EFiled: Jul 25 2016 04:02PM EDT
Filing ID 59324410
Case Number 291,2016

IN THE SUPREME COURT OF THE STATE OF DELAWARE

EMPLOYEES RETIREMENT SYSTEM OF THE CITY OF ST. LOUIS, Plaintiff Below, Appellant, v. TC PIPELINES GP, INC., TRANSCANADA AMERICAN INVESTMENTS, LTD., and TRANSCANADA CORPORATION, Defendants Below, Appellees, -and- TC PIPELINES, LP, Nominal Defendant Below, Appellee.	No. 291, 2016 Appeal from the Letter Decision and Final Order dated May 11, 2016 of the Court of Chancery of the State of Delaware, C.A. No. 11603-VCG

APPELLANT'S OPENING BRIEF

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Dated: July 25, 2016

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NATURE OF PROCEEDINGS

This case concerns the third of three transactions pursuant to which Nominal Defendant TC Pipelines, LP ("TCP" or the "Partnership") purchased from TransCanada Corporation ("TransCanada") the remaining interest in a TransCanada subsidiary Gas Transmission Northwest LLC ("GTN"). TCP is a Delaware master limited partnership controlled by its general partner, TC Pipelines GP, Inc. ("TCPGP"), which is an indirectly-owned subsidiary of TransCanada.[1]

Pursuant to a February 2015 agreement that TransCanada entered into with the Partnership, the Partnership purchased a 30% interest in GTN (which owns and operates a gas pipeline delivering gas to the Pacific Northwest and California) (the "2015 GTN Dropdown"). In two prior transactions, in which the Partnership had acquired 25% and then 45% of TransCanada's interest in GTN, the Partnership had paid in cash (and assumed a pro rata portion of the pipeline's debt). This time, however, the arrangement was radically different. This time, Defendants caused the Partnership to pay TransCanada cash and to assume debt and also to issue to TransCanada newly-issued Class B units valued at $95 million. The Class B units were structured to divert to TransCanada 44% of the expected revenue from the pipeline.

[1]GTN is an indirect, wholly owned subsidiary of TransCanada through TransCanada American Investment Ltd., which is referred to herein, along with its parent, as TransCanada.

Analysts have recognized that financing the transaction this way imposes a higher cost of capital on TCP. While in the Partnership's two previous acquisitions of interests in GTN from TransCanada, the enterprise value-to-EBITDA ("EV/EBITDA") ratio were, respectively, 9.4x and either 9.9x or 11.0x (depending on which year's earnings were used), the 2015 GTN Dropdown was substantially higher at 14.6x, rendering the deal severely unfair to the Partnership. Further, while in the 2015 GTN Dropdown, Partnership receives $20 million in annual revenue for the first 5 years of the deal in return for its investment of $351 million in cash and assumption of debt (a return of only 5.7%), TransCanada would receive an anticipated $16 million per year (based upon prior performance of GTN) in return for an investment of only $95 million (a return of nearly 17%). If the 2015 GTN Dropdown had been structured similar to the prior GTN dropdowns, the Partnership would receive annual returns of 8.1% on anticipated results.

TCP's Second Amended and Restated Agreement of Limited Partnership ("LPA") requires that related party transactions be conducted on terms "fair and reasonable" to TCP. LPA §7.6(e) (A157).[2] As the Court below recognized, "the Dropdown is permitted only to the extent it is contractually 'fair and reasonable' to

[2] There is a Third Amended and Restated Agreement of Limited Partnership, but that agreement does not govern this case. *See* p. 11 n.4 *infra*; *see also* Letter Decision and Final Order dated May 11, 2016 ("Decision") at 4 & n.14. (A copy of the Decision is Exhibit A hereto.)

TCP." Decision at 8. The LPA also requires that the determination of whether a transaction is fair and reasonable "shall be considered in the context of all similar or related transactions." LPA §7.9(c) (A160).

Notwithstanding the patent unfairness of the 2015 GTN Dropdown to the Partnership and its dramatic departure from the prior dropdowns involving the pipeline, however, the Court held that because the transaction received "Special Approval," *i.e.*, approval by TCPGP's Conflicts Committee, *see* LPA §7.9(a) (A159), it is conclusively deemed to be "fair and reasonable" such that Defendants are shielded from liability, even if the Conflicts Committee acted in bad faith in granting Special Approval. Such interpretation of the LPA renders the Special Approval process effectively meaningless. Under this interpretation of the LPA, Defendants could – without fear of liability – have diverted *all* of the revenue from the 2015 GTN Dropdown to the Class B shares, and none to the Partnership, so long as the transaction was blessed by the Committee.

This interpretation of the LPA is inconsistent with the implied covenant of good faith and fair dealing that inheres in all Delaware limited partnership agreements. The implied covenant of good faith and fair dealing is meant to fill gaps in contracts to avoid frustrating the intent of the parties, and there is an important gap here: The LPA specifies no standard of conduct governing the members of the Conflicts Committee in deciding whether to grant Special

Approval, *i.e.*, it does not say whether the Special Approval safe harbor can be invoked where, as here, the Committee acts in bad faith. It is Plaintiff's position that the gap should be filled by holding that in order for Special Approval to be effective, the Conflicts Committee must act in good faith when it is determining whether or not to grant Special Approval.

SUMMARY OF ARGUMENT

1. The Court below erred in holding that the 2015 GTN Dropdown must be conclusively presumed to be fair and reasonable to the Partnership because it received Special Approval by the Conflicts Committee. The Committee acted in bad faith in approving the transaction because the transaction diverted to TransCanada a huge share of the potential upside from the pipeline. In so doing, the structure of the transaction departed drastically from two prior sales to the Partnership of interests in the pipeline, neither of which diverted any future pipeline revenues to TransCanada. The approval by the Committee ran afoul of LPA §7.9(c) (A160), which provides that the "fair and reasonable nature" of a transaction "shall be considered in the context of all similar or related transactions." Because the LPA does not specify the standard of conduct governing the members of the Conflicts Committee, *i.e.*, whether in evaluating a transaction they must act in good faith or may act in bad faith, it is appropriate to apply the implied covenant of good faith and fair dealing to fill the gap and hold that in order for Special Approval to be effective, the members of the Conflicts Committee must act in good faith when determining whether or not to grant Special Approval.

STATEMENT OF FACTS

A. BACKGROUND OF THE PARTNERSHIP

The Partnership is a pipeline and energy transportation company that was formed as a Delaware master limited partnership ("MLP") by TransCanada. A009 ¶1; A013 ¶15. The Partnership has no employees, and no officers, management, or board of directors of its own. *Id.* The Partnership instead relies entirely on its general partner, TCPGP, to make all business decisions on behalf of the Partnership. *Id.*

B. THE LPA'S RESTRICTIONS ON CONFLICT-OF-INTEREST TRANSACTIONS

The transaction at issue is sometimes referred to as a "dropdown," an asset sale to the Partnership from its general partner or other controlling entity. This presents an obvious conflict of interest of concern to investors. Because the Partnership is entirely reliant on its general partner, TCPGP, to select and negotiate potential acquisitions, the Partnership faces the risk that TCPGP will favor the interests of its own parent corporation, TransCanada, when structuring dropdowns.

Accordingly, the LPA contains provisions that protect the Partnership from abusive related-party transactions. Specifically, §7.6(e) provides that "[n]either the General Partner nor any of its Affiliates shall sell, transfer or convey any property

to, or purchase any property from, the Partnership ... except pursuant to transactions that are *fair and reasonable* to the Partnership." A157.[3]

The LPA further provides explicit guidance as to how the fairness and reasonableness of a conflict-of-interest transaction is to be evaluated:

> Whenever a particular transaction, arrangement or resolution of a conflict of interest is required under this Agreement to be "fair and reasonable" to any Person, the fair and reasonable nature of such transaction, arrangement or resolution *shall be considered in the context of all similar or related transactions*.

LPA §7.9(c) (A160).

The LPA also provides that:

> Any conflict of interest and any resolution of such conflict of interest shall be conclusively deemed fair and reasonable to the Partnership if such conflict of interest or resolution is (i) approved by Special Approval (as long as the material facts known to the General Partner or any of its Affiliates regarding any proposed transaction were disclosed to the Conflicts Committee at the time it gave its approval) ….

LPA § 7.9(a) (A159). Special Approval, however, is defined simply as "approval by a majority of the members of the Conflicts Committee." A129. Thus, while the LPA specifies the procedural mechanism necessary to resolve a conflict of interest via Special Approval (approval by a majority of a properly-constituted and informed Conflicts Committee) and the question that the Conflicts Committee must answer when making Special Approval determinations (whether the proposed

[3] Unless otherwise noted, all emphasis in quoted material has been supplied.

transaction is fair and reasonable to the Partnership, in the context of all similar or related transactions), it does not state any standard of conduct for the Conflicts Committee members to abide by at the time they are casting their ballots. For example, the LPA does not expressly specify whether the Conflicts Committee must act in good faith, whether the Conflicts Committee may act in bad faith, whether the Conflicts Committee must act reasonably, or whether the Conflicts Committee may act negligently or recklessly.

C. THE PRIOR SALES OF INTERESTS IN THE PIPELINE FROM TRANSCANADA TO THE PARTNERSHIP

Prior to the 2015 GTN Dropdown, there were two other transactions in which interests in the pipeline were sold from TransCanada to the Partnership. These are highly relevant to the transaction here, particularly in light of the provision in the LPA, quoted above, requiring that the fair and reasonable nature of a conflict-of-interest transaction be considered in the context of all similar transactions. *See* LPA §7.9(c) (A160).

On May 3, 2011, the Partnership purchased a 25% interest in GTN, which owns the pipeline, from TransCanada for $405 million (including the assumption of $81.3 million in debt), a deal with an EV/EBITDA multiple of 9.4x. A018-19 ¶¶29-30.

On July 1, 2013, the Partnership purchased an additional 45% interest in GTN from TransCanada for $750 million (including the assumption of $146

million in debt), a deal with an EV/EBITDA multiple of 9.9x and 11.0x (depending on which years' earnings were used in the calculation). *Id.*

D. THE UNFAIR TRANSACTION GIVING RISE TO THIS LAWSUIT, WHICH DIFFERED DRAMATICALLY FROM THE TWO PRIOR TRANSACTIONS

On February 24, 2015, TCPGP caused the Partnership to enter into an agreement to acquire TransCanada's remaining 30% interest in GTN, effective April 1, 2015. A010 ¶3. But this deal was structured much differently than the previous two dropdowns had been structured. A010-11 ¶5. In this transaction, the Partnership agreed to pay $253 million in cash, the assumption of $98 million in debt, and the issuance of newly created Class B TCP units to TransCanada, valued at $95 million. *Id.* (The $95 million price assigned to the Class B units was agreed to solely by TCPGP and TransCanada. *Id.*)

The Class B units that TransCanada received in the 2015 GTN Dropdown cap TCP's benefits while allowing TransCanada to retain the upside of the Pipeline. A017 ¶26. The Class B units entitle TransCanada to distributions equaling: (1) all of the cash flow attributable to the 2015 GTN Dropdown over $15 million in 2015; (2) all of the cash flow attributable to the 2015 GTN Dropdown over $20 million from 2016 through 2019; (3) 43.75% of the cash flow attributable to the 2015 GTN Dropdown over $20 million in 2020; and (4) 25% of the cash flow attributable to the 2015 GTN Dropdown over $20 million in perpetuity. A017 ¶25.

Based on GTN's historical performance, the cash flow attributable to the 2015 GTN Dropdown is estimated at approximately $36 million per year, such that from 2016 through 2019 TransCanada will receive approximately $16 million of this $36 million via its $95 million in Class B units (versus $20 million a year for the Partnership for its $351 million investment) and $4 million in perpetuity every year thereafter. A017-18 ¶¶26, 28. In other words, the Partnership is receiving approximately a 5.7% annual rate of return on $351 million for the next five years, while TransCanada is receiving a 16.8% return on its $95 million in Class B shares. A018 ¶28. Taking into account this redistribution of cash flows, the EV/EBITDA multiple of the 2015 GTN Dropdown is 14.6x, much higher than the 9.4x and 9.9x / 11.0x multiples associated with the prior GTN dropdowns. A018-19 ¶¶29-30. Indeed, an analysis of EV/EBITDA ratios in comparable pipeline deals between 2011 and 2014 found that the mean EV/EBITDA ratio was 12.7x, the median ratio was 12.1x, and the highest ratio was 14.3x, such that the 2015 GTN Dropdown is significantly more expensive to the Partnership than peer transactions. A022 ¶39.

A number of analysts commented on the burdens that the 2015 GTN Dropdown's financial structure imposes on the Partnership and its limited partners. A023-24 ¶43. For example, in a February 26, 2015 research note, Barclays wrote:

> The primary driver behind the reduction in our growth estimate is the introduction of Class B units into TCP's funding scheme. Assuming

> future deals are structured with a similar mechanism, this will have the effect of reducing cash available for distribution to LP unitholders (at least in the near/medium term).... [Class B units] provid[e] a mechanism that would have the effect of returning an outsized portion of cash flows to the parent, at least in the beginning.

A023-24 ¶43(a). Similarly, in a March 5, 2015 research note, Wells Fargo Securities wrote that "[t]he cost of this [Class B] capital is significantly higher relative to financing a transaction with TCP common units or debt." A024 ¶43(b).

Because the then-operative LPA did not provide for the issuance of Class B units, TCPGP unilaterally drafted and executed the Third Amended and Restated Agreement of Limited Partnership to accommodate the deal structure of the 2015 GTN Dropdown. A020 ¶34. TCPGP also included a provision adding the 2015 GTN Dropdown to the list of transactions that were defined as being "fair and reasonable" to the Partnership. A020-21 ¶35.[4]

[4] Presumably cognizant of how negatively a Court would perceive their outrageous conduct regarding insertion of these provisions into the partnership agreement, during the briefing below Defendants disclaimed any reliance on the Third Amended and Restated Agreement of Limited Partnership. A072.

ARGUMENT

As this Court stated in *Central Mortg. Co. v. Morgan Stanley Mortg. Cap. Holdings LLC*, 27 A.3d 531, 536 (Del. 2011):

> The pleading standards governing the motion to dismiss stage of a proceeding in Delaware … are minimal. When considering a defendant's motion to dismiss, a trial court should accept all well-pleaded factual allegations in the Complaint as true, accept even vague allegations in the Complaint as "well-pleaded" if they provide the defendant notice of the claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof. Indeed, it may, as a factual matter, ultimately prove impossible for the plaintiff to prove his claims at a later stage of a proceeding, but that is not the test to survive a motion to dismiss.

The Complaint's allegations are plainly sufficient to allege that Defendants breached the requirement in the LPA that the General Partner or its affiliates cannot sell assets to the Partnership except on terms that are "fair and reasonable to the Partnership." A021 ¶36 (quoting LPA §7.6(e)). The Court below agreed:

> MR. SABELLA: …. If the safe harbors fail, clearly we've done enough in the complaint to say it's not fair and reasonable to overcome the motion to dismiss.
>
> THE COURT: I agree.

A243.

The Court, however, held that Defendants' conduct cannot constitute a breach of the LPA because they satisfied a safe harbor in the LPA – Special

Approval by an independent Conflicts Committee pursuant to LPA §7.9(a)(i) (A159). Decision at 2, 11-17. As discussed below, this was error.[5]

[5] Relying on LPA §7.10(b) (A160), Defendants also argued below that because they purportedly relied on the opinion of a financial consultant, their conduct is immune from judicial scrutiny. Plaintiff argued that §7.10(b) should not be construed to apply to conflict-of-interest transactions, because if it did apply it would render superfluous the detailed safe harbors in the LPA for such transactions. A233-34. The Court below did not need to resolve this issue, given its disposition of the case on the basis of the Special Approval safe harbor. Decision at 13 n.37. The Court did, however, state the following when Plaintiff's counsel addressed §7.10(b): "I don't think I dismiss because there's a fairness opinion by a financial advisor. So if that's what you're trying to convince me of, I agree." A234.

I. THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING PRECLUDES THE GENERAL PARTNER FROM RELYING ON THE SPECIAL APPROVAL SAFE HARBOR, BECAUSE SUCH APPROVAL WAS GIVEN IN BAD FAITH

A. QUESTION PRESENTED

Where a limited partnership agreement provides a safe harbor for conflict-of-interest transactions if special approval is given by an independent conflicts committee but does not specify a standard of conduct the conflicts committee must abide by in making its determinations, does the implied covenant of good faith and fair dealing fill the gap by precluding reliance on such approval unless the committee acts in good faith in approving the transaction? Decision at 14-15; A049-56; A226-31.

B. SCOPE OF REVIEW

This Court's review of the decision on a motion to dismiss under Ch. Ct. R. 23.1 is *de novo* and plenary. *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000). The Court must accept all well-pleaded allegations of the complaint as true and draw all reasonable inferences in Plaintiff's favor. *Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).

C. MERITS OF ARGUMENT

1. The Implied Covenant of Good Faith and Fair Dealing Is Applicable to the LPA

The implied covenant of good faith and fair dealing has long held a vital place in Delaware jurisprudence regarding breach of contract claims. The implied

covenant "attaches to every contract," *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 442 (Del. 2005), and requires that a party refrain from "arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of its bargain." *Gerber v. Enterprise Prods. Holdings, LLC*, 67 A.3d 400, 419 (Del. 2013), *overruled on other grounds by Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808 (Del. 2013). The implied covenant is a contractual gap-filler that protects "the spirit of the agreement rather than the form." *Allen v. El Paso Pipeline GP Co., L.L.C.*, 2014 WL 2819005, at *10 (Del. Ch. June 20, 2014) (citations omitted); *see also Dunlap*, 878 A.2d at 444 (the implied covenant "requires more than just literal compliance with [the contract]").

The "fair dealing" referred to in the implied covenant is "a commitment to deal 'fairly' in the sense of consistently with the terms of the parties' agreement and its purpose." *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 440 (Del. Ch. 2012), *aff'd in part, rev'd in part on other grounds*, 68 A.3d 665 (Del. 2013). Similarly, "'good faith' envision[s] … faithfulness to the scope, purpose and terms of the parties' contract." *Id.*

These principles apply with full force to partnerships like the one at bar. While, as the Court below noted, Delaware law gives contracting parties the freedom to surrender various rights, Decision at 1, that freedom does not go so far

as to allow contracts to exclude the implied covenant of good faith and fair dealing. The Legislature has dictated that "a partnership agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing." 6 Del. C. § 17-1101(d). Indeed, as this Court stated in *Gerber*, 67 A.3d at 424, with respect to a limited partnership agreement, "the implied covenant constrains how the Special Approval process may be carried out." *See also In re Kinder Morgan, Inc. Corporate Reorganization Litig.*, 2015 WL 4975270, at *9 (Del. Ch. Aug. 20, 2015), *aff'd sub nom. Haynes Family Trust v. Kinder Morgan G.P., Inc.*, 2016 WL 912184 (Del. Mar. 10, 2016) ("the implied covenant constrains the Special Approval process").[6]

[6] The Court below cited the statement in *Haynes Family Trust v. Kinder Morgan G.P., Inc.*, 2016 WL 912184 (Del. Mar. 10, 2016), that where there was compliance with the special approval process, there was "'no room for a substantive judicial review of the fairness of the transaction.'" Decision at 12 (quoting *Haynes*, 2016 WL 912184, at *2). But far from holding that the implied covenant of good faith and fair dealing is irrelevant in this context, in *Haynes* this Court reaffirmed that a partnership agreement cannot eliminate the implied covenant. 2016 WL 912184, at *2 n.1. In any event, *Haynes* is distinguishable. The issues there were (1) whether the individuals appointed to the committee were too conflicted to serve on it, and (2) whether the committee members had to believe that the transaction was fair to the limited partners as opposed to being fair to the partnership. *Kinder Morgan*, 2015 WL 4975270, at *8-11. The Court of Chancery held that the individuals were eligible, *id.* at *11, that fairness to the partnership was what was required,. *id.* at *8, and that there was "no basis to question the Committee's decision from the standpoint of the Partnership." *Id.* at *8. This Court affirmed. These are not the issues raised in the present appeal.

2. There Is a "Gap" in the LPA

As noted above, application of the implied covenant depends on whether there is a "gap" in the agreement. While the LPA sets forth a Special Approval process for resolving conflicts of interest, it contains a major gap insofar as it provides no guidance whatsoever as to the standard of conduct that the Conflicts Committee must abide by in order for the Special Approval safe harbor to be invoked.

While LPA §7.9(a) (A159) lists factors that the Committee may consider in reaching its conclusion, it omits to specify any relevant standard of conduct for the Committee members. The Court below stated that "[t]he relevant portions of the Special Approval provision, importantly, are silent as to good faith." Decision at 11. They are also silent as to bad faith (as well as negligence, gross negligence, reckless, and fraudulent conduct.) Is Special Approval valid if the Committee acts in bad faith? The LPA is silent on this question.

The fact that the LPA addressed Special Approval does not mean that there is no gap to fill. "[R]ecent authority teaches that a claim for violation of the implied covenant of good faith and fair dealing can survive if, notwithstanding contractual language on point, the defendant failed to uphold the plaintiff's reasonable expectations under that provision." *Renco Group, Inc. v. MacAndrews AMG Holdings LLC*, 2015 WL 394011, at *6-7 (Del. Ch. Jan. 29, 2015)

(upholding breach of implied covenant claim even though the agreement at issue "explicitly addresses the general topics underlying [the] dispute").

The Court of Chancery rejected Plaintiff's position that the LPA fails to supply a standard of conduct for the Conflicts Committee. The Court stated: "The LPA, however, explicitly supplies the standard the Conflicts Committee must follow; the LPA states that the Conflicts Committee must determine that the transaction is 'fair and reasonable' to TCP." Decision at 15. Such holding erroneously conflates the question the Committee was asked to resolve with the standard of conduct the Committee must follow in reaching its resolution.

Assigning to the Committee the issue of determining whether a transaction is fair and reasonable does not define the relevant standard of conduct governing the Committee's performance of its work. What if the Committee reaches the conclusion that the transaction was fair and reasonable but acts recklessly or fraudulently or otherwise in bad faith in doing so. Is such Special Approval valid? The LPA simply does not supply any standard of conduct with which the members of the Conflicts Committee must comply before the Special Approval safe harbor can be invoked.

It is not uncommon for cases to involve an opinion as to whether a transaction is fair and reasonable. But the mere fact that someone is charged with providing an opinion as to the fairness of a transaction has never been held to

obviate the question of whether the person acted negligently or fraudulently in reaching the determination. For example, in merger and acquisition transactions or other corporate transactions, parties routinely obtain a fairness opinion from a financial advisor, opining as to the fairness of the transaction. But the rendering of such an opinion does not supplant inquiry into whether the advisor rendered the opinion in a negligent or fraudulent manner, and claims against financial advisors for rendering fairness opinions negligently or in bad faith are common.[7] The fact that the Conflicts Committee is supposed to evaluate whether a transaction is fair and reasonable does not negate the fact that the LPA does not address whether the Committee is permitted to act in bad faith in making its evaluation.

3. The Gap Should Be Filled by Holding That Special Approval Cannot Be Relied on Unless the Conflicts Committee Acts in Good Faith When Making Special Approval Decisions

The gap in the LPA should be filled by providing that Special Approval is ineffective unless the Conflicts Committee acts in good faith in granting Special Approval.

Delaware courts have repeatedly held that where, as here, "a contract provides discretion to one party and the scope of that discretion is not specified, the

[7] *See, e.g.*, *The HA2003 Liquidating Trust v. Credit Suisse Sec. (USA) LLC*, 517 F.3d 454 (7th Cir. 2008); *Floyd v. CIBC World Mkts., Inc*., 426 B.R. 622 (S.D. Tex. 2009); *Ha-Lo Indus. v. Credit Suisse First Boston, Corp*., 2005 WL 2592495 (N.D. Ill. Oct. 12, 2005). *In re Reliance Sec. Litig*., 91 F. Supp. 2d 706 (D. Del. 2000).

implied covenant requires that the discretion be used reasonably and in good faith." *Policemen's Annuity & Benefit Fund of Chicago v. DV Realty Advisors LLC*, 2012 WL 3548206, at *12 (Del. Ch. Aug. 16, 2012). "Simply put, the implied covenant requires that the 'discretion-exercising party' make that decision in good faith." *Amirsaleh v. Board of Trade of City of New York, Inc.*, 2008 WL 4182998, at *8 (Del. Ch. Sept. 11, 2008).[8] These cases recognize the common-sense principles that "[p]art of corporate managers' proper performance of their contractual obligations is to use the discretion granted to them in the company's organizational documents in good faith," and that investors have a legitimate expectations that corporate managers "will properly perform the contractual obligations they have under the operative organizational agreements …." *Bay Center Apartments Owner*, 2009 WL 1124451, at *7.

As an article co-authored by counsel for Defendants states,

> One context in which application of the Implied Covenant is particularly note-worthy is in the instances where a party is allowed discretion under the agreement to take certain actions. When a party

[8] *See also, e.g., Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *7 (Del. Ch. Apr. 20, 2009) (holding that a contractual party with the discretion to cause supporting agreements to be performed would breach the implied covenant by failing to require performance through a bad-faith exercise of discretion); *Chamison v. HealthTrust, Inc. – Hospital Co.*, 735 A.2d 912, 922 (Del. Ch. 1999) (holding that a contractual party with broad discretion to select counsel as part of an indemnification agreement breached the implied covenant by requiring its counterparty to accept inadequate counsel); *Wilmington Leasing, Inc. v. Parrish Leasing Co., L.P.*, 1996 WL 560190, at *2 (Del. Ch. Sept. 25, 1996) ("Where either the definition or the declaration of occurrence of the condition is left to the sole discretion of the invoking party, the application of a good faith standard to the enforcement of conditions is appropriate.").

> is afforded discretion in a contract, the issue is whether the Implied Covenant will be invoked to add any limitations on the exercise of such discretion. *Delaware cases generally support the proposition that the Implied Covenant requires that such discretion must be exercised in good faith and consistent with the reasonable expectations of the parties.*

Paul M. Altman & Srinivas M. Raju, *Delaware Alternative Entities and the Implied Contractual Covenant of Good Faith and Fair Dealing Under Delaware Law*, 60 Bus. Law. 1469, 1480-81 (2005). The article further notes that even where limited partnership agreements contain language expressly vesting "sole discretion" in a general partner to make specified decisions, "the authors believe that such person nevertheless likely would be deemed to violate the Implied Covenant if he were to act in bad faith." *Id.* at 1484-85.

This case is comparable to *Gerber*, where the partnership agreement at issue included a contractual provision establishing a special approval procedure (namely, the procurement of a fairness opinion) that the general partner could use to "conclusively establish" that it met its contractual duty. *See* 67 A.3d at 419-20. Nonetheless, this Court held that the special approval procedure "may itself be subject to a claim that it was arbitrary and unreasonable and in violation of the implied covenant," noting that "[e]xamples readily come to mind of cases where a general partner's actions in obtaining a fairness opinion from a qualified financial advisor themselves would be arbitrary or unreasonable, and thereby frustrate[e] the fruits of the bargain that the asserting party reasonably expected." *Id.* at 420

(internal quotation omitted). The Court specifically noted that a general partner would violate the implied covenant by relying on a fairness opinion that was issued in bad faith. *Id.* at 420-21. There is no reason to draw a distinction between a financial advisor acting in bad faith and a Conflicts Committee acting in bad faith – in either case, such conduct violates the fundamental expectations of the parties at the time of contracting, and therefore violates the implied covenant. Despite the parallels between the two cases, the Court of Chancery did not even address *Gerber* in its opinion.[9] As in *Gerber*, the unitholders here surely had an expectation that Special Approval would have some practical effect, that the safe harbor could not be invoked if the Committee members closed their eyes to the relevant facts or refused to pay attention to the requirement of LPA §7.9(c) (A160) that "the fair and reasonable nature" of a conflict of interest transaction "be considered in the context of all similar or related transactions." Allowing reliance

[9] Defendants below attempted to distinguish *Gerber* on the grounds that (1) the partnership agreement at issue in *Gerber* included an affirmative good faith standard; (2) the *Gerber* case supposedly dealt with extraordinary transactions; and (3) the *Gerber* case included allegations of process issues. A205-07. None of these suggested distinctions have merit. First, the *Gerber* Court did not base its holding on the affirmative good faith standard in the partnership agreement, but rather, on the implied covenant. *See* 67 A.3d at 420-21. Second, there is nothing whatsoever unforeseeable about mergers and acquisitions, and partnership agreements routinely include provisions dealing with them. *See, e.g.,* LPA §§14.1-14.5 (A175-77). Finally, the *Gerber* partnership agreement did not specifically address the process matters at issue, which was exactly why the implied covenant was called into play there. *See* 67 A.3d at 422-23. TC Pipelines limited partners are entitled to protection from a Conflicts Committee that did not do the job reasonably expected of it, just as Enterprise Products limited partners in *Gerber* were entitled to protection from fairness opinions that did not do the jobs reasonably expected of them.

on the Special Approval safe harbor if Committee members act in bad faith would "'prevent[] the other party to the contract from receiving the fruits' of its bargain." *ASB Allegiance*, 50 A.3d at 441. *See Kinder Morgan*, 2015 WL 4975270, at *8 (in granting special approval, "members of the Committee … had to believe in good faith that the MLP Merger was in the best interests of the Partnership").[10]

Construing the LPA to permit reliance on Special Approval given in bad faith, on the other hand, leads to absurd consequences that the parties could not have intended.[11] For example, Vice Chancellor Glasscock posed the question at oral argument as to whether the implied covenant would allow a court to examine a transaction whereby the Conflicts Committee granted Special Approval to a dropdown transaction pursuant to which the partnership paid ten times the asset's value. Defendants' counsel replied that it would not. A200-01. Plainly troubled, the Vice Chancellor continued to press Defendants' counsel:

> THE COURT: …. [A] dropdown transaction, no matter how egregious the results of that transaction appeared on its face, the limited partners would not have a right of substantive review by a court.
>
> MR. RAJU: Yes.

[10] The Court below seemed of the view that when the *Kinder Morgan* decision was affirmed in *Haynes*, this Court rejected the foregoing statement in the Court of Chancery's opinion. Decision at 12 n.35. But this Court's decision in *Haynes* did not address Vice Chancellor Laster's statement that the members of the committee were obliged to act in good faith.

[11] Courts reject an interpretation of a contract that "produces an absurd result or one that no reasonable person would have accepted when entering the contract." *Estate of Osborn v. Kemp*, 991 A.2d 1153, 1160 (Del. 2010).

A202.

At oral argument, Plaintiff's counsel raised the hypothetical that a member of the Conflicts Committee might be bribed to give Special Approval to a transaction. A227-28. Since a bribed director is eligible to serve on the Conflicts Committee, *id*.; *see* LPA p. 5 (A122), under the decision below, even in such circumstances reliance on such Special Approval would not be barred by the implied covenant.

Recognizing the absurdity of applying the Special Approval safe harbor where the Committee members were bribed, the Court below stated that in that situation, the safe harbor would not apply. The Court stated that "[i]t is likely that such a situation was unanticipated by the parties at the time of contracting, and that the [parties] would not have agreed to it; moreover, it would fundamentally deprive the unitholders of the benefit of the bargain, the protection of an independent committee." Decision at 17 n.48. But these explanations do not distinguish the bribery situation from the situation where the Conflicts Committee acts in bad faith the way it did here.

First, assuming, *arguendo*, that a dropdown transaction could have been reasonably anticipated, it could not have been reasonably anticipated that the Conflicts Committee would act in bad faith and ignore the clear instructions of LPA §7.9(c) that "[w]henever a particular transaction, arrangement or resolution of

a conflict of interest is required under this Agreement to be 'fair and reasonable' to any Person, the fair and reasonable nature of such transaction, arrangement or resolution shall be considered in the context of all similar or related transactions." A160. As discussed above, the 2015 GTN Dropdown departed dramatically from the two prior dropdowns involving the pipeline; neither of the prior deals diverted to TransCanada any share, let alone a gigantic share, of the upside from the pipeline interest being sold, and neither involved EV/EBITDA ratios anywhere near that in the 2015 GTN Dropdown. When the LPA was entered into, the unitholders could not have envisioned that the Conflicts Committee would simply ignore the strictures of LPA §7.9(c). Delaware courts have recognized that "[g]aps also exist because some aspects of the deal are so obvious to the participants that they never think, or see no need, to address them." *In re El Paso Pipeline Partners, L.P. Deriv. Litig.*, 2014 WL 2768782, at *16 (Del. Ch. June 12, 2014).

Second, the fact is that bribing someone to obtain a favorable opinion or approval of a contract is no more unanticipated than what in fact occurred here.[12]

[12] Bribery is an all-too-common method of obtaining favorable opinions or approval of contracts. *See, e.g.*, *United States v. Murphy*, 323 F.3d 102, 106 (3d Cir. 2003); *United States v. Heffler*, 402 F.2d 924, 925-26 (3d Cir. 1968); *Hollinger Int'l v. Black*, 844 A.2d 1022, 1061-62 (Del. Ch. 2005); *United States v. Bezmalinovic*, 1996 WL 737037, at *1 (S.D.N.Y. Dec. 26, 1996); *Walco Invs. v. Thenen*, 168 F.R.D. 315, 331 (S.D. Fla. 1996); *Sterling Nat'l Bank v. Ernst & Young LLP*, 2008 WL 5157994 (Sup. Ct. 2008); *Estate of Sherman v. Almeida*, 747 A.2d 470, 471 (R.I. 2000); *State v. Jones*, 587 P.2d 742, 744 (Ariz. 1978); *Johnson v. Johnson*, 424 P.2d 414, 416 (Okla. 1967).

Third, if the parties had thought about whether Special Approval given in bad faith could be relied on, undoubtedly "the parties would not have agreed to it."

Lastly, a Conflicts Committee acting in bad faith "deprive[s] the unitholders of the benefit of the bargain, the protection of an independent committee" just as much as a bribed Committee does.

Another hypothetical discussed below further demonstrates the extreme consequences of construing the LPA in the manner adopted by the Court of Chancery. In the briefing below, Plaintiff posed the hypothetical of the Conflicts Committee granting Special Approval to the Partnership's purchase of multi-million dollar Christmas presents for the children of TransCanada's CEO. A053-54. Defendants replied that if such a transaction were approved, they "agree that it would justify invoking the 'limited and extraordinary legal remedy' of the implied covenant …." A091. Defendants argued the implied covenant could apply to that situation because it would be unanticipated. A091-92; A199-201. But that does not distinguish the hypothetical from the situation at bar, since gifts and other self-dealing transactions benefitting the families of officers and other fiduciaries are hardly unusual.[13]

[13] *See, e.g.*, *Sanderson v. H.I.G. P-Xi Holding, Inc.*, 2001 WL 406280, at *5 (E.D. La. Apr. 19, 2001); *Pereira v. Cogan (In re Trace Int'l Holdings, Inc.)*, 2001 WL 243537, at *14-15 (S.D.N.Y. Mar. 18, 2001); *Merritt v. Colonial Foods, Inc.*, 499 F. Supp. 910, 914 (D. Del. 1980); *Zaman v. Amedeo Holdings, Inc.*, 2008 WL 2168397, at *26 (Del. Ch. May 23, 2008); *Birnbaum v. Birnbaum*, 73 N.Y.2d 461, 466 (1989).

The Court of Chancery held that there is no gap for the implied covenant to fill here because "the parties anticipated that conflicted transactions would arise, and they bargained for a procedural safeguard, with the decision to enter the transaction referred to an independent and informed committee of the General Partner." Decision at 16. Yet interpreting the LPA's silence as to good faith[14] as an indication that the parties intended to affirmatively disregard any standard of conduct and treat Special Approval wholly as a mechanical exercise renders the Special Approval process a dead letter for all of the reasons discussed above. A more plausible reading of the LPA is that the reason it does not expressly specify that the Conflicts Committee is supposed to act in good faith is that "parties occasionally have understandings or expectations that were so fundamental that they did not need to negotiate about those expectations …." *Katz v. Oak Indus. Inc.*, 508 A.2d 873, 880 (Del. Ch. 1986) (quoting CORBIN ON CONTRACTS § 570 (Kaufman Supp. 1984)). As this Court recognized in *Gerber*, the notion that persons who are contractually charged with evaluating proposed transactions will make their determinations in good faith is one of those fundamental expectations that is sometimes left unstated.

[14] Decision at 11 ("The relevant portions of the Special Approval provision, importantly, are silent as to good faith.").

4. The Complaint's Allegations of Bad Faith Are Sufficient to Overcome the Motion to Dismiss

To overcome the motion to dismiss, Plaintiff recognizes that it is not enough merely to allege that the transaction price was unfair; the Complaint must also allege, and Plaintiff must later prove, that the Conflicts Committee did not act in good faith in approving the transaction, which is a separate inquiry. *See, e.g.*, *Stewart v. BF Bolthouse Holdco, LLC*, 2013 WL 5210220, at *5-9 (Del. Ch. Aug. 30, 2013). The allegations of the Complaint are clearly sufficient to satisfy the requirements for pleading that the Conflicts Committee did not act in good faith, and the Court below did not hold otherwise.

"To allege a breach of a contractual duty to act in good faith, a complaint need only allege facts related to the alleged act taken in bad faith, and a plausible motivation for it." *Clean Harbors, Inc. v. Safety-Kleen, Inc.*, 2011 WL 6793718, at *7 (Del. Ch. Dec. 9, 2011) (internal quotation marks omitted) (noting that this is a minimal standard, the purpose of which is to give defendants notice of the claims against them).[15]

[15] *See Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II L.P.*, 624 A.2d 1199, 1206 (Del. 1993) (finding that plaintiff's allegation that defendants "acted in bad faith and in a retaliatory manner" was sufficient to satisfy the notice pleading threshold); *Winston v. Mandor*, 710 A.2d 835, 844 (Del. Ch. 1997) (finding that allegations that defendant made valuation decision in bad faith and hired an interested party to perform the valuation and that controlling shareholders would benefit from undervaluation sufficient to survive motion to dismiss).

The allegations of the Complaint plainly satisfy this standard. The Complaint alleges that the Conflicts Committee's approval of the 2015 GTN Dropdown "was made in subjective bad faith." A021 ¶38. As the Complaint explains, the 2015 GTN Dropdown used an unprecedented funding mechanism (the issuance of Class B units), in order to benefit TCPGP's parent TransCanada at the expense of the Partnership. This resulted in a transaction in which the Partnership effectively paid TransCanada approximately 30% to 50% more on an EV/EBITDA basis than it had paid in the prior GTN dropdowns. A017-20 ¶¶25-32. As noted above, LPA §7.9(c) requires that the question of whether a transaction is "fair and reasonable" "shall be considered in the context of all similar or related transactions." A160. By thumbing their noses at §7.9(c), the members of the Conflicts Committee acted in bad faith.

Underscoring the lack of good faith, the Partnership is getting an annual rate of return of just 5.7% for the first five years of this transaction, while TransCanada, by virtue of its class B units, is receiving a 16.8% annual return. A018 ¶28. As stated in *In re Novell, Inc. S'holder Litig.*, 2013 WL 322560, at *10 (Del. Ch. Jan. 3, 2013) (quoting *In re Alloy, Inc. S'holder Litig.*, 2011 WL 4863716, at *12 (Del. Ch. Oct. 13, 2011)), "[o]ne way to [overcome the presumption that a fiduciary acts in good faith] would be for the plaintiff to demonstrate that the fiduciary's actions were 'so far beyond the bounds of reasonable judgment that it seems essentially

inexplicable on any ground other than bad faith.'" The *Novell* Court went on to hold: "[T]he Amended Complaint states a reasonably conceivable bad faith claim based on the [defendants'] unexplained, extremely favorable treatment of [one bidder over another] during the acquisition process." *Id.* at *18.

Breach of implied covenant claims present "a fact-based inquiry that is not well suited for a motion to dismiss," *Breakaway Solutions, Inc. v. Morgan Stanley & Co.*, 2004 WL 1949300, at *12 (Del. Ch. Aug. 27, 2004). Courts routinely deny motions to dismiss such claims, *id.*,[16] and the Court should have done so here.

[16] *See also CMS Inv. Holdings, LLC v. Castle*, 2015 WL 3894021, at *16 (Del. Ch. June 23, 2015); *Renco Group*, 2015 WL 394011, at *7; *Bakerman v. Sidney Frank Importing Co.*, 2006 WL 3927242, at *20 (Del. Ch. Oct. 10, 2006); *Comrie v. Enterasys Networks, Inc.*, 837 A.2d 1, 13 (Del. Ch. 2003); *Desert Equities,* 624 A.2d at 1206 (the "reasonableness" determination in an implied covenant claim is a "question of fact to be determined by a finder of fact").

CONCLUSION

As Vice Chancellor Laster wrote when faced with a defense that the vote of a conflicts committee put a transaction out of reach of judicial scrutiny: "While I agree that those provisions establish a weighty defense, the syllogism of 'if Teppco Audit Committee approval, then judgment for the defendants,' does not automatically follow.'" *Brinckerhoff v. Texas Eastern Products Pipeline Co., LLC,* 986 A.2d 370, 390 (Del. Ch. 2010).

It is respectfully submitted that the LPA should be construed so as to preclude reliance on the Special Approval safe harbor where, as here, the Conflicts Committee acted in bad faith in granting Special Approval. Therefore, for the reasons set forth herein, the decision below should be reversed, with costs.

Dated: July 25, 2016

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, James J. Sabella, do hereby certify that on July 25, 2016, I caused a copy of the foregoing Appellant's Opening Brief to be served by File & Serve*Xpress* upon the following counsel:

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