

Delaware Supreme Court Holds Indirect Equity Holders Not Bound by ROFR

Alert

06.15.2020

In a reversal of the Court of Chancery's decision, the Delaware Supreme Court held in its May 22, 2020 opinion in *Borealis Power Holdings Inc. v. Hunt Strategic Utility Investment, LLC* that the change in ownership of shares in an upstairs entity did not trigger the right of first refusal governing an entity three levels down the ownership chain. The complicated web of interrelated entities is abbreviated here for simplicity; a helpful graphic is available at page seven in the court's decision.

Hunt Strategic Utility Investment, L.L.C. owned a 1% stake in Texas Transmission Holdings Corporation (TTHC). The remaining 99% was split equally among two ownership factions, at 49.5% each. Thus, no single owner or ownership group controlled a majority of TTHC.

The direct shareholders of TTHC and TTHC itself entered into a shareholders agreement (SA) that provided a process for selling TTHC shares, including a right of first offer (ROFO) in favor of the non-selling shareholders.

Moving down the web of interrelated entities, TTHC wholly and only owned a subsidiary, which itself wholly and only owned Texas Transmission Investment LLC (TTI). TTI in turn owned 19.75% of Oncor Electric Delivery Company LLC.

The remaining 80.25% of Oncor was held by Oncor Electric Delivery Holdings Company LLC (Oncor Holdings), which itself was wholly owned and ultimately controlled through two layers of entities by Sempra Texas Holdings Corp. (STH and collectively with its subsidiaries Sempra).

Oncor, its equityholders (i.e., TTI and Oncor Holdings), and STH entered into an investor rights agreement (the Oncor IRA) that included a right of first refusal provision (ROFR). Hunt was not a party to the Oncor IRA.

Delaware Supreme Court Holds Indirect Equity Holders Not Bound by ROFR

A dispute arose when Hunt attempted to sell its shares to a Sempra subsidiary. After initially refusing to consent to the sale to Sempra, another TTHC shareholder subsequently indicated that it would exercise the TTHC SA's ROFO and purchase Hunt's shares. Sempra—having earlier concluded for itself that the Oncor IRA's ROFR would take priority over the ROFO—then sent notice of its intent to exercise the ROFR. The ROFO purchaser disagreed with Sempra's conclusion regarding the relationship between the Oncor IRA and TTHC SA.

The parties filed multiple claims and counterclaims seeking to enjoin their disfavored transactions and enforce their preferred agreements. The Delaware Court of Chancery decided that a sale of Hunt's TTHC stock to another TTHC shareholder effectively changed the control of TTI's Oncor LLC Units, which triggered the ROFR. After analyzing the Oncor IRA, the Delaware Supreme Court disagreed, reversed and remanded.

The court analyzed the Oncor IRA. Section 3.1 was entitled "Restrictions On Transfer of LLC Units" and provided that "[t]he Minority Member and its Permitted Transferees may only Transfer LLC Units as follows . . ." before listing a number of conditions.

Section 3.9 of the Oncor IRA, entitled "Right of First Refusal" (the "ROFR"), provided that, "in the event that a Selling Member intends to Transfer LLC Units . . . such Selling Member shall deliver to [STH] . . . written notice of its intention to Transfer LLC Units."

"Selling Member" was defined in Section 3.9 as "the Minority Member [or its] Permitted Transferee." "Minority Member" was defined in the Preamble of the Oncor IRA as TTI. Finally, "Transfer" means:

Any direct or indirect transfer . . . of any LLC Units (or any interest (pecuniary or otherwise) therein or rights thereto). In the event that any Member that is a corporation, partnership, limited liability company or other legal entity (other than an individual, trust or estate) ceases to be controlled by the Person controlling such Member or a Permitted Transferee thereof, such event shall be deemed to constitute a "Transfer" subject to the restrictions on Transfer contained or referenced herein.

Sempra argued that the intent of the parties to the Oncor IRA was to bind TTI's upstairs equityholders and restrict their transfers of that upstairs equity. In support of its position, Sempra cited the first sentence of the "Transfer" definition, which purports to encompass "any direct or indirect transfer" of Oncor LLC Units. Sempra argued that any Hunt transfer is an indirect transfer of 1% of TTI's Oncor LLC Units. Even if the Hunt sale was not alone a "Transfer" under the first sentence, Sempra argued alternatively, it was a "Transfer" under the second sentence because a transfer of Hunt's interest to another TTHC shareholder would change the control of TTHC, and thus of TTI.

Delaware Supreme Court Holds Indirect Equity Holders Not Bound by ROFR

The Delaware Supreme Court held that both of these contentions suffer from the same analytical flaw; they omit to address the subject—stated conjunctively as “the Minority Member and its Permitted Transferees,” or the “Selling Member”—of the operative portions of Sections 3.1 and 3.9 of the Oncor IRA, of which the verb phrases “may only Transfer” and “intends to Transfer” serve as the predicate. That subject, according to the court, was not accidental or unimportant; it provided critical information about the scope of the ROFR. The court thus found the Oncor IRA does not apply to the Hunt sale because the ROFR is triggered only by transfers by the Minority Member and its Permitted Transferees, and Hunt was neither.

It was therefore unnecessary to parse the definition of “Transfer” to determine the scope of Section 3.1 and Section 3.9. Put another way, the fact that the ROFR was only triggered by transfers by the Minority Member was dispositive in Borealis’s favor; and, this was true regardless of whether the Hunt sale could be said to effect an indirect transfer of Oncor LLC Units.

In sum, Hunt was not TTI, nor was it a Permitted Transferee, nor could it, as a minority shareholder of TTI’s controller, express the intent of TTI or unilaterally cause it to act. Accordingly, the court held Hunt’s sale therefore did not trigger Sempra’s ROFR.

For more information on interpretation of rights of first refusal in LLC agreements please contact, please contact [Steve Quinlivan](#), Ashlee Germany, Timothy Joyce, [Jennifer Cooke-Yin](#), Jennifer Moyer, [Jack Bowling](#), [Scott Gootee](#), [Patrick Respeliars](#), [David Jensen](#) or the Stinson LLP contact with whom you regularly work.

CONTACT

Stephen M. Quinlivan

STINSON

STINSON LLP \ STINSON.COM