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Delaware Supreme Court: No Fees for Stockholder Win at Trial if No Final Judgment

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DELAWARE INSIDER

Recent trends in Delaware business law

The recent Delaware Supreme Court decision in *Crothall v. Zimmerman*, 2014 Del. LEXIS 265 (Del. June 9, 2014), began as a derivative suit challenging certain transactions for which, the plaintiff alleged, the company failed to obtain the necessary consent by the unitholders. The lead unitholder, Robert Zimmerman, was a co-founder and the former CEO of Adhezion Biomedical LLC. In a post-trial opinion, the Delaware Court of Chancery determined that the defendant directors breached the operating agreement by failing to obtain the necessary unitholder consents, but rejected Zimmerman's claims that the directors had breached their fiduciary duties, which is consistent with the Court of Chancery's earlier decision in this case disposing of Zimmerman's duty of care claims against the directors on a motion for summary judgment.

After the trial, when the parties could not agree on an appropriate form of final order, Zimmerman moved for the entry of a proposed final order and a petition for the award of attorneys' fees. Shortly after he filed that motion, Zimmerman sold his interests in Adhezion. The defendants immediately moved to dismiss the entire litigation because Zimmerman no longer had standing as a plaintiff. The Court of Chancery applied the continuous ownership rule codified in Section 327 of the Delaware General Corporation Law, by analogy to the limited liability company involved in this

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case. Finding that Zimmerman no longer had standing, the court granted the motion to dismiss the case prior to entering a final judgment and notwithstanding the formal post-trial opinion finding in favor of Zimmerman on some claims.

Despite Zimmerman's abandonment of the case, Zimmerman's former counsel filed a motion to intervene and a petition for attorneys' fees. The Court of Chancery allowed counsel to intervene and approved counsel's petition for fees, explaining that counsel, by fully litigating the case to a successful conclusion, bestowed a benefit on Adhezion, and should be permitted to collect fees under the corporate benefit doctrine. Specifically, the court identified the corporate benefit to be the clarification of the unitholders' approval rights under the operating agreement. The Court of Chancery further reasoned that by litigating that issue and procuring a post-trial opinion in favor of the unitholders, counsel conferred a compensable corporate benefit on Adhezion and its unitholders – even if there was no final judgment and even if the post-trial opinion had no preclusive effect. The Court of Chancery explained that the power of the court to shift fees "is an equitable device not properly confined to rigid, predictable circumstances," such as whether a final order was entered.

Discussion

The Delaware Supreme Court, in a rare reversal, provided a different perspective and different reasoning in concluding that attorneys' fees were not warranted based on the unusual circumstances of this case.

The Delaware Supreme Court emphasized the fact that because Zimmerman sold his shares, the Court of Chancery could not issue a post-trial opinion that would ultimately be the subject of a final judgment. And without a final judgment, Adhezion was denied the opportunity to appeal the Court of Chancery's ruling directly.

The only issue on appeal was the merit of the Court of Chancery's decision that Zimmerman's former counsel created a corporate benefit for which he was entitled to attorneys' fees, notwithstanding the dismissal of the underlying claim due to the divestiture by Zimmerman of his interest in the company prior to a final judgment being entered.

The Supreme Court emphasized, as a basis for its ruling, that Zimmerman mooted his case by abandoning his claims and selling his units, causing the dismissal of his claims, and rendering any rulings he had obtained incapable of being turned into an appealable final judgment. Thus, the Supreme Court concluded that Zimmerman "did not obtain an authoritative ruling of the Court of Chancery that can create a corporate benefit." The Supreme Court did not view the nonbinding interpretation of the operating agreement to satisfy the definition of a corporate benefit for purposes of the award of attorneys' fees, but rather focused on

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the decision by Zimmerman to sell his shares resulting in the dismissal of his claims and the mooting of his case. The Delaware Supreme Court explained that: "We fail to see how a mooted ruling that was dismissed before a final judgment was entered could create any corporate benefit."

The high court of Delaware distinguished decisions in which a claim was mooted because of actions taken by the defendants which created a corporate benefit that the plaintiff in those cases had been seeking and for which the plaintiff was entitled to have its attorneys' fees paid. Unlike those distinguishable cases, the Delaware Supreme Court observed that a plaintiff like Zimmerman, "who generates a favorable trial court decision on a closely contested issue of corporate governance but then abandons his claim and renders the decision moot before it becomes final has not created a corporate benefit, he has merely caused uncertainty."

This decision can be compared to a separate recent opinion by the Delaware Court of Chancery in *Raul v. Astoria Financial Corp.*, 2014 Del. Ch. LEXIS 103 (Del. Ch. June 20, 2014), where the court denied a request for attorneys' fees in a case involving the demand for additional disclosures pursuant to the Dodd Frank Act. The court reasoned that the stockholder in that case did not satisfy the prerequisite that a claim must survive a motion to dismiss in order to satisfy the corporate benefit doctrine.

Conclusion

The Delaware Supreme Court did not squarely address the issue of whether Zimmerman's former counsel would have been entitled to an award of fees if a final judgment had been entered, and did not address the motion to intervene (other than in *dicta*) that was granted after Zimmerman sold his shares, but did not express optimism on those two points. In conclusion, the Delaware Supreme Court held that no corporate benefit was created because any benefit that might have been created by continuing the suit to a final appealable judgment disappeared when Zimmerman abandoned the lawsuit. Thus, a lesson can be learned from this case is that despite a successful post-trial opinion, unless the continuous ownership rule is satisfied through a final judgment, and perhaps even through and appeal, a victorious stockholder and her attorneys, may not realize the spoils of victory.

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