



Portfolio Media, Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Chancery Keeps Alive Class Suit Over \$110M Energy Co. Sale

By **Jeff Montgomery**

Law360 (October 2, 2018, 6:17 PM EDT) -- A putative class challenge to the \$110 million sale of U.S. Geothermal Inc. survived dismissal arguments Tuesday, with a Delaware vice chancellor describing the case as "very different" from merger litigation routinely dismissed under the court's mainstay deal review standards.

In his ruling from the bench, Vice Chancellor J. Travis Laster cautioned against reading any change in Delaware law from his decision to keep the case alive. The detailed complaint, however, "raises questions about whether directors fulfilled their duties under enhanced scrutiny," a standard that requires examination of the motives of directors or key parties.

"If one credits the allegations, which I have to at this stage, one is left with real questions about why the directors did what they did," Vice Chancellor Laster said.

The suit, led by stockholder Kenneth Riche, seeks damages based on a claim that the \$5.45-per-share sale to Omat Technologies Inc. in April was the unfair result of a flawed sales process initiated after activist hedge fund JCP Investment Management LLC acquired 15 percent of U.S. Geothermal's stock.

JCP founder James C. Pappas was said to have begun talk of an "exit strategy" — a term the suit said signaled interest in a sale — soon after JCP bought its stake. He also was said to have talked of possible "board structure" changes, an interest the stockholder suit said could be viewed as pressuring incumbent directors.

Vice Chancellor Laster said the case could prove difficult to win, but noted that it was based on evidence, investigation and allegations that stockholders were not fully informed by proxy disclosures.

"What we have here is exactly what the courts, I think, worry about," Vice Chancellor Laster said. "The proxy statement paints a picture. It depicts a story. We have more and more instances in this court where minutes and disclosure documents seem to have been drafted wishfully, rather than accurately. They've been drafted to create a story, rather than explain a story."

Juan E. Monteverde of Monteverde & Associates PC told the vice chancellor that "there was a threat at all times that Mr. Pappas could unseat the board. That retribution [threat] adds to the fact pattern" justifying the court's use of "entire fairness," a review standard that places a greater burden on defendants to show why courts should uphold their deal, he said.

Before JCP's arrival, the stockholder suit said, U.S. Geothermal had settled on operation as

a stand-alone company as the best way to maximize stockholder value. The company operates geothermal generating plants in Oregon, Nevada and Idaho, while Nevada-based buyer Ormat is the world's largest geothermal energy enterprise, with power plants in 30 countries.

Thomas P. Swigert of Dorsey & Whitney LLP, counsel to the directors, said the putative class "failed to allege any facts by which the court could draw any reasonable inference" that Pappas was a controlling shareholder. None of the directors had conflicts of interest in connection with the deal, and all voted in favor of the sale, Swigert said.

"Plaintiff's theory is because Mr. Pappas was an 'activist' investor, he must have needed liquidity, and because he needed liquidity, his interests were not aligned with shareholders," Swigert said. "There are no facts pled in the complaint to suggest that Mr. Pappas needed liquidity."

Vice Chancellor Laster pressed Swigert on his argument that the putative class needed to show more than a statement that Pappas needed liquidity or an exit from the investment.

"Imagine a world where a company's highest and best use alternative is to remain independent. Then you have one director who looks around and says, 'Man, I need an exit strategy,'" the vice chancellor said. "Explain to me why that wouldn't at least, at the pleading stage, support an inference that that person might be incented to do something other than pursue the best value and remain independent."

Swigert said that Pappas received the same consideration as other shareholders and had no obvious way to overcome seven other unconflicted directors.

Monteverde said there was evidence that a potentially higher bidder was "stonewalled" by the board, as well as failures to disclose details about bid prospects in the proxy.

"I think it shows that this was not a good process. We have bad faith, at a minimum, and bad faith when shareholder interest is not put first," Monteverde said.

Vice Chancellor Laster said that, in denying dismissal, he did not rely on the argument that Pappas was a controller, but added that "it is not a lunatic idea." He pointed out that a 15 percent stock ownership is considered an "interested stake" in a section of Delaware's corporation law on a stockholder's right to launch tender or exchange offers.

Enhanced scrutiny and entire fairness are standards of review used by the Chancery Court to weigh the actions of business entities and those who direct them when circumstances rule out deference to a board's business judgment.

The standards are also used to determine who bears the heavier burden of proof in cases where there is a potential or clear conflict of interest or when director interests are or might be different from those of the stockholders they represent.

U.S. Geothermal's directors are represented by Eric Lopez Schnabel, Alessandra Glorioso, Thomas P. Swigert and Phil Steger of Dorsey & Whitney LLP.

The putative class is represented by Blake A. Bennett of Cooch and Taylor PA, Michael J. Palestina and Christopher Tillotson of Kahn Swick & Foti LLC, and Juan E. Monteverde and Miles D. Schreiner of Monteverde & Associates PC.

The case is Kenneth Riche et al. v. James C. Pappas et al., case number 2018-0177, in the Court of Chancery of the State of Delaware.

--Editing by Aaron Pelc.

