 million. The parties memorialized their agreement in a Stipulation and Agreement of Settlement, Compromise and Release dated July 21, 2011.

Both named plaintiffs agreed to the settlement, and each initially submitted an affidavit averring that the settlement was in the best interest of the Fund and its limited partners. The named plaintiffs then had second thoughts. When a group of objectors coalesced and hired counsel, one of the named plaintiffs tried to meet with them. Purportedly to protect the attorney-client privilege, plaintiffs' counsel blocked the meeting. I ruled that the named plaintiffs could speak with the objectors and their counsel. By January 2012, the named plaintiffs had joined the objectors in opposing the settlement.

II. LEGAL ANALYSIS

The settlement of a derivative action requires court approval. *See* Ct. Ch. R. 23.1(c). Delaware law "favors the voluntary settlement of contested issues." *Rome v. Archer*, 197 A.2d 49, 53 (Del. 1964). The settlement of representative litigation, however, "is unique because the fiduciary nature of the [litigation] requires the Court of Chancery to participate in the consummation of the settlement to the extent of determining its intrinsic fairness." *Prezant v. De Angelis*, 636 A.2d 915, 921 (Del. 1994). "The Court of Chancery plays a special role when asked to approve the settlement of a class or derivative action. It must balance the policy preference for settlement against the need to insure that the interests of the class have been fairly represented." *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1283 (Del. 1989).

Assessing the fairness of a settlement does not require a definitive evaluation of the case on its merits. "To do so would defeat the basic purpose of the settlement of litigation." *Rome*, 197 A.2d at 53. The reviewing court instead must consider the nature

of the claims, possible defenses, the legal and factual circumstances of the case, and then apply its own business judgment in deciding whether the settlement is reasonable. *Polk v. Good*, 507 A.2d 531, 535 (Del. 1986). "The Court must especially balance the value of all the claims being compromised against the value of the benefit to be conferred . . . by the settlement." *In re MCA, Inc.*, 598 A.2d 687, 691 (Del. Ch. 1991).

That the named plaintiffs do not support the settlement does not preclude approval. By suing in a representative capacity, "the named plaintiffs gave up the right to dictate the outcome of the action unilaterally." *In re M & F Worldwide Corp. S'holders Litig.*, 799 A.2d 1164, 1174 (Del. Ch. 2002). "[C]ounsel in a derivative and/or class action may present a proposed settlement over the objections of the named plaintiffs. The mere fact that the counsel takes a different view on the advisability of a settlement than the named clients does not, in itself, constitute grounds for disqualification." *Id.* at 1176; *see Harman v. Masoneilan Int'l, Inc.*, C.A. No. 5935, at 36-37, 39-42 (Del. Ch. Nov. 25, 1986) (TRANSCRIPT) (noting that class action settlement was fair and would be approved notwithstanding the named plaintiff's objections). "'[A] contrary view would put too much power in a wishful thinker or a spite monger to thwart a result that is in the best interests of the corporation and its stockholders.'" *M & F Worldwide*, 799 A.2d at 1176 (quoting *Saylor v. Lindsley*, 456 F.2d 896, 899-900 (2d Cir. 1972) (Friendly, C.J.)).

A. The Reasonableness Of The Settlement

Several significant factors support the reasonableness of the settlement and weigh in favor of approval. The parties negotiated at arm's-length with the benefit of an

experienced and respected mediator. They had ample information about the case: settlement came on the eve of trial, after the completion of discovery, and after a series of rulings from this Court that helped the parties evaluate the strength of their claims and defenses. And plaintiffs' counsel obtained actual cash consideration, not intangible or therapeutic benefits.

Other factors count against the settlement. A large number of objectors with significant holdings have appeared, and the named plaintiffs have turned against it. The objectors have raised meaningful concerns about the adequacy of the consideration and spun out theories by which more can be obtained.

Evaluating the fairness of the consideration against the potential value of the claims presents a difficult issue. As noted, the plaintiffs asserted claims for losses suffered in each of the Fund's three investment categories: Trimaran, Merchant Banking, and Fund of Funds. Fairly read, the Summary Judgment Opinion foreshadowed a significant risk of liability on the Merchant Banking and Fund of Fund claims, but intimated that determining the appropriate remedy and quantifying damages would raise a host of difficult issues. *See, e.g.*, S.J. Op., 2010 WL 3168407, at *13. The Summary Judgment Opinion entered judgment for the defendants on the Trimaran claims, which constituted the largest portion of the plaintiffs' damages claims. In granting summary judgment, I reasoned that (i) the Amended and Restated Agreement of Limited Partnership of the Fund, dated March 10, 2000 (the "Partnership Agreement" or "PA") and the Fund's offering documents contemplated an investment in Trimaran, (ii) the Partnership Agreement delegated decision-making authority to Trimaran (the

"Investment Delegation"), and (iii) a Parallel Investment Agreement between the Fund and Trimaran prohibited the Fund from reducing its investment. *Id.* at *14.

The objectors argue that the settlement consideration represents only a small fraction of what they realistically could recover at trial on the Fund of Funds and Merchant Banking claims. More importantly, they contend that they can convince me to revisit the still-interlocutory ruling in the Summary Judgment Opinion and revive the Trimaran claims. They point out that an exemptive order issued by the Securities and Exchange Commission dated August 3, 1999 (the "Exemptive Order") granted the Fund relief from many but not all of the requirements of the Investment Company Act of 1940. The Partnership Agreement contractually prohibited the Fund from violating the Investment Company Act unless authorized by the Exemptive Order. *See* PA § 2.7(ii) ("[T]he Fund shall not engage in any other transaction prohibited by the [Investment Company Act] unless such transaction is permitted by the Exemptive Order or an exemption therefor has otherwise been duly obtained."). The objectors argue that the Partnership Agreement thereby incorporated by reference the restrictions of the Investment Company Act, giving the plaintiffs standing to pursue non-exempted violations of the statute as breaches of the Partnership Agreement.

According to the objectors, the terms of the Parallel Investment Agreement and the Investment Delegation, on which I relied in granting summary judgment, violated the Investment Company Act in a manner not authorized by the Exemptive Order. Therefore, they say, the Parallel Investment Agreement and the Investment Delegation could not insulate the defendants from liability, as the Summary Judgment Opinion held,

and the Trimaran claims come back into the case. Potential damages if that category of claims were restored could exceed $200 million. *See* Objectors' Supplemental Mem. in Supp. of Objections 7; S.J. Op., 2010 WL 3168407, at *10 (noting that by September 30, 2008, the Fund's performance left it "approximately $200 million below the returns generated by the lowest quartile of comparable funds").

I am far from infallible, and the objectors may be right. Nevertheless, they will face an uphill battle to revive the Trimaran claims, both because of the showing required to revisit the summary judgment ruling and the fact that "[t]he Offering Documents and Partnership Agreement made clear that the . . . Fund effectively would hand off to Trimaran." S.J. Op., 2010 WL 3168407, at *14; *see Encite LLC v. Soni*, 2011 WL 6225270, at *2 (Del. Ch. Dec. 13, 2011) ("A prior ruling becomes the law of the case and controls subsequent progress of the litigation except where (1) the prior ruling was clearly wrong; (2) there has been an important change of circumstances; or (3) equitable concerns render application of the law of the case doctrine inappropriate.").

Without the Trimaran claims, the substantial monetary payment contemplated by the settlement falls within the range of fairness, albeit at the low end. If the objectors achieve the difficult but not impossible task of resurrecting the Trimaran claims, then the settlement would be inadequate. The objectors contend that the potential rewards of pursuing the case justify the risks of abandoning the settlement. Plaintiffs' counsel believes otherwise. These positions predictably reflect the incentives each party faces at this stage of the case.

The requirement of judicial approval for settlements in representative litigation addresses the concern that counsel's interests may diverge from their client's interests.

> The class attorney's egoistic incentive is to maximize his or her fees—awarded by the court if the action succeeds—with a minimized time-and-effort investment. This objective does not align with a both zealous and time-consuming prosecution of the class action, aimed at maximizing the amount of recovery for the class members.

Alon Harel & Alex Stein, *Auctioning for Loyalty: Selection and Monitoring of Class Counsel*, 22 Yale L. & Pol'y Rev. 69, 71 (2004)

> The plaintiff's financial interest is in his share of the total recovery less what may be awarded to counsel, *simpliciter*; counsel's financial interest is in the amount of the award to him less the time and effort needed to produce it. A relatively small settlement may well produce an allowance bearing a higher ratio to the cost of the work than a much larger recovery obtained only after extensive discovery, a long trial and an appeal.

Saylor v. Lindsley, 456 F.2d 896, 900 (2d Cir. 1972) (Friendly, C.J.). "When the lawyer gains 40 cents to the client's dollar, the lawyer tends to expend too little effort . . . . [H]e would not put in an extra $600 worth of time to obtain an extra $1,000 for his client, because he would receive only $400 for his effort." *Kirchoff v. Flynn*, 786 F.2d 320, 325 (7th Cir. 1986) (Easterbrook, J.).

Because of these incentives, counsel may favor (consciously or not) a bird-in-the-hand settlement over the continuing and costly quest for an uncertain outcome. The agency problem becomes particularly severe on the eve of trial, when counsel has large sunk costs, must ramp up further to try the case, and no longer can put off confronting the specter of an adverse result.

Here, plaintiffs' counsel commendably invested significant resources in the case. They did not seek an early settlement to harvest a fee. *Cf. In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 959 (Del. Ch. 2010) ("[A] systemic problem emerges when entrepreneurial litigators pursue a strategy of filing a large number of actions, investing relatively little time or energy in any single case, and settling the cases early to minimize case-specific investment and maximize net profit."). Nevertheless, in part because they invested so much, I harbor some concern that plaintiffs' counsel may have faced subconscious pressure to settle rather than pursue the case to the end. *See In re Emerson Radio S'holder Derivative Litig.*, 2011 WL 1135006, at *3-4 (Del. Ch. Mar. 28, 2011).

In contrast to plaintiffs' counsel, the Fund and its limited partners rationally could prefer to fight on in pursuit of a larger recovery. Fifty-seven limited partner objectors have opposed the settlement. Their decision to hire separate counsel and advance a detailed objection speaks to their seriousness. They would bear the risk of recovering less or nothing depending on the outcome at trial. They have made a strong argument that the risk-reward calculus warrants allowing them to proceed.

At the same time, the objectors and their counsel may be undervaluing the cost of passing on the settlement. Because plaintiffs' counsel has carried the expenses of the action so far, neither the objectors nor their counsel have needed to confront the stark reality that going to trial could produce a net loss. If allowed simply to take over the litigation, they would be free riding on plaintiffs' counsel's work.

There is also some reason for concern that the objectors' interests may diverge from the Fund's. All fifty-seven of the objectors borrowed from CIBC to leverage their

investment in the Fund. The Fund does not have any obligation on the loans, and not all of the Fund's limited partners have loans outstanding. The objectors may hope that continuing the litigation will pressure CIBC to resolve pending loan disputes, which would be a personal interest not shared with the Fund. At the same time, the loan issue properly motivates the objectors to obtain a larger damages award for the Fund, because if the Fund receives more money, it can make larger distributions to the limited partners, who can use the increased amount to pay down their loans.

To balance the risk of losing the settlement against the possibility that the settlement consideration may be inadequate, particularly if the Trimaran claims could be revived, I will proceed as follows: In sixty days, I will enter an order approving the settlement and plaintiffs' counsel's fee award unless some combination of objectors or their counsel lodge with the Register in Chancery a secured bond, letter of credit, or similar security for the benefit of the Fund in the amount of the settlement consideration. If the objectors pursue the case and ultimately recover less than the current settlement, the Fund will have the right to execute on the security to collect the difference.

This approach draws on proposals to address agency cost problems in representative actions by auctioning claims. In one such proposal, the class or derivative claims would be sold at the outset of the case to the highest bidder (including potentially the defendants), and the net proceeds of the auction would be distributed to the class. The winning bidder would take over the rights of the plaintiffs, could pursue the action, and would keep any recovery for itself. If the defendants were to win the auction, they would simply dismiss the claims. *See* Jonathan R. Macey & Geoffrey P. Miller, *The*

Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. Chi. L. Rev. 1, 106-08 (1991). Auctioning the claims would reduce agency costs by uniting ownership and control in a single party with the means and incentive to pursue the case. *Id.* at 108-09.

By settling, the defendants effectively are purchasing the Fund's claims for $13.25 million. If the objectors believe the claims are worth more, they can act on their belief, put real money on the table, and outbid the defendants. Compared to an auction conducted at the outset of a case, the objectors are well-positioned to make an informed decision. At the start of a case, participants have only the complaint's allegations and limited additional information. Here, the parties have access to a thoroughly developed discovery record and multiple decisions from the Court.

Conditioning settlement rejection on a bond in the amount of the settlement establishes a floor for the Fund's recovery. The Fund can do better if the case proceeds, but it cannot do worse. The premium for the bond and the responsibility to make up any deficiency from a lesser recovery will force the objectors and their counsel to internalize the downside of not taking the proposal currently on the table, thereby aligning their interests more closely with the Fund's.

The bonding approach is admittedly imperfect. Although the objectors and their counsel must bond the entire amount of the settlement, they will not be entitled to the entire amount of any recovery. The objectors will receive only their *pro rata* share, and their counsel will be entitled to a percentage fee, less the amount awarded to original plaintiffs' counsel. In theory, therefore, a full bond imposes somewhat too great a cost on

the objectors and their counsel. On balance, however, a full bond appears to be the most feasible and appropriate option. Pursuing the litigation risks losing a substantial cash settlement that the parties bargained for at a late stage of the case. Because I have found that the existing settlement falls within the range of fairness, albeit at the low end, erring on the side of a higher bond ensures that the Fund is protected.

B. Attorneys' Fees

If the objectors do not post security and apply to take over the case within sixty days, then I will enter a final order approving the settlement and the plaintiffs' fee request. When a plaintiff pursues a cause of action relating to the internal affairs of a Delaware entity and generates benefits for the entity, Delaware law calls for the plaintiff to receive an award of attorneys' fees and expenses determined based on the factors set forth in *Sugarland Industries, Inc. v. Thomas,* 420 A.2d 142 (Del. 1980). In determining an appropriate award, a court applying Delaware law should consider:

> (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.

In re Plains Res. Inc. S'holders Litig., 2005 WL 332811, at *3 (Del. Ch. Feb. 4, 2005) (citing *Sugarland*, 420 A.2d at 149–50). "[T]his court has traditionally placed greatest weight upon the benefits achieved by the litigation." *In re Anderson Clayton S'holders Litig.*, 1988 WL 97480, at *3 (Del. Ch. Sept. 19, 1988) (Allen, C.).

The defendants do not oppose the plaintiffs' request for $2,972,500 in fees and expenses. The requested fee represents 29% of the $10,250,000 monetary recovery and a lower percentage to the extent value is attributed to the indemnification waiver. The substantial efforts and expenses incurred and the stage at which the case settled support an award in this range. "When a case settles after the plaintiffs have engaged in meaningful litigation efforts, typically including multiple depositions and some level of motion practice, fee awards range from 15–25% of the monetary benefits conferred. *Emerson*, 2011 WL 1135006, at *3. "[H]igher percentages are warranted when cases progress further . . . ." *Brinckerhoff v. Texas E. Products Pipeline Co.*, 986 A.2d 370, 396 (Del. Ch. 2010). The fee falls within a reasonable range, warranting deference to the parties' negotiated amount.

The final order will approve the plaintiffs' request for payments of $35,000 to Forsythe, $20,000 to Tesche, and $7,500 to Herbert Reznikoff. Forsythe and Tesche made substantial contributions to the case. Forsythe traveled to Wilmington four times, testified in the prior books and records action, was deposed in that action and again in this action, and attended both mediation sessions. Tesche traveled to New Jersey to meet with counsel and to Wilmington to be deposed. Their ultimate disagreement with counsel over the settlement does not negate the value of their contributions. To the contrary, the presence of objectors can aid the fairness inquiry.[2] Reznikoff, a limited partner but not a

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[2] *See Reynolds v. Beneficial Nat'l Bank*, 288 F.3d 277, 288 (7th Cir. 2002) (Posner, J.) ("It is desirable to have as broad a range of participants in the fairness hearing as possible because of the risk of collusion over attorneys' fees and the terms of

named plaintiff, traveled to Wilmington for the first mediation session. His involvement warrants authorizing the small award requested by plaintiffs' counsel. Each award will be paid out of and deducted from plaintiffs' counsel's fee.

III. CONCLUSION

The objectors have sixty days to post security for the benefit of the Fund in the amount of $13.25 million and apply to take over the case. Otherwise, I will enter a final order approving the settlement and the plaintiffs' fee award.

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settlement generally."); *Bell Atl. Corp. v. Bolger*, 2 F.3d 1304, 1310 (3d Cir. 1993) ("In seeking court approval of their settlement proposal, plaintiffs' attorneys' and defendants' interests coalesce and mutual interest may result in mutual indulgence. The parties can be expected to spotlight the proposal's strengths and slight its defects. In such circumstances, objectors play an important role by giving courts access to information on the settlement's merits." (citation omitted)); *Brinckerhoff*, 986 A.2d at 385-86 ("Once the parties have reached a negotiated settlement, 'the litigation enters a new and unusual phase where former adversaries join forces to convince the court that their settlement is fair and appropriate.' . . . Unless an objector appears and challenges the settlement, the proceedings will be uncontested." (quoting *Ginsburg v. Phila. Stock Exch., Inc.,* 2007 WL 2982238, at *1 (Del. Ch. Oct. 9, 2007))). *But see* Edward Brunet, *Class Action Objectors: Extortionist Free Riders or Fairness Guarantors*, 2003 U. Chi. Legal F. 403, 425-34 (2003) (discussing problems created by class action objectors).