

TUESDAY, APRIL 19, 2016

PERSPECTIVE

Disclosure obligations in absence of fiduciary duties

By Marc Boiron

In *Dieckman v. Regency GP LP*, the Delaware Court of Chancery considered disclosure obligations of the general partner of a limited partnership where the limited partnership agreement eliminated the fiduciary duties of the general partner. The court concluded that the general partner had no obligation to disclose even material information to unitholders because the common law duty of disclosure was eliminated in the limited partnership agreement and replaced with an alternate scheme.

Regency Energy Partners LP was managed by its general partner, Regency GP LP, and its units were held by certain public unitholders. Regency Energy's limited partnership agreement required that Regency GP, in its capacity as Regency Energy's general partner, act in good faith. In the event of a conflicted transaction, the agreement set out that the general partner's actions would "not constitute a breach" of the agreement "or of any duty stated or implied by law or equity" if one of four safe harbors was satisfied.

The safe harbors in the agreement included approval of the general partner's action by a majority of the members of Regency Energy's conflicts committee and approval by the vote of a majority of the common units (excluding those owned by Regency GP and its affiliates).

On Jan. 16, 2015, the board of directors of Regency Energy's ultimate parent approved a proposal to merge Regency Energy with an affiliate of the parent. Regency GP determined to establish, and subject the transaction to the approval of, a conflicts committee, which consisted of Richard Brannon and James Bryant.

On Jan. 25, 2015, three days after the conflicts committee was formally established, the conflicts committee of Regency Energy and the board of directors of Regency GP approved the merger. A definitive proxy statement was later sent to Regency Energy's unitholders along with a copy of the merger agreement.

Regency Energy held a special meeting of the unitholders on April 28, 2015, at which approximately 60 percent of

the outstanding common units unaffiliated with Regency GP, and over 99 percent of the outstanding common units unaffiliated with Regency GP that were voted, approved the merger. The merger closed two days thereafter.

The plaintiff-unitholder alleged that, among other things, Regency GP breached the terms of the limited partnership agreement by failing to act in good faith in connection with the approval of the merger by favoring the interests of its affiliates over those of Regency Energy's unitholders.

The defendants moved to dismiss the complaint for failure to state a claim because the approval of the merger by the conflicts committee and the unaffiliated unitholders shielded the transaction from judicial review.

With respect to the argument that Regency GP breached the terms of the limited partnership agreement, the court rejected the proposition that the approval of the unaffiliated unitholders was ineffective to safeguard the transaction from judicial review because the unitholders were not fully informed about the transaction when they voted to approve it. The plaintiff relied on principles of Delaware corporate law where stockholder ratification is effective only if the stockholders are fully informed at the time of the vote on the ratification. The requirement that stockholders be fully informed stems from the duty of disclosure, which requires that directors disclose all material information when seeking stockholder action.

The court found that Regency GP's failure to inform unitholders (i) that Brannon was a member of the board of the acquirer's subsidiary immediately before being appointed to the conflicts committee and (ii) that Brannon and Bryant would join that subsidiary's board after the transaction closed had no impact on the unitholders' approval of the merger. The language in the limited partnership agreement eliminated all fiduciary duties, including the duty of disclosure. The only disclosure obligation set forth in the agreement was to provide a copy or summary of the merger agreement with the notice of meeting, which Regency GP provided to the unitholders.

Although the plaintiff did not argue

that the defendants breached the implied covenant of good faith and fair dealing, the court considered whether a breach of that implied covenant occurred because it cannot be waived. The implied covenant of good faith and fair dealing is contractual in nature and only implies terms that the parties would have agreed to had they considered addressing them. The court held that the limited partnership agreement's elimination of fiduciary duties and inclusion of a clearly defined disclosure requirement prevented that implied covenant from creating additional disclosure obligations.

In reaching the foregoing conclusions, the court reiterated that the Delaware Revised Uniform Limited Partnership Act's policy is "to give maximum effect to the principle of freedom of contract and to enforceability of partnership agreements" even though the court recognized that it is "harsh to shield a conflicted transaction from judicial review under Delaware law based on a vote of unitholders without requiring the disclosure of all material information."

The *Dieckman* decision reinforces certain important issues that commonly arise in the context of alternative entities. First, like other fiduciary duties, the duty of disclosure may be eliminated in a limited partnership agreement or limited liability company agreement. Alternative entities are treated very differently in this respect as compared to corporations. Numerous cases address the importance of the duty of disclosure of directors of a Delaware corporation where stockholders of that corporation are being requested to vote on an action to be taken by the corporation. However, alternative entities may eliminate that duty in part or entirely in their governing agreements and avoid disclosing even material information.

Second, counsel should explain the consequences of eliminating fiduciary duties to any party that may enter into the governing agreement of an alternative entity in which fiduciary duties are waived. It is common for partners or members to enter into a partnership agreement or a limited liability company agreement, respectively, without understanding the impact of eliminat-

ing fiduciary duties. The Delaware Supreme Court has identified this as an issue as well, noting that investors "must be careful to read those agreements and to understand the limitations on their rights" they impose.

Counsel often fail to explain the loss in fundamental protections that partners and members suffer when fiduciary duties are eliminated. Partners and members frequently are surprised to find out that a controlling member or general partner may be able to take an action without considering the best interests of those partners or members or that they may be required to vote on a transaction without being fully informed of the circumstances around that transaction.

Lastly, it is important to keep in mind that the implied covenants of good faith and fair dealing do not replace the duties of care and loyalty. Although plaintiffs often rely on arguments based on those covenants, the arguments are rarely successful. Those covenants have a limited purpose: to fill gaps in contracts with terms that the parties would have included in the agreement had they not failed to consider them. Therefore, where fiduciary duties have been eliminated and replaced with language that contemplates, or a scheme that may be interpreted to contemplate, a specific action that is taken by a defendant, the implied covenant of good faith and fair dealing will not protect a plaintiff from that defendant's action.

Simply eliminating the duties of care and loyalty may not prevent a plaintiff from bringing successful allegations that the implied covenant of good faith and fair dealing was breached as a result of actions taken by a defendant. The risk of those allegations being successful can be reduced significantly or eliminated by setting out actions that may be taken or creating a process to

deal with those situations, as was the case in *Dieckman*.

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