Delaware Supreme Court Redefines Contractual Good-Faith Standard and Cautions Limited Partners that Their Obligations Under LPA Can Be Enlarged Without Their Consent

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Brinckerhoff v. Enbridge Energy Company Inc., Del. Supr., No. 273, 2016 (Mar. 20, 2017; revised Mar. 28, 2017) is the fifth opinion issued by the Delaware courts relating to the joint venture between Enbridge, Inc. (Enbridge), and Enbridge Energy Partners, L.P. (EEP). Enbridge is the ultimate parent of Enbridge Energy Company, Inc. (EEP GP), which is the general partner of EEP.

For purposes of this summary, the relevant facts are that Brinckerhoff, a public unitholder in the master limited partnership EEP, filed suit and alleged that Enbridge's proposal to sell a certain project known as the "Alberta Clipper project" to EEP was not fair and reasonable. As noted above, this transaction involved affiliated parties. In addition, in connection with the transaction, EEP GP caused EEP's limited partnership agreement (LPA) to be amended to effect a "special tax allocation," whereby the public investors would be allocated items of gross income that would otherwise be allocated to EEP GP, EEP's general partner. Brinckerhoff argued that it was unfair for EEP GP to shift a large tax burden from EEP GP to the public unitholders. Following the consummation of the transaction between Enbridge and EEP, Brinckerhoff filed a complaint claiming that the defendants named therein violated three specific provisions of the LPA by approving the "Alberta Clipper transaction"—Section 6.6(e), requiring that contracts with affiliates be "fair and reasonable to the Partnership;" Section 5.2(c), governing new unit issuance (Brinckerhoff later waived the argument that this section was breached); and Section 15.3(b), prohibiting enlargement of the unitholders' "obligations" under the LPA without their consent.

Brinckerhoff sought monetary damages against all defendants and equitable relief rescinding the Alberta Clipper transaction or reforming the transaction "to render the Transaction fair and reasonable to EEP and the Public Unitholders" and to remove the newly added Section 5.2(i) implementing the special tax allocation. Following briefing on the defendants' motion to dismiss, the Court of Chancery granted the motion. Relying on the trilogy of earlier Brinckerhoff decisions and other master limited partnership (MLP) cases, the court set aside the LPA's specific requirements and

focused instead on the LPA's good-faith standards. According to the court, "Brinckerhoff was obliged to state well-pled facts that would allow a reasonable inference that Defendants acted in bad faith" before considering his LPA breach claims. Because he had failed to do so under the rigorous pleading standard adopted in *Brinckerhoff v. Enbridge Energy Co., Inc.* (Brinckerhoff III), 67 A.3d 369 (Del. 2013), the court ruled that the defendants were exculpated from any liability under the LPA, and it dismissed the complaint. An appeal to the Delaware Supreme Court followed.

The provisions of the LPA relied on by the Court of Chancery—Sections 6.8(a), 6.9(a), and 6.10(d)—exculpate EEP GP and others from monetary damages if they act in good faith, apply a good-faith standard to EEP GP's resolution of conflicts of interest, and replace default fiduciary duties with a contractual good-faith standard.

The Delaware Supreme Court notes that under the Delaware Revised Uniform Limited Partnership Act (DRULPA), limited partnership agreements—like the EEP LPA— can be drafted to eliminate fiduciary duties. However, parties cannot disclaim the implied covenant of good faith and fair dealing.

The court found that the Court of Chancery erred when it determined that EEP GP and its affiliates were exculpated under Section 6.8(a) from any liability for breaching the LPA. In doing so, the Delaware Supreme Court acknowledged that the Court of Chancery was bound by an earlier pleading standard announced in *Brinckerhoff III* which was no longer applicable. Instead, the court applied the definition of bad faith that is commonly used in Delaware alternative entity law and incorporated into the EEP LPA. The court held that bad faith is sufficiently alleged under the EEP LPA if the plaintiff pleads facts supporting an inference that EEP GP did not ***reasonably*** believe it was acting in the best interest of the partnership. The Delaware Supreme Court also held that the LPA's general good-faith standards do not displace specific affirmative obligations contained in other provisions of the LPA. As the Delaware Supreme Court pointed out, "the Court of Chancery's interpretation of the LPA leads to an unreasonable result no public investor would have considered possible when reviewing the LPA—that EEP GP is free to violate any specific LPA requirement so long as the breach is in good faith."

Turning to the provisions of the EEP LPA, Section 6.10(d) of the LPA modifies, waives, or limits common law duties in favor of contractual duties. While such waivers are permitted under Delaware law, the Delaware Supreme Court acknowledged that the Court of Chancery "did its best to attempt to reconcile complex contractual provisions and confusing precedent." That being said, the Court of Chancery erred in holding that the generalized good-faith standard of Section 6.10(d) modified or enveloped LPA provisions that impose separate, specific, affirmative obligations, such as the "fair and reasonable" standard of Section 6.6(e) (transactions with affiliates). As noted, the Alberta Clipper transaction involved affiliated parties, and the issue at play in this case was whether it was sufficient for the general partner to take certain actions in good faith despite the possibility of breaching other provisions of the LPA. Specifically at issue was whether the Alberta Clipper transaction, which was an affiliated transaction, had to be fair and reasonable to the partnership even though EEP GP acted in good faith in approving and consummating the Alberta Clipper transaction. In answering that question, the court noted that "Section 6.6(e) is a specific affirmative obligation of EEP which is not displaced by other general provisions."

As such, the court found that Brinckerhoff pleaded sufficient facts leading to an inference that the Alberta Clipper transaction was not fair and reasonable to the partnership because EEP repurchased assets from Enbridge "less favorable to the Partnership than those generally being provided to or available from unrelated third parties." As the court noted, "it is essential that unitholders be able to hold the GP accountable for not complying with the terms of the LPA."

Another noteworthy point highlighted in the opinion is the LPA amendment of Section 15.3(b) of the LPA. Section 15.3(b) of the LPA sets forth the requirements to amend the LPA. It states that notwithstanding earlier provisions of Section 15 addressing when and how EEP GP can adopt LPA amendments without unitholder approval, "***no amendment to this Agreement may (i) enlarge the obligations of any Limited Partner without such Limited Partner's consent, which may be given or withheld in its sole discretion . …***" Brinckerhoff argues that the special tax allocation, and its potential to generate taxable income to the unitholders, "enlarges the obligations" of the unitholders without their consent. Stated differently, the special tax allocation increases their tax liability ***to the government*** without their consent (***emphasis added***). As the court pointed out, "essential to Brinckerhoff's argument is the meaning of 'obligations' which lacks a specific definition in the LPA." In understanding the meaning of a term which lacks a definition in the LPA, the court looked to how the term is used in other parts of the LPA to assess its meaning. In that context, the court found that "obligations" plainly means the responsibilities, or more accurately the lack of responsibilities, of the limited partners ***to the partnership***. The court noted that the special tax allocation might increase the limited partners' tax liability ***to the government***, but it did not enlarge the limited partners' ***obligations to the partnership***. Thus, the court held that EEP GP did not breach Section 15.2(b) by potentially allocating additional gross income to the limited partners through the special tax allocation without their consent. This opinion is noteworthy because the Delaware Supreme Court, through this opinion, has provided a new, less stringent test for bad-faith conduct, departing from its earlier standard. Second, limited partners may have their tax obligations enlarged absent a specific definition in the LPA defining the meaning of obligations.