

Court Rules When Managers Can Waive Their Duty of Good Faith

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A recent decision by the Delaware Court of Chancery underscored the difference between the fiduciary duties of corporate directors and those of managers of alternative entities. Based on a Delaware statute, managers may be entitled to have all of their fiduciary duties waived, with the exception of the implied duty of good faith and fair dealing. Thus, if the parties to a limited partnership agreement take full advantage of the statute, there will be little opportunity, if any, for stakeholders to seek judicial redress for what would, by comparison, subject corporate directors to liability.

In the case of *Employees Retirement System of the City of St. Louis v. TC Pipelines GP, Inc.*, the plaintiff held enough shares in TC Pipelines to qualify as a partner and challenged the sale of a pipeline asset to TC Pipelines, saying that the transaction was unfair and executed in bad faith. The partnership agreement provided that any affiliated transactions were subject to approval by a special committee to determine if they were “fair and reasonable.” Because the special committee approved the transaction, the court found that such approval precludes judicial scrutiny of the substance of the transaction and dismissed the claims.

In addition, the court found that the transaction was fair and reasonable because the require-

ments in the partnership agreement for the approval of conflicted transactions by a special committee were satisfied. For example, the agreement required that the special committee be composed of two or more directors who were neither employees nor security holders. The committee also was required to be fully informed of material facts and had to approve the transaction by majority vote. Compliance with those requirements was not challenged.

The partnership agreement, however, was silent regarding whether the special committee needed to act in good faith. Prior Delaware Supreme Court decisions set the standard for interpreting similar agreements. For example, in *The Haynes Family Trust v. Kinder Morgan G.P., Inc.*, the court reasoned that the plain language of the partnership agreement left no room for judicial scrutiny and that approval was given by a duly constituted and informed conflicts committee. Thus, there was no breach of the agreement. Moreover, when the terms of the agreement do not require the committee to act in good faith, the implied covenant of good and fair dealing will not always provide a substitute remedy.

The Delaware Revised Uniform Limited Partnership Act allows the duties of a partner to be expanded, restricted, or elim-

inated by a partnership agreement. The only duty that cannot be limited or eliminated is the implied duty of good faith and fair dealing. The implied covenant is not, however, a panacea for an unfair agreement. The implied covenant is intended to fill gaps in an agreement in order to address situations that the parties did not contemplate at the time of contracting. In general, the implied covenant cannot be used to form the basis of a claim for breach of terms in an agreement that expressly authorized certain conduct.

To determine whether the implied covenant applies, the court must discern the reasonable expectations of the parties at the time of contracting and cannot rewrite the contract to appease a party who later believes that certain provisions don’t provide them with a good deal. The contract in the TC Pipelines case sets a standard of what is “fair and reasonable,” as determined by the special committee, and there was no gap in the agreement for the implied covenant to fill.

In sum, unlike the directors of a corporation, the managers of a publicly traded limited partnership can be shielded from claims related to a conflicted transaction by the terms of the partnership agreement that waived their fiduciary duties.