

# Managing Related-Party Transactions With Yieldco and MLP Vehicles After *El Paso Pipeline*

Skadden

04/29/15

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

**Lance T. Brasher**

Washington, D.C.  
202.371.7402  
lance.brasher@skadden.com

**Paul S. Kraske**

Washington, D.C.  
202.371.7234  
paul.kraske@skadden.com

**Allison L. Land**

Wilmington  
302.651.3180  
allison.land@skadden.com

**Paul J. Lockwood**

Wilmington  
302.651.3210  
paul.lockwood@skadden.com

**Andrea L. Nicolas**

New York  
212.735.3416  
andrea.nicolas@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

Four Times Square  
New York, NY 10036  
212.735.3000

[skadden.com](http://skadden.com)

Sponsors generally form a yieldco or a master limited partnership (MLP) because the structure of these permanent capital vehicles allows for the issuance of equity to investors at a lower cost of capital, providing a cost-effective financing option. In forming the yieldco or MLP, the sponsor typically maintains control over the vehicle by way of a sole general partner or managing member interest and maintains economic interests in the vehicle. At or before the initial public offering of the vehicle's equity, the sponsor contributes long-term operating assets that are expected to generate stable, low-risk, contracted cash flows that are then regularly distributed to equity holders, including the sponsor. Additional operating assets are added to the vehicle over time through "dropdown" transactions, which typically involve a sale of assets from the sponsor to the vehicle. As a result, related-party transactions are inherent to the structure of these vehicles. To mitigate the risk of successful challenges to these transactions by outside investors, various safeguards in the partnership agreements and other operative agreements governing these vehicles have been widely adopted. One such safeguard for a related-party transaction is to include a review process by an independent "conflicts committee" of the board of directors of the general partner and to limit duties and liability, so long as the committee subjectively believes in good faith that the transaction is in the best interests of the vehicle. As a result, many potential dropdowns from the sponsor to the vehicle are referred to a conflicts committee for negotiation and approval.

The recent post-trial decision of the Delaware Court of Chancery in *In re El Paso Pipeline Partners, L.P. Derivative Litigation* provides useful guidance to sponsors, conflicts committee members and their advisers when considering dropdown transactions and other related-party interactions. In this case, El Paso Corp (sponsor) established an MLP, El Paso Pipeline Partners, L.P. (EP MLP), that sold common units to public investors. EP MLP was controlled by the sponsor through its general partner, El Paso Pipeline GP Co. LLC. The partnership agreement of the EP MLP established a special approval process to address related-party transactions through the use of a conflicts committee of the board of the general partner comprising three independent board members. The standard for the conflicts committee to approve a related-party transaction was that the members of the committee had to believe in good faith that the transaction was in the best interests of EP MLP.

Despite the protection offered by the committee process and the subjective good faith standard, the court concluded that the committee did not subjectively believe that EP MLP's purchase of a 49 percent interest in a pipeline business and a 15 percent interest in another pipeline company in a dropdown transaction were in the best interests of the partnership. The court awarded the common unitholders \$171 million in damages reflecting the lower value of the dropdown assets as determined by the plaintiff's expert.

## El Paso Pipeline Decision

In his post-trial decision, Vice Chancellor Laster closely scrutinized communications among the sponsor, the conflicts committee members and the committee's financial advisor and analyzed the financial advisor's presentations to the conflicts committee and other official documentation of the committee related to approval of the dropdown transactions. In its opinion, the court criticized a number of facts related to the committee process. Although it is unclear how much weight the court gave each fact in reaching its decision, it is worth highlighting some of the concerns raised by the court:

- The court commented on the close relationship and communications between the financial advisor for the conflicts committee and the sponsor. The court concluded that the financial advisor did not provide a fair evaluation of the proposed dropdown

# Managing Related-Party Transactions With Yieldco and MLP Vehicles After *El Paso Pipeline*

transactions and tailored its presentations to the conflicts committee “in the best possible light” to make the price proposed by the sponsor look fair so that the deal would close and the financial advisor could collect its contingent fee.

- In its evaluation of the dropdown transaction, the conflicts committee viewed increasing cash distributions to EP MLP’s unitholders as the appropriate metric for determining if the transaction was in the best interests of EP MLP. The court disagreed. It found that the best interests of EP MLP itself should be the proper focus of the analysis. It also stated that an accretion-based analysis was not the correct analytical framework given that short-term accretion does not address whether the buyer is paying a fair price or whether the dropdown creates value outside of the immediate impact on cash flow.
- The court’s view was that the conflicts committee did not reflect on and apply relevant experience that it had gained in previous dropdown transactions in negotiating the challenged dropdown transaction with the sponsor. In addition, the court concluded that the conflicts committee members did not act on their own views but subordinated those views to the sponsor’s wishes. It also expressed concern about the economic and business connections between two of the members of the conflicts committee and the sponsor, which the court viewed as one indication of the influence the sponsor had over the process. The court cited emails among committee members and other parties, including communications that revealed the abandonment of previously held views regarding the advisability and value of the transaction to EP MLP and, in the court’s opinion, a desire to please the sponsor management.

## Managing Conflicts Committee Process After *El Paso*

The decision in *El Paso Pipeline* serves as a reminder that contractual safeguards to limit duties and liabilities in yieldco and MLP operating agreements must be supported by a thoughtful and documented process to evaluate related-party transactions. Areas of focus for sponsors, yieldcos, MLPs and their advisers in the negotiation and approval of related-party transactions include:

### - Independent financial advisor.

- Establish communications procedures so that it is clear that the financial advisor is instructed by and reports to the conflicts committee.
- Reports and presentations delivered by the financial advisor should evidence an accurate and thoroughly considered financial analysis that is in line with industry standards, and any changes in analytical approach or methodologies should be clearly explained.
- Consideration should be given to using a flat-fee structure rather than a contingent fee, which creates the appearance of bias.

### - Robust analysis and documentation.

- Conflicts committee minutes and materials should demonstrate that the committee made a thorough investigation of relevant data and comparable transactions, free from external influences, and reached a rational and analytically supportable decision. The rationale for changes in the position of the committee members during the course of the negotiation should be clearly detailed.
- The minutes also should reflect an express determination as to whether a related-party transaction provides sufficient value to, and otherwise serves the best interests of, the yieldco or MLP or, depending on the applicable language in the governing documents, its limited partners.
- In addition to the official minutes and reports, a court may look to other contemporaneous communications, such as emails between members of the conflicts committee, as an indication of the members’ views and subjective beliefs.

### - Independence of conflicts committee members.

- Consider all of the connections between the members of the conflicts committee and the sponsor when appointing independent directors, particularly financial or other ties that could call into question the ability of a committee member to make an independent assessment of a related-party transaction with the sponsor.