Del. Justices' Reversal Of Boardwalk Award May Apply Widely

By **Gail Weinstein, Steven Steinman and Brian Mangino** (January 10, 2023)



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In the Dec. 19, 2022, Boardwalk Pipeline Partners LP v. Bandera Master Fund LP decision, the Delaware Supreme Court reversed a Delaware Chancery Court decision.

The Chancery's November 2021 decision had ordered the general partner of Boardwalk — a master limited partnership, or MLP — to pay the former public unit holders almost $700 million in damages in connection with the general partner's $1.56 billion take-private transaction for Boardwalk.

Notably, the Supreme Court did not overturn the Chancery's factual findings that the general partner and its affiliates had:

- Opportunistically timed the take-private transaction to occur during a temporary period of regulatory uncertainty and declining prices for Boardwalk's units; and
- Manipulatively pressured their law firm to deliver a "contrived [and] sham opinion," according to the decision, to satisfy the sole condition to the general partner's exercise of its call right to acquire the public units.

Nonetheless, the Supreme Court overturned the Chancery's legal holding that the general partner was liable for willful misconduct.

Instead, the Supreme Court viewed the general partner as simply having made full use of the broad flexibility a controller is permitted under Delaware law when its fiduciary duties have been contractually eliminated and the absence of those duties has been fully disclosed to investors.

"The Partnership Agreement allowed Boardwalk to exercise the call right to its advantage — and to the disadvantage of the minority unit holders — free from fiduciary duties," the Supreme Court wrote.

The Supreme Court also held that the opinion of counsel the general partner obtained satisfied the contractual condition to exercise of the call right. The Supreme Court stated that the court's focus should not be on the validity of the legal opinion but on whether the general partner had acted reasonably in relying on it.

The general partner's reliance was reasonable, the Supreme Court concluded, because it obtained and relied on a second opinion from another law firm — which was not challenged — which opined that it would be within the general partner's reasonable judgment to decide to rely on the first opinion.

As the partnership agreement provided a conclusive presumption of good faith for the general partner when relying on advice of counsel, the general partner was presumed to have acted in good faith and thus was entitled to exculpation from damages.

Key Points

The Broad Flexibility of Controllers When Fiduciary Duties Are Contractually Waived

When fiduciary duties have been contractually waived, a controller has broad flexibility to act in its own interest — and the court may not be likely to interpret agreement provisions broadly to afford protection to the other investors that is not explicitly provided for in the agreement.

We note that the decision is likely to have wide applicability, beyond the MLP context, to other noncorporate entities.

Private fund investors, for example, generally have more sophistication and greater bargaining leverage than public investors, and thus are not likely to be viewed by the courts as entitled to more protection than the public unit holders in Boardwalk were.

Possible Development of New Practice Obtaining Second Opinions

Given the Supreme Court's holding in Boardwalk that the general partner reasonably relied on what the Court of Chancery had found to be a fatally flawed opinion, on the grounds that it obtained and relied on a second opinion, from another law firm, that reliance on the first opinion was reasonable, controllers, and others, may more often turn to seeking such a second opinion in some circumstances.

Background

Boardwalk was controlled by its general partner. The general partner was controlled by its general partner, or GPGP.

The GPGP — a limited liability company — was controlled by its sole member, which was a wholly owned subsidiary of and controlled by Loews Corp.

Boardwalk's partnership agreement disclaimed fiduciary duties of the general partner.

In addition, as Loews wanted to be able to take Boardwalk private in the future if Federal Energy Regulatory Commission policies changed such that the MLP structure was no longer advantageous, the partnership agreement provided the general partner with a right to call the public units, or the call right.

The only condition to exercise of the call right was that the general partner obtain an opinion of legal counsel, acceptable to it, that a change in FERC policies occurred that likely would have a material adverse effect, or MAE, on the maximum applicable rate that Boardwalk could charge its customers in the future, or the opinion condition.

In 2018, the FERC announced certain new policies that potentially could have the MAE described in the opinion condition, but, until the FERC, at a minimum, clarified a certain tax issue, it was impossible to know whether the effect of the new policies on Boardwalk was likely to be negative, neutral or positive.

During this period of uncertainty, and a resulting significant decline in the prices of MLP public units, including Boardwalk's, the general partner decided to exercise the call right.

The general partner obtained a legal opinion from the law firm of Baker Botts LLP, which concluded that the new FERC policies likely would have the MAE described in the opinion condition.

In light of extensive issues relating to interpretation of the opinion condition, as well as uncertainty as to which entity could make the determination on behalf of the general partner as to acceptability of the Baker Botts opinion, as well as concerns about the exercise of the call right that were raised by the GPGP board, the GPGP sole member obtained another opinion from the law firm of Skadden Arps Slate Meagher & Flom LLP.

The Skadden opinion advised that the GPGP sole member was an appropriate entity to make the acceptability determination and that it would be within the GPGP sole member's reasonable judgment to find the Baker Botts opinion acceptable.

The day after the take-private transaction closed, the FERC announced the full, final package of its policy changes — including with respect to the critical tax issue — which made it clear that the new policies would have no effect on Boardwalk.

Boardwalk public unit holders brought suit in the Chancery challenging the general partner's exercise of the call right.

After a four-day trial, the Chancery held that:

- The Baker Botts opinion was fatally flawed and that the wrong Boardwalk entity made the acceptability decision;
- As a result, the opinion condition was not satisfied and the general partner had breached the partnership agreement when it exercised the call right; and
- The general partner was not entitled to exculpation from liability for the breach as its actions constituted "willful misconduct when it exercised the call right, and the exculpatory provisions in the partnership agreement therefore do not protect the general partner from liability," according to the decision.

The Supreme Court reversed and held that:

- The correct Boardwalk entity made the acceptability determination;
- Whether or not the Baker Botts opinion was flawed and delivered in bad faith, the general partner had been reasonable in accepting it, based on its reliance on the Skadden opinion, together with the partnership agreement's conclusive presumption of good faith for the general partner when relying on advice of counsel; and
- The general partner therefore was entitled to exculpation.

Discussion

Limited Nature of Minority Investors' Rights in Noncorporate Entities

The Supreme Court stressed that, when fiduciary duties have been explicitly disclaimed —

as is usual for noncorporate entities — and the absence or limitation of fiduciary duties has been clearly disclosed, a controller has "[a] right to make self-interested decisions to the economic disadvantage of the [other investors]."

Boardwalk's public disclosures had "explained in great detail…the self-interested decision-making permitted by the Partnership Agreement," including that, pursuant to the call right, unit holders could be forced to sell their units at an undesirable time or price.

The Supreme Court stressed that investors in limited liability entities are "willingly invest[ing] in [entities] that provide fewer protections [to them] than those provided under corporate fiduciary duty principles."

Misfocus on Validity of the Baker Botts Opinion

The Chancery, in its post-trial opinion, had found that the Baker Botts opinion was fatally flawed, based on blatantly improper assumptions, interpretations, and reasoning, in a "contrived effort to reach the result that the General Partner wanted."

The Supreme Court, however, stressed that the Partnership Agreement provided that damages could be recovered from the general partner only if it acted in bad faith or engaged in willful misconduct.

Therefore, the Supreme Court stated, the issue was not the validity of the Baker Botts opinion but whether the general partner had acted reasonably in finding the Baker Botts opinion acceptable.

Reasonableness of Reliance on the Baker Botts Opinion

The Supreme Court concluded that, based on the general partner's reliance on the Skadden opinion, it had acted reasonably in finding the Baker Botts opinion acceptable. The Supreme Court:

- Noted that the Skadden opinion had not been challenged nor found to have been delivered in bad faith;

- Noted the time and care that Skadden had taken — including:
    - Consulting with experts;
    - Analyzing Boardwalk's governing documents;
    - A "complete review of the Baker Botts opinion"; and
    - Delivering a "comprehensive written presentation" to the GPGP sole member's board.

- Emphasized that the partnership agreement provided the general partner with a conclusive presumption of good faith when relying on advice of counsel, writing: "Unlike a rebuttable presumption, [a] conclusive good faith presumption is, as its names denotes, conclusive";

- Rejected the contention that reliance on an "opinion on an opinion" was problematic; and

- Rejected the argument that concerns Skadden had raised in internal emails about the Baker Botts opinion during the course of its deliberations undermined any of its conclusions, writing that it is "what attorneys do — explore arguments as part of their professional advice."

Entity Making the Acceptability Determination

The Supreme Court held that the GPGP sole member was the correct entity to make the acceptability determination. The Court of Chancery had held that, as the partnership agreement was silent as to which entity should make the acceptability determination, the resulting ambiguity should be "interpret[ed] … in an investor-friendly way."

Therefore, the GPGP board, which was comprised half of independent directors, rather than the GPGP sole member, which was comprised solely of Loews insiders, should have made the acceptability determination.

The Supreme Court, however, stressed that the partnership agreement was unambiguous in leaving the acceptability determination in the hands of the general partner and, thus, it was the GPGP's limited liability company agreement that dictated how the general partner was to make the determination.

Read together, the Supreme Court concluded, the partnership agreement and the limited liability company agreement were clear that the GPGP sole member had exclusive authority to cause the general partner's exercise of the call right — and allowing the GPGP board to make the determination would have conflicted with that grant of authority.

No Imputation to the Controller of Bad Faith Acts by Others

The Supreme Court rejected the Court of Chancery's view that bad faith by various actors affiliated with the general partner could be imputed to the general partner. The Court of Chancery had held that the general partner was not entitled to exculpation under the partnership agreement as the actions by Loews and others could be imputed to it and constituted willful misconduct.

The Supreme Court, however, stressed that it was the GPGP sole member's board — as "the entity responsible for the call right exercise" — that should have been the focus of the court's review, "and not non-decisionmaker agents of the General Partner."

Concurring Opinion

A concurring opinion by two justices agreed with the majority's legal conclusions but argued that the Supreme Court should have overturned the Chancery's finding that the Baker Botts opinion was delivered in bad faith.

The concurring justices stressed that courts should accord deference to law firm opinions; that the lawyers at Baker Botts and Skadden testified that their advice was not affected by

any pressure from Loews; and that, in their view, the record overall indicated that the Baker Botts opinion was delivered in good faith, or at least not in bad faith.

Practice Points

Sponsor-Controllers of Noncorporate Entities

Sponsor-controllers of noncorporate entities — especially private entities — should seek to ensure that the organizational documents clearly and effectively eliminate, or limit, their fiduciary duties; and that the absence or limitation of fiduciary duties is clearly disclosed.

Potential Investors in Noncorporate Entities

A potential investor in a noncorporate entity, especially a private entity, depending on its negotiating leverage, may wish to seek to limit the waiver of fiduciary duties or to specify certain protections; and, before investing, should ensure that it fully understands the effects of any absence or limitation of fiduciary duties.

Sponsor-Controllers or Others Relying on Legal Opinions

When sponsor-controllers, or others, rely on a legal opinion, they should consider obtaining an "opinion on the opinion" from another law firm as to whether it is reasonable to rely on the first opinion, whether the correct entity has made the determination as to acceptability of the first opinion, or other issues related to the first opinion.

Such a second opinion may be advantageous where there is unusual complexity or difficulty relating to the legal issues, or to the reasoning or good faith of the law firm delivering the first opinion.

Law Firms Issuing Opinions

A law firm should maintain an appropriate record of its deliberations in connection with, and the reasoning underlying its conclusions set forth in, in a legal opinion.

In evaluating the reasonableness of reliance on a legal opinion, positive factors would include the firm having spent considerable time in considering the issues; and, where appropriate, having sought the views of other law firms and experts.

In all events, a law firm's advice should not be determined by its client's desired result, and should not be based on "counterfactual assumptions …[or] syllogistic reasoning." Law firms should keep in mind that their internal emails in the course of their deliberations over an opinion may become discoverable in litigation.

Drafters of Organizational Documents

Drafters of organizational documents for noncorporate entities should consider whether to include a provision granting a presumption of good faith to a controller when relying on a legal opinion — or other type of opinion, such as a fairness or valuation opinion.

Any such provision should be explicit as to whether the presumption would be conclusive or is rebuttable. Boardwalk highlights the impact of providing for a conclusive presumption of good faith.

Drafters of Conditions That Require Obtaining a Legal Opinion

Provisions requiring that a legal opinion be obtained should be clear with respect to:

- The required substance of the opinion;
- The meaning of any potentially ambiguous terms used in the provision;
- Which entity, within a chain of related entities, would make any required determination as to acceptability of the opinion;
- Whether any acceptability determination would be subjective or based on an objective standard; and
- Whether reliance on the opinion creates a — conclusive or rebuttable — presumption of good faith.

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