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# Claims Involving a Limited Partnership Deal Are Derivative Under 'Tooley' Test

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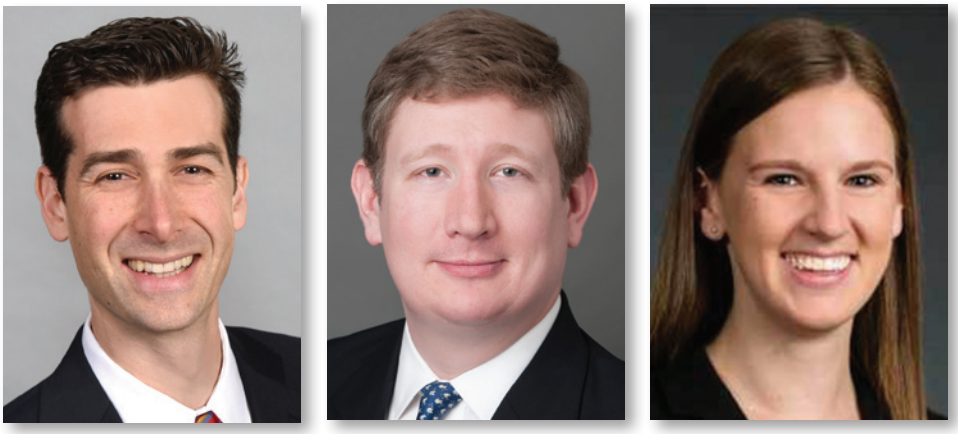
In *El Paso Pipeline Gas v. Brinckerhoff*, C.A. No. 7141-VCL (Del. Dec. 20, 2016), the Delaware Supreme Court reaffirmed the continued applicability of Tooley v. Donaldson, Lufkin & Jenrette, 845 A.2d 1031 (Del. 2004), in determining whether a claim is direct or derivative in nature, even when the claim involves a breach of contractual duty owed to a limited partnership. The El Paso decision also clarified the "unique" circumstances in which a claim could be considered dual-natured, such that a shareholder can sue directors and officers both directly to recover damages in the shareholder's individual capacity, and derivatively to recover damages or other relief on behalf of the company.



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## After Awarding $171 Million in Damages, the Court of Chancery Finds Sufficient Standing

The plaintiff in *El Paso* was Peter R. Brinckerhoff, a trustee of an entity that was a limited partner of El Paso Pipeline Partners, a publicly traded master limited partnership. The partnership's general partner, El Paso Pipeline GP Co. (the general partner), was owned by El Paso Corp., a publicly traded Delaware corporation (the parent). The parent controlled the Partnership through its ownership of the general partner.

In March and October 2010, the parent sought to effect a series of transactions in which it would transfer certain assets to the partnership in return for cash and the assumption of debt (the dropdowns). Due to the alleged conflict of interest presented by the parent's control of the partnership, the general partner formed a conflicts committee to approve each dropdown (the committees), pursuant to the partnership's limited partnership agreement (LPA). In March and November 2010, each committee approved the dropdowns.

In March 2012, Brinckerhoff brought suit on behalf of the partnership in the Court of Chancery against the partner, the general partner, and the committee members. Brinckerhoff asserted various causes of actions stemming from the partnership's alleged overpayment in the dropdowns. Following summary judgment, Brinckerhoff's sole claim remaining was for breach of the LPA's conflicts-of-interest provision that required both the general partner and the committees to act in good faith in approving conflicted transactions like the dropdowns. The parties proceeded to trial in November 2014.

Meanwhile, in May 2012, Kinder Morgan acquired the parent, which ceased to be a separately traded public company, although the partnership continued to be separately publicly traded. Then, in August 2014, the partnership announced a merger with Kinder Morgan. The trial court was presented with the question of whether the merger extinguished Brinckerhoff's standing to pursue derivative claims, but deferred the question until after trial. Shortly after the trial concluded, the

Kinder Morgan-partnership merger closed. On Dec. 2, 2014, the defendants filed a motion to dismiss, arguing that Brinckerhoff's standing to bring derivative claims was extinguished as a result of the merger, since the effect of the merger was to transfer ownership of the derivative claims to Kinder Morgan, an entity in which the plaintiff owned no stock. The Court of Chancery did not immediately rule on the defendants' motion to dismiss, instead issuing an opinion in April 2015 finding that the committee did not act in good faith as it did not subjectively believe that the dropdown was in the partnership's best interests, and awarding $171 million in damages for the overpayment.

On Dec. 2, 2015, the Court of Chancery denied the defendants' motion to dismiss for lack of standing, finding that under NAF Holdings v. Li & Fung (Trading) , 118 A.3d 175 (Del. 2015), a Tooley analysis did not apply to the contract rights at issue, namely whether the general partner breached the LPA's conflicts-of-interest provision. Accordingly, the court held that Brinckerhoff established at trial that his claim was direct, not derivative, and therefore his claim survived the Kinder Morgan merger. Relying on Gentile v. Rossette , 906 A.2d 91 (Del. 2006), the court also found that even under Tooley , Brinkerhoff had asserted a "dual-natured" claim.

## The Delaware Supreme Court Emphasizes Applicability of 'Tooley' and Reverses on Standing

On appeal, the Delaware Supreme Court reversed, finding that Brinckerhoff's claim was derivative and thus extinguished by the Kinder Morgan merger with the partnership. The court first took issue with the Court of Chancery's reading of NAF Holdings, explaining that case held only that *Tooley* does not apply where a plaintiff asserts a claim grounded in the plaintiff's own right, such as for breach of a commercial contract to which the plaintiff is party. The court explained that extending NAF Holdings to this context would "essentially abrogate *Tooley* with respect to alternative entities merely because they are creatures of contract."

The court then proceeded to apply the two-part *Tooley* test which considers only: who suffered the harm alleged; and who would receive the benefit of any recovery. As to the first prong, the court found that the harm "solely affected the partnership" because it had its funds depleted through the overpayment. "Any economic harm to Brinckerhoff devolved upon him as an equity holder in the form of the proportionally reduced value of his units—a classically derivative injury." As to the second prong, the court found that any recovery would flow to the partnership. Returning the amount of the alleged overpayment to the Partnership was the most appropriate remedy, while any recovery by Plaintiff necessarily could only be on a pro rata basis. Given that, the Court held that "the necessity of a pro rata recovery to remedy the alleged harm indicates that [Brinckerhoff's] claim is derivative."

The court also rejected the lower court's finding that Brinckerhoff's claim was dual-natured (that is, both direct and derivative) under *Gentile*. The court emphasized that it is only "in unique circumstances, that this court has recognized that some claims can be dual-natured." In so holding, the court distinguished *Gentile*, in which plaintiff had asserted a corporate overpayment claim coupled with allegations of a minority's loss of cash value and voting power. In those admittedly unique circumstances, the Court held that plaintiff could pursue a dual-natured claim. Pointedly, Chief Justice Strine wrote a separate concurring opinion in which he said that "*Gentile* cannot be reconciled with the strong weight of our precedent and it ought to be overruled" and congratulated the majority for refusing to extend *Gentile* to the alternative entity arena.

Putting aside whether the court ultimately overrules *Gentile*, the El Paso decision sets a high bar for shareholders to assert direct or dual-natured claims where the gravamen of the complaint is board action or inaction that adversely affects all shareholders in a common manner, and the remedy for which is damages that can only be recovered in pro rata fashion, or non-monetary relief granted that would benefit all shareholders equally. Going forward, it appears that the Chancery Court may apply the *Tooley* standards more rigorously, and further narrow the category of claims that can be brought directly in circumstances like those present in *El Paso*. •

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