IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

DONALD REITH, individually and on behalf of all others similarly situated, Plaintiff,	:	
v	:	C. A. No. 2018-0277-MTZ
WARREN G. LICHTENSTEIN, GLEN M. KASSAN, WILLIAM T. FEJES, JR., JACK L. HOWARD, JEFFREY J. FENTON, PHILIP E. LENGYEL, JEFFREY S. WALD, STEEL PARTNERS HOLDINGS L.P., STEEL PARTNERS, LTD., SPH GROUP HOLDINGS LLC, HANDY & HARMAN LTD., and WHX CS CORP., Defendants,	:	
and	:	
STEEL CONNECT, INC., a Delaware corporation, Nominal Defendant.	:	

- - -

Chancery Court Chambers
Leonard L. Williams Justice Center
500 North King Street
Wilmington, Delaware
Friday, September 23, 2022
3:19 p.m.

- - -

BEFORE: HON. MORGAN T. ZURN, Vice Chancellor

- - -

TELEPHONIC SETTLEMENT HEARING AND RULINGS OF THE COURT

APPEARANCES:

TRAVIS J. FERGUSON, ESQ.
McCarter & English, LLP
-and-
ELIZABETH K. TRIPODI, ESQ.
of the District of Columbia Bar
Levi & Korsinsky, LLP
for Plaintiff

JOHN M. SEAMAN, ESQ.
Abrams & Bayliss LLP
-and-
GEORGE M. GARVEY, ESQ.
of the California Bar
Munger, Tolles & Olson LLP
for Defendants Warren G. Lichtenstein, Glen M. Kassan, William T. Fejes, Jr., Jack L. Howard, Steel Partners Holdings L.P., and SPH Group Holdings LLC

MATTHEW D. PERRI, ESQ.
Richards, Layton & Finger, P.A.
for Defendants Jeffrey J. Fenton and Jeffrey S. Wald

ANDREA S. BROOKS, ESQ.
Wilks Law, LLC
for Nominal Defendant

ERIC M. ANDERSEN, ESQ.
Andersen Sleater Sianni
-and-
JESSICA SLEATER, ESQ.
of the New York Bar
Andersen Sleater Sianni
for Objector Mohammad Ladjevardian

- - -

THE COURT: Good afternoon. This is Morgan Zurn.

May I have appearances, please, beginning with counsel for the plaintiffs.

ATTORNEY FERGUSON: Good afternoon, Your Honor. Travis Ferguson of McCarter & English on behalf of the plaintiff. Also with me is Elizabeth Tripodi of Levi & Korsinsky.

THE COURT: Thank you.

And counsel for the Steel Holdings defendants.

ATTORNEY SEAMAN: Good afternoon, Your Honor. You have John Seaman at Abrams & Bayliss. I'm joined by George Garvey from Munger, Tolles & Olson.

THE COURT: Thank you.

And counsel for Mr. Fenton and Mr. Wald.

ATTORNEY PERRI: Good afternoon, Your Honor. Matthew Perri, Richards, Layton & Finger.

THE COURT: And counsel for the nominal defendant.

ATTORNEY BROOKS: Good afternoon, Your Honor. Andrea Brooks from Wilks Law.

THE COURT: Thank you.

Counsel for Mr. Ladjevardian.

ATTORNEY ANDERSEN: Good afternoon, Your Honor. This is Eric Andersen, and also with me is Jessica Sleater, also with my firm.

THE COURT: Thank you. I have some remarks to share. If you could all mute your lines, I would appreciate it.

On August 18th, 2022, I issued guidance to the parties in this case regarding the proposed settlement of derivative and class claims in the matter captioned Reith v. Lichtenstein, 2018-0277. On that call, I explained that based on the information the parties had provided to me, I struggled to find that the settlement was fair to the stockholders. For purposes of my ruling today, I incorporate those remarks.

The concerns I expressed on that call focused on a lack of information provided to the Court. The plaintiff had largely prevailed in opposing defendants' motion to dismiss and completed document discovery. At the settlement hearing, and in the supporting filings, plaintiff suggested that discovery demonstrated proving the claims would be

difficult, and that the claims were worth less than plaintiff originally believed. I was not provided with those documents, and it was unclear to me how plaintiff reached the conclusion that his claims were now worth less.

Because this Court favors settlements, I allowed the parties to supplement the record. In particular, I asked the parties to provide: (1) a more meaningful valuation of plaintiff's claims and the settlement consideration, (2) guidance on how to value the return of the equity grants and corporate governance reforms in light of the pending merger vote, (3) clarification on the issue of whether the claims should be discounted because plaintiff may lose standing, and (4) documentary support for the position that plaintiff's claims were weaker than originally thought. I stated the parties could negotiate the settlement and present stronger terms, or submit supplemental papers explaining why the settlement is fair. The parties attempted both.

On September 6th, defendant filed a supplemental memorandum. Plaintiff submitted one of his own on September 12th, and the objector submitted one on September 13th.

On Friday, September 16th, the parties informed the Court they were working to improve the settlement, and they "hoped" to have a revised agreement by the morning of Monday, September 19th. The parties submitted that revised offer the night of Wednesday, September 21st.

The revised settlement stipulation provides for an additional $250,000 cash payment, increasing the total cash consideration to $3 million. The revised terms also provide that after plaintiff's attorneys' fees are deducted, this cash would be distributed to the minority stockholders, if, and only if, they approved the pending merger. If the merger is not approved, the cash would stay with Steel Connect.

I will now turn to whether the settlement should be approved in light of the information provided and the revised settlement terms.

I will start with the most significant development: the parties citing and attaching the documents produced in discovery that they contend undermine plaintiff's claims. On review, these documents most plausibly strengthen, rather than weaken, the plaintiff's case.

Plaintiff was equivocal as to whether the documents demonstrated Steel Holdings controlled the company in late 2017; defendants' supplemental memorandum contends Steel Holdings did not control the Steel Connect board that approved the transactions at issue. The documents supplied support the position that Steel Holdings controlled the company at least with regard to the IWCO transaction, the preferred stock issuance, and the equity grants. Specifically, it appears Steel Holdings controlled the IWCO transaction process and made demands on the special committee with little or no pushback, and without needing to provide a serious rationale for any of its demands. These documents include Plaintiff's Exhibits 11, 12, 13, and 14, and Defendants' Exhibit 3.

Plaintiff argued that discovery demonstrated the special committee had a defendable basis for awarding the equity grants. I disagree. These documents show that the equity grants were proposed by Steel Holdings, and that Steel Holdings determined the amounts of the awards and the basis for awarding them. For example, Plaintiff's Exhibit 11 contains an email from Steel Holdings' president, Jack Howard, to the special committee, in which Howard

responds to the committee's request for "a detailed proposal listing the services to be rendered, personnel to provide the services and the goals to be accomplished," as follows: "The purpose of providing the shares are for Warren's past services as Executive chairman, finding the acquisition and structuring and for Bill and myself, it will be for future service and work done on this acquisition." Lichtenstein, as Steel Holdings' executive chairman, was cc'ed on that email. The documents also show that the special committee based its decision to approve the grants, in part, on the fact that the monetary value of the equity grants was less than what the company would have paid an investment banker. Both facts seem to bolster plaintiff's case.

The documents strengthen plaintiff's case in other ways. For example, these documents appear to show that the special committee lacked independence or that it did not function effectively. Additionally, the documents appear to show that Steel Holdings made demands of the committee, and that the committee gave into those demands without any significant pushback. For example, after its fourth meeting -- out of seven total -- the special committee

asked Steel Holdings why the company needed a $35 million investment. Steel Holdings appeared to provide an informal, two-paragraph written answer, which the special committee accepted without question. This, too, is in Plaintiff's Exhibit 11. The fact that the special committee was asking the party it was negotiating against for an explanation as to why the company should enter into the transaction at all is concerning, and reflects poorly on both the committee's disinterestedness and effectiveness."

I now turn to broader means of valuing plaintiff's claim. This is an important anchor to analyzing the give and the get: The Court must have some sense of what a plaintiff could recover at trial. On the August 18th call, I asked the parties to provide a more meaningful valuation of plaintiff's claims so that I could assess the value of the "give" here. One of my concerns was that the proffered valuation omitted any control premium and relied on the company's stock price without any indication that the stock price reflected the company's fair value, especially considering the presence of a controller.

I want to pause on why I have looked for more on the use of the stock price. There are

instances when stock price can be an appropriate proxy for the company's value in the settlement context. I do not expect parties seeking settlement approval to retain experts. But here, as explained in August, the context of the looming merger warrants greater care in ensuring the settlement is fair. And there were several reasons to believe the stock price did not accurately reflect the company's value. The parties did not address any of these problems.

The parties have both failed to provide a reasonable proxy for value on which the Court can rely. Both parties' experts rely on the $1.49 pre-December 18th 8-K filing stock price on the basis that it was unaffected by the announcement of the IWCO transaction. This necessarily requires an assumption that the fair market value of the company's stock reflects its intrinsic value, and that the increase in the stock price on the IWCO announcement to $2.19 had nothing to do with the value of that transaction. Despite my raising this as a concern in August, the parties again provided no basis for assuming the preannouncement stock price reflects the underlying value of the company, including even any suggestion that the stock trades in an efficient

market. The value of the company embarking upon the IWCO transaction is likely close to $2.19.

Defendants complain that they did not have a "crystal ball" at the time the preferred stock was issued, and could not anticipate that the stock would rise with the IWCO announcement. This is both irrelevant and inconsistent with plaintiff's theory of wrongdoing, which remains viable in my view. Our law requires that the Court look to the fair price of a transaction at the time it was entered into, and here the fair price should account for the added value of the IWCO transaction. And according to plaintiff, the preferred issuance was unfair because Steel Holdings was able to invest at a lower stock price and obtain a lower conversion price, knowing the transaction was in the works but not yet announced. Indeed, assuming $2.19 approximates the stock's value, the $1.96 conversion price represents a 10.5 percent discount -- a far cry from the premiums the parties point to in comparable transactions.

I conclude the plaintiff has failed to provide a good-faith estimate of what he could have recovered at trial. The positions taken by the parties and their experts with regard to the preferred

stock transaction are so flawed that I cannot reasonably rely on them. Where, as here, a plaintiff is this reticent to provide an accurate estimation of the value of her claims, the Court should proceed cautiously. And I suspect the likely recovery exceeds what the plaintiff claims it is.

I also continue to struggle with considering the surrender of the equity grants as part of the "get." This is for two independent reasons.

First is the fact that the grants were surrendered without Court approval or leave. The August 26th, 2021 MOU provided the grants should be surrendered no later than seven days after the settlement was approved and the time to appeal was expired or an appeal was exhausted. But the grants were surrendered in August and December of 2021, before the settlement stipulation was even signed. And there is no plan to claw back the grants, as defendants' counsel made clear during the August 12th hearing.

This Court's decisions in *Chickering v. Giles* and *In re SS & C Technologies, Inc.* make clear that where parties perform settlement obligations without seeking Court approval of the

settlement, the parties improperly circumvent the protections afforded to class members and stockholders by Rules 23 and 23.1. Those cases find that in such circumstances, the settlement is untimely presented, and the Court should not consider those aspects of a settlement in determining whether a settlement is fair and reasonable.

When asked about why certain defendants surrendered equity grants in mid to late 2021, defendants' counsel responded that it was his understanding that the decisions were "driven by some adverse tax consequences that might have followed if they waited another year." He then proceeded to provide other benefits from their surrendering shares earlier, such as making it easier for the special committee negotiating against Steel Holdings to negotiate a merger price. Defendants then argued that cases such as *Polk* and *Barkan* stand for the proposition that a party may perform settlement obligations before seeking Court approval so long as what they give up is a bargained-for part of the settlement.

On this point, I believe defendants misstated the law. It is true that the surrender of

the equity grants must be a bargained-for part of the settlement. But the law requires more to consider settlement components that were performed before the Court approved them: there must be a sufficient justification for fulfilling those obligations at the time. Both cases cited by plaintiff applied this exception because the settlement consideration at issue was being paid out in the form of increased merger consideration.

I see no such sufficient justification here. I understood defendants' answer to my question to be that the defendants surrendered their shares at the time they did to avoid adverse tax consequences, but that there were also certain other collateral benefits. That is, based on the information the parties have presented to me, I believe that any increase in merger consideration that occurred over a year later was not an intended benefit of this aspect of the settlement, but rather an incidental one. Indeed, defendants themselves described the impact of the surrenders on the merger negotiations as a "beneficial effect." The special committee was not a party to the settlement negotiations, and the parties have steadfastly contended the settlement was

negotiated in isolation from the merger (a contention which I doubt, as I explained on August 18th). And plaintiff's counsel simply did not know why the equity grants were surrendered when they were. I conclude the timing of the grant surrender was to benefit the surrendering defendants, not the settlement implementation and not the minority in the merger.

A party to a settlement stipulation may not avoid the obligations of Rules 23 and 23.1 so that they may obtain favorable tax treatment. In the absence of a sufficient justification for the timing of the surrender, these defendants have assumed the risk that the surrender would not be considered as part of the settlement consideration, as recognized might come to bear in *In re Amsted Industries*. I do not consider the surrender of the 3.3 million equity grants as part of the "get" for purposes of settlement approval.

There is a second independent reason for my doubts about the value of the equity grant surrender in evaluating the settlement. The parties' substantive support for their valuation of the surrender did not improve in supplemental briefing. The valuation suffers from the same flawed reliance on

the $1.49 per share as fair value.

Both expert affidavits value and justify a portion of the equity grants as if they were compensation paid to an investment banker. Plaintiff's expert concludes that because an investment banker would have received approximately $5.3 million and because he valued the equity grants that were not surrendered at $3.12 million, the equity grants were fair. Defendants took the same approach, but found that an investment banker would have been paid $3.377 million.

I do not believe that comparing the equity awards to what an investment banker would have received is a useful exercise because the men who received the grants are not investment bankers. I do not understand why saving on an investment banker warrants paying an investment banker's rate to people who are not investment bankers. The best explanation for the payments remains that the recipients are affiliates of a controller.

I now turn to what is probably the most confusing aspect of this settlement: the value of the corporate governance reforms. These are reforms that will essentially have no value if the pending

merger is approved. In the absence of any indication of whether the merger is likely to close, I suggested discounting the value of these reforms by 50 percent, but asked for additional guidance from the parties. The parties have both acquiesced to the application of that discount.

Initially, plaintiff contended these reforms were worth "at least hundreds of thousands of dollars." In response to my August 18th guidance, plaintiff agreed the reforms should be discounted by 50 percent but now contends the reforms are worth $2.6 million. Plaintiff argues this valuation is supported by this Court's decision in *In re Emerson Radio*.

In that case, the Court assessed the proper fees to be paid to the plaintiff's counsel after the settlement of a derivative action challenging related-party transactions. The settlement reached by the parties contained a $3 million cash component as well as reforms intended to prevent the challenged conduct from recurring. For purposes of assessing the value of the nonmonetary benefit from these reforms, the Court first determined the underlying conduct caused the company to suffer

damages of $3.9 million, measured by the cash consideration, and another $900,000 recovered for the same conduct following an internal investigation. The Court assumed that if the same conduct were to recur, the company would suffer damages in the same amount. The Court then determined that if the reforms were not in place, there was a 25 percent chance the same conduct would recur. So by discounting the $3.9 million by 75 percent, the Court found those reforms conferred a benefit of $1 million.

This case does not provide a helpful metric by which to value the corporate governance reforms here. Plaintiff's theory of liability about the equity grants is that Steel Holdings caused the company to issue the grants so that it could obtain majority control, despite that issuance being a violation of the company's stock plan. I do not see any reason, and plaintiff suggests none, why Steel Holdings would do this again, given this settlement allows Steel Holdings to maintain majority voting control of the company. Plaintiff also conspicuously ignores the fact that the *Emerson Radio* court discounted the value of the therapeutics to adjust for the likelihood of recurrence.

Nevertheless, *Emerson Radio* provides some guidance here. The Court noted that "[f]or defendants, therapeutic benefits ... are cheap and easy gives," and cautioned against "allowing plaintiffs to claim significant incremental credit for therapeutic benefits when (i) the defendants have paid a fixed amount of tangible consideration and (ii) awarding fees for the therapeutic benefits will increase the plaintiffs' attorneys' share of that consideration." The Court also reasoned that "[i]deally, plaintiffs' lawyers should be seeking to enlarge the total settlement pie by extracting more tangible consideration from defendants, not finding ways to argue for a bigger share of the existing pie."

But that is exactly what plaintiff is doing here: trying to find ways to argue for a bigger share of this incredibly modest pie. Comparing plaintiff's two briefs makes this plain. I adopt plaintiff's initial valuation of the corporate governance reforms, and value them at $300,000. Applying the 50 percent discount embraced by plaintiff, the value of these reforms is $150,000.

I will briefly dispose of the notion that the revised settlement terms affect my view of

the settlement in any meaningful way. I have already rejected the objector's suggestion that the settlement was unfair because the cash consideration was going to the company and not the minority stockholders. In doing so, I made clear that I expected the cash consideration to flow to the company's stockholders and that the company had a legal obligation to ensure that it did so in the merger. While a payment of settlement consideration directly to stockholders can be positive, the nature of the derivative payment here was not, and still is not, the problem with this settlement.

And the additional $250,000 does not appreciably adjust the scales on the give and the get when the rest of the "get" is so ethereal in value as to be nearly weightless.

In my view, the adjustment to the settlement terms "sweetens" the merger for the minority more than it does the settlement.

There are several other factors that weigh against approving this settlement. The first is plaintiff's credibility.

As suggested above, it is difficult for me to rely on plaintiff's representations at this

point. Plaintiff appears to have aggressively and intentionally undervalued his claims in an effort to gain Court approval of this settlement. Further, plaintiff has shifted positions on various issues throughout the settlement approval process. It is also not lost on me that plaintiff entirely disregarded my earlier statement that plaintiff would not be entitled to a fee of more than 15 percent.

And plaintiff's counsel has made misrepresentations to the Court about documents produced in discovery. One example speaks volumes. In plaintiff's opening brief in support of the settlement, he wrote, "discovery established a clear basis for the award of these grants and offered a defensible position to their size." That sentence cited an incorrectly named affidavit, which stated in paragraph 29, "The Special Committee viewed the Equity Grants as compensation to [Defendants] for 'finding, structuring, due diligence, financing and managing the IWCO acquisition and future acquisitions and financings.'" The affidavit quoted Exhibit 14 thereto, a standalone and puzzlingly informal and unsourced document. For reasons that are now clear to me, plaintiff omitted the cover email. The cover

email makes plain that Jack Howard, as president of Steel Holdings and an equity grant recipient, "put this [document] together," not the special committee. Howard then sent the document to Wald at the special committee, copying Lichtenstein, apparently to dictate the amount of equity grants to issue to each defendant and the reason the special committee should give for awarding those grants. This cover email and attachment are found at Exhibit 13 to plaintiff's supplemental affidavit.

The document's basis for the equity awards is Steel Holdings' idea of what the special committee should say about them -- not necessarily the special committee's view on the grants, as plaintiff's counsel's affidavit stated. This becomes clear only when the document is accompanied by its parent email. Whether this was extraordinary carelessness or a willful effort to mislead the Court, this conduct is emblematic of how plaintiff has approached this settlement approval process and demonstrates why it is so difficult to rely on anything plaintiff has represented to this Court.

In the settlement context, the Court must rely on the parties to provide information about

the strength of the case, and must rely on counsel's representations. If a settlement is, in fact, fair and reasonable, it should be easy to be forthright. Duplicitous and inconsistent positions support the conclusion that the truth is not helpful to the parties.

Relatedly, I have concerns as to whether plaintiff has adequately represented the other stockholders and class members, which further diminishes my confidence that this settlement is fair and reasonable. In his opening brief, plaintiff framed this settlement as favorable in light of the pending merger vote, making statements such as "Plaintiff understood that time was of the essence," and "[t]he fact that Plaintiff's claims could have been easily extinguished with the going private transaction further supports his basis for entering" into the settlement. But this Court has made clear that it should evaluate whether a settlement is fair where the parties are "not under any compulsion to settle." That's from *Forsythe v. ESC Fund Management*.

Further, the need to negotiate the settlement in the shadow of a pending merger was a crisis of plaintiff's own languid representation.

This case has languished on the docket for over four and a half years, and plaintiff elected not to seek expedition after learning of the potential acquisition in November 2020. By saying he was compelled to settle because of the pending merger vote, and by implying that the merger vote diminishes the value of his claims, plaintiff himself concedes that his lack of urgency cost the other stockholders and class members the favorable bargaining position afforded by surviving a motion to dismiss in a case where entire fairness very well may apply.

Lastly, by plaintiff's math, the settlement consideration is predominantly nonmonetary, and plaintiff sought to recover attorneys' fees consisting of most of the cash consideration. Specifically, plaintiff initially contended that the "get" was worth $9,977,000, with $2,750,000 consisting of cash consideration. Plaintiff sought a fee of $2,050,000 to be paid out of the cash payment. Based on the structure of the settlement and defendants' holdings in the company, only $364,000 would have flowed derivatively to the minority stockholders.

For the foregoing reasons, I cannot conclude the settlement is fair. The "get" that was

properly and timely offered under Rules 23 and 23.1 comprises $3 million in cash and $150,000 in corporate governance reforms as discounted for the likelihood of the merger. The "give" is a release negotiated by plaintiff's counsel who failed to protect, let alone monetize, the claim when a loss of standing was threatened, and who has repeatedly taken positions that undermine their credibility. The parties have utterly failed to offer a rational, supported, and credible valuation of those claims, making me even more skeptical in this *Brinckerhoff* arena that already warrants heightened skepticism. My concerns expressed on August 18th are unabated. As I stated, I incorporate those remarks into the ruling here today. I conclude the parties have failed to carry their burden of demonstrating this settlement is fair and reasonable. And the settlement is rejected.

The stockholder vote on Steel Holdings' proposed acquisition of the company is scheduled for September 30th, and that acquisition must be approved by a majority of the minority. Assuming the minority is properly informed, I will leave it to them to decide the price at which they will give up standing to pursue these derivative

claims.

I ask that counsel offer a status update in 30 days. I hope everyone has a good weekend. Thank you.

(Proceedings concluded at 3:45 p.m.)

- - -

CERTIFICATE

I, DOUGLAS J. ZWEIZIG, Official Court Reporter for the Court of Chancery of the State of Delaware, Registered Diplomate Reporter, Certified Realtime Reporter, do hereby certify that the foregoing pages numbered 3 through 26 contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing in the above cause before the Vice Chancellor of the State of Delaware, on the date therein indicated, except for the rulings, which were revised by the Vice Chancellor.

IN WITNESS WHEREOF I have hereunto set my hand at Wilmington, this 26th day of September, 2022.

/s/ Douglas J. Zweizig

Douglas J. Zweizig
Official Court Reporter
Registered Diplomate Reporter
Certified Realtime Reporter