IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

APPELLANTS' OPENING BRIEF

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NATURE OF PROCEEDINGS

Appellee, plaintiff below, brought a derivative action on behalf of Sierra Energy Partners LP (Sierra LP) on January 20, 2016. Mem. Op. at 8. Appellee alleged breach of fiduciary duties for approving a trust indenture which included a dead hand proxy put clause and sought the invalidation of the clause. *Id.* Appellants, defendants below, made a motion to dismiss for failure to state a claim, which the court ultimately characterized as a motion for summary judgment. *Id.* Likewise, the Appellee made a cross-motion for summary judgment. *Id.*

First, analyzing the existence of the dead hand proxy put clause in the indenture, the Chancery Court relied on the warning set forth in *San Antonio Fire & Police Pension Fund v. Amylin Pharms., Inc.*; specifically, the Chancery Court explained that in situations where an agreement may change the shareholders' free will to control the entity, the board of directors should be made aware of the terms, regardless of whether it is routine. *Id.* at 10.

Second, the Chancery Court determined that Sierra Resources and the Individual Defendants owe fiduciary duties to Sierra LP. *Id.* at 11. Following *In re USACafes, L.P. Litig.*, the Court of Chancery noted that a corporation's board of directors owe fiduciary duties to the limited partners and limited partnership when the corporation is the general partner. *Id.* Relying on Sierra Resources' and the board of directors' use of Sierra LP's joint venture investment, the Chancery Court determined Sierra Resources and the individual board members owe fiduciary duties to Appellee and Sierra LP. *Id.*

Appellants timely filed the notice of appeal on January 11, 2017. Ntc. of Appeal. Specifically, the Appellants appeal the Court of Chancery's order granting the cross-motion for summary judgment in favor of the Appellee. The Appellants request this Court reverse the grant of summary judgment and grant the motion for summary judgment in favor of the Appellants.

SUMMARY OF THE ARGUMENT

I. This Court should reverse the Chancery Court's grant of Appellee's cross-motion for summary judgment and the denial of Appellants' summary judgment motion determining a breach of fiduciary duty occurred. The Chancery Court's grant of summary judgment should be reversed for two reasons. First, the standard for determining whether a breach of fiduciary duty occurred, when a director's inaction occurs in reliance of outside counsel, is gross negligence. Here, Appellants inaction was in reliance of outside counsel, which is not gross negligence. Second, under the *Unocal* framework the proxy put, Section 11.01, is entirely fair to Sierra LP because the Notes' interest rates would have been up to fifty points higher, which would have reduced the overall profitability of Sierra LP.

II. This Court should reverse the Chancery Court's grant Appellee's cross-motion for summary judgment and the denial of Appellants' summary judgment motion finding Appellants owe a fiduciary duty to the limited partnership and the limited partner. The Chancery Court's grant of summary judgment should be reversed for two reasons. First, this Court has yet to squarely address the issue in this case. Second, if a fiduciary duty does exist, the only duty Appellants owe to Sierra LP and Appellee is the duty of loyalty; however, Appellants have not breached the duty of loyalty because Appellants were unaware of the inclusion of Section 11.01 in the Indenture.

STATEMENT OF THE FACTS

Sierra Resources, Inc. (Sierra Resources) is a real estate corporation that deals in commercial and residential properties. Mem. Op. at 4. Specifically, Sierra Resources predominantly uses consolidation and joint ventures to acquire ownership of leading real estate properties. *Id.* In the past, Sierra Resources has participated in joint ventures with Sierra Energy Partners LP (Sierra LP) and Sierra GP LLC (Sierra GP). *Id.* The focus of this case concerns one of the joint ventures in which Sierra Resources participated. *See id.*

In outlining the parties, it is of note that the involved parties include a corporation, a limited liability company, and a limited partnership. Mem. Op. at 3. Sierra Resources, a Delaware corporation, is the sole manager and member of Sierra GP. *Id.* Sierra GP is a Delaware limited liability company, which serves as the sole general partner and twenty percent limited partner of Sierra LP, a Delaware limited partnership. Mem. Op. at 3. The Plaintiff, North Carolina Police Retirement Fund, is a limited partner of Sierra LP and owns eighty percent of the limited partnership. *Id.* The Court of Chancery referred to Sierra GP and Sierra Resources as "Entity Defendants." Mem. Op. at 1. The "Individual Defendants" are Sierra Resources' board of directors, and additionally, The Bank of New York Mellon Trust Company, N.A. (BNY Mellon) is a Defendant. *See id.*

As a result of the depressed real estate market in 2008, North Carolina Police Retirement Fund, Plaintiff, began discussing a commercial joint venture with Sierra Resources. Mem. Op. at 4. Ultimately, Sierra LP was created. *Id.* Plaintiff provided $80 million

towards the joint venture, and Sierra Resources provided $20 million for the venture. *Id.* In order to make Sierra LP more profitable by increasing its debt, Sierra GP, with the Plaintiff's support, searched for debt financing. Mem. Op. at 5. Accordingly, Sierra LP's public offering occurred on August 15, 2013, which included 160 million in Notes with two percent interest. *Id.* The resulting Indenture from the public offering is the crux of this case. *See id.* at 2.

The attorney for Sierra LP and Sierra Resources did not draft the Indenture; instead, the lead underwriter's attorney, which is Morgan Stanley's attorney, created the Indenture. *Id.* at 5. Throughout the process of the Indenture's creation, the attorney for the Defendants did not discuss Section 11.01, with any employee of Morgan Stanley or any person at all. *Id.* Further, the attorney for the Defendants did not modify Section 11.01 during the drafting process. *Id.* Furthermore, "discovery did not reveal that any representative of the Entity Defendants ever suggested or encouraged the inclusion of that provision." *Id.* In sum, the Defendants, nor any agent of the Defendants, advocated for Section 11.01 to appear in the Indenture; conversed with anyone about Section 11.01; or amended the clause in Section 11.01. *See id.* Moreover, Morgan Stanley's attorney inserted Section 11.01 and failed to discuss this clause with the Defendants or the attorney for the Defendants. *See id.*

Prior to the approval of the Indenture, one of the directors of Sierra Resources inquired into whether the agreement included any unusual or "novel" terms, and the outside counsel of Sierra Resources answered in the negative. Mem. Op. at 6. The director, who

specifically asked the outside counsel, served on the finance committee for Sierra Resources' board of directors. *Id.* Additionally, prior to and during the execution of the Indenture, Sierra Resources had no suggestion of any change in control. *See id.* No specific threat or suggestion of an election contest existed; though, generally, shareholder activism in the real estate industry was known. *See id.*

Ultimately, the Indenture was entered into on August 16, 2013. Mem. Op. at 2. Section 11.01, the section at issue in this case, is a proxy put containing a "dead hand" provision. *Id.* More specifically, if a "Change of Control" transpires, the clause, provides the Noteholders with the right to immediate payment. *Id.* However, Section 11.01(b)(iii), the dead hand aspect, requires all the principal and interest be paid immediately upon any change of control, regardless of the current board's approval of new directors. *See* Mem. Op. at 2. In other words, the current board cannot prevent triggering the noteholder's acceleration rights by approving new directors elected from an election contest. *See id.*

Currently, the proxy put clause requiring the amount on the notes to become due has not been triggered. *See* Mem. Op. at 7. High Street Partners, LP (High Street), has mentioned using a contested solicitation to elect new directors for Sierra Resources' board of directors. *See* Mem. Op. at 6. High Street obtained the right to bring a proxy challenge by purchasing a small percentage of Sierra Resources' shares in October 2015—approximately 6.3 percent. *See id.* High Street provided options for Sierra Resources to adopt as a new business strategy, and High Street provided it would contemplate using

a contested solicitation, if Sierra Resources does not put in place one of the proposed business strategies. *See id.* Based on the proxy put in Section 11.01, if High Street gets a majority of Sierra Resources' board of directors elected, then the clause would accelerate the payments due on the Notes. *See* Mem. Op. at 7. Consequently, both Sierra Resources and Sierra LP would be financially impacted from having to refinance and pay the amounts owed on the Notes. *See id.*

After Defendants stated in a press release that Sierra LP's Notes would become due if High Street was successful in its proxy challenge, Plaintiff brought this derivative action on behalf of Sierra LP on January 20, 2016. *See* Mem. Op. at 1, 7.

ARGUMENT

Directors of a corporation, due to their positions of trust, are fiduciaries; however, establishing that directors are fiduciaries only begins the analysis. *SEC v. Chenery Corp.*, 318 U.S. 80, 85-86 (1943). What obligations, as fiduciaries, do the directors owe, and to whom these obligations are owed are questions this Court should answer. *See id.* In answering these questions, this Court should consider the evolving concepts and needs of the corporation. *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 957 (Del. 1985). As aptly stated in *Unocal*, corporate law is not static, rather, it must "grow and develop in response to, indeed in anticipation of, evolving concepts and needs." *Id.*

I. APPELLANTS HAVE NOT BREACHED THEIR FIDUCIARY DUTIES BY APPROVING AN INDENTURE THAT UNKNOWINGLY CONTAINED A DEAD HAND PROXY PUT BECAUSE APPELLANTS WERE NOT GROSSLY NEGLIGENT AND RECEIVING A LOWER INTEREST RATE IS ENTIRELY FAIR TO SIERRA LP.

A. Question Presented

Whether fiduciary duties are breached when the board of directors approves an indenture unknowingly containing a dead hand proxy put, even though a director inquired about any novel provisions to outside counsel and counsel answered in the negative. Mem. Op. at 8.

B. Scope of Review

The standard of review for an appeal from a grant of summary judgment is de novo. *Pike Creek Chiropractic Ctr., v. Robinson*, 637 A.2d 418, 420 (Del. 1994)(citing *Merrill v. Crothall-American, Inc.*, 606 A.2d 96, 99 (Del. 1992)).

C.Merits of Argument

The use of outside counsel is highly beneficial to corporations and, by extension, its shareholders. It follows, then, that director inaction from reliance on outside counsel does not, necessarily, create liability. *See San Antonio Fire & Police Pension Fund v. Amylin Pharms., Inc.*, 983 A.2d 304, 318-19 (Del. Ch. 2009).

In the context of takeover attempts, the invocation of defensive measures imposes a special burden on directors for the business judgment rule to apply. *See Unocal*, 493 A.2d at 955-56. Regardless, a board's failure to satisfy these requirements does not create liability. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 271 (Del. Ch. 1989). Rather, under the *Unocal* framework, the board's actions do not breach any fiduciary duties when the actions are found to be entirely fair to the principal. *Id.* at 271.

Assuming Appellants owe fiduciary duties to Sierra LP and Appellee, Appellants have not breached their fiduciary duties for two reasons. First, Appellants took no action, as a fiduciary, in regards to the implementation of the proxy put, and such inaction and reliance on outside counsel is not gross negligence. Second, under *Unocal*, the proxy put is fair to Sierra LP because the interest rate would have been higher had the provision not been included.

1. Appellants' inaction with the proxy put is not gross negligence because of their reliance on outside counsel.

Appellants' reliance on outside counsel and subsequent inaction in regards to the proxy put does not rise to the level of gross

negligence required for a breach of the duty of care. For a director to be liable for inaction, a plaintiff must establish that the defendant was grossly negligent in failing to learn of the existence of the dead hand proxy put provision. *See Amylin*, 983 A.2d at 318 (citing *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000)). Under this standard, directors are required to consider all material reasonably available. *Brehm*, 746 A.2d at 259.

Accordingly, because reasonableness is an objective test, a board does not have to be informed of every fact. *Id.* For example, in *Amylin*, the directors discussed the terms of the notes with outside counsel; however, outside counsel never brought the specific terms at issue to the attention of the directors, nor did the board advocate or draft the provisions in question. *Amylin*, 983 A.2d at 308. Further, the plaintiff, in *Amylin*, argued that questioning outside counsel as to whether an indenture contained anything unusual or not customary was insufficient and grossly negligent. *Id.* at 318. The court, in dicta, cautioned that terms, even if considered customary, should be highlighted to the board. *Id.* at 319. Nevertheless, the *Amylin* court held the inquiry the board made into the indenture was not gross negligence because the board retained highly-qualified counsel and the information was out of the reach of the board. *Id.* at 318-19.

Whether information is out of the reach of the board of directors depends on reasonableness—an objective standard. *Brehm*, 746 A.2d at 259. To illustrate this concept, in *Brehm*, the directors terminated an employment contract without cause before calculating the benefits packet that would be paid out. *Id.* at 260. In other words, the board

failed to consider the potential cost in terminating without cause. *Id.* Nonetheless, this Court, in *Brehm*, held the board was not grossly negligent because the board was advised by and relied on an expert, thus, putting the information out of reach. *Id.* at 261, 262.

Here, the inaction by Appellants occurred because of their reliance on outside counsel, placing the information out of reach. *See* Mem. Op. at 5-6. Similar to *Amylin*, Appellants were not aware of the proxy put, nor did they draft or advocate for its inclusion. *Id.* at 5. Rather, Counsel for Morgan Stanley prepared the original draft of the indenture. *Id.* Consequently, Appellants' inaction and failure to become informed of Section 11.01 should be measured by the standard set out in *Brehm*—gross negligence. *See Brehm*, 746 A.2d at 259.

Under this standard, the information of Section 11.01, the proxy put, was out of the board's reach and does not result in gross negligence on behalf of the directors. Appellants, similarly to *Amylin* and *Brehm*, relied on outside counsel. *See* Mem. Op. at 6. Specifically, here, one of the directors asked counsel if there were any novel terms that required attention and counsel responded in the negative. *Id.* Further evidencing that the information was out of reach, those who negotiated for the Indenture on behalf of Sierra LP and Sierra Resources testified in a deposition that they never communicated with anyone at Morgan Stanley or otherwise concerning the proxy put provision. *Id.* at 5. Accordingly, due to the reliance on outside counsel, the information the board lacked was not reasonably available. *See id.* Thus, because the board relied on outside counsel,

the approval of the Indenture was not grossly negligent. Therefore, Appellants have not breached a fiduciary duty.

2. The inclusion of Section 11.01 in the Indenture does not breach a fiduciary duty because the proxy put is entirely fair by attaining a lower interest rate.

Appellants have not breached a fiduciary duty because the proxy put is entirely fair to Sierra LP and Appellee. Under *Unocal* and its progeny, a board may act to defeat the threat of a takeover by implementing defensive measures. *See Unocal*, 493 A.2d at 955. In determining whether a defensive measure breaches a fiduciary duty, the *Unocal* framework takes a two-prong approach. *See id.* Under the first prong, whether the business judgment rule is applied is determined by scrutinizing whether the actions were in good faith and reasonable. *Id.* For the aspect of reasonableness, the board is required to have considered the threat by performing an analysis. *Id.* Here, however, because the board was unaware of the proxy put in the indenture, the board did not and could not perform such an analysis. Mem. Op. at 5.

Nevertheless, despite the absence of a *Unocal*, reasonableness analysis, the second prong must still be analyzed to determine whether a breach of fiduciary duty occurred. *See Shamrock Holdings*, 559 A.2d at 271 (citing *Unocal*, 493 A.2d at 958)). In the second prong, the issue scrutinized is whether the defensive measure was entirely fair. *Shamrock Holdings*, 559 A.2d at 271. Essentially, when the defensive measures are found to be fair, no duty is breached. *Id.* In *Shamrock Holdings*, the court illustrated three factors to consider for fairness. *See id.* Notably, the *Shamrock Holdings* Court considered

first, whether the productivity of the business is impaired or enhanced; second, the effects of preventing a proxy challenge; and third, the defensive measure's dilutive effect. *See id.*

Here, the proxy put included in the indenture is entirely fair to Sierra LP and Appellee because, notably, the interest rate would have been up to fifty basis points higher. Mem. Op. at 9. For this reason, the proxy put served a legitimate business purpose. Without the inclusion of the proxy put clause, Sierra LP would not have obtained the low—two percent—interest rate for the Notes; based on the affidavit from Morgan Stanley, the Notes' interest rates would have changed "'up to 50 basis points' higher." *See id.* Significantly, the proxy put aided in improving Sierra LP's profitability by decreasing the interest rate on the notes. *See id.*

The lower interest rate on the Notes allowed Sierra LP to obtain the capital from BNY Mellon. *See id.* at 5. As a result of the lower interest rate attained from the proxy put, Sierra LP increased its capital and tax deductions—enhancing the operations aspect of the business. *See id.* Accordingly, under the first factor, the productivity of Sierra LP is enhanced due to the inclusion of the proxy put by attaining a lower interest rate.

Although presently the proxy put, if triggered, stands to cause Sierra LP a substantial financial loss, despite the enhancement to business operations; importantly, at the time of the Indenture's approval, no specific threat of an election contest existed. *See id.* at 6, 7. Furthermore, the Notes were financed at two percent. *Id.* at 5. Without the proxy put inclusion, the interest rate would have been

fifty basis points higher, which also would have been a substantial burden. *See id.*

The effects of preventing a proxy challenge may be deemed unfair, if the defensive measure makes it impossible to bring a successful proxy challenge. *See Shamrock Holdings*, 559 A.2d at 274 (applying factor in traditional takeover situation). Here, the proxy put clause does not render a takeover, or change of control, impossible. *See* Mem. Op. at 2. A financial burden may be placed on the company should a takeover occur, which may act as a deterrence; however, a takeover still remains possible. *See id.* at 2, 6. Moreover, the Appellants were unaware of the existence of the proxy put clause, and thus, did not include this provision as a means of preventing a proxy challenge. *See id.* at 5-6. As a result of the possibility of a takeover occurring, the defensive measure is considered fair under this factor.

The dilutive effect of the defensive measure may be deemed unfair if the defensive measure dilutes the shareholders' interests in their stock. *See Shamrock Holdings*, 559 A.2d at 274. Here, none of the shareholders' interests were diluted because no stock was issued in conjunction with the Indenture. *See* Mem. Op. at 5. As a result, the proxy put has no dilutive effect and it is entirely fair under this factor. *See id.*

Ultimately, the proxy put is entirely fair to Sierra LP because without the proxy put, the interest rate would have been higher—decreasing the profitability of Sierra, LP.

In sum, this Court should reverse the Chancery Court's grant of Appellee's cross-motion for summary judgment for two reasons. First,

Appellants were not grossly negligence because their inaction was in reliance of outside counsel. Second, the proxy put is entirely fair to Sierra LP because the Notes' interest rates would have been up to fifty points higher, which would have reduced the overall profitability of Sierra LP.

II. APPELLANTS DO NOT OWE FIDUCIARY DUTIES TO APPELLEE AND SIERRA LP BECAUSE APPELLANTS DID NOT ABUSE THE INDIRECT CONTROL OVER SIERRA LP, AND AT A MAXIMUM ONLY THE DUTY OF LOYALTY IS OWED.

a. Question Presented.

Whether a corporation and its board of directors owe a fiduciary duty to a limited partnership and its limited partner when the corporation is the sole member of a limited liability company acting as the sole general partner in a limited partnership. Mem. Op. at 12.

b. Scope of Review.

A de novo standard of review is to be applied by the reviewing court following an appeal from a grant of summary judgment. *Pike Creek Chiropractic Ctr.*, 637 A.2d at 420.

c. Merits of Argument.

The issue of whether second-tier managers, such as the board of directors of a corporation who is the sole member of a limited liability company acting as the sole general partner of a limited partnership, owe fiduciary duties to the limited partnership and the limited partner is a question of first impression for this Court. *See In re USACafes, L.P. Litigation*, 600 A.2d 43, 48 (Del. Ch. 1991). With no prior precedent, the Chancery Court in *USACafes* applied general principles and analogies from trust law. *Id.* Essentially, the test utilized in *USACafes*, the ("Control Test"), examined the control exerted by the directors of the corporate general partner. *Id.* at 49. However, the Control Test remains too narrow for the evolving concepts and needs of the corporation. *See* Colin P. Marks, *Piercing the Fiduciary Veil*, 19 LEWIS & CLARK L. REV. 73, 74 (2015). Rather, the test this Court should utilize ("Control Plus")

involves more than control. *See id.* at 75. Particularly, the Control Plus test looks behind the corporate veil, or more aptly put, it allows the court to pierce the "fiduciary veil" when an abuse of control is shown. *Id.*

Further, the Chancery Court's decision in *USACafes* did not determine what specific duty was breached. 600 A.2d at 49 (noting that the court does not need to determine the full scope of the duty). Nevertheless, in later interpretations, only the duty of loyalty may be breached. *Feeley v. NHAOCG, LLC*, 62 A.3d 649, 671-72 (Del. Ch. 2012).

Appellants do not owe fiduciary duties, or alternatively, only owe a duty of loyalty to Sierra LP and Appellee. First, this Court should adopt a Control Plus standard in evaluating fiduciary duties in this context, and under Control Plus, Appellants do not owe a fiduciary duty. Second, subsequent cases which discuss *USACafes* has limited the scope of its application to the duty of loyalty; thus, Appellants only owe the duty of loyalty to Appellee.

1. Appellants do not owe fiduciary duties to Appellee because Appellants did not abuse their control of Sierra LP.

Though no precedent exists from this Court, the Chancery Court has established a standard for applying fiduciary duties on a corporate general partner and its directors to a limited partnership and its limited partner—the Control Test. *See USACafes*, 600 A.2d at 49. Under this standard, the court looks to the control exerted by the corporate general partner. *Id.* Particularly, when the controlling director exerts more control over the partnership's property than

corporate general partner, fiduciary duties are extended to the corporate general partner finding a breach when self-dealing occurs. *Id.* However, the court's Control Test remains limited and creates a problematic situation for directors of a corporate general partner who are second tier managers. Colin P. Marks, *Piercing the Fiduciary Veil*, 19 LEWIS & CLARK L. REV. 73, 85 (2015). Specifically, the directors owe competing fiduciary duties to the corporation and to the limited partnership and its limited partners. *Id.* at 85-86. Further, the director's obligations to the corporation, and by extension its shareholders, are its primary obligations. *Id.* Respectively, the director's obligations to the limited partnership are secondary. *Id.*

Under the Control Plus approach, however, the court assumes no fiduciary duties have attached due to the corporate general partner's removal and second tier status. *Id.* at 105. This follows Delaware law; which, generally, does not find a fiduciary relationship in an arms-length transaction. *Id.* at 103 (citing *Total Care Physicians, P.A. v. O'Hara*, 798 A.2d 1043, 1058 (Del. Super. Ct. 2001)). Nonetheless, this does not mean a breach of fiduciary duty cannot occur; rather, the fiduciary veil must be breached for liability to attach. *See* Colin P. Marks, *Piercing the Fiduciary Veil*, 19 LEWIS & CLARK L. REV. 73, 105 (2015).

To determine whether the veil may be pierced the court should apply a two-step test, the Control Plus test. *See id.* First, the court, like in *USACafes*, should determine whether Appellant exerted control over Sierra, LP. *See id.*; *see also* 600 A.2d at 49 (examining the corporate general partners control). Second, if control is exerted, the court

should determine whether the control has been abused. *See* Colin P. Marks, *Piercing the Fiduciary Veil*, 19 LEWIS & CLARK L. REV. 73, 105 (2015). Determining whether an abuse of control has occurred should be determined by a bad faith standard. *Id.* at 110-11; *See also Unocal*, 493 A.2d at 955 (requiring good faith). Because Delaware law generally applies a burden shift requiring the non-movant to show good faith, this step should also require such a burden shift, in this case Appellants will demonstrate their good faith. *See, e.g.*, *Unocal*, 493 A.2d at 955.

This proposed test is similar to the one used in *Cargill, Inc. v. JWH Special Circumstance LLC*; particularly, the court used a three-step series of questions to determine whether an entity exerted controlled and breached a duty: (1) whether the defendant(s) owed an *actual* duty to the plaintiff, (2) whether the defendant(s) exercised control over the plaintiff or plaintiff's property, and (3) whether defendant(s) exercise of control over the plaintiff or plaintiff's property benefit the defendant(s) to the detriment of the plaintiff or plaintiff's property. 959 A.2d 1096, 1118-24 (Del Ch. 2008). Both tests consider the control aspect plus the existence or non-existence of an abuse of control. *See Cargill*, 959 A.2d at 1118-24; *see also* Colin P. Marks, *Piercing the Fiduciary Veil*, 19 LEWIS & CLARK L. REV. 73, 105 (2015).

Here, Appellant exerted indirect control over Sierra LP because Sierra Resources was the sole manager and member of Sierra GP, the general partner for Sierra LP. Mem. Op. at 3. Thus, under the first step, this Court will likely find, as the Chancery Court found, that Appellants indirect control over Sierra LP, the limited partnership, creates an attachment of fiduciary duties. *See USACafes*, 600 A.2d at 49

(establishing fiduciary duties because the obligations pass from the limited partnership through the general partner-corporation).

However, the fact that Appellants exerted indirect control over Sierra LP does not indicate they abused such control. Rather, this Court should apply the further Control Plus analysis, and determine whether a fiduciary duty has attached through a bad faith standard. Under the second step in Control Plus, Appellant's have acted in good faith as a second-tier manager. Though Appellants have indirect control, they have not abused this control through bad faith. *See* Mem. Op. at 5. Specifically, Appellants were not aware of the inclusion of Section 11.01 of the Indenture and took reasonable steps in approving the Indenture by consulting outside counsel. *See id.* at 5-6. Thus, Appellants have not acted in bad faith and abused the indirect control they have over Sierra LP, as a second tier manager.

2. <u>If the Court finds the Appellants owe a fiduciary duty to Appellee, this duty is limited to a claim for breach of the duty of loyalty.</u>

A duty of care question arises when a board of directors approves an indenture agreement for Notes. *See Amylin*, 983 A.2d at 318. In determining whether the board of directors breached the duty of care, it is instructive to examine whether the board of directors considered all material reasonably available to them. *See id.* Moreover, for the board of directors to be liable for a duty of care breach, a plaintiff must establish that the board was grossly negligent in approving the indenture. *See id.* (noting board was not grossly negligent in failing to discover a proxy put clause in the indenture). The holding of *USACafes*

does not extend to duty of care questions and, accordingly, a corporate general partner's duty to the limited partner and partnership has been repeatedly restrained to duty of loyalty claims. *See Feeley v. NHAOCG, LLC*, 62 A.3d 649, 671-72 (Del. Ch. 2012).

If a fiduciary duty exists here, it is solely a duty of care question as Appellee's claim is based on the approval of the Indenture. Mem. Op. at 8. Specifically, the Appellee claimed that the Appellants violated a fiduciary duty by approving an Indenture that included a dead hand proxy put clause. *See id.* As here, when the board of directors approves an agreement, such as an indenture, the board's approval is a duty of care question, and the appropriate standard, is whether the board was grossly negligent.

Nevertheless, if this Court finds a duty is owed, it is limited to a duty of loyalty. *See Feeley*, 62 A.3d at 649. Specifically, the board of directors who serve the corporate general partner may not use the property of a limited partnership to the disadvantage of the partnership. *See USACafes*, 600 A.2d at 48. For example, the board of directors may not act in self-dealing in a transaction with the partnership's property, which includes the board of the corporate general partner receiving side compensation for the sale of the limited partnership's assets. *See id.* at 46.

Here, Appellants were unaware of the proxy put clause in Section 11.01. Mem. Op. at 5. Moreover, Appellants did not advocate for the inclusion of the proxy put. *Id.* During the drafting period of the Indenture until its ultimate execution, Appellants did not discuss Section 11.01 with anyone, including any employee or representative of

Morgan Stanley, the party responsible for the inclusion of the proxy put clause. *See id.* As a result of being unaware of the proxy put clause, Appellants did not have the requisite intent of wanting to use the investment money to Sierra LP's detriment.

Additionally, the proxy put clause is potentially detrimental to both Sierra LP and Sierra Resources. *See id.* at 7. Accordingly, the detriment to Sierra LP is a financial impact. *Id.* The detriment to Sierra Resources is also a financial impact, and Sierra Resources faces a change to its business model, if High Impact succeeds on a proxy challenge. *See id.* at 6-7. Specifically, Sierra Resources' business model focuses on investment in high-end real estate, and High Impact's proposed changes would negate Sierra Resources' business model by essentially selling substantially all of its assets. *See id.* at 4, 6-7.

Based on *USACafes*, a benefit must be conferred to the controller of the property, while the owner of the property must be disadvantaged. Here, if High Street, or any other activist, were successful in bringing a proxy challenge, Sierra Resources would receive no benefit; indeed, Sierra Resources would be disadvantaged by the financial impact and change to its business model. *See id.* at 7. Ultimately, no facts of self-dealing or benefit conferred have been alleged against Appellants, and therefore, there is no sufficient claim of a breach of the duty of loyalty.

In sum, this Court should reverse the Chancery Court's grant of the Appellee's cross-motion for summary judgment for two reasons. First, this Court has never determined the issue in this case; namely, whether a corporation and its board of directors owe a fiduciary duty

to a limited partnership and its limited partner when the corporation is the sole member of a limited liability company acting as the sole general partner in a limited partnership. Second, the only duty that Appellants might owe Sierra LP and Appellee is the duty of loyalty; however, Appellants have not breached the duty of loyalty because Appellants were unaware of the inclusion of Section 11.01 in the Indenture.

Conclusion

For the foregoing reasons, Appellants respectfully request that this Court reverse the Chancery Court's grant of summary judgment in favor of Appellee and grant Appellants motion for summary judgment.