LEGAL ASYMMETRY AND THE END OF CORPORATE LAW

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ABSTRACT

Before 2007, it was generally accepted wisdom that publicly held firms were organized as corporations, subject to the usual rules, checks, and balances of standard corporate law. The 2007 initial public offerings (IPOs) of the private equity firms Blackstone, Fortress, and Och-Ziff, however, challenged this notion.

While almost all publicly held firms are organized as corporations, Blackstone, Fortress, and Och-Ziff are each organized as noncorporations—a limited partnership in the case of Blackstone and limited liability companies in the cases of Fortress and Och-Ziff. Historically, private equity has used the noncorporate form for tax reasons. Under the federal tax code, noncorporations enjoy pass-through tax treatment, avoiding tax at the entity level that would otherwise reduce their investors' returns.

Noncorporations, however, also avoid another key feature of the corporate regime: the law of fiduciary duties. Under the corporate law of Delaware, the state in which a majority of publicly traded companies are incorporated, corporate managers owe shareholders the fiduciary duties of care, loyalty, and good faith. Although Delaware's corporate statute generally provides default rules from which parties can choose to deviate, the fiduciary duties binding corporate managers are unwaivable. In contrast, Delaware's noncorporate statutes permit noncorporate firms to opt out of the fiduciary regime by eliminating such duties wholesale.

The 2007 IPOs, thus, highlight a curious asymmetry in the law: in both substantive and structural respects, public noncorporations can resemble their corporate counterparts. Yet, unlike corporations, noncorporations are able to avoid one of the basic precepts, and arguably most cumbersome obligation, of corporate law.

Academics and practitioners have long debated the need for fiduciary duties in corporate law. This article eschews that tired debate and argues that, as a practical matter, the asymmetry between the fiduciary duties of corporate and noncorporate law today reflects nothing more than a substanceless vestige. Law and businesses have together evolved in ways

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that have blurred any distinctions between corporations and their noncorporate counterparts. Whatever the costs or benefits of fiduciary duties, the 2007 IPOs demonstrated that large firms and their managers seeking access to the capital of public markets now have a ready way to avoid the fiduciary duties imposed by corporate law—the noncorporate form. As a result, today, the legal asymmetry between corporations and noncorporations has been reduced to a hollow and archaic formalism—one that, if it subsists, portends an existential challenge to the continuing relevance of corporate law and the corporate form.

TABLE OF CONTENTS

I. INTRODUCTION

The initial public offering (IPO) of Blackstone Group was no ordinary event. "After months of hype, hoopla and controversy,"[1] investor interest was at a fever pitch, "[r]eminiscent of the heady dot-com days of the late 1990s."[2] Shares were six to seven times oversubscribed.[3] Wall Street analysts were ecstatic. "There's going to be huge demand," predicted one market watcher.[4] "Investors [will be] tripping over themselves," quipped another.[5] The press was equally excited, treating the IPO "like a Hollywood premiere."[6] At the New York Stock Exchange, "television trucks from networks around the world lined up to report [on] the offering."[7] Even celebrity-novelist Tom Wolfe took note of the occasion, paying a visit to the floor of the stock exchange on the first day of Blackstone's trading—in his trademark white suit—to witness, as he put it, "the end of capitalism as we know it."[8] Mr. Wolfe's hyperbole aside, Blackstone's IPO was indeed extraordinary. The IPO raised $4.13 billion, the largest domestic IPO of the last five years, and the sixth largest in United States history.[9]

Blackstone was the second of three private equity firms to go public in the United States in 2007.[10] Fortress Investment Group, a private equity

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[1]Andrew Ross Sorkin, *A Glamorous Public Debut for Blackstone*, N.Y. TIMES, June 23, 2007, at C3.

[2]David Cho, *Private-Equity King Blackstone to Test Roiling Public Waters*, WASH. POST, June 22, 2007, at A1.

[3]Alistair Barr, *Blackstone IPO Shows Strong Demand, Sources Say*, MARKETWATCH, June 21, 2007, http://www.marketwatch.com/news/story/blackstone-ipo-shows-strong-demand/story.aspx?guid={89E45F50-03E4-482F-95E6-200149F928D6}.

[4]Greg Farrell & Matt Krantz, *Anticipation for Blackstone IPO Saturates Street*, USA TODAY, June 22, 2007, at 1B (quoting Professor Reena Aggarwal from Georgetown's McDonough School of Business).

[5]Cho, *supra* note 2; *see also* Michael J. de la Merced, *Blackstone to Set a Stock Offering Price Sooner than Expected*, N.Y. TIMES, June 20, 2007, at C2 (regarding the Blackstone offering, one analyst stated that "the deal is going to be on all institutions' must-buy list").

[6]Sorkin, *supra* note 1.

[7]*Id.*

[8]*Id.*; *see also* Andrew Ross Sorkin, *A "Bonfire" Returns as Heartburn*, N.Y. TIMES, June 24, 2008, at C1 (reporting a year later that although "it may not be the end of capitalism, it looks as if Mr. Wolfe got it a lot closer than . . . the investors").

[9]*See* Kristen A. Lee & Dan Seymour, *Shares in Blackstone Rise 13 Percent in Stock Market Debut*, INT'L HERALD TRIB., June 22, 2007; Michael J. de la Merced & Andrew Ross Sorkin, *Blackstone Rival Plans Own I.P.O.*, N.Y. TIMES, June 22, 2007, at C1.

[10]At least three other private equity firms have also "gone public," albeit in less traditional transactions. In 2007, GLG Partners, a European hedge fund, went public in the United States through a $3.4 billion merger with a publicly traded U.S. entity. *See* Michael J. de la Merced, *Hedge Fund Based in London to Go Public in United States*, N.Y. TIMES, June 25, 2007, at C2. More recently, in 2008, Apollo Global Management went public by initially selling and listing its

firm known for its hedge fund operations, was the first, raising over $634 million in its February 2007 IPO.[11] In November 2007, despite tightening credit markets and the resulting decline in its predecessors' stock price, Och-Ziff Capital Management went public, raising $1.15 billion.[12]

Together, the IPOs of Blackstone, Fortress, and Och-Ziff marked the emergence of an oxymoronic phenomenon: the public ownership of private equity.[13] Before the 2007 IPOs, average investors were shut out of the private equity boon. Instead, private equity was the exclusive club of big money, limited to super-rich individuals and large institutional investors,[14] groups whom public securities laws have traditionally deemed to be financially sophisticated and therefore beyond the purview of regulatory protection.[15] Investments in private equity were lucrative but relatively illiquid, transferable in only limited circumstances, and often requiring the

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shares on the private GSTrUE market, and later registering those shares on the New York Stock Exchange. *See* Posting of Andrew Ross Sorkin to DealBook, http://dealbook.blogs.nytimes.com/2008/04/10/the-un-ipo/ (Apr. 10, 2008, 8:21 EST). Also in 2008, Blackstone's venerable rival, Kohlberg Kravis Roberts (KKR) went public by acquiring its publicly traded affiliate in a cashless share exchange, issuing partnership units in KKR as consideration for the affiliate's shares. *See* Posting of Steven M. Davidoff to DealBook, http://dealbook.blogs.nytimes.com/2008/07/31/plumbing-the-kkr-un-ipo/ (July 31, 2008, 15:37 EST). The transaction had the effect of converting the affiliate's public shareholders into public shareholders of KKR. Andrew Ross Sorkin, *After Delay, Buyout Firm Finds a Way to Go Public*, N.Y. TIMES, July 28, 2008, at C1. To keep the scope, focus, and length of this article manageable, these other firms are not considered.

[11] *See* Michael J. de la Merced, *Fortress Goes Public, A First for Hedge Funds Inside U.S.*, N.Y. TIMES, Feb. 9, 2007, at C2; Dan Seymour, *In a First, Hedge Fund Launches on NYSE; Fate of Fortress Eyed Closely by Peers*, WASH. POST, Feb. 10, 2007, at D1.

[12] Jenny Anderson & Michael J. de la Merced, *Unfazed by Market Ills, Hedge Fund Has Debut*, N.Y. TIMES, Nov. 14, 2007, at C3; Gregory Zuckerman & Lynn Cowan, *Och-Ziff Shares Slip in Debut but Yield $1 Billion for a Founder*, WALL ST. J., Nov. 15, 2007, at C3.

[13] *Cf.* Larry E. Ribstein, *The Rise of the Uncorporation* 35 (Univ. of Ill., Law & Econ. Working Paper No. 83, 2007), *available at* http://ssrn.com/abstract=1003790 (quoting Michael Jensen to describe the idea of private equity going public as a "non-sequitur both in language and economics").

[14] *See* Daniel Arnall, *Blackstone IPO: Private Equity 101*, ABCNEWS, June 21, 2007, http://abcnews.go.com/Business/IndustryInfo/Story?id=3303405&page=1. *See also* Michael J. de la Merced, *First Offering of a Hedge Fund Is Bid Up 67% on Opening Day*, N.Y. TIMES, Feb. 10, 2007, at C2 (noting that the Fortress IPO "was eagerly anticipated because it gives a much bigger pool of investors the opportunity to share in the returns of hedge funds and private equity[,] . . . [which previously were] limited to the very wealthy and to large institutional investors").

[15] *See* de la Merced, *supra* note 11 ("Securities regulations that restrict . . . [private equity] investors to the very wealthy and institutions like endowments and pension funds have furthered the mystique of the [private equity] funds."); Tomoeh Murakami Tse, *Investment Firms Open to the Masses, But Should You Buy?*, WASH. POST, Apr. 8, 2007, at F1 ("Until now, most [ordinary] investors have been excluded from the alternative investment game by federal securities law, which limits access to sophisticated investors such as pension funds, university endowments and wealthy individuals."). *See also infra* note 80 and accompanying text (establishing that both public securities statutory and case law have ensured that investors are financially sophisticated).

consent of the private equity fund's manager.[16] The 2007 IPOs, however, democratized private equity, allowing ordinary investors to freely buy and sell the shares of Blackstone, Fortress, and Och-Ziff on public exchanges just like any other public company.

But Blackstone, Fortress, and Och-Ziff are not just like any other public company.[17] While almost all publicly traded companies are organized as corporations, Blackstone, Fortress, and Och-Ziff are each organized as *noncorporations*[18]—a limited partnership (LP) in the case of Blackstone and limited liability companies (LLCs) in the case of Fortress and Och-Ziff. Historically, private equity has used the noncorporate form for tax reasons.[19] Under the federal tax code, noncorporations enjoy pass-through tax treatment, avoiding tax at the entity-level that would otherwise reduce their investors' returns.

Noncorporations, however, also avoid another key feature of the corporate regime: the law of fiduciary duties. Under the corporate law of Delaware, the state in which a majority of publicly traded companies and sixty percent of the Fortune 500 are incorporated,[20] corporate managers owe

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[16]There is, however, an emerging private market for trading interests in private equity called the Portal Alliance. *See* David Cho, *Nasdaq Gives High Rollers a Market Free of Regulation*, WASH. POST, Aug. 14, 2007, at A1; *12 Firms Unite for Trading in Unregistered Securities*, N.Y. TIMES, Nov. 13, 2007, at C6. The market takes advantage of the unregistered securities resales permitted by Rule 144A, adopted by the Securities and Exchange Commission under the Securities Act of 1934. Rule 144A allows resales among Qualified Institutional Investors, generally defined to include institutional investors with investable assets in excess of $100 million. *See* 17 C.F.R. § 230.144A(a)(iv) (2009).

[17]Indeed, the Blackstone registration statement makes clear that it will be "a Different Kind of Public Company." Blackstone Group L.P., Registration Statement (Form S-1), at 11 (June 21, 2007) [hereinafter Blackstone S-1], *available at* http://www.sec.gov/Archives/edgar/data/1393818/000104746907005100/a2178442zs-1a.htm.

[18]Although "*noncorporation*" could refer to a variety of noncorporate business entities, including limited partnerships, general partnerships, limited liability partnerships, and limited liability companies, this article focuses on only limited partnerships and limited liability companies, and all references to "*noncorporations*" are intended to refer only to these two forms. For the benefit of the lay reader, in the context of a limited partnership (LP), the investors are called "limited partners," and the manager, the "general partner." In the context of a limited liability company (LLC), the investors are called "members," and the manager, simply the "manager."

[19]*See generally* Victor Fleischer, *Taxing Blackstone*, 61 TAX L. REV. 89 (2008) [hereinafter Fleischer, *Taxing Blackstone*] (discussing a bill introduced in 2007 classifying publicly traded private equity firms, like Blackstone, Fortress, and Apollo as corporations for taxation); Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1 (2008) (arguing for a change in the tax code because most investment funds and financial intermediaries form as partnerships and are treated more favorably than corporations).

[20]Department of State, Delaware Division of Corporations, http://corp.delaware.gov (last visited Mar. 10, 2009) ("More than 850,000 business entities have their legal home in Delaware including more than [fifty percent] of all U.S. publicly-traded companies and [sixty-three percent] of the Fortune 500"); *see also* Marcia Coyle, *Delaware Courts in Crosshairs*, NAT'L L.J., Oct. 13,

shareholders the fiduciary duties of care, loyalty, and good faith.[21] Although Delaware's corporate statute generally provides default rules from which parties can choose to deviate, the fiduciary duties binding corporate managers are unwaivable.[22] In contrast, Delaware's noncorporate statutes permit these firms to opt out of the fiduciary regime by eliminating such duties wholesale.[23]

Thus, the 2007 IPOs highlight a curious asymmetry in the law: in both substantive and structural respects, public noncorporations can resemble their corporate counterparts. Yet, unlike corporations, noncorporations are able to avoid one of the basic precepts, and arguably most cumbersome obligation, of corporate law.

Academics and practitioners have long debated the need for fiduciary duties in corporate law. The debate can be roughly divided into two schools: contractarians argue, on freedom of contract principles, that corporate law should permit shareholders to waive or modify the fiduciary duties of their corporate managers,[24] while so-called anti-contractarians argue, on equitable principles, that corporate managers should be subject to certain minimum standards of conduct embodied by the law of fiduciary duties.[25]

This article eschews the tired contractarian/anti-contractarian debate and argues that, as a practical matter, the asymmetry between the fiduciary duties of corporate law and noncorporate law today reflects nothing more than a substanceless vestige. Law and businesses have together evolved in ways that have blurred any distinctions between corporations and their noncorporate counterparts. Whatever the costs or benefits of fiduciary duties, the 2007 IPOs demonstrated that large firms and their managers seeking access to the capital of public markets now have a ready way to avoid the fiduciary duties imposed by corporate law: the noncorporate form. As a result, today, the legal asymmetry between corporations and

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2008, http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202425197969 (discussing the possibility of federal government interference into Delaware's incorporation of over sixty percent of Fortune 500 companies and fifty-five percent of U.S. companies on the NYSE).

[21]Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001) ("The directors of Delaware corporations have a triad of primary fiduciary duties: due care, loyalty, and good faith."). *But see* Stone v. Ritter, 911 A.2d 362, 270 (Del. 2006) ("[A]lthough good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty.").

[22]*See infra* note 42.

[23]*See* DEL. CODE ANN. tit. 6, § 18-1101(d) (2005) (applying to LLCs); *id.* § 17-1101(d) (applying to LPs).

[24]*See* Larry E. Ribstein, *Unlimited Contracting in the Delaware Limited Partnership and Its Implications for Corporate Law*, 16 J. CORP. L. 299, 302-10 (1991).

[25]*See* Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 610-17 (1997).

noncorporations has been reduced to a hollow and archaic formalism—one that, if it subsists, portends an existential challenge to the continuing relevance of corporate law and the corporate form.

II. LEGAL ASYMMETRY

Private equity and its rise to prominence in the financial markets has been widely heralded in recent years.[26] The numbers are staggering. Between 1970 and 2007, private equity firms engaged in an estimated $3.6 trillion of leveraged buyout transactions, $2.7 trillion of which occurred after the year 2000.[27] Investors worldwide, clamoring to participate in the private equity boon, put up a record $518 billion in private equity firms in 2007 alone.[28] Domestically, businesses raised more from private investments in 2007 than from IPOs, a first in United States history.[29] At the end of 2007, Blackstone, by itself, held $102 billion of assets under management and reported a net annual income of $1.6 billion.[30]

Before the 2007 IPOs of Blackstone, Fortress, and Och-Ziff, investors in private equity were limited to wealthy individuals and institutional investors, groups generally considered financially sophisticated and able to fend for themselves in their investment decisions.[31] The 2007 IPOs, however, opened the door to a whole new world of average investors trading on the public markets.

And to the average investor, an investment in Blackstone, Fortress, or Och-Ziff would seem just like an investment in any other public company, except that almost all public companies are corporations, subject to the usual rules, checks, and balances of corporate law. As noncorporations, however, Blackstone, Fortress, and Och-Ziff are able to avoid many of the rules and constraints of the standard corporate model, including one of its most basic precepts: the law of fiduciary duties.

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[26] *See, e.g.*, Cho, *supra* note 16; Terence O'Hara, *Powered by Private Capital*, WASH. POST, Apr. 25, 2005, at E1; Andrew Ross Sorkin, *Huge Buyout of Hospital Group Highlights Era of Going Private*, N.Y. TIMES, July 25, 2006, at A1.

[27] WORLD ECONOMIC FORUM, GLOBALIZATION OF ALTERNATIVE INVESTMENTS WORKING PAPERS VOLUME 1: THE GLOBAL ECONOMIC IMPACT OF PRIVATE EQUITY REPORT 2008 viii (2008), http://www.weforum.org/pdf/cgi/pe/Full_Report.pdf.

[28] *The 2008 Global Private Equity Review Features Stats, Data, Expert Commentary and Analysis on Every Aspect of the Industry*, REUTERS, May 14, 2008, http://www.reuters.com/article/pressRelease/idUS131742+14-May-2008+BW20080514.

[29] *See* Cho, *supra* note 16.

[30] Blackstone Group, L.P., Annual Report (Form 10-K), at 60 (Mar. 12, 2008), *available at* http://www.sec.gov/Archives/edgar/data/1393818/000119312508053079/d10k.htm.

[31] *See infra* note 80 and accompanying text.

This section explains how noncorporations depart from the standard corporate model. Part A first describes the standard corporate model and the tools afforded shareholders to monitor and keep corporate managers accountable. Part B then describes the asymmetry reflected in noncorporate law, namely the ability to restrict or wholly eliminate the fiduciary duties that otherwise bind corporate managers.

A. *The Standard Corporate Law Model*

Traditionally, public companies are organized as corporations, with public shareholders as the investors of capital and the ultimate owners of the firm. Corporate law, however, makes clear that the shareholders' involvement in the management of the corporation is minimal. Instead, the management of the firm is controlled by a board of directors,[32] which typically delegates its authority to corporate officers to run the day-to-day business of the corporation.[33]

Although shareholders are generally excluded from the management of the firm, standard corporate law provides shareholders with certain tools intended to ensure that corporate managers remain accountable to the owners of the firm. Chief among these tools is shareholder franchise: the right of shareholders to elect and remove the directors of the corporation and to vote on certain fundamental corporate transactions.[34]

For several reasons, however, shareholder franchise has proven to be an ineffective tool for ensuring managerial accountability.[35] Shareholders of public corporations tend to be dispersed and fragmented, each holding only a small stake in the corporation. As a result, like all large groups, shareholders suffer from problems of collective action, making it difficult for shareholders to organize in large blocs to challenge their corporate managers.[36] Even if ordinary shareholders could overcome the problems of collective action, deficiencies in the proxy voting process serve to undermine shareholder

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[32]DEL. CODE ANN. tit. 8, § 141(a) (2001).

[33]*Id.* § 142.

[34]*See id.* §§ 141(k), 211(b), 212, 242, 251(c), 271 (providing various rights to shareholders including the right to remove directors, to annually elect directors, to amend the corporate charter, and to vote on certain mergers and sales of all or substantially all assets).

[35]*See* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 207-08 (2004); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 676-87 (2007).

[36]*See, e.g.*, JEFFREY D. BAUMAN ET AL., CORPORATIONS LAW AND POLICY: MATERIALS AND PROBLEMS 476-80 (5th ed. 2003) (quoting ROBERT CHARLES CLARK, CORPORATE LAW 389-94 (1986)).

participation.[37] Thus, most shareholders tend to be rationally apathetic to corporate governance, preferring to free ride on the efforts of larger shareholders than to participate in active monitoring,[38] even if the larger shareholders have interests that conflict with those of the smaller shareholders.[39] Exacerbating these difficulties, due to a variety of social, legal, and psychological factors, corporate managers are able to exert considerable influence over the nomination and election of directors.[40] As a result, corporate managers, not shareholders, tend to dominate the governance of corporations.[41]

To balance the weaknesses of shareholder franchise, corporate law also imposes upon managers certain fiduciary duties, a legally enforceable minimum standard of conduct developed by courts and intended to ensure managerial accountability. Any one shareholder is entitled to bring a derivative suit on behalf of the corporation to enforce these duties against a corporate manager. Although corporate statutes are typically described as "enabling statutes," designed to provide default rules from which business planners and their investors can choose to deviate, the fiduciary duties of managers imposed by corporate law are mandatory and cannot be waived or modified.[42]

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[37]Larry E. Ribstein, *Uncorporating the Large Firm* 14 (Univ. of Ill., Law & Econ. Research Paper Series, Paper No. LE08-016, 2008), *available at* http://ssrn.com/abstract=1138092 (citing Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1249-51 (2008)).

[38]*See* BAUMAN ET AL., *supra* note 36, at 476-77 (quoting CLARK, *supra* note 36, at 389-94); Ribstein, *supra* note 13, at 12-13; Ribstein, *supra* note 37, at 13; Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 140.

[39]*See* Ribstein, *supra* note 13, at 13.

[40]BEBCHUK & FRIED, *supra* note 35, at 25-34.

[41]*See* Bebchuk, *supra* note 35, at 682-87 (demonstrating the relative infrequency of successful challenges in director elections).

[42]Under Delaware's corporate statute, corporations are not permitted to waive or limit the fiduciary duties of loyalty and good faith. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001); *see, e.g.*, Sutherland v. Sutherland, No. 2399-VCL, 2009 WL 857468, at *4 (Del. Ch. Mar. 23, 2009) (noting that "[w]hile such a provision [limiting the fiduciary duty of loyalty] is permissible under the Delaware Limited Liability Company Act and the Delaware Revised Uniform Limited Partnership Act, where freedom of contract is the guiding and overriding principle, it is expressly forbidden by the [Delaware corporate statute]"). Unlike the duties of loyalty and good faith, Delaware's corporate statute does permit corporations to eliminate director liability for breaches of the fiduciary duty of care. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). But even when a corporation attempts to eliminate its directors' liability for breaches of the fiduciary duty of care, Delaware courts are willing to recast such breaches as breaches of the fiduciary duty of good faith, which cannot be exculpated under Delaware law. *See, e.g.*, Ryan v. Lyondell Chem. Co., No. 3176-VCN, 2008 WL 2923427, at *18-19 (Del. Ch. July 29, 2008), *reprinted in* 34 DEL. J. CORP. L. 333, 366-68 (2009), *rev'd*, No. 401, 2008, 2009 WL 1024764 (Del. Apr. 16, 2009).

Under Delaware corporate law, managers owe shareholders the fiduciary duties of care, loyalty, and good faith.[43] The specific requirements of these duties can be intricate, but the basic duties can be described as follows: The fiduciary duty of care requires managers to refrain from gross negligence and to consider all information reasonably available to them in making business decisions on behalf of the firm.[44] The fiduciary duty of loyalty requires managers to put corporate interests ahead of self-enrichment and to avoid any conflicts of interest.[45] The duty of loyalty also entails certain special applications, including: the corporate opportunity doctrine, which prohibits managers from personally usurping business opportunities that rightfully belong to the corporation;[46] enhanced obligations under *Unocal*,[47] which limit managers' ability to defend against a threatened change of corporate control; and heightened *Revlon*[48] duties, which require managers to seek the highest value for shareholders in the event of a corporate sale.[49] Finally, the fiduciary duty of good faith, the least understood of the fiduciary duties,[50] prohibits managers from intentionally abdicating their responsibilities to the corporation.[51]

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[43]*See supra* note 21.

[44]1 EDWARD P. WELCH ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 141.2.1.1 (5th ed. Supp. 2008); *see also* Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985) ("We think the concept of gross negligence is also the proper standard for determining whether a business judgment reached by a board of directors was an informed one."); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 968 (Del. Ch. 1996) ("Where a director in fact exercises a good faith effort to be informed and to exercise appropriate judgment, he or she should be deemed to satisfy fully the duty of [care].") (emphasis omitted).

[45]WELCH ET AL., *supra* note 44, § 141.2.1.2.

[46]*Id.*; *see also* Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 154-55 (Del. 1996) (listing the factors courts consider when evaluating the corporate opportunity doctrine).

[47]Unocal Corp. v. Mesa Petroleum, Co., 493 A.2d 946 (Del. 1985).

[48]Revlon, Inc. v. MacAndrews & Forbes, Inc, 506 A.2d 173 (Del. 1986).

[49]*See* WELCH ET AL., *supra* note 44, §§ 141.2.4, 141.2.5 (discussing the *Unocal* and *Revlon* decisions and their effects on Delaware corporate law).

[50]*See* Andrew S. Gold, *On the Elimination of Fiduciary Duties: A Theory of Good Faith for Unincorporated Firms*, 41 WAKE FOREST L. REV. 123, 133 (2006) ("The fiduciary duty of good faith is a source of potential confusion. This area of the law is still developing, and the doctrine may have different meanings in different contexts."); Lyman P.Q. Johnson & Robert V. Ricca, *(Not) Advising Corporate Officers About Fiduciary Duties*, 42 WAKE FOREST L. REV. 663, 675 (2007) ("No common method appears to exist among lawyers for advising directors (and perhaps officers as well) as to what the duty of good faith means."); Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 5, 29 (2007) (describing the fiduciary duty of good faith as "highly enigmatic" and "neither defined clearly anywhere in the case law nor even imaginably workable as a predictable, clear, and consistent standard of conduct").

[51]*See, e.g.*, Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006); *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66-67 (Del. 2006); WELCH ET AL., *supra* note 44, § 141.2.1.3.

As a result of its dominance in corporate law, Delaware today enjoys a robust, if not complicated, case law interpreting the contours of these fiduciary duties. The rich breadth of this case law is often cited as a primary reason for Delaware's dominance in attracting business incorporations.[52] Many academics and practitioners, however, have decried Delaware's corporate jurisprudence as indeterminate, inconsistent, and incoherent,[53] favoring a contextual, fact-intensive, standards-based approach over bright-line rules—a point with which even Delaware judges concur.[54] For its detractors, Delaware's standard-based approach creates unpredictability: vague, open-ended standards make ex ante predictions of legal outcomes difficult.[55] Legal uncertainty, in turn, complicates business planning, promotes costly litigation, and even suppresses jurisdictional competition for corporate charters.[56] For many of these critics, the noncorporate form represents an opportunity for businesses to escape the costs and uncertainty imposed by the fiduciary duties of corporate law.[57]

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[52]*See* Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 722-23 (1987) (stating that Delaware's corporate law "consist[s] of a store of legal precedents forming a comprehensive body of case law . . . providing a sound basis for corporate planning").

[53]*See* William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 11-17; Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1946-47 (1998) (arguing that the indeterminacy of Delaware's corporate law causes increase cost and isolation to corporations incorporated in other states); Larry E. Ribstein, *Why Corporations?*, 1 BERKELEY BUS. L.J. 183, 213 (2004) ("In general, fiduciary duties potentially permit open-ended ex post judicial manipulation of agreements, often to fit a particular pre-conceived notion of how the firm is governed.").

[54]*See, e.g.*, Myron T. Steele & J.W. Verret, *Delaware's Guidance: Ensuring Equity for the Modern Witenagemot*, 2 VA. L. & BUS. REV. 189, 193 (2007) ("Granted, . . . [Delaware's] standards are not exact. The predictability of judicial response to each permutation of a certain deal measure or structure is not absolute."); Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's* Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1265 (2001) (conceding that "in many ways Delaware corporation law is less than optimally clear"); E. Norman Veasey, *Juxtaposing Best Practices and Delaware Corporate Jurisprudence*, INSIGHTS, Dec. 2004, at 7 (acknowledging that Delaware's corporate law "may be somewhat indeterminate").

[55]*See* Kamar, *supra* note 53, at 1919.

[56]*Id.* at 1927-28, 1946-47.

[57]*See, e.g.*, Ribstein, *supra* note 38, at 133, 158; Ribstein, *supra* note 53, at 213-16; *cf.* Steele, *supra* note 50, at 29 (distinguishing the legal uncertainty inherent in the fiduciary duty of good faith when compared "to the relatively clear implied contractual covenant of good faith and fair dealing").

B. *Noncorporations and the Contractual Conception*

Like corporations, large noncorporations generally contemplate a division of ownership and control. Noncorporate investors provide the capital and are the ultimate owners of the firm, but control of the firm is vested in one or a group of managers.[58] And like corporate law, Delaware has proven to be the dominant leader in the noncorporate arena.[59] This dominance is particularly pronounced in the context of large and publicly traded noncorporations, where Delaware has recently enjoyed a virtual monopoly. Between January 1, 2006, and March 31, 2009, *every* domestic noncorporation that filed for or completed an IPO in the United States was a Delaware noncorporation[60]

But unlike its corporate law, Delaware's noncorporate law has, since at least 2004, allowed for such firms to limit or eliminate the fiduciary duties that would otherwise bind noncorporate managers. The basis for this legal asymmetry stems in large part from the historically distinct origins of the corporate and noncorporate forms. Corporations originated as "creatures of state law," chartered by and, therefore, subject to the regulation of the state.[61] Thus, "'[i]nto [every] corporate charter is written every pertinent provision'" of Delaware law, including the law of fiduciary duties.[62] In contrast, the law has traditionally viewed noncorporations as "creatures of contract," representing a voluntary, contractual relationship among private parties.[63] Under

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[58]While it is true that noncorporations are afforded the flexibility of choosing between a centralized management versus a more horizontal form of management, for purposes of this article, each of Blackstone, Fortress, and Och-Ziff contemplate robust centralized management. Ribstein, *supra* note 53, at 210-11; *see also* William H. Clark, Jr., *Rationalizing Entity Laws*, 58 BUS. LAW. 1005, 1012 (2003) (noting that all noncorporations "except the smallest general partnerships" are moving toward some form of centralized management).

[59]*See* Gold, *supra* note 50, at 125-26 ("[Noncorporations] are frequently formed in Delaware, and Delaware shows the potential to acquire jurisdictional dominance here, akin to its role in corporate law."); Saul Levmore, *Uncorporations and the Delaware Strategy*, 2005 U. ILL. L. REV. 195, 201 ("[M]ost students of corporate law would be surprised to learn that Delaware also dominates the market for partnerships . . . .").

[60]*See infra* p. 515 app. (listing all noncorporations that filed for or completed an IPO during this period). Noncorporations that filed for, but did not complete, an IPO are included in the Appendix because such firms are presumably sufficiently large to justify the expense of an IPO. Even though such firms have delayed or abandoned an IPO, they serve as a useful proxy for measuring Delaware's dominance for large, but private, noncorporations.

[61]*See, e.g.*, Fisk Ventures, LLC v. Segal, No. 3017-CC, 2008 WL 1961156, at *8 (Del. Ch. May 7, 2008); Larry E. Ribstein, *The Evolving Partnership*, 26 J. CORP. L. 819, 822-23 (2001); Ribstein, *supra* note 53, at 208-09.

[62]*Fisk*, 2008 WL 1961156, at *8 n.33 (quoting Bouree v. Trust Francais des Actions de la Franco-Wyo. Oil Co., 127 A. 56, 60 (Del. Ch. 1924)).

[63]*See* R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, No. 3803-CC, 2008

this view, the rights and duties of noncorporate managers are not fiduciary, but contractual—expressly spelled out by the terms of the noncorporate firm's governing agreement.[64] As a result, noncorporations have historically been afforded relative autonomy from state intervention.[65]

This contractual conception of the noncorporate form entails several traditional assumptions about noncorporations and their investors. First, because of the contractual nature of the firm, noncorporations are more likely to be closely held[66] and their shares more likely to be nontransferable.[67] As a result, noncorporate investors are more likely to be effective monitors of their managers than corporate shareholders, who, challenged by problems of collective action and rational apathy, would rather simply sell their shares on the public market than to invest time in meaningful monitoring.[68]

WL 3846318, at *4, *8 (Del. Ch. Aug. 19, 2008); *Fisk*, 2008 WL 1961156, at *8 n.33; Ribstein, *supra* note 61, at 822 ("The partnership is fundamentally a contractual entity."); Ribstein, *supra* note 53, at 212-13 (discussing a partnership's ability to contract and allocate its power according to its needs).

[64]*See R & R Capital*, 2008 WL 3846318, at *1 ("[I]t is the contract that 'defines the scope, structure, and personality of limited liability companies.'" (quoting *Fisk*, 2008 WL 1961156, at *1)); *Fisk*, 2008 WL 1961156, at *8 ("In the context of limited liability companies, which are creatures not of the state but of contract, [any] . . . duties or obligations must be found in the LLC [a]greement or some other contract.").

[65]*R & R Capital*, 2008 WL 3846318, at *6; Ribstein, *supra* note 53, at 212.

[66]*See, e.g.*, Ribstein, *supra* note 61, at 823 ("The basic model of the partnership set forth in the Uniform Partnership Act . . . is for a very closely held and informal firm."); Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK U. L. REV. 927, 941 (2004) [hereinafter Ribstein, *Fiduciary Duties*] ("Tax considerations suggest that limited partnership interests will not be publicly traded, and therefore will not appear in the guise of the standard corporate investment."); *id.* at 943 ("[L]imited partnership investments differ from corporate stock in the important respect that they are unlikely to be publicly traded."); *see also* Gold, *supra* note 50, at 179 (assuming that noncorporations are "closely held firms[,] . . . different from public corporations"); Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom With the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1628 (2004) ("Within Delaware, courts have consistently refused to impute heightened fiduciary duties to LLCs because of the closely held nature of the LLC."); Ribstein, *supra* note 53, at 185 ("The accepted wisdom is that firms generally divide into closely held and publicly held, with the partnership form being suited to the former and the corporate form to the latter."); Larry E. Ribstein & Bruce H. Kobayashi, *Choice of Form and Network Externalities*, 43 WM. & MARY L. REV. 79, 89 (2001) ("LLC statutes are better adapted than standard corporation statutes to closely held firms.").

[67]*See* Clark, *supra* note 58, at 1013 (noting that noncorporations have generally been reluctant to move to the corporate model of free transferability of shares); Ribstein, *Fiduciary Duties*, *supra* note 66, at 935, 941 ("Tax considerations suggest that limited partnership interests will not be publicly traded, and therefore will not appear in the guise of the standard corporate investment."); Ribstein, *supra* note 24, at 306-07 (noting that noncorporations have an incentive to limit the transferability of their shares because limited transferability ensures that a noncorporation will not be taxed as a corporation for federal tax purposes).

[68]*See* Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Entities*, 54 WASH. &

Second, unlike corporate shareholders who typically acquire their shares in secondary, public markets wholly removed from the issuing firm, noncorporate investors are more likely to purchase their shares directly from the noncorporation.[69] As a result, noncorporate investors are more likely to have a meaningful opportunity to negotiate the terms of their investment.[70] And because noncorporate investments are more likely to be the product of real negotiation, unlike shareholders of a public corporation who may only be constructively aware of the provisions in the corporate charter and bylaws, noncorporate investors are likely to "be directly exposed to, if not actually sign,"[71] the firm's governing agreement.[72]

LEE L. REV. 537, 547 (1997) [hereinafter Ribstein, *Fiduciary Duty Contracts*] ("Fiduciary duties may be appropriate for firms with dispersed, passive owners for whom active monitoring is impractical. But in . . . many closely-held firms, the beneficiary [of any fiduciary relationship] may have both an *ability* and a *need* to monitor whether or not the fiduciary is subject to fiduciary duties.") (emphasis added); Larry E. Ribstein, *Making Sense of Entity Rationalization*, 58 BUS. LAW. 1023, 1032 (2003) [hereinafter Ribstein, *Making Sense*] (arguing that fiduciary duties may be more important "in cases in which the owners have weak voting rights or are more dispersed than in cases in which they have strong rights and ability to participate in management").

[69]*See* Ribstein, *Fiduciary Duties*, *supra* note 66, at 935 ("[T]he combination of default restrictions on transferability of limited partnership interests and the corporate tax treatment of limited partnerships with publicly traded or tradable interests mean that most investments in limited partnerships will be purchased directly from the firm rather than in a secondary trading market.").

[70]*See, e.g.*, Twin Bridges Ltd. P'ship v. Draper, No. 2351-VCP, 2007 WL 2744609, at *8 (Del. Ch. Sept. 14, 2007) (noting that Delaware's policy of judicial deference in the noncorporate context is justified because "[t]he provisions of the [noncorporate governing] agreement define the contractually *bargained* rights and responsibilities of those who are parties to the agreement") (emphasis added); Abry Partners V, L.P. v. F&W Acquisition LLC, 891 A.2d 1032, 1063 (Del. Ch. 2006) (noting that Delaware's statutory provisions permitting the elimination of fiduciary duties in noncorporations are justified because "[i]n the alternative entity context, . . . it is more likely that sophisticated parties . . . carefully negotiated the governing agreement"); *In re* Cencom Cable Income Partners, L.P. Litig., No. 14,634, 1996 WL 74726, at *5 (Del. Ch. Feb. 15, 1996) (noting that "[w]hile the General Partner stands on both sides of the transaction," the plaintiff's claim must be dismissed because the General Partner "*presumably bargained for and clearly obtained* the Limited Partners' consent to do so in the Partnership Agreement") (emphasis added); Gold, *supra* note 50, at 179 ("[C]losely held firms are different from public corporations—they are often the subject of real negotiation for investors."); Ribstein, *Fiduciary Duty Contracts*, *supra* note 68, at 550 ("The antiwaiver argument [with respect to fiduciary duties] is a harder sell in most closely held unincorporated firms in which terms are often negotiated or voted on face-to-face . . . ."); *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, 585 (2007) (noting that the contractarian theory of LLCs assumes that the written LLC "operating agreements will be highly negotiated and will contain important express contractual protections for both sides"); Steele, *supra* note 50, at 9-10 (arguing that "[b]ecause the passive investor is ordinarily in no position to supervise the fiduciary, it must be assumed that the passive investor bargained for a power-sharing relationship that serves his or her best interests" and that "contract negotiations, or a review of the documents generated before the LLP [sic] or LLC agreement has been signed, would enable a reviewing court to conclude who the contracting partners agreed would bear the costs of monitoring the fiduciary's compliance with whatever duties or risks the documents impose").

[71]Ribstein, *Fiduciary Duties*, *supra* note 66, at 943.

Finally, because of the tax and legal implications associated with an investment in a noncorporation, noncorporate investors are more likely to be financially sophisticated[73] and more likely to seek legal advice in connection with their investment.[74] As a result, noncorporate investors are better able to knowledgably investigate and negotiate their investment.[75] And any language in the firm's governing agreement restricting or eliminating any fiduciary duties would raise red flags for such investors.[76]

Whatever their validity today, these assumptions were at one time justified both in law and in fact.[77] As a legal matter, a combination of

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[72]Gold, *supra* note 50, at 179; Ribstein, *Fiduciary Duties*, *supra* note 66, at 935 (arguing that, because LP interests are more likely to be purchased directly from the issuing firm rather than the secondary market, "[t]his focuses more investor attention on the specific language of the constitutive documents"); *see also* Miller, *supra* note 70, at 585 (noting that the contractarian theory of LLCs assumes that "written LLC operating agreements are likely to be executed").

[73]*See, e.g.*, R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, No. 3803-CC, 2008 WL 3846318, at *6 (Del. Ch. Aug. 19, 2008) (reasoning that the court need not intervene on behalf of the plaintiffs because doing so would "disregard a negotiated agreement among sophisticated parties"); Abry Partners V, L.P. v. F&W Acquisition LLC, 891 A.2d 1032, 1063 (Del. Ch. 2006) (noting that Delaware's statutory provisions permitting the elimination of fiduciary duties in noncorporate firms are justified because "[i]n the alternative entity context, . . . it is more likely that sophisticated parties . . . carefully negotiated the governing agreement"); *In re* Marriott Hotel Props. II Ltd. P'ship Unitholders Litig., No. 14,961, 1996 WL 342040, at *5 (Del. Ch. June 12, 1996), *reprinted in* 22 DEL. J. CORP. L. 373, 383 (1997) (noting that "[a] court should assume that parties involved in commerce who elect to join together in a business organization to pursue an enterprise have substantial knowledge of a wide range of business operational frameworks" and that, therefore, it can be assumed that such parties made "a thoughtful election with full knowledge of the significance of the operational framework they chose") (quoting *In re* Cencom Cable Income Partners, L.P. Litig., No. 14,634, 1996 WL 74726, at *4 (Del. Ch. Feb. 15, 1996)).

[74]*See, e.g.*, Gold, *supra* note 50, at 179 ("The nature of a limited partnership should encourage parties to seek legal advice."); Miller, *supra* note 70, at 570 ("Th[e] contractarian approach presupposes that [LLC] . . . participants will be represented by legal counsel and will be able to negotiate for suitable exit rights and/or remedies in the event of a dispute."); Ribstein, *supra* note 61, at 848 ("LLCs and limited partnerships . . . are usually [established] with the advice of counsel."); Ribstein, *Fiduciary Duties*, *supra* note 66, at 942 ("[T]he limited partnership form itself serves as a caution flag that should induce users to get legal advice . . . ."); Ribstein, *Making Sense*, *supra* note 68, at 1032 ("[L]imited partnership investments are more likely to be made on sophisticated legal advice . . . .").

[75]*See* Ribstein, *supra* note 24, at 305 (noting that because of the tax and legal implications associated with the limited partnership form, "expenditures in investigating, negotiating, and monitoring investments are more cost-justified in limited partnerships than in corporations").

[76]Gold, *supra* note 50, at 180 ("The language that eliminates fiduciary duties is also a cautionary signal. When a party negotiates a contract and announces he would like to completely eliminate fiduciary duties from the relationship, it is a wake up call to his partners.").

[77]Professor Sandra Miller has published several empirical studies raising doubts about the validity of the assumptions underlying in the contractual view of the noncorporate form. *See* Sandra K. Miller et al., *An Empirical Glance into Limited Liability Companies: Assessing the Need to Protect Minority Investors*, 43 AM. BUS. L.J. 609, 618 (2006) (reporting the results of a study showing the widespread use of form LLC agreements and the frequent formation of LLCs without a governing agreement in place); Sandra K. Miller, *A New Direction for LLC Research in a Contractarian Legal Environment*, 76 S. CAL. L. REV. 351, 357, 422 (2003) [hereinafter Miller, *A*

default statutory provisions limiting the transferability of noncorporate shares coupled with the tax code, which nominally discourages the free transferability of noncorporate shares,[78] ensured that most noncorporations would be closely held, and that their shares would be purchased directly from the noncorporate firm rather than from a secondary or public market.[79] Moreover, the overlay of public securities laws ensured that most noncorporate investors would be financially sophisticated[80] and able to negotiate the appropriate monitoring and accountability mechanisms for their investments.[81] As a factual matter, before the 2007 IPOs, very few noncorporations were publicly traded.[82] Instead, the vast majority of noncorporations were, and even today are, closely held. Thus, the picture painted by the contractual conception of the noncorporate form—one of a private contractual relationship among sophisticated parties—seemed tenable.

By distinguishing noncorporations and their investors from corporations and their shareholders, together, these assumptions ostensibly provided a basis for the asymmetry from corporate law. In the early 1990s, based on this contractual conception and the assumptions underlying it, Delaware amended its noncorporate statutes to make clear that noncorporate governing

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New Direction] (reporting the results of an empirical study in which over two-thirds of business attorneys surveyed indicated they believed most LLC agreements are not extensively negotiated).

[78]*See* I.R.C. §§ 7701(a)(3), 7704 (2008); *see also* Ribstein, *supra* note 37, at 32-33 (citing the corporate taxation imposed on partnerships with publicly traded shares as an explanation for the relatively few number of publicly traded partnerships).

[79]Ribstein, *Fiduciary Duties*, *supra* note 66, at 935; *see also* Ribstein, *supra* note 24, at 306 (reasoning that free transferability may be enough to subject a limited partnership to corporate taxation).

[80]The sophistication of private investors is a result of the Securities Act of 1933, which generally requires registration for the sale of any securities. 15 U.S.C. § 77e (2006). Section 77d(2) of the Securities Act, however, exempts from registration any sales of securities "not involving a[] public offering." *Id.* § 77d(2). The availability of this exemption has been interpreted by *SEC v. Ralston Purina Co.*, and its progeny, to turn on the financial sophistication of the individuals investing in the offering. SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953). As a result, in order to fall under this statutory exemption and avoid registration and the regulation of the Securities Act, private securities offerings are limited to investors who are able to demonstrate financial sophistication. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 205-06 (rev. 5th ed. 2006). Today, most private offerings are conducted pursuant to Rule 506 of Regulation D, which provides a rules-based safe harbor for the statutory exemption. *See* 17 C.F.R. § 230.501(a) (2008). Among other limitations, a private offering of securities made pursuant to Rule 506 must be limited to so-called "accredited investors" who meet certain wealth or income thresholds, or investors who otherwise possess "such knowledge and experience in financial and business matters that [they are] capable of evaluating the merits and risks of the prospective investment." 17 C.F.R. § 230.506 (2008).

[81]*See supra* note 70.

[82]*See* NAT'L ASS'N FOR PUBLICLY TRADED P'SHIPS, PUBLICLY TRADED PARTNERSHIPS TRADING ON MAJOR EXCHANGES (2009), http://www.naptp.org/PTP101/CurrentPTPs.htm. *See also* Ribstein, *supra* note 37, at 32 ("Publicly traded partnerships are only a small fraction of the many thousands of partnerships and publicly traded corporations.").

agreements could "restrict" the fiduciary duties of managers.[83] Before 2004, however, the Delaware courts were reluctant to hold that such *restrictions* could *eliminate* fiduciary duties altogether.[84] When the issue came before the Delaware Supreme Court in *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*,[85] the court, in dictum, suggested that although Delaware's statute permitted the *restriction* of fiduciary duties in the noncorporate context, it did not permit the *elimination* of such duties wholesale.[86]

The Delaware legislature promptly reversed the *Gotham* dictum in 2004 by again amending the state's LP and LLC statutes to make clear that these noncorporations could, in fact, *eliminate* fiduciary duties altogether.[87] Today, both Delaware's statutes and its courts are clear that Delaware's policy is to "give maximum effect to the principle of freedom of contract and to the enforceability"[88] of a noncorporate firm's governing agreement. Under Delaware's statutes, a noncorporate governing agreement may provide for the restriction or elimination of any or all fiduciary duties, provided "that the

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[83]*See* 3 EDWARD P. WELCH ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW §§ 17-1101.5.2 & n.128, 18-1101.11.1 (5th ed. Supp. 2009).

[84]*See* Paul M. Altman & Srinivas M. Raju, *Delaware Alternative Entities and the Implied Contractual Covenant of Good Faith and Fair Dealing Under Delaware Law*, 60 BUS. LAW. 1469, 1472 (2005); Steele, *supra* note 50, at 10-12. *But see* Gold, *supra* note 50, at 141 ("[S]everal [late 1990s] Delaware Chancery Court decisions . . . concluded that fiduciary duties were subject not only to restriction, but to elimination.").

[85]817 A.2d 160 (Del. 2002).

[86]*Id.* at 167-68. Discussing the Delaware statute before the 2004 amendments, the Delaware Supreme Court noted that the Delaware statute "states 'the partner's or other person's duties and liabilities may be *expanded* or *restricted* by provisions in the partnership agreement.' There is no mention in . . . [the Delaware statute] that a limited partnership agreement may *eliminate* the fiduciary duties or liabilities of a general partner." *Id.* (internal citations omitted).

[87]*See* WELCH ET AL., *supra* note 83, §§ 17-1101.5.6, 18-1101.11.4; *see also* Steele, *supra* note 50, at 10-14 (reviewing the Delaware Supreme Court's position towards the elimination of fiduciary duties within noncorporations and the Delaware legislature's response in expressly allowing noncorporations to contract away fiduciary duties).

[88]DEL. CODE ANN. tit. 6, § 17-1101(c) (2005) (governing LPs); *id.* § 18-1101(b) (governing LLCs); R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, No. 3803-CC, 2008 WL 3846318, at *4 (Del. Ch. Aug. 19, 2008); *see also* Sutherland v. Sutherland, No. 2399-VCL, 2009 WL 857468, at *4 (Del. Ch. Mar. 23, 2009) (noting that "[w]hile such a provision [limiting the fiduciary duty of loyalty] is permissible under the Delaware Limited Liability Company Act and the Delaware Revised Uniform Limited Partnership Act, where freedom of contract is the guiding and overriding principle, it is expressly forbidden by the [Delaware corporate statute]."); TravelCenters of Am., LLC v. Brog, No. 3516-CC, 2008 WL 1746987, at *1 (Del. Ch. Apr. 3, 2008) ("[L]imited liability companies are creatures of contract, 'designed to afford the maximum amount of freedom of contract, private ordering and flexibility to the parties involved.'" (quoting *In re* Grupo Dos Chiles, LLC, No. 1447-N, 2006 WL 668443, at *2 (Del. Ch. Mar. 10, 2006))); Twin Bridges Ltd. P'ship v. Draper, No. 2351-VCP, 2007 WL 2744609, at *12 (Del. Ch. Sept. 14, 2007) ("Consistent with the underlying policy of freedom of contract espoused by the Delaware Legislature, limited partnership agreements are to be construed in accordance with their literal terms.").

[governing] agreement may not eliminate the implied contractual covenant of good faith and fair dealing."[89] While traditional fiduciary duties may still provide the default rules for internal noncorporate governance, those duties are subject to, and limited by, the express terms of the noncorporation's governing agreement, including any terms that may limit or eliminate any fiduciary duties, which courts will enforce in preference to any claim of fiduciary duty.[90]

III. A CLOSER LOOK AT PUBLICLY TRADED PRIVATE EQUITY

Historically, the asymmetry between Delaware's corporate and noncorporate law was based on the notion that noncorporations are substantively different from corporations. Unlike corporations, noncorporations represent a contractual relationship negotiated among private parties, sophisticated in financial and legal matters. And thus, rather than relying on the fiduciary duties of corporate law to constrain managerial discretion, noncorporate investors are permitted to negotiate appropriate firm-specific mechanisms to ensure managerial accountability.

A closer look at Blackstone, Fortress, and Och-Ziff, however, shows that for these firms this "difference" no longer holds. Although Blackstone, Fortress, and Och-Ziff each went public in 2007 in a noncorporate form, the traditional assumptions underlying the contractual conception of the noncorporate form are inapplicable to these entities. Instead, Blackstone, Fortress, and Och-Ziff are substantively indistinguishable from their publicly traded corporate counterparts.

This section proceeds in three parts. Part A examines the basic ways in which the traditional assumptions underlying the contractual conception of the noncorporate form break down in the context of Blackstone, Fortress, and Och-Ziff. Part B describes the internal governance structures of Blackstone, Fortress, and Och-Ziff and shows that these firms are able to

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[89] DEL. CODE ANN. tit. 6, § 17-1101(d) (2005) (applying to LPs); *id.* § 18-1101(c) (applying to LLCs).

[90] *See, e.g.*, *Gotham Partners*, 817 A.2d at 170-71; *Twin Bridges*, 2007 WL 2744609, at *12, *18; Sonet v. Timber Co., L.P., 722 A.2d 319, 324 (Del. Ch. 1998); *see also* Ribstein, *supra* note 37, at 17-18 (reviewing the Delaware courts use of fiduciary duties solely as gap fillers in noncorporation governing agreements). As the Chief Justice of the Delaware Supreme Court has stated, "Courts should recognize parties' freedom of choice exercised by contract and should not superimpose an overlay of common law fiduciary duties, or the judicial scrutiny associated with them, where the parties have not contracted for those governance mechanisms in the documents forming their business entity." Steele, *supra* 50, at 4; *see also id.* at 23 (noting that the Delaware legislature has chosen to incorporate common law fiduciary duties only as gap fillers when the contract lacks specificity).

effectively mimic (and depart from) the traditional corporate governance structure. Yet, as Part C describes, because of their noncorporate forms, these firms are able to curtail and even eliminate the fiduciary duties that bind the managers of their corporate counterparts.

A. *Eschewing the Contractual Conception*

Recall the basic assumptions underlying contractual conception of the noncorporate form: (1) that noncorporations are closely held and their shares are generally nontransferable; (2) that noncorporate investors acquire their shares directly from the noncorporate firm and are, thus, afforded a meaningful opportunity to negotiate the terms of their investment; and (3) that noncorporate investors are financially and legally sophisticated.[91] In obvious ways, each of these traditional assumptions breaks down for the likes of Blackstone, Fortress, and Och-Ziff. Whatever the historical validity of the contractual conception, in a world of publicly traded noncorporations, the emperor has no clothes.

Most obviously, Blackstone, Fortress, and Och-Ziff are each now widely held and actively traded by thousands of disaggregate and dispersed investors,[92] most of whom individually own only a very small stake in the firm.[93] Setting aside the limited voting rights of these investors,[94] given the inherent nature of public ownership, there is no reason to believe that the public investors of these noncorporations will be any better at monitoring and holding their managers accountable than the shareholders of public corporations.[95] Like the shareholders of public corporations, the public investors of these noncorporations are subject to the same problems of collective action and rational apathy,[96] and limited by the same systemic

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[91] *See supra* notes 66-76 and accompanying text.

[92] For the three-month period ending on October 14, 2008, the average daily trading volumes for Blackstone, Fortress, and Och-Ziff, were 2,089,162, 662,753, and 453,965, respectively. *See* Yahoo! Finance, BX: Historical Prices for BLACKSTONE GRP LP UT, http://finance.yahoo.com/q/hp?s=BX&a=06&b=14&c=2008&d=09&e=14&f=2008&g=d (last visited Mar. 11, 2009); Yahoo! Finance, FIG: Historical Prices for FORTRESS INV GP LLC, http://finance.yahoo.com/q/hp?s=FIG&a=06&b=14&c=2008&d=09&e=14&f=2008&g=d (last visited Mar. 11, 2009); Yahoo! Finance, OZM: Historical Prices for OCH-ZIFF CAP MGMT, http://finance.yahoo.com/q/hp?s=OZM&a=06&b=14&c=2008&d=09&e=14&f=2008&g=d (last visited Mar. 11, 2009).

[93] For example, according to Blackstone's annual report for the calendar year 2007, only one investor held more than five percent of the outstanding publicly traded common units of the company. Blackstone Form 10-K, *supra* note 30, at 145.

[94] *See infra* notes 119-23 and accompanying text.

[95] *See* Ribstein, *supra* note 24, at 310 ("[T]here is no more reason to be concerned about owner voting problems in the corporation than in the limited partnership.").

[96] *Id.* ("Limited partners are just as susceptible to rational apathy and agenda control

deficiencies of proxy voting. Considering the relative ease with which their shares may be bought and sold, the dissatisfied investors of Blackstone, Fortress, and Och-Ziff likely will rather simply sell their shares than invest in any meaningful monitoring or accountability.

Moreover, each of Blackstone, Fortress, and Och-Ziff's public investors acquired his or her shares on a public market. These investors did not negotiate the terms of each firm's governing agreement, let alone sign the actual document. Instead, these investors resemble the shareholders of any other public corporation, only constructively aware of the firm's governing agreement, but nonetheless subject to it by mere virtue of acquiring the firm's shares.

Finally, unlike the contractual conception's idealized fiction of the sophisticated investor advised by counsel, public securities law expressly presumes that the public investors of Blackstone, Fortress, and Och-Ziff may be unsophisticated and unable to "fend for themselves."[97] Thus, like all other public corporations, these noncorporations are subject to the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002, and other regulations intended to protect public investors.[98]

In short, in the context of publicly traded noncorporations, the traditional assumptions underlying the contractual conception of the non-corporate form fail to distinguish noncorporations and their investors from their corporate counterparts. Instead, in basic substantive respects, Blackstone, Fortress, and Och-Ziff and their investors bear close resemblance to public corporations and their shareholders. And as the following part will show, these resemblances are not only substantive, they can also be structural.

B. *Mimicking the Corporate Structure*

Unlike the corporate form, the noncorporate form affords firms tremendous flexibility to devise an internal governance structure.[99] These structures can closely mimic the corporate form or dramatically depart from

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problems as are shareholders in equivalent corporations.").

[97]SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953). Under the *Ralston Purina* doctrine, the registration of securities for a public offering means, by negative implication, that investors lack the financial sophistication to "fend for themselves i[n] the transaction" and, therefore, "need[] the protection of the [federal Securities] Act." *Id.*

[98]*See, e.g.*, Blackstone S-1, *supra* note 17, at 38 ("As a public entity, we will be subject to the reporting requirements of the U.S. Securities Exchange Act of 1934, as amended, . . . and requirements of the U.S. Sarbanes-Oxley Act of 2002 . . . .").

[99]*See* Ribstein, *supra* note 61, at 843; Ribstein, *supra* note 53, at 210-11.

it.[100] Blackstone, Fortress, and Och-Ziff provide instructive examples of both.

Fortress and Och-Ziff, for example, are both organized as Delaware LLCs; however, each firm's governing agreement effectively duplicates the form and function of a Delaware corporation. Each firm's governing agreement creates a board of directors, authorized to manage the business of the company.[101] The board, in turn, is authorized to appoint and delegate its authority to officers to run the day-to-day business of the company.[102] Although the governing agreements specify that the firms' directors and officers will be considered "managers" for purposes of Delaware's LLC statute, both agreements make clear that the intent is that:

> [e]xcept as otherwise expressly provided in this Agreement... (i) the duties and obligations owed to the Company by the Officers and Directors shall be the *same* as the duties and obligations owed to a corporation organized under [Delaware's corporate law (DGCL)] by its officers and directors, respectively, and (ii) the duties and obligations owed to the Members by the Officers and Directors shall be the *same* as the duties and obligations owed to the stockholders of a corporation under the [DGCL] by its officers and directors, respectively.[103]

Like typical corporate boards of directors, the boards of Fortress and Och-Ziff are required to hold regular meetings[104] and are permitted to hold special meetings,[105] subject to notice[106] and quorum[107] requirements for both.

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[100]*See* Ribstein, *supra* note 53, at 210-11.

[101]FORTRESS INVESTMENT GROUP LLC, THIRD AMENDED AND RESTATED LIMITED LIABILITY COMPANY AGREEMENT, *in* Annual Report (Form 10-K), exhibit 3.2, § 5.1 (Mar. 28, 2008) [hereinafter FORTRESS AGREEMENT], *available at* http://www.sec.gov/Archives/edgar/data/1380393/000095013608001568/file2.htm; OCH-ZIFF CAPITAL MANAGEMENT GROUP LLC, SECOND AMENDED AND RESTATED LIMITED LIABILITY COMPANY AGREEMENT, *in* Annual Report (Form 10-K), exhibit 3.2, § 5.1 (Nov. 13, 2007) [hereinafter OCH-ZIFF AGREEMENT], *available at* http://www.sec.gov/Archives/edgar/data/1403256/000119312508064885/dex32.htm.

[102]FORTRESS AGREEMENT, *supra* note 101, §§5.1, 5.22; OCH-ZIFF AGREEMENT, *supra* note 101, §§ 5.1, 5.22.

[103]FORTRESS AGREEMENT, *supra* note 101, § 5.23 (emphasis added); *see also* OCH-ZIFF AGREEMENT, *supra* note 101, § 5.22 (laying out, nearly verbatim, a similar pseudo-corporate relationship among the firm's investors and the managers).

[104]FORTRESS AGREEMENT, *supra* note 101, § 5.10; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.10.

[105]FORTRESS AGREEMENT, *supra* note 101, § 5.11; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.11.

And like typical corporate boards, the Fortress and Och-Ziff boards are entitled to elect a chairman to preside over board meetings[108] and to form and delegate authority over specific matters to special committees comprised of the board's members.[109]

As for the investors of Fortress and Och-Ziff, like corporate shareholders, the investors are generally excluded from the management of the firm.[110] Instead, the investors' involvement is limited to electing and removing directors,[111] and voting on certain fundamental matters, such as a merger or sale of all or substantially all of the company's assets,[112] or an amendment to the company's governing agreement.[113] And like corporate shareholders, the investors of Fortress and Och-Ziff are required to hold annual meetings for the election of directors[114] and permitted to hold special meetings,[115] both again subject to notice[116] and quorum[117] requirements that are typical for corporate shareholders.

In short, in almost every formal respect, the structure of Fortress and Och-Ziff mimic that of a public corporation. The structure of Blackstone, in contrast, represents a stark departure from the corporate form.

Blackstone is organized as a Delaware LP, with Blackstone Group Management LLC, a private company controlled by Blackstone's managers, as the general partner of the company.[118] The general partner, as an entity,

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[106]FORTRESS AGREEMENT, *supra* note 101, § 5.11; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.11.

[107]FORTRESS AGREEMENT, *supra* note 101, § 5.14; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.14.

[108]FORTRESS AGREEMENT, *supra* note 101, § 5.8; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.8.

[109]FORTRESS AGREEMENT, *supra* note 101, § 5.15; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.15.

[110]FORTRESS AGREEMENT, *supra* note 101, § 5.1; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.1.

[111]FORTRESS AGREEMENT, *supra* note 101, § 5.3; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.3.

[112]FORTRESS AGREEMENT, *supra* note 101, § 10.3; OCH-ZIFF AGREEMENT, *supra* note 101, § 10.3.

[113]FORTRESS AGREEMENT, *supra* note 101, § 9.1; OCH-ZIFF AGREEMENT, *supra* note 101, § 9.1.

[114]FORTRESS AGREEMENT, *supra* note 101, § 11.1(a); OCH-ZIFF AGREEMENT, *supra* note 101, § 12.1(a).

[115]FORTRESS AGREEMENT, *supra* note 101, § 11.1(d); OCH-ZIFF AGREEMENT, *supra* note 101, § 12.1(d).

[116]FORTRESS AGREEMENT, *supra* note 101, § 11.2(a); OCH-ZIFF AGREEMENT, *supra* note 101, § 12.2(a).

[117]FORTRESS AGREEMENT, *supra* note 101, § 11.6(a); OCH-ZIFF AGREEMENT, *supra* note 101, § 12.6(a).

[118]THE BLACKSTONE GROUP L.P., AMENDED AND RESTATED LIMITED PARTNERSHIP AGREEMENT, *in* Annual Report (Form 10-K), exhibit 3.1, § 1.1 (June 27, 2007) [hereinafter

and the managers controlling the general partner effectively serve as the officers and directors of Blackstone, vested with "all management powers over the business and affairs of the Partnership . . . [with] full power and authority to do all things and on such terms as [the General Partner] determines, in its sole discretion, to be necessary or appropriate to conduct the business of the Partnership."[119] Thus, like corporations generally, and Fortress and Och-Ziff specifically, Blackstone features a clear division between ownership rights of its investors and management rights of the general partner.

But the rights of Blackstone's investors are substantially more restricted than would be allowed under standard corporate law. For example, Blackstone's general partner is not subject to annual election by the investors. Instead, the general partner's term is perpetual, subject only to removal upon a two-thirds supermajority vote.[120] Indeed, the investors have virtually no say or involvement in the business of the company,[121] other than approving amendments to the firm's governing agreement[122] or certain fundamental transactions.[123] And even so, any amendment or transaction must be first proposed by the general partner, and cannot be unilaterally considered by the investors.[124]

By limiting investor franchise in favor of a strong managerial role, Blackstone typifies the ways that internal noncorporate governance can depart from the standard corporate model. And ironically, this ability to limit investor franchise in the noncorporate context would seem to militate against the legal asymmetry from corporate law.[125] Unlike corporate law, which generally prohibits corporations from interfering with shareholder franchise,[126] noncorporate law affords the contractual freedom to

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BLACKSTONE AGREEMENT], *available at* http://www.sec.gov/Archives/edgar/data/1393818/000104746907005223/a2178627zex-3_1.htm.

[119] *Id.* § 7.1(a). Elsewhere, the Blackstone Agreement makes clear that all references to a decision made by the general partner in its "sole discretion" means that the general partner is:

> entitled to consider only such interests and factors as it desires, including its own interests, and shall have no duty or obligation (fiduciary or otherwise) to give any consideration to any interest of or factors affecting the Partnership or the Partners, and shall not be subject to any other or different standards imposed by this Agreement.

Id. § 7.9(b).

[120] *Id.* § 11.2.

[121] *Id.* § 3.2.

[122] BLACKSTONE AGREEMENT, *supra* note 118, § 13.2.

[123] *Id.* § 14.3.

[124] *Id.* §§ 13.2, 14.2.

[125] *See* Ribstein, *supra* note 24, at 307-09.

[126] *See, e.g.*, WELCH ET AL., *supra* note 44, § 141.2.4.8.

substantially limit investor franchise,[127] as the Blackstone governing agreement illustrates. These contractual limitations, coupled with the weaknesses of investor franchise inherent in public ownership, would suggest that Blackstone investors are *in even greater need* of fiduciary protections than any corporate shareholders.[128] Yet, as the following discussion will show, because of its noncorporate form, Blackstone, like Fortress and Och-Ziff, is able to substantially restrict and even eliminate the fiduciary duties that would otherwise bind its managers.

C. *Limiting and Eliminating Fiduciary Duties*

Because of the asymmetry in Delaware's noncorporate law, Blackstone, Fortress, and Och-Ziff are permitted to opt out of the mandatory and intricate system of fiduciary duties that Delaware law imposes on their corporate counterparts. And indeed each firm has exploited this advantage by including in its governing agreement significant restrictions on the fiduciary duties that the firm's managers would otherwise owe to its investors.

1. The Fortress/Och-Ziff Model: Fiduciary Restraint

Under the governing agreements of Fortress and Och-Ziff, the companies' officers and directors owe their investors the same "duties and

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[127]Indeed, in the LP context, limited partners were traditionally afforded *no* default voting rights under LP statutes. *See* Ribstein, *supra* note 37, at 12-13; Ribstein, *supra* note 24, at 307-08.

[128]*See* Ribstein, *supra* note 24, at 307-09; *cf.* Ribstein, *Fiduciary Duties*, *supra* note 66, at 939 (noting that fiduciary duties would be theoretically more important in the LP context because of the reduced voting rights of limited partners when compared to general partnerships). While the ability to restrict or eliminate investor franchise militates against the elimination of fiduciary duties in the context of publicly traded noncorporations, the issue is admittedly somewhat moot in the specific context of Blackstone, Fortress, and Och-Ziff because of the controlling voting interest held by the managers of each. As a result of a dual-share structure, immediately after their IPOs, Blackstone's managers held 86.4% of the company's outstanding voting interest; the managers of Fortress, 77.7%; and the managers of Och-Ziff, 79.1%. *See* Blackstone S-1, *supra* note 17, at 18-19; Fortress Investment Group LLC, Registration Statement (Form S-1), at 8 (Feb. 2, 2007) [hereinafter Fortress S-1], *available at* http://www.sec.gov/Archives/edgar/data/1380393/000095013607000635/file1.htm; Och-Ziff Management Group LLC, Registration Statement (Form S-1), at 53 (Nov. 9, 2007) [hereinafter Och-Ziff S-1], *available at* http://www.sec.gov/Archives/edgar/data/1403256/000119312507242704/ds1a.htm. As a result of these controlling stakes, the managers for Blackstone, Fortress, and Och-Ziff are able to effectively decide the outcome of every investor vote. Even so, the concept of managerial voting control over the firm is not unique to noncorporations and cannot justify the asymmetry from corporate law. *See infra* note 194 and accompanying text.

obligations owed to the shareholders of a corporation."[129] But the governing agreements go on to make clear that these "same duties and obligations" do not include the fiduciary duties owed by corporate directors and officers.[130]

While neither governing agreement purports to "eliminate" the fiduciary duties that would bind corporate managers, each provides that the express terms of the agreement are intended to replace any fiduciary duties that may otherwise apply under traditional law.[131] For example, under standard corporate law, the doctrine of corporate opportunities prohibits managers from usurping business opportunities that belong to the corporation.[132] Doing so would be a breach of the fiduciary duty of loyalty.[133] Yet the directors of Fortress and Och-Ziff are expressly authorized "to engage in outside business interests and activities in preference to or to the exclusion of the Company or in direct competition with the Company, . . . [with] no obligation . . . to present business opportunities to the Company that may become available to . . . such [d]irector."[134] Admittedly, Delaware's corporate statute allows corporations to renounce business opportunities that may rightfully belong to the corporation.[135] But unlike the provision in the Fortress and Och-Ziff governing agreements, Delaware's corporate statute is limited in two important respects. First, the waiver of a business opportunity in the corporate context must be specific, identifying the particular opportunity or category of opportunities being renounced.[136] The waiver cannot be general or unlimited. Second, any renunciation of a business opportunity in the corporate context is still subject to ex post judicial scrutiny under the rubric of the traditional fiduciary duty of loyalty.[137] In contrast, the governing agreements of Fortress and Och-Ziff

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[129]OCH-ZIFF AGREEMENT, *supra* note 101, § 5.23; *see also* FORTRESS AGREEMENT, *supra* note 101, § 5.23 (using the same language except for replacing shareholders with stockholders).

[130]FORTRESS AGREEMENT, *supra* note 101, § 5.23; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.23.

[131]FORTRESS AGREEMENT, *supra* note 101, § 2.1; OCH-ZIFF AGREEMENT, *supra* note 101, § 2.1.

[132]*See supra* note 46 and accompanying text.

[133]*See, e.g.*, Sci. Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 963 (Del. 1980) ("The doctrine of corporate opportunity is a species of the duty of a fiduciary to act with undivided loyalty.'" (quoting Gen. Auto. Mfg. Co. v. Singer, 120 N.W.2d 659, 663 (Wis. 1963))).

[134]FORTRESS AGREEMENT, *supra* note 101, § 5.24; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.24.

[135]DEL. CODE ANN. tit. 8, § 122(17) (2001).

[136]*Id.*

[137]WELCH ET AL., *supra* note 44, § 122.1 ("The subsection does not change the level of judicial scrutiny that will apply to the renunciation of . . . a business opportunity, which will be determined based on the common law of fiduciary duty, including the duty of loyalty.") (quoting 72 Del. Laws, c. 343, § 3 (2000)).

effectively grant their managers an unlimited waiver of any and all business opportunities that may arise, free of any post hoc judicial scrutiny.[138]

Elsewhere, the governing agreements of Fortress and Och-Ziff include detailed provisions for the resolution of any transaction that could represent a conflict of interest between the directors and officers, on one hand, and the company and its investors on the other.[139] Under standard corporate law, a manager's approval of a conflicted transaction could constitute a breach of the duty of loyalty, unless the transaction is "cleansed" by a majority vote of either the disinterested members of the board of directors or the disinterested shareholders of the corporation.[140] Fortress and Och-Ziff's governing agreements likewise provide for cleansing by vote of the independent directors or disinterested investors.[141] In addition to these two cleansing procedures, however, the agreements also provide for two alternative circumstances under which a conflicted transaction may be cleansed: first, if the terms of the transaction are "no less favorable" to the company than those generally available to unrelated third parties; and second, if the transaction is "fair and reasonable to the [c]ompany taking into account the totality of the relationships between the parties involved."[142] Importantly, the determination of whether the transaction is "no less favorable" or otherwise "fair and reasonable" is made by the company's board of directors as a whole, rather than by its independent or disinterested members.[143] Thus, the boards of Fortress and Och-Ziff are authorized to effectively "self-cleanse" any conflicted transaction between the companies and their managers. Moreover, the governing agreements provide that in determining such matters, the board will be presumed to have acted in good faith, and any investor challenging the transaction will have the burden of overcoming such presumption.[144]

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[138]To be sure, there may be legitimate reasons to waive business opportunities in the context of private equity funds or other firms that rely on human capital rather than hard assets. *See* Ribstein, *supra* note 53, at 213. The point being made here, however, is broader: the noncorporate form effectively allows the firms to restrict or eliminate the fiduciary duties that would otherwise bind their corporate counterparts.

[139]FORTRESS AGREEMENT, *supra* note 101, § 5.20; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.20.

[140]WELCH ET AL., *supra* note 44, §§ 141.2.2.9, 141.2.3.4; *see also* DEL. CODE ANN. tit. 8, § 144 (2001) (providing for shareholder ratification in certain circumstances).

[141]FORTRESS AGREEMENT, *supra* note 101, § 5.20; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.20.

[142]FORTRESS AGREEMENT, *supra* note 101, § 5.20; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.20.

[143]FORTRESS AGREEMENT, *supra* note 101, § 5.20; OCH-ZIFF AGREEMENT, *supra* note 101, § 5.20; *cf.* DEL. CODE ANN. tit. 8, § 144 (2001).

[144]FORTRESS AGREEMENT, *supra* note 101, § 5.20; OCH-ZIFF AGREEMENT, *supra* note

In addition to the substantive restrictions on the fiduciary duties of the firms' directors and officers, the governing agreements also include broad exculpatory provisions, eliminating *all* liability the directors or officers could possibly face for actions taken on behalf of the company, including any actions that may be alleged to breach any fiduciary duties.[145] Many corporate charters include similar exculpatory provisions; however, under Delaware's corporate statute, exculpation is effectively limited to breaches of the fiduciary duty of care.[146] Corporations may not exculpate directors for any breach of the fiduciary duties of loyalty or good faith.[147] And even where a corporation exculpates its directors for any breaches of the fiduciary duty of care, Delaware courts have demonstrated a willingness to work around any such exculpatory provisions by recasting breaches of due care as breaches of good faith, which cannot be exculpated under Delaware law.[148] In contrast, the governing agreements of both Fortress and Och-Ziff exculpate their directors and officers from *all* liability, provided their actions do not constitute fraud, gross negligence, or willful misconduct.[149] Thus, to the extent fiduciary duties are not eliminated by the governing agreements, the directors and officers of Fortress and Och-Ziff are effectively absolved of all liability that could arise from an alleged breach of such duties.

2. The Blackstone Model: A Fiduciary Black Hole

As described above, when compared to Fortress and Och-Ziff, the franchise rights afforded to Blackstone's investors are substantially more limited.[150] Ironically, any limitation on investor franchise would militate

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101, § 5.20.

[145]*See* OCH-ZIFF AGREEMENT, *supra* note 101, § 5.19(a) (exculpating and indemnifying the LLC's directors and officers for all acts taken on behalf of the company, unless such actions constitute fraud, gross negligence, or willful misconduct). *See also* FORTRESS AGREEMENT, *supra* note 101, § 5.19(a) (exculpating and indemnifying the LLC's directors and officers for all acts taken on behalf of the company, without any limitations for acts of fraud, gross negligence, or willful misconduct).

[146]DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

[147]*Id.*

[148]*See, e.g.*, Ryan v. Lyondell Chem. Co., No. 3176-VCN, 2008 WL 2923427 (Del. Ch. July 29, 2008), *reprinted in* 34 DEL. J. CORP. L. 333 (2009), *rev'd*, No. 401, 2008, 2009 WL 1024764 (Del. Apr. 16, 2009).

[149]OCH-ZIFF AGREEMENT, *supra* note 101, § 5.19(a); *cf.* FORTRESS AGREEMENT, *supra* note 101, § 5.19(a). Interestingly, by limiting exculpation in cases of "gross negligence," Och-Ziff decided to retain the basic standard of the fiduciary duty of care, even though both Delaware's corporate and noncorporate statutes would have permitted Och-Ziff to eliminate it. *See* OCH-ZIFF AGREEMENT, *supra* note 101, § 5.19(a); DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). Och-Ziff's managers are, thus, subject to a higher standard of conduct than the "bare minimum" permitted by Delaware law.

[150]*See supra* notes 118-24 and accompanying text.

against the restriction or elimination of traditional fiduciary duties. Yet, the fiduciary duties owed to Blackstone's investors are even more restricted.[151]

In the broadest terms possible, the Blackstone governing agreement eliminates the restrictions that any fiduciary duties may impose on its general partner:

> [T]o the fullest extent permitted by law, . . . the General Partner . . . shall have [no] duties or liabilities, *including fiduciary duties*, to the Partnership, [or] any Limited Partner . . . and the provisions of this Agreement, to the extent that they restrict or otherwise modify or eliminate the duties and liabilities, *including fiduciary duties*, of the General Partner . . . otherwise existing at law or in equity, are agreed by the Partners to replace such other duties and liabilities of the General Partner . . . .[152]

It may be difficult to imagine an investor who would agree to such a one-sided waiver in a privately negotiated transaction; yet, the governing agreement goes on. Like the governing agreements of Fortress and Och-Ziff, the Blackstone agreement provides that in the event a transaction presents a conflict of interest, the transaction can be self-cleansed if the general partner determines that the terms are "no less favorable" than terms generally available to unrelated parties or is otherwise "fair and reasonable."[153] Moreover, any investor challenging the transaction will likewise have the burden to overcome the presumption that the general partner acted in good faith in making its determination.[154]

Further, whenever the governing agreement permits the general partner to make a decision in its "sole discretion"—for example, in executing

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[151] *See id.*

[152] BLACKSTONE AGREEMENT, *supra* note 118, § 7.9(e) (emphasis added). Elsewhere, the agreement provides that:

> [t]o the fullest extent permitted by law, the General Partner shall have no duty or obligation to propose or approve, and may decline to propose or approve, the conduct by the Partnership of any business free of any duty (*including any fiduciary duty*) or obligation whatsoever to the Partnership or any Limited Partner or Record Holder and, in declining to so propose or approve, shall not be deemed to have breached this Agreement, any other agreement contemplated hereby . . . .

Id. § 2.4 (emphasis added); *see also id.* § 2.1 (providing that the "rights, duties (*including fiduciary duties*), liabilities and obligations" of all of the partners, including the general partner, are subject to the terms of the Blackstone Agreement) (emphasis added).

[153] *Id.* § 7.9(a); FORTRESS AGREEMENT, *supra* note 101, § 5.20(a); OCH-ZIFF AGREEMENT, *supra* note 101, § 5.20(a).

[154] BLACKSTONE AGREEMENT, *supra* note 118, § 7.9(a).

its "authority to do all things and on such terms as it determines, in its *sole discretion*, to be necessary or appropriate to conduct the business of the Partnership"[155]—the general partner is entitled to consider "only such interests and factors as it desires, *including its own interests*, and shall have no duty or obligation (*fiduciary or otherwise*) to give any consideration to any interest of or factors affecting the Partnership or the Partners."[156] Consistent with this broad latitude, in determining whether to agree to a merger or sale of the company, the general partner, in its *sole discretion*:

> shall have no duty or obligation to consent . . . and, to the fullest extent permitted by law, may decline to do so free of any duty (including any fiduciary duty) or obligation whatsoever to the Partnership, [or] any Limited Partner . . . and, in declining to consent . . . shall not be required to act pursuant to any other standard imposed by this Agreement, any other agreement contemplated hereby or under the Delaware Limited Partnership Act or any other law, rule or regulation or at equity.[157]

The Blackstone governing agreement, thus, effectively eliminates the fiduciary duties of loyalty enshrined in *Unocal*,[158] *Revlon*,[159] and their progeny.[160]

Finally, consistent with its comprehensive approach to the elimination of fiduciary duties, the Blackstone governing agreement also includes a broad exculpatory provision that eliminates *all* liability that could arise from a purported breach of any fiduciary duty.[161] Startlingly, however, the exculpation provision applies not only to the general partner and its managers and affiliates, but also to "*any [p]erson the General Partner in its sole discretion designates* . . ."![162] Thus, Blackstone represents a fiduciary black hole, from which no liability for managerial misbehavior can escape.

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[155] *Id.* § 7.1(a) (emphasis added).

[156] *Id.* § 7.9(b) (emphasis added).

[157] *Id.* § 14.2.

[158] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

[159] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

[160] *See* WELCH ET AL., *supra* note 44, § 141.2.4-141.2.5 (discussing the fiduciary duty of loyalty for boards under Delaware law as established by the *Unocal* and *Revlon* holdings and subsequent cases).

[161] BLACKSTONE AGREEMENT, *supra* note 118, § 7.8. Exculpation, however, is subject to limited exceptions in cases of bad faith, fraud, or willful misconduct. *Id.*

[162] *Id.* § 1.1 (emphasis added).

IV. OTHER JUSTIFICATIONS FOR LEGAL ASYMMETRY CONSIDERED

Thus far, this article has suggested that in the context of today's publicly traded noncorporations, the traditional assumptions underlying the contractual conception of noncorporate form fail to distinguish noncorporations from their corporate counterparts. And in the absence of any substantive distinctions, the asymmetry between the fiduciary duties of corporate and noncorporate law today represents a hollow formalism. This section considers and ultimately dismisses four possible counterarguments to this thesis.

A. *Substantively Distinguishing Noncorporations*

In a series of provocative articles, Professor Larry Ribstein has argued that certain default or traditional features of the noncorporate form—specifically (1) the periodic distributions of profits to investors, (2) the limited lifetime and compelled liquidation of noncorporations, and (3) the managerial stakes in the firm's success—substantively distinguish noncorporations from their corporate counterparts.[163] These noncorporate features, Professor Ribstein argues, incentivize and discipline noncorporate managers in ways that corporations cannot replicate.[164] Thus, noncorporate investors can rely on these noncorporate features to ensure managerial accountability, in lieu of the standard franchise rights and fiduciary protections afforded corporate shareholders.[165]

As an abstract matter, Professor Ribstein's thesis is compelling, but it is largely confined to private noncorporations. Indeed, as Professor Ribstein concedes, in the context of publicly traded noncorporations, the noncorporate features that he identifies may be inadequate substitutes for the fiduciary protections and franchise rights afforded by standard corporate law.[166]

Professor Ribstein's concession, however, stops too short. As this part demonstrates, in the context of public noncorporations, not only are the

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[163]Ribstein, *supra* note 13, at 3; Ribstein, *supra* note 37, at 3-4; Ribstein, *supra* note 38, at 136-43.

[164]*See* Ribstein, *supra* note 37, at 3-4.

[165]Ribstein, *supra* note 13, at 15-17; Ribstein, *supra* note 37, at 3-5, 15; Ribstein, *supra* note 38, at 133.

[166]Ribstein, *supra* note 37, at 37; *see also* Ribstein, *supra* note 38, at 164-65 ("The [non]corporate attributes . . . including customizing or eliminating fiduciary duties, may be best suited only to those firms that can use [non]corporate-type discipline instead of corporate-type monitoring.").

incentivizing and disciplining noncorporate features identified by Professor Ribstein likely *inadequate*, some are *altogether inapplicable* in the specific case of Blackstone, Fortress, and Och-Ziff. Thus, the noncorporate features identified by Professor Ribstein fail to distinguish public noncorporations from their corporate counterparts and, therefore, fail to provide a substantive basis for the asymmetry between corporate and noncorporate law.

1. Compelled Periodic Distributions

For Professor Ribstein, an essential difference between noncorporations and their corporate counterparts is the ability of each form to commit to making periodic distributions to investors.[167] Compelled distributions prevent managers from hording capital within the firm and thereby insulating themselves from the disciplining effects of capital markets.[168] Because noncorporations "are more likely than corporations to have effective provisions compelling [periodic] distributions,"[169] noncorporate investors have less need to rely on monitoring devices to constrain their managers' discretion over use of the firm's cash.[170]

Professor Ribstein argues that corporations, unlike noncorporations, are less inclined to make distributions to their shareholders because doing so is "inconsistent with the corporate norms of retaining earnings under managerial control."[171] The tax code reinforces this corporate norm by imposing a "double tax" on corporations—taxing both corporate income at the entity level, and any dividends distributed at the shareholder level.[172] The double tax, thus, provides corporations with an incentive to retain funds at the entity level, thereby avoiding the second layer of tax.[173] In contrast, because of the pass-through tax treatment of noncorporations, such firms have a strong incentive to make distributions to their investors, at least to the extent necessary to enable their investors to pay the tax they incur.[174]

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[167]Ribstein, *supra* note 13, at 10-12; Ribstein, *supra* note 37, at 7; Ribstein, *supra* note 38, at 137-39.

[168]Ribstein, *supra* note 13, at 12; Ribstein, *supra* note 37, at 9-10; Ribstein, *supra* note 38, at 140.

[169]Ribstein, *supra* note 37, at 7.

[170]Ribstein, *supra* note 13, at 12; Ribstein, *supra* note 37, at 7; Ribstein, *supra* note 38, at 139.

[171]Ribstein, *supra* note 37, at 7; *see also* Ribstein, *supra* note 13, at 11; Ribstein, *supra* note 38, at 139 (citing Steven A. Bank, *Tax, Corporate Governance, and Norms*, 61 WASH. & LEE L. REV. 1159, 1218-19, 1223-28 (2004)).

[172]Ribstein, *supra* note 37, at 8.

[173]*Id.*

[174]*Id.*

Corporate norms and the tax code notwithstanding, public noncorporations cannot be substantively distinguished from corporations on the basis of compelled distributions for at least four reasons. First, as Professor Ribstein notes, purchasers of preferred stock in the corporate context often couple the purchase of such stock with a right to periodic distributions.[175] Yet Professor Ribstein does not give a persuasive account of why these provisions are not effective in compelling distributions in the corporate context.[176] As a general matter, courts will enforce the compelled distribution of dividends in the corporate context so long as the contract or charter terms requiring the compelled distribution are clear and do not require the payment of dividends when doing so would be unlawful.[177]

Second, the tax code treats most publicly traded noncorporations as corporations for tax purposes.[178] As a result, most publicly traded noncorporations will forego pass-through tax treatment and be subject to the same double taxation on distributions as corporations. Blackstone, Fortress, and Och-Ziff have each claimed an exemption to this corporate tax

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[175]Ribstein, *supra* note 38, at 138.

[176]Professor Ribstein suggests corporate law would be reluctant to enforce any contractual or charter provisions compelling periodic payments to preferred shareholders, citing case law that suggests contractual provisions that "sterilize" a corporate board of directors are unenforceable because such provisions conflict with the standard corporate model of director primacy over the business affairs of the corporation. Ribstein, *supra* note 38, at 139 (citing Ribstein, *supra* note 53, at 197 & n.63). Professor Ribstein, however, cites only case law *enforcing* contractual provisions compelling the board to make periodic distributions. Ribstein, *supra* note 53, at 197 n.61 (citing Clark v. Dodge, 199. N.E. 641 (N.Y. 1936) (enforcing agreement concerning dividends among other things because the agreement did not unduly restrict director discretion) (internal quotation marks omitted); Galler v. Galler, 203 N.E.2d 577 (Ill. 1964) (enforcing close corporation agreement including dividend distribution provision where the provision was conditioned on a minimum earned surplus of $500,000) (internal quotation marks omitted)). Moreover, Professor Ribstein notes that debt agreements, which compel corporations to make periodic payments, can mimic the disciplining effects of noncorporations in the corporate context. Ribstein, *supra* note 37, at 8. Yet he does not explain why lawyers cannot structure preferred equity investments to mimic the features of debt agreements to achieve the same noncorporate-like result. Indeed, as Professor Steven Bank has noted, preferred stock gained popularity in the United States *specifically because* it "provided for guaranteed dividend rates similar to interest payments on debt, but the holder could not foreclose on the instrument if his dividends fell in arrears." Bank, *supra* note 171, at 1225.

[177]12 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5445 (perm. ed., rev. vol. 2004); *see also id.* § 5447 ("The business judgment principles governing the discretion of the board of directors in their decision to pay dividends are the same with respect to dividends on preferred shares, *unless the terms of the articles of incorporation or bylaws make the dividend mandatory.*") (emphasis added); *cf.* WELCH ET AL., *supra* note 44, § 170.7 (noting that although the decision to declare dividends under Delaware law is normally protected by the business judgment rule, "[t]his does not mean . . . that a board has untrammeled power to declare or not to declare a dividend").

[178]I.R.C. § 7704(a) (2008).

treatment,[179] although the validity of this claim has been the subject of some doubt.[180] Even so, as a general matter, most publicly traded noncorporations will be treated identically to corporations for tax purposes, eliminating any difference in tax treatment between corporations and noncorporations.[181]

Third, even if a publicly traded noncorporation retains its pass-through tax status, Professor Ribstein does not explain why noncorporations have any incentive to make distributions *in excess* of the amount necessary to offset *their investors' actual tax liability*. Although a noncorporate investor may be taxed on the portion of the noncorporation's income imputed to her regardless of whether that income is actually distributed by the firm, that noncorporate investor will be in the same position as a corporate shareholder so long as the noncorporation makes a distribution in the amount necessary to offset the investor's tax liability. To the extent a noncorporation retains any cash in excess of the tax liability incurred by its investors, the noncorporation behaves much like a corporation in that it pays taxes at the entity level and retains the balance of its cash within the firm.

Finally, in the specific cases of Blackstone, Fortress, and Och-Ziff, the feature of compelled periodic distributions is wholly absent. Even though the offering documents for Blackstone, Fortress, and Och-Ziff each claim that the firms intend to make quarterly distributions to their investors,[182] each firm's governing agreement makes clear that all distributions are within the "sole discretion" of the firm's managers.[183] Thus, the managers of Blackstone, Fortress, and Och-Ziff are free to make no distribution at all and to retain the whole of the firms' earnings at the entity level. In this sense, beyond the incentive to make the minimal distributions necessary to offset their investors' tax liability, Blackstone, Fortress, and Och-Ziff are no different than public corporations.

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[179] *See* Blackstone S-1, *supra* note 17, at 242-43; Fortress S-1, *supra* note 128, at 215-17; Och-Ziff S-1, *supra* note 128, at 230-32.

[180] *See* Fleischer, *Taxing Blackstone*, *supra* note 19, at 106-09; Posting of Victor Fleischer to the Conglomerate Blog: Business, Law, Economics & Society, http://www.theconglomerate.org/2007/03/blackstone_ipo_.html (Mar. 25, 2007).

[181] The exception to the corporate taxation of publicly traded noncorporations is quite limited. To qualify for pass-through taxation as a publicly traded noncorporation, a firm must derive at least ninety percent of its income from interest, dividends, real property rents, or certain other specified oil, gas, timber, and other natural resources activities. I.R.C. § 7704(c)-(d) (2008). Any publicly traded noncorporation that does not satisfy this requirement will be treated as if it were a corporation for tax purposes. *Id.* § 7704(a).

[182] Blackstone S-1, *supra* note 17, at 82-83; Fortress S-1, *supra* note 128, at 71-72; Och-Ziff S-1, *supra* note 128, at 93-94.

[183] BLACKSTONE AGREEMENT, *supra* note 118, § 6.3(a); FORTRESS AGREEMENT, *supra* note 101, § 4.3(a); OCH-ZIFF AGREEMENT, *supra* note 101, § 4.3(a).

2. Limited Lifetime and Compelled Liquidation

Like provisions requiring periodic distributions, Professor Ribstein argues that provisions requiring the firm to liquidate after a set period of time expose noncorporate managers to the disciplining effects of having to return to the capital markets.[184] Historically, Professor Ribstein notes, noncorporations were required to include a provision in their governing agreements setting the term of the firm.[185] Upon the expiration of the term, a noncorporation's managers would be forced to either return to the capital markets to raise cash or ask the firm's current investors to waive their rights to liquidation and distribution of the proceeds.[186] Corporate managers, Professor Ribstein argues, are insulated from the disciplining effect of forced liquidations because of the corporate norm of perpetual existence.[187]

Again, however, noncorporations cannot be substantively distinguished from corporations on the basis of limited lifetime and compelled liquidations for at least three reasons. First, as a general matter, Professor Ribstein notes that although noncorporate statutes once required a set termination date for the firm, under modern statutes, the terms of noncorporations are assumed to be perpetual.[188] Thus, under modern law, noncorporations are no different than corporations.[189]

Second, even if a noncorporation is subject to a limited term, the managers' exposure to the disciplining effects of capital markets is limited to the period *immediately preceding* the termination date. Corporate managers are, in contrast, exposed to *continuous* market discipline arising from the free transferability of corporate shares and the ever-present threat of a hostile takeover, even if, as Professor Ribstein notes, such a threat is dependent upon the existence of favorable financing conditions or a strategic bidder.[190]

Finally, in the specific case of Blackstone, Fortress, and Och-Ziff, the concept of limited lifetime and compelled liquidation is altogether absent. The term of each entity is not limited, but *perpetual*.[191] Thus, again,

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[184]Ribstein, *supra* note 13, at 11-12; Ribstein, *supra* note 37, at 8-9.

[185]Ribstein, *supra* note 13, at 11; Ribstein, *supra* note 37, at 8.

[186]Ribstein, *supra* note 13, at 12; Ribstein, *supra* note 37, at 9.

[187]Ribstein, *supra* note 13, at 12; Ribstein, *supra* note 37, at 9.

[188]Ribstein, *supra* note 13, at 11-12; Ribstein, *supra* note 37, at 8.

[189]*See* Clark, *supra* note 58, at 1012; *cf.* DEL. CODE ANN. tit 8, § 102(b)(5) (2001) (assuming perpetual corporate existence in the absence of a certificate provision to the contrary).

[190]Ribstein, *supra* note 37, at 9, 18-19.

[191]BLACKSTONE AGREEMENT, *supra* note 118, § 2.7; FORTRESS AGREEMENT, *supra* note 101, § 2.7; OCH-ZIFF AGREEMENT, *supra* note 101, § 2.7.

Blackstone, Fortress, and Och-Ziff are in this respect no different than their corporate counterparts. As Professor Ribstein notes:

> Rather than ensuring distributions to the owners and thereby forcing the managers to return to the capital markets in pursuit of cash, [private noncorporations] . . . go public partly in order to get "permanent" capital. It is not clear whether the other [non]corporate incentives and discipline will be enough to protect the outside owners of these firms.[192]

3. Managerial Equity Stakes

Finally, Professor Ribstein argues that both the size and form of the equity stakes typically held by noncorporate managers serve to closely align managerial interests with those of the investors.[193] Unlike a corporate manager, who may own only a small fraction of the firm's total equity, noncorporate managers typically hold substantial equity stakes in their firms.[194] As full-fledged owners of the firm, noncorporate managers are exposed to the same upside potential and downside risks as their investors—effectively aligning the interests of the managers with the investors.[195]

In the absence of large equity stakes held by corporate managers, corporations attempt to incentivize their managers by tying a portion of their executives' compensation to the firm's performance, typically in the form of stock options.[196] Stock options, however, are an imperfect tool to align managerial interests with the interests of shareholders.[197] Unlike full-fledged equity ownership, stock options do not expose managers to any downside risk below the option exercise price.[198] Even when the exercise price is "underwater," managers can manipulate stock options, as illustrated by the recent backdating scandal.[199] And on the upside, options may needlessly

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[192]Ribstein, *supra* note 37, at 37.

[193]*Id.* at 9-10; Ribstein, *supra* note 38, at 136-37.

[194]Ribstein, *supra* note 13, at 8; Ribstein, *supra* note 37, at 9.

[195]Ribstein, *supra* note 13, at 8; Ribstein, *supra* note 37, at 10; Ribstein, *supra* note 38, at 136-37.

[196]Ribstein, *supra* note 37, at 10.

[197]*Id.* (citing BEBCHUK & FRIED, *supra* note 35, at 139).

[198]BEBCHUK & FRIED, *supra* note 35, at 139; Ribstein, *supra* note 13, at 8; Ribstein, *supra* note 38, at 136-37.

[199]Ribstein, *supra* note 37, at 10; *see also* BEBCHUK & FRIED, *supra* note 35, at 165-68 (describing corporate managers' ability to manipulate stock options).

reward managers for generally favorable market conditions that are irrelevant to their performance.[200]

Indeed, the managers of Blackstone, Fortress, and Och-Ziff each retained a substantial equity stake in their firms after their respective IPOs.[201] Doing so gives the public investors of these firms a strong basis to believe that managerial interests will be aligned with those of the investors. But neither the size nor form of the equity stakes held by noncorporate managers distinguishes public noncorporations from their corporate counterparts.

With respect to *size*, noncorporations are not unique in having managers who are also full-fledged owners. Many public corporations are led by management teams who also own a majority or controlling equity stake in the firm. Take, for example, Google, Inc., a Delaware corporation, and its unassuming cofounders, Larry Page and Sergey Brin. Today, Messrs. Page and Brin both serve as directors and executive officers of Google, and together hold nearly sixty million shares of Google's Class B common stock, representing roughly sixty percent of the outstanding voting power of the company.[202] Messrs. Page and Brin's large equity stakes in Google give its public shareholders strong assurances that Messrs. Page and Brin's managerial interests are aligned with those of the other shareholders. Yet, because Google is organized as a corporation, Messrs. Page and Brin are still bound by the fiduciary duties prescribed by standard corporate law. In contrast, Stephen Schwartzman, the founder of Blackstone and a principal owner, is not bound by any fiduciary duties, all simply because Blackstone is organized as a noncorporation.

Likewise, with respect to the *form* of the managers' equity stakes, the disciplining and incentivizing effects of full-fledged ownership are not unique to noncorporations. As Professor Ribstein concedes, there is "[n]o corporate rule [that] would prevent corporate managers from being compensated like full-fledged [owners]."[203] Indeed, in response to growing criticisms of conventional stock options, corporations are displaying a greater willingness to replace options with restricted stock grants.[204] Professor Ribstein argues, however, that as a practical matter, shareholder outrage at executive compensation in the corporate context inhibits corporations from actually compensating managers as full-fledged owners of

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[200] *See* BEBCHUK & FRIED, *supra* note 35, at 138-40.

[201] For a review of percentage ownership allocations, see *supra* note 128.

[202] Google, Inc., Definitive Proxy Statement (Schedule 14A), at 33 (Mar. 25, 2008), *available at* http://www.sec.gov/Archives/edgar/data/1288776/000119312508064574/ddef14a.htm.

[203] Ribstein, *supra* note 37, at 10.

[204] BEBCHUK & FRIED, *supra* note 35, at 170-71.

the firm.[205] But this claim raises more questions than it answers: Why would corporate shareholders be more outraged by high positive swings in managerial compensation that may arise from equity ownership than from similar swings that would arise from the ownership of stock options? More generally, why would the same outrage constraints that purportedly inhibit corporations not also similarly inhibit publicly traded noncorporations? Putting these questions aside, shareholder outrage has not served to constrain corporate executive compensation historically,[206] so it is unclear why it would serve to inhibit corporations in this specific context. Finally, even assuming it is impractical to compensate corporate managers as full-fledged owners by awarding them equity stakes in their firms, stock options, the standard corporate form of incentive compensation, can be designed in ways to approximate the incentivizing effects of full-fledged ownership,[207] reducing any incentivizing or disciplining advantages that noncorporations may afford their investors.

To be sure, the fact that the managers of Blackstone, Fortress, and Och-Ziff are also full-fledged owners of a large equity stake in their respective firms serves as strong assurance to investors that managerial interests are aligned with theirs. Yet, neither the size nor form of the equity stakes held by these managers distinguishes noncorporations from their corporate counterparts and, therefore, cannot provide a substantive basis for the asymmetry from corporate law.

B. *Legal Asymmetry as Business Flexibility*

A final criticism to the thesis of this article can be summarized as follows: Even in the absence of a substantive distinction between corporations and noncorporations, the legal asymmetry regarding the law of fiduciary duties, even if purely formalistic, is not really problematic. Corporate law and noncorporate law evolved along historically distinct trajectories, and it should be no surprise that today the two bodies of law are not consistent or symmetrical. Indeed, asymmetry is advantageous because it affords business planners and investors an array of options to custom tailor the parties' business relationships, including whether to choose the corporate

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[205]Ribstein, *supra* note 37, at 10.

[206]*See generally* BEBCHUK & FRIED, *supra* note 35 (describing the ability of corporate managers to manipulate and inflate executive compensation in the face of any shareholder outrage). To the extent shareholder outrage does provide a meaningful check on executive compensation, Professors Bebchuk and Fried outline the many ways that corporate managers use camouflage to avoid such outrage. *Id.* at 67-68.

[207]*Id.* at 140-43.

form, subject to the rights and obligations of fiduciary duties, or the noncorporate form, which allows the parties to restrict or eliminate any such duties.[208]

This argument, however, misidentifies the source of this flexibility. Legal asymmetry does not afford business parties the flexibility to opt out of the regime of fiduciary duties. Noncorporate law, standing alone, provides this flexibility. Noncorporate law permits business planners and their investors to mimic the corporate structure, while choosing whether to be bound by some or all of the fiduciary duties applicable under corporate law[209] or to eliminate such duties altogether.[210] Even in the absence of the corporate form, business parties using the noncorporate form would still have the option to be bound by the fiduciary duties of corporate law.

Thus, to the extent that business planners and their prospective investors desire maximum flexibility to custom tailor their relationship, noncorporate law alone affords this flexibility. Legal asymmetry provides nothing more than burdensome formalism.

V. THE END OF CORPORATE LAW?

In light of the substantive and structural similarities between today's public noncorporations and their corporate counterparts, and in the absence of a substantive distinction, the asymmetry between the fiduciary duties of corporate and noncorporate law today reflects an archaic formalism. Yet there is little reason to believe this formalism will be resolved anytime soon. The right of Delaware noncorporations to eliminate fiduciary duties is rooted firmly in statute, amended just four years ago for this specific purpose.[211] And the historical inertia and settled expectations inhering in Delaware's corporate law of fiduciary duties makes it impossible to foresee a dramatic departure in the corporate context.[212]

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[208]Professor Ribstein has, in passing, made a nod to this argument. *See, e.g.*, Posting of Larry Ribstein to The Harvard Law School Corporate Governance Blog, http://blogs.law.harvard.edu/corpgov/2008/08/05/delaware-enforces-a-fiduciary-opt-out-in-a-publicly-held-firm/ (Aug. 5, 2008, 14:58 EST) ("There is also an argument for letting firms and investors choose between two distinct approaches to opting out of fiduciary duties.").

[209]Ribstein, *supra* note 38, at 154 ("A[] [non]corporate agreement may implicitly authorize judicial application of corporate-type fiduciary duties . . . .").

[210]*See supra* notes 83-90 and accompanying text.

[211]*See supra* note 87 and accompanying text.

[212]*See* Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1771-76 (2006) (noting that with respect to its corporate law, Delaware's legislature is motivated by the principles of stability, conservatism, and the avoidance of disruption to preexisting business relationships); *see, e.g.*, Sutherland v. Sutherland, No. 2399-VCL, 2009 WL

But continuing asymmetry poses a challenge for the future relevance of corporate law and the corporate form. Fiduciary duties have long vexed academics, practitioners, and business managers. Many have decried the corporate law of fiduciary duties as indeterminate, inconsistent, and incoherent.[213] As one commentary has put it, "[Delaware's corporate] law governing the responsibilities of directors has become so muddled that, incredibly, one can't get a consistent answer to the most basic corporate law question of how many fiduciary duties directors have—if you ask Delaware lawyers, the answer can range anywhere from two to five!"[214]

This indeterminacy is reflected, and somewhat exacerbated, by the unusually high reversal rates in Delaware's courts, which Professors Carney and Shepherd have found to be almost four times the rate of federal courts.[215] Indeterminacy in the law makes the ex ante prediction of legal outcomes difficult, which in turn complicates basic business planning.[216] Moreover, legal uncertainty promotes costly litigation.[217] Indeed, one study found that in a two-year period, 1,280 corporate law complaints were filed in Delaware courts;[218] of those, seventy-eight percent involved alleged breaches of fiduciary duties.[219]

Given an alternative, business managers and their investors would seek to avoid the costs and uncertainty imposed by the indeterminate fiduciary duties of corporate law.[220] The 2007 IPOs demonstrated that managers and investors now have an alternative: the noncorporate form. By going public as noncorporations, Blackstone, Fortress, and Och-Ziff showed that firms can mimic the corporate structure and seek public capital, while eliminating the costs and uncertainty of fiduciary duties.[221] In the absence of

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857468, at *4 (Del. Ch. Mar. 23, 2009) (holding that a corporate charter provision purporting to eliminate the fiduciary duty of loyalty it unenforceable under Delaware's corporate law).

[213] *See supra* notes 52-56 and accompanying text.

[214] Carney & Shepherd, *supra* note 53, at 11 (quoting Paul T. Schnell, *From the Editor—M&A at Year-End*, M&A LAW., Jan. 2005, at 3-4); *cf.* Johnson & Ricca, *supra* note 50, at 675-78 (noting the pervasive confusion among attorneys regarding whether good faith is a separate fiduciary duty and, if so, the obligations entailed by the fiduciary duty).

[215] Carney & Shepherd, *supra* note 53, at 12 & n.60.

[216] *Id.* at 12-13; Kamar, *supra* note 53, at 1919.

[217] Carney & Shepherd, *supra* note 53, at 36-39; Kamar, *supra* note 53, at 1919, 1947.

[218] Carney & Shepherd, *supra* note 53, at 38 (citing Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1761 (2004)).

[219] *Id.* (citing Thompson & Thomas, *supra* note 218, at 1761).

[220] *See* Ribstein, *supra* note 61, at 831-33 (describing various reasons why business forms will evolve efficiently); *cf.* Kamar, *supra* note 53, at 1947 (noting that Delaware firms wishing to avoid the costs and uncertainty associated with the indeterminacy of corporate law "have no real alternative").

[221] *See supra* notes 11-16 and accompanying text.

a substantive distinction between public corporations and their noncorporate counterparts, and in light of the legal uncertainty and costs imposed by the fiduciary duties of corporate law, it is difficult to see why business managers and their investors would continue to choose the corporate form.

But they do. Even today, public noncorporations are still a relative rarity.[222] This poses a difficult puzzle for those who criticize Delaware's fiduciary law as indeterminate and costly. Since the early 1990s, Delaware's noncorporate statutes have permitted noncorporations to *restrict* fiduciary duties and, since 2004, to *eliminate* such duties wholesale.[223] If the fiduciary duties of corporate law are indeed inefficiently indeterminate and costly, why then are public noncorporations still a relative rarity?[224] To be sure, transition costs,[225] along with other factors,[226] may impede *existing* corporations from unincorporating. But why do new and emerging firms still choose the corporate form?

This section considers three possible explanations for the enduring dominance of the corporate form: a market-based theory, a political theory, and a network effects theory. Together, these theories may help partially explain the *historical* dominance of the corporate form.[227] And at first blush, it may seem plausible that these theories would predict the *continued* dominance of the corporate form. But, as discussed below, recent develop-

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[222]*See* NAT'L ASS'N FOR PUBLICLY TRADED P'SHIPS, *supra* note 82 (identifying all of the publicly traded LPs and LLCs); *see also* Ribstein, *supra* note 37, at 32 ("Publicly traded partnerships are only a small fraction of the many thousands of partnerships and publicly traded corporations.").

[223]*See supra* notes 83-90 and accompanying text.

[224]One could argue that the relative dearth of publicly traded partnerships is a result of the tax code, which treats most publicly traded partnerships as corporations for tax purposes; thereby effectively eliminating the "pass-through" tax advantage that makes the noncorporate form attractive. I.R.C. § 7704(a) (2008); *see also* Fleischer, *Taxing Blackstone*, *supra* note 19, at 95-96 (citing Ribstein, *supra* note 13); Ribstein, *supra* note 37, at 32-33. This provision, however, does not *disadvantage* noncorporations as much it *neutralizes* the tax advantage otherwise afforded noncorporations over their corporate counterparts. *Cf.* Ribstein, *supra* note 37, at 33 (noting that the tax code alone cannot explain the relative dearth of publicly traded noncorporations because "large firms theoretically could adopt the partnership form while being taxed like corporations"). Thus, from a tax perspective, to the extent a noncorporation is subject to section 7704 of the tax code, there is no net advantage or disadvantage in choosing the corporate form over the unincorporated form, or vice versa.

[225]*See* Ribstein & Kobayashi, *supra* note 66, at 105-07.

[226]*See* Ribstein, *supra* note 61, at 851 (noting that switching business forms may hurt creditors and "frustrate the expectations of those who have relied on the existing rules"); Ribstein, *supra* note 24, at 311-13.

[227]This article takes no position on whether and to what extent any of these theories provide a persuasive explanation for the historic dominance of the corporate form. Rather, in considering these explanations, this article's sole purpose is to argue that no one can predict the *continuing* dominance of the corporate form, particularly in light of recent events.

ments in the law and financial markets cast serious doubt as to whether any of these theories can predict such continued dominance of the corporate form. Absent a compelling explanation that would predict the continued dominance of the corporate form, it is likely that the second decade of the twenty-first century will see the declining relevance of corporations and corporate law, and the increasing importance of noncorporations and noncorporate law.

A. *The Market-Based Explanation*

Perhaps the most obvious explanation for the enduring dominance of the corporate form and the relative dearth of publicly traded noncorporations is that public investors simply prefer the fiduciary protections afforded by corporate law. Therefore, the relative absence of public noncorporations is the product of an efficient market.[228] Under this theory, investors are skeptical of firms that cannot commit to a minimum set of duties intended only to ensure managerial accountability and the maximization of investor wealth. Indeed, one could argue, investor skepticism should be exacerbated by the 2008 financial crisis and the resulting collapse of Bear Stearns,[229] AIG,[230] Lehman Brothers,[231] Washington Mutual,[232] Freddie Mac, and Fannie Mae.[233] In a matter of weeks, each of these firms failed, wiping out billions of dollars in shareholder wealth, and all amid allegations of executive mismanagement.[234] The failure of these firms should cause

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[228] *Cf.* Ribstein & Kobayashi, *supra* note 66 (providing evidence that the inherent characteristics of business forms may play a larger role than network externalities in determining choice of form).

[229] Andrew Ross Sorkin, *In Sweeping Move, Fed Backs Buyout and Wall St. Loans*, N.Y. TIMES, Mar. 17, 2008, at A1.

[230] Edmund L. Andrews et al., *Fed in an $85 Billion Rescue of an Insurer Near Failure*, N.Y. TIMES, Sept. 17, 2008, at A1.

[231] Andrew Ross Sorkin, *Bids to Halt Financial Crisis Reshape Landscape of Wall St.*, N.Y. TIMES, Sept. 15, 2008, at A1.

[232] Eric Dash & Andrew Ross Sorkin, *Government Seizes WaMu and Sells Some Assets*, N.Y. TIMES, Sept. 26, 2008, at A1.

[233] Stephen Labaton & Edmund L. Andrews, *In Rescue to Stabilize Lending, U.S. Takes Over Mortgage Finance Titans*, N.Y. TIMES, Sept. 8, 2008, at A1.

[234] *See, e.g.*, Charles Duhigg, *At Freddie Mac, Chief Discarded Warning Signs*, N.Y. TIMES, Aug. 5, 2008, at A1; Charles Duhigg, *Pressured to Take More Risk, Fannie Reached Tipping Point*, N.Y. TIMES, Oct. 5, 2008, at A1; *Feds Secretly Investigated WaMu Slide for Months—U.S. Attorney Reveals Task Force Probing Whether Criminal Action Involved in Bank's Failure*, SEATTLE TIMES, Oct. 16, 2008, at A1; Eric Lichtblau, *F.B.I. Looks Into 4 Firms at Center of the Storm*, N.Y. TIMES, Sept. 24, 2008, at C1.

investors to be more skeptical of their corporate managers, placing an even higher premium on the fiduciary protections afforded by corporate law.

But there are reasons to doubt that an efficient market theory would predict the continued dominance of the corporate form. As an initial matter, to the extent corporate law has devolved into indeterminacy and incoherence,[235] an efficient market would not choose the corporate form over a less costly alternative. The noncorporate form provides a less costly alternative, allowing investors and business managers to rely on contractual certainty in place of vague, open-ended fiduciary standards of care, loyalty, and good faith.

Of course, even if the fiduciary duties of corporate law are indeterminate and, therefore, costly, one could still argue that this cost is efficient because it affords public investors the necessary protections to make capital investment possible. To be clear, this article makes no claims regarding the merits or costs of fiduciary duties in business associations. It may well be that fiduciary duties are helpful or even necessary to protect public investors, regardless of the organizational form their firms adopt. But even if fiduciary protections are an efficient feature of public firms, it is unlikely that the fiduciary duties imposed by corporate law are an efficient level of such protection.

The fiduciary duties of corporate law are more or less inflexible, mandatory on all firms irrespective of the unique characteristics of the firm or its investors.[236] But investors, like firms, are idiosyncratic. Some will be more risk seeking, willing to grant their managers broad discretion in hopes of greater returns. Others will not. The mandatory fiduciary protections of corporate law provide a one-size-fits-all approach to all of these investors. As a result, the corporate form requires at least some investors to pay for more fiduciary protection than they would otherwise prefer. Noncorporate law, in contrast, allows investors to pick and choose the fiduciary duties (if any) that will bind their managers. This noncorporate flexibility would allow for markets to efficiently price competing levels and forms of fiduciary protection,[237] ranging from the full fiduciary protections of standard corporate law to the neutered protections employed by Blackstone. So even if some form of fiduciary protection is efficient, the inflexible form afforded by corporate law does not achieve this efficiency because, unlike noncorporate law, it precludes efficient market pricing.

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[235] *See supra* notes 214-19 and accompanying text.

[236] *See* Ribstein, *supra* note 53, at 201-06.

[237] Ribstein, *supra* note 24, at 306 (arguing that an efficient market will effectively price the equity of firms offering competing levels of investor protection).

Finally, to the extent public investors value fiduciary protections, the recent financial crisis has demonstrated that such duties may be ineffective at protecting shareholder wealth. To be sure, investor enthusiasm for private equity was chastened since 2007.[238] Since the IPOS of Fortress, Blackstone, and Och-Ziff, there have been no comparably splashy noncorporate IPOs. But the absence of a notable noncorporate IPO since 2007 does not reflect a public repudiation of the noncorporate form, as much as it reflects the broader financial crisis currently devastating equity markets. Indeed, the financial crisis notwithstanding, several smaller noncorporations have completed IPOs since 2007.[239] And with respect to private equity in particular, two more private equity firms went public in 2008, albeit in transactions more circuitous than the traditional IPO.[240]

Moreover, it is worth noting that apart from the two government-sponsored entities Freddie Mac and Fannie Mae, each of the major firms that failed during the financial crisis that unfolded in 2008 *were traditional corporations*, subject to the usual rules, checks, and balances of standard corporate law. Moreover, with the sole exception of Washington Mutual, each was a *Delaware* corporation. Notwithstanding the protections supposedly afforded by the fiduciary duties of corporate law, each of these corporations failed—spectacularly. Thus, rather than creating a premium on fiduciary protections, the recent market turmoil may lead public investors to actually discount the value of such protections altogether. So even if public investors historically preferred the fiduciary protections afforded by corporate law, recent failures may cause investors to reassess.

B. *The Political Explanation*

In the absence of an efficient market preference for the fiduciary duties afforded by standard corporate law, Professor Ribstein has suggested that two alternative mechanisms may be contributing to the continued dominance of the corporate form: (1) the corporate-friendly regulatory scheme arising from our political system and (2) the network effects of corporate law.

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[238] *See* Michael J. de la Merced, *Hedge Fund Business Lifts Profit for Blackstone*, N.Y. TIMES, Aug. 7, 2008, at C2.

[239] *See infra* p. 515 app.

[240] *See supra* note 10 (describing the circumstances under which each of GLG Partners, Apollo Management, and KKR became publicly traded). Because GLG Partners, Apollo Group, and KKR went public in transactions not involving an IPO of shares to new investors, none are listed in the Appendix.

Under Professor Ribstein's political theory, even though the noncorporate form may provide a superior option for business organizations, the popularity of the corporate form subsists because of a mutually beneficial relationship that exists between corporate managers and the political actors that seek to regulate them.[241] The result of this relationship, Professor Ribstein argues, is regulation that effectively empowers and entrenches corporate managers, citing antitakeover statutes and, more generally, the standard corporate law model of managerial primacy as examples.[242] Professor Ribstein also identifies the double tax on corporate dividends as a regulation that empowers corporate managers by encouraging managers to retain cash at the entity level under managerial control, rather than distributing it to shareholders.[243]

As a general matter, however, a legal system that purportedly empowers and entrenches corporate managers cannot explain the continued dominance of the corporate form. Most obviously, in many ways, noncorporate law allows such entities to more firmly empower and entrench their managers. Take, for example, the Blackstone governing agreement which, while granting Blackstone's general partner virtually unfettered power,[244] makes removal of the general partner theoretically difficult[245] and in actuality impossible.[246] Indeed, under traditional limited partnership law, investors were granted virtually no voting rights and no ability to remove general partners.[247] Standard corporate law, at least, guarantees shareholder franchise, even if that right is generally a weak constraint on corporate managers. So it is unclear what material benefits, if any, corporate managers derive from government regulation that is not already available under noncorporate law.

With respect to the corporate double tax in particular, as discussed above,[248] the double tax fails to distinguish corporations from publicly traded noncorporations for several reasons. Most publicly traded noncorporations will be treated as corporations for tax purposes. Even if a publicly traded

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[241]Ribstein, *supra* note 53, at 223-29.

[242]Ribstein, *supra* note 13, at 50; Ribstein, *supra* note 53, at 225.

[243]Ribstein, *supra* note 13, at 50-51; Ribstein, *supra* note 53, at 226-27.

[244]*See supra* notes 152-63 and accompanying text.

[245]As noted above, the Blackstone general partner is not subject to annual elections and removal requires the vote of a two-thirds supermajority of the outstanding voting units. *See supra* note 120 and accompanying text.

[246]Because Blackstone's managers retained 86.4% of the company's outstanding voting interest following its IPO, removal of the general partner by action of the public investors is mathematically impossible. *See supra* note 128.

[247]Ribstein, *supra* note 37, at 12-13; Ribstein, *supra* note 24, at 307-09.

[248]*See supra* Part IV.A.1.

noncorporation retains its pass-through tax treatment, the firm does not have any incentive to make distributions *in excess* of the amount necessary to offset its investors' tax liability. And in the specific cases of Blackstone, Fortress, and Och-Ziff, pass-through tax treatment seems to have no effect on the managers' ability to retain each firm's cash because, as each firm's governing agreement makes clear, any distribution is within the "sole discretion" of the managers. In short, double taxation is not a regulation that uniquely empowers corporate managers to horde the firm's capital.

C. *The Network Effects Explanation*

Professor Ribstein has also suggested that certain network effects can help account for the dominance of the corporate form. Under this theory, corporations benefit from an extensive body of case law, commentary, and form that aid in the interpretation and application of corporate law.[249] This pre-existing network reduces transaction costs when compared to noncorporations—which are not as widely known or used.[250] Moreover, investors may also distrust the less familiar noncorporate form, uncertain that its governance and fiduciary rules will be sufficiently protective or that courts will even enforce such provisions.[251] Thus, Professor Ribstein quips, the move to public noncorporations presents "a kind of 'chicken-and-egg' problem."[252] Even though the noncorporate form may provide a superior option for business organizations, Professor Ribstein suggests that the network effects associated with corporate law may result in the continued dominance of the corporate form.

Regardless of the role network effects have *historically* played in contributing to the dominance of the corporate form, there are several

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[249]Ribstein, *supra* note 53, at 230; *see also* Ribstein & Kobayashi, *supra* note 66, at 108-10 (explaining the network externalities associated with the choice in business organizations). Professors Ribstein and Kobayashi have raised doubts as to the importance in network effects in the choice of business organizations. *See id.* at 121-26. These doubts, however, were raised in the context of the network effects of partnership law, not corporate law. In any case, this article takes no position on whether and to what extent the network effects of corporate law explain the historic dominance of the corporate form. Instead, this article suggests that *regardless of the role network effects have historically played*, there are several reasons to doubt that such effects would mean a *continued* dominance of the corporate form.

[250]Ribstein, *supra* note 53, at 230.

[251]*Id.*

[252]*Id.*; *see also* Ribstein, *Making Sense*, *supra* note 68, at 1041 ("There may be a kind of 'chicken-and-egg' problem in which rationalization will not develop even if it is efficient because the network of cases and other materials necessary to interpret rationalized statutes must first be in place.").

reasons to doubt that such effects would mean a *continued* dominance of the corporate form. First, as Professor Ribstein himself notes, network barriers are not impermeable.[253] The corporate form itself arguably overcame a network barrier in its early history, and the noncorporate form also could overcome the network barrier posed by the corporate form.[254] In fact, the rapid adoption of the LLC form in closely held businesses during the past two decades suggests that the LLC has overcome any network barriers that other forms may have posed.[255] And the wildly anticipated and over-subscribed IPOs of 2007 suggest that this popularity is ready to spill over into the public markets. Indeed, before 2007, public noncorporations were obscurities, relegated to niche real estate and natural resources management firms.[256] The 2007 IPOs, however, not only exposed millions of public investors to the noncorporate form, but also demonstrated a feverish investor interest in noncorporations.

Second, the benefit that today's corporations derive from the abundance of instructive case law wrought by the disputes of their predecessors is slowly fading. The recent popularity of the noncorporate form has itself led to an explosion of litigation regarding these entities.[257]

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[253]Ribstein, *supra* note 53, at 230.

[254]*Id.*

[255]Miller, *A New Direction*, *supra* note 77, at 384-85, 412 (reporting the results of an empirical study among business attorneys regarding the use of LLCs in preference to corporations); Ribstein & Kobayashi, *supra* note 66, at 117-19; *see also* Ribstein, *Making Sense*, *supra* note 68, at 1031 (noting that the hundreds of LLC-related cases that have accumulated in recent years have demonstrated the power of the LLC form "in attracting judicial decisions in a relatively short amount of time").

[256]*See, e.g.*, Fleischer, *Taxing Blackstone*, *supra* note 19, at 95 n.36 ("Prior to Fortress, most publicly traded partnerships conducted real estate, timber, and oil and gas activities, although a few conducted asset management activities."); Ribstein, *Fiduciary Duties*, *supra* note 66, at 934 (noting that LPs are typically formed for firms engaged in natural resources management and venture capital investment); Ribstein, *supra* note 37, at 32 (citing NAT'L ASS'N OF PUBLICLY TRADED P'SHIPS, *supra* note 82, for a list of one hundred publicly traded partnerships, most in the energy and resource field); Ribstein, *supra* note 53, at 223 ("[T]here is no discernable move to partnership by mainstream publicly held firms outside of specific industries such as real estate."). The concentration of publicly traded noncorporations to these specific industries is, in part, a result of the Internal Revenue Code, which exempts from corporate tax treatment any publicly traded noncorporation if over ninety percent of such noncorporation's income was attributable to interest, dividends, real property rents, or the certain oil, gas, timber, and other natural resources activities. I.R.C. § 7704(c)-(d) (2008).

[257]*See* Jack B. Jacobs, *Entity Rationalization: A Judge's Perspective*, 58 BUS. LAW. 1043, 1044 (2003) (noting the recent proliferation of litigation in Delaware in the noncorporate context); Ribstein, *Making Sense*, *supra* note 68, at 1031 ("[I]n recent years hundreds of LLC cases have shown the power of new forms in attracting judicial decisions in a relatively short amount of time."). An empirical study has shown that twenty-six percent of business lawyers surveyed responded that they had handled a dispute among parties in the LLC context. Miller, *A New Direction*, *supra* note 77, at 394. Interestingly, of the four states studied, Delaware reported the highest percentage of

This litigation will, in turn, translate into reams of judicial opinions, clarifying the rights and roles of noncorporate managers and investors.[258] As this burgeoning body of case law develops, it will afford noncorporate managers and investors with the same valuable interpretative guidance that corporate case law and commentary have historically offered, neutralizing any advantage of abundance in the corporate context.

Third, even if corporate law retains an advantage of abundance in its interpretive network over noncorporate law, the network benefits associated with this abundance are dubious. To the extent that Delaware's corporate law has devolved into indeterminacy and incoherence,[259] its body of interpretive case law and commentary fails to provide managers and their investors with any meaningful guidance to reduce transaction costs.[260] To the contrary, the abundance of indeterminate corporate law promotes confusion and uncertainty—and likely increases transaction costs.[261] In this sense, the mere abundance of corporate law fails to provide any network benefit, and the relative dearth of interpretative noncorporate case law does not necessarily pose a network barrier to the adoption of the noncorporate form.

And finally, to the extent network effects play a role in the choice of business organizations, the enduring currency of the contractual conception of the noncorporate form among Delaware's courts effectively cleaves noncorporate law from the indeterminate body of corporate law, and instead links it to an even richer network: contract law. Indeed, two recent Delaware cases have reinforced this linkage, definitively confirming the primacy of freedom of contract and strictly enforcing the terms of noncorporate governing agreements over breach of fiduciary duty claims.

In *Fisk Ventures, LLC, v. Segal*,[262] Chancellor Chandler expressly affirmed the contractual conception of the noncorporation, dismissing a plaintiff's complaint alleging the breach of various fiduciary and fiduciary-like duties by the defendants, members of a Delaware LLC's board of managers.[263] In his analysis, the chancellor held steadfast to a contractual

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attorneys who have dealt with such disputes, at thirty-six percent, and the highest percentage of such disputes having led to actual litigation, at fifty percent. *Id.* at 395.

[258]Indeed, the Delaware Supreme Court's recent opinion in *Wood v. Baum*, 953 A.2d 136 (Del. 2008), discussed below, is early evidence of this growing body of law.

[259]*See supra* notes 53-57 and accompanying text.

[260]*See* Ribstein & Kobayashi, *supra* note 66, at 112 ("[B]ecause courts often tailor open-ended terms, such as fiduciary duties for specific applications, . . . an interpretation in one case has little value for others. . . . [M]ore cases do not necessarily provide more clarity because courts may reach inconsistent results.").

[261]*See supra* notes 53-57 and accompanying text.

[262]No. 3017-CC, 2008 WL 1961156 (Del. Ch. May 7, 2008).

[263]*Id.* at *1. ("Contractual language defines the scope, structure, and personality of limited

analysis of the plaintiff's claims, reasoning that the alleged duties were simply inconsistent with an objective reading of the firm's governing agreement.[264] The chancellor reasoned that, even if such duties could be read into the firm's governing agreement, the agreement also included a broad exculpatory provision, exempting the defendants from all liability for breach of any fiduciary duty.[265] Perhaps as important as the chancellor's treatment of the plaintiff's fiduciary claims, however, was his interpretation of the residual contractual covenant of good faith and fair dealing, which, as noted above,[266] cannot be eliminated under Delaware's noncorporate statutes.[267] The chancellor made clear that the implied contractual covenant of good faith and fair dealing is a doctrine of contract law, "rarely invoked successfully" and inapplicable to contradict the express terms of the firm's governing agreement.[268] Thus, *Fisk Ventures* made clear that the corporate fiduciary duty of good faith would not pollute the contractual analysis of noncorporate law.[269]

On the heels of *Fisk Ventures*, the Delaware Supreme Court decided *Wood v. Baum*,[270] which affirmed the Delaware Court of Chancery's dismissal of a complaint alleging the breach of various fiduciary duties, based largely on the grounds that the noncorporation's governing agreement exculpated the defendant-managers from any liability that could arise from the alleged breach.[271] The opinion sparked immediate reactions among academics[272] and practitioners,[273] as *Wood* marked the first time the Delaware Supreme Court upheld the *complete* elimination of fiduciary duties in the context of a *public* noncorporation. Before *Wood*, Delaware's noncorporate case law was primarily set in the context of closely held

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liability companies."); *id.* at *8 ("In the context of limited liability companies, which are creatures not of the state but of contract, [any] duties or obligations must be found in the LLC agreement or some other contract.").

[264] *Id.* at *8-10.

[265] *Id.* at *11.

[266] *See supra* Part II.B.

[267] DEL. CODE ANN. tit. 6, § 17-1101(d) (2005) (applying to LPs); *id.* § 18-1101(e) (applying to LLCs).

[268] *Fisk Ventures*, 2008 WL 1961156, at *10.

[269] *Id.*

[270] 953 A.2d 136 (Del. 2008).

[271] *Id.* at 141-43.

[272] Ribstein, *supra* note 208; Posting of Larry Ribstein to Ideoblog, http://busmovie.typepad.com/ideoblog/2008/07/wood-v-baum-yes.html (July 13, 2008, 19:32 EST); Posting of Gary Rosin to Unincorporated Business Law Prof Blog, http://lawprofessors.typepad.com/unincorporated_business/2008/07/wood-v-baum-del.html (July 4, 2008).

[273] Delaware Corporate & Commercial Litigation Blog, http://www.delawarelitigation.com/2008/07/articles/delaware-supreme-court-updates/supreme-court-rejects-caremark-claims-and-other-fiduciary-claims-against-llc-managers-due-to-exculpation-clause/ (July 2, 2008).

firms.[274] Thus, *Wood* represented an important expansion of noncorporate law into the publicly held context. In an otherwise unremarkable opinion, the Delaware Supreme Court pointed out that the noncorporation's governing agreement included a broad exculpatory provision, exempting the firm's directors from all liability for breach of any fiduciary duties, "except in the case of fraudulent or illegal conduct."[275] Then, without even considering the plaintiff's various fiduciary claims, the court dismissed the suit because the plaintiff failed to adequately allege any fraud or illegal conduct.[276] And like Chancellor Chandler in *Fisk Ventures*, the Delaware Supreme Court made clear that the contractual covenant of good faith and fair dealing is rooted in the law of contracts, distinct and substantially narrower than the vague and open-ended corporate fiduciary duty of good faith.[277]

Resolving any doubt that may have existed in the past,[278] *Wood* and *Fisk* confirm the convergence of the Delaware Supreme Court and the Delaware Court of Chancery towards a contractual analysis of fiduciary claims in the noncorporate context, strictly enforcing the terms of noncorporate governing agreements without imputing the fiduciary duties of corporate law.[279] Thus, to the extent network effects play a role in the choice

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[274] *See* Ribstein, *supra* note 53, at 230 ("The cases concerning non-corporate business forms mainly relate to closely held firms.").

[275] *Wood*, 953 A.2d at 139.

[276] *Id.* at 141-42.

[277] *Id.* at 143.

[278] As late as 2003, former vice chancellor and now Delaware Supreme Court Justice Jacobs noted that Delaware courts had difficulty deciding whether fiduciary law, contract law, or a combination of both was the appropriate body of law in deciding noncorporate governance disputes. Jacobs, *supra* note 257, at 1044; *see also* Ribstein, *supra* note 38, at 161 ("Delaware courts do not yet fully recognize the fundamental differences between the corporate and [non]corporate cases."); *id.* at 164 ("[T]he judicial tendency to apply corporate rules is always lurking and . . . courts have not yet completely severed the [non]corporate cases from corporate indeterminacy.").

[279] This convergence is further reflected by Chancellor Chandler's later opinion in *R & R Capital, LLC v. Buck & Doe Run Valley Farms*, No. 3803-CC, 2008 WL 3846318, at *4 (Del. Ch. Aug. 19, 2008). Although *R & R Capital* does not involve the waiver of a fiduciary duty, the opinion nonetheless explicitly affirms the contractual conception of the noncorporate form and strictly enforces a waiver provision found in the express terms of the noncorporation's governing agreement. *Id.* at*1, *3-4. At least two other noncorporation cases were decided by the Delaware Court of Chancery in 2008. *See* Schuss v. Penfield Partners, L.P., No. 3132-VCP, 2008 WL 2433842 (Del. Ch. June 13, 2008), *reprinted in* 33 DEL. J. CORP. L. 960 (2008); Venhill, Ltd. P'ship v. Hillman, No. 1866-VCS, 2008 WL 2270488 (Del. Ch. June 3, 2008), *reprinted in* 33 DEL. J. CORP. L. 982 (2008). Although in both cases the plaintiffs prevailed on fiduciary claims, each vice chancellor's holding turned on the express terms of the noncorporate entity's governing agreement and, specifically, the exculpation provisions of the agreement. In *Schuss*, Vice Chancellor Parsons partially denied the defendant's motion to dismiss, reasoning that the plaintiffs could prove that the defendants acted in bad faith, with gross negligence, or otherwise engaged in willful misconduct, all grounds which were not exculpated under the noncorporate form's governing agreement. *Schuss*,

of business forms, by linking noncorporate law to the rich network of contract law, these cases not only neutralize the network benefits associated with corporate law, they also eliminate the most costly feature of the corporate network: the indeterminate law of fiduciary duties.

VI. CONCLUSION

The Blackstone IPO was indeed no ordinary event. Before 2007, it was generally accepted wisdom that publicly held firms were organized as corporations,[280] subject to the usual rules, checks, and balances of standard corporate law. The Blackstone IPO, however, along with those of Fortress and Och-Ziff, challenged this notion. Together, these IPOs demonstrated that large firms seeking access to the capital of public markets can closely mimic the structure and substance of the corporate form, while avoiding the costly regime of fiduciary duties.

The 2007 IPOs of Blackstone, Fortress, and Och-Ziff may mark the beginning of the end for corporate law. Given the striking resemblances of Blackstone, Fortress, and Och-Ziff to their publicly held corporate counterparts, and in the absence of any substantive distinction, today, the asymmetry between the fiduciary duties of corporate and noncorporate law reflects an archaic and substanceless formalism that, if it subsists, portends the ascendancy of the noncorporate form.

2008 WL 2433842, at *9-11, *reprinted in* 33 DEL. J. CORP. L. at 973-75. Likewise, in *Venhill*, Vice Chancellor Strine held in favor of the plaintiffs because the evidence presented showed that the defendant acted in bad faith, with gross negligence, and engaged in willful misconduct, all grounds which again were not exculpated under the noncorporate firm's governing agreement. *Venhill*, 2008 WL 2270488, at *23-30, *reprinted in* 33 DEL. J. CORP. L. at 1014-23.

[280]Ribstein, *supra* note 53, at 185.

APPENDIX†

United States Noncorporate IPOs and IPO Registrations January 1, 2006-March 31, 2009

	Company	IPO Date (Registration Date)	Market	Ticker Symbol	Entity Type	Domicile
1.	Compressco Partners, L.P.	(November 10, 2008)	(NASDAQ GM)	-	LP	Delaware
2.	Western Gas Partners, LP	May 9, 2008	NYSE	WES	LP	Delaware
3.	Pioneer Southwest Energy Partners L.P.	May 1, 2008	NYSE	PSE	LP	Delaware
4.	Williams Pipeline Partners L.P.	January 18, 2008	NYSE	WMZ	LP	Delaware
5.	NiSource Energy Partners, L.P.	(December 21, 2007)	(NYSE)	-	LP	Delaware
6.	El Paso Pipeline Partners, L.P.	November 16, 2007	NYSE	EPB	LP	Delaware
7.	Och-Ziff Capital Management Group LLC	November 14, 2007	NYSE	OZM	LLC	Delaware
8.	Navios Maritime Partners L.P.	November 13, 2007	NYSE	NMM	LP	Marshall Islands
9.	OSG America L.P.	November 9, 2007	NYSE	OSP	LP	Delaware
10.	Quest Energy Partners, L.P.	November 9, 2007	NASDAQ GM	QELP	LP	Delaware
11.	Vanguard Natural Resources, LLC	October 24, 2007	NYSE Arca	VNR	LLC	Delaware

†All information in this table was collected from the Hoover's IPO Reports database available on LexisNexis, except for information regarding each firm's state of organization, which was collected from such firm's public securities filings with the U.S. Securities and Exchange Commission. This table excludes any LLC that converted (or intended to convert) into a corporation immediately prior to its IPO. For firms that registered but never completed an IPO, the date shown in parentheses is the date the firm filed its first registration statement with the U.S. Securities and Exchange Commission to conduct an IPO, and the market name shown in parenthesis is the market on which the registration statement indicates the firm's securities were to be listed.

12.	Encore Energy Partners LP	September 12, 2007	NYSE	ENP	LP	Delaware
13.	Quicksilver Gas Services LP	August 7, 2007	NYSE Arca	KGS	LP	Delaware
14.	SemGroup Energy Partners, L.P.	July 18, 2007	NASDAQ GM	SGLP	LP	Delaware
15.	Abraxas Energy Partners, L.P.	(July 13, 2007)	(NASDAQ GM)	-	LP	Delaware
16.	KKR & Co. L.P.	(July 3, 2007)	(NYSE)	-	LP	Delaware
17.	Spectra Energy Partners, LP	June 27, 2007	NYSE	SEP	LP	Delaware
18.	The Blackstone Group L.P.	June 22, 2007	NYSE	BX	LP	Delaware
19.	Golub Capital Partners, LLC	(May 14, 2007)	(NASDAQ GM)	-	LLC	Delaware
20.	Atlas Industries Holdings LLC	(May 4, 2007)	(NASDAQ GM)	-	LLC	Delaware
21.	Capital Product Partners L.P.	March 30, 2007	NASDAQ GM	CPLP	LP	Marshall Islands
22.	Cheniere Energy Partners, L.P.	March 21, 2007	AMEX	CQP	LP	Delaware
23.	Fortress Investment Group LLC	February 9, 2007	NYSE	FIG	LLC	Delaware
24.	Targa Resources Partners LP	February 9, 2007	NASDAQ GM	NGLS	LP	Delaware
25.	Duncan Energy Partners L.P.	January 31, 2007	NYSE	DEP	LP	Delaware
26.	Teekay Offshore Partners L.P.	December 14, 2006	NYSE	TOO	LP	Marshall Islands
27.	Atlas Energy Resources, LLC	December 13, 2006	NYSE	ATN	LLC	Delaware
28.	Penn Virginia GP Holdings, L.P.	December 5, 2006	NYSE	PVG	LP	Delaware
29.	Constellation Energy Partners LLC	November 15, 2006	NYSE Arca	CEP	LLC	Delaware
30.	Eagle Rock Energy Partners, L.P.	October 25, 2006	NASDAQ GM	EROC	LP	Delaware
31.	Exterran Partners, L.P.	October 17, 2006	NASDAQ GS	EXLP	LP	Delaware
32.	BreitBurn Energy Partners L.P.	October 4, 2006	NASDAQ GM	BBEP	LP	Delaware

33.	EV Energy Partners, L.P.	September 27, 2006	NASDAQ GS	EVEP	LP	Delaware
34.	Hiland Holdings GP, LP	September 20, 2006	NASDAQ GM	HPGP	LP	Delaware
35.	Buckeye GP Holdings L.P.	August 4, 2006	NYSE	BGH	LP	Delaware
36.	Atlas Pipeline Holdings, L.P.	July 21, 2006	NYSE	APL	LP	Delaware
37.	NuStar GP Holdings, LLC	July 14, 2006	NYSE	NSH	LLC	Delaware
38.	Magellan Midstream Holdings, L.P.	February 10, 2006	NYSE	MGG	LP	Delaware
39.	Energy Transfer Equity, L.P.	February 3, 2006	NYSE	ETE	LP	Delaware
40.	Regency Energy Partners LP	January 29, 2006	NASDAQ GS	RGNC	LP	Delaware
41.	Calumet Specialty Products Partners, L.P.	January 26, 2006	NASDAQ GM	CLMT	LP	Delaware
42.	Linn Energy, LLC	January 13, 2006	NASDAQ GS	LINE	LLC	Delaware