EFiled: Aug 31 2012 03:35PM EDT
Transaction ID 46217184
Case No. 6347-VCP

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

In re: ENCORE ENERGY PARTNERS LP UNITHOLDER LITIGATION	)))	Cons. C.A. No. 6347-VCP

MEMORANDUM OPINION

Submitted: May 25, 2012
Decided: August 31, 2012

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PARSONS, Vice Chancellor.

This class action is the latest in a series of relatively recent cases challenging the use of a contractual "Special Approval" process by which the general partner of a master limited partnership may authorize otherwise self-interested transactions without breaching any duty to the partnership or its limited partners.[1] The master limited partnership in this case is Encore Energy Partners LP ("Encore" or the "Partnership"). In a transaction that closed on December 1, 2011, Vanguard Natural Resources, LLC ("Vanguard") acquired all of the outstanding common units of Encore in a unit-for-unit exchange (the "Merger"). Vanguard's indirect subsidiary, however, was Encore's general partner ("Encore GP" or the "General Partner"). Because the then-prospective Merger posed a potential conflict of interest, Encore GP sought and received Special Approval from its Conflicts Committee before approving the Merger and submitting it for unitholder approval. If that Special Approval is valid, Encore's Second Amended and Restated Agreement of Limited Partnership (the "LPA") immunizes the Merger from judicial challenge. If not, the General Partner could face liability if the economic terms of the Merger were shown to be unfair.

Plaintiffs, representing a class of Encore's former unaffiliated common unitholders, allege that the Conflicts Committee's purported Special Approval in fact was defective under the terms of the LPA and that the Merger reflects an unfair exchange.

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[1] *See, e.g., In re K-Sea Transp. P'rs L.P. Unitholders Litig.*, 2012 WL 1142351 (Del. Ch. Apr. 4, 2012); *Gerber v. Enter. Prods. Hldgs., LLC*, 2012 WL 34442 (Del. Ch. Jan. 6, 2012); *Lonergan v. EPE Hldgs., LLC*, 5 A.3d 1008 (Del. Ch. 2010); *Brinckerhoff v. Tex. E. Prods. Pipeline Co., LLC*, 986 A.2d 370 (Del. Ch. 2010).

Hence, they argue that Encore GP, its board of directors, and Vanguard (collectively, "Defendants") breached their duties under the LPA by proposing, approving, and consummating the Merger. For their part, Defendants assert that the Conflicts Committee's Special Approval satisfied the requirements of the LPA and, on that basis, have moved to dismiss for failure to state a claim. For the reasons discussed in this Memorandum Opinion, I grant Defendants' motion to dismiss.[2]

I. BACKGROUND

A. The Parties

Plaintiffs William Allen and Stephen Bushansky held Encore common units from before the Merger's announcement until its closing. They bring this action on behalf of a class of similarly situated former, unaffiliated unitholders of the Partnership.

Until the Merger, Encore was a publicly traded Delaware limited partnership based in Houston, Texas. Its business involved the acquisition, exploration, and development of oil and natural gas reserves from onshore fields in the United States. The legal name of Encore's General Partner is Encore Energy Partners GP LLC, a Delaware limited liability company headquartered in Dallas, Texas. At all times relevant to the alleged wrongdoing, Encore GP's board of directors comprised the following seven individuals: David Baggett, W. Timothy Hauss, John E. Jackson, Douglas Pence, Richard

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[2] The members of the Conflicts Committee and the remaining Defendants filed independent motions to dismiss. The two motions were briefed and argued jointly, however. Therefore, I refer to them, collectively, as Defendants' motion to dismiss for purposes of this Memorandum Opinion.

A. Robert, Scott W. Smith, and Martin G. White (collectively, the "Director Defendants"). Three of these Director Defendants—Baggett, Jackson, and White—constituted Encore GP's Conflicts Committee and were independent of both Encore and Vanguard. By contrast, the other four Director Defendants—Hauss, Pence, Robert, and Smith—are employees (indeed, with the exception of Hauss, executive officers) of Vanguard.

Defendant Vanguard is a publicly traded Delaware limited liability company based in Houston, Texas. Its business also focuses on the acquisition and development of oil and natural gas properties in the United States. Before the Merger, Vanguard's wholly-owned subsidiary, Vanguard Natural Gas, LLC ("VNG"), owned 100% of Encore GP and approximately 21 million Encore common units, or 45.5% of the Partnership. For simplicity's sake, this Memorandum Opinion refers to Vanguard and VNG collectively as if Vanguard directly held VNG's interests in Encore GP and Encore.

B. Facts[3]

1. Vanguard acquires an interest in Encore and then proposes the Merger

Vanguard acquired its pre-Merger interests in Encore and Encore GP from Denbury Resources Inc. in a transaction that closed on December 31, 2010. At the closing, Vanguard replaced four of Encore GP's former directors with Director

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[3] The following facts are drawn from the well pled allegations of Plaintiffs' Verified Consolidated Second Amended Class Action Complaint filed December 28, 2011 (the "Complaint"), together with certain documents integral thereto, which allegations are presumed true for purposes of Defendants' motion to dismiss.

Defendants Hauss, Pence, Robert, and Smith, and appointed Smith and Robert as Encore GP's CEO and CFO, respectively.[4] In a press release issued by Encore on January 3, 2011 (the "January 3 Press Release"), Smith stated, "We are excited about this acquisition and the prospect of managing a great set of assets for the long-term benefit of the Encore unitholders."[5]

Although analysts had been discussing the possibility that Vanguard might attempt to acquire Encore's remaining outstanding units soon after it acquired an interest in Encore and Encore GP on December 31, 2010, the Complaint alleges that Smith's statement in the January 3 Press Release "strongly implied that [Vanguard] did not have plans to buy Encore's publicly-held units."[6] In support of that allegation, the Complaint notes that Encore's trading price fell by 8.2% on a market-adjusted basis during the week after the January 3 Press Release even though the release contained no other material information about the Partnership. When Vanguard and Encore issued a Joint Proxy Statement/Prospectus on October 31, 2011 (the "Proxy") recommending that unitholders

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4 McCormick Aff. Ex. D, Ex. 99.1, (the "Jan. 3 Press Release"), at 1. This document is an exhibit to a Form 8-K filed by Encore with the SEC on January 3, 2011. It also is given a defined term and referred to explicitly and implicitly throughout the Complaint. Compl. ¶¶ 30, 31, 40, 76, 79. Therefore, it is "integral" to the Complaint and may be considered on a motion to dismiss under Rule 12(b)(6). *See, e.g.*, *e4e, Inc. v. Sircar*, 2003 WL 22455847, at *3 (Del. Ch. Oct. 9, 2003) (finding document "integral" to a complaint where it "was referred to extensively" and given a defined term in the complaint, and where "much of the wrongful conduct alleged . . . was taken directly from" the document).

5 Compl. ¶ 30 (quoting Jan. 3 Press Release at 1).

6 *Id*.

vote in favor of the Merger, however, the Conflicts Committee disclosed its "belief that, since . . . December 2010, investors had anticipated that Vanguard would propose to acquire the remaining Encore common units" and that Encore's trading price, therefore, "reflected the market's expectation of such a transaction."[7]

In addition to Smith's statement in the January 3 Press Release, the Complaint identifies other instances that purportedly indicate Vanguard intentionally drove down Encore's trading price before proposing the Merger. For example, on February 22, 2011, Encore GP (wholly-owned by Vanguard) announced the Partnership's financial results for the fourth quarter of 2010 (the "February 22 Press Release"). Although the actual financial results exceeded analysts' expectations, "Encore forecast 2011 oil and gas production at a level . . . significantly below analyst expectations."[8] Yet, when Encore reported its financial results for the first, second, and third quarters of 2011 (in May,

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[7] McCormick Aff. Ex. B, ("Proxy"), at 61. Like the January 3 Press Release, the Proxy is given a defined term and referred to extensively in the Complaint. Therefore, the Court also may consider it in deciding Defendants' motion to dismiss. *See supra* note 4. I note, however, that for purposes of the pending motion, the Proxy is not cited to support the allegation that Encore's market price reflected investors' expectation of the Merger, but rather only as an indication of the Conflicts Committee's subjective belief to that effect. As discussed further in Section II.C, *infra*, the Conflicts Committee's subjective belief is relevant to the fulfillment of any duties they owed under the LPA. Furthermore, the Complaint does not allege that the Conflicts Committee harbored a contrary belief.

[8] Compl. ¶ 34.

August, and November 2011, respectively), Plaintiffs aver that actual production exceeded the pessimistic February forecast.[9]

Also in the February 22 Press Release, Encore GP announced that: (1) it would more than triple Encore's capital expenditures, an amount far exceeding analysts' expectations; and (2) because of declining production but increasing expenditures, annual distributions to Encore unitholders in 2011 would be lower than analysts had expected. Indeed, the forecasted distributions of between $1.80 and $1.85 per unit represented "the lowest level of annual distributions since Encore began trading as a public company in late 2007, and substantially below . . . the $2.00 annual distributions per unit made in 2010."[10] The Complaint also notes that Encore's trading price declined 5.3% on a market-adjusted basis by the close of trading on February 23. Undaunted by this short-term decline in both market price and distributions per unit, Robert stressed during a May 2011 earnings call that the comparatively large capital expenditures ultimately would provide long-term value to unitholders. As discussed below, however, Vanguard publicly had proposed the Merger (*i.e.*, to acquire all of the outstanding Encore units it did not

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[9] The February 22 Press Release discloses that fourth quarter 2010 production was 8,567 barrels of oil equivalent per day ("BOE/D"). McCormick Aff. Ex. E, Ex. 99.1 at 3. As alleged in the Complaint, Encore GP's February 2011 announcement forecasted annual 2011 production of 7,930-8,350 BOE/D, but actual production reported in May, August, and November 2011 was in the range of 8,463-8,991 BOE/D. Compl. ¶¶ 34, 38. This difference between projected and actual production allegedly "show[s] that Vanguard's pessimistic forecast for 2011 was not well-founded." Compl. ¶ 38. In contrast, Defendants' counsel characterized the difference as "not far off." Hr'g Tr. 28.

[10] Compl. ¶ 36.

already own) before May 2011. In any case, the Complaint alleges that "Encore's common unit price [in early 2011] thus reflected negative pressure from disclosures that were inaccurate and reflected value-depressive policies adopted by Vanguard in the months leading up to the [Merger]."[11]

For its part, Vanguard had been planning to propose a merger as early as late 2010. Throughout the first three months of 2011, it continuously monitored the spread between Vanguard and Encore's respective trading prices. On March 24, 2011, when the implied exchange ratio of Vanguard to Encore units reached a relative low, Vanguard publicly proposed a merger of Encore into a Vanguard subsidiary, with each Encore common unit being converted into the right to receive 0.72 Vanguard common units. Based on Vanguard's March 24 closing price, this exchange ratio represented an implied value per Encore unit of $23.20. Encore's closing price on March 24, however, was $23.15. Thus, Vanguard's proposal represented a premium of only 5¢, or just over 0.2%. Furthermore, the formal offer letter conveyed to Encore stated that Vanguard would not (1) entertain any proposal to sell its own interests in Encore or Encore GP or (2) agree to a transaction conditioned on approval by a majority of Encore's unaffiliated unitholders (*i.e.*, if any transaction were to be submitted for unitholder approval, Vanguard would insist on voting its 45.5% interest).

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[11] *Id.* ¶ 40.

2. Encore GP seeks and obtains Special Approval from the Conflicts Committee

Section 7.9(a) of the LPA provides a number of mechanisms by which the General Partner can approve transactions involving a conflict of interest and still comply with its contractually defined duties to the Partnership. One such mechanism is Special Approval, or approval by a majority of the Conflicts Committee. Only the three independent directors of Encore GP served, or even were eligible to serve, on the Conflicts Committee.[12] Ultimately, they provided "the sole process protection for the Partnership's public investors" with respect to the Merger.[13]

As disclosed in the Proxy,

> In early February 2011, Mr. Smith advised the Encore GP Board that there was a possibility that a transaction involving a combination of Vanguard and Encore might be proposed [and] . . . suggested that the . . . Conflicts Committee[] begin considering engaging independent advisors, including independent legal counsel and financial advisors.[14]

Over the next month or so, the Conflicts Committee retained two reputable law firms, Bracewell & Giuliani LLP (because of its experience in the oil and gas industry, among other reasons)[15] and Richards Layton & Finger, P.A. (to advise on matters of Delaware law and unitholder litigation, which commenced on April 5)[16], as its independent legal

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12 *See infra* note 48 and accompanying text.

13 Compl. ¶ 51.

14 Proxy at 48.

15 *Id.*

16 *Id.* at 52.

advisors. "After being retained, Bracewell & Giuliani reviewed with the Encore Conflicts Committee the responsibilities of members of the committee under [the LPA] and Delaware law [including] . . . the circumstances . . . by which a potential or apparent conflict of interest could be resolved."[17] As its independent financial advisor, the Conflicts Committee engaged Jefferies & Company, Inc. ("Jefferies"), also based on its "experience in the oil and natural gas exploration and production industry and in transactions involving related parties or conflicts of interest."[18]

Shortly after Vanguard officially proposed the Merger on March 24, Encore GP delegated to the Conflicts Committee broad authority (1) to "study, review, evaluate and negotiate the terms and provisions" of Vanguard's proposal or any alternative and (2) to "determine whether the March 24 [p]roposal or any alternative thereto . . . is advisable and in the best interests of Encore and the Encore unaffiliated unitholders."[19] From March 31 to April 3, on Bracewell & Giuliani's advice, the Conflicts Committee

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17 *Id.* at 48.

18 *Id.* at 50. As noted in the Complaint, the Proxy offers somewhat inconsistent accounts regarding the extent to which the Conflicts Committee sought and received Jefferies's expert advice. In discussing the background of the Merger, the Proxy states that the Conflicts Committee met with Jefferies before making its opening counteroffer. Attached to the Proxy, however, is Jefferies's fairness opinion, which states the firm did not "provide services [related to the Merger] other than the delivery of this opinion," which occurred in early July 2011. Compl. ¶ 54 (quoting Proxy at C-2). For purposes of Defendants' motion to dismiss, I assume that Jefferies, in fact, did not advise the Conflicts Committee in any way other than by opining that the ultimate terms of the Merger were fair from a financial perspective to Encore and its unaffiliated unitholders.

19 Compl. ¶ 52 (quoting Proxy at 51).

negotiated and entered into amended indemnification agreements between themselves and Encore GP. Next, from April 12 to 29, also on advice of counsel, they negotiated and entered into standstill and confidentiality agreements between Encore and Vanguard. Only after those contracts were executed, *i.e.*, beginning on or about May 1, did the Conflicts Committee commence due diligence on Vanguard's proposal.

The Conflicts Committee conducted due diligence for approximately six weeks until the middle of June 2011. There is no allegation that they failed to inform themselves of the relevant facts, including Vanguard's allegedly value-depressive disclosures before March 24 and the two companies' trading prices throughout the negotiation process.[20] By the end of this six-week period, the Conflicts Committee believed that Vanguard's proposed exchange ratio of 0.72:1 was inadequate. Nevertheless, as the Proxy disclosed, they

> also believed that an acquirer was unlikely to agree to an exchange ratio that appeared to be immediately dilutive to its own distributable cash flow per unit, an important metric for master limited partnerships. Based in part on [information reviewed during due diligence], the Encore Conflicts Committee members believed that an exchange ratio of 0.75 approached the point at which the proposed merger would

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[20] *See also* Hr'g Tr. 42–43 (Plaintiffs' counsel: "the [C]onflicts [C]ommittee was conscious of the value-depressive disclosures by Vanguard in the months leading up to the announcement of the offer, was cognizant of the trading price of Vanguard and Encore at the time of the offer and the fact that the original offer represented not more than a 0.2 percent premium, cognizant of the subsequent company-specific rundown in Vanguard's trading price in the intervening nearly three months").

> become dilutive to Vanguard's distributable cash flow per unit.[21]

Thus, on June 15, 2011, the Conflicts Committee countered Vanguard's March 24 offer by proposing a similar transaction structure but with an increase of the exchange ratio to 0.75 Vanguard units per Encore unit. Vanguard initially revised its offer to 0.74, but the Conflicts Committee held firm at 0.75. On June 22, approximately one week after the Conflicts Committee's sole counteroffer, Vanguard agreed to an exchange ratio of 0.75:1, subject to working out a definitive merger agreement.

The Complaint sharply attacks the exchange ratio of 0.75:1 as "indefensible as an opening counteroffer."[22] Among other things, the increase from 0.72 to 0.75 represents "a ratio *just 4.17% higher than Vanguard's opening bid*."[23] Furthermore, Vanguard's trading price had declined between March 24 and June 15.[24] Consequently, although the Conflicts Committee proposed a higher exchange ratio in absolute terms, the counteroffer represented an implied value per Encore unit of $21.08 based on Vanguard's June 14 closing price. Compared to Vanguard's implied offer of $23.20 on March 24, the Conflicts Committee had taken almost three months to counter with "a 9.1% *discount* to

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21 Proxy at 53. The Court relies upon this portion of the Proxy as probative of the Conflicts Committee's subjective state of mind, not for the objective truth of their belief. *See supra* note 7.

22 Compl. ¶ 57.

23 *Id.* ¶ 56 (emphasis added).

24 According to the Complaint, "the significant run-down in Vanguard's unit price . . . did not reflect a decline in the broader market or the industry. Rather, Vanguard significantly underperformed the market" and its peers. *Id.* ¶ 68.

the value of Vanguard's opening [o]ffer at the time it had been made."[25] In that regard, however, the Proxy states that the "Conflicts Committee did not propose a price-protection mechanism because it viewed the relationship of the value of Encore common units to Vanguard common units as reflected in a number of different metrics [*e.g.*, as indicated above, distributable cash flow per unit] as more important than the market price of the Vanguard common units on any particular day."[26] In contrast, Vanguard's financial advisor, RBC Capital Markets, LLC, had valued Encore in a range that would have required an exchange ratio closer to 1:1. Moreover, the Complaint alleges that the methodology employed to derive this higher valuation "is widely used in the oil and gas industry," whereas Jefferies's methodologies were more "generalized."[27]

According to the Proxy, once the exchange ratio was settled, the Conflicts Committee and its legal counsel negotiated with representatives of Vanguard until July 9, 2011 regarding the terms of a final merger agreement (the "Merger Agreement"). On July 10, Jefferies gave the Conflicts Committee its oral opinion, later confirmed in writing and attached to the Proxy, that the Merger Agreement's exchange ratio was fair, from a financial perspective, to Encore and its unaffiliated unitholders. The same day, the Conflicts Committee reviewed with Bracewell & Giuliani the remaining terms of the

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25 *Id*. ¶ 56.

26 Proxy at 55. Again, this quotation is cited solely for its relevance to the Conflicts Committee's subjective belief. *See supra* note 7.

27 Compl. ¶ 61.

Merger Agreement and their duties and responsibilities under the LPA. At the conclusion of that meeting, the Conflicts Committee unanimously adopted a resolution that, among other things, (1) determined that the Merger Agreement was fair and reasonable to, and in the best interests of, Encore and its public unitholders and (2) recommended that the full board of Encore GP approve the Merger Agreement. That is, the Conflicts Committee purported to confer Special Approval on the Merger.

Upon receiving the Conflicts Committee's Special Approval on July 10, the full board of Encore GP likewise voted unanimously to approve the Merger Agreement. Representatives of Encore and Vanguard executed the Merger Agreement that same day and publicly announced it on July 11. Vanguard's trading price had closed at $29.25 on July 8, 2011, the last trading day before the Merger Agreement was announced, implying a valuation of Encore of $21.94 per unit at the 0.75:1 exchange ratio. Thus, the Merger Agreement continued to reflect a discount to the implied market price of $23.20 Vanguard had offered on March 24.

3. Subsequent events

To effect any merger of the Partnership, subject to certain exceptions not relevant here, Section 14.3 of the LPA requires approval by a majority of Encore's unitholders. Vanguard held approximately 45.5% of Encore's outstanding units, representing less than a majority. Encore scheduled a special meeting for November 30, 2011 to hold a unitholder vote on the Merger Agreement. On October 31, 2011, Vanguard and Encore jointly issued the Proxy, which, among other things, recommended that Encore

unitholders vote to approve the Merger Agreement and stated Encore GP's and the Conflicts Committee's various reasons for that recommendation.

On November 30, a majority of the unitholders approved the Merger Agreement, and the transaction closed the following day, December 1. Although there is no dispute that the Merger Agreement received valid unitholder approval, the Complaint alleges that only one-third of Encore's unaffiliated unitholders voted in favor of the Merger. Defendants note, however, that the Form 8-K publicly disclosing the results of the vote indicate that over 28 million Encore units were voted in favor of the Merger, while less than one million were voted against.[28] That is, approximately 97% of the units voted at the special meeting approved the Merger.

The closing price of Vanguard's common units on December 1, 2011 was $27.76. Hence, the 0.75:1 exchange ratio ultimately represented an implied market value of $20.82 per Encore common unit, still below the implied value of $23.20 Vanguard initially offered.

C. Procedural History

As indicated above, this action commenced on April 5, 2011, *i.e.*, shortly after Vanguard made its initial proposal on March 24 but before the Merger Agreement was executed on July 10. After Plaintiffs filed a consolidated and an amended consolidated

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[28] McCormick Aff. Ex. C at 2. *See In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170–71 (Del. 2006) (holding Court of Chancery, in deciding motion to dismiss under Rule 12(b)(6), properly took judicial notice of stockholder vote results not subject to reasonable dispute).

complaint in June and July 2011, both of which Defendants moved to dismiss, the parties agreed to defer further proceedings until after the November 30 special meeting. After the Merger closed, Plaintiffs filed the operative Complaint on December 28, 2011, and Defendants moved to dismiss it on January 11, 2012.[29] The Court heard argument on that motion on May 25, 2012. This Memorandum Opinion constitutes the Court's ruling on Defendants' motion.

D. Parties' Contentions

The Complaint contains a single claim for relief, averring that "Defendants breached their contractual duties to Plaintiffs and the [c]lass by proposing, approving and consummating a transaction that was not fair or reasonable and was undertaken in bad faith."[30] Defendants contend that the Complaint fails to allege sufficient facts to support a claim that any or all of the various actions they took in relation to the Merger breached the minimal duties imposed by the LPA. Specifically, Defendants emphasize the effects of the following sequence of express contractual provisions: (1) Section 7.9(e) waives all duties other than those expressly provided for in the LPA; (2) Special Approval immunizes conflict transactions such as the Merger from judicial challenge pursuant to Section 7.9(a); (3) Section 1.1 defines Special Approval such that the only requirement is that approval be by the Conflicts Committee acting in "good faith"; (4) Section 7.9(b)

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29 As indicated in note 2, *supra*, the Conflicts Committee and remaining Defendants separately moved to dismiss. Both motions were filed on January 11 and are treated herein as one.

30 Compl. ¶ 79.

defines "good faith" as merely requiring a subjective belief that the disputed determination is in the best interests of the Partnership; and (5) Section 7.10(b) provides the General Partner with a conclusive presumption of good faith whenever the General Partner acts or omits to act in reliance upon the advice or opinion of a legal or financial advisor as to a matter "the General Partner reasonably believes to be within such Person's professional or expert competence."[31] According to Defendants, even if the Merger reflects a poor deal for Encore's former unitholders, which Defendants deny as a factual matter, the Complaint does not allege that the Conflicts Committee subjectively believed that the Merger was contrary to the Partnership's best interests. In addition, Defendants acknowledge that the implied contractual covenant of good faith and fair dealing limits the manner in which Defendants can exercise Special Approval. Relying on precedents such as *Nemec v. Shrader*[32] and *Lonergan v. EPE Holdings, LLC*,[33] however, Defendants contend that the implied covenant does not automatically trigger an objective reasonableness review of the Merger itself. Consequently, to the extent Plaintiffs challenge the Merger as "unreasonable" or "unfair," Defendants argue that Plaintiffs overstate the potency of the implied covenant. According to Defendants, therefore, the sole count of the Complaint fails to state a claim that any Defendant violated the LPA's express or implied terms.

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31 LPA § 7.10(b).

32 991 A.2d 1120 (Del. 2010).

33 5 A.3d 1008 (Del. Ch. 2010).

For their part, Plaintiffs maintain that the Conflicts Committee's review was perfunctory and that the Committee effectively failed to negotiate. In either case, they criticize the Conflicts Committee's conduct as inconsistent with even the minimal duties prescribed by the LPA. In that regard, Plaintiffs emphasize the Complaint's allegations that Vanguard and the Director Defendants affirmatively acted to depress the trading price of Encore's units in the three months before Vanguard's March 24, 2011 offer and that the Conflicts Committee's sole counteroffer had a corresponding value less than Vanguard had offered initially. From these allegations, Plaintiffs argue, one reasonably can infer subjective bad faith. Additionally, Plaintiffs rely on a number of cases holding that the implied covenant requires contractually conferred discretion to be exercised reasonably. Based on the same allegations just mentioned, Plaintiffs further claim that the Conflicts Committee's purported Special Approval was objectively unreasonable. In sum, Plaintiffs assert that the Complaint adequately states a claim for an express and implied breach of the LPA.

II. ANALYSIS

A. Standard Under Rule 12(b)(6)

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.[34]

The Court, however, need not "accept conclusory allegations unsupported by specific facts or . . . draw unreasonable inferences in favor of the non-moving party."[35] Additionally, "the Court may consider documents both integral to and incorporated into the complaint" when deciding a motion to dismiss.[36] On that basis, the Court has considered the LPA, Proxy, January 3 Press Release, and February 22 Press Release in evaluating Defendants' motion.

B. The Scope of Defendants' Duties to Plaintiffs

When dealing with the internal affairs of a limited partnership, the reviewing court's first task is to determine what duties the defendants owe.[37] Although a general partner and its affiliates may owe fiduciary duties to a limited partnership,[38] a limited partnership agreement can "establish[] a contractual standard of review that supplants

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

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

36 *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)).

37 *In re K-Sea Transp. P'rs L.P. Unitholders Litig.*, 2012 WL 1142351, at *5 (Del. Ch. Apr. 4, 2012) ("[T]he Court's first task is to determine the nature of any duty that is owed under the LPA.").

38 *Brinckerhoff v. Enbridge Energy Co.*, 2011 WL 4599654, at *7 (Del. Ch. Sept. 30, 2011).

fiduciary duty analysis."[39] Indeed, the Delaware Revised Uniform Limited Partnership Act ("DRULPA") permits a limited partnership agreement to eliminate all duties, other than the implied contractual covenant of good faith and fair dealing, that a person may owe to a limited partnership and its limited partners.[40] "Only '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.'"[41]

Section 7.9(e) of the LPA provides, in pertinent part, as follows: "Except as expressly set forth in this Agreement, neither the General Partner nor any other Indemnitee shall have any duties or liabilities, including fiduciary duties, to the Partnership or any Limited Partner . . . ." This section explicitly refers to the "General Partner," *i.e.*, Encore GP. It also refers indirectly to Vanguard and the Director Defendants via the defined term "Indemnitee." The LPA defines "Indemnitee" to mean, among other things, any "*Affiliate* of the General Partner."[42] Furthermore, the LPA defines

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39 *Lonergan v. EPE Hldgs. LLC*, 5 A.3d 1008, 1020 (Del. Ch. 2010).

40 6 *Del. C.* § 17-1101(d).

41 *In re LJM2 Co-Inv., L.P.*, 866 A.2d 762, 777 (Del. Ch. 2004) (second alteration in original) (quoting *Gotham P'rs, L.P. v. Hallwood Realty P'rs, L.P.*, 817 A.2d 160, 170 (Del. 2002)).

42 LPA § 1.1, at 9 (emphasis added).

> "*Affiliate*" [as], with respect to any Person,[43] any other Person that directly or indirectly through one or more intermediaries controls, is controlled by or is under common control with, 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, whether through ownership of voting securities, by contract or otherwise.[44]

Vanguard owns 100% of, and thus "controls" "through ownership of voting securities," Encore GP.[45] As such, Vanguard is an Affiliate of Encore GP and, in turn, an Indemnitee. Likewise, the Director Defendants possess the power to direct the management of Encore GP as members of its board of directors. Construing the definition of "Affiliate" both in accordance with its literal terms[46] and consistently with past precedents interpreting identical language,[47] the Director Defendants also are Affiliates of Encore GP and, thus, Indemnitees under the LPA.[48] As a result, Section 7.9(e) applies to all Defendants.

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43 The term "Person" includes both natural persons and business entities. *Id.* at 14.

44 *Id.* at 2.

45 *Id.*

46 *See In re Nantucket Island Assocs. P'ship Unitholders Litig.*, 810 A.2d 351, 361 (Del. Ch. 2002) (requiring limited partnership agreements to be construed literally).

47 *See Gerber v. Enter. Prods. Hldgs., LLC*, 2012 WL 34442, at *9 (Del. Ch. Jan. 6, 2012).

48 The definition of "Indemnitee" also includes "any Person who is or was a . . . director . . . [of] the General Partner," LPA § 1.1, at 9, which is a more direct basis for concluding that Section 7.9(e) applies to the Director Defendants. Other relevant provisions of the LPA, however, refer only to the General Partner and its

The plain meaning of Section 7.9(e) is that Defendants owe Plaintiffs only those duties "expressly set forth in" the LPA together with whatever nonwaivable default obligations the implied covenant of good faith and fair dealing imposes. Accordingly, in the following sections, I address, first, the express provisions of the LPA and, second, the obligations imposed by the implied covenant.

C. Express Duties Under the LPA

As a general matter, Defendants owe an express contractual duty of good faith pursuant to Section 7.9(b) of the LPA. That provision states, in relevant part, that:

> Whenever 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, in its capacity as the general partner of the Partnership . . . then, unless another express standard is provided for in this Agreement, the General Partner, or such Affiliates causing it to do so, *shall* make such determination or take or decline to take such other action in good faith . . . .[49]

Hence, Defendants—including the Director Defendants and Vanguard as Affiliates of Encore GP—owe Plaintiffs an express contractual duty of good faith.

Notwithstanding the generality of the contractual duty of good faith prescribed by Section 7.9(b), Section 7.9(a) provides a specific mechanism for resolution of conflicts of interest. That Section provides, in pertinent part, as follows:

> Unless otherwise expressly provided in this Agreement . . . , whenever a potential conflict of interest exists or arises

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Affiliates. Concluding here that the Director Defendants also are Affiliates, therefore, streamlines the analysis *infra*.

[49] LPA § 7.9(b) (emphasis added).

> between the General Partner or any of its Affiliates, on the one hand, and the Partnership . . . , on the other, any resolution or course of action by the General Partner 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 in respect of such conflict of interest is (i) approved by Special Approval . . . . The General Partner shall be authorized but not required in connection with its resolution of such conflict of interest to seek Special Approval . . . .

The LPA defines "Special Approval" as "approval by a majority of the members of the Conflicts Committee acting in good faith."[50] Therefore, the Special Approval process permitted by Section 7.9(a) essentially is consistent with the duty imposed by Section 7.9(b); whereas Section 7.9(b) imposes an overarching obligation to act in "good faith," Section 7.9(a) permits the General Partner to delegate decisions involving potential conflicts of interest to a committee of independent directors[51] so long as they, too, act in "good faith."

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[50] *Id.* § 1.1, at 17.

[51] The defined term "'*Conflicts Committee*' means a committee of the Board of Directors of the General Partner composed entirely of two or more directors who are not (a) security holders, officers or employees of the General Partner, (b) officers, directors or employees of any Affiliate of the General Partner or (c) holders of any ownership interest in the Partnership Group other than Common Units and who also meet the independence standards required of directors who serve on an audit committee of a board of directors established by the Securities Exchange Act and the rules and regulations of the Commission thereunder and by the National Securities Exchange on which the Common Units are listed or admitted to trading." *Id.* at 6.

Section 7.9(b) goes on to define "good faith" for purposes of the LPA:

> In order for a determination or other action to be in "good faith" for purposes of this Agreement, the Person or Persons making such determination or taking or declining to take such other action must believe that the determination or other action is in the best interests of the Partnership.

In *In re Atlas Energy Resources, LLC*,[52] Vice Chancellor Noble interpreted identical language contained within an LLC agreement. He concluded, for purposes of the agreement there, that "an act is in good faith if the actor *subjectively believes* that it is in the best interests of [the company]"[53] and that, "to state a claim for breach of the contractually defined fiduciary duty," the defendants must have acted "in a manner they subjectively believed was *not* in the best interests of [the company] and its unitholders."[54] In other words, the relevant contractual language required a showing "that the Special Committee believed it was acting *against* [the company's] interest."[55] Where the relevant contractual language is identical, the Delaware Supreme Court and sound public

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52 2010 WL 4273122, at *12 (Del. Ch. Oct. 28, 2010).

53 *Id.* (emphasis added).

54 *Id.* at *14 (emphasis added).

55 *Id.*; *cf. In re K-Sea Transp. P'rs L.P. Unitholders Litig.*, 2012 WL 1142351, at *5–6 (Del. Ch. Apr. 4, 2012) (where partnership agreement did not provide a definition of "good faith," interpreting provision exculpating general partner and its affiliates from money damages claims "as a result of any act or omission [taken] in *good faith*" as permitting claims "only if th[e] breach resulted from an act or omission done in *bad faith*" (emphasis added) (citing *Amirsaleh v. Bd. of Trade of City of New York, Inc.*, 2009 WL 3756700, at *5 (Del. Ch. Nov. 9, 2009))).

policy instruct trial courts to interpret such language consistently from case to case.[56] Therefore, consistent with *Atlas Energy*, I interpret the identical contractual language of this LPA as requiring Plaintiffs to allege facts from which one reasonably can infer that Defendants subjectively believed that they were acting *against* Encore's interests.

In that regard, Plaintiffs allege that Defendants acted in bad faith in two ways: (1) Vanguard and the Director Defendants affirmatively acted to undercut Encore's trading price before proposing the Merger; and (2) the Conflicts "Committee's performance [in negotiating the Merger Agreement] was simply incompatible with that of an effective bargaining agent acting in good faith."[57] Although they alleged two different categories of wrongdoing, Plaintiffs have claimed only one breach of the LPA. The sole count of the Complaint avers that: "Defendants breached their contractual duties to Plaintiffs and the Class by proposing, approving and consummating a transaction that was not fair or reasonable and was undertaken in bad faith."[58] Because all of the alleged wrongdoing is part and parcel of a singular conflict transaction allegedly in breach of the LPA, and because the LPA provides that any "course of action by the General Partner or its Affiliates in respect of such conflict of interest [*i.e.*, the Merger] . . . shall not constitute a

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56 *See RAA Mgmt., LLC v. Savage Sports Hldgs., Inc.*, 45 A.3d 107, 119 (Del. 2012) ("The efficient operation of capital markets is dependent upon the uniform interpretation and application of the same language in contracts or other documents.").

57 Compl. ¶ 53.

58 *Id.* ¶ 79.

breach of [the LPA] . . . or of any duty stated or implied by law or equity" if there is Special Approval,[59] a determination that the Merger received contractually valid Special Approval would compel a finding that no Defendant breached the LPA.[60] The principal

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[59] LPA § 7.9(a).

[60] Alternatively, Plaintiffs may be arguing that there have been two distinct violations of the LPA, one by Vanguard and the Director Defendants in depressing Encore's trading price and the second by the Conflicts Committee in failing to negotiate effectively. The distinction may have legal significance. If Plaintiffs are advancing independent claims of discrete wrongs, perhaps one could argue that Special Approval has the potential to immunize the Merger itself but not also Vanguard and the Director Defendants' earlier bad acts. I need not address such a possibility here, however, because a careful review of the Complaint, briefing, and argument transcript convinces me that Plaintiffs have asserted only a single claim challenging Defendants' various conduct in relation to the Merger itself. For starters, the Complaint contains only one count expressly based on Defendants' conduct in "proposing, approving and consummating *a transaction* that was not fair or reasonable." Compl. ¶ 79 (emphasis added). Likewise, its first paragraph characterizes "[t]his class action [as] challeng[ing] the fairness and good faith *of a merger*," *id.* ¶ 1 (emphasis added), a characterization that Plaintiffs repeated verbatim at the outset of their answering brief, *see* Pls.' Ans. Br. 1. Plaintiffs' counsel also began his remarks at argument by stating, "this case involves a controller-led squeeze-out merger at a 10 percent discount to the preannouncement trading price of the target, a trading price that was itself impaired by the controller's value-depressive disclosures." Hr'g Tr. 34. Thus, Plaintiffs framed the relevance of the allegedly value-depressive disclosures as affecting the consideration Plaintiffs ultimately received *in the Merger* rather than as a discrete violation of the LPA. The only contrary indication that Plaintiffs may have intended to assert two claims of breach of the LPA stems from the structure of Plaintiffs' answering brief, which first addresses Vanguard and the Director Defendants' actions and then, under a separate heading, states "[t]he Conflicts Committee *also* violated *their* duty of good faith." Pls.' Ans. Br. 21 (emphasis added). Charitably read, that statement may suggest independent claims. With that thought in mind, however, even if one rereads the Complaint in search of vague allegations arguably consistent with such a theory, there is no notice of such a claim. *See Cent. Mortg. Co.*, 27 A.3d at 536 (holding courts must "accept even vague allegations in the Complaint as 'well-pleaded' if they provide the defendant notice of the claim"). For purposes of Defendants' motion to dismiss, therefore, I

issue, therefore, is whether the Conflicts Committee effectively gave its Special Approval, *i.e.*, approved the Merger acting in subjective good faith.

1. Did the Conflicts Committee approve the Merger acting in subjective good faith?

Plaintiffs argue that the Conflicts Committee members "violated their duty of good faith by failing to bargain with Vanguard in any meaningful way."[61] In that regard, the Complaint alleges that Vanguard's initial offer on March 24, 2011 was a unit-for-unit exchange at a fixed ratio of 0.72 Vanguard common units per Encore common unit, representing a premium of just over 0.2% to Encore's trading price. Furthermore, the spread between Vanguard and Encore was at a historical low point on March 24, allegedly caused by Vanguard and the Director Defendants' affirmative "steps to drive down the price of Encore common units" over the preceding three months.[62] Plaintiffs complain that, despite those facts, the Conflicts Committee's June 15 counteroffer sought only a paltry improvement to the exchange ratio, which in terms of dollar value represented a 9.1% discount to Vanguard's initial offer, because the trading price of Vanguard units had declined in the interim. The Complaint also alleges that Jefferies

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find that the only claim asserted in the Complaint concerns conduct related to the merger itself. *See Clinton v. Enter. Rent-A-Car Co.*, 977 A.2d 892, 895 (Del. 2009) ("Dismissal is appropriate . . . if it appears 'with reasonable certainty that, under any set of facts that could be proven *to support the claims asserted*, the plaintiff would not be entitled to relief.'" (emphasis added) (quoting *Feldman v. Cutaia*, 951 A.2d 727, 731 (Del. 2008))).

61 Pls.' Ans. Br. 21.

62 Compl. ¶ 76.

"did not provide advice concerning the structure, the determination of the specific [e]xchange [r]atio, or any other aspects of the Merger . . . other than the delivery of [its fairness] opinion."[63] Relatedly, the ratio of 0.75:1 finally agreed to reflected an implied value at the lower end of the range Jefferies identified was fair and, according to Plaintiffs, entirely below the ranges at which Vanguard's financial advisor had, and other "standardized measure[s]" would have, valued Encore.[64] In other words, the Complaint accuses the Conflicts Committee of being ineffectual negotiators.

Similar allegations were involved in *Atlas Energy*. There, a special committee consented to an exchange ratio representing a 0.3% premium over the target's then-current trading price.[65] The committee members also allegedly gave only cursory consideration to other options the company could have pursued once negotiations were underway, such as the possibility of a third party venture as an alternative to the merger or the inclusion of a majority of the minority provision in the merger agreement, and they allowed each of the purportedly independent directors to be promised a seat on the surviving company's board.[66] Nevertheless, the Court determined that,

> [w]hile allegations that the Special Committee failed even to look at all of its options or to negotiate the best deal available might suffice to state a colorable claim for breach of the traditional fiduciary duties of care and loyalty, they do not

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63 *Id.* ¶ 54 (quoting Proxy at C-2).

64 *Id.* ¶ 63.

65 *Atlas Energy*, 2010 WL 4273122, at *4.

66 *Id.* at *14.

> suggest the type of subjective bad faith required to state a claim under the duty imposed by § 7.9(b) of the LLC Agreement. Even the allegation that the Special Committee's independence was compromised . . . does not suggest that the Special Committee believed it was acting *against* [the company]'s interest . . . .[67]

Parallel reasoning applies here. At worst, the Complaint alleges that the Conflicts Committee ran a shoddy negotiation process. But, it does not allege sufficient facts from which one reasonably could infer that the Conflicts Committee members subjectively believed they were acting contrary to the Partnership's interests by giving Special Approval to the Merger.

Meager though it might have been, the June 15 counteroffer reflected a higher exchange ratio than Vanguard's initial offer. Furthermore, the Proxy discloses that the Conflicts Committee considered trading price to be less important than other financial metrics, especially because they believed that the market already expected a merger with Vanguard, and, thus, that the share price already reflected a premium. In that regard, the Proxy discloses that the Conflicts Committee selected the seemingly modest counteroffer because they "believed that an acquirer was unlikely to agree to an exchange ratio that appeared to be immediately dilutive to its own distributable cash flow per unit, an important metric for master limited partnerships," and that "an exchange ratio of 0.75 approached the point at which the proposed merger would become dilutive to Vanguard's

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67 *Id.*

distributable cash flow per unit."[68] The Committee also disclosed that they found the Merger to be in the Partnership's best interests because, among other reasons, distributable cash flow per unit would be higher in a combined entity and the Merger Agreement permitted Encore to continue making quarterly distributions until the Merger closed.[69] Plaintiffs make no allegation that Defendants were being insincere in authorizing these disclosures, *e.g.*, that the foregoing factors, in fact, were not among the bases for the Conflicts Committee members' subjective belief that the Merger was in the Partnership's best interests. Lastly, the Conflicts Committee retained and relied on the advice of independent legal counsel and a competent financial advisor before approving the final Merger Agreement.[70]

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68 Proxy at 53.

69 *Id.* at 61. In *Atlas Energy*, by comparison, the suspension of distributions was the only "allegation directly address[ing] the Special Committee members' subjective motivations and approach[ing] a suggestion they believed they were acting against the best interests of [the company]'s unitholders, but even that allegation [wa]s not sufficient to sustain Plaintiffs' claims against the Special Committee members." 2010 WL 4273122, at *14.

70 Although the Complaint alleges that Jefferies suffered from a conflict of interest, *see* Compl. ¶¶ 70–71, Plaintiffs essentially disclaimed any contention that Jefferies was unable to provide a reliable fairness opinion. Rather, their argument is that the Conflicts Committee should have done more to negotiate a deal at the higher range Jefferies identified as fair. Hr'g Tr. 46. Indeed, Plaintiffs' counsel stated: "Plaintiffs could have argued that the price is unfair and Jefferies was incompetent and that there was no basis for relying on the Jefferies analysis. That's not at all what [P]laintiffs argue. . . . [T]he fact that where they ended up was within a range of fair value doesn't answer the proposition that they were ineffective and not-in-good-faith bargaining agents." *Id.*

In the final analysis, the relevant inquiry dictated by the LPA is whether the Conflicts Committee approved the Merger with the subjective belief that it was in the best interests of the Partnership. Whether their determination was objectively reasonable is not relevant to that contractually prescribed standard.[71] However bad the Conflicts Committee's decision may appear from the allegations of the Complaint, Plaintiffs have not alleged facts from which one could infer that the Conflicts Committee made its decision in bad faith, *i.e.*, with the subjective belief that their approval was contrary to the Partnership's best interests. Absent such allegations, the Conflicts Committee's approval of the Merger satisfies Section 7.9(b)'s contractual definition of "good faith" and, in turn, Section 1.1's definition of Special Approval, thus immunizing Defendants' actions from challenge by operation of Section 7.9(a). As the LPA makes clear, because Special Approval was given to Defendants' Merger-related conduct, those actions are permitted and "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."[72] Therefore, Defendants have satisfied their express obligations under the LPA and, unless the Complaint

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71 *See Atlas Energy*, 2010 WL 4273122, at *12 ("[W]hile under Delaware's common law, the objective elements of good faith dominate the subjective element, under § 7.9(b), only the subjective intent of [the company]'s officers and directors matters when determining whether they acted in good faith." (internal quotation marks and footnote omitted)). The distinct issue of whether any Defendant exercised the discretion conferred by the LPA so unreasonably or arbitrarily as to have breached the implied covenant is addressed in Section II.D, *infra*.

72 LPA § 7.9(a).

adequately alleges that Defendants breached the implied covenant of good faith and fair dealing, Plaintiffs have failed to state a claim.

D. Duties Under the Implied Covenant

The Court's inquiry does not end with its conclusion that the Merger received contractually valid Special Approval, because "even the most carefully drafted agreement will harbor residual nooks and crannies for the implied covenant [of good faith and fair dealing] to fill."[73] The implied covenant is a limited gap-filling tool to infer contractual terms to which the parties would have agreed had they anticipated a situation they failed to address;[74] it is not a "free-floating duty"[75] or "a substitute for fiduciary duty analysis."[76] Put differently,

> "[f]air dealing" is not akin to the fair process component of entire fairness, *i.e.*, whether the fiduciary acted fairly when engaging in the challenged transaction as measured by duties of loyalty and care . . . . It is rather a commitment to deal "fairly" in the sense of consistently with the terms of the parties' agreement and its purpose. Likewise "good faith" does not envision loyalty to the contractual counterparty, but rather faithfulness to the scope, purpose, and terms of the parties' contract. Both necessarily turn on the contract itself

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73 *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, –A.3d–, 2012 WL 3027351, at *4 (Del. Ch. July 9, 2012) [hereinafter *ASB Allegiance*].

74 *Nemec v. Shrader*, 991 A.2d 1120, 1125 (Del. 2010) ("The implied covenant of good faith and fair dealing involves . . . inferring contractual terms to handle developments or contractual gaps that the asserting party pleads neither party anticipated.").

75 *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 441 (Del. 2005).

76 *Lonergan v. EPE Hldgs. LLC*, 5 A.3d 1008, 1017 (Del. Ch. 2010).

> and what the parties would have agreed upon had the issue arisen when they were bargaining originally.[77]

Additionally, when a contract confers discretionary rights on a party, the implied covenant requires that party to exercise its discretion reasonably.[78] And "what is 'arbitrary' or 'unreasonable'—or conversely 'reasonable'—depends on the parties' original contractual obligations"[79] and "reasonable expectations at the time of contracting."[80] Fundamentally, therefore, "[t]he implied covenant cannot be invoked to override the express terms of the contract."[81]

Plaintiffs argue that the implied covenant imposes a discrete duty "at least as broad as" Section 7.9(b) of the LPA and, therefore, that their allegations of ineffective bargaining demonstrate that "the Conflicts Committee did not exercise its discretion in

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77 *ASB Allegiance*, 2012 WL 3027351, at *3.

78 *Id.* at *4 & n.2; *see also Policemen's Annuity & Benefit Fund of Chi. v. DV Realty Advisors LLC*, 2012 WL 3548206, at *12 (Del. Ch. Aug. 16, 2012) [hereinafter *DV Realty*] ("[W]hen 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.'" (emphasis added) (quoting *Airborne Health, Inc. v. Squid Soap, L.P.*, 984 A.2d 126, 146–47 (Del. Ch. 2009))).

79 *ASB Allegiance*, 2012 WL 3027351, at *4; *see also DV Realty*, 2012 WL 3548206, at *12 ("[I]f 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.").

80 *Nemec*, 991 A.2d at 1126.

81 *Kuroda v. SPJS Hldgs., L.L.C.*, 971 A.2d 872, 888 (Del. Ch. 2009); *accord Dunlap*, 878 A.2d at 441.

good faith in conducting negotiations with Vanguard."[82] While Plaintiffs correctly contend that Defendants' discretionary use of Special Approval implicates the implied covenant, they appear to suggest that the implied covenant engenders a "free-floating duty" of objective fairness or effectiveness that both Delaware common law and Section 7.9(e) of the LPA disclaim. Indeed, "[t]o use the implied covenant to replicate fiduciary review 'would vitiate the limited reach of the concept of the implied duty of good faith and fair dealing.'"[83] Rather, to state a claim under the implied covenant, Plaintiffs must identify how the Conflicts Committee's allegedly feckless negotiations "frustrate[ed] the fruits of the bargain that the [parties] reasonably expected."[84]

The express and controlling provisions of the LPA belie a reasonable inference that the parties would have agreed to, or that Plaintiffs reasonably expected, Defendants'

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82 Pls.' Ans. Br. 23, 25.

83 *Lonergan*, 5 A.3d at 1019 (quoting *Nemec*, 991 A.2d at 1128).

84 *Nemec*, 991 A.2d at 1126. Additionally, relatively recent precedents hold that "'[t]he implied covenant . . . only potentially binds the parties to an agreement.'" *Gerber v. Enter. Prods. Hldgs., LLC*, 2012 WL 34442, at *11 (Del. Ch. Jan. 6, 2012) (quoting *Brinckerhoff v. Enbridge Energy Co.*, 2011 WL 4599654, at *11 (Del. Ch. Sept. 30, 2011)). The only Defendant that is a party to the LPA, however, is Encore GP. Therefore, Plaintiffs' emphasis on the Conflicts Committee arguably is inapposite to the issue of whether Encore GP unreasonably exercised *its* discretion. *But see Gerber*, 2012 WL 34442, at *11 n.46 ("[A]lthough the Director Defendants are not themselves bound by the implied covenant, the actions they take on behalf of [the general partner] could lead to a determination that [the general partner] has breached the implied covenant."). It is unnecessary to dwell on this point, however, because Plaintiffs ultimately failed to state a claim under the implied covenant even assuming the implied covenant applies directly to the Conflicts Committee.

use of Special Approval to be conditioned on achieving an objectively "fair or reasonable value for [Plaintiffs'] units."[85] For example, the contractual safe harbor provided by Section 7.9(a) applies equally to transactions "(iii) on terms no less favorable to the Partnership than those generally being provided to or available from unrelated third parties." Interpreting a similar provision in *Lonergan*, Vice Chancellor Laster reasoned that "Section 7.9(a)(iii) . . . disposes of the plaintiff's contention that [the] implied covenant requires an 'adequate and fair sales process.'"[86] That is, to meet the standard of terms as favorable as those available from third parties, the General Partner "might want (but would not be required) to explore third-party alternatives or test a transaction in the market. . . . [Having] contemplated third-party-sale standards[, i]t would have been easy [for the LPA] to mandate a sales process, even to the point of requiring specific auction procedures."[87] That the LPA does not do so, however, indicates that the parties would not have agreed to such an obligation at the time of contracting.[88]

Furthermore, even limiting the analysis to the contractual provisions germane to the Special Approval process, "the scope, purpose, and terms of the parties' contract"

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85 Compl. ¶ 6.

86 *Lonergan*, 5 A.3d at 1020 (quoting the complaint in that case).

87 *See id.* at 1020–21.

88 Furthermore, because the contractual language at issue in *Lonergan* and here are near facsimiles, the weight of precedent alone supports a conclusion that the implied covenant does not require a fair sales process. *See RAA Mgmt., LLC*, 45 A.3d at 119 (calling for uniform interpretation and application of the same language in contracts).

indicate an intent contrary to the implied condition of obtaining objectively fair value that Plaintiffs contend inheres in the meaning of Special Approval.[89] Among other things, the LPA: (1) limits the Conflicts Committee members' duties to a subjective good faith standard;[90] (2) neither requires nor prohibits the consideration of any particular factors by the Conflicts Committee in granting Special Approval, which also need not be unanimous;[91] (3) expressly "presume[s] that, in making its decision, the Conflicts Committee acted in good faith";[92] (4) offers the General Partner a conclusive presumption of good faith whenever it acts upon the advice of legal counsel or financial advisors reasonably believed to be competent to opine on the relevant matter (but who, implicitly, might not actually have been competent);[93] (5) exculpates Defendants in any case from all monetary liability unless they "acted in bad faith or engaged in fraud, willful misconduct or, in the case of a criminal matter, acted with knowledge that the . . . conduct was criminal";[94] and (6) expressly and unambiguously waives common law fiduciary duties.[95] This contractual framework appears to be inimical to *requiring* that a

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89 *ASB Allegiance*, 2012 WL 3027351, at *3.

90 LPA § 7.9(b).

91 *Id.* § 1.1, at 17 (defining Special Approval).

92 *Id.* § 7.9(a).

93 *Id.* § 7.10(b).

94 *Id.* § 7.8(a).

95 *Id.* § 7.9(e).

transaction receiving Special Approval be objectively fair and reasonable. Nevertheless, Plaintiffs argue that the manner in which the Conflicts Committee negotiated the Merger Agreement—which ultimately resulted in both an increase to the exchange ratio Vanguard offered and the potential for greater distributable cash flow per unit from the post-Merger entity than what Plaintiffs had been receiving from Encore—somehow frustrated their reasonable expectations. To the contrary, "the elimination of fiduciary duties implies an agreement that losses should remain where they fall."[96]

The near absence under the LPA of any duties whatsoever to Encore's public equity holders presumably would discourage risk averse investors unwilling to take a leap of faith from investing their money in an enterprise controlled by the General Partner and its Affiliates. But, the "right to enter into good and bad contracts"[97] makes the implied covenant an ersatz substitute for the warning '*caveat emptor*.' Investors apprehensive about the risks inherent in waiving the fiduciary duties of those with whom they entrust their investments may be well advised to avoid master limited partnerships like Encore. Having decided to take a leap of faith and to reach for the kind of returns a master limited partnership investment might yield, however, Plaintiffs cannot "re-introduce fiduciary review through the backdoor of the implied covenant."[98] Rather, Delaware law "give[s] maximum effect to the principle of freedom of contract and to the enforceability of

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96 *Lonergan*, 5 A.3d at 1018.

97 *Nemec*, 991 A.2d at 1126.

98 *Lonergan*, 5 A.3d at 1019.

partnership agreements."[99] The parties to the partnership agreement at issue here plainly intended to give the General Partner and its Affiliates maximum flexibility. Under these circumstances, an inference that the concededly modest protections afforded to Plaintiffs by the LPA frustrated their legitimate expectations would be unreasonable even on a motion to dismiss. Accordingly, in this case, there does not appear to be any reasonably conceivable set of circumstances susceptible of proof under which Plaintiffs could recover on a claim to that effect. Therefore, Plaintiffs have not stated a claim for breach of the implied covenant.

Although I conclude that Plaintiffs have not stated a claim for breach of the implied covenant because Defendants' actions could not have frustrated Plaintiffs reasonable expectations for their bargain, the language of the LPA provides an alternative and independent reason why Plaintiffs have not stated such a claim.

The Delaware Supreme Court made clear in *Nemec* that the implied covenant is a "limited and extraordinary legal remedy."[100] It is a gap-filler that "only applies to developments that could not be anticipated" at the time of contracting.[101] The applicability of the implied covenant is further limited in that it "only potentially binds

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99 6 *Del. C.* § 17-1101(c).

100 *Nemec*, 991 A.2d at 1128.

101 *Id.* at 1126.

the parties to an agreement."[102] Therefore, Encore GP is the only Defendant against whom a claim can be asserted for breach of the implied covenant.

When the Special Approval process is used, "[a]t a minimum, the approval must have been given in compliance with the implied covenant of good faith and fair dealing."[103] But "[t]he implied covenant will not infer language that contradicts a clear exercise of an express contractual right."[104]

Encore GP enjoys an express right to rely on the opinions of investment bankers under Section 7.10(b) of the LPA. That section provides, in pertinent part, as follows:

> The General Partner may consult with . . . investment bankers . . . , and any act taken or omitted to be taken in reliance upon the advice or opinion . . . of such Persons as to matters that the General Partner 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 advice or opinion.

There is no dispute that the Conflicts Committee relied on a fairness opinion provided by Jefferies, and the Proxy indicates that "[t]he Encore GP Board considered and relied in part upon the determinations and recommendation of the Encore Conflicts Committee in

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102 *Brinckerhoff v. Enbridge Energy Co.*, 2011 WL 4599654, at *11 (Del. Ch. Sept. 30, 2011) (citing *Nemec*, 991 A.2d at 1126 and Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 Del. J. Corp. L. 1, 17 (2007)).

103 *Lonergan*, 5 A.3d at 1021 (quoting *Brinckerhoff v. Texas E. Prods. Pipeline Co., LLC*, 986 A.2d 370, 390 (Del. Ch. 2010)).

104 *Nemec*, 991 A.2d at 1127.

making its determinations and recommendation."[105] The Conflicts Committee and the Encore GP Board admittedly are not Encore 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."[106] That is, the only reasonable inference from the allegations of the Complaint in this regard is that Encore GP relied on the investment banker's opinion. Furthermore, there is no allegation that Encore GP could not have believed reasonably that the fairness opinion was within Jefferies's professional competence. Therefore, Section 7.10(b) provides Encore GP with a conclusive presumption that it acted in good faith in exercising its discretion to use the Special Approval process.[107]

In two recent cases, *Gerber* and *In re K-Sea*, this Court has held that a plaintiff cannot "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."[108] In both

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105 Proxy at 64.

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

107 As in *Brinckerhoff v. Enbridge Energy*, there is no reason to believe that the good faith referred to in the LPA does not "impose a duty as broad, and likely broader, than the duty imposed by the implied covenant of good faith and fair dealing." *Enbridge Energy*, 2011 WL 4599654, at *11.

108 *Gerber*, 2012 WL 34442, at *12; *accord In re K-Sea Transp. P'rs L.P. Unitholders Litig.*, 2012 WL 1142351, at *9–10 (Del. Ch. Apr. 4, 2012) [hereinafter *K-Sea II*].

cases, dealing with master limited partnership agreements nearly identical to the LPA, the Court 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. . . . 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.[109]

These holdings apply here and protect Defendants from the claim that they acted other than in good faith.

III. CONCLUSION

Because the Conflicts Committee satisfied their express and implied duties under the LPA in giving their Special Approval to the Merger, Section 7.9(a) precludes Plaintiffs from stating a claim against any of the Defendants for breach of the LPA or of any duty stated or implied by law and equity. Therefore, I grant Defendants' motion and dismiss Plaintiffs' Complaint with prejudice.

IT IS SO ORDERED.

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[109] *Gerber*, 2012 WL 34442, at *12–13; *K-Sea II*, 2012 WL 1142351, at *10 (quoting *Gerber*).