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, 2017
Petitioners Below, Appellants	:	Court Below:
v.	:	Court of Chancery of the State of Delaware
NORTH CAROLINA POLICE RETIREMENT FUND, individually and derivatively on behalf of SIERRA PROPERTIES LP,	:	C.A. No. 12871-CS
Respondent Below, Appellee	:	

APPELLEE'S ANSWERING BRIEF

Filed by Team F
Attorneys for Appellee

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NATURE OF PROCEEDINGS

North Carolina Police Retirement Fund ("NCPF") commenced action on behalf of Sierra LP against Sierra GP, Sierra Resources, and the Independent Directors of Sierra Resources on January 20, 2016 because Sierra GP exercises exclusive control over Sierra LP and because Sierra LP is controlled by Sierra Resources. NCPF sought a declaration from the court invalidating the Indenture containing Section 11.01. NCPF claimed the approval of the Indenture violated the fiduciary duties owed to the NCPF and to Sierra LP by Sierra Resources and its Independent Board. The Defendants motioned to dismiss, and the lower court decided to treat the motions as summary judgment. The lower court addressed the motions with NCPF's cross-motion for summary judgment. The lower court granted summary judgement favoring NCPF and the Defendants submitted notice of appeal on January 11, 2017.

SUMMARY OF ARGUMENT

1. Denied. This Court should deny Appellants' petition to dismiss the fiduciary claims against Sierra Resources and Individual Defendants because Sierra Resources as the parent corporation, and the Independent Directors controlled the property of the limited partner. The equitable principle of fiduciaries may be applied across all statutory business forms and through successive tiers of a parent-subsidiary entity. Because Appellants' used the property of the limited partner to benefit themselves, without the consent of the limited partner, and to the detriment of the limited partner, a controlling parent corporation has a fiduciary duty to the property owner. Appellants owe fiduciary rights and their petition must be dismissed.

2. Denied. This Court should also deny Appellants' petition to validate Section 11.01 of the Indenture Agreement because Section 11.01 is not fair to Sierra LP. Section 141(a) and (d) require that a change to the authoritative control of the board of directors be implemented only through the certificate of incorporation. A validation of Section 11.01 would create voting power distinction within the unclassified board of directors, which is a right conferred on shareholders. A validation of Section 11.01 would also create a voting class distinction within the board of directors. In order to validate Section 11.01, and in order to allow Sections 141(a) and (d) to be circumvented, the Appellants' would need a compelling justification. Because Appellants' have no compelling justification, their petition must be dismissed.

STATEMENT OF FACTS

On October 13, 2008 the North Carolina Police Retirement Fund ("NCPRF"), Sierra GP and Sierra Resources entered into an agreement to form Sierra LP (the "LP Agreement"). NCPRF contributed and owns 80% of the limited partnership interest ($ 80 million) in Sierra LP. Sierra LP's general partner, Sierra GP, owns the remaining 20% of the interest, the $20 million in funds for which were contributed by Sierra Resources. Op. at 3-4.

In 2013, Sierra GP entered into Indenture on behalf of Sierra LP. This resulted in a $160 million public offering of 2% Notes due 2028 on August 15, 2013. Op. at 2. Without informing NCPR, the individuals acting on behalf of Sierra LP as the management of Sierra GP agreed to a dead hand provision ("DHP") contingent on a Change of Control provision. The put option affords Noteholders the right to immediate payment of the principal amount of the Notes as well as any accrued interest. The put is triggered in the event of a "Change of Control" as defined in Section 11.01 of the Indenture.

In drafting the Indenture, counsel for Sierra LP and Sierra Resources reviewed the draft—the Section 11.01 provision containing the DHP remained unchanged throughout the drafting stage. Op. at 6. Before Sierra Resources approved the terms of the offering of the Notes, a director asked outside counsel whether there were terms in the Indenture that were unprecedented. The answer was no. Op. at 6.

In 2015, High Street Partners, LP ("High Street") indicated that it wanted to acquire 6.3% of the outstanding shares of Sierra Resources. Op. at 6. High Street also indicated its intention to implement new strategies for Sierra Resources, including a possible

sale of the company. Op. at 6. These strategies were disseminated to the board of directors of Sierra Resources, which is an unclassified board with an annual election. Op. at 6.

While High Street filed for its 6.3% acquisition of Sierra Resources, numerous press releases and presentations were made asserting that if High Street constituted a majority of the board, the proxy put in the Sierra LP Indenture would require Sierra LP to pay off the principal of the Notes with interest. Op. at 7. While the financial impact of triggering the proxy put would only minimally effect Sierra Resources, the significance to Sierra LP could mean a refinancing within $2 to $3 million, the repayment of the principal amount to the Noteholders, as well as any accrued interest. Op. at 7.

ARGUMENT

I. THE COURT OF CHANCERY CORRECLTY APPLIED *USA CAFES* TO FIND THE PARENT CORPORATION AND THE INDIVIDUAL DIRECTORS OWED FIDUCIARY DUTIES TO A TWO-TIER SUBSIDIARY LP AND ITS LIMITED PARTNER.

A. QUESTION PRESENTED

Whether an upstream parent corporation and its individual directors owe fiduciary duties to a two-tier subsidiary LP and its limited partner.

B. SCOPE OF REVIEW

The Delaware Supreme has held the "Court of Chancery's legal conclusions are subject to de novo review." *Lawson v. Meconi*, 897 A.2d 740, 743 (Del. 2006). Because the issue at hand involves assessing the application of judicial standard, *de novo* is the appropriate standard of review.

C. MERITS OF THE ARGUMENT

1. The Court of Chancery relied on case law that is applicable to the instant case and correctly held that Sierra Resources and the Individual Directors owed fiduciary duties to a two-tiered limited partner and its owner

"Under corporate law, the directors of a corporation—those vested with control over management of the corporation—must be "natural persons." *Mohsen Manesh, The Case Against Fiduciary Entity Veil Piercing*, 72 Bus. Law, 65 (2016). Corporate law finds these duties necessary in order to "ensure that those vested with control and discretionary power over the business exercise that control and power in a manner that is in the best interests of the business and its owners, rather than in their own self-interests." Manesh at 65. However, the

context of alternative entities contrasts with corporate law; within that context, a legal entity rather than a natural person may manage the property of another entity. Manesh at 65. So while in corporate law a natural person always owes fiduciary duties to the corporation he or she controls, in the context of alternative entities, the entity may not be controlled by an individual person. The question then arises, "when the person who stands in a fiduciary position is not a natural person, but instead a legal entity, […] whether, in addition to this fiduciary entity, [will] the individuals controlling the fiduciary entity also owe a fiduciary duty directly to the beneficiary entity and its owners." Manesh at 66. The question was answered by the Court of Chancery in *USACafes*: the Court determined that, "where a corporation is the general partner of an LP, the directors of the corporate general partner owe a fiduciary duty directly to the LP and [to] the limited partners of the LP." Manesh at 66.

Since *USACafes*, the Court of Chancery has applied this within contexts similar to the entity structure in present case. The key element in determining whether a fiduciary relationship exists in such contexts is the element of abuse of *de facto* control — that is "the one who controls property of another may not, without implied or express agreement, 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). The Court of Chancery correctly applied the principle of *USACafes* to the instant case, because as the

progeny of *USACafes* demonstrates, 1. Fiduciary duties may be applied across all statutory business forms and through successive tiers of a parent-subsidiary entity.

For instance, a. In *Wallace v. Wood*, the Court of Chancery found that the "General Partner […] of a limited partnership and the directors of a corporate General Partner who control the partnership," could owe fiduciary duties to the LP and its limited partners. *Wallace v. Wood*, 752 A.2d 1175, 1178 (Del. Ch. 1999). Although "Delaware law clearly holds that officers of a corporation are not liable on [a] corporate contract as long as" that officer "does not bind [himself] individually," the court found the duties of the directors of the general partner analogous to the duties of a fiduciary in trust law. *Wallace v. Wood*, 752 A.2d 1175, 1178 (Del. Ch. 1999). Because the directors of the general partner "dominated and controlled the affairs of the limited partnership," and because the directors of the general partner "control[led] … the partnership's property to the advantage of the … directors […] at the expense of the partnership," the Court applied the principle in *USACafes* to find that a director of a general partner could owe fiduciary duties to the limited partnership. *Wallace v. Wood*, 752 A.2d 1175, 1178 (Del. Ch. 1999).

Paige Capital Management is another case where the Court of Chancery found a natural person controlling the general partner of an LP to owe fiduciary duties directly to the LP. *Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, Civil Action No. 5502-CS, 2011 Del. Ch. LEXIS 116 (Ch. Aug. 8,

2011). In determining whether a fiduciary relationship existed or not, the Court of Chancery looked for an element of control within the transaction. *Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, Civil Action No. 5502-CS, 2011 Del. Ch. LEXIS 116 (Ch. Aug. 8, 2011). The court determined that the managing member of an LLC owed fiduciary duties to the LP because that managing member controlled the property of the LP. *Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, Civil Action No. 5502-CS, 2011 Del. Ch. LEXIS 116 (Ch. Aug. 8, 2011).

In *Bigelow/Diversified*, the Court of Chancery found a general partnership, the partners of the general partnership, as well as "upstream entities and individuals affiliated," owed fiduciary duties to a partner LP and its limited partners. *Bigelow/Diversified Secondary P'ship Fund 1990 v. Damson/Birtcher Ptnrs*, C.A. No. 16630-NC, 2001 Del. Ch., at *31 (Ch. Dec. 4, 2001). The Court of Chancery reiterated that "mere ownership" of the general partner did not establish a fiduciary duty owed by the affiliates of that general partner to the subsidiary LP and its limited partner. *Bigelow/Diversified Secondary P'ship Fund 1990 v. Damson/Birtcher Ptnrs*, C.A. No. 16630-NC, 2001 Del. Ch. LEXIS 152, at *31 (Ch. Dec. 4, 2001). However, because the affiliates of the general partner "exercise[d] control over the partnership's property," the affiliates were fiduciaries to the partnership and to the limited partners. *Bigelow/Diversified Secondary P'ship Fund 1990 v. Damson/Birtcher Ptnrs*, C.A. No. 16630-NC, 2001 Del. Ch. LEXIS 152, at *31 (Ch. Dec. 4, 2001).

In *Bay Centers,* the Court of Chancery found where one LLC is managed by another LLC, the sole member of the managing LLC could owe a fiduciary duty to the first LLC, thus extending the principle to apply to LLCs as well as LPs. *Bay Ctr. Apts. Owner, LLC v. Emery Bay PKI, LLC*, No. 3658-VCS, 2009 Del. Ch. LEXIS 54, at *25 (Ch. Apr. 20, 2009). *Bay Centers* also demonstrates that the Court of Chancery first looks to whether there is a contract that delineates the fiduciary duties between the parties. *Bay Ctr. Apts. Owner, LLC v. Emery Bay PKI, LLC*, No. 3658-VCS, 2009 Del. Ch. LEXIS 54, at *25 (Ch. Apr. 20, 2009)."The Delaware LLC Act gives members of an LLC wide latitude to order their relationships, including the flexibility to limit or eliminate fiduciary duties." *Bay Ctr. Apts. Owner, LLC v. Emery Bay PKI, LLC*, No. 3658-VCS, 2009 Del. Ch. LEXIS 54, at *25 (Ch. Apr. 20, 2009).But "in the absence" of an LLC agreement that thoroughly delineates the fiduciary duties owed by the controller, the sole manager of the managing LLC owed fiduciary duties to the first LLC. *Bay Ctr. Apts. Owner, LLC v. Emery Bay PKI, LLC*, No. 3658-VCS, 2009 Del. Ch. LEXIS 54, at *25 (Ch. Apr. 20, 2009). Although the record in the instant case shows that the LP Agreement contained such detailed provisions, these primarily eliminated the duty of loyalty to refrain from competition with Sierra LP, and limited duty of care claims by eliminating monetary liability. Furthermore it should be noted that although under Delaware law, "[a] partnership agreement may provide for the limitation or elimination of any and all liabilities for […] breach of duties (including fiduciary duties) of a partner *or other*

person (emphasis added) to a limited partnership […]", however, the "agreement may not limit or eliminate liability for any act or omission that constitutes a *bad faith violation of the implied contractual covenant of good faith and fair dealing* (emphasis added). 6 Del. C. § 17-1101(f).

2. This Court should uphold the precedent set in *USACafes* and its progeny, that the directors of a controlling parent corporation of a general partner which owes fiduciary duties to an LP and its limited partners, may also owe such fiduciary duties to such LP and its limited partners.

In its aforementioned rulings, the Court of Chancery provides insight as to the reasons why it attaches fiduciary duties to 'second-tier' controlling managers. In each case these fiduciary duties were imposed on equitable grounds as to pierce the 'fiduciary veil' of separate legal entity law. *Colin P. Marks, Piercing the Fiduciary Veil, 19 Lewis & Clark L. Rev. 73, 76 (2015).* In other words, not the exercise of (indirect) managerial control as such, but the inequitable abuse of that control warrants an exception to the law. Relevant circumstances the Court examined were to what extent the managing corporation controlled a down-stream subsidiary, the manner in which that control was exerted—whether that would violate the duties of a fiduciary, and the motives of the controlling manager insofar as they demonstrate lacking good faith.

Under a traditional approach such as in Tower Investors, LLC v. 111 East Chestnut Consultants, the legal separateness of entities is upheld regardless of the second-tier manager's inequitable conduct.

Tower Investors, LLC v. 111 East Chestnut Consultants, Inc., 864 N.E.2d 927, 941 (Ill. App. Ct. 2007). Appellants may argue that this approach is in line with Delaware's deference to freedom of contract. Appellants may further invoke ease and clarity as arguments for such an approach. Yet in the context of an LP that is managed by non-natural persons, clarity is a far cry. After all, a judgment may not offer recourse or relief if the direct fiduciary of the party seeking relief is merely a shell company through which the ultimate managers exert their control. Under a strict approach, Sierra GP would have to be shown to have breached its fiduciary duties to Sierra LP in order to have the Court declare the litigated provision invalid and unenforceable. Sierra GP however can only act through its ultimate human actors, resulting possibly in the Court applying a standard of scrutiny that differs from one that may otherwise have been applied to those actors as *qua* fiduciaries of the LP. If this Court chooses to overrule USACafes and replace its flexibility with a strict, black-and-white rule, managers can avoid fiduciary duties by simply setting up an intermediate entity 'in between'. Hence, they may be more inclined to conduct themselves carelessly vis-à-vis subsidiaries since their behavior is not sanctioned by equity.

Appellants may also argue that upholding USACafes can result in conflicts of interest when directors are found to owe fiduciary duties to a subsidiary entity, when their first and foremost fiduciary is the parent corporation. *Gelfman v. Weeden Investors, L.P.*, 792 A.2d 977, 992 n.24 (Del. Ch. 2001) "The defendant's argument in this regard raises yet again the awkward position occupied by directors of corporate General Partners—do they owe

fiduciary duties to limited partners akin to those owed by corporate directors to stockholders, even though it is the corporate general partner which is the core fiduciary?"

This 'awkward situation' does not arise as a default. First, there is no indication that the interests of Sierra LP and NCPFR conflicted with those of Sierra Resources. Instead it may be argued that those interests aligned towards the success of the joint venture. Second, it should be noted that Appellants failed to provide convincing evidence to the Court of Chancery that they were fulfilling their fiduciary duty to Sierra Resources and its shareholders by agreeing to the inclusion of Section 11.01. Indeed, that Court found generally that the directors did not meet the Unocal standard of a reasonable measure taken against a reasonably perceived threat. Furthermore, in consequence, the Individual Directors' assent to Section 11.01 cannot be explained as having been a good faith effort to comply with a duty owed to Sierra Resources. Rather, the Individual Directors' conduct should be regarded as self-benefitting. Cf. *In re USACafes, L.P. Litig.,* 600 A.2d 43, 48-49 (Del. Ch. 1991).

II. THE COURT OF CHANCERY CORRECTLY INVALIDATED SECTION 11.01 OF THE INDENTURE AGREEMENT.

A. QUESTION PRESENTED

Whether Section 11.01 in the Indenture should be invalidated because it per se violates Delaware law since it deprived Sierra Resources' incumbent Board of Directors of any ability to avoid triggering the noteholders put rights.

Whether Section 11.01 should be invalidated because it resulted from Sierra Resources' and the Individual Directors' breach of fiduciary duty of care or good faith to Sierra LP when Sierra Resources and its Individual Directors were not aware of the content of Section 11.01, when they took no action as a fiduciary to Sierra LP to prevent the inclusion of the Dead Hand Provision ("DHP") an affidavit from a creditor institution recites that if Section 11.01 had not been included in the Indenture, the interest rates on the Notes would have been and when prior precedent requires terms that affect the stockholders' discretion be highlighted before the board.

B. SCOPE OF REVIEW

The Delaware Supreme has held the "Court of Chancery's legal conclusions are subject to de novo review." *Lawson v. Meconi*, 897 A.2d 740, 743 (Del. 2006). Because the issue at hand involves assessing the application of judicial standard, *de novo* is the appropriate standard of review.

C. MERITS OF THE ARGUMENT

Sierra Resources and the Independent Directors approved an Indenture with a DHP to govern Sierra LP's 2% notes. The Indenture affords noteholders the right to require Sierra LP to pay the principal of the Notes, together with accrued interest, if there is a Change of Control event pursuant to Section 11.01 of the Indenture. Section 11.01 of the Indenture coerces the board to approve the election of persons nominated in connection with an election contest or face triggering the DHP in the Indenture. Such a provision has both entrenching and defensive effects because,

not only does it place a penalty on the board, but also the provision prevents potential acquirers from seeking to elect a new board.

The DHP in Section 11.01 per se violates Section 141(a) and (d). While the Indenture essentially limits the board's authority in elections, Section 141(a) requires any limitation on the board's authority to be set out in the certificate of incorporation. In addition, while the Indenture essentially creates class distinctions among an unclassified board by excluding from the majority incumbent board any director elected through a proxy contest, section 141(d) recognized the power to create voting power distinctions among directors only where there is a classified board.

Courts should find a DHP illegal per se because the provision unlawfully restricts the power of future boards by unlawfully creating a class of directors who have the power to redeem the DHP, and a class of directors who do not have such power. Because section 141(d) requires a provision creating class distinctions to be included in the certificate of incorporation, because there is no evidence that such a restriction is included in the charter of Sierra Resources, the DHP is invalid on its face.

1. Section 141(a) and (d) and Delaware precedent allow only the certificate of incorporation to change the authoritative control of the board of directors.

A principle basic to Delaware corporate law is that the board has the "ultimate responsibility" for managing the corporation. *Quickturn Design Sys. v. Shapiro*, 721 A.2d 1281,

1291 (Del. 1998). In discharging this function the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders. *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986). Section 141(a) requires that any limitation on the board's authority be set out in the certificate of incorporation, while Section 141(d) vests the power to create voting power distinctions among directors only in the articles of incorporation. *Carmody v. Toll Bros.*, 723 A.2d 1180, 1191 (Del. Ch. 1998).

By applying a strict interpretation, this Court will find that Section 11.01 is illegal per se because it allows for the Indenture agreement to create class distinctions by excluding from the class of directors allowed to redeem the DHP, any director "whose initial nomination for, or assumption of office as, a member of that board or equivalent governing body occurs as a result of an actual or threatened solicitation of proxies or consents. Op. at 2. Not only does Section 11.01 unlawfully create class distinctions between board members who can redeem the DHP and board members who cannot redeem the provision, but also Section 11.01 allows for some directors to have greater voting powers. Op. at 2. By vesting the DHP redemption power exclusively in the continuing directors, Section 11.01 violates the right ordinarily bestowed on shareholders who would elect directors that would have such a right. *Carmody v. Toll Bros.*, 723 A.2d 1180, 1191 (Del. Ch. 1998). If the Court does not find any extraordinary circumstances, the Court should continue to enforce the statute as it reads, meaning that because Section 11.01 alters the authority of the directors from the authority

enumerated in the certificate of incorporation, then Section 11.01 is on its face invalid.

a. The strict interpretation of Section 141(a) and (d) confers the power to create voting power distinction among directors only in a classified board and only when those voting power distinctions are expressed in the certificate of incorporation.

Section 11.01 has a coercive effect on the board of directors. The effect of a DHP is to limit the ability of acquirers to solicit a proxy contest and replace the incumbent board of directors. Because it limits the ability of owners to replace directors, a DHP conflicts with corporate law because Section 141(a) provides that the only vehicle for limiting the "board's authority" is the "certificate of incorporation." *Carmody v. Toll Bros.,* 723 A.2d 1180, 1184 (Del. Ch. 1998). Per Section 11.01, "any individual whose initial nomination … occurs as a result of an actual or threatened solicitation of proxies or consents" [is] "excluded" from being within the "majority of the members of the board of directors" who are able to redeem the DHP. Op. at 2.

Toll Brothers is a case holding that a DHP interfered with stockholders' rights and was coercive because the provision forced shareholders to vote for the incumbent board in order to redeem the defensive device: "In substance, the [DHP] operat[ed] to prevent any directors of Toll Brothers, except those who were in office as of the date of the Rights Plan's adoption … or their designated successors, from redeeming the Rights." *Carmody v. Toll Bros.,* 723 A.2d 1180, 1184 (Del. Ch. 1998). Therefore, a DHP is inherently unfair to Sierra LP because it leads to two unfair results: First, it creates the unlikelihood of an unsolicited offer for Sierra LP

because an acquiror is no longer able to gain control through a proxy contest. The consequence of an acquiror attempting a proxy contest to replace the incumbent board is the triggering of the Noteholders' put rights requiring Sierra LP to immediately pay the principal with interest to the Noteholders. Op. at 2.

Second, the DHP prevents dissident directors from the opportunity to redeem the DHP: Section 11.01 withholds the ability to redeem the DHP from those directors "whose initial nomination … occurs as a result of an actual or threatened solicitation of proxies or consents for the election or removal of one or more directors." Op. at 2. The Court of Chancery has determined that such a limitation on the election of the future board of directors is effectively disenfranchising the shareholders who would want the company managed by a different board. Carmody v. Toll Bros., 723 A.2d 1180, 1184 (Del. Ch. 1998).

b. Section 141(d) mandates that the right to elect one or more directors with distinctive voting rights is a right conferred on shareholders and not continuing board members.

Section 141(d) mandates that only stockholders possess the reserved right to elect one or more directors with greater voting power than other directors. The effect of the DHP is that the right traditionally bestowed on only the stockholders is extended to a subset of directors—that is, per Section 11.01, only "approved" directors are eligible to be considered part of the "majority of the members" that retain the ability to prevent put rights from being triggered. Op. at 2. "Absent express language in the charter, nothing in Delaware law suggests that some directors of a public

corporation may be created less equal than other directors, and certainly not by unilateral board action." *Carmody v. Toll Bros.,* 723 A.2d 1180, 1185-86 (Del. Ch. 1998). Furthermore, vesting a redemption power exclusively in Continuing Directors will provide the basis to violate the shareholder right to choose directors with the power to redeem the DHP. For that reason, and because the agreement allocating voting powers to redeem the defensive provision was not found in the certificate of incorporation, the Court of Chancery in *Toll Brothers* determined the dead hand feature in a Rights Plan was statutorily invalid under Delaware law. *Carmody v. Toll Bros.,* 723 A.2d 1180, 1190-91 (Del. Ch. 1998)

2. A board's decision to adopt a DHP cannot be validated without compelling justification.

a. Because the adoption of the DHP disenfranchises the shareholder vote, a DHP may only be valid in agreements that make alternative provisions for the shareholder vote.

Although DHP are inherently defensive, they are not inherently coercive. In *Moran*, the Court of Chancery and the Supreme Court allowed a "'flip over' rights plan" because of "three distinct fact[s]:" First, the defensive device "would not erode fundamental shareholder rights, because the target board" could not "arbitrarily … reject a hostile offer … or refuse [to] redeem a pill." *Carmody v. Toll Bros.,* 723 A.2d 1180, 1190-91 (Del. Ch. 1998). The Indenture agreement, in contrast, allows a target board to arbitrarily reject a hostile offer; the threat of triggering the put rights allows the Continuing Directors to wield the power to render Sierra LP unattractive to acquirers.

The second fact that was significant to the Court of Chancery in *Moran* was that "even if the board refused to redeem the pill," preventing the shareholders from accepting an unsolicited offer, the Rights plan allowed for an acquiror to solicit proxies "for consents to remove the Board and redeem the Rights." *Moran v. Household International, Inc.*, Del. Ch., 500 A.2d 1059, 1072. The biggest issue with Section 11.02 is that it does not provide for the acceptance of an unsolicited offer, but rather entrenches the incumbent board of directors by not allowing them the ability to avoid triggering the put rights in the context of an acquisition that would disrupt the Continuing Board. Op. at 2.

Third, per *Moran*, even if an offer was precluded, stockholders would still be able to "wage a proxy contest to remove the board." *Moran v. Household International, Inc.*, Del. Ch., 500 A.2d 1059, 1355. Thus, because the Rights Plan effectuated opportunities to redeem the pill, "the Supreme Court concluded 'the Rights Plan [would] not have a severe impact [on] proxy contests and [would] not preclude [ ]hostile acquisitions." *Moran v. Household International, Inc.*, Del. Ch., 500 A.2d 1059, 1355. In contrast, because Section 11.01 provides no opportunities for the incumbent board of directors to avoid triggering the put right, having a substantially detrimental impact on Sierra LP and no material impact to Sierra Resources. Op. at 7. If triggered, the put right would require Sierra LP to immediately pay off the Notes with interest and hope to obtain alternative financing of up to $3 million to pay off the Notes. Op. at 7. Therefore because the Indenture Agreement does not preclude the board of directors from arbitrarily rejecting an acquirer, because the Indenture agreement essentially precludes the

solicitation of proxies to replace the incumbent board and does not provide an alternative voting opportunity for shareholders, and because the financial effects of triggering the Indenture are substantial, the Indenture Agreement is inherently coercive and therefore must be invalidated under principles of *Moran* and *Toll Brothers.*

b. A board's unilateral decision to adopt a defensive measure touching "upon issues of control" that purposefully disenfranchises its shareholders is strongly suspect under *Unocal*, and cannot be sustained without a compelling justification.

The disenfranchisement of shareholders occurs here because shareholders are powerless to elect a board that is both willing and able to accept a hostile bid. Applying Section 11.01 to a corporate setting would effectively force shareholders to vote for [incumbent] directors whose policies they reject because only those directors have the power to change them." *Carmody v. Toll Bros.,* 723 A.2d 1180, 1193-94 (Del. Ch. 1998). A claim that the directors have unilaterally "created a structure in which shareholder voting is either impotent or self-defeating" is necessarily a claim of purposeful disenfranchisement. *Carmody v. Toll Bros.,* 723 A.2d 1180, 1193-94 (Del. Ch. 1998). Considering the Supreme Court's rationale for upholding the validity of the poison pill in Moran, and the importance that corporate law places on the shareholder vote, it is difficult for the Appellant to justify the existence of Section 11.01 in the case of a fiduciary duty found between Sierra Resources and the Independent Board with Sierra Lp. While in *Moran* the Supreme Court validated the poison pill because its minimal effect on a proxy context, but also, it was important that the board refused to

redeem the plan, the shareholders could still exercise their prerogative to remove and replace the board.

In *Unocal* the Supreme Court reinforced the idea that the safe harbor justifying a board’s resistance to a hostile offer is that the shareholders always have their ultimate recourse in the ability to vote. Here, because of the fact that Sierra LP is an alternative entity, the inability of a shareholder vote as recourse only magnifies the unfairness of Section 11.01 that precludes a proxy contest or hostile bid. Therefore, a fundamental value in corporate jurisprudence is the preservation of the shareholder vote because it is the "ideological underpinning upon which the legitimacy of directorial power rests." Because of the importance of the shareholder vote to corporate law, and because in the context of an alternative entity there is no shareholder recourse via vote to compensate for the inability of a hostile acquisition or a proxy contest replacing the incumbent board, therefore, in the context of Sierra LP as an alternative entity, Section 11.01 is illegal per se under Delaware law.

CONCLUSION

For the foregoing reasons, this Court should affirm the Court of Chancery's decision in granting NCPF's motion for Summary Judgment.

Respectfully submitted,

Team F,

Counsel for Appellee