THE GOVERNANCE OF PUBLICLY TRADED LIMITED LIABILITY COMPANIES

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ABSTRACT

The limited liability company is not only a widespread business form for non-listed firms but also is used by listed companies. There were twenty publicly traded Delaware LLCs in September 2013. Given the policy of the Delaware legislators and courts to give maximum effect to the principle of freedom of contract in LLCs, the use of this business form by publicly traded companies can jeopardize traditional corporate governance mechanisms used in listed corporations and create risks for investors in stock markets. The author analyzed the governance agreements and structures of twenty publicly traded LLCs to establish the demand for contractual freedom in LLC governance and examine the practice of investor rights in listed LLCs. The study shows that the founders of publicly traded LLCs extensively relied on the default statutory rules to strengthen their decision-making rights, entrench control, and limit the role of fiduciary duties of care and loyalty. But they included provisions in the operating agreements that could balance the rights of controlling and minority members. The study also found that other factors—such as ownership structure, dividend policies, board composition and board practices, market forces, and the standardization of the governance structures of listed LLCs–can be substitutes for legal rights. As predicted in theory, publicly traded LLCs used different combinations of contractual rights and the mentioned non-legal factors to make their IPOs attractive for investors.

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I. INTRODUCTION

According to the most recent data available for active business forms in the United States, more than one-third of all firms are limited liability companies ("LLCs").[1] This is a remarkable statistic if one considers the fact that the majority of the states enacted their LLC statutes in the early 1990s.[2] LLCs combine the limited liability of their members with strong contractual freedom in relations of the members and in internal governance matters.[3] Hence, LLCs are positioned between corporations and partnerships as a hybrid business form that borrows limited liability from the former and contractual flexibility and pass-through taxation from the latter.[4] The widespread use of LLCs by American private business has given rise to the term "uncorporations,"[5] which emphasizes their difference from corporations. However, the LLC form is no longer the exclusive domain of non-listed companies. A new

[1] *See infra* Figure II.

[2] *See infra* note 56 and accompanying text.

[3] *See* Larry E. Ribstein, *Uncorporating the Large Firm* 4 (Univ. Ill. Law & Econ. Research Paper Series, Paper No. LE08-016, 2008), *available at* http://perma.cc/VXF4-7G82 (discussing characteristics of LLCs).

[4] *See id.*

[5] *Id.* at 3 n.4.

term that has been introduced recently by the *Economist* is "distorporation," which includes LLCs and similar hybrid business forms that are publicly listed.[6] Such publicly traded business forms, due to specific taxation and strong contractual freedom, employ different governance structures and, according to the *Economist*, are changing the "face of American capitalism."[7] Publicly traded alternative business forms, unlike their non-listed peers, are not the majority in the total number of listed firms nor in new listings,[8] but their use has reached a level where they cannot be ignored.

In light of statutory enabling rules, LLC operating agreements ("LLC agreements") play a special role in LLC corporate governance.[9] LLC members are free to choose a governance structure that best fits their needs.[10] This is in stark contrast to listed corporations that have to comply with mandatory governance structures offered by the law.[11] The question is whether, in publicly traded LLCs, the founding and controlling members use the statutory default rules to create governance structures that entrench their control, limit their accountability, or are potentially oppressive towards outside investors in any other way. To the extent that LLCs are subject to less regulation, do they really "distort" long-established corporate governance practices and investor protection mechanisms of corporations?

Early empirical evidence, though focusing not only on publicly traded LLCs—the studies cover either different publicly traded hybrid business forms or all LLCs, including non-listed companies—suggests that, perhaps the answer is yes. Professor Mohsen Manesh conducted a first-hand analysis of the operating agreements of publicly traded limited partnerships ("LPs") and LLCs.[12] This study looked into the operating agreements of 85 listed entities formed in Delaware, with the main focus

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[6] *The New American Capitalism: Rise of the Distorporation*, ECONOMIST (Oct. 26, 2013), *archived at* http://perma.cc/WUG9-AHDL.

[7] *Finance in America: Subterranean Capitalist Blues*, ECONOMIST (Oct. 26, 2013), *archived at* https://perma.cc/CE9E-5V5E.

[8] *Id.*

[9] *See, e.g.*, Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J. CORP. L. 555, 561 (2012) (discussing treatment of fiduciary duties in Delaware LLC operating agreements).

[10] *See id.* (emphasizing freedom of contract in Delaware LLC law).

[11] *See id.* at 596; *see also* 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, 1260 (2001) (discussing a more prescriptive and less flexible variety of corporate statute).

[12] *See* Manesh, *supra* note 9, at 567.

on the fiduciary duties of the members and managers and on exculpation provisions.[13] There are two main findings of this study: (1) the majority of the sample either totally waived the fiduciary duties of the managers or eliminated the liability of the managers arising from the breach of fiduciary duties; and (2) the sample LPs and LLCs did not use commensurate substitute mechanisms to counterbalance the waiver or the elimination of liability arising from the breach of fiduciary duties.[14] A parallel study looked into the operating agreements of 129 mostly non-listed LLCs which were filed with the SEC by their listed members or by the LLCs themselves in cases of issuing debt securities.[15] This study pointed to the possible imbalances in the bargaining power of LLC members.[16] For instance, the modifications of the managers' duties and liabilities were not accompanied with the buy-out rights of the members,[17] and large LLC members were able to protect their fiduciary duty and liability modifications through special procedures for amending LLC agreements.[18] Two other empirical studies used questionnaires distributed among bar members in several U.S. states to document the experience of practicing lawyers with regard to LLCs.[19] Both articles point to low rates of using contractual minority protections and conclude that the minority members of LLCs tend to be vulnerable to majority expropriation.[20] The most recent study, and the one that presents separately the findings for publicly traded LLCs, was conducted by Professor Brent Horton. Professor Horton studied the application of fiduciary duties in 86 publicly traded non-corporate business associations—17 LLCs and 69 LPs—with the aim of defining the position of minority investors of these firms in going-private-freeze-out

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[13] *Id.*

[14] *Id.* at 575, 581-83.

[15] Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879, 898, 901 (2012).

[16] *Id.* at 883.

[17] *Id.* at 914.

[18] *See id.* at 923-24 (noting an association between modification of member duty of loyalty requirements in operating agreements and a requirement of unanimous consent to amend the agreements).

[19] Sandra K. Miller, *A New Direction for LLC Research in a Contractarian Legal Environment*, 76 S. CAL. L. REV. 351, 364 (2003) [hereinafter *A New Direction*]; Sandra K. Miller et al., *An Empirical Glimpse into Limited Liability Companies: Assessing the Need to Protect Minority Investors*, 43 AM. BUS. L.J. 609, 615 (2006) [hereinafter *An Empirical Glimpse*].

[20] *See* Miller, *A New Direction*, *supra* note 19, at 397-98; Miller et al., *An Empirical Glimpse*, *supra* note 19, at 628-29.

transactions.[21] The study found that in the majority of listed LLCs investors faced higher risks during freeze-outs than in corporations.[22]

Based on the predictions of financial contracting theories, this study starts from the presumption that to obtain financing from outside investors, publicly traded LLCs choose governance and financing structures that, at the end of the day, offer sufficient mechanisms to outside investors to deal with adverse selection, moral hazard, and agency problems or compensate investors for their absence. Given the contractual freedom and flexibility of LLCs,[23] the combinations of mechanisms within these structures can be myriad and particular mechanisms can act as substitutes for each other.[24] However, the end results are expected to be equivalent. This implies that the empirical study of publicly traded LLCs should be broad enough to cover all possible substitute mechanisms. In this sense, this study comes closer to Conrad Ciccotello and Chris Muscarella's 2001 study of the operating agreements of 119 publicly listed LPs, which showed that contracting and equity ownership act as substitutes in these entities.[25] This study, by widening the focus, shows that the governance structures of listed LLCs contain elements that address the risks of minority investors.

The objective of this study is to conduct an in-depth analysis of corporate governance in publicly traded U.S. LLCs by looking to the legal mechanisms used in the operating and other relevant agreements of the sample companies, their ownership structures, management incentives, actual board practices, dividend distributions, and other corporate governance mechanisms. The sample includes twenty listed LLCs that, to the best of this author's knowledge, were all listed U.S. LLCs at the end of September 2013.[26]

The analysis shows that publicly traded LLCs used contractual freedom to enhance the control of management by the founding members and to strengthen their decision-making rights, but these measures were accompanied by other legal mechanisms directed towards balancing the

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[21] Brent J. Horton, *The Going-Private Freeze-Out: A Unique Danger for Investors in Delaware Non-Corporate Business Associations*, 38 DEL. J. CORP. L. 53, 60-61 (2013).

[22] *Id.* at 93.

[23] *See* Ribstein, *supra* note 3, at 4 (discussing the flexibility of LLCs).

[24] *See generally* Manesh, *supra* note 9, at 557-66 (discussing the various governance devices available to LLCs and similar alternative entities).

[25] Conrad S. Ciccotello & Chris J. Muscarella, *Contracts Between Managers and Investors: A Study of Master Limited Partnership Agreements*, 7 J. CORP. FIN. 1, 2 (2001) (analyzing the substitution of organizational constraints for traditional ownership control in the context of master limited partnerships).

[26] *See infra* Part III.

rights of the controlling and minority members.[27] The choice of ownership structures was used in the sample companies as a signal to outside investors about the quality of the investments.[28] Other factors that disciplined the controlling members and managers were the board structures and board practices, dividend policies, market forces, and the high level of standardization of governance structures.[29]

The rest of this article is organized as follows. The next section provides brief statistical information about LLCs and describes their origins.[30] Then the article proceeds to describing the search and coding strategy, and the background data.[31] Part IV presents the results of the analysis of the LLC agreements.[32] Parts V and VI look to non-legal factors that affect the governance of publicly traded LLCs, such as ownership structure, board composition and board practices, dividend policies, market discipline, and the standardization of governance structures.[33] It is argued that these factors can substitute or complement contractual mechanisms of protecting the rights of outside investors.[34]

II. STATISTICAL DATA ON LLCS

Currently, LLCs are one of the most popular business forms in the United States.[35] In new business formations, LLCs and different types of partnerships outnumber corporations in many U.S. states.[36] Starting from 1993—the first year that the Internal Revenue Service of the U.S. Department of the Treasury ("IRS") provided data about partnership tax filings by LLCs and their members—the number of LLCs has been rising at a remarkable pace.[37]

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[27] *See infra* Part IV.

[28] *See infra* Part V.

[29] *See infra* Part VI.

[30] *See infra* Part II.

[31] *See infra* Part III.

[32] *See infra* Part IV.

[33] *See infra* Parts V-VI.

[34] *See infra* Part VII.

[35] Rodney D. Chrisman, *LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004-2007 and How LLCs Were Taxed for Tax Years 2002-2006*, 15 FORDHAM J. CORP. & FIN. L. 459, 459-60 (2010).

[36] *See id.* at 460 (noting that in 2007, new Delaware LLCs outnumbered new Delaware corporations three to one); Jens Dammann & Matthias Schündeln, *Where Are Limited Liability Companies Formed? An Empirical Analysis*, 55 J.L. & ECON. 741 app. A (2012).

[37] *See* INTERNAL REVENUE SERVICE, SOI TAX STATS—PARTNERSHIP STATISTICS BY SECTOR OR INDUSTRY, *archived at* http://perma.cc/P7V4-NWAB (last visited July 25, 2015) (providing data from 1993); Howard M. Friedman, *The Silent LLC Revolution—The Social Cost of Academic Neglect*, 38 CREIGHTON L. REV. 35, 36-37 (2004) ("[By 2003,] [i]n almost all the states, the percentage of businesses choosing the LLC form increased from the prior year.").

Figure I demonstrates the percentage changes in the numbers of several business forms in the United States since 2001—the starting year is considered as a basis.[38] During an eleven-year period, the number of LLCs more than tripled.[39] In the same period, the number of LPs rose marginally, while the share of general partnerships ("GPs") dropped by approximately 30%.[40] The number of corporations increased; but compared to LLCs this increase was not significant.[41] The only other business form that could compete with the success of LLCs was the limited liability partnership ("LLP").[42] Yet, one should consider that the IRS only started to provide data on LLPs in 1998.[43] Hence, the low basis from which LLPs started could bias the results in favor of this business form. In contrast, 808,692 LLCs filed tax returns with the IRS in 2001.[44] This number is higher than the number of active GPs at that time, and is more than twice the number of the then-active LPs.[45] If the starting date in Figure I had been 1996—the fourth year following the introduction of LLCs in the IRS data—then the number of LLCs would have increased more than 1,350%. Interestingly, the LLC is the only U.S. business form which continued to rise in number even in 2008 and 2009, when the number of all other business forms decreased, affected by the financial crisis and the following recession.[46]

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[38] *See infra* Figure I. The data used in the calculations are available from the IRS Business Tax Statistics documents. *See* INTERNAL REVENUE SERVICE, STATISTICS OF INCOME, PARTNERSHIP RETURNS, 2011 (2013) [hereinafter PARTNERSHIP RETURNS], *archived at* http://perma.cc/Z65Q-M9KH; INTERNAL REVENUE SERVICE, STATISTICS OF INCOME, CORPORATE INCOME TAX RETURNS, TAX YEAR 2011 [hereinafter CORPORATE INCOME TAX RETURNS], *archived at* http://perma.cc/R6PR-A2K9 (last visited July 25, 2015).

[39] *See infra* Figure I.

[40] *See infra* Figure I.

[41] *See infra* Figure I.

[42] *See infra* Figure I.

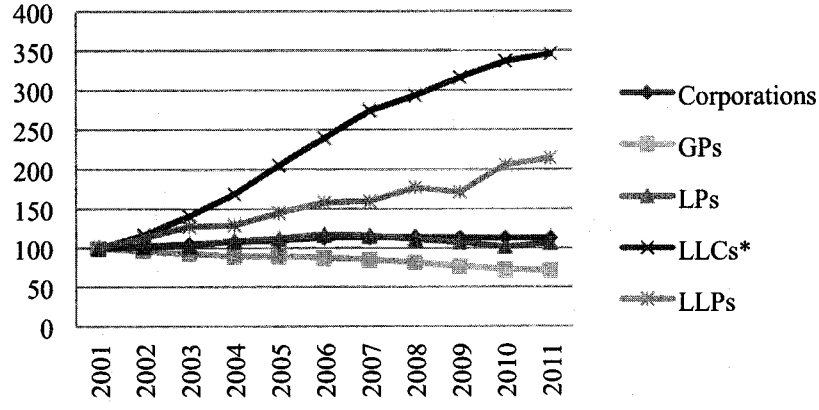
[43] Alan Zempel, *Partnership Returns, 1996*, STATISTICS OF INCOME BULLETIN, Fall 1998, at 49; *see also* Fallany O. Stover & Susan Pace Hamill, *The LLC Versus LLP Conundrum: Advice for Businesses Contemplating the Choice*, 50 ALA. L. REV. 813, 815-17 (1999) (explaining that LLPs rose to great prominence in the 1990s as states passed laws authorizing their formation and general partners sought to protect themselves from their partners' losses in the aftermath of the savings and loan financial crisis).

[44] *See* INTERNAL REVENUE SERVICE, STATISTICS OF INCOME, INTEGRATED BUSINESS DATA 1980-2008, *archived at* http://perma.cc/RNS8-JZYL (last visited July 25, 2015).

[45] *See* INTERNAL REVENUE SERVICE, *supra* note 44; *see also* Chrisman, *supra* note 35, at 462 ("[T]here is no other alternative entity on the horizon that shows the promise or potential to unseat the LLC . . . .").

[46] *See infra* Figure I.

Figure I: Changes in the numbers of business forms in the U.S., 2001 = 100%



Source: U.S. Internal Revenue Service, the author's own calculations.

Notes: GP = general partnership; LP = limited partnership; LLC = limited liability company; LLP = limited liability partnership.

* LLCs taxed as a C corporation or S corporation are not included in the data.

Nowadays, LLCs along with partnerships constitute almost half of all tax-reporting business entities.[47] Indeed, recent data on the number of different business forms in the U.S. corporate landscape, based on the tax filings of business entities and their members with the IRS, demonstrate that corporations have been giving away part of their share of the corporate landscape to other business forms.[48]

The ratio of corporations to LLCs in 2011 was 1.80.[49] Almost 57% of all active business forms in 2011 were corporations and one-third were formed as LLCs.[50] The share of the remaining business forms, mainly GPs and LPs, did not exceed 11.5%.[51] Figure II also shows that

[47] *See infra* Figure II.

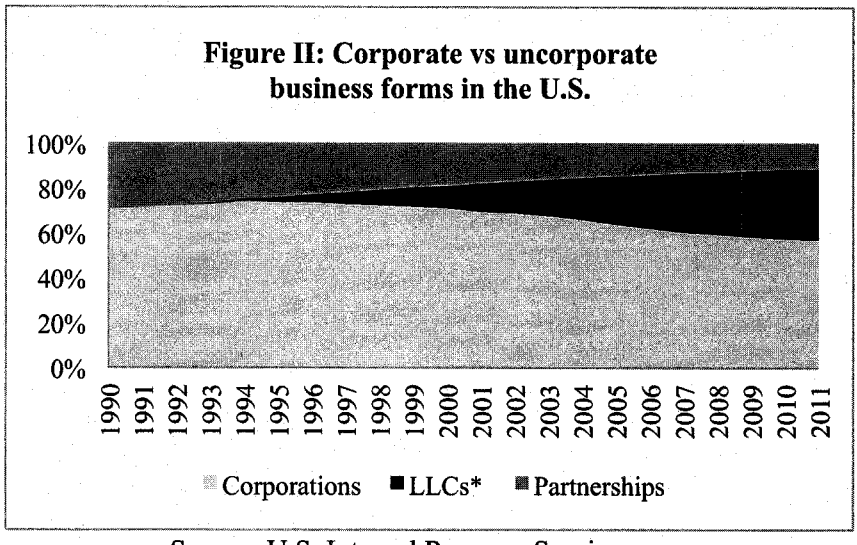
[48] *See infra* Figure II.

[49] There were roughly 3.3 million tax returns filed by partnerships and 5.8 million tax returns filed by corporations in 2011. *Compare* Ron DeCarlo et al., *Partnership Returns, 2011*, STATISTICS OF INCOME BULLETIN, Fall 2013, at 83 fig.C, *archived at* http://perma.cc/XE9W-5VRD, *with* CORPORATE INCOME TAX RETURNS, *supra* note 38.

[50] *See infra* Figure II.

[51] The data on partnerships include domestic GPs, domestic LPs, domestic LLPs, foreign partnerships, and other partnerships. *See* DeCarlo et al., *supra* note 49, at 85-87. Foreign partnerships must file tax returns in the United States if they have gross income effectively connected with the conduct of a trade or business within the United States or have gross income derived from sources in the United States. *Id.* at 91-92. The IRS classifies other

the rise of LLCs came not only at the expense of corporations, but also of partnerships.[52] The share of GPs was declining before the LLC had become a popular business tool among entrepreneurs—if initially the rise in the number of corporations compensated this decline, later the LLC took up a significant share previously occupied by GPs.[53] Prior to 2002, GPs were the most common type of "uncorporations."[54] However, they have ranked second since that time.[55]



Source: U.S. Internal Revenue Service.
Notes: LLC = limited liability company.
* Data on single-member LLCs taxed as sole proprietorships are added starting from 2001. LLCs taxed as a C corporation or S corporation are not included in the data.

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partnerships as those that checked the "other" box in Form 1065, Schedule B, line 1, Type of Entity, or did not check a box. *Id.* at 86. Potentially this category may also include LLCs, meaning that the share of LLCs in Figure II could be understated. *See id.* at 87. "In some cases, LLCs file as sole proprietorships on individual income tax returns or as corporations on corporate income tax returns." *Id.* at 94. "LLC data reported on [corporate income tax] returns [are] not included in the IRS data," which further understates the real number of LLCs. *Id.*

[52] *See infra* Figure II. The number of GPs formed each year cannot be ascertained exactly because no filing is required. Chrisman, *supra* note 35, at 461. However, because all advantages of general partnerships can be achieved by using LLCs, it has been suggested that currently, most GPs arise from unlawyered transactions where entrepreneurs start business together informally. *See id.*; Friedman, *supra* note 37, at 59.

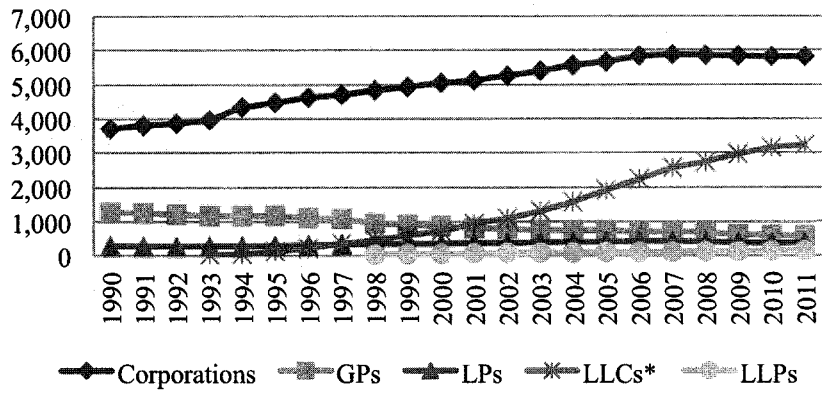
[53] *See infra* Figure II.

[54] *See infra* Figure II; *see also* Friedman, *supra* note 37, at 49 ("The once-elaborately drafted partnership agreement has gone the way of the buggy whip and slide rule.").

[55] *See infra* Figure III.

It is remarkable that LLCs have achieved this statistic in a period that is significantly shorter than the periods during which corporations and partnerships have existed. As recently as the early 1990s, not all states had even passed LLC statutes.[56]

Figure III: Active business entities in the U.S.† (thousands)



Source: U.S. Internal Revenue Service.

Notes: Number of business entities is in thousands. The numbers are rounded up to zero decimal places. GP = general partnership; LP = limited partnership; LLC = limited liability company; LLP = limited liability partnership.

† All business forms that filed tax forms with the IRS are considered as active, regardless of incurring profits or losses in the result of their activities.

* Includes single-member LLCs. Data on single-member LLCs taxed as sole proprietorships are added starting from 2001. LLCs taxed as C corporations or S corporations are not included in the data.

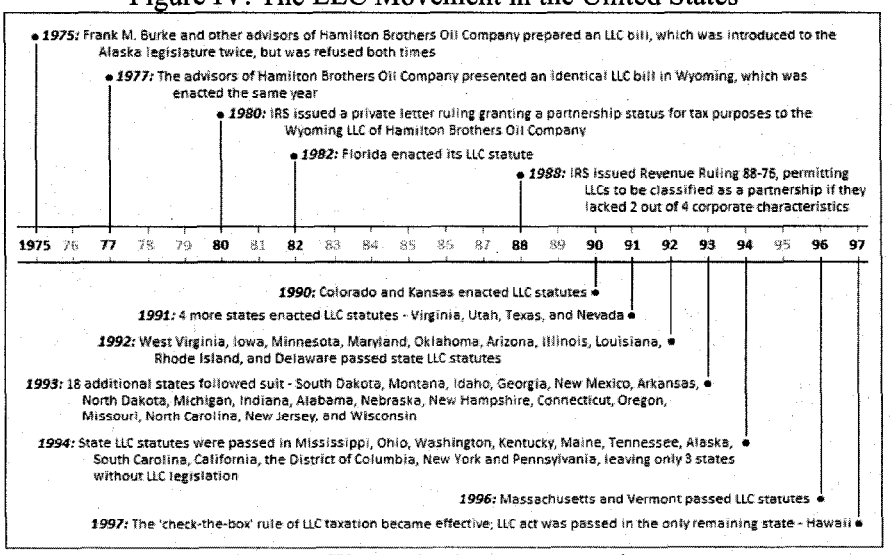
The process of enacting LLC statutes by all U.S. states, strongly influenced by regulatory competition, was quick.[57] The 1988 IRS ruling,

[56]Friedman, *supra* note 37, at 45-46 (noting that after an IRS ruling allowed LLCs to be taxed as partnerships and Colorado enacted its LLC statute in 1990 all states followed in order to attract business and revenue to their state).

[57]*See* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1475 (1998) ("From 1992 through 1996, LLC legislation swept across the country."); Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race*

according to which all Wyoming LLCs that lacked two out of the four main corporate characteristics—continuity of life, centralization of management, limited liability, and free transferability of interests—were eligible for partnership tax treatment, served as a catalyst for the development of the LLC legislation.[58] What followed was a surge in the number of state LLC statutes, resembling a race between the states.[59] It started in Colorado in 1990 and ended in Hawaii in 1997.[60] By the beginning of April 1997, all 50 states and the District of Columbia had enacted state LLC statutes.[61] The number of active LLCs in the United States by the end of 1997 was about 350,000.[62] This was a sharp contrast to the earlier data on LLCs reported by Carol Goforth—one year after the enactment of the Florida LLC statute in 1982, only two LLCs had been formed in Florida; as of February 22, 1988, there were only 26 Wyoming LLCs.[63] The timeline in Figure IV displays the chronology of the development of the state LLC legislation.[64]

Figure IV: The LLC Movement in the United States



Source: The author's own research.

Between the States, but Heading Where?, 45 SYRACUSE L. REV. 1193, 1193-99 & n.1 (1995) (discussing the adoption of LLC statutes in the context of regulatory competition).

[58] *See* Rev. Rul. 88-76, 1988-2 C.B. 360; Hamill, *supra* note 57, at 1469-70, 1478.

[59] *See* Hamill, *supra* note 57, at 1475-78.

[60] *See id.* at 1470 & n.43, 1477 & n.75.

[61] *See id.* at 1476-77 & nn.74-75.

[62] *See supra* Figure III.

[63] *See* Goforth, *supra* note 57, at 1202 n.50.

[64] *See infra* Figure IV.

III. DATA

A. *Sources of Data and Search Strategy*

The database of LLC agreements was created by using the operating agreements of LLCs filed with the SEC.[65] The full text search tool of the SEC's Electronic Data Gathering, Analysis, and Retrieval database ("EDGAR") provides access to the electronic texts of the documents filed with the SEC during the past four years.[66] The search was conducted in the annual reports—form 10-K—of all filing entities submitted to the SEC during 2012—search start date: January 1, 2012, search end date: December 31, 2012. Because state LLC statutes employ different terminology for referring to the operating agreements of LLCs,[67] a number of separate searches were conducted using different groups of keywords: (1) "LLC agreement," (2) "limited liability company agreement," and (3) "company operating agreement." The aim of conducting three separate searches using the LLC agreement names used in different states was to avoid creating a biased database populated with LLC agreements of companies formed in any particular state.

The searches yielded a total of 1,380 documents—mostly 10-K annual reports.[68] This author identified references to LLC agreements in these documents and located the texts of the agreements in company filings.[69] An LLC agreement can be filed as an exhibit to the annual report of a company,[70] or it can be incorporated by reference to exhibits of previous filings—annual or quarterly reports (forms 10-K and 10-Q), current reports (form 8-K), or securities registration statements (forms S-

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[65] *See, e.g.*, Nexeo Solutions Holdings, LLC, Third Amendment to Amended and Restated Limited Liability Company Agreement (Aug. 31, 2012), *archived at* http://perma.cc/DKJ2-FTGM.

[66] *Full-Text Search*, SEC. & EXCH. COMM'N, https://searchwww.sec.gov/EDGARFSClient/jsp/EDGAR_MainAccess.jsp (last visited Dec. 8, 2014).

[67] The Delaware Limited Liability Company Act uses the term "limited liability company agreement." DEL. CODE ANN. tit. 6, § 18-101(7) (2011). The drafters of the Revised Prototype Limited Liability Company Act decided to use this term as well. REV. PROTOTYPE LTD. LIAB. CO. ACT § 102(14) (2011). Unlike these two acts, the Revised Uniform Limited Liability Company Act uses the term "operating agreement." REV. UNIF. LTD. LIAB. CO. ACT § 102(13) (2006). Indeed, in practice an LLC agreement can take other names as well. For instance, LLC agreements can be named "company agreement" or "company by-laws." *See* Kennebrew v. Harris, 425 S.W.3d 588, 592 (Tex. App. 2014) (referencing "Company Agreement"); Shaun M. Klein, Comment, *Piercing the Veil of the Limited Liability Company, from Sure Bet to Long Shot:* Gallinger v. North Star Hospital Mutual Assurance, Ltd., 22 J. CORP. L. 131, 143 (1996) (referencing "Company Bylaws").

[68] Original Research (on file with the author).

[69] *See, e.g.*, Nexeo Holdings Solutions, LLC, Annual Report 88 (Form 10-K) (Sept. 30, 2012); Nexeo, *supra* note 65.

[70] *See, e.g.*, Nexeo, *supra* note 65, at 129.

1, S-4, and S-11).[71] In this way the LLC agreements of twenty publicly traded U.S. LLCs were identified. The LLC agreement of a publicly traded company formed in the Marshall Islands was not included in the sample. The last LLC IPO—data updated in November 2013—took place in October 2012.

The filings of the sample companies with the SEC were used to obtain other data. The ownership information was obtained from the prospectuses, annual reports, and definitive proxy statements of the companies.[72] The annual reports and definitive proxy statements were also the source of information on the board composition and practices and on profit distribution practices.[73] In addition to the LLC agreements and other data described above, where necessary, other company agreements, such as management agreements, exchange agreements, and shareholders agreements, were studied.

B. *Research Design and Coding*

One of the main differences between LLCs and corporate-type business forms is the enhanced role of enabling rules in regulating the internal governance matters of the company and the relations between members.[74] This feature allows LLC members to choose different governance structures and enhances the role of LLC agreements.[75] In many cases, the latter contain detailed regulations of relations between managers and members and between different groups of members.[76] The contractual freedom of LLC governance provides ample room for studying different privately chosen governance mechanisms, establishing whether there is a demand for this freedom in practice, and comparing the real-life contractual governance structures with the predictions of the financial contracting theories.[77] The coding criteria were defined based

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[71] *See, e.g.*, *id.*

[72] *See, e.g.*, Macquarie Infrastructure Company LLC, Annual Report (Form 10-K) (Feb. 19, 2014).

[73] *See, e.g.*, *id.* at 113, 165.

[74] *See* Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 390-91 (1992) (discussing the various governance mechanisms available to LLCs and their freedom to choose from among them).

[75] *See id.*

[76] *See, e.g.*, *id.* at 390 (discussing the functioning of LLC agreements and possible pitfalls of failing to understand particular provisions).

[77] *See* 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, 1610-14 (2004) (emphasizing contractual freedom as an important

on: (1) the background information, (2) information about the ownership of voting and equity rights, and (3) the main differences of the legal regime of LLCs as opposed to corporate statutes. Within these three areas, eighty-four primary questions were identified.[78] This author read all twenty sample LLC agreements and coded all variables (except background information) as either zero (a negative answer) or one (a positive answer).

The research design of this study is outlined by the basic assumption that contractual techniques employed in LLC agreements should be assessed, keeping in mind the larger picture that stipulated the choice of one clause over the other. Publicly traded LLCs operate in an institutional environment where many factors interact with each other.[79] LLC agreements and their particular provisions are only a small number of elements that need to be examined in this system.[80] In particular, earlier research supports the argument that ownership structure acts as a substitute for contractual arrangements.[81] Following this assumption, one of the distinctive characteristics of this study is the consideration of a large number of corporate governance techniques that can act as a substitute for legal protection rules such as ownership structure, management incentives, reputation building, board composition and practices, profit distribution practices, and others.[82] Nevertheless, this study does not claim to cover all possible elements affecting LLC governance. The second innovation in the research design was the grouping of the sample companies based on their industry division or specialization. For example, publicly traded LLCs that were the managing partners of private equity and hedge funds tended to use different ownership structures than oil and gas LLCs.

As mentioned above, the total number of LLCs in the database is twenty.[83] All sample LLCs were formed in one state—Delaware.[84] This characteristic of the data eliminates the possible influence of state statutory differences on contractual choices that parties had made. On the other hand, the governance structures of publicly traded LLCs, indeed, are highly affected by the listing regulations of the national exchanges (*e.g.*, the requirement of having a board of directors).[85] But in

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feature of LLC laws and examining contractual freedom to eliminate fiduciary duties in Delaware LLCs and the judicial response as of 2004).

[78] *See infra* Appendix (listing questions).

[79] *See infra* notes 434-37 and accompanying text.

[80] *See infra* notes 422-34 and accompanying text.

[81] *See, e.g.*, Ciccotello & Muscarella, *supra* note 25, at 15-19.

[82] *See infra* Appendix.

[83] *See infra* note 92 and accompanying text.

[84] *See infra* note 97 and accompanying text.

[85] Robert B. Thompson, *Corporate Federalism in the Administrative State: The SEC's Discretion to Move the Line Between the State and Federal Realms of Corporate Governance*,

many cases these LLCs qualify for exemptions from some of these requirements and, therefore, use different governance structures than a typical listed corporation is expected to use.[86] Usual exemptions are related to the role of independent directors, dual-class ownership structures, board committees, and the obligation to convene annual member meetings.[87]

Since the study focused on a specific group of LLCs—publicly traded LLCs—any extrapolation of the results of the study to all LLCs (including those used by small businesses) should be approached very carefully. Tax filings of LLC members with the IRS (excluding LLCs that elected corporate taxation) show that the average number of LLC members in 2011, including publicly traded LLCs, was only 3.04.[88] The mean of the average members in the period from 2001 to 2011 was 3.22.[89] Therefore, most LLCs have only a few members who face completely different conflicts of interest than the controlling and minority members of publicly traded LLCs. Moreover, at least one-third of all LLCs have one member,[90] and in these cases LLC agreements contain only very basic information about the name, term, and location of the LLC or, perhaps, are not even written. The governance structure of publicly traded LLCs has more similarities with the governance structure of listed LPs.[91]

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82 NOTRE DAME L. REV. 1143, 1151-52 (2007) (discussing the role of exchange listing standards on corporate governance).

[86] *See infra* notes 427, 434-37 and accompanying text.

[87] *See, e.g.*, NYSE LISTED CO. MANUAL § 303A.00 (2009) (exempting companies of which more than 50% of voting power is held by an individual, group, or another company from the requirements in §§ 303A.01, 303A.04, or 303A.05).

[88] *See* DeCarlo et al., *supra* note 49, at 184; Adrian Dungan, *Sole Proprietorship Returns, 2011*, STATISTICS OF INCOME BULLETIN, Summer 2013, at 33, *archived at* http://perma.cc/J2EX-RQ73.

[89] Dungan, *supra* note 88, at 33; Tim Wheeler & Maureen Parsons, *Partnership Returns, 2002*, STATISTICS OF INCOME BULLETIN, Fall 2004, at 56-57; Tim Wheeler & Nina Shumofsky, *Partnership Returns, 2004*, STATISTICS OF INCOME BULLETIN, Fall 2006, at 190-91; Tim Wheeler & Nina Shumofsky, *Partnership Returns, 2006*, STATISTICS OF INCOME BULLETIN, Fall 2008, at 215-16; Tim Wheeler & Nina Shumofsky, *Partnership Returns, 2008*, STATISTICS OF INCOME BULLETIN, Fall 2010, at 167-68; Nina Shumofsky et al., *Partnership Returns, 2010*, STATISTICS OF INCOME BULLETIN, Fall 2012, at 167-68; DeCarlo et al., *supra* note 49, at 184.

[90] There were 1,125,132 nonfarm sole proprietorships in 2011 that filed taxes as registered LLCs. Dungan, *supra* note 88, at 33. This is out of 3,236,191 total LLCs. *See id.*; DeCarlo et al., *supra* note 49, at 184.

[91] *Cf.* Manesh, *supra* note 9, at 559 (discussing the similarities in governance structure between larger LPs and LLCs).

C. *Descriptive Summary of the Background Information*

As of September 2013, there were twenty publicly traded LLCs in the United States.[92] The sample LLCs represented three industrial groups. More than half of the LLCs operated in the oil and gas sector, including transportation and retail operations (Macquarie Infrastructure Company LLC, which was included in this group, was also famous for operating airport infrastructure such as parking).[93] The next group was composed of the managing companies of private equity and hedge funds and one relatively smaller investment company.[94] In this group, the listed companies were the managers of the funds, rather than the funds themselves; the principal sources of their income was: (1) management fees based upon a percentage of the committed or invested capital, (2) transaction and advisory fees received from private equity portfolio companies for consultations, (3) income based on the performance of the funds, and (4) investment income from direct investments.[95] The third group consisted of companies investing in mortgage securities.[96]

All LLCs in the database were formed in Delaware, though none of them had a principal place of business in Delaware.[97] Owing to the

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[92]*See infra* Table I. Seadrill Partners LLC was organized according to the laws of the Marshall Islands and was headquartered in London, and, hence, was not included in the data. BLOOMBERG LAW, COMPANY REPORT SEADRILL PARTNERS LLC (2015). At the end of September 2012, the shares of W.P. Carey & Co. LLC were delisted and cancelled and the common stock of its successor (W.P. Carey Inc., a Maryland corporation) was listed. BLOOMBERG LAW, COMPANY REPORT W.P. CAREY INC. (2015); *W.P. Carey Announces Shareholder Approval of REIT Conversion*, BLOOMBERG LAW, Sept. 14, 2012. Thus, at the end of 2013 there were nineteen listed U.S. LLCs.

[93]*See infra* Table I.

[94]*See infra* Table I.

[95]*See, e.g.*, Apollo Global Mgmt., LLC, Annual Report 230-33 (Form 10-K) (Mar. 1, 2013).

[96]*See infra* Table I.

[97]*See* EDGAR Search Results for Apollo Global Mgmt., LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Compass Grp. Diversified Holdings LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Constellation Energy Partners LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Copano Energy, L.L.C., Sec. & Exch. Comm'n (2014); EDGAR Search Results for Ellington Fin. LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Enbridge Energy Mgmt., L.L.C., Sec. & Exch. Comm'n (2014); EDGAR Search Results for Fortress Inv. Grp. LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Kinder Morgan Mgmt, LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for KKR Fin. Holdings LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Linn Energy, LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for LinnCo, LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Macquarie Infrastructure Co. LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for MMA Capital Mgmt. LLC (formerly Municipal Mortgage & Equity, LLC), Sec. & Exch. Comm'n (2014); EDGAR Search Results for Niska Gas Storage Partners LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for NuStar GP Holdings, LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Oaktree Capital Grp., LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Och-Ziff Capital Mgmt. Grp. LLC, Sec. & Exch. Comm'n (2014);

large number of oil and gas companies in the sample, Texas was the most common state where the headquarters of the listed LLCs were located (nine companies).[98] It was followed by New York (five LLCs); California, and Connecticut (two companies each).[99] The remaining two LLCs were headquartered in Maryland and Ohio.[100] The largest number of IPOs of LLCs took place in 2006 and 2007 (four and five, respectively).[101] The second largest concentration of LLC IPOs was during the last few years—five listings in the period from 2010 to 2012.[102] Partnership taxation was elected by fourteen sample LLCs, and six LLCs, all oil and gas companies, elected corporate taxation.[103] Table I lists all publicly traded LLCs and presents data on their distribution according to the industry division, the date of listing, and the election of taxation.[104]

EDGAR Search Results for Travelcenters of Am. LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for Vanguard Natural Res., LLC, Sec. & Exch. Comm'n (2014); EDGAR Search Results for W.P. Carey, Inc. (Formerly W.P. Carey & Co. LLC), Sec. & Exch. Comm'n (2014).

[98]The nine LLCs headquartered in Texas are Constellation Energy Partners LLC; Copano Energy, L.L.C.; Enbridge Energy Mgmt., L.L.C.; Kinder Morgan Mgmt., LLC; Linn Energy, LLC; LinnCo, LLC; NuStar GP Holdings, LLC; Travelcenters of Am. LLC; and Vanguard Natural Res., LLC.

[99]The five LLCs headquartered in New York are Apollo Global Mgmt. LLC; Fortress Inv. Grp. LLC; Och-Ziff Capital Mgmt. Grp., LLC; Macquarie Infrastructure Co. LLC; and W.P. Carey & Co. LLC. The two LLCs headquartered in California are KKR Fin. Holdings LLC and Oaktree Capital Grp., LLC. The two LLCs headquartered in Connecticut are Compass Grp. Diversified Holdings LLC and Ellington Fin. LLC.

[100]The two other LLCs are MMA Capital Management, LLC and Niska Gas Storage Partners LLC.

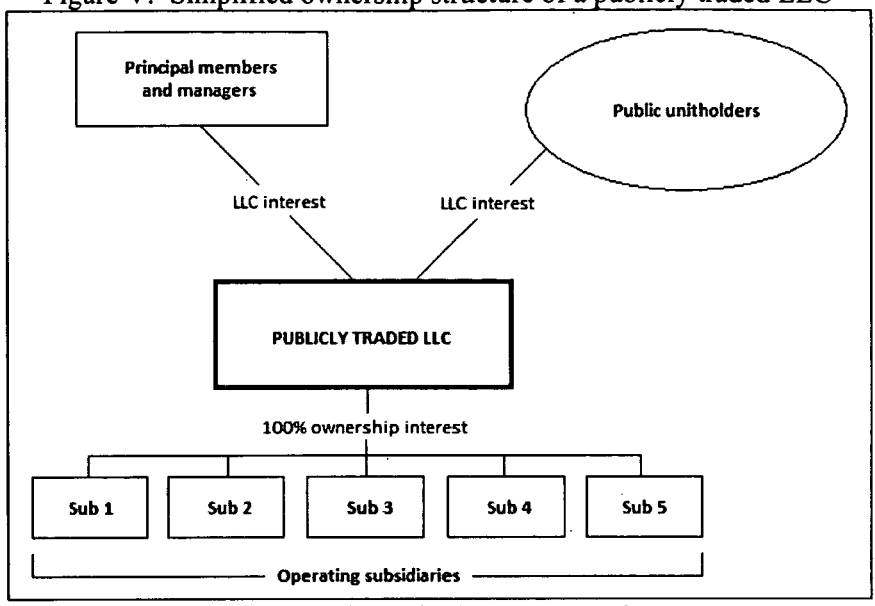
[101] WILMERHALE, 2013 MID-YEAR IPO REPORT 2 (2013), *archived at* https://perma.cc/EZQ3-4CAX.

[102]*See id.*

[103]*See infra* Table I.

[104]*See infra* Table I.

Figure V: Simplified ownership structure of a publicly traded LLC



Source: The author's own research.

Where available, the data show that publicly traded LLCs had a large number of members and were thus completely different from an average LLC that had just 3.22 members.[105] The approximate number of members in publicly traded LLCs ranged from a minimum of 2,000 to a maximum of 98,000. Twelve of the LLCs on the date of listing and nine LLCs in 2012 had a large member (group of affiliated members) controlling at least 20% of the voting rights.[106] This ownership structure, in which controlling members coexist with a large number of minority members, obviously makes publicly traded LLCs different from the rest, especially regarding the perspective of conflicts of interest arising during corporate governance.[107] The typical simplified (omitting intermediary holding companies) ownership structure of a publicly traded LLC is presented in Figure V.

[105] *See infra* Table I; *see also supra* text accompanying note 89.

[106] *See infra* Table I.

[107] *See Delaware Court Refuses to Dismiss Breach of Fiduciary Duty Claims Against Controlling Unitholder of LLC*, CORPORATE GOVERNANCE GROUP CLIENT ALERT (Milbank, Tweed, Hadley & McCloy, LLP, New York, N.Y.), Dec. 22, 2010, at 4, *archived at* http://perma.cc/5ZK2-4B8Y ("'[C]ontrolling members in a manager-managed LLC owe minority members the traditional fiduciary duties that controlling shareholders owe minority shareholders' in the corporate context.") (quoting *In re* Atlas Energy Res., LLC, 2010 WL 4273122, at *7 (Del. Ch. Oct. 28, 2010), *reprinted in* 36 DEL. J. CORP. L. 823 (2011)).

IV. CONTRACTUAL RIGHTS

The sample LLCs actively used the default provisions of the Delaware LLC Act to design various governance structures.[108] In many ways these structures differed from the traditional governance models of listed corporations.[109] After describing the main provisions of the operating agreements of the publicly traded LLCs, this section goes on to find whether the waivers of the traditional investor protection rights were accompanied by offering substitute contractual protections to minority members.[110] The main idea is that to attract outside investors, along with tailoring the governance of publicly traded LLCs to the needs of their founders and managers, these companies should offer some additional legal protection to outside investors.[111]

Board entrenchment and the use of control-enhancing mechanisms were common practices in publicly traded LLCs.[112] In 40% of the LLCs, the operating agreements contained provisions that effectively entitled the founding members to appoint the majority or all of the members of the board of directors.[113] More than half of the companies also limited the right to remove directors and officers by employing different techniques, such as allowing removal only for cause, requiring the approval of certain members, or supermajority voting.[114] In 30% of the companies, dual class interests separated voting rights from economic

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[108] *See* DEL. CODE ANN. tit. 6, § 18-402-07 (2011).

[109] *See* Martin Lipton & Paul K. Rowe, *The Inconvenient Truth About Corporate Governance: Some Thoughts on Vice-Chancellor Strine's Essay*, 33 J. CORP. L. 63, 64 (2007):

> The key elements of the existing corporate governance order have been (1) centralized professional management; (2) supervision of management by knowledgeable, largely independent groups of directors who help set long-term policy and deal with extraordinary events; (3) a federal regulatory system largely limited to disclosure and punishment for outright fraud; (4) a body of state law that recognizes the critical importance of the business judgment rule and therefore limits judicial intervention to egregious cases; and (5) a role for shareholders that is generally restricted to votes on rare events like mergers and proxy contests.

[110] *See infra* text accompanying notes 190-225.

[111] *See* Manesh, *supra* note 9, at 578-83 (discussing substitutes for fiduciary duties in the governance structures of alternative entities).

[112] *See infra* Table I.

[113] *See infra* Table I. Apollo Global Mgmt., LLC, Oaktree Capital Grp., LLC and Och-Ziff Capital Mgmt. Grp., LLC tied the appointment rights of the founding members with a particular threshold of the founding members' minimum voting rights. In the first two LLCs it was only 10%, while in the latter the threshold was 50%. Original Research (on file with author).

[114] *See infra* Appendix.

interests.[115] Dual class membership interests were not the only means available for enhancing control in listed LLCs.[116]

The detailed analysis of the ownership structures demonstrates that another mechanism was the pooling of membership interests.[117] In several cases, the founders of the company brought together their membership interests in one holding company.[118] In this situation, the founders were the beneficial owners of the membership interests in a listed LLC, but the immediate holder was an intermediate legal entity that combined the interests of several founders and voted as a single large member.[119] This mechanism resembles that of the voting trust mechanism where the settlors of the trust transfer their interests to the trust and the trustee votes the interests according to the trust agreement.[120] Similarly, at the level of an intermediate holding entity, the beneficial owners of a public LLC can enter into an agreement guiding the voting by the holding entity.[121] At least four LLCs included in the sample (20%) used intermediate holding structures to enhance the control and rights of the founding members and managers.[122]

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[115] *See infra* Table I.

[116] *See infra* Table I.

[117] *See infra* Table I.

[118] *See infra* Table I.

[119] *See infra* Table I.

[120] *See* 18 AM. JUR. 2D *Corporations* § 956 (2007) ("[A] voting trust is an agreement between stockholders on one side and a trustee on the other whereby rights to vote the stock are transferred to and vested in the trustee.").

[121] *See id.*; *see also infra* Table I.

[122] The four LLCs are Niska Gas Storage Partners LLC, Apollo Global Mgmt., LLC, Oaktree Capital Grp., LLC, and Ellington Fin. LLC. *See infra* Table I.

Table I
Publicly traded LLCs, September 2013

LLC name	Stock exchange	Listing date	Election of taxation	Number of members	Share of the largest member, listing date, %*	Share of the mgmt.., listing date, %*	Share of the largest member, 2012, %*	Share of the mgmt.., 2012, %*
Panel A: Oil and gas exploration and production; pipelines and other midstream operations (including retail marketing)								
Constellation Energy Partners LLC	NYSE Amex	Nov 2006	Corporation	4,460	60[†,‡]	0	26.4[†]	6.1
Copano Energy, L.L.C.	NASDAQ	Nov 2004	Partnership	n/a	19.71	21.36	14.07	2.49
Enbridge Energy Management, L.L.C.	NYSE	Oct 2002	Corporation	9,000	100 (10)[†]	<1	100 (16.8)[†]	<1
Kinder Morgan Management, LLC	NYSE	May 2001	Corporation	97,550	100 (10)[†,‡]	0	100 (14.27)[†,‡]	<1
Linn Energy, LLC	NASDAQ	Jan 2006	Partnership	n/a	39.2	56.7	<1	1.95
LinnCo, LLC	NASDAQ	Oct 2012	Corporation	n/a	<1[†]	0	<1[†]	0
Macquarie Infrastructure Company LLC	NYSE	Dec 2004	Corporation	18,500	7.8	8.1	9.7	10.3
Niska Gas Storage Partners LLC	NYSE	May 2010	Partnership	n/a	74.1[†]	0	74.1[†]	<1
NuStar GP Holdings, LLC	NYSE	Jul 2006	Partnership	n/a	59.4	0	17.74	18.85
Travelcenters of America LLC	NYSE Amex	Jul 2007	Corporation	19,900	8.2[‡]	<1	8.8[‡]	7.6
Vanguard Natural Resources, LLC	NYSE	Oct 2007	Partnership	n/a	29	3.7	1.3	1.3
Panel B: Investment and financial management								
Apollo Global Management, LLC	NYSE	Mar 2011	Partnership	n/a	80.7 (0)[†,††]	80.7 (4)[†,††]	78.4 (0)[†,††]	78.4 (≈3)[†,††]
Compass Group Diversified Holdings LLC	NYSE	May 2006	Partnership	> 20,000	28.67	1.49	16.4	1.9
Fortress Investment Group LLC	NYSE	Feb 2007	Partnership	n/a	77.7 (0)[‡‡]	77.7 (0)[‡‡]	59.5 (3.2)[‡‡]	59.5 (3.2)[‡‡]
Oaktree Capital Group, LLC	NYSE	Apr 2012	Partnership	n/a	97 (0.01)[†,†††]	97 (0.01)[†,†††]	97 (0.01)[†,†††]	97 (0.01)[†,†††]
Och-Ziff Capital Management Group LLC	NYSE	Nov 2007	Partnership	n/a	79.1 (0)[†,‡‡‡]	79.1 (0)[†,‡‡‡]	66.6 (1)[†,‡‡‡]	66.7 (1.4)[†,‡‡‡]

Panel C: Real estate—mortgage securities								
Ellington Financial LLC	NYSE	Oct 2010	Partnership	n/a	17.7‡	17.7	18.8‡	16.7
KKR Financial Holdings LLC	NYSE	Aug 2007	Partnership	n/a	9.8‡	5.3	15‡	1
Municipal Mortgage & Equity, LLC	OTC	Jul 1998	Partnership	1,955	6.33	8.54	2.56	12.85
W.P. Carey & Co. LLC	NYSE	Jan 1998	Partnership	39,893	2.79	2.90	28.93	32.07
			*Average***	*26,407.25*	*44.91*	*23.11*	*36.87*	*20.89*

* For the purposes of defining the largest members/managers affiliated entities were considered as one member. The percentages of the holdings are based on the voting rights; the economic interests, if different, are indicated in the parentheses. The sources of data are the securities registration statements (Forms S-1, S-4, S-11), annual reports (Form 10-K) and proxy statements (Form 14A DEF) of the LLCs filed with the SEC and available through the SEC's EDGAR database. For the last two columns the percentages of the shares of the largest members and managers were defined based on the documents filed in 2012.

** For average calculations membership interests indicated as below 1% were equaled to 1; the numbers were rounded up to the hundredth decimal place.

† The member had special rights of appointing managers or the majority of the board members of the LLC (including the right to elect the board fully).

‡ The LLC agreement placed voting caps or maximum ownership restrictions on the beneficial ownership of the interests.

†† The group of the largest members (three managers) owned 58.9% effective economic interest in the operating subsidiaries at the date of the IPO.

‡‡ The largest member (a group of managers) separately owned 77.7% and approximately 60% economic interest in the operating subsidiaries in 2007 and 2012 respectively.

††† The largest member (a group of managers) separately owned 78% economic interest in the operating subsidiaries.

‡‡‡ The largest member separately owned 80.8% economic interest in 2007 and 68.1% economic interest in 2012 in the operating subsidiaries.

Shareholder agreements among the large members of publicly traded LLCs were also used as a control-enhancing mechanism. The sample contains three companies, all from the finance sector, where the principal members entered into shareholders agreements with the aim of enhancing their voting rights.[123] These agreements provided for: (1) special approval rights (including the appointment of officers) as long as the principals held more than 40% of the total voting power (two companies), (2) special board representation rights (all three), and (3) transfer restrictions (all three), as a rule, during a certain period after the IPO.[124] Shareholders agreements were used only where a group of members held a large membership interest.[125] In general, unlike U.S. listed corporations,[126] shareholders agreements seem to be practiced in publicly traded LLCs.

In total, 65% of the listed LLCs, by employing director appointment rights, dual-class interests, holding structures, and shareholders agreements, had strong management control rights. However, only 35% in 2012 had a large member with a voting share above 50% and just one LLC had a large member holding a majority economic interest.[127]

The founders of an LLC are free to make it more partnership-like by bestowing upon members day-to-day management tasks and responsibilities and agreeing to dissolve the LLC upon the withdrawal of members, or make it more corporate-like with centralized management structure and unlimited existence.[128] Notwithstanding this freedom, all publicly traded LLCs opted for the centralized management by the board

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[123] Apollo Global Mgmt., LLC, Shareholders Agreement (Form S-1/A Ex. 10.10) (July 13, 2007); Fortress Inv. Grp. LLC, Shareholders Agreement (Form S-1/A Ex. 4.2) (Dec. 31, 2013); Och-Ziff Capital Mgmt. Grp. LLC, Class B Shareholders Agreement (Form 10-K Ex. 4.2) (Dec. 31, 2013).

[124] *See* Och-Ziff Capital Mgmt. Grp. LLC, *supra* note 123, §§ 3.1-5.1; Fortress Inv. Grp. LLC, *supra* note 123, at §§ 2.1-4.1; Apollo Global Mgmt., LLC, *supra* note 123, §§ 2.1-3.2.

[125] *See supra* Table I.

[126] *See* Steven N. Bulloch, *Shareholder Agreements in Closely Held Corporations: Is Sterilization an Issue?*, 59 TEMP. L.Q. 61, 62 (1986); Marco Ventoruzzo, *Why Shareholders' Agreements are not Used in U.S. Listed Corporations: A Conundrum in Search of an Explanation* 3 (Pa. State Univ. Dickinson Sch. of Law, Bocconi Legal Studies Research Paper No. 42-2013, 2013), *archived at* http://perma.cc/GVG9-V76B (noting that there is a strong belief among business law scholars and corporate law attorneys (probably wrong) that the use of shareholders' agreements is not common in listed corporations in the United States).

[127] *See supra* Table I; *infra* Appendix.

[128] *See* Carol R. Goforth, *Continuing Obstacles to Freedom of Choice for Management Structure in LLCs*, 1 J. SMALL & EMERGING BUS. L. 165, 173 (1997).

of directors.[129] The LLCs also tended to apply the rules of the Delaware General Corporation Law ("DGCL") to divide the powers between the board and the member meetings, and between the board and the company officers.[130] In one case, the centralized management was vested in the founding member who then delegated the day-to-day decision making to the board and officers appointed by the board.[131] Accordingly, in publicly traded LLCs, the members did not have actual nor apparent authority to bind the company.[132] Similarly, although the board was a centralized management body, separate board members could not bind the company, as only officers were endowed with this power.[133]

All publicly traded LLCs opted out from the default rule of the Delaware LLC Act, which restricts interest transfers,[134] to allow free transferability of LLC interests.[135] Preemptive rights in cases of new equity issuances and share transfer restrictions were not common.[136] However, in three publicly traded LLCs, which capped a maximum ownership share in order to maintain preferential real estate investment trust ("REIT") taxation,[137] transfer restrictions were used to prevent purchases above the maximum ownership limit, and two other companies used approval clauses for change-of-control transactions.[138]

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[129] *See infra* Appendix.

[130] *See infra* Appendix.

[131] *See infra* Appendix. Niska Gas Storage Partners LLC adopted this member management style.

[132] *See* Goforth, *supra* note 128, at 173 ("Manager management exists where management authority, both actual and apparent, is vested in designated managers.").

[133] *See, e.g.*, Apollo Global Mgmt., LLC, Annual Report 249-50 (Form 10-K) (Dec. 31, 2013), ("[O]ur board of directors will have no authority other than that which our manager chooses to delegate to it.").

[134] *See* DEL. CODE ANN. tit. 6, § 18-702(a) (2011).

[135] *See infra* Appendix.

[136] *See infra* Appendix. For the only company that had a centralized member-managed structure, only the managing member had a preemptive right. *See* Niska Gas Storage Partners LLC, Annual Report 27 (Form 10-K) (May 30, 2014).

[137] KKR Fin. Holdings LLC, Municipal Mortgage & Equity, LLC, and W.P. Carey & Co. LLC all have single-member ownership values under 10% to prevent an aggregate ownership of more than 50% by five individuals. *See supra* Table I; *see also* I.R.C. §§ 856(a)(5)-(6), 857(a)(1) (providing that REITs are generally exempt from taxation at the trust level as long as they distribute at least 90% of their income to their unit holders, and that a company is classified as a REIT for tax purposes if it has more than 100 beneficial members); I.R.C. § 856(h)(1)(A) (providing that REITs must not be "closely held" with more than 50% value of its interest owned by more than five individuals as established in I.R.C. § 542(a)(2)). Typically, REITs tend to be more value than growth oriented. ROBERT W. HAMILTON & RICHARD A. BOOTH, BUSINESS BASICS FOR LAW STUDENTS § 16.7 (4th ed. 2006) ("[A modern REIT] usually functions as a conservative manager of completed income-producing properties.").

[138] Original Research (on file with author).

Save for the three special cases discussed in detail below,[139] all publicly traded LLCs could engage in any lawful activity.[140] All companies had perpetual existence and were not subject to dissolution upon the death, retirement, or resignation of their members or any other special events.[141] None of the LLCs provided their members with resignation or appraisal rights in the events of opposing important corporate matters, such as LLC agreement amendment, mergers, consolidations, and capital decrease.[142] Publicly traded LLCs, similarly to Delaware corporations,[143] tended to allow dissolution by the affirmative vote of the majority of the members and the approval of the board of directors.[144] Only six LLCs could dissolve by member vote without obtaining the approval of the board.[145] The voting threshold in the latter case, however, was usually higher than a simple majority.[146]

None of the LLCs waived the judicial dissolution rule of the Delaware LLC Act,[147] according to which courts can dissolve an LLC if it is not reasonably practicable to carry on its business in conformity with the LLC agreement.[148] At the same time, none of them expanded it, which means that the judicial dissolution of publicly traded LLCs based on minority member oppression grounds, similar to Delaware corporations, was not possible.[149] The practice of the Delaware courts makes judicial dissolution of listed LLCs a very limited remedy.[150] Bearing in mind the broad definition of the purpose of publicly traded LLCs in the operating agreements, it is rather difficult to prove that it is no longer reasonably practicable for an LLC to operate in accordance with its broad purpose clause.[151] The second ground for judicial

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[139] *See infra* Part V.

[140] *See infra* Appendix.

[141] *See infra* Appendix.

[142] *See infra* Appendix.

[143] *See* DEL. CODE ANN. tit. 8, § 275(a)-(c) (2006).

[144] *See infra* Appendix.

[145] Original research (on file with author).

[146] *See infra* Appendix.

[147] *See infra* Appendix.

[148] *See* DEL. CODE ANN. tit. 6, § 18-802 (2011).

[149] *See infra* Appendix; *see also* Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L.Q. 1099, 1101 (1999) ("In 1993, in *Nixon v. Blackwell*, the Delaware Supreme Court considered '[w]hether there should be any special, judicially-created rules to "protect" minority shareholders of closely held Delaware corporations.' The court emphatically declined to create any such special rules.").

[150] *See* Huatuco v. Satellite Healthcare, 2013 WL 6460898, at *5 (Del. Ch. Dec. 9, 2013), *aff'd*, 93 A.3d 654 (Del. 2014) (showing the reluctance of Delaware courts to consider a right to judicial dissolution as a "default right" that cannot be waived by a contract).

[151] *See In re* Seneca Invs. LLC, 970 A.2d 259, 263 (Del. Ch. 2008) ("The role of this Court in ordering dissolution under § 18-802 is limited, and the Court of Chancery will not

dissolution applied by the Delaware courts—deadlock in decision making—is not likely to be applied to listed LLCs due to their ownership structure.[152]

Delaware law differs significantly with regard to the legal formalities that corporations and LLCs must meet.[153] Legal formalities have much narrower scope in LLCs.[154] However, the operating agreements of listed LLCs contained many procedural rules, thus, making listed LLCs similar to their corporate peers.[155] In particular, almost all LLCs had strong procedural rules for the member and board meetings: minimum quorum requirement (100%), voting threshold rules (100%), notice period (90%), and record date for the member meetings (100%).[156] The LLC agreements of publicly traded LLCs allowed board action without a meeting, but they diverged with regard to the minimum-consent requirement. In 80% of the companies, such action was possible only by the unanimous consent, in one case by a super-majority vote, and in the remaining three cases by a simple majority.[157] Action without a meeting by the members was less common.[158] Such action was not possible in six LLCs and in three LLCs unanimous consent of all members was required.[159] Those eleven LLCs where the members were entitled to act by written approval by a majority of members were mostly

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attempt to police violations of operating agreements by dissolving LLCs."); Wiggs v. Summit Midstream Partners, LLC, 2013 WL 1286180, at *13 (Del. Ch. Mar. 28, 2013) (holding, in light of a broad company purpose clause, that plaintiff failed to plead how it was no longer practicable for management to operate in accordance with the LLC agreement). *But see In re* Silver Leaf, L.L.C., 2005 WL 2045641, at *10-11 (Del. Ch. Aug. 18, 2005), *reprinted in* 31 DEL. J. CORP. L. 326 (2006) (looking to the actual purpose of the LLC based on past activities).

[152]*See* Phillips v. Hove, 2011 WL 4404034, at *26 (Del. Ch. Sep. 22, 2011); *Silver Leaf*, 2005 WL 2045641, at *11 (addressing situation where the vote of the members is deadlocked and the operating agreement provides no means around the deadlock); Haley v. Talcott, 864 A.2d 86, 95, 97-98 (Del. Ch. 2004) (holding that given deadlock between the parties and the absence of a reasonable exit mechanism in the LLC agreement, it was not reasonably practicable for the LLC to continue to carry on business in conformity with the LLC agreement).

[153]*Compare* DEL. CODE ANN. tit. 8, §§ 101-398 (2006) (establishing formalities that Delaware corporations must observe) *with* DEL. CODE ANN. tit. 6, §§ 18-101 to -1109 (2011) (establishing formalities that Delaware LLCs must observe).

[154]*See* Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 864 (2008) ("[E]ach of the mandatory terms of the DGCL identified above[—stockholders' right to elect directors, to inspect books and records, and the directors' duty of loyalty—]is absent from the LLC Act . . . .").

[155]*See infra* Appendix.

[156]*See infra* Appendix.

[157]*See infra* Appendix.

[158]*See infra* Appendix.

[159]*See infra* Appendix.

controlled by a large member.[160] All LLCs provided their members with broad information rights, though in three cases the extent of the disclosure had to be defined by the board.[161] LLC members also agreed about detailed rules for amending LLC agreements.[162] Only members were entitled to vote, though in most cases the prior board approval was necessary.[163]

The companies diverged significantly in annual member meetings and board elections. A mandatory requirement on holding an annual member meeting was absent in LLCs with a large controlling member.[164] Annual board election was not necessary in three LLCs.[165] In six LLCs, operating agreements provided for staggered three-year term boards.[166] Thus, only 55% of the boards of publicly traded LLCs had one-year terms.[167] This is lower than a similar measure at the S&P 500 boards, but is similar to the situation at the boards of the S&P SmallCap 600 and S&P MidCap 400 companies.[168] If one admits that the change in board formation rules that occurred in large listed corporations during the last decade was driven by investor pressure, then, perhaps, investor expectations with regard to governance standards in listed LLCs are more moderate.

The Delaware LLC Act contains flexible rules on LLC capital structure and capital contributions.[169] Yet, almost all publicly traded LLCs allowed member admission only on the basis of purchasing an LLC interest.[170] However, more than half of the sample LLCs had different classes of members (twelve out of the twenty).[171] In addition,

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[160] *See infra* Appendix.

[161] *See infra* Appendix.

[162] *See infra* Appendix.

[163] *See infra* Appendix.

[164] *See infra* Appendix.

[165] *See infra* Appendix.

[166] *See infra* Appendix.

[167] *See infra* Appendix.

[168] *See* SPENCER STUART, SPENCER STUART BOARD INDEX 2014 15 (2014), *archived at* https://perma.cc/CBB6-UWH4 (reporting that 93% of the S&P 500 companies had annually elected boards in 2014); EQUILAR, S&P 1500 BOARD PROFILE: COMPOSITION & RECRUITING TRENDS (PART 3) 9 (2013), *archived at* http://perma.cc/R2XE-ZGNE (reporting that in 2012, the share of staggered boards was 17.8%, 44.8%, and about 46% in the S&P 500, mid-cap and small-cap companies, respectively).

[169] *See* DEL. CODE ANN. tit. 6, § 18-501 (2011); *see also* Michael D. Goldman & Eileen M. Filliben, *Corporate Governance: Current Trends and Likely Developments for the Twenty-First Century*, 25 DEL. J. CORP. L. 683, 708 (2000) ("LLCs also have significant non-tax advantages, including: flexible management choices, liberal member qualification requirements, and flexible capital structures.").

[170] *See infra* Appendix.

[171] *See infra* Appendix.

some LLCs issued special classes of LLC interests that allowed member admission without contribution.[172] This was particularly popular among the finance LLCs, where the founding members and managers held controlling voting rights without making contributions to the capital of their respective companies.[173] In the majority of the LLCs (thirteen companies), the issuance of additional securities was the sole prerogative of the board of directors.[174] In seven other LLCs, members had limited issuance approval rights—in the case of the issuance of a new class of interests or for the definition of the maximum authorized number of LLC interests.[175] None of the classes of LLC interests was sidelined from voting on matters that affected the rights of the holders of such interests or created additional obligations for them.[176]

Less than half of the LLCs, all from oil and gas sector, had specific target distribution obligations included in the LLC agreements.[177] However, in most cases (six out of the nine), these provisions had very broad language and provided large discretion to the boards of directors in defining the share of the profits that should be distributed to the members.[178] In the remaining cases, the LLCs did not promise any distributions and left the question to the discretion of the board of directors.[179]

Finally, publicly traded LLCs used the default rules of the Delaware LLC Act to waive or restrict the fiduciary duties of the members and managers, or to limit or eliminate any and all liabilities for the breach of these duties.[180] The freedom to contract out of fiduciary duties is considered one of the principal advantages of a Delaware LLC as opposed to a corporation.[181] Delaware LLCs allow their members to (1) expand, restrict partially, or waive in full the fiduciary duties of members or managers (with the exemption of the implied contractual covenant of good faith and fair dealing),[182] or (2) limit or eliminate liability for breach of fiduciary duties and contractual obligations (with

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[172] *See infra* Appendix.

[173] *See infra* Appendix. Namely, Ellington Fin. LLC, Och-Ziff Capital Mgmt. Grp. LLC, Oaktree Capital Grp., LLC, Fortress Inv. Grp. LLC, and Apollo Global Mgmt., LLC.

[174] *See infra* Appendix.

[175] *See infra* Appendix.

[176] *See infra* Appendix.

[177] *See infra* Appendix.

[178] *See infra* Appendix.

[179] *See infra* Appendix.

[180] *See infra* Appendix.

[181] Paul M. Altman et al., *Eliminating Fiduciary Duty Uncertainty: The Benefits of Effectively Modifying Fiduciary Duties in Delaware LLC Agreements*, BUS. L. TODAY, Feb. 2013, at 1-2.

[182] DEL. CODE ANN. tit. 6, § 18-1101(c) (2011).

the exception of acts violating the implied contractual covenant of good faith and fair dealing).[183]

The usual practice of publicly traded LLCs was not to waive or restrict any of the fiduciary duties of the members.[184] The only exception was the duty to avoid competition with the company itself.[185] Competition by members or managers with the company can include not only engaging in competing businesses, but also using private information obtained from the company to enter into individual contracts surpassing the company.[186] The agreements of the sample LLCs typically banned the latter but allowed investments and engagement in other competitive activities not related to the use of confidential information.[187] Such competition, including direct competition with the LLC, was allowed in 70% of the companies.[188] The LLC agreements

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[183] *Id.* § 18-1101(c).

[184] *See infra* Appendix (illustrating that, although fourteen LLCs restricted fiduciary duties of LLC members, those same LLCs also carved out the majority of duties from the restrictions). In six LLCs, however, the operating agreements contained special provisions resolving conflicts of interests between the controlling and all other minority members. *See* Ellington Fin. LLC, Second Amended and Restated Operating Agreement § 6.22 (Form S-11/A Ex. 3.1) (July 1, 2009); Fortress Inv. Grp. LLC, Fourth Amended and Restated Limited Liability Agreement § 5.20(a) (Form 10-Q Ex. 3.3) (Aug. 10, 2009); Niska Gas Storage Partners LLC, First Amended and Restated Operating Agreement § 7.11(a) (Form 8-K Ex. 3.1) (May 17, 2010); NuStar GP Holdings, LLC, Second Amended and Restated Limited Liability Company Agreement § 7.9(a) (Form 8-K Ex. 3.01) (July 19, 2006) (known as "Valero GP Holdings, LLC" in 2006); Oaktree Capital Grp., LLC, Third Amended and Restated Operating Agreement § 6.17(a) (Form S-1/A Ex. 3.2) (Aug. 31, 2011); Och-Ziff Capital Mgmt. Grp. LLC, Second Amended and Restated Limited Liability Company Agreement § 5.20(a) (Form 10-K Ex. 3.2) (Nov. 13, 2007). In light of the Delaware Court of Chancery's judgment in *In re Atlas Energy Resources, LLC*, 2010 WL 4273122 (Del. Ch. Oct. 28, 2010), *reprinted in* 36 DEL. J. CORP. L. 823 (2011), these conflict of interest rules are very likely to be interpreted as substituting the fiduciary duties of controlling members owed to minority members. Only one of these companies adopted its operating agreement after the Delaware Court of Chancery's judgment in *Atlas Energy*. Oaktree Capital Grp. LLC, *supra* (agreement dated Aug. 31, 2011). However, in all six companies the LLC agreements were entered into after the judgment of the Delaware Court of Chancery interpreting a similar provision of the partnership agreement of a listed LP. *See* Brickell Partners v. Wise, 794 A.2d 1, 4 (Del. Ch. 2001).

[185] *See infra* Appendix.

[186] *See* J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, LIMITED LIABILITY COMPANIES: A STATE-BY-STATE GUIDE TO LAW AND PRACTICE § 8:7 (2014) ("[The] duty of loyalty includes . . . the duty *not to usurp LLC opportunities* for his or her personal benefit, and a duty *not to compete* with the LLC.") (emphasis in original).

[187] *See, e.g.*, Constellation Energy Partners LLC, Second Amended and Restated Operating Agreement § 7.5(a) (Form 8-K Ex. 3.1) (Nov. 28, 2006) ("It shall be deemed not to be a breach of any duty . . . of . . . any Manager . . . 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; *provided* such Affiliate does not engage in such business or activity as a result of or using confidential or proprietary information . . . .").

[188] *See infra* Appendix.

also did not limit liability of members for breaching fiduciary duties. Only two firms had exculpation clauses for members which, however, did not cover duty of loyalty, actions in bad faith, and actions with the knowing violation of criminal law.[189]

The waivers and restrictions of the fiduciary duties of the managers were not common either.[190] Only three LLCs waived the duties completely and one more LLC waived all fiduciary duties except duties of care and loyalty.[191] However, the operating agreements of all sample LLCs included exculpation provisions for managers.[192] Only in one case was exculpation full, while the remaining LLC agreements carved out one or more duties from the exculpation provision, meaning that in the absence of other provisions clearly eliminating fiduciary duties, the managers were not protected and were liable for the breach of these carved-out duties.[193] In four LLCs, the exculpation clauses were applicable only to the directors or board members and only to the extent

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[189] *See infra* Appendix.

[190] *See infra* Appendix.

[191] *See infra* Appendix; Oaktree Capital Grp., *supra* note 184, § 6.20(a).

[192] *See infra* Appendix.

[193] *See* Fortress Inv. Grp., *supra* note 184, § 5.19(a) (full exculpation). The position of the Delaware Court of Chancery is that exculpation carve-outs are not intended to establish any duties or assume their existence; rather they serve only the aim of limiting the liability. *See* Dawson v. Pittco Capital Partners, L.P., 2012 WL 1564805, at *28 (Del. Ch. Apr. 30, 2012); Fisk Ventures, LLC v. Segal, 2008 WL 1961156, at *9 (Del. Ch. May 7, 2008). In other words, if an operating agreement waives fiduciary duties, then the effect of an exculpatory provision and its carve-outs is that if in a case any fiduciary duty is ever found in any agreement of the members, then the fiduciaries are not liable except in the cases mentioned in the carve-outs. *See Dawson*, 2012 WL 1564805, at *28. Hence, if there are no duties, then any carve-outs are irrelevant. *See id.* The situation is different where duties are not modified—in addition to injunctive or other equitable relief, a breach of fiduciary duties can be remedied by potential monetary damages. *See* Manesh, *supra* note 9, at 569 (suggesting that to take advantage of these remedy options, the operating agreement must first include specific provisions expressing the adoption of the fiduciary duties). In the latter case, the carve-outs define the extent of availability of damages. *See id.* at 570 ("[A] fiduciary exculpation provision prevents unitholders from seeking monetary damages after the fact for harm caused by a manager's breach."). If a duty is carved out in full (for instance, the duty of loyalty), then damages are available for any breach of the duty. *See id.* at 577 (managers are only liable for breaches of duties explicitly carved out). But it is also possible to carve out a chunk of a duty and limit the liability of fiduciaries to specific cases of breaching the duty requiring a higher standard of proof. *See id.* ("Provided a manager's actions do not fit into [a] heightened categor[y] of culpable conduct, the manager will not be liable for any actions, even if such actions otherwise breach the manager's default fiduciary duties or express contractual duties."). For example, carving out only willful misconduct implies that fiduciaries are liable for self-dealing transactions that they entered with intent to harm the protected parties; but the mere fact that self-dealing caused damages is not sufficient to hold a fiduciary liable. *See, e.g.*, Venhill LP v. Hillman, 2008 WL 2270488, at *23 (Del. Ch. June 3, 2008), *reprinted in* 33 DEL. J. CORP. L. 982 (2008) (requiring bad faith, gross negligence, or some other form of culpable conduct that had been carved out in the exculpation provision in order to recover damages based on an "unfair, self-dealing transaction").

allowed by the DGCL; they did not apply to the officers, who were fully liable for the breach of their duties.[194] Hence, the sample LLCs did not fully use the freedom of contract provided by the Delaware LLC Act to limit the liability of fiduciaries.[195]

Duty of care was the only fiduciary duty that was never carved out explicitly, but two companies excluded gross negligence—the standard for evaluating the breach of the duty of care by Delaware courts[196]—from the scope of the exculpation provisions.[197] Duty of loyalty was carved out in nine cases.[198] Apart from excluding duty of loyalty itself from exculpation clauses, the sample LLCs also carved out other standards for evaluating breaches of the duty of loyalty by fiduciaries.[199] In particular, actions in bad faith[200] were carved out from the exculpation clauses in fifteen cases, and duties not to engage in fraud or willful misconduct[201] in thirteen and twelve cases, respectively.[202] Exculpation carve-outs, considered together with non-modified fiduciary duties in many companies, imply that the directors and officers of the sample LLCs in the majority of the cases discharged their functions under some fiduciary duties protected by potential monetary-damage claims.

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[194] *See infra* Appendix. The fiduciary duties in Delaware corporations are mandatory and cannot be eliminated or restricted by contract. *See* Manesh, *supra* note 9, at 557. However, the liability for breach of the fiduciary duties of directors (not officers)—excluding the duty of loyalty, acts not in good faith or involving intentional misconduct, or a knowing violation of law—can be eliminated or limited by including an express indication in the certificate of incorporation of a corporation. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2006).

[195] *Cf.* Manesh, *supra* note 9, at 560 ("Delaware alternative entity law has long allowed firms to contractually limit or even eliminate the fiduciary duties of managers through the terms of the firm's operating agreement.").

[196] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (explaining gross negligence as the standard of care applicable to the business judgment rule), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000); Albert v. Alex. Brown Mgmt. Servs., Inc., 2005 WL 2130607, at *8 (Del. Ch. Aug. 26, 2005), *reprinted in* 31 DEL. J. CORP. L. 267 (2006).

[197] *See infra* Appendix.

[198] *See infra* Appendix.

[199] *See infra* Appendix.

[200] *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("[T]he requirement to act in good faith 'is a subsidiary element[,]' i.e., a condition, 'of the fundamental duty of loyalty.'") (quoting Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)); *Guttman*, 823 A.2d at 506 n.34 ("A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest.").

[201] *See* Feeley v. NHAOCG, LLC, 62 A.3d 649, 664 (Del. Ch. 2012) ("Willful misconduct is one standard for evaluating whether a fiduciary breached the duty of loyalty by acting in bad faith."); Dawson v. Pittco Capital Partners, L.P., 2012 WL 1564805, at *28 n.303 (Del. Ch. Apr. 30, 2012).

[202] *See infra* Appendix.

In addition to serving as standards for evaluating breaches of traditional fiduciary duties, exculpation carve-outs can cover contractually created substitutes of these duties, for example, special approval rules for large or related party transactions. The significance of ensuring the compliance with contractually created duties is obvious given the role LLC agreements play in the governance of listed LLCs.[203] The limitation of liability for breaching the contractual substitutes of traditional fiduciary duties places outside investors in a risky position where fiduciaries are liable neither for the breach of duties established by law, nor for their contractual equivalents.[204] At least seven companies expressly did not limit the liability of officers for breaching the provisions of the operating agreements.[205] Many others, although covering breaches of contract by exculpatory provisions, had carve-outs that probably can be invoked to hold managers liable for breaching the operating agreements.[206] For example, bad faith behavior may be shown where a director or officer fails to act in the face of a known duty to act;[207] willful misconduct occurs where a director or officer knows that she is committing a breach of duty or knowingly acts outside the scope of her authority intending to harm a protected party.[208] However, where a fiduciary believes that her action does not violate any contractual provision and it is an action about which reasonable minds may disagree

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[203] *See supra* notes 155-63 and accompanying text.

[204] *See* Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295, 316-17 (2014) ("Fiduciary duties provide constraints that may help investors deter, rein in, or root out dishonest, irresponsible, or excessively careless management . . . . Eliminating business laws that help deter or combat dishonest and extremely careless management could result in increased fraud, theft, safety violations, injuries, etc.").

[205] *See infra* Appendix.

[206] *See infra* Appendix.

[207] *See* Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006) (citing *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 n.111 (Del. 2006)).

[208] *See* Dawson v. Pittco Capital Partners, L.P., 2012 WL 1564805, at *37 (Del. Ch. Apr. 30, 2012):

> [W]hen intentional misconduct or bad faith is the standard at issue, and not the general, broader loyalty standard, some showing of the requisite mental state is necessary for the defendant to be liable; mere participation in a self-dealing, unfair transaction is not enough, without a showing of the requisite mental state. . . . [I]t will often be "useful" for the Court to apply an entire fairness analysis in such a case, but it is not the test by which liability is established under an intentional misconduct standard.

In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 290 (Del. Ch. 2003) (quoting DEL. CODE ANN. tit. 8, § 102(b)(7)(ii)) ("Where a director consciously ignores his or her duties to the corporation, thereby causing economic injury to its stockholders, the director's actions are either 'not in good faith' or 'involve intentional misconduct.'").

as to whether it breaches the agreement, then willful misconduct cannot be established.[209]

Additionally, where the carve-outs from the exculpation provisions were limited, in exchange for contracting around the fiduciary duties of the members and managers, the majority of the LLC agreements in the sample contained conflict of interest rules for members and managers.[210] These conflict of interest rules allow self-dealing but establish standards of fair price (terms of the transaction shall be substantially equivalent to the terms of a comparable unaffiliated transaction) and fair dealing (certain procedures for approval).[211] Under these standards, the manager or member can either bear the burden "to perform a reliable market check or valuation analysis *ex ante* or bear the risk of any uncertainty that exists *ex post*."[212] Such rules create a contractual fiduciary duty of entire fairness that is a substitute for the traditional duty of loyalty.[213] However, as noted earlier in the literature, the wording of these contractual fiduciary standards shifts the burden of proof and puts it on outside investors, rather than on fiduciaries.[214] Nevertheless, these provisions were not less protective for outside investors than functionally similar provisions in listed corporations.[215] In the latter case, the compliance with statutory safe harbor provisions of special procedural rules and fairness standards also complicates fiduciary liability for the breach of the duties, because the transaction either becomes subject to review under the business judgment rule or the burden shifts to the plaintiffs to prove unfairness.[216]

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[209] *See Disney*, 825 A.2d at 290 (explaining when willful misconduct can be established).

[210] *See infra* Table II.

[211] *See, e.g.*, Manesh, *supra* note 9, at 585-86.

[212] Gotham Partners v. Hallwood Realty Partners, 795 A.2d 1, 27 (Del. Ch. 2001).

[213] *See* Gotham Partners v. Hallwood Partners, 817 A.2d 160, 171 (Del. 2002).

[214] *See* Manesh, *supra* note 9, at 587 (citing Blackstone Grp. L.P., Amended & Restated Agreement of Limited Partnership § 7.9(a) (Form 8-K Ex. 3.2) (June 27, 2007)). Yet, it is not obvious that putting the burden of proof on plaintiffs in this case is bad for the firm, as such a provision may deter speculative litigation by incentivizing members to bring fiduciary duty claims before the courts only if the likelihood of proving the breach is high.

[215] *See, e.g.*, *id.* ("Sections 7.05 and 7.10(a) 'operate together as a contractual statement of the traditional entire fairness standard [of fair price and fair dealing], with § 7.05 reflecting the substantive aspect of that standard and § 7.10 reflecting the procedural aspect of that standard.'") (citing *Gotham Partners*, 795 A.2d at 26).

[216] *See* Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 2014 COLUM. BUS. L. REV. 663, 688-89; J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1462 (2014).

Table II

Correlation of the governance aspects of the publicly traded LLCs

The table shows whether the pairs of the provisions of the LLC agreements of the publicly traded LLCs and other aspects of their governance structures are positively correlated (likely to appear together), negatively correlated (likely that one appears without the other) or are not correlated. The calculations are based on phi coefficient of correlation for 2x2 tables of categorical variables of each pair. φ values range from 0 (no relation between the pairs) to 1 (perfect positive relation) or −1 (perfect negative relation). One asterisk indicates significance at the 10% level, two asterisks at the 5% level and three asterisks at the 1% level.

	Sell out rights	Purpose limitations	Dissolution by member vote (not unanimous)	Waiver or exculpation of managers' self-dealing duty	Conflict of interest rules for managers	Debt limits	Specific target distributions	Right to call member meetings (min. 10%)	Right to make business and director nominations (min. 10%)	More than 30% economic interest[†,‡]	More than 5% management interest or IDRs[†]
Strong control of management	0.245	0.308	0.015	0.179	−0.105	0.308	−0.179	−0.105	0.319	0.424*	0.257
Sell-out rights		0.793***	0.793***	−0.369*	0.167	0.793***	0.369*	−0.111	−0.245	−0.192	−0.408*
Purpose limitations			0.608***	−0.183	0.210	1.000***	0.464**	−0.140	−0.308	−0.243	−0.514**
Dissolution by member vote (not unanimous)				−0.183	0.210	0.608***	0.183	0.327	−0.015	−0.243	−0.229
Waiver or exculpation of managers' self-dealing duty					0.302	−0.183	0.010	0.302	−0.032	0.522**	0.492**
Conflict of interest rules for managers						0.210	0.201	0.167	−0.157	0.000	0.102
Debt limits							0.464**	−0.140	−0.308	−0.243	−0.514**
Specific target distributions								−0.302	−0.664***	−0.290	−0.492**
Right to call member meetings (min. 10%)									0.454**	−0.192	0.272
Right to make business and director nominations (min. 10%)										0.061	0.385*
More than 30% economic interest[†,‡]											0.471**

[†] Ownership data are for 2012 and are obtained from the annual reports (Form 10-K) and proxy statements (Form 14A DEF) of the LLCs filed with the SEC. IDRs are management incentive distribution rights. For details on IDRs *see infra* notes 247-49 and accompanying text.

[‡] For the calculation of the economic interest of the largest members in the publicly traded LLCs the adjusted data for private equity and hedge fund managing companies were taken into account (for the details see *infra* Part V).

The relations between several important contractual provisions and the ownership aspects of the publicly traded LLCs are presented in Table II.[217] Significant positive correlation suggests that provisions tended to appear together. Two important results of the correlation analysis are: (1) in cases where some investor protection rights were waived, the operating agreements included substitute rights, and (2) the LLCs had ownership structures that mitigated the conflicts created by the waived rights.

In particular, strong control of management had a positive association with the ownership of a large economic interest in the company.[218] The larger the economic share of the largest member in the company is, the more likely it is that management decisions are made in the interests of the company.[219] The waiver or exculpation of the duty to avoid self-dealing was positively correlated with the existence of a large economic member and the management ownership of membership interests.[220] The main implication of this positive correlation is that the waiver and exculpation provisions were not likely to create strong agency problems, because the managers had strong incentives to increase shareholder value—in order to increase the price of their shareholdings and avoid removal by the decision of a large member.[221]

Table II also shows strong positive association between such provisions as the company purpose limitation clauses, minority sell-out rights, specific target distribution obligations, and a right of the members to dissolve the company by majority vote without prior board approval.[222] All these four provisions are strong minority rights.[223] In addition, they tended to be used in the absence of membership interest ownership by managers.[224] As is shown below, these minority protection mechanisms are likely to be used as counterbalancing mechanisms in those listed LLCs where the governance structures create some potential minority risks.[225]

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[217] *See supra* Table II.

[218] *See supra* Table II.

[219] *See In re* Oracle Corp., 867 A.2d 904, 930 (Del. Ch. 2004) ("[A]s Ross Perot would say, 'skin in the game' will tend to align their interests with those of the public stockholders.").

[220] *See supra* Table II.

[221] *See* LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 208 (2009) (suggesting the interests of the managers of LLCs are aligned with those of the businesses).

[222] *See supra* Table II.

[223] *See* Sandra K. Miller, *Discounts and Buyouts in Minority Investor LLC Valuation Disputes Involving Oppression or Divorce*, 13 U. PA. J. BUS. L. 607, 613 (2011) (listing rights affecting control).

[224] *See supra* Table II.

[225] *See infra* Part V.

To conclude, the operating agreements of publicly traded LLCs often altered investor protection mechanisms typically used in listed corporations. In some instances, the operating agreements included contractual substitutes that ensured results equivalent to investor protections available in the corporate law setting. In a few cases, the substitute mechanisms were absent. However, contractual safeguards for outside investors were not the only means of protecting their rights and interests. The correlation analysis shows that ownership structure might have played some role as well. The next section discusses this factor in more detail.

V. THE OWNERSHIP STRUCTURE OF PUBLICLY TRADED LLCS

Ownership structure can be important from the perspective of the protection of the rights and interests of minority investors by aligning the interests of insiders and outsiders and by creating unique relations that can explain the choices of contractual investor rights.[226] This section starts with the alignment argument and then proceeds to the description of several cases that demonstrate that the study of LLC agreements in publicly traded LLCs, detached from their unique ownership structures, may lead to incorrect conclusions with regard to the level of investor protection.

Given the possibility of modifying the enabling rules of the Delaware LLC statute to expropriate minority members,[227] the scholarly literature emphasizes the special role of the ownership structures of companies in aligning the interests of different groups of members.[228] In particular, Ribstein argued that the managers of an LLC are also the owners of the firm and thus bear the same risks as other outside investors.[229] This argument is in line with the predictions of the financial contracting theories where one of the important remedies for agency problems, in the classic principal-agent models, is granting shareholdings to managers.[230] This aligns the interests of managers with those of other shareholders and thus makes less probable actions of managers aimed at obtaining private benefits.[231] Similarly, even if managers do not hold significant membership interests, the presence of a large controlling member can be a guarantee for minority members that the managers will

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[226] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 305, 308-09 (1976).

[227] *See* Miller, *A New Direction supra* note 19, at 397-98.

[228] *See, e.g.*, RIBSTEIN, *supra* note 221, at 4-5.

[229] *See id.* at 208.

[230] *See* Jensen & Meckling, *supra* note 226, at 312 ("If a wholly owned firm is managed by the owner, he will make operating decisions which maximize his utility.").

[231] *See id.* at 316-17.

take actions in the interests of members.[232] Unlike cases where voting rights are held by numerous small members, concentrated control rights make action less costly.[233] Large investors have more incentives to monitor LLC managers, and perhaps more importantly, can appoint and remove them.[234] The downside of concentrated ownership and management holdings is that large members alone, or by combining their holdings with the units of managers, can expropriate minority members.[235]

Table I shows that at the date of listing not all publicly traded LLCs had significant management holdings.[236] In half of the companies, managers either did not have membership interests at all or their holdings did not exceed 5%.[237] However, with the exception of a few cases where the membership interests of the management were small, most LLCs had a controlling member with more than 20% of votes.[238] In 2012, a larger number of LLCs had insignificant management ownership (45%), and in more cases these small management holdings were not accompanied by the presence of a large controlling member (holding more than 20% of votes).[239] Moreover, in half of the LLCs, the share of the largest member decreased over time along with the increasing share of LLC units held by outside investors.[240] The average ownership of the largest member was 44.9% at the date of IPO and 36.9% in 2012.[241] On both dates, the average ownership concentration level was high enough to conclude that public LLCs had a concentrated ownership structure.[242] A direct implication of this is the prevalence of conflicts between controlling and minority members, rather than manager versus member conflicts. In addition, these patterns also suggest that publicly traded LLCs have more

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[232] *Cf. id.* at 348-49 (finding the reassurance minority shareholders enjoy from mangers having all of their wealth invested in the firm removes the risk of agency problems arising).

[233] *See* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651 (2006).

[234] *See id.*

[235] *See id.*

[236] *See supra* Table I.

[237] *See supra* Table I.

[238] *See supra* Table I.

[239] *See supra* Table I.

[240] *See supra* Table I.

[241] *See supra* Table I.

[242] A study of U.S. public corporations found that most of these corporations had blockholders and were not much different from public corporations elsewhere. *See* Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1405 (2009). The average ownership of the largest shareholder was 26%. *Id.* at 1384. However, unlike here, the reported data on listed corporations included only the firms that had a blockholder. *Id.* at 1382.

concentrated ownership at the date of listing and increase the free float of shares representing LLC interests gradually—probably along with developing their reputation among public investors.[243]

Although listed LLCs gradually increased the share of free float at the expense of their largest members, a reverse trend can be observed for management holdings—in about half of the LLCs, the share of the management membership interests was higher in 2012 than at the date of listing.[244] This increase may correspond with the use of insider purchases and the option plans to incentivize management and align their interests with the interests of other unit holders.[245] A quote from a *Wall Street Journal* article is illustrative of the message that such ownership can send to outside investors according to a general belief among the public and investors:

> [I]nsider activity [in Kinder Morgan Management, LLC] is sending a strong "buy" signal. . . . Kinder Morgan is run by a highly respected insider—Chief Executive Richard Kinder. Mr. Kinder earns just $1 a year in salary; his fortune rises and falls with his ownership stake in the company. And he's increasing that stake.[246]

In addition to management holdings, listed LLCs occasionally used management incentive interests (two sample companies).[247] The incentive interests entitle management to receive a higher share of distributions from the surplus above the targeted distributions.[248] For instance, if quarterly distributions are below or equal to the targeted amount, all payments are made to the holders of common units; when

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[243] Reputation based theories of financial contracting show that controlling shareholders and managers can implicitly commit not to expropriate minority investors and signal the market about their commitments in order to get higher share valuations and improved prospects for firm financing. *See* Armando Gomes, *Going Public Without Governance: Managerial Reputation Effects*, 55 J. FIN. 615, 629 (2000). The main prediction of these models is that firm insiders sell equity gradually as they develop reputation. *Id.* at 630.

[244] *See supra* Table I.

[245] *See* Gomes, *supra* note 243, at 631 n.16 (suggesting that LLCs slowly increase the share of free float by divesting shares of the largest members).

[246] Beverly Goodman, *Getting the Inside Scoop*, WALL ST. J. (Apr. 17, 2005), http://www.wsj.com/articles/SB111368299538708824.

[247] *See infra* Appendix. Management incentive distribution rights (IDRs) are more popular in publicly traded master limited partnerships. *See* John Goodgame, *New Developments in Master Limited Partnership Governance*, 68 BUS. LAW. 81, 88 (2012). Some LLCs point to the absence of incentive distribution rights as an advantage compared to their competitors using the LP structure, because the absence of IDRs lowers the cost of equity capital for financing growth opportunities. *E.g.*, *id.*

[248] *See* John Goodgame, *Master Limited Partnership Governance*, 60 BUS. LAW. 471, 477-78 (2005).

quarterly distributions exceed the targeted amount, a certain percentage of the surplus is distributed among the holders of the incentive interests—which are evidenced by a separate class of LLC interests. Hence, these interests incentivize managers to deliver higher distributions even if they do not hold large equity interest in the company. In both cases where management incentive interests were used, the management did not have significant ownership interest in the LLC at the IPO date.[249] This suggests that share ownership by management and management incentive interests were used as substitute mechanisms for aligning the interests of managers and members.

As mentioned earlier, concentrated ownership and management holdings, along with mitigating conflicts of interest between insiders and outsiders, in fact, can work in the opposite direction and exacerbate these conflicts.[250] As long as the interests of the large and minority members overlap, managers are expected to act in the interest of the members.[251] This means that outside investors have no substantial reasons to worry about member versus manager conflicts.[252] But where these interests diverge, minority members can encounter problems. The divergence of the interests can be for legally justified reasons—such as different investment horizons[253]—or can come from a wish to benefit illegally from related party transactions—for example, in cases where managers own equity stakes in the parent of a listed LLC that dwarf their holdings in the latter.[254] In most of these cases, the potential conflict is between controlling and minority members.[255] Hence, it was important that the

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[249] *See supra* Table I (showing information for Constellation Energy Partners LLC and Niska Gas Storage Partners LLC).

[250] *See, e.g.*, James R. Booth et al., *Boards of Directors, Ownership, and Regulation*, 26 J. BANKING & FIN. 1973, 1974 (2002) ("[C]oncentration of power can exacerbate potential conflicts of interest . . . ."); Gilson, *supra* note 233, at 1652-53.

[251] *See* John C. Coffee, Jr., *Transfers of Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions While Chilling Inefficient Ones?*, 21 DEL. J. CORP. L. 359, 403 & n.200 (1996) ("[S]ignificant shareholders reduce agency cost problems and enable shareholders to hold managers accountable, thus causing firm value to rise.").

[252] *See id.* at 403.

[253] *See, e.g.*, F. HODGE O'NEAL & ROBERT B. THOMPSON, 1 OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 2:2 (2014) (discussing causes of "protracted policy disagreements").

[254] LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 9:3 (2014) ("Managers of an LLC are subject to a duty of loyalty . . . . When the courts speak of a duty of loyalty, they are really referring to the more specific duty to act without being subject to an obvious conflict of interest.").

[255] Maria Maher & Thomas Andersson, *Corporate Governance: Effects on Firm Performance and Economic Growth*, ORG. FOR ECON. CO-OPERATION & DEV. 24 (1999), *archived at* http://perma.cc/9VKX-TE2G (explaining that with concentrated ownership, the

operating agreements of the listed LLCs did not waive the fiduciary duties of the members. In dealings with the companies, the controlling members owed the traditional fiduciary duties of corporations.[256] In six LLCs, controlling members were exempt from the application of fiduciary duties because the LLC agreements included special conflict of interest rules for resolving conflicts between controlling and minority members.[257] Whereas two of these LLCs had neither a large controlling member, nor provided to any of the members the right to appoint the majority of the board members, the remaining four firms had controlling members.[258] In the latter case, the alteration of the fiduciary duties of controlling members can be a serious concern for outside investors.[259]

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potential for conflict is usually between controlling and minority members); *see also* Dammann & Schündeln, *supra* note 36, at 748.

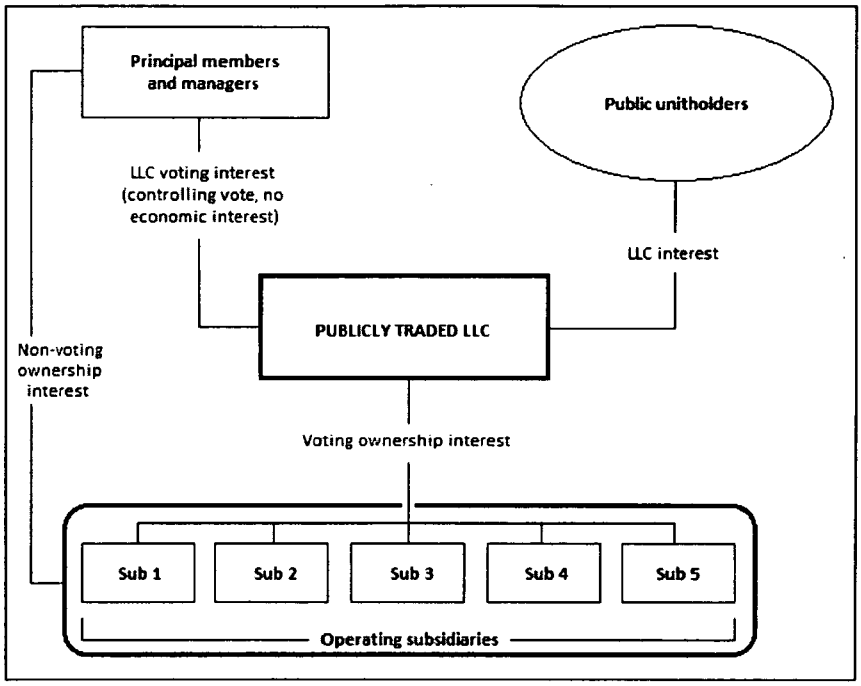
[256] *See* RIBSTEIN & KEATINGE, *supra* note 254, §§ 9:2-9:3 (discussing duties of care and loyalty); Winnifred A. Lewis, *Waiving Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 82 FORDHAM L. REV. 1017, 1028-30 (2013) (discussing the waiver of fiduciary duties in LPs and LLCs).

[257] *See supra* note 206.

[258] *See supra* Table I.

[259] *See* Manesh, *supra* note 9, at 585 ("Operating agreements typically include various provisions that impose duties and obligations that act as contractual substitutes for default fiduciary standards. But these contractual duties and obligations rarely, if ever, match the exacting rigor of fiduciary duty law.").

Figure VI: Simplified ownership structure of a publicly traded LLC from finance sector



Source: The author's own research.

Another distinctive characteristic of the ownership structure of publicly traded LLCs was the granting of economic interests in the listed entities only to outside investors.[260] This structure, practiced in the investment management and finance sector, in a simplified way can be described as follows: the founders and managers of an LLC obtain a controlling vote in the LLC after an IPO by holding voting units that do not entitle them to economic rights, while public investors purchase voting units of a different class entitling them to 100% of economic interest in the LLC.[261] Separately, the founders and managers own economic (but non-voting) interests in the subsidiary operating entities (as a rule, in the size corresponding to their voting rights in the LLC).[262] The remaining economic ownership in the operating entities is held by

[260] *See supra* Figure VI (illustrating how the ownership structure of publicly traded LLCs functions by affording the principal members and managers no economic interests, but rather having the economic interest held by outside investors).

[261] *See supra* Figure VI.

[262] *See supra* Figure VI.

the listed LLC, implying that the public unit holders own an effective minority economic interest in the operating entities.[263]

The described ownership structure can send contradictory messages to outside investors. On the one hand, this structure can deepen majority versus minority conflicts, because it allows principal members and managers to participate in the distribution of profits at the level of the operating entities, but refrain from making dividend payment decisions at the level of the listed company.[264] Profit distribution practices of the sample LLCs suggest that this concern may be true—the majority of the LLCs that used the described ownership structure had lower than average dividend-price ratios.[265] On the other hand, under this ownership structure, public investors, as the sole holders of economic interest, receive all property of the LLC in the case of its bankruptcy or dissolution.[266] Therefore, this ownership structure sends a signal to investors about the successful prospects of the firm and the commitment of its managers, and aims to mitigate the adverse selection problems of investing in the shares of an unknown LLC.[267] Founders can

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[263] *See supra* Figure VI. Company filings with the SEC show that similar corporate structures are also used in cases where the listed firm is a corporation. A few examples were Artio Global Investors Inc., an asset management company, Duff & Phelps Corporation, a provider of financial advisory and investment banking services, DynaVox Inc., a developer of speech generating devices, Manning & Napier, Inc., an investment management firm, and FXCM Inc., an online provider of foreign exchange trading services. *See* Artio Global Investors Inc., Annual Report 26 (Form 10-K) (Mar. 4, 2013); Duff & Phelps Corp., Annual Report F-21 (Form 10-K) (Feb. 25, 2013); DynaVox Inc., Annual Report 17 (Form 10-K) (Nov. 22, 2013); Manning & Napier, Inc., Annual Report 1 (Form 10-K) (Mar. 3, 2014); FXCM Inc., Annual Report 31 (Form 10-K) (Mar. 17, 2014). The corporation holds controlling interests in a non-listed LLC, taxed as a partnership, which operates the business. Unlike public investors, the founders of the business have only voting rights in the listed corporation, but they own the same share of economic interests in the operating LLC. As a result, the founding members receive distributions from the LLC avoiding the additional layer of corporate taxation, while the cash distributions made to the outside investors before reaching them in the form of dividends are first taxed by the corporate income tax. This corporate structure is used for tax purposes. However, where the listed firm is another partnership taxed entity, rather than a corporation, the tax rationale is not obvious anymore, unless the structure gives the founders flexibility to change the election of taxation or the business form at the level of the listed firm (for instance, to attract more institutional investors) without increasing their effective tax obligations.

[264] *See generally* O'NEAL & THOMPSON, *supra* note 253, § 3:5 (discussing problems that can arise when authority to pay dividends is concentrated in majority shareholders).

[265] Original Research (on file with author).

[266] *See* Robert R. Keatinge, *Allocations and Distributions in Partnerships and LLCs*, GP SOLO & SMALL FIRM, Jan./Feb. 1999, at 23, 24, *archived at* http://perma.cc/H538-46GY ("Most . . . operating agreements provide that upon liquidation of the organization, each owner will receive an amount equal to the owner's capital account . . . .").

[267] *Cf.* Stuart C. Myers & Nicholas S. Majluf, *Corporate Financing and Investment Decisions When Firms Have Information that Investors Do Not Have*, 13 J. FIN. ECON. 187, 209 (1984) (discussing how under circumstances of severe information asymmetries, outside investors undervalue equity and this may prevent current shareholders from offering equity to finance investments).

signal that success is more likely by offering investors senior claims—such as debt instead of equity[268] or preferred stock instead of ordinary stock.[269]

Until a reputation is developed, the founders and managers have strong incentives to commit to this ownership structure. Along with reputation building, they can exchange their economic interests in the operating subsidiaries for the economic interests of the listed LLC. Correspondingly, voting interests in the listed LLC without economic interests will be cancelled. The signaling, however, can be misleading if the operating subsidiaries are liquidated prior to the liquidation of the listed LLC,[270] or where the founders and managers can, without any restrictions, convert their only-voting interests in publicly traded LLC to the interests entitling both to voting and cash flow rights. To make their initial commitments reliable, the founders and managers of publicly traded LLCs can use contractual mechanisms.[271] With the exception of Fortress Investment Group LLC,[272] the sample listed LLCs used some form of legal restriction on such conversions—establishing specific periods when the exchange can occur, empowering the board with veto rights on the exchange or with the right to define other equivalents in lieu of the economic interests, allowing the exchange only if the received economic interests will be sold subsequently, subjecting the exchange requests to vesting schedules, and setting transfer restriction periods on the economic interests of the operating entities.[273] Vesting and transfer restriction periods may be a signal to public investors that the managers believe in the success of the company after the sale of the interests to the public investors.[274]

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[268] *See id.* at 220.

[269] *See* Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281, 302-03 (2003).

[270] As a rule, the managing partners' direct ownership in the operating entities is only economic, thus, they cannot dissolve or bankrupt the entities directly. *See* CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 1.04, at 52-53 (2015). However, through their controlling rights in the public LLC, which, in its turn, is the controlling member of the operating entities, the partners have a say over the future of these entities.

[271] *See generally* Manesh, *supra* note 9, at 596-97 (explaining how founders and managers of publicly traded LLCs can use contractual mechanisms to make their initial commitment more reliable via effective limitation and contractual restraints).

[272] *See* Fortress Inv. Grp. LLC, Annual Report 157 (Form 10-K) (Feb. 28, 2012).

[273] *See, e.g.*, Constellation Energy Partners LLC, *supra* note 187, § 4.6 (addressing "Restrictions on Transfers").

[274] *See* ALAN S. GUTTERMAN, BUSINESS TRANSACTIONS SOLUTIONS § 156:305 (2014):

Two LLCs from the oil and gas sector had a large discrepancy between the voting rights and economic interests of the largest members as well.[275] Yet, unlike the LLCs from the finance sector, in both cases the detachment of voting rights from economic interest did not come with a separate economic interest by the largest members in the capital of the operating entities.[276] In another case, the founding member of LinnCo, LLC (LinnCo)—Linn Energy, LLC (Linn Energy)—had a right to appoint all members of the board, though it held only 1% of the membership interests in LinnCo.[277] If considered independently, these structures, where controlling members hold voting power in excess of their cash flow rights, suggest an increased risk of minority oppression by extracting excessive private benefits—when the costs of private benefit extraction exceed the benefits of more focused monitoring of management.[278] In these situations, the market for corporate control does not work either—neither as an instrument for transferring control to more efficient managers, nor as an *ex ante* disciplining mechanism.[279]

The primary purpose of vesting provisions and associated repurchase rights is to provide a mechanism for the founders to 'earn' their equity by continuing to work for the company. In most cases, the founders will have purchased their interest in the company for a nominal or relatively low purchase price, usually at a price per share much less than the current market value of the shares inherent in the price paid by the investors. The investors have an interest in ensuring that the founders continue to serve the company and help generate the returns anticipated by the investors before the founders are able to capitalize on the appreciation in their interest created by the financing.

[275] In Kinder Morgan Management, LLC and Enbridge Energy Management, L.L.C., the largest members held 100% voting rights against 10% and about 15% economic interests on the date of listing and in 2012, respectively. *See supra* Table I.

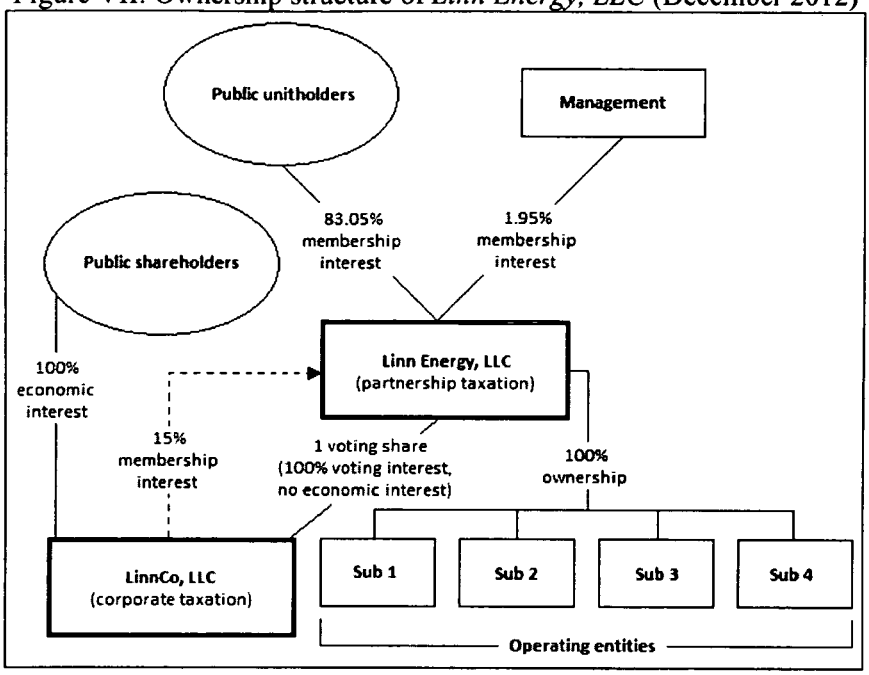
[276] *See supra* Table I.

[277] *See* LinnCo, LLC, Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 42 (Schedule 14A) (Mar. 12, 2014).

[278] *See* Sanford J. Grossman & Oliver D. Hart, *One Share-One Vote and the Market for Corporate Control*, 20 J. FIN. ECON. 175, 178-181 (1988).

[279] In general, in the majority of the sample publicly traded LLCs, the threat of unsolicited change of control was ruled out, with the exception of one due to the high level of ownership concentration. *See generally* Troy A. Paredes, *The Firm and the Nature of Control: Toward a Theory of Takeover Law*, 29 J. CORP. L. 103, 132-38 (2003) (discussing the function of the market for corporate control).

Figure VII: Ownership structure of *Linn Energy, LLC* (December 2012)



Source: The author's own research.

Closer look, however, dispels this concern. In particular, publicly traded LLCs used ownership structures with separated voting and cash flow rights only in combination with counterbalancing contracting mechanisms that offer protections to outside investors—such as mandatory dividends and high standards of protecting the rights and interests of outside investors.[280]

The case of LinnCo is indicative.[281] The IPO of Linn Energy, a crude petroleum and natural gas company taxed as a partnership, took place in the beginning of 2006.[282] Based on the information contained in the annual report and proxy statements filed with the SEC in the beginning of 2012, the largest members of the company were a group of directors and officers holding less than 2% membership interest.[283] In

[280] *See supra* Table II.

[281] *See Year's First IPO, for Linn Energy, Posts Gain*, WALL ST. J., Jan. 14, 2006, at B4.

[282] *Id.*

[283] Linn Energy, LLC, Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 38 (Schedule 14A) (Mar. 12, 2012).

April 2012, Linn Energy formed LinnCo, which was taxed as a corporation.[284] LinnCo's IPO took place in October 2012 and all proceeds from the offering were used to acquire the membership interests of Linn Energy—the number of the acquired interests was equal to the number of LinnCo shares sold in the IPO.[285] LinnCo's sole purpose was to own units in Linn Energy.[286] Linn Energy owned the only voting share of LinnCo and thus had 100% voting rights, including the right to appoint all board members of LinnCo.[287] Common units of LinnCo were all held by the public.[288] At the end of 2012, LinnCo held approximately 15% of Linn Energy's outstanding units.[289] LinnCo had an obligation to submit to a vote of its shareholders any matter submitted by Linn Energy to a vote of its unitholders, including the annual election of the latter's board.[290] LinnCo would vote the units of Linn Energy based on the results of the vote of its own shareholders.[291]

According to the IPO prospectus of LinnCo, the company was created to enhance Linn Energy's ability to raise additional equity capital and widen the base of its investors.[292] Corporation taxation of LinnCo enabled its public shareholders to own indirectly membership interests in Linn Energy without creating any partnership tax-related obligations.[293] These obligations are related to: (1) onerous tax administration—the need to file individual income tax returns as partners; and (2) payment of taxes for unrelated business taxable income—if Linn Energy generates unrelated business income (income generated as a result of activities which fail to qualify for the criteria of the partnership taxation of LLCs),[294] then its members shall pay unrelated business income tax. Conversely, if the new investment structure is used, the unrelated business income tax is paid by LinnCo, rather than its shareholders.[295] This investment structure is attractive for several types of institutional

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[284] LinnCo, LLC, Quarterly Report 5-6 (Form 10-Q) (Oct. 26, 2012).

[285] *Id.* at 11.

[286] *Id.* at 5.

[287] *Id.* at 3.

[288] *See generally* LinnCo, LLC, Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A) (Mar. 12, 2014).

[289] *See supra* Figure VII; Linn Energy, LLC, Units Representing Limited Liability Company Interests 2 (Schedule 13G) (Oct. 11, 2012).

[290] *Id.*

[291] *Id.*

[292] LinnCo, LLC, Final Prospectus 8 (Form 424B1) (Oct. 12, 2012).

[293] *See id.* at 6.

[294] *See* I.R.C. § 7704(d)(1) (2012) (listing qualifying incomes of publicly traded LLCs); HAMILTON & BOOTH, *supra* note 137, § 10.8 ("The [partnership] provisions of the IRC and the regulations issued thereunder are exceptionally complex.").

[295] *See supra* Figure VII.

investors that avoid partnership units for tax reasons, such as pension funds.[296]

In fact, LinnCo imitated Linn Energy with the only difference being the election of taxation.[297] The shareholders of LinnCo had an indirect vote during the annual and special member meetings of Linn Energy and could participate in the election of Linn Energy's board.[298] Further, pursuant to LinnCo's LLC agreement, it had to distribute all dividends received from Linn Energy among its shareholders.[299] Under this governance structure, the conflicts of interests between the management and public investors within LinnCo were minimized, and actually were transferred to the level of Linn Energy. Thus, the fact that the managing member of LinnCo held full control rights in the company without corresponding economic rights does not *per se* imply higher risks of outside investor expropriation. Meanwhile, the capital structure of Linn Energy was based on full correspondence of voting and cash flow rights.[300]

Two other oil and gas publicly traded LLCs with wide discrepancies between voting and economic rights, mentioned earlier, were treated as corporations for federal income tax purposes as well, and served as an alternative way of investing in the partnership units of "sister" publicly traded master limited partnerships ("MLPs").[301] Once the company raises money in its IPO, it uses the proceeds to buy a new class of units in the MLP (*i-units*) in the same amount as the number of

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[296]Because partnership taxation implies pass-through taxation where the taxes are paid by the investors, tax-exempt institutional investors such as pension funds and mutual funds cannot invest in these entities. *See generally* Samuel D. Brunson, *Repatriating Tax-Exempt Investments: Tax Havens, Blocker Corporations, and Unrelated Debt-Financed Income*, 106 NW. U. L. REV. 225 (2012) (discussing the difficulties tax exempt entities can face investing in certain other entities). Therefore, most of the investors are individuals and non-institutional entities. In contrast to this, the election of corporate taxation by publicly traded LLCs makes the interests available for tax-exempt institutional investors as well. *See* Thomas J. Gallagher, III, *The Taxation of Investments by Pension Funds and Other Tax-Exempt Entities*, 67 TAXES 981, 981 (1989) ("Once an exempt organization moves beyond the more traditional investment vehicles, i.e., stocks, bonds, debentures and non-hybrid securities, and particularly where the organization assumes a more entrepreneurial role with respect to its investments, the tax consequences of these transactions to the exempt entity become less clear . . . .").

[297]*Compare* Linn Energy, LLC, Quarterly Report 16 (Form 10-Q) (Apr. 25, 2013), *with* LinnCo, LLC, Quarterly Report 8 (Form 10-Q) (Aug. 8, 2014).

[298]*See supra* note 291 and accompanying text.

[299]*See* LinnCo, LLC, Amended and Restated Limited Liability Company Agreement § 6.1 (Form 8-K Ex. 3.1) (Oct. 17, 2012).

[300]*See supra* Figure VII (showing consolidated voting and economic interests).

[301]*See supra* note 275 and accompanying text.

the LLC units offered to the outside investors.[302] Unlike the common units of the MLP, instead of cash distributions, the holder of the new class of units receives an equivalent number of *i-units*, while the MLP retains the cash and uses it in its business.[303] The corresponding number of the LLC interests is increased automatically as well.[304] Hence, the investment resembles an automatic dividend reinvestment, which does not generate any tax obligations for the investors unless they sell the interests.[305] Sale income on interests held more than one year is considered as a long-term capital gain, and is taxed at a favorable rate.[306] The right to receive regular cash distributions is actually traded off with reduced tax payments.[307]

Under these governance structures, the full control of management by founding members and the high divergence between the voting and economic interests of founding members are counterbalanced by additional minority rights and guarantees.[308] First, the companies were established only for the purpose of buying *i-units* and could invest the IPO proceeds only in these units.[309] They were not entitled to sell or transfer these units in any other way; they could not raise any debt or engage in any other activity, including mergers and consolidations with other entities.[310] As a result, in the event of liquidation, the economic members would be the sole claimants of the LLCs and could receive *i-units* in the MLPs in the number equal to the number of their LLC interests.[311] Second, the companies voted the *i-units* in a manner that the outside investors voted their listed membership interests in the LLCs.[312] The outside investors had a right to dissolve the LLCs by a two-thirds vote.[313] Third, the controlling members were obliged to buy out the LLC interests held by the outside investors if (1) the market price of the listed MLP common units was less than double the targeted distributions made on those units, (2) the MLPs merged with other entities, or (3) the

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[302] *See, e.g.*, Conrad S. Ciccotello & Chris J. Muscarella, *The Energy MLP Goes Institutional: Implications for Strategy and Governance*, 15 J. APPLIED CORP. FIN. 112, 114 (2003).

[303] *See id.* at 112.

[304] *See id.* at 114.

[305] *See id.* at 115.

[306] *See* Ciccotello & Muscarella, *supra* note 302, at 115; HAMILTON & BOOTH, *supra* note 137, § 8:13.

[307] *See* Ciccotello & Muscarella, *supra* note 302, at 115.

[308] *See id.* at 118.

[309] *See id.* at 119.

[310] *See, e.g.*, Kinder Morgan Mgmt., LLC, Annual Report 7 (Form 10-K) (Feb. 20, 2014).

[311] *See, e.g.*, *id.* at 11.

[312] *See* Ciccotello & Muscarella, *supra* note 302, at 117 fig.2.

[313] *See infra* Appendix.

controlling members and their affiliates were no longer the controlling members of the MLP's general partners.[314]

The correlation analysis presented in Table II demonstrates that the company purpose limitation clauses, sell-out rights, specific target distribution obligations, and the right of the members to dissolve the company by the majority vote without the prior board approval were likely to appear together, particularly in cases where the managers did not have interests aligned with outside investors via the ownership of economic interests.[315] In summary, although public investors had limited control rights in these LLCs, the governance rules of the LLCs offered additional protections to them and limited the options available to insiders for oppressing outside investors.

Finally, in some cases investments in the listed LLCs could be tied to the personality of their founders and managers.[316] This could be particularly true in the sample companies from the finance sector where the reputation of the founders and managers plays a crucial role during the regular rounds of raising money for private equity and hedge funds.[317] Where the personality of the firm insiders makes a difference, outside investors can close their eyes to deviations from standard corporate governance mechanisms.[318]

VI. OTHER NON-CONTRACTUAL GOVERNANCE MECHANISMS IN PUBLICLY TRADED LLCS

In addition to trading and combining different contractual provisions and ownership structures to ensure a certain level of protection of the interests of outside investors, other mechanisms of balancing controlling member versus minority member rights and interests were important as well.[319] This Part focuses on four such mechanisms, which, to distinguish them from the contractual rights of investors, are conditionally grouped under the term "non-contractual/non-legal."[320]

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[314] *See* Kinder Morgan Mgmt., LLC, *supra* note 310, at 12.
[315] *See supra* Table II.
[316] *See supra* text accompanying note 245-46.
[317] *See supra* text accompanying note 245-46.
[318] *See supra* text accompanying note 245-46.
[319] *See infra* Part VI.A-D.
[320] *See infra* Part VI.A-D.

A. *Dividends and Specific Target Distributions*

Theoretical literature predicts that mandatory profit distribution clauses are used by the controlling members of LLCs to attract minority members in the absence of strong minority rights aimed to mitigate the agency problems between the majority and minority members.[321] This argument has two components. First, mandatory distribution clauses limit the amount of the retained cash and thus reduce the discretion of managers.[322] Second, the promise of paying higher dividends can make an investment in LLC interests attractive for outside investors even in the absence of strong corporate governance elements; higher dividends are actually the price that a company pays to its members for weaker legal protection.[323]

Several sample companies indicated explicitly in their IPO prospectuses a commitment to ensure a certain minimum level of profitability of their membership interests (defined as a percentage of the offering price).[324] The correlation analysis of the contractual clauses of the operating agreements of the publicly traded LLCs shows that specific target distribution clauses were negatively correlated with the right of minority members to make business and director nominations during the member meetings and with the management ownership of economic interest in the LLCs.[325] This negative correlation implies that mandatory profit distribution clauses, indeed, are used as a substitute for strong minority rights and management ownership.[326] As predicted, weak minority rights are compensated by higher dividends.[327] However, the study also shows that only nine out of the twenty publicly traded LLCs made strong commitments in their LLC agreements to make mandatory quarterly distributions.[328] The rest of the sample provided full discretion to the board to make profit distribution decisions.[329] Moreover, except the three special cases of using LLCs taxed as corporations for enhancing investment bases in "sister" partnership taxed firms (special-purpose

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[321] *E.g.*, RIBSTEIN, *supra* note 221, at 209-10.

[322] *See id.*

[323] *See id.*

[324] *See supra* Table II (showing a correlation for specific target distributions).

[325] *See supra* Table II.

[326] *See supra* Table II.

[327] *See supra* Table II.

[328] *See infra* Appendix.

[329] Some of the companies that did not include mandatory distribution clauses in their LLC agreement nevertheless made non-binding promises to pay out a specific minimum quarterly distribution or to distribute substantially all net cash flow from operations in their IPO prospectuses. Original Research (on file with author).

LLCs),[330] the LLCs with profit distribution commitments used broadly defined legal terminology and, in fact, allowed the management to retain a significant amount of the profits.[331] The question is whether in practice the management of publicly traded LLCs relies on these broad definitions to limit the amount of cash distributions to the members.

The data from the sample LLCs suggest that this is not the case.[332] Publicly traded LLCs commonly declared and paid more dividends to their interest holders than they earned in net income.[333] In thirteen LLCs—excluding the three special-purpose LLCs—the amount of annual dividends per unit of ownership exceeded the earnings per unit of ownership.[334] These companies issued debt and used other sources to finance the dividend payments.[335] Only four listed LLCs practiced retaining earnings.[336]

As it was a common practice among the publicly traded LLCs to pay dividends from other sources than their net income and because the mandatory distribution clauses, as a rule, declared that the companies would distribute "all available cash" (with the term being defined broadly),[337] this study also looked at the share of annual distributions to members in the total amount of the sample companies' cash at the end of the reporting periods.[338] Figure VIII compares the data on the percentage share of distributed cash in publicly traded LLCs with and without mandatory distribution clauses.[339] On average, publicly traded LLCs with mandatory distribution rights used almost 76% of all cash to pay dividends to their members, whereas in the LLCs without legal obligations to pay dividends the share of the distributed cash was less

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[330] *See supra* Part V. LinnCo, LLC, Kinder Morgan Management, LLC, and Enbridge Energy Management, L.L.C. were taxed as corporations for the benefit of their associated business entities.

[331] Similarly, in an earlier study Manesh found that while the majority of publicly traded LPs and LLCs had provisions in their operating agreements that compelled the firms to make quarterly profit distributions, almost all used contractual language that provided the managers with broad discretion with regard to the definition of the amount of the distributions. Manesh, *supra* note 9, at 579-80.

[332] *See infra* Figure VIII.

[333] Original Research (on file with author).

[334] Original Research (on file with author).

[335] *See, e.g.*, Copano Energy, L.L.C., Annual Report 85-86 (Form 10-K) (Mar. 1, 2013).

[336] *See, e.g.*, Travelcenters of Am. LLC, Annual Report 36 (Form 10-K) (Mar. 3, 2013).

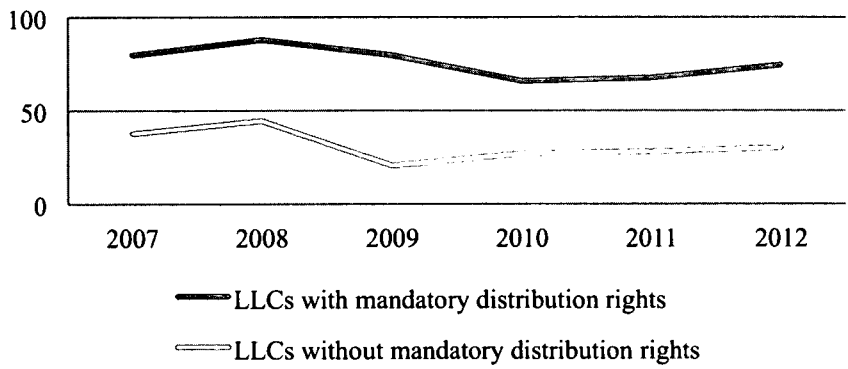
[337] *See, e.g.*, Copano Energy, *supra* note 335, at 34.

[338] *See infra* Figure VIII.

[339] *See infra* Figure VIII.

than 31.5%.[340] The figure does not cover the three special-purpose LLCs that owing to the specifics of their structure did not provide full data about the cash flows. These three companies automatically paid out all their earnings to the members[341] and, if added in the calculations, would further enhance the data for LLCs with mandatory distribution clauses. Yet, even in the absence of these three companies, it is clear that mandatory distribution clauses, notwithstanding the broad legal terminology used for their formulation, were not mere declarations.[342]

Figure VIII: LLC cash distributions in the total amount of cash at the end of the reporting period, %



Source: The author's own calculations based on the data from the annual reports of the publicly traded LLCs filed with the SEC.

Figure IX compares average annual dividend yield in publicly traded LLCs and corporations.[343] The data demonstrate that publicly traded LLCs paid larger distributions than listed corporations.[344] The average dividend yield of publicly traded LLCs in the ten-year period from 2003 till 2012 was 6.6%, while S&P 500 corporations had only 2% average dividend yield for the same period.[345] The average annual dividend yield of the oil and gas companies was 6.9%; in finance and real estate sectors the average annual dividend yield was 7.1% and 7.8%,

[340] *See infra* Figure VIII.
[341] *See supra* notes 330-31 and accompanying text.
[342] *See infra* Figure VIII.
[343] *See infra* Figure IX.
[344] *See infra* Figure IX.
[345] *See infra* Figure IX; Original Research (on file with author).

respectively.[346] Few companies had an average annual dividend income above 10%.[347] Another interesting observation is that before the crisis of 2008 the sample LLCs without mandatory distribution obligations ensured dividend yields at the level of the total sample.[348] During the crisis and the following few years, dividend yield in these companies fell more than the dividend yield of the total sample.[349] However, in 2012 the dividend-price ratios in both cases again demonstrated similar patterns.[350] The likely explanation for this is that during the crisis, cash-strapped listed LLCs made lower distributions, but the companies that included specific distribution obligations in their operating agreements were less flexible. Therefore, during normal circumstances all publicly traded LLCs are expected to have much higher dividend yields than listed corporations.[351] They have, possibly, non-legal incentives to do this—like making the offered securities attractive for investors or meeting market expectations.[352] In times of crisis, however, specific target distribution clauses make a difference and ensure higher distributions for investors.[353]

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[346] Original Research (on file with author).

[347] Original Research (on file with author).

[348] *See infra* Figure IX.

[349] *See infra* Figure IX.

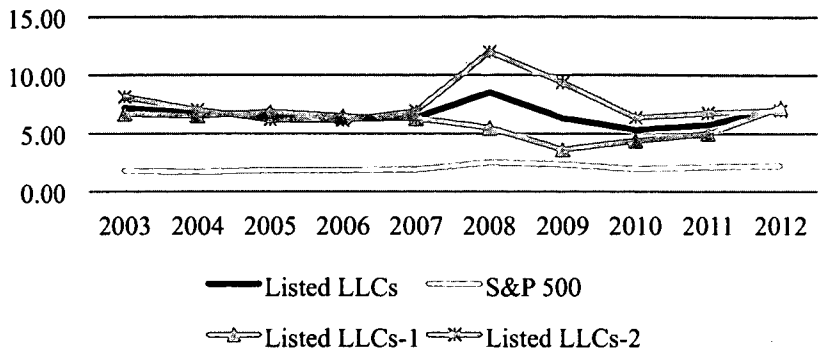
[350] *See infra* Figure IX.

[351] *See infra* Figure IX.

[352] *See* 11 FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5318 (2014) ("The purpose of modern business corporations is to earn money for their shareholders. When a corporation increases its wealth from profitable operations, the shareholders are entitled to a distribution of those corporate profits in proportion to their shares or interest in the corporation.").

[353] *See infra* Figure IX.

Figure IX: Annual dividend yield of listed corporations and LLCs* (%)



Sources: S&P Dow Jones Indices (for S&P 500 corporations); the author's own calculations based on the data from the annual reports of the publicly traded LLCs filed with the SEC.
Notes: Listed LLCs = all sample; Listed LLCs-1 = sample LLCs that did not include mandatory distribution rights in their LLC agreement; Listed LLCs-2 = sample LLCs with mandatory distribution obligations.
* The calculation of the annual dividend yield of the LLCs for the first year of the listing in cases where an LLC did not declare dividends for one or more quarters ended before the IPO is based on the annualized data taking into account the total dividend yield for the quarters of the same year when dividends were paid.

The industrial division of the companies did not reveal strong differences in the annual dividend yields.[354] The average dividend yields in the three industries differed mainly during the period from 2007 to 2009.[355] Oil and gas companies, due to the fact that only companies from this sector had target distribution rights, had higher dividend-price ratios; firms in the finance sector had relatively stable annual dividend yield; the outlier was the real estate sector.[356]

Lastly, the study checked whether there is a correlation between higher dividend yields and specific target distribution clauses. Several approaches were used to divide the listed LLCs into groups based on

[354]Original Research (on file with author).
[355]Original Research (on file with author).
[356]Original Research (on file with author).

their dividend-price ratios. First, all companies were ranked based on their average dividend yield for the full lifetime of each company. Then they were grouped as top and bottom half or above or below the average dividend yield for the total sample. Second, the companies were grouped on the basis of the number of the times they appeared above or below the average dividend yield of the total sample each year for the last five and ten years of the observations. Whereas the first grouping did not show any correlation between the dividend yield and specific target distribution clauses, for the second grouping the correlation is positive at the 10% level (φ values are equal to 0.414 and 0.382 for five and ten year periods, respectively).[357]

This evidence suggests that, indeed, dividend payment obligations and practices are an important element in the governance structure of publicly traded LLCs and are used to mitigate conflicts of interests between controlling members and outside investors. The large share of cash payments to LLC members limits the discretion of the managers and controlling members, while high dividend incomes compensate outside investors for poor corporate governance practices.[358] This compensation can also be upfront at the IPO stage through lower prices for the offered securities.[359] There are many cases where companies that are organized as LLCs convert to corporations immediately before the IPO, as this can attract more investors and raise firm valuation.[360]

This study did not find any evidence supporting the claim that partnership treatment of publicly traded LLCs for taxation purposes is a reinforcing incentive for maintaining high levels of profit distribution.[361] In none of the cases of grouping the sample LLCs based on their dividend-price ratios is there any significant correlation with the election of partnership taxation.[362] This finding confirms the argument made earlier in the scholarly literature that the election of partnership taxation, at best, means that an entity has an incentive to distribute the amount necessary to offset the pass-through tax liability of its members.[363] While in REITs high dividend distributions are the result of the tax

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[357] Original Research (on file with author).

[358] *See supra* Part VI.A.

[359] *See* Paul A. Gompers et al., *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107, 109-10 (2003) (finding correlation between shareholder rights and firm value).

[360] *See* MARK A. SARGENT & WALTER D. SCHWIDETZKY, LIMITED LIABILITY COMPANY HANDBOOK § 3:67 (2014) ("Typically, . . . owners will want to be operating as a C corporation at the time [a] public offering is made.").

[361] Original Research (on file with author).

[362] Original Research (on file with author).

[363] *See* Manesh, *supra* note 9, at 592.

rules,[364] in listed LLCs high profit distributions are stipulated by their governance structure and market expectations.[365]

B. *The Structure, Composition, and Practices of the Board of Directors*

The analysis of the LLC agreements showed that all publicly traded LLCs had a board of directors and adopted procedural rules for the functioning of the boards, such as minimum quorum requirements, voting thresholds, and notice periods.[366] The majority of the agreements allowed the boards to create different committees, yet only six LLC operating agreements directly required the establishment of board committees.[367] In less than half of the sample (eight companies), the LLC agreements required that the board should be composed of the majority of independent directors.[368]

However, the listing requirements of stock exchanges impose similar rules in this field for all listed companies regardless of their organizational structure.[369] This means that although there are many differences between the governance structures of publicly traded LLCs and corporations because of the default rules of the LLC statutes,[370] one of the aspects of the governance structures where these two business forms are coming together is the characteristics of the boards of directors. Therefore, to define the true role of the boards in the governance of publicly traded LLCs, it is necessary to study the real-life practices of the boards. The summarized data are presented in Table III.

The boards of directors of the listed LLCs had more than three board committees on average.[371] In the majority of the cases, these committees were fully composed of independent directors whose independence was defined based on the listing requirements of the stock exchanges.[372] The most frequent committees were audit, compensation, and nomination and corporate governance committees.[373] Some LLCs also established conflicts committees that reviewed transactions with

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[364] *See supra* note 137.

[365] *See supra* note 324 and accompanying text.

[366] *See infra* Appendix.

[367] Original Research (on file with author).

[368] Original Research (on file with author).

[369] *See, e.g.*, NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 303A.05(a) (2015) (requiring that compensation committees be composed entirely of independent directors).

[370] *See* RIBSTEIN & KEATINGE, *supra* note 254, § 2:1 ("[A wide variety of financial and managements] characteristics may be engrafted on an LLC.").

[371] *See infra* Table III.

[372] *See infra* Table III.

[373] *See infra* Table III.

affiliated and interested parties.[374] The average number of annual committee meetings was 16.8.[375]

Table III
Board practices in the publicly traded LLCs (listing year-2012, incl.)

	Boards of directors in general		Composed of entirely independent directors	
	Number	Percentage	Number	Percentage
Audit committee	20	100	20	100
Compensation committee	17	85	16	80
Nomination & CG committee	16	80	16	80
Conflicts (affiliated transactions) committee	7	35	7	35
Executive committee	3	15	0	0
Average number of the board committees	3.15	n/a	2.95	n/a
Frequency of annual committee meetings*	16.77	n/a	n/a	n/a
Frequency of annual board meetings*	9.88	n/a	n/a	n/a
Majority independent directors	16	80	n/a	n/a

Source: The author's own calculations based on the annual reports and definitive proxy statements of the publicly traded LLCs filed with the SEC.
* The data are available only for fourteen sample companies.

The entire boards of directors were actively functioning with the average number of annual meetings close to ten.[376] In 2012, the boards of the publicly traded LLCs met 8.42 times.[377] Although many LLCs had a large controlling member or used other mechanisms to control their boards, 80% of listed LLCs had boards of directors composed of a majority of independent directors.[378] Parallels with the boards of S&P

[374] *See infra* Table III.
[375] *See infra* Table III.
[376] *See supra* Table III.
[377] Original Research (on file with author).
[378] *See supra* Table III.

500 corporations reveal many similarities. In 2012, the average number of board meetings of S&P 500 was eight, and 85% of all board members were independent directors.[379] The average number of standing board committees in S&P 500 corporations was 4.3 in 2013.[380] All boards had audit and compensation committees.[381] With the exception of several controlled listed corporations, all S&P 500 boards also had nomination and corporate governance committees.[382] The mentioned board committees of S&P 500 corporations were fully composed of independent directors.[383]

These data suggest that the structure, composition, and practices of the boards of directors of the publicly traded LLCs did not differ significantly from the boards of listed corporations. Some of the publicly traded LLCs were eligible for exemptions from the listing requirements of the stock exchanges as controlled companies (*e.g.*, they could opt out from the requirements to have a majority of independent directors, to create board committees, or to hold annual member meetings).[384] Yet, even these LLCs voluntarily complied with all or several corporate governance requirements.[385] Thus, if in corporations, boards are considered active actors in dealing with governance problems, LLC boards should receive similar credit. Even with regard to fiduciary duties, the boards of listed LLCs did not seem to differ significantly from the boards of listed corporations.[386] Indeed, an empirical study of the articles of incorporation of Fortune 100 companies shows that it is a widespread practice for listed corporations to limit the liability of directors for the breach of duty of care.[387] Only in few listed LLCs, were the fiduciary duties of the directors less rigorous than they are in corporations.[388]

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[379] *See* SPENCER STUART, SPENCER STUART BOARD INDEX 2013 6 (2013), *available at* http://www.corpgov.deloitte.com.

[380] *Id.* at 27.

[381] *Id.*

[382] *Id.*

[383] *See* SPENCER STUART, *supra* note 379, at 27.

[384] *E.g.*, Enbridge Energy Mgmt. LLC, Annual Report 42 (Form 10-K) (Feb. 18, 2015) ("Because we are a controlled company, the NYSE listing standards do not require that we or the General Partner have a majority of independent directors or a nominating or compensation committee of the General Partner's Board of Directors.").

[385] *See supra* Table III.

[386] *See infra* Appendix. As mentioned earlier, the liability for breach of certain duties of board members of Delaware corporations can be exculpated by including an express indication in their charters. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2006).

[387] *See* J. Robert Brown, Jr. & Sandeep Gopalan, *Opting Only in: Contractarians, Waiver of Liability Provisions, and the Race to the Bottom*, 42 IND. L. REV. 285, 310-11 (2009).

[388] *See infra* Appendix.

Nevertheless, the role of the boards of directors in publicly traded LLCs might be somewhat diminished by the fact that in several cases independent directors were appointed and could be removed by the controlling members of the publicly traded LLCs.[389] Second, although not widespread, in some listed LLCs fiduciary duties of directors were less rigorous than they are in corporations.[390] A further concern, that might be true for corporate boards as well, is low turnover of the board members—many times, directors of the publicly traded LLCs continued their terms from the date of becoming a director.

C. *Market Discipline*

The structure and practices of publicly traded LLCs force them to return regularly to the capital markets after an IPO to raise financing.[391] Thus, market discipline strongly affects the governance of these companies. The ownership information in Table I shows that it was common among the sample LLCs to gradually reduce the share of the largest member by conducting secondary offerings of the shares after the initial offering.[392] To be able to attract outside investors in these follow-up interest offerings, LLCs have to establish an investor-friendly reputation.[393] Even in cases where LLC agreements provide wide discretion to controlling members to govern and make decisions, they have strong incentives to use their decision-making powers in the interests of the companies, rather than solely in their own interests.[394]

Similarly, publicly traded LLCs often issue debt to finance their current activities and pay promised distributions.[395] Listed LLCs distribute their net income and a significant part of cash flows among the members.[396] Among the sample LLCs, it was common to declare and pay dividends above the net income.[397] To make such payments possible and, at the same time, have some cash left to finance the current activities of companies, including future acquisitions and new business

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[389] *See infra* Appendix.

[390] *See infra* Appendix.

[391] *See* Manesh, *supra* note 9, at 565.

[392] *See supra* Table I.

[393] *See* Ying Cao et al., *Company Reputation and the Cost of Equity Capital*, 20 REV. ACCT. STUD. 42, 44 (2015) ("We find that companies with better reputations enjoy a lower cost of equity . . . .").

[394] *See* Goodgame, *supra* note 247, at 501-02 (making similar arguments in the context of master limited partnerships).

[395] *See* Manesh, *supra* note 9, at 565.

[396] *See supra* Part VI.A.

[397] *See supra* Part VI.A.

project developments, publicly traded LLCs often issue debt securities.[398] Therefore, market disciplining strongly—perhaps stronger than in listed corporations—and constantly influences the governance of publicly traded LLCs.[399] It incentivizes the controlling members to stick to their promises made in IPO prospectuses and ensure a certain minimum level of investor protection, even if there are no effective legal mechanisms to enforce the promises or oppose the actions of the controlling members and managers directed towards investor wealth appropriation.

Market disciplining is also a crucial element in the argument for aligning the interests of controlling and minority members by ownership structures.[400] Obviously, this argument is stronger in listed than in non-listed firms.[401] Where the securities are priced by the market, the holders of economic interests that can affect decision making see the effects of their actions on security prices.[402] Contrary to this, controlling members in non-listed firms are less constrained by market factors in expropriating minority investors.[403] Therefore, in publicly traded LLCs, market discipline combined with concentrated ownership structure helps to mitigate the conflicts between controlling and minority members. In cases where the ownership structure is the only factor aligning the conflicting interests—for instance, if the controlling members wish to delist the securities and the market reaction is no longer crucial—potential majority versus minority conflicts in publicly traded LLCs become more acute. In this situation, the role of contractual protections of minority investors is enhanced.[404]

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[398] *See supra* note 335 and accompanying text.

[399] *Cf.* Goodgame, *supra* note 247, at 502 (making similar argument in the context of master limited partnerships).

[400] *See* Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 GEO. L.J. 1207, 1218 (2009); Henry Hansmann, *Ownership of the Firm*, 4 J.L. ECON. & ORG. 267, 283 (1988) ("[A] great strength of investor-owned firms is the fact that the owners generally share a single, well-defined objective: to maximize the net present value of the firm's earnings per dollar invested").

[401] *See* Mohsen Manesh, *Legal Asymmetry and the End of Corporate Law*, 34 DEL. J. CORP. L. 465, 498 (2009).

[402] *See* Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 136-37 (discussing how managers holding securities that are publicly traded will see the effects of their decisions quickly).

[403] *See* F. HODGE O'NEAL & ROBERT B. THOMPSON, 2 O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLCS: LAW AND PRACTICE § 9:34 (Rev. 3d ed. 2014) (discussing the features of the close corporation that make minority shareholders subject to oppression, including the lack of a marketability for their interests).

[404] Professor Horton shows that due to contractual alterations of fiduciary duties during freeze-outs, minority investors in listed LLCs face less risk than in listed limited partnerships but more risk than the minority shareholders of corporations. Brent J. Horton, *The Going-Private Freeze-Out: A Unique Danger for Investors in Delaware Non-Corporate Business Associations*, 38 DEL. J. CORP. L. 53, 85-93 (2013).

D. *The Practice of Using Standardized Governance Structures and Contractual Techniques*

The analysis of the LLC agreements and governance structures of the publicly traded LLCs showed that they were highly standardized—in the sense that the companies opted into one or another governance structure that had been chosen earlier by other LLCs, but not in the sense of using the default statutory rules.[405] They used similar legal formulations and wording in the LLC agreements and other additional governance agreements.[406] Notwithstanding the freedom of contracting the members of publicly traded LLCs enjoy under the Delaware LLC statute,[407] they tended to use standard governance structures.[408]

The governance agreements of listed LLCs contain provisions that might raise different expectations among outside investors. Specifically, broadly defined mandatory distribution clauses can be interpreted as giving managers too much discretion in retaining profits and cash.[409] The waiver of fiduciary duties or exculpation clauses might be treated as increasing the probability of opportunistic behavior by managers.[410] Strong control of management and decision making by founding members and entrenched control can be used to oppress the rights and interests of minority investors.[411] Standardized governance structures

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[405] *See* Miller, *supra* note 204, at 319 (discussing empirical data showing the vast majority of publicly traded LLCs deviated from statutory defaults concerning fiduciary duties and member competition).

[406] Professor Manesh likewise found similar wording in LLC agreements. *See* Manesh, *supra* note 9, at 575 ("We found nearly identical language [eliminating fiduciary duties] in the operating agreements of all 42 firms [that chose to do so].").

[407] *See id.* at 561.

[408] *See id.* at 575.

[409] *See* RIBSTEIN & KEATINGE, *supra* note 254, § 6:2 ("[There can be] problems regarding excessive retention of earnings . . . in LLCs because they are likely to be closely held . . . ."); Manesh, *supra* note 9, at 579-80.

[410] *See* Andrew S. Gold, *On the Elimination of Fiduciary Duties: A Theory of Good Faith for Unincorporated Firms*, 41 WAKE FOREST L. REV. 123, 178 (2006) ("[F]iduciary waivers raise concerns that unsophisticated investors will fail to realize what they are getting into. In light of the potential for opportunism, commentators have expressed fears that fiduciary waivers will harm unwitting parties. . . . [A]llowing a complete elimination of the fiduciary relationship looks suspect from this perspective."); *see also* Nicole M. Sciotto, Note, *Opt-In vs. Opt-Out: Settling the Debate Over Default Fiduciary Duties in Delaware LLCs*, 37 DEL. J. CORP. L. 531, 550 n.124 (2012).

[411] *Cf.* Robert C. Illig, *Minority Investor Protections as Default Norms: Using Price to Illuminate the Deal in Close Corporations*, 56 AM. U. L. REV. 275, 286-87 (2006) (discussing oppression of minority investors in the context of close corporations).

bolster the attractiveness of LLC IPOs for investors in several ways.[412] First, by using standardized governance structures, new issuers let potential investors clarify their expectations and reduce uncertainty by looking to the practices of other issuers that used similar structures before.[413] Second, investors familiar with these structures have to invest fewer resources into understanding and interpreting the governance structure of an offering company.[414]

On the supply side, the organizers of IPOs have strong incentives to offer structures around which they have developed knowledge and which have been successfully tested in practice.[415] They invest resources in developing governance structures, reviewing its risks, drafting agreements, and assessing its compliance—and they receive feedback from investors.[416] To reduce their own costs and increase the likelihood of a successful offering, instead of using unfamiliar provisions and completely new governance terms in a subsequent IPO, consultants are more likely to use their previous experience and adapt already tested structures to each new offering.[417] Practical evidence supports this argument. The underwriters of the IPOs of the sample LLCs were often led by the same investment banks. Particularly, Citigroup Global Markets and RBC Capital Markets jointly or separately participated in the IPOs of almost 65% of all oil and gas publicly traded LLCs; Goldman, Sachs & Co. was the lead underwriter of four (out of the total of five) equity and hedge fund managers.[418] Similarly structured IPOs were likely to have the same lead underwriters.[419]

To conclude, the practice has developed structures that have been tested and accepted by investors. Given the high level of standardization in LLC listings, any offering deviating from the standardized practices

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[412] *See* Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 916-17 (2007) (discussing advantages of standardized governance structures when evaluated by investors and advisers).

[413] *See* Anita Indira Anand, *An Analysis of Enabling vs. Mandatory Corporate Governance: Structures Post-Sarbanes-Oxley*, 31 DEL. J. CORP. L. 229, 241-42 (2006) (discussing the reduced investor cost and uncertainty accompanying standardized governance structures).

[414] *See* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713, 723-24 (1997).

[415] *See id.* at 720-21 (discussing learning externalities related to drafting efficiency).

[416] *See id.* at 722-23 (explaining the benefits of using terms and provisions that have withstood judicial scrutiny and investor review).

[417] The corporate governance industry benefits from adopting familiar governance structures because there are fewer costs involved in formulation and litigation. *See id.* at 720-23.

[418] The data on the lead underwriters of the sample publicly traded LLCs were obtained from the *Wall Street Journal* and NASDAQ. The information was available for nineteen out of the twenty sample companies. Original Research (on file with author).

[419] Original Research (on file with author).

may raise concerns and be subject to a thorough study by investors before they decide to invest. Hence, the freedom of contract provided by the statute is actually limited.

VII. CONCLUSIONS

The analysis of the operating and other governance agreements of publicly traded LLCs showed that these companies tended to use the contractual freedom of the Delaware LLC statute to devise governance structures where the founding members had effective control over the boards of directors and officers and faced fewer formalities during decision making.[420] However, these companies used different contractual mechanisms to balance the rights of controlling and minority members.[421] In addition to the legal mechanisms of investor protection, other factors—such as ownership structures, board structures and board practices, dividend policies, market disciplining, and the standardization of the governance structures—affected the governance of the publicly traded LLCs.[422] As a result, investors do not get identical levels of investor protection in listed LLCs as in corporations, but the contractual freedom to shape the governance of listed LLCs, contrary to expectations, has not led to an extensive lowering of the bar in the protection of investors' rights of financial markets.

The data on the ownership structure of publicly traded LLCs permits several observations. First, the evidence is clear that the choice of these structures was not accidental or a result of the preferences of the founders. Ownership and capital structures were actively used by listed LLCs to mitigate adverse selection, moral hazard and agency issues, and to make public offerings of shares representing LLC interests attractive for outside investors. These structures are dynamic—changing depending on where a company is in its life cycle, its capital needs, and other factors. Thus, the ownership and capital structures serve both as substitutes for and complements to the legal protection mechanisms of the operating agreements of listed LLCs. Second, outside investors in publicly traded LLCs, as a rule, had voting rights and could participate in the decision-making procedures.[423] In the majority of the publicly traded

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[420] *See supra* text accompanying notes 111-27.

[421] *See supra* text accompanying notes 222-225.

[422] *See supra* Part VI.

[423] *See supra* Table 1; *see also* Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. 189, 214 (2011) (discussing shareholder voting rights in the context of publicly traded LLCs).

LLCs, the controlling members had to hold significant ownership interests to get control rights;[424] in cases where the controlling member's economic interest was small, outside investors received additional guarantees in the form of the limitation of the scope of the activities of the company and the discretion of the managers.[425] Finally, although the majority of publicly traded LLCs elected partnership taxation, several LLCs were taxed as corporations.[426] Innovative ownership structures combined these two taxation options and offered a choice to public investors with the aim of widening the investor base.

With regard to the structure, composition, and practices of the boards of directors, publicly traded LLCs did not differ significantly from listed corporations. Most of them had to comply with the corporate governance requirements of stock exchanges.[427] However, the companies that were considered controlled and were eligible for exemptions from these requirements opted for complying with one or several corporate governance requirements as well. The boards of the listed LLCs were mostly composed of the majority of independent directors, they established audit, compensation and other committees composed of independent directors, and they regularly held board and committee meetings.[428]

Publicly traded LLCs tended to distribute a significant part of their earnings and cash flows among the members.[429] This practice complies with the prediction of the theory that cash distributions limit the discretion of the managers and, hence, the agency problems within LLCs.[430] The annual dividend yield of the listed LLCs was usually more than triple the dividend yield of S&P 500 corporations. High level of cash payments compensated outside investors of listed LLCs for their limited investor rights, but limited their growth opportunities, particularly through acquisitions.

Finally, to keep going as a business, publicly traded LLCs had to turn to the markets regularly through SPOs and the issuance of debt notes.[431] The practice of paying high dividends did not allow them to retain earnings and accumulate cash similarly to corporations.[432] For this reason, market discipline could be stronger for listed LLCs than for corporations. Additionally, the public offerings of LLC interests were

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[424] *See supra* Part IV.
[425] *See supra* text accompanying notes 308-15.
[426] *See supra* Table I.
[427] *See supra* text accompanying notes 369-85.
[428] *See supra* Part VI.B.
[429] *See supra* Part VI.A.
[430] *See supra* text accompanying note 322.
[431] *See supra* Part VI.C.
[432] *See supra* Part VI.A.

clustered around several standardized governance structures.[433] This standardization could establish confidence among outside investors and further discipline the founding members.

As listed businesses, publicly traded LLCs are subject to many rules that apply to listed corporations, including securities laws, stock exchange regulations, say-on-pay rules, and others.[434] However, they can elect partnership taxation,[435] they have more options for enhancing control by founding members and managers,[436] and they can opt out from several corporate law concepts in order to reduce formalities in decision-making and limit incentives of speculative litigation induced by some abstract standards applicable in the corporate law setting.[437] By using this freedom, publicly traded LLCs distort the traditional governance mechanisms of listed corporations, but they have alternatives to offer to investors. Therefore, this distortion does not swing the pendulum of investor protection strongly in the direction of insiders.

Certainly, this comes with a cost for public firms choosing the LLC form, because the cost of financing can be higher.[438] During a certain period after early IPOs, non-corporate business forms were and in some matters are still surrounded by a layer of uncertainty.[439] Additionally, many professional advisors, which have built their knowledge around IPOs by corporate business form, are perhaps reluctant to invest new resources in knowledge development for securities offerings by non-corporate business forms. However, more IPOs, the development of the case law, and academic and newspaper publications are gradually dispelling the dense layer of uncertainty and making such structures familiar among investors and professional investment advisors. In the end, the risk related to investments in publicly traded LLCs and LPs, if not mitigated by alternative rights, can be priced into their securities. Thus, investors can choose between strong legal protection and low investment returns or weak protection and higher returns. Where alternative protections offered by LLC

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[433] *See supra* Part VI.D.

[434] *See supra* text accompanying notes 369-85; Manesh, *supra* note 401, at 484 ("[L]ike 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.").

[435] *See supra* Table I; *see also* Heather M. Field, *Checking In on "Check-the-Box"*, 42 LOY. L.A. L. REV. 451, 471 n.113 (2009).

[436] *See supra* text accompanying notes 111-27.

[437] *See supra* text accompanying notes 9-11; *see also* Horton, *supra* note 21, at 57-58 (discussing how non-corporate entities can opt out of fiduciary duty requirements).

[438] *See supra* Part VI.C.

[439] *See supra* Part VI.C.

governance structures are not equivalent to the rights of investors in listed corporations and the weaker protection is not compensated by higher cash distributions, the offered securities are expected to be priced lower.

APPENDIX

Summary scorecard: LLC agreement provisions of the publicly traded LLCs and their prevalence, N = 20

If the answer to the question was positive, then the coding variable took a value of 1; otherwise it took a value of 0. Numbers show how many sample LLCs had a respective provision in their LLC agreements. The percentage shows the share of companies with a respective provision in the total number of sample LLCs.

LLC agreement provision	Number	Percentage
Formalities		
Is there an annual member meeting?	15	75
Are there procedural rules of member meetings?		
a) quorum requirement	20	100
b) voting threshold	20	100
c) notice period	18	90
d) record date	20	100
Is there an appraisal right in cases of mergers and consolidations?	0	0
Does the agreement define a member's inspections rights of books and records?	17	85
Do members have audit rights?	0	0
Is there an annual board/management election?	11	55
Are there procedural rules of board meetings?		
a) quorum requirement	20	100
b) voting threshold	20	100
c) notice period	19	95
Is manager/board member:		
a) named in an LLC agreement?	9	45
b) designated pursuant to an LLC agreement?	20	100
Management structure		
Is there a centralized management with:		
a) one member?	1	5
b) non-member?	20	100
c) more than one member?	0	0
Can a board member/manager resign?	19	95

If a board member/manager resigns, can LLC recover damages (other remedies)?	0	0
Is there a board of directors?	20	100
Are board members the same as officers?	0	0
Are board members/managers compensated by members rather than the LLC?	0	0
Is the compensation of board members/managers defined by:		
a) managers?	20	100
b) members?	0	0
Can minority members (10% and more) call member meetings?	2	10
Can minority members (10% and more) make business and director nominations?	7	35
Is written board action without board meeting allowed?	20	100
Is unanimous consent required for written board action without board meeting?	16	80
Is written decision-making by members without member meetings allowed?	14	70
Is unanimous consent required for written decision-making by members?	3	15
Can members remove board members by the vote of:		
a) 50%?	11	55
b) 2/3 or other supermajority vote?	6	30
c) subject to the approval of a certain member?	3	15
d) only for cause?	4	20
Can the board of directors remove officers:		
a) at any time without any cause?	15	75
b) only for cause?	4	20
Interest transfer restrictions		
Is there a general default approval clause for becoming an LLC member?	0	0
Is there a right of first offer?	0	0
Is there a right of first refusal?	0	0
Is there a drag-along right/limited call option?	11	55

Is the minimum threshold for activating drag-along right/limited call option set at:		
a) 80%?	6	30
b) 90%?	5	25
c) other threshold?	0	0
Is there a mandatory purchase/sell-out right?	2	10
Is there other buy-sell option?	0	0
Do members have preemptive rights during the issuance of new interests?	1	5
Is the assignment of LLC interests fully banned?	0	0
Dissolution and member withdrawal		
Does an LLC have perpetual existence?	20	100
Are there special events when an LLC can be dissolved?	4	20
Is LLC dissolution by member vote not allowed?	0	0
Can members dissolve an LLC by the minimum vote of:		
a) 50%?	20	100
b) 2/3? (if only non-voting shares are voting for dissolution)	2	10
c) unanimous consent? (if the approval of the board of directors is not obtained)	3	15
Is judicial dissolution of an LLC:		
a) expanded as compared to § 18-802 of the Delaware LLC Act?	0	0
b) waived?	0	0
Does the death, retirement, resignation of any member lead to an LLC dissolution?	0	0
Does the death, retirement, resignation of a specific member lead to an LLC dissolution?	3	15
Can any member resign before an LLC dissolution:		
a) at will?	0	0
b) if a member votes against important company matters?	0	0
Are there substitutes for freedom of dissolution and member withdrawal?		
a) unanimous voting or minority veto rights	0	0
b) buy-sell options	0	0

c) drag-along/sell-out rights	0	0
d) resignation rights at will	0	0
e) resignation rights upon occurrence of specific events	0	0
Amending LLC agreement		
Is an LLC agreement amendment allowed by:		
a) unanimous vote?	0	0
b) supermajority vote? (only certain matters)	6	30
c) simple majority vote?	20	100
d) the prior approval of the board of directors/managers?	17	85
e) the approval of persons who are not signatories?	0	0
Capital structure & capital contributions		
Is it possible to make capital contributions by:		
a) promissory notes?	1	5
b) future services?	1	5
Can a member be admitted without a contribution?	5	25
Can a member be admitted without an interest?	1	5
Can non-members vote on LLC governance matters?	1	5
Does the issuance of additional LLC interests within the existing classes require member vote?	4	20
Does the issuance of new classes of LLC interests require member vote?	7	35
Are there different classes of members?		
a) non-voting	1	5
b) preferred	1	5
c) other	11	55
Are certain classes of LLC interests sidelined from voting on:		
a) important matters?	0	0
b) LLC agreement amendments and other matters adversely affecting their rights?	0	0
Fiduciary duties		
Are fiduciary duties of LLC members restricted?	14	70
If LLC members' fiduciary duties are restricted, are the following duties carved out from the		

restrictions?		
a) duty of care	14	70
b) duty of loyalty – avoiding self-dealing	14	70
c) duty of loyalty – avoiding competition with the LLC	0	0
d) not acting in bad faith	14	70
e) not engaging in fraud	14	70
f) not engaging in willful misconduct	14	70
g) not acting with knowing violation of law	14	70
Are fiduciary duties of LLC members fully eliminated?	0	0
Are fiduciary duties of LLC members fully eliminated and members exculpated?	0	0
Are LLC members exculpated?	2	10
If LLC members are exculpated, are the following duties not covered by the exculpation clauses?		
a) duty of care	0	0
b) duty of loyalty – avoiding self-dealing	2	10
c) duty of loyalty – avoiding competition with the LLC	0	0
d) not acting in bad faith	2	10
e) not engaging in fraud	0	0
f) not engaging in willful misconduct	0	0
g) not acting with knowing violation of criminal law	2	10
Are fiduciary duties of LLC managers restricted?	13	65
If LLC managers' fiduciary duties are restricted, are the following duties carved out from the restrictions?		
a) duty of care	12	60
b) duty of loyalty – avoiding self-dealing	12	60
c) duty of loyalty – avoiding competition with the LLC	2	10
d) not acting in bad faith	11	55
e) not engaging in fraud	11	55
f) not engaging in willful misconduct	11	55
g) not acting with knowing violation of criminal law	11	55

Are fiduciary duties of LLC managers fully eliminated?	3	15
Are fiduciary duties of LLC managers fully eliminated and managers exculpated?	3	15
Are LLC managers exculpated?	20	100
Do LLC manager exculpation clauses apply to officers as well?	16	80
If LLC managers are exculpated, are the following duties not covered by the exculpation clauses?		
a) duty of care	20	100
b) duty of loyalty – avoiding self-dealing	9	45
c) duty of loyalty – avoiding competition with the LLC	3	15
d) not acting in bad faith	15	75
e) not engaging in fraud	13	65
f) not engaging in willful misconduct	12	60
g) not acting with knowing violation of any law	7	35
h) not acting with knowing violation of criminal law	7	35
i) not acting with material violation of any law and committing a felony	1	5
j) not acting with gross negligence	2	10
Are there substitutes for fiduciary duties?		
a) conflict of interest rules for LLC managers	16	80
b) conflict of interest rules for LLC members	19	95
c) large transaction rules	10	50
d) large member holding 30% or more economic interest	5	25
e) unanimous voting/veto rights on important matters and large transactions	0	0
Limited liability & veil piercing		
Do members and managers have personal obligations for the debts of the LLC?	0	0

Ownership structure & control rights		
Is there a large member holding more than:		
a) 20% economic interest?	7	35
b) 30% economic interest?	5	25
c) 50% economic interest?	5	25
d) 20% voting rights?	9	45
e) 30% voting rights?	7	35
f) 50% voting rights?	7	35
Does management have 5% or more economic interest?	11	55
Is there a member with rights to:		
a) appoint majority of board members/officers?	8	40
b) appoint board members/officers?	4	20
c) make specific decisions?		
i) LLC agreement amendment	3	15
ii) LLC dissolution	3	15
iii) approve mergers	2	10
d) exert effective control over decision-making in other ways?	11	55
Can the board oppose mergers without taking into account fiduciary duties?	5	25
Can an LLC engage in any lawful activity?	17	85
Is there a proportional allocation of income and losses?	18	90
Is there a specific target distribution payment for members?	9	45
Are there management incentive distribution rights?	2	10
Are there specific debt limits for an LLC?	3	15