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Case No. 5890-VCL

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

MICHAEL SCULLY, on behalf of himself and all others similarly situated, Plaintiff, v. NIGHTHAWK RADIOLOGY HOLDINGS, INC., DAVID ENGERT, PETER Y. CHUNG, DAVID J. BROPHY, CHARLES R. BLAND, JEFF TERRILL, VIRTUAL RADIOLOGIC CORPORATION and EAGLE MERGER SUB CORPORATION, Defendants.	C.A. No. 5890-VCL

NIGHTHAWK DEFENDANTS' BRIEF IN RESPONSE
TO THE COURT'S DECEMBER 22, 2010 ORDER

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTRODUCTION 1

I. FACTUAL BACKGROUND 5

A. NightHawk and Its Board of Directors. 5

B. The Merger Negotiations and Events Leading the Board to Accept vRad's Merger Proposal. 6

1. NightHawk's Initial Contact with Providence And the Board's Rejection of Providence's First Request for an Exclusive Negotiating Period. 7

2. NightHawk Receives a Proposal from "Party A." 8

3. The Board Continues to Negotiate and Enters Into a 30 Day Exclusivity Agreement with vRad and Providence. 10

4. The NightHawk-vRad Negotiations Continue and NightHawk Receives a Proposal from "Party B." 12

C. The Merger Agreement. 14

1. The Board's Decision to Enter into the Merger Agreement and Its Terms. 14

2. The Go-Shop Process. 15

3. The Interest of NightHawk's CEO in the vRad Merger. 16

4. The NightHawk-vRad Merger is Overwhelmingly Approved by NightHawk's Shareholders. 16

II. THE MERGER LITIGATIONS AND THEIR RESOLUTION 17

A. The Litigations. 17

B. The Motion to Expedite. 18

TABLE OF CONTENTS (Continued)

			Page
	C.	Procedural Events Following the Court's Denial of Plaintiffs' Motion to Expedite.	19
	D.	The Final Settlement Negotiations.	24
III.	THE BROADER POLICY ISSUES		25
	A.	Counsel Defending Parallel Class Actions in Multiple Jurisdictions Have an Obligation to Consider the Best Forum Available to their Client in Compliance with the Rules of the Adversary System.	26
	B.	What is a "Collusive Settlement" and is Forum Shopping to Achieve Such a Settlement Improper? (Question 1).	33
		1. Definition of Collusion in The Class Action Settlement Context.	33
		2. Courts Have Been Cautious To Identify Collusion in the Class Action Settlement Context.	37
	C.	The Role of The Courts When it Receives Notice of a Collusive Settlement In A Representative Litigation. (Question 2).	38
		1. Judicial Coordination.	38
		2. Retaining Jurisdiction.	40
	D.	How Can A Court Ensure that Information in One Forum is Provided to the Court in Another Forum? (Question 3).	45
	E.	What Remedies are Available if the Court Determines that Counsel Engaged in a Collusive Settlement? (Question 4).	46
	F.	Application of the Foregoing Questions to the Facts of this Case. (Question 5).	48
CONCLUSION			50

TABLE OF AUTHORITIES

Page(s)

CASES

Brown v. Ticor Title Ins. Co.,
982 F.2d 386 (9th Cir. 1992) 44

Chickering v. Giles,
270 A.2d 373 (Del. Ch. 1970)....................41

Copper Mountain, Inc. v. Poma of Am., Inc.,
890 P.2d 100 (Colo. 1995)....................36

De Angelis v. Salton/Maxim Housewares, Inc.
641 A.2d 834 (Del. Ch. 1993), *rev'd sub nom. Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994) .... Passim

Epstein v. MCA, Inc.,
179 F.3d 641 (9th Cir. 1999), cert. denied, 528 U.S. 1004 (1999)....................43

Goad v. Celotex Corp.,
831 F.2d 508 (4th Cir. 1987) 29

Gonzales v. Cassidy,
474 F.2d 67 (5th Cir. 1973) 43

Hartsell v. Source Media,
2003 WL 21245989 (N.D. Tex. Mar. 31, 2003)....................44

Hospitality Mgmt. Assocs., Inc., v. Shell Oil Co.,
591 S.E.2d 611 (S.C. 2007), *cert. denied*, 543 U.S. 916 (2004)....................43

Hutchison v. Bernard,
220 A.2d 782 (Del. Ch. 1965)....................42

In re Abbott,
925 A.2d 482 (Del. 2007) 25

In re "Agent Orange" Prod. Liab. Litig.,
996 F.2d 1425 (2d Cir. 1993)....................43

In re Allion Healthcare S'holder Litig.,
C.A. No. 5022-CC (Del. Ch. Jan. 19, 2011 (TRANSCRIPT) 26, 29, 32, 38

In re Boehme,
256 S.W.3d 878 (Tex. App. 2008)....................29

TABLE OF AUTHORITIES (Continued)

Page(s)

In re Burlington N. Santa Fe S'holder Litig.,
C.A. No. 5043-VCL (Del. Ch. Dec. 15, 2010) 38-39

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C.A. No. 5043-VCL (Del. Ch. Oct. 28, 2010) 39

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C.A. No. 6084-VCL (Del. Ch. Jan. 13, 2011) 26, 38, 40

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799 A.2d 1164 (Del. Ch. 2002)..31

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270 F.R.D. 45 (D. Mass. 2010)..42

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659 A.2d 760 (Del. Ch. 1995).. 34-35

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785 A.2d 625 (Del. 2001) 32

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1993 WL 43024 (Del. Ch. Feb. 16, 1993) 41

In re Monogram Biosciences, Inc. Shareholders Litigation
C.A. No. 4703-CC (Del. Ch. Jan. 26, 2010) (TRANSCRIPT)..27

In re New Alliance Bancshares S'holders Litig.,
C.A. No. 5785-VCP (Del. Ch. Oct. 22, 2010) 38-39

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C.A. No. 5848-VCS (Del. Ch. Nov. 10, 2010) 38-40

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229 B.R. 914 (Bankr. N.D. Ind. 1998)..47

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911 A.2d 816 (Del. Ch. 2006)..41

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924 A.2d 951 (Del. Ch. 2007)..40

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C.A. No. 4329-VCN (Del. Ch. Apr. 7, 2009) 38-39

TABLE OF AUTHORITIES (Continued)

Page(s)

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C.A. No. 5296-VCL (Del. Ch. Mar. 30, 2010) (TRANSCRIPT) 40

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497 F.3d 615 (6th Cir. 2007) 37

Jaeger v. Muscat,
221 A.2d 607 (Del. Ch. 1966)....................42

Kahn v. Occidental Petroleum Corp.,
1989 WL 79967 (Del. Ch. July 19, 1989).................... 35-36

Keeton v. Hustler Magazine, Inc.,
465 U.S. 770 (1984)....................29

Larson v. Sprint Nextel Corp.,
2010 WL 234934 (D.N.J. Jan. 15, 2010) 33

Louisiana Mun. Police Emps.' Ret. Sys. v. Pyott,
C.A. No. 5795-VCL (Del. Ch. Jan. 21, 2011) (TRANSCRIPT) 31, 38

Masucci v. Fibernet Telecom Group,
C.A. No. 4680-VCS (Del. Ch. Nov. 25, 2009) 27-28, 31

Mruz v. Caring, Inc.,
166 F. Supp. 2d 61 (D.N.J. 2001) 47

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523 F.3d 1091 (9th Cir. 2008) 32, 37

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187 F.R.D. 108 (S.D.N.Y. 2000) 32

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288 F.3d 277 (7th Cir. 2002) 33

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2009 WL 1856460 (Del. Ch. June 26, 2009)....................26, 38

Rutter & Wilbanks Corp. v. Shell Oil Co.,
314 F.3d 1180 (10th Cir. 2002) 37

TABLE OF AUTHORITIES (Continued)

Page(s)

Simmermon v. Dryvit Sys., Inc.,
953 A.2d 478 (N.J. 2008) 42

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747 A.2d 1098 (Del. Ch. 1999), *aff'd,* 746 A.2d 277 (Del. 2000) 4, 6

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1989 WL 100884 (Del. Ch. Aug. 21, 1989) 35-36

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862 P.2d 978 (Colo. App. 1993) 36

Sygenta Crop Protection Inc. v. Henson,
537 U.S. 28 (2002) 43

Torres v. State,
979 A.2d 1087 (Del. Super. 2009) 46

Vallier v. Am. Fid. Assur. Co.,
2008 WL 4330028 (D. Kan. Sept. 16, 2008) 37

Versata Enters., Inc. v. Selectica, Inc.,
5 A.3d 586 (Del. 2010) 4

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2010 WL 2355306 (Del. Super. June 9, 2010) 46

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925 F.2d 518 (1st Cir. 1991) 41

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Warwick, 22 Am. J. Trial Advoc. 37

RULES AND STATUTES

Court of Chancery Rule 23 ....40, 42

TABLE OF AUTHORITIES (Continued)

Page(s)

Court of Chancery Rule 23(c)....................40

Court of Chancery Rule 23(e).................... 41-43

Court of Chancery Rule 41 42

Pursuant to the Court's letter of December 22, 2010 (the "Letter"), NightHawk Radiology Holdings, Inc. ("NightHawk" or the "Company") and its Board of Directors (the "Board" and collectively with NightHawk the "NightHawk Defendants") respectfully submit this response to the questions raised by the Court in the Letter as well as in the December 17, 2010 status conference.

INTRODUCTION

We expressly answer the Court's questions at pages 25 through 50. In addition, we are filing herewith the Declaration of Professor Geoffrey Hazard, also addressing the issues raised by the Court. Prior to addressing the specific questions raised in the Letter, however, we thought it might be useful to set forth a few overarching thoughts.

This Court has identified a systemic problem occurring far too frequently. A merger is announced and within days (or even hours) after the announcement multiple lawsuits are filed in multiple jurisdictions by plaintiffs' counsel making essentially the same allegations challenging the deal price and process. In response, and regardless of the merits of the allegations (or the lack thereof) the boards of both the target company and the acquirer look to settle the cases. A board's decision to settle is not based on the merits of the lawsuit but rather done for sound and legitimate business reasons: to eliminate even a small risk to the transaction as well as the cost and distraction inherent to any litigation, but which is particularly disruptive at a time when both the target company and bidder are focused upon how best to consummate and implement the proposed transaction. Frequently the decision to settle is made despite the strong belief of the board and its counsel that the company would prevail in any litigation. In these circumstances settlement may be less expensive than litigating the case, while also resolving the business issues identified above. As a result, company counsel is often instructed by its client to

obtain a global settlement to all the litigations challenging the merger without changing the structure or terms of the deal.

That was precisely the issue here. In this case all defendants and their counsel consistently believed that the case lacked any merit. As we set forth at the October 21, 2010 hearing on plaintiffs' Motion for Expedited Proceedings, the NightHawk Defendants believed there was no merit to plaintiffs' disclosure claims. Although at this hearing the Court stated that the case raised "interesting" questions about the process employed by the Board during the negotiations, as the facts detailed below indicate, the NightHawk Defendants believed at the time and remain convinced today that the Board fully satisfied its obligations to act in a reasonable manner to achieve the best price reasonably obtainable. Simply put, all of the defendants and all of the defendants' counsel believed at the time, and continue to believe, that all defendants would prevail in this case if it proceeded, whether to a preliminary injunction or in subsequent motion practice to dismiss the case. Yet despite this confidence in the merits of the case, a decision was made to attempt to settle this litigation to satisfy both the broader business goals of eliminating even the small theoretical risk to the transaction while also ending the cost and distraction caused by multiple pending lawsuits in multiple courts throughout the country.

As a result, it was counsel's obligation, on its clients' behalf, to pursue settlement, on the best terms possible, consistent with the clients' wishes and counsels' ethical obligations. At the same time, it was the responsibility of plaintiffs' counsel to advocate for their clients, and in particular to attempt to stop the transaction if plaintiffs believed the process (or other) claims were valid or that a settlement was not in their clients' best interest.

For this reason we believe that there was no "collusion" here. To the contrary, the settlement was negotiated at arms-length; plaintiffs' counsel in both Arizona and Delaware were

invited to participate in these negotiations, and in fact plaintiffs' counsel in both Delaware and Arizona did participate in these negotiations. Delaware plaintiffs' counsel approved the proposed settlement, signed on to the Memorandum of Understanding ("MOU") and has the right to participate in confirmatory discovery. It was also always understood that the terms of the proposed settlement would have to be fully disclosed to both this Court and the Arizona Superior Court, and in fact this Court was the first court informed that a settlement in principle had been reached, just as it had previously been informed that plaintiffs' counsel in this case was coordinating its efforts with counsel for the Arizona plaintiffs. Certainly there was no consideration for the settlement – express or implied – other than what was set forth in the MOU, and there was no discussion, consideration or understanding about any matters other than these suits. Nor did defendants either seek to "freeze out" the plaintiffs with the stronger claims or litigate against a plaintiffs' counsel less able to litigate the case, while nothing prevented the Delaware plaintiffs' counsel from bringing a motion before this Court if they believed that their interests (or the interests of their clients) were not being served by a settlement in Arizona.

Similarly, we believe that the selection of Arizona as the forum to present the settlement was proper; it was certainly not an inappropriate forum under the circumstances. Most of the cases were filed in Arizona – including the first six filed cases – and there were multiple pending motions to expedite in Arizona, but not in Delaware (where expedition had been denied, and plaintiff had not brought any further claims). Further Arizona, like many jurisdictions, believes that first-filed cases should be given some deference. Perhaps even more significant, the most efficient way to get a global settlement was to settle in Arizona because counsel for the Arizona plaintiffs were unwilling to transfer all of their cases to Delaware while the Delaware plaintiffs' counsel was willing to agree to a settlement in Arizona. Thus, agreeing

on a forum in this litigation was not collusion; it was both legally proper under the circumstances and the only one in which all of the plaintiffs would proceed.

We submit that the procedures followed in this case were fully consistent with our obligation to our clients and the respective courts. Furthermore, in the course of seeking approval, the parties would necessarily address both the disclosure issues and the alleged process claims. Thus while the existence of multi-jurisdiction litigation attacking every merger and acquisition transaction is a serious policy issue to be addressed, the conduct of defense counsel in this case was entirely proper and consistent with both well established practice and the highest ethical standards.

This memorandum has three parts. Part I provides a detailed recitation of the facts underlying the merger, including the Board process that led to its decision to enter into the Agreement and Plan of Merger dated as of September 26, 2010 (the "Merger Agreement") between NightHawk and Virtual Radiologic Corporation ("vRad"). We include this section to respond to the Court's questions about the Board's decision-making process, and also inform the Court about why defense counsel believed that the process claims would not survive motion practice and could not support a claim for injunctive relief. Part II addresses the litigation, including the various filings and the proposed settlement. Part III discusses the broader issues regarding the problems created by multi-jurisdictional shareholder litigation in the merger and acquisition context, including the litigation and settlement of such litigation, and responds to the questions posed by the Court in its Letter.

I. FACTUAL BACKGROUND[1]

A. NightHawk and Its Board of Directors.

NightHawk provides high quality, cost-effective services to radiology groups and hospitals throughout the United States. NightHawk's team of U.S. board-certified, state-licensed and hospital-privileged physicians located in the United States, Australia and Switzerland provide 24 hour radiology services to approximately 27% of all hospitals in the United States. NightHawk's Board of Directors consists of five individuals, four of whom have no affiliation with NightHawk other than as directors of the Company and had no interest in the Merger other than in their capacities as shareholders of the Company. The five directors are as follows:

- *Jeff Terrill*, the former President and General Manager of CIGNA Health Care Arizona and former President and CEO of Scottsdale Healthcare's PHO, an affiliation of more than 500 primary care and multi-specialty physicians and hospitals;
- *Peter Chung*, a Managing Director of Summit Partners, a leading private equity and venture capital firm. Mr. Chung is also a director of Sea Bright Insurance Holdings, Inc., a provider of multi-jurisdictional workers compensation insurance, as well as a number of privately held companies;

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[1] The facts set forth below are taken primarily from NightHawk's Definitive Proxy Statement filed with the Securities and Exchange Commission (the "SEC") on November 23, 2010 (the "Proxy") in connection with the NighHawk-vRad merger (the "Merger"). The Proxy is attached to the Transmittal Affidavit of Ryan D. Stottmann in Support of the NightHawk Defendants' Memorandum in Response to the Court's December 22, 2010 Order (the "Stottmann Affidavit") at Exhibit ("Ex.") 1. The Court may take judicial notice of the contents of the Proxy. *See Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 604 n.41 (Del. 2010) (taking judicial notice of proxy statement for charter amendment); *Solomon v. Armstrong*, 747 A.2d 1098, 1121 n.72 (Del. Ch. 1999), *aff'd,* 746 A.2d 277 (Del. 2000) ("it is well settled that where certain facts are not specifically alleged (or in dispute) a Court may take judicial notice of facts publicly available in filings with the SEC"). Certain facts are taken from documents produced to plaintiffs in this litigation, and/or that will be demonstrated during confirmatory discovery.

- *David Brophy*, a professor of finance at the University of Michigan's Ross School of Business and the Director of the Office of Private Equity, who is an expert in valuation and private equity;
- *Charles Bland*, the former chief financial officer of a number of public companies including American Gaming Systems and Sirenza Microdevices. Mr. Bland also worked for 24 years in positions of increasing responsibility at Owens-Corning, leaving the company as President of Latin America/Africa operations; and
- *David Engert*, who is President and CEO of the Company.

B. The Merger Negotiations and Events Leading the Board to Accept vRad's Merger Proposal.

NightHawk and its Board had been engaged in a strategic process for more than a year to determine how to grow NightHawk's business. As part of this process, and as disclosed in the Company's Proxy, NightHawk's Board engaged Morgan Stanley in 2008 in an attempt to sell the Company. Proxy at 17. Morgan Stanley ultimately prepared offering materials, identified 10 potential buyers, and contacted all 10 of these potential buyers; not a single one of these parties made an offer to acquire the Company or even expressed serious interest in acquiring the Company. *Id.*

While the Company operated as a standalone business in 2009, it also continued to explore various strategic options to expand its business. Among the options considered was a potential merger with vRad, a competitor providing a similar type of national radiology solution to hospitals and other medical services providers. vRad was facing similar issues as NightHawk, and in December 2009 had begun its own process to try and sell or grow the company, which led to it contacting multiple bidders and ultimately being acquired by investment funds affiliated with Providence Equity Partners ("Providence"). *Id.* at 18. As part of this process, during the

first half of 2010 vRad approached NightHawk to see if it would be interested in acquiring vRad. *Id.* at 17. NightHawk and vRad entered into a non-disclosure agreement, and held discussions in April and May 2010 about a possible business combination, but NightHawk did not offer to acquire vRad. *Id.* at 17-18. On May 17, 2010, vRad announced that it had agreed to be acquired by Providence. *Id.* at 18.

1. NightHawk's Initial Contact with Providence And the Board's Rejection of Providence's First Request for an Exclusive Negotiating Period.

The day the vRad/Providence transaction was announced, NightHawk's Board held a special meeting to discuss vRad's proposed sale. Proxy at 18. At that meeting, the Board discussed the impact of the Providence/vRad transaction, and concluded that the transaction further evidenced that NightHawk needed to merge with another company to achieve the appropriate scale for its business. *Id.* At the same time, NightHawk also decided to terminate any discussions with vRad in light of its proposed sale. *Id.* On June 29, 2010, less than six weeks after Providence's announced acquisition of vRad, representatives of Providence had contacted NightHawk and made a non-binding proposal to acquire NightHawk for $7.00 per share.[2] *Id.*

[2] At the hearing on Plaintiffs' Motion for Expedited Proceedings, the Court noted that there were "CEO-led discussions . . . for a month before the [NightHawk] board got involved." *See* October 21, 2010 Telephonic Oral Argument On Plaintiffs' Motion For Expedited Proceedings And Rulings Of The Court ("Expedited Proceedings Hearing") Transcript ("Tr.") at 13. NightHawk's CEO had only one conversation with a Providence representative "a month before" the Board was involved, and in this conversation Mr. Engert made clear that if Providence wanted to proceed it should make an offer in writing that could be presented to the Board. Proxy at 18. Mr. Engert had a second conversation with Providence representatives on June 28, where he repeated this message, and Providence sent its letter the following day at which time the Board immediately became involved. *Id.* There were no negotiations or substantive discussions about a transaction with Providence prior to the Board's involvement.

In response to this proposal, the Board met three times in the six day period between June 30 and July 5, 2010. *Id.* at 18-19. The purpose of these meetings was, among other things, to retain an investment bank (the board considered Morgan Stanley as well as another bank, before eventually approving the retention of Morgan Stanley), and to discuss with counsel the Board's fiduciary duties with counsel in the context of Providence's proposal. *Id.* At the end of the July 5 meeting Morgan Stanley informed the Board that Providence had stated that it was willing to continue discussions on a possible $7.00 per share acquisition of NightHawk only if NightHawk entered into an exclusivity agreement with it. *Id.* at 19.

2. NightHawk Receives a Proposal from "Party A."

Events continued to develop quickly for NightHawk and its Board of Directors. On July 6, 2010 NightHawk received a potential acquisition proposal from a newly created entity formed by Chirinjeev Kathuria and Naiyer Imam (the "Kathuria/Imam Proposal"), two former principals of a company NightHawk acquired in 2005, before it went public. The Kathuria/Imam group was identified as "Party A" in NightHawk's Definitive Proxy. Proxy at 19. Messrs. Kathuria and Imam had no significant experience in mergers and acquisitions, did not have any funds committed to support an acquisition of NightHawk, and had no experience in raising the funds necessary to purchase NightHawk. In addition, the proposal was substantially inferior from a financial point of view to that being made by Providence. Specifically, in contrast to the $7.00 per share cash proposal by Providence, the Kathuria/Imam proposal was to acquire between 51% and 100% of NightHawk's equity for a proposed price of between $3.50 and $4.50 per share, which would include the alleged value of the "stub" equity of the NightHawk shares remaining outstanding. *Id.* at 19. The offer was also conditioned upon the buyer obtaining equity and debt financing for such transaction (*id.*), and anticipated that NightHawk would buy

two companies (including a stem cell therapy company unrelated to NightHawk's existing business) affiliated with Messrs. Kathuria and Imam.

The Board met with its financial and legal advisers on July 9, 2010 to consider the latest information from Providence as well as the Kathuria/Imam proposal. *Id.* During this meeting the Board discussed with its advisors the 2008 process which led to no offers for the Company being made, as well as the substantially lower price and conditional nature of Kathuria/Imam's proposal. *Id.* NightHawk's independent directors also excused management from a portion of this meeting so that these directors could discuss separately with just the Company's independent advisors the various proposals as well as the exclusivity being demanded by Providence. *Id.* Following this deliberation and discussion, the Board determined that it was unlikely that the Kathuria/Imam group would present a compelling price to NightHawk. *Id.* Nonetheless, the Board *did not agree* to enter into exclusivity with Providence; instead, the Board instructed Morgan Stanley to go back to Providence and demand a higher price if Providence wanted some type of exclusivity agreement. *Id.*

One day later, on July 10, 2010, the Board met telephonically with its advisors to hear Morgan Stanley's report of its discussions with Providence and to deliberate over how best to respond. *Id.* at 20. In the course of this meeting – the Board's fifth meeting in the less than two-week period since it had received Providence's original indication of interest – Morgan Stanley reported that Providence made clear that it would withdraw its proposal if NightHawk did not enter into an exclusivity agreement and that Providence was unwilling to raise its price. *Id.* At the same time, Providence indicated that it could complete its due diligence and be prepared to enter into a definitive agreement within 30 days. *Id.* The Board then had an extensive discussion with its advisers, including a review of its alternatives. Following this

discussion the Board authorized Morgan Stanley to tell Providence that it could complete its due diligence with a goal of providing a definitive proposal, including terms and financing. *Id.* At the same time, the Board again *did not* authorize the Company to enter into an exclusivity arrangement with Providence.[3] *Id.*

3. The Board Continues to Negotiate and Enters Into a 30 Day Exclusivity Agreement with vRad and Providence.

During the next two weeks the parties engaged in preliminary due diligence, and Providence closed its acquisition of vRad. Proxy at 20. On July 23, 2010 Providence sent a revised proposal to NightHawk. *Id.* This proposal: (1) reaffirmed a $7.00 per share offer price; (2) provided for a 30-day go-shop period after the signing of a definitive acquisition agreement; (3) provided that such transaction would not be subject to any financing contingency; (4) included a more extensive request for information about NightHawk; and (5) provided for an exclusive negotiation period with vRad. *Id.*

NightHawk's Board met on two separate occasions over the next four days to discuss the revised proposal while the Company's advisors continued to negotiate Providence's proposal in an effort to improve it in accordance with the Board's instructions. *Id.* at 20-21. As a result, on July 30, 2010, vRad sent NightHawk a revised non-binding letter of interest which: (1) reaffirmed a $7.00 per share offer price; (2) changed the post-signing 30-day go-shop period to include an additional 15-day period to continue discussions with parties with which

[3] At the October 21 Expedited Proceedings Hearing one of the issues noted by the Court was the Board's decision to grant "exclusivity at a time when there was already a second bidder . . . on the scene." Expedited Proceedings Hearing Tr. at 13. In fact, the Board did not immediately grant exclusivity to Providence, and the record demonstrates that the Board rejected many of Providence's requests for exclusivity including the requests in early July 2010.

NightHawk conducted discussions during the go-shop period, and a provision that if the merger agreement were terminated by NightHawk to enter into a superior acquisition proposal during the additional period, a lower termination fee would be payable; (3) included changes that increased the certainty of closing a potential transaction; (4) included provisions enhancing the Board's ability to satisfy its fiduciary obligations; and (5) provided that NightHawk would enter into exclusive negotiations with vRad for a period ending on August 25, which period would be automatically extended in one-week increments (but not more than twice) so long as vRad was working diligently and in good faith to complete its due diligence process and negotiate a definitive agreement. *Id.* at 21.

On August 1, 2010, the Board met yet again with its advisors, to discuss the revised letter of intent. *Id.* As part of this meeting Morgan Stanley presented a preliminary financial analysis with respect to the vRad offer. The Board discussed this financial analysis, as well as, among other things, the failure of NightHawk's 2008 sale process, the impact of Providence's acquisition of vRad (including but not limited to vRad's extensive effort to sell itself), the go-shop and other fiduciary protections being offered by Providence as part of any definitive agreement, the viability of any Kathuria/Imam proposal and vRad's repeated insistence on exclusivity as a condition to proceed. *Id.* Following this discussion, the Board determined that the potential benefits associated with pursuit of alternatives (including the possibility of seeking alternative offers) would be outweighed by the effect that such a process may have on vRad's offer and authorized management to enter into the non-binding letter of interest, including the binding exclusivity period. *Id.*

When the Board entered into this letter of intent the only other proposal it had received was Kathuria/Imam proposal, which was far more conditional than the vRad proposal,

materially inferior from a financial point of view and significantly less likely to be consummated than the vRad proposal. No other bidder had come forth despite NightHawk's extensive efforts over the prior two years to interest other buyers in a possible acquisition of the Company and despite the vRad transaction which had alerted market participants of consolidation in the industry.

4. The NightHawk-vRad Negotiations Continue and NightHawk Receives a Proposal from "Party B."

Between August 1 and September 1, 2010, vRad and NightHawk (and their respective advisors) continued negotiating a potential transaction, including engaging in due diligence and negotiating the terms of a potential merger agreement. Proxy at 21-23. NightHawk's Board received regular updates of the progress during this one-month period. Also, on August 16, NightHawk received an unsolicited initial inquiry from H.I.G. Capital ("HIGC"), who was identified as "Party B" in the Proxy. *Id.* at 21. Because NightHawk was in the middle of the exclusivity period with vRad it did not respond to HIGC's inquiry. *Id.*

On September 1 and 2, 2010, representatives of NightHawk, vRad and Providence continued to finalize the proposed terms of a transaction. *Id.* at 22-23. On September 2, Providence informed Morgan Stanley that it was prepared to proceed with a transaction at $6.00 per share, and asked for an extension of the exclusivity period through September 10 to finalize all of the documents, including the loan documents. *Id.* at 23. While NightHawk encouraged Providence and vRad to complete the various proposed documents, NightHawk informed Providence and vRad that NightHawk *would not* extend the exclusivity period.[4] *Id.*

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[4] At the hearing on Plaintiffs' Motion for Expedited Proceedings, the Court noted that "exclusivity [was] extended" after Party B [HIGC] "c[a]me on the scene." Expedited

(Continued . . .)

Over the next two weeks the parties' advisors continued to engage in negotiations to finalize the documentation for a transaction.[5] By September 15 the documents were in essentially final condition, and the Board met to consider the $6.00 per share offer. *Id.* Again the Board received a lengthy presentation from Morgan Stanley discussing the offer, the value of the Company and the available alternatives. Again the Board discussed with counsel its fiduciary obligations as it considered the offer. Again the Board discussed, among other things, the risks of remaining independent, the potential for alternative proposals, the value and prospects of the Company as a standalone business and the Company's prospects for the future. Following this discussion, the Board directed Morgan Stanley to inform vRad that the $6.00 per share price was not adequate and to increase the price if it wanted to acquire the Company. *Id.*

On September 20, NightHawk received a preliminary indication of interest from HIGC to acquire the Company for between $3.50 and $4.50 per share, subject to due diligence and other conditions. *Id.* On September 21, vRad and Providence increased their offer to $6.50 per share. *Id.* at 24. The Board met on September 22 and again on September 26 to consider its alternatives, including the revised vRad offer at $6.50 per share, the terms of the proposal (including the go-shop provision), the HIGC expression of interest, and the other alternatives available to the Company. *Id.* Morgan Stanley gave presentations at both meetings, including

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Proceedings Hearing Tr. at 13. Although Providence and vRad requested an extension of the exclusivity period on September 2, NightHawk did not agree to an extension.

[5] The Board determined not to reach out at this time to HIGC. The board's decision was based on a number of factors, including its belief following consultation with its financial advisers that HIGC was unlikely to offer a sufficiently compelling proposal from a financial point of view as well as the board's ability to check with HIGC post-signing, so that the Company could offer shareholders the certainty provided by the vRad proposal while still having an adequate opportunity to determine HIGC's interest.

advising the Board that the $6.50 price was fair to NightHawk's shareholders from a financial point of view. *Id.* The Board also discussed with its advisors the opportunity the "go-shop" provision in the proposed merger agreement offered NightHawk, and in particular the ability of NightHawk to follow up with HIGC in light of this provision, as well as comparing the benefits of having the $6.50 per share price "locked in" as the floor while the Board explored alternative transactions with the possible deterrent that a signed agreement with a break-up fee might have on other bidders. *Id.* Following these meetings, the Board determined to enter into the Merger Agreement with vRad. *Id.*

C. The Merger Agreement.

1. The Board's Decision to Enter into the Merger Agreement and Its Terms.

By the time the members of the Board (all but one of whom were independent directors with no affiliation or relationship with vRad or Providence or NightHawk after the Merger and whose only interest in the Merger was in their capacity as NightHawk equity holders) decided to enter into the Merger Agreement the Board had held 13 meetings over the course of five months to consider the possibility of merging with vRad. In addition, the Board had gone through an extensive auction process in 2008 run by Morgan Stanley, during which it had contacted 10 potential buyers. Proxy at 17. Thus the Board was well informed on the Company, its potential value as an acquisition target and the available alternatives in the market.

The Board was also well informed about the value of the Company and the benefits of the proposed merger. The Merger Agreement approved by the Board provided that NightHawk's stockholders would be paid $6.50 per share, a price which was more than a 100% premium to the Company's trading price the day before the announcement of the Merger and more than a 130% premium to the Company's trading price for the 90 days prior to the date of

the announcement. The price was also substantially higher than that offered on a conditional, preliminary basis by the other two possible bidders.

Significantly, the Merger Agreement also provided an opportunity for the Board to continue testing the market to determine if a higher offer could be achieved. Specifically, the Merger Agreement provided that for a 30 day period following signing the Company could actively "initiate, solicit and encourage Acquisition Proposals" from any other parties. *Id.* at A-29 (Merger Agreement § 5.10(A)). Once this first 30 day period expired, the Merger Agreement provided an additional 25 days to further negotiate with any party who made a bid during the go-shop period.[6] *Id.* at A-37 (Merger Agreement § 7.02(b)). Moreover, to ensure that no bidder was deterred from participating in this process, the Merger Agreement provided that any bidder who participated in the go-shop process would only have to pay a relatively small break-up fee equal to about 2.1% of the total deal value, and that this low break-up fee would apply to offers made during the second-stage of the go-shop process. *Id.*

2. The Go-Shop Process.

NightHawk actively solicited a number of parties during the go-shop period. As part of this process Morgan Stanley contacted 15 potential strategic buyers that it thought might be interested, and 8 potential private equity/financial buyers. Not a single one of these parties expressed a desire to see confidential materials, and several expressed surprise at the price paid

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[6] At the Motion for Expedited Proceedings Hearing, the Court noted that the exclusivity period entered into by the Board prior to its entering into the Merger Agreement was longer than the go-shop period. Expedited Proceedings Hearing Tr. 13:20-23. The exclusivity period and the first stage of the go-shop period were both 30 days; however the go-shop period could be extended for an additional 25 days while the exclusivity period could only be extended for 14 days (two one-week periods), and in fact was not extended at all.

in the Merger. No other bidder emerged during the go-shop process or at any time prior to the Merger.

3. The Interest of NightHawk's CEO in the vRad Merger.

One other issue raised by the Court during the Expedited Proceedings Hearing was the advisory agreement entered into by Mr. Engert, NightHawk's CEO, in connection with the transaction. *See* Expedited Proceedings Hearing Tr. at 14-15. As discussed in the hearing, Mr. Engert's only interest in the transaction was a short, six-month consulting agreement for which he was to be paid $60,000.00. Proxy at 34. Mr. Engert did not "roll over" any of his equity, nor did he retain his positions as CEO or a director. Rather, his short-term consulting agreement was just designed to ensure that Mr. Engert was available to assist in the transition period following the sale of the Company, and he was paid at a rate far below salary when he was CEO of NightHawk.[7]

4. The NightHawk-vRad Merger is Overwhelmingly Approved by NightHawk's Shareholders.

The NightHawk-vRad Merger was voted upon by NightHawk's stockholders on December 22, 2010. As set forth in NightHawk's 8-K filed with the SEC on December 22, 2010, of the 17,104,349 shares voted at that meeting 16,669,885 – 97.4% of those voting, or approximately 70% of NightHawk's outstanding shares – voted in favor of the Merger. Stottmann Affidavit Ex. 2 at Item 5.07.

[7] According to NightHawk's Proxy, Mr. Engert was paid $466,000.00 in salary and benefits alone from NightHawk for being CEO, and this did not include his equity benefits. Proxy at 35.

II. THE MERGER LITIGATIONS AND THEIR RESOLUTION

A. The Litigations.

The Merger was announced on September 27, 2010. The first complaint challenging the Merger was filed within 24 hours, on September 28. That complaint was filed in Arizona Superior Court for Maricopa County, where NightHawk has its principal place of business and all its executives are based. Over the next three days four more complaints were filed in the same Arizona state court. A sixth case was filed in Arizona on October 7, the same day that NightHawk first filed its preliminary proxy. That same day the first motion for expedited discovery was filed in Arizona.

The first (and only) Delaware case (but the seventh case overall) was filed on October 8, the day after NightHawk filed its preliminary proxy. A few days later the motion to expedite was filed in this Court, at the same time the Arizona plaintiffs moved to consolidate all cases, with Robbins Umeda LLP as proposed lead counsel.[8] In this stipulation defendants took no position as to who should be lead counsel.

Defendants' frustration with the multi-forum litigation was expressed early to all of plaintiffs' counsel. For example, on October 20, before any motions had been heard or any forum disputes had occurred, counsel for the NightHawk Defendants sent a letter to all plaintiffs' counsel in both Arizona and Delaware urging plaintiffs to "confer among yourselves and decide on one court in which this litigation will proceed[.]" Stottmann Affidavit Ex. 4. Counsel further noted that "while we think there may be good arguments for proceeding in one court rather than

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[8] Attached at Ex. 3 to the Stottmann Affidavit is a chart identifying all of the cases that were filed, the date filed and plaintiffs' counsel on each of the cases.

the other, our clients (and the other defendants) are willing to avoid that dispute in lieu of an agreement to proceed in only one forum." *Id.*

While none of the plaintiffs ever responded to defense counsel's letter, plaintiffs' counsel in both Arizona and Delaware were repeatedly urged to coordinate their efforts so that the parties did not have largely duplicative litigations in multiple forums.

B. The Motion to Expedite.

On October 21, 2010 this Court denied plaintiffs' motion to expedite. During the hearing the Court stated that "none of the disclosure claims . . . raised anything colorable when compared against the description of the banker's book" although it did note that the background section was "pretty breezy." Expedited Proceedings Hearing Tr. at 14, 23.

The Court also expressed its view that "the case presents interesting process issues about what the state of the go-shop is, particularly when you've given exclusivity early under the type of circumstances that happened here." *Id.* at 20. For the reasons summarized above, however, the Board had very understandable doubts about the ability of Party A (the Kathura/Imam group) to put together a serious bid, and the Board did not extend the exclusivity period after Party B's (HIGC's) offer.

The Court then denied plaintiffs' motion to expedite, ruling that the "case will proceed on a nonexpedited track." *Id.* at 25. While the Court recognized that plaintiffs retained the "ability to amend or to seek some type of other relief," the Court also noted that "obviously I'll take into account the fact that it would be a renewed application in terms of considering whether to expedite at some future date." *Id.*

C. Procedural Events Following the Court's Denial of Plaintiffs' Motion to Expedite.

Following this Court's denial of plaintiffs' motion to expedite, counsel for defendants continued to have discussions with plaintiffs' counsel in both Arizona and Delaware about the cases. As part of these discussions, we continued to urge plaintiffs' counsel in both Arizona and Delaware to coordinate their activities, so that the parties could litigate these claims in a single forum. At the same time, a new lawsuit was filed in Arizona federal court, while the state court plaintiffs in Arizona agreed to consolidate all of their cases and withdraw the motions for expedited discovery in return for the production of certain documents.[9] In the Delaware action the plaintiffs filed an amended complaint but chose not to seek expedited discovery in return for the same production of documents made to the plaintiffs in Arizona. This production included the final bankers' books provided to the Board as well as several sets of minutes from the NightHawk board of director meetings leading up to the board's decision to enter into the Merger Agreement.

By early November plaintiffs' counsel in Arizona and Delaware had agreed to coordinate their activities. On November 8, 2010 the Delaware plaintiffs submitted a letter to this Court, informing the Court that: (1) in light of the production of documents plaintiffs did not anticipate seeking expedited discovery; and (2) plaintiffs in the Delaware case had agreed with the plaintiffs in the Arizona actions to "share and coordinate discovery and efforts to litigate both cases." *See* Letter from Blake A. Bennett dated November 8, 2010 Transaction ID 34235433

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[9] The NightHawk Defendants filed an opposition to the first of plaintiffs' motions to expedite in Arizona (which was joined by vRad) prior to the withdrawal of both motions by plaintiffs. The opposition referred to this Court's ruling and attached a copy of the Judicial Action Form (but not the transcript) reflecting the Court's Order. NightHawk's opposition and vRad's joinder are attached to the Stottmann Affidavit at Exs. 5-6.

("Plaintiff would like to inform Your Honor that the parties have reached an agreement wherein Defendants have agreed to produce discovery related to Plaintiff's process claims concerning the Transaction. . . . Defendants have agreed to produce the same documents in the Arizona [a]ctions and this [a]ction, further plaintiffs in the Arizona [a]ctions and this [a]ction have agreed to share and coordinate discovery and efforts to litigate both cases."). This letter did not indicate whether the case would move forward in Delaware or Arizona, but did make clear that there would be a "coordinated" approach to the litigation by plaintiffs' counsel.

On November 10, 2010 counsel for the Arizona plaintiffs served a demand letter on the NightHawk Defendants (Stottmann Affidavit Ex. 7), and on November 16 counsel for the Delaware plaintiffs served a demand letter on Defendants. Stottmann Affidavit Ex. 8. The letters were largely similar and focused almost entirely on a disclosure-based settlement. Again, this was not surprising since we had made clear the following points:

- the NightHawk Defendants and vRad were willing to consider settling the case;[10]
- any settlement would have to be a global settlement, which would include a global release and resolve all of the litigations, including the litigation in Arizona federal court as well as the various state court actions;
- the NightHawk Defendants and vRad were unwilling to change any of the substantive terms of the merger agreement;[11]

[10] As any settlement would require the consent of vRad under the terms of the Merger Agreement, its counsel obviously was required to be involved in the decision as to whether or not to settle the case. vRad agreed to the idea of settling the litigation on these general terms presumably for the same reasons as the NightHawk Defendants: to avoid the costs and disruption inherent in any lawsuit and to eliminate even the smallest deal risk which also comes with any lawsuit regardless of its merit.

[11] Not surprisingly, vRad was unwilling to pay more money to NightHawk's stockholders or change any of the deal protection terms of the Merger Agreement, while the

(Continued . . .)

- the NightHawk Defendants and vRad were willing to consider supplemental disclosures as part of a settlement, although both the NightHawk Defendants and vRad believed that no additional disclosures were required by federal or state law; and
- ultimately Defendants agreed to not object to an award of attorneys' fees to plaintiffs' counsel in an amount to be negotiated after the terms of the settlement were negotiated, provided that such fee was within the range of what is by now considered "reasonable" by many courts (including this Court) in similar types of cases and settlements.

While counsel for the NightHawk defendants was the lead negotiator with plaintiffs in the settlement discussions, throughout the process counsel for vRad was closely involved in the strategy of achieving the mutual goal of a global settlement without changing the structure or terms of the deal. Further, all defense counsel, including Delaware counsel for both the NightHawk Defendants and vRad, found nothing objectionable about having the settlement approved in Arizona. Indeed, at no time did any counsel in the case ever raise or identify the issue of a settlement in Arizona as creating a potential ethical violation in any way. To the contrary, defense counsel agreed to a settlement in Arizona for a very simple reason: it was the most efficient way to achieve a global resolution of the litigations, since plaintiffs' counsel for the seven Arizona litigations was unwilling to have the settlement in Delaware, while plaintiffs' counsel in Delaware was willing to have the settlement proceed in Arizona.

(. . . CONTINUED)

NightHawk Defendants were unwilling to alter the terms in any way that made the deal less certain.

For a number of reasons this Court's ruling on plaintiffs' motion to expedite also had a very important practical impact on the settlement discussions. First, the Court's decision denying expedited discovery meant that the Delaware plaintiffs had lost a motion to expedite at a time when the Arizona plaintiffs still had multiple such motions pending in front of separate judges, and thus there remained a possibility of expedited proceedings in Arizona. Second, the Court's comments on plaintiffs' disclosure claims in Delaware did not impact the ability of the Arizona plaintiffs to proceed with different disclosure claims in Arizona and/or to seek an injunction on the basis of such claims. Third, although the Court had raised some questions about the process engaged in by the NightHawk Defendants, all of the defendants believed that plaintiffs would not succeed on a motion for preliminary injunction based on these process claims, and that defendants could defeat these claims in an appropriate motion, although such motion could not be resolved until after the deal closed.

The NightHawk Defendants produced additional documents, including Board minutes dating back to April 2010, and we continued to engage in settlement discussions during the final two weeks of November. The principal issues in dispute during these settlement discussions were the specific additional disclosures to be made by the NightHawk Defendants (as well as its investment bank) about the background to the Merger and the financial analysis leading to the fairness opinion issued by NightHawk's financial adviser. The choice of forum for the settlement was not a significant negotiation point from defense counsel's perspective; as for Plaintiffs, the Delaware plaintiffs did not push for the settlement to be heard in Delaware, but counsel for the Arizona plaintiffs were insistent that they take the lead in a settlement and that therefore the settlement should be in Arizona. Defendants also recognized that Arizona was a logical jurisdiction to settle the litigation because: (1) 7 of the 8 cases were pending in Arizona;

(2) the first-filed action was in Arizona; (3) the plaintiffs' counsel in Arizona had greater resources and ability to litigate the case than plaintiffs' counsel in Delaware; (4) NightHawk is based in Arizona; and (5) because the Delaware plaintiffs were willing to settle their litigation in Arizona while the Arizona plaintiffs were unwilling to settle in Delaware, a global settlement was more likely to be achieved in Arizona than in Delaware.

There was no collusion during these negotiations. Counsel for the NightHawk Defendants sought the best settlement they could obtain for their clients consistent with their ethical obligations. While NightHawk's counsel encouraged – and in fact insisted – that plaintiffs agree to a global settlement as part of any agreement, the idea of which court would oversee the settlement process only arose insofar as the Arizona plaintiffs were unwilling to transfer their cases to Delaware or allow the Delaware plaintiffs to take the lead in the settlement process, while the Delaware plaintiffs were willing to have the settlement process led by counsel for the Arizona plaintiffs. Defense counsel did not make any side deals or arrangements with counsel for the Arizona plaintiffs or anyone else as part of this settlement, and there was no understanding, agreement or discussion about how a settlement in this case would affect any other case.

Similarly, plaintiffs' counsel, both in Arizona and Delaware, negotiated on behalf of their clients. If the Delaware plaintiffs believed that the settlement was improper or inadequate, or that the litigation (or even the settlement) should go forward in Delaware rather than Arizona they had an easy remedy: seek appropriate relief from this Court, which of course had jurisdiction over this matter. Instead, the Delaware plaintiffs' counsel agreed to proceed in Arizona and sign the MOU.

There also can be no basis to claim that a settlement in Arizona was with the "weaker" of plaintiffs' counsel. To the contrary, plaintiffs' counsel in Arizona had greater resources to litigate the case and the Arizona plaintiffs had not lost a motion to expedite.

D. The Final Settlement Negotiations.

Extensive settlement discussions occurred between approximately November 16 and November 24, 2010. This timing was driven by the recognition that if there was a settlement any additional disclosures needed to be provided to the market in a timely fashion, as well as the understanding that if there was no settlement plaintiffs would need appropriate time to bring a possible motion for a preliminary injunction in advance of the anticipated mid-December shareholder vote. Counsel for all of the parties, including Delaware counsel for both plaintiffs and defendants, raised no objection about presenting the settlement to the Arizona court.

The focus of the settlement discussions was on the specific additional disclosures to be made in connection with the proxy being sent to NightHawk's shareholders. In this regard, while this Court had indicated its views that NightHawk's preliminary proxy had adequately disclosed the information the Delaware plaintiff had originally claimed to be omitted, counsel for the plaintiffs in both Arizona and Delaware identified new areas where each thought additional disclosures were required. *See, e.g.* Stottmann Affidavit Exs. 7-8. As defense counsel had expressed a willingness to enter into a disclosure-based settlement, several drafts over the scope of potential additional disclosures were exchanged.

On November 19, defense counsel conveyed to plaintiffs the final disclosures that became part of the settlement. Plaintiffs confirmed their acceptance of those disclosures on November 21. By November 24, after brief negotiations conducted via phone calls and some emails, the parties concluded their fee discussions. The fee discussions were brief because of the

extensive case law in this jurisdiction and elsewhere as to the generally appropriate fee award to plaintiffs for a disclosure-based settlement. Ultimately, defendants agreed to not contest a fee award to plaintiffs' counsel of up to $485,000.00. This amount included a payment to plaintiffs' counsel in both the Arizona and Delaware cases, as again it was a condition of the settlement (and MOU) that the Delaware action (as well as the Arizona federal action) be dismissed. Stottmann Affidavit Ex. 9 at ¶ 6(a).

On November 24, 2010 all of the parties, including counsel for the Delaware plaintiffs, entered into the MOU. On December 10, 2010 counsel for the plaintiffs informed this Court of the MOU and the proposed settlement. This Court issued its letter requesting a status conference on December 13, and the status conference was held on December 17. In light of Your Honor's comments no further action has been taken on the settlement; confirmatory discovery has not begun, and no papers seeking preliminary approval or otherwise moving the settlement forward in Arizona have been filed.[12]

III. THE BROADER POLICY ISSUES

In its Letter, this Court directed the parties to address a number of policy issues that arise in the settlement of multi-forum merger litigations. We agree that these are important questions that arise frequently, as mergers today are often greeted by shareholder lawsuits in the state in which the company is located (in both federal and state courts) and in the court of the

[12] In response to an order of the Arizona court, the parties filed a joint status conference statement with the Arizona court on January 28, 2011 informing the court of the proposed settlement and providing, among other things, a copy of the transcript from the December 17, 2010 hearing. The joint statement is attached hereto as Stottmann Affidavit Ex. 10. On February 9, 2011 the Arizona court issued an Order directing the parties to submit a Joint Pretrial Memorandum by February 28, 2011 and setting a Comprehensive Pretrial Conference for March 7, 2010. The Order is attached to the Stottmann Affidavit as Ex. 11.

state of incorporation (most frequently the Delaware Court of Chancery). These situations implicate the interests of courts (and legislatures) in multiple states, as well as the parties on all sides of merger lawsuits. Given these multiple interests, we question whether these issues can be properly determined by one case or even in one court; rather we believe these may be issues best addressed in a broader forum, such as by the Bar or with a possible legislative solution. At the same time, in response to the Court's questions we address below the specific questions posed by the Court in its letter dated December 22, 2010.

A. Counsel Defending Parallel Class Actions in Multiple Jurisdictions Have an Obligation to Consider the Best Forum Available to their Client in Compliance with the Rules of the Adversary System.

The Model Rules of Professional Conduct and the Delaware Rules of Professional Conduct provide that "[a] lawyer shall act with reasonable diligence . . . in representing a client." Model Rules of Prof'l Conduct ("M.R.P.C.") R. 1.3 (2009); Delaware Lawyer's Rules of Prof'l Conduct ("D.L.R.P.C.") R. 1.3 (2003). This obligation encompasses the duty to "act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf" (M.R.P.C. R. 1.3 cmt. 1), and to "zealously assert[] the client's position under the rules of the adversary system." D.L.R.P.C. pmbl. § 2; *see also* Geoffrey C. Hazard, Jr. & W. William Hodes, *The Law of Lawyering* § 5.3 (2d ed. 1994, Vol. 1) ("One of the single most fundamental principles of the law of lawyering is that so long as lawyers stay within the bounds of the law, they serve society best by zealously serving their clients, one at a time."). The Delaware Supreme Court has reiterated that lawyers "are obligated to represent the[ir] clients zealously *within* the bounds of both the positive law and the rules of ethics." *In re Abbott*, 925 A.2d 482, 487-88 (Del. 2007) (emphasis in original).

Counsel faced with duplicative and burdensome multi-jurisdictional litigation must seek an efficient and favorable resolution of such actions for the benefit of their client. *See Manual for Complex Litigation* § 20, at 217 (4th ed. 2004) ("Control over the proliferation of cases and coordination of multiple claims is crucial to effective management of complex litigation.").[13] As plaintiffs' counsel in competing actions often fail to agree to a cooperative and organized approach to representative actions, defense counsel must balance competing actions in multiple forums on a highly expedited basis.[14] This Court has acknowledged the duplication and waste imposed upon defendants by plaintiffs' counsel that are unwilling to coordinate multi-jurisdictional litigation and in fact often compete to take the lead in such actions. *Rosen v. Wind River Sys. Inc.*, 2009 WL 1856460, at *7 (Del. Ch. June 26, 2009) ("The Court also generally eschews decisions that would require parties, such as Defendants here, to litigate nearly identical actions simultaneously in two distant forums."). As noted recently by Chancellor Chandler "my empathies and sympathies are with the defense bar because they're the ones who are caught in the midst of these multi-forum litigations. They aren't there by choice. They simply have to deal with it." *In re Allion Healthcare S'holder Litig.*, C.A. No. 5022-CC, at 7 (Del. Ch. Jan. 19,

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[13] Achieving efficiency is made particularly difficult in light of the numerous representative actions that are filed in connection with virtually every merger and acquisition. *In re Compellent Techs., Inc. S'holder Litig.*, C.A. No. 6084-VCL, at 30 (Del. Ch. Jan. 13, 2011) (TRANSCRIPT) ("It's an unfortunate thing that [multi-forum litigations] happens. And it's certainly an unfortunate thing that this happens in case after case. So I really do think it's just a problem that we're all grappling with and trying to find a solution to and what the right mechanism is."); *see generally* Dionne Searcey & Ashby Jones, *First, the Merger; Then the Lawsuit*, The Wall Street Journal, Jan. 10, 2011 (noting that deal-related lawsuits jumped from 20 in 2007 to 216 (through October) in 2010); John Armour, Bernard Black and Brian Cheffins, *Is Delaware Losing Its Cases?*, Law Working Paper No. 151/2010, European Corporate Governance Institute (January 2011) (discussing the shift in the filing of corporate law cases involving Delaware corporations from the Delaware Court of Chancery to the federal court or the court of another state).

[14] *See* Part III.C.1 *infra* for a discussion of defense counsel's attempts to confine representative litigation to a single forum.

2011) (TRANSCRIPT); *see also Compellent*, C.A. No. 6084-VCL, at 34 ("I regret the fact that the defendants now face proceedings in two forums. But again, this is something that is driven by the dynamics of the entrepreneurial plaintiffs bar in class action situations, rather than by what is collectively rational for the system.").

Due to the burden and expense of litigating competing representative actions and defendants' interest in closing the challenged transaction, the prospect of settling such litigation is routinely considered. Indeed, in any litigation, an attorney has a responsibility to consider and discuss with her client the alternatives to litigation, such as a settlement. *Ethical Guidelines for Settlement Negotiations*, American Bar Association (August 2002), Section 3.1.1 (available at http://www.abanet.org/litigation/ethics/settlementnegotations.pdf) ("A lawyer should consider and should discuss with the client, promptly after retention in a dispute, and thereafter, possible alternatives to conventional litigation, including settlement.").

This Court has recognized the legitimate and rational motivations behind settling representative litigation. In *Masucci v. Fibernet Telecom Group*, this Court considered a motion for final approval of a proposed settlement, certification of the class, and an award of attorneys' fees and reimbursement of expenses. C.A. No. 4680-VCS (Del. Ch. Nov. 25, 2009) (TRANSCRIPT). The Court took the opportunity to remark upon the unfortunate proliferation of class action lawsuits filed in connection with virtually every transaction and noted that it's "perfectly rational, from the defense perspective" to settle even weak representative cases to achieve "deal certainty" and save the "cost of an injunction proceeding." *Id*. at 22-23.

In *In re Monogram Biosciences, Inc. Shareholders Litigation*, the Court again noted the propriety and rationality of settlement from the perspective of defense counsel:

> This type of litigation puts defendants in an awkward situation and actually puts investors as a class in an awkward situation, because of the potential toll it extracts. On the other hand, it's no particular answer for investors as a class, or defendants, to nihilistically run up even more costs than would be involved in resolving something like this. But it's a bit of a predicament.

C.A. No. 4703-CC, at 14-15 (Del. Ch. Jan. 26, 2010) (TRANSCRIPT).

Although an attorney is obligated to review alternatives to litigation, the decision regarding whether to settle a case must come from the client. *Ethical Guidelines for Settlement Negotiations*, Section 3.1.2 ("The decision whether to pursue settlement discussions belongs to the client. A lawyer should not initiate settlement discussions without authorization from the client."). Accordingly, in the event a client makes the decision to settle a representative action, that client's attorney has a responsibility to diligently pursue a settlement in the best interest of the client in accordance with the law and ethical rules. D.L.R.P.C. Rule 1.2 ("A lawyer shall abide by a client's decision whether to settle a matter."). The court in *Masucci* acknowledged this obligation, stating:

> The reality is, [defendants' counsel] are representing people who are doing a transaction, get it done, and who are being sued. The evidence is, frankly, to get rid of the case. *That's their job and that's their duty so long as they do it within the bounds of ethics*. And there's excellent counsel on the defense side who don't get close to any kind of ethical lines, then it's okay.

C.A. No. 4680-VCS, at 17 (emphasis added). Indeed, "[t]he purpose of settlement negotiations is to arrive at agreements satisfactory to those whom a lawyer represents and consistent with law and relevant rules of professional responsibility. During settlement negotiations and in concluding a settlement, *a lawyer is the client's representative and fiduciary, and should act in*

the client's best interest and in furtherance of the client's lawful goals." *Ethical Guidelines for Settlement Negotiations*, Section 2.1 (emphasis added).

In multi-jurisdictional litigation, diligently pursing the client's objectives includes entering into advantageous settlements in a particular forum, again, so long as doing so is consistent with law and ethical rules. *See Allion*, C.A. No. 5022-CC, at 10 ("I'm not going to fault defendants' counsel for settling a case in one jurisdiction. They settled it based upon what they thought was the reasonable value of these claims."). Indeed, a defendant's lawyer has a duty to present a settlement in whatever forum, legally available, is perceived as being the most advantageous for her client. In *Keeton v. Hustler Magazine, Inc.*, the United States Supreme Court permitted a libel suit to proceed against a nationally-distributed magazine in a forum state selected for its unusually long statute of limitations. *Keeton*, 465 U.S. 770 (1984). The Court accepted the forum-shopping strategy employed by the plaintiff, calling it "no different from the litigation strategy of countless plaintiffs who seek a forum with favorable substantive or procedural rules or sympathetic local populations." *Id.* at 779; *see also Goad v. Celotex Corp.*, 831 F.2d 508, 512 n.12 (4th Cir. 1987) ("There is nothing inherently evil about forum-shopping.").[15]

This approach is consistent with academic literature addressing so-called "forum-shopping." According to one academic commentator:

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[15] A Texas court recently held that "an attorney who is properly representing his client in a zealous fashion, if faced with a legitimate decision as to two forums in which his client's case might be heard, should to some extent prefer the forum that presents his client with the best chance of success." *In re Boehme*, 256 S.W.3d 878, 883, n.2 (Tex. App. 2008).

> [E]very lawyer thinks about the best forum before filing a case or before answering a complaint. If a lawyer did not at least explore the question of which forum is most advantageous for the client, his neglect might be considered malpractice and would certainly represent a failure to do something that the lawyer on the other side would have done, or will do at the first available opportunity. No statute, rule of procedure, or ethical prohibition bars forum shopping, and the existence of choices of venues under both state and federal laws, and the statutory right to remove certain cases to federal court, are policy statements approving at least some forum shopping.

Alan B. Morrison, *Removing Class Actions to Federal Court: A Better Way to Handle the Problem of Overlapping Class Actions*, 57 Stan. L. Rev. 1521, 1524 (2005); *see also* Debra Lyn Bassett, *The Forum Game*, 84 N.C. L. Rev. 333, 371-72 (2006) ("[S]o long as the forum shopping behavior comports with choices permitted under the law, such behavior should be supported – and is not subject to sanctions – because it falls within the legally permissible choices available to lawyers in furthering their clients' causes. . . . One of the most enduring canons of legal ethics – that a lawyer zealously represent her client within the bounds of the law – requires lawyers to seek the law most favorable to their clients' interests, that is, to forum shop."); Note, *Forum Shopping Reconsidered*, 103 Harv. L. Rev. 1677, 1690-91 (1990) ("'An advocate's duty is to represent a client zealously within the bounds of the law.' Under both the Model Code and the more recent *Model* Rules of Professional Conduct, a lawyer is obligated to engage in forum shopping when it will be useful to the client.").

On the other hand, the plaintiffs' counsel must fulfill their obligation as fiduciaries to the stockholder class in connection with the litigation, including in any settlement negotiation. "[I]t is well established that by asserting a representative role on behalf of a proposed class, representative plaintiffs and their counsel voluntarily accept a fiduciary

obligation towards members of the putative class. Such a fiduciary obligation exists even before the class has been certified." *In re M & F Worldwide Corp. S'holders Litig.*, 799 A.2d 1164, 1174 n.34 (Del. Ch. 2002) (citing *Manual for Complex Litigation* § 30 at 21-32 (3d ed. 1995)).

In *Monogram*, the court reminded plaintiff's counsel of their responsibilities in representative litigation and the independent monitoring role of the court in such actions. C.A. No. 4703-CC, at 15-16; *Louisiana Mun. Police Emps.' Ret. Sys. v. Pyott*, C.A. No. 5795-VCL, at 48-49 (Del. Ch. Jan. 21, 2011) (TRANSCRIPT) ("What I am hostile to, and on the watch for, is fiduciary shirking and fiduciary self-dealing. That applies to all fiduciaries . . . . It applies to plaintiffs' counsel and representative plaintiffs when acting as fiduciaries for the class. That is the traditional role of this Court, as a court of equity, to guard against fiduciary misbehavior."); *see also Masucci*, C.A. No. 4680-VCS, at 22-23 ("I don't have any permanent or durable solutions to this. It's not an easy thing to deal with. We want to incentivize plaintiffs' lawyers and we do. But I think the point is that the big rewards come in cases where there is genuine risk taken and there's a genuine accomplishment of an economic benefit for the class."); Pamela Tikellis, Practicing Law Institute, 18080PLI/Corp 381, *Under the Microscope – The Court of Chancery's Heightened Scrutiny of Settlements of Representative Suits* (May 6, 2010) ("Plaintiffs' counsel must remain cognizant of her obligation to investigate adequately and promptly the claims to be settled. The investigation may be conducted before, during or after negotiation of the settlement. In the case of confirmatory discovery, the Plaintiffs' adherence to the agreement in principle must be conditioned on the completion of an adequate investigation. The purpose of the investigation is to provide a basis for Plaintiffs' counsel and the Court to assess the strength of the claims to be released against the consideration provided by the settlement.").

B. What is a "Collusive Settlement" and is Forum Shopping to Achieve Such a Settlement Improper? (Question 1).

1. Definition of Collusion in The Class Action Settlement Context.

"Collusion" is defined as "[a]n agreement to defraud another or to do or obtain something forbidden by law." *Black's Law Dictionary* 281 (8th ed. 1999). "Collusion within the class action context essentially requires an agreement – actual or implicit – by which the defendants receive a 'cheaper' than arm's length settlement and the plaintiffs' attorneys receive in some form an above-market attorneys' fee." John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 Colum. L. Rev. 1343, 1367 (1995); *see also* Brian W. Warwick, *Class Action Settlement Collusion*, 22 Am. J. Trial Advoc. 605, 605 (Spring 1999) ("'Collusion' in the settlement of class action lawsuits refers to action taken by lawyers representing a class to the detriment of the class members, but for the benefit of the attorneys.").

The Delaware Supreme Court has defined a collusive settlement as one that is not negotiated at arm's length. *In re MCA, Inc. S'holder Litig.*, 785 A.2d 625, 637 (Del. 2001) ("[T]he Court of Chancery's holding that there was no collusion is the equivalent of saying that the parties negotiated the settlement at arm's length."); *see also Allion*, C.A. No. 5022-CC, at 9 (dismissing claims of a collusive settlement and finding that "the settlement negotiations were reasonable and conducted in good faith, at arm's length, and designed to get the best results for each side of the equation, for the defense side and for the plaintiffs' side."); *Polar Int'l Brokerage Corp. v. Reeve*, 187 F.R.D. 108, 118 (S.D.N.Y. 2000) (describing a collusive settlement as the product of a "non-arm's length" process).

Some courts have suggested that in the class action settlement context a reverse auction can suggest collusion. *See, e.g., Negrete v. Allianz Life Ins. Co. of North America*, 523

F.3d 1091, 1099 (9th Cir. 2008) (holding that collusion can be considered a reverse auction and noting that such a concept "has an odor of mendacity about it"); *Larson v. Sprint Nextel Corp.*, 2010 WL 234934, at *13 (D.N.J. Jan. 15, 2010) (defining reverse auction and noting that the "danger underlying a reverse auction is the potential for collusiveness"). A reverse auction is "the practice whereby the defendant in a series of class actions picks the most ineffectual class lawyers to negotiate a settlement with the hope that the district court will approve a weak settlement that will preclude other claims against the defendant." *Reynolds v. Beneficial Nat'l. Bank*, 288 F.3d 277, 282 (7th Cir. 2002).

Delaware courts have noted at least two types of situations that raise a suspicion of collusion or a reverse auction: (1) settling with a plaintiff that is at some procedural disadvantage or in a case that has not been actively litigated; and (2) settling a case without the participation of plaintiffs who were actively litigating a parallel action. In *De Angelis v. Salton/Maxim Housewares, Inc.*, the court considered whether to approve a proposed settlement arising out of litigation challenging the disclosures made in a prospectus marketing a stock offering. 641 A.2d 834, 836 (Del. Ch. 1993), *rev'd sub nom. Prezant v. De Angelis*, 636 A.2d 915, 918 (Del. 1994). The plaintiffs from a competing action in Illinois objected to the settlement arguing that it was grossly unfair and "that the process by which the settlement was reached was fatally tainted." *Id.* at 838. Seven class action suits alleging violations of the federal securities laws were brought in Illinois starting on November 29, 1991. *Id.* at 836. On January 6, 1992, Joseph De Angelis, brought a class action in District Court in Pennsylvania, but sought to voluntarily dismiss that action ostensibly to avoid being transferred to Illinois by the federal Judicial Panel for Multi-District Litigation. *Id.*

Then, on January 28, 1992, De Angelis brought suit in the Delaware Court of Chancery. *Id*. at 837. Within two weeks of filing the Delaware complaint and without seeking formal discovery, counsel for De Angelis began settlement negotiations and the parties in the Delaware action reached an agreement in principle to globally resolve the litigation. *Id*. The negotiation of the settlement allegedly took place after defendants reached an impasse with plaintiffs' counsel in the Illinois action regarding a settlement. *Id*. at 836. The court noted that there were several "disturbing" aspects of the settlement, including the fact that De Angelis had no valid explanation for why the Delaware action was brought when the Illinois action had been pending for two months, particularly when the claims were based on federal laws, and the fact that defendants did not seek to stay the Delaware action. *Id*. at 838. Although the trial court ultimately approved the settlement, the Supreme Court reversed the decision on the basis that the trial court did not make an explicit determination that De Angelis was an adequate class representative and remanded the action for further proceedings. *Prezant v. De Angelis*, 636 A.2d 915, 922 (Del. 1994). The Supreme Court noted its concern of "premature, inadequate, and perhaps collusive settlements," which the Court described as putting "plaintiffs' counsel . . . under strong pressure to conform to the defendants' wishes at the early stages of the litigation. This is so because a defendant may seek to negotiate with another class member in the event negotiations stall." *Id*. (citations omitted). Thus, in *Prezant*, suspicion of collusion was raised by settling a case that had not been actively litigated with a plaintiff that was at a procedural disadvantage. 636 A.2d at 918.

Similarly, in *In re Maxxam, Inc.*, the "settlement was achieved" in a "flawed manner" because it was negotiated without the participation (and over the objection) of a 14% stockholder that was "vigorously prosecuting its derivative claim against the defendants." 659

A.2d 760, 776 (Del. Ch. 1995). According to the court, the case had the "unmistakable footprint of an effort by the defendants to negotiate a settlement with an adversary that they preferred, in order to extinguish claims being pressed by the adversary whom they disfavored, and to relegate that disfavored adversary to the status of an objector to the settlement." *Id.*; *Stepak v. Tracinda Corp.*, 1989 WL 100884, at *6 (Del. Ch. Aug. 21, 1989) (noting "disdain that is pronounced and lingers" about settlement in later filed Delaware action where the complaint was not served for two years and was only served once plaintiffs in first-filed action moved for class certification in California); *Kahn v. Occidental Petroleum Corp.*, 1989 WL 79967, at *3 (Del. Ch. July 19, 1989) (noting concern where defendants approached plaintiff's attorney in a later-filed action and negotiated a settlement while ignoring and failing to advise counsel in the first-filed action about the settlement).

Nothing in any of these cases can compare with the facts of this situation. For example, in this case the settlement was reached through an arms-length process where the parties held extensive negotiations over the disclosures that formed the consideration for the settlement. Further, plaintiffs' attorneys' fees were consistent with that of other disclosure-based settlements. Additionally, there was absolutely no understanding or agreement, implicit or otherwise, involving defense counsel and plaintiffs' counsel in Arizona or Delaware, to provide some future benefit if the settlement was entered into in this case. Nor was there any effort by defense counsel to negotiate with the "weaker" or more "ineffectual" plaintiffs' counsel to obtain an easier settlement. Rather, the settlement process here was conducted at arms-length between defense counsel who believed there was no merit to plaintiffs' claims but was under instruction to settle the case, and plaintiffs' counsel who believed that a disclosure-based settlement provided greater benefits to the class than litigation on the process claims. With respect to the

forum for presenting the settlement, that too was not a collusive process; rather, it simply reflected the reality that Arizona was both an appropriate forum for settlement and the forum most likely to result in a global settlement.

2. Courts Have Been Cautious To Identify Collusion in the Class Action Settlement Context.

Due to the cooperation inherent in any negotiated settlement, Delaware courts and courts in other jurisdictions have been hesitant to definitively identify a settlement as collusive. As a general matter, courts have cautioned that "a collusive agreement requires more than mere confederacy: 'Any negotiated settlement involves cooperation, but not necessarily collusion. It becomes collusive in this context when it is aimed to injure the interests of an absent tortfeasor.'" *Copper Mountain, Inc. v. Poma of Am., Inc.*, 890 P.2d 100, 108 (Colo. 1995) (quoting *Stubbs v. Copper Mountain*, 862 P.2d 978, 984 (Colo. App. 1993)). This is consistent with the Delaware case law regarding collusion in the class action settlement context. In *Prezant*, *Occidental*, and *Tracinda*, the court noted its suspicion regarding collusion, but was careful to state that it could not find that there was collusion without direct proof. *See Prezant*, 636 A.2d at 920 (describing Court of Chancery's findings of "highly suspicious" circumstances and "deficiencies in the settlement process," but not finding "collusion" or wrongful conduct); *Occidental*, 1989 WL 79967, at *3 (noting the "spectre of a possible overreaching" that was worthy of heightened scrutiny of the settlement, but nothing more); *Tracinda*, 1989 WL 100884, at *6 ("While I would not say without a more thorough investigation that such conduct has in fact occurred here, I note the history of the prosecution of these matters seems consistent with that possibility.").

Many courts, including the Ninth and Tenth Circuits, have said that without direct proof the "reverse auction argument 'would lead to the conclusion that no settlement could ever occur in the circumstances of parallel or multiple class actions – none of the competing cases

could settle without being accused by another of participating in a collusive reverse auction.'" *Rutter & Wilbanks Corp. v. Shell Oil Co.*, 314 F.3d 1180, 1189 (10th Cir. 2002); *see also Negrete*, 523 F.3d at 1100 (quoting *Rutter*, 314 F.3d at 1189); *Int'l Union, United Auto., Aerospace, and Agr. Implement Workers of Amer. v. Gen. Motors Corp*., 497 F.3d 615, 627 (6th Cir. 2007) (same); *Vallier v. Am. Fid. Assur. Co.*, 2008 WL 4330028, at *4 (D. Kan. Sept. 16, 2008) (same). In fact, "most courts . . . require that to find collusion, a court must also find fraud." Edwin Lamberth, *Injustice By Process: A Look At And Proposals For The Problems And Abuses Of The Settlement Class Action*, 28 Cumb. L. Rev. 149, 159 (1997-1998) (citations omitted); *see also* Warwick, 22 Am. J. Trial Advoc. at 607 (noting the Black's Law Dictionary definition of collusion and stating: "Thus, when the word collusion is used to describe actions taken by attorneys in class action settlements, it should not be taken lightly.").

C. The Role of The Courts When it Receives Notice of a Collusive Settlement In A Representative Litigation. (Question 2).

Courts act as monitors to reduce the agency costs inherent in representative litigation. Courts have several tools available to ensure that multi-jurisdictional representative litigation is handled responsibly. The most effective of these are employed prospectively at the outset of litigation, but they are also available during the settlement approval process.

1. Judicial Coordination.

In order to eliminate the duplication and waste caused by multi-jurisdictional representative litigation, courts often determine, in a coordinated fashion, where the case should rightly proceed. Chancellor Chandler has endorsed this approach: "[T]hat's my preferred solution, if the judges of the different states would simply agree that they'll have some type of informal process whereby Delaware says, You go, or New York says, You go ahead and handle

the case, just in the interest of time and efficiency." *Allion*, C.A. No. 5022-CC, at 11; *see, e.g.*, *Rosen v. Wind River Sys., Inc.*, 2009 WL 1856460, at *7 (Del. Ch. June 26, 2009) ("I contacted Judge Steven Brick of the Alameda Superior Court, who is handling the Consolidated California Action, to discuss how best to proceed. Given these specific circumstances, both Judge Brick and I agreed that only one of our two courts should hear a preliminary injunction motion regarding the Proposed Transaction."). This Court has recently offered to contact judges presiding over parallel actions in other forums in order to avoid wasteful duplicative proceedings. *Pyott*, C.A. No. 5795-VCL, at 58-59; *Compellent*, C.A. No. 6084-VCL, at 29-30; *In re Burlington N. Santa Fe S'holder Litig.*, C.A. No. 5043-VCL, at 11 (Del. Ch. Dec. 15, 2009) (TRANSCRIPT) ("*Burlington I*").[16] Although judicial coordination is most effective at the outset of litigation, there is no reason why a similar tactic would not be available to determine the proper forum for the presentation of a proposed settlement, if courts were receptive to it.

In order to further their clients' interest in reducing the duplication and waste created by competing representative actions, defense counsel view judicial coordination as an efficient outcome and often encourages communication between courts by filing a so-called "One Forum Motion." *See In re RAE Sys., Inc. S'holders Litig.*, C.A. No. 5848-VCS (Del. Ch. Nov. 10, 2010) (TRANSCRIPT); *In re New Alliance Bancshares S'holders Litig.*, C.A. No. 5785-VCP (Del. Ch. Oct. 22, 2010) (TRANSCRIPT); *In re Wyeth S'holders Litig.*, C.A. No.

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[16] The lack of formal procedures for handling multi-district litigation in state courts should not discourage cooperation. *See, e.g.*, *Manual for Cooperation Between State and Federal Courts*, Introduction (1997) ("This manual seeks to promote cooperation between state and federal judges and courts and to suggest many practical ways of doing so. It contains examples of practical steps state and federal judges and courts can take to save resources through sharing or other means, to avoid scheduling or other conflicts that adversely affect court operations and the bar, and to plan programs and other services that benefit both judiciaries.").

4329-VCN (Del. Ch. Apr. 7, 2009) (TRANSCRIPT); *In re Burlington N. Santa Fe S'holder Litig.*, C.A. No. 5043-VCL, at 36 (Del. Ch. Oct. 28, 2010) (TRANSCRIPT) ("*Burlington II*").[17] More specifically, the defendants file simultaneous pleadings in both forums urging the courts to confer and agree in which forum the action will proceed. But despite laudable goals, One Forum Motions have met judicial resistance in Delaware. *See RAE Sys.*, C.A. No. 5848, at 33 ("It's been granted. It's just I haven't determined which jurisdiction. I don't have any authority to do it. . . . I grant the motion for peace on earth, to the extent Strine has the authority."); *New Alliance*, C.A. No. 5785, at 22 ("And then as Judge Blawie gets involved in the case . . . at that point, I'm certainly happy to speak to him or to call him or have him call me or those kinds of things, but it seems it might be a little bit premature at this point."); *Wyeth*, C.A. No. 4329, at 21 ("With respect to the one jurisdiction motion, my hands are fairly limited – or fairly well tied in terms of what I can do about it."); *but see Burlington II*, C.A. No. 5043-VCL, at 42-43, 59, 67.

2. Retaining Jurisdiction.

In the absence of judicial coordination, a court is still able to retain some control over a representative action, although this may also result in defendants having to litigate in multiple forums if more than court takes the same position. One way to ensure that representative cases are litigated under the supervision of a particular court is for that court to notify the parties that the court expects the action to be prosecuted in a particular forum. By expressing to counsel and to sister courts the expectation that the action will proceed in its own jurisdiction, the court effectively retains a role in the case. *See RAE*, C.A. No. 5848, at 26-27

[17] In this case, defense counsel also raised the issue of a single forum informally with plaintiffs in both Arizona and Delaware before any motions had been heard with any court. None of the plaintiffs' counsel agreed to a single forum at that time.

("And so sometimes what we are doing is we are having a little bit of a conversation, bi-coastal in some ways already, because we have good members of the California bar on the phone. But this transcript is a bit of a conversation with folks who aren't here."); *In re Zenith Nat'l Ins. Corp. S'holders Litig.*, C.A. No. 5296-VCL, at 19 (Del. Ch. Mar. 30, 2010) (TRANSCRIPT) (inviting plaintiffs' counsel prosecuting a parallel action in another jurisdiction to file appropriate papers with the Court to participate in discovery); *see also In re Topps Co. S'holders Litig.*, 924 A.2d 951, 953 (Del. Ch. 2007) (denying motion to dismiss or stay in favor of pending New York action; the "paramount interest is ensuring that the interests of the stockholders in the fair and consistent enforcement of their rights under the law governing the corporation are protected.").

A court can also directly and promptly invite and consider a motion for class certification. Under Court of Chancery Rule 23, class certification should be decided "[a]s soon as practicable after the commencement of an action brought as a class action." Ct. Ch. R. 23(c). The Delaware courts have ruminated about the benefits of prompt class certification motions. *See Compellent*, C.A. No. 6084-VCL, at 27 ("What I would like to do to avoid the plaintiffs' efforts having gone for naught in terms of the excellent submissions they gave me, so I would like to go ahead and address class certification."); *RAE*, C.A. No. 5848, at 26 ("[T]here is no reason why a motion for class certification couldn't be brought on, frankly, jointly by the parties here, and certify a class. It creates a situation. Could another court – would my California colleague certify a class in the face of an already certified class? I think probably not."); *Silverstein*, 1991 WL 12835, at *3 (encouraging prompt filing of motion for class certification and discussing need for class certification to avoid forum shopping between class representatives).

If the parties reach agreement in principle to resolve a case before the forum issue has been decided, both courts retain jurisdiction and are able to effectively monitor the case. The parties are forced to choose; they must present their settlement to one of the two courts for fairness review, approval, and final judgment. But both the forum where the settlement is presented ("Court 1") and the other forum ("Court 2") have the power to stop any settlement that it perceives to be collusive.

Court 1 can refuse to dismiss the action pending before it on the basis that the settlement was improperly effected. *See, e.g.*, *In re SS & C Techs., Inc. S'holders Litig.*, 911 A.2d 816 (Del. Ch. 2006) (rejecting proposed settlement as untimely presented and holding that settlement agreement was not fair and reasonable and that class counsel failed to demonstrate adequate representation to the class); *Chickering v. Giles*, 270 A.2d 373, 376 (Del. Ch. 1970) (refusing to approve settlement where parties had already taken actions to implement proposed settlement). Rule 23(e) is "intended to guard against surreptitious buy-outs of representative plaintiffs, leaving other class members without recourse." *Wied v. Valhi, Inc.*, 466 A.2d 9, 15 (Del. 1983). Court 1 "must be particularly careful in reviewing a proposed settlement that has the effect of barring claims of at least arguable merit that are not asserted in Delaware but are being asserted in another forum." *In re MCA, Inc. S'holders Litig.*, 1993 WL 43024, at *3 (Del. Ch. Feb. 16, 1993). "It is because of the potential risk that plaintiffs' attorneys and defendants will team up to further parochial interests at the expense of the class that the Rule 23(e) protocol" obligates Court 1 to "scrutiniz[e] settlements for indicia of collusion . . . including collusive fee settlements." *Weinberger v. Great N. Nekoosa Corp.*, 925 F.2d 518, 524 (1st Cir. 1991) (citations omitted). "[C]onsiderations stemming from structural concerns about potential collusion and reverse auctions in settlement class actions make it incumbent on the [reviewing]

court to give heightened scrutiny to the requirements of Rule 23 in order to protect absent class members." *In re M3 Power Razor Sys. Mktg. & Sales Practice Litig.*, 270 F.R.D. 45, 54 (D. Mass. 2010) (quotations omitted).

Court 2 also has an important role, because even if the parties choose to present the settlement to Court 1, they still must also resolve the matter pending before Court 2. Court 2 need not accept a voluntary dismissal if it deems the settlement unfair. A voluntary dismissal under Rule 41 "is explicitly made 'subject to the provisions of Rule 23(e)' so that this route is unavailable without court approval for the voluntary dismissal of an action filed as a class action, either by the plaintiff's unilateral action or by stipulation of the parties." 4 Alba Conte & Herbert B. Newberg, *Newberg on Class Actions* § 11:67, at 258 (2002) (footnotes omitted); *see generally Jaeger v. Muscat*, 221 A.2d 607, 608-09 (Del. Ch. 1966) (discussing intersection of Rules 41 and 23 and dismissing claim under Rule 41 without prejudice as to other stockholders); *Hutchison v. Bernard*, 220 A.2d 782, 784 (Del. Ch. 1965) (discussing court involvement in dismissal of representative actions "because to allow a dismissal in this situation without court control would make possible one of the very abuses sought to be controlled by the notice requirement of [Rule 23], *i.e.*, the buy-off of an objector without regard to the rights of the stockholders generally."). A putative class action is "assumed to be a class action for purposes of dismissal or compromise under 23(e) unless and until a contrary determination is made." Conte, *supra*, § 11:65, at 253.

But Court 2 is, of course, bound by principles of comity and federalism and the full faith and credit clause. Thus, a state court ordinarily does not entertain challenges to the fairness or adequacy of another state's judgments, including judgments enforcing or approving of class action settlements. *E.g.*, *Simmermon v. Dryvit Sys., Inc.*, 953 A.2d 478, 486-87 (N.J.

2008); *see also Hospitality Mgmt. Assocs., Inc., v. Shell Oil Co.*, 591 S.E.2d 611, 619 (S.C. 2007) (challenges to class action judgments rendered by Alabama and Tennessee state courts should be addressed in those courts, not by collateral review in South Carolina state court), *cert. denied*, 543 U.S. 916 (2004). State courts therefore often decline to engage in "collateral second-guessing" of the judgment of a sister state court because to do so would undermine the efficiency and efficacy of class actions. *Epstein v. MCA, Inc.*, 179 F.3d 641, 648 (9th Cir. 1999), *cert. denied*, 528 U.S. 1004 (1999).

Court 2, however, remains free, and indeed obligated, to reject the propriety of the settlement if it finds that the settlement was a collusive settlement or otherwise improper. *See* Restatement of the Law (Second) of Judgments § 42 cmt. f (1982) ("[A] judgment is not binding on the represented person where it is the product of collusion between the representative and the opposing party."). If Court 2 believes a settlement to be collusive, it may also find that absent class members were denied due process by Court 1. *See, e.g.*, Rhonda Wasserman, *Dueling Class Actions*, 80 B.U. L. Rev. 461, 494 (2000) ("Even if claims presented in dueling class actions are identical, absent class members may avoid the preclusive effect of a judgment entered in one such action if they were not afforded due process therein."). But a judge approving a settlement under Rule 23(e) – *i.e.* Court 1 – will have already made factual findings that class representation was adequate and, therefore, that it complied with due process. Courts differ on the degree to which they afford issue preclusive effect to these findings of a sister state court. *Id.* at 495-97; *compare In re "Agent Orange" Prod. Liab. Litig.*, 996 F.2d 1425, 1435-37 (2d Cir. 1993) (holding that plaintiffs who did not develop symptoms from Agent Orange until after the settlement of another class action were adequately represented by the first class) (*overruled on other grounds, Sygenta Crop Protection Inc. v. Henson*, 537 U.S. 28 (2002)) *and Gonzales v.*

Cassidy, 474 F.2d 67, 75 (5th Cir. 1973) (overturning prior finding of adequate representation) *with Brown v. Ticor Title Ins. Co.*, 982 F.2d 386, 390-91 (9th Cir. 1992) (declining to "second-guess a prior decision that counsel adequately represented a class" and requiring showing that prior representative "failed to prosecute or defend the action with due diligence and reasonable prudence," and also that "the opposing party was on notice of facts making that failure apparent") (citations omitted).

With respect to this case, the court has several options available to it to express its views. This is because this Court was notified first of the MOU, and confirmatory discovery has not occurred, notice to the prospective class has yet to be given and no settlement has been approved. While the Court has ample opportunity to express its views to the Arizona court, the evidence set forth above indicates that there is no basis for concluding that a collusive settlement occurred here.

D. How Can A Court Ensure that Information in One Forum is Provided to the Court in Another Forum? (Question 3).

Courts necessarily rely on the parties to provide a comprehensive and accurate record upon which to evaluate any proposed settlement in a representative action. *See Manual for Complex Litigation* § 13.14, at 173 (4th ed. 2004) ("The Judge must have information sufficient to consider the proposed settlement fully and fairly."); *id.* § 21.641, at 325 ("Counsel for the parties are the main court's source of information about the settlement."). Accordingly, "[c]ounsel owe a duty of candor to the court to disclose all information relevant to the fairness of the settlement." *Id.* § 21.641, at 324. This traditional duty is heightened in the context of presenting a class action settlement. *Hartsell v. Source Media*, 2003 WL 21245989, at *3 (N.D. Tex. Mar. 31, 2003). The ABA Section of Litigation has promulgated *Ethical Guidelines For Settlement Negotiations* under which it advises:

> When seeking court approval of a settlement agreement or describing in court matters relating to settlement, a lawyer shall not knowingly make a false statement of fact or law to the court, fail to correct a false statement of material fact or law previously made to the court by the lawyer, or fail to make disclosure to the court, if necessary as a remedial measure, when the lawyer knows criminal or fraudulent conduct related to the proceeding is implicated. Failure to make such disclosure is not excused by the lawyer's ethical duty otherwise to preserve the client's confidences.

Ethical Guidelines For Settlement Negotiations, Section 2.5.

Counsel here have fully complied with their duty of candor to this Court. Thus, this Court was specifically informed in connection with the Motion to Expedite Proceedings of the various cases in Arizona; was informed in November that plaintiffs' counsel in Arizona and Delaware had agreed to "coordinate" discovery; and was informed immediately upon the parties entering into the MOU. At no time did any counsel ever suggest or imply that a settlement would occur in this Court, nor did any counsel ever raise an objection to the settlement being presented to the Arizona court.

E. What Remedies are Available if the Court Determines that Counsel Engaged in a Collusive Settlement? (Question 4).

Any discussion of remedies must begin with what we believe to be the obvious point for this case: because no wrong was committed by any of Defendants or their counsel in this case, no remedy against any of them is appropriate. Indeed, as described above, the use of such terms as "collusion" in the circumstances present here is simply not justified by any reading of the factual situation that led to this MOU. Nonetheless, in the interest of completeness and of answering the Court's questions, we include this discussion of remedies that would be available in a case that did involve a collusive or wrongful settlement.

When functioning properly as described above, the system is self-policing. If a set of defendants agree to a collusive settlement and pay fees only to have failed to secure the

global peace sought by defendants in merger litigation because of a finding of collusion, defendants and their counsel will never allow the situation to recur. Similarly, the presence of a collusive settlement on a plaintiff firm's resume would cause severe reputational harm to the firm. Moreover, in multi-jurisdictional disputes, the loser of the "reverse auction" is always free to challenge the settlement – as occurred, for example, in *Prezant*.

For this reason, if counsel is found to have participated in a collusive settlement, the most obvious remedy available for the court is to simply reject the settlement. If the court determines additional sanctions are warranted, the court may utilize the formal attorney disciplinary process (if Delaware counsel negotiates or participates in the collusive settlement) and revocation of *pro hac vic*e admissions (if out-of-state counsel negotiates or participates in the settlement). The severity of these remedies must be understood. For example, Delaware courts have recognized that filing a matter with Delaware's Office of Disciplinary Counsel of the Supreme Court ("ODC") is a severe sanction. *See Villare v. Katz*, 2010 WL 2355306, at *6 (Del. Super. June 9, 2010) ("[T]he Court finds itself in the regrettable position of having to refer another opinion in this litigation to the Office of Disciplinary Counsel."); *Torres v. State*, 979 A.2d 1087, 1094 (Del. Super. 2009) ("However, other options are available to remedy even egregious misconduct, such as referring the matter to the Attorney General or the Office of Disciplinary Counsel.").[18] Similarly, the "[r]evocation of an attorney's *pro hac vice* admission is

[18] Although the trial court "has full power to employ the substantive and procedural remedies available to properly control the parties and counsel before it, and to ensure the fairness of the proceedings" (*Appeal of InfoTechnology, Inc.*, 582 A.2d 215, 221 (Del. 1990)), if the court envisions remedies that will extend outside any particular action the proper course of action is referral to the ODC. Indeed, the ODC is the arm of the Supreme Court "charged with evaluating, investigating, and, if warranted, prosecuting" potential violations of the Delaware Lawyers' Rules of Professional Conduct. *Office of Disciplinary Counsel – State of Delaware*, *available at* http://courts.delaware.gov/odc/index.htm (last visited Jan. 27, 2011). As such, the ODC

(Continued . . .)

a harsh sanction, perhaps one of the harshest" that a court can impose, and "is not a step to be taken lightly." *In re Rimsat, Ltd*., 229 B.R. 914, 922 (Bankr. N.D. Ind. 1998). In addition, revocation of an attorney's *pro hac vice* admission "sends a strong message which works a lasting hardship on an attorney's reputation." *Mruz v. Caring, Inc.*, 166 F. Supp. 2d 61, 70 (D.N.J. 2001).[19]

F. Application of the Foregoing Questions to the Facts of this Case. (Question 5).

The answers to the questions raised by the Court demonstrate that no sanctions are appropriate here. Specifically, the facts demonstrate that: (i) this was not a collusive settlement nor was there any "forum shopping" done to secure an advantageous settlement; (ii) this Court had—and has—adequate opportunity to participate in the settlement process; (iii) the parties have kept both this Court and the Arizona court fully informed about the litigations and the settlement; and (iv) there was nothing inappropriate about the settlement or the decision to present the settlement in Arizona. Accordingly, the proper response here is for the Court to explicitly recognize that the settlement here was the result of arm's-length negotiations and not the result of a collusive process, and to continue to monitor the proceedings as set forth in Section III. C above.

(. . . CONTINUED)
has established procedural protections and developed competency in the investigation and ultimately prosecution of lawyer misconduct. *See generally* Delaware Lawyers' Rules of Disciplinary Procedure.

[19] The revocation of an attorney's *pro hac vice* admission is a "much more extreme" sanction than other forms of attorney sanctions, because such revocation "affects not only [the attorney], but his clients as well," by "depriv[ing] his clients of their chosen attorney well after the initiation of the case." *Mruz v. Caring, Inc.*, 166 F. Supp. 2d 61, 70-71 (D.N.J. 2001). The *pro hac vice* Certification signed by out-of-state counsel provides that counsel "shall be bound by the Delaware Lawyers' Rules of Professional Conduct" and that counsel "has reviewed the Principles of Professionalism for Delaware Lawyers."

Three other points must be mentioned. First, the particular forum in which to seek approval generally does not raise an ethical issue, and the selection here of Arizona was not in any way improper. Many more cases were filed in Arizona than in Delaware – seven versus one. Further, NightHawk is based in Arizona, the first action was filed in Arizona, and the Arizona courts generally give deference to the first filed action. While it is obviously true that this Court had held one hearing in the litigation and the Arizona court had not yet held a hearing, that is not a basis under any precedent that we are aware of to require that all future litigation activity in the case, or the settlement, to occur here rather than in Arizona.

Most important, this was not a situation such as in *Prezant* where defendants were trying to avoid litigating against one set of plaintiffs or to obtain a settlement with the "weaker" plaintiffs. 636 A.2d at 920. In this matter, *all* plaintiffs' counsel were involved in the settlement negotiations, and *all* plaintiffs' counsel signed the MOU providing for the settlement to be presented to the Arizona court. If plaintiffs' counsel in Delaware felt that the MOU was improper or somehow disadvantageous to the class, they not only had the opportunity to object to the settlement, they could have easily chosen to not sign the MOU and instead seek appropriate relief in this Court.

For the same reason this case does not implicate any of the "reverse auction" scenarios described above. In all of those situations there are competing plaintiffs' counsel working with defendants' counsel to obtain a settlement that was contrary to the interests of the class and/or seeking to prevent plaintiffs with stronger claims from bringing those claims. Here, the settlement accurately reflects the relative merits of the case, and all plaintiffs' counsel were involved in achieving that settlement.

Finally, it bears repeating that the agreement on a forum for the settlement was not collusion between Arizona plaintiffs' counsel and counsel for the NightHawk Defendants; it was a point in the negotiations, eventually agreed to by all plaintiffs' counsel and all defense counsel (including Delaware counsel for all of the parties).

CONCLUSION

For the reasons set forth above, we believe defense counsel acted entirely appropriately throughout the litigation and settlement process.

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