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'Own Counsel' Defense Rejected in Awarding Class Counsel Fees

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Can a party that retains its own counsel be liable to pay a fee to another party's counsel or to class counsel? The answer, according to the recent Court of Chancery opinion in *Smith, Katzenstein & Jenkins v. Fidelity Management & Research,* C.A. No. 8066-VCL (Del. Ch. April 16, 2014), is a resounding yes. The court rejected the defendants' "own counsel" defense in an action to recover attorney fees and costs for benefits conferred as a result of the plaintiffs' prosecution and settlement of a class action as contrary to longstanding Delaware precedent dealing with shared causation in the award of fees and expenses when an attorney creates a common fund for, or confers a common benefit upon, a readily ascertainable group.

The plaintiffs were law firms that successfully prosecuted a class action lawsuit on behalf of the stockholders of Revlon against its controlling stockholder and board of directors. The defendants were investment funds and entities affiliated with the Fidelity financial services group that held or controlled shares constituting approximately 75 percent of the class. After the law firms began pursuing their case, but before the firms settled on behalf of the class, the Fidelity defendants settled their claims for a fixed amount per share plus a contingent payment based on any additional amount that the law firms obtained for the rest of the class. The law firms ultimately settled the claims for the rest of the class for an amount per share in excess of the Fidelity defendants' fixed payment, resulting in an additional payment to the Fidelity defendants of approximately $4 million. After settling with Revlon, the law firms approached the Fidelity defendants seeking compensation for the benefits that they had conferred on the Fidelity defendants, but the defendants refused to pay anything. The firms then instituted suit against the Fidelity defendants. Subsequently, the court approved the class action settlement on behalf of the

remainder of the class and awarded the firms fees and expenses based solely on the benefits that they had conferred on the class members other than the Fidelity defendants.

In order to obtain a fee award from the Fidelity defendants, the law firms had to show that the claims in the underlying lawsuit were meritorious at the time it was filed; the underlying lawsuit created a common fund for, or conferred an identifiable benefit on, the Fidelity defendants; and a causal connection existed between the litigation and the benefit. The court concluded that the law firms' complaints were meritorious when filed, a matter not in dispute, and that the firms conferred benefits on all Revlon stockholders, including the Fidelity defendants. The critical question in the case was the degree to which the law firms contributed causally to the Fidelity settlement.

The Fidelity defendants argued for a bright-line rule that any party that retains its own counsel cannot be liable to another party's counsel or to class counsel for a fee. As the court characterized the Fidelity defendants' argument, "According to the Fidelity defendants, a party that hires its own counsel has gone its own way and is responsible for its own fate, thereby breaking the chain of causation necessary for a fee award." The court found this position to be contrary to longstanding Delaware precedent that recognizes that counsel can recover a fee even though multiple factors may have contributed causally to the creation of a common fund or benefit. The court pointed to the leading decision by the Delaware Supreme Court in *Sugarland Industries v. Thomas*, 420 A.2d 142 (Del. 1980), which awarded fees in a shared-credit scenario. The court noted that Delaware cases have long taken into account the degree of causation between counsel's efforts and the result achieved when awarding attorney fees. The court explained, "Delaware courts have not adopted a bright-line rule that precludes plaintiffs counsel from obtaining a fee just because another actor retains counsel and contributes to the creation of the fund."

The Fidelity defendants also argued that, as a matter of public policy, the shared-credit approach encourages additional litigation and penalizes parties that select their own counsel and therefore should be rejected. Although the court recognized it was bound by precedent to apply the shared-credit approach, it nonetheless disagreed with the Fidelity defendants' policy arguments. First, the shared-credit approach does not encourage additional litigation or create a risk that parties will pay twice for the same work. Rather, it ensures that those who generate the benefits are paid in proportion to their role in creating the benefit. If a party shows that its own efforts generated the entire benefit and that the other counsel did not contribute to the benefit, then the other counsel will not be entitled to any fee award.

Second, the shared-credit approach does not penalize a party that selects its own counsel. It is free to do so, just as the Fidelity defendants did in this case. If the party's own counsel is solely responsible for creating the common fund or benefit, then the party will not owe any fee to the other counsel. Conversely, if the other counsel is responsible for some or all of the common fund or benefit, then the other counsel is entitled to a fee award, but only to the extent that it is responsible for the common fund or benefit.

Finally, the Fidelity defendants argued that they should not have to pay any fees to the law firms because the Fidelity defendants had separate interests and the firms acted contrary to those

interests. Specifically, the Fidelity defendants pushed an earlier settlement proposal that the firms rejected because it was too low. The Fidelity defendants wanted an early end to the litigation in part because of a myriad of business relationships Fidelity had with Revlon and because it did not want to have a reputation for litigating against its own clients. In rejecting this argument, the court found that Fidelity was confusing its business interests as a fund manager with the interests of the Fidelity funds as holders of Revlon stock and members of the class. By rejecting the earlier settlement proposal and continuing to litigate, the law firms properly exercised independent judgment for the benefit of all holders of the Revlon stock, including the Fidelity defendants. Indeed, said the court, by acting contrary to Fidelity's desires and rejecting the earlier settlement proposal, the firms caused the Fidelity defendants to ultimately receive additional compensation in the form of the contingent payment. Accordingly, the firms' decision not to comply with the wishes of the Fidelity defendants was not an impediment to their recovering a fee from the Fidelity defendants.

The court proceeded to determine the benefit that the law firms' activities had conferred on the Fidelity defendants. Then, applying the *Sugarland* factors to determine the reasonableness of the requested fee, the court awarded the firms a fee equal to approximately 20 percent of the benefit.

On the one hand, the court in this case applied well-known and long-accepted precedent and principles to determine the fee to which the law firms were entitled. On the other hand, in rejecting the Fidelity defendants' "own counsel" defense, the court gave further vitality to that precedent and those principles, including the shared-credit approach to fee awards in cases involving the creation of a common fund or benefit.

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