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.	:	

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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

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, PA
for Defendants Jeffrey J. Fenton and Jeffrey S. Wald

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

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

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

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

ATTORNEY TRIPODI: Good morning, Your Honor.

THE COURT: Good morning.

And counsel for the Steel Holdings defendants.

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

THE COURT: Thank you.

Counsel for Mr. Fenton and Mr. Wald.

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

THE COURT: Good morning.

Counsel for the nominal defendant.

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

THE COURT: Good morning.

And counsel for Mr. Ladjevardian.

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

THE COURT: Good morning.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Turning to the equity awards. Plaintiff's complaint took issue with these grants because, one, they were oversized; two, they contributed to Steel Holdings' majority voting control; and, three, they were issued in violation of the stock plan. Plaintiff's expert affidavit attributes a value of $10,950,000 to the equity awards granted to Lichtenstein, Howard, and Fejes in 2017. This value is also predicated entirely on the December 19th stock price of $2.19. As mentioned, this stock price presumably suffers from a control discount. The value also omits the additional control these grants afforded to Steel Holdings. Additionally, the expert affidavit attributes no value whatever to the 450,000 unvested shares granted to these directors, without explanation. Surely these shares had some value at the time they were awarded.

In short, the expert affidavit appears to have myriad flaws and provides no support for the

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

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

If the claims in the complaint

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

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

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

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

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

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

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

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

good-faith basis to do so.

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

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

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

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

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

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

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

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

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

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

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

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

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

With that, Ms. Tripodi, are there any

questions? Was anything unclear?

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

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

ATTORNEY GARVEY: No, Your Honor.

THE COURT: Mr. Perri?

ATTORNEY PERRI: No, Your Honor. Thank you.

THE COURT: Ms. Brooks?

ATTORNEY BROOKS: Nothing from me, Your Honor.

THE COURT: Mr. Andersen?

ATTORNEY ANDERSEN: No, Your Honor.

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

VARIOUS COUNSEL: Thank you, Your Honor.

THE COURT: Bye.

(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