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Delaware Court Faults Committee Process & Advisory Work in Finding Lack of Good Faith

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Editor's note: William Savitt is a partner in the Litigation Department of Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum by Mr. Savitt, Jonathan M. Moses, and Ryan A. McLeod. This post is part of the Delaware law series, which is cosponsored by the Forum and Corporation Service Company; links to other posts in the series are available here.

On April 20, 2015, the Delaware Court of Chancery entered a $171 million post-trial judgment after finding a master limited partnership overpaid for assets from its parent. *In re El Paso Pipeline Partners L.P. Derivative Litig.*, C.A. No. 7141-VCL (Del. Ch. Apr. 20, 2015).

The case concerned a 2010 "dropdown" transaction in which El Paso Pipeline Partners L.P. purchased assets from its controlling parent entity, El Paso Corporation. The limited partnership agreement governing the MLP permitted such transactions so long as they were approved by a conflicts committee whose members believed in good faith that the transaction was in the best interests of the MLP. After the parent proposed a dropdown transaction, the MLP's committee retained legal and financial advisors and negotiated revised terms. Although the committee members initially expressed reservations about aspects of the proposed transaction in light of an earlier dropdown deal, each testified that he ultimately concluded that the transaction was in the best interests of the MLP, stressing that it was immediately accretive to the holders of the MLP's common units. After receiving a fairness opinion from its financial advisor, the committee approved the transaction and litigation ensued.

After trial, the Court of Chancery declined to credit the committee members' testimony as to their own state of mind, holding that the directors did not hold a good faith view that the transaction was in the MLP's best interests. The Court criticized the committee for "fixat[ing] myopically on accretion," for failing to make "the types of arguments that one would expect a motivated bargainer to make" in the negotiations, for failing to learn from past negotiating failures with its controlling parent entity, and for merely "[going] through the motions" before capitulating to "a determined controller." Thus, notwithstanding the trial testimony, the Court concluded that the committee members "consciously disregarded their own independent and well-considered views about value" in approving the dropdown. The Court further held that the committee's financial advisor, motivated by the prospect of "future business" from the controller, "manipulated its presentations in unprincipled ways." The Court found that the advisor "did not use appropriate numbers" in its analyses but instead "did what it could to justify the [d]ropdown, get to closing, and collect its contingent fee." The Court thus rejected the advisor's evaluation work and adopted the lower valuation proffered by the plaintiff's expert.

While no doubt driven by the specific facts of this case, the Court's willingness to discredit the committee's testimony about its own subjective opinions further emphasizes the importance of contemporaneous documentation of deal negotiations and processes. The decision also continues the recent trend of Delaware's intense scrutiny of financial advisors and reaffirms the special need for careful process in controller transactions, even in the context of transactions involving MLPs where the entire fairness doctrine typically does not apply.