

June 2020

Follow @Paul_Hastings



Delaware Supreme Court Clarifies Elements of Disclosure Claims in Limited Partner Context

By [Kevin Logue](#), [Kevin Broughel](#) & [Molly Wolfe](#)

On June 23, 2020, the Delaware Supreme Court (the “Court”) in *Dohmen v. Goodman*, No. 403, 2019, reframed and answered in the negative two questions of law certified by the Court of Appeals for the Ninth Circuit: (a) whether, in a Delaware Limited Partnership context, a general partner’s request to a limited partner for a one-time capital contribution constituted a request for limited partner action triggering a fiduciary duty of disclosure, and (b) whether a claim for compensatory damages could be pursued for failure to disclose material information under the circumstances without proof of reliance/causation or actual (and not mere *per se*) damages. The decision provides important Delaware guidance regarding the scope of fiduciary duties a general partner assumes when it communicates with a limited partner, when such duties have not been disclaimed by agreement.

Background

The action involved a hedge fund formed as a Delaware limited partnership (the “Fund”). Under the Fund’s limited partnership agreement, investors in the Fund became limited partners.

The Fund did not perform well. Accordingly, one of the limited partners sued, claiming misrepresentations by the Fund’s general partner in connection with a request to the limited partner for a capital contribution. Specifically, the limited partner alleged that the general partner misrepresented that the Fund would have other investors.

After a bench trial, the federal district court found for the limited partner with respect to his fiduciary duty claim, and held that because the general partner made a misrepresentation “when seeking [limited] partner action” the limited partner was not required to prove reliance or causation to recover damages in connection with his fiduciary duty claim. On appeal, the Ninth Circuit certified variants of the above described questions of law to the Court.

Analysis

The limited partnership agreement at issue did not disclaim or modify fiduciary duties, as is permitted under Delaware law. Accordingly, and consistent with prior precedent, the Court noted that the general partner would be subjected to such fiduciary duties as are applicable in the Delaware corporate context, including the duty of loyalty.¹ In the context of a director request for stockholder action, the Court observed that the duty of loyalty encompasses a disclosure obligation that requires “disclos[ing] fully and fairly all material facts within the[] [directors] control bearing on the request.”² Further, the Court

noted that a breach of this duty of disclosure may entitle a stockholder to equitable relief or nominal damages without a showing of causation or reliance.³

In this case, the Court distinguished between the general partner's request to the limited partner for a capital contribution to the Fund from a request for stockholder action that would trigger a duty of disclosure of all material facts relevant to the action. In particular, the Court held that the general partner's request for a capital contribution from the limited partner was an individual transaction because the limited partner had direct access to the general partner, the limited partner had the Fund's private placement memorandum, and the limited partner and general partner had direct email communications regarding the specifics of the limited partner's contribution. The Court contrasted this type of transaction from one where a director seeks "collective" stockholder action, where it is difficult or impossible for each stockholder to ask and have answered by the corporation its own set of questions.⁴

Having found that the requested limited partner capital contribution would not have imposed a duty to disclose all material facts within the general partner's control without more, the Court nonetheless acknowledged that the general partner was still required to deal honestly with the limited partner, and that the general partner could breach its fiduciary duty of loyalty to the limited partner if it acted with scienter in disclosing false information.⁵ In that regard, based on the findings of the district court reflected in the stipulated facts in the certification request, the general partner had breached its duty of loyalty by falsely misrepresenting to the limited partner that "several other close friends ... are now liquidating some assets in order to participate [in the Fund]."⁶ At the time this statement was made, the general partner knew that it was false, and in making a disclosure that was not required, the general partner could not knowingly disclose false information.⁷

Aside from requiring scienter on the part of the general partner, the Court also clarified that per se damages do not apply to this type of fraud-based disclosure claim where no duty of disclosure applies.⁸ Instead, the limited partner would need to establish reliance, causation, and actual damages to obtain an award of more than nominal damages.⁹

Ramifications

The Court's decision clarifies further the fiduciary duties in the disclosure context owed by general partners to limited partners where those obligations are not modified or disclaimed by the operative limited partnership agreement. Specifically, the Court's opinion underscores that disclosure obligations are defined by the context in which they are made, and that individual transactions between general and limited partners, as opposed to requests by the general partner for collective action, do not trigger an affirmative duty of disclosure on behalf of the general partner. Nevertheless, general partners must still deal honestly with limited partners, and can be liable for breach of fiduciary duty if they knowingly disseminate false information.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings New York lawyers:

Kevin P. Broughel
1.212.318.6483
kevinbroughel@paulhastings.com

Kevin C. Logue
1.212.318.6039
kevinlogue@paulhastings.com

¹ See Op. at 9 (“As a fiduciary, and absent contractual modification, a general partner’s duties to limited partners and the partnership parallel those exercised by directors of Delaware corporations.”).

² *Id.* at 10.

³ See *id.* at 10-11 (“That is, when directors seek stockholder action, and the directors fail to disclose material facts bearing on the decision, a beneficiary need not demonstrate other elements of proof—reliance, causation, or damages.”).

⁴ *Id.* at 16-17.

⁵ See *id.* at 11 (“But under the board’s duties of care and loyalty, the directors must still deal honestly with stockholders. And to state a claim for breach of fiduciary duty in this context, the directors must have knowingly disclosed false information. By requiring scienter, we have sought to distinguish innocent or negligent disclosure violations from those involving an intent to mislead stockholders.”).

⁶ *Id.* at 4.

⁷ *Id.* at 17.

⁸ *Id.* at 23-24 (“[T]he per se damages rule ... cover[s] only breaches of the fiduciary duty of disclosure involving requests for stockholder action that impair the economic or voting rights of investors.”).

⁹ *Id.* at 24.

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2020 Paul Hastings LLP.