

# Court of Chancery Finds Committee Did Not Believe Dropdown Transaction Was in the Best Interests of MLP

## **Client Alert**

04.22.2015

On April 20, 2015, the Court of Chancery issued its opinion after trial in the *El Paso Pipeline Partners L.P.* derivative litigation. Plaintiffs challenged a “dropdown” transaction whereby the parent corporation (“Parent”) in a master limited partnership (“MLP”) structure sold interests in two of its subsidiaries to the limited partnership (“El Paso MLP”), and the Court found that the general partner, in engaging in the transaction with Parent, had violated the El Paso MLP limited partnership agreement. The Court held that a committee of independent members of the general partner’s board (the “Committee”) who approved the transaction (*i.e.*, giving “special approval” in the terminology of the limited partnership agreement) failed to form the requisite subjective belief that the dropdown transaction was in the best interests of El Paso MLP. The opinion closely examined the Committee’s process and offers important lessons to conflicts committees and their advisors both as to the process and as to the appropriate factors that a committee should consider in approving or disapproving a dropdown transaction for an MLP.

Plaintiffs originally challenged two dropdown transactions, which the Court referred to as the “Spring Dropdown” and the “Fall Dropdown.” The Court previously had granted defendants’ motion for summary judgment as to the Spring Dropdown and partially denied defendants’ motion for summary judgment as to the Fall Dropdown, finding that questions of material fact existed requiring a trial as to the state of mind of the members of the Committee when approving the Fall Dropdown. The opinion noted that, at trial, the Court expected that the Committee members and their financial advisor would provide a credible account of how they evaluated the Fall Dropdown, negotiated with the Parent and ultimately determined that the transaction was in the best interests of El Paso MLP. However, that is not what the Court found. Rather, the Court found that the Committee members went against their better judgment and did what the Parent wanted and not what they believed was in the best interests of El Paso MLP. The Court rejected trial testimony of the Committee members that they believed the transaction was in the best interests of El Paso MLP, finding that the testimony was rehearsed, not credible, and inconsistent with their contemporaneous emails and deposition testimony. Specifically, the Court pointed to various internal assessments by Committee

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members suggesting they believed that the actual value of the assets was lower than the price proposed by the Parent - and accepted by the Committee - and also that it was not in the best interest of El Paso MLP to acquire additional interests in the subsidiary, which related to the importation of liquefied natural gas, a market that appeared to be in decline. Consequently, the Court determined that El Paso MLP had paid \$171 million more for one of the assets that it acquired than it would have if the general partner had not breached the limited partnership agreement.

The Court also expressed concern regarding the process followed, and the work product generated, by the Committee's banker. Specifically, the Court noted that the banker met with Parent's management before meeting with the Committee, did not emphasize certain relevant information in their presentation and failed either to follow the same approach in the Fall Dropdown as in the Spring Dropdown - or bring the inconsistency to the Committee's attention - all in an effort to make the Spring Dropdown look as attractive as possible. The Court noted that the banker's entire fee was contingent on delivering a fairness opinion suggesting that the banker did what it could to justify the Fall Dropdown, get to closing and collect its contingent fee.

The Court also found that the Committee was unduly focused on accretion of distributable cash to the holders of the common units, when they should have been focused on carrying out their known contractual obligation to determine whether the Fall Dropdown was in the best interests of El Paso MLP. In its prior opinion, the Court had noted that the contractual standard under the limited partnership agreement was whether a proposed transaction was in the best interests of El Paso MLP, which meant that the Committee could consider constituencies including employees, creditors, suppliers, customers, the general partner, IDR holders and "of course" the limited partners. The Court's post-trial opinion, however, makes clear that in considering the interests of the limited partners, it is not sufficient to focus only on whether a proposed transaction is accretive to cash distributions. Rather, a rigorous valuation analysis is required and one which, in the present case, took into account prior transactions involving the same assets. The Court noted that the Fall Dropdown related to two separate assets that the Committee should have evaluated separately, and had it done so, it would have realized that it was paying more than it agreed to pay for one of the assets when it was the only asset in the proposed transaction.

In conclusion, the Court's opinion in *El Paso Pipeline Partners L.P.* derivative litigation offers important guidance to conflicts committees and their advisors in dropdown transactions.

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