IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

MICHAEL DEPINTO, On Behalf of Himself and All Others Similarly Situated, Plaintiff, v. JOHN S. STAFFORD, III, BASSIL I. DAHIYAT, JONATHAN FLEMING, ATUL SARAN, HAROLD R. WERNER, BRUCE L.A. CARTER, CHARLES STEWART, DONALD C. FOSTER and XENCOR, INC., Defendants.	)	Consol. C.A. No. 10742-CB PUBLIC INSPECTION VERSION FILED: MARCH 15, 2017
IN RE XENCOR, INC.	)	

PLAINTIFF'S BRIEF IN SUPPORT OF SETTLEMENT AND PLAN OF ALLOCATION, AWARD OF ATTORNEYS' FEES AND EXPENSES AND PLAINTFF INCENTIVE AWARD

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NATURE AND STAGE OF PROCEEDINGS

This is the brief of Plaintiff Michael DePinto ("Plaintiff") in support of the proposed settlement of a class action challenging the 2013 recapitalization ("Recapitalization") of Xencor, Inc. ("Xencor" or the "Company"). Subject to this Court's approval, the settlement provides for a $2.375 million payment (the "Settlement") for the benefit of a class of former minority holders of Series A through E preferred stock of Xencor whose equity position was diluted in the Recapitalization (the "Class").

The Settlement follows two years of litigation that began in 2014 with a contested § 220 action, followed by this plenary action filed in March 2015. The litigation was hard fought and included (1) a § 205 counterclaim filed by Xencor to secure judicial ratification of numerous defective corporate actions taken in connection with the Recapitalization; (2) a partial settlement of the § 205 claim in 2015; (3) extensive document production from the defendants and nine third parties; (4) a contested class certification motion; (5) 11 depositions including Plaintiff's, seven of Xencor's eight directors, two third parties and Xencor's chief financial officer; (6) expert consultation; and (7) a Rule 174 mediation before Vice Chancellor Joseph R. Slights III on September 27, 2016.

The terms of the Settlement are set forth in the Stipulation and Agreement of Compromise, Settlement, and Release (the "Stipulation of Settlement") filed on November 21, 2016. (Trans. ID 59860299)

On November 28, 2016, the Court entered a Scheduling Order providing for notice of the Settlement to be mailed to Class members and setting a settlement hearing for Tuesday, April 4, 2017, at 10:00 a.m. (Trans. ID 59880873)

Notice of the Settlement has been disseminated and Plaintiff now seeks final approval of the Settlement and a plan for allocating the net settlement proceeds among Class members (the "Plan of Allocation"). In addition, counsel for the Class seek reimbursement of $126,901.51 for case expenses incurred after this Court's approval of the partial settlement of the § 205 claim on December 10, 2015. Plaintiff also seeks an attorney fee award of 20% of the balance of the Settlement fund ($449,619) (the "Fee Award"), together with approval of a $3,000 incentive award to Plaintiff to be paid from the Fee Award. The Fee Award represents less than half of the value of the time invested in this case after December 10, 2015, the date on which the Court approved the partial settlement.

The deadline for objections to the Settlement is March 22, 2017. To date, no objections have been received.

STATEMENT OF FACTS AND SUMMARY OF LITIGATION

A. Xencor's Capital Structure Before the Recapitalization

In June 2013, Xencor was a privately held clinical-stage biopharmaceutical company financed primarily through convertible preferred stock and convertible notes. The Company had outstanding 37,785,063 shares of preferred stock issued in five series (Series A, B, C, D and E) (together, the "Preferred Stock"), 224,319 shares of common stock, 3,861,024 common stock options, and approximately $15.1 million principal of convertible notes (the "Notes"). Most of the Preferred Stock and the Notes was owned by (1) defendant John S. Stafford, III ("Stafford"), and his family and affiliated entities (collectively, the "Stafford Holders") and (2) five other major investors: Novo Nordisk A/S ("Novo Nordisk"); MedImmune Ventures, Inc. and affiliated entities ("MedImmune"); Merlin Nexus II, LP and affiliated entities ("Merlin"); Oxford Biosciences Partners V, LP and affiliated entities ("Oxford"); and HealthCare Ventures VIII, LP and affiliated entities ("Healthcare Ventures," and together with the foregoing, the "Major Investors").

The Stafford Holders and four of the five Major Investors – Oxford, MedImmune, Healthcare Ventures and Novo Nordisk – had representatives on Xencor's board, giving them five of eight board seats.[1] Another significant

[1] Defendant Stafford represented the Stafford Holders. Defendants Donald C. Foster ("Foster"), Atul Saran ("Saran"), Harold R. Werner ("Werner") and

investor, Novon III, LP ("Novon"), was represented on the board by Defendant Charles Stewart ("Stewart"). In addition, the Company's President and CEO, Defendant Bassil I. Dahiyat ("Dahiyat"), was a director. The eighth director, Defendant Bruce L.A. Carter ("Carter"), was Xencor's only independent director.

The Stafford Holders and the Major Investors collectively owned approximately 88% of the Notes. While the Stafford Holders also owned Preferred Stock, their economic interests were heavily weighted towards the Notes.

B. The 2013 Recapitalization

1. The Reclassification of the Preferred Stock

In 2012 and early 2013, Xencor needed funding to reach certain clinical milestones for two of its products. The Company had searched for financing, including outside investment and borrowing, without success. The Company's Notes had matured and while the maturity date had been extended several times, discovery revealed that Stafford, who owned most of the Notes, was not willing to agree to another extension unless a financing plan, including outside investment, was developed. The board believed that to attract new investors, Xencor would have to simplify its complicated capital structure and pay off the Notes.

In response to this funding need, Xencor's directors, the Stafford Holders and the Major Investors approved a multi-part recapitalization of the Company.

Jonathan Fleming ("Fleming") represented Novo Nordisk, MedImmune, Healthcare Ventures and Oxford, respectively.

First, Xencor amended its charter (1) to increase its authorized common and preferred stock; (2) to create a new series of A-1 Preferred Stock (the "A-1 Stock") and A-2 Preferred Stock (the "A-2 Stock"); and (3) to reclassify each existing share of Series A through E Preferred Stock into a fraction of a share of A-1 Stock as follows: Series A (0.035 of a share of A-1 Stock); Series B (0.040); Series C (0.045) Series D (0.050); Series E (0.055)(the "Reclassification"). Xencor's 224,319 shares of common stock and its 3,861,024 common stock options were not reverse split in the Reclassification despite being inferior to the Series A-E Preferred Stock. As a result of this and the subsequent conversion of A-1 Stock into common stock discussed below, the amount of Xencor's equity represented by the common stock and common stock options (most of which were held by Dahiyat and other employees) increased as a result of the Recapitalization.

2. The Note Conversion

Next, pursuant to a Note Conversion Agreement dated June 13, 2013, Xencor's Notes were converted into A-1 Stock at a conversion price of $0.33, so that 3.03 shares of A-1 Stock were issued for each $1 of principal of the Notes (the "Note Conversion"). The conversion rate exceeded the rate specified in the conversion feature of the Notes.[2] While holders of Notes received 45,902,321

[2] For example, the Notes provided that in the event of a Qualified Financing, such as an initial public offering, outstanding principal and accrued interest on the Notes would automatically convert into common stock at a per share price equal to the

shares of A-1 Stock as a result of the Note Conversion, holders of Series A through E Preferred Stock were reclassified into 1,977,137 shares of A-1 Stock. Approximately $6.5 million of interest accrued on the Notes was waived.

Prior to the Reclassification and Note Conversion, the Stafford Holders and Major Investors collectively owned approximately 84% of Xencor's outstanding stock (including 79.2% of the Preferred Stock) and 92% of the outstanding Notes. After the Reclassification and the Note Conversion, the Stafford Holders and the Major Investors owned approximately 89% of Xencor's outstanding stock. The ownership of the minority holders of the Preferred Stock was reduced from approximately 16% to less than 1%.

3. The Series A-1 Financing

The final step of the Recapitalization was Xencor's sale of $10 million of A-1 Stock to its existing stockholders and certain new investors (the "Series A-1 Financing"). On June 26, 2013, Xencor sold 5,586,510 shares of A-1 Stock to the Stafford Holders and to three of the four Major Investors for $1.36 per share or $7,597,653.60 in the aggregate. The fourth Major Investor, Novo Nordisk, did not participate in the Series A-1 Financing and its equity position in Xencor was

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product of (i) the purchase price of the stock sold in the qualified financing multiplied by (ii) 0.70. Thus, had the Notes been outstanding when Xencor went public in December 2013, they would have converted at 70% of the $5.50 offering price, or $3.85, instead of the $0.33 used in the Recapitalization.

reduced by a reverse split of 3 for 1 as a result of refusing to "pay to play" in the Series A-1 Financing.[3]

4. Board and Stockholder Approval of the Recapitalization

The Stafford Holders, the Major Investors, and the directors approved the Recapitalization. Based on documentary evidence and testimony, it appears that Stafford set the conversion ratios for the Reclassification and the Note Conversion, and the other directors acquiesced. No special committee was appointed to review the Recapitalization, and no fairness opinion was secured. The minority preferred stockholders were not given the opportunity to vote on the Recapitalization. Xencor's directors approved the Recapitalization by unanimous written consent and the Stafford Holders and the Major Investors approved it by written stockholder consents.

C. The Notice to Stockholders of the Recapitalization

On July 18, 2013, Xencor notified its minority stockholders of the Recapitalization and gave them the opportunity to participate in the Series A-1 Financing (the "July 18, 2013 Notice and Offer"). Minority stockholders who were accredited investors were offered their pro-rata share of 1,766,430 shares of A-1 Stock at $1.36 per share. They were also given the opportunity to purchase

[3] Documentary evidence showed that Novo Nordisk's stated reason for not participating in the Series A-1 Financing was a change in its investment strategy. There was other evidence, however, that Novo Nordisk did not invest because it was skeptical of Xencor's ability to raise outside money.

additional shares of A-1 Stock to the extent that the Major Investors declined to participate on a pro rata basis.

D. Xencor's Initial Public Offering

In December 2013, Xencor effected a public offering of its common stock at $5.50 a share (the "IPO"). Xencor sold 14,639,500 shares, for total net proceeds of approximately $72.5 million.

Before the IPO, Xencor converted all of its outstanding A-1 and A-2 Preferred Stock into common stock. On November 1, 2013, Xencor amended its certificate of incorporation to effect a 3.1-for-1 reverse stock split of its common stock. Immediately after the IPO, on December 6, 2013, Xencor amended its certificate to delete the terms of the A-1 and A-2 Stock and to authorize Xencor to issue 200,000,000 shares of common stock and 10,000,000 shares of "blank check" preferred stock.

E. Summary of Litigation

On September 10, 2014, Plaintiff, a holder of shares of Series C and D Preferred Stock, made a books and records demand for documents relating to the Recapitalization. Plaintiff filed a § 220 action on November 26, 2014, after which Xencor agreed to produce documents responsive to the demand. After reviewing and analyzing these documents and other information, Plaintiff filed a Verified Class Action Complaint for Breach of Fiduciary Duties (Count I) and Invalidity of

Director and Stockholder Written Consents (Count II) on March 6, 2015 (the "Class Action Complaint"). The Class Action Complaint named as defendants Xencor's eight directors, Stafford, Dahiyat, Fleming, Saran, Werner, Carter, Stewart and Foster (collectively the "Director Defendants," and together with Xencor, the "Defendants").

On June 10, 2015, Xencor filed a verified petition for relief under 8 *Del. C.* § 205 seeking judicial ratification validating the corporate acts challenged in Count II of the Class Action Complaint. The Court directed Xencor to re-file its petition as a counterclaim in this action. Xencor filed its Verified Counterclaim on July 14, 2015 and Plaintiff filed an answer on August 3, 2015. In September 2015, the parties negotiated a settlement of the invalidity claims.

On October 5, 2015, the Parties filed a Stipulation of Partial Settlement (Trans. ID 57961783), pursuant to which Plaintiff consented to entry of an order ratifying the corporate acts challenged in Count II of the Class Action. The Court approved the partial settlement at a hearing on December 10, 2015 and entered an Order and Partial Final Judgment in accordance with the terms set forth in the Stipulation of Partial Settlement on December 14, 2015 (Trans. ID 58294434). The Court also approved an attorney fee award of $950,000.

The resolution of the invalidity claims did not address Plaintiff's fiduciary duty claims, which focused on the fairness of the economic terms of the

Recapitalization. Specifically, Plaintiff questioned the fairness of (a) the $75 million valuation placed on Xencor in the Recapitalization, and (b) the Preferred Stock and Notes conversion ratios. Plaintiff alleged that holders of Notes received a disproportionate amount of Xencor's post-Recapitalization equity.

Pursuant to a scheduling order entered on December 15, 2015 (Trans. ID 58300865), the parties engaged in extensive discovery throughout late-2015 and 2016. Several sets of written discovery were served and Plaintiff issued nine third party subpoenas. The defendants and third-parties produced over 25,000 documents. Plaintiff deposed ten witnesses including seven of the eight Director Defendants, Xencor's CFO, and representatives of two of Xencor's IPO underwriters. Defendants deposed Plaintiff.

On January 6, 2016, Plaintiff moved for certification of a class consisting of former minority holders of Xencor's Series A through E Preferred Stock. Defendants opposed certification and sought to exclude from the class those holders of Preferred Stock who also held Notes. Defendants argued that Plaintiff, who held only Preferred Stock, could not adequately represent class members who owned both Preferred Stock and Notes because of Plaintiff's claim that holders of Notes received a disproportionately greater amount of Xencor's equity in the Recapitalization. For the same reason, Defendants argued that Plaintiff's claims were not typical.

After briefing and argument, on June 21, 2016, this Court granted Plaintiff's class certification motion and, pursuant to Court of Chancery Rules 23(a) and 23(b)(1), certified a Class of all former holders of Series A through E preferred stock of Xencor whose shares were converted to A-1 Stock in Xencor's 2013 Recapitalization, excluding defendants and any person, firm, trust, corporation or other entity related to, or affiliated with, any defendant (Trans. ID 59171697). The Court also appointed Plaintiff as Class representative and Prickett, Jones & Elliott, P.A. and Kessler Topaz Meltzer & Check, LLP as counsel to the Class ("Class Counsel"). *Id.*

In rejecting Defendants' adequacy and typicality arguments, the Court stated that any differences in damages to Class members who held only Preferred Stock versus Class members who held both Preferred Stock and Notes could be addressed at a later stage of the litigation. June 21, 2016 Tr. at 27. (Trans. ID 59437381).

On July 19, 2016, the Court entered a Third Revised Stipulation and (Proposed) Order Governing Case Schedule that provided, among other things, for a four-day trial to commence on March 7, 2017 (Trans. ID 59295501).

On September 27, 2016, the parties and/or their representatives attended a voluntary Rule 174 mediation session before Vice Chancellor Joseph R. Slights III. At the end of the full-day session, the parties agreed to settle Plaintiff's fiduciary duty claims for $2.375 million. On November 21, 2106, the parties filed the Stipulation of Settlement.

ARGUMENT

I. THE SETTLEMENT SHOULD BE APPROVED AS FAIR, REASONABLE AND ADEQUATE

A. The Applicable Standard for Judicial Review of Settlements

In considering a proposed settlement, the Court considers "the nature of the claim, the possible defenses thereto, the legal and factual circumstances of the case," and then applies its own business judgment in deciding whether the settlement is reasonable. *Polk v. Good*, 507 A.2d 531, 535 (Del. 1986); *see also In re Tulia Inc. S'holder Litig.*, 129 A.3d 884, 890-91 (Del. Ch. 2016) (Court exercises its own judgment "to determine whether settlement is reasonable and intrinsically fair."). "The principal focus is upon the benefits provided in the settlement, in light of the nature of the claims and the likelihood of success on the merits." *Baupost Ltd. P'ship 1983 A-1 v. Providential Corp.*, 1993 WL 401866, at *2 (Del. Ch. Sept. 3, 1993). "The resulting judicial inquiry is most akin to range-of-reasonableness review…." *Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, 2013 WL 458373, at *2 (Del. Ch. Feb. 6, 2013).

B. The Settlement Provides a Significant Financial Benefit for the Class

The Settlement provides a $2.375 million recovery for the Class. After deducting any attorneys' fees and expenses, the fund will be distributed pursuant to an allocation plan that takes into account losses suffered from the dilution of the

Preferred Stock and the monetary benefit realized on the Note Conversion.[4] As explained in greater detail below, the Settlement represents a fair and reasonable recovery for the Class given the risks associated with pursuing the claims through trial and appeal.

C. The Difficulty, Delay and Uncertainty of Continuing the Litigation Justifies the Settlement

Plaintiff agreed to the Settlement based on an informed analysis of his claims, which included a review of over 25,000 documents, ten depositions, expert financial analysis and a day-long mediation.

1. Plaintiff Had Strong Process and Fair Dealing Claims

The Recapitalization would likely have been subject to entire fairness review because it was a controlling stockholder transaction effected without approval of independent directors and without approval of a majority of the minority of Xencor's preferred stockholders. *See Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014); *Kahn v. Tremont Corp.*, 694 A.2d 422, 428 (Del. 1997). The Stafford Holders and the Major Investors combined controlled 79% of the Preferred Stock and 88% of the Notes.[5] In addition, a majority of the directors

[4] Sixty-four of the 188 members in the Class held both Preferred Stock and Notes. After offsetting gains from the Note Conversion with losses on the Reclassification of Preferred Stock, 3 of the 64 had no net losses and, accordingly, will not receive any Settlement distribution.

[5] The Stafford Holders alone owned 28% of Xencor's Preferred Stock, 32% of its common stock and 58% of the Notes.

who approved the Recapitalization were "dual fiduciaries" because they owed fiduciary duties both to Xencor's minority stockholders and to the Major Investors whom they represented on Xencor's board. *See In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 46-47 (Del. Ch. 2013).

Plaintiff developed favorable documentary evidence and testimony on the process and fair dealing prong of the entire fairness standard. The Recapitalization was initiated, structured and approved by interested directors who had a financial incentive to maximize the conversion ratio for the Notes. Despite this conflict, no protective devices were used to safeguard the interests of the minority holders of Preferred Stock.

Discovery revealed that Stafford and, to a lesser extent, the director designees of MedImmune, Oxford, Healthcare Ventures, Novo Nordisk and Novon, presented the economic terms of the Recapitalization and Xencor accepted the terms they presented. In short, Stafford and directors following his lead unilaterally set the key economic terms of the Recapitalization, including (i) the $75 million valuation of Xencor; (ii) the $0.33 Note conversion price; and (iii) the conversion ratios for the Series A through E Preferred Stock.

While Plaintiff believes that the Recapitalization would have been subject to entire fairness review, Plaintiff recognized that the Defendants had factual and legal arguments supporting a more lenient review standard or, alternatively, burden shifting to Plaintiff. First, while Stafford and the Stafford Holders reaped most of the economic benefit from the Recapitalization, the other Major Investors and Novon suffered net losses because their respective holdings of Preferred Stock outweighed their respective positions as Note holders.[6] Thus, Defendants would have argued that the director designees with ties to the Major Investors and Novon were not conflicted and that the entities they represented did not receive any personal benefit from the Recapitalization.

Second, Defendants would have argued that entire fairness did not apply because, unlike other recapitalizations reviewed by this Court, Xencor's minority stockholders were given the opportunity to purchase shares of A-1 Stock at the same price paid by the Stafford Holders and the other Major Investors who bought in the Series A-1 Financing.[7] Defendants would have used this fact as evidence that, at least in terms of the Series A-1 Financing, they did not treat the minority differently from the Stafford Holders and the Major Investors.

Third, Defendants would have argued that there was no viable alternative to the Recapitalization. Xencor clearly needed money both in the short and long

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[6] Novo Nordisk did not purchase any A-1 Stock in the Series A-1 Financing and, pursuant to a "pay to play" provision, had its equity position reduced substantially. The other Major Investors held a substantial amount of the Notes but held a greater amount of Series E. Their economic interests were, accordingly, more heavily weighted toward the Series E than the Notes.

[7] *Compare In re Nine Sys. Corp. S'holder Litig.*, 2014 WL 4383127 (Del. Ch. Sept. 4, 2014) (only major investors allowed to participate in recapitalization).

term. Efforts to raise outside money had not succeeded. By early 2013, the only potential funding sources were the Stafford Holders and the Major Investors. Stafford was unwilling to put more money in unless Xencor's capital structure was simplified and made more appealing to outside investors. The Major Investors were reluctant to invest more money in the Company and Novo Nordisk refused to buy A-1 Stock. Without money from the Stafford Holders and the Major Investors, the Company likely would have been forced into a bankruptcy in which the Stafford Holders and the Major Investors, as the Company's largest creditors, could have acquired the Xencor's assets, leaving little or nothing for the holders of Preferred Stock, including members of the Class.

Fourth, the proximity of the June 2013 Recapitalization and Xencor's December 2013 IPO initially suggested that the Recapitalization had been timed to take advantage of the IPO. Discovery revealed, however, that a public offering was far from a sure thing at the time of the Recapitalization.

In sum, Defendants did have some arguments against application of entire fairness review. Even if these arguments were not persuasive enough to garner business judgment review or burden shifting, they likely would have influenced the Court's ultimate determination of entire fairness. As controllers, the Stafford Holders and the Major Investors did not have to engage in self-sacrifice.[8] While

[8] *In re Synthes Inc. S'holder Litig.*, 50 A.3d 1040, 141 (Del. Ch. 2012).

they were not free to impose an unfair transaction on the minority, the Company's financial condition, its inability to raise outside financing, and the financial detriment sustained by the Major Investors are factors that the Court would likely consider in assessing the fairness of the Director Defendants' conduct.

2. Plaintiff Had Proof Issues with Respect to Damages

Assuming that the Defendants were unable to show fair dealing, the Court would have to consider financial fairness and damages. There would have to be a showing of damages for the Class to obtain any monetary recovery.[9] To establish damages, Plaintiff would have to show that (a) Xencor was worth substantially more than the $75 million used in the Recapitalization and/or (b) the Notes were worth substantially less than their valuation in the Recapitalization. Both of these requirements were problematic.

a. Xencor's Valuation

At the time of the Recapitalization, Xencor was a clinical-stage biopharmaceutical company. Most of its value was for products that had not reached market. Those products had potential but that potential was speculative and could only be unlocked through substantial additional investment by Xencor.

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[9] A finding of unfair dealing does not, by itself, result in a damage award. As the Court recently stated in *In re Ezcorp Inc. Consulting Agreement Deriv. Litig.*, 2016 WL 301245, at *28 (Del. Ch. Jan. 25, 2016), "application of entire fairness is not outcome determinative and . . . defendants prevail under this standard of review with some degree of frequency."

Xencor did not have the cash or finished products that could generate the cash to fund completion of its "unfinished" products so it needed to raise money externally. As a result, traditional valuation methodologies like a discounted cash flow analysis and earnings multiples analysis would be difficult to perform to establish Xencor's valuation in this action.

Xencor valued itself at $75 million in the Recapitalization. Plaintiff's expert concluded that $75 million was within a range of reasonableness based on review of valuation-related documents produced by Defendants in the litigation.

Market evidence did not support a substantially higher valuation than $75 million. Plaintiff considered that the $10 million Series A-1 Financing at the $75 million Xencor valuation had a "pay-to-play" provision to induce participation by the Major Investors. Major Investors that did not participate in it had their existing shares of Series A-1 reverse split 3-for-1 into Series A-2 stock. If Xencor was worth far more than $75 million, it would be unnecessary to compel its largest investors to purchase additional equity. To the contrary, there was evidence that Major Investors did not want to further invest in Xencor but did so only because of the severity of the "pay to play" penalty. One of Xencor's largest investors, Novo Nordisk, still elected not to participate despite the consequences. Significantly, none of the Major Investors purchased more than its pro rata portion and the Series A-1 Financing was not fully subscribed by existing stockholders. Xencor had to find new investors to raise the full $10 million. These facts suggested that Xencor's existing investors, including the Major Investors, believed it was not worth substantially more than $75 million.

Xencor raised $70 million in an IPO at $5.50 per share several months after the $10 million Series A-1 Financing in 2013. The post-IPO implied value of Xencor was approximately $161.8 million ($5.50 x 29,422,576 shares outstanding after the IPO), which included the $70 million raised in the IPO. The pre-IPO implied value based on $5.50 was $91.8 million (i.e. $161.8 - $70), which included $10 million raised in the Series A-1 Financing. Thus, Plaintiff considered that the IPO implied Xencor was worth up to approximately $81.8 million at the time of Recapitalization. There were issues with this data point as well because the common stock sold in the IPO was marketable and liquid (*i.e.*, worth more than Series A-E Preferred Stock). Moreover, Defendants could argue Xencor's prospects were better in the IPO because its complicated capital structure had been flattened and the threat of default of the Notes eliminated, which made the common stock more valuable. Indeed, Plaintiff's expert stated that private placement valuations (as in the Recapitalization) would generally be expected to be 20-30% lower than an IPO valuation.

Based on this information and Plaintiff's expert's advice, Plaintiff assessed a low probability of establishing that Xencor was worth more than $75 million but still analyzed Class damages at a Xencor valuation range of $75 to $125 million.

b. The Note Valuation

The Recapitalization primarily addressed the allocation of Xencor's equity among existing equity and debt holders. Accordingly, any gain by the holders of Notes came at the expense of the stockholders. In the litigation, the lower the value ascribed to the Notes, the greater the value that should have been distributed to the Class in the Recapitalization.

In the Note Conversion, holders of Notes gave up approximately $21.58 million in principal and accrued interest in exchange for 95.87% of the A-1 Stock. The Notes were due on March 31, 2013 but Xencor did not have the funds to repay the Notes. Given that the holders of the Notes could have called the Notes and instead agreed to receive stock, Defendants would have argued that the Noteholders were entitled to a premium. The terms of the Notes provided that in a Qualified Financing (capital raise of $14 million), the Notes converted at 70% of the price of the financing. Plaintiff analyzed the value of the Notes at this rate ($21.58 million in principal and accrued interest ÷ 70% = $30.83 million), which was likely his best case scenario. Defendants would have argued that the Recapitalization was not a Qualified Financing and no one was willing to invest

$14 million in Xencor, as it struggled to raise $10 million in the Series A-1 Financing after the Note Conversion.

Based on this information and Plaintiff's expert's advice, Plaintiff assessed a low probability of the Court valuing the Notes at anything more favorable to the Class than $30.83 million but analyzed Class damages at a Note valuation range of $30.83 million to $21.53 million.

c. Stockholder Losses Offset by Noteholder Gains

Many Class members and most Major Investors held both Series A-E Preferred Stock and Notes. Plaintiff claimed the Preferred Stock was undervalued in the Recapitalization and the Notes were overvalued. Accordingly, there were complicated offsetting issues that Plaintiff would have address at trial. A Class member may have suffered a loss from receiving insufficient consideration for his Preferred Stock but also had a gain from receiving too much consideration for Notes. Thus, an individual Class member's loss would have to be offset by any gain from holding Notes, meaning total Class damages would be at least partially offset by gains from the Note Conversion. This further would have required a Class member by Class member calculation of damages.

d. Major Investors' Net Loss

When Plaintiff initially filed the action, he believed that the Major Investors and Stafford structured the Recapitalization to increase their equity stake in Xencor at the expense of the Class. Following discovery and in consultation with his expert, Plaintiff determined that Stafford and Dahiyat (discussed below) were the only Defendants to experience a net gain in their equity from the Recapitalization. MedImmune, Healthcare Ventures, Oxford, Novo Nordisk and Merlin all experienced a net loss because their economic interests were more heavily weighted to Series E than Notes. This undermined the theory that the Major Investors conspired with Stafford to execute the Recapitalization to benefit themselves to the detriment of the Class. The Defendants would have argued that the Major Investors' support of the Recapitalization under those circumstances is proof the Recapitalization was not financially unfair to the Class but rather was the best deal available for a Company in desperate need of capital to continue operating.

e. Common Stock and Common Stock Options

As explained above, Xencor's common stock (224,319) and common stock options (3,861,024) were not reverse split in the Recapitalization despite being inferior to the Series A-E Preferred Stock. The A-1 Stock was subsequently converted into common stock on a 1-for-1 basis. Accordingly, the common stock and options were the functional equivalent to the A-1 Stock in the Recapitalization. Xencor's CEO, defendant Dahiyat, did not own Preferred Stock or Notes and instead held common stock (37,684) and common stock options (1,841,585). The valuation of Xencor's common stock options was speculative and complicated. Moreover, while Dahiyat and other Xencor employees owned significant options, it is not uncommon for companies like Xencor to compensate employees with stock options. Plaintiff believed it unlikely the Court would rule that Xencor was required to wipe out in the Recapitalization the equity stake of the employees it depends on for success. Excluding or reducing the impact of the common stock and common stock options would have further reduced potential damages to the Class below the range of damages Plaintiff considered possible.

f. Damage Calculation

Based on the above and in consultation with an expert, Plaintiff estimated that Class damages could range from approximately $5.5 to $13 million. The Settlement represents a recovery of 18% to 43% of this range. This outcome is within the range of reasonableness given the risks associated with proceeding to trial.

D. The Mediation Supports the Settlement

The reasonableness of the Settlement is further supported by the parties' mediation efforts. Informed mediation before a respected mediator strongly suggests that a settlement is fair and reasonable. *Forsythe v. ESC Fund Mgmt. Co. (US), Inc.,* 2012 WL 1655538, at *3 (Del. Ch. May 9, 2012) ("Several significant factors suggest the reasonableness of the settlement and weigh in favor of approval. The parties negotiated at arm's length with the benefit of an experienced and respected mediator."). Through mediation, Vice Chancellor Slights received both sides' confidential mediation statements that contained frank discussion of the strengths and weaknesses of their respective positions. The Settlement is the result of that candid assessment.

II. THE PROPOSED PLAN OF ALLOCATION IS FAIR, REASONABLE AND ADEQUATE

A. Standards for Allocation of the Class Fund

Approval of a plan of allocation is part of the process of approving the settlement. *CME Grp., Inc. v. Chicago Bd. Options Exch., Inc.*, 2009 WL 1547510, at *7 (Del. Ch. June 3, 2009). "An allocation plan must be fair, reasonable and adequate," but it "does not need to compensate Class members equally to be acceptable." *Schultz v. Ginsburg*, 965 A.2d 661, 667 (Del. 2009). Thus, "[a] reasonable plan may consider the relative values of competing claims." *Id*. In determining whether to approve a plan of allocation, the Court gives substantial weight to counsel's opinion. *See CME Grp.*, 2009 WL 1547510, at *10 ("Class counsel, in the Court's judgment, came to a fair and reasonable balancing of the various interests of all class members.").

B. The Objective and Details of the Allocation Plan

The proposed Plan of Allocation is designed to distribute the Settlement fund equitably among Class members, taking into account (a) the number of shares of the Series A through E Preferred Stock owned by each Class member, and (b) the amount of Notes, if any, owned by each Class member. For Class members who owned both Preferred Stock and Notes, the Plan of Allocation offsets losses attributable to the Preferred Stock holdings with gains associated from the conversion of the Notes. This is consistent with Plaintiff's central allegation that the Notes were overvalued and in the Recapitalization.

The formula used in the Plan of Allocation is based on the following assumptions used by Class counsel:

i. Xencor's value was $75 million, which is the same value that was used in the Recapitalization;

ii. Xencor issued 47,879,602 shares of A-1 Stock, which is the number of shares issued in the Recapitalization;

iii. Xencor valued the Notes (including accrued interest) at a price of $0.70 (*i.e.*, [Principal + Interest] ÷ 0.70) instead of $0.33, which was the price the Notes (excluding interest) were valued at in the Recapitalization. This change results in holders of Notes receiving fewer shares of A-1 Stock than what they actually received in the Recapitalization; and

iv. Xencor used the same proportionate allocation of A-1 Stock among the Series A through E Preferred Stock, subject to adjustments made to the exchange ratios used in the Recapitalization to account for Class counsel's belief that holders of Notes should have received fewer and Class members should have received a greater number of shares of A-1 Stock in the Recapitalization.

Using the above assumptions, the Plan of Allocation allocates the Net Settlement Fund among Class members based on the following steps. First, a

"Stockholder Loss" is calculated for each Class member by determining the number of shares of A-1 Stock the Class member should have received in the Reclassification minus the number of shares of A-1 Stock the Class member actually received. Second, for those Class members who also owned Notes, a "Noteholder Gain" is calculated by determining the number of shares of A-1 Stock the Class member actually received from the conversion of the Class member's Notes minus the number of shares A-1 Stock the Class member should have received. Third, a "Net Loss" is calculated for those Class members whose Stockholder Loss exceeded their Noteholder Gain by subtracting the Class member's Noteholder Gain from the Class member's Stockholder Loss.[10] Class members who did not suffer any Net Loss (because their Noteholder Gain exceeded their Stockholder Loss such that they had a "Net Gain") will not receive any of the Settlement Fund. Fourth, a "Total Net Loss" is calculated using the sum of all Net Losses. Fifth, a Class member's "Net Loss Percentage" is calculated by dividing the Class member's Net Loss by the Total Net Loss of Class members that submit timely, valid and properly executed claim forms. The Fund will be

[10] Some Class members may have owned Notes in a different name but remained the actual owner or beneficial owner of the Notes. If Class counsel determines that a Class member was the actual owner or beneficial owner of Notes held in a different name, it will offset the Class member's Stockholder Loss by any Noteholder Gain of that investor.

distributed to Class members in an amount equal to the Class member's Net Loss Percentage times the Net Settlement Fund.

C. The Allocation Plan Is Fair and Reasonable

The Plan of Allocation is fair and reasonable. The Class is made up of holders of different series of Preferred Stock (with different rights and preferences) and members that held no or differing amounts of Notes. Plaintiff recognized that he needed to consider the unique nature of the Recapitalization and holdings of Class members so he could not simply allocate an equal pro rata portion of settlement proceeds like in a cash-out merger case.

Plaintiff sought to take these differences into account by using the same framework as the Recapitalization. The only substantive difference between the Recapitalization "model" and the Plan of Allocation "model" is that in the Plan of Allocation, the value of the Notes is reduced. This is because the overvaluation of the Notes is what Plaintiff alleged caused damages. Thus, the Plan of Allocation allocates proceeds among Class members based on the net difference between the number of shares of A-1 Stock Class members actually received in the Recapitalization and the number of shares Class members would have received in the Recapitalization if the Notes were valued at less. As a result

- Class members who held Notes will receive less of the settlement proceeds, which is fair because those Class members received the benefit of the overvaluation of the Notes in the Recapitalization.
- the Plan of Allocation, like the Recapitalization, uses different exchange ratios for the Series A through E Preferred Stock in calculating a Class member's Net Loss, which is fair because it takes into account the differences in rights and preferences of the different series of Preferred Stock.

This is the same methodology that Plaintiff intended to use to establish and quantify damages if the case had proceeded to trial.

III. THE REQUEST FOR ATTORNEYS' FEES AND EXPENSES SHOULD BE GRANTED

Plaintiff requests reimbursement of $126,901.51 in case expenses, a Fee Award of 20% of the balance of the Settlement fund, and approval of the $3,000 incentive payment to Plaintiff payable from the Fee Award.[11]

A. The Legal Standard Governing the Award of Attorneys' Fees

The amount of an award of fees and expenses is committed to the sound discretion of the trial court. *Sugarland Indus., Inc. v. Thomas*, 420 A.2d 142, 149-

[11] The $126,901.51 of case expenses includes only those expenses incurred after December 10, 2015, the date on which the Court approved the partial settlement of the § 205 claim. Affidavit of Elizabeth M. McGeever ¶ 4; Affidavit of Eric Zagar ¶ 5.

50 (Del. 1980). The primary consideration is the benefit achieved through the litigation. *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1254 (Del. 2012). Secondary factors include the time and effort expended by counsel, the quality of the work performed, the standing and skill of the lawyers involved, the complexity of the case and the contingent nature of the representation. *See Sugarland*, 420 A.2d at 149; *In re Talley Indus., Inc. S'holders Litig.*, 1998 WL 191939, at *15 (Del. Ch. Apr. 13, 1998). The Court may also consider awards in similar cases, *Dow Jones & Co. v. Shields*, 1992 WL 44907, at *3 (Del. Ch. Jan. 10, 1992), as well as the stage of the litigation at the time of settlement, *In re Emerson Radio S'holder Derivative Litig.*, 2011 WL 1135006, at *6 (Del. Ch. Mar. 28, 2011).

B. The Benefit Achieved and all other Relevant Factors Support the Fee Award

1. The Significant Monetary Benefit

The benefit achieved in the litigation is straightforward and undisputed. Plaintiff secured a $2.375 million common fund for the Class, less fees and expenses awarded and costs of administration. As discussed above, this represents a substantial percentage of any potential trial recovery.

2. The Time and Effort of Counsel Support the Requested Fee Award

The time and effort of counsel often serve as a cross-check on the reasonableness of a fee award. *In re Del Monte Foods Co. S'holder Litig.*, 2011

WL 2535256, at *12 (Del. Ch. June 27, 2011). Here, Class Counsel had to spend a significant amount of time to understand the Recapitalization and analyze its effect on the minority stockholders. At the time of the Recapitalization, Xencor was privately held. Plaintiff had received very limited information about the Recapitalization from Xencor. Class Counsel had to analyze the Plaintiff's documents, Secretary of State filings, post-IPO public filings and the documents obtained under § 220 in order to reconstruct the multiple steps of the complicated Recapitalization. Likewise, during discovery, Class Counsel had to track through multiple revisions of transaction documents to understand the development of the transaction. Finally, the valuation issues were especially challenging given the Company's business stage and prospects at the time of the Recapitalization.

Class Counsel expended approximately 1906.30 hours in pursuing the fiduciary duty claims with a value of $885,806.00.[12] A Fee Award of $449,619.00 represents approximately $236 per hour, which is below the implied hourly fee awards in numerous other cases.[13]

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[12] Affidavit of Elizabeth M. McGeever, ¶ 3; Affidavit of Eric Zagar, ¶ 3. This figure reflects the time of Prickett Jones and Kessler Topaz between December 11, 2015, the day after the partial § 205 settlement was approved, and September 27, 2016, the date on which an agreement in principle was reached to settle the case.

[13] *Seinfeld v. Coker*, 847 A.2d 330, 337 (Del. Ch. 2000) (awarding fees in excess of $1,300 per hour for derivative settlement of $2.5 million paid by insurers to the company in an action challenging payments of $5.7 million to directors); *In re Physicians Formula Holdings, Inc. S'holder Litig.,* C.A. No. 7794-VCL (Jan. 20,

3. Awards in Similar Cases Support the Requested Fee Award

The fee sought is well within the range of precedent fee awards. This Court has approved fee requests of 30% or more of the benefits where the settlement benefits are attributable solely to the litigation. *Marie Raymond Revocable Trust v. Mat Five LLC*, 980 A.2d 388, 410 and n.71 (Del. Ch. 2008). Here, this litigation is the sole cause of the recovery for the Class.

The 20% fee sought is reasonable in light of this Court's most recent fee awards. *See, e.g.*, *Montgomery v. Erickson Inc.*, C.A. No. 8784-VCL, at 11-12, 15, 17 (Del. Ch. Sept. 12, 2016) (TRANSCRIPT) (Trans. ID 59594847) (awarding 22.5% of settlement fund plus expenses for a monetary recovery and charter amendments that the Court found to be of minimal value); *Kusnyer v. Platinum Energy Res., Inc.*, C.A. No. 7063-VCMR at 15, 19 (Del. Ch. Aug. 30, 2016) (TRANSCRIPT) (Trans. ID 59531822) (awarding 25% of common fund and expenses); *In re Orchard Enters., Inc. S'holder Litig.*, 2014 WL 4181912, at *7-8 (Del. Ch. Aug. 22, 2014) (awarding 24% of portion of the settlement fund that was caused by counsel's efforts).

2017) (Order) (Trans. ID 60098538) and brief (Trans. ID 60017360) ($333 implied hourly rate in $5.6 million settlement); *In re Prospect Med. Holdings Inc. S'holder Litig.*, C.A. No. 5760-VCN (Jan. 21, 2016) (Order) (Trans. ID 58462090) and brief (Trans. ID 58406045) ($577 implied hourly rate in $6.5 million settlement).

4. Stage of the Litigation Supports the Fee Award

A 20% fee is warranted based on the stage of the litigation at the time of the Settlement. As this Court has observed: "A mid-stage settlement supports a range of approximately 20-25 percent." *In re ArthroCare Corp. S'holder Litig.*, Consol. C.A. No. 9313-VCL, at 33 (Del. Ch. Nov. 6, 2014) (TRANSCRIPT) (Trans. ID 56395435). Here, the case settled six months before trial and at the start of expert discovery. All fact discovery had been completed except for one deposition that was postponed when the parties agreed to mediation.

5. The Contingency Risk Justifies the Fee Award

The contingent nature of the representation further supports the requested Fee Award. *In re First Interstate Bancorp Consol. S'holders Litig.*, 756 A.2d 353 (Del. Ch. 1999), *aff'd sub nom. Bradley v. First Interstate Bancorp*, 748 A.2d 913 (Del. 2000) (TABLE). Contingent representation entitles counsel to both a "risk" premium and an "incentive" premium on top of the value of their hourly services. *Seinfeld*, 847 A.2d at 337.

6. The Standing of Counsel

The ability and reputation of Class Counsel support the requested Fee Award. The Court is familiar with their well-established records in successfully representing stockholders in this Court and other courts. The standing of opposing counsel may also be considered in determining an allowance of counsel fees. *In re*

Warner Commc'ns Sec. Litig., 618 F. Supp. 735, 749 (S.D.N.Y. 1985), *aff'd*, 798 F.2d 35 (2d Cir. 1986). Defendants are represented by experienced, skilled and well-respected firms, Cooley LLP and Morris Nichols Arsht & Tunnell, LLP.

IV. THE REQUEST FOR AN INCENTIVE AWARD TO PLAINTIFF IS APPROPRIATE

Plaintiff and Class Counsel seek approval of an incentive award for Plaintiff in the amount of $3,000, payable out of any attorneys' fee award. In determining whether to grant an incentive award, this Court considers four factors set forth in *Raider v. Sunderland*, 2006 WL 75310 (Del. Ch. Jan. 5, 2006). The factors are (i) whether lead plaintiff makes unusually significant efforts; (ii) the efforts result in a direct benefit to the class; (iii) the lead plaintiff owns few shares and stands to gain a small pro-rata recovery; and (iv) notice is provided to the class.

Here, Plaintiff stepped forward in this plenary action and the preceding § 220 action. He reviewed important case documents, including the Complaint, discovery documents, and expert analyses, and he responded to interrogatories, produced documents, and was deposed for approximately five hours. Affidavit of Michael DePinto ¶¶ 4-5. These efforts ultimately resulted in the Settlement and a common fund for the Class, of which Plaintiff will recover his relatively small pro rata share. His willingness to step forward and the resulting benefit merit an incentive award, as do the other *Raider* factors.

The award sought, $3,000, or 0.1% of the common fund, is modest and in line with other incentive awards. *See, e.g.*, *Orchard Enters.*, 2014 WL 4181912, at **1, 7, 13 ($12,500, or 0.1% of common fund awarded to lead plaintiffs); *Forsythe*, 2012 WL 1655538, at **1, 8 (total of $62,500, or 0.5% of benefit achieved, awarded to three plaintiffs in derivative action). The award is especially appropriate because Plaintiff put forth this effort as a small shareholder. *See Raider*, 2006 WL 75310, at *2. Finally, the notice of Settlement distributed to the Class describes the incentive fee requested, and to date there have been no objections to the incentive award or any other aspect of the Settlement or Fee Award.

CONCLUSION

The proposed Settlement and Plan of Allocation are fair and reasonable to the Class and should be approved. In addition, the Court should approve reimbursement of case expenses and the Fee Award, including a $3,000 incentive payment to the Plaintiff.

PRICKETT, JONES & ELLIOTT, P.A.

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Dated: March 10, 2017

CERTIFICATE OF SERVICE

I, Elizabeth M. McGeever, do hereby certify on this 15th day of March, 2017, that I caused a copy of the Public Inspection Version of Plaintiff's Brief in Support of Settlement and Plan of Allocation, Award of Attorneys' Fees and Expenses and Plaintiff Incentive Award to be served via eFiling through File and Serve*Xpress* upon the following counsel of record:

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