EFiled: Apr 4 2012 3:14PM EDT
Transaction ID 43476249
Case No. 6301-VCP

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE K-SEA TRANSPORTATION PARTNERS L.P. UNITHOLDERS LITIGATION

C.A. No. 6301-VCP

MEMORANDUM OPINION

Submitted: February 21, 2012
Decided: April 4, 2012

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PARSONS, Vice Chancellor.

This is a class action brought on behalf of the common unitholders of a publicly-traded Delaware limited partnership. In March 2011, the partnership agreed to be acquired by an unaffiliated third party at a premium to its common units' trading price. The merger agreement, which governs the transaction, also provided for a separate payment to the general partner to acquire certain partnership interests it held exclusively. The plaintiffs allege that the amount of that payment far exceeded the economic value of those interests. To avoid this potential conflict of interest, the board submitted the transaction to a conflicts committee of independent directors who, relying on an investment bank's fairness opinion, determined that the overall transaction was fair and reasonable to the partnership's common unitholders. On that basis, the full board approved the transaction, which closed on July 1, 2011.

The plaintiffs claim that the conflicts committee was improperly constituted and provided with incentives to approve the transaction, thus undermining its purportedly disinterested approval. The plaintiffs further assert that, because the conflicts committee's approval process was defective, the general partner, certain of its affiliates, and the members of the board breached the limited partnership agreement and their fiduciary duties by approving the transaction. Additionally, the plaintiffs accuse those same entities and individuals of authorizing materially misleading disclosures concerning the merger agreement. For their part, the defendants emphatically deny that the conflicts committee's approval was defective, and they assert that, in any event, neither the transaction nor the disclosures breached any contractual or fiduciary duty. On that basis, the defendants have moved to dismiss the plaintiffs' claims.

Upon a careful review of the limited partnership agreement and the parties' respective arguments, I conclude that the defendants' approval of the merger agreement cannot constitute a breach of any contractual or fiduciary duty, regardless of whether the conflict committee's approval was effective. I also find that the disclosures authorized by the defendants are not materially misleading. The plaintiffs, therefore, cannot succeed on their claims under any reasonably conceivable set of circumstances. Accordingly, I grant the defendants' motion to dismiss.

I. BACKGROUND

A. Parties

Plaintiffs are common unitholders of K-Sea Transportation Partners L.P. ("K-Sea" or the "Partnership").

K-Sea is a Delaware limited partnership. Before the transaction at the center of this case, K-Sea's common units traded on the New York Stock Exchange under the ticker symbol "KSP," and the Partnership's affairs and conduct of its business were subject to the Fourth Amended and Restated Agreement of Limited Partnership (the "LPA"). The general partner of K-Sea is K-Sea General Partner L.P. ("K-Sea GP"), itself a Delaware limited partnership controlled by its general partner, K-Sea General Partner GP LLC ("KSGP"). KSGP is a Delaware limited liability company. The following individuals were, at all relevant times, members of the board of directors of KSGP: Anthony S. Abbate, Barry J. Alperin, James C. Baker, Timothy J. Casey, James J. Dowling, Brian P. Friedman, Kevin S. McCarthy, Gary D. Reaves, and Frank Salerno (collectively, the "K-Sea Board"). Directors Abbate, Alperin, and Salerno also served on

the Conflicts Committee of the K-Sea Board. Collectively, K-Sea, K-Sea GP, KSGP, and the individual members of the K-Sea Board are referred to herein as "Defendants."

B. Facts[1]

In early February 2011, Kirby Corporation ("Kirby") made an initial proposal to acquire all of K-Sea's common and preferred units for $306 million. The K-Sea Board rejected Kirby's offer as inadequate and advised Kirby that any future offers should account for the incentive distribution rights ("IDRs") held by a wholly-controlled affiliate of K-Sea GP.[2] Approximately one week later, Kirby made a revised offer to acquire all of the outstanding equity interests in K-Sea and K-Sea GP, which specifically allocated $18 million to acquiring K-Sea GP's interest in the IDRs. Due to the "possible conflict of interest" created by the $18 million payment to K-Sea GP, the K-Sea Board directed the Conflicts Committee to review Kirby's proposal and to make a recommendation regarding it.[3]

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1 Unless otherwise noted, the facts recited herein are drawn from the allegations in Plaintiffs' Verified Consolidated Amended Class Action Complaint (the "Amended Complaint"). This recitation of the facts focuses on the allegations pertinent to the Analysis, *infra*, regarding the motion to dismiss. For additional background, the Court refers the reader to its earlier Memorandum Opinion addressing Plaintiffs' motion to expedite, *In re K-Sea Transp. P'rs L.P. Unitholders Litig.*, 2011 WL 2520209, at *1-4 (Del. Ch. June 10, 2011) [hereinafter *K-Sea I*].

2 For simplicity, I refer to the IDRs in the remainder of this Memorandum Opinion as if they were held directly by K-Sea GP.

3 Am. Compl. ¶ 50. The Amended Complaint does not provide a citation for the quoted phrase "possible conflict of interest," but the Amended Registration Statement Form S-4 (the "Form S-4") jointly issued by K-Sea and Kirby employs the same phrase. *See* Keener Aff. Ex. 2, Form S-4, at 46. Drawing the inferences in favor of the nonmoving party, the Court attributes the quote to Defendants.

Under the LPA, the Conflicts Committee is empowered to give their "Special Approval" to any conflict of interest they deem fair and reasonable to the Partnership, thereby immunizing the conflict from challenge by the common unitholders. The LPA, however, also restricts membership on the Conflicts Committee to K-Sea Board members who, among other things, do not hold "any ownership interest in [K-Sea or affiliated entities] other than Common Units."[4] In December 2010, shortly before merger discussions began, the K-Sea Board granted 15,000 phantom units to each member of the Conflicts Committee. Each phantom unit entitles its holder to one K-Sea common unit or its cash equivalent at a prescribed, future date, but vesting occurs immediately upon a change of control. The parties dispute whether this grant of phantom units created a disqualifying "ownership interest . . . other than Common Units" for anyone serving on the Conflicts Committee. Other than by receipt of these phantom units, however, there is no allegation that Abbate, Alperin, or Salerno failed to satisfy the LPA's requirements for membership on the Conflicts Committee.

The Conflicts Committee retained independent legal counsel and a financial advisor, Stifel Nicolaus & Co. ("Stifel"), in connection with its review of Kirby's offer. After full negotiations, Kirby's offer comprised, among other things, the following terms: (1) $8.15 per common unit (in cash or, at the election of the holder, roughly half in cash and half in Kirby stock) and (2) a total of $18 million in cash for all of K-Sea GP's IDRs. The offer of $8.15 per common unit represented a 26% premium to the closing price of

[4] Keener Aff. Ex. 3, LPA, § 1.1.

the Partnership's common units on March 11, 2011, the day before the merger was announced. On or about March 12, 2011, Stifel opined that the consideration was fair from a financial perspective to K-Sea's common unitholders. Stifel's opinion, however, did not specifically address the fairness of the $18 million allocated to K-Sea GP. The Conflicts Committee then unanimously approved the transaction (also without specific reference to the $18 million payment) and recommended it to the full K-Sea Board.

Later on March 12, the K-Sea Board unanimously approved the transaction, entered into a definitive merger agreement with Kirby (the "Merger Agreement"), and recommended that the common unitholders vote to adopt the Merger Agreement. On May 26, 2011, K-Sea and Kirby publicly disseminated a Form S-4, recommending that K-Sea unitholders adopt the Merger Agreement. The Form S-4 provides well over 100 pages of disclosures including, among other things, the Merger Agreement itself, a summary of the negotiation process and Stifel's fairness opinion, risk factors of the Merger Agreement, and selected financial information regarding both K-Sea and Kirby.

On July 1, 2011, after Plaintiffs had filed the operative Amended Complaint, the transaction closed and all outstanding K-Sea common units were cancelled and delisted from the New York Stock Exchange.[5]

C. Procedural History

Plaintiffs filed their original complaint on March 21, 2011, and I granted two orders of consolidation on April 13 and May 5, 2011. Plaintiffs then filed their Verified

[5] K-Sea Transportation Partners L.P., Current Report (Form 8-K) (July 1, 2011).

Consolidated Class Action Complaint and a motion to expedite on May 23. Defendants filed the pending motion to dismiss on June 6. I denied Plaintiffs' motion to expedite in a Memorandum Opinion issued on June 10, *K-Sea I*. After Plaintiffs amended their complaint on June 28, the parties briefed Defendants' motion to dismiss. The Court heard argument on that motion on October 26, 2011.

After careful review of the briefing, argument transcript, and relevant agreements, I reached a preliminary conclusion that the motion to dismiss should be granted. As to three of the Amended Complaint's four counts, however, that conclusion depended on an interpretation of the LPA that was neither argued nor briefed by the parties. To minimize the risk of any misapprehension of the applicable facts or law, I advised the parties by letter of my interpretation of the LPA and invited additional briefing regarding it. The parties submitted supplemental opening and reply briefs on February 14 and 21, 2012. This Memorandum Opinion constitutes my decision on Defendants' motion.

D. Parties' Contentions

Plaintiffs' Amended Complaint consists of four counts. Count I accuses the Conflicts Committee members of breaching their fiduciary duties of care and loyalty by approving the Merger Agreement without specifically evaluating the fairness or reasonableness of the $18 million payment for the IDRs held by K-Sea GP. Count II alleges that K-Sea GP, KSGP, and the K-Sea Board also breached the LPA by approving the Merger Agreement without evaluating the fairness of the $18 million payment. Count III avers that K-Sea GP, KSGP, and the K-Sea Board breached the LPA by approving the Merger Agreement in reliance on the purported, but ineffective, Special Approval of a

Conflicts Committee comprised of members who improperly held phantom units. Lastly, Count IV asserts that the Form S-4 is materially misleading and, therefore, that K-Sea GP, KSGP, and the K-Sea Board breached their fiduciary duty of disclosure by authorizing it. In terms of relief, because the challenged merger has closed, Plaintiffs seek only money damages.[6]

Defendants contend that all four Counts fail to state a claim. Initially, before learning of my tentative interpretation of the LPA, Defendants argued that the grant of phantom units did not render the Conflicts Committee improperly constituted and that the LPA required the Conflicts Committee to consider only the Merger Agreement overall, not any particular portion of it. Thus, according to Defendants, the Merger Agreement received valid Special Approval. If that Special Approval is valid, the LPA expressly precludes holding any Defendant liable for approving the Merger Agreement, and Counts I, II, and III must be dismissed. As to Count IV, Defendants assert that the LPA waives

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[6] The Amended Complaint includes requests for, among other things, both money damages and rescission. Am. Compl. at 26. In support of their motion to dismiss, however, Defendants asserted repeatedly that Plaintiffs' only remaining claims are for money damages. *See, e.g.,* K-Sea Defs.' Op. Br. 18-19 (arguing Defendants' *only* duty when approving the Merger Agreement was to act in good faith by operation of Section 7.8(a) of the LPA, which Section pertains exclusively to claims for money damages); K-Sea Defs.' Reply Br. 19 (arguing money damages are unavailable to remedy a post-closing disclosure claim and, therefore, Plaintiffs cannot state a disclosure claim); Oct. 26, 2011 Hr'g Tr. 4-5 ("[W]hat's left here in the case at this point, procedurally, are money damages claims."). At no point did Plaintiffs take issue with Defendants' assertions that Plaintiffs' only remaining claims are for money damages. Therefore, Plaintiffs have waived any request for rescissionary relief. *See Emerald P'rs v. Berlin*, 2003 WL 21003437, at *43 (Del. Ch. Apr. 28, 2003) (holding a party waives unaddressed arguments), *aff'd*, 840 A.2d 641 (Del. 2003).

the traditional duty of disclosure and that, in any event, the Form S-4 is not materially misleading.

In preliminarily concluding that certain counts should be dismissed, I did not rely at all on the Special Approval process. Rather, I interpreted the LPA as prescribing an express and distinct set of procedures for approval of mergers, the challenged transaction in this case. Although the general provisions related to approval of conflicts of interest, if utilized properly, could shield Defendants from liability related to a merger transaction, I tentatively concluded that Defendants' only obligations with respect to the Merger Agreement were to comply with the express merger approval provisions of the LPA. In this sense, I construed the Special Approval provisions as affording a permissive safe harbor but not imposing any mandatory duties pertinent to this case. Accordingly, I asked the parties to address whether Defendants' compliance with the merger approval provisions of the LPA would render Special Approval unnecessary.

Defendants generally subscribe to this theory, noting that management review of potential conflicts of interest is not necessary to protect the common unitholders where, as is the case in mergers but not ordinary business transactions, a majority of those unitholders must vote to approve the transaction. Plaintiffs do not dispute the applicability of the express merger provisions of the LPA to this case; rather, they argue that the conflict of interest provision is mandatory regardless of the type of transaction that creates the conflict. That is, because the challenged transaction here involves both a merger and a conflict of interest, Plaintiffs contend that the LPA's provisions regarding both mergers and conflicts of interest apply.

II. ANALYSIS

Pursuant to Court of Chancery Rule 12(b)(6), this Court may grant a motion to dismiss for failure to state a claim if a complaint does not assert sufficient facts that, if proven, would entitle the plaintiff to relief. When considering such a motion, the Court must

> 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.[7]

The Court, however, need not "accept conclusory allegations unsupported by specific facts or . . . draw unreasonable inferences in favor of the non-moving party."[8] Additionally, "the Court may consider documents both integral to and incorporated into the complaint" when deciding a motion to dismiss.[9] On that basis, I have considered both the LPA and Form S-4 in evaluating Defendants' motion.

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7 *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011).

8 *Price v. E.I. duPont de Nemours & Co., Inc.*, 26 A.3d 162, 166 (Del. 2011) (citing *Clinton v. Enter. Rent-A-Car Co.*, 977 A.2d 892, 895 (Del. 2009)).

9 *LeCrenier v. Cent. Oil Asphalt Corp.*, 2010 WL 5449838, at *3 n.32 (Del. Ch. Dec. 22, 2010) (citing *Orman v. Cullman*, 794 A.2d 5, 15-16 (Del. Ch. 2002)).

A. Contractual Standard of Review Established by the LPA

As noted in *K-Sea I*, "limited partnership agreements are to be construed in accordance with their literal terms,"[10] and "[o]nly 'if the partners have not expressly made provisions in their partnership agreement . . . will [a court] look for guidance from the statutory default rules, traditional notions of fiduciary duties, or other extrinsic evidence.'"[11] Furthermore, although a general partner and its affiliates may owe fiduciary duties to a partnership,[12] "a limited partnership agreement can 'establish[] a contractual standard of review that supplants fiduciary duty analysis.'"[13] Indeed, the Delaware Revised Uniform Limited Partnership Act provides that a limited partnership agreement may expand, restrict, or eliminate any duty, other than the implied contractual covenant of good faith and fair dealing, a person may owe to a limited partnership and the partnership's limited partners.[14] Accordingly, the Court's first task is to determine the nature of any duty that is owed under the LPA.

The LPA prescribes a number of duties applicable to various circumstances. As a general matter, however, the only remedy Plaintiffs now seek is money damages. In that

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10 *K-Sea I*, 2011 WL 2520209, at *8 (citing *In re Nantucket Is. Assocs. P'ship Unitholders Litig.*, 810 A.2d 351, 361 (Del. Ch. 2002)).

11 *Id.* (third alteration in original) (quoting *In re LJM2 Co-Inv., L.P.*, 866 A.2d 762, 777 (Del. Ch. 2004)).

12 *Brinckerhoff v. Enbridge Energy Co.*, 2011 WL 4599654, at *7 (Del. Ch. Sept. 30, 2011) [hereinafter *Enbridge Energy*].

13 *K-Sea I*, 2011 WL 2520209, at *8 (alteration in original) (quoting *Lonergan v. EPE Hldgs. LLC*, 5 A.3d 1008, 1020 (Del. Ch. 2010)).

14 6 *Del. C.* § 17-1101(d).

regard, Section 7.8(a) of the LPA provides: "Notwithstanding anything to the contrary set forth in this Agreement, no Indemnitee shall be liable for monetary damages to the Partnership [or] the Limited Partners . . . for losses sustained or liabilities incurred as a result of any act or omission if such Indemnitee acted in good faith." The term "Indemnitee" is defined in Section 1.1 to include K-Sea GP, KSGP, and the individual members of the K-Sea Board. Thus, even if K-Sea GP, KSGP, or any member of the K-Sea Board breached the LPA or any default fiduciary duty, that breach can support a claim for money damages only if Plaintiffs also allege that the breach resulted from actions that were not taken in good faith. As to good faith, Section 7.10(b) further provides:

> [K-Sea GP] may consult with . . . investment bankers and other consultants and advisers selected by it, and any act taken or omitted to be taken in reliance upon the opinion . . . of such Persons as to matters that [K-Sea GP] reasonably believes to be within such Person's professional or expert competence shall be conclusively presumed to have been done or omitted in good faith and in accordance with such opinion.

By its express terms, however, Section 7.10(b) applies only to K-Sea GP; no other Defendant is entitled to its conclusive presumption.[15]

Taken together, the above provisions of the LPA establish the following contractual standard of review: K-Sea GP, KSGP, and the members of the K-Sea Board may be liable for money damages for a breach of the LPA, or of any default fiduciary

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[15] *See Enbridge Energy*, 2011 WL 4599654, at *9 (consistently interpreting substantially similar language).

duty not eliminated by the LPA, only if that breach resulted from an act or omission done in bad faith,[16] and K-Sea GP is conclusively presumed to have acted in good faith if it relied on an expert it reasonably believed to be competent to render an opinion on the particular matter. Hence, to survive Defendants' motions to dismiss, Plaintiffs must plead facts that, if true, show that Defendants both (1) breached the LPA or a fiduciary duty and (2), in doing so, acted in bad faith. With this standard in mind, I now turn to Plaintiffs' particular claims of contractual and fiduciary breaches.

B. Counts I, II & III

1. Contractual and fiduciary duties

Counts I, II, and III of the Amended Complaint allege that K-Sea GP, KSGP, and the K-Sea Board breached various contractual and fiduciary duties by approving the Merger Agreement. Consistent with the principles recited above, therefore, the Court's analysis must begin with any express provisions in the LPA regarding approval of mergers.

Article 14 of the LPA expressly permits, and prescribes the procedures for, the Partnership to enter into merger agreements. In general, approval of a merger requires, first, consent by K-Sea GP and, second, an affirmative vote by a majority of the holders of K-Sea common units.[17] As to K-Sea GP's consent, Section 14.2 provides that any

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[16] *See Amirsaleh v. Bd. of Trade of City of New York, Inc.*, 2009 WL 3756700, at *5 (Del. Ch. Nov. 9, 2009) ("[T]here is no meaningful difference between 'a lack of good faith' and 'bad faith.' Accordingly, to prove a breach of the implied covenant plaintiff must demonstrate that defendants acted in 'bad faith.'").

[17] LPA §§ 14.2, 14.3. More specifically, Section 14.3(b) requires "the affirmative vote or consent of the holders of a Unit Majority," which is defined by section 1.2

prospective merger "requires the prior approval of [K-Sea GP]. If [K-Sea GP] shall determine, *in the exercise of its discretion*, to consent to the merger or consolidation, [K-Sea GP] shall approve the Merger Agreement . . . ."[18] Furthermore, Section 7.9(b) states:

> Whenever this Agreement . . . provides that [K-Sea GP] is permitted or required to make a decision (i) in its "sole discretion" or "discretion," . . . [K-Sea GP] 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 [or] any Limited Partner [and] (ii) it may make such decision in its sole discretion (regardless of whether there is a reference to "sole discretion" or "discretion") . . . .

Regarding the requirement that any merger receive the affirmative vote of the majority of the holders of K-Sea common units, there is no dispute that the merger received such a vote. Moreover, Plaintiffs do not allege that any Defendant qua unitholder breached any contractual or fiduciary obligation to K-Sea.

The LPA, therefore, establishes only one contractual duty applicable to Defendants' consent to the Merger Agreement: K-Sea GP must exercise its discretion. Furthermore, Sections 14.2 and 7.9(b) grant K-Sea GP the authority to consider whatever interests and factors it chooses and expressly eliminates a duty to consider any specific interest or factor when determining whether to consent to a merger. There is no contractual requirement that the Merger Agreement be fair and reasonable to, or that K-

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as "a majority of the Outstanding Common Units (including the outstanding Series A Preferred Units on an as-converted basis)."

[18] LPA § 14.2 (emphasis added).

Sea GP even consider, the interests of any particular Limited Partner.[19] As a practical matter, however, this seemingly minimal standard is cabined by Section 14.3's prescription that K-Sea GP, "upon its approval of [a] Merger Agreement, shall direct that the Merger Agreement be submitted to a vote of the Limited Partners," who are free to vote against any prospective merger they deem contrary to their interests.

Having determined that, for purposes of Counts I, II, and III, the LPA requires only that K-Sea GP exercise discretion in consenting to a merger, the next question is whether that contractual duty is constrained by any other default statutory or fiduciary duty. As to that question, Section 7.10(d) provides:

> Any standard of care and duty imposed by this Agreement or under [6 *Del. C.* §§ 17-101 to 17-1111] or any applicable law, rule or regulation shall be modified, waived or limited, to the extent permitted by law, as required to permit [K-Sea GP] to act under this Agreement . . . and to make any decision pursuant to the authority prescribed in this Agreement, so long as such action is reasonably believed by [K-Sea GP] to be in, or not inconsistent with, the best interests of the Partnership.

Because traditional fiduciary duties would impede K-Sea GP's contractual authority to consent to mergers in its sole discretion, Section 7.10(d) operates to waive, restrict, or eliminate those duties. Section 7.10(d) does not waive fiduciary duties altogether, however. Instead, it substitutes a different, more narrow duty: K-Sea GP may not

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[19] *See Gelfman v. Weeden Investors, L.P.*, 792 A.2d 977, 986 (Del. Ch. 2001) (holding "other contractual standards . . . 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"); *Sonet v. Timber Co.*, 722 A.2d 319, 326-27 (Del. Ch. 1998) [hereinafter *Sonet I*] (holding limited partnership agreement's express conferral of discretion precludes traditional fiduciary duties).

exercise its discretion in a manner inconsistent with the best interests of the Partnership as a whole. This narrower duty essentially comports with Section 7.8(a)'s indemnification provision. For liability to attach, that provision requires "a showing that [K-Sea GP] . . . acted in bad faith (*i.e.*, that the General Partner believed that its actions did not advance a proper Partnership purpose)."[20]

Taken together, Sections 14.2, 7.9(b), and 7.10(d) establish a contractual standard of review regarding approval of mergers under which K-Sea GP enjoys broad discretion to consider whatever factors it chooses and, provided that K-Sea GP's consent to any merger is not in bad faith, waives all other contractual, legal, and fiduciary duties. Thus, the only way for Plaintiffs to state a claim predicated on any Defendant's approval of the Merger Agreement is to show that K-Sea GP, the only Defendant with any duty related to approval of merger agreements, acted in bad faith.

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[20] *Gelfman*, 792 A.2d at 987 (interpreting similar contractual language). Furthermore, the LPA cannot "eliminate the implied contractual covenant of good faith and fair dealing." 6 *Del. C.* § 17-1101(d). "When a contract confers discretion on one party, the implied covenant requires that the discretion be used reasonably and in good faith." *Airborn Health, Inc. v. Squid Soap, L.P.*, 984 A.2d 126, 146-47 (Del. Ch. 2009) (footnote omitted); *accord Nemec v. Shrader*, 991 A.2d 1120, 1128 (Del. 2010) (The implied covenant "'requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the bargain.'" (quoting *Nemec v. Shrader*, 2009 WL 1204346, at *5 (Del. Ch. Apr. 30, 2009))). The effect of the implied covenant, therefore, is coextensive with the LPA's contractual requirement that K-Sea GP exercise its discretion in good faith.

2. The Special Approval process

The Special Approval process to which the parties initially dedicated the majority of their argument is referred to in Section 7.9(a) of the LPA. It provides, in pertinent part, as follows:

> Unless otherwise expressly provided in this Agreement, . . . whenever a potential conflict of interest exists between [K-Sea GP], on the one hand, and the Partnership [or any Limited Partner, among others], on the other, any resolution or course of action by [K-Sea GP] or its Affiliates in respect of such conflict of interest shall be permitted and deemed approved by all Partners, and shall not constitute a breach of this Agreement . . . or of any duty stated or implied by law or equity, if the resolution or course of action is, or by operation of this Agreement is deemed to be, fair and reasonable to the Partnership. . . . 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 Plaintiffs correctly observe, Section 7.9(a) applies "whenever a potential conflict of interest exists." Drawing all inferences in Plaintiffs' favor, the Merger Agreement posed a conflict of interest to K-Sea GP because the consideration included $18 million allocated only to K-Sea GP and not shared with any common unitholder. Thus, notwithstanding the generality of the merger approval procedures contained in Article 14, Section 7.9(a) arguably still applies to the Merger Agreement.

Plaintiffs are incorrect, however, that Section 7.9(a) requires that the Merger Agreement be "fair and reasonable to the Partnership." Essentially, the section is drafted as a logical syllogism. The first sentence is the major premise: if resolution of a conflict of interest is fair and reasonable to the Partnership, there is no breach of the LPA or

fiduciary duty. The second sentence in the block quote above provides the minor premise: if resolution of a conflict of interest receives Special Approval, it is fair and reasonable to the Partnership. Therefore, the conclusion is a permissive safe harbor: if there is Special Approval, there is no breach of the LPA or fiduciary duty. Furthermore, in contrast to other types of transactions that the LPA commits to K-Sea GP's unilateral approval, nothing in Article 14 requires that the Merger Agreement be "fair and reasonable" in the first place.[21] That is, the flaw in Plaintiffs' argument is that it incorrectly assumes the truth of the major premise's inverse—*i.e.*, "if the resolution of the conflict of interest is *not* fair and reasonable to the Partnership, there *is* a breach of the LPA or fiduciary duty." Nothing in Section 7.9(a) or Article 14 stands for that proposition. Rather, the existence of a right to veto the Merger Agreement via the unitholder franchise "confirms that to the extent that unitholders are unhappy with the proposed terms of the merger . . . their remedy is the ballot box, not the courthouse."[22]

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[21] This fact distinguishes cases that gave primacy to special approval such as *Enbridge Energy* and *Gerber v. Enterprise Products Holdings, LLC*, 2012 WL 34442 (Del. Ch. Jan. 6, 2012). In those cases, the plaintiffs challenged sales of partnership assets to affiliates of the general partner, and the limited partnership agreements expressly required that any such transaction be fair and reasonable to the partnership. *Enbridge Energy*, 2011 WL 4599654, at *8; *Gerber*, 2012 WL 34442, at *10 n.41. To meet that requirement in *Enbridge Energy* and *Gerber*, the defendant general partners sought to demonstrate that they qualified for the conclusive presumption of fairness provided by the special approval process of the relevant partnership agreements. *Gerber*, 2012 WL 34442, at *11. In this case, although Section 7.6(d) of the LPA similarly imposed a requirement that transactions with an affiliate of K-Sea GP be fair and reasonable to the Partnership, the LPA imposed no such restriction on approval of the Merger Agreement with Kirby, an unaffiliated third party.

[22] *Sonet I*, 722 A.2d at 326.

Thus, although Special Approval could immunize Defendants' approval of the Merger Agreement by raising a conclusive presumption that no Defendant breached the LPA or any fiduciary duty,[23] a failure to utilize effectively that safe harbor does not mean that liability automatically follows. Put differently, failure to qualify for a safe harbor does not mean that the challenged conduct is improper. Rather, such a failure requires Defendants to satisfy the otherwise controlling standard of review. In this case, that standard is whether K-Sea GP exercised its discretion in good faith. Accordingly, if I determine that Plaintiffs have not identified any reasonably conceivable set of circumstances susceptible of proof that would support a finding that K-Sea GP failed to exercise its discretion in good faith when it approved the Merger Agreement, I need not reach the issues of whether the Special Approval process was flawed because of the grant of phantom units or the failure to consider specifically the fairness of the $18 million payment.

3. Did K-Sea GP approve the Merger Agreement in good faith?

Returning to the otherwise controlling standard of whether K-Sea GP approved the Merger Agreement in good faith, the well-pleaded allegations of the Amended Complaint

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[23] By referring to "any resolution or course of action by [K-Sea GP] *or its Affiliates*," Section 7.9(a) potentially provides a safe harbor to each Defendant. Section 1.1 defines '"Affiliate' [to] mean[], with respect to any Person, any other Person that directly or indirectly through one or more intermediaries controls . . . the Person in question. As used herein, the term 'control' means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a Person . . . ." KSGP and the members of the K-Sea Board (indirectly through KSGP) possess the power to direct the management and policies of K-Sea GP and, thus, are Affiliates of K-Sea GP for purposes of the LPA. *See also Gerber*, 2012 WL 34442, at *9 (consistently interpreting identical language).

conceivably could support a reasonable inference that K-Sea GP approved the Merger Agreement only after exploiting its position as general partner to extract personal benefits for itself and its affiliates. According to the Amended Complaint, the K-Sea Board caused K-Sea GP to refuse to consent to any transaction until Kirby offered a separate payment of $18 million for K-Sea GP's IDRs.[24] Those IDRs allegedly may have been worth as little as $100,000.[25] As further evidence of bad faith, Plaintiffs aver that the K-Sea Board incentivized the otherwise independent members of the Conflicts Committee to approve the Merger Agreement by granting on the eve of negotiations phantom units, which would vest upon a change of control.[26] Together, these allegations could support an inference that K-Sea GP unreasonably exploited the LPA's limited duties to extract a personal gain that did not advance a proper Partnership purpose and, thus, failed to act in good faith.[27]

Section 7.10(b) of the LPA, however, directly addresses good faith. As mentioned above, Section 7.10(b) entitles K-Sea GP to a conclusive presumption of good faith whenever it acts in reliance on an expert opinion as to matters it reasonably believes to be within the expert's professional competence. In this case, Plaintiffs allege that the Conflicts Committee relied on a fairness opinion provided by Stifel.[28] There is no

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24 Am. Compl. ¶¶ 47-49.

25 *Id.* ¶ 63.

26 *Id.* ¶¶ 72-75.

27 *See Gelfman*, 792 A.2d at 987.

28 Am. Compl. ¶ 55.

allegation that the fairness opinion was outside Stifel's professional competence. The Conflicts Committee admittedly is not K-Sea GP. Nevertheless, "it would be unreasonable, even on a motion to dismiss, for the Court to infer that although an independent subset of the Board relied upon a fairness opinion, the entity that the Board manages did not rely upon that opinion."[29] That is, the only reasonable inference from the allegations of the Amended Complaint is that K-Sea GP relied on a qualified expert's opinion. Therefore, Section 7.10(b) provides K-Sea GP with a conclusive presumption that it acted in good faith in exercising its discretion to approve the Merger Agreement.

That conclusive presumption of good faith satisfies the substitute duty imposed by Sections 7.8(a) and 7.10(d) of the LPA, *i.e.*, the requirement that K-Sea GP exercise its discretion in good faith. The only remaining issue is whether the LPA's conclusive presumption of good faith also satisfies the implied covenant of good faith and fair dealing.

4. The implied covenant

Earlier this year, in a case dealing with a limited partnership agreement nearly identical to the LPA, Vice Chancellor Noble directly addressed whether a plaintiff can

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[29] *Gerber*, 2012 WL 34442, at *12. Here, the Conflicts Committee comprises a subset of the K-Sea Board, which manages KSGP, and KSGP ultimately manages K-Sea GP. Thus, in comparison to *Gerber*, the Court would have to assume that an additional entity relied on the relevant fairness opinion. That distinction, however, is immaterial. As Plaintiffs allege, "[K-Sea GP] acts as a pass-through entity and is controlled by its general partner, [KSGP]." Am. Compl. ¶ 17. Therefore, despite the presence of an additional pass-through entity, the management and control structure of K-Sea is identical for all intents and purposes to that of the limited partnership at issue in *Gerber*.

"plead that a defendant breached the implied covenant when the defendant is conclusively presumed by the terms of a contract to have acted in good faith?"[30] Answering in the negative, Vice Chancellor Noble held,

> Under the plain terms of the LPA, if Section 7.10(b) applies to an action taken by [the general partner], then [the general partner] is protected from any claims asserting that the action was taken other than in good faith. That would include good faith claims arising under the duty of loyalty, the implied covenant, and any other doctrine. In contrast to Section 7.10(b)'s broad pronouncement, our Supreme Court has determined that the implied covenant . . . is a gap-filler, and may not be used to "infer language that contradicts a clear exercise of an express contractual right." Moreover, our Supreme Court has repeatedly stated that "one generally cannot base a claim for breach of the implied covenant on conduct authorized by the agreement."
>
> The drafters of the LPA foresaw that claims against [the general partner] asserting a failure to act in good faith could arise in a number of circumstances. The drafters decided that none of those claims could be asserted if [the general partner] acted in reliance upon the opinion of an expert. Under the LPA, [the general partner] has an "express contractual right" to rely upon the opinion of an expert . . . . The Court may not "infer language that contradicts a clear exercise" of that right.[31]

I concur with that analysis. Indeed, it arguably may serve to protect unaffiliated unitholders of Delaware limited partnerships. On its own, Section 14.2 endows K-Sea GP with unfettered discretion to consent to a merger and submit it for unitholder approval. Section 7.10(b), however, incentivized K-Sea GP to obtain a fairness opinion

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30 *Gerber*, 2012 WL 34442, at *12.

31 *Id.* at *12-13 (footnote omitted) (quoting *Nemec v. Shrader*, 991 A.2d 1120, 1125-26, 1127 (Del. 2010)).

and rely upon it in connection with its approval of the merger. Presumably, the general partner's reliance on a fairness opinion would benefit K-Sea's unaffiliated unitholders, even though the LPA does not require such an opinion.

In sum, Section 14.2 directly addresses prospective mergers and provides K-Sea GP with sole discretion to determine whether to consent to any proposed merger agreement. The only limitations on K-Sea GP's discretion are an express and implied requirement that it exercise its discretion in good faith. Because it relied on the fairness opinion of an investment banker, K-Sea GP is conclusively presumed to have acted in good faith. Moreover, K-Sea GP is the only Defendant with any contractual or default duty in connection with approval of the Merger Agreement. Having determined that K-Sea GP is conclusively presumed to have complied with that duty in good faith, I cannot conceive a set of circumstances under which Plaintiffs could prove that any Defendant breached a duty by approving the Merger Agreement. Therefore, I dismiss Counts I, II, and III of the Amended Complaint.

C. Count IV

Count IV claims that Defendants breached the fiduciary duty of disclosure by disseminating materially misleading information in the Form S-4 in connection with the common unitholders' vote on the Merger Agreement. "[I]n the limited partnership context, *absent contractual modification*, a general partner owes fiduciary duties that

include a 'duty of full disclosure.'"[32] I determined in *K-Sea I* that Section 14.3 of the LPA waived the traditional duty of disclosure and, even if it had not, that "Plaintiffs have not shown that either of the disclosures about which they complain was misleading."[33] Plaintiffs now effectively request that I reconsider whether the plain language of the LPA reflects a clear intent to preempt fiduciary principles related to disclosures.[34] Such reconsideration is not necessary, however, because I still conclude that the allegedly misleading disclosures cannot support a disclosure claim under any reasonably conceivable set of circumstances.

Assuming Section 14.3 of the LPA does not modify the traditional duty of disclosure, Defendants' duty of disclosure would be commensurate with the duty corporate directors owe to shareholders.[35] Thus, Defendants would have been required to disclose fully and fairly all material information within their control when they submitted the Merger Agreement to a vote of the Limited Partners.[36] "A fact is material if (i) there is a substantial likelihood that a reasonable [partner] would consider it important in deciding how to vote; (ii) [it] would have assumed actual significance in the deliberations

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[32] *Lonergan v. EPE Hldgs. LLC*, 5 A.3d 1008, 1023-24 (Del. Ch. 2010) (emphasis added) (quoting *Sussex Life Care Assocs. v. Strickler*, 1988 WL 156833, at *4 (Del. Ch. June 13, 1989)).

[33] *K-Sea I*, 2011 WL 2520209, at *8-9.

[34] *See* Pls.' Ans. Br. 21-22.

[35] *See Sonet v. Plum Creek Timber Co.*, 1999 WL 160174, at *6 (Del. Ch. Mar. 18, 1999) [hereinafter *Sonet II*].

[36] *See Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992); *Sonet II*, 1999 WL 160174, at *6 (applying the *Stroud* standard to limited partnerships).

of the reasonable [partner]; or (iii) it would have significantly altered the 'total mix' of information made available."[37] Partial disclosures, even if literally true, also may violate the duty of disclosure if they create "a materially misleading impression of relevant factual circumstances bearing on the fairness of the transaction subject to the vote."[38]

I also note that the challenged transaction and the related vote of the limited partners have been completed. Therefore, the remedy Plaintiffs seek is money damages. Plaintiffs do not dispute, however, that Section 7.8(a) would exculpate Defendants from any liability for a disclosure violation, provided they acted in good faith. Thus, to state a claim, Plaintiffs must allege facts sufficient to support a reasonable inference that Defendants, in authorizing a materially misleading disclosure, acted in bad faith.

Plaintiffs contend that the Form S-4 is materially misleading in two respects. First, it states that the K-Sea Board voted to approve the Merger Agreement after considering, among other factors, that "the merger would provide the holders of K-Sea common units with the option to receive $8.15 in cash . . . , which represented a 9.56% increase to consideration proposed by Kirby in its initial proposal."[39] There is no dispute that K-Sea persuaded Kirby to increase its offer from $306 million to approximately $335 million, or that Kirby's final offer literally represented a 9.56% increase to its initial proposal. As Plaintiffs point out, however, $18 million of that increase was allocated

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[37] *R.S.M. Inc. v. Alliance Capital Mgmt. Hldgs. L.P.*, 790 A.2d 478, 500 (Del. Ch. 2001) (quoting *Sonet II*, 1999 WL 160174, at *7) (internal quotation marks omitted).

[38] *Id.*

[39] Am. Compl. ¶ 84 (quoting Form S-4 at 51).

exclusively to the IDRs and provided no additional consideration to K-Sea common unitholders. In this regard, the sentence arguably is ambiguous and, considering it on its own and drawing every inference in favor of Plaintiffs, could give "a materially misleading impression of relevant factual circumstances bearing on the fairness of the transaction subject to the vote."[40]

Reading the disputed sentence in context, however, resolves any ambiguity. The sentence appears on page 51 of the Form S-4 and follows a lengthy discussion from pages 42 to 51 that discloses, in detail, precisely how much the offer increased, and how each increase was allocated, at every stage of the negotiations. No reasonable unitholder likely would have been misled by this presumptively ambiguous sentence because the preceding eight pages "contain[ed] all of the information necessary . . . [to resolve the ambiguity and] calculate the actual increase represented by the price in the Merger Agreement over Kirby's initial offer."[41] That is, the unitholders readily could discern that $18 million in consideration was allocated to the IDRs and that, if that amount were subtracted from the total amount of the increase, the result would be an increase of less than 9.56%. Therefore, it is not reasonably conceivable that the arguably misleading statement in the Form S-4 regarding the percentage increase significantly would have altered the "total mix" of information available to the common unitholders. In addition, Plaintiffs have not alleged any facts from which the Court reasonably could infer that any

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40 *R.S.M. Inc.*, 790 A.2d at 500.

41 *K-Sea I*, 2011 WL 2520209, at *9.

Defendant acted in bad faith by authorizing the disclosure of one arguably misleading sentence after first authorizing the disclosure of all of the information necessary to render that statement not misleading.

Plaintiffs' second asserted disclosure violation is that Defendants misled K-Sea unitholders by stating, "the members of the K-Sea Conflicts Committee will not personally benefit from the completion of the merger in a manner different from the K-Sea unitholders."[42] As I stated in *K-Sea I*,

> [t]his statement implies that the interests of the Committee members are aligned with those of the common unitholders. Generally, this is true because the Committee members' holdings in K–Sea consisted only of common units and phantom units, whose value was derived from that of common units. Therefore, a higher merger price would increase the value of the holdings of Committee members and K-Sea unitholders by the same percentage. Finally, [the Form S-4] explicitly discloses that Defendants' phantom unit holdings would be accelerated if the merger was effected.[43]

While acknowledging this aspect of *K-Sea I*,[44] Plaintiffs offer no new argument or any explanation of why that earlier statement was incorrect. In any event, the allegedly misleading statement is generally true, and the Form S-4 discloses additional information that makes clear the nature of the benefits the Defendant Board members, including the members of the Conflicts Committee, would receive if the merger was effected.[45] In such

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42 Form S-4 at 54.

43 *K-Sea I*, 2011 WL 2410395, at *9

44 Pls.' Ans. Br. 24.

45 Form S-4 at 71-78.

circumstances, there is no basis from which one reasonably could infer that Defendants acted in bad faith by authorizing the disclosure.

In sum, there is no conceivable set of circumstances susceptible of proof in this case under which Plaintiffs could recover damages for any materially misleading statement in the Form S-4. Therefore, I also dismiss Count IV of the Amended Complaint.

III. CONCLUSION

For the reasons stated in this Memorandum Opinion, I grant Defendants' motion to dismiss the Amended Complaint in its entirety with prejudice.

IT IS SO ORDERED.