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.	:	

Appellants' Opening Brief

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February 3, 2017

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NATURE OF PROCEEDINGS

This is an appeal from Chancellor Snyder's Memorandum Opinion ("Mem. Op.") in the Court of Chancery, decided January 9, 2017. The present action was commenced on January 20, 2016 by Plaintiff North Carolina Police Retirement Fund, individually and derivatively against Defendants: Sierra GP LLC ("Sierra GP") and Sierra Resources, Inc. ("Sierra Resources") (collectively the "Entity Defendants"), together with the Bank of New York Mellon Trust Company, N.A. ("BNY Mellon"), individual Sierra Resources board of directors members—Sarah W. Bryant, Robert P. Gray, Richard T. Hanson, Elizabeth F. Prince, and John W. Reynolds (collectively the "Individual Defendants")—and, nominally, Sierra Properties LP ("Sierra LP" or the "Partnership").

On January 20, 2016, Defendants moved pursuant to Court of Chancery Rule 12(b)(6) to dismiss Plaintiff's complaint for failure to state a claim upon which relief can be granted. (Mem. Op. at 1). Defendants presented matters not included in the complaint, and thus the motion was treated instead as one for summary judgment pursuant to Rule 12(b). *Id.* Plaintiff cross-moved for summary judgment claiming that Individual Defendants' approval of the August 2013 trust indenture (the "Indenture") entered into with BNY Mellon as trustee, which contains Section 11.01, violated Defendants' fiduciary duties to Plaintiff and Sierra LP and should be declared invalid and unenforceable. (Mem. Op. at 1, 8). Chancellor Snyder determined that Defendants failed to exercise adequate care in adopting the Indenture, and therefore the put provision was held invalid and unenforceable. (Mem. Op. at 10). In responding to Defendants' alternative argument—that Defendants owed no fiduciary duties to Plaintiff, because they are not general partners of Sierra LP—the Chancellor was bound by outdated precedent and thus forced to reject such a contention. (Mem. Op. at 11).

The Defendant-Appellants filed a notice of appeal of the Court of Chancery's Memorandum Opinion denying their motion for summary judgment and granting Plaintiff-Appellee's cross-motion for summary judgment. (Mem. Op. at 1); (Ntc. of Appeal). This is the Appellants' opening brief. For the reasons that follow, this court should reverse the decision below.

SUMMARY OF ARGUMENT

I. The Court of Chancery erred in determining that the transaction from which the Indenture containing Section 11.01 resulted was not entirely fair to Plaintiff, and that the provision was unenforceable. Because there was no finding that the Individual Defendants' primary purpose in adopting the Indenture was to interfere with the stockholder franchise, the fair price inquiry of entire fairness ought to have been subjected to a lesser scrutiny—one able to have been satisfied with a broader character of evidence—and the fair dealing inquiry construed broader, revealing no misconduct by the Individual Defendants rising to the level that would qualify remediation. Further, the dead hand proxy put is a customary provision and, here, was not adopted in the shadow of a proxy contest. Therefore the provision does not violate Delaware law, and is valid and enforceable.

II. The Court of Chancery similarly erred in failing to determine that the facts of the present case were different than those relied upon in *USACafes.* Sierra Resources neither intentionally used the Partnership's property for its benefit nor in a manner detrimental to the Partnership or its beneficiaries. Additionally, new precedent is needed to clarify a corporate general partner's fiduciary duties when the corporate entity's actions do not reflect self-dealing or inequity. Doing so will provide increased consistency in not only the case of the corporate fiduciary, but also in the situation, such as at present, where the interests of a corporation may not be identical to those of an associated limited partnership.

STATEMENT OF THE FACTS

Sierra Resources—a full service real estate company that owns, acquires, develops, and manages various nationwide properties—is a Delaware corporation and is the sole member and manager of Sierra GP, a Delaware limited liability company that in turn is the sole general partner and a 20 percent limited partner in Sierra LP. (Mem. Op. at 3). The North Carolina Police Retirement Fund is a public pension fund owning 80 percent of the Sierra LP limited partner interest. *Id.*

In 2008, Plaintiff and Sierra Resources negotiated to form a joint venture, with Sierra LP as the investment vehicle, that would develop, redevelop, and invest in high performance commercial buildings. *Id.* at 4. Sierra LP received capital contributions of $80 million from Plaintiff, and $20 million from Sierra Resources. *Id.*

In early 2013, Entity Defendants determined that Sierra LP was underleveraged, and being that newly issued debt was "relatively cheap" at the time, they obtained Plaintiff's general endorsement to line up financing in order to improve Sierra LP's profitability. *Id.* at 5. On August 15, 2013, Sierra LP completed a public offering of $160 million in principal amount of 2 percent notes (the "Notes") due 2028, with BNY Mellon as trustee. *Id.* The following day the trust indenture (the "Indenture") governing the Notes and prepared by counsel for Morgan Stanley, the lead underwriter in the offering, was entered into. *Id.* at 2, 5. Of central importance, Section 11.01 of the Indenture contained a "Change of Control" provision that triggered a dead hand proxy put accelerating repayment to the noteholders in the event a change of control occurred. *Id.* at 2.

In the course of obtaining the debt financing, outside counsel for the Entity Defendants reviewed drafts of the Indenture and made suggestions, but Section 11.01 remained unchanged from its initial preparation until the execution of the final form. *Id.* at 5. The individuals who negotiated the Indenture's content, however, testified in a deposition that they never communicated with anyone at Morgan Stanley on the subject of Section 11.01. *Id.* Though, indeed, when the terms of the offering were approved by Sierra Resources, a director queried outside counsel as to whether any novel terms required attention; counsel's response was in the negative. *Id.* at 6. In August 2013, there was no indication of any plans for an election contest to replace one or more of Sierra Resource's directors. *Id.*

On October 12, 2015, High Street Partners, LP ("High Street"), an activist hedge fund, filed a Schedule 13D with the SEC indicating that it had acquired approximately 6.3 percent of Sierra Resource's outstanding shares. *Id.* The filing stated an intention that Sierra Resources implement and explore new strategic alternatives, and that if the directors did not implement those listed, High Street would undertake to replace at least one director through a contested solicitation of proxies. *Id.* A later press release issued wherein Sierra Resources acknowledged the proxy put would trigger if High Street nominees constituting a majority of the board were elected, which would require Sierra LP to pay off the Notes and seek refinancing that could potentially cost upwards of $2 million. *Id.* at 7. Plaintiff commenced the underlying action on January 20, 2016, individually and derivatively in the right of Sierra LP. *Id.*

ARGUMENT

I. SECTION 11.01 OF THE INDENTURE IS VALID, ENFORCEABLE, AND THE RESULT OF AN ENTIRELY FAIR TRANSACTION IN WHICH APPELLANTS BREACHED NO FIDUCIARY DUTIES.

A. Question Presented

Whether a corporate fiduciary is permitted to adopt a dead hand proxy put provision on a "clear day," and not in an affirmatively defensive manner, without breaching any fiduciary duties.

B. Scope of Review

The Court of Chancery's legal conclusions underlying motions to dismiss and motions for summary judgment are reviewed *de novo*. *Ramirez v. Murdick*, 948 A.2d 395, 399 (Del. 2008).

C. Merits of the Argument

1. The Court of Chancery improperly determined that Section 11.01 of the Indenture was not the result of an entirely fair transaction

For nearly three decades, the laws of Delaware have permitted boards of disinterested directors who either fail to become adequately informed or fail to apply a *Unocal* analysis to preserve a corporate transaction so long as the transaction is entirely fair. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 271 (Del. Ch. 1989); *see Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 954, 955 (Del. 1985) (interested directors must first proffer "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" before receiving the protections of the business judgment rule). "[T]hat a transaction must be subjected to an entire fairness analysis is not an implication of liability": entire fairness is the metric for determining directors' compliance with their fiduciary duties. *Reis* *v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 465 (Del. Ch. 2011) (quoting *Emerald Partners v. Berlin*, 787 A.2d 85, 93 (Del. 2001)). When assessing a transaction for entire fairness, the transaction must be the result of both fair price—an assessment of all relevant economic and financial considerations—and fair dealing—"embrac[ing] questions of when the transaction was timed, how it was initiated, structured, disclosed to the directors, and how approval . . . [was] obtained." *Weinberger v. Uop*, 457 A.2d 701, 711 (Del. 1983). Indeed, while these two factors must be examined in conjunction and totality, in a non-fraudulent transaction, the fair-price inquiry may become the predominating consideration. *Id.*

In determining whether a transaction resulted in a fair price, the scope of review is broad, and "all relevant factors involving the value of a company" are to be considered. *Id.* at 713. At the outset, where an indenture provision is adopted "for the primary purpose of interfering with or frustrating the stockholder franchise" the ultimate price of the transaction must have a "compelling justification" to be fair. *San Antonio Fire & Police Pension Fund v. Amylin Pharms, Inc.*, 983 A.2d 304, 315 n.31 (Del Ch. 2009), *aff'd*, 981 A.2d 1173 (Del. 2009); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del Ch. 1988). However, in the absence of a showing that a provision is adopted solely for its entrenching effect on the company's directors and at the expense of the shareholders, a "lesser burden" is appropriate, and fair price may be demonstrated by some evidence that an "extraordinarily valuable economic benefit[] . . . that would not otherwise be available" was received in exchange for agreeing to the indenture provision. *Amylin*, 984 A.2d at 315 & n.31.

As Section 11.01 of the Indenture governing the Notes was entered into August 2013, and because there was no indication of *any* intent by High Street Partners to even *potentially* undertake to replace one or more of the Sierra Resources directors until High Street's October 2015 Schedule 13D filing—that is, until in excess of two years had elapsed—even assuming *arguendo* that interference with the stockholder franchise was *a* purpose for adopting Section 11.01, there is necessarily no basis for determining, as a matter of law, that it was the *primary* purpose, because the provision was adopted on a "clear day" and not under the shadow of a proxy contest. (Mem. Op. at 2, 6); *see* discussion *infra* Section I.2. Thus a conclusion of fair price, in the course of the entire fairness review, need not be satisfied by the "compelling justification" standard of *Blasius*: the "extraordinarily valuable economic benefit" standard is the appropriate one. Therefore, the Court of Chancery's failure to find convincing the merits of the Morgan Stanley Affidavit as of a suitable character, in conjunction with the undisputed fact that new debt capital was "relatively cheap," as sufficient to carry the burden of demonstrating fair price, at a minimum—much less evidence entire fairness—constitutes reversible error. (Mem. Op. at 5, 9).

Specifically underlying its determination that the directors' transacting for Section 11.01 was not entirely fair to Sierra LP, the Court of Chancery found fatal the "limited character" of the Morgan Stanley Affidavit insofar as there was no "proof that the inclusion of Section 11.01 avoided any specific additional interest cost." (Mem.

Op. at 9). However, this finding in essence subjects review of the provision's transactional price to the exacting, yet incorrect, compelling justification standard because nothing more precise could reasonably be proffered to a court. Implicit in having at least two separate standards of review is the notion of different characters of evidence that may satisfy the burden of each standard separately. While such specific proof that additional interest costs would be avoided may suffice as a confined instance that tends to demonstrate either a compelling justification or that an extraordinarily valuable economic benefit was received, searching for and relying upon this character of evidence alone is misguided, in view of the latter standard's breadth, because such a showing is not also indicative of the co-requisite that the economic benefit be not otherwise available.

The desirability of increasing leverage when debt is cheap is a notion fundamental to the continued capitalization of a company. *See, e.g.*, 20 Elizabeth S. Miller & Robert A. Ragazzo, *Texas Practice Series: Business Organizations* § 28.4 (3d ed. 2016) ("The notion that the best business is a debt-free business, while sounding attractive, is usually not consistent with . . . the maximization of profits."). Sierra LP was founded in 2008, a period in which the general availability of debt significantly decreased from the years just prior. (Mem. Op. at 4); *see* Victoria Ivashina & David Scharfstein, *Bank Lending During the Financial Crisis of 2008*, 97 J. Fin. Econ. 319, 322 (2010). Having been in existence for only five years at the time, Sierra LP was determined to be underleveraged in early 2013, at which point—after obtaining the plaintiff's endorsement—a public offering of $160 million in the principal amount of 2 percent notes was completed. (Mem. Op. at 5). Although there is an absence of case law interpreting what may satisfy as an "extraordinarily valuable economic advantage," the Court of Chancery has proposed a workable and objective interpretation: the directors must only accede to the proxy put provision "for clear economic advantage." *Kallick v. Sandridge Energy, Inc.*, 68 A.3d 242, 248 (Del. Ch. 2013). Even so, not only did Sierra Resources' transacting obtain Sierra LP a subjectively and "extraordinarily valuable economic advantage" in entering into the Indenture—because the Partnership was in its infancy, underleveraged, and not experiencing optimal profitability when the debt financing was sought—and an objectively "clear economic advantage"—because of the macroeconomic trends in existence at the time of Sierra LP's conception—when these two factors are viewed in combination, it is not only plausible, but rather, reasonably certain, that this opportunity was not, and will not be, "otherwise available." (Mem. Op. at 4, 5). Therefore, Section 11.01 and the Notes are fair in price to Sierra LP.

In holistically reviewing a transaction for entire fairness, the fair dealing inquiry "informs the court as to the fairness of the price obtained through that process," and consists in considerations of a transaction's timing, initiation, structuring, negotiation, disclosure, and approval. *Weinberger*, 457 A.2d at 711; *Valeant Pharms. Int'l v. Jerney*, 921 A.2d 732, 746 (Del. Ch. 2007). The Court of Chancery erred in concluding that the corporate fiduciary failed to exercise adequate care in not becoming aware of the proxy put provision of the Indenture, because an incorrect standard was applied in assessing the process of the transaction. (Mem. Op. at 10). A corporate board's obligation to become adequately informed is a contextual application of the board's fiduciary duties of care, loyalty, and good faith. *Cf. RBC Capital Mkts., LLC v. Jervis*, 129 A.3d 816, 858 (Del. 2015). In context, this obligation bears most notably on the duty of care, which only requires that directors not act grossly negligent in the course of considering reasonably available and material information: there is no requirement that a corporate fiduciary review every fact in arriving at a decision. *Amylin*, 983 A.2d at 318 (quoting *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000)). Thus, while "terms which may affect the stockholders' range of discretion in exercising the franchise should, even if considered customary, be highlighted to the board" by outside advising counsel, only conduct rising to the level of a "substantial deviation from the standard of care" may be remediable against a corporate fiduciary. *Id.* at 318, 319.

While a review of entire fairness certainly ought not to completely ignore a board's failure to become informed of such a provision even if customary, yet which remained undisclosed by outside counsel, as the Court of Chancery noted below, nevertheless it is just one of relevant considerations in the fair dealing inquiry, which is to be construed at least as broadly as the fair price inquiry. Change-in-control provisions *identical* to the one contained in Section 11.01 of the Indenture are not novel arrangements: in fact, these types of provisions are customary, and appear in nearly every bond indenture and every syndicated credit facility. *Pontiac Gen. Emps.*

Ret. Sys. v. Ballantine et al., 2014 WL 6388645, slip op. at 25 (Del Ch. Oct. 14, 2014) [hereinafter *Healthways*]; (Mem. Op. at 10). Thus, on its face, an invalidation of this boilerplate item on the basis of a fiduciary's failure to become adequately informed thereof has far-reaching market implications.

Also central to the inquiry of fair dealing is nature of the parties' relations: while arm's-length contractual parties are permitted to negotiate for the best terms possible, a counterparty may not propose, insist, demand, contemplate, or incorporate terms "that take advantage of a conflict of interest that the fiduciary counterparties on the other side of the negotiating table face." *Healthways*, slip op. at 79. Where a defendant corporate fiduciary entered into an indenture containing a change-in-control provision *identical* to that at issue here, even though the dead hand proxy put was adopted by the board in response to stockholder pressure—in the form of an affirmative vote to declassify the board's structure—and at the insistence of the lender, Vice Chancellor Laster determined that neither party bargained at the advantage of a counterparty's conflict of interest. *Id.*, slip op. 7, 69, 70. Even so, bargaining at arm's length "negates claims of aiding and abetting" a breach of fiduciary duties, which requires knowing participation. *Id.*, slip op. at 79.

There are an absence of facts establishing that the transaction instituting the Indenture containing the change-in-control provision prepared by Morgan Stanley was the result of anything other than arm's-length bargaining. Although the customary provision ought to have been highlighted to the directors, unlike it was in *Healthways*, the fact that there was no direct knowledge of this provision by the fiduciaries leads to the conclusion that there may have been a deviation from the expected standard of care. (Mem. Op. at 9). But however, also unlike *Healthways*, being that the directors may not have been informed of the provision, there was no opportunity for any party to transact at the advantage of a conflict of interest that an opposing fiduciary counterparty faced. Thus, in no sense could the deviation from the standard of care be viewed as a "substantial" one. Therefore, when taken in conjunction with the popularity of change-in-control provisions, Section 11.01 of the Indenture was also adopted as a result of fair dealing.

In conclusion, because the transaction that resulted in the board's adoption of Section 11.01 of the Indenture was fair in price and in consequence of fair dealing, the transaction was entirely fair. Finally, because entire fairness is the metric for determining directors' compliance with their fiduciary duties, *Reis*, 28 A.3d at 465, the defendant-appellants breached no fiduciary duties.

2. Section 11.01 of the Indenture is valid and enforceable because there is no guarantee of the put rights' triggering and its adoption was not tainted by the shadow of a proxy contest.

Plaintiff's contention that the adoption of the "dead hand" proxy put necessarily precludes Sierra Resources' incumbent board of directors from the ability to avoid the put rights' triggering by approving a dissident slate in connection with an election contest—thus effecting to a *per se* violation of Delaware law—is inapposite with the current state of Delaware's common law. (Mem. Op. at 2). Change-in-control provisions, such as the dead hand proxy put, are "properly understood to permit the incumbent directors to approve as a continuing director any person, whether nominated by the board or a stockholder" to prevent the automatic triggering of associated rights and obligations. *Amylin*, 983 A.2d at 307. Where a corporate board refused without reasonable justification to approve a dissident slate for the narrow purpose of avoiding a trigger of the proxy put clause contained in an indenture, the Court of Chancery determined the directors likely violated their fiduciary duties. *Kallick*, 68 A.3d at 259–60. However, where two stockholders, together controlling in excess of 20 percent of a corporation's stock, each sought to nominate their own five-person slate to a board of twelve directors, but where, prior to the suit, the corporation agreed to approve the directors in the event they were required to do so to avoid triggering the put rights in the change-in-control provision, the court determined there was no breach of fiduciary duties. *Amylin*, 983 A.2d at 309, 312, 314.

Though it is not argued here at length, and has not been preserved on appeal, arguably, that Plaintiff points to a potential injury—in the event that High Street Partners seeks to nominate a slate of directors to Sierra LP's general partner corporate board—and "is able to conjure up hypothetical situations in which the challenged provisions *may* be applied contrary to Delaware law" supports a conclusion that the present dispute is not ripe as a matter of law. *Wayne Cty. Emps. Ret. Sys. v. Corti*, 2009 Del. Ch. LEXIS 126, at *68 (Del. Ch. July 24, 2009); (Mem. Op. at 7 n.3). In fact, Vice Chancellor Laster has suggested that there may be no ripe and redressable injury to stockholders until there are both continuing and noncontinuing directors on the board. *Healthways*, slip op. 78. This alone warrants reversal of the decision below and remanding for dismissal in the interests of justice—an inherent power of this Court. *See Brehm*, 746 A.2d at 267. Nevertheless, however, because Sierra Resources' board of directors is comprised only of continuing directors, and as there has been no contested solicitation of proxies, actual or threatened—that is, a substantive threat combined with reasonably foreseeable consequences in the event that such threat is defied, not one merely contingent upon uncertain future events—there are no facts indicating Sierra Resources would not heed the advice of outside counsel at the time to approve a dissident slate for purposes of avoiding the triggering of the put rights. (Mem. Op. at 3, 7).

"[D]ead hand proxy puts in debt are legally permissible in most circumstances." Arthur Fleischer, Jr. et al., *Takeover Defense: Mergers and Acquisitions* § 6.11 (7th ed. 2015). The distinction is drawn between those affirmatively bargained for in the shadow of a proxy contest, as in *Healthways*, and those that are simply the result of an entirely fair transaction. *Healthways*, slip op. at 16, 69, 70. Vice Chancellor Laster illustrates this point: where heavy artillery overlooks a town,

> it is definitely true that before a shell can land on [the] town, people have to go up there, . . . load the weapon, . . . go through the firing sequence, . . . [and] the shell actually has to fire, . . . arc through the air, . . . [and] land . . . . But that's a different thing from how I change my behavior driven by the fact that somebody has a piece of artillery on a hill over my town.

Id., slip op. at 16. Thus, while the mere fact of a looming proxy contest to replace incumbent directors may inhere of a somewhat deterring character, that character does not become emboldened substantially enough to have a judicially-cognizable effect on the stockholder franchise unless and until a dead hand proxy put is adopted under the shadow of the looming contest: "[a] truly effective deterrent is never triggered." *Id.*, slip op. at 73. In fact, this customary class of provisions, which appear in nearly every bond indenture and every syndicated credit facility, peculiarly promote the joint interests lenders have in respect of corporations insofar as the provisions protect against wholesale changes in boards of directors within short periods of time while also helping to enforce lenders' "legitimate interests in getting paid." *Id.*, slip op. at 25, 60, 66.

As Section 11.01 of the Indenture governing the Notes was entered into August 2013, and because there was no indication of *any* intent by High Street Partners to even *potentially* undertake to replace one or more of the Sierra Resources directors until High Street's October 2015 Schedule 13D filing—that is, until in excess of two years had elapsed—*Healthways'* temporal inquiry necessarily mandates the conclusion that the provision was adopted on a clear day—not under the shadow of a proxy contest—because the provision was adopted prior to High Street's involvement with Sierra Resources. (Mem. Op. at 2, 6).

II. DEFENDANT-APPELLANTS OWED NO FIDUCIARY DUTIES TO SIERRA LP AS ITS GENERAL PARTNER BECAUSE DIFFERENT CONSIDERATIONS INHERE IN THIS CASE THAN WERE RELIED UPON IN STANDING PRECEDENT, AND THUS A DEPARTURE THEREFROM IS WARRANTED.

A. Question Presented

Whether the Chancery Court erred in applying the standard set in *USACafes* regarding fiduciary duties owed by a corporate general partner to a limited partnership in which it exhibits control.

B. Scope of Review

The Court of Chancery's legal conclusions underlying motions to dismiss and motions for summary judgment are reviewed *de novo*. *Ramirez v. Murdick*, 948 A.2d 395, 399 (Del. 2008).

C. Merits of the Argument

1. **The facts of this case do not align with those of *USACafes* as Sierra Resources neither intentionally used the Partnership's property for its own benefit nor was it used in a manner that was to the detriment of the Partnership property, or its beneficiaries, and thus did not owe fiduciary duties to Sierra LP.**

Sierra Resources did not owe fiduciary duties to Sierra LP because the standing precedent is inapplicable to the focus of this case. A corporate general partner owes a duty to a limited partner if there is (1) corporate/general partner control of property owned by the limited partnership; and (2) an implied or express agreement, and intentional use of the property in a manner that benefits the holder of the control to the detriment of the property or its beneficial owner. *In re USACafes, L.P. Litig.*, 600 A.2d 43, 48 (Del. Ch. 1991) [hereinafter *USACafes*]. Consideration of these elements ultimately leads to the single conclusion being that Sierra Resources did now owe fiduciary duties to Sierra LP.

The guiding principle of the first element is that "when directors of a corporate general partner control the partnership's property because of their control of the corporation that in turn controls the limited partnership, they owe a fiduciary duty to the limited partners as beneficial owners of the property." *Id.* Sierra Resources is the sole member of Sierra GP, which is the general partner of Sierra LP. (Mem. Op. at 3). By virtue of arrangements between Sierra Resources, Sierra GP, Sierra LP, and Plaintiffs, Sierra Resources exercises indirect but exclusive control over Sierra LP. *Id.* This element of the standard is therefore not in controversy.

The second element of the standard set in *USACafes* is the crux of the disagreement, and the complexity of the standard warrants a bipartite analysis. The first part of the rule considers whether the controlling entity received consent from the interested party to perform the act in question. *USACafes*, 600 A.2d at 48. If the controlling party acts with "implied or express agreement" they will not be found in breach of their fiduciary duties. *Id.* "Where the conduct of a complainant, subsequent to the transaction objected to, is such as reasonably to warrant the conclusion that he has accepted or adopted it, his ratification is implied through his acquiescence." *Frank v. Wilson & Co.*, 32 A.2d 277, 283 (Del. 1943). Basic contract principles hold that a court must "assess the parties' reasonable expectations at the time of contracting and not rewrite the contract to appease a party who later wishes to rewrite a contract he now believes to have been a bad deal." *Nemec v. Shrader*, 991 A.2d 1120, 1126 (Del. 2010).

Multiple inspections by representatives of Sierra LP provided them with opportunities to object to the provision, and failure to do so, at a minimum, amounts to an implied acceptance on behalf of Sierra LP. In 2013, after discovering that Sierra LP was underleveraged, Sierra Resources obtained plaintiff's consent to obtain additional debt financing. (Mem. Op. at 5). By agreeing with defendants as to the needs of the partnership, the Plaintiff approved Sierra Resources' plan to seek additional debt financing on behalf of the partnership. *Id.* The second element is therefore inapplicable, as Sierra Resources obtained an express agreement to perform the act that has been called into question in this case. (Mem. Op. at 5–6). Additionally, upon creation of the Indenture granting Sierra LP with the additional financing that both Plaintiff and Defendants desired, counsel for both parties reviewed the agreement and directed changes be made in accordance with their demands. (Mem. Op. at 5). However the provision in question, Section 11.01, was not included in the alterations requested. *Id.* Although given multiple opportunities, at no point did members of either Sierra Resources or Sierra LP question the provision located at Section 11.01, which is at the center of this breach of fiduciary duty claim by Plaintiff. *Id.*

Had Sierra Resources acted independently, without the approval of Sierra LP, this standard still would not be applicable to the matter. The second element requires "intentional use" of the LP property "in a manner that benefits the holder of the control to the detriment of the property or its beneficial owner." *USACafes*, 600 A.2d at 48. Critical to the application of the *USACafes* standard was evidence that the corporation's board of directors "received substantial side payments that induced them to authorize the sale of the Partnership assets for less than the price that a fair process would have yielded." *Id.* at 46. In developing this standard, Chancellor Allen recognized that it should not be applicable in all circumstances, but did note its applicability in cases facing self-dealing by the controlling entity at the expense of the partnership. *Feeley v.*

NHAOCG, LLC, 62 A.3d 649, 670 (Del. Ch. 2012) (quoting *USACafes*, 600 A.2d at 49). Several courts have "declined to expound the full scope of *USACafes* duties" refusing to extend the clear application of the duties beyond one who uses their "control over the partnership's property to advantage the corporate director at the expense of the partnership." *Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *10 (Del. Ch. Apr. 20, 2009).

As previously stated by the defendant, and acknowledged by the Court of Chancery, Defendants were unaware of the existence of the provision. (Mem. Op. at 9). Sierra Resources did not draft, advocate, or even know of the provision's existence, just as Sierra LP did not acknowledge the provision's existence when their independent counsel viewed the Indenture. (Mem. Op. at 10). Further, when entering into the Indenture, Sierra Resources had no knowledge that any person was planning an election contest to replace any of its directors, and in fact was accurate making this assumption, as it was not until two years later that an "activist" filed a Schedule 13D to become a minority shareholder of Sierra Resources. (Mem. Op. 6). Sierra Resources' absence of knowledge of the provision in question eliminates any opportunity they may have had to intentionally use property of the partnership solely for their own benefit. (Mem. Op. 2-3). Without evidence of any knowledge, the directors could not have intentionally acted in any manner adverse to the interests of Sierra LP. Further, in *Bay Center*, the Chancery Court required the plaintiff to plead that the defendant benefited himself at the expense of the plaintiff to withstand a motion to dismiss. This requirement is applicable to the circumstances here, as there was no evidence of self-dealing by Sierra Resources, and leads to the conclusion that Sierra Resources did not owe fiduciary duties to Sierra LP.

Unlike in *USACafes* where the defendants authorized a sale of partnership assets at a deficient price to receive side payments for themselves, Sierra Resources provided Sierra LP with the equal opportunity to review the Indenture. (Mem. Op. at 5, 6). Upon review by independent counsel of both entities, neither party proceeded to question the provision, and in fact failed to mention any part of the provision altogether. Moreover, individuals from Sierra LP negotiated the content of the Indenture on their behalf, and testified that from the time it was initially drafted by Morgan Stanley's underwriter until the final execution, the provision remained unchanged. (Mem. Op. at 5). By failing to raise issue with the provision upon review of the Indenture by their own counsel team, at a minimum Sierra LP established an implied agreement that they accepted the terms.

Should this court determine that the corporation itself breached its fiduciary duty to Sierra LP, the independent directors could not be found in breach of their duties to the limited partner because the threshold standard that ought to be applied is one akin to "knowing inducement" in an aiding and abetting claim. For an aiding and abetting claim, the burden of proof rests with the plaintiffs, including proving the existence of a breach of fiduciary duty. *In re Rural Metro Corp.*, 88 A.3d 54, 85 (Del. Ch. 2014). To determine whether a breach of fiduciary duties occurred on the part of the individual directors, the complaint must allege facts that satisfy the four elements of an aiding and abetting claim: "(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, . . . (3) knowing participation in that breach by the defendants," and (4) damages proximately caused by the breach. *Malpiede v. Townson*, 780 A.2d 1075, 1096 (Del. 2001).

The very treatise relied on by Chancellor Allen in *USACafes* states "[a] director or officer is liable to the beneficiaries only if he is personally at fault and has violated a duty that he owes to the beneficiaries." 4 William F. Fratcher, *Scott on Trusts* § 326.3, at 307 (4th ed. 1989). An aiding and abetting claim fails because the first two prongs cannot be met as no fiduciary duties were owed as previously expressed. Since the corporation itself did not owe fiduciary duties to the limited partnership, there can be no breach by the individual directors. The third prong of the claim requires "knowing participation" by the individual directors, which also cannot be demonstrated. The directors did not draft the indenture, and played no role in the development of the proxy put provision in question. (Mem. Op. at 10). Even more persuasive is the undisputed fact that the individual directors of Sierra Resources were unaware of the content of Section 11.01 when the Indenture was entered into. (Mem. Op. at 10). Despite an injury that may be suffered by the Plaintiff based on the triggering of the proxy put, individual directors could not have contributed to aiding and abetting a breach of fiduciary duties.

Despite Sierra Resources maintaining control over the partnership, the Chancery Court erred in concluding that the Indenture was entered into without the consent of the Partnership, and with the intention of Sierra Resources planning to use the property of the Partnership for their own benefit and to the detriment of the Partnership or its beneficiaries. Further, a claim of aiding and abetting against Individual Defendants could not survive a motion to dismiss as each element of the claim could not be met.

2. New precedent and clarification is needed in cases of a corporate general partner's fiduciary duties when the actions taken by the corporate entity are not based in self-dealing or inequity.

i. *USACafes* should be limited to acts by corporate general partners that are found to be based in self-dealing inequity.

The only duty specifically delineated in *USACafes* was "the duty not to use control over the partnership's property to advantage the corporate director at the expense of the partnership." *Cargill, Inc. v. JWH Special Circumstance LLC*, 959 A.2d 1096, 1121 (Del. Ch. 2008) (citing *USACafes*, 600 A.2d at 43). Cases that have found corporate general partners to owe fiduciary duties to entities that they control, have almost unanimously ruled this way based on the corporation or it's individual directors performing acts of self-dealing. *See USACafes*, 600 A.2d at 43; *Phillips v. Hove*, 2011 Del. Ch. LEXIS 137, at *66 (Del. Ch. Sep. 22, 2011); *Wallace v. Wood*, 752 A.2d 1175, 1181 (Del. Ch. 1999).

Relying on precedent set in *USACafes* creates a great deal of confusion as directors of a corporation will likely be unsure as to whom they owe fiduciary duties when making decisions that could ultimately affect the corporation and any entities under its controls. Opinions to this point have held that if directors of a corporate general partner have acted in a manner that is advantageous to their personal interest at the expense of the limited partner, then this standard shall be applied, but have failed to lay out duties that would apply otherwise. *Gelfman v. Weeden Inv'rs, L.P.*, 792 A.2d 977, 992 (Del. Ch. 2001); *Wallace*, 752 A.2d at 1180; *In re Boston Celtics Ltd. P'ship S'holders Litig.*, 1999 WL 641902, at *4 (Del. Ch. Aug. 6, 1999). This court should eliminate the use of this standard in cases in which self-dealing has not occurred, and set new precedent to create greater consistency in this case and those in the future.

Acting in the best interest of the shareholders as required by the Delaware General Corporation Law's fiduciary standards, will not always align with the interests of the limited partner. In certain situations, acting in the best interests of the corporate shareholders could ultimately be viewed as a breach of fiduciary duties to the limited partnership. The standard created in *USACafes* creates a "lose-lose" situation for corporate general partners who owe a fiduciary duty to limited partners simply because they exhibit control over the limited partnership. It is unjust to determine an act taken by a corporation that is in the best interest of its shareholders is a breach of its fiduciary duties owed to a separate entity which the corporation also controls. Where no act of self-dealing is evident, a corporate general partner should not owe additional fiduciary duties to two separate entities, which may have competing interests. For these reasons, the standard set in *USACafes* is inapplicable here, and should not be followed in these types of cases.

ii. New precedent is needed limiting corporate general partner fiduciary duties in fair and good faith transactions.

Limiting the duty to simply forbid the type of self-dealing at issue in *USACafes* will increase the consistency in these types of cases, while continuing to resolve the issue of bad faith actions performed by general partners that *USACafes* attempted to curtail. The current precedent overreaches its original intention in effectively ignoring the business judgment rule and good faith standards altogether. A new standard of duties owed by corporate general partners should be developed and precisely defined to appropriately guide directors when making decisions that could have an effect on entities they control.

CONCLUSION

Based on the foregoing, the Court of Chancery's decision below denying Defendants' motion for summary judgment and granting Plaintiff's cross-motion for summary judgment should be reversed.

Dated: February 3, 2017

Respectfully Submitted,

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