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PUBLICLY-TRADED LLCs: THE NEW KID ON THE EXCHANGE

Mary Siegel*

THE rise of LLCs as the business association of choice is well documented.¹ Created to provide a business model that combines freedom of contract, limited liability, and tax choice,² LLCs have soared in popularity, far outpacing the creation of corporations or partnerships, both nationally³ and in Delaware.⁴ Noteworthy in the LLC field is Delaware's departure from the Uniform Limited Liability Company Act (ULLCA)⁵ in one critical respect: the ULLCA permits the reduction but not the elimination of the fiduciary duties of care and loyalty,⁶ while the Delaware LLC Act (DLLCA) allows all fiduciary duties to be eliminated by contract.⁷ Until fairly recently, the debate about the wisdom of complete contractual flexibility was centered on privately-held LLCs.

Of late, a handful of LLCs have gone public,⁸ thereby changing the dimensions of the debate regarding complete contractual freedom. This debate is, no doubt, further framed by the fact that Delaware corpora-

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1. Rodney D. Chrisman, *LLCs Are The New King Of The Hill: An Empirical Study Of The Number Of New LLCs, Corporations, and LPs Formed in the United States Between 2004-2007 And How LLCs Were Taxed For Tax Years 2002-2006*, 15 *FORDHAM J. CORP. & FIN. L.* 459, 459-60, 468-85 (2010) (“[T]he limited liability company . . . is now undeniably the most popular form of new business entity in the United States.”).

2. *Id.* at 466, 485.

3. Winnifred A. Lewis, Note, *Waiving Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 82 *FORDHAM L. REV.* 1017, 1020 n.31 (2013).

4. *Id.* at n.32 (noting that in Delaware in 2011, three times as many LLCs were formed than were corporations).

5. See UNIF. LTD. LIAB. CO. ACT (2006).

6. *Id.* § 105(d)(1).

7. DEL. CODE ANN. tit. 6, § 18-1101(e) (West 2015). Delaware's default rule is that LLC managers owe fiduciary duties. *Id.* § 18-1104.

8. As of September 2013, there were 20 publicly-traded LLCs. Suren Gomtsian, *The Governance of Publicly Traded Limited Liability Companies* 9 (Tilberg Law and Economics Center, Discussion Paper No. 2014-008, 2014). While many of the issues involving Delaware LLCs are also true for Delaware Limited Partnerships (LPs), structural differences affecting unitholder voting rights and stock exchange rules make it unwise to group LPs and LLCs together. See Wells Fargo Securities, LLC, MLP PRIMER 20 (5th ed. 2013); see also NYSE Listed Co. Manual § 303A.00, 2003 WL 23737119, available at http://nysemanual.nyse.com/LCMTTools/PlatformViewer.asp?selectednode=chp_1_4_3&manual=%2Ffcm%2Fsections%2Ffcm-sections%2F.

tions lack the option to eliminate fiduciary duties.⁹ As such, Delaware LLCs may now trade publicly without their managers owing any fiduciary duties, while their counterparts, publicly-traded corporations, may not. After briefly summarizing in Part I the debate involving private LLCs without fiduciary duties and corporations with fiduciary duties, Part II will explore both private responses and regulatory systems that provide oversight of public entities. The Article concludes that an investment in a publicly-traded Delaware LLC is neither irrational nor unprotected despite the entity's total contractual freedom.

I. PART I: SETTING THE STAGE

A. PRIVATE LLCs WITHOUT FIDUCIARY DUTIES

Different views exist regarding the DLLCA's permissive treatment of fiduciary duties. A primary argument in support of this permissiveness is that LLCs are a nexus of contracts, and contract law does not impose fiduciary duties.¹⁰ One article cogently summarized other arguments supporting complete contractual flexibility:

Foremost, in an entity context, "freedom of contract" signifies to a reviewing court that a Delaware LLC is a bargained-for, contractual entity where terms are not uniformly set by statute, but rather terms are dictated by the parties and the marketplace. . . . Second, freedom of contract also represents that parties may bargain in self-interest or freely waive self-interest, if desired. Third, contractual freedom . . . most importantly permits parties to determine for themselves whether to contract or to walk away from the bargaining table due to unfair or untenable terms.¹¹

Furthermore, elimination of fiduciary duties concomitantly eliminates the risk imposed by unforeseen judicial applications of these duties and instead allows for substitution of specific conduct that is contractually mandated.¹² Professor Johnson summarized additional, less tangible, reasons regarding why investors might rationally make this choice:

Many investors may completely understand, reasonably foresee, and yet still be willing to bear, the risks associated with blanket waivers. They may believe that a manager's past performance, desire to protect and enhance his or her reputation, need to access capital markets in the future . . . all coalesce to provide sufficient safeguards against truly egregious misconduct. There is, consequently, a respect-

9. See, e.g., Lyman Johnson, *Delaware's Non-Waivable Duties*, 91 B.U. L. REV. 701, 721 (2011) (noting that even Delaware statutory close corporations, which offer great contractual freedom, cannot contract away fiduciary duties).

10. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); U.C.C. § 1-203 (2004).

11. Ann E. Conaway & Peter I. Tsoflias, *Challenging Traditional Thought: No Default Fiduciary Duties in DE LLCs After Augira*, 13 J. BUS. & SEC. L. 1, 6 (2012); see also *id.* at 12 (noting that imposition of fiduciary duties "counteracts free will and the parties' ability to tailor their deals according to specific desires, businesses, internal operations, and niche ventures, including self-dealing transactions[]").

12. Lewis, *supra* note 3, at 1049.

able policy case to be made for permitting broad fiduciary duty waivers *ex ante*.¹³

Finally, the lack of fiduciary duties does not mean that investors are helpless against unacceptable behavior; they may utilize the array of contract remedies, including the covenant of good faith.¹⁴

Opponents of this permissiveness argue that public policy mandates fiduciary duties in all business associations because one party has control over another's property.¹⁵ As Professor Kleinberger argued: "To . . . uproot fiduciary duty . . . involves a sea of change in: (i) how the law approaches the risks that inherently exist in people entrusting their property . . . into management . . . and (ii) what the law believes possible of contract drafters."¹⁶ Opponents further claim that fiduciary duties are founded in equity, not in contract law.¹⁷

Moreover, opponents argue that the contractarian view is premised on an idealistic and unrealistic view of how an LLC and the governing contract are formed.¹⁸ Opponents further contend that mandatory fiduciary duties decrease transaction costs in the drafting process as parties need not draft for every contingency.¹⁹ Finally, opponents contend that fiduciary duties are the best way to control management misconduct.²⁰ Even if investors agree to eliminate fiduciary duties, they do not "bargain for betrayal."²¹

While the DLLCA departs from the ULLCA in permitting the elimina-

13. Johnson, *supra* note 9, at 721 (internal quotations omitted).

14. Conaway & Tsoflias, *supra* note 11, at 14 (listing reformation of the contract, the doctrine of unconscionability, failure of assent, interpreting terms against the drafter, adhesion contracts, frustration of purpose, and intentional breach of contract to terminate an unsatisfactory contract); Ann E. Conaway, *Lessons to be Learned: How the Policy of Freedom to Contract in Delaware's Alternative Entity Law Might Inform Delaware's General Corporation Law*, 33 DEL. J. CORP. L. 789, 807 (2008) (reasoning that the duty of good faith is the linchpin to the integrity of the contractarian argument); *see also infra* notes 23–27 and accompanying text (discussing reach of the covenant of good faith).

15. Johnson, *supra* note 9, at 712 (citing Sokol Holdings, Inc. v. Dorsey & Whitney, LLP, C.A. No. 3874-VCS, 2009 WL 2501542, at *3 (Del. Ch. Aug. 5, 2009) ("[t]he hallmark of a fiduciary relationship is that one person has the power to exercise control over the property of another"); *In re Atlas Energy Res., LLC*, C.A. No. 4589 VCN, 2010 WL 4273122, at *7 (Del. Ch. Oct. 28, 2010) (due to policy concerns regarding entrusting property to another, courts will assume LLCs have fiduciary duties unless there is explicit language eliminating them).

16. Daniel S. Kleinberger, *Two Decades of "Alternative Entities": From Tax Rationalization Through Alphabet Soup to Contract as Deity*, 14 FORDHAM J. CORP. & FIN. L. 445, 471 (2008); *see also* Sandra K. Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More than a Decade of Experimentation*, 32 J. CORP. L. 565, 603 (2007) (arguing for a system that permits some modification, but not the elimination of the fiduciary duty of loyalty).

17. Lewis, *supra* note 3, at 1044.

18. Johnson, *supra* note 9, at 722 ("There are well-recognized shortcomings with much *ex ante* bargaining. These include lack of sophistication, high initial trust, difficulties of foreseeing opportunism, hesitancy to raise concerns about suspicions, and understandable concerns about creating hard feelings at the outset of a rosy business relationship.").

19. Lewis, *supra* note 3, at 1045.

20. *Id.* at 1044.

21. Johnson, *supra* note 9, at 722.

tion of all fiduciary duties,²² these two statutes agree that good faith will not constitute a fiduciary duty, as it is in corporate law,²³ but will instead be a covenant that cannot be eliminated.²⁴ There is ample caselaw²⁵ and scholarly literature²⁶ delineating the parameters of this covenant, explaining that the covenant can be used only to interpret contract provisions, rather than to supply new terms. As such, there is no dispute that the covenant of good faith is neither broad-based nor equivalent to a fiduciary duty.²⁷

B. MANDATORY FIDUCIARY DUTIES IN CORPORATIONS

While many aspects of Delaware corporate law offer corporations and stockholders contractual freedom,²⁸ the corporate contract fundamentally differs from the DLLCA because Delaware corporations lack the option to eliminate fiduciary duties.²⁹ Thus, directors and officers³⁰ of Delaware corporations owe the corporation the fiduciary duties of care and loyalty, with the latter including the fiduciary duty of good faith.³¹ Corporations may exculpate directors (but not officers) for breaches of the duty of care,³² an option nearly universally chosen,³³ but elimination

22. *Supra* notes 6–7 and accompanying text.

23. *See infra* text accompanying note 31.

24. DEL. CODE ANN. tit. 6, § 18-1101(e) (2011) (preventing agreement from limiting or eliminating liability for bad faith violations of covenant of good faith and fair dealing); UNIF. LTD. LIAB. CO. ACT § 110(c)(5) (2006) (prohibiting operating agreement from eliminating the contractual obligation of good faith and fair dealing).

25. *See, e.g.,* *Nemec v. Shrader*, 991 A.2d 1120, 1125–26 (Del. 2010) (explaining that the covenant of good faith does not allow a party to rewrite a contract, but instead is only a tool to interpret existing terms).

26. *See, e.g.,* Andrew S. Gold, *On the Elimination of Fiduciary Duties: A Theory of Good Faith for Unincorporated Firms*, 41 WAKE FOREST L. REV. 123, 124 (2006) (“Under freedom of contract principles, good faith functions as an interpretive doctrine, not as a source of mandatory obligations.”).

27. Stephen M. Bainbridge, *INSIDER TRADING LAW AND POLICY* 79 (Foundation Press, 1st ed. 2014) (“An implied covenant of good faith arises from the express terms of a contract and is used to fulfill the parties’ mutual intent. In contrast, a fiduciary duty has little to do with the parties’ intent . . . a fiduciary duty requires the party subject to the duty to put the interests of the beneficiary of the duty ahead of his own, while an implied duty of good faith merely requires both parties to respect their bargain.”); *see also* Johnson, *supra* note 9, at 723 (noting that covenant of good faith provides little protection to investors); *Auriga Cap. Corp. v. Gatz Prop., LLC*, 40 A.3d 839, 853 (Del. Ch. 2012), *aff’d*, 59 A.3d 1206 (Del. 2012) (noting the covenant of good faith “is not a tool . . . to govern the discretionary actions of business managers”). *Contra* Conaway, *supra* note 14, at 807 (reasoning that the duty of good faith is the linchpin to the integrity of the contractarian argument).

28. Conaway, *supra* note 14, at 814 (delineating provisions of the Delaware corporate statute that permit contractual flexibility).

29. *Supra* note 9.

30. *Gantler v. Stevens*, 965 A.2d 695, 708 (Del. 2009) (holding that officers owe the same fiduciary duties as do directors).

31. *Stone v. Ritter*, 911 A.2d 362, 369–70 (Del. 2006) (holding that good faith is a subset of the fiduciary duty of loyalty).

32. DEL. CODE ANN. tit. 8, § 102(b)(7) (2011).

33. *See* Geoffrey P. Miller, *A Modest Proposal for Fixing Delaware’s Broken Duty of Care 4* (NYU Center for Law, Econ. and Org., Working Paper No. 09-41, 2009) (“All or virtually all public Delaware companies have opted out of liability, making the possibility

of the right to sue directors for a violation of the duty of care is not equivalent to elimination of this fiduciary duty.³⁴ Thus, in broad terms, the major difference between a Delaware publicly-traded corporation and a Delaware publicly-traded LLC is that directors of a corporation owe a fiduciary duty of care that will likely be exculpated and fiduciary duties of loyalty and good faith that cannot be exculpated, while LLCs have the option to eliminate all fiduciary duties or to retain them and provide limitations for any violation aside from the covenant of good faith.

There are several rationales for imposing mandatory fiduciary duties in corporations. First, the corporate statute is written for public corporations where shareholders' lack of bargaining power makes them dependent on corporate management to act in a manner that benefits investors.³⁵ Second, corporations tend to retain their earnings in order to become self-sustaining after their initial stock offering; as a result, managers of corporations have control over vast sums of money with no mandate to declare dividends to their shareholders.³⁶

Despite these reasons, the logic of mandatory corporate fiduciary duties is easily questioned: why is it against public policy for a corporation to operate without fiduciary duties if investors can achieve that goal through forming an LLC instead of a corporation? Similarly, concerns that investors lack bargaining power or need fiduciary protection from overbearing managers cannot be limited to one business association versus another.

While responses to this obvious contradiction vary,³⁷ there is a strong benefit to mandatory fiduciary duties in corporations: these duties are part of the corporate "brand." Branding benefits potential investors who need not investigate each investment for the existence and contours of management's fiduciary duties.³⁸ As one article explained:

of money damages for violations of the duty of care effectively a dead letter . . ."); John C. Kairis, *DISGORGEMENT OF COMPENSATION PAID TO DIRECTORS DURING THE TIME THEY WERE GROSSLY NEGLIGENT: AN AVAILABLE BUT SELDOM USED REMEDY* 3 (Grant & Eisenhofer P.A. 2011) (noting that nearly all Delaware public and Fortune 500 companies adopted exculpation provisions).

34. *Feeley v. NHAOCG, LLC*, 62 A.3d 649, 664 (Del. Ch. 2012) ("By limiting or eliminating the prospect of liability but leaving in place the duty itself, [such] a provision . . . restricts the remedies that a party . . . can seek. Monetary liability may be out, but injunctive relief, a decree of specific performance, rescission, the imposition of a constructive trust, and a myriad of other non-liability-based remedies remain in play.").

35. Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 142-43 (2009) ("[C]orporations need fiduciary duties . . . to address the misalignment of managers' incentives with those of their owners.").

36. Gomtsian, *supra* note 8, at 29 ("The practice of paying high dividends did not allow [the LLC to] retain[] earnings and accumulate[] cash similar to corporations.").

37. While some would respond to this contradiction by reasoning that all business associations should have mandatory fiduciary duties, *see supra* note 15 and accompanying text, LLCs' and corporations' different financing methods provide a plausible rationale for different fiduciary needs. *See supra* text accompanying note 36.

38. John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1678 (1989) ("[S]tandardization of contract terms through the use of mandatory legal rules reduces information costs for investors.").

Merely by branding itself as a Delaware corporation, a firm can signal easily that it has certain core characteristics that provide basic protections to investors. Anyone contemplating buying shares of stock in a Delaware corporation can be confident, without having to obtain and examine the certificate of incorporation, that the directors . . . will be subject to a duty of loyalty By contrast, anyone contemplating buying interests in a limited liability company . . . can have no such confidence without carefully examining the governing agreement. Thus, if the core characteristics of the corporate form were not mandatory, the signaling value of the brand would be lost.³⁹

Based on the commanding position Delaware holds as the leading state for incorporation for publicly-held companies,⁴⁰ there is little incentive for Delaware to change its corporate brand.

II. PART II: THE NEW PLAYER: PUBLIC LLCs WITHOUT FIDUCIARY DUTIES

The advent of Delaware publicly-traded LLCs without fiduciary duties has not yet generated headlines. While the Delaware Supreme Court has upheld this waiver of fiduciary duties in publicly-traded LLC's without much fanfare,⁴¹ Vice Chancellor Noble noted, perhaps reluctantly, that publicly-traded entities that lack fiduciary duties may “permit self-dealing transactions . . . with almost no oversight by this Court. . . . The General Assembly has decided that this Court has only a limited role in protecting the investors . . . and that is a role this Court must accept.”⁴²

Early on, some academics raised alarms about the potential dangers of complete contractual freedom when business associations go public. Several scholars—although focused on both publicly-traded Limited Partnerships as well as LLCs—concluded that minority owners are vulnerable to abuse.⁴³ These articles expressed concern that non-corporate business associations did not offer rights or benefits to minority owners to offset the

39. Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 847 (2008).

40. “More than 50% of all publicly-traded companies in the United States including 65% of the Fortune 500 have chosen Delaware as their legal home.” See About Agency, DELAWARE.GOV, <http://corp.delaware.gov/aboutagency.shtml> (last visited Nov. 12, 2014).

41. Wood v. Baum, 953 A.2d 136, 141 (Del. 2008) (reviewing the case de novo but accepting without any review the publicly-traded LLC's right to waive all fiduciary duties).

42. Gerber v. Enter. Prod. Holdings, LLC, CA No 5989-VCN, 2012 WL 34442, at *10 n.42 (Del. Ch. Jan. 6, 2012).

43. Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J. CORP. L. 555, 558 (2012) (cautioning that LPs and LLCs either waived fiduciary duties or exculpated managers without counter-vailing mechanisms to protect minority investors); Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879, 924 (2012) (concluding that LLC agreements eliminated managers' liabilities while owners lacked buyout rights); see also Lawrence A. Hamermesh & Ruby R. Vale, *The “Outer Reaches” of Allowable Conduct? Or “You Ain't Seen Nuthin' Yet?”*, WIDENER L. BLOG (Jan. 17, 2012), <http://blogs.law.widener.edu/delcorp/2012/01/17/the-%E2%80%9Couter-reaches%E2%80%9D-of-allowable-conduct-or-%E2%80%9Cyou-ain%E2%80%99t-seen-nuthin%E2%80%99-yet%E2%80%9D/#sthash.REqmJGs4.dpbs>.

dominant rights granted to the majority owners and the elimination of fiduciary duties.⁴⁴ Similarly, Professor Horton concluded that noncorporate investors face higher risks of being squeezed out than do their corporate counterparts.⁴⁵

With these warnings, why would investors choose to invest in publicly-traded LLCs? The reasons are varied: private-ordering responses; the regulatory system in which any publicly-traded entity operates; and concerns about corporate fiduciary duties.

A. PRIVATE-ORDERING RESPONSES

If one drills down on the early conclusion that investors in publicly-traded LLCs are vulnerable due to the LLC's contractual freedom, much of these concerns evaporate by examining the LLCs' response to this freedom. When Professor Gomtsian conducted the most recent study of publicly-traded LLCs to ascertain whether "the founding and controlling members use the statutory default rules to create governance structures that entrench their control, limit their accountability or are potentially oppressive towards outside investors in any other way,"⁴⁶ his answer was no.⁴⁷

First, although LLCs can eliminate all fiduciary duties, Gomtsian reported that only three of the twenty publicly-traded LLCs had done so for managers.⁴⁸ Gomtsian also reported that while all twenty had provided for some exculpation from liability, only one LLC exculpated for all types of violations.⁴⁹ The other nineteen LLCs all exculpated for breaches of the duty of care;⁵⁰ various LLCs excepted from exculpation violations of the duty of loyalty, acts in bad faith, and/or knowing violations of the law,⁵¹ and sixteen LLCs created conflict-of-interest rules for managers.⁵² While Delaware permits only corporate directors to be exculpated,⁵³ sixteen LLCs exculpated officers as well.⁵⁴ In sum, as the vast majority of LLCs did not use their contractual freedom either to eliminate fiduciary duties or to provide total exculpation, the primary difference from corporations was that LLCs extended exculpation to officers.

44. See, e.g., Manesh, *supra* note 43, at 596–97.

45. Brent J. Horton, *The Going-Private Freeze-Out: A Unique Danger for Investors in Delaware Non-Corporate Business Associations*, 38 DEL. J. CORP. L. 53, 61 (2013) (concluding 58.82% of LLCs agreements and 94.2% of LP agreements create higher risks for investors being frozen out than are corporate shareholders because managers of these non-public, non-corporate entities lack fiduciary duties).

46. Gomtsian, *supra* note 8, at 2.

47. *Id.* at 28.

48. *Id.* at 14; see also Manesh, *supra* note 43, at 604–13 app. B (reporting that four of the twelve publicly-traded LLCs as of 2011 had waived all fiduciary duties).

49. Gomtsian, *supra* note 8, at 14–15.

50. *Id.*

51. *Id.*

52. *Id.* at 39.

53. DEL. CODE ANN. tit. 8, § 102(b)(7) (2011) (permitting exculpation for directors but not for officers).

54. Gomtsian, *supra* note 8, at 39.

Second, while fiduciary duties and exculpation form the nucleus of governance concerns, corollary management issues also exist. Specifically, LLCs could use their contractual freedom to entrench management's control to the detriment of investors. Gomtsian reported that 65% of the listed LLCs had strong management control rights.⁵⁵ In order to discipline management, however, 45% committed to mandatory quarterly distributions⁵⁶ and 80% regularly declared dividends.⁵⁷ As Professor Gomtsian reasoned:

[D]ividend payment obligations and practices are an important element in the governance structure of publicly traded LLCs and are used to mitigate the conflicts of interests between controlling members and outside investors. The large share of cash payments to LLC members limits the discretion of the managers and controlling members, while high dividend incomes compensate outside investors for poor corporate governance practices.⁵⁸

Moreover, frequent dividend declarations create another ancillary monitor: LLCs must return to the capital markets to replenish their funds.⁵⁹ Success in raising capital necessitates an investor-friendly reputation sufficient to offset risks created by the LLC's governance structure.⁶⁰ One author synthesized well the connection between governance and capital: “[p]ass-through businesses have to be far more intertwined with investors. Staying alive means routinely inhaling capital, as well as exhaling.”⁶¹

Finally, in response to Professor Horton's conclusion that minority shareholders in publicly-traded LLCs face higher freeze-out risks when managers have eliminated fiduciary duties,⁶² the short answer is that only

55. *Id.* at 4, 9–10 (delineating control devices, such as contracts to appoint the majority of the directors, limiting the right to remove directors, or requiring supermajority voting).

56. *Id.* at 40; *see also* Manesh, *supra* note 43, at 614 app. C (specifying that five of twelve listed LLCs mandated distributions of all profits).

57. Gomtsian, *supra* note 8, at 23 (reporting that only four LLCs regularly retained earnings).

58. *Id.* at 24.

59. *Id.* 26–28 (noting that public LLCs must continuously access capital); Manesh, *supra* note 43, at 565 (linking distributions with returning to the markets to raise additional funds); Larry E. Ribstein, *THE RISE OF THE UNINCORPORATION* 209 (2010) (finding that mandatory distributions force LLCs to turn to the market for new funding); *see also* Larry E. Ribstein *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 140 (2009) (framing required distributions as owners' most important right due to the resulting exposure to capital markets); John Goodgame, *Master Limited Partnership Governance*, 60 BUS. LAW. 471 (2005) (discussing systemic reliance on capital markets for entities with mandatory distributions); *cf.* Wells Fargo Securities, LLC, *supra* note 8, at 11 (attributing growth in the offerings of MLPs, including listed LLCs and LPs, in part to “distribut[ions of] the majority of their cash flow[]”).

60. Gomtsian, *supra* note 8, at 26; *see also id.* at 28 (“Ownership and capital structures were actively used by listed LLCs to mitigate adverse selection, moral hazard and agency issues, and make the public offering of shares representing LLC interests attractive for outside investors.”).

61. *The Rise of the Distorporation*, *ECONOMIST*, Oct. 26, 2013.

62. Horton, *supra* note 45, at 61.

three of twenty LLCs totally eliminated fiduciary duties.⁶³ Nevertheless, Professor Horton's concern remains, given that none of the LLCs provided appraisal rights to dissenting owners,⁶⁴ and six used their contractual freedom to lower slightly the percentage of stock that must be owned under Delaware corporate law in order to squeeze out minority owners without a stockholder vote.⁶⁵ These concerns dissipate, however, because the high cost of the appraisal remedy limits its usefulness,⁶⁶ and the choice of only six LLCs to lower slightly the squeeze-out percentage is not significant. As a result, Gomtsian concluded: "contractual freedom . . . contrary to the expectations, has not led to an extensive lowering of the bar in the protection of the rights of investors in financial markets."⁶⁷ Furthermore, minority investors receive some protection from the securities laws' going-private rules.⁶⁸

B. THE REGULATORY SYSTEM FOR PUBLICLY-TRADED ENTITIES

Even if a listed LLC lacks fiduciary duties, its managers are not unregulated. Publicly-traded entities operate under layers of oversight that do not apply to private entities. Specifically, the Securities Exchange Act of 1934 ('34 Act) and the stock exchanges each impose governance rules, and the stock market will mete out some degree of discipline.

The hallmark of securities regulation is mandated disclosure of all material facts. While not all public entities have identical disclosure obligations,⁶⁹ an LLC's registration statement will disclose the lack of fiduciary duties.⁷⁰ Thereafter, certain '34 Act rules apply to all public entities.⁷¹

63. *Supra* text accompanying note 48.

64. Gomtsian, *supra* note 8, at 12.

65. *Id.* (stating that six LLCs provided squeeze-out rights when a member owned more than 80% of the voting rights). In contrast, under Delaware corporate law, a shareholder must own 90% of the voting stock to effectuate a squeeze-out. DEL. CODE ANN. tit. 8 § 253 (2011).

66. Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79, 82 (1995) (discussing the high cost of exercising appraisal rights).

67. Gomtsian, *supra* note 8, at 28. *But see* Manesh, *supra* note 43, at 596 (concluding that LLC managers have used their contractual freedom without corresponding checks or incentives to discipline management).

68. *See infra* note 78 and accompanying text.

69. *See, e.g.*, 17 C.F.R. § 240.14a-21(a)-(c) (2011) (permitting Emerging Growth Companies (EGCs) to phase into executive compensation and financial disclosures, as well as into new accounting standards); 15 U.S.C. §§ 78m(a), (d), (e), 78n(a), (c), (d), (f), 78p(a) (2012) (limiting §§ 13, 14 and 16 to § 12(g) companies, thereby exempting § 15(d) filers from these requirements).

70. Given that the definition of a material fact is what "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available," *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), the elimination of fiduciary duties would be deemed material. A registration statement must disclose all material facts. *See* 15 U.S.C. § 77aa (2012) (listing required information to be disclosed in a registration statement).

71. *See, e.g.*, 15 U.S.C. § 78j-1(m) (requiring exchanges to mandate an independent audit committee for all listed companies); 17 C.F.R. § 240.13a-1 (2003) (requiring annual reports from §§ 12(b) and 12(g) filers); 17 C.F.R. § 240.13a-14(c) (2003) (requiring certifications of annual reports for §§ 12(b) and 12(g) filers); 17 C.F.R. § 240.15d-1 (requiring

Moreover, additional rules for listed LLCs⁷² will apply.⁷³ Among these myriad rules are some that relate to governance, such as disclosure of executive compensation,⁷⁴ and mandated certifications attesting to the veracity of various financial reports.⁷⁵

The '34 Act's going-private rule best demonstrates how disclosure may constrain management's behavior.⁷⁶ Under Delaware law, those in control must provide both fair dealing and a fair price to minority shareholders in a going-private transaction.⁷⁷ Similarly, the '34 Act's going-private rule requires the issuer to respond to questions about its going private process;⁷⁸ since an issuer might be embarrassed responding that it had not taken steps to assure fairness, the disclosure rules "persuade" the issuer to commit to a process likely to offer fair dealing and a fair price.

Stock exchange listing requirements also provide mechanisms to monitor management's conduct. The New York Stock Exchange, for example, imposes on all listed entities certain core governance standards,⁷⁹ such as maintaining an audit committee and disclosing governance standards, but allows some entities, including qualified LLCs,⁸⁰ to claim exemptions from other standards. While not a *quid pro quo* for fiduciary regulation,

annual reports from § 15(d) filers); 17 C.F.R. § 240-15d-14(c) (2003) (requiring certifications of annual reports for § 15(d) filers).

72. See 15 U.S.C. § 781(b) (requiring registration if an issuer lists a class of securities on a national securities exchange); *cf. supra* note 69 (noting ECGs are given more time to phase into some reporting requirements); *see also* 15 U.S.C. § 781(g)(1)(a)–(b) (requiring under § 12(g) entities that have "total assets exceeding \$10,000,000 and a class of equity securities . . . held of record by either 2,000 persons, or 500 persons who are not accredited investors" to comply with all rules of the '34 Act, although ECGs are given more time to phase into some requirements; *supra* note 69 (discussing ECGs)).

73. Since the twenty LLCs discussed in this article are publicly-traded, Gomtsian, *supra* note 8, at 9, all will be subject to section 12(b) registration requirements. *See supra* note 72.

74. See 17 C.F.R. § 240.14a-21 (2011) (requiring §§ 12(b), 12(g) and 15(d) filers to comply with "say-on-pay" rule).

75. See 17 C.F.R. § 240-13a-14 (2003) (requiring §§ 12(b), 12(g) and 15(d) filers to provide CEO and CFO certifications).

76. See 15 U.S.C. § 78m (2012) (limiting requirements for going-private transactions to §§ 12(b) & 12(g) companies).

77. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983) (explaining that fair dealing concerns timing, structure and negotiations, and fair price concerns all relevant economic factors).

78. 17 C.F.R. § 229.1014(a), (c)–(d) (1979) (mandating disclosure of whether issuer "reasonably believes that the . . . transaction is fair or unfair to unaffiliated security holders," including specifying whether a majority of unaffiliated shareholders approved, and whether unaffiliated directors negotiated on behalf of minority shareholders).

79. See NYSE Listed Company Manual, *supra* note 8 (requiring that all listed companies comply with § 303A.00, but only certain provisions are mandatory for all listed entities).

80. A qualified LLC must either be a "Controlled Company," where 50% of the voting power for the election of directors is held by an individual, a group, or another company, or the LLC lists preferred or debt securities on the exchange. *See* NYSE Listed Company Manual, *supra* note 8 (specifying exemptions for "Preferred and Debt Listing" and for "Controlled Companies"). Since the majority of the twenty publicly-listed LLCs in 2012 employed mechanisms to control the board, Gomtsian *supra* note 8, at 9–10, the majority of LLCs would likely qualify as "Controlled Companies."

listing requirements provide a structure for good management.⁸¹

Finally, the stock market provides some oversight of management's conduct. If the LLC trades in an efficient market,⁸² the market's response to management's misconduct will lower the price of the LLC interests.⁸³ A lower price not only hurts management whose compensation may be tied to stock prices, but also may invite unwanted takeover bids.⁸⁴ While it is more likely that the LLC will trade in an inefficient market,⁸⁵ even this scenario will mete out some degree of discipline as inefficient markets still respond to material information.⁸⁶ Furthermore, as discussed above,⁸⁷ since LLCs commonly distribute income to their owners and therefore must continuously return to the capital markets, success in subsequent efforts to raise capital will require managers to have established an investor-friendly reputation: "market disciplining strongly, perhaps stronger than in listed corporations . . . influences the governance of publicly traded LLCs."⁸⁸

C. REFLECTIONS ON CORPORATE FIDUCIARY DUTIES

As noted above,⁸⁹ fiduciary duties are endemic to corporations. The reasons for mandatory fiduciary duties vary, but the corporate financial model of retaining substantial portions of earnings⁹⁰ results in huge pools of capital that would raise concerns if managers who oversaw these pools lacked fiduciary duties. In other words, the corporate financial model necessitates accountability that is served, at least partially, by mandatory fiduciary duties. Since listed LLCs work from a different financial model, there is reason to question whether fiduciary duties are necessary for both models.

81. See, e.g., NYSE Listed Company Manual, *supra* note 8, which requires a majority of independent directors, § 303A.01, a nominating/corporate governance committee composed entirely of independent directors, § 303A.04, and a compensation committee composed entirely of independent directors, § 303A.05, but allows exemptions that many LLCs would meet, § 303A.00. Despite the availability of an exemption, many qualified LLCs voluntarily complied with most or all standards. See Gomtsian, *supra* note 8, at 25.

82. *Cammer v. Bloom*, 711 F. Supp. 1264, 1270, 1276 (D.N.J. 1989) (quoting *Harman v. Lymphomed, Inc.*, 122 F.R.D. 522, 525 (N.N.Ill 1988)) (defining efficient market as open, i.e., a large number of shares can be purchased and sold, and developed, i.e., a high level of trading activity, where "material information on the company is widely available and accurately reflected in the value of the stock[]").

83. *Id.* at 1286–87 (describing an efficient market as reporting immediate movement of stock prices after unexpected corporate events or financial releases).

84. *Conaway*, *supra* note 14, at 805 (correlating poor governance to lower stock prices, thereby rendering entity vulnerable to hostile takeovers).

85. LLCs typically trade in an inefficient market because of their concentration of ownership, limited floats and low levels of trading activity. Gomtsian, *supra* note 8, at 32; see *supra* note 82 (defining efficient market).

86. Bradford Cornell, *Market Efficiency and Securities Litigation: Implications of the Appellate Decision in Thane*, 6 VA. L. & BUS. REV. 237, 251 (2011) (finding that inefficient markets react to important information).

87. *Supra* notes 57–60 and accompanying text.

88. Gomtsian, *supra* note 8, at 26.

89. *Supra* text accompanying note 9.

90. *Supra* text accompanying note 36.

Moreover, the frequency of litigation over fiduciary duties in corporate deals is breathtaking. One article reported:

Multiple teams of plaintiffs file lawsuits challenge virtually every public company merger. . . . In 2012, 93% of deals over \$100 million and 96% of deals over \$500 million were challenged In 2013 . . . 97.5% of deals over \$100 million were challenged . . . and each transaction triggered an average of seven separate lawsuits.⁹¹

Not only do other scholars reporting similarly-staggering statistics,⁹² but one article reported that “merits count for little in the decision to bring a fiduciary suit”⁹³ Therefore, investors may rationally believe that an LLC without fiduciary duties will attract less risk-averse managers who will govern without fear of nuisance litigation. Investors can further capitalize on this logic by using the LLC’s contractual flexibility to shield both officers and directors.⁹⁴

III. CONCLUSION

The Delaware legislature has offered an array of limited liability business associations. The substantial differences between LLCs and their corporate counterparts, particularly on the freedom to eliminate fiduciary duties, should not cast LLCs either as predatory or as harbingers of a better business association. LLCs simply depart from corporate norms.

Equally valid is that investors who choose to buy into listed Delaware LLCs are not unprotected. The choice of only three listed LLCs to eliminate fiduciary duties suggests that entrepreneurs believe fiduciary duties are necessary to attract investors. Moreover, even if an LLC eliminates fiduciary duties or expands exculpation coverage, securities and stock exchange rules provide their own monitors. Finally, regardless of the degree of efficiency of the market in which the LLC trades, the market provides added protection for investors.

Nor can investors of listed Delaware LLCs be deemed irrational. It is not surprising that investors and managers view corporate litigation warily, and seek a different model.⁹⁵ Moreover, when one compares public LLCs and public corporations, one factor dominates: LLC owners have received “double or triple the market average” in dividends.⁹⁶ Although

91. Steven Davidoff Solomon, et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform* 2 n.6 (U. Penn. Inst. For Law & Econ., Working Paper No. 14-4, 2014).

92. See, e.g., Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2013* (Ohio State Pub. Law Working Paper No. 236, 2014, available at <http://ssrn.com/abstract=2377001>) (showing takeover litigation in 98% of deals in 2013).

93. Minor Myers & Charles Korsmo, *The Structure of Stockholder Litigation: When Do The Merits Matter?*, 75 OHIO STATE L.J. 829 (2014).

94. See *supra* text accompanying note 32 (specifying that Delaware corporations can exculpate directors but not officers).

95. Cf. *The Rise of the Distorporation*, ECONOMIST, Oct. 26, 2013 (noting that non-corporate entities give management greater flexibility in structuring transactions).

96. *Id.*; see also Wells Fargo Securities, LLC, *supra* note 8, at 11 (comparing median yields of 6.5% in MLPs, which includes listed LLCs, to S&P 500 yields of 2%).

no study has differentiated financial returns based on whether the LLC maintained or eliminated fiduciary duties, the most recent study showing that only three of twenty publicly-traded LLCs had eliminated fiduciary duties suggests little correlation.

The point is not that monitors or distributions replicate the benefits of fiduciary duties. Instead, the point is that investors appear to be compensated for their risks, and those risks are further mitigated by private ordering, federal regulation, and the stock market. Thus, the contractual freedom afforded publicly-traded LLCs allows investors to calibrate their investment vehicle to their preference for risk and return.