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**IN THE SUPREME COURT OF THE STATE OF DELAWARE**

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| EMPLOYEES RETIREMENT SYSTEM OF THE CITY OF ST. LOUIS,<br><br>Plaintiff Below, Appellant<br><br>v.<br><br>TC PIPELINES GP, INC. TRANSCANADA AMERICAN INVESTMENTS, LTD., and TRANSCANADA CORPORATION,<br><br>Defendants Below, Appellees<br><br>-and-<br><br>TC PIPELINES, LP,<br><br>Nominal Defendant Below, Appellee. | No. 291,2016<br><br>Case below:<br>Court of Chancery of the State of Delaware<br>C.A. No. 11603-VCG |

# APPELLEES' ANSWERING BRIEF

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## NATURE OF PROCEEDINGS

This matter concerns a transaction in which a Delaware master limited partnership ("MLP") purchased certain assets from an affiliate of its general partner. This "dropdown" transaction, in MLP parlance, received "Special Approval" by the partnership's "Conflicts Committee" pursuant to the Partnership's Second Amended and Restated Agreement of Limited Partnership (the "LPA"). As a result, the transaction is "***conclusively deemed fair and reasonable to the Partnership***" and is "***deemed approved by all Partners and shall not constitute a breach of the [LPA] … or of any duty stated or implied by law or equity.***" LPA § 7.9(a) (A159) (emphasis added).

In this appeal, Employees Retirement System of the City of St. Louis ("Plaintiff" or "Appellant") does not dispute that the transaction here received Special Approval by a Conflicts Committee that was properly constituted and was acting with full knowledge of all material facts. That is, Plaintiff has abandoned its breach of contract claims and does not contest that the general partner acted in accordance with the Special Approval process as set forth in the LPA. Nonetheless, Plaintiff contends that the general partner's conduct breached the implied covenant of good faith and fair dealing (the "implied covenant"). This is the sole basis for Plaintiff's appeal. But the implied covenant cannot save Plaintiff's case.

In fact, Plaintiff acknowledges that the LPA not only expressly anticipates dropdown transactions like the one at issue here, but also sets forth a comprehensive framework for dealing with such transactions. That established contractual framework precludes Plaintiff's assertion that the LPA contains a gap that must be filled by the implied covenant. Specifically, Section 7.9(a) of the LPA provides a detailed Special Approval process, which if followed, results in the subject transaction being "***conclusively*** deemed fair and reasonable to the Partnership." As this Court has explained, such conclusive language precludes a unitholder from seeking a substantive review of the fairness of the Conflicts Committee's decision. *See Haynes Family Trust v. Kinder Morgan G.P., Inc.*, 135 A.3d 76, 2016 WL 912184 (Del. Mar. 10, 2016) (TABLE). Nonetheless, this is exactly what Plaintiff seeks here under the guise of the implied covenant. Indeed, Plaintiff's "implied covenant" claim is nothing more than a disagreement with the Conflicts Committee about the value that the Partnership paid in the transaction. Plaintiff believes that the Conflicts Committee simply agreed to pay too much. Plaintiff does not identify any unanticipated events or other factors that might justify the use of the limited and extraordinary remedy of the implied covenant.

Instead, Plaintiff relies on a line of non-MLP cases to argue that whenever a contract provides a party with discretion the implied covenant requires that such discretion be exercised in "good faith." Plaintiff ignores, however, that this

general rule must yield to the express language of the contract. Thus, if the contract expressly addresses how the grant of discretion should be exercised and/or whether the discretionary decision should be subject to review, the implied covenant has no gap to fill and the plain language controls. This is the situation here.

Section 7.9(a) provides the Conflicts Committee with broad authority to consider any interests or factors that it determines in its "sole discretion" to be relevant when providing Special Approval. A159. Section 7.9(b) further explains that whenever the Conflicts Committee is permitted to make a decision in its "sole discretion" or similar authority, it "shall be entitled to consider only such interests and factors as it desires and shall have no duty or obligation to give any consideration to any interest of, or factors affecting, the Partnership, … any Limited Partner or any Assignee." A159-60. In light of this clear language concerning how the Conflicts Committee's discretion should be exercised, the implied covenant has no role. Plaintiff's implied covenant claim is also precluded by Section 7.9(a)'s requirement that the decision of a properly constituted and informed Conflicts Committee be "conclusive." Indeed, if, as Plaintiff insists, the Conflicts Committee's exercise of its discretion is always subject to review for "good faith," it effectively reads the word "conclusive" out of the LPA. This is impermissible, as the Court of Chancery rightly concluded.

For these and other reasons set forth below, Plaintiff has failed to identify any gap in the LPA to be filled and, therefore, the judgment of the Court of Chancery dismissing the implied covenant claim should be affirmed.

Moreover, even if an implied obligation is found to exist requiring the Conflicts Committee to act in subjective good faith (which it is not), Plaintiff has failed to allege any facts from which this Court could infer that the Conflicts Committee violated that standard. Plaintiff's analysis of the purported costs of the Class B units issued in connection with the challenged transaction is facially flawed. In fact, Plaintiff's allegations actually show that the 2015 dropdown transaction cost the Partnership ***less*** than earlier dropdowns involving the same asset. This clearly does not suggest bad faith conduct under even liberal pleading standards. Thus, for this reason as well, Plaintiff's appeal must be rejected and the decision of the Court of Chancery should be affirmed.

## SUMMARY OF ARGUMENT

I. Denied. The court below properly determined that, because the challenged dropdown transaction received "Special Approval" by a properly constituted Conflicts Committee acting with knowledge of all material facts, it was conclusively deemed to be fair and reasonable to the Partnership. This conclusion was correctly based on the plain language of the LPA, which provides that any transaction receiving Special Approval shall "conclusively" be deemed fair and reasonable to the Partnership and that the Conflicts Committee may determine in its "sole discretion" what factors to consider in granting Special Approval. *See* LPA §§ 7.6(e), 7.9(a) (A157, A159). The court below further properly rejected Plaintiff's implied covenant claim because the challenged dropdown was a form of transaction anticipated by the parties and for which they crafted a detailed contractual framework. That contractual framework plainly shows that the parties never intended the Special Approval decision to be subject to judicial review for "good faith." Finally, even if the good faith of the Conflicts Committee is a relevant inquiry (which it is not), Plaintiff has failed to allege any facts from which a court could infer that the Conflicts Committee acted in bad faith.

## STATEMENT OF FACTS

### A. TCP's Business

Nominal Defendant Below TC Pipelines, LP ("TCP" or the "Partnership") is a Delaware limited partnership whose Class A units are publicly traded on the New York Stock Exchange. A013. TCP was formed in 1998 to acquire, own, and participate in the management of energy infrastructure businesses in North America. *Id.* TCP owns interests in six pipeline systems, including the Gas Transmission Northwest ("GTN") pipeline. A014.

### B. The Conflicts Committee Unanimously Approves Acquiring The Remaining 30% Interest In The GTN Pipeline

The GTN pipeline is a 1,353 mile pipeline that stretches between British Columbia and Malin, Oregon near the California border. A009. The GTN pipeline is owned by Gas Transmission Northwest LLC ("GTN LLC"). A010. Prior to February 24, 2015, TCP owned a 70% interest in GTN LLC, which interest it had acquired from TransCanada American Investments, Ltd. ("TransCanada America") in two earlier transactions. *Id.* In November 2014, TCP announced that TransCanada America had offered to sell it the remaining 30% interest in GTN LLC. *Id.* On February 24, 2015, TCP entered into a definitive agreement to acquire the remaining 30% interest in GTN LLC, effective as of April 1, 2015 (the "2015 GTN Dropdown"). *Id.*

In exchange for the remaining 30% interest in the GTN pipeline, TCP agreed

to pay $446 million, comprised of $253 million in cash, the assumption of $98 million in debt, and the issuance of $95 million in newly-created Class B units to TransCanada America.[1] A017. The Class B units are entitled to annual distributions as follows:

> (1) for the partial year of 2015, all of the distributable cash flow generated by the 2015 GTN Dropdown over $15 million;
>
> (2) for each of the years 2016 through 2019, all of the distributable cash flow generated by the 2015 GTN Dropdown over $20 million;
>
> (3) for the year 2020, 43.75% of the distributable cash flow generated by the 2015 GTN Dropdown over $20 million; and
>
> (4) for each year after 2020, 25% of the distributable cash flow generated by the 2015 GTN Dropdown over $20 million.

*Id.*.; *see also* B85 (Third Amended and Restated Agreement of Limited Partnership of TC Pipelines, LP).

Although Plaintiff takes issue with the terms of the Class B units, Plaintiff admits that the total purchase price of $446 million for the 2015 GTN Dropdown was "in line with the prices paid" by TCP in the prior GTN dropdowns. A014. In addition, the enterprise value to EBITDA ratio ("EV/EBITDA multiple") was announced as 10.4x, which Plaintiff also admits was "in line" with the prior GTN dropdowns. A018. In fact, according to Plaintiffs' own allegations, the amount

[1] Pursuant to Section 5.6(a) of the LPA, TCP was authorized to "issue additional Partnership Securities ... for any Partnership purpose at any time and from time to time to such Persons for such consideration and on such terms and conditions as shall be established by the General Partner in its sole discretion, all without the approval of any Limited Partners." A143.

paid by the Partnership in the 2015 GTN Dropdown was ***less*** than what was paid in the earlier transactions on a percentage basis. A010-11, A018-19; *see also infra* Argument, Section I.C.3.

The 2015 GTN Dropdown, including the creation and issuance of the Class B units, was unanimously approved by the "Conflicts Committee." A021-22.

### C. The LPA Provides A Safe Harbor For Transactions Approved By The Conflicts Committee

Under the LPA, TCP's business and affairs are managed by its general partner, defendant TC Pipelines GP, Inc. ("TCPGP"). LPA § 7.1(a) (A152). In turn, TCPGP is managed by its board of directors (the "Board"). The Conflicts Committee is a committee of the Board. The Conflicts Committee is composed entirely of directors who are neither security owners, officers nor employees of TCPGP nor officers or employees of any affiliate of TCPGP. *Id.* §1.1 (A122).

Section 7.6(e) of the LPA provides that transactions between TCP and TCPGP or its affiliates must be "fair and reasonable to the Partnership." A157. This requirement shall be: "***deemed to be satisfied as to …*** (ii) ***any transaction approved by Special Approval ….***" *Id.* (emphasis added).

Similarly, Section 7.9(a) of the LPA provides that "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, … [or] any Partner or any Assignee, on the other," such conflict of interest "shall be permitted and deemed

approved by all Partners, and shall not constitute a breach of this Agreement" if the course of action taken "is or by operation of this Agreement is deemed to be, fair and reasonable to the Partnership." A159. Thereafter, Section 7.9(a) sets forth a clear path by which conflict transactions may be deemed fair and reasonable to the Partnership. Specifically, Section 7.9(a) of the LPA provides:

> The General Partner shall be authorized but not required in connection with its resolution of such conflict of interest to seek Special Approval of such resolution. 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)….

*Id.* (emphasis added). Special Approval is defined by the LPA to mean "approval by a majority of the members of the Conflicts Committee." LPA § 1.1 (A129).

The LPA further grants TCPGP, including the Conflicts Committee, wide discretion to consider any interests or factors that it determines in its "sole discretion" to be relevant when providing Special Approval. In particular, Section 7.9(a) provides:

> The General Partner (including the Conflicts Committee in connection with Special Approval) shall be authorized ***in connection with its determination of what is "fair and reasonable" to the Partnership*** and in connection with its resolution of any conflict of interest to consider (A) the relative interests of any party to such conflict, agreement, transaction or situation and the benefits and burdens relating to such interest; (B) any customary or accepted industry practices and any customary or historical dealings with a particular

> Person; (C) any applicable generally accepted accounting practices or principles; and (D) ***such additional factors as the General Partner (including the Conflicts Committee) determines in its sole discretion to be relevant, reasonable or appropriate under the circumstances***.

A159 (emphasis added).

Finally, Section § 7.9(b) of the LPA explains that whenever the General Partner or its affiliates are permitted to make a decision in their "sole discretion" or similar authority, they "shall be entitled to consider only such interests and factors as it desires and shall have no duty or obligation to give any consideration to any interest of, or factors affecting, the Partnership, … any Limited Partner or any Assignee." A159-60.

# ARGUMENT

## I. THE COURT OF CHANCERY PROPERLY DISMISSED PLAINTIFF'S IMPLIED COVENANT CLAIM

### A. Question Presented

Was it appropriate for the Court of Chancery to grant the Motion to Dismiss and to hold that the implied covenant of good faith and fair dealing did not apply to the decision to provide Special Approval of the 2015 GTN Dropdown?

### B. Scope of Review

This Court's review of the decision dismissing the Complaint is *de novo* and plenary. *See Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

### C. Merits of the Argument

#### 1. The Motion to Dismiss Standard

On a motion to dismiss, the trial court should "deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof." *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011). The court must further take well-pled facts as true, and "draw all reasonable inferences in the plaintiff's favor." *Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004). "The Court need not, however, 'blindly accept as true all allegations, nor must it draw all inferences from them in the plaintiff's favor unless they are reasonable inferences.'" *LeCrenier v. Cent. Oil Asphalt Corp.*, 2010 WL 5449838, at *3 (Del. Ch. Dec. 22, 2010); *see also Cent. Mortg.*,

27 A.3d at 536. The court should disregard conclusory statements of fact or law not otherwise supported by specific factual allegations. *See Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 140-41 (Del. 1997).[2]

The Court of Chancery applied these well-established standards in determining that all of Plaintiff's claims related to the 2015 GTN Dropdown should be dismissed for failure to state a claim. *See* May 11, 2016 Opinion ("Letter Op.") (Ex. A to Appellant's Opening Brief).

### 2. The Court of Chancery Properly Found That There Is No Gap In The LPA For The Implied Covenant To Fill

It is well settled under Delaware law that the implied covenant provides a "limited and extraordinary legal remedy that addresses only events that could not reasonably have been anticipated at the time the parties contracted." *In re Atlas Energy Res., LLC Unitholder Litig.*, 2010 WL 4273122, at *13 (Del. Ch. Oct. 28, 2010) (internal quotation marks omitted). Here, the challenge is to a dropdown transaction pursuant to which the Partnership acquired assets from affiliates of its general partner. As Plaintiff itself recognizes, "MLPs frequently rely on

[2] Plaintiff's assertion that implied covenant claims often raise fact-based inquiries that are not well suited for a motion to dismiss misses the point. *See* Appellee's Opening Brief ("OB") at 30. There are no difficult factual issues to resolve here. Instead, the issues may be resolved based on the plain language of the parties' contract. In such circumstances, the Court of Chancery frequently grants motions to dismiss implied covenant claims, which decisions have been upheld by this Court. *See, e.g.*, *Nemec v. Shrader*, 991 A.2d 1120, 1128 (Del. 2010); *Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808, 819 (Del. 2013); *Blaustein v. Lord Balt. Capital Corp.*, 84 A.3d 954, 959 (Del. 2014); *Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 994 (Del. 1998).

'dropdowns,' asset purchases from their general partner or a related entity, in order to drive growth." A044; A016. Therefore, a dropdown transaction, such as the 2015 GTN Dropdown, is hardly a transaction that "could not reasonably have been anticipated."

Even more significantly, as explained above, both Sections 7.6(e) and 7.9(a) of the LPA provide a safe harbor for any transaction that receives "Special Approval." A157, A159. Specifically, if a transaction receives Special Approval, it shall be deemed to be "fair and reasonable to the Partnership." A157. Here, Plaintiff does not contest that Special Approval (*i.e.*, approval by a majority of the Conflicts Committee) was in fact obtained and does not suggest that the Conflicts Committee's members failed to satisfy the qualifications for membership on the committee or that the General Partner failed to disclose any material facts to the Conflicts Committee. A021-22.

Furthermore, Plaintiff acknowledges that that the LPA grants the Conflicts Committee broad authority to consider and address whatever factors it deemed in its "sole discretion" to be "relevant, reasonable or appropriate under the circumstances." LPA § 7.9(a) (A159). Indeed, nowhere in its Opening Brief does Plaintiff ever contend that TCPGP failed to follow the letter of the Special Approval provision in considering the 2015 GTN Dropdown.

As a result of this Special Approval, the transaction is "conclusively deemed fair and reasonable to the Partnership," and "shall not constitute a breach" of the LPA or any "duty stated or implied by law or equity." LPA § 7.9(a) (A159). While some other MLP agreements provide that Special Approval creates only a rebuttable presumption that the transaction is fair and reasonable,[3] the Special Approval section of the LPA here does more—its effects are ***conclusive***.

Plaintiffs are not offering an alternative reading of Section 7.9(a), but instead are seeking to re-write the provision or to ignore the provision altogether under the guise of the implied covenant. Plaintiff's claim fails as a result. Because Special Approval conclusively deems the transaction fair and reasonable, there is no room for second-guessing of whether the transaction is, in fact, "fair and reasonable." *See* LPA § 7.9(a) (A159). While Plaintiff complains about such a result, this is exactly what the LPA mandates. And it is exactly how Delaware courts have interpreted analogous contractual terms.

The Court of Chancery first analyzed the effects of a special approval provision nearly identical to Section 7.9(a) of the LPA over fifteen years ago in *Brickell P'rs v. Wise*, 794 A.2d 1, 3 (Del. Ch. 2001). As the court stated there in granting a motion to dismiss, "[s]uch Special Approval is ***conclusive*** evidence of

[3] *See, e.g.*, *Allen v. Encore Energy P'rs, L.P.*, 72 A.3d 93, 102 (Del. 2013) ("If Special Approval is sought, then it shall be presumed that, in making its decision, the Conflicts Committee acted in good faith . . . .") (citation omitted).

the fairness and reasonableness of a conflict transaction, and bars any challenge to the transaction based on the Agreement, other contracts, or default principles of law or equity." *Id.* at 4 (emphasis added and internal quotations omitted). The holding in *Brickell*—which was based on a plain reading of the express language of the partnership agreement—cannot be more clear: Special Approval is "conclusive evidence of the fairness and reasonableness" of the underlying transaction. *Id.*

Subsequent decisions by this Court and the Court of Chancery have reached similar results. For example, as this Court recently explained in *Haynes Family Trust v. Kinder Morgan G.P., Inc.*, there is "no room for a substantive judicial review of the fairness of the transaction, because the general partner had complied with its contractual duties in the approval process of the [transaction] and that compliance ***conclusively*** established the fairness of the transaction, ***precluding*** the judicial scrutiny that the unitholders now seek." 2016 WL 912184, at *1. (emphasis added); *see also* Letter Op. at 5.[4] The same is true here.

[4] In its Opening Brief, Plaintiff argues that the *Haynes Family Trust* decision actually supports finding an implied duty of good faith because it affirmed the Court of Chancery opinion, which concluded that the conflicts committee there was required to "believe in good faith that the MLP Merger was in the best interests of the Partnership." *See* OB at 23 n.10; *In re Kinder Morgan, Inc. Corp. Reorg. Litig.*, 2015 WL 4975270, at *8 (Del. Ch. Aug. 20, 2015). However, the *Kinder Morgan* Court's finding of a good faith obligation was based on an express provision of the partnership agreement at issue in that case, which (as Plaintiff admits) has no analog here. *See Kinder Morgan*, 2015 WL 4975270 at *5. Also, there are no credible allegations here as to the Committee members' "beliefs" with regard to the challenged dropdown. *See infra* Section Argument, Section I.C.3.

The LPA sets forth the contractual steps necessary for obtaining Special Approval. If the General Partner satisfies those contractual requirements (as it did with respect to the 2015 GTN Dropdown), the transaction is "conclusively" deemed fair and reasonable, and shall not be a breach of the LPA. *See* LPA § 7.9(a). Plaintiff cannot seek a substantive fairness review of the Conflicts Committee's decision under either notions of fiduciary duty or the implied covenant.[5] Yet this is exactly what Plaintiff seeks to do here by insisting that the Court review the Conflicts Committee's conduct for "good faith."

**a. Plaintiff's Purported Gap Ignores The Terms And Structure Of The LPA**

The implied covenant is a narrow doctrine that may only apply when the contract at issue (i) has a gap in which the parties failed to address a particular issue and (ii) it is clear from the agreement what the parties would have agreed to regarding that issue had they thought to negotiate the matter. *See Fisk Ventures, LLC v. Segal*, 2008 WL 1961156, *10 (Del. Ch. May 7, 2008). As such, Plaintiff

[5] Where, as here, parties to a limited partnership agreement contractually agree to eliminate default fiduciary duties, a plaintiff may not invoke the implied covenant "as a back door through which such [fiduciary] duties may be reimposed after the fact." *Atlas Energy*, 2010 WL 4273122, at *13; *see also Nemec*, 991 A.2d at 1128 (noting that by using the implied covenant to replicate fiduciary review, it "would vitiate the limited reach of the concept of the implied duty of good faith and fair dealing"); *Lonergan v. EPE Hldgs., LLC*, 5 A.3d 1008, 1016-18 (Del. Ch. 2010) (rejecting effort to "cloak familiar breach of fiduciary duty theories in the guise of the implied covenant"); *Miller v. Am. Real Estate P'rs, L.P.*, 2001 WL 1045643, at *8 (Del. Ch. Sept. 6, 2001) ("This court has made clear that it will not [be] tempted by the piteous pleas of limited partners who are seeking to escape the consequences of their own decisions to become investors in a partnership whose general partner has clearly exempted itself from traditional fiduciary duties.").

must identify some purported gap in the LPA. Before the trial court, Plaintiff asserted that the LPA "contains a major gap insofar as it provides no guidance whatsoever as to the criteria that should be used to obtain Special Approval." A052; *see also* A053 (asserting that "[a] Conflicts Committee member looking to the LPA to determine whether or not he should vote for Special Approval of a particular transaction finds no concrete standards to be applied"). This argument ignored Sections 7.9(a) and 7.9(b) of the LPA, which expressly describe the factors (or criteria) that the Conflicts Committee may consider in providing Special Approval.[6] Plaintiff has abandoned that theory and now, on appeal, presents a purported new "gap" in the LPA. Plaintiff is not permitted, however, to make arguments on appeal that were not considered below; as such, its new theory should be rejected out of hand. *See* Supr. Ct. R. 8; *see also Tumlinson v. Advanced Micro Devices, Inc.*, 106 A.3d 983, 989 (Del. 2013); *Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 68 A.3d 665, 678 (Del. 2013).

[6] Responding to Plaintiff's original gap theory, the court below found that the LPA "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." Letter Op. at 15. On appeal, Plaintiff criticizes this holding on the grounds that it "erroneously conflates the question the Committee was asked to resolve with the standard of conduct the Committee must follow in reaching its resolution." OB at 18. The Court of Chancery's holding, however, was entirely correct as to the question presented before the trial court. Hence, any perceived "conflation" arises solely as a result of Plaintiff unfairly attempting to link the trial court's holding to a previously unidentified purported gap that is being raised for the first time in this appeal.

Even if considered, Plaintiff's new theory fares no better. Plaintiff's new theory is that the "LPA specifies no standard of conduct governing the members of the Conflicts Committee in deciding whether to grant Special Approval." OB at 3-4. Plaintiff contends that this purported gap must be filled by an implied duty to act in good faith. *Id.* at 4. This contention, however, ignores the entire framework of LPA with regard to conflict transactions.

The LPA sets forth various options that may be used for consideration and approval of conflict transactions. For example, under Sections 7.6(e)(iv) and 7.9(a)(iii), the conflicted General Partner is permitted to approve an affiliate transaction, but its decision is subject to the substantive requirement that the transaction be "equitable" or "fair" to the Partnership. As such, this option provides a robust substantive safeguard (substantive fairness) but no procedural safeguard (decision by a conflicted general partner). On the other end of scale, the LPA provides for Special Approval, which involves robust procedural safeguards but a very deferential substantive standard. *See* LPA §§ 7.6(e)(ii) and 7.9(a)(i) (A157, A159). Specifically, Special Approval may only be validly granted if the members of the Conflicts Committee satisfy the requirements of Section 1.1 and were provided all material facts by the General Partner and its affiliates. *See id.* If those requisites are satisfied, the Conflicts Committee may determine how to

resolve the conflict in its "sole discretion," as that term is broadly defined in the LPA. *See* LPA § 7.9(b) (A157).

Given this framework, Plaintiff's assertion that the Conflicts Committee's approval of the 2015 GTN Dropdown must nevertheless also be subject to review for "good faith" misses the point. Where the Special Approval option is chosen, the protection that is afforded to the Partnership is the mandated involvement of the properly constituted Conflicts Committee as an informed gatekeeper with respect to the related party transaction.

Plaintiff's attempt to impose a substantive standard (*i.e.*, "good faith") when the maximum procedural protection has already been afforded demonstrates that Plaintiff is asking the Court to rewrite the express terms of the LPA under the guise of the implied covenant. Delaware law does not permit this. *See Nationwide Emerging Mgrs., LLC v. Northpointe Hldgs., LLC*, 112 A.3d 878, 896-97 (Del. 2015) ("[The implied covenant] does not apply when the contract addresses the conduct at issue. . . . An interpreting court . . . 'should be most chary about implying a contractual protection when the contract could easily have been drafted to expressly provide for it.'") (citation omitted). Plaintiff's proposed good faith review standard would further render the "conclusive" language, as well as the

"sole discretion" language of the LPA meaningless.[7] This too is contrary to Delaware law. *See, e.g.*, *Fisk Ventures*, 2008 WL 1961156, at *10 ("[B]ecause the implied covenant is, by definition, *implied*, and because it protects the *spirit* of the agreement rather than the form, it cannot be invoked where the contract itself expressly covers the subject at issue."); *Williams Nat. Gas Co. v. Amoco Prod. Co.*, 1991 WL 58387, at *6 (Del. Ch. Apr. 16, 1991) (explaining that "as a matter of law, no obligation can be implied that is contrary to or inconsistent with [an] express contract provision").

### b. Plaintiff's Reliance On *Gerber* Is Misplaced

Plaintiff relies heavily on this Court's opinion *Gerber v. Enterprise Products Holdings LLC*, 67 A.3d 400, 423 (Del. 2013), arguing that the present situation is analogous to the circumstances at issue there. *See* OB at 21-22. Not so. Several

[7] Delaware courts have long enforced sole discretion provisions similar to that found in the LPA. *See, e.g.*, *Sonet v. Timber Co.*, 722 A.2d 319, 325 (Del. Ch. 1998) (finding that under the sole discretion provision "there is no *requirement* that the General Partner consider the interests of the limited partners in resolution of a conflict of interest") (emphasis in original). Indeed, in *Gelfman v. Weeden Investors, L.P.*, 792 A.2d 977 (Del. Ch. 2001), the Court wrote:

> Does § 6.11(b) mean that a General Partner may act in a "conflict" situation under a standard by which it need not—as a contractual matter—consider the interests of the limited partners? I conclude so. However harsh it may sound, this is in fact the only reasonable reading of the Agreement. By its terms, § 6.11(b) indicates that other contractual standards—such as those contained in § 6.11(a)—give way and are of no force and effect when the Agreement subjects certain action of the General Partner to an "express" sole and complete discretion standard.

*Id.* at 986.

significant factual distinctions between *Gerber* and the present case show that *Gerber* has no application here.

First, the underlying circumstances and allegations in *Gerber* stand in sharp contrast to the present situation. The underlying transactions in *Gerber* were not dropdown transactions—which are routine and often anxiously anticipated by MLP investors—but rather were extraordinary and unanticipated related party transactions.[8] This is a critical difference given that the implied covenant only operates in those circumstances that "could not reasonably have been anticipated." *Atlas Energy*, 2010 WL 4273122, at *13.

Second, the allegations in *Gerber* raised legitimate questions as to the process employed by the conflicts committee and its financial advisor. Here, by contrast, no legitimate process issues have been raised, and the Complaint is based solely on the fact that Plaintiff disagrees with the merits of the 2015 GTN

[8] The claims in *Gerber* were brought by unitholders of Enterprise GP Holdings, L.P. ("EPE"). The challenged transactions involved a sale by EPE of a general partner in another MLP (the "sale transaction") and a merger transaction that was primarily effected to eliminate pending derivative claims (the "merger"). Plaintiff's assertion that these were all routine transactions is wrong. *See* OB at 22 n.9. The allegations concerning the sale transaction were that (i) EPE sold Teppco GP to an affiliate for less than one-tenth of what it had paid for Teppco GP just two years earlier and (ii) the fairness opinion received by the EPE conflicts committee did not address the fairness of the consideration received in this transaction. *Gerber*, 67 A.3d at 406. The allegations in the merger transaction were that (i) a primary purpose of a merger of EPE with and into a wholly owned subsidiary of Enterprise Products LP was to eliminate pending derivative claims being made by EPE unitholders and (ii) the financial advisor for the EPE conflicts committee did not independently value the derivative claims and the value of the derivative claims was not considered in connection with negotiating the merger consideration. *Id.* at 407-08.

Dropdown from a valuation perspective. Indeed, the only criticism that Plaintiff has of the Conflicts Committee's process is that the members allegedly "closed their eyes to the relevant facts or refused to pay attention to the requirement of LPA § 7.9(c) that the 'fair and reasonable nature' of a conflict of interest transaction 'be considered in the context of all similar or related transactions.'" OB at 22.[9] Plaintiff apparently is unhappy that the Conflicts Committee did not structure the 2015 GTN Dropdown in a manner more similar to the 2011 and 2013 GTN dropdowns. This is merely a disagreement, however, with the Conflicts Committee's ultimate judgment rather than any legitimate concern about the process employed by the Committee.

Third, the agreement at issue in *Gerber* contained a provision that affirmatively required the Enterprise general partner to act in good faith "[w]henever the General Partner makes a determination or takes or declines to take any other action, or any of its Affiliates causes it to do so." *Gerber*, 67 A.3d at 409, 419, 423 (quoting section 7.9(b) of the EPE partnership agreement). Section 7.9(b) in *Gerber* has no analog in the LPA here. While Plaintiff notes that the

[9] Plaintiff repeatedly asserts that by structuring the 2015 GTN Dropdown differently than the earlier GTN dropdowns, the Conflicts Committee acted in violation of Section 7.9(c), which provides that whether a transaction is "fair and reasonable" shall be "considered in the context of all similar or related transactions." A160. Plaintiff, however, has not pled any facts supporting the notion that the Conflicts Committee did not "consider" the prior GTN dropdowns. To the contrary, Plaintiff has acknowledged that the total purchase price for the 2015 GTN Dropdown was "in line" with the prices paid in the earlier GTN dropdowns, which suggests that they were in fact considered. A011. Nothing in Section 7.9(c) requires all dropdowns to be structured in an identical manner.

Court did not base its decision on the presence of this contractual good faith standard, relying instead on the implied covenant (*see* OB at 22 n.9), the existence of the express good faith provision undoubtedly influenced the *Gerber* Court's views as to what the parties reasonably expected at the time of contracting. *See Gerber*, 67 A.3d at 421-22.

Finally, although Plaintiff likes to quote *Gerber* for the proposition that the "implied covenant constrains how the Special Approval process may be carried out" (*see* OB at 16), that statement does not suggest that a free floating duty to act in "good faith" attaches to every aspect of the Special Approval process. To the contrary, the *Gerber* Court was clear that "[a]pplying the implied covenant is a 'cautious enterprise'" and that its holding was limited to the extraordinary process defects at issue in that case, where the defendant sought to rely on a fairness opinion that failed to actually address the relevant valuation inquiry. *Gerber*, 67 A.3d at 421-22. For all of these reasons, *Gerber* is inapposite and of no help to Plaintiff's implied covenant claim.

**c. Plaintiff's Other Authorities Also Cannot Save Its Claim**

Plaintiff also relies heavily on a string of Delaware cases that hold where "a contract provides discretion to one party and the scope of that discretion is not specified 'the implied covenant requires that the discretion be used reasonably and in good faith.'" *See Policemen's Annuity & Benefit Fund of Chi. v. DV Realty*

*Advisors LLC*, 2012 WL 3548206, at *12 (Del. Ch. Aug. 16, 2012), *aff'd*, 75 A.3d 101 (Del. 2013); *see also* OB at 20.[10] As recognized by the Court of Chancery in *DV Realty Advisors* (a case Plaintiff relies upon), however, this rule only applies where the "scope of that discretion is not specified" in the contract. 2012 WL 3548206, at *12. The Court of Chancery further explained that "[w]hen a contract provision states how a grant of discretion is to be exercised, there is no place for the implied covenant in that provision." *Id.* (further stating that "if the scope of discretion is specified, there is no gap in the contract as to the scope of the discretion, and there is no reason for the Court to look to the implied covenant to determine how discretion should be exercised"). That is the situation here.

As explained above, Sections 7.9(a) and 7.9(b) expressly provide that the Conflicts Committee shall exercise its "sole discretion" and explicitly define that term to provide the Committee with a broad grant of authority. A159, A160. None of the cases cited by Plaintiff arise in such circumstances. This is a critical distinction, as recognized by the Court of Chancery in *Allen v. El Paso Pipeline*

[10] Plaintiff also makes much of an article written by defense counsel concerning this line of cases. *See* OB at 20-21 (quoting Paul M. Altman & Srinivas M. Raju, *Delaware Alternative Entities and the Implied Covenant of Good Faith and Fair Dealing Under Delaware Law*, 60 Bus. Law. 1469 (2005)). Once again, Plaintiff's reliance is misplaced. The article notes the general rule that discretionary powers granted by a contract should be exercised in good faith under the implied covenant, but then goes on to explain how the contract's language may restrict the application of this general rule by setting forth how the discretionary rights should be exercised. *See id.* at 1484. The article further notes that a sole discretion provision "should have a significant impact on analyzing any claim that the general partner or managing member violated the Implied Covenant." *Id.* (stating that "the inclusion of such Sole Discretion Language should have a significant bearing on the reasonable expectations of the parties").

*GP Co.*, 113 A.3d 167 (Del. Ch. 2014). In that case, the plaintiff argued that, *á la Gerber*, the implied covenant required the conflicts committee's banker to have evaluated the dilution that the transaction would cause the limited partners. *See id.* at 187-89. The Court of Chancery rejected this argument, finding that it was contrary to the carefully crafted Special Approval process established by the MLP agreement. *See id.* at 191; *see also Haynes Family Trust*, 2016 WL 912184, at *2 ("This case therefore stands as another reminder that with the benefits of investing in alternative entities often comes the limitation of looking to the contract as the exclusive source of protective rights."). The same result is appropriate here, given the clear language and structure of the LPA indicating that the Conflicts Committee's decision shall be conclusive.

**d. Plaintiff's Argument Is Contrary To Well Established Cannons Of Contract Construction**

As noted above, Plaintiff's theory that the Conflicts Committee's decision is subject to good faith review would render the language granting the Conflicts Committee "sole discretion" and providing that its decision shall be "conclusive" meaningless. This is contrary to Delaware's long-standing cannons of contract construction. *See Sonitrol Hldg. Co. v. Marceau Investissements*, 607 A.2d 1177, 1183 (Del. 1992) ("Under general principles of contract law, a contract should be interpreted in such a way as to not render any of its provisions illusory or meaningless."); *see also Matria Healthcare, Inc. v. Coral SR LLC*, 2007 WL

763303, at *6, *9 (Del. Ch. Mar. 1, 2007) ("[W]hen possible, the Court should attempt to give effect to each term of the agreement and to avoid rendering a provision redundant or illusory.").

Plaintiff's argument also ignores the fact that Section 7.9(b) expressly distinguishes between decisions subject to the "sole discretion" standard and those subject to a "good faith" standard. Specifically, Section 7.9(b) identifies three different options concerning the General Partner's decision making authority: (i) those decisions vested in the General Partner's "sole discretion"; (ii) grants of authority that do not specify any standard of conduct; and (iii) decisions that must be made "in 'good faith' or under another express standard." A159-60. Indeed, several provisions of the LPA expressly require the General Partner, and even the Conflicts Committee, to act in good faith. For example, under Section 7.12(a), the issuance of a registration statement may be delayed "if the Conflicts Committee determines in its good faith judgment that a postponement of the requested registration for up to six months would be in the best interests of the Partnership." *See also* LPA §§ 2.6(b) (A133); 3.4(b) (A135); 6.1(d)(vi) (A147); 7.8(b) (A158); 7.8(c) (A159); 12.3 (A169); 15.1(a) (A177-78).

As Plaintiff admits, however, there is no similar requirement here that the Conflicts Committee act in good faith when approving a dropdown transaction. This is not a gap in the contract, but rather evidence that "sole discretion" and

"good faith" are used as distinct standards in the LPA. If the sole discretion standard were found to include an implied obligation to act in "good faith," then the distinction between the standards would become meaningless. Delaware law does not permit such a result. *See Sonitrol*, 607 A.2d at 1183; *Matria Healthcare*, 2007 WL 763303, at *6, *9. Accordingly, Plaintiff's attempt to insert an implied "good faith" standard into the Conflicts Committee's exercise of its "sole discretion" must be rejected.

**e. Plaintiff's Many Hypotheticals Are Irrelevant But, In Any Event, Demonstrate That The Implied Covenant Does Not Apply Here**

In its Opening Brief, Plaintiff presents a series of hypothetical situations that apparently are intended to illustrate the wisdom of its position. However, this Court does not decide cases based on hypotheticals but rather on the concrete set of facts presented by each individual action. *See AIU Ins. Co. v. Am. Guarantee & Liability Ins. Co.*, 2013 WL 154263, at *2 (Del. Jan. 15, 2013) (TABLE). Even if the Court were to consider the hypotheticals, it would conclude that they do the opposite of what Plaintiff intends, *i.e.*, they demonstrate the type of extreme situations in which the implied covenant might apply, which contrast sharply with the present facts.

For example, both below and in its Opening Brief, Plaintiff posed the hypothetical of a Conflicts Committee that granted Special Approval to the

Partnership's purchase of multi-million dollar Christmas gifts for the children of TransCanada's CEO. A052-53; OB at 26. Of course, this is exactly the type of thing that independent directors acting with full knowledge do not do. Nevertheless, accepting Plaintiff's hypothetical that such a transaction could occur, Defendants agree that it may justify invoking the "limited and extraordinary" remedy of the implied covenant. This is because such a situation is clearly outside the reasonable expectations of the parties. This is quite different than a routine dropdown transaction, such as the 2015 GTN Dropdown.

Plaintiff's observation that cases frequently arise involving self-dealing by managers does not bolster its argument. Few, if any, cases involve *independent* directors providing gratuitous gifts to managers or their families and, if such extraordinary circumstances ever do arise, extraordinary doctrines such as the implied covenant are available to provide relief. Here, on the other hand, we merely have a plaintiff that believes that the terms of an otherwise expected and routine business transaction should have been more attractive. This hardly merits invoking the implied covenant.

Next, Plaintiff posits the possibility that the Conflicts Committee members could be bribed. As the Court of Chancery properly found, bribery would be a situation in which the implied covenant would likely apply. Again, as the court below explained, this is because "[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." Letter Op. at 17 n.48. This analysis is correct. Contracting parties are undoubtedly entitled to assume that independent decision makers will not be bribed to vote in favor of conflicted transactions. Moreover, bribery of the otherwise independent decision maker would create a colossal procedural defect. As such, if a party can plead a sufficient basis to believe bribery has occurred, then the courts should examine such claim. Here, in contrast, there are no allegations whatsoever as to any defects in the process, let alone something as serious as bribery. Instead, Plaintiff merely disagrees with the Conflicts Committee's business decision.

Finally, Plaintiff raises a hypothetical posed by the court below, in which Special Approval is granted to a dropdown transaction pursuant to which the Partnership "paid ten times the asset's value." OB at 23. Defendants continue to believe that, assuming no process defects, such a situation is not one in which the implied covenant may be invoked. Rather, in such situation, the unitholders would have received the fruits of their bargain—namely, the vetting of the transaction by a properly constituted Conflicts Committee with full knowledge of material facts—regardless of the Committee's ultimate determination of value. In any event, this hypothetical is not relevant because, as explained in the next section, the present

case involves a dropdown in which the Partnership paid ***less*** than it had in prior transactions involving the same asset.

*  *  *

In sum, Plaintiff's attempt to impose a substantive judicial review under the guise of the implied covenant fails as a matter of law and under the express terms of the LPA.

### 3. Plaintiff Fails Sufficiently To Allege Bad Faith

Even if the Court were to consider Plaintiff's contention that the good faith of the Conflicts Committee is relevant here (which it is not), Plaintiff has failed to allege any facts from which this Court could infer that the Conflicts Committee acted in bad faith.

A person acts in bad faith if such person "intentionally fails to act in the face of a known duty to act." *Allen v. Encore*, 72 A.3d at 105 (citation omitted). However, as this Court has recognized, in order "[t]o fail intentionally to act in the face of a known duty, . . . there must be a 'duty.'" *Id*. at 105-06. Thus, where "the only duty the Conflicts Committee members had was to form a subjective belief that the [transaction] was in [the partnership's] best interests," the plaintiff "must show that the Conflicts Committee consciously disregarded its contractual duty to form a subjective belief." *Id.* The Court concluded, "It would take an extraordinary set of facts to do that." *Id.*; *see also DV Realty Advisors v.*

*Policmen's Annuity & Benefit Fund of Chi.*, 75 A.3d 101, 110 (Del. 2013) (finding that lack of good faith requires conduct "so far beyond the bounds of reasonable judgement that it seems essentially inexplicable on any ground other than bad faith").

Hence, any consideration of whether the Conflicts Committee acted in subjective bad faith must begin with the limited duties owed pursuant to the plain language of the LPA. Under the LPA, the Conflicts Committee need only believe that the 2015 GTN Dropdown was "fair and reasonable to the Partnership." LPA § 7.9(a) (A159); *see also Allen v. Encore*, 72 A.3d at 105. In making that determination, the Conflicts Committee is expressly permitted to consider whatever interests and factors that it determines in its "sole discretion." *See* LPA § 7.9(a)-(b) (A159-60).

Plaintiff's only allegation in support of its assertion of subjective bad faith is that "[a]t the time the Conflicts Committee approved the 2015 GTN Dropdown they knew that they were authorizing a payment well in excess of the value what [sic] was acquired, because they could compare the deal to the 2011 GTN Dropdown and the 2013 GTN Dropdown, both involving the very same assets and the very same counterparty." A021-22. Thus, Plaintiff's claim is based entirely upon the notion that the 2015 GTN Dropdown is unfair when compared to earlier 2011 and 2013 dropdowns involving the same pipeline. This allegation falls far

short of suggesting bad faith. Indeed, while the transactions all involve the same pipeline business, they are separated by years during which the energy markets experienced numerous fluctuations. Simply saying the Conflicts Committee paid more in 2015 than it had paid two to four years earlier in no way raises an inference of subjective bad faith.

Moreover, Plaintiff's assertion that the Partnership paid more in the 2015 GTN Dropdown is not even supported by its own allegations. While Plaintiff says that the purchase price for the 2015 GTN Dropdown was "in line" with the earlier GTN dropdowns (A011, A018), in fact, the Partnership paid ***less*** in 2015 than it had in the earlier transactions. The below chart shows the relative purchase prices paid in the earlier dropdown transactions and in the 2015 GTN Dropdown.

| Dropdown Transaction | Percentage Interest of GTN Acquired | Transaction Price | Transaction Price as Percentage of Aggregate Price |
|---|---|---|---|
| **2011 and 2013 GTN Dropdowns** | 70% | $1,155 million | 72.1% |
| **April 2015** | 30% | $446 million | 27.9% |
| **Total** | 100% | $1,601 million | 100% |

A010-11, A018-19. As the chart shows, the total aggregate price for the 100% interest in GTN was $1,601 million. The 2015 GTN Dropdown involved acquiring a 30% interest, yet the Partnership only paid 27.9% of the aggregate purchase for that interest. For the 2015 GTN Dropdown to be truly "in line," as Plaintiff

contends, with the earlier dropdowns the consideration paid should have been $480 million ($1,601 x 30% = $480). Here, the nominal price paid by the Partnership was only $446 million, implying a discount to the benefit of the Partnership of $34 million relative to the earlier dropdown transactions involving the same asset.

Faced with this reality, Plaintiff focuses its assertion of bad faith exclusively on one specific component of the 2015 GTN Dropdown, the Class B units. The Class B units are entitled to annual distributions as follows:

> (1) for the partial year of 2015, all of the distributable cash flow generated by the 2015 GTN Dropdown over $15 million;
>
> (2) for each of the years 2016 through 2019, all of the distributable cash flow generated by the 2015 GTN Dropdown over $20 million;
>
> (3) for the year 2020, 43.75% of the distributable cash flow generated by the 2015 GTN Dropdown over $20 million; and
>
> (4) for each year after 2020, 25% of the distributable cash flow generated by the 2015 GTN Dropdown over $20 million.

B85. The Partnership received $95 million in value in exchange for the Class B units. A017.

Plaintiff assumes that the cash flows attributable to the 2015 GTN Dropdown will be $36 million in perpetuity and, on that basis, argues that the Class B unfairly redistributes these cash flows in favor of TransCanada. Specifically, Plaintiff contends that the Partnership will receive an annual return of only 5.7% on its investment of $351 million over the next five years, while

TransCanada will receive a nearly 17% return on its $95 million in Class B units. *See* OB at 2; A018. This argument is flawed for several reasons.

First, Plaintiff makes a fundamental error by wholly ignoring the structural subordination of the cash flows to be received by the Class B. Under its express terms, the Class B is *not entitled to any cash flows* until the Partnership first gets $20 million. Therefore, while it is true that the Class B should expect to receive $16 million under Plaintiff's $36 million per year of cash flow assumption, any underperformance is going to come directly at the expense of the Class B. For example, assume a 30% reduction in overall cash flows from GTN. This would reduce the total $36 million of expected cash flows to $25.2 million. Nevertheless, the Partnership would still get its full $20 million. The Class B, however, would only get $5.2 million (a 67.5% reduction from its expected $16 million).[11]

Second, Plaintiff ignores the fact that the cash flow to the Class B units drop off dramatically after five years. Even assuming Plaintiff's steady rate of $36 million in annual cash flow, the return to the Class B units drops down to 7.4% in

[11] Plaintiff also argues that the transaction multiple paid by the Partnership in the 2015 GTN Dropdown was an unprecedented high of 14.6x and that this indicates bad faith. *See* OB at 2; A018, A019, A022. As Plaintiff admits, however, the actual transaction multiple as calculated by the Partnership was 10.4x, which is well below what Plaintiff contends is the average multiple in comparable transactions of 12.7x. A018, A022. Plaintiff supposedly calculates its 14.6x multiple based on adjusting the cash flows for the Class B. A047. Even assuming for argument's sake that Plaintiff's re-calculation is correct, it fails to take into account the fact that because the Class B has riskiest portion of the cash flows, the Partnership's share of the cash flows has become less risky (and, therefore, more valuable). Less risky cash flows command higher prices (*i.e.*, greater multiples). Plaintiff makes no attempt to account for this increased value to the Partnership.

Year 6 and drops down further to 4.2% following Year 6 and into perpetuity. Any meaningful analysis of the Class B has to take into account the full life cycle of the security, including Year 6 and thereafter where the cash flow from GTN gets reallocated in favor of the Partnership and the returns on the Class B drop precipitously.

In sum, Plaintiff's allegations with respect to the Class B are fundamentally flawed. They are superficial allegations that fail to provide any meaningful or relevant metric for assessing the value or fairness to the Partnership of the Class B. Accordingly, even assuming *arguendo* that the Conflicts Committee's determination is subject to a good faith standard, Plaintiff's allegations still would be insufficient to survive the motion to dismiss.

## CONCLUSION

For all of the foregoing reasons, Appellees respectfully request that the decision of the Court of Chancery dismissing all of Plaintiff's claims be ***affirmed***.

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