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Court of Chancery Delineates Pleading Standards for Implied Covenant and Tortious Interference Claims in Buyout Transaction

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The Court of Chancery has further clarified the parameters of a claim for breach of the implied covenant of good faith and fair dealing in *In re CVR Refining, LP Unitholder Litigation*, which denied the defendants' motion to dismiss the plaintiffs' claims for breach of the implied covenant as well as claims for tortious interference with the partnership agreement and breach of the partnership agreement.

Case Background

The plaintiffs, certain former minority unitholders of CVR Refining LP (the partnership), commenced litigation against the partnership; CVR Energy GP, LLC (the general partner); CVR Energy, Inc. (CVR and the general partner's indirect parent); CVR Refining Holdings, LLC; Icahn Enterprises, L.P. (Icahn Enterprises and the controller of the general partner); and the individual directors of the general partner, including Carl Icahn. The plaintiffs alleged that the defendants orchestrated and executed a plan to lower the cost of exercising a call right (the call right) in the same fashion as the scheme that occurred at Boardwalk Pipeline Partners L.P. and which the Court of Chancery criticized in *Bandera Master Fund LP v. Boardwalk Pipeline Partners L.P.*

Specifically, the plaintiffs contended that the defendants essentially engaged in a copycat transaction by using the buyout at Boardwalk as a blueprint for "how the controller of a [master limited partnership] could weaponize a trailing-market-price-based buyout price by artificially manipulating the stock price." In May 2018, on the heels of an announcement that Boardwalk's controller was considering exercising its own call right, the general partner and CVR Energy's representatives met to discuss a partial exchange offer that would position CVR Energy to be able to exercise the call right. To exercise the call right, CVR Energy needed to acquire over 80% of the partnership's units. Several days later, there was a meeting of the partnership's board of directors, which was composed of eight members, including Carl Icahn and several individuals also serving as officers or employees of Icahn Enterprises. Notably, the board did not use a conflicts committee to consider this transaction, nor did it use any other safe harbor provided in the partnership agreement. The board ultimately determined that it would not make a recommendation in favor of or against the exchange offer. This no-recommendation position was set forth in the partnership's SEC filings.

At the end of May 2018, CVR Energy launched the exchange offer at a price of $27.63, which was 25% higher than the unit price before the announcement of the exchange offer. The exchange offer closed a month later, with almost half of the unitholders tendering, thereby increasing Icahn Enterprises' ownership to approximately 84.5% of the partnership's units. During this time, CVR Energy and Icahn Enterprises specifically denied in public filings any intention to exercise the call right. Analysts remained skeptical of this denial, particularly given the similar transaction at Boardwalk and the fact that the price of the partnership's units continued to fall while CVR Energy's unit price increased.

Approximately four months after closing the exchange offer, Icahn Enterprises and CVR Energy announced that CVR Energy was contemplating exercising the call right. Almost two months later, the partnership and CVR Energy announced that the partnership had assigned the call right to CVR Energy and that entity intended to exercise it.

Court of Chancery Decision

The plaintiffs' claim for breach of the implied covenant of good faith and fair dealing focused on the theory that the general partner, CVR Energy, and CVR Holdings breached the implied covenant by undermining certain price-setting mechanisms in the call right provision of the partnership agreement. In evaluating this claim, the court cited *Dieckman v. Regency GP LP*, a 2017 Delaware Supreme Court opinion governing the application of the implied covenant in the MLP context. *Dieckman* explains that the implied covenant applies "when the party asserting the implied covenant proves that the other party has acted arbitrarily or unreasonably, thereby frustrating the fruits of the bargain that the asserting party reasonably expected." The Supreme Court further clarified that "[p]artnership agreement drafters … do not include obvious and provocative conditions in an agreement like 'the General Partner will not mislead unitholders when seeking Unaffiliated Unitholder Approval' or 'the General Partner will not subvert the Special Approval process by appointing conflicted members to the Conflicts Committee.'" Terms like these are "so obvious to the participants that they never think, or see no need, to address them."

Using the foregoing legal framework, the court in *CVR* focused on the reasonable meaning of the partnership agreement's price-setting mechanisms for the call right. The partnership agreement included two such mechanisms. The first prevented minority unitholders from having their units called at a price lower than what the general partner (or any affiliates) paid to purchase any units within the 90 days preceding the exercise date. The second required that the call right price be the average of the daily closing prices for the 20 consecutive trading days immediately prior to the exercise date.

Ultimately, the court concluded that it was reasonably conceivable that the language of the call right implied a requirement that the defendants not act to undermine the protections afforded to unitholders by the price-protection mechanisms as it would be "obvious" and "provocative" to demand the inclusion of an express condition that a general partner and its affiliates not subvert price-protection mechanisms through a scheme designed to manipulate the unit price. Contrary to the defendants' attempts to distinguish *Dieckman* and *Boardwalk*, the court further found that it was reasonably conceivable that the general partner worked with CVR Energy to frustrate the call right's price protection mechanisms. All of the board members had strong ties to Mr. Icahn and Icahn Enterprises, the controller of CVR Energy, and given their positions in the industry, it was also reasonably conceivable that the board members followed analyst coverage of the Boardwalk call right, particularly given that the Boardwalk transaction occurred close in time to the CVR call right.

With respect to the plaintiffs' tortious interference claim, the court explained the origin of the "stranger rule" — relied upon by the defendants as a defense — and clarified its application.

The stranger rule, which means that only strangers to a contract can tortiously interfere with it, originated from jurisdictions employing an “absolute affiliate privilege” such that a parent and its wholly owned subsidiary constitute a single economic unit and a parent’s interference with its subsidiary’s contracts is never actionable regardless of how aggressive the interference is. The court here emphasized that Delaware law eschews such bright-line rules that ignore the corporate form.

The court again referenced *Boardwalk*, explaining that the Delaware Supreme Court has adopted the restatement’s “more nuanced, ‘limited privilege’” approach to tortious interference claims. The restatement provides a balancing test composed of multiple factors and does not foreclose the possibility of liability on the basis of related-party status. The court here echoed *Boardwalk*’s refusal to “layer on the stranger rule as an additional element of the [tortious interference] analysis” because that rule and its absolute privilege framework are a threat to the restatement’s limited privilege approach. Thus, the court rejected the defendants’ stranger rule-based defense and also found that they had not offered any arguments supporting justification —that is, why any interference with the partnership agreement was justified. However, the court did dismiss the tortious interference claim against the individual director defendants because the acts complained of were within the scope of the directors’ agency (Mr. Icahn remained a defendant because he resigned as a director the day before the close of the exchange offer).

Takeaways

This decision clarifies the parameters of the often elusive and hard-to-prove claims for breach of the implied covenant of good faith and fair dealing and tortious interference with a contract. This opinion also should serve as a cautionary tale to directors and entities that seek to use another (questionable) transaction as a guide in crafting an equally questionable transaction on which they can capitalize. The Court of Chancery is known for its scrutiny of suspect corporate behavior and will not turn a blind eye.