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Eliminating Fiduciary Duties and the Status of the Implied Contractual Covenant of Good Faith and Fair Dealing

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Special to the Delaware Business Court Insider | February 22, 2012

Section 17-1101(d) of the Delaware Revised Uniform Limited Partnership Act provides that a partnership agreement may expand, restrict or eliminate the fiduciary duties owed by a partner or other person to the limited partnership, a partner or any other person that is a party to or is otherwise bound by such partnership agreement, provided that the implied contractual covenant of good faith and fair dealing may not be eliminated.

In *Gerber v. Enterprise Products Holdings LLC*, the Delaware Court of Chancery upheld the elimination of fiduciary duties contained in the partnership agreement of a publicly traded Delaware limited partnership and added to a growing list of cases in which courts have failed to find a breach of the implied covenant. However, *Gerber* also illustrates the need for care and diligence when drafting partnership agreements.

BACKGROUND

According to the opinion, Enterprise Products Holdings LLC (formerly known as EPE Holdings LLC) (Enterprise Products GP) was the general partner of Enterprise GP Holdings L.P., a publicly traded Delaware limited partnership (EPE) that indirectly owned the general partner interests in Enterprise Products Partners L.P., another publicly traded Delaware limited partnership (Enterprise Products). In 2007, EPE purchased a company (Teppco GP) from an affiliate of Enterprise Products GP's parent for $1.1 billion. Approximately two years later, Enterprise Products GP considered a transaction in which EPE would sell Teppco GP to Enterprise Products for about $100 million. Because the 2009 sale involved a conflict of interest, the special approval of the audit and conflicts committee of the board of directors of Enterprise Products GP was sought pursuant to EPE's partnership agreement, the opinion said. The conflicts committee approved the 2009 sale and, as part of its approval process, received a fairness opinion from Morgan Stanley & Co.

Approximately one year after the 2009 sale, Enterprise Products made two offers to the board to merge EPE with Enterprise Products. Both offers were rejected and no counteroffers were made. Enterprise Products then made a third offer, after which the special approval of the conflicts committee was again sought pursuant to EPE's partnership agreement. Following a meeting between the conflicts committee and its legal and financial advisers regarding legal claims that had been asserted in connection with the 2007 purchase and potential claims that might arise as a result of the 2009 sale, EPE made a counteroffer. A deal was ultimately reached, and the conflicts committee approved the merger. In approving the merger, the conflicts committee received another fairness opinion from Morgan Stanley. The merger received the requisite unitholder approval under EPE's partnership agreement, and EPE merged into a wholly owned subsidiary of Enterprise Products.

The plaintiff, Joel A. Gerber, owned limited partner units in EPE at the time of the 2009 sale and the merger. Gerber asserted several claims against Enterprise Products GP, the board and others, including claims for breach of fiduciary duties and breach of the implied covenant.

THE COURT'S RULING

After holding that the plaintiff's claims could be brought directly as opposed to derivatively, the court, in applying a long line of Delaware cases, found that, absent contractual modification, Enterprise Products GP and the members of the board owed EPE and the holders of its limited partner units fiduciary duties. To determine the extent of the fiduciary duties owed, the court analyzed the provisions of EPE's partnership agreement. In particular, the court focused much of its attention on a provision addressing transactions that present a potential conflict of interest.

Section 7.9(a) of EPE's partnership agreement, similar versions of which are commonly found in partnership agreements of publicly traded limited partnerships, provides:

"Unless otherwise expressly provided in this Agreement, whenever a potential conflict of interest exists or arises between [Enterprise Products GP] or any of its Affiliates, on the one hand, and [EPE] or any Partner, on the other hand, any resolution or course of action by [Enterprise Products 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 agreement contemplated herein or therein, 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, (ii) approved by the vote of a majority of the Units excluding Units owned by [Enterprise Products GP] and its Affiliates, (iii) on terms no less favorable to [EPE] than those generally being provided to or available from unrelated third parties or (iv) fair and reasonable to [EPE], taking into account the totality of the relationships between the parties involved (including other transactions that may be particularly favorable or advantageous to [EPE])."

"Special approval," as contemplated by Section 7.9(a)(i) of EPE's partnership agreement, meant the approval by a majority of the members of the conflicts committee. After finding that the 2009 sale presented a conflict of interest as contemplated by Section 7.9(a), the court found that because the conflicts committee granted special approval to the 2009 sale and the merger, pursuant to the terms of Section 7.9(a), the 2009 sale and the merger "shall be permitted and deemed approved by all Partners, and shall not constitute a breach of [EPE's partnership agreement] or of any agreement contemplated ... therein, or of any duty stated or implied by law or equity." As a result, the court held there to be no breach of fiduciary duty in connection with the 2009 sale or the merger, and in so holding reaffirmed a partnership agreement's ability to eliminate fiduciary duties and replace such duties with contractual standards.

The court also analyzed the plaintiff's claims for breach of the implied covenant. Stating that the implied covenant "only potentially binds the parties to an agreement," the court found that Enterprise Products GP, which was the only defendant that was also a party to EPE's partnership agreement, was the only defendant that could potentially be liable for breaching the implied covenant. The court stated that the implied covenant required Enterprise Products GP to "act in good faith if it took advantage of the Special Approval process" set forth in Section 7.9(a) of EPE's partnership agreement. To determine whether Enterprise Products GP acted in such a manner, the court turned to Section 7.10(b) of EPE's partnership agreement, another provision commonly found in partnership agreements of publicly traded limited partnerships, which provides:

"[Enterprise Products GP] may consult with legal counsel, accountants, appraisers, management consultants, investment bankers and other consultants and advisors selected by it, and any act taken or omitted to be taken in reliance upon the opinion (including an Opinion of Counsel) of such Persons as to matters that [Enterprise Products 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."

As discussed above, the conflicts committee received and relied upon a fairness opinion from Morgan Stanley for both the 2009 sale and the merger. The court found that the conflicts committee's reliance upon the two opinions constituted reliance by Enterprise Products GP upon such opinions "in deciding whether to use the Special Approval process to take advantage of the contractual duty limitations provided by Section 7.9(a) [of EPE's partnership agreement]." Consequently, Enterprise Products GP "is conclusively presumed to have acted in good faith in deciding to use the Special Approval process." The court held that if a defendant "is conclusively presumed by the terms of a contract to have acted in good faith," it cannot breach the implied covenant. As a result, the court dismissed the claims asserted against the defendants for breach of the implied covenant.

THE SIGNIFICANCE OF *GERBER*

The court in *Gerber* reaffirmed that the implied covenant "only potentially binds the parties to an agreement." While this statement is not new, some doubt among Delaware practitioners previously existed as to whether a Delaware court might expand the application of the implied covenant to people owing fiduciary duties to a partnership and its partners but who are not parties to the partnership agreement, such as directors and officers of a corporate general partner. The *Gerber* court declined to expand the implied covenant to such people, finding that "the only defendant potentially liable under the [Implied Covenant] is Enterprise Products GP," which was the only defendant that was a party to EPE's partnership agreement. As a result:

"Although many entities that do not sign a limited partnership agreement will, absent contractual modification, owe unremitting duties to the limited partnership and the holders of the partnership's LP units, those entities may, through contract, be fully absolved of any duties they would have owed the limited partnership at common law, and still not be subject to the [Implied Covenant]."

The court, seemingly aware of the potential impact of its ruling, noted that "although the [board members] are not themselves bound by the implied covenant, the actions they take on behalf of Enterprise Products GP could lead to a determination that Enterprise Products GP has breached the implied covenant." Even so, it would appear that nonparties to the partnership agreement would, absent special circumstances, be absolved of personal liability in connection with a breach of the implied covenant.

Another significant aspect of *Gerber* is the court's discussion of the contractual good-faith standard set forth in EPE's partnership agreement and the protection it afforded Enterprise Products GP. While the ability to contractually define a standard that could potentially remove any gaps from a partnership agreement and thereby make the implied covenant inapplicable is, in and of itself, worthy of discussion, the fact that the court's analysis focused solely on Enterprise Products GP is also important. As discussed above, although the members of the board were not subject to the implied covenant, the court found that, absent contractual modification, they owed fiduciary duties to EPE and the holders of its limited partner units. However, nowhere did the court indicate that the board or anyone else other than Enterprise Products GP would be protected by Section 7.10(b) of EPE's partnership agreement.

It is unclear what led the court to focus its attention on Enterprise Products GP. Perhaps it was a result of the court's prior determination that fiduciary duties owed to EPE and the holders of its limited partner units had been eliminated and Enterprise Products GP was the only party to which the implied covenant applied, and therefore the only party that could benefit from such protection in this case. Alternatively, perhaps the court focused its attention on Enterprise Products GP because Section 7.10(b), by its terms, only explicitly protected the "general partner" of EPE. While it may seem odd to allow an entity, but not those who control such entity, to benefit from those protections, it is not clear how a court would rule on this matter. In any event, this illustrates the need for diligence when drafting partnership (or limited liability company) agreements in order to make sure all fiduciaries are explicitly protected to the extent desired.

Gerber is an important case in the ever-expanding world of alternative entities. Not only does it reaffirm the position of Delaware's legislature and judiciary that a partnership agreement may completely eliminate fiduciary duties (except, of course, the implied covenant) that a fiduciary owes to a partnership, its partners and anyone else that is a party to or is otherwise bound by such partnership agreement, but it also confirms that only those who are a party to a partnership agreement may be subject to the implied covenant. It also illustrates the need to carefully and clearly draft provisions in partnership agreements purporting to eliminate, modify or otherwise define those duties.

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