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Delaware Court of Chancery Declines to Enforce Safe Harbors in Alternative Entity Context

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On October 29, 2019, the Delaware Court of Chancery issued an important decision concerning master limited partnerships ("MLPs") and other alternative entities in the context of conflict-of-interest transactions. In *Dieckman v. Regency GP LP*, C.A. No. 11130-CB, 2019 WL 5576886 (Del. Ch. Oct. 29, 2019), the Court of Chancery considered whether a General Partner's attempt to satisfy three contractual safe harbors—provisions concerning (i) "Special Approval" by an independent "Conflicts Committee" of the General Partner's board, (ii) "Unitholder Approval" by a majority of the limited partnership's unitholders unaffiliated with the General Partner, and (iii) action taken by a General Partner in reliance on advisors—immunized a conflict-of-interest transaction. The Court ultimately determined that the General Partner's efforts were undermined by an undisclosed conflict of interest on the part of one of the "independent" directors on the Conflicts Committee.

In *Dieckman*, a limited partner of Regency Energy Partners LP had sued Regency's General Partner alleging that a merger transaction approved by the General Partner was not in the best interest of Regency or its unitholders. Following discovery, both plaintiff and defendants cross-moved for summary judgment. The Court denied defendants' motion and granted plaintiff's motion, holding that the General Partner had attempted, but failed, to satisfy the three contractual safe harbors. Specifically, the Court held that the General Partner had not satisfied the Special Approval safe harbor because one of the directors who had sat on the Conflicts Committee was not truly independent of the General Partner. The limited partnership agreement required that the directors who sat on the General Partner's Conflicts Committee could not also serve on the board of any of the General Partner's affiliates. However, one of the members of the Conflicts Committee had for a short time served on the board of Sunoco, which was partially owned by Regency's acquirer, ETP (an affiliate of the General Partner). While this overlap in directorship was temporary, and in fact lasted only five days, the Court found that "the Conflicts Committee was not validly constituted from its inception," and the Special Approval safe harbor was therefore not satisfied.

In addition, although the challenged merger was approved by Regency's unitholders—which facially would satisfy the Unitholder Approval safe harbor—the Court held that the unitholders' approval was ineffective given that the proxy statement circulated in connection with the vote was materially misleading. In particular, the proxy statement failed to disclose that the

member of the Conflicts Committee had temporarily served on the Sunoco board and had misleadingly described the merger as being approved by an "independent" committee. Both of the alleged material misstatements derived from the same conflict which also negated Special Approval.

Finally, the General Partner had argued that a separate provision of the limited partnership agreement conclusively established that the General Partner had acted in good faith due to its reliance on an investment banker's fairness opinion. The Court rejected this argument, finding that there was an open question of fact concerning whether the General Partner had, in fact, relied on the fairness opinion, given evidence that the Conflicts Committee had determined the merger was fair several days *before* receiving the fairness opinion. The Court also suggested, without deciding, that the "reliance-on-advisors" provision may not apply to conflict-of-interest transactions given that provision was contained in a different section of the agreement than the conflict-of-interest safe harbors.

The *Dieckman* decision underscores a number of practice points when considering a conflict-of-interest transaction in the alternative-entity context:

- Even where a limited partnership agreement grants a general partner substantial flexibility, liability risk remains in the absence of meticulous adherence to the provisions of the governing limited partnership agreement.
- To the extent conflicts of interest or other deficiencies in the process exist, full disclosure to unitholders should be made in connection with any vote. Such disclosure may have the effect of cleansing the conflict (to the extent a unitholder approval safe harbor is available).
- If the governing partnership agreement contains a reliance-on-advisors safe harbor similar to the provision in *Dieckman*, the record must clearly reflect actual reliance on the advisors.

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