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When Relying on a Banker's Fairness Opinion, Really Rely–and Other Lessons from Dieckman v. Regency

Dieckman v. Regency (Nov. 3, 2019) reflects the potential for general partners of master limited partnerships (*i.e.*, publicly traded limited partnerships) to be subject to scrutiny and possible liability in connection with approving conflicted transactions. More broadly, the decision underscores the critical importance of clarity in drafting and compliance with the precise terms of agreements.

The decision is the latest issued in long-standing litigation challenging the 2015 acquisition of Regency Energy Partners LP, a master limited partnership ("Regency"), by Energy Transfer Partners L.P. ("ETP"), in an $11 billion unit-for-unit merger (representing a 13.2% premium to the unaffected unit price) (the "Merger"). Both Regency's general partner (the "General Partner") and the general partner of ETP were indirectly owned and controlled by Energy Transfer Equity, L.P. ("ETE"). Given ETE's control of both Regency and ETP, it was undisputed that the Merger presented a potential conflict of interest between, on the one hand, the General Partner, and, on the other hand, the common unitholders of Regency, who had no connections to ETE.

Regency's limited partnership agreement (the "LP Agreement") provided typical "safe harbors" for approval of conflicted transactions by either an independent conflicts committee (the "Special Approval safe harbor") or the unaffiliated unitholders (the "Unitholders Approval safe harbor"). The Merger was approved by Regency's Conflicts Committee and by the unaffiliated unitholders. Although the plaintiff challenged the independence of the Conflicts Committee that approved the Merger, Chancellor Bouchard, in a 2016 decision issued at the pleading stage of the litigation, had dismissed the case on the basis that the Unitholders' Approval safe harbor was satisfied. On appeal, the Delaware Supreme Court (2017) reversed the dismissal. The Supreme Court held that the plaintiff had pled sufficient facts to support an inference that the Unitholders Approval safe harbor was *not* satisfied because the proxy statement used to secure the unitholders' approval allegedly was false and misleading in stating that the Merger had been approved by an "independent" Conflicts Committee and that the Unitholders Approval safe harbor thus was satisfied.

The litigation then proceeded at the Court of Chancery and, following fact-discovery, the plaintiff requested summary judgment that neither of the safe harbors was satisfied and that, in the absence of safe harbor protection, the General Partner's approval of the Merger was a breach of the "good faith" standard of conduct required by the LP Agreement. The General Partner made a cross-motion for summary judgment that it met the good faith requirement because the LP Agreement provides a conclusive presumption of good faith when the General Partner relies on a fairness opinion and it had

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obtained a fairness opinion. In this most recent decision, the Chancellor (i) granted summary judgment that the safe harbors were not satisfied (based on the Supreme Court decision); and (ii) declined to grant summary judgment with respect to the conclusive presumption of good faith because, in the court's view, there is an open issue of fact whether the General Partner "*actually* relied" on the fairness opinion.

Key Points

- **When a board or committee intends to rely on a fairness opinion, it should *actually rely* on the opinion and the record should clearly establish that it did so.** In *Dieckman*, the question of reliance arose because the minutes of a Conflicts Committee meeting held *before* the Committee received the fairness opinion indicated that the Committee determined, at *that* meeting, that the proposed transaction (which at that time reflected terms that were less favorable than the final terms of the Merger) was fair. The issue was compounded by the fact that the fairness opinion was never updated to reflect the final terms of the Merger. A final determination as to fairness should not be made *before receipt* of the fairness opinion and meeting minutes should state that the board or committee received "*and relied on*" the fairness opinion.

- **A partnership agreement with a provision granting the general partner a presumption of good faith under specified circumstances should clearly state whether the presumption applies in the context of conflicted transactions.** The court found it unnecessary to decide whether the good faith presumption in the LP Agreement--or only the safe harbor provisions, which were "specifically dedicated" to the approval of conflicted transactions--applied to approval of the conflicted Merger. The court reasoned that, given the open issue of fact relating to reliance on the fairness opinion, the court in any event was precluded from granting summary judgment on the basis of the presumption. Notably, however, the court indicated its view that the LP Agreement parties probably did *not* intend that the good faith presumption would apply to conflicted transactions. The court endorsed the view that "when sophisticated parties intend to provide a conclusive presumption in a conflicts situation, they know how to draft such a provision."

- **An invalidly constituted conflicts committee may not only result in non-satisfaction of a safe harbor based on conflicts committee approval, but at the same time is likely to lead to non-satisfaction of a safe harbor based on the unitholders' approval.** *Dieckman* illustrates that, based on the Supreme Court decision in the litigation, when a general partner does not follow the requirements set forth in the partnership agreement for independence of the members of a conflicts committee, the proxy statement used to secure the *unitholders'* approval under an alternative safe harbor likely will be materially false and misleading as it will have stated that the conflicts committee members were independent and the conflicts committee-based safe harbor was satisfied. Accordingly, the case suggests that MLP general partners--who generally have been accustomed to operating with wide latitude, including with respect to conflicted transactions--may now face more scrutiny and greater potential for liability in connection with approving conflicted transactions. The decision thus underscores the critical importance of a general partner's ensuring that the directors appointed to a conflicts committee meet the independence requirements set forth in the partnership agreement--an area where non-compliance by general partners has not been infrequent. (See the Practice Point below with respect to disclosure of any issues as to the satisfaction of safe harbors, including relating to the independence of committee members.)

Discussion

The court granted summary judgment that the Special Approval safe harbor was not satisfied after finding that the Conflicts Committee was not validly constituted. The LP Agreement required that the Committee be comprised entirely of persons who (among other conditions) were not simultaneously serving on the board of any "Affiliate" of the General Partner. It was undisputed that: B served on the Sunoco board until January 20; Sunoco was an Affiliate of the General Partner; a written consent of the General Partner dated January 16 stated that "A" and "B" were appointed to the Conflicts Committee effective as of that date; from January 16 to January 20, A and B engaged in Committee activities; and, on January 20, B resigned from the Sunoco board and the General Partner signed a new written consent appointing B to the Conflicts Committee "effective as of January 20." The General Partner contended that the January 20 consent "rescinded and superseded" the January 16 consent and that it indicated that the January 16 consent had been "sent in error" and did not reflect the board's intent. The General Partner cited precedents where the court reasoned that when a second resolution is adopted only a few days after a resolution covering the same subject matter a "logical inference" can be drawn that the first resolution did not accurately reflect the board's intent and was superseded. The Chancellor found those cases "readily distinguishable," however, because they involved resolutions that the court found had revoked earlier *inconsistent* actions. By contrast, here, the court stated, the January 16 and January 20 consents "evince the *same* intent--to put [B] on the Conflicts Committee."

The court's discussion suggests that the conclusion might well have been different if there had been evidence in the record that the General Partner's intention was to rescind and supersede the January 16 consent--rather than there being simply two consents, each stating a different effective date for B's appointment. The court wrote: "[D]efendants assert they are confident that the evidence adduced at trial would demonstrate that the January 16 Consent was circulated in error and did not accurately reflect the Regency Board's intent. This assertion is unsupported by any *evidence*, however, and thus is legally insufficient to defeat [plaintiff]'s summary judgment motion." The court observed: "There is no language in the January 20 Consent [itself]…that purports to revoke or supersede the January 16 Consent insofar as [B]'s appointment to the Conflicts Committee is concerned"; the affidavit that was submitted by B "never states nor intimates that the January 16 Consent was mistaken in any respect or that it was never intended that he would begin his service on the Conflicts Committee effective January 16" and, indeed, "ducks the issue [by] stat[ing], elliptically, that he 'served on the Conflicts Committee'…without providing any precision concerning when that service began"; and no testimony from any board members or from the partnership's General Counsel was provided "stating that the January 16 Consent was sent in error."

The court granted summary judgment that the Unitholders Approval safe harbor was not satisfied after finding that the proxy statement was materially false and misleading with respect to the Special Approval safe harbor. Following the dictates of the Supreme Court decision, the Chancellor concluded that the Proxy Statement for the Merger "misrepresented material facts that undermined an important safe harbor protection in the LP Agreement." First, the Proxy stated that the Conflicts Committee "consists of two independent directors." The implication of this representation, according to the Supreme Court, was that the members, at a minimum, had satisfied "at all relevant times" the criteria in the LP Agreement for who could serve on the Committee. As discussed above, B did not meet those requirements in the court's view. The disclosure was material "because it would have been important to a reasonable stockholder deciding whether to approve a Merger to know that one of the two individuals entrusted to negotiate the terms of a conflicted transactions was not independent within the terms of the LP Agreement." Second, the Proxy Statement stated that the Special Approval safe harbor was satisfied.

As discussed above, in the court's view, the Special Approval safe harbor was *not* satisfied because the Committee was invalidly constituted. The court (quoting the Supreme Court) stated that this disclosure was material "because it would have been important to a reasonable unitholder to know that a form of protection in the LP Agreement that was featured in the Proxy to reassure unitholders that the proposed merger was the product of arm's-length bargaining actually was not satisfied."

Observations on *Dieckman*. While the Delaware courts extend a high degree of deference to partnership agreement provisions, the facts and circumstances can very much affect the judicial results. In the past, it has generally been only in the context of a patently egregious process that an MLP general partner would face potential liability. For example, in *El Paso* (2015), the court deemed the conflicts committee approval of a conflicted "dropdown" transaction to have been ineffective (although the standard of approval set forth in that partnership agreement arguably was even lower than in *Dieckman*--*i.e.,* a "*subjective* belief" that the transaction was in the best interests of the partnership and lesser independence requirements for committee membership). In *El Paso,* the court concluded that the committee did not in fact form a subjective view that the dropdown was in the best interests of the partnership. The court emphasized the incomplete, inaccurate and "manipulative" nature of the information provided to the committee by its financial advisor, as well as the committee having totally ignored information it had relating to the partnership's other recent, almost identical dropdowns. It appeared that the committee did not have a base of information upon which it was even *possible* to form a subjective belief as to whether the transaction was in the partnership's best interests--and, moreover, the record evidence included contemporaneous emails among the committee members that indicated that they *actually* believed that the transaction would *not* be in the best interests of the partnership.

By contrast, we observe, in *Dieckman*, while the plaintiff raised issues as to the independence of the Committee members: (i) the Committee engaged in a process that included obtaining unitholder approval (which was required by statute for a merger) and a fairness opinion; (ii) there was no "informational vacuum"; (iii) the pleadings did not include allegations of an egregious result; and (iv) there was no indication that the Committee members had not formed the requisite "belief" that the transaction was in the best interests of the partnership. Indeed, as noted, initially the Court of Chancery had dismissed the case. The Delaware Supreme Court emphasized, however, what appeared to it to be "deceptive," "manipulative" and "misleading" acts by the General Partner in an effort to "undermine the protections afforded unitholders in the safe harbor process" by "creat[ing] the false appearance of an unaffiliated, independent Committee." Of note in this respect is not only the General Partner's apparent carelessness in possibly having appointed B to the Committee before he had resigned from the Sunoco board, but also (a fact not mentioned in the Court of Chancery's recent decision, but addressed in the Supreme Court decision) the General Partner's having *reappointed* B (and also appointed A) to the Sunoco board *the day after the Merger closed*--and, as the Supreme Court noted, without any disclosure in the 165-page proxy statement that the Committee members were or would be serving on the board of an affiliate of the General Partner.

Practice Points

- **Potential investors in MLPs should understand that their rights are limited to the express provisions set forth in the partnership agreement.** Unlike corporate shareholders who have the protection of fiduciary duties that require directors to act in the best interests of shareholders, MLP unitholders' rights are contractual in nature. MLP agreements typically expressly disclaim all fiduciary duties of, and prescribe limited obligations for, the general partner. If an MLP agreement is drafted well and the general partner is careful to follow the

terms of the agreement, a unitholder's rights and protections typically will be very limited, even with respect to conflicted transactions.

- **When seeking to satisfy a safe harbor based on unitholders' approval, a general partner should consider disclosing any issues of which it is aware relating to the satisfaction of alternate safe harbors.** A partnership agreement can provide for a minimal disclosure obligation of the general partner in connection with the unitholders' approval of a transaction--such as the obligation only to provide a copy or summary of the transaction agreement (as the *Dieckman* LP Agreement provided). Of course, disclosure obligations under the federal securities laws still would apply but would not give rise to contractual liability under the partnership agreement. In *Dieckman* (where unitholder approval of the Merger was required under the state statute), the General Partner provided a 165-page proxy statement. Based on *Dieckman*, a general partner who believes, and discloses in the proxy statement that, for example, a safe harbor based on conflicts committee approval was satisfied should consider disclosing in the proxy statement any issues relating to whether the committee members actually met the independence requirements set forth in the partnership agreement. In this way, depending on the facts and circumstances and the particulars of the disclosure, the general partner should improve the possibility that, even if those issues ultimately preclude reliance on the committee approval-based safe harbor, the general partner still would be able to rely on the unitholders approval-based safe harbor.

- **An LP agreement's requirements should be *followed precisely*.** For example, in *Dieckman*, the Conflicts Committee should not have determined fairness prior to receiving the fairness opinion, should have ensured that the banker updated the fairness opinion to reflect the final terms of the Merger, and should have stated in the meeting minutes not only that the Committee received the opinion but that it relied on it. Also, the issues relating to independence of the Committee would have been avoided if the General Partner had established a clear record as to when "B" was appointed to the Committee and when he had resigned from the Sunoco board. Notably, the court indicated that it might have found the January 20 consent appointing B to the Committee as of that date to have been effective in rescinding and superseding the January 16 consent that had appointed him as of that earlier date *if* the later consent had expressly stated that it "rescinded and superseded" the earlier consent (and/or there had been testimony supporting the assertion that the January 16 consent had been sent in error and did not reflect the board's intent).

- **Even in the context of technical compliance with partnership agreement requirements, MLP general partners should ensure that they do not engage in what may be considered by a court to be deceptive or misleading conduct.** Most MLP agreements provide a safe harbor for approval by a conflicts committee. This safe harbor plays a marketing role in assuring investors that there will be at least some check on the general partner's ability to cause the partnership to engage in transactions as to which it has a conflict of interest. In most cases, this approval provides the easiest and quickest safe harbor process for the general partner, as the agreement itself establishes the standards for the process. MLP agreements typically provide for a small number of committee members (for example, as in *Dieckman*, two or more directors) and can provide minimal requirements for the independence of the members. (While in *Dieckman* the independence definition required that the committee members were not at the same time serving as directors of Affiliates of the

General Partner, we note that such a restrictive definition of independence may not be necessary.) Further, the standard for the committee's determination is usually only that the committee "reasonably believes," "believes," or even just "subjectively believes" that the transaction is in the best interests of the partnership. As *Dieckman* and *El Paso* (also discussed above) illustrate, however, a general partner should be careful to comply with the precise terms of a partnership agreement and--even in the context of technical compliance--to avoid conduct that may be viewed as deceptive or misleading.

- **If a limited partnership agreement includes both a presumption of good faith for the general partner under specified circumstances and also safe harbors for approval of conflicted transactions, the drafters should ensure that it is clear whether the presumption applies (or only the safe harbors apply) in the context of a conflicted transaction.** The applicability of the good faith presumption will be relevant if the safe harbors are not satisfied.

- **A committee or board, and its financial advisor, should ensure that a fairness opinion reflects the final terms of the transaction being opined on.** Even if the change in terms is arguably immaterial, generally the opinion should be updated. For example, in *Dieckman*, the court stated that it was an open issue of fact whether the change in terms was or was not material given that the value of the merger consideration could fluctuate because there was no collar on the exchange ratio.

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