

In Rare Dismissal of Up-C Reorganization Case, Chancery Court Holds That Claim Is Derivative, Not Direct

May 22, 2025

On April 10, 2025, the Delaware Court of Chancery [granted a motion to dismiss](#) in a breach of fiduciary duty action arising from BGC's conversion from an Up-C corporation to a traditional full C corporation. While multiple fiduciary duty cases involving Up-C reorganizations have been filed recently in the Delaware Court of Chancery, very few have been dismissed at the pleading stage. In dismissing the case, the court held that the plaintiff's claim – which was styled as a direct, putative class action – was in fact derivative, and thus failed because the plaintiff neither made a demand nor attempted to plead demand futility.

Cooley and Young Conaway Stargatt & Taylor represented the defendants.

Background

The umbrella partnership corporation (Up-C) structure has become increasingly popular for businesses taxed as partnerships that are going public. In a typical Up-C structure, the publicly traded corporation sits on top of a pass-through entity (usually a limited partnership or a limited liability company), which holds the assets and operations of the business. The structure provides certain tax benefits for the pre-initial public offering (IPO) owners, who continue to hold their interests in the business directly through the pass-through entity. In recent years, a number of companies that have gone public under an Up-C structure have decided to reorganize into traditional full C corporations due to the complexities of the Up-C structure. As is often the case, stockholder lawsuits followed on the heels of some of those transactions.

In 2023, BGC reorganized from an Up-C to a traditional full C corporation. Before the reorganization, BGC's controlling stockholder Cantor Fitzgerald held BGC's Class B shares (which have 10 votes per share), as well as limited partnership units in the pass-through entity. The public stockholders held Class A shares, which have one vote per share. Through the reorganization, Cantor exchanged its limited partnership units for additional Class B shares, which led to an increase in its voting power. The reorganization proved to be beneficial to BGC's public stockholders, as BGC's stock price surged after the reorganization closed.

A few months after the transaction closed, a minority stockholder of BGC filed suit and asserted a direct claim for breach of fiduciary duty for the increase in Cantor's voting power.

Court holds that a dilution claim is always derivative

The court held that the plaintiff's claim is derivative, not direct. Because the plaintiff neither made a demand nor pled demand futility, the court dismissed the complaint under Court of Chancery Rule 23.1.

Tooley and Brookfield

In reaching this decision, the court applied the so-called *Tooley* test and the 2021 Delaware Supreme Court case [Brookfield Asset Management, Inc. v. Rosson](#).

The *Tooley* test stems from the 2004 Delaware Supreme Court case [Tooley v. Donaldson, Lufkin & Jenrette, Inc.](#) Under *Tooley*, the determination of whether a claim is direct or derivative turns "solely on the following questions: (1) who suffered the alleged harm (the corporation or suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?"

In *Tooley*, the Delaware Supreme Court explicitly rejected the "special injury" concept that had appeared in prior cases. In those cases, the courts allowed the plaintiffs to bring direct claims where they had alleged a "special injury," defined as "a wrong suffered by plaintiff that was not suffered by all stockholders generally."

While the *Tooley* test was meant to provide a "simple analysis," its application did not prove to be straightforward, and there remained substantial confusion among the courts with respect to the direct versus derivative nature of a dilution claim. Two years after *Tooley*, the Delaware Supreme Court decided [Gentile v. Rossette](#), which held that the minority

stockholders' dilution claim against a controlling stockholder was "dual-natured," i.e., both derivative and direct. Notably, despite *Tooley's* express rejection of the "special injury" concept, it still crept its way into *Gentile*, which relied on a pre-*Tooley* case applying that concept.

Enter *Brookfield*. In 2021, the Delaware Supreme Court overruled *Gentile* and held that "when a corporation exchanges equity for assets of a stockholder who is already a controlling stockholder for allegedly inadequate consideration, the dilution/overpayment claim is exclusively derivative." In doing so, the court rejected *Gentile's* focus on "whether one group of stockholders (a controller) was impacted differently from another group (the public or minority holders)," and put the final nail on the coffin of the "special injury" concept.

In the BGC case, the court held that under *Tooley* and *Brookfield*, any "harm complained of is an overpayment to Cantor by BGC in the form of Class B shares," and "the benefit of any recovery would flow to BGC, with its minority stockholders benefiting indirectly and pro rata." Importantly, the court rejected the plaintiff's attempt to distinguish *Brookfield* on the grounds that the transaction in that case involved a capital raise, rather than a reorganization. The court held that under *Brookfield*, "dilution claims are derivative, regardless of the nature or purpose of the underlying transaction." Because the plaintiff neither made a demand on the board nor pled demand futility, the court dismissed the complaint under Rule 23.1.

***Parnes* does not apply**

The court also rejected the plaintiff's argument that, because the reorganization took the form of multiple merger transactions, the claim was direct under [*Parnes v. Bally Entertainment Corp.*](#) In *Parnes*, the Delaware Supreme Court permitted a stockholder plaintiff, whose derivative standing was extinguished as a result of a merger transaction, to pursue a direct claim challenging the fairness of the merger. Noting that the *Parnes* exception is "not so broad," the court observed that under the *Parnes* line of cases, in order to state a direct claim, a plaintiff "must allege facts showing that a side payment improperly diverted proceeds that would have, if the defendant directors had acted properly, ended up in the consideration paid to the target stockholders." The court found *Parnes* inapplicable because the BGC reorganization did not involve an "acquiror paying consideration to the minority stockholders," and "there was no side payment that diverted value from minority stockholders." Since "BGC public stockholders sold nothing," they "retained derivative standing after the reorganization."

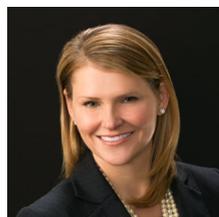
Key takeaways

- The distinction between direct and derivative claims is important and often outcome determinative, as plaintiffs must meet a higher hurdle of pleading demand futility in order to survive a motion to dismiss a derivative claim. Just because a claim is styled as direct, however, does not mean that it is in fact direct, and the court will analyze the nature of the claim under the familiar *Tooley* test.
- The court's opinion clarifies *Brookfield's* holding and confirms that a dilution claim is always derivative, even if the transaction in question involves one or more mergers.
- The case also serves as a reminder that the court will look beyond labels and analyze the nature of the transaction at issue. Here, the mere fact that the BGC reorganization took the form of a series of mergers does not mean that the *Parnes* exception applies.

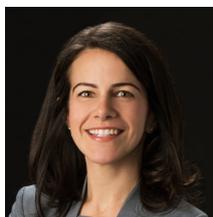
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