

Conclusive Presumption of Good Faith in MLP Agreements

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The Delaware Supreme Court provided helpful guidance on the operation of the conclusive presumption of good faith in master limited partnership agreements in three recent decisions: *Brinckerhoff v. Enbridge Energy*, No. 574, 2011 (Del. May 28, 2013); *Norton v. K-Sea Transportation Partners L.P.*, No. 238, 2012 (Del. May 28, 2013); and *Gerber v. Enterprise Products Holdings LLC*, No. 46, 2012 (Del. June 10, 2013). These decisions validate the use of conclusive presumption provisions in accordance with the intent of the Delaware Revised Uniform Limited Partnership Act (DRULPA) to give "maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements," yet demonstrate that such contractual freedom is not without limits.

In both *Brinckerhoff* and *K-Sea*, the Supreme Court affirmed dismissals of complaints brought against MLPs, their general partners and directors, upholding, among other things, the enforceability of provisions providing for a conclusive presumption of good faith where the general partner reasonably relies upon an opinion prepared by a competent expert. Moreover, the protections of the provision may be invoked even if the general partner did not directly rely on a financial adviser's opinion. For example, the provision as drafted in *K-Sea* created a presumption that K-Sea Transportation Partners L.P.'s general partner, K-Sea General Partner L.P., had acted in good faith if K-Sea GP relied on a competent expert's opinion. Although the conflicts committee of the board of K-Sea GP's general partner, K-Sea General Partner GP LLC (KSGP), actually obtained the financial adviser's opinion, K-Sea GP nevertheless was entitled to the protection of the presumption. Under the court's analysis, it was "unreasonable to infer" that the entire board did not rely on the opinion obtained by the conflicts committee, and "because K-Sea GP is a 'pass through' entity controlled by KSGP, the only reasonable inference is that K-Sea GP relied on the fairness opinion."

While unitholders' ability to challenge a conflicted transaction may be significantly restricted by a conclusive presumption provision, it is not completely eliminated. In *K-Sea*, the provision at issue required only that K-Sea GP rely upon its financial adviser's opinion "as to matters that [K-Sea GP] reasonably believes to be within such person's professional or expert competence" in order to trigger the conclusive presumption that K-Sea GP acted in good faith. Nevertheless, the court noted that appellant Edward F. Norton III failed to substantively attack the financial adviser's opinion. Specifically, Norton did not allege (1) that the financial adviser lacked expertise to render the opinion, or (2) that the analyses underlying the fairness opinion were flawed, and he "concede[d] that the unaffiliated unitholders received a fair price." While the court therefore had no opportunity to examine the financial adviser's work, its opinion suggests that a successful substantive attack on a financial adviser's opinion may prevent reliance on the opinion from triggering the conclusive presumption.

The court in *K-Sea* further observed that appellant Norton did not claim on appeal that the defendants breached the implied covenant of good faith and fair dealing, thereby suggesting that an implied covenant claim would not be foreclosed even where a conclusive presumption of good faith was triggered. This opening was definitively recognized in *Gerber*, where the Supreme Court held that insofar as Enterprise GP Holdings L.P.'s limited partnership agreement created a conclusive presumption of good faith, "that provision does not bar a claim under the implied covenant." Crucial to the court's reasoning was the temporal distinction between a fiduciary duty concept of good faith and the implied covenant concept of good faith. Unlike the fiduciary duty of good faith, which looks to the parties' relationship at the time of the alleged wrong, the implied covenant looks to the past and asks "what the parties would have agreed to themselves had they considered the issue in their original bargaining positions at the time of contracting," according to the opinion, quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member LLC*, 50 A.3d 434, 440-42 (Del. Ch. 2012). "The conclusive presumption of 'good faith' applies only to the contractual fiduciary duty. It cannot operate retroactively to alter the parties' reasonable expectations at the time of contracting, and it cannot be used to fill every gap in" a limited partnership agreement. The *Gerber* opinion also expressly rejects the notion that an express contractual provision eliminating the implied covenant could withstand judicial scrutiny because such provision would expressly contravene the DRULPA.

In sum, *Brinckerhoff*, *K-Sea* and *Gerber* teach that Delaware courts will give effect to conclusive presumption provisions, but that unitholders may still seek recourse via an implied covenant of good faith and fair dealing claim and, potentially, a substantive attack on the opinion triggering the presumption. Nevertheless, practitioners would do well to heed the court's admonition that those who "willingly invest in a limited partnership that provide[s] fewer protections than those provided under corporate fiduciary duty principles" are "bound by [their] investment decision."

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