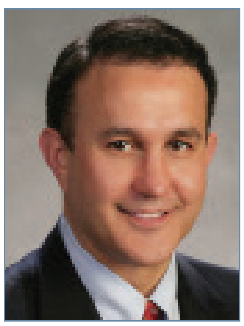
Court Rules on Fiduciary Duties in Limited Partnerships

By Francis G. X. Pileggi



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Publicly traded limited partnerships face issues different than traditional public enterprises, and the Delaware Supreme Court acknowledged in a recent case that the precedents in this area of the law are confusing. Let me try to simplify.

The intricacies of Enbridge Energy Co.'s limited partnership agreement (LPA) have been examined in several decisions of the Delaware courts in recent years.

In *Brinckerhoff v. Enbridge Energy Company*, the Delaware Supreme Court determined that the LPA in this case provides a contractual fiduciary standard similar if not identical to the entire fairness standard. Such contractual standards can still subject the general partner to paying monetary damages if the trial court determines that the provisions of the LPA were breached.

Brinckerhoff, a limited partner in Enbridge (EEC), alleged that a transaction was economically unfair to the partnership because it primarily benefited the general partner. Specifically, the partnership paid $200 million more to repurchase assets it sold in 2009, despite slumping oil prices; declining earnings before interest, depreciation, taxes, and amortization; and the absence of the expansion rights that were sold as a part of that original deal. However, the terms of Enbridge's LPA waived fiduciary duties of the general partner in favor of a contractually defined standard of conduct.

The Delaware Supreme Court determined that the Court of Chancery violated the rules of contract interpretation, which require the court to prefer specific provisions over general ones. Specifically, the LPA stipulated that the general partner may not enter into any transaction that is not "fair and reasonable to the partnership;" the court described that standard as "something similar, if not equivalent to the entire fairness review."

By applying that standard to the challenged transaction, the court reasoned that there was an inference that the transaction was not fair and reasonable to the partnership.

Although all fiduciary duties were waived, the court relied on other language in the agreement for the contractually defined standard of conduct to satisfy the good faith provision. Namely, the general partner was permitted to act under the LPA so long as such action was reasonably believed by the general partner to be in, or not inconsistent with, the best interests of the partnership.

In reversing the Court of Chancery's 2013 decision which interpreted the same LPA, the Supreme Court announced a new standard of what would suffice to establish a claim at the pleadings stage that the general partner did not act in good faith. That is, the court determined that such a claim must plead facts supporting an inference that the general partner "did not reasonably believe that the [challenged] transaction was in the best interest of the partnership." The court explained that the qualifier "reasonably" imposes an objective standard of good faith.

The court also explained that timing is indeed everything. Although the general partner argued that it received advice to affirm that it was acting in good faith prior to pursuing the deal, the court found that the financial terms of the deal were set by the time the expert appeared on the scene. Therefore, the general partner did not actually rely on the expert opinion, and thus was not entitled to a presumption of good faith for relying on that fairness opinion.

In sum, those directors or managers of alternative entities who think the governing agreement waiving fiduciary duties—such as an LPA—shields them from liability should be aware that, depending on the terms of the agreement, there can still be a basis of liability for claims other than breach of fiduciary duty.