

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

DONALD REITH, individually and on behalf of all others similarly situated,

Plaintiff,

v

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.

C. A. No. 2018-0277-MTZ

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Chancery Court Chambers
Leonard L. Williams Justice Center
500 North King Street
Wilmington, Delaware
Thursday, August 18, 2022
9:15 a.m.

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BEFORE: HON. MORGAN T. ZURN, Vice Chancellor

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TELEPHONIC GUIDANCE OF THE COURT REGARDING PROPOSED SETTLEMENT

CHANCERY COURT REPORTERS
Leonard L. Williams Justice Center
500 North King Street - Suite 11400
Wilmington, Delaware 19801
(302) 255-0522

1 APPEARANCES:

2 TRAVIS J. FERGUSON, ESQ.
McCarter & English, LLP

3 -and-

4 ELIZABETH K. TRIPODI, ESQ.
of the District of Columbia Bar
Levi & Korsinsky, LLP
5 for Plaintiff

6 JOHN M. SEAMAN, ESQ.
Abrams & Bayliss LLP

7 -and-

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

11 MATTHEW D. PERRI, ESQ.
12 Richards, Layton & Finger, PA
for Defendants Jeffrey J. Fenton and
13 Jeffrey S. Wald

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

16 ERIC M. ANDERSEN, ESQ.
17 JESSICA J. SLEATER, ESQ.
Andersen Sleater Sianni LLC
18 for Objector Mohammad Ladjevardian

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1 THE COURT: Good morning. This is
2 Morgan Zurn. May I have appearances, please,
3 beginning with counsel for Mr. Reith.

4 ATTORNEY FERGUSON: Good morning, Your
5 Honor. Travis Ferguson of McCarter & English on
6 behalf of the plaintiff. Also joining me is Elizabeth
7 Tripodi of Levi & Korsinsky.

8 ATTORNEY TRIPODI: Good morning, Your
9 Honor.

10 THE COURT: Good morning.
11 And counsel for the Steel Holdings
12 defendants.

13 ATTORNEY SEAMAN: Good morning, Your
14 Honor. You have John Seaman of Abrams & Bayliss. I'm
15 joined by George Garvey from Munger Tolles & Olson.

16 THE COURT: Thank you.
17 Counsel for Mr. Fenton and Mr. Wald.

18 ATTORNEY PERRI: Good morning, Your
19 Honor. Matthew Perri from Richards, Layton & Finger.

20 THE COURT: Good morning.
21 Counsel for the nominal defendant.

22 ATTORNEY BROOKS: Good morning, Your
23 Honor. It's Andrea Brooks from Wilks Law.

24 THE COURT: Good morning.

1 And counsel for Mr. Ladjevardian.

2 ATTORNEY ANDERSEN: Good morning, Your
3 Honor. This is Eric Andersen and Jessica Sleater from
4 Andersen Sleater Sianni.

5 THE COURT: Good morning.

6 I have some thoughts to share on the
7 settlement. As a spoiler, I am neither approving nor
8 rejecting the settlement today. I'm going to share my
9 thoughts and give you the opportunity to regroup.

10 With that, my remarks are somewhat
11 lengthy, so if you could all mute your lines, I will
12 proceed to share them.

13 On Friday, August 12th, I heard from
14 the parties regarding the proposed derivative
15 settlement of the matter captioned Reith v.
16 Lichtenstein, Civil Action No. 2018-0277. I have
17 spent a considerable amount of time trying to get to a
18 place where I view this settlement as fair, and I am
19 struggling. Frankly, that's because the parties have
20 given me very little that I may use to value the
21 claims or the "give" and the "get." As I am presently
22 thinking about this settlement, I am inclined to
23 reject it, but I wanted to give you the chance to
24 respond and/or improve its terms.

1 My role in approving settlements is to
2 ensure the interests of the other stockholders and
3 class members are protected, and I need sufficient
4 information to do that. In making this determination,
5 the Court has highlighted two considerations: one,
6 whether the settlement falls within the range of
7 reasonable values; and, two, whether more is available
8 to the plaintiff on similar terms.

9 As further context, the looming merger
10 between the company and defendant Steel Holdings
11 raises concrete concerns in evaluating the settlement.
12 Vice Chancellor Laster, building on an admonition by
13 Chancellor Allen, pointed out that in such
14 circumstances "due regard for the protective nature of
15 ... derivative actions ... requires the court, in
16 these cases, to be suspicious, to exercise such powers
17 as it may possess to look imaginatively beneath the
18 surface of events, which, in most instances, will
19 itself be well-crafted and unobjectionable. ... The
20 lure of a premium transaction, the self-evident
21 benefits of settlement to the controller and other
22 defendants, and the prospect of an easy end to the
23 litigation -- coupled with a large fee -- create
24 powerful pressures. No one need cross the line of

1 collusion or conscious shirking for these forces to
2 have an effect." That's a quote from *Brinckerhoff v.*
3 *Texas Eastern Products Pipeline* out of this Court in
4 2010. These concerns are salient here, and I believe
5 they warrant a focused look at the settlement's terms.

6 There are four topics I would like
7 more information on. I don't expect the parties to
8 provide this information on the call. As I will
9 explain, I will provide an opportunity for
10 supplemental briefing.

11 Before I continue, I would like to
12 share at a high level how I'm thinking about this
13 settlement. What I see is a relatively small cash
14 payment to the company, which is the source of a
15 relatively large cash payment to plaintiff's counsel.
16 There is a surrender of equity grants, but Steel
17 Holdings still retains majority control of the
18 company. That surrender does not cut to the heart of
19 plaintiff's claims, which I believe to be that Steel
20 Holdings used its de facto control to acquire majority
21 voting control. The corporate governance reforms
22 could address this control, but they will evaporate if
23 Steel Holdings succeeds in acquiring the company on
24 terms that have already been agreed upon. When

1 coupled with the context of this settlement, I have
2 reservations about approving it.

3 My first area of concern is with the
4 strength of plaintiff's claims. The Court's function
5 is "to consider the nature of the claim, the possible
6 defenses thereto, the legal and factual circumstances
7 of the case, and to apply its own business judgment in
8 deciding whether the settlement is reasonable in light
9 of those factors." That's a quote from the Delaware
10 Supreme Court in *In re Philadelphia Stock Exchange*.

11 Both parties have stated that the
12 claims are weaker than they once appeared. I read
13 plaintiff's complaint to be built on the theory that
14 Steel Holdings, as a de facto controller, orchestrated
15 majority voting control without paying an adequate
16 premium, thereby causing damages. This theory makes
17 sense to me. But during the settlement approval
18 process, plaintiff and his expert have abandoned the
19 idea of a lost control premium, and instead assert
20 that seeking damages for the increase in voting
21 control would be "double dipping for a control
22 premium."

23 As partial explanation, plaintiff's
24 counsel stated their original damages theory was

1 undermined when I "deemed Steel Holdings a controller
2 for purposes of the motion to dismiss and going
3 forward." But I did not deem Steel Holdings was a
4 controller going forward. I took plaintiff's
5 allegations of de facto control as true, and plaintiff
6 would have to establish such control at trial.
7 Finding an approximately 36 percent stockholder is a
8 controller at trial is not a foregone conclusion. If
9 plaintiff failed to establish Steel Holdings was a
10 controller before the issuance of preferred stock and
11 equity grants, then the lost control premium,
12 recoverable on the unjust enrichment claim, would
13 conceivably be even greater.

14 Plaintiff's doctrinal shift is
15 unsupported. The parties' derogation of plaintiff's
16 claims relies on general references to documents
17 uncovered during discovery. Though I give these
18 statements by counsel some weight, I am skeptical of
19 them, as my role requires, given that the parties have
20 not shown me any documents that appear to materially
21 weaken plaintiff's case. For example, as to his claim
22 against the special committee members for approving
23 the equity grants, plaintiff stated "the discovery
24 established a clear basis for the award of these

1 grants and offered a defensible position to their
2 size." That's from the opening brief, page 43. In
3 support, the brief cites an affidavit, which in turn
4 cites a nondescript document, the author of which is
5 not apparent, providing generic rationales for
6 granting 5.5 million shares, allegedly worth \$12
7 million, to three individuals. Without more, I do not
8 see this document as detrimental to plaintiff's
9 claims.

10 If the parties intend to assert that
11 discovery weakened the claims, I suggest that they
12 point me to the documents. It is more helpful to
13 attach the documents as exhibits to the relevant
14 filing rather than citing an affidavit that in turn
15 cites exhibits. I also recommend that the parties
16 include cover emails or other relevant documents as
17 context.

18 Next, and most importantly, I need
19 more information on the value of plaintiff's claims,
20 as well as the value of the consideration being
21 offered in the settlement. To assess the value of the
22 "give" and the "get" here, I must have some sense of
23 the value of each. Plaintiff has valued his claims at
24 \$25,160,000. For reasons I will explain, I have

1 serious questions about how plaintiff has reached this
2 conclusion, and I believe the value of these claims is
3 likely higher.

4 Plaintiff's valuation, as articulated
5 in a supporting expert affidavit, appears facially
6 flawed and was not helpful to me in assessing the
7 value of these claims. At present, I am not
8 comfortable relying on plaintiff's valuation.

9 One area of concern is what the
10 valuations seem to omit. The valuation of both the
11 preferred stock and equity grants assumes that Steel
12 Holdings is a de facto controlling stockholder at the
13 time the preferred stock and equity grants were issued
14 and, therefore, attributed no value whatsoever to the
15 increase in control from approximately 36 percent to
16 over 50 percent. But at the same time, plaintiff's
17 valuation theory asserts the preferred stock's \$1.96
18 conversion price had a built-in control premium.
19 That's from the hearing transcript at 18. These
20 positions are inconsistent with each other, with the
21 complaint, and with my understanding of the value that
22 voting control offers.

23 Next, the valuation of the stock at
24 issue. Plaintiff's expert affidavit assumes \$2.19,

1 the trading price as of December 19th, 2017, is the
2 fair value of the common stock, but neither he nor
3 plaintiff provides a basis for that. Plaintiff cannot
4 assume Steel Holdings is a controller and then rely on
5 the stock's unmodified market price, as our law
6 presumes that the presence of a controller causes
7 stock to trade at a discount. The preferred stock and
8 equity grants were awarded before that day, so Steel
9 Holdings and its affiliates controlled more than
10 50 percent of the stock, supporting a meaningfully
11 discounted trading price. That day's stock price is
12 likely not a helpful indicator of the value of the
13 preferred shares.

14 Next, the preferred stock dividend.
15 Plaintiff's expert values it at 10.1 million, relying
16 on the dividends actually paid by the company to date
17 and the interest earned on unpaid dividends to date.
18 But Steel Holdings received so much more: the right to
19 a \$2.1 million dividend in perpetuity. Plaintiff has
20 not explained why five years of payments would reflect
21 the fair value of the dividend component at the time
22 the agreement to issue the preferred stock was
23 reached. If I'm correct, the value of the dividend
24 component may be much higher.

1 In addition, I would have the option
2 of awarding prejudgment interest on any damages award,
3 which could be significant given these transactions
4 were completed nearly five years ago. No party
5 mentions this.

6 Turning to the equity awards.
7 Plaintiff's complaint took issue with these grants
8 because, one, they were oversized; two, they
9 contributed to Steel Holdings' majority voting
10 control; and, three, they were issued in violation of
11 the stock plan. Plaintiff's expert affidavit
12 attributes a value of \$10,950,000 to the equity awards
13 granted to Lichtenstein, Howard, and Fejes in 2017.
14 This value is also predicated entirely on the
15 December 19th stock price of \$2.19. As mentioned,
16 this stock price presumably suffers from a control
17 discount. The value also omits the additional control
18 these grants afforded to Steel Holdings.
19 Additionally, the expert affidavit attributes no value
20 whatever to the 450,000 unvested shares granted to
21 these directors, without explanation. Surely these
22 shares had some value at the time they were awarded.
23 In short, the expert affidavit appears
24 to have myriad flaws and provides no support for the

1 valuation methods and assumptions that it relies on.
2 The expert has not been cross-examined, and his
3 affidavit cites documents apparently produced in
4 discovery that were not attached as exhibits,
5 including a valuation of the preferred stock performed
6 by Stout Risius Ross, LLC. To boot, it concludes,
7 rather than assumes, that Steel Holdings is a de facto
8 controlling stockholder, which is a conclusion of law.
9 On one hand, I'm not comfortable relying on any of its
10 conclusions. On the other, if I reject the affidavit
11 outright, I am left with no benchmark for the value of
12 these claims. This is not a position in which parties
13 seeking settlement approval should place the presiding
14 judge.

15 To be clear, I am not requiring the
16 parties to submit an extensive valuation analysis or a
17 perfect valuation. In this context, there is no
18 blueprint for submitting a settlement for approval.
19 But the parties need to provide me with enough
20 information for me to determine whether the proposed
21 settlement falls within a reasonable range of values.
22 That starts with providing me a supported basis to
23 value the claims.

24 If the claims in the complaint

1 primarily rely on a de facto controller forcing down a
2 transaction to acquire majority voting control, I
3 expect your damages assessment to attribute some value
4 to that increase or explain why it was excluded.

5 Now I turn from attempting to value
6 the claims to attempting to value the "get." Given a
7 lack of meaningful guidance, my best estimate of the
8 value of the benefits of this settlement does not
9 exceed \$6 million.

10 At the hearing, I asked plaintiff's
11 counsel how I should value the corporate governance
12 improvements in light of the pending merger vote. I
13 did not receive a clear answer. If the merger closes,
14 these corporate governance reforms are worthless
15 because, as I understand it, the company's stock will
16 be delisted, which means they are no longer mandatory
17 under the terms of the settlement. One approach would
18 be for me to conclude that I have insufficient indicia
19 of the likelihood of the merger closing, so I cannot
20 assign any value to these therapeutics. Another
21 approach would be to assume the merger is as likely to
22 close as it is not to close and to discount these
23 reforms by 50 percent. I would appreciate any
24 guidance the parties can offer on this issue.

1 Plaintiff's \$6.2 million figure for
2 the surrendered grants has the same issues as its
3 valuation of the grants overall, and some additional
4 issues. Surrendering the 3.3 million shares does not
5 dilute Steel Holdings' control to under 50 percent, so
6 this does not cut to the heart of plaintiff's claims.
7 Surrendering these shares did bring the company back
8 into compliance with the plan. I'm not convinced that
9 simply surrendering shares nearly five years later
10 adequately compensates the company here.

11 Though not addressed by the parties, I
12 believe that the surrender of the equity grants
13 should, in theory, offer value to cashed-out
14 stockholders in the form of increased merger
15 consideration per share. From what I can tell, this
16 figure would total just under \$4.2 million for the
17 common stockholders that would be cashed out. But
18 this benefit goes to the stockholders, not the
19 company. It only manifests if the merger closes,
20 subjecting this benefit to the same 100 percent or
21 50 percent discount. And the parties have offered no
22 contemporaneous documents showing the share surrender
23 actually increased the per share merger consideration.
24 Again, any guidance or evidence would be appreciated.

1 My final area of substantive concern
2 is that plaintiff has positioned this settlement as
3 being necessary to monetize the claims because the
4 stockholders are going to lose derivative standing in
5 the merger. This is, generally speaking, true. But I
6 do not perceive the merger as diminishing the value of
7 the claims themselves.

8 If plaintiff, or the parties together,
9 are going to take the position that this settlement is
10 reasonable in light of the fact that plaintiff will
11 lose standing, they should explain why the value of
12 these claims, as assets belonging to the corporation,
13 will decrease.

14 More specifically, I would like to
15 better understand why the stockholders' options are
16 limited to either a release or a loss of standing. It
17 seems to me that plaintiffs could sue on the merger
18 and set up the *Cox Communications* dance in a global
19 settlement. Instead, we have only half of that dance
20 before me today, which has caused my concerns about
21 the discounting of the settlement components. It also
22 seems to me that plaintiff could sue after the merger
23 under a *Lewis v. Anderson* theory that the merger was
24 designed to extinguish his standing, if supported by a

1 good-faith basis to do so.

2 It also appears that if this action
3 does not settle, the merger consideration would have
4 to include the fair value of these claims. If the
5 merger consideration were not increased to reflect the
6 fair value of these claims, plaintiff could bring a
7 *Primedia* claim for the value of the derivative asset.
8 So I see additional options for Steel Connect's
9 stockholders beyond settlement or being extinguished,
10 and I do not understand why plaintiff wrote these
11 other options off.

12 Finally, and perhaps relatedly, I do
13 not view the work by plaintiff's counsel to have been
14 as valuable as plaintiff would like me to. In
15 awarding attorneys' fees, my role is to "make an
16 independent determination of reasonableness" as to the
17 fee award. That's from *Activision*. There is no set
18 formula for determining the appropriate amount of
19 attorneys' fees.

20 After the controller sent its
21 November 2020 expression of interest, I have concerns
22 that plaintiff at best sat, and at worst rolled over,
23 while a merger that would extinguish plaintiff's
24 standing was negotiated. Once plaintiff learned that

1 a merger was threatened and loss of standing was
2 threatened, plaintiff stopped litigating. This
3 behavior does not suit a plaintiff ostensibly seeking
4 to obtain value for a derivative claim with the
5 knowledge that his standing may be extinguished.

6 My goal is to incentivize good
7 litigation of good claims. And negotiated resolutions
8 are preferred. I want to be clear that a negotiated
9 standdown does not, in my view, preclude awarding good
10 litigation and good negotiation with a generous
11 top-of-range fee. In this context, for a good
12 representative claim, the Court expects pursuit of
13 monetization by the representative plaintiff, either
14 by strategic and value-maximizing negotiation, by
15 litigation, or by an ardent pursuit of both. A
16 standdown may be justified when necessary to negotiate
17 a settlement that offers clear, meaningful, and
18 supported value.

19 But here, we had no strategic
20 standdown agreement, as conceded by counsel at
21 argument. Nor did plaintiff litigate. He responded
22 to the letter of interest by beginning six months of
23 negotiations to enter into an MOU and entering into a
24 scheduling order setting trial for a year out. As the

1 events have unfolded, we could have had a trial before
2 the merger is approved and consummated. And the value
3 of this settlement is not apparent for the reasons I
4 have explained.

5 Looking at this docket, when there is
6 such a period of silence between the letter and the
7 MOU, and then an even longer period of silence before
8 a merger is announced, and no claim on the merger, I
9 have serious concerns along the lines of those
10 expressed in *Brinckerhoff* of the pressure the
11 combination of a premium transaction, an easy end to
12 litigation, and a large fee for plaintiff's counsel
13 can exert. The fact that there was no objection to a
14 20 percent fee by defendants, when no depositions had
15 been taken, raises yet another question.

16 Under *Americas Mining*, this case
17 warrants a fee award of between 15 to 25 percent of
18 the monetary benefits conferred. The litigation tasks
19 that have been accomplished warrant no more than
20 15 percent. I think this is generous in view of the
21 litigation silence once the November 2020 expression
22 of interest came in.

23 So for the foregoing reasons, I
24 struggle to conclude that the settlement is fair. But

1 because Delaware law favors settlements, I want to
2 give you-all another opportunity to negotiate further,
3 tell me what I have misunderstood, or both.

4 To recap, I would appreciate, one, a
5 more meaningful valuation of plaintiff's claims and
6 the settlement consideration; two, additional guidance
7 on how to discount certain benefits of the settlement
8 in light of the pending merger vote; three,
9 clarification on the issue of whether the pending
10 merger vote should cause me to apply a discount to the
11 nominal defendant's derivative claims; and, four,
12 documentary support for your contentions that
13 discovery has revealed plaintiff's claims are weaker
14 than originally believed.

15 I will suggest simultaneous letters in
16 two weeks, and the objector is welcome to weigh in as
17 well. But if a different format or time frame works
18 for you, please just file a stipulation to that
19 effect. If you come to new terms, please also suggest
20 how you wish to proceed as far as notice to the
21 stockholders. And with the benefit of your
22 submissions, I will reconsider the settlement and the
23 objections.

24 With that, Ms. Tripodi, are there any

1 questions? Was anything unclear?

2 ATTORNEY TRIPODI: No, Your Honor. I
3 appreciate your comments today. Thank you.

4 THE COURT: Mr. Garvey, any questions?
5 Anything unclear?

6 ATTORNEY GARVEY: No, Your Honor.

7 THE COURT: Mr. Perri?

8 ATTORNEY PERRI: No, Your Honor.

9 Thank you.

10 THE COURT: Ms. Brooks?

11 ATTORNEY BROOKS: Nothing from me,
12 Your Honor.

13 THE COURT: Mr. Andersen?

14 ATTORNEY ANDERSEN: No, Your Honor.

15 THE COURT: All right. Thank you all.
16 I will leave you to it. Have a good rest of the week.

17 VARIOUS COUNSEL: Thank you, Your
18 Honor.

19 THE COURT: Bye.

20 (Proceedings concluded at 9:35 a.m.)

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CERTIFICATE

I, DEBRA A. DONNELLY, Official Court Reporter for the Court of Chancery for the State of Delaware, Registered Merit Reporter, Certified Realtime Reporter, and Delaware Notary Public, do hereby certify that the foregoing pages numbered 3 through 21 contain a true and correct transcription of the rulings 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.

IN WITNESS WHEREOF I hereunto set my hand at Wilmington, this 18th day of August, 2022.

/s/ Debra A. Donnelly

Debra A. Donnelly
Official Court Reporter
Registered Merit Reporter
Certified Realtime Reporter
Delaware Notary Public