

Delaware Court of Chancery Dismisses Derivative Suit in Limited Partnership Context for Failing to Make Demand or Show Demand Futility

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In *Inter-Marketing Group USA, Inc. v. Armstrong*, the Delaware Court of Chancery dismissed a derivative suit brought on behalf of a Delaware limited partnership because the plaintiff failed to make demand or show that demand was futile.

Plains All American Pipeline, L.P., a Delaware master limited partnership (the “Partnership”), owned a pipeline that spilled oil in California costing the Partnership hundreds of millions of dollars. As a result, Inter-Marketing Group USA, Inc., a unitholder of the Partnership (the “Unitholder”), brought a derivative suit on behalf of the Partnership for breaches of fiduciary duty, waste of corporate assets, entitlement to contribution, breach of contract, and breach of the implied contractual covenant of good faith and fair dealing against the general partner of the Partnership (the “General Partner”), certain individuals who served as directors of both the Partnership and a parent entity of the Partnership (the “Director Defendants”), and various others that the Unitholder claimed managed the Partnership (collectively, the “Defendants”). The Defendants moved to dismiss the complaint for, among other things, failing to make demand or plead demand futility.

In its analysis, the Court of Chancery applied the well-developed corporate law that exists with respect to the demand requirement by analogy. A plaintiff seeking to assert claims on behalf of a corporation must make a demand on the directors of the corporation to assert the corporate claims unless such demand would be futile. The Unitholder did not make a pre-suit demand and needed to allege particularized facts showing demand futility.

To determine whether demand was futile, the Court analyzed the complaint under the *Rales* test, which applies when a plaintiff challenges an action not taken by the board that would consider the demand. Under *Rales*, a court must determine whether the particularized factual allegations in the complaint create a reasonable doubt that, at the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to the demand.

The Unitholder argued that the Director Defendants were not disinterested because they faced a

substantial likelihood of personal liability. The Court, however, found that the partnership agreement of the Partnership, in accordance with Section 17-1101(d) of the Delaware Revised Uniform Limited Partnership Act, eliminated common law fiduciary duties, which formed the basis for the personal liability that the Unitholder alleged. As such, the Court held that the Director Defendants could not have faced a substantial likelihood of personal liability for breaching duties they did not owe.

The Court also held that the Unitholder failed to adequately allege that a majority of the Director Defendants were not independent. Of the ten directors on the board, the Unitholder made no allegations regarding the independence of three of the directors. The Unitholder argued that four of the Director Defendants had disabling business and pecuniary interests, while the remaining three Director Defendants lacked independence because they served on the Partnership's Audit Committee. The Unitholder argued that because the Partnership violated legal and regulatory requirements in connection with the oil spill, which the Audit Committee was responsible for enforcing, doubt existed as to the independence of the Director Defendants on the Audit Committee. The Court disagreed stating that it is "settled Delaware law that membership on a committee responsible for decisions subject to challenge does not call into question a director's impartiality." Alleging that a director previously approved the challenged transaction, without more, will not call into question the director's ability to consider demand.

The Unitholder also argued that because the Audit Committee failed to ensure the Partnership's compliance with certain legal and regulatory requirements, "cognitive bias" suggested that the Audit Committee would continue to act in a manner consistent with its prior course of action as a means of resisting information that it could have made a bad decision in the past. According to the Court, however, the "cognitive bias" argument required the Unitholder to allege a series of similar transactions that the Defendant Directors knew or had an indication might not be in the best interest of the Partnership. The Unitholder failed to do so and the Court proceeded to dismiss the complaint. The Court did, however, find that the Unitholder showed good cause that dismissal with prejudice would not be just under the circumstances given recent developments and new information arising from criminal charges in California. As such, the Unitholder was permitted to amend its complaint.

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