IN THE SUPREME COURT OF THE
STATE OF DELAWARE

SIERRA GP LLC, SIERRA RESOURCES, INC., THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., SARAH W. BRYANT, ROBERT P. GRAY, RICHARD T. HANSON, ELIZABETH F. PRINCE, AND JOHN W. REYNOLDS,	
	No. 31, 2016
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,	
Plaintiff Below, Appellee.	

APPELLANTS' OPENING BRIEF

Filed by Team G,
Counsel for the Defendants Below,
Appellants

Date Filed: February 3, 2017

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NATURE OF PROCEEDINGS

On January 20, 2016, The North Carolina Police Retirement Fund ("Appellee") brought this suit individually and derivatively on behalf of Sierra Properties LP ("Sierra LP"). It named as defendants Sierra LP, Sierra GP LLC ("Sierra GP"), Sierra Resources, Inc. ("Sierra Resources")(collectively the "Entity Appellants"), and The Bank of New York Mellon Trust Company, N.A. ("BNY Mellon").[1] It additionally named Sierra Resources' directors, Sarah W. Bryant, Robert P. Gray, Richard T. Hanson, Elizabeth F. Prince, and John W. Reynolds (collectively the "Individual Appellants"), as defendants. Appellee alleged that Appellants breached their fiduciary duties to Appellee in approving a trust indenture and sought a declaration that the indenture was unenforceable. Op. at 8.

All Appellants moved to dismiss the complaint, pursuant to Court of Chancery Rule 12(b)(6). Op. at 1. The Court of Chancery determined that Appellants presented matters in support of their motion to dismiss not included in the complaint, and, pursuant to Court of Chancery Rule 12(b), determined to treat the motion as one for summary judgment. Op. at 1. After additional discovery, Appellee submitted a cross motion for summary judgment in its favor. Op. at 1. On January 9, 2017, the Court of Chancery granted Appellee's cross motion for summary judgment. Op. at 12. Appellants timely filed a notice of appeal on January 11, 2017. (Notice of Appeal).

[1] BNY Mellon is a trustee of the trust indenture at issue and consequently is a necessary party to the action. Appellee, however, has not asserted that BNY Mellon owed, breached, or aided and abetted any breach of, fiduciary duty. Op. at 1, n.1.

SUMMARY OF ARGUMENT

I. This Court must reverse the decision of the Court of Chancery because dead hand proxy put provisions are not *per se* improper. The Individual Appellants made an informed, good faith decision to include Section 11.01 in the trust indenture. Furthermore, inclusion of the dead hand provision in Section 11.01 was proper because it served a legitimate business purpose. The Individual Appellants included Section 11.01 in the trust indenture to benefit and protect Sierra LP's business and did not intend for the dead hand provision to function as an entrenchment device.

II. Summary judgment must be granted in favor of Appellants for two reasons. First, the Individual Appellants did not owe fiduciary duties to Appellee. Because the Individual Appellants did not act with personal self-interest to benefit themselves at the expense of Sierra LP, the holding of *In re USACafes L.P. Litigation*, 600 A.2d 43 (Del. Ch. 1991) is inapplicable to the present case. Second, even if this Court determines that the Individual Appellants did owe fiduciary duties to Appellee, neither they nor the Entity Appellants breached those duties. The Appellants did not breach their duty of loyalty because they were neither interested in the outcome of the decision nor lacked independence, and they did not breach their duty of care because their actions were reasonably prudent.

STATEMENT OF FACTS

In 2008, Sierra LP was formed as a result of a joint venture between Sierra Resources and Appellee. Op. at 4. Sierra Resources operates in the real estate industry and thus is aware that companies in the industry often experience shareholder activism. Op. at 4, 6. Appellee owns 80% of Sierra LP and is the sole limited partner. Op. at 3-4. Sierra GP is the sole, 20% general partner of Sierra LP and is a wholly owned subsidiary of Sierra Resources. Op. at 3.

In early 2013, the Entity Appellants consulted with Appellee and obtained approval for debt financing of Sierra LP to improve the limited partnership's profitability. Op. at 5. On August 15, 2013, Sierra LP issued 2% Notes (the "Notes") for a public offering of $160 million. Op. at 5. The next day, Sierra LP entered into a trust indenture to govern the Notes, dated August 16, 2013, (the "Indenture"), with BNY Mellon. Op. at 2. Section 11.01 contains a dead hand proxy put provision that accelerates Sierra LP's debt if there is a majority change in control of Sierra Resources' board of directors. Op. at 2, 7. The financial repercussions of said change in control for Sierra Resources could be between $2 million and $3 million. Op. at 7. Sierra LP could also sustain a substantial economic impact as a result of a change in control but only if the limited partnership could not obtain alternative financing on short notice. Op. at 7.

The Indenture was drafted by Morgan Stanley and was reviewed by counsel for Sierra Resources and Sierra LP. Op. at 5. Throughout the Indenture revision process, Section 11.01 was never changed. Op. at 5. Furthermore, the Entity Appellants never advocated for the inclusion of

Section 11.01 to the Indenture. Op. at 5. Before the Notes were issued, the finance committee of Sierra Resources' board of directors requested that the company's outside counsel inform them of any novel terms in the Indenture. Op. at 5-6. In response, outside counsel informed the finance committee there were no novel terms that required the directors' attention. Op. at 6. Morgan Stanley also presented an affidavit to Appellants indicating the interest rate on the Notes would have been much higher than 2% without inclusion of Section 11.01 in the Indenture. Op. at 9.

On October 12, 2015, more than two years after Sierra LP issued the Notes, High Street Partners, LP ("High Street") acquired approximately 6.3% of Sierra Resources' outstanding shares. Op. at 6. In its 13D Filing, High Street stated its intent to repurchase Sierra Resources stock and possibly replace some of Sierra Resources' directors. Op. at 6. At the time legal proceedings began in this case, High Street had not initiated a proxy contest. Op. at 6-7.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN ITS GRANT OF SUMMARY JUDGMENT IN FAVOR OF APPELLEE BECAUSE SECTION 11.01 OF THE INDENTURE IS VALID AND ENFORCEABLE.

A. QUESTION PRESENTED

Whether the Court of Chancery erred in finding that the dead hand proxy put provision present in Section 11.01 of Indenture was invalid and unenforceable.

B. SCOPE OF REVIEW

Motions for summary judgment are reviewed *de novo* with deference to the non-moving party. *Williams v. Geier,* 671 A.2d 1368, 1375 (Del. 1996); *see also Hoechst Celanese Corp v. Certain Underwriters at at Lloyd's, London*, 656 A.2d 1094, 1099 (Del. 1995)(quoting *Merrill v. Crothall-American, Inc.*, 606 A.2d 96, 100 (Del. 1992)). When a case is reviewed *de novo*, this Court is free to make its own assessments and determinations of the facts presented by the respective parties. *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 844 (Del. 1987).

C. MERITS OF THE ARGUMENT

Appellants are entitled to summary judgment in their favor. The Individual Appellants were informed and acted in good faith when Section 11.01 was included in the Indenture. The Individual Appellants also had legitimate business reasons to include Section 11.01 in the Indenture. Characteristics of Section 11.01 demonstrate the provision was narrowly tailored and left much of Sierra LP's shareholders' franchise undisturbed. Furthermore, the Individual Appellants' inclusion of Section 11.01 in the Indenture was non-pretextual. For these reasons, this Court must find the dead hand provision in Section 11.01 is valid and reverse the decision of the Court of Chancery.

1. **The Individual Appellants' actions should be afforded business judgment rule deference because their decision to include Section 11.01 in the Indenture was made on an informed basis and in good faith.**

The actions of the Individual Appellants should be afforded business judgment rule deference because the facts of this case demonstrate they made an informed, good faith decision to include Section 11.01 in the Indenture. The business judgment rule "is a 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 v. Lewis*, 473 A.2d 805, 812 (Del. 1984). The initial burden to demonstrate that a director is not entitled to business judgment rule protection falls on the plaintiff. *Id.* To rebut the presumption of the business judgment rule, Appellee must show the Individual Appellants, as directors of Sierra Resources, breached their fiduciary duties. *Id.*

The Individual Appellants' utilization of outside counsel to facilitate the issuance of the Notes is analogous to the actions of the board of directors in *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*, 983 A.2d 304 (Del. Ch. 2009). In *Amylin,* the Pricing Committee of Amylin's board of directors failed to learn of a continuing director provision similar to that in Section 11.01. *Id.* at 318. The Court of Chancery held that Amylin's board was not grossly negligent in failing to know the continuing director provision existed in the Indenture, thus the directors did not violate their duty of care. *Id.* The Court of Chancery reached this conclusion because the "board retained highly qualified counsel" to facilitate the issuance of the notes. *Id.* Although the Court of Chancery in *Amylin* emphasized the importance of outside counsel’s advice related to actions that affect shareholders’ franchise, the court did not find the directors breached their duty of care. *Id.* at 319. Business judgment rule protection of directors’ reliance on outside counsel is further solidified in Delaware General Corporation Law, Title 8, § 141(e) (“DGCL”). DGCL § 141(e) states that members of a company’s board of directors, or committee members, are fully protected by the business judgment rule when such directors or board committee members rely in good faith on statements made by any person with expert competence and who was selected with reasonable care.

Ample evidence exists in the facts of this case to demonstrate that the Individual Appellants were informed and acting in good faith when they included Section 11.01 in the Indenture. The Individual Appellants obtained outside counsel to assist with the issuance of the Notes in compliance with their fiduciary duties. Op. at 6. Furthermore, the finance committee of Sierra Resources’ board of directors sought advice from outside counsel regarding any “novel terms” in the Indenture that required special attention. Op. at 5-6. This inquiry by the finance committee demonstrated the Individual Appellants’ desire to remain informed about the details of the Indenture. In response to the finance committee’s inquiry, outside counsel informed the committee there were no terms that required the board’s special attention. Op. at 6.

The Individual Appellants properly retained outside counsel to assist with the issuance of the Notes. Furthermore, they sought advice from outside counsel regarding the terms of the Indenture. The rationale of the Court of Chancery in *Amylin* along with the protection of directors in DGCL § 141(e) indicates this Court must find that the Individual

Appellants were not grossly negligent when they adopted Section 11.01 of the Indenture.

The Court of Chancery's transcript ruling in *The Fire & Police Pension Fund, San Antonio v. Stanzione*, demonstrates the court's belief that dead hand proxy put provisions with a "narrowed focus" are not overly harmful to shareholders and therefore are not *per se* invalid. *The Fire & Police Pension Fund, San Antonio v. Stanzione*, C.A. No. 10078-VCG, (Del. Ch. Telephonic Bench Ruling Tr. 7:24, Feb. 25, 2015). The Court of Chancery found that because the dead hand proxy put provision in *Stanzione* reset every year and required "a majority of dissident directors [to] be elected to take effect," the harm caused by the provision was minimized. *Id.* at 8:1-3. The limiting language of the provision in *Stanzione* left "much of the shareholders' franchise intact." *Id.* at 8:4. The Court of Chancery also emphasized, "as our case law describing the use of similar proxy puts as problematic becomes more developed, the value of removing such a device decreases. The situation begins to be less like chaining up a vicious bulldog and more like chaining up a toothless bulldog." *Id.* at 8:5-10. This statement by the Court of Chancery in *Stanzione* demonstrates a preference towards inclusion of provisions similar to that in Section 11.01, rather than removal of such devices.

The facts of this case indicate that Appellants acted in good faith because Section 11.01, like the provision in *Stanzione*, was sufficiently narrow in focus as to prevent disenfranchisement of the entity's shareholders. Section 11.01 of the Indenture resets every year as evidenced by the language, "during any period of 12 consecutive months

. . . .” Op. at 2. Furthermore, Section 11.01 requires a change in a “majority” of members of the board of directors. Op. at 2. This limiting language found in the Indenture protects the entity’s shareholders’ franchise and demonstrates that the Individual Appellants adopted Section 11.01 in good faith. This Court should follow the rationale of the Court of Chancery in *Stanzione* and grant summary judgment in favor of Appellants because the directors exercised good faith by including a narrowly tailored dead hand provision in Section 11.01.

2. The Individual Appellants’ actions should be afforded business judgment rule deference because inclusion of Section 11.01 in the Indenture was reasonably justified and served a legitimate business purpose.

Section 11.01 served a legitimate business purpose and was not intended by the Individual Appellants to function as an entrenchment device to maintain their position on Sierra Resources’ board of directors. On several occasions this Court has cautioned that a court should not “substitute its judgment for that of the boards if the [board’s] decision can be ‘attributed to any rational business purpose.’” *Unocal v. Mesa Petroleum Co.*, 493 A2d 946, 954 (Del. 1985), *see also Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

Research conducted on dead hand proxy put provisions demonstrates the benefits corporations receive when dead hand provisions, like the one present in Section 11.01, are included in debt agreements. *See* Sean J. Griffith & Natalia Reisel, *Dead Hand Proxy Puts, Hedge Fund Activism, and the Cost of Capital* (SSRN, Working Paper Dec. 17, 2016) (summarizing studies on effects of dead hand provisions). Delaware courts have previously looked to the scholarship of Sean J. Griffith and in his working paper, *Dead Hand Proxy Puts, Hedge Fund Activism, and the Cost* *of Capital*, Griffith and co-author Natalia Reisel find "that the inclusion of a Dead Hand Proxy Put reduces the cost of debt by approximately 45 basis points."[2] *Id.* at 5. Griffith's study also demonstrates that bondholders positively react to the inclusion of dead hand provisions in debt agreements. *Id.* The research shows that dead hand provisions like Section 11.01 provide firm-level benefits because they reduce the cost of capital. *Id.* Importantly, this study indicates that shareholders are not harmed by the inclusion of dead hand provisions in debt agreements. *Id.*

The Morgan Stanley affidavit is evidence that dead hand provision in Section 11.01 served a legitimate and rational business purpose. Op. at 9. The affidavit stated that without the inclusion of Section 11.01 in the Indenture, "the interest rate on the Notes would have had to have been 'up to 50 basis points' higher than 2% for the offering to have succeeded." Op. at 9. Inclusion of Section 11.01 benefitted Sierra LP because the entity was able to offer the Notes at a low interest rate.

Griffith and Reisel's research supports the information Appellants received in the Morgan Stanley affidavit and provides data demonstrating the numerous other benefits that corporations receive when provisions like Section 11.01 are included in trust indentures. Section 11.01 ensured that the Notes could be issued at a low interest rate which economically benefitted Sierra LP and appeased the needs of bondholders. The Individual Appellants were reasonably justified in including Section

[2] The Delaware Court of Chancery has referenced the scholarship of Griffith in *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884, 893 (Del. Ch. 2016), and in *In re Riverbed Technology, Inc. Stockholders Litigation*, 2015 WL 5458041 (Del. Ch. Sept. 17, 2015).

11.01 in the Indenture because of the benefits the provision conferred to Sierra LP.

The Court of Chancery has emphasized that dead hand proxy put provisions are not *per se* improper. *Pontiac General Employees Retirement System v. Ballantine* ("*Healthways I*"), 2014 WL 6388645 (Del. Ch. Oct. 14, 2014). In *Healthways I*, Vice Chancellor Laster warned that directors could be liable if dead hand proxy puts are included in credit agreements. *Id*. However, Vice Chancellor Laster later stated that his oral ruling in *Healthways I* was widely misunderstood. *Pontiac General Employees Retirement System v. Ballantine* ("*Healthways II*"), C.A. No 9789-VCL (Del. Ch. Hearing Tr., May 8, 2015). In *Healthways II*, the Vice Chancellor clarified that *Healthways I* was determined based on the unique facts of the case, specifically, that the dead hand provision in *Healthways I* was "adopted in the shadow of a proxy contest." *Id*. at 35:14-15.

This Court should follow the rationale of Vice Chancellor Laster and find that the facts of this case do not indicate the Individual Appellants intended Section 11.01 to function as an entrenchment device. The Individual Appellants have articulated several legitimate business purposes for including Section 11.01 in the Indenture therefore the provision was not intended to function as an entrenchment device.

Appellants entered into the Indenture with BNY Mellon as the trustee on August 16, 2013. Op. at 2. Appellants issued the Notes because Sierra LP was underleveraged and issuance of new debt would improve the entity's profitability. Op. at 5. The shareholder activism of High Street and threatened replacement of Sierra Resources' directors did not take place until more than two years after the Individual Appellants entered into the Indenture. Op at. 6. These facts demonstrate that Section 11.01 was adopted on a clear day, "when a company does not face an actual or realistically potential proxy contest." F. William Reindel et al., *Dead Hand Proxy Puts: What You Need to Know*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (June 10, 2015), https://corpgov.law.harvard.edu/2015/06/10/dead-hand-proxy-puts-what-you-need-to-know/(last visited Feb. 1, 2017). Section 11.01 was not included in the Indenture in the shadow of a threatened proxy contest therefore this Court should reverse the decision of the Court of Chancery.

3. **The Individual Appellants are entitled to summary judgment because their actions also satisfy the heightened scrutiny of *Unocal*.**

If this Court is not persuaded that the Individual Appellants are entitled to business judgment rule deference and applies the heightened reasonableness standard under *Unocal*, the Individual Appellants will still prevail. The first prong of the *Unocal* test requires Appellants to demonstrate that, after a reasonable investigation, they determined in good faith the corporation faced a threat warranting a defensive response. *Unocal*, 493 A.2d 946, 955-57. The second prong of *Unocal* requires Appellants to demonstrate the proportionality of defensive measures to the threats identified. *Id.*; *see also Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 269-70 (Del. Ch. 1989)(discussing how directors demonstrate they are entitled to business judgment rule deference).

The Individual Appellants, as competent directors of Sierra Resources, were aware of the potential for shareholder activism because such "activism was well known in the real estate industry." Op. at 6. In *Kallick v. Sandridge*, the company's board of directors refused to approve a dissident slate during a proxy contest in violation of their fiduciary duties. *Kallick v. Sandridge Energy, Inc.*, 68 A.3d 242, 260-61 (Del. Ch. 2013). In the present case, a dissident slate of directors has yet to be nominated. Op. at 6. Although *Sandridge* is distinguishable from the instant case, the Court of Chancery emphasized that *Unocal* can be satisfied if directors can articulate a "proper and non-pretextual" reason for their actions. 68 A.3d at 259.

In the present case, the Individual Appellants likely were aware of the threat that shareholder activism could pose to Sierra LP, specifically the threat that activist shareholders could attempt to leverage up the limited partnership. Section 11.01 protects against changes in control of Sierra Resources' board. This protection in turn provides assurance to the company and its creditors that new board nominees will not be able to impose short-cited or self interested business strategies. Reindel, *supra*. Similarly, directors in *Hills Stores Co. v. Bozic* defensively created severance agreements that would vest in the event of a change in control without the incumbent board's approval because they were concerned that the acquirer would leverage up the company. *Hills Stores Co. v. Bozic*, 769 A.2d 88, 91-92 (Del. Ch. 2000). In *Hills*, the directors were under pressure by an acquirer to repurchase the company's shares. *Id.* 95-96. Similarly, High Street, the activist hedge fund in the present case, stated in its 13D filing that it intended to accelerate "distributions through dividends or stock repurchases or both . . . ." Op. at 6. As informed and experienced board members, the Individual Appellants had industry experience and understood a threat existed that short-cited and self interested activist investors could attempt to exploit the limited partnership. The Court of Chancery in *Hills* analyzed the directors' actions under *Unocal* and found that they did not violate their fiduciary duties because the acquirer's future plans, that included leveraging up the company, would "be seriously adverse to the interests of the company and its stockholders." *Hills*, 769 A.2d at 101. This Court should find Appellants in the present case, like the directors in *Hills*, had a proper and non-pretextual reason for their actions and thus satisfy the requirements of *Unocal*. The Individual Appellants properly included Section 11.01 in the Indenture to protect against the threat of an activist shareholder leveraging up the company in an industry prone to shareholder activism. The Individual Appellants have shown they had a proper and non-pretextual purpose for including Section 11.01 in the Indenture, therefore this Court must reverse the Court of Chancery, find the directors satisfied the requirements of *Unocal,* and grant summary judgment in favor of Appellants.

II. THE COURT OF CHANCERY ERRED IN HOLDING THAT THE INDIVIDUAL APPELLANTS OWED FIDUCIARY DUTIES TO APPELLEE AND THAT APPELLANTS BREACHED THOSE DUTIES.

A. QUESTION PRESENTED

Whether the Individual Appellants owed fiduciary duties to Appellee, and assuming *arguendo* that they did, whether they along with the Entity Appellants breached their fiduciary duties to Appellee by approving the Indenture containing Section 11.01.

B. SCOPE OF REVIEW

Summary judgment should be granted only if "there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." Del. Super. Ct. Civ. R. 56(c). Additionally, a trial court's decision on a motion for summary judgment is reviewed *de novo*. *AeroGlobal Capital Mgmt., LLC v. Cirrus Indus., Inc.*, 871 A.2d 428, 443 (Del. 2005).

C. MERITS OF THE ARGUMENT

An actionable claim for breach of fiduciary duty requires that two elements be proven: (1) that the defendant had a fiduciary duty to the plaintiff and (2) that the defendant breached that duty. *Beard Research, Inc. v. Kates*, 8 A.3d 573, 601 (Del. Ch. 2010). This Court should reverse the Court of Chancery for two reasons. First, the Individual Appellants did not owe fiduciary duties to Appellee because the holding of *In re USACafes L.P. Litigation*, 600 A.2d 43 (Del. Ch. 1991) is inapplicable to the present case. Second, even if this Court determines that the Individual Appellants did owe fiduciary duties to Appellee, reversal is warranted because neither they nor the Entity Appellants breached those duties.

1. The Individual Appellants owed no fiduciary duties to Appellee.

USACafes held that the individual directors of a corporate general partner owe fiduciary duties to both the limited partnership and its limited partners. 600 A.2d at 48. This conclusion has been criticized by academics,[3] practitioners,[4] and judges.[5] *USACafes* should not be expanded beyond the narrow confines of its facts because it contravenes the foundational principle of entity law that a business entity is legally distinct from its individual owners. The case conferred liability on the directors of a corporate general partner who allegedly engaged in unethical behavior to personally and financially benefit at the expense of the limited partnership. By conferring liability on the Individual Appellants, about whom no such allegations have been made, the court below improperly expanded *USACafes'* application.

At issue in *USACafes* were the fiduciary duties present in a limited partnership. Plaintiffs, holders of limited partnership units, brought suit against a limited partnership, its corporate general partner, and the individual board members of the corporate general partner. *Id*. at 45-46. Plaintiffs alleged, among other things, that the individual board members breached their duty of loyalty by accepting side payments inducing them to sell the limited partnership's assets to a third-party at less than fair market value. *Id*. at 46. These payments allegedly included money for the release of a claim that was non-existent, large sums in the event of a then-imminent change of control, and money

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[3] Mohsen Manesh, *The Case Against Fiduciary Entity Veil Piercing*, 72 Bus. Law. 61 (2017). Professor Manseh's work has been cited approvingly by Delaware courts multiple times. *See, e.g., Allen v. El Paso Pipeline GP Co., L.L.C.*, 113 A.3d 167, 183 (Del. Ch. 2014).

[4] Russell C. Silberglied and Blake Rohrbacher, *Tousa, USACafes, And The Fiduciary Duties of a Parent's Directors Upon A Subsidiary Insolvency*, Norton's Annual Survey of Bankruptcy Law, 33, 51 (2011).

[5] *Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, 2011 WL 3505355, at *30, n. 186-187 (Del. Ch. Aug. 8, 2011).

"disguised" as consideration for personal covenants not to compete. *Id.* The individual board members moved to dismiss the breach of fiduciary duty claim, arguing that they as directors of the corporate general partner owed no fiduciary duty to the limited partners. *Id.* at 47. The court rejected this argument, concluding that the individual board members did in fact owe such a duty. *Id.* at 48.

In reaching this conclusion, the court conceded that there was no corporate legal precedent on the issue and instead analyzed general fiduciary principles. *Id.* The court understood the broad principle of fiduciary duty to be that "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." *Id.* Because the directors of a general partner are in control of the partnership's property, the court reasoned, they owe a fiduciary duty to the limited partnership. *Id.* at 49. The court concluded that it was unnecessary to outline the full scope of this newly articulated duty, but that it included the duty not to "use control over the partnership's property to advantage the corporate director at the expense of the partnership." *Id.* at 48.

Because the decision was anchored in abstract fiduciary principles, *USACafes* can be interpreted as approving a broad expansion of liability to any individual that exercises control over a business entity. Later cases addressing the issue of individual director liability in a limited partnership have, however, circumscribed the application of *USACafes*, rendering it inapplicable to the present case. *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 2000 WL 1476663, at *20 (Del. Ch. Sept.

27, 2000), involved a contractual partnership agreement governing fiduciary duties in a partnership, but the parties analogized to common law principles and the court reflected on *USACafes.* The court in *Gotham Partners* referred to *USACafes* as "unorthodox" and contrasted it with the "traditional approach" to limited partnerships that would impose fiduciary duties only on the general partner as an entity. *Id.* While addressing the potentially limited scope of *USACafes*, the court focused on the particular facts of the case, noting specifically that it "involved serious accusations of actual *personal* self-dealing by the individual directors." *Id*. n. 58 (emphasis in original).

Similarly, in *Gelfman v. Weeden Investors, L.P.*, 792 A.2d 977, 992, n. 24 (Del. Ch. 2001), the court, in considering *USACafes,* noted the "awkward position occupied by directors of corporate General Partners" and their fiduciary relationship to limited partners. There, a group of individual defendants moved to dismiss, arguing that they as directors of the general partner in a limited partnership owed no fiduciary duty to the limited partnership. *Id*. The court denied the motion because the directors had allegedly acted to increase their proportionate ownership in the partnership at the expense of other investors. *Id*.

The essential holding in the line of cases following *USACafes* is that in order to impose fiduciary duties on individual director defendants, it must be shown that they acted with personal self-interest to benefit themselves at the expense of the limited partnership. *See Bigelow/Diversified Secondary Partnership Fund 1990 v. Damson/Birtcher Partners*, 2001 WL 1641239, at *8 (Del. Ch. Dec. 4, 2001) (directors personally received unearned disposition fees and management contracts for selling the partnership's properties at less than fair market value); *In re Boston Celtics Ltd. Partnership Shareholders Litigation*, 1999 WL 641902, at *1 (Del. Ch. Aug. 6, 1999) (directors personally received privileged treatment in an unfair reorganization process); *Wallace ex rel. Cencom Cable Income Partners II, Inc., L.P. v. Wood*, 752 A.2d 1175, 1179 (Del. Ch. 1999) (directors used partnership funds to circumvent a provision in the partnership agreement and generate fees for themselves).

In the present case, the Individual Appellants did not act with personal self-interest to benefit themselves at the expense of Sierra LP. Appellee has argued that the mere inclusion of Section 11.01 in the Indenture violated Appellants' fiduciary duties, yet this does not meet the standard outlined in the cases discussed above.

First, the Individual Appellants did not act to affirmatively include the provision in the Indenture. The original draft was prepared by the lead underwriter in the public offering, Morgan Stanley, and no representative of Appellants suggested or encouraged that Section 11.01 be included. Op. at 5. In fact, the key action taken by the Individual Appellants in regards to Section 11.01 was when the finance committee asked outside counsel whether any provision in the Indenture required attention from the board and was told no. Op. at 6. These steps are readily distinguishable from other cases imposing fiduciary obligations on individual directors. In *Bigelow*, the directors actively sold the partnership's assets. 2001 WL 1641239, at *8. In *Boston Celtics*, the directors actively participated in the reorganization. 1999 WL 641902 *1. In *Wallace*, the directors actively used partnership funds to circumvent the partnership agreement. 752 A.2d at 1179. And in *USACafes*, the directors actively sold the partnership's assets. 600 A.2d at 46. Here, conversely, the directors did not act at all, beyond approving what they thought to be a standard indenture.

Second, the Individual Appellants did not act with personal self-interest to benefit themselves. The only way in which Section 11.01 benefits the Individual Directors is its theoretical and speculative entrenchment effect. Presumably, shareholders would want to avoid a change in control because the lender could then accelerate the debt, which could require refinancing and consequently harm the limited partnership's equity holders. This appears to be a relatively limited "benefit" because such an entrenchment effect is not materializing. In this very case, High Street has indicated that it may nonetheless replace one or more of the directors. Op. at 6-7. Furthermore, the effect of Section 11.01 on Sierra Resources, the corporation in which the Individual Appellants have a vested interest, is a potential loss of $2 to $3 million. Op. at 7. Unlike in *Bigelow*, *Wallace,* and *USACafes*, where the individual directors all personally received specific fees or payments due to their actions, here, nothing of the sort has been alleged.

Finally, it is worth noting that those cases applying *USACafes* seem to do so with some trepidation. In *Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, 2011 WL 3505355, at *30 (Del. Ch. Aug. 8, 2011), then-Chancellor Strine described the extension of fiduciary duty to a corporate director that is the general partner of a limited partnership as "a bit of an oddment" and found that the "step was taken in *USACafes* without much analysis." He then outlined his "concerns" with *USACafes* in a lengthy footnote. *Id.* n. 186-87. In *Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *9, n. 44 (Del. Ch. Apr. 20, 2009), the court noted that "the imposition of fiduciary duties on individuals who work for a corporate fiduciary charged with managing an alternative entity raises some difficult policy issues and disregards corporate formalities in a manner unusual for Delaware law."

This case provides the Court an opportunity to clarify *USACafes'* limited application. Because the Individual Appellants did not act with personal self-interest to benefit themselves as the corporate general partner, they owed no fiduciary duties to the Appellee.

2. **Even if the Individual Appellants did owe fiduciary duties to Appellee, reversal is warranted because neither they nor the Entity Appellants breached those duties.**

Fiduciaries who honestly and faithfully act on behalf of those to whom they owe a duty are given wide latitude. *In re Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 697 (Del. Ch. 2005). And here, even assuming that all Appellants owed Appellee fiduciary duties, the Appellants acted with the requisite honesty and faith. The fiduciary duties owed are the duties of loyalty and due care. *Id.* at 745. The Appellants did not breach their duty of loyalty because they were neither interested in the outcome nor lacked independence, and the Appellants did not breach their duty of due care because their actions were reasonably prudent. Accordingly, the Court of Chancery should be reversed.

The duty of loyalty requires that the best interest of the corporation and its shareholders take precedence over any interest of a director or officer that is not concurrent with the shareholders' general interests. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993). This duty requires that directors not only affirmatively act to protect the interests of the corporation, but also refrain from any act that would bring injury to it. *Id*. To live up to this duty, a director must be both disinterested and independent when making decisions. *See Orman v. Cullman*, 794 A.2d 5, 22 (Del. Ch. 2002). A director is "disinterested" in a decision if he or she does not expect to derive any personal and financial benefit from it. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). In the absence of self-dealing, however, it is not enough to demonstrate that the director received just *any* benefit. *Orman*, 794 A.2d at 23. Instead, the benefit must have been such that the director could not have acted without being influenced by overriding personal interest. *Id*. And a director is "independent" if his or her decision is based on the merits of the issue rather than any extraneous influence. *Aronson*, 473 A.2d at 816.

Here, the Appellants did not breach their duty of loyalty. They acted to protect the interests of Sierra LP, and did so while disinterested and independent. Morgan Stanley, the lead underwriter in the offering, signed an affidavit in which it stated that the interest rate on the Notes would have been up to 50 basis points higher than 2% had Section 11.01 not been included in the Indenture. Op. at 9. Although Section 11.01 could potentially have a negative financial impact on Sierra LP if triggered, Op. at 7, its inclusion guaranteed positive financial benefits for Sierra LP from the outset. Again, the directors did not draft Section 11.01 and were told that there were no novel provisions requiring their attention. But even assuming that they made an active and affirmative decision to include it, they did so with disinterest and independence. They were disinterested because they did not expect to derive any personal and financial benefit from the inclusion of Section 11.01. As discussed above, the only potential benefit conferred on the directors is a speculative, incumbency-enforcing aspect of Section 11.01 that is not relevant here based on High Street's behavior. Additionally, the directors were independent, as there have been no allegations of any extraneous or outside influence. Accordingly, the Appellants did breach their duty of loyalty.

The duty of care requires that directors of a corporation "use that amount of care which ordinarily careful and prudent men would use in similar circumstances and consider all material information reasonably available in making business decisions." *Walt Disney Co.,* 907 A.2d at 749. The duty of care is breached if a loss results from an ill-advised board action or an unconsidered failure to act. *Id.* Additionally, any purported breach is actionable only if the director acted with gross negligence. *Id.*

Here, the Appellants did not breach their duty of care. In approving the Indenture, they acted as ordinarily careful and prudent people would in similar circumstances because Section 11.01 serves a legitimate business purpose. Creditors have a genuine interest in knowing their debtors, and Section 11.01 ensured that Morgan Stanley had confidence in the general business approach involved over the life of its credit. *See* Reindel, *supra*. This, of course, advances the interest of the lender, but without Section 11.01, the interest rate on the Notes would have been up to 50 basis points higher, which could have harmed Sierra LP. Op. at 9. Appellants further demonstrated reasonable prudence by retaining outside counsel that examined the Indenture. Op. at 6. This hardly rises to the level of gross negligence. A person acts with gross negligence when

> the person fails to perceive a risk that the element exists or will result from the conduct. The risk must be of such a nature and degree that failure to perceive it constitutes a gross deviation from the standard of conduct that a reasonable person would observe in the situation.

Del. Code Ann. tit. 11, § 231 (West).[6] Because provisions similar to Section 11.01 have frequently been used by banks without controversy, *see* Reindel, *supra*, approving Section 11.01 after consultation with outside counsel is not a gross deviation from a reasonable standard of conduct. Accordingly, the Appellants did not breach their duty of due care.

CONCLUSION

For the foregoing reasons, this Court should reverse the Court of Chancery's order grating summary judgment against Appellants.

Respectfully submitted,
Team G,
Counsel for Appellants

[6] Although § 231 is a criminal law provision, this Court has held that it is the applicable standard in civil cases as well. *Jardel Co., Inc. v. Hughes*, 523 A.2d 518, 530 (Del. 1987).