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IN THE SUPREME COURT OF THE STATE OF DELAWARE

THE HAYNES FAMILY TRUST and WILLIAM BRYCE ARENDT, Plaintiffs-Below/Appellants, v. KINDER MORGAN G.P., INC., TED A. GARDNER, GARY L. HULTQUIST, and PERRY M. WAUGHTAL, Defendants-Below/Appellees.	)	No. 515, 2015 Court Below: Court of Chancery of the State of Delaware The Honorable J. Travis Laster Cons. C.A. No. 10093-VCL

APPELLANTS' REPLY BRIEF

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TABLE OF CONTENTS

Page No.

TABLE OF AUTHORITIES

PRELIMINARY STATEMENT[1]

Defendants' argument rests on two key false premises: (i) the Conflicts Committee could immunize itself and the General Partner from liability by doing nothing more than raising their hands and invoking the magic words "Special Approval" and (ii) Defendants could solicit votes on the basis that they determined the MLP Merger to be fair and reasonable to the limited partners, where such a determination could not have been made in good faith.

Both premises fail. Having assumed a duty to determine fairness to the limited partners in connection with their Special Approval vote, Defendants were required by both the (non-waivable) implied covenant of good faith and fair dealing and the terms of the contract to do so in good faith (or, at least, in the absence of bad faith). They failed to do so. As the Court of Chancery correctly found, the Complaint sufficiently alleged that the Conflicts Committee approved the terms of the MLP Merger "*to accommodate Parent, rather than because they believed they were in the best interests of the limited partners*." Thus, the trial court's decision should be reversed.

[1] Capitalized terms have the same meaning as those used in Appellants' Opening Brief ("POB").

ARGUMENT

I. THE VOTE OF THE CONFLICTS COMMITTEE DOES NOT IMMUNIZE DEFENDANTS' WRONGFUL ACTIONS

Defendants argue that superficial adherence to the procedural terms of the Partnership Agreement precludes liability for "*any* claim, 'stated or implied' in law or equity.'" Appellees' Answering Brief ("DAB") at 12. More specifically, Defendants assert that the Partnership Agreement replaced all common-law duties with contractual provisions; the General Partner followed the Special Approval process as provided for in the Partnership Agreement; the Special Approval process did not require the Conflicts Committee to act in the best interests of the limited partners; and thus, the Conflicts Committee's "exercise" of its discretion to "consider the interests" of the limited partners and subsequent "disclosure" of that exercise does not give rise to any duty or concomitant liability. DAB at 10-13. But the Conflicts Committee's rote invocation of the Special Approval process does not defeat Plaintiffs' claim for at least two reasons.

First, Defendants themselves acknowledge that the invocation of the Special Approval process does not eliminate claims under "the implied covenant of good faith and fair dealing, which cannot be waived under the statute, [or] fraud." DAB at 12 n.3. That is precisely what Plaintiffs allege here. In contrast to Defendants' tendentious misreading of Plaintiffs' argument, Plaintiffs do not complain that Defendants "exercised their discretion" to consider the interests of the limited

partners, or that they "disclosed" their determination regarding those interests. *See* DAB at 4, 11. Rather, Plaintiffs allege that the Conflicts Committee and General Partner went far beyond simply considering the limited partners' interest by affirmatively representing and warranting that, "each [had] determined" that "the [MLP] Merger is fair and reasonable to, and in the best interests of, the [limited partners]." A77-A78, ¶¶ 113,115; A632; A643; A742. As the Court of Chancery found, "[i]t is reasonably conceivable, based on the facts alleged, that the members of the Committee approved the terms of the MLP Merger to accommodate Parent, rather than because they believed they were in the best interests of the limited partners." POB, Ex. A at 16; *see also id.* at 15-16 ("If the applicable standard required that the members of the Committee determine that the MLP Merger was in the best interests of the limited partners, ***then the Complaint's allegations would support a pleading-stage inference that that the members of the Committee did not act in good faith***.") (emphasis added).

In other words, this is a question of bad faith and/or deception—a breach of, *inter alia*, the implied covenant of good faith and fair dealing that the Special Approval process cannot immunize.

Defendants argue that they cannot be held to their promise under an implied-covenant analysis because Plaintiffs have not identified a "gap" in the contract. DAB at 22-23 (citing *Nemec v. Shrader*, 991 A.2d 1120, 1127 (Del. 2010)). But

that is precisely the argument that this Court rejected in *Gerber*. There—echoing Defendants' argument here—the Court of Chancery held "that under *Nemec*, the implied covenant is merely a 'gap filler' that by its nature must always give way to, and be trumped by, an 'express' contractual right that covers the same subject matter." *Gerber v. Enter. Prods. Holdings, LLC*, 67 A.3d 400, 419 n.48 (Del. 2013), *overruled in part on other grounds, Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808 (Del. 2013). This Court reversed, finding the lower court's reasoning to be "fatal[ly] infirm[]" because the DRULPA "explicitly prohibits any partnership agreement provision that eliminates the implied covenant" and "[i]t creates no exceptions for contractual eliminations that are 'express.'" *Id. Gerber* stated that *Nemec* was not intended and should not be "read as, an open-ended invitation to scriveners of partnership agreements to 'fill the gap' by employing 'express' contractual provisions that manifestly contravene Section 1101(d) of the DRULPA." *Id.*

In a conclusory footnote, Defendants attempt to distinguish *Gerber* on the grounds that "*Gerber* was about a general partner taking action that had 'the effect of preventing the other party to the contract from receiving the fruits of its bargain'" and "[h]ere, the General Partner did not deprive the limited partners of the benefit of their bargain." DAB at 23 n.14. Yet, Defendants fail to offer any response to Plaintiffs' argument that the General Partner *did* deprive the limited

partners of the benefit of their bargain. As set forth in the Opening Brief, because the Partnership Agreement contained a waiver of fiduciary duties, the limited partners' primary source of protection from an unfair transaction was the ballot box. Given the importance of the vote, the parties would, undoubtedly, have agreed *ex ante* that if the General Partner sought to influence the vote by voluntarily undertaking to ensure that a conflicted merger was fair to the limited partners, then the General Partner should be held to its word. POB at 22-23; *see also id.* at 24 ("The limited partners were entitled to expect that the General Partner and the Conflicts Committee would not undermine the protection of the ballot box and would not solicit votes on the basis that they had made a determination that the MLP Merger was in the best interests of and fair and reasonable to the limited partners, unless they had actually, and in good faith, done so.").

The second reason why the Special Approval vote does not defeat Plaintiffs' claim is the last sentence of Section 6.9(a) of the Partnership Agreement. That sentence provides that, in order for their actions not to "constitute a breach" of the Partnership Agreement, "or a breach of any standard of care … under the Delaware Act or any other law, rule or regulation," the "resolution, action or terms so made, taken, or provided by the General Partner," must occur "[i]n the absence of bad faith." A76, ¶ 111; A201-A202 (Partnership Agreement § 6.9(a)). This is consistent with the overarching duty to act in good faith found in § 6.10(d) of the

Partnership Agreement.[2] *See* A737-A740 (Plaintiffs' Ans. Br. in Opp. To Motion to Dismiss at 23-26). Here, Defendants imported a determination of fairness to the limited partners into the Special Approval process. A77, ¶ 113. Having done so, the Defendants were required to make that determination in good faith.

In sum, neither the implied covenant of good faith nor the Partnership Agreement itself permit the General Partner or Conflicts Committee to elect to consider the limited partners' interests, make a bad faith determination of those interests, solicit votes on the basis of that bad-faith determination, and then immunize that determination by a rote invocation of Special Approval.

[2] *Gerber*, 67 A.3d at 423 ("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.").

II. BY ELECTING TO CONSIDER AND DETERMINE THE LIMITED PARTNERS' BEST INTERESTS, DEFENDANTS BOUND THEMSELVES TO MAKING THE DETERMINATION IN GOOD FAITH

A. *Cencom* Is Not Merely a Disclosure Case

Plaintiffs' allegations here are similar to those that were found sufficient to defeat summary judgment in *Cencom*. Defendants try to distinguish *Cencom* by arguing that *Cencom II* implicated only a duty of disclosure. DAB at 14, 16. Defendants further assert that subsequent *Cencom* opinions and other decisions citing *Cencom* support this reading. Defendants are incorrect. Nothing in *Cencom II*, or its progeny, supports Defendants' argument that *Cencom II* implicates only a duty of disclosure.

Rather, *Cencom II*, *III* and *IV* recognize that a general partner can voluntarily assume duties beyond those required in a partnership agreement. In *Cencom II*, the Court of Chancery found that by retaining outside legal counsel, Husch & Eppenberger ("Husch"), and making representations in a disclosure statement about Husch's role, "the General Partner voluntarily assumed a duty to ensure that Husch would fulfill [those] obligations and that the Limited Partners could rely on the General Partner's representations that Husch would do so." 1997 WL 666970, at *5; *accord id.* at *4 (describing allegation that "the General Partner . . . breached th[at] voluntarily-assumed duty by failing to ensure that Husch undertook the duties described in the Disclosure Statement"). Similarly, here, by

electing to consider the interests of the limited partners and representing that the MLP Merger was fair and reasonable and in their best interests, Defendants had a duty to ensure that their representation was true.

At the summary judgment stage, the Court of Chancery found that "[t]he state of the record precludes any conclusion other than that a genuine issue of material fact exists about whether Husch *fulfilled its duties* outlined in the Disclosure Statement." *Id.* at 6 (emphasis added). That plain language demonstrates that the *Cencom II* court was concerned not only about disclosure, but also about the General Partner's compliance with the assurances made to the limited partners.[3] *See* Martin I. Lubaroff & Paul M. Altman, *Lubaroff & Altman on Delaware Limited Partnerships* § 11.2.6.1, at 11-23 (2015 Supplement) (writing that in *Cencom II*, "the Court found that the complaint could be read to assert a

[3] The cases Defendants cite as purportedly analyzing *Cencom II* do not limit *Cencom II* to a duty of candor claim. *See* DAB 16-17 & nn. 6 & 7. Defendants cite *Cencom III* through *V*, none of which supports the position that *Cencom II* is only a duty of disclosure case, for the reasons described herein. Aside from their citation to the lower court's opinion here, Defendants also cite to *Sonet v. Timber Co., L.P.*, 722 A.2d 319 (Del. Ch. 1998). For the reasons discussed in Plaintiffs' Opening Brief (at 25-26), *Sonet* is distinguishable. Moreover, the *Sonet* court's analysis is consistent with Plaintiffs' reading of *Cencom*. *Sonet* described *Cencom II* as a refusal "to dismiss claims that the general partner had breached a 'voluntarily assumed' fiduciary duty that was not originally imposed in the partnership agreement" when it retained a law firm to act as independent counsel for the limited partners. 722 A.2d at 326. Having been decided in 1998, *Sonet* did not benefit from the *Cencom* court's discussion of its own holding in *Cencom III – V*, and the plain language of those cases demonstrates that the claim in *Cencom* was not only one of disclosure.

claim that the defendants had voluntarily assumed such a duty outside of their obligations under the partnership agreement, and denied summary judgment on that ground").[4]

Cencom III provides further support. There, the Court of Chancery described *Cencom II* and then once again concluded that "whether Husch fulfilled its duties outlined in the Disclosure Statement" was a triable issue. *Cencom III*, 2000 WL 640676, at *2. Moreover, the *Cencom* plaintiffs argued that "defendants breached their fiduciary duty of loyalty by failing to assure that both the appraisal process and the Sale Transaction would be *fair* to the Limited Partners." *Id.* at *3 (emphasis in original). Or, stated alternatively, plaintiffs argued that the general partner voluntarily assumed a duty by engaging Husch to make a fairness determination and breached that duty by not holding Husch to that determination. The court did not hold that this was *only* a disclosure claim, but instead required a trial on the merits (*Cencom V*) to resolve that argument.

Cencom IV is also instructive. There, citing *Cencom III*, the Court of Chancery described the proper inquiry as "whether Husch only assumed the limited duty described under the Partnership Agreement . . . or whether the disclosure statement would lead *a reasonably prudent Limited Partner* to conclude

[4] Plaintiffs cited this treatise in their Opening Brief (at 25 n.9), to which Defendants failed to respond.

that Husch would opine on (and thereby 'assure') the fairness of the Sale Transaction." *Cencom IV*, 2008 WL 5050624, at *4 (emphasis in original). The court again denied defendants' motion for summary judgment because defendants had not offered "any new evidence bearing on the issue of whether the General Partner *breached its voluntarily-assumed duty*." *Id.* at *3 (emphasis added). By its plain language, *Cencom IV* did not limit the plaintiffs' claims in *Cencom II* to a potential duty of candor claim.[5]

Nothing in the Court of Chancery's post-trial opinion in *Cencom V* limits *Cencom II, III* or *IV*. Instead, *Cencom V* turned on the scope of the duty assumed, which the trial court determined based on the description of what the Husch law firm was retained to do. The representations in Cencom's disclosure statement made clear that Husch had only "undertaken an effort to assure that the Limited Partners received that which they contracted for through the Partnership Agreement." *Cencom V*, 2011 WL 2178825, at *6. Because Husch performed the

[5] Defendants try to mischaracterize Plaintiffs' case as one about fiduciary duties. Even if it were, which it is not, *Cencom IV* rejected the argument (proffered here) that the terms of the contract limited the scope of defendants' potential liability. Instead, the Court of Chancery held that the general partner had voluntarily assumed an extra-contractual duty stating: "Here, however, by voluntarily undertaking to deliver to the Limited Partners an opinion by Husch, the General Partner 'imported common law fiduciary duties into its relationship' with the Limited Partners. Accordingly, the Defendants' contention that contractual principles are controlling and thus limiting is unavailing." *Cencom IV*, 2008 WL 5050624, at *4 (quoting *Sonet*, 722 A.2d at 327).

assumed duty, there was no breach. Here, by contrast, the Proxy Statement repeatedly assured the limited partners that the General Partner and the Conflicts Committee had *actually determined* that the MLP Merger was "fair and reasonable to, and in the best interests of" the limited partners. A77-A78, ¶¶ 113, 115; A632; A643. Thus, the General Partner here went beyond what was required by the Partnership Agreement or for Special Approval and elected to determine that the MLP Merger was fair and reasonable to and in the limited partners' best interests.

B. Defendants' "Promise" Versus "Historical Fact" Distinction Is Unavailing

In trying to distinguish *Cencom II*, Defendants argue that "*Cencom II* involved a promise . . . [b]ut here, the General Partner accurately disclosed a historic fact." DAB at 18-19. This distinction is both incorrect and inapposite. The representation made here was not true and the analysis in *Cencom II* did not turn on whether the general partner made a promise or represented a historical fact. Defendants make no effort to show otherwise.

As noted above, in *Cencom II*, the general partner affirmatively disclosed that it had retained Husch to assure the fairness of a conflicted transaction to the limited partners. *Cencom II*, 1997 WL 666970, at *5. Here, the General Partner affirmatively represented to the limited partners that both the General Partner and the Conflicts Committee had "determined" that the conflicted MLP Merger was

"fair and reasonable to, and in the best interests of" the limited partners. A77-A78, ¶¶ 113, 115; A632; A643.

In each case, the general partner described steps purportedly taken to protect limited partners *above and beyond* the requirements of the respective partnership agreements. Whether labeled a "promise" or "historical fact," the result is the same: a general partner must truthfully describe what it did *and it must actually have done what it said it did or promised to do.* Here, the General Partner and the Conflicts Committee said that they determined that the MLP Merger was "fair and reasonable to, and in the best interests of" the limited partners. The General Partner and Conflicts Committee are accountable for that determination, and as *Cencom II* demonstrates, whether they have stayed true to their word is not a determination appropriate for the pleadings stage.[6]

Notwithstanding Defendants' contrary assertion (DAB at 18-19), Plaintiffs have challenged whether the Conflicts Committee actually made a fairness determination. The Complaint is replete with allegations that the MLP Merger was unfair and that the Conflicts Committee's approval of it was in bad faith. *See* A79, ¶ 117 ("the terms of the KMP Transaction were neither in the best interests of nor fair and reasonable to KMP or its Common unitholders"); A92-A95, ¶¶ 146-147,

[6] The *Cencom* plaintiffs survived three motions for summary judgment on the voluntary assumption of duty claim, demonstrating that resolution of this claim on a motion to dismiss is inappropriate. *See* POB at 19 n.4.

150-151 (the Conflicts Committee never attempted to increase consideration paid to the limited partners relative to what was paid to GP Delegate's stockholders); A85-A86, A97-A98, ¶¶ 133-135, 157 (the MLP Merger represented a negative after-tax premium for the limited partners); A39, ¶ 8 and A69, ¶ 90 (the Conflicts Committee transferred a deferred tax benefit from the limited partners to the Parent); A99, ¶ 162 (the fairness opinion did not consider the tax consequences to the KMP unitholders); and A98, ¶¶ 158-160 (the limited partners' post-tax income for the five years following the transaction was projected to be 61% lower than pre-merger projections).

Indeed, based on those and other allegations, the trial court concluded that Plaintiffs had alleged that Conflicts Committee "approved the terms of the MLP Merger to accommodate Parent, rather than because they believed they were in the best interests of the limited partners."[7] POB, Ex. A at 16; *accord id.* at 15-16 ("***If the applicable standard required that the members of the Committee determine that the MLP Merger was in the best interests of the limited partners, then the Complaint's allegations would support a pleading-stage inference that that the members of the Committee did not act in good faith***.") (emphasis added). In short, Plaintiffs have challenged whether the General Partner and the Conflicts

[7] Surely Defendants are not justifying their actions by arguing that the accurate "historical fact" was that the Conflicts Committee merely sat in a room and took a vote.

Committee *actually* (and in good faith) determined that the MLP Merger was "fair and reasonable to, and in the best interests of" the limited partners.

C. Defendants' Arguments Against Applying *Cencom* Should be Rejected

Recognizing that *Cencom II* fully supports Plaintiffs' position, Defendants proffer several reasons for not applying it to this case.

First, Defendants argue that the grant of Special Approval specifically precludes the importation of duties other than those specifically set out in the Partnership Agreement. DAB at 17. For all the reasons explained above, however, Special Approval does not immunize Defendants' actions here.

Second, Defendants assert that Plaintiffs' position imposes a "new duty" on general partners that would conflict with 6 *Del. C.* § 17-1101(c), which states that the DRULPA is intended to give "maximum effect to the principle of freedom of contract." DAB at 20-21. Here, however, there is no conflict. The Partnership Agreement does not preclude the General Partner or a Conflicts Committee from voluntarily assuming duties to the limited partners. As such, Plaintiffs' argument is not inconsistent with either the Partnership Agreement or the DRULPA.[8]

[8] Plaintiffs are not relying on a single passing reference in the Proxy Statement. Instead, the General Partner repeated its promise to the limited partners throughout the Proxy Statement, and it did so to induce the necessary votes to approve the MLP Merger. A77-78, ¶¶ 113, 115; A632; A643.

Third, Defendants argue that because the General Partner was required by federal law to express its opinion as to the fairness of the MLP Merger, "Plaintiffs' extension of *Cencom*" would impose a new obligation in some going-private transactions. DAB at 21. Defendants, however, did not raise any argument premised on 17 CFR § 229.1014(a) below, and the argument is therefore waived. *See* Supr. Ct. R. 8; *see* A386-A387, A769-A770. Even if the argument is fairly before the Court, it fails. Defendants do not explain the parameters of what is required by 17 CFR § 229.1014(a) beyond just quoting the regulation, and stating in conclusory fashion that Plaintiffs' position would alter some undefined legal landscape. That unsupported argument should be rejected.

Moreover, 17 CFR § 229.1014(a) merely requires a statement of "**whether** the subject company or affiliate filing the statement reasonably believes that the Rule 13e-3 transaction is fair or unfair to unaffiliated security holders." (emphasis added). Nothing in federal law requires or sanctions a statement that a transaction is fair where such a determination could not have been made in good faith. Moreover, this statement did not need to be incorporated into the Special Approval process and the General Partner went far beyond the required disclosure by purportedly determining, *along with its Conflicts Committee*, that the MLP Merger was fair, reasonable, and in the best interests of the limited partners. A77-A78, ¶¶ 113, 115; A632; A643. There is nothing unfair or inconsistent with federal law

in holding the General Partner and the Conflicts Committee to the fairness determinations they claim to have made, even if they were not contractually required to so act. This is particularly so here, where that fairness determination was done in bad faith, to secure votes in a contested, far-from assured merger vote.

Finally, Plaintiffs' position will not deter general partners from exercising their discretion to consider the interests of limited partners or disclosing the reasons for their decision. It would merely ensure that when general partners consider the limited partners' interests, they do so in good faith and issue accurate disclosures in connection therewith. *Cencom II* was written nearly twenty years ago. Yet, nothing about its recognition of voluntarily assumed duties has deterred general partners from pursuing conflicted transactions based on whatever factors they want to consider. The General Partner and the Conflicts Committee did not make their purported fairness determinations out of the goodness of their hearts. Rather, as the Complaint alleges (A77, ¶ 113) they used these determinations to solicit the limited partners' approval of the MLP Merger.

CONCLUSION

For all the foregoing reasons and those set forth in Plaintiffs' Opening Brief, the trial court's decision should be reversed and remanded with instructions to deny the motion to dismiss as to the General Partner and the Conflicts Committee.

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