IN THE COURT OF COMMON PLEAS OF PHILADELPHIA COUNTY
FIRST JUDICIAL DISTRICT OF PENNSYLVANIA
CIVIL TRIAL DIVISION

THE TREASURER OF THE STATE OF CONNECTICUT AS TRUSTEE FOR THE STATE OF CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS, ET AL., Derivatively on behalf of Keystone Venture V, L.P., Plaintiffs, v. BALLARD SPAHR ANDREWS & INGERSOLL LLP, Defendant.	DECEMBER TERM, 2003 NO. 01796 COMMERCE PROGRAM Control Nos.: 122501, 021771

ORDER AND MEMORANDUM

AND NOW this 2nd day of March, 2004, upon consideration of plaintiffs' unopposed Motion for Final Approval of Proposed Settlement, plaintiffs' unopposed Motion Seeking Reimbursement of Costs, Expenses, and Fees, the memoranda in support thereof, and all other matters of record, upon hearing the oral argument of counsel on March 2, 2004, and in accord with the Memorandum Opinion filed contemporaneous herewith, it is hereby

ORDERED and **DECREED** that said Motion for Final Approval and said Motion Seeking Reimbursement are **DENIED**, and it is further

ORDERED that defendant shall serve and file an Answer or other pleading responsive to plaintiff's Complaint within twenty (20) days of the date of entry of this Order.

BY THE COURT,

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GENE D. COHEN, J.

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MEMORANDUM OPINION

The parties have requested that the court approve a proposed settlement entered into between them (the "Proposed Settlement"). Plaintiffs[1] are certain public pension funds that are limited partners of Keystone Venture V, L.P. ("Keystone").[2] Defendant Ballard Spahr Andrews & Ingersoll, LLP ("Ballard") is the law firm that allegedly represented Keystone at the time that Kiernan Dale, the Acting Managing Director of

[1] The plaintiffs are: The Treasurer of the State of Connecticut as Trustee for the State of Connecticut Retirement Plans and Trust Funds, which allegedly invested approximately $27.5 million in Keystone; The Commonwealth of Pennsylvania State Employees' Retirement System, which allegedly invested approximately $25 million in Keystone; The City of Philadelphia Board of Pensions and Retirement, which allegedly invested approximately $15 million in Keystone; The Middlesex (Massachusetts) Retirement System; and The Melrose (Massachusetts) Retirement System. Plaintiffs hold a combined total of 71% of the partnership interests in Keystone.

Middlesex and Melrose purchased their partnership interests after the misappropriation and other misconduct complained of occurred, but before it was revealed to the Limited Partners or the public. As a result, Middlesex and Melrose have additional non-derivative claims against Ballard, which are the subject of a separate settlement agreement that is not before the court.

[2] Keystone, "which received contributed capital in excess of $100 million, was recently liquidated for approximately $5.5 million, less than 6 cents on the dollar." Plaintiffs' Memorandum of Law in Support of Motion For Final Approval of Proposed Settlement ("Plaintiffs' Memo"), p. 28.

Keystone, wrongfully diverted approximately $9-10 million of Keystone's funds (the "Misappropriation of the Keystone Funds") to certain entities connected with and/or controlled by Michael Liberty (collectively the "Liberty Entities").

I. The Procedural History of the Proposed Settlement.

This is the third action of which this court is aware that arises out of the Misappropriation of the Keystone Funds. The first action was commenced by Keystone filing with this court a Writ of Summons against Dale in February, 2002 (the "Dale Action"). At about the same time, Keystone commenced a second action with this court against Liberty and the Liberty Entities, also by Writ of Summons (the "Liberty Action").[3]

No Complaint was ever filed in the Dale Action, and the docket does not indicate whether any discovery was taken in that action. Keystone discontinued the Dale Action without prejudice in October, 2002, seven months after it was filed. The docket in the Liberty Action shows that some discovery was taken of Liberty's law firm in Maine.[4] However, Keystone never filed a Complaint in the Liberty Action either, and Keystone discontinued that action without prejudice in January, 2003, less than a year after its commencement.

Plaintiffs commenced this action on December 12, 2003, by filing a Complaint in which they assert derivative claims on behalf of Keystone against Ballard for legal malpractice and for breach of fiduciary duty. Plaintiffs allege that in the course of

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[3] Ballard served as counsel for Keystone with respect to the commencement of both the Dale Action and the Liberty Action. However, Ballard subsequently withdrew as counsel for Keystone and was replaced by Duane Morris LLP, which firm also represents plaintiffs in this action.

[4] Apparently, approximately 2/3 of the misappropriated Keystone funds flowed to the Liberty Entities through this law firm.

representing Keystone, Ballard became aware of the Misappropriation of Keystone Funds by Dale, but did not advise the other Managing Directors, John Regan and Peter Ligeti, to inform the Limited Partners of the Misappropriation prior to the call of additional capital from the Limited Partners. Plaintiffs further allege that Ballard assisted Regan and Ligeti in settling Keystone's claims against Liberty, even though the Limited Partners had not been informed of the settlement, and it was not in Keystone's favor. In addition, plaintiffs allege that Ballard failed to inform the Managing Directors of Keystone that the contribution of overvalued stock by one of the Liberty entities in exchange for a partnership interest in Keystone violated Keystone's Partnership Agreement.

Five days after commencing this action, plaintiffs filed an Unopposed Motion for Preliminary Approval of the Proposed Settlement. The Proposed Settlement is purportedly the result of certain pre-Complaint mediation that the parties undertook with a private alternative dispute resolution provider, Judicial Arbitration and Mediation Services, Inc. ("JAMS"). The parties do not claim to have taken any discovery in this action, but instead they claim that they undertook extensive discovery prior to the JAMS mediation.

As part of its due diligence in this matter, the court requested copies of the depositions of Ballard representatives taken in connection with the JAMS mediation. The parties informed the court that no such depositions were ever taken, although they claim to have interviewed three Ballard attorneys, as well as Regan, Ligeti, and a few other persons. *See* Plaintiffs' Memo, p. 14. The deposition of the records custodian for Liberty's Maine law firm, which was taken in connection with the Liberty Action, is the

only deposition that the parties produced to the court. However, that deposition did not add much of substance to the court's understanding of this case.

With the parties' permission, the court then questioned the JAMS mediator in person, in camera, and on the record as to what issues were before him. Both the mediator and the parties claim that the mediation was contentious and that the settlement negotiations were hard fought. *See* Plaintiffs' Memo, p. 15. However, due to the nature of the task delegated to the mediator, his focus was on this case alone, and his knowledge of the facts of this case was based upon only what the parties chose to present to him. His job was to facilitate settlement of the claims raised by the plaintiffs, and, in doing so, he was not necessarily concerned with how appropriate or advantageous the settlement was for each of the parties.[5] Instead, it is this court's job to determine whether the settlement is fair, reasonable, and beneficial to Keystone, its limited partners, and the public employees whose money was invested in Keystone and subsequently lost.

II. The Legal Standards to Be Applied to Settlement of a Derivative Action.

A derivative action "shall not be dismissed or compromised without the approval of the court." Pa. R. C. P. 1506(d). The court is responsible for determining whether the proposed settlement is "fair and reasonable" and "beneficial to" the corporation. *See* Shlensky v. Dorsey, 574 F.2d 131, 147-9 (3d Cir. 1978).[6] "The standards . . . of class

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[5] The court believes that the mediator fulfilled the duties given to him by the parties and does not believe that the proposed settlement reflects badly upon him.

[6] The Pennsylvania rule regarding derivative settlement is taken verbatim from the last sentence of the federal rule regarding derivative settlements. Pa. R. C. P. 1506, Explanatory Comment (1990). Therefore, to the extent that there is no Pennsylvania case law interpreting the Pennsylvania rule, the court will apply local federal courts' interpretations of the identical federal rule.

In addition, the court looks for guidance to those courts having the most experience with the settlement of derivative actions, namely courts sitting in the States of Delaware and New York.

suit settlements have . . . been applied, although perhaps with somewhat less rigor, in the settlement of shareholder derivative suits." *Id*.

> The criteria heretofore employed by the courts [in ruling on class action settlements] include evaluations of
> (1) the risks of establishing liability and damages,
> (2) the range of reasonableness of the settlement in light of the best possible recovery,
> (3) the range of reasonableness of the settlement in light of all the attendant risks of litigation,
> (4) the complexity, expense and likely duration of the litigation,
> (5) the stage of the proceedings and the amount of discovery completed,
> (6) the recommendations of competent counsel, and
> (7) the reaction of the class to the settlement.

Dauphin Deposit Bank & Trust Co. v. Hess, 556 Pa. 190, 194, 727 A.2d 1076, 1078 (1999). Furthermore, in such cases,

> the proponents have the burden of proving that (1) the settlement is not collusive, but was reached after arm's length negotiation; (2) the proponents are counsel experienced in similar cases; (3) there has been sufficient discovery to enable counsel to act intelligently; and (4) the number of object[or]s or their relative interest is small.

Krasner v. Dreyfus Corp., 500 F. Supp. 36, 41 (S.D.N.Y. 1980).

Litigation in this matter will no doubt be very complex, contentious, and protracted. Furthermore, counsel for both plaintiffs and Ballard strongly support the proposed settlement, and there have been no objections lodged by any of the other persons or entities holding partnership interests in Keystone. However, the court does not believe that the parties have satisfied their burden of proving that the proposed settlement is fair, reasonable, and beneficial to Keystone.

III. The Benefit of the Settlement to Keystone

The most important factor to consider is the net benefit of the Proposed Settlement to Keystone.

> It is generally assumed that recoveries in derivative actions belong to the corporation on whose behalf the suit was brought. . . . Since the corporation is the intended beneficiary of the suit, fairness of the settlement must in the first instance . . . be measured by the benefit or detriment [to the corporation.]

In re Pittsburgh and Lake Erie Railroad Securities and Antitrust Litigation, 543 F.2d 1058, 1069 (3d Cir. 1976).

"The adequacy of the recovery provided the corporation by the settlement must be considered in light of the best possible recovery, of the risks of establishing liability and proving damages in the event the case is not settled, and of the cost of prolonging the litigation." Shlensky v. Dorsey, 574 F.2d 131, 147 (3d Cir. 1978). Therefore, the plaintiffs' probability of succeeding on the merits of their claims must be analyzed thoroughly. *See* Bell Atlantic Corp. v. Bolger, 2 F.3d 1304, 1312 (3d Cir. 1993).

In this case, the Proposed Settlement fund is approximately $4.5 million, out of which plaintiffs' attorneys fees and other costs shall be paid, and in exchange for which the defendant will receive releases from the plaintiffs. Plaintiffs claim that the settlement amount is 46% of the actual damages Keystone suffered. *See* Plaintiffs' Memo, p. 25. However, it is quite possible that Keystone would be entitled to more than its actual damages given that Ballard, Dale, Liberty, Regan, Ligeti and possibly others, acting in concert, apparently caused the damages suffered by Keystone.[7]

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[7] The court also believes that a criminal complaint could have been brought against some, if not all, of the possible co-conspirators. Plaintiffs have represented to the court that Keystone's Advisory Board referred this matter to the United States Attorney's Office for the Eastern District of Pennsylvania and to the United States Securities and Exchange Commission. Plaintiffs' Memo, pp. 5-6

Given that the Misappropriation of Keystone Funds was orchestrated by the Active Managing Director, and apparently overlooked by the other Managing Directors, the court believes that the plaintiffs should also have requested that a receiver be appointed for Keystone, so that a thorough examination of Keystone's assets could be undertaken by a disinterested party. *See* Pa. R. Civ. P. 1533. Instead, Keystone's Advisory Board apparently hired a law firm (not Ballard) and an accounting firm "to conduct an independent internal investigation into [Keystone's] transactions and in particular, the investments involving or relating to Liberty." Plaintiffs' Memo, p. 3.

Under state tort law, a plaintiff may recover punitive damages on a successful claim for civil conspiracy. *See* Shared Communications Services of 1800-80 JFK Boulevard, Inc. v. Bell Atlantic Properties, Inc., 692 A.2d 570 (Pa. Super. 1997). Similarly, under federal law, a plaintiff may recover treble damages on a successful civil RICO claim. *See* 18 U.S.C.A. § 1964. However, in bringing their claims against each of the possible co-conspirators in piecemeal fashion, Keystone and the plaintiffs neglected to bring their conspiracy claims against all potentially responsible parties.[8]

Furthermore, the parties have failed to take such potentially greater claims into consideration in apprising the court of the fairness of the settlement, and they have failed to provide the court with estimates of the best possible recovery and the probability of recovery on such claims. *See* Krasner v. Dreyfus Corp., 500 F. Supp. 36, 44-5 (S.D.N.Y. 1980) (court declined to approve the proposed settlement of a derivative suit "without further evidence of the best possible recovery and the probable recovery.")

The court believes that there is the distinct possibility that Keystone could recover substantially more from Ballard and from the other potential defendants if plaintiffs asserted conspiracy claims against them all. Therefore, the court finds that the Proposed Settlement, in which Keystone and the plaintiffs agreed to release all such claims for a mere $4,499,640.00, is not in Keystone's best interest. *See, e.g.,* In re MAXXAM, Inc., 659 A.2d 760 (Del. Ch. 1995) (court refused to approve derivative settlement because court believed that plaintiffs could recover substantially more on additional claim not pressed by parties); Saylor v. Bastedo, 100 F.R.D. 44 (S.D. N.Y. 1983) (court refused to

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[8] Both parties agree that, if this litigation goes forward, Dale, Liberty, Regan, Ligeti, and others will have to be brought in as additional defendants. Plaintiffs' Memo, p. 23; Ballard's Memorandum of Law in Support of Motion to Approve Settlement, p. 8.

approve derivative settlement because it felt there was a significant "likelihood that plaintiffs could recover, on at least one of their claims, an amount substantially in excess of the settlement amount.")

IV. The Early Stage in the Proceedings at Which Settlement Occurred.

The court is also troubled by the fact that the proposed settlement is proffered prior to any formal discovery being taken in this action. The stage of the litigation at which settlement occurs is an important consideration in determining whether to approve settlement.

> On the one hand, settlement late in the day means only the costs of trial and appeal are saved. On the other hand, completed discovery means the parties are more likely to form an accurate, and thus more convergent, estimate of the likely outcome of the case and potential damages. Thus, post-discovery settlements are more likely to reflect the true value of the claim and be fair.

Bell Atlantic Corp. v. Bolger, 2 F.3d 1304, 1311-2 (3d Cir. 1993).

In this case, the court is unable to evaluate fully the adequacy of the proposed settlement because it was hatched in the shadows of private mediation and not in the full light of public court proceedings. The plaintiffs claim to have engaged in extensive document review, but the court does not believe that such limited, informal, investigation is any substitute for court sanctioned and supervised discovery. *See* Lewis v. Hirsch, 1994 WL 263551 (Del. Ch. Jun. 1, 1994) (The court concluded that "it is unable to evaluate the overall reasonableness of the proposed settlement at the present time because [plaintiff] has not shown that he adequately investigated [his] claims.") Therefore, the court finds that the parties have not sufficiently investigated the facts underlying their claims and defenses, and the court declines to approve the Proposed Settlement.

CONCLUSION

For all of the foregoing reasons, plaintiffs' unopposed Motion for Final Approval of the Proposed Settlement and plaintiffs' unopposed Motion Seeking Reimbursement of Costs, Expenses, and Fees are denied.

BY THE COURT,

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GENE D. COHEN, J.

Dated: March 2, 2004