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Delaware Supreme Court Strictly Construes Limited Partnership Agreement in Reviewing a Related Party Transaction

Delaware Supreme Court "Changes Course" on Prior Ruling and Reverses Court of Chancery

SUMMARY

On March 20, 2017, in *Brinckerhoff* v. *Enbridge Energy Co., Inc.*,[1] the Delaware Supreme Court reversed the Court of Chancery's April 29, 2016 decision[2] that granted defendants' motion to dismiss a master limited partnership unitholder's challenge to an affiliate transaction. In reversing the Court of Chancery's dismissal, the Supreme Court retreated from two prior holdings. The Court reversed itself on its previously established pleading standard for bad faith, making it easier for a master limited partnership unitholder to state a claim for relief. The Court also rejected its previous interpretation of the Limited Partnership Agreement's (LPA) provisions related to affiliate transactions.

BACKGROUND

On January 2, 2015, Enbridge Energy Partners, L.P. (EEP or the Partnership) repurchased Enbridge Energy Company Inc.'s (EEP's General Partner) 66.7% interest in the United States segment of the Alberta Clipper pipeline (the Transaction). EEP's General Partner had acquired the interest in the pipeline in 2009 when it helped to fund the construction of the pipeline during the economic downturn of the financial crisis. Peter Brinckerhoff, as a holder of EEP limited partnership units, had challenged the original 2009 sales transaction, and the Delaware Court of Chancery dismissed his complaint after reviewing the standards of conduct established by EEP's LPA.[3] In that original challenge, the Court of Chancery concluded that the LPA displaced all fiduciary duties with a general contractual standard of good faith. The Chancery Court stated that to claim a breach of the duty to act in good faith the complaint

had to plead facts suggesting bad faith. The Delaware Supreme Court affirmed the Court of Chancery's interpretation of the LPA, including provisions that addressed standards for exculpating the general partner and affiliates from liability in related party transactions. In doing so, the Delaware Supreme Court set a high pleading standard for a unitholder challenging a related party transaction in order to survive a motion to dismiss – that a decision was "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."[4]

In connection with 2015 EEP's repurchase of the Alberta Clipper interest, the same plaintiff brought a new challenge against the General Partner, its affiliates, and certain current and former directors of the General Partner (collectively, the Defendants) under the same EEP LPA, alleging that EEP overpaid for the repurchase.

THE COURT OF CHANCERY DECISION

On April 29, 2016, the Court of Chancery dismissed the complaint in its entirety, relying extensively upon the Supreme Court's decision in *Brinckerhoff III*.[5] The Court of Chancery (VC Slights) held that consistent with *Brinckerhoff III*, the LPA effectively replaced all fiduciary duties owed by the General Partner to the Partnership and its unitholders with a contractual governance scheme of good faith.[6] The Chancery Court held that the general good faith standard worked in tandem with the more specific and interrelated provisions of the agreement to ensure that the General Partner, and its affiliates, would not be liable for any actions taken in good faith. Thus, the motion to dismiss was granted based on an insufficient pleading of bad faith.

THE DELAWARE SUPREME COURT DECISION

On appeal, Justice Seitz authored an *en banc* opinion of the Delaware Supreme Court, reversing the Court of Chancery. The Court reiterated its settled interpretation from *Norton* v. *K-Sea Transp. Partners L.P.*,[7] that an LPA can replace any standard of care or duty "imposed by [the LPA] or under the Delaware Act or any applicable law, rule or regulation" with a general contractual good faith standard.[8]

But the Court "changed course" and withdrew its prior interpretation that the provisions of the LPA imposed an overarching "good faith" standard to review general partner approval of related party transactions. The Court relied on the rule of contract interpretation "requiring that the court prefer specific provisions over more general ones" and held that the general contractual good faith standard "operates in the spaces of the LPA without express standards."[9] Accordingly, it disagreed with the Court of Chancery's application of the general contractual good faith standard to "displace express standards in other provisions of the LPA."[10]

To that end, the Supreme Court stated that the LPA contained an express standard that limited affiliate transactions to those that are "fair and reasonable to the Partnership" and that a transaction is "fair and

reasonable" if the transaction terms are "no less favorable to the Partnership than those generally being provided to or available from unrelated parties." The Court offered the view that the LPA's "fair and reasonable" standard was "similar, if not equivalent to entire fairness review" in the fiduciary duty context.[11] Thus, according to the Court, the related party transaction needed to pass muster under the "fair and reasonable" standard regardless of whether it was entered into in good faith.

Turning to remedies, the Court acknowledged that an LPA can exculpate defendants from monetary damages for actions taken in good faith. However, the Court "departed" from the pleading standard of bad faith announced in *Brinckerhoff III*. Instead, it held that to plead bad faith, the plaintiff was only required to plead facts supporting an inference that the General Partner "did not reasonably believe" the Transaction "was in the best interest of the Partnership."[12]

The Court also rejected, at the pleading stage, the invocation of the LPA's conclusive presumption of good faith for actions taken in reliance on the advice of a financial advisor. Taking the allegations in the Complaint as true, the Supreme Court accepted the allegation that "the financial terms were fully baked" by the time the financial advisor was hired to render a fairness opinion.[13] Thus, under the facts as alleged in the Complaint, the Court found an inference that the reliance on the financial advisor did not meet the requirements contemplated under the LPA.

IMPLICATIONS

In the oil and gas Master Limited Partnership context where related party transactions are common, LPAs are often designed to allow related party transactions to be undertaken consistent with the risk profile of the MLP. To that end, MLPs have taken advantage of the Delaware Revised Uniform Limited Partnership Act to replace traditional fiduciary duties with contractual standards. Although reversing prior LPA rulings, the Delaware Supreme Court in this decision confirmed that it will enforce a waiver of fiduciary duties in an LPA. Nevertheless, the change in interpretation of the LPA represented by the reversal, underscores that drafting of these key terms for an LPA requires precision to ensure that the intent of the parties will be later enforced in litigation over transactions using the contractual procedures specified in the LPA.

The Court's willingness to "change course" on the pleading standard of bad faith will likely directly translate into more claims on related-party transactions surviving the motion to dismiss stage of litigations. The introduction of a good faith standard similar to the corporate context appears to be based on perceived abuses in various related party transactions in MLPs.[14] The Court's decision also underscores the importance of process in connection with the retention of advisors and the analysis provided, so that defendants may invoke certain "safe harbors" in the LPAs.

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ENDNOTES

1 -- A.3d --, No. 273, 2016, slip op. at 37 (Del. Mar. 20, 2017). Sullivan & Cromwell LLP represented Enbridge, Inc. and certain of its subsidiaries and directors in this litigation as well as the earlier litigation referenced in this memo.

2 2016 WL 1757283, at *2 (Del. Ch. Apr. 29, 2016) (Memorandum Decision).

3 *Brinckerhoff* v. *Enbridge Energy Co., Inc.*, 2011 WL 4599654, at *8-9 (Del. Ch. Sept. 30, 2011) (*Brinckerhoff I*), *aff'd*, 67 A.3d 369 (Del. 2013). *See also Brinckerhoff* v. *Enbridge Energy Co., Inc.*, 2012 WL 1931242 (Del. Ch. May 25, 2012) (*Brinckerhoff II*).

4 *Brinckerhoff* v. *Enbridge Energy Co., Inc.*, 67 A.3d 369, 373 (Del. 2013) (*Brinckerhoff III*).

5 Memorandum Decision.

6 Memorandum Decision at 36 (citing *Brinckerhoff III*, 67 A.3d at 373).

7 67 A.3d 354, 362 (Del. 2013).

8 Op. at 18-19.

9 *Id*. at 20-21.

10 *Id*. 21-22.

11 *Id*. at 25.

12 *Id*. at 32.

13 *Id*. at 35.

14 Chief Justice Strine noted at oral argument that the LPA at issue was not out of the ordinary, but noted a general sentiment of perceived abuses through the drafting of LPAs. For a video of the oral argument, *see* 2017-01-11 273, 2016 *Brinckerhoff* v. *Enbridge Energy*, https://livestream.com/DelawareSupremeCourt/events/6861166/videos/146499243 (last visited Mar. 22, 2017).

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