KEY DECISIONS OF 2015 IN DELAWARE ALTERNATIVE ENTITY LAW

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I. FIDUCIARY DUTIES IN THE ALTERNATIVE ENTITY CONTEXT

In 2015, the Delaware Court of Chancery furthered its jurisprudence concerning fiduciary duties in the alternative entity arena in three separate opinions. In the first opinion, *Lewis v. AimCo Properties, L.P.*,[1] the Court of Chancery demonstrated that traditional control analyses do not necessarily apply in the alternative entity context, in holding that the owner of a majority equity stake was not a controller with corresponding fiduciary duties because, despite its large equity holdings, the limited partnership agreement precluded its exercise of control. In two other opinions—*In re El Paso Pipeline Partners, L.P. Derivative Litigation*[2] ("*El Paso*") and *In re Kinder Morgan Inc. Corporate Reorganization Litigation*[3] ("*Kinder Morgan*")—the Court of Chancery analyzed whether the defendants had breached contractual provisions establishing a subjective belief standard. In *El Paso*, the Court entered judgment against the general partner who was found to have not formed a subjective belief that a transaction was in the best interests of the limited partnership. In *Kinder Morgan*, the Court dismissed the complaint, holding that while the operative agreement required that the defendants consider the best interests of the limited partnership, the complaint alleged only that the defendants failed to consider the best interests of the limited partners. Each of these decisions is discussed in greater detail below.

In *Lewis v. AimCo*,[4] the Court of Chancery considered whether entities that indirectly owned a majority of a limited partnership's units through a series of affiliates constituted a control group of the limited partnership that owed fiduciary duties to the limited partnership and its limited partners. The Court held that the entities were not controllers and did not owe fiduciary duties.

The plaintiffs held limited partnership units in four limited partnerships (the "LP Defendants").[5] Each of the LP Defendants was managed by a corporate entity-general partner, and each of those general partners was indirectly owned by non-party Apartment Investment and Management Company ("AimCo").[6] AimCo also owned a majority of

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1. C.A. No. 9934-VCP, 2015 Del. Ch. LEXIS 33 (Del. Ch. Feb. 10, 2015).

2. C.A. No. 7141-VCL, 2015 Del. Ch. LEXIS 116 (Del. Ch. Apr. 20, 2015).

3. C.A. No. 10093, 2015 Del. Ch. LEXIS 221 (Del. Ch. Aug. 20, 2015), *aff'd sub nom, Haynes Family Trust v. Kinder Morgan G.P., Inc.,* 135 A.3d 76 (Del. 2016).

4. 2015 Del. Ch. LEXIS 33.

5. *Id.* at *3.

6. *Id.*

the limited partnership units of each of the LP Defendants.[7] Another defendant, Aimco Properties L.P. ("Aimco OP"), was an affiliate of AimCo. Defendant Terry Considine ("Considine") was an officer of AimCo.[8]

The plaintiffs brought a breach of fiduciary duty claim challenging a series of mergers through which the LP Defendants were merged into a subsidiary of Aimco OP.[9] The fiduciary duty claims against many of the defendants were dismissed when the Court found that the limited partnership agreements contained a broad arbitration clause and that the arbitrability of the claims should be decided by an arbitrator.[10] Aimco OP and Considine moved separately to dismiss the Complaint on the basis that they did not owe fiduciary duties to the plaintiffs and therefore could not be liable for any breach thereof.[11]

With regard to Aimco OP, the Court first pointed out that the Complaint had alleged only that non-party AimCo owned the majority stake in the LP Defendants, not Aimco OP.[12] The Court found that this was not altered by the plaintiffs' "less precise" assertion that AimCo and its affiliates, which included AimCo OP, owned a majority of the limited partnership units of the LP Defendants.[13] The Court explained:

> Underlying this proposition is a misplaced invocation of the concept in corporate law that a majority or controlling stockholder owes fiduciary duties to the corporation and its minority stockholders. The fundamentally different nature of limited partnerships renders Plaintiffs' overly simplistic argument in this regard unavailing…. A general partner of a limited partnership generally has rights and powers to manage and control the business and affairs of the limited partnership. It is not uncommon, however, for the general partner to have a small ownership stake in the limited partnership. By contrast, a limited partner may have a large or even a majority ownership interest in the limited partnership, but, by design, that limited partner would not have any power to manage or control the business and affairs of the partnership …. Thus, the fact that AimCo, through its affiliates, may have a majority interest in the LP Defendants does not support a reasonable inference that AimCo, or its affiliate Aimco OP, had a fiduciary duty to those limited partnerships or their limited partners.[14]

To determine whether Aimco OP owned fiduciary duties to the plaintiffs, the Court explained that it would not just examine Aimco OP's equity interest, but rather it "would need to look to the terms of the limited partnership agreements of the LP Defendants and to DRULPA."[15] As there was no allegation that either AimCo or Aimco OP was a general partner under those agreements, or that they acted as though they were general partners, they did not owe fiduciary duties

7. *Id*.

8. *Id*. at *3.

9. *Id*. at *4-5.

10. *Id*. at *6-12.

11. *Id*. at *13.

12. *Id*. at *15-16.

13. *Id*. at *15.

14. *Id*. at *16-17.

15. *Id*. at *18-19.

to the LP Defendants.[16] The Court explained that even if cases dealing with corporate controllers were relevant, and the plaintiffs had alleged that AimCo OP held a large block of the units of the LP Defendants, the other factual allegations were not sufficient to show that it exercised control.[17] The Court stated:

> [W]hile Aimco OP may have been involved in the day-to-day, operational management of AimCo's business, it did not "control" the LP Defendants in the sense that it exercised ultimate decision-making power with respect to partnership policy in general or with respect to the [challenged] Mergers in particular. "The bare conclusory allegation that a [defendant] possessed control is insufficient. Rather, the Complaint must contain well-pled facts" showing that the alleged controller "exercised actual domination and control" over the subject entity[.][18]

The Court also rejected the plaintiffs' reliance on cases like *In re: USA Cafes*[19] to impose fiduciary duties on Aimco OP.[20] The Court noted that the cases imposing fiduciary duties in that context had looked to individual controllers of entity managers or managing members.[21] In the case at hand, however, the managing entities were the LP Defendants, and the analogous individual controllers were the board of directors of the LP Defendants.[22] To hold Aimco OP liable under such a theory would require the Court to go "materially beyond" *USA Cafes* and cases following it.[23]

The Court found that the same reasoning applied "with even greater force" to Defendant Considine.[24]

Because the plaintiff had not alleged facts showing that Aimco OP and Considine had exercised control over the LP Defendants, the Court concluded that they did not owe fiduciary duties and dismissed the breach of fiduciary duty claim with prejudice.[25]

In *El Paso*,[26] the Court of Chancery evaluated whether the defendant general partner (the "General Partner") of El Paso Pipeline Partners, LP (the "Partnership") breached its obligations under the Partnership's limited partnership agreement (the "LP Agreement") by causing the Partnership to engage in a transaction involving an asset sale by El Paso

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16. *Id*. at *19.

17. *Id*. at *19-20.

18. *Id*. at *20.

19. 600 A.2d 43 (Del. Ch. 1991).

20. 2015 Del. Ch. LEXIS 33, at *21-22.

21. *Id*. at *21-22 (citing Feeley v. NHAOCG, LLC, 62 A.3d 649 (Del. Ch. 2012) and Cargill Inc. v. JWH Special Circumstance LLC, 959 A.2d 1096 (Del. Ch. 2008)).

22. *Id*.

23. *Id*. at *22.

24. *Id*. at *24.

25. *Id*. at *25.

26. 2015 Del. Ch. LEXIS 116. A second decision in this matter is discussed *infra*. An appeal in this case has been taken to the Delaware Supreme Court.

Corporation ("Parent"), an entity that wholly owned the General Partner.[27] Following a full trial, the Court concluded that the General Partner breached its obligations under the LP Agreement because the members of the special committee appointed to approve the sale transaction did not form a subjective belief that the transaction was in the best interest of the Partnership.[28]

The challenged transaction was one of a series of "drop down" transactions between the Parent and the Partnership, in which the Parent sold the Partnership assets (or rather, percentage interests in these assets) for cash.[29] These "drop down" transactions created an inherent conflict of interest for the General Partner, in light of its position as a wholly-owned subsidiary of the Parent.[30] But the LP Agreement permitted such transactions between the Parent and General Partner, if the transaction received the approval of a special committee appointed to approve the transaction (the "Committee").[31] The only contractual requirement for the Committee's approval was that its members *subjectively* believe in "good faith" that the transaction was in the best interest of the Partnership.[32]

In 2010, Parent and the Partnership engaged in three "drop down" transactions—in March, June, and November.[33] These "drop down" transactions involved sales by the Parent to the Partnership of partial interests in each of two assets.[34] The plaintiff, pursuing derivative claims on behalf of the Partnership, challenged the March transaction (the "Spring Dropdown") and the November transaction (the "Fall Dropdown").[35] In the Spring Dropdown, Parent sold a 51% interest in a subsidiary natural gas plant ("Sub A") to the Partnership for $963 million.[36] In the Fall Dropdown, Parent sold the remaining 49% interest in Sub A, along with a 15% interest in a separate subsidiary natural gas plant ("Sub B") for $1.412 billion.[37]

On summary judgment, the Court had earlier dismissed the plaintiff's challenge to the Fall Dropdown, concluding that the then-available evidence was insufficient to overcome the presumption that the Committee had acted in subjective good faith in approving the Spring Dropdown.[38] The Court partially denied summary judgment as to the Fall

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27. *Id.* at *1-3.

28. *Id.* at *5-6.

29. *Id.* at *2-3.

30. *Id.* at *1-3.

31. *Id.* at *3.

32. *Id.* at *45.

33. *Id.* at *24-25, 27-28, 40-41.

34. *Id.* at *10-11.

35. *Id.* at *42.

36. *Id.* at *10.

37. *Id.* at *11.

38. *Id.* at *43, 46.

Dropdown, concluding that questions of fact remained as to the subjective state of mind of the Committee with respect to that transaction.[39]

Thus, trial in *El Paso* focused on the narrow issue of whether "the Committee members believe[d] subjectively that the Fall Dropdown was in the best interests of [the Partnership]."[40] The Court held that they disregarded their duty to determine that the Fall Dropdown was in the best interests of the Partnership, and concluded that the General Partner breached the LP Agreement on that basis.[41]

The decision was the product of a trial record that "revealed numerous problems" with the Fall Dropdown and, specifically, the process by which the Committee approved the transaction.[42] The Court began by noting that two of the three Committee members had significant ties to the Parent, which impacted their ability to negotiate disinterestedly on behalf of the Partnership.[43] While the Court's earlier decision rejecting the plaintiff's challenge to the Spring Dropdown remained the "law of the case," the Committee's earlier behavior in that transaction informed the Court's view of the Committee's behavior in the context of the Fall Dropdown.[44]

The Court concluded that by the time of the Fall Dropdown—in the wake of the Spring Dropdown and the subsequent dropdown in June 2010—the Committee had fallen into a "comfortable pattern" whereby it merely went "through the motions" in approving the transactions.[45] Despite expressing their opinion in private emails that increasing the Partnership's percentage ownership of Sub A (beyond the 51% it acquired in the Spring Dropdown) was not in the Partnership's best long-term interest, the Committee members quickly acceded to the Parent's proposal to acquire the remaining 49% of Sub A in the Fall Dropdown.[46] The Court also concluded that the Committee "consciously disregarded" lessons learned from the Spring Dropdown in approving the Fall Dropdown. In particular, the Court found that the Committee was privy to market evidence following the Spring Dropdown that indicated it had paid too much for the 51% interest in Sub A, and had not effectively negotiated on behalf the Partnership.[47] In spite of this benefit of hindsight, the Committee negotiated only a minimal price reduction beyond the Parent's initial offer in the Fall Dropdown for the remaining 49%, but then "blindly gave up" this minimal price reduction after the Parent changed the terms of the deal, proposing instead that the Partnership acquire, in addition to the 49% in Sub A, a 15% interest in Sub B.[48] The Court further faulted the Committee—in the context of the revised deal now for purchase of *both* Sub A and Sub B—for failing

39. *Id.* at *43-44.

40. *Id.* at *45.

41. *Id.* at *78.

42. *Id.* at *49.

43. *Id.* at *8-9, 11.

44. *Id.* at *43. 60-64.

45. *Id.* at *50, *77.

46. *Id.* at *29, 51.

47. *Id.* at *60.

48. *Id.* at *38-40, 61.

to value each asset independently and instead evaluating the transaction as a "unitary whole."[49] The result was that the price the Committee ultimately negotiated for Sub A in the context of the "unitary" transaction was ultimately *higher* than the price it had previously negotiated, to which the Parent had agreed, when the proposed transaction was for the acquisition of Sub A only.[50]

To be sure, the Court's analysis of the Committee's failings was colored significantly by the Court's conclusion that the Committee's financial advisor, Tudor, Pickering, Holt & Co., was deeply conflicted, particularly given that it had been retained for *all* of the dropdown transactions, and its fee for each of the transactions was wholly contingent upon its issuance of a fairness opinion.[51] The Court concluded that the Committee was "assisted by a financial advisor that presented each dropdown in the best possible light, regardless of whether the depictions conflicted with the advisor's work on similar transactions or made sense as a matter of valuation theory."[52]

Ultimately, the Court concluded that while none of the problems with the Fall Dropdown "standing alone" would have supported a finding that the Committee members did not act in subjective good faith, the "composite picture that emerged" supported such a conclusion.[53]

In *Kinder Morgan*,[54] the Court of Chancery considered whether the defendant general partner (the "General Partner") of Kinder Morgan Energy Partners LP (the "Partnership") breached its express and implied contractual obligations to plaintiff limited partner under the Partnership's limited partnership agreement (the "LP Agreement") in structuring a reorganization of the Partnership.[55] On a motion to dismiss, the Court rejected the plaintiff's claims, finding that the General Partner did not breach its obligations under the LP Agreement because the express terms of the LP Agreement supplanted fiduciary duties to individual limited partners and the applicable contractual duty required only that the interests of the Partnership be considered, as opposed to those of the limited partners. [56]

The General Partner was wholly owned by defendant Kinder Morgan, Inc. ("Parent"). The General Partner delegated its authority to manage the Partnership to Kinder Morgan Management, LLC ("GP Delegate"), a limited liability company controlled by the Parent.[57] Prior to the reorganization at issue, Parent, GP Delegate, and the Partnership were all publicly traded entities.[58] Through the reorganization, the Partnership would merge with a wholly-owned subsidiary of the General Partner, and GP Delegate would merge with a different, wholly-owned, subsidiary of the General Partner.[59]

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49. *Id*. at *42.

50. *Id*.

51. *Id*. at *12-13, *64-65.

52. *Id*. at *4.

53. *Id*. at 49-50.

54. 2015 Del. Ch. LEXIS 221.

55. *Id*. at *2, 13-14.

56. *Id*. at *30

57. *Id*. at *2.

58. *Id*. at *3.

59. *Id*.

The intention of the reorganization was to consolidate the entities and have Parent emerge as the only publically traded entity.[60] Because Parent controlled the Partnership through the General Partner, and because Parent would be acquiring total ownership of the Partnership through the reorganization, the transaction created a conflict of interest for the General Partner, which the General Partner addressed by appointing a special committee (the "Special Committee"), under the terms of the LP Agreement, to approve the reorganization.[61]

The plaintiff alleged that the General Partner unfairly structured the reorganization on terms that benefitted the Parent and owners of GP Delegate's shares—which were disproportionally owned by insiders of Parent—to the detriment of the Partnership's limited partners.[62]

The Court's analysis of the pertinent provision of the LP Agreement was guided by the Delaware Supreme Court's earlier decision in *Norton v. K-Sea Transportation Partners, L.P.*,[63] in which the Court construed a provision in a limited partnership agreement that was identical to the terms of the provision currently at issue. The pertinent provision of the agreement provided:

> Any standard of care[,] any duty imposed by this Agreement or under the Delaware Act or any applicable law, rule or regulation shall be modified, waived or limited as required to permit the General Partner to act under this Agreement or any other agreement contemplated by this Agreement and to make any decision pursuant to the authority prescribed in this Agreement *so long as such action is reasonably believed by the General Partner to be in, or not inconsistent with, the best interests of the Partnership.*[64]

Following the Supreme Court's guidance in *Norton*, the Court of Chancery interpreted the language of the provision "to eliminate[] all common law fiduciary duties" to the limited partners and "substitute in their place a contractual duty under which the General Partner 'must reasonably believe that its action is in the best interest of, or not inconsistent with, the best interests of the Partnership.'"[65]

The Court concluded that this displacement of common law fiduciary duties to the *limited partners*, in favor of a contractual obligation by the General Partner to take action "in, or not inconsistent with, the best interest of the *Partnership*" was fatal to the plaintiff's claims for breach of the LP Agreement.[66] The Court emphasized that if the LP Agreement had *not* eliminated fiduciary duties as such, and if the plaintiff had asserted claims for breach of fiduciary duty (which it deemed "they doubtless would have"), then the Court would not have dismissed their claims.[67] But following the Supreme Court's guidance in *Norton*, the Court ruled that the effect of the provision was to render the analysis "solely contractual."

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60. *Id*.

61. *Id*. at *5-6.

62. *Id*. at *4, 13-14.

63. 67 A.3d 354 (Del. 2013).

64. *Kinder Morgan*, 2015 Del. Ch. LEXIS 221, at *15-16 (citing Section 6.10(d) of the LP Agreement) (emphasis in original).

65. *Id*. (quoting *Norton*, 67 A.3d at 362).

66. *Id*. (emphasis added).

67. *Id*. at *17.

The Court concluded that the plaintiff had not adequately alleged a contractual breach by the General Partner. The Court interpreted the relevant contract language, bearing on the General Partner's reliance on the Special Committee, to require only that the Special Committee: (i) believe "subjectively" that the transaction was "fair and reasonable" to the *Partnership*; and (ii) believe "subjectively and reasonably" that it was in the best interest of the *Partnership*.[68] The Court concluded that the Complaint failed to sufficiently allege facts to support a "reasonable inference" that the Special Committee had not satisfied the "minimal" requirements in the LP Agreement.[69] Again, the Court emphasized that it would have reached a different result had the contractual duties of the Special Committee extended to the limited partners *specifically*, as opposed to the Partnership *generally* (which necessarily included *both* the General Partner and the limited partners). As the Court remarked:

> If the applicable standard required that the members of the Committee determine that the [Merger] was in the best interests of the limited partners, then the Complaint's allegations would support a pleading-stage inference that the members of the Committee did not act in good faith. It is reasonably conceivable, based on the facts alleged, that the members of the Committee approved the terms of the [Merger] to accommodate Parent, rather than because they believed they were in the best interests of the limited partners…. But the members of the Committee did not have to believe that the MLP Merger was in the best interests of the limited partners. They rather had to believe in good faith that the MLP Merger was in the best interests of the Partnership.[70]

Thus, the Court concluded that the General Partner's reliance on the Special Committee conformed with the terms of the LP Agreement, and dismissed the plaintiff's claim against the General Partner for breach of the same.[71]

II. DISTINGUISHING BETWEEN DIRECT AND DERIVATIVE CLAIMS

In two separate opinions in 2015, the Court of Chancery considered the distinction between direct and derivative claims and how the traditional analysis applied in the alternative entity context. In *CMS Inv. Holdings, LLC v. Castle*,[72] the Court held that claims against the managers of a limited liability company alleging that they had improperly diverted distributions in an effort to force a company into bankruptcy were direct or, at a minimum, were dual natured. Similarly, in *In re El Paso Pipeline Partners, L.P. Derivative Litigation,*[73] the Court held that breach of contractual claims against a general partner were direct claims or, at a minimum, were dual natured claims and refused to dismiss the claims where the limited partners had lost their standing to pursue derivative claims against the general partner as a result of a post-trial merger.

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68. *Id.* at *23.

69. *Id.*

70. *Id.* at *26-28.

71. The Court similarly dismissed Plaintiff's claim for breach of the implied covenant that was founded on allegations that the General Partner appointed conflicted individuals—with divergent allegiances to the Partnership and the GP Delegate—to serve on the Special Committee. The Court concluded that purported conflict was not sufficient to implicate the covenant.

72. C.A. No. 9468-VCP, 2015 Del. Ch. LEXIS 169 (Del. Ch. June 23, 2015).

73. C.A. No. 7141-VCL, 2015 Del. Ch. LEXIS 295 (Del. Ch. Dec. 2, 2015).

CMS Investment Holdings involved a dispute over events that led to the demise of a Delaware limited liability company, RP Holdings Group LLC ("RPH"). RPH provided non-legal services to law firms in connection with mortgage foreclosures.[74] RPH was created by the defendants and was purchased by the plaintiff, CMS Investment Holdings, LLC ("CMSIH").[75] CMSIH received Class A preferred membership units as part of the transaction.[76] After the sale, the defendants continued to run the business as managers, officers and employees of RPH.[77]

In the action, CMSIH alleged that the defendants failed to collect administrative services fees owed to RPH by the law firms and clients, instead retaining the fees for themselves or paying themselves through improper distributions.[78] As this began to place RPH in danger of defaulting on its debt obligations, CMSIH further alleged, the defendants conspired to purposely drive the company into insolvency so that they could buy back its assets at a fire-sale price.[79] CMSIH's claims included breach of the limited liability company agreement (the "LLC Agreement'), breach of the implied covenant of good faith and fair dealing, unjust enrichment, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, civil conspiracy, and fraudulent transfer.[80]

In a dismissal motion, the defendants argued, among other things, that the claims were derivative and therefore could not be brought by CMSIH absent satisfaction of the demand requirement of Court of Chancery Rule 23.1.[81] The Court rejected this contention, however, and held that the claims were direct or, at a minimum, dual-natured.[82]

The Court began its analysis of the direct/derivative issue by repeating the familiar standard: whether a claim is direct or derivative depends solely on: (1) who suffered the alleged harm (the corporation or the stockholders, individually); and (2) who would receive the benefit of any recovery (the corporation or the stockholders, individually).[83] It then examined CMSIH's claims.[84]

With respect to the breach of contract and related claims, the Court explained that the allegations could be characterized as follows: the parties to RPH's LLC Agreement promised CMSIH that the holders of Class A units would receive distributions before the other classes of units.[85] Accepting those allegations as true, the Court explained, there may

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74. 2015 Del. Ch. LEXIS 169, at *1-2.

75. *Id*. at *2.

76. *Id*. at *10.

77. *Id*.

78. *Id*. at *2-3, *14.

79. *Id*.

80. *Id*. at *22.

81. *Id*. at *24.

82. *Id*. at *26.

83. *Id*. at *25-26.

84. *Id*.

85. *Id*. at *26-27.

have been a sense in which RPH was harmed by the defendants' breach of that agreement, but the predominant harm fell on CMSIH as the Class A unitholder.[86]

The Court used similar logic to find that the fiduciary duty and related claims also were direct.[87] The Court noted that, under Delaware law, equity interests entitle their owners to exercise certain rights by virtue of being the owners, and "[d]irect claims for breach of fiduciary duty arise when those rights are infringed."[88] The Court concluded that CMSIH's complaint adequately alleged that the defendants engaged in a series of actions to dissolve RPH and purchase its assets out of receivership, thereby re-allocating economic and voting power away from Class A unitholders for less than fair value.[89] The Court noted that any recovery for those allegedly wrongful actions would go to the Class A unitholders "individually, and not on a pro rata basis along with all the unitholders of RPA."[90] Moreover, the Court observed that while RPH was also harmed by the defendants' scheme and that a derivative action may lie on behalf of RPH, here CMSIH had "limited the claims it is asserting based on the RPH fiduciaries' alleged breaches of fiduciary duties solely to breaches that [it] can pursue directly."[91] Thus, the fiduciary duty and related claims therefore were deemed direct.[92]

The defendants argued that CMSIH's allegations amounted to nothing more than a "'sensational story about how Defendants pillaged RPH for years causing it immeasurable harm and, as a result, Plaintiff lost its investment.'" [93] The Court acknowledged that this might be "one way to read the Complaint, but it is not the only reasonable one."[94] The Court pointed out that, at the motion to dismiss stage, CMSIH was entitled to have all reasonable inferences drawn in its favor.[95] As such, CMSIH's claims were deemed direct and it was not required to comply with the Rule 23.1 demand requirement.[96]

The Court in *El Paso*[97] undertook a similar analysis, but in connection with its consideration of whether a plaintiff had lost standing to assert derivative claims following a post-trial merger. The underlying facts in *El Paso* are discussed above. As discussed, in a post-trial opinion the Court held that the general partner had breached its contractual duties to the limited partners by failing to act with subjective good faith in approving a drop-down transaction.[98] As a result,

86. *Id*. at *27.

87. *Id*.

88. *Id*. at *28.

89. *Id*.

90. *Id*. at *28-29.

91. *Id*. at *29.

92. *Id*.

93. *Id*. at *30.

94. *Id*.

95. *Id*.

96. *Id*. at *30-31.

97. 2015 Del.Ch. LEXIS 295, *rev'd* 2016 Del. LEXIS 653 (Del. Dec. 20, 2016).

98. *Id*. at *18.

the general partner was liable to the limited partners for $171 million in damages plus pre- and post-judgment interest.[99] Following trial, the limited partnership at issue was merged out of existence in a related party transaction.[100] As a result, the defendants argued that because the plaintiff had pled the claims as derivative, the claims must be dismissed.[101]

The Court rejected this contention. The Court held that if the law required the claims to be characterized as exclusively direct or derivative, then the claims were direct.[102] But in the Court's view, the claims were more properly characterized as "dual-natured" claims which should be viewed as derivative for purposes of Rule 23.1 standing and direct for purposes of determining standing following a merger.[103] The Court's legal analysis on each of these issues is instructive.

The primary holding of the Court is that a breach of contract claim asserted by a unitholder in a limited partnership is a direct claim.[104] In so holding, the Court rejected the defendants' argument that because the limited partnership suffered harm as a result of the defendants' actions, the claim must, under *Tooley,* be characterized as a derivative claim.[105] The Court held that such a view "overstates Tooley's reach" in that *Tooley* does not "obviate the need to address 'an important initial question': Does the plaintiff seek to bring a claim belonging to her personally or one belonging to the corporation itself?"[106] The Court also rejected the defendants' argument that *Tooley*, through its elimination of the special injury requirement, eliminated direct claims by stockholders to enforce their rights under the DGCL, charter and bylaws.[107] The Court reasoned that although *Tooley* rejected the term "special injury" when analyzing whether a claim is direct or derivative, it did not reject the concept that stockholders may sue directly to enforce their statutory or contractual rights.[108] Instead, *Tooley* enforced the principle that stockholders may sue directly to enforce contract claims.[109] Further, the Court held that *Tooley's* two-step analysis does not apply to such claims because *Tooley* dealt with fiduciary duty claims, not contract claims.[110] This rule, reasoned the Court, may result in more claims in the alternative entity context being deemed direct claims.[111] It does not, however, make all alternative entity claims (which are largely creatures of contract)

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99. *Id*. at *2.

100. *Id*.

101. *Id*. at *3.

102. *Id*. at *3-4.

103. *Id*. at *4-5.

104. *Id*. at *23-24.

105. *Id*. at *36.

106. *Id*. (citations omitted).

107. *Id*. at *66.

108. *Id*. at *70.

109. *Id*.

110. *Id*. at *72.

111. *Id*. at *75.

direct.[112] Claims that assert a breach of a specific provision of a governing agreement will be direct.[113] Claims challenging the decision-making of a manager or general partner will continue to be subject to the *Tooley* two-step analysis.[114]

The Court, in *dictum*, went onto analyze whether the claims asserted by the plaintiffs were more properly characterized as dual-natured claims.[115] The Court analyzed whether the plaintiffs' claim was a dual-natured claim, *i.e.*, one that has both direct and derivative characteristics.[116] The Court observed that Delaware recognizes a third category of claims - dual-natured claims.[117] These are claims that "affect *both* the corporation and the stockholder and could be remedied either at the corporate *or* the stockholder level."[118] To determine if a claim is dual-natured, courts use the *Tooley* test.[119] In the case at hand, the Court held that the injury alleged by plaintiffs (eliminating the contractual element) was injury that impacted both the limited partners and the partnership. Specifically, the Fall Dropdown transaction caused the partnership to overpay for assets resulting in injury to the partnership.[120] Because, however, the Fall Dropdown also involved monies being extracted from the entity (here the partnership) and being allocated to a "wrongful insider" (in this case the General Partner) the limited partners suffered injury in the form of a "reallocation of value among the existing entity claimants."[121] The Court explained,

> All of the claimants suffer a proportionate loss according to the priority of their claims, but the insider receives an offsetting benefit that exceeds the insider's share of the loss. In reality, the insider isn't injured at all. The insider gains at the expense of the other investors. The net effect is to extract value from the unaffiliated investors for the benefit of the insider.[122]

The limited partners and the general partner suffered a loss as a result of the overpayment. But the general partner obtained an offsetting gain by virtue of its inside position.[123] Thus, the limited partners' loss inured to the benefit of the general

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112. *Id*. at *73-74.

113. *Id*. at *75.

114. *Id*.

115. *See id*. at *33 n.8 ("This aspect of this decision is admittedly dictum, but because this decision effectively decides the fate of the Liability Award, the losing party can be expected to appeal.")

116. *Id*. at *82.

117. *Id*. at *83 n.41.

118. *Id*. at *83 (emphasis in original).

119. *Id*. at *84.

120. *Id*. at *86.

121. *Id*. at *88.

122. *Id*. at *88-89.

123. *Id*. at *89.

partner resulting in a "separate and distinct loss" to the unaffiliated limited partners.[124] The Court also held that any remedy for the wrong could operate at either the limited partner or partnership level. If the partnership were to continue as a viable entity, the general partner could repay the overpayment to the limited partnership.[125] Alternatively, the general partner could pay the offsetting benefit it obtained to the limited partners so that all limited partners "receive *pro rata* treatment."[126]

The Court went onto discuss how dual-natured claims should be treated for purposes of (i) claim initiation and a Rule 23.1 analysis and (ii) claim elimination and a standing analysis, each of which presents different policy considerations.[127] The Court reasoned:

> When considering how a dual-natured claim should be treated for purposes of Rule 23.1 and other doctrines that protect the board's central role in overseeing the business and affairs of the corporation, Delaware law can and should prioritize the derivative aspects of the claim. Classifying the claim as derivative for purposes of this stage of the litigation serves the policy goal of screening for meritless claims through a combination of the demand doctrine and the heightened pleading standards of Rule 23.1. These standards weed out weak claims while permitting strong claims involving breaches of the duty of loyalty to survive. Treating a dual-natured claim as derivative during this stage also serves the pragmatic goal of ensuring that "injury to a whole association [of investors] is adjudicated on behalf of that whole and not just for the benefit of the individuals who have undertaken to pursue the claims." *In re Cencom Cable Income Partners, L.P.*, 2000 Del. Ch. LEXIS 10, 2000 WL 130629, at *4 (Del. Ch. Jan. 27, 2000)
>
> When considering how a dual-natured claim should be treated for purposes of whether it can be maintained after a merger, Delaware law can and should prioritize the individual aspects of the claim. The policies supporting a derivative characterization no longer apply once the separate legal existence of the represented entity has terminated. There is no need to screen again for weak claims, because the Rule 23.1 analysis already has served that purpose. Nor is there a continuing need for the entity to play its pragmatic role as a collection agent. In a merger, at the singularity of the effective time, the identities of the investors on whose indirect behalf the derivative action was being pursued become forever fixed. *See Brinckherhoff v. Tex. E. Prods. Pipeline Co., LLC*, 986 A.2d 370, 383 (Del. Ch. 2010). The constituent entities know the identities of those investors because they send them the merger consideration. From that point on, a dual-natured claim "should be seen for what [it is], a form of class action." *Parfi Hldg. AB v. Mirror Image Internet*, 954 A.2d 911, 940 (Del. Ch. 2008) (Strine, V.C.).[128]

Such treatment, the Court observed, would also address other policy considerations such as the disincentive and the wealth transfer that results when a stockholder invests time and money to assert a derivative claim only to lose standing to assert it at a later time.[129] For purposes of the current case, the Court held:

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124. *Id*. at *90-91.

125. *Id*. at *106-07.

126. *Id*. at *90.

127. *Id*. at *109-110.

128. *Id*. at *110-12.

129. *See id*. at *112-13 ("If derivative actions promote firm value, even marginally, then a rule that forecloses some number of both meritorious and meritless derivative actions will, all things being equal, inherently transfer some degree of wealth from

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> [F]or as long as El Paso MLP retained its separate legal existence, it was preferable for the action to proceed in the name of El Paso MLP and for any remedy to run through El Paso MLP. Now that El Paso MLP no longer exists as a separate entity, the possibility of remedying the situation through a payment to the entity no longer exists. In my view, that does not mean that the harm no longer exists or that a remedy is no longer warranted. The Proxy Statement admits that the consideration that holders of common units received in the Merger did not incorporate any value for this litigation. Under the circumstances, it does not seem logical or equitable to disregard the Liability Award, dismiss this action, and invite the plaintiff potentially to start all over again by challenging the Merger. Rather, it seems to me that the remedy should be implemented differently. I believe that the direct aspects of the remaining breach of contract claim should enable the unaffiliated limited partners to receive their *pro rata* share of the Liability Award.[130]

III. STANDING TO SEEK DISSOLUTION

In 2015, the Court of Chancery issued an opinion that held that a non-member of a limited liability company had standing to seek an equitable dissolution of an entity where the same was not available to the non-member by statute or by the parties' agreement. In doing so, the Court explained how its equitable power to grant dissolution was not and could not be usurped by the statutory provision in the Delaware Limited Liability Company Act (the "Delaware LLC Act") providing for dissolution.

In *In re Carlisle Etcetera LLC*,[131] the Court denied a limited liability company member's motion to dismiss a petition for dissolution filed under 6 *Del. C.* § 18-802 by petitioners that included the company's parent and its wholly-owned subsidiary. The member argued that the Delaware LLC Act only permits members and managers to seek dissolution, and that neither the parent nor the subsidiary was a member or a manager.[132] The Court agreed that the petitioners were not managers because the managing power was vested with a board of directors.[133] The Court also agreed that the petitioners were not members because the parent had assigned its rights to the wholly-owned subsidiary, leaving the parent without member rights by operation of 6 *Del. C.* § 18-702(b)(3).[134] Under the Delaware LLC Act, an assignment of interests does not automatically make an assignee a member unless the operating agreement provides otherwise.[135] Because the operating agreement did not otherwise provide, the wholly-owned subsidiary was not a member.[136] Although the Court agreed

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corporations to the individuals who commit corporate wrongs. The resulting wealth transfer confers a windfall on faithless fiduciaries and creates perverse incentives for misbehavior.") (quoting Hamilton Partners v. Englard, 11 A.3d 1180, 1206 (Del.Ch. 2010).

130. Id. at *127-28.

131. 114 A.3d 592 (Del. Ch. 2015).

132. *Id.* at 597.

133. *Id.*

134. *Id.* at 598.

135. *Id.* (discussing 6 *Del. C.* § 18-702(b)(1)).

136. *Id.* at 598-99.

with these aspects of the member's arguments, the Court denied the motion to dismiss. The Court reasoned that Section 18-802 was not the exclusive extra-contractual means of seeking dissolution of a limited liability company.[137] The parent and wholly-owned subsidiary were permitted to seek dissolution of the company under the Court's broad equitable power, to avoid becoming "locked-in as a silent and powerless passive investor."[138] Despite not having the ability to seek a statutory dissolution or a contractual dissolution, the Court held that the "real relations" of the parties warranted allowing the subsidiary standing to seek an equitable dissolution.[139] The Court held that Section 6 *Del. C.* §18-802 of the Delaware LLC Act does not (and could not) provide the "exclusive method of dissolving an LLC."[140] *First*, the language of Section 18-802 does not state that it shall be the exclusive means by which to obtain dissolution.[141] Instead, the Delaware LLC Act elsewhere recognizes that in a case not provided for, equity provides a "backstop."[142] *Second*, even if Section 18-802 would purport to provide the exclusive means for dissolving an LLC, it would be unconstitutional because it would divest the Court of its traditional equity jurisdiction and power to order the dissolution of an insolvent entity and the appointment of a receiver.[143] The Court compared its holding to that of the Delaware Supreme Court in *CML V, LLC v. Bax*,[144] which held that creditors did not have standing to sue derivatively on behalf of an limited liability company. The Court observed that, unlike in the current case where the parties had no relief absent an equitable remedy, creditors have sufficient legal remedies available to them to avoid any similar constitutional problem.[145] The Court also observed that while the parties to a limited liability company agreement may waive the right to seek statutory dissolution, the remedy of equitable dissolution may not be waived and is available as a backstop where statutory or contractual dissolution is not available.[146]

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137. *Id.*

138. *Id.* at 606.

139. *Id*. at 601.

140. *Id*. at 607.

141. *Id*. at 601.

142. *Id*. at 602 (citing 6 *Del. C.*§18-1104)

143. *Id*. at 602-03.

144. 28 A.3d 1037 (Del. 2011).

145. 114 A.3d. at 605.

146. *See id*. at n.8 (citing to the adoption of 6 *Del. C.* § 18-1104 providing that "In any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity relating to fiduciary duties and the law of merchant shall govern.") and at 606 (citing Huatuco v. Satellite Healthcare and Satellite Dialysis of Tracy, LLC, 2013 Del. Ch. LEXIS 298, at *1 n.2 (Del. Ch. Dec. 9, 2013) (reserving decision on "whether the parties may, by contract, divest this Court of its authority to order a dissolution in all circumstances, even where it appears manifest that equity so requires – leaving for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre's *Huis Clos*.") *aff'd* 93 A.3d 654 (Del. 2014) (Order).