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DELAWARE BUSINESS COURT INSIDER

Del. High Court Overturns Landmark Chancery Ruling in 'Boardwalk Pipeline Partners'

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By David J. Margules

Delaware's Supreme Court unanimously overturned a landmark Chancery Court judgment holding a general partner liable for exercising an option to cash out minority holders in bad faith reliance on a "contrived" legal opinion.

The December 2022 ruling in *Boardwalk Pipeline Partners v. Bandera Master Fund* demonstrates the strength of contractual limitations on judicial review, and underscores the need for careful consideration of investor protections, rights and remedies.

In *Boardwalk Pipeline Partners*, a three-Justice majority held the defendants were protected by contract provisions creating a "conclusive presumption" of good faith when decision-makers rely on an opinion of counsel. A two-Justice concurrence rejected the trial court's holding that the opinion was "contrived" and "not rendered in good faith." Both appellate opinions reflect a highly deferential approach to the language of the partnership agreement, even though the trial court found a bad faith, manipulative process.

Boardwalk Pipeline Partners (the partnership) was a Delaware LP operating oil and gas pipelines. Most of the partnership's units were owned by Loews Corp. through another Delaware LP—Boardwalk GP, LP (the GP)—the partnership's general partner. Management authority over the GP's general partner, Boardwalk GP, LLC, was split between a board of directors and the sole member, a Loews subsidiary (the sole member).

The partnership held an option to call minority units if "the general partner receives an opinion of counsel that the partnership's status as an association not taxable as a corporation and not otherwise subject to an entity-level tax for federal, state or local income tax purposes has or will reasonably likely in the future have a material adverse effect on the maximum applicable rate that can be charged to customers." On June 29, 2018, the sole member directed the partnership to exercise the option after receiving an opinion from the Texas-based law firm Baker Botts, that a proposed Federal Energy Regulatory Commission (FERC) rule change triggered the option. The sole member also received an opinion from Skadden Arps Slate Meagher & Flom that it was reasonable to rely on the Baker opinion.

In a 193-page post-trial opinion in November 2021 in *Bandera Master Fund v. Boardwalk Pipeline Partners*, the Chancery Court held the GP liable for $689,827,343.38 in damages for wrongfully cashing out minority limited partners. Characterizing the Baker Botts opinion as "contrived," the trial court held that "counsel did not render it in good faith," in part because it was premised on "unrealistic and counterfactual assumptions, knowingly relied on an artificial factual predicate and consistently engaged in goal-directed reasoning …"

The trial court quoted the partnership's own public disclosures that the potential rule change was not expected to have a material adverse effect on results.

The trial court's decision turned largely on its rejection of Baker's interpretation of two governance provisions. In both cases, the trial court held Baker failed to apply what it found to be an intent to protect minority holders. The trial court noted evidence that counsel originally resolved the contract issues inconsistently with its ultimate opinions, but changed those views under pressure from partnership executives.

In determining the likelihood of a material adverse effect, Baker evaluated the maximum tariffs FERC would permit the partnership to charge, rather than the partnership's effective rates, most of which were determined by contract. Focusing on the former "meshed imperfectly with Loews' business goal of protecting against future regulatory action that would have a material adverse effect on Boardwalk."

The trial court also held the sole member had no authority to accept the opinion and trigger the option on behalf of the partnership; only GP's board of directors could do so. Having found the governance documents ambiguous on the question, the trial court reasoned that vesting the Sole Member with authority "enjoyed more textual support," but vesting the board "made sense from a governance perspective" because the presence of outside directors on the GP board "injected a measure of independence into the determination."

The trial court found inapplicable a governance provision stating reliance on counsel conclusively established good faith. The measure required "subjective good faith," the trial court reasoned, explaining that decision-makers could not rely on an opinion premised on assumptions known to be untrue.

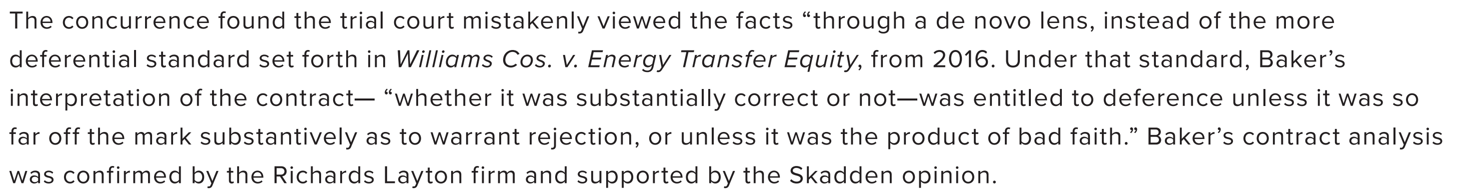
Chief Justice Collins Seitz's majority Supreme Court opinion reversed based on contract interpretation. Its "disagreement" with the Chancery Court "begins with its assumption that the partnership agreement's silence about the mechanics of the general partner's acceptability review means an ambiguity existed in the partnership agreement. The partnership agreement places the acceptability determination in the hands of the general partner. Having directed the acceptability determination to the general partner, the LLC agreement dictated how it was to make the acceptability determination." Partnership agreement provisions supported the sole member's authority to receive and accept the Baker opinion, including one defining "Opinion of counsel" as one "acceptable to the sole member."

Regarding the standard for reviewing the defendants' conduct, the court described the governance documents as making "full use of the [master limited partnership] structure to limit fiduciary duties and to consolidate governing power in its general partner." A provision disclaimed fiduciary and other duties in the decision whether to exercise the option, other than the "non-waivable implied covenant of good faith and fair dealing." Moreover, the governance agreements established a "conclusive presumption" of good faith where decision-makers rely on advice of counsel.

The majority held the general partner reasonably relied on the Skadden opinion that it could rely on Baker and, therefore, "is presumed to have acted in good faith and is immune from damages." The majority considered it important that the Chancery Court "did not find, nor did [plaintiff] contend, that the Skadden opinion was the product of bad faith or willful misconduct."

In addition, "other law firms, Davis Polk, Richards Layton & Finger, and Vinson & Elkins, provided advice … bolstering the credibility of Skadden's opinion."

The majority's contract analysis made it unnecessary to address the trial court's findings that Baker's opinion was unreliable. It noted the lack of a finding that "a majority of the sole member board engaged in fraud, bad faith, or willful misconduct," declining to attribute to the board the findings of "bad faith" conduct by executives. "Allowing agency law to displace … the contractual terms undermines the approval structure in the partnership agreement and the LLC agreement. The proper review centers on the sole member board—the entity responsible for the call right exercise—and not nondecision-maker agents of the general partner."A two-member concurring opinion authored by Justice Karen Valihura supported reversing "the finding that the Baker opinion was not rendered in good faith." It observed the bad faith findings "were the focal point of the case and are important to both practitioners and their corporate clients. The Breach Holding has the potential to fundamentally alter the legal environment in which opinions of counsel are prepared."



The concurrence found the trial court mistakenly viewed the facts "through a de novo lens, instead of the more deferential standard set forth in *Williams Cos. v. Energy Transfer Equity*, from 2016. Under that standard, Baker's interpretation of the contract— "whether it was substantially correct or not—was entitled to deference unless it was so far off the mark substantively as to warrant rejection, or unless it was the product of bad faith." Baker's contract analysis was confirmed by the Richards Layton firm and supported by the Skadden opinion.

The concurrence did not view as evidence of bad faith the opinions expressed by various lawyers conflicting with Baker's final contract interpretations. "One should recognize that what emerges as the end product may differ significantly from earlier drafts," it reasoned, "and that earlier drafts may reflect differences of views among the working group members, and theories and views may change over time." Again, the trial court's finding that lawyers were pressured into their final opinions was undercut by Skadden's and Richards Layton's support for Baker's conclusion.

The concurring justices were troubled by the public statements that the proposed rule changes were not expected to affect results materially. While the comments were "not favorable to the appellants," they were "not sufficient to render the opinion a product of bad faith."

The Supreme Court opinions demonstrate the strength of contractual limitations on judicial review and liability. They underscore the need for investment organizers to consider carefully the effectiveness of their protections, and for investors to understand fully the constraints on their rights and remedies.

David J. Margules *is a litigation partner in the Delaware office of Ballard Spahr, where he concentrates on complex litigation matters, with an emphasis on Delaware Chancery Court cases.*

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