

DELAWARE CHANCERY COURT DECISION PROVIDES REMINDERS FOR MLP TRANSACTIONS

To Our Clients and Friends:

On November 12, 2021, the Delaware Court of Chancery issued a post-trial decision finding that the general partner of a Master Limited Partnership (“MLP”) breached the partnership agreement of the MLP that it controlled and engaged in willful misconduct that left the general partner unprotected from the exculpatory provisions in the partnership agreement. It is rare for a court to find such a breach on the part of the general partner of an MLP, and this decision is based on the particular facts of the case, not a change in established law. The decision offers useful reminders to participants in MLP transactions about the limits of acceptable conduct under standard partnership agreement provisions.

Background

In 2005, Loews Corporation (“Loews”) formed and took Boardwalk Pipeline Partners, LP (the “Partnership” or “Boardwalk”) public as an MLP after the Federal Energy Regulatory Commission (“FERC”) implemented a regulatory policy that made MLPs an attractive investment vehicle for pipeline companies. Boardwalk served as a holding company for its subsidiaries that operate interstate pipeline systems for transportation and storage of natural gas. Loews, through its control of the general partner of the Partnership (the “General Partner”), controlled Boardwalk.

The General Partner itself was a general partnership controlled by its general partner, Boardwalk GP, LLP (“GPGP”). GPGP had a sole member, Boardwalk Pipelines Holding Corp., a wholly owned subsidiary of Loews (“Holdings”). Holdings had exclusive authority over the business and affairs of GPGP not relating to the management and control of Boardwalk. Holdings’ board of directors consisted entirely of directors affiliated with Loews. GPGP had its own eight-person board (the “GPGP Board”), consisting of four directors affiliated with Loews and four directors unaffiliated with Loews. The GPGP Board had authority over the business and affairs of GPGP related to the management and control of Boardwalk. The different composition of the GPGP Board and the Holdings Board meant that if Holdings made a decision for GPGP as its sole member, then Loews controlled the decision. If the GPGP Board made the decision for GPGP, however, then the four directors unaffiliated with Loews could potentially prevent GPGP from taking the action that Loews wanted.

Boardwalk’s Agreement of Limited Partnership (“Partnership Agreement”) included a provision that would allow the General Partner to acquire all of the common equity of Boardwalk not owned by Loews through the exercise of a Call Right, so long as three conditions were met. First, the General Partner had to own “more than 50% of the total Limited Partnership Interests of all classes then Outstanding.” Second, the General Partner had to receive “an Opinion of Counsel (the “Opinion”) that Boardwalk’s status as an association not taxable as a corporation and not otherwise subject to an entity-level tax for federal, state or local income tax purposes has or will reasonably likely in the future have a material

adverse effect on the maximum applicable rate that can be charged to customers” (the “Opinion Condition”). Third, the General Partner had to determine that the Opinion was acceptable (the “Acceptability Condition”). The Partnership Agreement did not specify whether the GPGP Board, as the board that managed the publicly traded partnership, or Holdings, as the General Partner’s sole member, should determine whether the Opinion was acceptable on behalf of the General Partner.

If the three conditions above were met, then, under the terms of the Partnership Agreement, the General Partner could exercise the Call Right in its individual capacity “free of any fiduciary duty or obligation whatsoever to the Partnership, any [l]imited [p]artner or [a]ssignee” and not subject to any contractual obligations. The Call Right would be exercised based on a trailing market price average.

On March 15, 2018, the FERC proposed a package of regulatory policies that potentially made MLPs an unattractive investment vehicle for pipeline companies. The trading price of Boardwalk’s common units declined following the FERC announcement. In response to the March 15th FERC action, several MLPs issued press releases stating that they did not anticipate the proposed FERC policies would have a material impact on their rates, primarily because customers were locked into negotiated rate agreements. Boardwalk issued a press release stating that it did not expect FERC’s proposed change to have a material impact on revenues (rather than rates). A few weeks after the press release, Boardwalk publicly disclosed the General Partner’s intention to potentially exercise the Call Right (the “Potential-Exercise Disclosure”). The common unit price of Boardwalk further declined.

Loews retained outside counsel to prepare the Opinion required under the Partnership Agreement. The Court found that counsel, after discussion with Loews, created a “contrived” opinion in order to find an adverse impact on rates when the FERC proposals were not final. Loews also sought advice from additional outside counsel to advise on whether the Opinion was sufficient for purposes of the Opinion Condition requirements under the Partnership Agreement and whether Holdings had the authority to make the acceptability determination, or whether the GPGP should make such determination. Ultimately, following the legal advice it received, Loews had the Holdings board, comprised entirely of Loews insiders, find the Opinion acceptable.

On May 24, 2018, Boardwalk’s unitholders filed suit in the Court of Chancery seeking to prevent the General Partner from exercising the Call Right using a 180-day measurement period that included trading days affected by the Potential-Exercise Disclosure, claiming that the disclosure artificially lowered the unit trading price and undermined the contractual call price methodology. The parties soon reached a settlement on the 180-day measurement period. On July 18, 2018, Loews exercised the Call Right and closed the transaction just one day before FERC announced a final package of regulatory measures that made MLPs an even more attractive investment vehicle. After the Court of Chancery rejected the settlement Loews reached with the original plaintiffs, the current plaintiffs took over the litigation.

The Court’s Findings

In its post-trial opinion, the Court held that the General Partner breached the Partnership Agreement by exercising the Call Right without first satisfying the Opinion Condition or the Acceptability Condition. The Court found that the General Partner acted manipulatively and opportunistically and engaged in

willful misconduct when it exercised the Call Right. Further, the Court held that the exculpatory provisions in the Partnership Agreement do not protect the General Partner from liability.

The Court held the Opinion failed to satisfy the Opinion Condition, because the Opinion did not reflect a good faith effort on the part of the outside counsel to discern the facts and apply professional judgment. In making the determination, the Court reviewed in detail factual events submitted at trial and took into account the professional and personal incentives the outside counsel faced in rendering the Opinion.

In holding the General Partner failed to satisfy the Acceptability Condition, the Court noted that a partnership agreement for an MLP is not the product of bilateral negotiations and the limited partners do not negotiate the agreement's terms, and, as a result, Delaware courts would construe ambiguous provisions of the partnership agreement against the general partner. The Court found that, "because the question of who could make the acceptability determination was ambiguous, well-settled interpretive principles require that the court construe the agreement in favor of the limited partners." As such, the Court determined that the GPGP Board, which included directors who were independent of Loews, was the body that had the authority to make the acceptability determination. Because the GPGP Board did not make the determination regarding the Acceptability Condition, the General Partner breached the Partnership Agreement by exercising the Call Right.

The Court further held that the provision in the Partnership Agreement stating the General Partner would be "conclusively presumed" to have acted in good faith if it relied on opinions, reports or other statements provided by someone that the General Partner reasonably believes to be an expert did not apply to protect the General Partner from liability, because the General Partner participated knowingly in the efforts to create the "contrived" Opinion and provided the propulsive force that led the outside counsel to reach the conclusions that Loews wanted.

In addition, the Court held the exculpation provision in the Partnership Agreement, which would generally protect the General Partner from liability except in case of bad faith, fraud or willful misconduct, did not apply because the General Partner engaged in willful misconduct when it exercised the Call Right.

The Court found the General Partner liable for damages of approximately \$690 million, plus pre- and post-judgment interest.

Key Takeaways

While this case does not reflect a departure from established law, it provides helpful lessons for participants in MLP transactions to consider, including:

- **Outside counsel and advisors should be independent.** The Boardwalk decision highlights the importance of retaining independent outside counsel and advisors in transactions involving conflicts of interest. Outside counsel and advisors should independently discern the facts, conduct analysis, and apply professional judgment.

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- **Ambiguity in the partnership agreement may be resolved in favor of the public limited partners.** MLPs and their sponsors should carefully consider their approach when making determinations with respect to any ambiguous provisions of the partnership agreement. Although the partnership agreement may provide for a presumption that they have acted in good faith, the general partner and sponsor should conduct their activities with respect to a conflict transaction as if there were no such presumptive provision.
- **Focus on precise compliance with the partnership agreement.** Consistent with previously issued case law, to obtain the benefits provided in the partnership agreement, MLPs and their sponsors must strictly comply with the terms of the partnership agreement. Equally as important, they should be prepared to establish a clear and consistent record of satisfaction of such conditions.
- **Always be mindful of written communications and that actions will be judged with benefit of hindsight.** The Court cited multiple emails, handwritten notes and other written communications (including from lawyers and within law firms) introduced as evidence at the trial. The Court also cited drafts of minutes of committee meetings in reviewing the written record. Participants in MLP transactions should be mindful that any written communications, including those thought to be privileged, could be evidence in litigation. Participants should also recognize that communications and actions taken will be reviewed with the benefit of 20/20 hindsight.

For the full opinion, please reference: *Bandera Master Fund LP v. Boardwalk Pipeline Partners, LP*



Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Mergers and Acquisitions, Oil and Gas or Securities Litigation practice groups, or the following authors:

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