IN THE SUPREME COURT OF THE STATE OF DELAWARE

SIERRA GP LLC, SIERRA RESOURCES, INC., THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., SARAH W. BRYANT, ROBERT P. GRAY, RICHARD T. HANSON, ELIZABETH F. PRINCE, and JOHN W. REYNOLDS,	:	No. 31, 2016
Appellants,	:	Court Below:
	:	Court of Chancery of the State of Delaware
v.	:	
	:	No. 12871-CS
NORTH CAROLINA POLICE RETIREMENT FUND, individually and derivatively on behalf of SIERRA PROPERTIES LP,	:	
Appellee.	:	

Appellants' Opening Brief

Team C
Attorneys for Appellants
February 3, 2017

TABLE OF CONTENTS

PAGE

TABLE OF CITATIONS

PAGE

DELAWARE SUPREME COURT CASES

DELAWARE COURT OF CHANCERY CASES

STATUTES

SECONDARY SOURCES

NATURE OF PROCEEDINGS

This is an appeal by Sierra GP, LLC, Sierra Resources, Inc., Bank of New York Mellon Trust Company ("BNY Mellon"), Sarah W. Bryant, Robert P. Gray, Richard T. Hanson, Elizabeth F. Prince, John W. Reynolds (collectively "Appellants"), defendants below-appellants, to the Supreme Court of the State of Delaware from the order of the Court of Chancery by Chancellor Snyder, dated January 9, 2017, granting North Carolina Police Retirement Fund's, individually and derivatively on behalf of Sierra Properties ("Appellee"), petitioner below-appellee, motion for summary judgment. Mem. Op. at 12. The Court of Chancery granted this order in response to a petition filed by the Appellees on January 20, 2016 against Appellants for the purpose of nullifying an indenture. Mem. Op. at 3. Appellants filed a motion to dismiss the petition, and the Appellee filed for summary judgment. Mem. Op. at 1.

Chancellor Snyder rejected Sierra's first contention that they did not breach any fiduciary duties to the Appellant because the transaction was entirely fair, and the Appellant made no action that could constitute a breach. Mem. Op. at 9-10. Second, Appellant argued that even if Sierra GP did breach its fiduciary duties, the only entity that owed fiduciary duties to Appellee is Sierra GP, LLC. Chancellor Snyder rejected this argument and granted the Appellee's cross-motion for summary judgment. Mem. Op. at 13.

Appellants filed a notice of appeal of the Court of Chancery's Order granting the Appellee's motion with this Court on January 11, 2017. Ntc. Of Appeal. This is Appellant's opening brief.

SUMMARY OF ARGUMENT

I. This Court should reverse the Court of Chancery's decision to grant summary judgment in favor of the Appellee, invalidating Sierra LP's debt financing agreement with BNY Mellon that contained a dead hand proxy put. The dead hand proxy put, as a lending tool, is not a per se violation of Delaware law because it is a necessary, useful tool in corporate lending that serves a valid business purpose for both the lender and the borrower. Further, the Court of Chancery erroneously determined that Sierra GP breached its fiduciary duties to Sierra LP by agreeing to Section 11.01. First, the court erroneously denied Sierra GP the protections of the business judgment rule. Secondly, even if Sierra GP's decision was not entitled to deference, its transaction with BNY Mellon was entirely fair to the Appellee.

II. The Court of Chancery relied on the *USACafes* doctrine to extend liability to Sierra Resources and its individual directors. However, this Court should overturn the *USACafes* doctrine because it is contrary to established Delaware law. First, *USACafes* disregards the foundational principles of legal separateness and limited liability and easily allows veil piercing. Second, *USACafes* provides a manner through which parties can bypass the basic principles of contract law. Third, *USACafes* creates conflicting fiduciary duties through its imposition of a multi-tiered fiduciary system. Finally, the doctrine is unnecessary because it substantially overlaps with aider and abettor liability.

STATEMENT OF FACTS

In 2008, the North Carolina Police Retirement Fund and Sierra Resources, Inc. entered into a joint venture to develop commercial real property, eventually creating a limited partnership, with Sierra Resources (through its specially created LLC, Sierra GP) as the general partner. Mem. Op. at 3. In 2013, after discussion with Sierra LP, Sierra GP entered into negotiations with Bank of New York Mellon ("BNY Mellon") to obtain debt financing. *Id.*

The Indenture, drafted by the lead underwriter, referred to as Section 11.01, contained a change-of-control provision that allowed BNY Mellon to accelerate the debt in the event of a change of control. *Id.* This provision, a dead hand proxy put, remained unnoticed to Sierra GP throughout the negotiation and was never pointed out by hired expert counsel. The provision provided for acceleration of the debt in the event of any successful proxy contest. Mem. Op. at 6. In return, the underwriter stated Sierra LP received an interest rate about 50 basis points lower. Mem. Op. at 9.

Two years later, High Street Partners, LP, an activist hedge fund, acquired a substantial interest in Sierra Resources and stated an intention to replace the directors of Sierra Resources if a certain strategy was not adopted. Mem. Op. at 7. However, any such action would trigger the put, accelerating the debt owed to BNY Mellon.

The Appellee filed suit on January 20, 2016. Appellants timely filed a motion to dismiss (converted into a motion for summary judgment). The Appellee filed a motion for summary judgment. *Id.* The Court of Chancery granted the Appellee's motion. *Id.*

ARGUMENT

I. THIS COURT SHOULD OVERTURN THE COURT OF CHANCERY'S GRANT OF SUMMARY JUDGMENT BECAUSE DEAD HAND PROXY PUT PROVISIONS IN DEBT INDENTURES ARE NOT PER SE A VIOLATION OF DELAWARE LAW NOR IS THE INCLUSION OF SUCH A PUT IN THE PRESENT CASE A BREACH OF SIERRA GP'S FIDUCIARY DUTIES.

A. Question Presented

Are dead hand proxy puts a per se violation of Delaware law? If so, was Sierra GP's approval of the Indenture containing Section 11.01 in this case a violation of its fiduciary duties to Appellee?

B. Scope of Review

This court reviews motions for summary judgement de novo. *Ramirez v. Murdick*, 948 A.2d 395, 399 (Del. 2008).

C. Merits of the Argument

Sierra Resources' directors—acting through Sierra GP, a wholly owned subsidiary—authorized the sale of 2% Notes as a legitimate method of debt financing. Dead hand proxy puts are not a per se violation of Delaware law, nor did Sierra GP breach their fiduciary duties in agreeing to a debt indenture that contained a dead hand proxy put provision. The acceptance of a dead hand proxy put in a debt indenture on a clear day, without knowledge of such a provision, and upon the recommendation of counsel, should be analyzed under the business judgment rule. Further, Sierra GP's approval of the Indenture was entirely fair and thus not a breach of Sierra GP's fiduciary duties.

1. A Brief Introduction to Dead Hand Proxy Puts

A provision that lenders often include in debt instruments is a change-of-control provision. Camisha L. Simmons, *Lenders and Directors*

Beware of the Dead-Hand Proxy Put, 34-Sept Am. Bankr. Inst. J. 20, 20 (2015). Proxy puts are a form of change-of-control provisions, which generally designates an event of default as when a majority of the borrowing company's board of directors is replaced by non-continuing directors during a specified period of time. *Id.* A dead hand feature in a proxy put provides that any director elected as a result of an actual or threatened proxy contest would not be considered a continuing director for purposes of the put. David Epstein et al, *Change-of-Control Provisions in Significant Non-Debt Commercial Agreements: The Importance of the "Dead Hand Provision,"* 19 No. 8 M & A Law. NL2, 1 (2015). If a proxy put is triggered, the lender may opt to accelerate the amounts that are due and owing under the loan agreement, often with potentially disastrous economic consequences for the company. Simmons, *supra*, at 20.

In the case of a dead hand proxy put, a board cannot circumvent the put by nominally accepting a dissident slate, which in turn provides lending institutions greater protection. Epstein et al, *supra*, at 1; *see also* F. William Reindel, "Dead Hand Proxy Puts——What You Need to Know," *Harvard Law School Forum on Corporate Governance and Financial Regulation*, at 2 (June 10, 2015). A dead hand provision provides important protection to creditors, but often has the unintended effect of deterring shareholder proxy activity. *Id.* This form of protection is more relevant to lenders now with the advent of shareholder activism because the election of a dissident slate could signal the appointment of new directors with short-term shareholder agendas, which may be inconsistent with the business strategy

communicated to the lender to obtain credit. Arthur Fleischer, Jr. et al, *§ 6.11 "Shark Repellents" in Debt Instruments and Dead Hand Proxy Puts*, Takeover Def. § 6.11, (2016). Proxy puts are a mechanism for lenders to have familiarity with their borrowers and feel comfortable with the direction of a company's business. T. Brad Davey & Christopher N. Kelly, *Dead Hand Proxy 'Puts' Face Continued Scrutiny From Plaintiffs Bar*, Bloomberg BNA (Jan. 22, 2017 at 3:42 PM), https://www.bna.com/dead-hand-proxy-n17179927613.

When companies take on high levels of debt, existing bondholders bear much of the risk that the company will not pay back the debt. Mark H. Mixon, Jr., *Regulating Proxy Puts: A Proposal to Narrow the Proper Purpose of Proxy Puts After Sandridge*, 17 U. Pa. J. Bus. L. 1313, 1347 (2015). Lenders incentivize companies to enter into debt agreements with change-of-control provisions in order to secure debt with lower interest rates to avoid restrictive covenants and high interest rates. *Id.* Oftentimes, shareholders also benefit from a change-of-control covenant because the debt financing increases the firm's overall worth. Marcus Kai Hintze, *"If You Poison Us Do We Not Die?" – A Critical Analysis of the Legality of Poison Puts in the Wake of San Antonio Fire & Police Pensions Fund v. Amylin, Inc.*, 2010 BYU L. Rev. 767 (2010). As such, proxy puts serve an important, substantive function in modern corporate lending.

2. Dead Hand Proxy Put Provisions Are Not a Per Se Violation of Delaware Law.

While there has been recent judicial criticism of dead hand change-of-control provisions, neither the Delaware General Assembly nor Delaware's courts have taken action to void or limit the validity

of dead hand proxy puts. Epstein et al, *supra*, at 4. Although at least three different cases concerning proxy put provisions have come before Delaware courts in the last eight years, the Delaware General Assembly has made no move to amend the Delaware General Corporate Law ("DGCL") to invalidate dead hand provisions in debt agreements. *See* Reindel, *supra*, at 2. Further, when given the opportunity to void proxy put provisions, the Delaware courts took no action other than to express mild skepticism regarding such provisions. *See San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals*, 983 A.2d 304, 315 (Del. 2009). The inaction of the Delaware General Assembly and this court seems to suggest an acceptance of these provisions if adopted under appropriate conditions.

The reputation of dead hand proxy puts has suffered by erroneous comparisons to dead hand poison pills. *Id.* at 3; *See*, e.g. Danielle A. Rappaccioli, note, *Keeping Shareholder Activism Alive: A Comparative Approach to Outlawing Dead Hand Proxy Puts in Delaware*, 84 Fordham L. Rev. 2947, 2982-88 (2016); Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. Corp. L. 381, 383-84 (2002). A poison pill "is a shareholder rights plan that a company adopts in connection with the threat of a tender offer or as a predefensive measure. The purpose and effect of the poison pill is to thwart hostile bidders." Rappaccioli, *supra,* at 2978. Dead hand poison pills have been invalidated by Delaware courts because their impact restricts the board in carrying out its fiduciary duties. *Id.* Dead hand proxy puts differ from these provisions because a poison pill is enacted unilaterally by a board and only serves the board's own

interests. Reindel, *supra*, at 5. Contrarily, a proxy put is a negotiated agreement between a corporation's board and an uninterested third party who obtains economic value from such an agreement. *Id.* Further, unlike a poison pill, a proxy put can be waived by the lender or potentially renegotiated so that its enactment is not a foregone conclusion. *Id.* Such comparisons are unfounded and misleading due to great differences between dead hand poison pills and dead hand proxy puts.

Dead hand proxy puts are not per se in violation of Delaware law because, without crafting a proxy put with the dead hand language, lenders would not receive the protections they bargained for by including these provisions. For example, in *Amylin*, the debt indenture contained a proxy put without a dead hand provision. 983 A.2d at 308. The Court of Chancery ruled that Amylin was able to maneuver around the proxy put provision in a debt indenture by *approving* the dissident slate, which changed a majority of the board members. *Id.* By approving the dissident slate, the incoming directors were considered continuing directors for purposes of the put, contravening the provision's purpose. *Id.* The inclusion of dead hand provisions provides assurance to lenders that a corporation's leadership will remain substantially similar for a specified period of time by removing this loophole, allowing lenders to offer debt financing at a low interest rate. *See* Reindel, *supra*, at 5.

In summation, a dead hand proxy put is not a per se violation of Delaware law, and such provisions serve a valid function in protecting lending institutions.

3. Sierra GP Did Not Breach its Fiduciary Duties in Approving the Indenture.

a. Sierra GP's acceptance of Section 11.01 was not a defensive measure, and it is entitled to deference under the business judgment rule.

Sierra GP's agreement to the Indenture is entitled to the protections offered under the business judgment rule and should not be analyzed under any enhanced scrutiny standard. The business judgment rule is a "presumption that in making a business decision that directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Where the business judgement rule is properly invoked, the directors' decision will be upheld bar an abuse of discretion. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 269 (Del. Ch. 1989). The Delaware Supreme Court has asserted that when a board is facing a takeover event, among the "omnipresent specter" that the board is acting primarily for its own benefit rather than those of the corporation and its shareholders, the board's actions are subject to an enhanced duty, often referred to as the *Unocal* standard. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985). This enhanced duty requires directors to meet a two-part test before receiving the deference of the business judgment rule. *Id.* at 955. However, because Sierra GP's actions do not constitute a defensive measure within the *Unocal* context, the Court of Chancery erroneously applied the *Unocal* enhanced scrutiny standard.

Several cases define the criteria for a defensive measure under the *Unocal* standard. In *Doskocil Cos., Inc. v. Griggy*, the Court of

Chancery analyzed whether Wilson Foods' actions were defensive after a Schedule 13D was filed. 1988 WL 85491 (Del. Aug. 18, 1988). The court held that a showing of long-term planning and deliberation to implement a measure weighed in favor of such measure not being considered defensive in the *Unocal* context. *Id.*; *Contra Henley Group, Inc. v. Santa Fe S. Pac. Corp*, 1988 WL 23945, *13 (Del. Ch. Mar. 11, 1988) (holding that board action taken prior to a threat could be considered a defensive measure if circumstances surrounding the adoption of the measure evidence defensive behavior). In summary, Delaware courts review a board's actions based on the totality of the circumstances to determine whether the primary purpose of the actions are defensive or merely ancillary to a valid business decision.

Here, the Indenture served a valid business purpose. Sierra GP was entirely unaware of the existence of Section 11.01 when it approved the Indenture, meaning its inclusion could not be considered a defensive measure. The record clearly states, "[w]hen Sierra LP entered into the Indenture, there had been no indication specific to Sierra Resources that any person was planning an election contest to replace one or more of its directors; indeed, there had not been any indication that any investor who might have been described as an 'activist' was specifically interested in acquiring a significant equity position in Sierra Resources." Mem. Op. at 6. The Court of Chancery incorrectly applied *Unocal*, rather than the business judgment rule, to Sierra GP's action, despite the lack of any defensive measure that would require enhanced scrutiny.

b. Even if this court determines Sierra GP's actions constitute a defensive measure, its transaction with BNY Mellon was entirely fair.

The Court of Chancery noted in *Shamrock Holdings* that a company's failure to apply the *Unocal* analysis does not automatically invalidate a transaction. 559 A.2d at 271. Instead, the business judgment rule will not be applied, and the transaction will be closely scrutinized to determine if the action was entirely fair. *Id.*

Entire fairness has two basic facets: fair dealing and fair price. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983). First, the fair dealing aspect involves questions of the timing of the transaction, its initiation, structure, negotiation, disclosure to the directors, and how approval was obtained. *Id.* The latter aspect of fairness relates to the economic and financial considerations of the proposed transaction. *Id.* However, the test for fairness is not a bifurcated one as between fair dealing and price. *Id.* The court should examine the totality of the circumstances of a particular transaction because the inquiry is of entire fairness. *Id.*

In the present case, Sierra GP initiated negotiations with BNY Mellon to acquire debt financing for Sierra LP. Mem. Op. at 1. Throughout the transaction, Sierra GP was advised by hired, independent legal counsel. Mem. Op. at 5. Further, there is "no suggestion of any conflict of interest among [BNY Mellon and the board]," or between the directors and their fiduciary duties. Mem. Op. at 1, n.1. Finally, Sierra GP obtained fair value for Section 11.01's inclusion in its negotiations with BNY Mellon, as represented

by its in savings. Mem. Op. at 1, 9. As such, the transaction at issue was entirely fair.

Further, Sierra GP did not breach its duty of care in relying on the advice of counsel regarding the provisions in the agreement. *See Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d, 150, 192 (Del. Ch. 2005) (defining a gross negligence standard for duty of care claims in determining a board did not breach its duty in relying on experienced advisors). Delaware law has established a precedent that a board may rely on the advice of its expert advisors. 8 Del. C. § 141(e); *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156 (Del. 1995); *Smith v. Van Gorkom*, 488 A.2d 858, 881 n.22 (Del. Ch. 1985). Furthermore, in *Amylin*, 983 A.2d at 318, the Court of Chancery highlighted Amylin's retention of highly qualified counsel to seek advice as to the terms of the agreement as evidence that the board was fully informed throughout the transaction. *Id.* In fact, the court determined the board's total conduct was not the type of conduct that is generally imagined when contemplating the concept of gross negligence. *Id.* The court concluded that Amylin did not breach any fiduciary duties concerning the inclusion of the proxy put after consulting with expert advisors. *Id.* The Delaware Supreme Court, in affirming the Court of Chancery, reasoned that the board's actions further justified the court's decision because there were not any foreseeable risks for the corporation or its stockholders. *San Antonio Fire & Pension Fund v. Amylin Pharmaceuticals*, 981 A.2d 1173, 1173 (Del. Ch. 2009). The supreme court warned future outside counsel, because these instruments create the possibility of impinging

on shareholders' franchise rights and the debtholders' interests, such transactions may create fiduciary duty issues and counsel should be prepared to bring such provisions to a board's attention. 983 A.2d at 319.

Here, Sierra GP took actions similar to that of Amylin's board. Sierra GP put together a finance committee and retained highly qualified counsel to advise Sierra GP throughout the transaction. Mem. Op. at 5. Sierra GP inquired as to whether there were any novel terms of which it should be made aware, and the outside counsel responded in the negative. Mem. Op. at 6. When Sierra GP entered into the Indenture, there was no indication of an election contest or that any investors were specifically interested in acquiring a significant position in Sierra Resources. *Id*. Therefore, Sierra GP's actions cannot be considered gross negligence in breach of its fiduciary duties.

Sierra GP adopted the Indenture at issue on a "clear day," which further proves entire fairness. Reindel, *supra*, at 5. The term clear day means a company is not facing an actual or potential proxy contest at the time it enacts a measure. Epstein et al, *supra*, at 2; *contra Pontiac Gen. Emps. Ret. Sys. v. Ballantine*, Del. Ch., No 9789-VCL, Laster, V.C. (Oct. 14, 2014) (emphasizing the dead hand provision at issue was added to a long-standing change-of-control provision at a time that the board was "in the shadow" of a potential proxy contest)(hereinafter referred to as *Healthways*). The Court of Chancery has previously held that a proxy put provision agreed to

outside the regular course of business and specifically for its entrenching effect is untenable. *Healthways* at *16.

Here, however, there was no indication that any shareholders were planning a proxy contest, nor was there any indication that any activist investors were planning to obtain a significant number of shares to leverage a real threat. Mem. Op. at 6. The Indenture containing the dead hand provision was intended more as a protection to the lender than as an entrenchment tool by the board because there was no perceived threat at that point. Mem. Op. at 6. The Sierra Resources' directors, acting through Sierra GP, were completely unaware of Section 11.01; therefore, the inclusion of Section 11.01 could not have been primarily included as an entrenchment tool.

Sierra LP obtained an extraordinarily valuable economic benefit from the inclusion of the dead hand proxy put in its indenture. In *Amylin*, the court, in dicta, addressed its concerns with dead hand proxy put provisions. 983 A.2d at 315. The court stated that if a board were to agree to a dead hand proxy put, as Sierra GP did here, the board must have believed in good faith that it would receive "extraordinarily valuable economic benefits for the corporation" in return. *Id.* Here, Sierra GP was able to secure the notes at 2% interest because of the dead hand provision included in the Indenture. Mem. Op. at 9. Morgan Stanley, the lead underwriter of the offering, produced an affidavit to the Court of Chancery, stating that "the interest rates in the Notes would have been up to 50 basis points higher than 2%. . .if Section 11.01 was not included in the Indenture." *Id.* Fifty basis points, while perhaps seeming

insignificant, actually represents a differential of nearly $8 million to Sierra LP. Therefore, without the Indenture with Section 11.01, Sierra LP would have owed substantially greater interest to the lender; thus, the inclusion of such a provision represented an extraordinarily valuable economic benefit to Sierra LP.

In conclusion, dead hand proxy put provisions are not a per se violation of Delaware law because they serve legitimate business interests. Sierra GP deserves deference under the business judgment rule, and in the alternative, Sierra GP's actions were entirely fair.

II. THIS COURT SHOULD OVERTURN THE COURT OF CHANCERY'S GRANT OF SUMMARY JUDGMENT TO THE APPELLEES BECAUSE THE *USACAFES* DOCTRINE CONFLICTS WITH ESTABLISHED DELAWARE LAW.

A. Question Presented

Should this court continue to uphold the *USACafes* doctrine even though it conflicts with established entity and contract law principles and subverts a legislatively created cause of action?

B. Scope of Review

This court reviews motions to dismiss and motions for summary judgment de novo. *Ramirez v. Murdick*, 948 A.2d 395, 399 (Del. 2008).

C. Merits of the Argument

The Court of Chancery, in *In re USACafes, L.P. Litigation,* 600 A.2d 43 (Del. Ch. 1991), sought to hold non-fiduciary directors liable for their grievous actions in stealing from the partnership and its limited partners. Instead of applying already existing aider and abettor liability principles, the Court of Chancery created a new rule that allowed the injured limited partners to pierce the corporation's

veil and subvert the limited partnership agreement through a showing of control. *Id.* at 48-49. Given the rule was created without any defining limitations or guidelines besides general equitable principles—it has led to conflicts with existing law and confusion among the courts. The case at bar is the perfect example of how *USACafes*' injudicious decision has led to absurd results, especially when applied to alternative entities.

The Delaware Supreme Court has never expressly embraced the *USACafes* doctrine. Mohsen Manesh, *The Case Against Fiduciary Entity Veil Piercing*, 72 Bus. Law. 61, 64 (Winter 2016-2017). The time is ripe for this Court to denounce the friction between the *USACafes* doctrine and established entity and contract law principles—as well as its redundancy as an equitable remedy—and overrule the doctrine.

This Court should reverse the summary judgment motion granted by the Court of Chancery imposing fiduciary duties upon Sierra Resources and the Individual Appellants. *USACafes* conflicts with long-established Delaware law in four ways. First, *USACafes* disregards the foundational principles of legal separateness and limited liability through its incredibly lax standard for veil piercing. Second, *USACafes*, especially when applied to unincorporated alternative entities, provides a manner through which parties can circumvent basic principles of contract law. Third, *USACafes* creates conflicting fiduciary duties through its imposition of a multi-tiered fiduciary system. Fourth, it is a redundant, unnecessary doctrine that overlaps with aider and abettor liability.

1. *USACafes* should be overturned because it disregards the foundational principles of legal separateness and limited liability.

Although Delaware entity law differs depending on whether the entity is a corporation or an unincorporated alternative entity, there are two fundamental principles that apply to the entity regardless of form: legal separateness and limited liability. *See Feeley v. NHAOCG, LLC*, 62 A.3d 649, 667 (Del. Ch. 2012). A business entity is a legal person, separate and distinct from its owners and managers, with the same power as an individual to take actions necessary to conduct and transact business in its own name. Manesh, *supra*, at 72-73. Recognizing the separate legal identity of a business entity also serves to limit the liability of parties controlling the entity. The debts and obligations of the entity are its own and liability for such is not usually imposed upon other entities or individuals that possess some control over the business entity. *See* Colin P. Marks, *Piercing the Fiduciary Veil*, 19 Lewis & Clark L. Rev. 73, 74 (2015).

To pierce an entity's veil is to disregard the legal separateness of the entity. Manesh, *supra*, at 72. Courts have generally been reluctant to pierce the veil and abandon the formalism of Delaware corporate law. *Id.*; *BASF Corp. v. POSM II Props. P'ship, L.P.*, 2009 WL 522721, at *8 n.50 (Del. Ch. Mar. 3, 2009). Thus, veil piercing has traditionally been an exceptional, uncommon remedy. *Irwin & Leighton, Inc. v. W.M. Anderson Co.*, 532 A.2d 983, 987 (Del. Ch. 1987); *see* 18 Am. Jur. 2D *Corporations* § 48 (2016) ("Piercing the corporate veil is a rare exception."). Moreover, Delaware's public

policy does not lightly disregard the separate legal existence of a business entity. *BASF Corp.*, 2009 WL 522721, at *8 n.50.

Traditionally, Delaware courts apply a stringent standard in determining the liability of non-fiduciaries. *Wallace v. Wood*, 752 A.2d 1175, 1183 (Del. Ch. 1999); Manesh, *supra*, at 74. A claimant must show the entity is nothing more than a sham and exists for no other purpose than as a vehicle for fraud. *Id.* at 1179-80; *see also, Outokumpu Eng'g Enters., Inc. v. Kvaerner EnviroPower, Inc.*, 685 A.2d 724, 729 (Del. 1996).

In the seminal case, *USACafes*, limited partners filed suit claiming a breach of fiduciary duties against the corporate general partner and its directors. 600 A.2d at 48. The directors argued, in line with traditional corporate law, that only the corporate general partner owed such duties. *Id.* However, the Court of Chancery broke from the traditional doctrine of legal separateness by ruling that the directors owed a duty to the limited partners because the directors exercised control over the corporate general partner. *Id.* at 49. The Court of Chancery explained that one who controls the property of another may not, without implied or express consent, intentionally use that property in a way that benefits the holder of control to the detriment of the property or its beneficial owner. *Id.* at 48. In this misguided action, the court abandoned the stringent requirements for veil piercing and replaced them with a mere showing of control. Manesh, *supra*, at 75.

This doctrine has turned a once exceptional, uncommon remedy into what Chief Justice Strine and Vice Chancellor Laster describe as "an

odd pattern of routine veil piercing." Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, in RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS, AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 11, 21 (Robert W. Hillman & Mark J. Loewenstein eds., 2015). As Vice Chancellor Laster stated, "there are good reasons to question the entity-piercing implications of USACafes." *Feeley v. NHAOCG, LLC*, 2012 WL 966944, at *20 (Del. Ch. March 20, 2012). The Court of Chancery has also noted the tensions between corporate separateness and the application of *USACafes*. *Feeley*, 62 A.3d at 671. The need to question this doctrine becomes more apparent when considering most unincorporated alternative entities, such as limited partnerships and LLCs, are managed by another entity that is in turn managed by another entity or corporation. Manesh, *supra*, at 65.

The case at bar is the perfect example of *USACafes*' disregard for fundamental principles of entity law. Here, the Court of Chancery has disregarded the legal separateness of three business entities: Sierra LP, Sierra GP, and Sierra Resources. This doctrine has led to an absurd result in this case and will continue to do so in future cases.

2. *USACafes* inhibits the contractual freedom allowed in alternative entity formation and acts as a subversive mechanism to avoid established and uncontroversial principles of contract law.

Unincorporated alternative entities, such as LLCs and limited partnerships, are creatures of contract. *Kelly v. Blum*, 2010 WL 629850, at *7 (Del. Ch. Feb. 24, 2010); *Twin Bridges Ltd. P'ship v. Draper*, 2007 WL 2744609, at *8 (Del. Ch. Sept. 14, 2007). Limited partnerships are governed by a partnership agreement, which is the contract between the parties involved in the limited partnership. *See*

Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A.2d 160, 170 (Del. 2002). The parties to the contract have the power and discretion to decide on the provisions of the partnership agreement. *Id.* The intent of the Delaware legislature is "to give maximum effect to the principle of freedom of contract." 6 Del. C. § 17-1101(c); 6 Del. C. § 18-1101(b). Demonstrating this freedom, parties can contractually limit fiduciary duties. *Gotham Partners, L.P.*, 817 A.2d at 167.

It is an undisputed principle of contract law that only a party to a contract can be liable for breach of that contract. *Id.* at 172. Applying this rule to limited partnership agreements, the general partner, as a party to the agreement, owes the contracted duties to the partnership and its partners. *Gotham Partners, L.P.*, 2000 WL 1476663, at *35. The entity effectuating control over the general partner is not a party to the agreement and thus owes no duties to any member of the partnership. Manesh, *supra*, at 79. However, the court in *USACafes*, ignored these basic principles by extending liability for a breach of contract to individuals that were not parties to the contract. *USACafes* enables a plaintiff to circumvent the contractually agreed upon fiduciary and reach non-contracting parties if the claimant presents mere evidence of control. Manesh, *supra*, at 75.

Courts should not forsake the limited partnership's distinct doctrinal foundation in contract theory in pursuit of some highly-generalized interest in equity. *Sonet v. Timber Co., L.P.*, 722 A.2d 319, 324 (Del. Ch. 1998). In *Gotham Partners, L.P. v. Hallwood*

Partners, L.P., then-Vice Chancellor Strine called *USACafes*' approach "unorthodox." 2000 WL 1476663, at *68 (Del. Ch. Sept. 27, 2000). He explained that when limited partners contract to join a limited partnership run by a general partner, the traditional approach would be to impose fiduciary duties solely on the general partner as an entity because *it is the entity the limited partners agreed would manage their assets*. *Id.* (emphasis added). He clarified that limited partners would only be able to circumvent the contractually agreed upon fiduciary if there was an abuse of the corporate form. *Id.* at *69. Criticizing *USACafes* again, then-Chancellor Strine, proffered that the court's decision in *USACafes* was not accompanied by sufficient analysis as to why investors in the limited partnership were not required, in the absence of a reason for veil piercing, to look solely to the entity *they knew was their fiduciary for relief*. *Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, 2011 WL 3505355, at *108 (Del. Ch. Aug. 8, 2011) (emphasis added).

Here, the Appellee's claim revolves around the Indenture governing Sierra LP's 2% Notes. Mem. Op. at 5-6. The parties to the Indenture are Sierra LP and BNY Mellon. *Id.* However, the Court of Chancery imposed liability on Sierra Resources and its directors, who are neither parties to the Indenture nor to the limited partnership agreement. *Id.* Further, Sierra Resources and its directors took no action to utilize the Sierra LP's property to benefit the corporation at the expense of Sierra LP, which is a hallmark of abuse of the corporate form.

3. *USACafes* creates conflicting fiduciary duties through the imposition of a multi-level fiduciary system.

The precedent established in *USACafes* places entity partners and directors of corporate general partners in a "strange and unsettling position." *Brickell Partners v. Wise*, 794 A.2d 1, 4 (Del. Ch. 2001); *Gelfman v. Weeden Investors, L.P.*, 792 A.2d 977, 992 (Del. Ch. 2001) (containing then-V.C. Strine's description of this position as "awkward"). Under traditional fiduciary doctrine, regardless of the entity's form, the controlling fiduciary owes an unyielding duty to the beneficial entity and its members. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993); *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (emphasis added). This unyielding duty requires the exercise of managerial authority to maximize the value of the entity for the benefit of its members. *Feeley*, 62 A.3d at 668. To satisfy this requirement, the fiduciary must act in the best interest of the entity to which it owes a duty. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

In attempts to limit conflicts created by *USACafes* and to avoid subjugation of all individuals who work for a managing member to wide ranging causes of action, Delaware courts have prevented *USACafes* from expansion beyond the duty of loyalty. *See Bay Ctr. Apts. Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *37 (Del. Ch. April 20, 2009); *Feeley*, 62 A.3d at 672-73. However, limiting *USACafes* to the duty of loyalty does not answer the most salient question: Are the duties owed equally applied to each entity, or is one entity favored over the other? The vague ruling in *USACafes* invites litigation and

promotes uncertainty regarding the distribution of liability. Manesh, *supra*, at 81.

The case at bar presents a perfect example of the conflicting fiduciary duties that result from *USACafes'* application. Under traditional fiduciary doctrine, the Individual Appellants, as directors of Sierra Resources, owe an unyielding duty of loyalty to Sierra Resources. Mem. Op. at 3. Sierra Resources in turn owes a duty to its shareholders——and Sierra GP as it is the sole managing member. Mem. Op. at 3. The Court of Chancery, applying *USACafes*, held that Sierra Resources and the Individual Appellants also owe a duty to Sierra LP and its members. Mem. Op. at 11. Such a result creates an inherent conflict of interest evidenced by the present litigation.

An ideal corporate director owes fidelity to only one entity. *Brickell Partners*, 794 A.2d at 4. Regardless of the distribution of duties, this ideal director is impossible if *USACafes* remains governing precedent. *Id.* The Court of Chancery placed the directors of Sierra Resources in the unenviable position of owing contrasting duties to its own shareholders and Sierra LP, to whom it owes no legally recognized fiduciary duties beyond the implication of *USACafes*.

4. *USACafes* is a restatement of an already existing theory of liability.

In *USACafes*, the court held that those who exercise control over another's property and use that control to benefit himself to the detriment of the owner can be held liable for such action. The Court of Chancery created this rule to hold non-fiduciaries liable for

actions taken that contributed to a breach of fiduciary duty. *See USACafes*, 600 A.2d at 49. Interestingly, the court in *USACafes* recognized its rule could fall within the scope of aider and abettor liability and reach the same desired, equitable result. *Id.*

Under aider and abettor liability, to find a non-fiduciary liable for a fiduciary's breach of duty, the claimant must prove: (1) the existence of a fiduciary relationship, (2) the fiduciary breached its duty, (3) a defendant, who is not a fiduciary, knowingly participated in a breach, and (4) damages to the plaintiff resulted from the concerted action of the fiduciary and the non-fiduciary. *Gotham Partners, L.P.*, 817 A.2d at 172. Delaware law recognizes the concept of aiding and abetting a breach of contract in entity agreements, particularly relating to contractual standards of fiduciary duty. *Feeley*, 62 A.3d at 658-59 (Del. Ch. 2012). The purpose of aider and abettor liability in these situations is to allow a partnership and its partners to bring claims against non-fiduciaries who encourage or otherwise collaborate with the contracting fiduciary to breach a duty. *Id.* at 659.

The apparent redundancy of *USACafes'* holding has been noted by Delaware Courts. In *USACafes*, Chancellor Allen admitted the same result could have been reached by applying aider and abettor principles. 600 A.2d at 49. Later, in *Gotham Partners, L.P.*, then-Vice Chancellor Strine stated uncertainty as to whether the directors of the general partner would be culpable of breach of fiduciary duty or as aiders and abettors. 2000 WL 1476663, at *41. In fact, many of the cases in which *USACafes* has been applied or referenced fall within

the scope of aiding and abetting. *See In re Boston Celtics Ltd. P'ship S'holders Litig.*, 1999 WL 641902 (Del. Ch. Aug. 6, 1999) (directors of general partner personally received preferential treatment in reorganization); *see also Bigelow/Diversified Secondary P'Ship Fund 1990 v. Damson/Birtcher Ptnrs*, 2001 WL 1641239 (Del. Ch. Dec. 4, 2001) (non-fiduciaries used control of fiduciary entity to personally receive unearned fees and other benefits); *see also Wallace*, 752 A.2d at 1175 (controllers of general partner diverted partnership assets for purpose of benefitting themselves).

The *USACafes'* doctrine simply provides the same remedy available through legislatively created aider and abettor liability. In practice, *USACafes* usurps this legislative standard by allowing the same result to be achieved through a less stringent, judicially-created standard that requires a less stringent burden of proof.

CONCLUSION

For the foregoing reasons, the Appellants, Sierra Resources, Sierra GP, BNY Mellon, and the Individual Appellants, respectfully request that this Court reverse the Court of Chancery's Order granting North Carolina Police Retirement Fund's motion for summary judgment.

Respectfully submitted,

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Team C,
Counsel for Appellants.