

## DELAWARE SUPREME COURT ADDRESSES THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

By Carl D. Neff

In a very recent Delaware Supreme Court decision, *Dieckman v. Regency GP LLC, et al.*,<sup>1</sup> the High Court reversed the Court of Chancery and upheld claims based upon breach of the implied covenant of good faith and fair dealing. The decision is noteworthy because the limited partnership agreement disclaimed fiduciary duties, and provided for conflict resolution safe harbors which defendants asserted were met.

However, the manner in which such safe harbors were obtained doomed defendants' reliance upon the same.

### Background

The plaintiff is a limited partner/unitholder in the publicly-traded master limited partnership ("MLP"). The general partner proposed that the partnership be acquired through merger with another limited partnership in the MLP family. The seller and buyer were indirectly owned by the same entity, creating a conflict of interest.

The general partner sought refuge in two safe harbor conflict resolution provisions contained in the limited partnership agreement: "Special Approval" of the transaction by an independent Conflicts Committee, and "Unaffiliated Unitholder Approval." The former requires approval by a special committee independent of the sponsor and its affiliates review and make a recommendation to the board whether to approve the transaction. The latter requires approval by a majority of unitholder unaffiliated with the general partner and its affiliates. Under the Limited Partnership Agreement ("LPA"), if either safe harbor is satisfied, then the transaction is not a breach of the agreement.

Plaintiff brought a petition before the Court of Chancery challenging the propriety of the transaction.

Plaintiff alleged that the Conflicts Committee itself was conflicted. Plaintiff also alleged that the unitholder approval was not satisfied because the general partner made false and misleading statements in a 165 proxy statement to secure such approval. According to plaintiff, the proxy statement failed to disclose that the Conflicts Committee was not disinterested.

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Defendants moved to dismiss the Chancery action, taking the position that the general partner need only satisfy what the partnership agreement expressly required — to obtain the safe harbor approvals and follow the minimal disclosure requirements. Defendants asserted that, whether the information contained in the proxy statement was misleading, or who served on the special conflicts committee, was immaterial based upon the literal reading of the LPA.

The Court of Chancery granted Defendants' motion to dismiss, which prompted the appeal. Chancellor Bouchard found that fiduciary duties could not be used to impose disclosure obligations on the general partner beyond those in the LPA, because the LPA disclaimed fiduciary duties.

The Court of Chancery also found that the only express requirement contained in the LPA in the event of a merger was that the general partner provide notice of the merger agreement, and there was no requirement to provide notice of a conflict among the Conflicts Committee.

### Analysis

The Supreme Court noted that the partnership agreement does not address how the general partner must conduct itself when seeking safe harbors contained in the partnership agreement. However, the Court found that where the express terms of the partnership agreement naturally imply certain corresponding conditions, unitholders are entitled to have those terms enforced according to the reasonable expectations of the parties to the agreement.

Specifically, the High Court stated:

The implied covenant is well-suited to imply contractual terms that are so obvious—like a requirement that the general partner not engage in misleading or deceptive conduct to obtain safe harbor approvals — that the drafter would not have needed to include the conditions as express terms in the agreement.

In other words, the general partner could not rely upon the safe harbor approvals, when it engaged in misleading or deceptive conduct to obtain such approvals, regardless of whether the LPA disclaimed fiduciary duties.

### Key Takeaway

Although alternative entities may choose to waive fiduciary duties, the one duty that parties cannot waive in a Delaware alternative entity agreement is the duty to act consistently with the implied contractual covenant of good faith and fair dealing.

Moreover, once parties go beyond the minimal requirements set forth in safe harbor provisions, their actions and disclosures are likewise bound by the covenant.

#### ENDNOTES:

- 1 No. 208, 2016 (Del. Jan. 20, 2017).