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IN THE SUPREME COURT OF THE STATE OF DELAWARE

BROOKFIELD ASSET MANAGEMENT, INC., ORION US HOLDINGS 1 L.P., BROOKFIELD BRP HOLDINGS (CANADA) INC., BRIAN LAWSON, HARRY GOLDGUT, RICHARD LEGAULT, SACHIN SHAH, and JOHN STINEBAUGH	)	
Defendants-Below, Appellants,	)	No. 406, 2020
v.	)	Court Below: Court of Chancery of the State of Delaware, Consolidated C.A. No. 2019-0757-SG
MARTIN ROSSON and CITY OF DEARBORN POLICE AND FIRE REVISED RETIREMENT SYSTEM (CHAPTER 23)	)	
Plaintiffs-Below, Appellees.	)	

APPELLANTS' OPENING BRIEF

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Dated: January 19, 2021

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NATURE OF PROCEEDINGS

This is an interlocutory appeal from an Opinion and Order of the Court of Chancery[1] holding that former stockholders of TerraForm Power, Inc. ("TerraForm" or the "Company") have direct standing to challenge TerraForm's 2018 private placement of common stock to an alleged controlling stockholder, for allegedly inadequate consideration. The trial court correctly found that Plaintiffs' claims would be exclusively derivative under the Supreme Court's seminal decision in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). Nevertheless, the trial court held that Plaintiffs' claims were predicated on a factual paradigm similar to that of *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), and determined that it was bound by the principle of *stare decisis* to deny Defendants' Motion to Dismiss. Because *Tooley* and *Gentile* are conceptually at odds and *Gentile* injects uncertainty and confusion into the law, the *Gentile* doctrine should be overruled, and Plaintiffs' direct claims should be dismissed.

In June 2018, TerraForm issued $650 million of Class A common stock to affiliates of Brookfield Asset Management, Inc. ("Brookfield") through a private placement (the "Private Placement"). TerraForm used the proceeds of the Private

[1] *See* Exhibit A (Memorandum Opinion, dated October 30, 2020 (the "Opinion" or "Op.")); Exhibit B (Order Denying Defs.' Mot. to Dismiss, dated November 24, 2020 (the "Order")).

Placement to fund a portion of the $1.2 billion purchase price for its acquisition of Saeta Yield, S.A. ("Saeta"), a Spanish energy company. As a result of the Private Placement, Brookfield's ownership stake in TerraForm increased from approximately 51% to approximately 65.3%.

Plaintiffs challenged the fairness of the price paid by Brookfield in the Private Placement, purporting to assert claims both directly and derivatively. Defendants moved to dismiss Plaintiffs' direct claims on the basis that dilution claims are exclusively derivative. Defendants explained that *Gentile* was not only incorrectly decided but, more importantly, conflicts with the applicable law as stated in *Tooley*. In *Tooley*, the Supreme Court stated explicitly that the "special injury" concept was "not helpful and should be regarded as erroneous."[2] Under the *Tooley* test, Plaintiffs' supposedly direct claims would be dismissed.

In July 2020, affiliates of Brookfield acquired all of the outstanding shares of TerraForm common stock not already owned directly or indirectly by Brookfield (the "Merger"), after which Plaintiffs acknowledged that they lacked standing to sue derivatively on behalf of TerraForm and stipulated to the dismissal of their derivative claims with prejudice.[3] Thus, the sole issue before the trial court, and now this Court, was whether Plaintiffs had direct standing to challenge the Private Placement.

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[2] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033, 1035(Del. 2004).

[3] A448-451; A452-456.

On October 30, 2020, the Court of Chancery issued its Opinion denying Defendants' Motion to Dismiss. The Opinion held that, "under *Tooley* alone, the Plaintiffs' overpayment claims neatly fall into the derivative category."[4] With respect to *Gentile*, however, despite acknowledging that the current state of the law "is, as a matter of doctrine, unsatisfying,"[5] the trial court determined that it was "not free to decide cases in a way that deviates from binding Supreme Court precedent."[6] Accordingly, the trial court held that, "if law settled by our Supreme Court is to be changed, it requires a reasoned analysis by that Court."[7]

The Court of Chancery granted Defendants' request for certification of an interlocutory appeal, finding that review of the Opinion may terminate the litigation and would serve considerations of justice.[8] The Supreme Court accepted the interlocutory appeal.

As the trial court recognized, *Gentile* is an "awkward carve-out to the otherwise straightforward [*Tooley*] doctrine,"[9] and a former member of the Supreme Court similarly opined that *Gentile* "muddies the clarity of [Delaware] law in an important context" and "cannot be reconciled with the strong weight of [Delaware]

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[4] Op. at 32.
[5] *Id.* at 41.
[6] *Id.* at 44.
[7] *Id.* at 45.
[8] A487-490 (Letter Opinion, dated November 24, 2020 ("Letter Op.")); A491 (Order Granting Leave to Appeal, dated November 24, 2020).
[9] Op. at 41.

precedent."[10] For the reasons set forth below, even if the trial court was bound by precedent to adhere to *Gentile* in these circumstances, this Court can and should overrule *Gentile* and order the dismissal of Plaintiffs' direct claims.

[10] *El Paso Pipeline GP Co. v. Brinckerhoff*, 152 A.3d 1248, 1265-66 (Del. 2016) (Strine, C.J. concurring).

SUMMARY OF ARGUMENT

1. Plaintiffs do not have direct standing to pursue a breach of fiduciary duty claim for dilution in connection with the Private Placement. The authoritative test for distinguishing direct claims from derivative claims was set forth in *Tooley*. Under *Tooley*, Plaintiffs' dilution claim is exclusively derivative. As a result of the continuous ownership requirement, the Merger extinguished Plaintiffs' standing to pursue their derivative claims and the litigation should be dismissed.

Gentile relied on *Tri-Star*, a decision based on the old "special injury" rule that the Supreme Court discarded in *Tooley*. Because *Gentile* is doctrinally inconsistent with *Tooley*, *Gentile* has been repeatedly criticized as a source of confusion for trial courts, market participants, and practitioners. *Gentile* also undermines the common-sense rule that damages which result from harm to a company in a derivative action should be awarded to the company.

2. *Stare decisis* does not prevent this Court from dismissing Plaintiffs' direct claims. This Court has the power to overrule *Gentile*, and *stare decisis* should not apply given the difficulty trial courts have encountered in attempting to apply *Gentile* consistently and the great uncertainty *Gentile* has produced. Where there is confusion and uncertainty in the law, this Court should revisit—and, if necessary, refine or overrule—its prior decisions to foster clarity, stability, and fixed expectations.

3. As a policy matter, *Gentile* introduces uncertainty in the marketplace, because it allows both a corporation and its current or former stockholders to pursue the same recovery. Among other real-world complications, this presents the potential for a double-recovery. There is no "gap" in the law for *Gentile* to fill that would justify the uncertainty it causes.

STATEMENT OF FACTS

A. The Parties

Plaintiffs Martin Rosson and City of Dearborn Police and Fire Revised Retirement System (Chapter 23) allege that, prior to the Merger, they were stockholders of TerraForm,[11] then a publicly traded Delaware corporation, that "acquires, owns and operates solar and wind assets in North America and Western Europe."[12]

Defendant Brookfield is a Canadian corporation with its principal executive offices in Toronto.[13] Brookfield is an alternative asset manager.[14]

Defendants Orion US Holdings 1 L.P. ("Orion") and Brookfield BRP Holdings (Canada) Inc. ("BRP") are affiliates of Brookfield.[15] Orion is a Delaware limited partnership.[16] BRP is a Canadian corporation.[17]

Defendants Brian Lawson, Harry Goldgut, Richard Legault, and Sachin Shah are senior executives of Brookfield and served as four of the seven members of the

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[11] A086 (Verified Stockholder Derivative and Class Action Complaint, ¶ 12, C.A. No. 2020-0050-SG (Del. Ch. Jan. 27, 2020) (the "Complaint" or "Compl.")); A044 (Verified Stockholder Derivative and Class Action Complaint, ¶ 10, C.A. No. 2019-0757-SG (Del. Ch. Sept. 19, 2019) (the "Rosson Complaint")).
[12] A086 (Compl. ¶ 13).
[13] A087 (*Id*. ¶ 14).
[14] *Id*.
[15] A088-089 (*Id*. ¶¶ 17-18).
[16] *Id.*
[17] *Id.*

TerraForm Board.[18] Under TerraForm's Amended and Restated Certificate of Incorporation (the "Charter"), Brookfield had the right to designate four directors for nomination to the TerraForm Board.[19]

Defendant John Stinebaugh is an executive of Brookfield and served as TerraForm's Chief Executive Officer ("CEO") pursuant to a 2017 Governance Agreement between TerraForm and Brookfield.[20]

B. Brookfield's Investment In TerraForm

In October 2017, Orion and BRP collectively acquired approximately 51% of TerraForm's outstanding shares of Class A common stock.[21] In connection with the transaction, Brookfield and its affiliates entered into several sponsorship agreements with TerraForm.[22] Each of these agreements was approved by TerraForm's stockholders.[23]

Pursuant to a Master Services Agreement, Brookfield provided certain management and administrative services to TerraForm and had the right to appoint TerraForm's CEO, Chief Financial Officer, and General Counsel.[24] A Governance

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[18] A089-091 (*Id*. ¶¶ 19-22).
[19] A095 (*Id*. ¶ 37); A237 (Transmittal Aff. of Stephen C. Childs, Esq. in Support of Defs.' Mot. to Dismiss ("Childs Aff."), Ex. 2 (Charter Art. VI, § 3(b)).
[20] A091, A094 (Compl. ¶¶ 23, 34-36).
[21] A093 (*Id*. ¶¶ 30, 32).
[22] A093-094, A096 (*Id*. ¶¶ 33-35, 40); A177 (Defs.' Mot. to Dismiss and Stay at 10 ("Defs.' Mot. to Dismiss")).
[23] A246 (Childs Aff., Ex. 3).
[24] A094 (Compl. ¶¶ 34-35).

Agreement required that the TerraForm Board have a Conflicts Committee comprising three independent directors.[25] The Conflicts Committee was responsible for, among other things, reviewing and approving material transactions in which a potential conflict may exist between TerraForm and Brookfield.[26] Additionally, TerraForm's Charter contained a supermajority voting provision, requiring an affirmative vote of at least 66-2/3% of the outstanding shares of common stock to amend certain Charter provisions.[27]

C. The Saeta Acquisition and the Private Placement

In February 2018, TerraForm announced that it intended to launch a tender offer to acquire 100% of the outstanding shares of Saeta, a Spanish yieldco that owned and operates wind and solar energy assets, for an aggregate purchase price of $1.2 billion.[28] Prior to the announcement, TerraForm anticipated that the acquisition would be funded through a combination of debt financing and approximately $600-700 million in equity to be raised in the public markets.[29] Brookfield agreed to purchase its pro rata interest in TerraForm common stock that would be issued in the public offering, as well as any other shares not acquired by the public as a "backstop"

[25] A096 (*Id*. ¶ 40).
[26] *Id*.
[27] A243 (Childs Aff., Ex .2 (Charter, Art. XIII)).
[28] A098, A116-117 (Compl. ¶¶ 44, 67).
[29] A108 (*Id*. ¶ 54).

to the public offering.[30] This agreement was memorialized in a Support Agreement approved by the Conflicts Committee.[31] The Support Agreement specified that the share price of the backstop, if necessary, would be equal to TerraForm's five-day volume weighted average price ending the trading day prior to the announcement of the Saeta acquisition.[32] This yielded a price of $10.66 per share.[33]

In June 2018, the Conflicts Committee approved the exercise of the backstop, and the Board approved the sale of 60,975,609 shares of TerraForm Class A common stock to Brookfield at $10.66 per share for an aggregate price of $650 million.[34] The Private Placement increased Brookfield's economic and voting interest in TerraForm from approximately 51% to approximately 65.3%.[35]

D. Brookfield Acquires All Outstanding TerraForm Common Stock In The Merger

On July 31, 2020, affiliates of Brookfield purchased all TerraForm common stock not already held by Brookfield or its affiliates in a stock-for-stock transaction.[36] The Merger was conditioned on the approval of both a duly empowered committee of independent Board members and those stockholders

[30] A083-084, A108, A113-115 (*Id*. ¶¶ 5, 54, 60, 61).
[31] A113-115 (*Id*. ¶¶ 60-63).
[32] A114-115 (*Id*. ¶¶ 61, 63).
[33] A115 (*Id*. ¶ 63).
[34] A085, A126 (*Id*. ¶¶ 8, 9, 93).
[35] A082, A126 (*Id*. ¶¶ 2, 94).
[36] A261 (Childs Aff., Ex. 6); Op. at 22.

holding a majority of the outstanding shares of TerraForm's Class A common stock not held by Brookfield and its affiliates.[37] Following the Merger, TerraForm's public stockholders ceased to have any interest in TerraForm, and all of TerraForm's assets, liabilities, rights, and causes of action became the property of TerraForm's new owner.[38]

E. Proceedings Below

On September 19, 2019, Martin Rosson filed a derivative and purported class action complaint against Brookfield, Orion, and BRP Holdings for breach of fiduciary duties.[39] City of Dearborn filed a derivative and purported class action complaint against all Defendants for breach of fiduciary duties on January 27, 2020.[40] On February 13, 2020, the trial court consolidated the two actions and designated the Complaint filed by City of Dearborn as the operative complaint in the consolidated action.[41] The Complaint alleges that Brookfield caused TerraForm to

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[37] A262 (Childs Aff., Ex. 6).

[38] 8 *Del. C.* § 259(a) (upon merger, "the rights, privileges, powers and franchises of each of said corporations, and . . . all other things in action or belonging to each of such corporations shall be vested in the corporation surviving or resulting from such merger . . . ."); *see also In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455, 476 (Del. Ch. 2013) ("In *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984), the Delaware Supreme Court held that the right to bring a derivative action passes via merger to the surviving corporation.") (internal citations omitted).

[39] A038-077 (Rosson Complaint).

[40] A078-144 (Compl.).

[41] A145-153.

issue its stock in the Private Placement for inadequate value, diluting both the financial and voting interest of the minority stockholders.[42]

Defendants moved to dismiss Plaintiffs' direct claims on the basis that they are entirely derivative.[43] The Motion to Dismiss was fully briefed by June 10, 2020,[44] and argued on July 16, 2020.[45]

The Court of Chancery issued its Opinion denying the Motion to Dismiss on October 30, 2020[46] and the Order on November 24, 2020.[47]

On November 9, 2020, Defendants submitted an application to the trial court for certification of an interlocutory appeal of the Opinion.[48] The trial court granted Defendants' application on November 24, 2020,[49] finding that the appeal could end the litigation and would serve considerations of justice "by clarifying an area of law that appears to be in a state of flux."[50] Specifically, the trial court held that, "in light of case law questioning the continued vitality of *Gentile* at the trial court level, and in light of criticism at the Supreme Court level, I find it in the interest of justice that

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[42] A085-086, A128-129, A129-130 (Compl. ¶¶ 10, 101, 103).
[43] A159-213 (Defs.' Mot. to Dismiss).
[44] A339-380 (Defs.' Reply Br. to Mot. to Dismiss).
[45] A402-447.
[46] Op.
[47] Order.
[48] A457-471.
[49] A491.
[50] A488-490 (Letter Op. at 2-4).

the matter be available for review by the Supreme Court at this Motion to Dismiss stage."[51]

Defendants filed a Notice of Appeal with the Supreme Court on November 30, 2020.[52] The Supreme Court accepted the appeal on December 14, 2020, adopting the Court of Chancery's reasoning that the appeal could potentially terminate the litigation and would serve considerations of justice.[53] Those considerations of justice are paramount: beyond the parties to this appeal, Delaware entities and practitioners who advise as to issues of Delaware law need certainty and clarity on this important issue. For the reasons set forth below, Defendants request that the Supreme Court explicitly overrule *Gentile* and return Delaware law to "the clarity and coherence that *Tooley* brought" in determining the nature of stockholder claims.[54]

[51] A489 (*Id.* at 3).
[52] C.A. No. 406, 2020, Notice of Appeal from Interlocutory Order and Opinion.
[53] Dkt. 2 at 3-4.
[54] *El Paso Pipeline*, 152 A.3d at 1266 (Strine, C.J. concurring).

ARGUMENT

I. PLAINTIFFS LACK STANDING TO PURSUE THEIR CLAIMS DIRECTLY

A. Question Presented

Whether Plaintiffs have direct standing to challenge the Private Placement under *Gentile*, when Plaintiffs' dilution claims are exclusively derivative under *Tooley* and the Merger extinguished stockholders' standing to bring derivative claims.[55]

B. Scope of Review

"Whether a party has standing is a question of law that is subject to *de novo* review."[56]

C. Merits of the Argument

"[A] party must have standing to sue in order to invoke the jurisdiction of a Delaware court."[57] Standing is a "threshold question" that "refers to the right of a party to invoke the jurisdiction of a court to enforce a claim or to redress a grievance."[58] "The party invoking the jurisdiction of a court bears the burden of

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[55] This question was presented below at A159-213, A339-380.
[56] *El Paso*, 152 A.3d at 1256.
[57] *Ala. By-Prods. Corp. v. Cede & Co. ex rel. Shearson Lehman Bros., Inc.*, 657 A.2d 254, 264 (Del. 1995).
[58] *Dover Hist. Soc'y v. City of Dover Planning Comm'n*, 838 A.2d 1103, 1110 (Del. 2003) (standing determination "ensure[s] that the litigation before the tribunal is a 'case or controversy' that is appropriate for the exercise of the court's judicial powers.").

establishing the elements of standing."[59] Although a stockholder need not retain its stock to assert direct claims, under the continuous ownership rule, "[a] plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason, loses standing to continue a derivative suit."[60] Accordingly, whether a claim is direct or derivative may be case-dispositive, as it is here, given that the Merger eliminated Plaintiffs' standing to prosecute derivative claims.

1. Plaintiffs' Claims Are Exclusively Derivative Under *Tooley*

Prior to the Supreme Court's decision in *Tooley*, the analysis for determining whether a claim was direct or derivative was based on "confusing propositions [that] encumbered [Delaware] caselaw governing the direct/derivative distinction," including the "special injury" test.[61] In *Tooley*, the Supreme Court jettisoned these "amorphous," "confusing," and "inaccurate" concepts in favor of a framework intended to be "clear, simple and consistently articulated and applied by [Delaware] courts."[62] The *Tooley* test "turn[s] *solely* on the following questions: (1) who

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[59] *Id.* at 1109.

[60] *Lewis*, 477 A.2d at 1049; *see also Ark. Teacher Ret. Sys. v. Countrywide Fin. Corp.*, 75 A.3d 888, 890, 894-95, 897 (Del. 2013) (discussing, "ratify[ing]," and "reaffirm[ing]" the continuous ownership rule recognized in *Lewis v. Anderson*).

[61] *Tooley*, 845 A.2d at 1038; *see also Lipton v. News Int'l, Plc*, 514 A.2d 1075, 1078 (Del. 1986) (recognizing the "special injury" test in which a stockholder "may maintain an individual action if he complains of an injury distinct from that suffered by other shareholders or a wrong involving one of his contractual rights as a shareholder").

[62] *Tooley*, 845 A.2d at 1035-37.

suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?"[63] "To answer the question[s], the reviewing court must look to the body of the complaint and consider the nature of the wrong alleged and the relief requested."[64] *Tooley*'s "simple analysis" has become "well imbedded in [Delaware's] jurisprudence."[65]

Here, as the Court of Chancery held below, Plaintiffs' claims "neatly fall into the derivative category" under the *Tooley* framework.[66] The Complaint alleges that "the *Company* and the Company's minority stockholders (through a reduction in economic value and voting power) have been damaged"[67] because the $10.66 per share price that Brookfield paid in the Private Placement was allegedly too low and, therefore, unfair.[68] Likewise, the primary relief that Plaintiffs seek is rescissory damages on behalf of TerraForm—*i.e.*, for TerraForm to be paid the "fair value" of the stock sold in the Private Placement.[69] Thus, the answer to both *Tooley* questions—who suffered the alleged harm and who would receive the recovery—is

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[63] *Id.* at 1033.
[64] *Culverhouse v. Paulson & Co. Inc.*, 133 A.3d 195, 198 (Del. 2016).
[65] *Tooley*, 845 A.2d at 1035.
[66] Op. at 32.
[67] A140 (Compl. ¶ 135 (emphasis added)).
[68] A129 (*Id.* ¶ 102).
[69] A082, A141 (*Id.* ¶¶ 1, 140).

TerraForm. Indeed, dilution claims, as alleged here, are "quintessential example[s] of [] derivative claim[s]."[70]

2. ***Gentile*** **Deviated From The "Simple Analysis" Of** ***Tooley***

Two years after deciding *Tooley*, the Supreme was called upon to apply *Tooley*'s "simple analysis" with respect to "a self-dealing transaction in which the CEO/controlling stockholder forgave the corporation's debt to him, in exchange for being issued stock whose value allegedly exceeded the value of the forgiven debt."[71] The issue of whether the claim was derivative or direct was potentially dispositive because, after the transaction at issue, the corporation was acquired by a third party and the plaintiffs lost derivative standing.[72] Additionally, following the acquisition,

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[70] *El Paso*, 152 A.3d at 1265 (Strine, C.J. concurring) ("As the majority opinion [in *El Paso*] makes clear, a claim that an entity has issued equity in exchange for inadequate consideration—a so-called dilution claim—is a quintessential example of a derivative claim."); *see also id.* n.2 ("'Classically, Delaware law has viewed as derivative claims by shareholders alleging that they have been wrongly diluted by a corporation's overpayment of shares.'" (quoting *Green v. LocatePlus Hldgs. Corp.*, 2009 WL 1478553, at *2 (Del. Ch. May 15, 2009))); *Klein v. H.I.G. Cap., L.L.C.*, 2018 WL 6719717, at *6 (Del. Ch. Dec. 19, 2018) ("Klein's claims are a classic form of an 'overpayment' claim. He disputes the fairness of the consideration paid for the Preferred Stock given its terms, in particular its dividend rate and the implied call option value of its conversion feature. . . . Such claims are quintessentially derivative."); *Silverberg v. Padda*, 2019 WL 4566909, at *5 (Del. Ch. Sept. 19, 2019) ("[C]laims that a corporation overpaid for corporate financing, thereby diluting the value of its stock, are quintessentially derivative."), *rearg. denied*, 2019 WL 5295141 (Del. Ch. Oct. 18, 2019).

[71] *Gentile*, 906 A.2d at 93.

[72] *Id.* at 93, 96.

the acquiring company was liquidated, leaving the stockholders of the acquired company as the only parties left who could possibly recover for the dilution claim.[73]

In reciting the applicable law, the Supreme Court in *Gentile* recognized that "[n]ormally, claims of corporate overpayment are treated as causing harm solely to the corporation and, thus, are regarded as derivative" because "(expressed in *Tooley* terms) . . . the corporation is both the party that suffers the injury (a reduction in its assets or their value) as well as the party to whom the remedy (a restoration of the improperly reduced value) would flow."[74] Nevertheless, in a departure from *Tooley*, the Supreme Court in *Gentile* created an exception permitting direct claims where "(1) a stockholder having majority or effective control causes the corporation to issue 'excessive' shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders."[75]

Although the Supreme Court acknowledged in *Gentile* that this scenario would lead to a *derivative* claim, it held that "the public (or minority) stockholders

[73] *Id.* at 93, 96, 103.
[74] *Id.* at 99.
[75] *Id.* at 100.

also have a separate, and direct, claim arising out of that same transaction"[76] because "the harm resulting from the overpayment is not confined to an equal dilution of the economic value and voting power of each of the corporation's outstanding shares."[77] Under *Gentile*, the "separate harm" is found in "an extraction from the public shareholders, and a redistribution to the controlling shareholder, of a portion of the economic value and voting power embodied in the minority interest."[78] In these circumstances, *Gentile* held that the value represented by the corporate overpayment is "an entitlement that may be claimed by the public shareholders directly and without regard to any claim the corporation may have."[79]

3. The *Gentile* Exception is Doctrinally Inconsistent with *Tooley* And Has Been Repeatedly Criticized

In *Tooley*, this Court rejected its prior holding in *In re Tri-Star Pictures, Inc. Litigation*, 634 A.2d 319 (Del. 1993) because it recognized that *Tri-Star* "lapsed back into the 'special injury' concept," which this Court explicitly "discard[ed]" in *Tooley*.[80] In *Tri-Star*, this Court held that plaintiffs had "stated a cause of action for 'special injury'"[81] (*i.e.*, a direct claim) because a significant stockholder who became the company's 80% owner following an assets-for-stock transaction "did not suffer

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[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *Tooley*, 845 A.2d at 1038 n.21.
[81] *In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 332 (Del. 1993).

a dilution of cash value, of voting power, or of ownership percentage to the same extent and in the same proportion as the minority shareholders, [and] the plaintiffs had suffered an injury that was unique to them individually[.]"[82] In direct conflict with *Tooley*, *Gentile* explicitly relied upon *and expanded* the application of *Tri-Star* and the special injury test.[83]

Below, the trial court observed that "*Gentile* was decided *after Tooley*, and *Gentile* holds that the decision therein 'fits comfortably within the analytical framework mandated by *Tooley*.'"[84] But in *Tooley*, the Supreme Court could not have been clearer: "the concept of 'special injury' that appears in some Supreme Court and Court of Chancery cases is not helpful to a proper analytical distinction between direct and derivative actions."[85] Accordingly, this Court "disapprove[d] the use of the concept of 'special injury' as a tool in that analysis."[86] *Gentile*, however, nevertheless relied on the concept of "special injury" in finding that the minority stockholders suffered a "*separate* harm" that injured them "*uniquely* and

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[82] *Gentile*, 906 A.2d at 101 (citing *Tri-Star*, 634 A.2d at 332-33).
[83] *Id.* at 101 (finding *Tri-Star* "created the analytical framework for this issue" and "*Tri-Star*'s governing rule should control" irrespective of whether the suing stockholder suffered a material loss of economic value and voting power).
[84] A508 (Op. at 36) (quoting *Gentile*, 906 A.2d at 102).
[85] *Tooley*, 845 A.2d at 1035.
[86] *Id*.

individually" under the principles enunciated in *Tri-Star*.[87] Indeed, Plaintiffs admitted that "*Gentile*'s rule is a continuation" of *Tri-Star*.[88]

Not surprisingly, courts have "struggled with how to interpret *Gentile* and its potential to undercut the traditional characterization of stock dilution claims as derivative."[89] "Early understandings of *Gentile* . . . assumed that direct standing was only available in circumstances in which there was a controlling stockholder or, by implication, a functionally equivalent control group."[90] This was an understandable reading of *Gentile*, since it was not the "voting power" component of a dilution claim that had caused the Court to find direct standing—indeed, *all* dilution claims necessarily involve some level of dilution of voting power—but, rather, the presence of a controlling stockholder that allegedly used its control to "expropriate[]" value *and* voting power from the minority.[91]

As courts have explained subsequently, however, if *Gentile* was correctly decided, "the core insight of dual injury"[92] under *Gentile* should logically extend to

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[87] *Gentile*, 906 A.2d at 100 (emphasis added).
[88] A306 (Pls.' Ans. Br. in Opp. to Mot. to Dismiss at 27 ("Pls.' Ans. Br.")).
[89] *Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 657 (Del. Ch. 2013) (citing *Feldman v. Cutaia*, 956 A.2d 644, 657 (Del. Ch. 2007), *aff'd*, 951 A.2d 727 (Del. 2008)), *abrogation recognized by Sciabacucchi v. Liberty Broadband Corp.*, 2018 WL 3599997 (Del. Ch. July 26, 2018).
[90] *In re Nine Sys. Corp. S'holders Litig.*, 2014 WL 4383127, at *26 (Del. Ch. Sept. 4, 2014), *aff'd sub nom. Fuchs v. Wren Hldgs., LLC*, 129 A.3d 882 (Del. 2015) (Order).
[91] *Gentile*, 906 A.2d at 99-100.
[92] *Carsanaro*, 65 A.3d at 658.

any situation "when defendant fiduciaries (i) had the ability to use the levers of corporate control to benefit themselves and (ii) took advantage of the opportunity."[93] In other words, as a matter of doctrine, *Gentile* should then also "appl[y] to non-controller issuances in which insiders participate."[94] Accordingly, in *Carsanaro v. Bloodhound Technologies, Inc.*, 65 A.3d 618 (Del. Ch. 2013), the trial court found direct standing in connection with dilutive venture capital financings in which directors and affiliated funds participated.[95] Similarly, in *In re Nine Systems Corp. Shareholders Litigation*, 2014 WL 4383127, at *28(Del. Ch. Sept. 4, 2014), the Court of Chancery found direct standing with respect to a dilutive recapitalization transaction in which the directors and their affiliated funds participated, stating that "it makes little sense to hold a controlling stockholder to account to the minority for improper expropriation after a merger but to deny standing for stockholders to challenge a similar expropriation by a board of directors after a merger" given that "Delaware law endows the board -- not a controller -- with the exclusive authority

[93] *Thermopylae Cap. P'rs, L.P. v. Simbol, Inc.*, 2016 WL 368170, at *11 (Del. Ch. Jan. 29, 2016) (quoting *Carsanaro*, 65 A.3d at 658–59).
[94] *Carsanaro*,65 A.3d at 658-59.
[95] *Id*. at 659 ("[E]ach financing challenged in the complaint was a self-interested transaction implicating the duty of loyalty and raising an inference of expropriation.").

to manage and direct the corporation's business affairs," including "the power to issue stock."[96]

Likewise, the Court of Chancery's *El Paso* decisions[97] further expanded the type of corporate overpayment claim that could be brought directly (an expansion this Court later overruled).[98] In particular, the lower court decisions in *El Paso* held that a corporate overpayment claim brought on behalf of a partnership against the partnership's general partner and controller could be pursued "dually" or directly.[99] Following the partnership's merger with its parent entity, the partnership's limited partners no longer owned partnership units and therefore lost standing to pursue their claims derivatively under the continuous ownership rule.[100] After a trial in which the general partner was found to have caused the partnership to overpay for assets it acquired from the parent entity, the limited partners attempted to convert the derivative overpayment award of damages to a direct, "*pro rata* recovery" on behalf of the former limited partners.[101] Among other rulings, the Court of Chancery relied

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[96] *Nine Sys.*, 2014 WL 4383127, at *28-29 ("Plaintiffs may also establish standing by proving that a majority of the Board was conflicted -- here, meaning interested or not independent -- when it approved and implemented the Recapitalization.").
[97] *Allen v. El Paso Pipeline GP Co., L.L.C.*, 90 A.3d 1097, 1111 (Del. Ch. 2014); *In re El Paso Pipeline P'rs, L.P. Deriv. Litig.*, 132 A.3d 67, 111 (Del. Ch. 2015), *rev'd sub nom. El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, 152 A.3d 1248 (Del. 2016).
[98] *El Paso*, 152 A.3d 1248.
[99] *El Paso*, 132 A.3d at 86-118.
[100] *El Paso*, 132 A.3d at 74.
[101] *Id.*

on *Gentile* and held that the claim could be pursued either "dually" or directly, given that the controlling parent company had expropriated economic value from the public unitholders.[102] The court further ordered that the damages award, which was based on the harm to the partnership from overpaying for the assets in the challenged transaction, be paid directly to a class of the former limited partners.[103]

This Court reversed, holding that the *Tooley* analysis governed and that the corporate overpayment claim was exclusively derivative because: (i) the partnership was harmed by the challenged transaction; and (ii) the partnership would accordingly be entitled to any recovery.[104] Because the challenged transaction in *El Paso* did *not* fall squarely under the *Gentile* paradigm,[105] the defendants in *El Paso* did not argue on appeal that *Gentile* should be overruled, the question presented in this appeal was not briefed, and this Court did not need to reconsider *Gentile* at that time.[106] This Court nevertheless "decline[d] the invitation to further expand the

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[102] *Id.* at 92.
[103] *Id.* at 86-118, 132.
[104] *El Paso*, 152 A.3d at 1265 ("Brinckerhoff's overpayment claim is exclusively derivative under *Tooley*.").
[105] Rather, as the Supreme Court recognized, the alleged dilution—an "expropriation of economic value to a controller [that] was not coupled with any voting rights dilution"—did "not satisfy the unique circumstances presented by the *Gentile* 'species of corporate overpayment claim[s].'" *Id.* at 1264.
[106] Likewise, in *Sheldon v. Pinto Technology Ventures, L.P.*, 220 A.3d 245, 250 n.15 (Del. 2019), the Supreme Court had no cause to overrule *Gentile*, because the sole question appealed and briefed was whether the plaintiff had adequately alleged the existence of a control group, which plaintiff had failed to do.

universe of claims that can be asserted 'dually.'"[107] To do so, the Court reasoned, "would deviate from the *Tooley* framework and largely swallow the rule that claims of corporate overpayment are derivative."[108]

The implications of this Court's opinion in *El Paso* are significant. The decision to limit the universe of dual-natured claims not only "implicitly rejected the reasoning of decisions such as *Carsanaro* and *Nine Systems*, which had extended *Gentile* to any dilutive issuance approved by a conflicted board," but also led the Court of Chancery to conclude that "*Gentile* must be limited to its facts."[109] Indeed, since this Court decided *El Paso*, the Court of Chancery "has exercised caution in applying the *Gentile* framework."[110]

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[107] *El Paso*, 152 A.3d at 1264.
[108] *Id.* (internal quotation marks omitted).
[109] *Sciabacucchi v. Liberty Broadband Corp.*, 2018 WL 3599997, at *10 (Del. Ch. July 26, 2018). For example, in *Reith v. Lichtenstein*, 2019 WL 2714065 (Del. Ch. June 28, 2019), the Court of Chancery determined that even an issuance of preferred stock to a controller for allegedly unfair consideration, which "resulted in a dilution of the minority stockholders' voting power," was derivative because stockholders "retained the same percentage of the Company's shares of common stock after the Preferred Stock was issued as they had before." 2019 WL 2714065, at *11 (quoting *Klein*, 2018 WL 6719717, at *8). It appears that the court refused to grant dual standing although the controller had allegedly expropriated voting power and economic value from the minority—the very principles undergirding the *Gentile* exception—simply because the transactions involved preferred stock rather than common stock.
[110] *Klein*, 2018 WL 6719717, at *7; *see also W&M Helenthal Hldg. LLC v. Schmitt*, C.A. No. 2018-0505-AB (Del. Ch. June 3, 2019) (TRANSCRIPT) at 51:11–15 ("In its 2016 *El Paso* decision, our Supreme Court made clear that the *Gentile* doctrine is *to be construed narrowly and that the sort of dual claims described in that case only apply in the unique circumstances of that case*.") (emphasis added). The Court

Notwithstanding this caution, as the Court of Chancery observed in *Sciabacucchi v. Liberty Broadband Corp.*, 2018 WL 3599997 (Del. Ch. July 26, 2018), "limiting *Gentile* to controller situations, rather than expanding it to conflicted board non-controller dilution cases, *or overruling it entirely*, is, as a matter of doctrine, unsatisfying."[111] There is no principled reason to allow "dilution" or overpayment claims to proceed directly against controllers when the law rightly refuses to permit such claims to proceed directly in other contexts.

In this case, although the court below acknowledged the concern enunciated by Chief Justice Strine in his *El Paso* concurrence, it determined that it was "not free to decide cases in a way that deviates from binding Supreme Court precedent" and that "if law settled by our Supreme Court is to be changed, it requires a reasoned analysis by that Court."[112] Given the clear conflict between *Gentile* and *Tooley*, the confusion *Gentile* imposes on *Tooley*'s straightforward and easy-to-apply analysis, and the policy reasons for removing the exception (explained below), this Court should exercise its discretion to overrule *Gentile*.

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of Chancery, in an effort to make conceptual sense of the ruling, has further cabined *Gentile* to situations where a controller "extract[s] a benefit" from the challenged transaction. *Daugherty v. Dondero*, 2019 WL 4740089, at *3 (Del. Ch. Sept. 27, 2019). In *Daugherty*, Vice Chancellor McCormick also found that "*Gentile* and its progeny require that the expropriated benefit inure *exclusively* to the controllers." *Id*.

[111] 2018 WL 3599997, at *10 n.147 (emphasis added).

[112] Op. at 44-45.

4. ***Gentile* Should Be Overruled**

a. ***Stare Decisis* Is Inapplicable**

"[I]t is well settled law that the judiciary has the power to overturn judicially-created doctrine . . . ."[113] The distinction between direct and derivative claims is one such area of "judicially-created doctrine," which this Court has the power to overrule or refine.[114] Plaintiffs concede as much.[115] Furthermore, Delaware jurisprudence is "continuously being developed in nuanced ways with each new opinion."[116] This continuous development depends upon the Court's willingness to revisit, and, if necessary, overrule prior decisions, including where such decisions

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[113] *See Schoon v. Smith*, 953 A.2d 196, 205 (Del. 2008) (internal citation and emphasis removed) (noting that the Court has "recognized that the law should be an ever developing body of doctrines, precepts, and rules designed to meet the evolving needs of society").

[114] *See Tooley*, 845 A.2d 1031 (discarding the "special injury test" and adopting the two-part test set forth above); *see also Urdan v. WR Cap. P'rs.*, 2020 WL 7223313, at *7 (Del. Dec. 8, 2020) (overruling part of prior Supreme Court decision, *Schultz v. Ginsburg*, 965 A.2d 661 (Del. 2009), which had "caused some confusion in later cases" and which the Court of Chancery had unsuccessfully attempted to distinguish given that "a plain reading of [*Schultz*] shows that the admission it relied upon is inconsistent with the nature of a dilution claim").

[115] A304 (Pls.' Ans. Br. at 25) (quoting *Shea v. Matassa*, 2006 WL 258312, at *5 (Del. Super. Jan. 10, 2006) (the Supreme Court has "singular authority to overrule its prior cases")).

[116] A492-520 at A519 (Hon. Karen L. Valihura, "The Role of Appellate Decision-Making in the Development of Delaware Corporate Law—A View from Both Sides of the Bench," Lecture at Seventeenth Annual Albert A. De Stefano Lecture on Corporate Securities and Financial Law at the Fordham Corporate Law Center (Apr. 3, 2017) (23 Fordham J. Corp. & Fin. L. 5, 28 (2017)).

"conflict[] with our prior case law,"[117] a doctrine "has lost its place in the growth of modern law,"[118] or decisions have resulted in conflicting and "confusing precedent" that has been difficult for lower courts to apply.[119] Indeed, that is precisely what this Court did in *Tooley* and its approach to *Gentile* should be no different.

The doctrine of *stare decisis* provides that "settled law is overruled only for urgent reasons and upon clear manifestation of error."[120] "The doctrine of *stare decisis* exists to protect the settled expectations of citizens because, '[e]lementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly.'"[121] *Gentile* is not settled law, *undermines* the settled expectations created by *Tooley*, and is based upon a flawed view of the direct/derivative distinction.

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[117] *Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808, 815 n.13 (Del. 2013) (overruling *Gerber v. Enter. Prod. Hldgs., LLC*, 67 A.3d 400 (Del. 2013)).
[118] *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 46 (Del. 1991) (overruling the *lex loci delicti* rule applied in prior Supreme Court cases).
[119] *Brinckerhoff v. Enbridge Energy Co., Inc.*, 159 A.3d 242, 252 (Del. 2017), *as revised* (Mar. 28, 2017) ("In this appeal, we change course from the earlier pleading standard announced in *Brinckerhoff III* to which the Court of Chancery was bound, and apply the definition of bad faith that is commonly used in our entity law and incorporated into the Enbridge LPA.").
[120] *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 124 (Del. 2006) (citation and internal quotations omitted).
[121] *State v. Barnes*, 116 A.3d 883, 891 (Del. 2015) (quoting *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265 (1994)).

Following *El Paso*, it has been widely acknowledged that "[w]hether *Gentile* is still good law is debatable."[122] Nor is *Gentile* consistently applied.[123] While *stare decisis* is premised on "the need for stability and continuity in the law and respect for court precedent,"[124] *Gentile* has promoted doubt and uncertainty. *Gentile* has confused the straightforward test set forth in *Tooley*, causing numerous courts and commentators to speculate that *Gentile* should—and would—be overruled.[125]

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[122] *ACP Master, Ltd. v. Sprint Corp.*, 2017 WL 3421142, at *26 n.206 (Del. Ch. July 21, 2017, *corrected* Aug. 8, 2017), *aff'd*, 184 A.3d 1291 (Del. 2018) (Table); *see also Mesirov v. Enbridge Energy Co., Inc.*, 2018 WL 4182204, at *8 n.77 (Del. Ch. Aug. 29, 2018) ("I note that there is reason to question whether *Gentile* will remain the law of Delaware. At the very least, *El Paso* makes clear that *Gentile* and its progeny should be construed narrowly.") (citations omitted).

[123] *Compare Almond for Almond Family 2001 Tr. v. Glenhill Advisors LLC*, 2018 WL 3954733, at *28 (Del. Ch. Aug. 17, 2018) ("[A] transaction does not fit within the *Gentile* paradigm if the controller itself is diluted by that transaction."), *aff'd* 2019 WL 6117532 (Del. Nov. 18, 2019), *reh'g denied* (Jan. 6, 2020) *and Daugherty v. Dondero*, C.A. No. 2019-0101-KSJM (Del. Ch. July 2, 2019) (TRANSCRIPT) at 19:19–20:7 ("It strikes me that in order for the *Gentile* argument to work, . . . that it's really not just the dilutive transaction, but also the loans and no right to dividends together which made the transaction more economically advantageous for the insiders that puts this closer to the direct claim kind of box."), *with Liberty Broadband*, 2018 WL 3599997, at *9–10 ("*Gentile* must be limited to its facts, which involved a dilutive stock issuance to a controlling stockholder.").

[124] *Account v. Hilton Hotels Corp.*, 780 A.2d 245, 248 (Del. 2001) (citations omitted).

[125] *El Paso*, 152 A.3d at 1266 (Strine, C.J., concurring) ("*Gentile* cannot be reconciled with the strong weight of our precedent and it ought to be overruled . . . .").

Even if *Gentile* were settled law, *stare decisis* should not apply because a crucial fact distinguishes this case from *Gentile*.[126] In *Gentile*, unlike here, there was no other party who could recover because the acquirer of the company had been liquidated by the time the Supreme Court issued its opinion.[127] Accordingly, there were "no 'overpayment' shares that a court of equity could cancel, and there [wa]s *no corporate entity to which a recovery of the fair value of those shares could be paid*."[128] Thus, "[t]he only available remedy [was] damages" and plaintiff minority stockholders were "[t]he *only parties to whom that recovery could be paid*."[129] The Company's continuing existence here renders *Gentile* distinguishable and precludes the application of *stare decisis*.

b. *Gentile* Contradicts Long-Standing Case Law That A Derivative Harm Should Not Be Recovered Directly By Stockholders

Both before and after *Gentile*, Delaware courts have held that economic harms stemming from dilutive transactions are derivative and that the appropriate remedy for issuing shares for too little consideration is typically a payment to the

[126] *See Account*, 780 A.2d at 248 ("The doctrine of stare decisis operates to fix a specific legal result to facts in a pending case based on a judicial precedent directed to identical or similar facts in a previous case in the same court or one higher in the judicial hierarchy.").
[127] *Gentile*, 906 A.2d at 93, 103.
[128] *Id.* at 103 (emphasis added).
[129] *Id.* (emphasis added).

corporation.[130] *Gentile*, however, allows an asset that should belong to the corporation—a derivative claim and potential award of monetary damages—to be transferred to third-party stockholders for no consideration. The Court should eliminate this doctrinal defect.

Expressed in *Tooley* terms, the reason that dilution claims are traditionally classified as derivative is because the corporation is the party that suffers the injury (inadequate value) and is also the party to whom the remedy (a repayment to the entity of the amounts overpaid) would flow.[131] Indeed, a damages award premised

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[130] *See, e.g.*, *El Paso*, 152 A.3d at 1261 (holding that claims for economic dilution were derivative and reversing ruling that derivative damages award could be paid *pro rata* to public unitholders); *Daugherty v. Dondero*, 2019 WL 4740089, at *4 (Del. Ch. Sept. 27, 2019) ("[D]ilution claims challenging the Stock Offerings are classic derivative overpayment claims."); *Agostino v. Hicks*, 845 A.2d 1110, 1124 (Del. Ch. 2004) (finding devaluation of stockholder's stock "a natural and expected consequence of the injury initially borne" by the corporation); *Behrens v. Aerial Commc'ns Inc.*, 2001 WL 599870, at *4 (Del. Ch. May 18, 2001) (finding all stockholders, including controller, suffer economic dilution when a company is alleged to have issued shares to the controller at unfairly low price), *overruled by Gentile*, 906 A.2d 91 (Del. 2006); *Rothenberg v. Santa Fe Pac. Corp.*, 1992 WL 111206, at *3 (Del. Ch. May 18, 1992) (finding issuance of shares for no consideration caused "dilution [that] would have diminished the value of the shares held by *all* Santa Fe stockholders" and that "only the corporation could recover damages for the injury") (emphasis in original); *Avacus P'rs, L.P. v. Brian*, 1990 WL 161909, at *6 (Del. Ch. Oct. 24, 1990) ("[I]f a board of directors authorizes the issuance of stock for no or grossly inadequate consideration, the corporation is directly injured and shareholders are injured derivatively.").

[131] *See In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 818-19 (Del. Ch. 2005) (holding claims derivative in nature where stockholders alleged that their interests were diluted when company overpaid in a stock-for-stock merger; claim that an entity overpaid for an asset is "clearly" derivative because any harm is suffered by the entity, and "[t]he only harm to the stockholders would have been the

upon harm to the entity does not in and of itself establish damages suffered directly by a stockholder plaintiff.[132] *Gentile*, however, effectively allows individual stockholders to convert a corporate overpayment claim into an individual claim for no consideration. This is inconsistent with the fundamental precept of *Tooley* that, when a suit is brought on a corporation's behalf and the only injury is to the entity, the recovery "must go to the" entity and "only to the" entity.[133]

c. A Dilutive Impact on "Voting Power" Cannot Alone Support Direct Standing

Plaintiffs conceded below that to state a direct claim, they must demonstrate not only that a duty was owed to TerraForm's stockholders, but also that Plaintiffs "can prevail without *showing an injury to the corporation*."[134] Plaintiffs incorrectly

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natural and foreseeable consequence of the harm to JPMC"), *aff'd*, 906 A.2d 766 (Del. 2006) (Table).

[132] *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 772-73 (Del. 2006) (holding "any damages recovery would flow *only* to [the entity], not to the shareholder class" and that it "simply cannot be" that "directors of an acquiring corporation would be liable to pay both the corporation and its shareholders the same compensatory damages for the same injury") (emphasis added).

[133] *Tooley*, 845 A.2d at 1036; *see also, e.g.*, *Bokat v. Getty Oil Co.*, 262 A.2d 246, 250 (Del. 1970) (holding derivative claims are an asset of the corporation which pass to the acquirer in a merger, rejecting non-Delaware cases holding that stockholders can continue the suit in their own name, and declining to award *pro rata* recovery), *disapproved of on other grounds sub nom. Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031(Del. 2004); *Levien v. Sinclair Oil Corp.*, 1975 WL 1952, at *3-4 (Del. Ch. Aug. 12, 1975) (denying corporation's application for *pro rata* distribution even where entity was arguably "for all practical purposes, in a state of virtual liquidation and [was] about to cease to exist as a viable entity for shareholder investment").

[134] A298 (Pls.' Ans. Br. at 19) (emphasis added).

argued, however, that *any* change in voting power stemming from a dilutive transaction constitutes a "direct harm" because such harm "exist[s] irrespective of the existence or quantum of wrongful economic value expropriation . . . ."[135] Not so. If all that were required to state a direct claim was to show some impact on voting power, then *all* dilution claims would be direct.[136] As former Chief Justice Strine recognized in his *El Paso* concurrence, "[a]ll dilution claims involve, by definition, dilution."[137] In a typical dilutive issuance, any impact on voting power that minority holders experience is merely a collateral, indirect effect flowing from the alleged under-payment to the company.[138]

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[135] A302 (*Id.* at 23). Notably, the *Gentile* defendants *conceded* that a stock dilution claim was direct "if voting rights were harmed," arguing only that the court should restrict standing to cases "where the loss of voting power is 'material.'" *Gentile*, 906 A.2d at 98. In other words, the defendants in *Gentile* did not argue that the effect on voting power was *de minimis* in contrast to the harm experienced by the company, nor did the defendants argue that the stockholders had no right to the economic recovery of the company. However, the *Gentile* defendants' concession is not binding on this case and should not be the basis of the Court's ruling. *See Urdan*, 2020 WL 7223313, at *7 (overruling prior holding which had been based on a concession in a prior matter).

[136] *El Paso*, 152 A.3d at 1263 n.76 (declining to extend *Gentile* in a way that "would swallow the general rule that equity dilution claims are derivative").

[137] *Id.* at 1266 (Strine, C.J., concurring).

[138] *See Agostino v. Hicks*, 845 A.2d 1110, 1122, 1124 (Del. Ch. 2004) (holding transaction with 49% stockholder which allegedly resulted in "a transfer of absolute voting control" to the stockholder and allowed the stockholder "to take 'majority voting control from minority stockholders without paying a control premium'" was entirely derivative because plaintiff merely "question[ed] the adequacy of the consideration the Company received" for the dilutive issuance).

Although some pre-*Tooley* decisions suggest that stockholders may have direct standing in limited circumstances to seek injunctive relief, those cases do not suggest that stockholders have the right to prosecute a direct claim for *damages* belonging to the corporation.[139] For example, in *Grimes v. Donald*, 673 A.2d 1207(Del. 1996), this Court held that a claim for abdication of a statutory duty could be brought directly where the plaintiff sought "only a declaration of the invalidity of" certain agreements and no monetary recovery would accrue to the corporation as a result.[140] In so ruling, however, this Court explicitly held that damages claims were solely derivative.[141]

d. *Gentile* Risks a Double-Recovery and Complicates Real-World Commercial Transactions

In addition to *Gentile*'s doctrinal flaws, *Gentile* has practical consequences that make its holding difficult to apply and suggest it should be overruled. Put simply, *Gentile* is unruly in practice because it could allow two separate parties—a

[139] *Grimes v. Donald*, 673 A.2d 1207, 1212–13 (Del. 1996) (noting that "courts have been more prepared to permit the plaintiff to characterize the action as direct when the plaintiff is seeking only injunctive or prospective relief"), *overruled sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *In re Gaylord Container Corp. S'holders Litig.*, 747 A.2d 71, 80 n.11 (Del. Ch. 1999) ("If the relief sought by the plaintiffs is solely or primarily injunctive in nature, this factor (the nature of the relief sought) would seem to be neutral, if not supportive of individual, rather than exclusively derivative, classification . . . .").
[140] *Grimes*, 673 A.2d at 1213.
[141] *Id.*

corporation and its current or former stockholders—to pursue the same judicial recovery.

Although derivative claims always involve some struggle for control over the suit between the corporation's board and its stockholders, important rules have developed over time to balance the competing interests of investors with the board's statutory authority to govern the corporation.[142] These rules include the contemporaneous ownership rule,[143] the continuous ownership rule,[144] the demand requirement,[145] pleading burdens for alleging demand futility,[146] and rules governing special litigation committees.[147] But when stockholders are allowed to pursue the exact same judicial recovery as the corporation, that careful balance is thrown into disarray.[148] It is not clear whether the corporation or its stockholders (current or former) have the right to recover.

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[142] 8 *Del. C.* § 141(a) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .").

[143] 8 *Del. C.* § 327 ("In any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which such stockholder complains or that such stockholder's stock thereafter devolved upon such stockholder by operation of law.").

[144] *Lewis*, 477 A.2d 1040.

[145] Ct. Ch. R. 23.1(a).

[146] *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984), *overruled on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

[147] *See, e.g.*, *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981).

[148] Apart from standing issues, the distinction of whether a claim is direct or derivative has myriad collateral effects on litigation, including the form and manner

For example, in the context of a claim against a controlling stockholder where the board appoints a special litigation committee to consider whether to bring litigation on the corporation's behalf, if each of the committee and the company's stockholders seek to litigate (and, ultimately, recover) on the same overpayment claim, who has the superior right to payment? They cannot both recover monetary damages, as that would impose a double penalty on the controlling stockholder.

Gentile did not expressly grapple with this problem, but simply supposes that any such claim could be brought *either* directly or derivatively,[149] perhaps suggesting that it could be pleaded in the alternative and then addressed through an election of remedies.[150] But that rubric breaks down when there are two distinct

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of bringing the suit, the procedures for certifying a class, settlements, and when notice is required to other investors. *See, e.g.*, Ct. Ch. R. 23; Ct. Ch. R. 23.1. And, as the Court of Chancery has recognized, *res judicata* also becomes difficult to apply in the context of "dual" claims. *See In re Ebix, Inc. S'holder Litig.*, 2016 WL 208402, at *10 n.88 (Del. Ch. Jan. 15, 2016) ("A conceptual knot this Court need not attempt to untangle at present is how [*res judicata*] might apply in the context of a claim that is simultaneously direct and derivative. Cleanly applying a bright-line rule may prove problematic in contexts where, as in the case of classifying a given claim as direct or derivative, the lines creating the operative distinction themselves may blur.") (citations omitted).

[149] *Gentile,* 906 A.2d at 98 n.16 (concluding that "the debt conversion claim is not exclusively derivative and could have been brought *either* directly or derivatively") (emphasis added).

[150] To the extent a direct recovery was favored in such an election of remedies, that result may also be unsatisfying to holders in the public company context, as trading in the corporation's shares in the interim between the challenged transaction and any recovery could result in different stockholders receiving the recovery than would otherwise be the case in the event a damages award was made directly to the corporation.

claimants—the corporation and current or former stockholders—jockeying to receive the same economic recovery.

The double recovery problem is also cast into the spotlight in the context of a merger transaction with a third-party. In that scenario, derivative claims pass to the corporation's new owner as an asset of the company by operation of law,[151] and the new owner has the right to determine whether to pursue the claims.[152] In the event that both the new owner and the corporation's former stockholders each want to litigate the claims, *Gentile* does not answer which claimant has the greater right to recovery. Do the parties race to trial and judgment? Do they consolidate and hope for a global resolution that will likely make neither of them completely whole?

Likewise, in the case where a company becomes insolvent and liquidates, the company's creditors or a bankruptcy trustee may wish to assert claims on behalf of the company's estate. In that scenario, it is not clear whether creditors, standing in the shoes of the corporation as its residual claimants,[153] or the stockholders, acting individually, would have the right to recover.

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[151] 8 *Del. C.* § 259.

[152] 8 *Del. C.* § 261; *see also Lewis*, 477 A.2d at 1043, 1049-50 (finding acquiror of company with pre-existing claims pending against former officers and directors is the "shareholder beneficiary" of such claims rather than original derivative plaintiff).

[153] *See N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) (granting derivative standing to creditors as "residual beneficiaries" in the event of corporate insolvency).

These questions are impossible to answer as long as the lower courts, investors, other market participants, and corporate law practitioners are left to grapple with *Gentile*. A buyer of a company can never know the value of what it is buying if there is a "dual-claim" belonging to the company because the potential buyer cannot know whether it, or the stockholders of the counterparty, will have the right to assert that claim if the transaction closes. The market relies on the consistent interpretation of Delaware law,[154] but *Gentile* creates uncertainty for purchasers and investors alike as to what post-closing rights and liabilities they actually obtain (or relinquish) in a merger transaction.

In short, the *Gentile* framework has caused doctrinal confusion and reintroduced guesswork to an area of law that this Court has sought to simplify.[155] *Gentile* fractures that foundation and undermines Delaware's goal of "promoting reliable and efficient corporate and commercial laws."[156] Thus, in addition to its

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[154] *See, e.g.*, *Edgerly v. Hechinger Co.*, 1998 WL 671241, at *2 (Del. Ch. Aug. 27, 1998) (discussing the importance of predictability in the M&A context and reading a corporate statute narrowly because "[a]ny other result would embroil merging corporations in a morass of confusion and uncertainty, none of which was of their making.") (quoting *Enstar Corp. v. Senouf*, 535 A.2d 1351, 1356 (Del. 1987)).

[155] *Tooley*, 845 A.2d at 1036; *see El Paso*, 152 A.3d at 1266 (Strine, C.J., concurring) ("[B]y refusing to extend *Gentile* to the alternative entity arena, we implicitly recognize that *Gentile* undercuts the clarity and coherence that *Tooley* brought to the determination of what claims are derivative.").

[156] *Aspen Advisors LLC v. United Artists Theatre Co.*, 843 A.2d 697, 712 (Del. Ch.), *aff'd*, 861 A.2d 1251 (Del. 2004); *see also Elliott Assocs., L.P. v. Avatex Corp.*, 715 A.2d 843, 854 (Del. 1998) ("The outcome here continues a coherent and rational

doctrinal deficiencies, *Gentile* should be overruled because the practical uncertainties it creates cause friction in the market for corporate control, impede price certainty, and complicate deal-making for Delaware entities.

e. There Is No "Gap" for *Gentile* to Fill

Finally, *Gentile* should be overruled for the simple reason that "there is no gap in [the] law for *Gentile* to fill."[157] The law "already accords a direct claim to stockholders when a transaction shifts control of a company from a diversified investor base to a single controlling stockholder[,]"[158] and further subjects such transactions to "enhanced scrutiny."[159] Moreover, to the extent derivative standing is extinguished by merger under the continuous ownership rule, a stockholder that loses derivative standing as a result of such a merger is free to challenge that merger on the basis that the selling company's board failed to obtain sufficient value for the derivative claims.[160] The fact that a merger could cancel the stockholder's derivative standing should not—and does not—change the analysis. Derivative standing rules

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approach to corporate finance. The contrary result, in our view, would create an anomaly and could risk the erosion of uniformity in the corporation law.").

[157] *El Paso*, 152 A.3d at 1266 (Strine, C.J., concurring).

[158] *Id.*

[159] *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173, 184 (Del. 1986).

[160] *See, e.g.*, *In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455 (Del. Ch. 2013).

should not be twisted to escape the application of the continuous ownership rule, a bedrock principle of Delaware law.

In sum, "*Gentile* cannot be reconciled with the strong weight of [Delaware] precedent and it ought to be overruled."[161] Given the widespread acknowledgement that *Gentile* is not settled law,[162] Defendants respectfully submit that this Court should explicitly overturn *Gentile*, which has been a confusing decision. Accordingly, Plaintiffs' standing to challenge the Private Placement should be held exclusively derivative under *Tooley*'s "simple analysis," and Plaintiffs' claims should be dismissed.

[161] *El Paso*, 152 A.3d at 1266 (Strine, C.J., concurring).
[162] *See, e.g.*, *ACP Master*, 2017 WL 3421142, at *26 n.206; *Mesirov v. Enbridge Energo Co.*, 2018 WL 4182204, at *8 n.77(Del. Ch. Aug. 29, 2018); *Cirillo Fam. Tr. v. Moezinia*, 2018 WL 3388398, at *16 n.156 (Del. Ch. July 11, 2018), *aff'd*, 220 A.3d 912 (Del. 2019) (Order).

CONCLUSION

For the foregoing reasons, the Supreme Court should reverse the Order below and direct the trial court to dismiss the claims against Appellants with prejudice.

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