IN THE SUPREME COURT
OF THE STATE OF DELAWARE

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

APPELLEE'S REPLY BRIEF

TEAM J
Attorneys for Appellees
February 3, 2017

TABLE OF CONTENTS

NATURE OF PROCEEDINGS

This case embodies the spirit of David and Goliath; it protects the shareholder in the face of the unchecked power of a board to entrench itself in management.

Plaintiff below-appellee North Carolina Police Retirement Fund ("Appellee") filed a derivative action on behalf of Sierra Properties LP ("Sierra LP") on January 20, 2016. *North Carolina Police Ret. Fund v. Sierra GP, LLC*, C.A. No. 12871-CS, at *8 (Del. Ch. Jan. 9, 2017). Appellee sought a declaration that Section 11.01 of the trust indenture is invalid and unenforceable under Delaware law, and the defendant below-appellants' ("Appellant") approval of the indenture violated their fiduciary duties to the Appellee and Sierra LP. *Id.* Appellant filed motions to dismiss, and Appellee filed a cross-motion for summary judgment. *Id.* at *1. Pursuant to Court of Chancery Rule 12(b), the Delaware Court of Chancery treated Appellant's motions to dismiss as motions for summary judgment because Appellant presented matters not included in their complaint. *Id.* at *8. Both parties and the lower court agreed that there were no genuine issues of material fact. *Id.*

The Delaware Court of Chancery granted Appellee's cross-motion for summary judgment and denied Appellant's motions to dismiss on January 9, 2017. *Id.* at *12. Appellant filed notice of appeal in the Supreme Court of Delaware on January 11, 2017.

SUMMARY OF ARGUMENT

1. The Delaware Chancery Court correctly declared that the dead hand proxy put in Section 11.01 of Sierra LP's Indenture was invalid and

unenforceable as a matter of Delaware law and public policy. First, *Amylin* and *Healthways* both point to the Chancery Court's continued dissatisfaction and skepticism towards dead hand proxy puts. Second, the circumstances surrounding the inclusion of this provision fly in the face of public policy and serve to entrench management and deter justified shareholder activism.

2. This Court should follow the path it took to outlaw the use of dead hand poison pills and take this opportunity to per se invalidate dead hand proxy puts. Both dead hand poison pills and dead hand proxy puts are substantially similar in their purpose, their entrenching and deterrence effects, and restrict boards of directors from exercising their duties under DGCL § 141(a).
3. The Delaware Court Chancery properly applied the entire fairness standard to this case. Appellant did not prove that the transaction was entirely fair to Sierra LP and if there would be financial impact or additional interest cost.
4. The Delaware Court of Chancery correctly held that Appellant's approval of the dead hand proxy put provision breached their fiduciary duties. Because the provision is material and was within reasonable reach of the directors, Appellant had a duty to affirmatively inform themselves of this provision, Appellant cannot blame outside counsel for not informing them about the provision. Therefore, Appellant did not act in the best interest of the company.
5. The Delaware Court of Chancery correctly held that both Sierra Resources and its directors owe fiduciary duties to Sierra LP

because they control property of Sierra LP to their own benefit and also to the detriment of the property.

STATEMENT OF FACTS

Sierra Resources is a full-service real estate company that frequently engages in strategic joint ventures through its wholly-owned subsidiary, Sierra GP, LLC ("Sierra GP"). *North Carolina Police Ret. Fund v. Sierra GP, LLC*, C.A. No. 12871-CS, at *4 (Del. Ch. Jan. 9, 2017). In 2008, Sierra Resources and Appellee, the North Carolina Police Retirement Fund, a public pension fund, entered into negotiations to form an investment vehicle, Sierra Energy Partners LP ("Sierra LP"), that would take advantage of the capsized real estate market. *Id.* at *4. Appellee and Sierra Resources capitalized the new venture with $80 million and $20 million, respectively. *Id.* Accordingly, the structure of the entities is as follows: Sierra Resources owns 100% of Sierra GP; Sierra GP owns 20% of Sierra LP; and Appellee owns 80% of Sierra LP. *Id.* at *4.

In early 2013, Sierra Resources acknowledged the possibility of raising new debt capital, optimistically resulting in substantial improvement to Sierra LP's profitability. *Id.* at *5. After receiving general endorsement for this strategy from Appellee, Sierra GP, on behalf of Sierra LP, began the process of completing a public offering of $160 million in principal amount of 2% notes ("Notes"). *Id.* Section 11.01 of the resulting trust indenture dated August 16, 2013 (the "Indenture") is at the heart of this proceeding. Section 11.01, governing change of control processes, includes what has been termed a "Dead Hand Proxy Put". *Id.* at *6. Appellants vehemently claim that the board of directors of Sierra Resources was not informed of the inclusion of this provision and

relied solely on outside counsel's representation that there was nothing "novel" in the Indenture. *Id.* at *5–6. At the time of its drafting, the phenomenon of shareholder activism was well-known throughout the real estate industry. *Id.* at *6.

In late 2015, two years after the creation of the Indenture, High Street Partners, LP ("High Street"), an activist hedge fund, indicated to the SEC that it had acquired 6.3% of Sierra Resources' outstanding shares. *Id.* at *6. High Street further indicated on its 13D filing of its intent to pursue strategies involving accelerating distributions and home-run alternatives, possibly by undertaking a contested solicitation of proxies. *Id.*

In its press releases and investor presentations following the filing of High Street's 13D, Sierra Resources asserted that if High Street-nominated board members were elected and constituted a majority of the board, the dead hand proxy put in Sierra LP's Indenture would be triggered. *Id.* at *7. The result would be an acceleration of Sierra LP's debt. *Id.*

ARGUMENT

IV. THE DELAWARE CHANCERY COURT CORRECTLY DECLARED THAT THE DEAD HAND PROXY PUT IN SECTION 11.01 OF THE INDENTURE WAS INVALID AND UNENFORCEABLE AS A MATTER OF DELAWARE LAW AND PUBLIC POLICY.

A. Question Presented

1. Whether the Delaware Chancery Court correctly declared that the dead hand proxy put in Section 11.01 of the Indenture was invalid and unenforceable as a matter of Delaware law and public policy.

2. Should this Honorable Court per se invalidate dead hand proxy puts?

B. Scope of Review

On appeal, the Delaware Supreme Court reviews trial court decisions on a motion for summary judgment *de novo* regarding matters of the law. *AeroGlobal Capital Mgmt., LLC v. Cirrus Indus., Inc.*, 871 A.2d 428, 443 (Del. 2005). The Supreme Court must review all facts in the light most favorable to the plaintiff below-Appellee, the non-moving party. *Delmarva Power & Light Co. v. City of Seaford*, 575 A.2d 1089, 1092 (Del. 1990) (citing *Alexander Indus., Inc. v. Hill*, 211 A.2d 917 (Del. 1965)). Ultimately, the Court should sustain a grant for summary judgment if it determines the moving party was entitled to summary judgment as a matter of law, and "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact." *Emmons v. Hartford Underwriters Ins. Co.*, 697 A.2d 742, 744-45 (Del. 1997).

C. MERITS OF THE ARGUMENT

The inclusion of the dead hand proxy put provision of Section 11.01 of the Indenture constitutes an illegitimate attempt by Sierra Resources' board to entrench themselves in management and quash the threat of a shareholder initiated proxy contest. In addition, both Delaware case law and public policy point to the conclusion that dead hand proxy puts, as was the case when this Court outlawed dead hand poison pills, create substantially more harm than benefit. Accordingly, this Honorable Court should affirm the Chancery Court's declaration of Section 11.01's

invalidity and unenforceability, and further declare dead hand proxy puts per se invalid under Delaware law.

1. The Delaware Court of Chancery correctly granted Appellee's cross-motion for summary judgment, declaring that Section 11.01 of the Indenture is invalid and unenforceable.

Within the context of Sierra LP's trust indenture agreement with BNY Mellon, and in light of the circumstances surrounding the inclusion of the change of control provision of the Indenture, the dead hand proxy put clause of Section 11.01 is invalid and unenforceable as a matter of Delaware law and public policy. The specific language at issue comes as an exception to the Change of Control provision in Section 11.01:

> ([E]xcluding, in the case of both clause (ii) and clause (iii), any individual 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 for the election or removal of one or more directors by any person or group other than a solicitation for the election of one or more directors by or on behalf of the board of directors).

Sierra GP, LLC, C.A. No. 12871-CS, at *4.

The crux of the dead hand feature of this proxy put is that it binds the hands of the "continuing directors" of the company from approving newly nominated directors if the nomination arose from an actual or threatened proxy contest. As a result, the lender has the power to immediately accelerate the company's debt. Upon acceleration, the newly elected board will be forced to seek refinancing or renegotiate its agreement with the original lender or risk the financial health and future of the company.

a. The Court of Chancery has historically frowned upon the inclusion of dead hand proxy puts in loan agreements.

The advent of dead hand proxy puts dramatically shifted the corporate landscape, creating significant advantages for creditors and management,

while disadvantaging for shareholders. For creditors, dead hand proxy puts are contractual tools to ensure that the lender intimately knows the borrower. *See* Danielle A. Rapaccioli, *Keeping Shareholder Activism Alive: A Comparative Approach To Outlawing Dead Hand Proxy Puts In Delaware*, 84 FORDHAM L. REV. 2947, 2980 (2016). "Creditors don't want to wake up one day and find out someone else is driving the train." Liz Hoffman, *Banks Feel the Heat from Lawsuits*, WALL STREET J. (Apr. 28, 2015, 6:14 PM), http://www.wsj.com/articles/banks-feel-the-heat-from-lawsuits-1430259260?alg=y. While potentially comforting for creditors, however, there is a much darker side to these provisions. Dead hand proxy puts, as a defensive measure, are easily accessible to boards of directors as tools to entrench themselves perpetually in management. Finally, to the detriment of the shareholder franchise, the inclusion of a dead hand proxy put serves as a formidable, and sometimes fatal, deterrent for shareholder activists looking to engage in a justified proxy contest.

Over the past several years, Delaware has tousled with the concept of proxy puts and whether they serve a legitimate business purpose, or rather serve to only benefit the current board of directors at the expense of the shareholders. *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.* represented the court's first prominent look at the validity of both traditional and dead hand proxy puts. 983 A.2d 304 (Del. Ch. 2009). In *Amylin*, the Chancery Court examined whether a standard change of control provision found in the company's indenture prevented the board from approving an opposition slate of directors as "continuing directors". *Id.* at 306. This dead hand language had the

effect of restricting the incoming board from waiving the acceleration of Amylin's debt if their nomination arose from an actual or threatened proxy contest. *Id.* at 310 n.7. The magnitude of this provision would have been the immediate acceleration of well over $900 million. *Id.* In 2009, Icahn Partners LP notified Amylin's board of its intention to nominate its own slate of directors, and requested that the board take action to remove the dead hand language from its agreement; litigation ensued. *Id.* at 309.

While not explicit in its holding, the key takeaways from *Amylin* are as follows: First, the Court expressed skepticism towards these types of dead hand provisions, stating, "Provision[s] so strongly in derogation of the stockholders' franchise rights would likely put the trustee and noteholders on constructive notice of the possibility of its ultimate unenforceability." *Id.* at 315 n.32. Second, the Court explained that there must have been "extraordinary economic value" given in consideration for the inclusion of such a restrictive provision in a company's indenture. *Id.* at 315. Finally, the Court explained that, while it was not outlawing dead hand proxy puts, provisions with such an "eviscerating effect on the stockholder franchise" might be unenforceable as a matter of public policy. *Id.*

The Chancery Court's most recent dialogue on the issue of dead hand proxy puts arose in *Pontiac General Employees Retirement System v. Ballantine* (*Healthways*). No. 9789-VCL (Del Ch. Oct. 14, 2014). After being pressured to declassify the board, but, notably, before any threatened or initiated proxy contest, the board amended its loan agreement with SunTrust to include a dead hand feature that restricted

the board from approving any newly nominated board members resulting from an actual or threatened proxy contest. *Id.* at 68–69. Shortly after the amendment, Pontiac made a 220 demand on the board to inspect the company's books to independently determine, as was expressed in *Amylin*, whether the board received any "extraordinarily valuable economic benefits that might justify the proxy put." Transcript of Oral Argument at 71, *Pontiac Gen. Emps. Ret. Sys. v. Ballantine*, No. 9789-VCL (Del. Ch. Oct. 14, 2014). According to the Complaint, "the company failed to produce documents showing that there was substantive negotiation about the proxy put and no documents that suggested, to use the language of Amylin, that the company received 'extraordinarily valuable economic benefits' that might justify the proxy put." *Id.*

At oral argument, Vice Chancellor Laster noted that this provision, while not adopted in direct reaction to an actual or threatened proxy contest, was adopted in the wake of "stockholder opposition and identified insurgency." *Id.* Importantly, Vice Chancellor Laster explained:

> Given the facts here, as alleged, including that there was a historic credit agreement that had a proxy put but not a dead hand proxy put, and then that under pressure from stockholders, including the threat of a potential proxy contest, the debt agreements were modified so that the change-in-control provision now included a dead hand proxy put, and considering that all of this happened well after Sandridge and Amylin let everyone know that these provisions were something you ought to really think twice about....

Id.

While *Healthways* did not per se invalidate dead hand proxy puts, it continued the trend of Delaware's dissatisfaction with them as defensive measures.

b. The circumstances in the instant case surrounding the inclusion of the dead hand proxy put clause of Section 11.01 fly in the face of public policy.

While lenders may purport that there is a legitimate business interest behind them, boards of directors have a fairly unchecked power to entrench themselves in management and deter shareholders from exercising their rights. *Amylin* and *Healthways* each built upon the set of factors that this Court should consider when determining whether or not rule against the inclusion of a dead hand proxy put provision as a matter of public policy: 1) Was the dead hand proxy put provision enacted on a 'clear day'; 2) what was the magnitude of the accelerated debt and what are the costs of refinancing; 3) what are the customs of the lender and the industry; 4) what was the board's level of involvement in the decision and what purpose, if any, was given; 5) what were the known objectives of the company's shareholder activists; and 6) what alternative protections were available. *See generally* F. William Reindel, *"Dead Hand Proxy Puts" – What You Need to Know*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE & FINANCIAL REGULATION, DELAWARE LAW SERIES (June 10, 2015).

Starting with the first factor, The present case fits snugly between *Amylin* and *Healthways*. While there had been no threat of a proxy contest, Sierra Resources unquestionably was aware of the shareholder activism permeating throughout the real estate industry at the time, especially given Corvex Management's efforts to modify CommonWealth REIT's strategy and composition of trustees in 2013. *Sierra GP, LLC*, C.A. No. 12871-CS, at *6.

As to the second factor, while the magnitude of the accelerated debt in this case does not rise to the level of *Amylin*, a $3 million cost of

refinancing for Sierra Resources, 5x greater impact on Sierra LLP, and 4x greater impact on Appellee cannot be overlooked. *Sierra GP, LLC*, C.A. No. 12871-CS, at *7. Defendant did offer an affidavit from Morgan Stanley purporting that the interest rate on the notes would have been greater without the inclusion of the dead hand language, likely to satisfy the 'extraordinary economic benefit' consideration expressed in both *Amylin* and *Healthways*. Opposing counsel, however, cannot provide any evidence other than that the notes could have been "*up to* 50 basis points" higher. *Sierra GP, LLC*, C.A. No. 12871-CS, at *9. The Chancery Court rightfully pointed out that "up to" has no concrete meaning. *Id.*

Factor three should be treated as an unknown in this case, because it is unclear what the customs of the lender and the industry were at the time.

Factor four falls heavily in Appellee's favor in this case. Appellants have made it very clear that the board had no involvement in the inclusion of the dead hand proxy put and did not review the Indenture on an informed basis. *Sierra GP, LLC*, C.A. No. 12871-CS, at *9. Hindsight 20-20, Appellants would ask this Court to believe that the potentially higher percentage rate on the notes serves as a legitimate business interest. However, this assertion is baseless given the lack of any due diligence on the part of the board at the time of the inclusion. The recklessness of this action flies in the face of Delaware's continued efforts to protect shareholders.

High Street's short-term activist vision under factor five does not help Appellee's case. The dead hand proxy put had already been installed two years prior to High Street's acquisition of Sierra Resources stock.

Id. If Appellant attempts to cite the short-term strategic goals of High Street as a reason behind their entrenching inclusion of the dead hand proxy put, Appellant is conceding that dead hand feature was not adopted on a 'clear day', which only lends to Appellee's public policy argument.

Finally, while the Chancery Court did not point out any alternative protections to the dead hand proxy put, a sophisticated and informed board would have weighed each carefully. Other creditor-includable devices such as covenants that restrict the payment of excessive dividends, limit the increase in a company's outstanding debt, or prevent the sale of the company's assets above a target level can address the same concerns in a less entrenching and disenfranchising fashion. *See* Danielle A. Rapaccioli, *Keeping Shareholder Activism Alive: A Comparative Approach To Outlawing Dead Hand Proxy Puts In Delaware*, 84 Fordham L. Rev. 2947, 2985–86 (2016).

An evaluation of these public policy considerations, several of which have been explicitly discussed through the years by the Chancery Court, points heavily in Appellee's favor. This Honorable Court should take the unbalanced scale as dispositive that the Chancery Court correctly declared that the dead hand proxy put of Section 11.01 of the Indenture is invalid and unenforceable as a matter of Delaware law and public policy.

2. The Court should take this opportunity to set the record straight and declare Dead Hand Proxy Puts per se invalid under Delaware law.

a. The similarities between dead hand proxy puts and dead hand poison pills are substantial enough to necessitate the per se invalidation of dead hand proxy puts

While Appellee recognizes that a dead hand poison pill and a dead hand proxy put are operatively dissimilar, the similarities in each's

purpose and resulting effects are substantial enough to necessitate the parallel per se invalidation of dead hand proxy puts as a matter of both Delaware law and public policy. First, each are purposed as powerful takeover defense mechanisms. Based on empirical evidence, industries more prone to takeovers see a higher percentage of proxy puts included in financing agreements, but companies with proxy puts are historically less likely to be acquired. *See* Frederick L. Bereskin & Helen Bowers, *Poison Puts: Corporate Governance or Mechanism for Shifting Risk?* at 10 (2015), http://irrcinstitute.org/wp-content/uploads/2015/09/FINAL-Poison-Puts-Research-Sept-2015.pdf. Further, "firms with proxy puts are less likely to also have poison pills… indicat[ing] that firms likely believe that proxy puts and poison pills serve a similar function, and management may use them interchangeably to serve the same purpose." *See* Danielle A. Rapaccioli, *Keeping Shareholder Activism Alive: A Comparative Approach To Outlawing Dead Hand Proxy Puts In Delaware*, 84 FORDHAM L. REV. 2947, 2983 (2016). Again, while Appellee does not contend that poison pills and proxy puts are operatively similar enough to allow for interchangeability, there is certainly a uniformity of purpose enough for this Court to take pause.

Second, both devices have a substantially similar deterrent effect on shareholders. The Court in *Healthways* compared the paralyzing risk of considering launching a proxy contest in the face of a dead hand defense mechanism with the mythological tale of the "Sword of Damocles." In fact, *Healthways* cited *Toll Bros.* in its opinion to associate dead hand proxy puts with dead hand poison pills:

> The problem in *Toll Brothers* was that… [the] dead hand feature in [the] pill would have a chilling effect on, among other things,

> potential proxy contests such that the stockholders would be deterred, they would have the Sword of Damocles hanging over them, when they were deciding what to do with respect to a proxy contest.

Transcript of Oral Argument at 71, *Pontiac Gen. Emps. Ret. Sys.*, No. 9789-VCL.

While opposing counsel may argue that the financial effects of a triggered poison pill far outweigh that of a triggered proxy put, the effect relies fully on the magnitude of the situation. In *Amylin*, the triggering of the dead hand proxy put would have immediately accelerated over $900 million in debt. 983 A.2d at 310 n.7. Without a swift refinancing agreement for similar terms at approximately the same interest rate, the financial result would be just as catastrophic for the company's future as the irredeemable nature of a triggered dead hand poison pill. In essence, both dead hand devices can serve as formidable, and sometimes fatal, foes given the magnitude of the company's financing arrangements.

Third, both devices can be manipulated by the board of directors to perpetually entrench themselves in the management of the company, contrary to the best interests of its shareholders. Because a board previously was able to unilaterally adopt a dead hand poison pill, the entrenchment effect can be said to be unmatched. However, in *Kallick v. Sandridge Energy Inc.*, the Chancery Court alerted the legal community that independent directors would be wise to "police aspects of [proxy put] agreements to ensure that the company itself is not offering up these terms lightly precisely because of their entrenching utility." 68 A.3d 242, 248 (Del. Ch. 2013).

Finally, dead hand proxy puts similarly restrict the board of directors from exercising its duties under § 141(a) of the DGCL. The

Court in *Quickturn* expressed that the company's poison pill served to prevent the new board from redeeming the poison pill, even when doing so would be in the best interest of the shareholders. 721 A.2d at 1291. The Court accordingly held that "no defensive measure can be sustained when it represents a breach of the directors' fiduciary duty." *Id.* at 1291–92. With the installation of a dead hand proxy put, the proxy contest elected non-continuing members of the board are powerless to keep the existing loan or indenture agreement in place, when doing so may very well be in the best interest of the shareholders. While opposing counsel might point to the possibility of refinancing or renegotiation, one, these options are not always available to the board and may be cost prohibitive, and two, forcing the new board members to pursue this route flies in the face of § 141(a).

Since *Healthways*, the plaintiffs' bar has been campaigning to eliminate dead hand proxy puts from the debt agreements of public companies. *See generally* F. William Reindel, *"Dead Hand Proxy Puts" – What You Need to Know*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE & FINANCIAL REGULATION, DELAWARE LAW SERIES (June 10, 2015), https://corpgov.law.harvard.edu/2015/06/10/dead-hand-proxy-puts-what-you-need-to-know/. The case at hand provides this Honorable Court with the opportunity to do so. Based on the substantial similarities between dead hand poison pills and dead hand proxy puts, this Court should per se invalidate dead hand poison pills as a matter of Delaware law and public policy.

V. THE COURT OF CHANCERY CORRECTLY HELD THAT APPELLANT'S APPROVAL OF THE DEAD HAND PROXY PUT PROVISION BREACHED THEIR FIDUCIARY DUTIES TO APPELLEE.

A. Question Presented

1. Whether the Chancery Court correctly held that Appellant's approval of the dead hand proxy put provision breached their fiduciary duties to Appellee?

B. Scope of Review

The Delaware Supreme Court reviews trial court decisions on a motion for summary judgment using a *de novo* standard of review regarding matters of the law. *AeroGlobal Capital Mgmt., LLC v. Cirrus Indus., Inc.*, 871 A.2d 428, 443 (Del. 2005).

C. Merits of Argument

1. The Chancery Court correctly held that *Unocal* should not apply here and that Appellant failed to prove entire fairness.

The Chancery Court correctly held that *Unocal*'s enhanced scrutiny standard does not apply here. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). "Under [the *Unocal*] standard, to merit the protection of the business judgment rule the board must...satisfy a 'reasonableness' test under which the board of directors must demonstrate that it had reasonable grounds to believe that a danger to corporate policy and effectiveness existed." *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 494–95 (Del. Ch.), *aff'd and remanded*, 670 A.2d 1338 (Del. 1995). Appellant had no "reasonable grounds" to believe anything about the dead hand proxy put since Appellant vehemently claims the directors were not aware of its existence; therefore, Appellant cannot now hide behind this protection.

Instead, the board's decisions will be reviewed under an entire fairness standard, which Appellant failed to prove. *See Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 271 (Del. Ch. 1989) ("[N]either a board's failure to become adequately informed nor its failure to apply a *Unocal* analysis... will automatically invalidate the corporate transaction. Under either circumstance, the business judgment rule will not be applied and the transaction at issue will be scrutinized to determine whether it is entirely fair."). However, the Chancery Court correctly held that Appellant nonetheless did not satisfy their burden of proving entire fairness since Appellant did not provide any proof that the provision avoided any specific additional interest cost, nor did they contest the adverse financial impact of the proxy put. In addition, this brief has previously detailed at length the invalidity and unenforceability of such a provision because of its catastrophic economic potential. *See supra* Part I.C. Therefore, Appellant breached its fiduciary duties in approving such a provision under the entire fairness standard.

2. The Chancery Court correctly held that Appellant violated its fiduciary duties to Appellee and Sierra LP.

The Chancery Court correctly held that Appellant violated its fiduciary duties to Appellee and Sierra LP in approving the dead hand proxy put provision because: 1) the provision was both material and within reasonable reach of the directors; 2) Appellant had a duty to affirmatively inform themselves of this provision; 3) Appellant cannot shift blame to outside counsel for not informing them about the provision; and 4) Appellant did not act in the best interest of the company.

a. Appellant violated their fiduciary duties because the provision was material information and was within reasonable reach.

Appellant violated their fiduciary duties because the dead hand proxy put provision was material information and was within reasonable reach in the Indenture. Directors are protected by the business judgment rule, which 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." *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). "[I]n making business decisions, directors must consider all material information reasonably available... The Board is responsible for considering only material facts that are reasonably available, not those that are immaterial or out of the Board's reasonable reach." *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*, 983 A.2d 304, 318 (Del. Ch. 2009) (citing *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000)). "The decision-makers entrusted by shareholders must act out of loyalty to those shareholders. They must in good faith act to make informed decisions on behalf of the shareholders, untainted by self-interest." *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 698 (Del. Ch. 2005), *aff'd,* 906 A.2d 27 (Del. 2006).

Appellant breached its fiduciary duties because the provision was material information that was reasonably available. By approving Section 11.01, it is assumed that Appellant made an informed decision, and in doing so, considered all material and reasonably available information. There is no proof that the lead underwriter, counsel, directors, officers, or affiliates attempted to hide the provision or sneak it into the Indenture. In addition, a dead hand proxy put is material and not a

typical provision, although its prevalence has increased in the last few years. See supra Part I.C. Therefore, Appellants did not make an informed decision and breached their fiduciary duties.

b. Appellant breached their fiduciary duties by not informing themselves of the provision.

Furthermore, Appellant's fiduciary duty to make informed decisions is an affirmative duty. "Representation of the financial interests of others imposes on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information of the type and under the circumstances present here." *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). In addition, "boards have a duty to their stockholders to pay very close attention to provisions that affect the stockholder franchise, such as Proxy Puts. This court made this duty explicit in *Amylin.*" *Kallick v. Sandridge Energy Inc.*, 68 A.3d 242, 257 (Del. Ch. 2013). "Under the business judgment rule there is no protection for directors who have made an unintelligent or unadvised judgment. A director's duty to inform himself in preparation for a decision derives from the fiduciary capacity in which he serves the corporation and its stockholders." *Van Gorkom*, 488 A.2d at 872 In other words, a director cannot feign ignorance and must take on the duty to inform himself before making business decisions. Appellant argues that because they did not draft and advocate for the provision, and especially because they did not know of its existence, that they took no action as a fiduciary to Sierra LP. *Sierra GP, LLC*, C.A. No. 12871-CS, at *10.

However, Delaware law is clear that directors must demonstrate that the board must take affirmative action and that ignorance is not a defense. In *Sandridge*, the testifying director claimed ignorance of any

proxy put provision in the indenture until the proxy contest. Thus, the Court assumed the board had accepted the provision without resistance or input. *Sandridge*, 68 A.3d at 248. The Court in both *Sandridge* and *Amylin* implied that directors have an affirmative duty to be informed and look for proxy put provisions because of their unique features. "[B]ecause of management's special interest in retaining office, the independent directors of the board should police aspects of agreements like this, to ensure that the company itself is not offering up these terms lightly precisely because of their entrenching utility, or accepting their proposal when there is no real need to do so." *Sandridge Energy*, 68 A.3d at 248. "The court would want, at a minimum, to see evidence that the board believed in good faith that, in accepting [a Proxy Put], it was obtaining in return extraordinarily valuable economic benefits for the corporation that would not otherwise be available to it." *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*, 983 A.2d 304, 315 (Del. Ch. 2009). Additionally, the company should "bargain hard to exclude that toll on the stockholder franchise and only accede to the Proxy Put after hard negotiation and only for clear economic advantage." *Sandridge*, 68 A.3d at 248.

Here, there is no evidence of affirmative action on behalf of the directors such as policing, investigating, negotiating, or bargaining the terms of the Indenture. Appellant's only defense is that a member of the finance committee asked the company's outside counsel if there were any "novel terms" in the Indenture and presumably did not read the indenture himself. *Sierra GP, LLC*, C.A. No. 12871-CS, at *10. This Court should follow the logic of *Sandridge* and *Amylin* in that there is no

reason why directors would not scrutinize the provisions related to their office. In addition, Appellant did not offer evidence that they affirmatively sought to include the provision. Therefore, ignorance of the existence of the provision is not a defense, and Appellant breached its fiduciary duty to Sierra LP.

c. Appellant cannot shift blame and delegate its duty to outside counsel.

This Court should not allow Appellant to delegate their authority to approve such a material provision and shift blame to its outside counsel. Although *Amylin* held that the board was not grossly negligent in "failing to learn of the existence of the Continuing Directors provisions" after asking counsel about any "unusual or not customary" terms in the Notes, the Chancery Court's subsequent dicta is extremely telling: "[T]here are few events which have the potential to be more catastrophic for a corporation than the triggering of an event of default under one of its debt agreements... [the board] must be especially solicitous to its duties both to the corporation and to its stockholders." *Amylin*, 983 A.2d at 319. The most recent case to discuss dead hand proxy puts was *Healthways*, where the Chancery Court held there was a claim for breach of fiduciary duty because the provision has an entrenching effect and ample precedent from cases such as *Amylin* and *Sandridge* has put lenders on notice that these provisions were "highly suspect" and could lead to a breach of fiduciary duty. Transcript of Oral Argument at 80, *Pontiac Gen. Emps. Ret. Sys. v. Ballantine*, C.A. No. 9789-VCL (Del. Ch. Oct. 14, 2014). For this reason and the reasons set forth in Part I.C. concerning the "catastrophic" nature of these provisions, this Court cannot allow Appellant to take advantage of Section 11.01 to their benefit by now

blaming outside counsel. By 2017, we now know that dead hand proxy puts are not "novel" terms as they have been debated by the Chancery Court since 2009. This Court now has the opportunity to rule on such provisions.

d. Appellant breached its fiduciary duty because it did not act in the best interest of the company.

Appellant breached its fiduciary duty because Appellant did not act in the best interest of the company when it approved the proxy put provision. Directors must act in the corporation's best interest to prevent refinancing and default. *See Sandridge*, 68 A.3d at 260 ("[I]t follows that a board may only fail to approve a dissident slate if the board determines that passing control to the slate would constitute a breach of the duty of loyalty, in particular, because the proposed slate poses a danger that the company would not honor its legal duty to repay its creditors."). Appellant has not brought forth any proof why approving the dissident slate would harm the corporation. Although Appellant claims that Morgan Stanley recited that the interest rate on the Notes would have been "up to 50 basis points" higher than the 2% for the offering to succeed, this approximation is not enough proof that the provision did in fact avoid additional interest. Therefore, Appellant breached its fiduciary duty to Sierra LP and Appellee.

VI. The Chancery Court correctly held that corporate general partners owe fiduciary duties to a limited partnership and limited partners.

A. Question Presented

1. Whether the Chancery Court correctly held that a corporate general partner and its board of directors does owe fiduciary duties to a limited partnership and limited

partners, even when it is not a general partner of that limited partnership?

B. Scope of Review

The Delaware Supreme Court reviews trial court decisions on a motion for summary judgment using a *de novo* standard of review regarding matters of the law. *AeroGlobal Capital Mgmt., LLC v. Cirrus Indus., Inc.*, 871 A.2d 428, 443 (Del. 2005).

C. Merits of Argument

The Delaware Court of Chancery correctly held that both Sierra Resources and its directors owe fiduciary duties to Sierra LP because they control property of Sierra LP to their benefit and also to the detriment of the property.

1. Sierra Resources and Its Directors Both Owe Fiduciary Duties Because They Used Sierra LP's Property to Benefit Themselves.

The Chancery Court correctly held that Sierra Resources and its board of directors owe fiduciary duties to Sierra LP, and in turn Appellee, because Sierra Resources and its board have used Sierra LP's property to benefit themselves. This Court should continue to uphold *In re USACafes, L.P. Litig.*, which held that directors of a corporate general partner owe fiduciary duties to the limited partnership and its limited partners because "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." 600 A.2d 43, 48 (Del. Ch. 1991). In *USACafes*, the limited partners sued the limited partnership and corporate general partner for breach of fiduciary duties after directors approved of a

buyout from which some of the directors received additional side payments. 600 A.2d at 46. The Chancery Court has reaffirmed this seminal case several times under different facts. *See In re Boston Celtics Ltd. P'ship Shareholders Litig.*, 1999 WL 641902, at *4 (Del. Ch. Aug. 6, 1999) ("[D]irectors of a corporate General Partner who control the partnership, like the directors of a Delaware corporation, have the fiduciary duty to manage the partnership in the partnership's interests and the interests of the limited partners.").

Sierra Resources and the directors have used Appellee's investment in Sierra LP to benefit themselves to the detriment of Sierra LP and Appellee. Appellant claims that it owes no fiduciary duties to the Appellee because they are not the direct general partners of Sierra LP. However, Sierra Resources is the manager and sole member of Sierra GP, LLC, which in turn is the sole general partner of Sierra LP and owns 20% of Sierra LP's limited partnership interest. Thus, Sierra Resources indirectly and exclusively controls Sierra LP. Because Sierra Resources engages in joint real estate ventures through its subsidiaries Sierra GP and Sierra LP, Sierra Resources and its board benefits from this arrangement. Therefore, following *USACafes*, Sierra Resources and its directors owe a fiduciary duty to Appellee.

In addition to the directors, Sierra Resources, as the corporate general and "second-tier manager", owes a fiduciary duty to Appellee. Colin P. Marks, *Piercing the Fiduciary Veil*, 19:1 LEWIS & CLARK L. REV. 73, 74 (2015). While *USACafes* was specific to directors of a corporate general partner, a progeny of cases following *USACafes* expanded its application to include corporate general partners. *See Wallace ex rel.*

Cencom Cable Income Partners II, Inc., L.P. v. Wood, 752 A.2d 1175, 1182 (Del. Ch. 1999) (denying defendants' motion to dismiss breach of fiduciary claims because "Officers, Affiliates and Parents utilized Partnership assets which they controlled to enrich themselves at the expense of [plaintiffs]."); *James-River Pennington, Inc., v. CRSS Capital, Inc.*, 1995 WL 106554 (Del. Ch. Mar. 6, 1995) (holding that a corporation owes the duty of loyalty to a partnership because corporation controls general partner). The Chancery Court has even expanded this to affiliates of the limited partnership.[1] Since the Chancery Court has expanded who owes this fiduciary duty, this Court should hold that corporate general partners also owe a fiduciary duty to a limited partnership, even if they are not the direct partner.

2. Sierra Resources Owes Fiduciary Duties to Sierra LP Because It Controls Sierra LP's Property.

Sierra Resources also owes fiduciary duties to Sierra LP because it controls the property of Sierra LP. Appellant argues that Sierra Resources does not sufficiently "control" Sierra LP because its subsidiary Sierra GP only owes a 20% limited partnership interest in Sierra LP, while Appellee owns the other 80%. *Sierra GP, LLC*, C.A. No. 12871-CS, at *3. However, the Chancery Court has made it clear that the percentage ownership is not the only factor, and that "control" can be

[1] *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *9 (Del. Ch. Apr. 20, 2009) ("USACafes does not apply to all affiliates in all circumstances. First, to have any fiduciary duties to an entity, the affiliate must exert control over the assets of that entity."); *Bigelow/Diversified Secondary P'ship Fund 1990 v. Damson/Birtcher Partners*, 2001 WL 1641239, at *8 (Del. Ch. Dec. 4, 2001) ("those affiliates of a general partner who exercise control over the partnership's property may find themselves owing fiduciary duties to both the partnership and its limited partners").

identified in other ways. *Lewis v. AimCo Properties* held that Aimco OP, an affiliate of AimCo, the corporate general partner entity, did not owe fiduciary duties to limited partnership defendants and plaintiff shareholders because affiliate did not exercise sufficient control over the partnership, such as being involved in the day to day operations or have decision making power. 2015 WL 557995, at *6 (Del. Ch. Feb. 10, 2015) ("[T]he fact that AimCo, through its affiliates, may have a majority interest in the LP Defendants does not support a reasonable inference that AimCo, or its affiliate Aimco OP, had a fiduciary duty to those limited partnerships or their limited partners"). Even an affiliate or an individual can owe a fiduciary duty. *Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, 2011 WL 3505355, at *30 (Del. Ch. Aug. 8, 2011) (holding that Michele Paige, the managing member of LLC that acted as general partner for LP exercised control over the partnership's property and owed a fiduciary duty to partnership); *Feeley v. NHAOCG, LLC*, 62 A.3d 649, 671 (Del. Ch. 2012) (holding that controller of AK-Feel could be held liable for breach of fiduciary duty).

Sierra Resources owes fiduciary duties to Sierra LP because it implicitly controls the limited partnership through decision making power and its involvement in the day to day operations of Sierra LP. In *Wallace*, the Chancery Court did not distinguish between the parents and affiliates with directors because "Plaintiffs detail sufficiently the Parents and Affiliates control of the affairs of the Partnership including the creation of and distribution of Partnership assets for their own benefit." 752 A.2d at 1182, 1182 n. 23 (citing *Barbieri v. Swing-N-Slide Corp.*, 1997 WL 55956 (Del. Ch. Jan. 29, 1997) (holding

"fiduciary duties may be imputed to a separate entity formed and controlled by fiduciaries for the purpose of engaging in a transaction with an entity to whom those duties are owed."). Here, Sierra Resources and Appellee formed Sierra LP as an investment vehicle and funded it with $100 million in capital so that it could form a joint venture to develop and invest in high performance, sustainable commercial building. Therefore, Sierra Resources is in fact in control of Sierra LP.

In addition, percentage ownership is not determinative of control. Appellant argues that because Sierra GP, LLC only has a twenty percent stake in the partnership Appellee does not have control. However, the Chancery Court did not delineate a threshold percentage that the holder must have in the partnership in order to be in "control" but instead whether they were "able to exercise such control, and did exercise such control, for their benefit and to the detriment of the Limited Partners." *Bigelow/Diversified Secondary P'ship Fund 1990 v. Damson/Birtcher Partners*, 2001 WL 1641239, at *8 (Del. Ch. Dec. 4, 2001).

3. Sierra Resources Owes Fiduciary Duties Because It Acted in Self-Interest at the Expense of Sierra LP.

Sierra Resources and its directors also have a fiduciary duty to not use Sierra LP's property to advantage themselves at the expense of the partnership. *USACafes* and its progeny have made clear that the corporate general partner and its directors have a "duty not to use control over the partnership's property to advantage the corporate director at the expense of the partnership". *See In re USACafes, L.P. Litig.*, 600 A.2d at 49; *Cargill, Inc. v. JWH Special Circumstance LLC*, 959 A.2d 1096, 1110 (Del. Ch. 2008) ("[I]f a corporate parent of the fiduciary exercises dominion and control over the fiduciary in connection with a transaction

that benefits the corporate parent at the expense of the underlying entity, the corporate parent may owe fiduciary duties directly to the underlying entity in connection with that transaction."). Here, Sierra Resources and its directors have benefitted themselves by approval of the dead hand proxy put provision in the Indenture by exercising its control over the limited partnership, and therefore owe a fiduciary duty.

This Court should follow the traditional definition of a fiduciary where there is no evidence of contractual fiduciary duties. *See Gotham P'rs, L.P.*, 795 A.2d 1, 34 (Del. Ch. 2001) ("[W]here a corporate General Partner fails to comply with a contractual standard that supplants traditional fiduciary duties and the General Partner's failure is caused by its directors and controlling stockholder, the directors and controlling stockholders remain liable"); *James River-Pennington Inc. v. CRSS Capital, Inc.*, 1995 WL 106554, at *11 (Del. Ch. Mar. 6, 1995) ("The tension exists here, of course, between a fiduciary's contractual sanction to act independently in its own best interests and the fiduciary's obligation to act in the best interests of the Partnership."). "The high court might hold, contrary to *USACafes*, that when parties bargain for an entity to serve as the fiduciary, that entity is the fiduciary, and the parties cannot later circumvent their agreement by invoking concepts of control or aiding and abetting. Or the high court might distinguish between cases involving default fiduciary duties, in which traditional equitable principles of control and aiding and abetting could be permitted to extend liability beyond the entity fiduciary, and cases involving purely contractual duties, in which parties would be limited to contractual remedies against their contractual

counterparties."). *Feeley v. NHAOCG, LLC*, 62 A.3d 649, 670 (Del. Ch. 2012). The Delaware Revised Limited Partnership Act explicitly recognizes that partners may modify their fiduciary duties through contract. *See Paige Capital Mgmt., LLC v. Lerner Master Fund, LLC*, 2011 WL 3505355, at *31 (Del. Ch. Aug. 8, 2011) ("[S]uch waivers [of fiduciary duties] must be set forth clearly…there is no provision of the Partnership Agreement that says that Paige General Partner does not owe fiduciary duties to the Fund and its investors. As a result, when Paige General Partner acts as the general partner, it must do so in the good faith belief that it is advancing the best interests of the Fund and its investors, i.e., the limited partners.").

Appellant argues that there are no fiduciary duties owed because Sierra LP's limited partnership agreement dated October 13, 2008 limited or eliminated all fiduciary duties of Sierra LP and its affiliates and that Sierra Resources had the opportunity to negotiate and modify their duties in this Agreement. However, *USACafes* did not specify all duties owed to the partnership, and for the above reasons, this Court must default to the traditional fiduciary duty definition as defined by *USACafes.* 600 A.2d at 49.

This Court should affirm the Chancery Court's decision that corporate general managers and its directors do owe a fiduciary duty to limited partnerships and therefore cannot act in a self-interested way to the detriment of the partnership.

CONCLUSION

For the foregoing reasons, this Court should affirm the decision of the Delaware Court of Chancery.