

Supreme Court Suggests Caution for MLPs in Conflicted Transactions

By **Robert B. Little and Louis J. Matthews**

In *Brinckerhoff v. Enbridge Energy*, C.A. No. 11314 (Del. March 20), the Delaware Supreme Court reviewed the limited partnership agreement (LPA) of a master limited partnership (MLP) in the context of a conflicted transaction. The Supreme Court's opinion offers valuable guidance to MLPs engaging in transactions involving their general partner or other related parties.

As background, in July 2009, Enbridge Energy Partners (EEP) sold a two-thirds interest in the Alberta Clipper project, a proposed \$1.2 billion pipeline project, to Enbridge Inc. Peter Brinckerhoff, a common unit-holder in EEP, challenged the fairness of the transaction, but these claims were ultimately dismissed pursuant to decisions by the Delaware Court of Chancery and the Supreme Court.

In January 2015, at Enbridge's urging, EEP repurchased Enbridge's interest in the Alberta Clipper project at a substantially higher price, notwithstanding strong indications that the value of the interest had declined. Brinckerhoff brought a new complaint alleging that Enbridge Energy Company (EEP GP), the general partner of EEP and a wholly-owned subsidiary of Enbridge, and other culpable persons approved such conflicted transaction in bad faith and in violation of the LPA. The Court of Chancery dismissed the complaint. However, the Supreme Court reversed the lower



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court's decision on several grounds that should be noteworthy to MLPs, their advisers and investors.

First, the Supreme Court reiterated the settled position of the Delaware courts that MLPs may replace fiduciary duties imposed by common law with contractual standards in the LPA. The Supreme Court held that if fiduciary duties have been validly disclaimed, the limited partners cannot rely on common law fiduciary duties to regulate the general partner's conduct and must instead look exclusively to the LPA for their rights and remedies.

Second, the Supreme Court reaffirmed its continued use of two principles of contract interpretation: the court should "prefer specific provisions over more general ones," and

the court should review how a term is used elsewhere in the agreement to determine such term's meaning. The application of these two principles was critical to the Supreme Court's reasoning.

With respect to the first principle, the Supreme Court held that, unless the LPA clearly provides otherwise, general good-faith standards contained in the agreement are not grafted onto the specific affirmative obligations contained elsewhere in the agreement. Rather, the general contractual good-faith standard "operates in the spaces of the LPA without express standards." The EEP LPA waived fiduciary duties and permitted EEP GP to take any action so long as such action is reasonably

believed by EEP GP to be in EEP's best interests; the court referred to this standard as a contractual good-faith standard of care. EEP's LPA also included a provision requiring affiliate transactions to be "fair and reasonable to the partnership." The court held that this provision contained the governing standard with respect to affiliate transactions and that this standard was not modified by the good-faith standard of care contained elsewhere in the agreement. Consequently, the Supreme Court reversed the Court of Chancery's holding that a finding of "bad faith" was a precondition to determining whether the general partner breached the LPA provision regarding affiliate transactions.

With respect to the second principle, the Supreme Court reaffirmed its approach of reviewing how a term is used elsewhere in the agreement to determine such term's meaning. The EEP LPA provided for exculpation of the general partner if it acted in good faith. However, while the LPA provided a definition of "good faith" with respect to general standards applicable to the general partner (specifically, a reasonable belief that such action was "in the best interests of the partnership"), the LPA did not provide a definition of "good faith" for purposes of determining eligibility for exculpation. Rather than using the pleading standard advanced by the defendants (the requirement that plaintiff "plead facts that ruled out all legitimate explanations" for the transaction other than bad faith), the Supreme Court defined "good faith" in the manner used elsewhere in the LPA. Therefore, in order to plead a claim that EEP GP did not act in good faith (and was therefore ineligible for exculpation), Brinckerhoff was merely required to "plead facts supporting an

inference that EEP GP did not reasonably believe that the Alberta Clipper transaction was in the best interests of the partnership." The Supreme Court ruled that Brinckerhoff had met this requirement.

Third, while the Supreme Court reaffirmed that "safe harbors," if followed, will immunize conflicted transactions from judicial review, the Brinckerhoff decision reiterates the importance of adhering to the proper process to satisfy the safe harbor. In this case, EEP's LPA contained a conclusive presumption of good faith for actions taken in reliance on the advice of a financial adviser. Brinckerhoff alleged that EEP GP's financial adviser did not provide any structuring advice, negotiate the sale price or (c) consider the prior sale (i.e., the most comparable transaction) in its analysis. The court reasoned that a fact finder could conclude that EEP GP may not have actually relied on such advice because the terms of the deal were "fully baked" by the time the financial adviser got involved. Therefore, the Brinckerhoff decision should serve as a reminder to MLPs of the importance of process (e.g., best practice suggests you should not negotiate all of the deal terms prior to involving a financial adviser) when retaining a financial adviser, seeking their advice and obtaining a fairness opinion.

In practice, the Brinckerhoff decision will likely have a limited impact on most MLPs because the decision was based on atypical terms rarely found in more modern LPAs. For example, modern LPAs often provide for a general duty of directors to act in good faith, which is usually defined to mean that the director subjectively believed that the action or decision was in (or not opposed to) the best interests of the partnership.

This subjective standard is far easier to satisfy than the objective "fair and reasonable" standard applicable to conflict of interest transactions contained in EEP's LPA. Further, modern LPAs typically contain a provision that a conflict of interest approved by a committee of independent directors acting in good faith constitutes the deemed approval by all partners of any such conflict of interest. While EEP used a special committee to handle the conflicted transaction, the LPA did not provide that use of the special committee satisfied a safe harbor.

Nevertheless, this decision should serve as a reminder to MLPs to closely review their LPA prior to engaging in conflicted transactions. Disputes over such transactions have become increasingly common, and MLPs should tread carefully. Further, MLPs not using a modern LPA should consider whether it would be prudent to amend their LPA.

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