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. 339, 2014

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

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CASES

PRELIMINARY STATEMENT[1]

Defendants' arguments in favor of affirmance sidestep Plaintiff's arguments. As set forth in his Opening Brief ("Op. Br."), Plaintiff's express duty claim is premised on the Committee approving a transaction that was significantly value-destructive to the LP unitholders, in reliance on a discounted cash flow analysis that its members knew ignored the IDRs and in spite of widespread industry discussion of IDRs' detrimental impact on an MLP's cost of capital and ability to make acquisitions. *See* Op. Br. at 8-13, 24-28.

Plaintiff's implied duty claim is likewise premised on EPB GP's reliance on "Special Approval" that was based on a fairness opinion it knew was defective – as shown by its own internal valuation analysis, which emphasized the benefit to El Paso from the IDRs. *See* Op. Br. at 10-11, 34, A1394, A1399.

Each of these points is well-established in the record, and none is seriously disputed by Defendants. Instead, they erroneously assert that Plaintiff "concedes" that the Drop Down "conferred a benefit on the common unitholders," and that he merely grieves that "the benefit conferred upon the common unitholders was not sufficiently accretive." Appellees' Answering Brief ("Ans. Br.") at 1. In fact, as the Opening Brief clearly states (at 15-17), the record shows that the Drop Down

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[1] Capitalized terms not defined herein have the respective meanings ascribed in Appellant's Opening Brief, filed September 12, 2014.

was value-destructive, and no credible source treats "cash flow accretion" as a basis to measure value.

Defendants also repeatedly claim that Plaintiff merely objects to the Committee's failure to adopt his valuation methodology. Ans. Br. at 2, 23-24. Plaintiff does not challenge methodology; he objects to using a valuation approach that entirely ignored a prominent valuation issue that is well-recognized in the industry and that El Paso itself recognized in evaluating the benefit of the Drop Down from its own perspective.

Defendants assert that the Committee adequately considered the IDRs, citing its members' awareness that the IDRs had crossed into "high splits" shortly before the Drop Down and their requests for information related to IDRs. Ans. Br. at 9-10. Defendants ignore, however, that the Committee failed to actually consider the impact of IDRs on value, and further ignore the crucial fact noted in the Opening Brief (at 27-28) – that on the central issue of whether "high splits" IDRs warranted a reduced purchase price, the Committee members asked the question, but could not remember if they got any answer at all.

These facts raise a genuine question as to both the Committee's subjective good faith and the General Partner's compliance with the implied covenant of good faith and fair dealing. The Court of Chancery's grant of summary judgment should therefore be reversed.

ARGUMENT

I. THE CONFLICTS COMMITTEE WAS REQUIRED TO DETERMINE WHETHER THE DROP DOWN WAS IN THE BEST INTERESTS OF LP UNITHOLDERS

Plaintiff's Opening Brief identified six reasons that the Committee was required to determine whether the Drop Down was in the best interests of the LP unitholders. Op. Br. at 19-23. Defendants' arguments do not sufficiently rebut any of them.

First, Plaintiff cited *Gerber v. Enterprise Products Holdings, LLC*, 67 A.3d 400 (Del. 2013), which described a fairness opinion's "basic function" as "evaluating the consideration *the LP unitholders received*" under a limited partnership agreement that included the same "best interests of the Partnership" standard at issue here. *Id.* at 410, 422 (emphasis added). Op. Br. at 19. Defendants try to distinguish *Gerber* on the grounds that the particular fairness opinion defects there and here differ. (Ans. Br. at 15-16). But Defendants' analysis of *Gerber* misses the point. Both cases, in fact, involved an error in defining the financial interests to be valued by the respective advisors. Defendants cannot refute that.

Second, Plaintiff explained that the relevant provision of the LPA, Section 7.9(a) (A1161-62), specifically contemplates conflicts between the General Partner and "any Partner," and an interpretation that ignores conflicts at the partner level

therefore conflicts with the express purpose of the LPA. Op. Br. at 19-20. Defendants contend that Plaintiff's approach would cause the "best interests of the Partnership" to differ "depending on the nature of the potential conflict at issue" and they then suggest that this is somehow improper. Ans. Br. at 14-15. Defendants' contention is nothing more than their opinion. It does not reflect the reality that it is entirely appropriate that a conflict resolution provision be applied with due regard for the nature of the conflict under review.

Third, Plaintiff cited the meaning given to the "best interests of the corporation" standard in Delaware law, as supporting an approach that gives due regard to the competing interests of different classes of limited partnership equityholders. Op. Br. at 20. Defendants' arguments – that Plaintiff improperly relies on caselaw interpreting the phrase "best interests of the corporation" (Ans. Br. at 16-17 & n.7) – ignore the key point: that in adjudicating conflicts *among* equityholders, directors are required to proceed with due regard for all, rather than disregarding how a transaction would differently affect each constituency, as the Court of Chancery's enterprise-level analysis contemplates.

Fourth, Plaintiff cited the unequivocal statements by the Committee members that their duty was to act for the benefit of the unaffiliated LP unitholders. Op. Br. at 21. Defendants evade the issue, and cannot seriously dispute that the Committee members themselves recognized that their duty was to

protect the LP unitholders. *See* Ans. Br. at 17-18. Defendants also ignore the indisputable statements contained in the Committee's resolution to grant Special Approval to the Drop Down (A1153), Tudor's retention letter (A1110), and Tudor's fairness opinion (A1189), that the Drop Down was being evaluated solely from the viewpoint of the unaffiliated LP unitholders. Op. Br. at 21.

Fifth, Plaintiff cited then-Chancellor Strine's observation during the motion to dismiss argument that in light of the Committee's function – protecting LP unitholder interests – analysis at the enterprise level "wasn't their job." Op. Br. at 21-22. Defendants dismiss these observations as merely "a line of questions during colloquy." Ans. Br. at 20. They do not dispute, however, that they accurately describe the Court's analysis at the motion to dismiss hearing.

Sixth, Plaintiff cited EPB's public statements that approval of the Drop Down was premised on fairness "to the Partnership's public unitholders." Op. Br. at 22-23. Defendants contend that this argument was not sufficiently raised below (Ans. Br. at 18), but Plaintiff in fact did argue below that "even if the LPA were read not to impose this duty, Defendants voluntarily assumed it," citing *Cencom Cable Income Partners, L.P. Litig.*, 1997 Del. Ch. LEXIS 146, at *19 (Del. Ch. Oct. 15, 1997). *See* A1350 n.157. The argument was not further briefed because Defendants all but conceded the entire issue, arguing the "best interests of the Partnership" point in passing in a footnote. A392 n.151. Defendants also argue

that *Cencom* is limited by *Sonet v. Timber Co.*, 722 A.2d 319 (Del. Ch. 1998), to cases where unitholder action is required. Ans. Br. at 19-20. But *Sonet* did not impose this requirement, and instead focused on reliance. *Sonet*, 722 A.2d at 327. The LP unitholders were therefore entitled to rely on Defendants' public statements, even without a specific vote.

As this Court ruled in *Gerber*, and as the Committee itself recognized, the purpose of a conflicts committee is to protect the interests of LP unitholders. The Court of Chancery's ruling – that partner-level conflicts between the General Partner and the LP unitholders are outside the ambit of the Committee's review – conflicts with this basic purpose of such committees. As such, the Court of Chancery applied the incorrect legal standard by failing to find that the LPA required that the Committee believe subjectively that the Drop Down was in the best interests of the unaffiliated LP unitholders.

II. THE RECORD ESTABLISHES THAT LP UNITHOLDERS WERE HARMED BY THE DROP DOWN AND PRESENTS GENUINE ISSUES OF MATERIAL FACT AS TO THE CONFLICTS COMMITTEE'S GOOD FAITH

In opposing summary judgment below, Plaintiff submitted an expert report showing that the Drop Down had a negative net present value, after accounting for the IDRs, of negative $82 to negative $216 million. A1289. Defendants respond by arguing that "Plaintiff's argument boils down to a contention that the Committee's advisor (Tudor) should have employed" Plaintiff's methodology. Ans. Br. at 23.

Instructively, however, *Defendants do not contend that any alternative valuation analysis that incorporates the IDRs would show a positive net present value to the LP unitholders*. Rather, their criticism of Plaintiff's methodology seeks to mask the fact that Tudor did not account for the IDRs *at all* in its valuation analysis. What Defendants seek to characterize as a mere dispute over methodology in fact concerns the fundamental issue of whether Tudor and the Committee acted in good faith by using an approach that simply ignored the effect of the IDRs.

By referring to Plaintiff's expert's approach as a "novel valuation analysis" (*id.*), Defendants seek to cast consideration of the IDRs in a discounted cash flow analysis as outside accepted practice. But as the industry materials cited at length in Plaintiff's Opening Brief show (at 10-11), IDRs have a well-recognized impact

on cost of capital -- a basic component of a discounted cash flow analysis. Reflecting the industry approach, El Paso recognized the positive impact of the IDRs to itself in its own analysis of the Drop Down. A1394, A1399.

In lieu of squarely addressing the failure by Tudor and the Committee to account for IDRs in the valuation of the Drop Down, Defendants repeatedly cite the "pro forma" slide in Tudor's analysis, which reflects some cash flow accretion to the LP units. Ans. Br. at 10, 25; A1162, A1184, B33. As Plaintiff explained at length in the Opening Brief (at 15), however, there is simply no precedent for using cash flow accretion as a proxy for value, and doing so violates basic finance principles. Instructively, Defendants make *no* attempt to rebut this point, they simply ignore it.

Defendants also seek to obscure the Committee's failure to consider the impact of the IDRs by citing the Committee members' conclusory assertions that if they believed the Drop Down was harmful to the LP unitholders it "would not have been approved" (Ans. Br. at 25), and that each "believed the Transaction was in the best interests of both EPB and its unaffiliated unitholders." *Id.* at 27.

In his Opening Brief, Plaintiff showed that the Committee members (1) were aware of the widely recognized fact that IDRs impair the economics of asset acquisitions for LP unitholders (Op. Br. at 8-9), (2) knew that IDRs result in concessionary pricing in related-party drop down transactions (*id.* at 9-10),

(3) understood that a discounted cash flow analysis should accordingly reflect the impact of the IDRs (*id.* at 12-13), and (4) knew that Tudor's analysis did not (*id.*), but (5) relied on it anyway. *Id.*

Defendants do not and cannot contest any of these points, and none of the deposition testimony on which Defendants rely actually contradicts any of them. *See* Ans. Br. at 25-27 (citing A261 (Reichstetter 31:2-16); A32 (Kuehn 50:15-18); A104, A108, A120 (Smith 90:4-14, 106:8-25, 155:12-14); A276 (Reichstetter 91:3-91:25); A182, A189 (Simmons 106:4-5, 106:18-19, 172:13-16); A111-12 (Smith 119:22-121:24, 123:5-124:3)).

In sum, the Committee's failure to account for the IDRs – a basic component of EPB's capital structure – in valuing the Drop Down raises a genuine issue as to its members' good faith, and the Court of Chancery erred by holding otherwise. Summary judgment on Plaintiff's express contract claim should be reversed.

III. THE IMPLIED COVENANT BARS EPB'S GENERAL PARTNER FROM RELYING ON "SPECIAL APPROVAL" THAT WAS PREMISED ON A FAIRNESS OPINION IT KNEW WAS DEFECTIVE

In the Opening Brief (Point III, at 29-34), Plaintiff showed that under *Gerber*, a general partner breaches the implied covenant of good faith and fair dealing if it relies on Special Approval that is premised on what the general partner knows to be a defective fairness opinion.

In response, Defendants sidestep the issue, arguing that Section 7.9(a) "does not require reliance on a fairness opinion to support Special Approval," and that the implied covenant "cannot be applied to require the Committee's use of a judicially proscribed [sic] fairness opinion in connection with the Special Approval process." Ans. Br. at 4, 30, 33. This argument misses the point. Plaintiff does not contend that the Committee was required to obtain a fairness opinion, or that any opinion should take a particular form. Rather, Plaintiff argues that, as this Court held in *Gerber*, if a conflicts committee elects to obtain and rely on a fairness opinion, a general partner cannot rely on Special Approval to insulate the transaction from review where it knows that the fairness opinion is fundamentally defective.

Even if the Committee and Tudor managed, in subjective good faith, to overlook what the entire industry recognizes – that IDRs siphoning off more than 25% of the cash flow of an asset impair its value to the LP unitholders – there is no

question that the management of EPB GP knew better, because EPB GP's management (members of El Paso's senior management) emphasized the corresponding benefit from the IDRs to El Paso when presenting the Drop Down to El Paso's board. Their analysis shows an above-market EBITDA multiple to El Paso (11.1x vs. precedent transactions in the range of "8x – 10x"), based explicitly on "Cash Flows Back to EP," principally from the IDRs. *See* A1394. They further explained to the El Paso board that:

> We are cognizant that the financial benefit of this drop to El Paso is higher than the nameplate multiple on this deal. Due to El Paso's continued significant ownership interest in EPB, El Paso participates in EPB's accretion through its existing limited partner units *and also through its incentive distribution rights. Therefore the net impact to El Paso of the contribution is closer to an 11.1x multiple.*

A1399 (emphasis added).

As the Court held was true of the plaintiff in *Gerber*, Plaintiff here "could hardly have anticipated that [EPB] GP 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." *Gerber*, 67 A.3d at 422.

Defendants attempt to distinguish *Gerber* by repeating the Court of Chancery's argument – that *Gerber* was concerned only with the section of the partnership agreement providing a conclusive presumption for a general partner's

reliance on an expert opinion. Ans. Br. at 31-33; Op. at 32-33. Plaintiff addressed that argument at length in his Opening Brief (at 31-32), but Defendants, instructively, entirely ignore Plaintiff's discussion. As Plaintiff explained, *Gerber* expressly *did* address Special Approval – as it had to in order to defeat the general partner's reliance on Special Approval and find that the plaintiff had stated an implied covenant claim. Op. Br. at 30-32; *Gerber*, 67 A.3d at 423-25.

Gerber stands for the modest proposition that a general partner does not act in good faith when it relies on Special Approval that it knows was procured with a fundamentally flawed analysis. That is true of EPB GP here, and summary judgment for EPB GP on Plaintiff's implied claim should therefore be reversed.

IV. DELAWARE LAW RECOGNIZES AIDING AND ABETTING CLAIMS BASED ON BREACH OF SUBSTITUTE CONTRACTUAL DUTIES ESTABLISHED BY A PARTNERSHIP AGREEMENT

Defendants argue that Plaintiff's aiding and abetting claims should be dismissed because – based on their understanding of the Court of Chancery's holding – the LPA here involves a "purely contractual standard" that is distinguishable from the "contractually established 'fiduciary duty' of entire fairness" at issue in *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 172-73 (Del. 2002). *See* Ans. Br. at 34. Defendants fail to address, however, then-Chancellor Strine's analysis in *Brinckerhoff v. El Paso Pipeline GP Co.*, No. 7141-CS, a case against the Defendants here, and that case explicitly contradicts their position. *See* Op. Br. at 35; A1642. *Gotham* itself further undermines the distinction. While the decision described the duties at issue as "contractual fiduciary duties," the operative contractual language there did not use the term "fiduciary," and was in fact very similar to the operative language in the LPA here. *See Gotham*, 817 A.2d at 166 nn.8-9 (quoting the relevant partnership agreement provisions).

Accordingly, the Court of Chancery erred by dismissing Plaintiff's aiding and abetting claims on the grounds that a party cannot aid and abet the breach of a limited partnership agreement under Delaware law.

CONCLUSION

For all of the foregoing reasons, and for the reasons set forth in Plaintiff's Opening Brief, the judgment of the Court of Chancery should be reversed.

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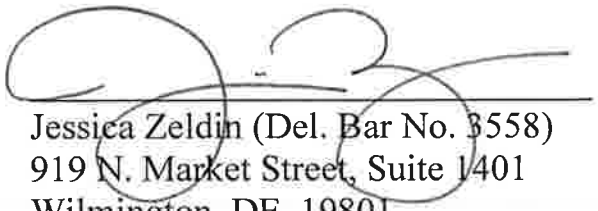

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November 19, 2014

CERTIFICATE OF SERVICE

I, Jessica Zeldin, do hereby certify that on the 19th day of November, 2014, I caused to be served a true and correct copy of the APPELLANT'S REPLY BRIEF on the following counsel in the following manner:

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