IN THE

Supreme Court of the State of Delaware

WILLIAM ALLEN,

Plaintiff Below, Appellant,

v.

ENCORE ENERGY PARTNERS L.P., ENCORE ENERGY PARTNERS GP LLC, SCOTT W. SMITH, RICHARD A. ROBERT, DOUGLAS PENCE, W. TIMOTHY HAUSS, DAVID BAGGETT, JOHN E. JACKSON, MARTIN G. WHITE, and VANGUARD NATURAL RESOURCES LLC,

Defendants Below, Appellees.

No. 534, 2012

COURT BELOW:

COURT OF CHANCERY OF THE STATE OF DELAWARE, C.A. NO. 6379-VCP (CONSOLIDATED INTO CONS. C.A. NO. 6347-VCP)

APPELLANT'S OPENING BRIEF

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NATURE OF THE PROCEEDINGS

Plaintiff appeals an opinion and order of the Court of Chancery dismissing his Verified Consolidated Second Amended Class Action Complaint (the "Complaint") pursuant to Court of Chancery Rule 12(b)(6).

The class action below challenged the fairness and good faith of a squeeze-out merger (the "Merger") through which Defendant Vanguard Natural Resources, LLC ("Vanguard"), which owned the general partner of Encore Energy Partners LP ("Encore" or the "Partnership"), acquired the outstanding publicly-held common units of Encore at a 10.1% discount to their pre-announcement trading price.

While Vanguard's opening offer (the "Acquisition Offer" or "Offer") represented a merger premium of just 0.2%, the opening counteroffer from the Conflicts Committee of the Encore general partner's board of directors (the "Conflicts Committee") was just 4% higher – an amount far below the *midpoint* of its *own financial advisor's valuation analysis* and one that valued Encore at nearly 10% less than Vanguard's opening Offer as a result of Vanguard's significant (company-specific) market underperformance in the intervening months.

In addition, Vanguard's Offer was – by Vanguard's own statement – opportunistically timed to exploit a decline in the trading ratio between Vanguard and Encore units, and in the months leading up to Vanguard's announcement of the Offer, Vanguard caused the Partnership to make two public announcements regarding its future plans and prospects that caused material declines in the trading price of its units. The takeunder effected by the Merger was thus at a discount to a pre-announcement trading price that was itself depressed by bad faith disclosures in the months before the Acquisition Offer was made.

Finally, Vanguard's refusal to consider a sale or agree to a majority-of-the-minority voting condition at the outset of the negotiations foreclosed any procedural or market-based check on the Merger's fairness, and the Merger was ultimately approved by only one-third of Encore's unaffiliated public unitholders.

Presented with a Complaint that pled the foregoing facts with specificity and alleged bad faith by the Conflicts Committee and Vanguard, the Court of Chancery dismissed the Complaint, holding in its Memorandum Opinion dated August 31, 2012 (the "Opinion" or "Op."), *reported at* 2012 WL 3792997, that Plaintiff failed to state a claim because objective facts were "not relevant" to pleading subjective bad faith on the part of the Conflicts Committee, and the Conflicts Committee's approval of the Merger "would compel a finding that no

Defendant breached" Encore's partnership agreement, whether or not Vanguard's bad faith conduct was reviewed by or even known to the Conflicts Committee.

The Court of Chancery thereby applied an incorrect pleading standard that – this Court has previously recognized – would be impossible for any plaintiff to satisfy at the pleading stage. It also erroneously interpreted the Conflicts Committee's duties as far narrower than the Partnership's Second Amended and Restated Agreement of Limited Partnership, dated as of September 17, 2007 (the "LPA") required, and erred as a matter of law by concluding that Conflicts Committee approval of the Merger rendered Vanguard's bad faith conduct non-actionable simply because it was related to the Merger.

Accordingly, the Court of Chancery's judgment dismissing the Complaint should be reversed.

SUMMARY OF ARGUMENT

I. The Court of Chancery erred by holding that objective facts were "not relevant" to a determination of the Conflicts Committee's good faith, by requiring specific allegations regarding Defendants' state of mind, and by accepting statements in the joint proxy statement/prospectus on Form 424B3 issued by Vanguard on October 31, 2011 (the "Proxy") as proof of what the Conflicts Committee actually believed.

II. The Court of Chancery erred by holding that breach of the contractual duty of "good faith" under the LPA required a showing that Defendants "were acting *against*" the interests of the Partnership, thereby excluding intentional dereliction of duty or conscious disregard for one's responsibilities.

III. The Court of Chancery erred by holding that the Conflicts Committee's undisputed failure to meaningfully bargain on behalf of Encore's public unitholders and its approval of the Merger at a significant discount to Encore's unaffected trading price was insufficient to plead bad faith.

IV. The Court of Chancery erred by holding that the Conflicts Committee's approval of the Merger eliminated Vanguard's liability for bad faith conduct, without any showing that the Conflicts Committee considered or evaluated such conduct.

STATEMENT OF FACTS

A. Background Regarding the Partnership and the Events Leading to the Merger

Encore conducted its initial public offering in late 2007 and was operated and controlled by its sponsor, Encore Acquisition Company ("Encore Acquisition"), from that time until early 2010, when Encore Acquisition was acquired by Denbury Resources Inc. ("Denbury"). A443.[1] As reflected by the following price chart, Encore's unit price generally increased gradually between mid-2010 and the date of the Offer, March 24, 2011:

A443.)

On November 17, 2010, Denbury and Vanguard announced that Denbury had agreed to sell Encore's general partner ("Encore GP") and its approximately 46% limited partner interest in Encore to Vanguard. The sale to Vanguard closed on December 31, 2010. A444.

B. Disclosures Directed by Vanguard Drove Down Encore's Unit Price Prior to the Acquisition Offer

Before the closing of Vanguard's acquisition of Encore GP and a 46% limited partner interest in Encore, analysts discussed the possibility that Vanguard would acquire the remaining common units of Encore. However, prior to the announcement of the Acquisition Offer, in the press release announcing the closing of its acquisition of Encore on January 3, 2011 (the "January 3 Release"), Vanguard strongly implied that it did not have plans to buy Encore's publicly-

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[1] Citations in the form "A__" are to the accompanying Appendix to Appellant's Opening Brief.

held units. Defendant Smith stated in the January 3 Release: "We are excited about this acquisition and the prospect of managing a great set of assets for the long-term benefit of the Encore unitholders." A444. The January 3 Release did not contain other new information of possible materiality to Encore investors, and there was no other Partnership-specific news in the week of January 3. Nonetheless, Encore's common units traded down substantially, declining 7.2% for the week – an 8.2% drop on a market-adjusted basis. A444.

On February 22, Vanguard caused Encore to issue a press release (the "February 22 Release"), announcing its fourth quarter 2010 ("4Q10") results and providing guidance for 2011. A444. The 4Q10 results exceeded analysts' expectations, with the Partnership (under Denbury's control through quarter-end) posting earnings per unit of $0.33 (vs. $0.30 analyst consensus) and distributable cash flow per unit of $0.59 (vs. $0.58 analyst consensus). A444.

The Partnership's forward-looking statements under Vanguard's management, by contrast, were decidedly negative. First, despite the strong 4Q10 results, Encore forecast 2011 oil and gas production at a level of 7,930 to 8,350 barrels of oil equivalent per day ("BOE/D") – significantly below analyst expectations. A444-45. Second, Encore announced that its strategy for 2011 was "to significantly increase capital expenditures to approximately $19.5 million to $21.0 million compared to $6.2 million in 2010." This level of capital expenditures far exceeded the level forecasted by analysts. A445.

As a direct result of Vanguard's decision to more than triple the Partnership's capital expenditures, Encore forecasted that it would distribute between $1.80 and $1.85 per unit to investors in 2011 – the lowest level of annual distributions since Encore began trading as a public company in late 2007, and substantially below both the $2.00 in annual distributions per unit made in 2010 and analysts' forecasts for 2011. A445. As a consequence, following issuance of the February 22 Release before the market opened, Encore traded down on February 22 and 23 by 5.4% (5.3% on a market adjusted basis). A445.

As reported on May 10, 2011, after the Acquisition Offer had been made, on August 4, 2011, after the final terms of the Merger had been announced, and on November 3, 2011, shortly before the Merger closed, Encore's actual results for the first three quarters of 2011 ("1Q11," "2Q11" and "3Q11," respectively) show that Vanguard's pessimistic forecast for 2011 was unfounded. Actual production for 1Q11 was 8,463 BOE/D, and 8,572 BOE/D after adjusting for "production-related outages as a result of extreme weather conditions." Actual production for 2Q11 was 8,534 BOE/D. Actual production for 3Q11 was 8,991 BOE/D. Each was comparable to or exceeded the Partnership's 4Q10 production, and far exceeded the sharply declining production rate of 7,930 to

8,350 BOE/D that Vanguard forecasted for Encore shortly before it made its Acquisition Offer. A445.

Encore's common unit price at the time of the Acquisition Offer thus reflected negative pressure from disclosures that were inaccurate and reflected value-depressive policies adopted by Vanguard in the months leading up to the Offer. A446.

Subsequent to the date of the Offer, on a May 10, 2011 earnings call, Defendant Richard A. Robert, an Encore director and Chief Financial Officer of Vanguard, specifically emphasized that the result of the sharp increase in capital expenditures in 2011 would be to provide "long-term value to unit holders" – Vanguard itself – at the expense of near-term cash flow distributions, stating (A446):

> It's important to bring to your attention this capital expenditure timeline. While we believe capex spending is important as it provides long-term value to unit holders by maintaining well production and reducing the decline rate, it is likely that ENP will generate less distributable cash flow in the next three quarters and ENP unit holders can expect to see a reduction in the distribution rate.

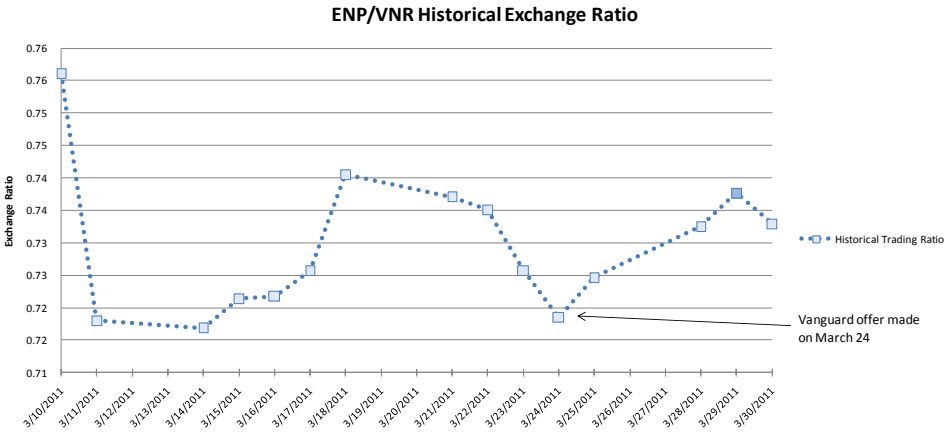
C. The Acquisition Offer Was Opportunistically Timed

According to the Proxy, Vanguard contemplated the Merger even before it completed its acquisition of Encore GP, and following the closing of the acquisition in December 2010, "Vanguard management continued to study the potential effects of a combination of Vanguard and Encore . . . ." A446 (Complaint), A226 (Proxy).

In early February 2011, Vanguard asked its financial advisor, RBC Capital Markets, LLC ("RBC"), to update its financial analysis of the Merger, and advised the Encore GP Board that "there was a possibility that a transaction involving a combination of Vanguard and Encore might be proposed." A446 (Complaint); A226 (Proxy). Beginning in early March 2011, the Proxy states that Vanguard management "monitored the relative trading prices of both Vanguard and Encore common units" and at one point, informed the Vanguard Board of Directors (the "Vanguard Board") that "while they continued to believe that a combination of Vanguard and Encore was desirable, the then-current market conditions and relative trading prices of Vanguard and Encore were not conducive to completing a business combination" and that "they would continue to monitor market conditions." A446-47 (Complaint); A227-28 (Proxy). The

Proxy also discloses that the Vanguard Board approved making the Offer on March 24, 2011, after management had "updated the Vanguard Board on the market conditions surrounding a potential offer." A447 (Complaint); A228 (Proxy).

As indicated by the Proxy, the Acquisition Offer was thus opportunistically timed for a date when the trading price of Encore units had dropped significantly in relation to the trading price of Vanguard units:



A447.

D. Vanguard Foreclosed a Market Check or Majority of the Minority Voting Condition

Vanguard's Offer, 0.72 Vanguard common units per Encore common unit, valued Encore at $23.20 when made – a premium of just 0.2% to Encore's pre-announcement closing price of $23.15. A447. In addition to providing almost no premium, Vanguard's Offer stated that it "would not entertain any proposal to sell its interests in Encore or Encore GP." A447 (Complaint); A228 (Proxy).

Accordingly, as Defendants acknowledged in the Proxy, Vanguard "foreclosed" the possibility of conducting an auction that would establish a market-tested price for the Partnership's common units. A448 (Complaint); A193, A240 (Proxy). In addition, Vanguard's counsel advised counsel for the Conflicts Committee that Vanguard "would not agree to a merger agreement that required the approval of a 'majority of the minority' of the Encore unitholders to effect the merger." A448 (Complaint); A230 (Proxy).

Because Vanguard owned approximately 46.0% of the Encore common units, the outcome of the unitholder vote was all but assured, without regard to how Encore's public unitholders voted, and the sole process protection for the Partnership's public investors was the Conflicts Committee. A448. Recognizing that the Merger was a conflict transaction, the Encore GP Board delegated broad authority to the Conflicts Committee to:

> among other things, (i) study, review, evaluate and negotiate the terms and provisions of the March 24 Proposal or any alternative to the March 24 Proposal on behalf of Encore and the Encore unaffiliated unitholders, (ii) select and retain independent legal and financial advisors, (iii) determine whether the March 24 Proposal or any alternative thereto, or none of them, is advisable and in the best interests of Encore and the Encore unaffiliated unitholders, and (iv) if appropriate, recommend to the Encore GP Board the acceptance of the March 24 Proposal or any alternative thereto.

A448 (Complaint); A229 (Proxy).

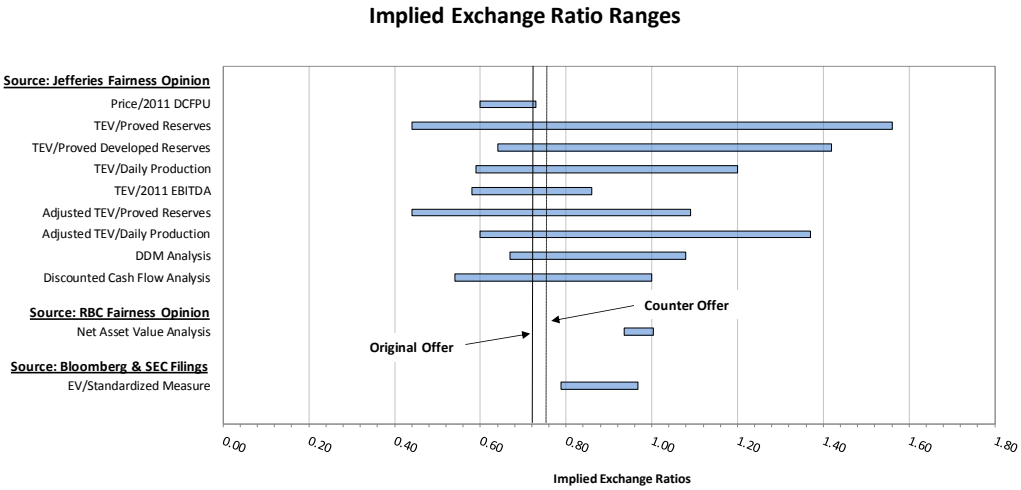
E. The Conflicts Committee Did Not Meaningfully Negotiate with Vanguard

Notwithstanding the broad delegation of negotiating responsibility to the Conflicts Committee, its subsequent performance was simply incompatible with that of an effective bargaining agent acting in good faith.

Crucially, despite the *de minimis* 0.2% merger premium reflected by the Offer and the subsequent *company-specific* run-down in Vanguard's unit price in the intervening months (A453), the Conflicts Committee chose to make its first counteroffer at a fixed exchange ratio of 0.75 – a ratio *just 4% higher than Vanguard's opening bid*. Due to the run-down in Vanguard's unit price, the counteroffer valued each Encore unit at a 9.1% *discount* to the value of Vanguard's opening Offer at the time it had been made. A450.

In addition, the Conflicts Committee's counteroffer cannot be reconciled with the analysis of its own financial advisor, Jefferies & Company, Inc. ("Jefferies"), or with other widely-used valuation metrics in the oil and gas industry. As reflected in the following chart, the 0.75 opening counteroffer is far below the midpoint of many of Jefferies' own valuation metrics. As further discussed below, it is also far below the bottom of the valuation range using the industry-specific metric that RBC adopted to value the Merger for Vanguard, as

well as other widely-used industry metrics, and the premiums paid in precedent transactions involving similar entities:



A450.

Unsurprisingly, Vanguard's management directed their counsel to "begin preparing an initial draft merger agreement" immediately after receiving the 0.75 demand, and after floating an initial counterproposal at 0.74, Vanguard readily acceded to the Conflicts Committee's insistence on 0.75. A451 (Complaint); A231-32 (Proxy). At the date it was announced, the final 0.75 exchange ratio (the "Exchange Ratio") valued Encore at a more than 5% *discount* to its trading price before the Offer was announced. A453. By the time of the closing, the Exchange Ratio valued Encore at a more than 10% discount to its last unaffected trading price. A453.

The final Exchange Ratio also impaired distributions to Encore's public unitholders. As explained in the Proxy, "based on current distribution rates and the exchange ratio, an Encore unitholder would initially receive approximately 7.8% less in quarterly cash distributions on an annualized basis after giving effect to the merger" and that "if Vanguard does not increase its cash distributions per Vanguard common unit, holders of Encore common units would receive on a pro forma basis smaller cash distributions than they could be expected to receive from Encore on their existing Encore common units." A180, 240.

In determining to make its counteroffer, the Conflicts Committee apparently did not rely on Jefferies or other financial advisors. Jefferies' fairness

opinion explicitly states that it did not actually provide any guidance to the Committee in connection with the negotiation of the Merger:

> In connection with Vanguard's merger proposal to Encore, the Encore Conflicts Committee retained Jefferies to render an opinion, if requested, as to the fairness from a financial point of view of the exchange ratio proposed by Vanguard to the Encore unaffiliated unitholders.
>
> * * *
>
> In addition, *we were not requested to and did not provide advice concerning the structure, the determination of the specific Exchange Ratio, or any other aspects of the Merger, or to provide services other than the delivery of this opinion*. We were not authorized to, and did not, solicit any expressions of interest from any other parties with respect to the sale of all or any part of ENP or any other alternative transaction. We *did not participate in negotiations with respect to the terms of the Merger and related transactions*. Consequently, we have assumed that such terms are the most beneficial terms from the perspective of the ENP Unaffiliated Unitholders that could under the circumstances be negotiated among the parties to such transactions, and no opinion is expressed whether any alternative transaction might result in consideration more favorable to the ENP Unaffiliated Unitholders than that contemplated by the Merger Agreement.

A449 (Complaint); A435 (Proxy) (emphasis added).

Elsewhere, the Proxy also indicates that Jefferies' role was limited to providing a fairness opinion at the end of the process. It states (at A252) that Jefferies "was not requested to and did not provide advice concerning the structure, the determination of the specific exchange ratio, or any other aspects of the merger." In addition, in a section listing factors "related to procedural safeguards" utilized by the Encore Conflicts Committee, it states only "[t]hat the Encore Conflicts Committee retained Jefferies to provide an opinion, if requested, as to the fairness, from a financial point of view, of the exchange ratio proposed by Vanguard to the Encore unaffiliated unitholders." A449-50 (Complaint); A241 (Proxy).

F. The Exchange Ratio Was Not Fair or Reasonable to Encore's Common Unitholders

By an array of well-established valuation measures, the Exchange Ratio was manifestly inadequate. A451.

1. Asset-Based Analysis

Unlike the generalized comparable company valuation methodologies used by Jefferies, which yield broad implied value ranges, *see* chart at page 9 above and A256 (Proxy), an analysis performed by RBC that is widely used in the oil and gas industry – the Net Asset Value analysis – provided a far tighter valuation range, and implied values between 24.7% and 33.7% *above* the Exchange Ratio. A451.

In performing its Net Asset Value analysis, RBC "calculated the present value of the future cash flows that each of Vanguard and Encore could be expected to generate from their existing bases" of proved reserves and adjusted for the value of hedges, changes in working capital, value of other assets, and certain other factors, including net debt. Future cash flows were then determined using forecasted commodity pricing and discount rates calculated by RBC. Depending on how commodity prices were forecasted, the fair exchange ratios calculated by RBC were as follows:

Method	Range of Ratios	Premium to Exchange Ratio	Implied Encore Fair Value
NAV, Strip Pricing Method	0.935-0.996	24.7%-32.8%	$27.35-$29.13
NAV, Wall Street Consensus Pricing Method	0.941-1.003	25.5%-33.7%	$27.52-$29.34

A451-52.

2. Enterprise Value to Standardized Measure

RBC's Net Asset Value analysis is further supported by a second well-established, industry-specific metric, the "standardized measure." A452.

The standardized measure reflects the present value of future cash inflows from proved reserves, less future production costs, development costs, net abandonment costs, and income taxes, using a uniform 10% discount rate. The standardized measure is a required footnote disclosure in the financial statements of petroleum exploration and production companies, and is reported annually in the Form 10-K filings of publicly traded companies. It provides a

metric that incorporates all future production expected from proved reserves, while considering the present-value effects of the timing of such production through the use of the discount rate. A452.

Analyzing the enterprise value-to-standardized measure multiples of Encore's public peer companies resulted in implied exchange ratios ranging from 0.61 to 1.01. Excluding the highest and lowest peers yielded an implied exchange ratios range of 0.79 to 0.97, higher than both the 0.72 Offer and the Conflicts Committee's 0.75 counteroffer. A452.

3. Premiums to Pre-Announcement Unit Price

The unfairness of the Exchange Ratio is further demonstrated by the fact that it was at a significant discount to Encore's pre-announcement trading price. A452.

Specifically, the Merger consideration at the Exchange Ratio of 0.75 was valued at $21.94, based on Vanguard's closing price as of the last trading day before the final terms of the Merger were announced. By contrast, Encore's closing price immediately before the Offer was announced was $23.15, more than 5.5% higher. Using Vanguard's trading price on the closing date, December 1, 2011, the Merger consideration was valued at $20.82, a 10.1% discount from Encore's last pre-Offer closing price. A453.

Crucially, the significant run-down in Vanguard's unit price that impaired the value of the exchange ratio offered to Encore did not reflect a decline in the broader market or the industry. Rather, Vanguard significantly underperformed the market: from the market close on the date of the Offer, March 24, 2011, to the last close before announcement of the Merger, on July 10, 2011, the trading price of Vanguard's units declined 9.2%. By contrast, the trading price of its peers declined only 2.0%. A453.

The Merger's negative premium contrasts sharply with precedent transactions, which reflect consistently and substantially positive premiums. According to data compiled by Thomson Reuters, the median one-day merger premium for a set of twelve recent transactions involving similar target companies was 22.6%, and the bottom quartile of transactions had an average merger premium of 10.6%. While the five-day and 20-day premiums for Encore were also negative (in the -4% range), the premiums for precedent transactions over those periods were even greater – 25.6% and 24.6%, respectively, for the median, and 16.9% and 17.0%, respectively, for the bottom quartile. A453.

G. The LPA and Defendants' Breaches Thereof

Section 7.9(a) of the LPA provides, in relevant part, that in the event of a conflict between Encore's general partner, its affiliates, and the Partnership or a unitholder, the action taken shall not violate the LPA or other duty if it is:

> (i) approved by Special Approval, (ii) approved by the vote of a majority of the Common Units (excluding Common Units owned by the General Partner and its Affiliates), (iii) on terms no less favorable to the Partnership than those generally being provided to or available from unrelated third parties or (iv) fair and reasonable to the Partnership, taking into account the totality of the relationships between the parties involved (including other transactions that may be particularly favorable or advantageous to the Partnership).

A083-84.

Section 1.1 of the LPA defines "Special Approval" as "approval by a majority of the members of the Conflicts Committee acting in good faith." A037.

Section 7.9(b) further establishes a "good faith" standard for Encore's general partner and its affiliates when it acts in its capacity as general partner of the Partnership:

> Whenever the General Partner makes a determination or takes or declines to take any other action [with exceptions not relevant here], then, unless another express standard is provided for in this Agreement, the General Partner, or such Affiliates causing it to do so, shall make such determination or take or decline to take such other action in good faith and shall not be subject to any other or different standards . . . .

A084.

Section 7.9(b) defines "good faith" as follows:

> In order for a determination or other action to be in "good faith" for purposes of this Agreement, the Person or Persons making such determination or taking or declining

> to take such other action must believe that the determination or other action is in the best interests of the Partnership.

A084.

Section 2.1 of the LPA adopts the provisions of the Delaware Revised Uniform Limited Partnership Act ("DRULPA") (including the fiduciary obligations established thereby) except "as expressly provided to the contrary" in the LPA:

> Except as expressly provided to the contrary in this Agreement, the rights, duties (including fiduciary duties), liabilities and obligations of the Partners and the administration, dissolution and termination of the Partnership shall be governed by [DRULPA].

Section 7.9(e) of the LPA in turn contains an express waiver of fiduciary duties, but only "to the extent" inconsistent with the express language of the LPA:

> Except as expressly set forth in this Agreement, neither the General Partner nor any other Indemnitee shall have any duties or liabilities, including fiduciary duties, to the Partnership or any Limited Partner or Assignee and the provisions of this Agreement, to the extent that they restrict, eliminate or otherwise modify the duties and liabilities, including fiduciary duties, of the General Partner or any other Indemnitee otherwise existing at law or in equity, are agreed by the Partners to replace such other duties and liabilities of the General Partner or such other Indemnitee.

By negotiating the Merger, by entering into and approving the Merger on terms that are unfair and unreasonable, and by taking steps to drive down the price of Encore common units in the period leading up to the Offer, the conduct of Vanguard, Encore GP, and the individual Defendants breached Defendants' duty of good faith to the Partnership and to its common unitholders. A454-455.

H. Procedural History

The Merger was announced on March 24, 2011 and the first of the constituent actions below was commenced on April 5, 2011. Based on the absence of potential irreparable harm, Plaintiff did not seek expedition, and the Merger closed on December 1, 2011. Plaintiff then filed the Complaint on December 28, 2011, oral argument was held on May 25, 2012 (transcript at A495), the Court of Chancery issued its Opinion on August 31, 2012, and this appeal followed.

ARGUMENT

I. THE COURT OF CHANCERY APPLIED THE INCORRECT LEGAL STANDARD IN HOLDING THAT THE COMPLAINT DID NOT ADEQUATELY PLEAD BAD FAITH AND IMPROPERLY RELIED ON THE PROXY TO ESTABLISH DEFENDANTS' STATE OF MIND

A. Question Presented

Did the Court of Chancery err by holding that objective facts were "not relevant" to a determination of the Conflicts Committee's good faith, by requiring specific allegations regarding Defendants' state of mind, and by accepting statements in the Proxy as proof of what the Conflicts Committee actually believed? A480.

B. Scope of Review

Dismissal of a claim pursuant to Court of Chancery Rule 12(b)(6) is reviewed *de novo*. *Kuhn Constr., Inc. v. Diamond State Port Corp.*, 990 A.2d 393, 396 (Del. 2010). In addition, interpretation of contract language is reviewed *de novo*. *Id.* This Court will "not affirm a trial judge's dismissal of a claim unless the judge (i) accepts as true all well-pleaded factual allegations, (ii) accepts even vague factual allegations as 'well-pleaded' if they give the opposing party notice of the claim, (iii) draws all reasonable inferences in favor of the non-moving party, and (iv) dismisses the Complaint only if the plaintiff would not be entitled to recover under 'any reasonably conceivable set of circumstances susceptible of proof.' " *CML V, LLC v. Bax*, 28 A.3d 1037, 1040 (Del. 2011) (citations omitted).

C. Merits of the Argument

1. The Court of Chancery Applied the Incorrect Legal Standard in Reviewing the Complaint

As discussed below in Points II and III, the Court of Chancery misdefined "bad faith" and the nature of the Conflicts Committee's duties under the LPA. Even under the erroneously narrow definitions applied by the Court of Chancery, however, its dismissal of the Complaint resulted from applying the incorrect standard under Court of Chancery Rule 12(b)(6).

In *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund II, L.P.*, 624 A.2d 1199 (Del. 1993), this Court reversed a decision dismissing a

limited partner's claim of breach of the implied covenant of good faith and fair dealing at the pleading stage. This Court rejected the argument that bad faith had to be pled with particularity, observing that "[i]ntent and state of mind, on the other hand, may be averred generally because 'any attempt to require specificity in pleading a condition of mind would be unworkable and undesirable.' " *Id.* at 1208 (quoting 5 Charles A. Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1301, at 674 (2d ed. 1983)).

As this Court explained, "a claim of bad faith hinges on a party's tortious state of mind," and even under Court of Chancery Rule 9(b), "state of mind may be pled generally . . . because *it may be virtually impossible for a party plaintiff to sufficiently and adequately describe the defendant's state of mind at the pleadings stage*." *Id.* (emphasis added).

Here, the Court of Chancery acknowledged that the Complaint alleged that "the Conflicts Committee ran a shoddy negotiation process," Op. at 28, 2012 WL 3792997, at *10, and pled that it was "feckless," Op. at 33, 2012 WL 3792997, at *12, and the Court recognized that the price improvement obtained by the Conflicts Committee through negotiation was "[m]eager," Op. at 28, 2012 WL 3792997, at *11, but ultimately held that "*[h]owever bad* the Conflicts Committee's decision may appear from the allegations of the Complaint, Plaintiffs have not alleged facts from which one could infer that the Conflicts Committee made its decision in bad faith . . . ." Op. at 30, 2012 WL 3792997, at *11 (emphasis added).

The Court of Chancery thus declined to draw the reasonable inference it was obligated to draw at the pleading stage: that the experienced businessmen on the Conflicts Committee opened with a counteroffer just 4% higher than Vanguard's opening bid, disregarded the much higher valuations supported by their own financial advisor's analysis, ignored the run-down in Vanguard's unit price, and accepted an offer below Encore's unaffected trading price, not because they were "ineffectual negotiators," Op. at 27, 2012 WL 3792997, at *10, but because they wanted to accommodate Vanguard or preferred to avoid the hard work of a true arm's length negotiation.

In reaching its conclusion, the Court of Chancery noted that the relevant standard under the LPA was "whether the Conflicts Committee approved the Merger with the subjective belief that it was in the best interests of the Partnership," and ruled that "*[w]hether [the Conflicts Committee's] determination was objectively reasonable is not relevant to that contractually prescribed standard.*" Op. at 30, 2012 WL 3792997, at *11 (emphasis added).

The Court's statement that an objectively "feckless" and "shoddy" process and "meager" result is "not relevant" to the issue of subjective bad faith would be an incorrect statement of the law even after discovery. *See CBS Corp. v. FCC*, 663 F.3d 122, 175 (3d Cir. 2011) ("The law has traditionally allowed the use of objective evidence to prove a party's subjective state of mind."), *cert. denied*, 132 S. Ct. 2677 (2012). It certainly has no application at the pleading stage.

As this Court recognized in *Desert Equities*, it will ordinarily be "virtually impossible for a party plaintiff to sufficiently and adequately describe the defendant's state of mind at the pleadings stage," 624 A.2d at 1208, and the effect of applying the Court of Chancery's pleading standard would be effectively to immunize limited partnership conflict transactions from judicial review. Nothing in the LPA or this Court's precedent supports such a result.

2. The Court of Chancery Improperly Relied on the Proxy as Evidence of Defendants' State of Mind

The Court of Chancery reached its determination regarding the Conflicts Committee members' state of mind, in part, by conducting an independent review of the Proxy and crediting statements therein that were neither cited nor discussed by the parties in their arguments before the Court as "probative of the Conflicts Committee's subjective state of mind . . . ." Op. at 11 n.21, 2012 WL 3792997, at *4 n.21.

In particular, the Court below emphasized that, according to the Proxy, the Conflicts Committee "believed that an acquirer was unlikely to agree to an exchange ratio that appeared to be immediately dilutive to its own distributable cash flow per unit, an important metric for master limited partnerships" and that the 0.75 exchange ratio "approached the point" at which this would occur. Op. at 10, 2012 WL 3792997, at *4. The Court of Chancery's Opinion later repeated this observation, Op. at 28-29, 2012 WL 3792997, at *11, and also cited the Proxy's statement that "distributable cash flow per unit would be higher in a combined entity . . . ." *Id.*

By crediting the Proxy as proof of what the Conflicts Committee actually believed and therefore as evidence concerning the ultimate issue in the case – bad faith – the Court of Chancery violated this Court's holding that on a motion to dismiss, the contents of a proxy statement are "hearsay with respect to claims other than the disclosure claims" and that "[w]hen a proxy statement . . . is not put forth by plaintiffs as an admission of the truth of the facts referred to therein, the defendants may not use it at the pleading stage for purposes other than

disclosure issues or perhaps to establish formal, uncontested matters." *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 70 (Del. 1995).

In addition to the evidentiary and pleading errors reflected in the Court of Chancery's use of the Proxy to conclusively establish the Defendants' state of mind, its reference to points in the Proxy that were nowhere cited or addressed by the parties in their briefing or at oral argument led it to an incomplete and thereby misleading perception of the facts.

Distributions to unitholders are, without question, a crucial characteristic of publicly-traded master limited partnerships such as Encore. *See Lonergan v. EPE Holdings, LLC*, 5 A.3d 1008, 1012 (Del. Ch. 2010) ("Investors purchase LP units for yield, and MLPs try to increase their yield over time."). What the Court of Chancery's independent search of the Proxy omitted, however, was that the Merger resulted in *lower actual distributions* to Encore unitholders. As the Proxy itself explained (A180 (emphasis added)):

> The current annualized distribution rate per Encore common unit is $1.88 (based on the quarterly distribution of $0.47 per Encore common unit declared on October 27, 2011 with respect to the third quarter of 2011). Based on the exchange ratio, the annualized distribution rate for each Encore common unit exchanged for 0.75 Vanguard common units would be approximately $1.7325 (based on the quarterly distribution of $0.5775 per Vanguard common unit declared on October 27, 2011 with respect to the third quarter of 2011). *Accordingly, based on current distribution rates and the exchange ratio, an Encore unitholder would initially receive approximately 7.8% less in quarterly cash distributions on an annualized basis after giving effect to the merger.*

In brief, the Court of Chancery applied the incorrect standard in reviewing the Complaint under Court of Chancery Rule 12(b)(6) and improperly relied on self-serving statements outside of the Complaint for their truth.

II. THE COURT OF CHANCERY ERRED BY INTERPRETING THE LPA'S "GOOD FAITH" STANDARD TO REQUIRE A SHOWING THAT "DEFENDANTS SUBJECTIVELY BELIEVED THAT THEY WERE ACTING *AGAINST* ENCORE'S INTERESTS"

A. Question Presented

Did the Court of Chancery err by holding that breach of the contractual duty of "good faith" under the LPA required a showing that Defendants "were acting *against*" the interests of the Partnership, thereby excluding intentional dereliction of duty or conscious disregard for one's responsibilities? A486-88.

B. Scope of Review

Dismissal of a claim pursuant to Court of Chancery Rule 12(b)(6) and the interpretation of contract language are reviewed *de novo*. *See* Point I.B above (at 16).

C. Merits of the Argument

The Court of Chancery misinterpreted the LPA by holding that to state a claim, Plaintiff was required "to allege facts from which one reasonably can infer that Defendants subjectively believed that they were acting *against* Encore's interests." Op. at 24, 2012 WL 3792997, at *9 (emphasis in original).

Section 7.9(b) (A084) provides that:

> In order for a determination or other action to be in "good faith" for purposes of this Agreement, the Person or Persons making such determination or taking or declining to take such other action must believe that the determination or other action is in the best interests of the Partnership.

By its terms, a decision is made in good faith, and is therefore non-actionable under the LPA, only if the decisionmaker has the affirmative belief

that the action at issue is in the best interests of the Partnership and its public unitholders.[2]

By reversing this affirmative duty to require a showing that the decisionmakers "were acting *against*" the interests of the Partnership, the Court of Chancery adopted a formulation that suggests a need to show malice or an intent to injure. This redefinition of "bad faith" has a substantial practical effect: it excludes the broad category of circumstances where a party acts with conscious indifference or inattention, and further excludes the category of wrongdoing where disloyalty may exist, but cannot be proved – a substantial category where state of mind is at issue.

The Court of Chancery's rewording acts to narrow the protections for Encore's public unitholders, and is therefore improper under the established principle that the terms of an LPA should be construed against its drafter. *See SI Mgmt. L.P. v. Wininger*, 707 A.2d 37, 43 (Del. 1998) (if the terms of a partnership agreement are ambiguous, they "should be construed against the General Partner as the entity solely responsible for the articulation of those terms"); *Penn Mut. Life Ins. Co. v. Oglesby*, 695 A.2d 1146, 1149-50 (Del. 1997) ("it is the obligation of the issuer of securities to make the terms of the operative document understandable to a reasonable investor whose rights are affected by the document").

The Court of Chancery's changes to the plain language of the LPA are also wholly unnecessary. The proper formulation of Plaintiff's task under the LPA on a Rule 12(b)(6) motion would directly track the language of the LPA: "Has Plaintiff pled sufficient facts, drawing all reasonable inferences in his favor,

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[2] Where, as here, the conflict transaction affects the ownership of the Partnership rather than the entity itself, the "best interests of the Partnership" should be construed as requiring reference to the interests of its unitholders, and as requiring that those interests be balanced to the extent that they are in conflict. *See In re Trados Inc. S'holder Litig.*, 2009 WL 2225958, at *7 (Del. Ch. July 24, 2009) (in corporate context, duty to act "in the best interests of the company" in connection with a merger required balancing the interests of common and preferred stockholders).

This is consistent with the Encore board of directors' delegation to the Conflicts Committee of responsibility to "determine whether the [Offer] or any alternative thereto, or none of them, is advisable and in the best interests of Encore *and the Encore unaffiliated unitholders* . . . ." A448 (Complaint); A229 (Proxy) (emphasis added).

to overcome the presumption that Defendants believed they were acting in the best interests of the Partnership and its public unitholders?" Given that the Merger both reduced the market value of the public unitholders' securities and impaired the cash distributions they would receive, this standard has readily been satisfied.

In recasting the plain language of the LPA, the Court of Chancery relied primarily on a recent decision involving a limited liability company whose operating agreement contained the same language, *In re Atlas Energy Resources, LLC Unitholder Litigation*, 2010 WL 4273122 (Del. Ch. Oct. 28, 2010). The Court's ruling on this point in *Atlas*, however, was not ultimately dispositive because it found that the company's controller owed fiduciary duties that had not been waived, and the case then settled before appeal.

There is no other support for the Court of Chancery's reformulation, and as discussed below, the great weight of bad faith jurisprudence is to the contrary.[3]

The LPA does not define the requirements of "good faith" beyond the language quoted above: that for a determination or other action to be in "good faith," the relevant person "must believe that the determination or other action is in the best interests of the Partnership." LPA § 7.9(b).

Under the terms of the LPA, the appropriate source for further defining "good faith" is Delaware's corporate fiduciary jurisprudence.

Section 2.1 of the LPA explicitly directs that fiduciary standards apply except where the LPA expressly provides otherwise: "Except as expressly provided to the contrary in this Agreement, the rights, duties (including fiduciary duties), liabilities and obligations of the Partners and the administration, dissolution and termination of the Partnership shall be governed by [DRULPA]."

The fiduciary waiver provision of the LPA, Section 7.9(e), bars the application of fiduciary principles only *to the extent inconsistent* with the LPA:

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[3] The decision below also cited *Amirsaleh v. Board of Trade of New York, Inc.*, 2009 WL 3756700, at *4 (Del. Ch. Nov. 9, 2009), in which then-Chancellor Chandler discussed whether "conduct not in good faith" was broader than "bad faith" and concluded that it was not, while recognizing that certain decisions of this Court have suggested otherwise. Plaintiff does not seek resolution of this issue on this appeal.

> the provisions of this Agreement, *to the extent that they restrict, eliminate or otherwise modify* the duties and liabilities, including fiduciary duties, of the General Partner or any other Indemnitee otherwise existing at law or in equity, are agreed by the Partners to replace such other duties and liabilities of the General Partner or such other Indemnitee.

(Emphasis added.)

Section 7.9(e) could have been written to entirely exclude fiduciary principles, rather than limiting them "to the extent" inconsistent with the duties prescribed under the LPA; the very purpose of the "to the extent" language, however, is necessarily to allow them to perform a gap-filling function.

The meaning of "good faith" in the fiduciary context was articulated by this Court in *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27 (Del. 2006), and restated in *Lyondell Chemical Co. v. Ryan*, as follows:

> At least three different categories of fiduciary behavior are candidates for the "bad faith" pejorative label. The first category involves so-called "subjective bad faith," that is, fiduciary conduct motivated by an actual intent to do harm. Such conduct constitutes classic, quintessential bad faith.
>
> The second category of conduct, which is at the opposite end of the spectrum, involves lack of due care – that is, fiduciary action taken solely by reason of gross negligence and without any malevolent intent. We address the issue of whether gross negligence (including failure to inform one's self of available material facts), without more, can also constitute bad faith. The answer is clearly no.
>
> That leaves the third category of fiduciary conduct, which falls in between the first two categories. This third category is what the Chancellor's definition of bad faith – intentional dereliction of duty, a conscious disregard for one's responsibilities – is intended to capture. The question is whether such misconduct is properly treated as a non-exculpable, nonindemnifiable violation of the fiduciary duty to act in good faith. In our view, it must be.

970 A.2d 235, 240 (Del. 2009) (quoting *Walt Disney*, 906 A.2d at 64-66 (alterations and ellipses omitted)).

The Court below thus erred by defining "bad faith" in a manner that was limited to the first category, "acting *against* Encore's interests," and failing to recognize that conduct within the third category – "intentional dereliction of duty, a conscious disregard for one's responsibilities" also constituted bad faith.

Even if fiduciary principles were disregarded, the same standard would apply to protect public unitholders' reasonable expectations. *See Kaiser Alum. Corp. v. Matheson*, 681 A.2d 392, 395 (Del. 1996) ("Where, as here, the ultimate purchaser of the securities is not a party to the drafting of the instrument which determines her rights, the reasonable expectations of the purchaser of the securities must be given effect.").

The explicit purpose of the Conflicts Committee was to provide an intra-entity mechanism for protecting unitholders in conflict transactions, and under the LPA, Special Approval by the Conflicts Committee served as a substitute for two alternative standards: the arm's length, open-market dealing embodied in "terms no less favorable to the Partnership than those generally being provided to or available from unrelated third parties," and the judicial determination of fairness reflected by the default standard of "fair and reasonable to the Partnership, taking into account the totality of the relationships between the parties involved . . . ." LPA § 7.9(a).

Given that the role of Special Approval by the Conflicts Committee was to substitute for an arm's length bargain or independent judicial determination of fairness, it would not have been an investor's reasonable expectation that the Conflicts Committee could discharge its responsibilities by consciously disregarding them and acting – as all evidence indicates the Conflicts Committee did here – as a rubber stamp that demanded only token price improvement in a situation where the median values of its own financial advisor's valuation analysis supported a far higher number and where its opening counteroffer represented a discount to the trading price fixed by the market.

Accordingly, the Court of Chancery erred by misdefining "bad faith" in a manner not supported by the terms of the LPA.

III. THE COURT OF CHANCERY ERRED BY HOLDING THAT THE CONFLICTS COMMITTEE ACTED IN GOOD FAITH IN LIGHT OF THE FACTS PLED

A. Question Presented

Did the Court of Chancery err by holding that the Conflicts Committee's undisputed failure to meaningfully bargain on behalf of Encore's public unitholders and its approval of the Merger at a significant discount to Encore's unaffected trading price was not sufficient to plead bad faith? A489-92.

B. Scope of Review

Dismissal of a claim pursuant to Court of Chancery Rule 12(b)(6) and the interpretation of contract language are reviewed *de novo*. *See* Point I.B above (at 16).

C. Merits of the Argument

1. The Conflicts Committee Had a Duty to Bargain in Good Faith on Behalf of Encore and Its Public Unitholders

The LPA's definition of "good faith" sets forth the state of mind with which the Conflicts Committee's members were required to act – "belie[f] that the determination or other action is in the best interests of the Partnership" – but it does not establish a standard of conduct against which to measure the Conflicts Committee's performance; it does not answer the question "what does an independent committee tasked with reviewing a conflict transaction in good faith actually do?" Stated differently, the LPA clearly imposes liability only if a director fails to act with the belief that his or her determination is in the best interests of the Partnership, but the conduct expected of a Conflicts Committee member, acting in good faith, is not addressed by the LPA. *See generally* Melvin A. Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437 (1993) (addressing the distinction between standards of conduct and standards of review).

What constitutes "good faith" conduct varies with context; "what is utterly unreasonable in one setting may be perfectly acceptable in another." *Policemen's Annuity & Benefit Fund of Chicago v. DV Realty Advisors LLC*, 2012 WL 3548206, at *13 (Del. Ch. Aug. 16, 2012).

Here, given the absence of any language in the LPA addressing this issue, the standard of conduct for the directors on the Conflicts Committee could be determined either through reference to the conduct of committees of independent directors developed in the corporate context, or through the development of a new contractual standard for limited partnership directors tasked with addressing conflict transactions.

As with the definition of "good faith" itself, discussed above in Point II (at 22), the absence of controlling language in the LPA and its adoption of default fiduciary standards "to the extent" consistent with the express terms of the LPA supports a determination that the traditional standard of conduct of directors should apply, albeit with liability attaching only if the directors act in bad faith.

Even in the absence of any reference to fiduciary duties, however, the obligations of the members of the Conflicts Committee would be similar. As a general principle, "one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities." *Tydings v. Loewenstein*, 505 A.2d 443, 445 (Del. 1986) (quoting RESTATEMENT (SECOND) OF TORTS § 299A (1965)). *See also Seiler v. Levitz Furniture Co. of E. Region, Inc.*, 367 A.2d 999, 1007-08 (Del. 1976) (architect bound to "use reasonable and ordinary care and diligence in the application of his professional knowledge to accomplish the purpose for which he is retained") (citation omitted).

Here, the task of the members of the Conflicts Committee was to address conflict transactions and, as discussed above, serve as a substitute for market mechanisms ("terms no less favorable to the Partnership than those generally being provided to or available from unrelated third parties") or a court's determination of what would be "fair and reasonable to the Partnership . . . ." LPA § 7.9(a).

Under these circumstances, the reasonable expectation of Encore unitholders would be that independent-minded businessmen would bargain at arm's length and seek in good faith to obtain financially advantageous terms for public unitholders, the same as they would do if bargaining for their own interests.

2. The Facts Pled Support the Inference that the Conflicts Committee Acted in Bad Faith

Measured by either a fiduciary or contractual standard, the Complaint amply pleads bad faith by showing that the Conflicts Committee failed to bargain with Vanguard in any meaningful way.

First, presented with an opening offer that reflected a merger premium of less than 1% and was – Vanguard acknowledges – opportunistically timed to exploit a decline in the trading ratio between Vanguard and Encore, (A446-447), the Conflicts Committee's decision to open with a counteroffer just 4% higher is indefensible on its face.

The surrounding circumstances make the Conflicts Committee's decision even more difficult to reconcile with its members' duty of good faith.

First, due to the intervening, *company-specific* run-down in Vanguard's unit price, the counteroffer valued each Encore unit, at the time it was made, at a *9.1% discount to the value of Vanguard's opening offer*. A450, 453.

Second, the counteroffer was far *below the median* of the fair value ranges implied by many of the Conflicts Committee's *own financial advisor's* valuation analyses. A439, 450.[4]

Third, the counteroffer was far below the *bottom* of the valuation range determined by *Vanguard's* advisor, RBC, using an analysis widely recognized in

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[4] In the Court below, Defendants asserted that good faith should be conclusively presumed under Section 7.10(b) of the LPA because Defendants relied on the fairness opinion by Jefferies. The fairness opinion explicitly stated, however, that Jefferies "did not participate in negotiations," did not provide advice concerning "the determination of the specific Exchange Ratio, or any other aspects of the Merger" and did not provide any other services "other than the delivery of this opinion." A449 (Complaint), quoting A435 (Proxy). Accordingly, the Conflicts Committee cannot justify its negotiating strategy on the basis of professional advice from Jefferies, and the Court of Chancery rightly held that "[f]or purposes of Defendants' motion to dismiss, I assume that Jefferies, in fact, did not advise the Conflicts Committee in any way other than by opining that the ultimate terms of the Merger were fair from a financial perspective to Encore and its unaffiliated unitholders." Op. at 9 n.18, 2012 WL 3792997, at *4 n.18.

the oil and gas industry, and was also below the valuation range resulting from reference to a second widely used industry metric, the "standardized measure." A451-52.

All of these facts sufficiently allege that the Conflicts Committee did not act in good faith in conducting negotiations with Vanguard.

Prior decisions of the Court of Chancery have recognized that the good faith of a Conflicts Committee is called into doubt by an inadequate bargaining process.

In *Brinckerhoff v. Texas E. Products Pipeline Co.*, 986 A.2d 370 (Del. Ch. 2010) ("*Teppco*"), on a motion to approve a settlement, the court considered the merits of a challenge to a limited partnership squeeze-out merger involving negotiations by an independent committee and a "Special Approval" provision similar to the one here. 986 A.2d at 389-90. The court found the plaintiff's claims challenging the merger sufficient to require factual development and a trial. *Id.* at 390.

In reaching this conclusion, the court questioned the adequacy of the independent committee's conduct in negotiating the sale of the limited partnership to its controller, taking into account pending derivative claims against the controller. *Id.* at 393-94. It observed:

> Most troubling to my mind, the record established that the special committee focused repeatedly on the Derivative Action, embraced the premise that the claims had significant value, but then approved a deal in reliance on a fairness analysis that afforded no value whatsoever to those very same claims. These and other factors left me to wonder about the good faith of the special committee and brought to mind Chancellor Allen's admonition, offered in a different context, that "due regard for the protective nature of the stockholders' class action [and to which I would add derivative actions as well], requires the court, in these cases, to be suspicious, to exercise such powers as it may possess to look imaginatively beneath the surface of events, which, in most instances, will itself be well-crafted and unobjectionable." *In re Fort Howard Corp. S'holders Litig.*, 1988 WL 83147, at *12 (Del. Ch. Aug. 8, 1988).

Id. at 374.

Although the negotiation process in *Teppco* involved a counteroffer and final deal at substantial premiums to the controller's opening offer and the unaffected market price of the partnership's units, the court still questioned the process, observing that "[i]n the context of a controlling shareholder, one might wonder about the illusion of resistance followed by the reality of submission." *Id.* at 393. While the court approved the settlement as fair and reasonable, it stated that it "continue[d] to have concerns" and that the question of whether the special committee had "used the Derivative Action as an effective negotiation tool to increase the Merger consideration and obtain a fair result" was "close." *Id.* at 395.

Here, the record reflects that there was no serious, arm's length negotiation process involving multiple offers and counteroffers. Rather, there was an opening counteroffer at a level that represented a token improvement on a percentage basis and a *discount* on dollar basis over an offer that provided a merger premium of less than 1%. Furthermore, as set out in detail in the Complaint, the Conflicts Committee's counteroffer was manifestly inadequate under well-established valuation measures, and was *not justified by its own advisor's analysis*. A450; 451-53. Unlike in *Teppco*, the Conflicts Committee did not even attempt to project the "illusion of resistance" but, from the first, all but submitted to Vanguard's initial, inadequate Offer.

IV. THE COURT OF CHANCERY ERRED BY HOLDING THAT SPECIAL APPROVAL ELIMINATED LIABILITY FOR BAD FAITH ACTS BY THE GENERAL PARTNER

A. Question Presented

Did the Court of Chancery err by holding that the Conflicts Committee's approval of the Merger eliminated Vanguard's liability for bad faith conduct, without any showing that the Conflicts Committee considered or evaluated such conduct? A484-86.

B. Scope of Review

Dismissal of a claim pursuant to Court of Chancery Rule 12(b)(6) and the interpretation of contract language are reviewed *de novo*. *See* Point I.B above (at 16).

C. Merits of the Argument

1. The Court of Chancery Erroneously Deemed Special Approval to Immunize Any Related Bad Faith Conduct, Whether or Not Known to or Evaluated by the Conflicts Committee

As the Court of Chancery recognized, Op. at 4-7, 24, 2012 WL 3792997, at *2-3, *9, the Complaint pleads with specificity that Vanguard took steps to drive down Encore's trading price in the period leading up to its initial purchase offer. A444-46. The Court of Chancery ruled, however, that any bad faith by Vanguard was immunized by the Conflicts Committee's Special Approval, holding that "[b]ecause all of the alleged wrongdoing is part and parcel of a singular conflict transaction allegedly in breach of the LPA . . . a determination that the Merger received contractually valid Special Approval would compel a finding that no Defendant breached the LPA." Op. at 24, 2012 WL 3792997, at *9.

By its plain language, Special Approval pursuant to Section 7.9 of the LPA resolves "a potential conflict of interest" and deems "the resolution or course of action in respect of such conflict of interest" to be "permitted and deemed approved by all Partners . . . ."

The Court of Chancery erred by broadly defining "a potential conflict of interest" to include bad faith acts that were not presented to the Conflicts Committee or even known by it. It could not have been the "reasonable expectation" of an investor in the Partnership, *Kaiser Aluminum*, 681 A.2d at 395, that Special Approval would immunize conduct of which the Conflicts Committee was not even aware. To the extent that the breadth of the phrase "potential conflict of interest" is ambiguous, it was error to narrow unitholders' rights by construing it to broadly apply to any conduct related to the specific conflict transaction at issue. *SI Management*, 707 A.2d at 43 (partnership agreement should be construed against its drafter).

2. The Facts Pled Support the Inference that Vanguard Acted in Bad Faith

As discussed above, "good faith," as defined by Section 7.9(b) of the LPA, is the "belie[f] that the determination or action is in the best interests of the Partnership." The Complaint pleads with specificity that Vanguard and its affiliated Encore directors took steps to drive down the price of Encore common units in the period leading up to the Offer in a manner that they could not have believed to be in the best interests of Encore and its unitholders.

First, prior to the announcement of the Acquisition Offer, Vanguard strongly implied that it did not have plans to buy Encore's publicly-held units. Defendant Smith stated in the January 3 Release: "We are excited about this acquisition and the prospect of managing a great set of assets for the long-term benefit of the Encore unitholders." A444. The January 3 Release contained no other new information of possible materiality to Encore investors, yet Encore's common units declined 7.2% for the week. A444. According to the Proxy, at the time of this statement, Vanguard was actively "study[ing] the potential effects" of an acquisition of Encore's publicly-held units. A446.

Thereafter, on February 22, 2011, Encore issued the February 22 Release. In the February 22 Release, the 4Q10 results reported exceeded analysts' expectations; however Encore's forward-looking statements under Vanguard's management were decidedly negative for investors. A444. First, Encore forecasted declining 2011 oil and gas production that was significantly below analyst expectations. A444-45. However, as later reported, the pessimistic forecast was inaccurate: actual production for the first three quarters of 2011 was comparable to or exceeded Encore's 2010 fourth quarter production and far exceeded the forecast made in the February 22 Release. A445.

Second, Encore announced that it intended in 2011 "to significantly increase capital expenditures" to a level far exceeding the level forecasted by

analysts. A445. As a result of Vanguard's decision to *more than triple* the Partnership's capital expenditures, Encore forecasted that it would distribute the lowest level of annual distributions since it began trading as a public company in late 2007. A445. The issuance of the February 22 Release caused Encore's units to decline in value by 5.4%. A445.

In the May 10 earnings call, Defendant Robert emphasized that the result of the sharp increase in capital expenditures in 2011 would be to provide "long-term value to unit holders" – Vanguard itself – at the expense of near-term cash flow distributions. A446.

Accordingly, the Complaint pleads with specificity that Vanguard and its affiliated Encore directors acted in bad faith and thereby breached the LPA by issuing damaging releases that were inaccurate and reflected value-depressive policies adopted by Vanguard in the months leading up to the Offer.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Chancery should be reversed.

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