IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

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**Appellee's Answering Brief**

Team "D"
Counsel for
Plaintiff Below-Appellee
NORTH CAROLINA POLICE RETIREMENT FUND
on behalf of separately and
derivatively of
SIERRA PROPERTIES LP.

Dated: February 3, 2017

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## NATURE OF PROCEEDINGS

This appeal arises out of a suit filed by the North Carolina Police Retirement Fund ("NCPRF"), individually and derivatively as a limited partner on behalf of Sierra Properties LP ("Sierra LP"), to enjoin enforcement of an unlawful provision in a trust indenture. Mem. Op. 1. The present action was commenced on January 20, 2016 by Plaintiff Below, Appellee, NCPRF. NCPRF named as defendants Sierra GP LLC ("Sierra GP") as sole general partner of Sierra LP, Sierra Resources, Inc. ("Sierra Resources") as sole member and manager of Sierra GP, The Bank of New York Mellon Trust Company, N.A. ("BNY Mellon"), Sierra LP as a nominal defendant, and Sierra Resources' Board of Directors ("the Board"). Mem. Op. 8. NCRPF requested declaratory relief that the Board's use of a Dead Hand Proxy Put ("DHPP") contained in a trust indenture ("Indenture") was a breach of various fiduciary duties owed to Sierra LP and NCPRF. Mem. Op. 8. The named Defendants filed a motion to dismiss, which was treated as a motion for summary judgment pursuant to Court of Chancery Rule 12(C). Mem. Op. 8. NCPRF also filed a cross-motion for summary judgment. Mem. Op. 8.

In an opinion issued on January 9, 2017, the Court of Chancery determined the Board's inclusion of the DHPP in the trust indenture breached various fiduciary duties owed to NCPRF and Sierra LP. Mem. Op. 10. The Court further found the Board breached its fiduciary duties owed to NCPRF and Sierra LP as sole general partner of Sierra Properties under *In re USACafes, L.P. Litigation*, 600 A.2d 43, 48–49 (Del. Ch. 1991) ("*USACafes*"). Mem. Op. 11. Accordingly, Chancellor Snyder denied Defendants' motion to dismiss, and instead granted NCPRF's cross-motion

for summary judgment. Mem. Op. 12. On January 11, Defendants filed notice of appeal to this Court. Notice of Appeal From Summary Judgment at 2. This is Plaintiff Below, Appellee NCPRF's Opening Brief.

## SUMMARY OF ARGUMENT

I. The Court of Chancery properly granted NCPRF's motion for summary judgment to enjoin enforcement of the DHPP for three reasons. First, Sierra Resources' Board exercised exclusive control of NCPRF's assets, so the Board owed NCPRF, as the Board's limited partner, fiduciary duties. Second, the Board was on notice that inclusion of a DHPP created an impermissible entrenchment effect that impacts shareholder voting rights, which overcomes the business judgment presumption. Finally, the Board approved the Indenture containing the DHPP without adequately informing themselves of the provision and the impact it could have on Sierra LP. This overcomes the business judgment presumption as well. Because the Indenture was approved without a fair price or fair dealings to Sierra LP and NCPRF, the transaction is not entirely fair; therefore, the Board breached its fiduciary duties of loyalty and care.

II. Summary judgment was also appropriate because a DHPP provision, as a defensive measure, is *per se* violative of Delaware law. The DHPP is a defensive measure, so it must be reasonable and proportional to the threat trying to be avoided. There is no threat. Furthermore, the provision prevents the Board from taking approving an insurgent slate of directors in a proxy contest when their fiduciary duties require them to do so to avoid triggering the put. Such a provision is contrary to Section 141(a) of Delaware law.

## STATEMENT OF FACTS

### The Parties

NCPRF is a public pension fund holding an 80% limited partnership interest in Sierra LP, a Delaware limited partnership. Mem. Op. 3. The remaining 20% interest in the limited partnership is owned by Sierra GP, a Delaware limited liability company, which also acts as sole general partner of Sierra LP. Mem. Op. 3. Sierra GP's sole member and sole manager is Sierra Resources, a publicly traded Delaware Corporation. Mem. Op. 3. Sierra Resources' directors, the Board, are five individuals named as Defendants Below, Appellants in this action. Mem. Op. 1. By the terms of this arrangement, the Board, who controls Sierra Resources, exercises "indirect but exclusive control over Sierra LP." Mem. Op. 3.

### NCPRF Invests in Sierra LP

Sierra Resources' principal business operations are the acquisition, ownership, development, and management of mixed real estate on a national basis. Mem. Op. 4. In 2008, seeking an opportunity to profit from the collapsed real estate market, NCPRF and Sierra Resources entered negotiations to form a joint venture to develop and invest in "high-performance, sustainable commercial buildings." Mem. Op. 4. Sierra LP formed through a limited partnership agreement ("LP Agreement") on October 13, 2008, to act as an investment vehicle funded by an $80 million contribution from NCPRF and $20 million from Sierra Resources. Mem. Op. 4. The LP Agreement limited or eliminated fiduciary duties of Sierra GP and its affiliates, but both Appellants and Appellee agree the agreement does not prohibit the relief sought in this action. Mem. Op. 4–5.

**The Note Issuance and the Trust Indenture**

By 2013, Sierra LP was underleveraged, and after seeking NCPRF's endorsement, Sierra GP, on behalf of Sierra LP, sought to raise new debt capital between $150–175 million. Mem. Op. 5. Sierra GP contacted Morgan Stanley to underwrite an Indenture for a public offering of 2% Notes due 2028 with BNY Mellon as trustee. Mem. Op. 2, 5. Counsel for both Sierra LP and Morgan Stanley read, revised, and edited the Indenture. Mem. Op. 5. The finance committee of Sierra Resources' Board met to approve the Indenture's terms, and at that time one director asked the company's outside counsel if there were any novel terms that required the committee's attention. Mem. Op. 5–6. Outside counsel responded in the negative, and on August 15, 2013, Sierra LP completed a public offering of $160 million in 2% Notes. Mem. Op. 5, 6. However, Sierra Resources' counsel was mistaken. Mem. Op. 5.

The Indenture contained Section 11.01, which is the provision challenged in this action. Mem. Op. 2. Section 11.01, titled the "Change of Control" provision, provided that if within a twelve-month look back period, the majority of the Board was not continuing directors, the notes would be payable with accrued interest on demand. Mem. Op. 2. A continuing director is defined as: (1) directors that served on the board longer than the look back period; (2) directors that were approved by previous directors that existed within the look back period; and (3) directors who were approved by either of the first types of continuing directors. Mem. Op. 2. However, excluded from the definition were directors who were elected or approved "as a result of an actual or threatened solicitation of proxies." Mem. Op. 2. Thus, if a majority of

the Board was elected or approved because of a proxy contest, the provision is triggered and payment is due on demand. Mem. Op. 2. This is the Dead Hand Proxy Put. Mem. Op. 2.

Morgan Stanley, through affidavit, submitted that had the DHPP not been included in the Indenture, the interest rates on the Notes would have been "up to 50 basis points" higher than the 2% rate offered. Mem. Op. 9. The named Defendants did not read the Indenture, nor did they seek to alter or encourage changes. Mem. Op. 5. It is undisputed that the named Defendants "were unaware of the content of Section 11.01 when the Indenture was entered into." Mem. Op. 9. This fact was "heavily emphasize[d]" by the named Defendants in the court below. Mem. Op. 9.

**The High Street Partners 13D and the Impact of Section 11.01**

In 2015, High Street Partners, LP ("High Street"), a hedge fund, acquired 6.3% of Sierra Resources' outstanding common stock. Mem. Op. 6. On October 12, 2015, High Street filed its Schedule 13D with the SEC and stated its intent to propose strategies for Sierra Resources, including "(i) accelerating distributions through dividends or stock repurchases or both, (ii) selling selected real estate assets, and (iii) exploring other strategic alternatives, including a possible sale of the company." Mem. Op. 6. High Street threatened to solicit and run a proxy contest to unseat Sierra Resources' unclassified board if it did not implement this strategy or a substantially similar one. Mem. Op. 6. However, High Street has not yet initiated its threatened contest. Mem. Op. 6–7.

Sierra Resources, through press release and investor presentations, announced that if High Street managed to overthrow a majority of the Board, the Notes will be payable on demand. Mem. Op. 7. Payment of the Notes will require new financing to support the payoff. Mem. Op. 7. Sierra Resources estimated that the financial impact of the refinancing would not be material because the estimated cost would be between $2 to $3 million. Mem. Op. 7. The impact on Sierra LP, however, would be substantial. Mem. Op. 7. In fact, "the direct financial impact on Sierra LP would be five times greater than the indirect impact on Sierra Resources; [and] the indirect impact on [NCPRF] would be four times greater." Mem. Op. 7 n. 4. This would undoubtedly be "catastrophic" to Sierra LP's equity holders. Mem. Op 7.

In fear of these consequences, NCPRF filed this lawsuit individually and derivatively on behalf of Sierra LP on January 20, 2016. Mem. Op. 8. NCPRF did not assert demand, but successfully pleaded demand futility in accordance with Court of Chancery Rule 23.1, as Sierra GP exercises exclusive control over Sierra LP and is thus controlled by Sierra Resources and the Board. Mem. Op. 8. NCPRF asks this Court to affirm Chancellor Snyder's order granting NCPRF's motion for summary judgment to enjoin Section 11.01 as a breach of the named Defendants' fiduciary duties.

## ARGUMENT

### I. THE BOARD'S INCLUSION OF A DEAD HAND PROXY PUT WITHIN THE INDENTURE BREACHED THE BOARD'S FIDUCIARY DUTIES OF LOYALTY AND CARE OWED TO SIERRA LP AS ITS CONTROLLING MEMBER BECAUSE THE PROVISION WAS UNKNOWINGLY ADOPTED BY A MISINFORMED BOARD, CAUSING AN IMPERMISSIBLE ENTRENCHMENT EFFECT THAT IS NOT ENTIRELY FAIR TO SIERRA LP.

#### A. Question Presented

Whether Sierra Resources' Board, who exercised exclusive control over Sierra LP's assets though a subsidiary, Sierra GP, owed fiduciary duties to NCPRF, as a limited partner. And, if so, whether the Board breached its duties of loyalty and care owed to NCPRF when it entered into an Indenture containing a dead hand proxy put that could cause substantial losses directly to Sierra LP and indirectly to NCPRF.

#### B. Scope of Review

This case arises from a grant of summary judgment by the Court of Chancery for NCPRF. Mem. Op. 12. This Court reviews appeals from the Court of Chancery's grant of summary judgment and questions of law *de novo*. *See In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 42 (Del. 2006).

#### C. Merits of the Argument

Under Delaware law "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors." Del. Code tit. 8, § 141(a) (2016). In carrying out the "business and affairs" of the corporation, a director must act with care, good faith, and loyalty; these are a director's fiduciary duties owed to the corporation and the shareholders. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (overruling *Aronson's* standard of review section). There is

a strong, rebuttable presumption that "in making a business decision the 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*, 473 A.2d at 812. Thus, it is presumed that a director acts with care, good faith, and loyalty. *Id.* This is the business judgment presumption. *Id.* If the director subscribes to his or her fiduciary duties, the director's actions will be afforded deference by the safe haven of the business judgment presumption; however, if the director acts from "improper motive," *Gagliardi v. TriFoods International, Inc.*, 683 A.2d 1049, 1051 (Del. Ch. 1996), then the business judgment presumption is rebutted. *HMG/Courtland Props., Inc. v. Gray*, 749 A.2d 94, 115 (Del. Ch. 1999).

A board's failure to adhere to its fiduciary duties will not automatically invalidate a corporate transaction. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 271 (Del. Ch. 1989). However, such conduct will not benefit from the safe haven of the business judgment presumption either. *Id.* Rather, "[u]nder these circumstances . . . the transaction at issue will be scrutinized to determine whether it is entirely fair." *Id.* If the terms of the transaction are not entirely fair, the transaction is invalidated. *Id.* Entire fairness requires both fair dealings and fair price. *Boyer v. Wilmington Materials, Inc.*, 754 A.2d 881, 898 (Del. Ch. 1999).

In the present case, Chancellor Snyder correctly determined that the appropriate standard of scrutiny for the DHPP was entire fairness, Mem. Op. 9, because the Board breached its fiduciary duties owed to Sierra LP. *Id.* This Court should determine the Board owed fiduciary

duties to NCPRF, and it breached its fiduciary duties by including the DHPP in the Indenture, which resulted in a transaction that is not entirely fair to Sierra LP.

First, when a person or entity is entrusted with control of property of another, the holder owes the property's owner fiduciary duties. NCPRF entrusted $80 million to Sierra GP, and indirectly the Board, to run Sierra LP as the general partner. In so doing, the Board exercised exclusive control over how Sierra LP would be run and its resources spent. Therefore, the Board owed NCPRF, as a limited partner, fiduciary duties. Second, a director has the fiduciary duties of loyalty and care, meaning the director must act in the best interest of the company on an informed basis. The Board, hastily and without reading the Indenture, included a DHPP that has an impermissible effect of entrenchment because it leaves shareholders with no choice but to approve the incumbent board or face financial loss. This loss will be four to five times greater on NCPRF and Sierra LP. Thus, the Board breached its duties of loyalty and care. Therefore, the transaction is not entirely fair to Sierra LP.

1. The Board owed NCPRF fiduciary duties under *In Re USACafes L.P. Litigation* because the Board indirectly ran Sierra GP, whom NCPRF entrusted exclusive control of its assets as the general partner of Sierra LP.

"[O]ne who controls property of another may not . . . intentionally use that property in a way that benefits the holder of the control to the detriment of the property or its beneficial owner." *In re USACafes, L.P. Litig.*, 600 A.2d 43, 48 (Del. Ch. 1991). In-other-words, a person or entity entrusted with controlling another's property owes the owner of the property fiduciary duties. *Id.* at 49. This has come to be

colloquially known as "fiduciary entity veil piercing" ("fiduciary piercing"). *See generally* Mohsen Manesh, *The Case Against Fiduciary Entity Veil Piercing*, 72 BUS. LAW. 61, 61 (2016). The crux of fiduciary piercing by a Court of Chancery is evaluated on the extent to which the holder exercises control over the property it is entrusted with. *Brinckerhoff v. Enbridge Energy Co.*, C.A. NO. 5526-VCN, 2011 WL 4599654, at *7 (Del. Ch. Sept. 30, 2011) (holding fiduciary duties are "tether[ed] to control"). In turn, if the holder exercises control of the property, then a fiduciary relationship is created; if no control is exerted, however, fiduciary duties are not actionable. *See Bay Ctr. Apartments Owner, L.L.C. v. Emery Bay PKI, L.L.C.*, C.A. No. 3658-VCS, 2009 WL 1124451, at *9 (Del. Ch. Apr. 20, 2009).

In a limited partnership, the general partner controls the partnerships' assets and therefore "unquestionably" owes fiduciary duties to the limited partner. *Wallace v. Woods*, 752 A.2d 1175, 1180 (Del. Ch. 1999). Appellants argue this arrangement should shield a parent corporation and its board from owing any fiduciary duties to the limited partners irrespective of its undeniable control over the partnerships' assets. Mem. Op. 4. This argument, however, is contrary not only to Delaware Courts of Chancery's jurisprudence of fiduciary piercing, but also general principles of equity. *See USACafes*, 600 A.2d at 48–49. The time has come for this Court to recognize the need for fiduciary piercing within these business structures. Therefore, this Court should declare that fiduciary piercing is correct as a matter of Delaware law, and affirm that Sierra Resources' Board owes fiduciary duties to Sierra LP and NCPRF.

The Courts of Chancery have consistently held that when the general partner of a limited partnership is a corporation, the board of that corporation owes fiduciary duties to the limited partners. *USACafes*, 600 A.2d at 48–49. Drawing mostly from common law, the earliest courts to recognize such fiduciary duties did so in the form of analogies to boards being "trustees" when controlling the shareholders' property. *Id.* at 48. In fact, common law recognized that even shareholders who controlled corporate property would be obliged to carry out control of the business enterprise in accordance with fiduciary duties. *Allied Chem. & Dye Corp. v. Steel & Tube Co. of Am.*, 120 A. 486, 491 (Del. Ch. 1923). It is only a natural extension that any party who controls corporate property be obligated to act within its fiduciary duties. *See Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) (explaining that controlling shareholders owe some fiduciary duties to non-controlling members).

Courts of Chancery have not limited the obligation to act within fiduciary duties only to corporate general partners; instead, these principles have been extended to officers, affiliates, and parents of general partners in a limited partnership, if they exercise control over partnership property. *Wallace*, 752 A.2d at 1181–82. In fact, layering subsidiary corporations as an entity shield has not foreclosed Courts of Chancery from holding that parent corporations owe fiduciary duties when they exercise control over partnership property. *U.S.W., Inc. v. Time Warner, Inc.*, C.A. No. 14555, 1996 WL 307445, at *20 (Del. Ch. June 6, 1996).

In *Time Warner*, Time Warner, a corporation, controlled a limited partnership, Time Warner Entertainment, with limited partner U.S. West,

a corporation, through a series of subsidiary companies. 1996 WL 307445, at *1. One of Time Warner's subsidiaries, a corporation, controlled the limited partnership as general partner. *Id.* at *2. After a break down in the partnership relationship, U.S. West sued. *Id.* The Court of Chancery noted that Time Warner, the parent corporation, owed fiduciary duties under *USACafes* as "the entity that control[ed] [the limited partnership], even though it [did] so through the intermediation of several wholly owned subsidiaries that serve[d] as the general partners of [the partnership]." *Id.* at *20. Thus, even though Time Warner's board indirectly controlled the subsidiaries, it still indirectly ran and controlled the limited partnership as the general partner. *Id.*

In the present case, Sierra Resources and its Board controlled NCPRF's assets in Sierra LP, and as such owed fiduciary duties to Sierra LP and NCPRF as a limited partner. Mem. Op. 4. To start, NCPRF contributed $80 million to Sierra LP as a limited partner. Mem. Op. 3. As a limited partner, NCPRF had absolutely no input regarding the funds of Sierra LP because Sierra GP, as general partner, held total control pursuant to Delaware Law. Del. Code tit. 6, § 17-403(a) (2016). Therefore, because Sierra GP had exclusive control of the investments of Sierra LP, Sierra GP owed fiduciary duties to NCPRF as a limited partner. *USACafes*, 600 A.2d at 48.

Next, Sierra GP is a wholly owned subsidiary of Sierra Resources. Mem. Op. 3. Like in *U.S. West*, where Time Warner controlled the limited partnership through a series of wholly owned subsidiaries that operated as the general partner, 1996 WL 307445, at *20, Sierra Resources controls the limited partnership through a series of wholly owned subsidiaries

(namely Sierra GP). Mem. Op. 3. Because the Board operates Sierra Resources, it indirectly controls Sierra LP. Mem. Op. 3. Thus, like in *Wallace* where the Court of Chancery held the parent corporation's board control over the property of a limited partnership created fiduciary duties, 752 A.2d at 1180, Sierra Resources' Board controls the resources of Sierra LP through its subsidiary, Sierra GP. Mem. Op. 3. Therefore, Sierra Resources' Board owes fiduciary duties to Sierra LP and NCPRF as a limited partner.

Thus, because Sierra Resources' Board owed fiduciary duties to NCPRF as a limited partner, Chancellor Snyder did not err in granting NCPRF's cross-motion for summary judgment, Mem. Op. 12, and her decision should be affirmed.

2. The Board breached its duties of loyalty and care by unknowingly including a Dead Hand Proxy Put within the Indenture that entrenches the Board at the expense of Sierra LP and NCPRF.

Because the Board exercised control over Sierra LP's property, the Board owed fiduciary duties to NCPRF and Sierra LP. Therefore, inquiry now focuses on whether the inclusion of a DHPP violated the Board's fiduciary duties. Chancellor Snyder correctly concluded that the inclusion of the DHPP violated the Board's fiduciary duties. Mem. Op. 11. Therefore, the Court of Chancery's granting of summary judgment should be affirmed.

A transaction that results from the breach of fiduciary duties is subject to entire fairness review. *Boyer v. Wilmington Materials, Inc.*, 754 A.2d 881, 898 (Del. Ch. 1999). The components of entire fairness

review are two-fold: fair dealing and fair price. *Boyer*, 754 A.2d at 898–99. Fair dealing and fair price are defined as follows:

> Fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained." Fair price "relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock." In making a determination as to the entire fairness of a transaction, the Court does not focus on one component over the other, but examines all aspects of the issue as a whole.

*Id.* at 898–99. In the present case, the Board breached both the duty of loyalty and care, which resulted in a transaction that is not entirely fair to Sierra LP.

i. The Dead Hand Proxy Put violates the Board's fiduciary duty of loyalty because it has an impermissible entrenchment purpose.

A board must only act in the best interest of the company; any deviation breaches the fiduciary duty of loyalty. *Gagliardi*, 683 A.2d at 1051. Breaching the fiduciary duty of loyalty is not limited to self-dealing or self-interest, but may occur through corporate transactions aimed at entrenching a board of directors or other officers into their positions. *Gantler v. Stephens*, 965 A.2d 695, 707 (Del. 2009) (holding entrenchment may breach duty of loyalty).

The Courts of Chancery have extended the duty of loyalty to poison puts. *Kallick v. Sandridge Energy, Inc.*, 68 A.3d 242, 246 (Del. Ch. 2013). In *Kallick*, an indenture offered by Sandridge contained a poison put that required payment on demand of the notes if the majority of the board was not comprised of continuing directors. *Id.* at 244–45. A continuing director was one who was either a director at the time of the

note's issuance or a director that was approved by a then-existing continuing director. *Kallick*, 68 A.3d at 244–45. After the indentures were issued, a proxy contest threatened to cause a majority of the then-existing board to not be continuing directors under the provision; the board could have avoided triggering the put by merely approving, but not endorsing, the insurgent slate. *Id.* However, the board chose not to approve the slate. *Id.* The court determined that absent "substantial risk" to corporate policy, a board that failed to approve an insurgent slate to avoid triggering the put breached the duty of loyalty. *Id.* at 260–61. *See also San Antonio Fire & Police Pension Fund v. Amylin Pharm., Inc.*, 983 A.2d 304, 319 (Del. Ch. 2009) (holding that "terms which may affect the stockholders' range of discretion in exercising the franchise [], even if considered customary" should be discussed with the board.).

The Courts of Chancery have also recognized that including a DHPP in debt agreements states a legally cognizant claim for breach of the duty of loyalty, and thus, can survive a motion to dismiss. *Pontiac Gen. Emps. Ret. Sys. v. Ballantine (Healthways)*, C.A. No. 9789-VCL, 2014 WL 6388645, at *70–72 (Del. Ch. Oct. 14, 2014). In *Healthways*, the board of directors unknowingly included a DHPP in a trust indenture. *Id.* at *68–69. Vice Chancellor Laster determined the DHPP created a "Sword of Damocles" effect on the shareholders even though it was not triggered at the time. *Id.* at *74. The shareholders could run a proxy contest and risk forcing payment of the indentures, which could negatively impact the corporation's finances, or begrudgingly accept the existing directors without triggering the DHPP. *Id.* The court recognized these options had a "chilling effect" on the shareholder franchise and its

ability to choose directors, so it denied dismissal. *Healthways*, 2014 WL 6388645, at *74, *81. The case was settled before trial. *Pontiac Gen. Emps. Ret. Sys. v. Ballantine (Healthways)*, C.A. No. 9789-VCL, 2015 WL 3658647, at *41-42 (Del. Ch. May 8, 2015).

This Court should determine that the Board's adoption of a DHPP breached its duty of loyalty to NCPRF and resulted in a transaction that was not entirely fair to Sierra LP. To begin, after *Healthways*, where Vice Chancellor Laster denied a motion to dismiss because the DHPP created a legally cognizant breach of loyalty claim, 2014 WL 6388645, at *80, the Board was on notice that inclusion of these provisions created a claim for breach of loyalty. Ignorance of the inclusion of the DHPP is also no excuse to avoid breach, as the provision substantially interferes with the Sierra Resources shareholder franchise, so the Board should have been made aware of its existence. *Amylin*, 983 A.2d at 319. Unlike in *Kallick*, where the board could just approve the directors to avoid triggering the poison put, 68 A.3d at 244-45, this Board cannot cure the DHPP, nor can the shareholders actually exercise their right to vote for directors pursuant to Section 11.01, because High Street Partners has threatened a proxy context, which triggered the exclusionary language of the put. Mem. Op. 2, 6. If the shareholders exercise their vote and approve the insurgent slate, both Sierra Resources and Sierra LP will lose $2 to 3 and $10 to 15 million respectively. Mem. Op. 7. The only option for the shareholder then, is to accept the current board, and the result is an impermissible effect of entrenchment. This breaches the duty of loyalty and overcomes the business judgment presumption. *See Gantler*, 965 A.2d at 707.

The Board may avoid breaching its duty of loyalty if the inclusion of the DHPP was entirely fair to Sierra LP; but it is not. *Boyer*, 754 A.2d at 898–99. Sierra Resources only stands to lose $2 to 3 million if the notes become due. Mem. Op. 7. However, Sierra LP stands to lose "five times" more than Sierra Resources, which equates to $10 to 15 million, or 10 to 15% of its total resources. Mem. Op. 7 n. 4. NCPRF owns an 80% interest in Sierra LP, whereas Sierra Resources only owns 20%. Mem. Op. 3. Therefore, any loss will cause NCPRF to suffer 80% of the loss, ranging from $8 to $12 million. NCPRF only contributed $80 million to start, so a loss of this magnitude will indirectly impact NCPRF substantially more than Sierra Resources. Mem. Op. 7. This is neither a fair price, nor a fair dealing to NCPRF or Sierra LP.

The only persuasive argument presented by the Board at the Court of Chancery was that if the DHPP was not included, then the Indenture's interest rate would increase by "up to" fifty basis points. Mem. Op. 9. While true that an additional half-percentage point would increase the amount of interest paid on the loans, Chancellor Snyder correctly recognized that this was speculative at best. Mem. Op. 9. There is no evidence that the percentage would go up to the full 2.5% interest if the DHPP was not included. In fact, the interest paid on an additional half a percent of interest, even if compounded daily, would only yield an addition $1 million in payments on interest as opposed to a foreseeable loss of $10 to 15 million. The Board made a transaction that would allow Sierra LP to lose substantially more assets if a proxy contest is threatened, and reap the benefits of this transaction at the expense of the resources that it was entrusted with. Mem. Op. 3. There

can be no doubt that unless the Board avoided some other oppressive or unusual term in the Indenture, which the Board has not asserted, Mem. Op. 9, this provision is neither a fair price, nor were the dealings of this inclusion fair to Sierra LP or NCPRF. Therefore, the provision is not entirely fair and cannot stand.

ii. When the Board failed to inform themselves of the inclusion of a Dead Hand Proxy Put in Section 11.01 of the Indenture, a provision that Delaware courts have revealed disdain for, the Board of Directors breached its fiduciary duty of care.

As fiduciaries of a corporation and its shareholders, a board of directors must subscribe to the duty of care, which requires directors to act on an informed basis. *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993), *decision modified on reargument*, 636 A.2d 956 (Del. 1994). In turn, a board will be deemed to have breached the duty of care where directors "collectively have failed to inform themselves fully and in a deliberate manner." *Id.* at 368. Under such circumstances, a board loses its protection of the business judgment presumption and must undertake the burden of establishing the entire fairness of its decision. *Id.*

Particularly, in order to act in a fully informed manner, a board must inform itself on the existence of "terms which may affect the stockholders' range of discretion in exercising the franchise [], even if considered customary." *Amylin*, 983 A.2d at 319. This is especially true in the context of agreeing to a DHPP, which is "highly suspect" and "might be unenforceable as against public policy." *Healthways*, 2014 WL 6388645, at *80; *Amylin*, 983 A.2d at 315. Due to its constraining nature, the Delaware Courts of Chancery has explicitly warned directors regarding

the use of DHPPs in indentures. *See, e.g.*, *Amylin*, 983 A.2d at 319; *Kallick*, 68 A.3d at 248.

In *Kallick*, the Court of Chancery endorsed the idea that "the board should police aspects of agreements like this" when considering a proxy put. 68 A.3d at 248. The court further specified that it is to be expected that "any public company would bargain hard to exclude that toll on the stockholder franchise and only accede to the Proxy Put after hard negotiation and only for clear economic advantage." *Id.* Furthermore, in *Healthways*, the Court of Chancery (in a bench ruling) stated that there was "[a]mple evidence putting lenders on notice that these provisions . . . could potentially lead to a breach of fiduciary duty" by the directors that the lenders negotiate with. 2014 WL 6388645, at *80. Therefore, the collaborative effect of the duty of care with the unique nature of a DHPP imposes on the board a duty to fully inform itself on the existence of such a "catastrophic" provision. *Amylin*, 983 A.2d at 319.

Under such guiding principles, the Court of Chancery correctly identified that the Board "failed to exercise adequate care." Mem. Op. 10. It is undisputed that the Board adopted a "catastrophic," *Amylin*, 983 A.2d at 319, and "highly suspect," *Healthways*, 2014 WL 6388645, at *80, provision that "might be unenforceable against public policy," *Amylin*, 68 A.2d at 315, without the slightest hint of inquiry, Mem. Op. 5-6. Instead of subscribing to the scrupulousness expected from a board of directors, the Board ignored, Mem. Op. 5-6, the warnings specified to it by the Court of the Chancery. *Amylin*, 983 A.2d at 319; *Kallick*, 68 A.3d at 248; *Healthways*, 2014 WL 6388645, at *80. The record establishes that the Board was not "even [] aware of the existence the

proxy put in Section 11.01" and that the matter was never discussed before approving the terms of the Indenture. Mem. Op. 5, 10. How then, can the Board be said to have policed the agreement, bargained hard for its exclusion, or pursued a "clear economic advantage" as expected by *Kallick*? 68 A.3d at 248. The obvious answer is that it cannot. As such, by utterly failing to even consider the existence of a DHPP, the Board failed to fully inform itself and breached the duty of care. Mem. Op. 10.

Moreover, the Court of Chancery correctly identified that while a breach of the duty of care was not found under a similar sequence of events in *Amylin*, 983 A.2d at 307-308, "the admonition from that opinion" placed boards on notice that DHPPs may be subject to judicial review and invalidation. Mem. Op. 10-11. The progeny of *Amylin* further strengthened this admonition, expressly iterating that parties should be on notice for the connection between DHPPs and breaches of fiduciary duty. *See Kallick*, 68 A.3d at 248; *Healthways*, 2014 WL 6388645, at *80. Therefore, based on the open contempt that Delaware courts have expressed towards DHPPs, there is no excuse for the Board to have negotiated for the Indenture without the slightest consideration of the existence of such a controversial provision. Mem. Op. 5-6.

Finally, the Board is no longer entitled to the business judgment rule due to its breach of the duty of care. As stated within the duty of loyalty claim, the Board has failed to establish entire fairness of the Indenture to Sierra LP. Therefore, the inclusion of the DHPP cannot stand.

## II. THE BOARD'S INCLUSION OF A DEAD HAND PROXY PUT IN THE INDENTURE IS *PER SE* INVALID UNDER THE DELAWARE GENERAL CORPORATE LAW SECTION 141(a), AS IT IMPERMISSIBLY DENIES THE BOARD ANY ABILITY TO APPROVE A DISSIDENT SLATE OF DIRECTORS CHOSEN BY A PROXY CONTEST.

### A. Question Presented

Whether the inclusion of a DHPP in the Indenture, which has the effect of removing the Board's ability to approve any non-continuing director that is nominated or elected as a result of an actual or threatened proxy solicitation, is *per se* violative of Section 141(a) because it prevents the Board from exercising its fiduciary duties where approval is in the best interest of the corporation.

### B. Scope of Review

The present case arises from a grant of summary judgment by the Court of Chancery for NCPRF. Mem. Op. 12. In turn, this Court reviews appeals from a lower court's grant of summary judgment, as well as questions of law, *de novo*. *See In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 42 (Del. 2006). While the Court of Chancery provided no ruling on the issue of *per se* invalidity, the issue presents a question of law to be reviewed *de novo*. Mem. Op. 1.

### C. Merits of the Argument

A DHPP is a defensive measure. A board may adopt defensive measures to dissuade outside interference with the corporation's business and affairs if it (1) had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985), and (2) the defensive measure is "proportional" to the threat posed. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1367 (Del. 1995). Defensive measures are not

evaluated under the business judgment presumption until these two conditions are met under *Unocal* review. *Unitrin*, 651 A.2d at 1373.

Chancellor Snyder correctly determined that the appropriate standard of scrutiny for the DHPP was entire fairness, which the Board failed. Mem. Op. 9. Yet, Appellants still maintain *Unocal* is the correct review for the DHPP. The Board relied heavily in the Court of Chancery on the fact that it was ignorant of the DHPP inclusion in the Indenture, Mem. Op. 9, so it could not have "reasonable grounds" to institute the defense. *Id.* Therefore, the provision should not be evaluated under *Unocal*, but under entire fairness. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 271 (Del. Ch. 1989).

Even if *Unocal* is the correct standard, this Court should formally recognize the use of a DHPP is *per se* violative of Del. Code tit. 8, § 141(a) (2016) because it prevents the Board from using its statutory authority to approve non-continuing directors elected or nominated through proxies, and therefore, is disproportionate under *Unocal*. Section 141(a) provides that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors." 8 Del. C. § 141(a) (2016). This Court has required that, in carrying out this statutory mandate, "the directors have a fiduciary duty to the corporation and its shareholders." *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1292 (Del. 1998). As such, "a contract, or a provision thereof, [that] purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable." *Paramount Commc'ns', Inc. v. QVC Network, Inc.*, 637 A.2d 34, 51 (Del. 1993).

Consequently, it is established that "no defensive measure can be sustained which would require a [] board of directors to breach its fiduciary duties." *Quickturn*, 721 A.2d at 1292. In *Quickturn*, this Court found a continuing directors "Delayed Redemption Provision" invalid under Section 141(a). *Id.* at 1293. The Court reasoned that the provision, which would have the effect of delaying a newly-elected board's ability to redeem a rights plan for six months, "impermissibly circumscribe[d] the board's statutory power under Section 141(a) and the directors' ability to fulfill their concomitant fiduciary duties." *Id.* Particularly, the provision was problematic because it contravened the board's ability to act in its managerial capacity (through redemption of the rights plan) where fiduciary duties required it to do so. *Id.* at 1291.

In making that decision, this Court cited affirmatively to a Court of Chancery decision that found a claim of invalidity under Section 141(a) regarding a dead hand poison pill to be legally cognizable. *Id.* at 1291 (referencing *Carmody v. Toll Bros., Inc.*, 723 A.2d 1180, 1190 (Del. Ch. 1998)). In *Toll Brothers*, the plaintiff challenged a dead hand poison pill provision that "would jeopardize a newly-elected future board's ability to achieve a business combination by depriving that board of the power to redeem the pill without obtaining the consent of the 'Continuing Directors.'" 723 A.2d at 1191. The plaintiff reasoned that the provision impermissibly interfered with the board's Section 141(a) powers by withdrawing its ability to redeem the pill. *Toll Brothers*, 723 A.2d at 1191. In denying a motion to dismiss and recognizing the claim

as legally cognizable, the court found support in New York case law[1] that similarly found a continuing director provision violative of an eerily comparable statute. *Toll Brothers*, 723 A.2d at 1192.

In the present case, the DHPP acts as a defensive measure to a shift in control that requires the Board to breach its fiduciary duties. Mem. Op. 2. In this sense, it is analogous to the condemned delayed redemption provision in *Quickturn*, 721 A.2d at 1292, and the questioned dead hand poison pill in *Toll Brothers*, 723 A.2d at 1192. To begin, while taking different forms, all three of the provisions are rooted in the concept of continuing directors. Mem. Op. 2; *Quickturn*, 721 A.2d at 1289; *Toll Bros.*, 723 A.2d at 1184. Further, just as the delayed redemption provision estopped the board from redeeming the rights plan in *Quickturn*, 721 A.2d at 1292, and the dead hand poison pill precluded redemption of the pill in *Toll Brothers*, 723 A.2d at 1292, the DHPP removes the ability of the Board to pursue the best interests of the company and approve dissident directors from an actual or threatened proxy solicitation. Mem. Op. 2. In other words, the DHPP is a contractual provision that prohibits the Board from acting in a specified fashion (approving the non-continuing directors), even where its fiduciary duties require it to do so. *Id.* The DHPP is disproportionate to the threat posed, which is nothing, Mem. Op. 9, and as such, violates the principle this Court set forth twenty-four years ago in *Paramount*, 637 A.2d at 51, *Toll Brothers*, 723 A.2d at 1291, and *Unocal*, 493 A.2d at 955.

[1] Bank of NY Co. v. Irving Bank Corp., 528 N.Y.S.2d 482, 484 (N.Y. Sup. Ct. 1988)

Certainly, this Court could identify the subtle differences between a DHPP, delayed redemption provision, and dead hand poison pill. For example, the delayed redemption provision in *Quickturn* stopped the board from a *redemption* action. 721. A.2d at 1192. Alternatively, the DHPP in the present case precluded an action of *approval*. Mem. Op. at 2. Yet, despite the recognized difference between the two, the core effect is the same: each stop a board of directors from taking an action it can exercise under Section 141(a) and subsequently must perform under each director's fiduciary duties. Due to this inherent link between DHPPs and the condemned delayed redemption provision, this Court should extend the reasoning it employed in *Quickturn*, 721 A.2d at 1291-93, to the present case and find the DHPP *per se* violative of Section 141(a).

## Conclusion

For all of the foregoing reasons, NCPRF respectfully requests that this Court AFFIRM the opinion of the Court of Chancery granting Plaintiff Below, Appellee's cross-motion for summary judgment invalidating the DHPP provision.

/s/ Team D
Team D
Counsel for
Plaintiff Below-Appellee