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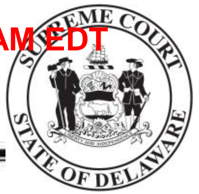

IN THE

Supreme Court of the State of Delaware

WILLIAM ALLEN,

Plaintiff Below-Appellant,

v.

EL PASO PIPELINE GP COMPANY, L.L.C., RONALD L. KUEHN, JR., JAMES C. YARDLEY, JOHN R. SULT, DOUGLAS L. FOSHEE, D. MARK LELAND, ARTHUR C. REICHSTETTER, WILLIAM A. SMITH, and EL PASO PIPELINE PARTNERS, L.P.,

Defendants Below-Appellees,

and

EL PASO PIPELINE PARTNERS, L.P.,

Nominal Defendant Below-Appellee.

No. 399, 2014

COURT BELOW:
COURT OF CHANCERY OF THE STATE OF DELAWARE
C.A. NO. 7520-VCL

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NATURE OF THE PROCEEDINGS

Plaintiff owns limited partner ("LP") units of El Paso Pipeline Partners, L.P. ("EPB" or the "Partnership"), a publicly-traded Delaware master limited partnership ("MLP"). He appeals the grant of summary judgment to Defendants in this unitholder class and derivative action, which challenges a conflict transaction in which EPB acquired assets from its parent and sponsor, El Paso Corp. ("El Paso" or "EPC") for $895 million (the "Drop Down").

As pled in Plaintiff's complaint (the "Complaint"), and later substantiated through expert testimony, the Drop Down had a negative net present value for Plaintiff and other LP unitholders of EPB of approximately $170 million, after taking into account the incentive distribution rights ("IDRs") held by EPB's general partner, El Paso Pipeline GP Co., L.L.C. ("EPB GP" or the "General Partner"). The members of the conflicts committee (the "Committee") tasked with reviewing the Drop Down concluded it was fair to the LP unitholders only by relying on a valuation analysis that ignored the financial impact of the IDRs.

The Committee members relied on a valuation analysis that did not consider the IDRs despite knowing that the IDRs had reached "high splits" just weeks before they approved the Drop Down, being aware that the IDRs had a major impact on deal economics, and understanding that the IDRs thus would have a direct impact on a discounted cash flow analysis for the transaction. The

Committee members also knew that the benefit to parent companies such as El Paso from IDRs is reflected in a lower purchase price (Points E & H).

While the Committee members testified that they placed primary reliance in reviewing the Drop Down on a discounted cash flow analysis, they nonetheless approved the Drop Down based on a discounted cash flow analysis that its members knew did not account for the impact of the IDRs. They also did not attempt to bargain for a better deal from El Paso based on the benefit it would be obtaining on account of the IDRs – a benefit that El Paso's own management emphasized in internal documents discussing the value of the Drop Down to El Paso (Point F).

Instead, the Committee members testified that they believed the Drop Down was a good deal for EPB's LP unitholders because it was cash flow accretive (Point J). As a matter of basic finance, however, cash flow accretion does not provide a basis for concluding that a transaction is value-creating, it is never used to support a conclusion as to fairness, and it was not relied on by the Committee's advisor, Tudor, Pickering, Holt & Co. ("Tudor"), in performing its valuation analysis here. The chair of the Committee was a career investment banker, who himself had issued numerous fairness opinions, and Defendants' after-the-fact claim to have relied on a metric that is recognized not to measure value is not credible.

In sum, these facts do not reflect a subjective belief on the part of the Committee, as required under the First Amended and Restated Agreement of Limited Partnership of El Paso Pipeline Partners, L.P., dated Nov. 21, 2007 ("LPA"), that the Drop Down was in the best interests of EPB and its unaffiliated LP unitholders; rather, they reflect a subjective intent to do El Paso's bidding.

The implied covenant of good faith and fair dealing was likewise violated. As this Court recently held in reviewing the similarly flawed fairness opinions and accommodationist committee approval in *Gerber v. Enterprise Products Holdings, LLC*, 67 A.3d 400 (Del. 2013), no investor would reasonably expect that a conflict transaction would be approved in reliance on a fairness opinion "that did not value the consideration that the LP unitholders actually received." *Id.* at 422.

In granting summary judgment, the Court of Chancery erred, *first*, by holding that the Committee was not obligated to take into account the IDRs at all, because its only task was to evaluate fairness at the enterprise level, and it was not required to determine whether the Drop Down was in the best interests of the LP unitholders. This holding is inconsistent with this Court's holding in *Gerber*, the text of the LPA, the longstanding meaning given to the phrase in Delaware law, Defendants' stated understanding of their own duties, then-Chancellor Strine's interpretation of the language at the motion to dismiss stage, and the analysis that Defendants publicly represented that they had performed.

Second, the Court of Chancery erred in finding that the LP unitholders benefitted from the Drop Down and that the Committee provided Special Approval in good faith. In reaching this conclusion, the Court of Chancery apparently concluded that cash flow accretion constituted a sufficient "benefit" even if the transaction was value-destructive, and the Court of Chancery also credited defense assertions not supported in the record concerning the Committee's consideration of the IDRs.

Third, the Court of Chancery erred by holding that Defendants' use of the Special Approval process provided in the LPA precluded review of the merits of Tudor's fairness opinion under the implied covenant of good faith and fair dealing. *Gerber* held exactly the opposite.

Finally, the Court of Chancery further erred in holding that the LPA creates a "purely contractual relationship" for which aiding and abetting claims are unavailable. As this Court previously held in *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 166 (Del. 2002), Delaware law allows claims for aiding and abetting breach of a general partner's "contractual fiduciary duties."

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

SUMMARY OF ARGUMENT

1. The Court of Chancery erred in holding that the Committee was not obligated to determine whether the Drop Down was in the best interests of the LP unitholders.

2. The Court of Chancery erred in holding that the LP unitholders benefitted from the Drop Down and that the Committee provided Special Approval in good faith.

3. The Court of Chancery erred in holding that Defendants' use of "Special Approval" precluded review of the merits of Tudor's fairness opinion under the implied covenant of good faith and fair dealing.

4. The Court of Chancery erred in holding that the LPA creates a "purely contractual relationship" and that aiding and abetting claims are therefore unavailable.

5. The Court of Chancery erred by resolving conflicts, weighing evidence, deciding upon competing inferences and making factual findings in favor of Defendants.

STATEMENT OF FACTS

A. The Parties

Plaintiff is and was an owner of EPB LP units. A000415-18. EPB is a Delaware MLP. A001380. Defendant EPB GP is the general partner of the Partnership and owned all of the Partnership's IDRs. A001373. EPB GP was indirectly wholly-owned by El Paso. *Id.* EPB has no employees, and was managed at the time of the Drop Down by the directors and officers of EPB GP. A000429.

Individual defendants Douglas L. Foshee, Ronald L. Kuehn, Jr. ("Kuehn"), David Mark Leland ("Leland"), Arthur C. Reichstetter ("Reichstetter"), William A. Smith ("Smith"), John Raymond Sult and James C. Yardley were all members of EPB GP's Board of Directors (the "Board"). A001373-74. For purposes of reviewing conflict transactions between El Paso and EPB, the LPA permits EPB GP to constitute a conflicts committee comprised of the independent members of the Board. For the Drop Down, as with the prior drop down transactions undertaken by EPB, the Committee was comprised of Messrs. Kuehn, Smith and Reichstetter. A000036.

B. Summary of the Drop Down

Southern Natural Gas Company ("SNG") is a natural gas pipeline and storage company. A001375. Through the Drop Down, EPB acquired an

incremental 25% interest in SNG, increasing its ownership from 60% to 85%. A001375.[1] The total purchase price was $895 million, consisting of $667 million in cash and the assumption of $228 million of SNG's existing debt. A000977.

C. Description of the IDRs

In addition to its 2% general partner interest, EPB GP holds IDRs that entitle it to an increasing share of EPB's quarterly cash distributions as they exceed certain minimum and target distribution levels, as follows (A001376):

	Total Quarterly Distribution per Unit Target Amount	Marginal Percentage Interest in Distribution	
		Unitholders	General Partner
Minimum Quarterly Distribution	$0.2875	98%	2%
First Target Distribution	above $0.2875 up to $0.33063	98%	2%
Second Target Distribution	above $0.33063 up to $0.35938	85%	15%
Third Target Distribution	above $0.35938 up to $0.43125	75%	25%
Thereafter	above $0.43125	50%	50%

D. The IDRs Reached "High Splits" Immediately Before the Drop Down, Entitling the General Partner to Nearly 30% of the Cash Flow from the Drop Down

On February 15, 2011, one week after El Paso proposed the Drop Down to the Committee, EPB's distributions crossed the threshold into the highest tier of the IDRs – referred to as "high splits" – in which 50% of any increases in distributions were to be paid to EPB GP. A001095; A0001399. The Committee

[1] The Drop Down was structured as the purchase of a 22% interest in SNG, together with an option to purchase an additional 3% interest, which EPB GP exercised. A00173.

and Tudor were aware that the IDRs had reached high splits prior to the Drop Down. A000267 at 54:23-55:4; A000197-8 at 169:20-170:11.

As a result of the IDRs reaching high splits, EPB GP was forecasted to receive between 26% and 30% of the additional distributable cash flow resulting from the Drop Down. A001294; A000450.

E. The Negative Impact of IDRs in "High Splits" on MLP Economics Has Been Widely Recognized in the Industry, Prompting Numerous Restructuring Transactions and Deal-Specific Concessions by IDR Holders

While IDRs provide a strong incentive for MLP general partners to grow cash distributions, the diversion of a large fraction of incremental cash flow to the general partner after reaching high splits has a major disadvantage – it significantly impairs the economics of transactions for the LP unitholders.

IDRs' adverse impact on the economics of acquisitions by MLPs – expressed as a higher cost of capital – has been widely recognized in the industry. As one commentator explained:

> Recall that for every dollar that such an MLP distributes to its common unitholders, it must distribute one dollar to its general partner, and so the contemplated acquisition or growth project must generate twice as much cash as the MLP hopes to distribute to its common unitholders. The bottom line is that, in order to make the economics work, an MLP that is in the high splits simply cannot afford to pay as much for a new asset as an MLP that is not because the former's cost of capital is simply too high.

Philip H. Peacock, *Master Limited Partnerships: At the Crossroads?*, 4 TEX. J. OIL, GAS & ENERGY L. 397, 405-06 (2009). Numerous other industry sources recognize the same fact,[2] as did the Court of Chancery below. Op. at 2.

Scott Simmons ("Simmons"), Tudor's 30(b)(6) witness, agreed that high split IDRs effectively require a doubling of the bottom line cash flow in any drop down to deliver the same return to limited partner units. A000185 at 118:23-119:15. Reichstetter, the Committee chair, acknowledged the same. A000275 at 87:5-89:17; 91:23-25.

MLPs with IDRs frequently cite the adverse impact IDRs have on their cost of capital and resulting ability to compete for acquisitions. Two of the six EPB peers identified by Tudor cited these factors in moving to eliminate their IDRs prior to the Drop Down. A001179; A001714; A001728-29. For the same reasons, many other MLPs engaged in capping or elimination of IDRs.[3] The adverse impact of IDRs has also been addressed in individual transactions through both the voluntary reduction of IDR payments and concessionary asset pricing. In transactions with third parties, concessions take the form of voluntary IDR

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[2] *E.g.*, John Goodgame, *Master Limited Partnership Governance*, 60 BUS. LAW. 471, 504 (2005); A001663.

[3] *See* A001324-25 (discussing 14 MLPs that engaged in transactions to eliminate or cap their IDRs prior to the Drop Down).

reductions by the general partner.[4] In related-party transactions, such as the Drop Down, general partner economic concessions are implemented through a lower purchase price. Tudor and two Committee members corroborated this in their depositions. A000194 at 155:1-156:8; A000120 at 155:18-20; A000051 at 129:6-8.

F. El Paso's Internal Analysis of the Drop Down and a Later Tudor Analysis Recognized the IDRs' Financial Impact

El Paso prepared an internal analysis for the Drop Down, dated January 31, 2011, that explicitly recognized the benefit of IDR payments to it (through EPB GP) and the corresponding detriment to EPB's LP unitholders. A0001394; A001407. Taking into account the IDRs, the EBITDA multiple from the Drop Down to El Paso, 11.1x, was substantially higher, *i.e.*, less favorable to LP unitholders, than the EBITDA multiple for the overall transaction used by Tudor in its financial analyses, 9.2x, and was substantially in excess of the 8x-10x precedent transactions range identified by El Paso. *Id.*

El Paso management emphasized the benefit from the IDRs in their accompanying "white paper" to the El Paso board, explaining that: "We are

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4 A001158 (listing seven transactions); A001847-48 (IDR reduction in connection with PAA Natural Gas Storage transaction); A001863 (agreement to forego all incentive distributions in 2010 and 2011 in connection with joint venture).

cognizant that the financial benefit of this drop to El Paso is higher than the nameplate multiple on this deal." A001399.

Several months after the Drop Down, in September 2011, Tudor performed a similar analysis, and calculated an "effective multiple" to El Paso of 12.1x. A001435.d. This "effective multiple" far exceeds both the precedent transactions range of 8x–10x cited by El Paso management (A001394; A001407) and the forward TV/EBITDA multiples from *all but one* of the 24 precedent transactions identified by Tudor in its fairness opinion presentation to the Committee for the Drop Down. A001180.

G. Tudor's Valuation Analysis – Including the Discounted Cash Flow Analysis on Which the Committee Principally Relied – Wholly Ignored the Financial Impact of the IDRs

While the fact that IDRs have a major impact on the economics of an acquisition is self-evident and is widely recognized in the MLP industry, Tudor's discounted cash flow analysis – on which the Committee members principally relied – *entirely ignored it.* Tudor's representative, Simmons, directly admitted this, testifying without qualification that "IDRs are not adjusted for in the discounted cash flow analysis . . .." A000185 at 120:15-19.

Each Committee member testified that Tudor's discounted cash flow analysis was for them the most relevant and important valuation analysis of the

Drop Down. A000260 at 28:5-8; A000265 at 49:14-21; A000280 at 109:6-8; A000280 at 140:13-14; A000097 at 62:17-63:2; A000026 at 29:1-4.[5]

Ultimately, Simmons directly acknowledged that Tudor never determined whether the Drop Down was value-creating for EPB's LP unitholders. A000206-7 at 205:22-206:2.

H. The Committee Members Knew that Tudor's Valuation Analyses Did Not Account for the IDRs, But Relied on Them Anyway

The Committee members knew that EPB's IDRs had reached "high splits" before they approved the Drop Down, A000267 at 54:23-55:4; A000036 at 69:8-15, understood that the IDRs impaired the economics of the Drop Down to EPB's LP unitholders, A000267 at 203:3-204:16; A000047 at 110:23-111:18; A000111 at 118:10-119:5, and specifically testified that they understood that IDRs impact a discounted cash flow analysis. A000276 at 91:3-25; A000111 at 119:22-120:2, 121:12-17. The Committee nonetheless approved the Drop Down in reliance on what they knew was a flawed valuation analysis.

Smith acknowledged that he knew the discounted cash flow and other valuation analyses performed by Tudor did not reflect the effect of the IDRs. A000104-5 at 92:2-6, 94:4-14. The Committee Chair, Reichstetter, was less

[5] With respect to comparable companies and transactions, Simmons testified that IDRs were "not directly adjusted for" and that the only effect given to IDRs was "implicit" as a result of the comparable companies or buyers in certain instances also having IDRs. A000185 at 120:2-11.

candid, claiming that he believed Tudor's cost of capital calculation took the IDRs into account. A000276 at 91:3-21.[6] There is substantial evidence contradicting Reichstetter's assertion. *First*, it is not credible that Smith was aware of the true facts but Reichstetter – who led the communications with Tudor and was the primary conduit for financial information to the Committee – was not.[7] *Second*, Reichstetter's claim is undermined by his earlier insistent denials that the IDRs were a relevant consideration for a discounted cash flow analysis – until confronted with industry documents making this position untenable.[8] *Third*, Reichstetter's claim is further undermined by the fact that the cost of capital range used by Tudor was unchanged from the rate used nine months earlier, well before EPB had entered "high splits." *Compare* A001496 (June 2010 Tudor board book,

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[6] Reichstetter acknowledged he never actually was provided a supporting analysis from Tudor that accounted for the IDRs. A000304 at 205:4-19.

[7] *See* A000026 at 29:16-22; A000027 at 31:8-10; A000031 at 49:10-16; A000036 at 68:6-9; A000039 at 80:17-20; A000117 at 143:19-144:2, 144:24-145:15; A000174 at 74:10-18.

[8] *Compare* A000268 at 61:12-18 ("Q. Mr. Reichstetter, were the IDRs taken into account in the discounted cash flow analysis that was performed for the March 2011 drop? A. I don't know how to answer that question because it is not a financial question based on reality as to how valuations are done. It is not a concept in the -- in analysis.") *and* A000274 at 83:2-11 ("Q. And the financial obligation associated with the IDRs, does that show up anywhere in the DCF? A. No. As I have told you before, it is -- it -- to me, it is not a financial concept of discounting IDRs. I have never heard -- except for you, a perfectly learned guy, I guess, asking the question -- I have never thought about it, never had anyone ask, never heard anyone refer to it. And there's some pretty smart guys practicing in this area."), *with* A000275 at 88:22-89:1 (addressing the Copano Form 8-K and stating "[i]t is a fact among all companies that MLPs -- it is the majority of them, by the way -- who have IDR programs that are disclosed when they first go out and secure contractual obligation is you go further up in the splits, the cost of equity increases").

showing 8% to 12% discount rate range) *with* A001178 (Tudor board book for the Drop Down, showing the same range).

I. Tudor's Fairness Opinion Disclaimed Any Opinion on the Ultimate Financial Impact of the Drop Down on EPB's LP Unitholders

Tudor's fairness opinion disclaimed any opinion on the ultimate financial impact of the Drop Down on the LP unitholders, stating that "we express no view or opinion with respect to the amount or level of ownership dilution to the current holders of Common Units as a result of the [Drop Down]." A001188. Simmons testified that the language meant what it said. A000204-05 at 197:24-198:8. The Court of Chancery agreed, finding, for purposes of summary judgment, that "Tudor's fairness opinion did not take the possibility of excessive dilution into account." Op. at 34.

While the language disclaiming ownership dilution had been added to Tudor's form opinion letter only months earlier, in the letter for EPB's November 19, 2010 drop down transaction, A000203 at 190:20-191:6, neither Simmons nor the Committee members could recall discussing the new language. A000205 at 199:10-20; A000291 at 151:21-152:2; A000045 at 105:6-8; A000109 at 113:19-22. However, Reichstetter testified that they paid close attention to the language in Tudor's fairness opinions – "[y]ou sat there and listened to it word by word" A000293 at 159:12-15 – and he testified that all language changes were reviewed by the Committee's counsel. *Id.* at 159:16-160:16.

J. The Committee Members Justify Their Approval of the Drop Down on the Ground that It Was Cash Flow Accretive – a Position that Violates Well-Recognized Economic Principles and Valuation Practice

In the proceedings below, the Committee asserted that they adequately considered the impact of the IDRs by looking at cash flow accretion, which reflected a modest increase in distributions per unit. *The good faith of Defendants asserted (after-the-fact) reliance on a metric that is widely recognized not to establish financial fairness, combined with their reliance on a valuation analysis that they knew was deeply flawed, presents, at the least, a triable issue of fact.*

First, deeming a transaction "fair" because it is cash flow accretive is unprecedented; in a recent survey of the methodologies used in 352 public company fairness opinions, there is no reference to accretion being recognized as a valid consideration.[9] As Simmons acknowledged, "I would not describe this as a valuation analysis." A000185 at 121:1-7. There is a good reason that no credible fairness opinion relies on an accretion/dilution analysis. As Professor Damodaran and other valuation experts have explained, accretion or dilution results from relative PE multiples and the form of financing; it does not analyze an asset's net present value. A001877-78; A001881.

[9] *See* Gilbert E. Matthews, *Valuation Methods in Fairness Opinions: An Empirical Study of Cash Transactions*, 31 BUS. VALUATION REV. 55 (2012).

It is simply not credible that Reichstetter – a career energy sector investment banker who had authored or reviewed numerous fairness opinions in the course of his career and for decades advised on M&A transactions,[10] and on whom the other Committee members relied for his financial acumen,[11] genuinely believed that the mere fact the Drop Down was cash flow accretive to the LP unitholders made it financially beneficial to them.

Second, consistent with Simmons' testimony, Tudor's board book did not itself present cash flow accretion as a measure of value. Rather, it was included in a separate section at the end of the presentation, titled "Pro Forma Impact." A001182-84.

Third, the Committee stated members' reliance on cash flow accretion[12] – assuming those statements are credited – does not excuse their reliance on what they knew was a flawed valuation analysis.

K. The Valuation Analysis Prepared by Plaintiff's Expert Establishes That the Drop Down Was Value Destructive After Giving Effect to the IDRs

Plaintiff's expert, Matthew Morris, calculated the economic impact of the Drop Down on the LP unitholders by performing a discounted cash flow analysis

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[10] *See* A000291 at 152:19-153:6; A000258 at 19:20-20:22.

[11] *See* A000026 at 29:16-22; A000027 at 31:8-10; A000031 at 49:10-16; A000036 at 68:6-9; A000039 at 80:17-20; A000117 at 143:19-144:2, 144:24-145:15; A000174 at 74:10-18.

[12] *See* A000260 at 28:5-8; A000265 at 49:14-21; A000280 at 109:6-8; A000288 at 140:13-14; A000097 at 62:17-63:2; A000104 at 90:24-91:12; A000026 at 29:1-4.

that adopted and utilized Tudor's inputs and then deducted the value of the incremental cash flows payable to EPB GP on account of the IDRs. A001199-1207. Based on the *pro forma* numbers used by Tudor, Mr. Morris calculated the financial impact of the Drop Down to LP unitholders as a range of negative $92 to negative $228 million. A001191-92. Using actual, finalized deal numbers, Mr. Morris calculated the negative financial impact of the Drop Down to LP unitholders as in a range of negative $82 to negative $216 million. A001289.

L. Relevant LPA Provisions

The EPB LPA is very similar to other MLP partnership agreements that have come before this Court, and substantially identical, in relevant part, to the limited partnership agreement before the Court in *Gerber*. A001885-86. In fact, both in *Gerber* and here: (i) Section 7.9(a) directly addressed conflict of interest transactions and provided four safe harbors, one of which was "Special Approval" by a committee of independent directors (67 A.3d at 410; A001885-86); (ii) Section 7.9(b) defined "good faith" as a "belie[f] that the determination or other action is in the best interests of the Partnership" (67 A.3d at 410; A001885); and (iii) Section 7.10(b) of the partnership agreement provided a conclusive presumption of good faith for reliance on financial advisor fairness opinions (67 A.3d at 410-11; A001886).

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN HOLDING THAT THE COMMITTEE DID NOT NEED TO DETERMINE WHETHER THE DROP DOWN WAS IN THE BEST INTERESTS OF THE LP UNITHOLDERS

A. Question Presented

Did the Court of Chancery err in holding that the Committee was not obligated to determine whether the Drop Down was in the best interests of the LP unitholders? *See* A001350 (question presented below).

B. Scope of Review

The ruling below is reviewed by this Court *de novo*. *See Dabaldo v. URS Energy & Constr.*, 85 A.3d 73, 77 (Del. 2014).

C. Merits of the Argument

The Court of Chancery held that because the LPA's good faith standard refers to "the best interests of the Partnership," the LPA "does not require the Committee to make a determination regarding the best interests of the limited partners as a class." Op. at 16. The effect of the Court of Chancery's ruling was to place the central issue in the case – the differential economics of the Drop Down for the EPB GP and the LP unitholders – outside the ambit of the Committee's review. On this basis, the Court of Chancery concluded that Defendants were entitled to summary judgment on Plaintiff's express claim, holding that "[t]he evidence does not support a reasonable inference that the Committee did not

subjectively believe that the Drop-Down was in the best interests of El Paso MLP." *Id.* at 21.

The Court of Chancery's holding is inconsistent with *Gerber*, the LPA, the longstanding meaning given to the phrase in Delaware law, Defendants' stated understanding of their own duties, then-Chancellor Strine's interpretation of the language at the motion to dismiss stage, and the scope of review that Defendants publicly represented they had undertaken.

First, the Court of Chancery's interpretation is inconsistent with *Gerber's* holding that unitholders "could hardly have anticipated that [the general partner] would rely upon a fairness opinion that did not fulfill its basic function – evaluating the consideration *the LP unitholders received* for purposes of opining whether the transaction was financially fair." 67 A.3d at 422 (emphasis added). Later, *Gerber* reiterated that unitholders "could not have anticipated that [the general partner] would rely upon a fairness opinion that failed to evaluate the consideration the LP unitholders received when concluding that the 2009 Sale was fair. Nor could [plaintiff] have anticipated that the ACG Committee would grant Special Approval based on their reliance on such a flawed opinion." *Id.* at 424.

Second, Section 7.9(a) of the LPA expressly contemplates that it will apply "whenever a potential conflict of interest exists or arises between the General Partner or any of its Affiliates, on the one hand, and the Partnership, any Group

Member, *any Partner* or any Assignee, on the other . . .." A001061-62 (emphasis added). It thus expressly contemplates that it will address conflicts between partners, and not only between the General Partner or its affiliates and the Partnership as a whole. *Id.* IDRs create well-recognized conflicts between general partners and limited partners, as Tudor itself explained in an analyst report, among other sources. A001447; *see also* A000604. Given the overt purpose of Special Approval was to address conflicts with the General Partner, an interpretation that entitles the Committee to simply ignore conflicts that arise from IDRs is at odds with the very purpose of this LPA provision.

Third, Delaware courts regularly use the phrase "best interests of the corporation" to define directors' duties, *e.g.*, *Gantler v. Stephens*, 965 A.2d 695, 713 n.54 (Del. 2009); *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006), and have recognized the "best interests" standard as imposing a duty to proceed with due regard for the competing interests of different classes of equity holders. *E.g.*, *In re Tele-Commc'ns, Inc. S'holder Litig.*, 2005 Del. Ch. LEXIS 206, at *27-*30 (Del. Ch. Dec. 21, 2005) (conflict between Class A and Class B stockholders); *In re FLS Holdings, Inc. S'holder Litig.*, 1993 Del. Ch. LEXIS 57, at *2-*3 (Del. Ch. Apr. 2, 1993) (conflict between preferred and common stockholders). Here, the Court of Chancery offered no reason to construe the same phrase as entitling the Committee to disregard the interests "of the limited partners as a class." Op. at 16.

Fourth, the Committee members understood their duty as acting for the benefit of the unaffiliated LP unitholders. Reichstetter stated that the Committee's "role is to ensure . . . that we do our level best to represent the unitholders that are not affiliated with El Paso." A000265 at 47:7-10. Kuehn described the Committee's duty as "to ensure that the deal is fair to the public unitholders." A000027 at 32:24-33:9. Smith explained that "[t]he purpose of the conflicts committee is to make sure that the unaffiliated unitholders got a good deal." A000115 at 136:20-21. Simmons agreed. A000166 at 44:20-45:1.

Consistent with these statements, the Committee resolved in granting Special Approval that the Drop Down was "fair and reasonable to the Partnership and to holders of common units of the Partnership other than the General Partner and its affiliates[.]" A001153 (emphasis added). Tudor's retention letter likewise stated that its task was to opine on the financial fairness of the Drop Down solely from the viewpoint of the unaffiliated LP unitholders. A001110. Its fairness opinion later opined as to the fairness "from a financial point of view, to the holders of Common Units of the Partnership, other than [EPB GP] and its affiliates." Ex. A001189, at 4.

Fifth, in denying Defendants' motions to dismiss, then-Chancellor Strine pointedly questioned whether the Committee could properly disregard the interests of the LP unitholders (A001545-46):

MR. RALSTON: Well, the -- well, I guess I would just step back and say they looked at this at the enterprise level. They looked --

THE COURT: I understand that, but that wasn't their job.

MR. RALSTON: I guess maybe that's where we disagree. I think that --

THE COURT: Then why did they give -- they gave a fairness opinion to the holders of common units other than the GP; right?

Finally, EPB repeatedly publicly represented to the LP unitholders that the Special Approval mechanism would evaluate drop down transactions from the standpoint of *their* best interests. EPB made these representations in multiple Form 10-K filings prior to the Drop Down, *see* A000772; A000933, and in a public disclosure immediately following to the Drop Down. A001875 (disclosing as a condition to closing that Tudor must have opined that the deals are "fair to the Partnership's public unitholders from a financial point of view"). Accordingly, even if the LPA were read not to impose a duty on the Committee to directly consider the interests of the LP unitholders, Defendants voluntarily assumed that duty. *See In re Cencom Cable Income Partners, L.P. Litig.*, 1997 Del. Ch. LEXIS 146, at *19 (Del. Ch. Oct. 15, 1997) (summary judgment denied where general partner "voluntarily assumed a duty to ensure that [the law firm] would fulfill these obligations and that the Limited Partners could rely on the General Partner's representations that [the law firm] would do so").

In reaching its contrary conclusion, the Court of Chancery relied on *Sonet v. Timber Co.*, 722 A.2d 319 (Del. Ch. 1998). Op. at 15. *Sonet*'s statement that "there is no *requirement* that the General Partner consider the interests of the limited partners in resolution of a conflict of interest" *id.* at 325, however, was addressing a grant of broad discretion to the general partner in circumstances that did not involve a conflict of interest, and the Court of Chancery specifically held that the conflict of interest section – the equivalent of Section 7.9(a) of the LPA here – did not apply to the transaction at issue in *Sonet*. *See id.* at 325 & n.15.

In sum, the LPA required that the Committee believe subjectively that the Drop Down was in the best interests of the unaffiliated LP unitholders, and the Court of Chancery thus applied the incorrect legal standard in concluding that Defendants were entitled to summary judgment on the issue of bad faith.

II. THE COURT OF CHANCERY ERRED IN HOLDING THAT LP UNITHOLDERS BENEFITTED FROM THE DROP DOWN AND THAT THE COMMITTEE ACTED IN GOOD FAITH

A. Question Presented

Did the Court of Chancery err in finding that the LP unitholders benefitted from the Drop Down and that the Committee provided Special Approval in good faith? A001349-53 (question presented below).

B. Scope of Review

The ruling below is reviewed *de novo*. *See* Point I.B above.

C. Merits of the Argument

In reaching its conclusion that Defendants were entitled to summary judgment on Plaintiff's express contract claim, the Court of Chancery prominently relied on its finding that:

> [Plaintiff's] argument is not that the Drop–Down did not benefit the limited partners, because they now concede that the distributions received by the holders of common units did increase. Rather, the plaintiffs argue that the Drop–Down did not benefit the limited partners enough relative to what the General Partner received.

Op. at 20. The Court of Chancery later again noted that "the plaintiffs . . . recognized that the Drop–Down conferred some benefit on the limited partners (albeit, say the plaintiffs, not enough)." *Id.* at 21.

In fact, Plaintiff's central contention has steadily been that the Drop Down was value-destructive to LP unitholders, despite being modestly cash-flow accretive. The complaint noted the "modest incremental cash flow accretion to the

common units" but explained that the cash flow analysis "fails to recognize the actual economic effect of the Drop Down on the value of the Partnership's common units" and a discounted cash flow analysis that "valued the cash flows to the common unitholders, net of the cash payments made to the General Partner on account of the IDRs" indicated a "negative net present value to the Partnership's common unitholders of approximately $169 million using the midpoints of the terminal multiple and discount rate ranges adopted by Tudor." A001379-80. At the motion to dismiss argument, Defendants repeatedly cited cash flow accretion (*see* A001536; A001538-39; A001551; A001553; A001555) and the Court of Chancery, then-Chancellor Strine, in response correctly focused throughout the argument on net present value:

> But don't they allege that the transaction was, in fact, negative to limited partners? A001537
>
> * * *
>
> How can I, on a pleading standard, not find that there's a pleading-stage inference of bad faith if a special committee, charged with representing the limited partners, approves the transaction at a price level that's negative -- has a negative net present value to the interests that they're representing? A001542-43
>
> * * *
>
> We're talking about it's net -- you're not really supposed to do negative net present value transactions. A001543
>
> * * *

> I have to put together the reason the bank didn't give that is the other fact that the plaintiffs plead, which is that the fact this was at a net negative present value for the partners because of the distributional split. A001550
>
> * * *
>
> The plaintiffs then plead an additional fact about why that might be so, which is that the -- that the effect of this transaction was a -- was negative to the limited partners in economic reality and that -- I think the plaintiff's point is people buy things in -- for economic reality. They don't buy abstractions. (Continuing) -- and that this transaction was, on a net present value basis, negative to the limited partners

A001576. Plaintiff then presented the same point in his summary judgment brief, supported by expert analysis. A001346-47. Vice Chancellor Laster, however, disregarded Plaintiff's discounted cash flow analysis, and it is unclear whether the Court's reference to a "benefit" to LP unitholders reflected a view that cash flow accretion was a valid basis for evaluating the drop down, or simply that the existence of *some* form of benefit entitled the Defendants to summary judgment under the "best interests of the Partnership" standard that it applied.

In any event, there is a substantial basis for concluding that Defendants were aware they were not acting with subjective good faith in the LP unitholders' best interests when they approved the Drop Down. Specifically, the Committee approved the Drop Down in reliance on what they knew to be a deficient valuation analysis that did not account for the impact of the IDRs. This inadequate analysis served as the basis for a flawed fairness opinion – a fairness opinion meant to evaluate the financial fairness of the Drop Down only to the unaffiliated LP

unitholders – that expressly disclaimed any opinion on the ultimate economic impact of the Drop Down on the LP unitholders. Adjusted for the impact of the IDRs, the Drop Down was significantly value-destructive to the LP unitholders. Left with nothing else to rely upon, the Committee pointed to a financial metric that their own financial advisor conceded was an unacceptable valuation tool.

Taken together, and viewing the facts in the light most favorable to Plaintiff (*see Merrill v. Crothall-Am., Inc.*, 606 A.2d 96, 99 (Del. 1992)), this evidence is sufficient to establish that the Committee believed it was acting against the LP unitholders' best interest in approving the Drop Down, or that the Committee consciously disregarded its duty to form a subjective belief that the Drop Down was in the LP unitholders' best interest. *See Allen v. Encore Energy Partners, L.P.*, 72 A.3d 93, 106 (Del. 2013).

In reaching its conclusion that the Committee acted in good faith, the Court of Chancery also erred by crediting defense assertions not supported in the record. Specifically, the Court of Chancery held that "[t]he members of the Committee asked questions about the IDRs and transactions involving MLPs in the high splits, and Tudor investigated the issues raised by the Committee and provided answers." Op. at 21. In fact, on the central issue in the case – whether "high splits" warranted a discounted purchase price – the Committee members asked the question, but could not remember if they got an answer at all. Specifically,

Reichstetter's February 23, 2011 email asked Tudor if there was "a discernable decrease in multiples paid by *drop down MLPs to their sponsors* as the sponsors get into progressively higher splits[.]" A001155; A001154 (emphasis added). Reichstetter and Simmons both testified that they could not remember whether or how Tudor responded to this critical question, A000305 at 208:2-11; A000195 at 159:9-160:11, and there is no evidence that the Committee ever received an answer.

Taken together, the Committee's knowing reliance on a fundamentally deficient valuation analysis, a flawed fairness opinion, and a financial metric (cash flow accretion) that cannot establish financial fairness, presents, at the least, a triable issue of fact concerning whether the Committee subjectively believed it was acting in good faith when approving the value-destructive Drop Down. Summary judgment on Plaintiff's express contract claim should be reversed.

III. THE COURT OF CHANCERY'S HOLDING THAT USE OF "SPECIAL APPROVAL" PRECLUDED IMPLIED COVENANT CLAIMS BASED ON A DEFECTIVE FAIRNESS OPINION CONFLICTS DIRECTLY WITH THIS COURT'S HOLDING IN *GERBER V. ENTERPRISE PRODUCTS HOLDINGS, LLC*

A. Questions Presented

Did the Court of Chancery err in holding that Defendants' use of "Special Approval" precluded review of the merits of Tudor's fairness opinion under the implied covenant of good faith and fair dealing? A001353-56.

B. Scope of Review

The ruling below is reviewed *de novo*. *See* Point I.B above.

C. Merits of the Argument

The Court of Chancery held that Defendants' use of the "Special Approval" process set forth in Section 7.9(a) of the LPA precluded any implied covenant claim based on Tudor's defective fairness opinion because the role of the implied covenant is to "fill gaps in the express provisions of a specific agreement" and "Section 7.9(a) is controlling, leaving no fairness-opinion-related gap to fill." Op. at 28, 38.

Addressing this Court's decision in *Gerber*, 67 A.3d 400, the Court of Chancery explained that "[a]s I read *Gerber,* that decision turned on the Conclusive Presumption Provision and its gaps. Although the LP Agreement contains a section identical to the Conclusive Presumption Provision, this decision does not rely on it. This decision instead rests on the terms for Special Approval."

Op. at 37. The Court below acknowledged that "[t]his is, of course, the interpretation of one trial judge, and it may not accurately reflect the Delaware Supreme Court's view of *Gerber*." *Id.* at 37.

In fact, the Court of Chancery's holding that Special Approval precludes implied covenant claims based on a defective fairness opinion is fundamentally incompatible with *Gerber* and the LPA. *Gerber* involved a public unitholder's challenge to two conflict transactions involving a Delaware MLP, Enterprise GP Holdings, L.P. ("EPE"), and affiliates of its general partner. There, as here, the partnership agreement contained a Special Approval provision. *See* 67 A.3d at 410; A001885. There, as here, the Special Approval process was invoked by the general partner, the independent committee retained a financial advisor, and obtained fairness opinions with respect to each of the transactions at issue. *See id.* at 410-13. There, as here, a unitholder challenged the transactions as financially unfair to him, and pled that the fairness opinions rendered were based on fundamentally flawed analyses. *See id.*

The Court of Chancery in *Gerber* dismissed all claims, holding, *first*, that valid Special Approval had been obtained under Section 7.9(a), and *second*, that the general partner was entitled to a conclusive presumption of good faith under Section 7.10(b). *See id.* at 413-14. As this Court explained, Sections 7.9(a) and, 7.10(b) of the partnership agreement "created two separate layers of protection

designed to insulate the Defendants from judicial review of whether the general partner or its 'Affiliates' had satisfied their contractual duty." *Id.* at 410.

Addressing these allegations, this Court upheld dismissal of the express contract claims, finding compliance with the express terms of Sections 7.9(a) and 7.10(b), *see id.* at 423, but reversed on the implied covenant claim. *See id.* at 423-25. It first addressed the application of the implied covenant to Section 7.10(b)'s conclusive presumption, and as the Court of Chancery noted, *see* Op. at 26-32, held that the basic flaws in the fairness opinions violated the implied covenant as applied to that section. *See* 67 A.3d at 421-23.

Having found a violation of the implied covenant under Section 7.10(b), however, this Court next turned to Special Approval under Section 7.9(a), explaining that:

> Although Gerber has pled that Enterprise Products GP breached the implied covenant, that does not end the analysis. If Enterprise Products GP independently satisfied the contractual Special Approval safe harbor in Section 7.9(a), then by Section 7.9(a)'s plain language, the general partner did not breach the LPA. Therefore the Court must address this second layer of contractual insulation, and determine whether the Complaint cognizably alleges that Enterprise Products GP violated the implied covenant in its effort to comply with Section 7.9(a).

67 A.3d at 423.

This Court explained that the Special Approval "safe harbor, however, is limited. The selection and carrying out of the Special Approval process must

satisfy both the express overarching contractual duty in Section 7.9(b) to act in good faith and the duty under the implied covenant." *Id.* Echoing its earlier implied covenant analysis under Section 7.10(b), the Court then proceeded to rule that the general partner had breached the implied covenant under Section 7.9(a) by proceeding with the transactions based on fairness opinions that were fundamentally flawed. *See id.* at 424-25. *The Court of Chancery simply ignored this portion of the Court's opinion, which directly refutes its holding that Special Approval precludes implied covenant claims based on a defective fairness opinion.*

The Court of Chancery's analysis diverges from this Court's in its definition of the type of gap the implied covenant serves to fill. In the Opinion below, the Court concluded that the LPA's demonstrated interest in "minimizing the potential for litigation" would "lead to the conclusion that if the issue had been raised in a hypothetical original bargaining position, the parties would not have agreed" to allow judicial review of the merits of a fairness opinion on which the Committee chose to rely. Op. at 39.

In *Gerber*, by contrast, this Court underscored the "command of DRULPA § 1101(d)," which "explicitly prohibits any partnership agreement provision that eliminates the implied covenant." 67 A.3d at 419 n.48. As this Court held in *Gerber*, a holding that excludes the implied covenant "would lead to nonsensical results," such as allowing approval based on a fairness opinion where "the

controller has intentionally concealed material information" or "bribes the financial advisor to opine (falsely) that the transaction is fair" or the advisor "compromises its professional valuation standards to achieve the controller's unfair objective." *Id.* at 420-21.

Here, the Court of Chancery suggested that the alternative to its implied covenant bar is that "a limited partner states a viable implied covenant claim whenever a Committee obtains and relies on a fairness opinion that does not consider all elements of the consideration from the standpoint of the limited partners . . ." Op. at 33. Under *Gerber*, however, the implied covenant is not so broad. Rather, applying the implied covenant is a "cautious enterprise" that applies only when a limited partner can show that the general partner "acted arbitrarily or unreasonably, thereby frustrating the fruits of the bargain that [Gerber] reasonably expected." *Id.* at 421 (quoting *Nemec v. Shrader*, 991 A.2d 1120, 1126 (Del. 2010)).

Turning to the question of whether Plaintiff has shown a violation of the implied covenant here, the flaws in the fairness opinions in *Gerber* are instructive. With respect to one of the two transactions challenged there, the investment banker opined as to the fairness of the transaction at issue in combination with a second transaction and, similar to Tudor's carve out here, "explicitly disclaimed to opine as to the fairness of any specific component of the total consideration." 67 A.3d at

422. As the Court stated, using language equally applicable to the opinion in the present matter:

> That requires us to decide whether an implied covenant claim is stated where the defendant allegedly has attempted to satisfy its contractual obligations by relying on a fairness opinion that did not value the consideration that the LP unitholders actually received.
>
> We answer that question in the affirmative.

Id.

With respect to the second transaction challenged in *Gerber*, a merger of the partnership, the financial advisor simply ignored a principal element of value – certain legal claims belonging to the Partnership. *See id.* This Court observed that the plaintiff "could not fairly be charged with having anticipated that [the general partner] would merge EPE for the purpose of eliminating EPE's derivative claims, but then rely on a fairness opinion that did not even consider those claims' value." *Id.* at 423.

Here, EPB GP likewise acted unreasonably by relying on Special Approval that was based on a fairness opinion that ignored the economic effect of the IDRs in valuing the assets acquired and carved out the ultimate dilutive effect of the transaction, *while at the same time recognizing the IDRs' positive impact on value when analyzing the benefit of the transaction from the standpoint of El Paso*. *See* Point F above.

IV. THE COURT OF CHANCERY ERRED IN HOLDING THAT THE LPA CREATES A "PURELY CONTRACTUAL RELATIONSHIP" AND THAT AIDING AND ABETTING CLAIMS ARE THEREFORE UNAVAILABLE

A. Question Presented

Did the Court of Chancery err in dismissing Plaintiff's aiding and abetting claims? A001353-56 (question presented below).

B. Scope of Review

The ruling below is reviewed *de novo*. *See* Point I.B above.

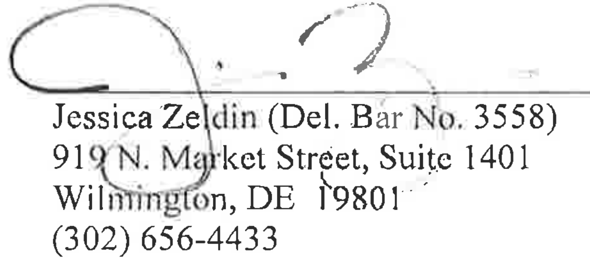
C. Merits of the Argument

This Court's ruling in *Gotham Partners,* 817 A.2d 160, approved claims for "aiding and abetting the General Partner's breach of fiduciary duties created by the Partnership Agreement." Distinguishing *Gotham Partners*, the Opinion drew a distinction between the "contractual fiduciary duties" the Court held were at issue there, and the "purely contractual" duties at issue here. Op. at 45. Other decisions, however, have not drawn this distinction. Then-Chancellor Strine explained:

> What *Gotham Partners* said is in that situation of substituted contractual duties, we're going to continue to allow plaintiffs to bring aiding and abetting claims. So *Gotham* says that.

A001642; *see also Gerber*, 67 A.3d at 412, 418-23 (referring to "contractual duties"). Here, as in *Gotham Partners*, aiding and abetting claims may properly be asserted, and the Court of Chancery erred by dismissing them.

ROSENTHAL, MONHAIT &
GODDESS, P.A.



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CERTIFICATE OF SERVICE

I, Jessica Zeldin, do hereby certify that on the 24th day of September, 2014, I caused to be served a true and correct copy of the PUBLIC VERSION of APPELLANT'S OPENING BRIEF on the following counsel in the following manner:

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