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FREEDOM OF CONTRACT AND THE PUBLICLY TRADED UNCORPORATION

JONATHAN G. ROHR*

Over the past decade, individual investors have poured hundreds of billions of dollars into publicly traded companies that have opted-out of traditional fiduciary duties. These publicly traded "uncorporations" are typically organized as limited partnerships (although they can take the form of a limited liability company), and most are governed by operating agreements that eliminate the fiduciary duties of managers and controlling equity holders. Advocates for this contractarian approach to fiduciary duties argue that parties should have the freedom opt-out of fiduciary duties and, instead, deploy contractual mechanisms for reducing agency costs. In 2004, Delaware fully integrated this contractarian approach to fiduciary duties into its alternative entity statutes, paving the way for today's growing population of fiduciary-free public companies. Many other states followed. Yet, over a decade later, Delaware judges and commentators have begun to call for reintroduction of a mandatory fiduciary duty of loyalty. While these advocates for a mandatory duty of loyalty acknowledge the contractarian paradigm of contracting for substitutions, they argue that in the context of publicly traded companies, robust contractual freedom leaves investors vulnerable to self-dealing and other misconduct and has also led to sub-optimal levels of standardization with regard to the terms that govern these entities.

As argued in this Article, reintroduction of a mandatory duty of loyalty is not the only (or even best) way to address these issues. First, it is not clear that such potent medicine is necessary or desirable. There are other forces, such as investor expectations of cash distributions, that constrain the behavior of MLP management. And second, even if adoption of a mandatory duty of loyalty where the ideal solution, the forces that shape state business lawmaking, such as jurisdictional competition and internal interest group dynamics, make legislative adoption of a mandatory fiduciary duty of loyalty unlikely.

* Assistant Professor of Law, University of Tennessee-Knoxville College of Law. The Author would like to thank William Bratton, Joan MacLeod Heminway, Mohsen Manesh, Stewart Sterk, Jeanne Schroeder, and Charles Yablon for helpful comments and suggestions.

This Article offers an alternative approach that reflects a new model for business lawmaking in the era of contractual freedom. With information available about commonly adopted governance structures and terms, their coherence in light of the circumstances under which these entities operate, and the ways that investors are routinely left vulnerable, it is possible to design a set of standardized terms that capture the benefits of "contractability" while also providing investors with additional protection where needed. Importantly, achieving widespread adoption of standardized terms would not require state lawmakers to negate their commitments to contractual freedom. Recent empirical and theoretical work on the role of statutory menus indicates that widespread adoption can be achieved even if the standardized terms are not mandatory.

INTRODUCTION

Since the early 2000s, investors have spent hundreds of billions of dollars purchasing the securities of publicly traded companies that have largely opted-out of the traditional fiduciary duties owed by management and controlling equityholders. These publicly traded alternative entities—or "uncorporations"[1]—are typically organized as limited partnerships (LPs) but can also take the form of limited liability companies (LLCs).[2] Most avail themselves of state statutes that allow them to modify and even eliminate fiduciary duties. In much of the business world, these entities are known as master limited partnerships (MLPs), and they have recently become a popular investment for yield-hungry retail investors.[3] MLP equity securities are called units rather than shares, and their current market capitalization exceeds $380 billion, a significant increase since 2000, when it was around $14 billion.[4] As with publicly traded corporations, most MLPs are organized in Delaware.

MLPs' popularity results from their tax treatment. Despite being publicly traded, MLPs are treated as partnerships for tax purposes.[5] Income is not taxed at the entity level; rather, income and losses "pass through" to the unitholders, which are responsible for paying taxes on their share of the MLP's earnings.[6] Thus, unlike corporate dividends (which are taxed at both the entity and investor levels) distributions to MLP inves-

1. LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 1 (2010) [hereinafter RIBSTEIN, UNCORPORATION].

2. David N. Fleischer et al., *Master Limited Partnerships*, in THE HANDBOOK OF INFRASTRUCTURE INVESTING 83 (Michael D. Underhill, ed. 2010) (An MLP may be organized as either a limited partnership or as a limited liability company . . . .).

3. James Comtois, *Investors Not Swayed by MLP Flameout*, PENSIONS & INV. (Jan. 11, 2016), http://www.pionline.com/article/20160111/PRINT/ 301119977/investors-not-swayed-by-mlp-flameout (estimating that 75% of the MLP market has been comprised of retail investors and 25% has been comprised of institutional investors); Eric Rosenbaum, *Energy MLPs: Now There's Only Pain for Investors*, CNBC (Dec. 10, 2015), https://www.cnbc.com /2015/12/10/the-big-energy-investing-myth-now-hurting-investors.html (reporting that approximately 70% of MLP accounts belong to retail investors).

4. *Asset Class Overview*, YORKVILLE CAPITAL MGMT. (2017), http://www.yorkvillecapital.com/asset-class-overview.aspx

5. Fleischer, *supra* note 2, at 83 ("Because of the MLP's partnership tax status, MLP investors avoid the double taxation experienced by shareholders of regular corporations.").

6. John Goodgame, *New Developments in Master Limited Partnerships*, 68 BUS. LAW. 81, 82 (2012) [hereinafter Goodgame, *New Developments*] (noting that the reason for an MLP's existence is "its classification as a partnership for federal income tax purposes, which. . .provides 'tax-sheltered' income to its common unitholders.'"); LAURA E. CUNNINGHAM & NOËL CUNNINGHAM, THE LOGIC OF SUBCHAPTER K 1 (4th ed., 2011).

tors are taxed only once.[7] This feature makes MLPs a good fit for "firms with high levels of free cash flow" because it allows them "to distribute their excess cash in a tax-efficient manner."[8] Maintaining this privileged tax status depends on compliance with IRS restrictions on source of income: pursuant to Section 7704 of the Internal Revenue Code, at least 90% of an MLP's income must be "qualifying income" for it to maintain pass-through status.[9] Qualifying income can only be generated by particular types of assets, which include those related to energy and the exploration, extraction and transportation of natural resources, as well as certain real estate and investment assets.[10] For this reason, most MLPs are energy companies. Regular cash distributions have earned MLPs the reputation (and expectation) of being high yield investments.[11] It is the prospect of these cash distributions that attract investors and distinguish MLP units from shares in a traditional corporation.[12]

Publicly traded corporations and MLPs also differ significantly in their governance arrangements. Unlike corporations, alternative entities can modify and even eliminate the fiduci-

7. In many instances, MLP investors are able to defer a significant portion of their tax liabilities until they sell their units. When the MLP distributes cash in excess of net income (as often happens as a result of non-cash expenses like depreciation and depletion), those distributions will count as return of capital, reducing the investor's basis in the investment. This is known as an MLP's tax shield.

8. Conrad S. Ciccotello & Chris J. Muscarella, *The Energy MLP Goes Institutional: Implications for Strategy and Governance*, 15 J. APPLIED CORP. FIN. 113 (2003); *see also* Larry E. Ribstein, Energy Infrastructure Investment and the Rise of the Uncorporation, 23 J. APPLIED CORP. FIN. 75, 83 (2011).

9. 26 U.S.C.S. § 7704 (2017).

10. *Id.*

11. Fleischer, *supra* note 2, at 83 (MLPs have consistently traded in the public market with distribution yields of 6 percent to 7 percent.").

12. Diana Liebman et al., *Recent Developments in United States and Texas Energy Law*, 4 TEX. J. OIL & GAS L. 363, 402 (2009) ("At this point, one might ask why anyone would ever become a unitholder in an MLP . . . . The answer lies in the cash distributions that unitholders receive."); Hillary Holmes & James Chenoweth, *Master Limited Partnerships – And Their Benefits and Risks*, LAW360 (March 10, 2016), http://www.law360.com/articles/769662/master-limited-partnerships-and-their-benefits-and-risks ("MLPs are typically valued off of their higher yield and, as a result, they tend to trade at a premium valuation to C corps. MLPs are also increasingly valued on an EBITDA (earnings before interest, taxes, depreciation and amortization.").

ary duties of management and controllers.[13] The *only* mandatory duty is the contractual duty of good faith and fair dealing, but it offers limited protection.[14] In the case of MLPs, eliminating the duty of loyalty is significant when (as is often the case) a publicly traded corporation responsible for organizing the MLP—its "sponsor"—retains control of the entity after it goes public[15] *and* continues to transact business with it regularly.[16]

Advocates for this contractual approach to fiduciary duties emphasize the costs associated with relying on mandatory duties as a mechanism for controlling agency costs.[17] They argue that fiduciary duties inject uncertainty into business activities and with it, risk, which may cause management to be overly conservative.[18] Fiduciary duty litigation is itself costly, and the primary beneficiaries often seem to be the lawyers involved. Contractarians argue that fiduciary duties may do more harm than good and parties should, therefore, be free to

13. DEL. CODE ANN. tit. 6, § 18-1101(c) (2013) (allowing elimination of fiduciary duties owed by managers and members of an LLC); DEL. CODE ANN. tit. 6, § 17-1101(d) (2010) (allowing for elimination of duties owed by partners to limited partnership or other partners). *See also* DEL. CODE ANN. tit. 6, § 18-1101(b) (2013) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."); DEL. CODE ANN. tit. 6, § 17-1101(c) (2010) ("It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.").

14. Douglas M. Branson, *Alternative Entities in Delaware – Reintroduction of Fiduciary Concepts by the Backdoor?*, *in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS, AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 55, 61 (Robert W. Hillman & Mark J. Loewenstein eds., 2015) (noting that an action for breach of the implied covenant not available for "conduct which is pursuant to some express term of the contract or express language in the contract."). Some commentators state that the Delaware courts are using the covenant "*arguably, in certain instances* to bring back into the picture duties very similar to fiduciary duties." *Id.* at 56 (emphasis added).

15. *See, e.g.*, Goodgame, *New Developments*, *supra* note 6, at 83.

16. *See, e.g.*, Brinckerhoff v. Enbridge Energy Co., 159 A.3d 242, 245 (Del. 2017) ("MLPs are typically families of entities that often engage in internal business transactions, referred to as dropdowns, rollups, insider financings, incentive distribution rights, and equity investments."); Goodgame, *New Developments*, *supra* note 6, at 83.

17. RIBSTEIN, UNCORPORATION, *supra* note 1, at 203–05.

18. RIBSTEIN, UNCORPORATION, *supra* note 1, at 204; Larry Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131 (2009).

substitute their own customized governance arrangements.[19] This line of argument certainly makes sense when parties of similar sophistication actually bargain over the terms of an LP or LLC operating agreement (e.g., a joint venture agreement between two real estate developers). In such a situation, an investor who is asked to relinquish the protection offered by fiduciary duties can seek contractual substitutions for those duties and likely has some bargaining power to do so.

Delaware (the home of most MLPs) adopted this strong contractarian approach to uncorporate fiduciary duties in 2004, when it enacted a statute declaring the state's commitment to contractual freedom and explicitly allowing elimination of fiduciary duties. Many other states followed suit, particularly with regard to their LLC statutes.[20] Yet, just over a decade later, two of the state's most renowned judges (Chief Justice Strine and Vice Chancellor Laster) alongside academic commentators have called for reinstitution of a mandatory duty of loyalty.[21] They argue that in the context of publicly traded entities, the contractarian paradigm fails. No bargaining takes place between MLP organizers and unitholders, and terms are offered on a "take-it-or-leave-it" basis.[22] Investors are systematically left vulnerable to self-dealing, for which Strine, Laster, and others prescribe a mandatory duty of loyalty. Advo-

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19. *See, e.g.*, Myron T. Steele, *Freedom of Contract and Default Contractual Duties in Delaware Limited Partnerships and Limited Liability Companies*, 46 AM. BUS. L.J. 221, 224 (2009) (arguing that "[c]ourts should favor the contracting parties ex ante calculation of the costs and benefits of fiduciary duties . . . .").

20. Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. 189, 225 n.190 (2011) [hereinafter Manesh, *Market for LLC Law*].

21. Leo E. Strine & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, *in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS, AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 11, 12 (Robert W. Hillman & Mark J. Loewenstein eds., 2015). They recognize that, even within the corporate realm, Delaware law gives some latitude to modify the duty of loyalty and would extend this level of contractual freedom to publicly traded alternative entities as well. *See also* Sandra K. Miller & Karie Davis-Nozemack, *Toward Consistent Fiduciary Duties for Publicly Traded Entities*, 68 FLA. L. REV. 263 (2016); Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879 (2012).

22. Strine & Laster, *supra* note 21, at 12; *see also* Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295 (2014).

cates for a new mandatory duty of loyalty also cite the lack of meaningful standardization in the terms that govern MLPs. Although they have begun to coalesce around certain types or categories of contractual terms (e.g., cash distribution provisions and conflict-of-interest provisions governing the approval of conflicted transactions, to name just two examples), the way in which those terms are drafted differs from one agreement to another.[23] This lack of standardization drives up investors' information costs[24] and diminishes the value of judicial opinions outside of the particular dispute being adjudicated.[25] Widespread variations in wording increase uncertainty and often lead to unexpected results, even for those responsible for the drafting.[26]

Recent studies of operating agreements indicate that there is at least some cause for concern, although precisely how much cause is unclear. Fiduciary duties are routinely eliminated, and the adopted contractual substitutions can leave investors vulnerable to misconduct, specifically self-dealing by management and the MLP sponsor.[27] Similarly, empirical studies[28] have identified at least one variety of term that is adopted almost across-the-board, but variations in implemen-

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23. Strine & Laster, *supra* note 21, at 18 ("A degree of surface-level standardization has begun to occur, with alternative entity agreements coalescing around particular features and concepts. At present, however, this superficial standardization is overwhelmed by diversity in implementation, which limits the efficacy of precedent and creates fertile opportunities for future litigation."); *see also* Brent J. Horton, *Modifying Fiduciary Duties in Delaware: Observing Ten Years of Decisional Law*, 40 DEL. J. CORP. L. 921, 922 (2016) [hereinafter Horton, *Modifying Fiduciary Duties in Delaware*] ("Successful uncorporations . . . appear to be coalescing around a standardized approach: approval by a special committee, coupled with a good faith standard.").

24. *See* Strine & Laster, *supra* note 21, at 18.

25. *Id.*

26. *Id.* at 12–13.

27. *See, e.g.*, 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, 58 (2013) [hereinafter Horton, *Going-Private Freeze-Out*]; Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J. CORP. L. 555, 562–63 (2012) [hereinafter Manesh, *Contractual Freedom*]; Strine & Laster, *supra* note 21, at 12.

28. *See, e.g.*, Horton, *Going-Private Freeze-Out*, *supra* note 27; Suren Gomtsian, *The Governance of Publicly Traded Limited Liability Companies,* 40 DEL. J. CORP. L. 207, 257 (2015). These studies find routine elimination of the duty of loyalty and regular adoption of contractual, conflict-of-interest provisions. As discussed by Professor Horton, Chief Justice Strine and Vice Chancellor

tation inject uncertainty and limit the relevance of case law from one dispute to another. Although reliance on seemingly weak contractual rights to substitute for mandatory fiduciary duties is troubling, other forces, particularly market expectations related to cash distributions, *do* constrain MLP managers and sponsors to some degree. As discussed previously, investors in MLP units are primarily interested in cash distributions, and the ongoing payment of regular distributions is something that investors are capable of assessing easily. Although the MLP structure creates the opportunity for MLP sponsors and managers to engage in self-dealing, the need to meet investor expectations (or at least limit the extent to which those expectations will be disappointed) is one constraint, admittedly an imperfect one, on the degree to which sponsors and managers are actually able to do so. It is unclear, therefore, precisely how vulnerable investors really are as a class and how this compares to the risk presented by more traditional equity investments.

Reintroducing a mandatory duty of loyalty would certainly be a quick way both to increase the accountability mechanisms available to MLP investors and to impose some degree of standardization when it comes to certain recurring issues. However, a mandatory duty of loyalty is not the only, or even the most feasible, solution. It would require state lawmakers to act in opposition to the pressures created by jurisdictional competition for business entities, and would also threaten to chill beneficial transactions and business practices that allow MLPs to meet investor expectations of regular cash distributions.

Rather than move MLP governance toward corporate governance, state legislatures (mainly Delaware's) can look to statutory menus of standardized terms as a way of both increasing standardization and encouraging contracting outcomes that are more protective of investors' interests. Importantly, this terms-based approach does not require state lawmakers to act in opposition to the pressures created by state competition for business entities. Delaware is not the only state to offer alternative entities the contractual freedom to modify and eliminate fiduciary duties. Many other states followed Delaware's lead after it adopted the 2004 amendments, and these states would

Laster, these provisions can be utilized to insulate problematic transactions from any meaningful judicial review.

be available to MLP organizers in the event Delaware's legislature re-imposed a mandatory duty of loyalty. From a competitive perspective, Delaware's commitment to contractual freedom has become a double-edged sword. Although contractibility is part of what attracts uncorporate organizers to Delaware, it has also leveled the competitive playing field insofar as it is easy for other jurisdictions to commit to enforcing operating agreements as contracts.[29]

As against other states that allow modification and elimination of fiduciary duties, Delaware's competitive advantage seems to result from various Delaware-specific benefits that it offers, including its first-mover advantage, generally positive reputation, and high-quality legal infrastructure.[30] While these benefits would remain even after reintroduction of a mandatory duty of loyalty, whether they are sufficient to retain and attract alternative entities that also value the ability to avoid a mandatory duty of loyalty is anyone's guess. Alternative entities may simply value the ability to avoid mandatory fiduciary duties more than they value other Delaware-specific advantages, and there is reason to think that this is the case.[31] For state lawmakers, the prudent course of action is maintaining the state's commitment to contractual freedom.

In the past, concern over federal preemption of state corporate law has prompted state lawmakers to take actions that are not necessarily in the state's competitive interest vis-à-vis other states, but that threat is unlikely to play a similar role here. Federal intervention in state business law is sporadic and typically follows economic crisis. To the extent federal lawmakers have given any attention to MLPs recently, it has been in the course of efforts to expand the types of income that will qualify a publicly traded alternative entity for pass-through tax treatment.[32] Current conditions simply are not ripe for federal intervention.

29. *See, e.g.*, Manesh, *Contractual Freedom, supra* note 27, at 562–63.

30. *See, e.g.*, Franklin A. Gevurtz, *Why Delaware LLCs?*, 91 OR. L. REV. 57 (2012).

31. *See id.*; RIBSTEIN, UNCORPORATION, *supra* note 1; Manesh, *Market for LLC Law*, *supra* note 20, at 193 (noting that contractibility diminishes the value of Delaware's advantages).

32. *See* The Master Limited Partnership Parity Act, H.R. 2883, 114th Cong. (2015).

As mentioned above, this Article offers an alternative, terms-based approach to addressing these issues that would not require state lawmakers to buck the trend of increasing contractability. Given the information available about trends in MLP structure and governance (including the type of terms included in operating agreements) and the areas in which investors are left vulnerable, it is possible for state lawmakers to design a set of standardized terms that offer the types of structures and arrangements that MLPs need and routinely contract for, but in a way that does not leave investors systematically unprotected. This approach offers two advantages as compared to re-adoption of a mandatory duty of loyalty. First, successful implementation will not require state lawmakers to act in opposition to their state's competitive interests. Recent empirical and theoretical research demonstrates that these terms would not have to be mandatory to be effective.[33] State lawmakers can encourage the adoption of a term by making a state-sanctioned, standardized version of it available to firms that wish to adopt it. Among other things, such terms can become focal points around which standardization-related benefits grow, encouraging adoption.[34] Moreover, provided relevant market participants are aware of the terms' availability, a company that chooses not to adopt them can face reputational and market related consequences.[35] Provided the terms successfully capture the usefulness of the actual MLP terms on which they are based, the benefits of voluntarily adopting a standardized term can outweigh the benefits of adopting a bespoke version, even if that standardized term differs to some degree from the bespoke version that would have otherwise appeared in the operating agreement. Second, a terms-based approach based on actual contracting practices can offer MLPs, sponsors, and unitholders the advantages of both contractibility and standardization: If the standardized terms are based on the widely adopted bespoke versions that facilitate legitimate business needs, adopters will still enjoy terms that are more tailored than general fiduciary duty principles. If a

33. Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Analysis*, 6 J. EMPIRICAL LEGAL. STUD. 279 (2009); Ian Ayres, *Menus Matter*, 73 U. Chi. L. Rev. 3 (2006).

34. Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995).

35. *See* Ayres, *supra* note 33.

sufficient number of MLPs adopt them, these terms will also offer the full suite of standardization-related benefits.

Part I is an overview of MLPs, including common structure and IRS restrictions on income source for publicly traded pass through entities. Part I includes a discussion of the rise of alternative entities, the trend of extending them the freedom to limit and eliminate fiduciary duties, and recent calls to restrict the contractual freedom they currently enjoy under state law.

Part II explores the concerns raised by proponents of a new mandatory fiduciary duty as well as the literature examining the operating agreements of these entities and relevant case law. This literature demonstrates that there is some cause for concern: fiduciary duty eliminations are common, and the contractual substitutions adopted in their place leave investors vulnerable to malfeasance by the MLP's management and sponsor. The literature and case law also confirm that MLP operating agreements show little meaningful standardization. This increases information costs for investors, prevents the development of a coherent body of case law relevant to future disputes, and compromises the informational efficiency of the market for MLP units (as compared to the market for corporate securities). Nevertheless, there are countervailing forces that discipline MLP management and sponsors. First, there are strong market expectations of cash distributions, and failure to meet these expectations can lead to loss of investors and increased cost of capital. To the degree MLP operating agreements may permit self-dealing, it should be cabined by the degree to which it is does not prevent the MLP from meeting its investors' distribution expectations. Second, as recent cases have shown, there is a role for judicial oversight under frameworks provided by traditional contract enforcement as well as the contractual duty of good faith and fair dealing. It may not be as robust as the role of judicial oversight under a fiduciary duty regime, but it does exist.

Part III is a discussion of the role that state competition, interest group dynamics, and the threat of federal action to displace state law are likely to play in the capacity and willingness of state corporate lawmakers to reintroduce a mandatory duty of loyalty. It argues that state competition for business entities and the pressures created by interest group dynamics are likely to prevent Delaware's legislature from taking this step.

To the degree the federal government has paid any attention to MLPs recently, it has been in the course of efforts to expand their use—currently, there does not seem to be any threat of federal preemption strong enough to affect state lawmakers on this issue.

Part IV explores a terms–based approach to addressing the problems resulting from allowing publicly traded alternative entities to eliminate fiduciary duties. With information about the terms MLPs commonly utilize, the reason these terms are utilized regularly (i.e., *why* they are useful to MLPs), and the ways in which investors are routinely left vulnerable by the bespoke versions currently adopted, it should be possible to create a set of standardized terms that are designed to give MLPs the governance arrangements they need, but in a way that does not systematically disadvantage investors. Part IV uses the commonly adopted "conflict–of–interest" provision as an example of a term that can be standardized in a way that facilitates the legitimate business practices that have led almost all MLPs to adopt a version of it, but with increased protection against self-dealing. Recent empirical and theoretical research on the impact that statutory menus have on the content of corporate "contracts" indicate that these terms do not have to be mandatory to be effective. In other words, they can be implemented in way that is consistent with state lawmakers' commitments to contractual freedom. Additionally, as analysis of the "conflict-of-interest" provision demonstrates, a set of standardized terms can combine the benefits of contractability (*i.e.*, governance structures that have been tailored to the needs of particular types of firms) with increased investor protection and standardization.

I.
Overview of MLPs

A. *The Rise of Alternative Entities and the Move to Contractual Freedom*

American business law has entered the era of the uncorporation. Once a "backwater in the U.S. law of business associations," unincorporated business organizations are now "the cutting edge of U.S. entity law."[36] Recent years have seen more newly-formed alternative entities than corporations, and the trend seems likely to continue. LLCs have become especially popular. Internal Revenue Service data from 2013, for example, shows that 2,285,420 LLCs filed federal income tax returns that year, while corporations filed 5,887,804. Between 2000 (in which 718,704 LLCs filed federal income tax returns) and 2012, the number grew over 300%.[37] The success Delaware enjoys in attracting corporations holds true here as well, particularly with large uncorporations that organize outside of their "home" state.[38]

Alternative entities are attractive because they combine the pass-through tax treatment of partnerships with corporate-style limited liability.[39] Notably, they allow parties significant freedom to adopt individually tailored governance arrangements, including the modification and elimination of fiduciary duties. The duties of care and loyalty are treated as default rules subject to modification or even total elimination under the law of many states.[40] In the corporate context, parties have considerable flexibility with regard to the duty of care (an exculpatory charter provision can eliminate much of its bite),[41] but the duty of loyalty is mandatory.[42]

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36. Daniel S. Kleinberger, *Two Decades of "Alternative Entities": From Tax Rationalization Through Alphabet Soup to Contract as Deity*, 14 FORDHAM J. CORP. & FIN. L. 445, 445–46 (2009).

37. INTERNAL REVENUE SERVICE, Number of Returns, Total Receipts, Business Receipts, Net Income (less deficit), Net Income, and Deficit by Form of Business Tax Years 1980–2012, https://www.irs.gov/pub/irs-soi/12otidb1.xls.

38. *See, e.g.*, Franklin A. Gevurtz, *Why Delaware LLCs?*, 91 OR. L. REV. 57 (2012); Manesh, *Contractual Freedom, supra* note 27, at 562–63.

39. Limited partners enjoy limited liability, but limited partnerships must have a general partner, who can be held liable for the limited partnership's debts. This is easily addressed by having a corporation or LLC with minimal assets act as general partner. The LLC form includes corporate style limited liability – there is no LLC analogue to the general partner.

40. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-1101(c) (2013); DEL. CODE ANN., tit. 6 § 17-1101(d) (2013).

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

42. Delaware does allow its corporations to adopt limited carve-outs from the corporate opportunity doctrine (a component of the duty of loyalty) with a charter provision "renounc[ing]. . .any interest or expectancy of the corporation in, or in being offered an opportunity to participate in specified business opportunities or specified classes or categories of business opportu-

The move toward contractual freedom reflects an acceptance, to some degree, of the arguments that contractarians have been making for decades.[43] They argue that fiduciary relationships are best understood as fundamentally contractual in nature. Fiduciary duties arise in contractual relationships that are "characterized by unusually high costs of specification and monitoring"[44] and they allow parties to forego the impossible task of negotiating a complete contractual relationship. When a party owed a fiduciary duty seeks to enforce it, the court both supplies and applies the applicable term *ex post*, according to the generalized fiduciary standard.[45] The contractarians' claim is not only descriptive, however. They also argue that mandatory fiduciary duties are often inefficient:[46] they increase uncertainty and risk, introduce considerable litigation costs, and do not appear to be all that effective at deterring bad behavior. Because the parties to these relationships are in the best position to determine the terms and arrangements that should govern their relationship, they should be able to rely on other mechanisms for ordering their relationship.[47]

Importantly, the contractarian outlook has made a difference. Various uniform alternative entity statutes and their state enactments reflect a contractual approach to these entities

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nities that are presented to the corporation or 1 or more of its officers, directors or stockholders."). DEL. CODE. ANN., tit 8, § 122(17).

43. *See, e.g.*, Larry Ribstein, *Fiduciary Duty Contracts in Unincorporated Entities*, 54 WASH. & LEE L. REV. 537, 559 (1997) [hereinafter Ribstein, *Fiduciary Duty Contracts*]; Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990).

44. Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J. L. & ECON. 425, 427 (1993).

45. *Id.* ("The duty of loyalty replaces detailed contractual terms, and courts flesh out the duty of loyalty by prescribing the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced.").

46. *See, e.g.*, Butler & Ribstein, *supra* note 43, at 53–56 (arguing that mandatory terms are inefficient); Myron T. Steele, *Freedom of Contract and Default Contractual Duties in Delaware Limited Partnerships and Limited Liability Companies*, 46 AM. BUS. L.J. 221 (2009) (arguing that "default fiduciary duties add significant contracting and litigation costs and that therefore "[c]ourts should favor the contracting parties ex ante calculation of the costs and benefits of fiduciary duties").

47. *See, e.g.*, Ribstein, *Fiduciary Duty Contracts*, *supra* note 43, at 551; Butler & Ribstein, *supra* note 43.

and the fiduciary duties that they have traditionally incorporated.[48] For example, the Revised Uniform Partnership Act ("RUPA"), Uniform Limited Partnership Act (RULPA), and the Revised Uniform Limited Liability Company Act (RULLCA) all allow modification of the duty of loyalty (including the elimination of certain "aspects" of the duty) and require only that these changes to the traditional duty not be "manifestly unreasonable."[49]

Delaware's legislature has embraced a strong version of contractarianism and, in 2004, amended its alternative entity statutes to make this clear.[50] After disagreement in the Delaware courts over whether Delaware's limited partnership and limited liability company statutes authorized the elimination of fiduciary duties (rather than just limitations and modifications of those duties),[51] the Delaware Revised Uniform Partnership Act ("DRUPA"), Delaware Revised Uniform Limited Partnership Act ("DRULPA"), and the Delaware Limited Liability Company Act ("DLLCA") all expressly allow for total fiduciary duty elimination, with no limitation, aside from a nonwaivable *contractual* duty of good faith and fair dealing.[52] Many other states have followed Delaware's lead, particularly with their LLC statutes.[53]

Notably, Delaware's alternative entities enjoy this degree of contractual freedom even when they are publicly traded.[54]

48. *See, e.g.*, Reza Dibadj, *The Misguided Transformation of Loyalty into Contract*, 41 TULSA L. REV. 451, 453–56 (2006) (discussing contractarian view of fiduciary duties and its adoption in uniform statutes).

49. Revised Uniform Partnership Act § 105(d)(2);Revised Limited Partnership Act § 105(d)(2); Revised Uniform Limited Liability Company Act § 105(d)(3).

50. Branson, *supra* note 14 ("In Delaware alternative entities, then, contract, indeed, seems in all instances supreme, as the contractarians wished it to be.").

51. Gotham Partners LP v. Hallwood Realty Partners LP, 817 A.2d 160, 167–68 (Del. 2002).

52. DEL. CODE ANN. tit. 6, § 18-1101(c) (2013); DEL. CODE ANN. tit. 6 § 17-1101(d) (2010). *See also* DEL. CODE ANN. tit. 6, § 18-1101(b) (2013); DEL. CODE ANN., tit. 6 § 17-1101(c) (2010).

53. Manesh, *Market for LLC Law, supra* note 20, at 225 n.190 (listing states that have adopted Delaware approach to contractual freedom in LLC statutes).

54. *See, e.g.*, Hite Hedge LP v. El Paso Corp., 2012 WL 4788658 (Del. Ch. Oct. 9, 2012); *In re* Atlas Energy Res., LLC, 2010 WL 4273122 (Del. Ch. Oct. 28, 2010).

Despite their diverse investor base and the absence of actual bargaining over the terms of their operating agreements, publicly traded uncorporations are just as capable of modifying and eliminating fiduciary duties as their closely-held siblings, and they typically do.[55]

B. *MLP Structure and Governance*

Publicly traded alternative entities typically operate in the energy sector. They are collectively referred to as "master limited partnerships" (MLPs),[56] but this name can be misleading because they can take (and have taken) the form of LLCs.[57] To further confuse things, although the term is typically used to refer to *all* publicly traded alternative entities taxed as partnerships, others use it only in reference to companies that operate in the energy sector. This article uses MLP in the broader sense.

MLP equity investors hold units instead of shares, and these units are sold on various public securities exchanges.[58] MLPs are governed according to the terms included in their organizational documents. Different state statutes assign these documents a variety of names; here they will be referred to collectively as operating agreements.[59] Operating agreements are bespoke documents, meaning they are individually drafted for each MLP.[60]

MLPs are structured in a variety of ways, but the sponsored model dominates.[61] Under this model, a corporation

55. Manesh, *Contractual Freedom, supra* note 27, at 562–63.

56. *In re* El Paso Pipeline Partners, LP, 2014 WL 2768782 (Del. Ch. June 12, 2014).

57. Tim Fenn, *Master Limited Partnerships (MLPs): A General Primer*, Latham & Watkins, LLP 2 (Apr. 2014), https://www.lw.com/admin/Upload/Documents/MLP/Resources/Latham-Master-Limited-Partnership-Primer-2014.pdf ("[M]ost commonly the MLP is formed as a Delaware limited partnership. Increasingly, the MLP may instead be a state law limited liability company—preferably a Delaware limited liability company (an LLC). . . .")

58. Goodgame, *New Developments, supra* note 6, at 82.

59. *See, e.g.*, Joan MacLeod Heminway, *The Ties that Bind: LLC Operating Agreements as Binding Commitments*, 68 S.M.U. L. REV. 812 (2015).

60. Strine & Laster, *supra* note 21, at 1.

61. *See, e.g.*, Miller & Davis-Nozemack, *supra* note 21; Deborah Fields et al., *Triangles in a World of Squares: A Primer on Significant U.S. Federal Income Tax Issues for Natural Resources Publicly Traded Partnerships (Part I)*, TAXES - THE

(usually publicly traded) acts as a "sponsor" that organizes the MLP, typically under Delaware law.[62] The sponsor forms an affiliated entity, usually an LLC or a corporation, to serve as the general partner of the LP (or managing member if the LLC form is chosen).[63] The sponsor retains complete ownership over the general partner[64] and acts as the "ruler behind the throne."[65] The sponsor contributes qualifying assets to the MLP or otherwise arranges for the MLP to acquire them. Even after the MLP goes public, transactions in which the MLP acquires assets from its sponsor or an affiliate of the sponsor are common.[66] Individuals with actual management power over the MLP (*i.e.*, directors, managers, or employees of the general partner) are often affiliated with the sponsor in some capacity.

Other structures exist, but are less common. Some MLPs organized as LLCs have a board of directors and allow unitholders to participate in elections. These entities look very much like corporations,[67] and some opt for corporate-style fiduciary duties. Other arrangements known as "tuck-ins" still take the limited partnership form. However, in a tuck-in, the MLP (rather than the sponsor) owns the general partner, and the sponsor owns MLP units alongside public unitholders.[68] This tuck-in arrangement allows the public unitholders to participate in choosing the board of the general partner.[69]

TAX MAGAZINE, Dec. 2009, at 21, 28 [hereinafter Fields, *Triangles in a World of Squares (Part I)*] ("The 'sponsor' typically is the person or entity behind the formation and operation of the PTP. The sponsor typically structures the PTP with a goal of raising capital through the public markets to fund the acquisition, development and/or operation of property.").

62. Goodgame, *New Developments, supra* note 6, at 83.

63. Fields, *Triangles in a World of Squares (Part I), supra* note 61, at 21, 31.

64. Goodgame, *New Developments, supra* note 6, at 83.

65. Miller & Davis-Nozemack*, supra* note 21, at 269.

66. *See, e.g.*, Deborah Fields et al., *Triangles in a World of Squares: A Primer on Significant U.S. Federal Income Tax Issues for Natural Resources Publicly Traded Partnerships (Part II – Property Acquisitions)*, TAXES: THE TAX MAGAZINE, Feb. 2010, at 73 ("Typically, the sponsor of a PTP transfers property to the PTP or otherwise arranges for the PTP to acquire property, while the PTP raises capital to acquire, develop or operate the property through an initial public offering (IPO).").

67. Goodgame, *New Developments, supra* note 6, at 88.

68. *Id.* at 91–93.

69. *Id.*

To qualify for pass-through tax treatment (which is the primary reason to form an MLP), at least 90% of an MLP's income must be qualifying passive income. Section 7704 of the Internal Revenue Code provides a list of assets that will generate qualifying income. Most Section 7704 assets are related to energy and the exploration, extraction and transportation of natural resources, but certain real estate and investment assets also qualify.[70] As a result, most MLPs operate in the energy and natural resources sector.[71]

The qualifying income requirement is intended to ensure that publicly traded entities that engage in "active business activities" which are usually conducted by corporations will be treated as such for tax purposes.[72]Pass–through treatment is reserved for those entities that "are engaged in activities commonly considered as essentially no more than investments" or which were historically organized in the partnership form.[73] As discussed above, any income earned by the MLP will be taxed only at the level of the unitholder[74] and not twice, as is the case with corporate dividends.

The tax benefits of MLP investing do not end with avoidance of an entity-level tax. Because MLPs typically recognize significant non-cash expenses (depreciation, amortization, and depletion), the cash distribution received by a unitholder

70. 26 U.S.C. § 7704.

71. Goodgame, *New Developments, supra* note 6, at 82.

72. HR REP. NO. 100-391(II), at 71, 282 (1987).

73. *Id.* Many energy MLPs do engage in "active business activities," such as the ongoing management of assets utilized in the development and transportation of natural resources. Presumably, their inclusion in Section 7704 resulted from the traditional use of the partnership form for these activities.

74. 26 U.S.C. § 701 ("A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities."); John Goodgame, *Master Limited Partnership Governance*, 60 BUS. LAW. 471, 472 (2005) [hereinafter Goodgame, *Governance*] ("A dollar of income generated by such a partnership would only be taxed once ('passed-through'), at the marginal tax rate of the limited partner to whom that dollar of income was allocated. Accordingly, assuming that the relevant entity distributes all of its income to its equity holders and that the equity holder's marginal tax rate is thirty-five percent, an MLP must generate $1.54 of income for an equity holder to have one dollar of after-tax income, although a corporation must generate $2.20 of income for its equity holder to have one dollar of after-tax income." "This assumes a corporate tax rate of thirty percent." *Id.* at 472 n.9).

often exceeds the net income allocable to that unitholder.[75] Distributions in excess of the income allocable to that unitholder will qualify as return of capital and serve to reduce the unitholder's basis to the extent that the distribution exceeds net income allocable to that unitholder.[76] The effect is to delay any taxes owed on distributions until the units are sold. The prospect of regular distributions (the value of which are affected by the "tax shield" created by distributions that exceed net income) are the reason investors put their money into MLPs,[77] and for the most part, MLPs have delivered. As a class, they typically pay out more in cash distributions than stock holdings pay in dividends, and they regularly outperform the S&P 500.[78]

There is real money in MLPs. Since 2004, the market capitalization of MLPs has increased from $14 billion to almost $400 billion.[79] There is no reason to think the trend will re-

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75. *See, e.g.*, Fields, *Triangles in a World of Squares (Part I)*, *supra* note 61, at 30 ("Deductions for depreciation, depletion, and amortization (DD&A) can reduce the share of taxable income allocable to each unit.").

76. Goodgame, *Governance*, *supra* note 73, at 472.

77. *See, e.g.*, Fields, *Triangles in a World of Squares (Part I)*, *supra* note 61, at 30 ("From a market perspective, investors typically view a PTP unit as a yield-based security. To this end, the amount of 'tax shield' associated with a PTP can be relevant to potential buyers of a PTP's units. . . If an investor does not view the tax shield of the units of a particular PTP as adequate, he or she may choose to sell such units and to buy another investment, such as units in a different PTP that delivers a higher tax shield.").

78. Charles F. Beauchamp, *The Future of Master Limited Partnerships*, 30 J. APPLIED BUS. RES. 1493 (2014) (finding that "MLPs produce strong performance with lower risk and lower correlations" as compared to other asset classes); Fleischer, *supra* note 2 at 109 (reporting that "MLPs total return profile has historically averaged in the low to mid teens"). YORKVILLE PUBLICLY TRADED PARTNERSHIPS UNIVERSE INDICES: A COMPLETE STUDY OF RISK AND RETURN (1986–2011) (finding that "100% of MLP sectors have outperformed the S&P 500 on a total return basis over the past five years"); Chris Dieterich, *IPO Wave Kicks Off with Trio of MLPs*, WALL ST. J. (Jan. 13, 2013), http://www.wsj.com/articles/SB10000142412788732458150457823611329690679 2 (reporting that the average MLP had a "dividend yield of more than 6%, topping most dividend-paying stocks and rivaling high-yield bonds."); Maria Halmo, *Greatest Hits: The Periodic Table of Performance*, ALERIAN (Aug. 13, 2014), https://www.alerian.com/greatest-hits-the-chemistry-of-mlps-periodic-table-of-performance/. This does not mean that MLPs are all guaranteed winners. They are subject to market and firm-specific risk like any other company and have had periods of slower growth or losses.

79. YORKVILLE CAPITAL MGMT., *supra* note 4.

verse. In recent years, the IRS has experienced an increase in requests for private letter rulings related to Section 7704's qualifying income requirement, prompting it to instate a moratorium on issuing such rulings in early 2014.[80] It lifted the moratorium in 2015,[81] and has since promulgated regulations related to the assets that generate qualifying income.[82] Additionally, in recent years, members of Congress affiliated with both major parties have introduced various versions of the "Master Limited Partnerships Parity Act" to expand the definition of qualifying income (and with it, the availability of pass-through treatment), to new assets.[83]

MLPs are peculiar in another way. In an age dominated by institutional investors, MLP investors are primarily *individuals* looking for high yields.[84] Industry professionals estimate the MLP market to be around 70–75% retail,[85] raising ques-

80. Amy S. Elliott, *IRS Has Stopped Ruling on Publicly Traded Partnership Qualifying Income*, TAX NOTES TODAY (March 31, 2014), 2014 TNT 61-4; Alison Sider, *Energy Spinoffs Are Moving Into Tax Limbo*, WALL ST. J. (Apr. 9, 2014), https://www.wsj.com/articles/energy-spinoffs-are-moving-into-tax-limbo-1397089584?tesla=y (reporting IRS moratorium given increased interest in MLP formation and requests for rulings as to the qualifying nature of various new asset classes).

81. Reuters Staff, *IRS Lifts 'Pause' on Rulings for Energy Partnerships*, REUTERS (Mar. 9, 2015, 1:10 PM), http://www.reuters.com/article/usa-irs-mlps-idUSL1N0WB19220150309 ("The Internal Revenue Service has lifted its temporary 'pause' on rulings about what businesses qualify for tax-free inclusion in energy master limited partnerships (MLPs), after about a year of study that held up some transactions.").

82. Treas. Reg. 1.7704-4, 82 Fed. Reg. 8338 (Jan. 19, 2017); 80 Fed. Reg. 25970 (May 6, 2015).

83. Versions of this bill were introduced in both 2013 and 2015. *See* S. 795, 113th Cong. (Apr. 24, 2013); H.R. 2883, 114th Cong. (June 24, 2015); S. 1656, 114th Cong. (June 24, 2015).

84. WRITTEN STATEMENT OF THE NATIONAL ASSOCIATION OF PUBLICLY TRADED PARTNERSHIPS, Senate Committee on Finance Tax Reform Working Group (Apr. 15, 2015) ("According to surveys done by some of our members, the vast majority of the investors providing this capital are individual investors. Many of the investors are seniors—roughly 75 percent are over the age of 50. For the most part, they are individuals seeking a relatively secure income-oriented investment providing a reasonable return, something that is hard to come by in today's market."); Fleischer, *supra* note 2, at 94 (noting that MLP investors are "primarily motivated by the cash distributions").

85. James Comtois, *Investors not Swayed by MLP Flameout*, PENSIONS & INVESTMENTS (Jan. 11, 2016) (estimating that 75% of the MLP market has been comprised of retail investors); Eric Rosenbaum, *Energy MLPs: Now There's Only Pain for Investors*, CNBC (Dec. 10, 2015) (estimating that 70% of MLP

tions regarding the ability of most MLP investors to understand the way their rights differ from those of shareholders in a public corporation.[86]

C. *Contractual Freedom at Risk: Calls for A Mandatory Duty of Loyalty*

Just over a decade after Delaware's legislature adopted the strong version of contractarianism, two of its most prominent jurists, Chief Justice Strine and Vice Chancellor Laster, called for the reintroduction of a mandatory duty of loyalty for publicly traded alternative entities (and potentially for other entities with a diverse investor base).[87] In their provocatively titled book chapter, *The Siren Song of Unlimited Contractual Freedom*, Strine and Laster argue that the contractarian paradigm of "rational parties contracting efficiently to allocate risks is. . .an ideal."[88] Their criticisms of the current regime of contractual freedom focuses on inadequate investor protection and the negative consequences of decreased standardization.[89] According to Strine and Laster, investors have "no dependable protection against self-dealing and other conflicts of interest."[90] The lack of standardization contributes to investors' disadvantage (requiring them to either "become diligent and expert readers of alternative entity agreements, which may involve the expenditure of material costs for legal advice, or to blindly accept the risk"), but also subjects MLP management and sponsors to drafting-related uncertainty.[91] Strine and Laster also point out that decreased levels of standardization create systemic issues—it dilutes the value of case law, as deci-

accounts belong to retail investors); Fleischer, *supra* note 2, at 94 ("[I]ndividual investors own approximately 75 percent of all MLP units . . . .").

86. Jim Cahn, *Don't be Seduced by Tax Benefits and High Yield: Beware the MLPs*, FORBES (Jul. 21, 2014), http://www.forbes.com/sites/ jamescahn/ 2014/07/21/dont-be-seduced-by-tax-benefits-and-high-yield-beware-the-mlps/#77d7ba092924.

87. Chief Justice Strine and Vice Chancellor Laster acknowledge that Delaware law extends to publicly traded corporations some latitude to limit aspects of the duty of loyalty, and they would extend similar leeway to publicly traded alternative entities.

88. Strine & Laster, *supra* note 21, at 11, 17.

89. *Id.*

90. *Id.* at 12.

91. *Id.*

sions interpreting one particular version of a contractual provision have little relevance to disputes over differing implementations of that type of term. Notably, Strine and Laster do not propose simply restoring Delaware law to its pre–2004 state, when fiduciary duties could be modified but not eliminated. Nor do they advocate for the approach taken by various uniform statutes which allow the duty of loyalty to be limited but not in a way that is "manifestly unreasonable."[92] Rather, they advocate for a mandatory duty of loyalty analogous to that applicable to publicly traded corporations.

This position appears to represent an evolution in Chief Justice Strine's views on fiduciary duty eliminations. When he was Vice Chancellor, his opinion in *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*[93] stated that Delaware law allowed limited partnerships to eliminate fiduciary duties. On appeal, the Delaware Supreme Court repudiated this "dictum" as beyond the language of the statute.[94] This, in turn, prompted the Delaware legislature to amend its LP and LLC statutes to provide expressly for the elimination of fiduciary duties. Professors Sandra Miller and Karie Davis–Nozemack also argue for disallowing fiduciary duty eliminations and also advocate for application of certain stock exchange listing requirements from which MLPs are currently exempt.[95]

II.
CONTRACTUAL FREEDOM'S DOWNSIDES

This Part analyzes recent efforts to identify the effects of permitting fiduciary duty opt-outs in the context of publicly traded companies in light of the arguments made by Strine, Laster and others in favor of a mandatory fiduciary duty of loyalty. These commentators demonstrate that there is some cause for concern: fiduciary duties are regularly eliminated (or

92. UNIFORM LIMITED PARTNERSHIP ACT § 110(b)(5) (2001) (UNIFORM LAW COMMUNICATION, amended 2013); UNIFORM PARTNERSHIP ACT § 103(b)3) (1997) (UNIFORM LAW COMMUNICATION, amended 2013); UNIFORM LIMITED LIABILITY COMPANY ACT § 110 (2006) (UNIFORM LAW COMMUNICATION, amended 2013).

93. Gotham Partners v. Hallwood Realty Partners, No. CIV.A.15754., 2000 WL 1476663, at *10 (Del. Ch. Sept. 27, 2000).

94. Gotham Partners v. Hallwood Realty Partners, 817 A.2d 160, 167 (Del. 2002).

95. *See* Miller & Davis-Nozemack, *supra* note 21, at 58.

weakened through exculpation provisions), and contractual substitutions appear to leave investors with no real means of holding MLP managers and controlling equity holders accountable for misconduct. This is not to say, however, that there is nothing that constrains the management and controllers of MLPs. Rather, other disciplinary forces, and in particular investor expectations related to cash distributions, act as one constraint on the degree to which management and sponsors can exploit the apparent vulnerability of unitholders. Additionally, in recent cases, the Delaware judiciary has indicated its willingness to utilize both the duty of good faith and fair dealing and the more traditional tools of contract enforcement and interpretation to police the behavior of MLP management with. Undoubtedly, these are not perfect replacements for fiduciary duties (and they do nothing to increase standardization), but they do place some constraint on the degree to which MLP management can exploit the gap when limited contractual substitutions are adopted for eliminated fiduciary duties.

A. *Contractual Freedom and Investor Protection*

The case for contractual freedom in business associations rests, in large part, on predictions about contracting behavior. According to contractarians, contractual freedom is good policy because parties who are permitted to eliminate fiduciary duties can "substitute other, possibly more cost-effective mechanisms for ensuring that fiduciaries act in the owners' interests."[96] Specifically, contractarians predict that mandatory cash distribution and liquidation provisions will be adopted when fiduciary duties are eliminated.[97] Mandating cash distributions limits management's discretion by both restricting their ability to control the entity's earnings and by forcing more frequent returns to capital markets for financing:[98] they "have a perpetual reliance on external equity and debt financing . . . ."[99] Provisions mandating liquidation on a specified future date disci-

96. Ribstein, UNCORPORATION, *supra* note 1, at 221; Ribstein, *Fiduciary Duty Contracts*, *supra* note 43, at 559.

97. *See, e.g.*, Ribstein, UNCORPORATION, *supra* note 1, at 193–222.

98. Larry E. Ribstein, *Partnership Governance of Large Firms*, 76 U. Chi. L. Rev. 289, 290–91 (2009)

99. Fleischer, *supra* note 2, at 86.

pline management by requiring them to take into account their return to the capital markets on a date certain in order to continue.

Efforts to determine the extent to which publicly traded alternative entities adopt contractual substitutes for eliminated fiduciary duties have employed a variety of methodologies and have reached differing conclusions. Nevertheless, when taken as a whole, this body of research shows that while MLP operating agreements often adopt contractual substitutions for eliminated fiduciary duties, investors are still vulnerable to management or the sponsor misconduct, particularly self–dealing. In a study of 85 publicly traded alternative entities, Professor Mohsen Manesh examined the extent to which publicly traded LPs and LLCs adopted cash distribution and liquidation provisions when fiduciary duties and other corporate governance features were eliminated. Of the 85 entities studied, 75 "fully waive[d] or exculpate[d] liability arising from the breach of fiduciary duties."[100] Out of these 75, 51 firms employed only mandatory cash distributions; 1 employed only mandatory liquidation; 14 employed both; and 9 employed neither.[101] Clearly, some level of substitution is taking place, and, mandatory cash distribution appears to be the more popular of the two mechanisms. However, these substitutions offer less protection than they appear to provide. Although cash distribution provisions often require distribution of all "available cash," they leave managers with wide latitude to determine how much cash is "available."[102] Similarly, the effect of mandatory liquidation provisions can be illusory when the liquidation will not occur until far into the future.[103]

Another common substitution is a provision designed to govern the treatment of conflicts-of-interest by specifying methods for the approval of conflicted transactions. These provisions typically provide a variety of procedures or conditions pursuant to which an action implicating a conflict of in-

100. Manesh, *Contractual Freedom, supra* note 27, at 574.

101. *Id.* at 578.

102. *Id.* at 579.

103. *Id.* at 580. Of the 20 firms in Professor Manesh's study that included a mandatory liquidation provision, 16 had liquidation dates in the year 2080 or beyond. Provisions with a liquidation date that occurs far past the point at which current management will have left the workforce can have no meaningful effect on their behavior.

terest will be deemed approved by all partners and, in doing so, substitute for the rubric supplied by the duty of loyalty. These conditions typically include: (1) approval by a committee appointed to evaluate conflicts (Special Approval); (2) approval by a majority of unitholders that are not affiliated with the general partner or its affiliates (which would include the sponsor); (3) transactions containing terms that are no less favorable than those available in an arm's length transaction; or (4) transactions that are fair on their terms.[104] In a study of 86 publicly traded alternative entities, Professor Brent Horton found that 84.88% included a conflict-of-interest provision in place of a fiduciary duty of loyalty.[105] As Professor Horton observes (and a variety of Chancery Court litigations show), Special Approval provisions may be utilized to insulate self-dealing transactions from any meaningful challenge by (1) allowing individuals of questionable independence to serve on the conflicts committee, and (2) requiring unitholders seeking to challenge the transaction to prove that the decision-makers acted in subjective bad faith.[106]

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104. Take, as an example, the provision at issue in *Gerber v. Enter. Prods. Holdings, LLC*, 67 A.3d 400 (2013):

> Unless otherwise expressly provided in this Agreement, whenever a potential *conflict of interest* exists or arises between the General Partner or any of its Affiliates, on the one hand, and the Partnership or any Partner, on the other hand, *any resolution or course of action by the General Partner or its Affiliates* in respect of such conflict of interest shall be permitted and deemed approved by all Partners, and *shall not constitute a breach of this Agreement . . ., or of any duty stated or implied by law or equity, if* the resolution or course of action in respect of such conflict of interest is[:]
>
> (i) approved by Special Approval,
>
> (ii) approved by the vote of a majority of the Units excluding Units owned by the General Partner and its Affiliates,
>
> (iii) on terms no less favorable to the Partnership than those generally being provided to or available from unrelated third parties or
>
> (iv) fair and reasonable to the Partnership, taking into account the totality of the relationships between the parties involved (including other transactions that may be particularly favorable or advantageous to the Partnership).

Id. at 410 (emphasis added by the court).

105. Horton, *Going-Private Freeze-Out*, *supra* note 27, at 94.

106. Unitholder approval is also problematic. Because of the regular elimination of any duty to disclose (a component of fiduciary duties owed by managers in the corporate setting), voting unitholders are not entitled to receive all information material to the issue being decided. In other words,

In re: El Paso Pipeline Partners, L.P. Derivative Litigation provides an apt example of a Special Approval prong at work.[107] There, common unitholders in an MLP, El Paso, challenged a drop-down transaction between El Paso and its sponsor in which El Paso purchased various liquid-natural-gas-related assets from the sponsor. This transaction was approved by a conflicts committee comprised of three individuals, two of whom had past ties to the sponsor (both had been high-level executives of the sponsor in the past). Ultimately, El Paso paid approximately 22% above the price that the sponsor concluded was too expensive to pay for similar assets offered to the sponsor by a third party. Despite the obvious appearance of self-dealing (which would have almost certainly led to entire fairness review under Delaware corporate law), the Chancery Court granted summary judgment to the defendants because the plaintiffs could not show "subjective bad faith" on the part of the members of the conflicts committee.

However, in challenges to later drop-down transactions between El Paso and its sponsor, the investors *were* able to meet this subjective bad faith standard, in large part on account of (1) the committee member's knowledge as to just how poor the prior transactions (on which the company won summary judgment) turned out to be, and (2) an email record in which the committee members actually expressed their subjective belief that the transactions were not favorable to El Paso.[108] As this case demonstrates, conflict-of-interest transactions can be utilized to insulate self-dealing that is not accompanied by a record establishing a state of mind that most individuals serving in the relevant capacities will know not to memorialize in writing. Had it not been for the prior round of unfair transactions and the committee's sloppy email practices, the claims challenging the second round of drop-downs would likely have been resolved in favor of defendants on a summary judgment motion as well.

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their approval can be effective even if it was given without knowledge of material facts.

107. *In re* El Paso Pipeline Partners, 2014 WL 2768782.

108. *In re* El Paso Pipeline Partners Deriv. Litig., 132 A.3d 67 (2015). This judgment was subsequently reversed by the Delaware Supreme Court on standing grounds. *In re* El Paso Pipeline Partners Deriv. Litig., 152 A.3d 1248 (2016).

Conflict-of-interest provisions can also leave investors vulnerable to going-private freeze-outs.[109] The appraisal remedy (which, when triggered, allows a shareholder in a corporation to secure a judicial determination of the fair value of its shares) is not mandatory for alternative entities,[110] which makes it possible to leave minority investors without any real ability to challenge a merger between the MLP and another entity affiliated with its sponsor.

Concerns over investor protection have extra salience in the context of MLPs because of the market's primarily retail base.[111] Institutional investors have historically avoided these investments for tax reasons.[112] The federal unrelated business income tax that tax-exempt institutional investors must pay on income generated by MLP units[113] discourages their invest-

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109. Horton, *Going Private Freeze-Out, supra* note 27, at 71 ("In short, because Delaware follows a contractarian approach to regulation of non-corporate business associations, investors in publicly traded LLCs and LPs are now uniquely susceptible to going-private freeze-outs.").

110. DEL. CODE ANN., tit. 6 § 17-212 ("A partnership agreement or an agreement of merger or consolidation or a plan of merger may provide that contractual appraisal rights with respect to a partnership interest or another interest in a limited partnership shall be available for any class or group or series of partners or partnerships interests. . ."); DEL. CODE ANN., tit. 6 § 18-210 ("A limited liability company agreement or an agreement of merger or consolidation or a plan of merger may provide that contractual appraisal rights with respect to a limited liability company interest or another interest in a limited liability company shall be available for any class or group or series of members or limited liability company interests. . .").

111. James Comtois, *Investors not swayed by MLP Flameout*, PENSIONS & INVESTMENTS (Jan. 11, 2016); Eric Rosenbaum, *Energy MLPs: Now There's Only Pain for Investors*, CNBC (December 10, 2015).

112. Goodgame, *New Developments*, *supra* note 6; Conrad S. Ciccotello & Chris J. Muscarella, *The Energy MLP Goes Institutional: Implications for Strategy and Governance*, 15 J. APPLIED CORP. FIN. 112 (2003).

113. 26 U.S.C. §§ 511–12. *See also* Christine Hurt, *The Private Ordering of Publicly Traded Partnerships*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2969175 ("This relatively low percentage of institutional ownership may be a product of the lack of dividends-received deduction in limited partnership investments, creating a preference for corporations to invest in other corporations; the added administrative burden of filing K-1 forms for distributions versus corporate dividends, or the imposition of Unrelated Business Interest [*sic*] Tax for 501(c)(3) investors who hold limited partnership interests."). Unaware individual investors have found themselves facing significant, unanticipated tax liabilities when they unknowingly hold MLP shares in their IRAs. *See* Laura Saunders, *Thousands Hit With Surprise Tax Bill on Income IRAs*, WALL ST. J. (Nov. 13, 2015).

ment in the MLP sector. Similarly, mutual funds must limit the number of MLP units they hold in order to maintain their status as regulated investment companies, and typically avoid them as a result.[114] Although more evidence is necessary to determine the profile of the typical MLP investor and the disclosures they receive,[115] anecdotal evidence indicates that unsophisticated investors purchase MLP units through brokers without understanding the risks involved.[116] The largely absent institutional investors are more likely than retail investors (even sophisticated ones) to have the resources required to assess the risks presented by a particular MLP investment, which raises questions about the informational efficiency of the market for MLP units[117] and the degree to which their prices reflect governance terms. In short, it appears that MLP units are often held by investors that do not have the resources or ability to assess the risks that MLP investments present,

114. 26 U.S.C. § 851(b)(3)(B).

115. Miller & Davis-Nozemack, *supra* note 21, at 317–18.

116. *See, e.g.*, Isaac Arnsdorf & Alex Nussbaum, *Master Limited Partnerships: Investors May Not See the Risks*, BLOOMBERG (Mar. 20, 2014), http://www.bloomberg.com/news/articles/2014-03-20/master-limited-partnerships-investors-may-not-see-the-risks. *See also* Miller & Davis-Nozemack, *supra* note 21, at 317–18. Professors Miller and Davis-Nozemack report that according to their "discussions with industry experts and unpublished data gathered from industry sources, individuals, estates, IRA/SEP/Keoghs, or Roth/Education IRAs comprise over 75% of investor accounts. The inclusion of tax-advantaged accounts on this list raises questions about the degree to which investors holding MLPs in such accounts actually understand them—the consequences of holding MLPs in a tax-advantaged investment account can destroy much of the investment's yield if the investment yields taxable net income. *See* Saunders, *supra* note 111.

117. *See, e.g.*, Ekkehart Boehmer & Eric K. Kelley, *Institutional Investors and the Informational Efficiency of Prices*, 22 REV. FIN. STUD. 3563 (2009). Unlike most retail investors, institutional investors can afford extensive research and analysis and benefit from advice given by governance advisors who analyze issues in order to make recommendations to their clients. Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. LAW 887 (2007). When traded upon, that information is incorporated into the market's valuation of the relevant shares, which ultimately benefits retail investors who never would have been able to generate such information on their own. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 694 (1984); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, (1984). *See generally* Mary Siegel, *Publicly-Traded LLCs: The New Kid on the Exchange*, 68 S.M.U. L. REV. 885, 895 (2015).

which can have negative effects on the informational efficiency of the market.

These studies of MLP governance alongside the information that has emerged about MLP investors raise questions about the current system of unrestrained contractual freedom. Nevertheless, this account—which focuses primarily on contractual and other legal accountability mechanisms—risks underemphasizing the role of other disciplinary forces, such as investor expectations related to cash distributions. Although contractual provisions requiring cash distributions may leave management with considerable discretion over distributions, regular distributions are the norm.[118] There are strong market expectations that distributions will occur, and in many instances other contractual mechanisms, such as Incentive Distribution Rights (which allocate additional distributions to the general partner after certain distribution benchmarks to public investors are reached) provide additional reasons for management to distribute cash regularly.[119] Common valuation metrics for MLPs focus on "yield, distributable cash flow, and EBITDA" rather than net income.[120] MLP units are yield investments, and whether or not a MLP makes cash distributions is something that even the most unsophisticated investor can assess. When MLPs stop distributing cash without a good reason for doing so, investors can flee quickly.[121]

Additionally, the need to maintain and regularly increase cash distributions likely acts as a constraint on the degree to which MLP sponsors can indulge in the misconduct that seems to be authorized by commonly adopted conflict-of-interest provisions. If the market expects increased cash distributions after drop downs and other similar going-concern transactions, self-dealing will be limited to that which will not have a

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118. *See* Beauchamp, *supra* note 77.

119. *See, e.g.*, Goodgame, *New Developments, supra* note 5 at 83–84. Gomtsian's study of LLC operating agreements confirms the role that market expectations of cash distributions can play. This study found that, despite the discretion retained by management over distributions, LLCs with a cash distribution provision distributed 76% of their cash. Suren Gomtsian, *The Governance of Publicly Traded Limited Liability Companies,* 40 DEL. J. CORP. L. 207, 257 (2015).

120. Fleischer, *supra* note 2, at 98.

121. Alison Sider, *Linn Energy to Stop Making Dividend-Like Payments*, WALL ST. J. (July 30, 2015), http://www.wsj.com/articles/linn-energy-to-stop-making-dividend-like-payments-1438294871.

negative effect on the ability of the MLP to meet market expectations as to cash distributions. Thus, the importance of meeting investor expectations with regard to cash distributions also suggests that investors' likely inability to assess the details of governance arrangements is less important that it might appear to be. If those arrangements affect (either positively or negatively) the ability of the MLP to make ongoing cash distributions, then those arrangements will be at least partially reflected in price at which MLP units are valued. The recent appearance of variable distribution MLPs appears to confirm the relationship between cash distribution and fiduciary duties. These entities engage in activities that do not generate the regular cash flows that make predictable distributions possible, and they typically do not opt out of traditional fiduciary duties.[122]

An additional countervailing force is the role that the judiciary plays in policing the behavior of MLP management and sponsors under the frameworks provided by traditional contract enforcement[123] or the contractual duty of good faith and fair dealing.[124] Of course, good faith and fair dealing does not stand in the place of the duty of loyalty, but as recent cases demonstrate, it does provide a means of invalidating problematic actions that are incompatible with fundamental notions of fairness.[125]

B. *Lack of Standardization*

Another negative side effect resulting from state law commitments to contractual freedom is the decreased level of standardization across MLP operating agreements (as compared to other publicly traded companies organized as corporations). In the corporate law context, the largely positive effects of standardization are well documented.[126] When firms are subject to the same terms (e.g., mandatory fiduciary duties and widely-adopted default terms), they enjoy increased cer-

122. Gomtsian, *supra* note 117.
123. *See, e.g.*, *In re* Energy Transfer Equity LP Unitholder Litig., No. 12197-VCG, 2017 WL 782495 (Del. Ch. Feb. 28, 2017).
124. *See, e.g.*, Dieckman v. Regency GP LP, 155 A.3d 358 (Del. 2017); Gerber v. Enter. Prods. Holdings, LLC, 67 A.3d 400 (Del. 2013).
125. *See generally* Branson, *supra* note 14, at 61.
126. Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995).

tainty resulting from development of case law relevant to those terms and business techniques that have been tested against that case law.[127] Lawyers and other advisors are able to offer their services more cheaply to more clients because they are able to transfer knowledge about standardized terms from one deal or case to another.[128] They also save firms negotiating and drafting costs by allowing them to adopt standardized terms "off–the–rack."[129] Even when state corporate statutes allow corporations to contract out of particular terms, they often opt for default terms, at least partially on account of these advantages.[130]

Advocates of a mandatory fiduciary duty of loyalty point out that uncorporate governance has coalesced around certain common features and types of terms,[131] but the use of individually drafted operating agreements allows each version to take a different form. Even in those areas where "a degree of surface-level standardization has begun to occur"[132] (e.g., the presence of a conflict–of–interest provision governing interested transactions[133]), variation in the wording used to implement them exists.[134] Poorly drafted and conflicting provisions confound courts tasked with interpreting operating agreements,[135] leading to results that the drafters were almost cer-

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127. *Id.*

128. *Id.*

129. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 34 (1996) [hereinafter EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE].

130. Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 4 (2006) ("While closely held business firms commonly have detailed, specifically tailored charters, the charters of publicly traded corporations are remarkably empty. . .They effectively defer to the default terms of the state corporation law in virtually all matters of significance.").

131. Goodgame, *New Developments, supra* note 6, at 81.

132. Strine & Laster, *supra* note 21, at 18.

133. Horton, *Modifying Fiduciary Duties in Delaware, supra* note 23.

134. *See, e.g.*, Allen v. Encore Energy Partners, LP, 72 A.3d 93, 100 (Del. 2013) ("Although the limited partnership agreements in these cases contain similar provisions, those facial similarities can conceal significant differences between the limited partnership agreements.").

135. *See, e.g.*, Kahn v. Portnoy, No. 3515-CC, 2008 WL 5197164, at *6 (Del. Ch. Dec. 11, 2008) ("I have been unable to explain these provisions as anything other than poor drafting or a strategy of 'if one exculpatory provision is good, then two must be better.'").

tainly intending to avoid.[136] Cases "turn on the unique and often seemingly contradictory terms of specific governing instruments,"[137] which "limits the efficacy of precedent and creates fertile opportunities for future litigation."[138] This state of affairs has led, in the words of the Delaware Supreme Court, to a body of "confusing precedent."[139] Empirical studies support these accounts of both inconsistent contractual provisions and variations in the way common contractual substitutions are implemented.[140] Alongside the largely retail investor base, the lack of standardization raises questions about the degree to which the market for MLP units accurately prices governance arrangements. Market efficiency is a function of information costs,[141] and standardization lowers those costs.[142] Without standardization, investors are faced with either investing blindly or spending considerable resources evaluating and understanding MLP operating agreements: they cannot rely on pre-existing experience of their own or of others. It is therefore not unreasonable to question the degree to which the market is able to incorporate information about MLP governance into the prices. However, the point should not be overstated: MLP units are yield investments and, as such, are subject to market expectations of regular distributions at particular levels. To the degree MLP governance features impact cash distributions, those features should have some effect on the market price of an MLP's publicly traded units.

136. *Id.*

137. Strine & Laster, *supra* note 21, at 24.

138. *Id.* at 18.

139. Brinckerhoff v. Enbridge Energy Co., 159 A.3d 242, 252 (Del. 2017).

140. Horton, *Going-Private Freeze-Out, supra* note 27; Horton, *Modifying Fiduciary Duties in Delaware*, *supra* note 23.

141. Gilson & Kraakman, *supra* note 115, at 593 ("Since efficiency in the capital market depends on the distribution of information, it is ultimately a function of the cost of information to traders. The lower the cost of particular information, the wider will be its distribution, the more effective will be the capital market mechanism operating to reflect it in prices, and the more efficient will be the market with respect to it.").

142. *See id.* at 615 (noting that "repeated use of the same form document will eliminate the costs of determining, for each issue, what alternative formulations mean and how effective they are."). *See also* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or the Economics of Boilerplate)*, 83 VA. L. REV. 713, 720–22 (1997).

III.
A MANDATORY DUTY OF LOYALTY AND THE FORCES THAT SHAPE STATE BUSINESS LAW

This Part addresses the likelihood that Delaware will re-adopt a mandatory duty of loyalty in this context in light of three forces that affect state business lawmaking: interstate (or horizontal) competition for entities, the influence of the Delaware bar, and the threat of federal preemption (or vertical competition). All three owe their influence to the forbearance of the federal government in the realm of business law: Congress has never enacted a comprehensive federal business association statute[143] despite almost certainly having Commerce Clause[144] power to do so. Instead, responsibility for American business lawmaking is split between the federal and state governments according to a blurry distinction between issues related to the internal affairs of business entities and those related to securities transactions and markets. Federal law generally focuses on the latter, primarily through disclosure requirements and anti-fraud rules.[145] State law provides the statutes and cases that govern "the powers, rights, and duties of the corporation, its shareholders, officers, and direc-

143. *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 27 (2012) ("No one seriously doubts that Congress has the power under the Commerce Clause to preempt the field of corporate governance law."); Mark J. Roe, *Regulatory Competition in Making Corporate Law in the United States—and its Limits*, 21 OXFORD REV. ECON. POL'Y 232, 236 (2005) ("If Washington wanted to, it could take over all of corporate law from the states, obliterating Delaware as producer of state-made corporate law."). The federal government could also choose to relinquish control over certain corporate law areas, and Professor Romano has argued that the federal government should take this approach with regard to securities regulation. Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2361 (1998).

144. U.S. CONST. art. I, § 9, cl. 3.

145. *See, e.g.*, BAINBRIDGE, *supra* note 141, at 34 (2012) ("As a general rule of thumb, federal law appropriately is concerned mainly with disclosure obligations, as well as procedural and antifraud rules designed to make disclosure more effective."); Leo E. Strine, Jr., Vice Chancellor, Del. Court of Chancery, Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward, Address at Various Forums in Spring 2008, *in* 63 BUS. LAW, Aug. 2008 at 1079–80 (2008); ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 3 (1993).

tors"[146]—its internal affairs. This power–sharing arrangement between state and federal governments has had significant impact on the content of state business law and the factors that impact it.

Primarily, business law federalism has created a lawmaking environment that allows states to compete for corporations and other business organizations. Generally, it will be in a state's interest to enact rules that will maximize the number of entities that choose to organize in that state. Of course, Delaware has been the dominant player in this competition for decades with regard to corporations, and it has recently established a similarly dominant position with regard to large alternative entities.

This interstate, or horizontal, competition is not the only force that affects the content of state business law. Rather, because Congress has left internal affairs to state governments, intrastate interest groups, and in particular the Delaware bar, are able to influence the content of state business law. If their interests are aligned with the more generalized state interest in maximizing entity formations, intrastate interest groups will tend to encourage adoption of rules that will maintain or enhance a state's competitive position. When they diverge, however, these groups are in a position to push for rules that will benefit them, even if they will compromise the State's competitive advantage.

Another force that impacts state business lawmaking (and which results from corporate federalism) is the threat of federal preemption, or vertical competition. Again, federalism in the business law context is voluntary. The federal government *could* step in and preempt state business law at any time, and this forces state lawmakers to pay attention to federal preferences and policies for fear of losing jurisdiction over parts or all of business law.[147]

Together, these three forces—all of which result from the power-sharing arrangement between state and federal governments—interact to impact the content of state business law. Interstate competition pushes states to adopt rules that will

146. Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1607 (2005).

147. *See, e.g.*, Mark Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 600–01 (2003).

maximize the number of entities that organize there. Pressures created by internal interest group dynamics will often be consistent with the competitive pressures that favor formation-maximizing rules, but this is not necessarily the case. At times, the interests of groups like the Delaware bar will not be advanced by adoption of formation-maximizing rules, and in these instances, the pressures created by internal interest groups will work in opposition to those created by interstate competition. Above the state-level fray sits the federal government, which can preempt aspects of state business law and has done so in the past. State lawmakers—whether acting in response to competitive pressures or those created by the Delaware bar—must also pay attention to this threat of federal preemption if they are to maintain their power over important aspects of business law. Delaware, of course, has the most to lose from federal preemption, and the state's responsiveness to the threat is well-documented.

In this Part, I evaluate the prospect of reinstating a mandatory duty of loyalty in light of the pressures created by state competition, the influence and likely preferences of the Delaware bar, as well as the threat of federal preemption. As I argue below, they are unlikely to lead to legislative reintroduction of a mandatory duty of loyalty in this context.

A. *Interstate Competition*

1. *Overview of Interstate Competition*

Despite periodic calls for a federal incorporation statute, Congress has yet to adopt one.[148] Its forbearance has allowed states to compete for corporate charters (and other business entities) and the tax revenue they generate. Delaware currently enjoys tremendous success in attracting these entities and has done so for several decades.[149] It is the state of incor-

148. *See, e.g.*, William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); Daniel Schwartz, *Towards New Corporate Goals: Co-existence with Society*, 60 GEO. L.J. 57 (1971); Harold G. Reuschlein, *Federalization—Design for Corporate Reform in a National Economy*, 91 U. PA. L. REV. 91, 106–07 (1942).

149. Delaware first started to compete for corporate charters in the late nineteenth and early twentieth centuries, when New Jersey dominated. Charles M. Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910*, 32 J. CORP. L. 323, 358–59 (2007). It has since enjoyed considerable success.

poration of over 50% of publicly traded corporations and approximately 65% of the Fortune 500.[150] This is a lucrative business for Delaware. It collected approximately $677 million in corporate franchise taxes during its 2014–2015 fiscal year and approximately $700 million during its 2015-2016 fiscal year.[151]

The reason for Delaware's success has been a primary focus of corporate law scholarship for decades. Some argue that the competition for corporate charters is a race to the bottom. Because managers are responsible for making decisions about where to incorporate or reincorporate, state lawmakers have an incentive to offer corporate law that elevates interests of management over those of shareholders.[152] According to race-to-the-bottom theorists, this is exactly what Delaware has done. Its success represents an orientation that privileges management at the expense of investors.

Other scholars, however, argue that the race is to the top. Proponents of this position argue that the costs of a jurisdiction's corporate law regime will be reflected in the price of securities issued by corporations organized there.[153] If a state's corporate law is overly friendly to management (or otherwise negatively impacts shareholder value), it will be reflected in price of securities issued by corporations that are organized there.[154] The state will eventually lose incorporations to states with "better" legal regimes.[155] According to this take on the charter competition, Delaware has won because it provides efficient corporate law that effectively balances the interests of management and shareholders.[156] For both race-to-the-top and race–to–the–bottom theorists, state competition exerts pressures on states vis-à-vis the content of their corporate law.

150. Jeffrey W. Bullock, Delaware Division of Corporations 2016 Annual Report, https://corp.delaware.gov/2016AnnualReport.pdf.

151. Delaware Dep't of Fin., Div. of Acct., 2016 Delaware Comprehensive Annual Financial Report (Dec. 30, 2015), https://auditor.delaware.gov/wp-content/uploads/sites/40/2017/01/State-of-Delaware-Fiscal-Year-2016-Comprehensive-Annual-Financial-Report-CAFR.pdf

152. *See, e.g.*, Cary, *supra* note 146.

153. EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 127, at 17.

154. This, of course, assumes that the securities are traded in a market of sufficient efficiency for prices to reflect jurisdictional variations in corporate law.

155. ROMANO, *supra* note 143 at 14–15.

156. *See, e.g.*, Ralph K. Winter Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUDIES 251 (1977).

They differ, however, as to "whose demand schedule for corporate charters is driving the system."[157]

Explorations of Delaware's success in this jurisdictional competition have focused on a variety of explanations for Delaware's competitive advantage and have identified its prestigious and specialized courts,[158] its first-mover advantage,[159] the network effects that result from the widespread adoption of the standardized terms that appear in the state's corporate statute,[160] the state's credible commitment to updating its statute, path dependence,[161] and its generally favorable legal environment and infrastructure[162] as possibilities. Given the convergence of relevant factors, it is impossible to identify conclusively the reasons for Delaware's success at attracting corporations. As is often the case with reality, the situation is too complicated for a single explanation.[163]

The following Part analyzes jurisdictional competition in the context of publicly traded alternative entities and argues that state competitive pressures will discourage Delaware's lawmakers from readoption of a mandatory duty of loyalty.

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157. ROMANO, *supra* note 143, at 15.

158. *See, e.g.*, Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1068 (2000).

159. ROMANO, *supra* note 143 at 44.

160. Klausner, *supra* note 34.

161. *See* Brian J. Broughman & Darian M. Ibrahim, *Delaware's Familiarity*, 52 SAN DIEGO L. REV. 273, 304–05 (2015).

162. Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987) ("[D]elaware, over time, has developed an important capital asset in the form of a legal environment that is highly desired by consumers of its corporate law both for the present structure of its rules, and—perhaps more importantly—for the reliable promise it makes that rules adopted in the future will also be highly desired.").

163. There is empirical evidence tending to show that horizontal competition has had a positive effect on the content of state law. *See, e.g.*, Sanjai Bhagat & Roberta Romano, *Event Studies and the Law: Part II – Empirical Studies and Corporate Law*, 4 AM. L. ECON. REV. 380, 384 (2002) ("[T]he event study literature suggests that Winter's core insight is accurate: competition for corporate charters benefits investors."). However, the presence of state corporate law features that clearly favor management, such as anti-takeover statutes, raise legitimate questions about both the direction of the race and whether the race even has an overall direction or if, instead, jurisdictional competition pushes states in different directions with regard to different issues.

2. *State Competition for Alternative Entities*

As is the case with publicly traded corporations, most publicly traded alternative entities are organized as Delaware[164] LPs or LLCs.[165] Nevertheless, Delaware's success may imply that the state has more market power than it actually does.

Although Delaware's decision to grant alternative entities significant contractual freedom "likely enhance[s] the value" of its law, other states have made similar commitments, and this has the same effect of the value of the law products they offer.[166] All of these states, including Delaware, are simply offering themselves as jurisdictions committed to enforcing contracts. For firms that value the contractual freedom to modify or waive fiduciary duties, ready substitutes for Delaware law are available. As against these other states that have adopted a con-

164. It is important to acknowledge up front that regulatory competition in the context of alternative entities has received too little scholarly attention. The work that has been done focuses primarily on LLCs and usually includes data relating to closely-held firms alongside that relating to publicly traded firms. Nevertheless, it is possible to draw some conclusions as to whether or not state competition is likely to prompt reintroduction of a mandatory duty of loyalty.

165. Mohsen Manesh, *Legal Asymmetry and the End of Corporate Law*, 34 DEL. J. CORP. L. 465, 476 (2009); Goodgame, *New Developments, supra* note 6, at 81–83; Tim Fenn, *Master Limited Partnerships (MLPs): A General Primer* 2 (2014) https://www.lw.com/admin/Upload/Documents /Latham-Master-Limited-Partnership-Primer-2014.pdf ("[M]ost commonly the MLP is formed as a Delaware limited partnership. Increasingly, the MLP may instead be a state law limited liability company—preferably a Delaware limited liability company (an LLC). . .").

166. Sandra K. Miller & Yvonne L. Antonucci, *Default Rules and Fiduciary Duty Waivers in Alternative Entities: Policy Issues and Empirical Insights,* 42 J. CORP. L. 147 (2016); Manesh, *Market for LLC Law, supra* note 20, at 225 n.190. Significantly fewer states have amended their LP statutes to allow for total elimination of fiduciary duties. *See, e.g.*, ALA. CODE § 10A-9-1.10(a)(2)(LexisNexis 2017) (repealed 2017). On January 1, 2017, recent amendments to Alabama's limited partnership law will go into effect, and the provision allowing for elimination of fiduciary duties will be Section 10A-9A-1.08(b)(1). Even statutes that do not allow for total elimination of the duty of loyalty regularly allow for restrictions on it. *See, e.g.*, UNIFORM LIMITED PARTNERSHIP ACT § 110(b)(5) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2001); UNIFORM PARTNERSHIP ACT § 103(b)(3) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1997). In any event, the ability of MLPs to take the LLC form (and increasing regularity with which this is occurring) makes it possible for states to compete against Delaware with their LLC statutes, even if they do not amend their LP statutes to provide for the same level of contractual freedom to eliminate duties.

tractual approach to alternative entities, Delaware's primary competitive advantages seem to be other, Delaware-specific benefits (such as its generally superior legal infrastructure)[167] rather than ways in which the content of its law differs from that of other states.

As Professor Manesh has argued, these Delaware-specific advantages may be less valuable in this context on account of commitments to contractual freedom. Reliance on operating agreement provisions rather than on fiduciary principles may render some of the expertise of Delaware judges and lawyers less relevant.[168] This is not to say that these other advantages are rendered totally valueless: operating agreements are long and complex documents, and there is an obvious advantage to calling upon commercially-savvy, experienced legal professionals when issues arise.

Delaware's tax schedule is consistent with this account of its competitive position in the market for alternative entities. Delaware LPs and LLCs pay a flat annual tax of $300,[169] which is comparable to the tax other states impose.[170] In the corporate realm, however, corporations pay an initial filing fee as

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167. Efforts to determine Delaware's success at attracting alternative entities have focused on LLCs and have utilized a variety of methodologies. Two correlation studies have reached differing effects. *Compare* Jens Damman & Matthias Schündeln, *Where are Limited Liability Companies Formed? An Empirical Analysis,* 55 J. LAW & ECON. 741 (2012) *with* Bruce H. Kobayashi & Larry Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91 (2011). Damman and Schündeln find that LLCs flee their home state (usually to Delaware) if it offers lax protection for minority investors or creditor-friendly veil piercing rules. Kobayashi and Ribstein interpret their data as indicating that Delaware's success is largely attributable to Delaware's legal system and general reputation. On the other hand, Professor Franklin Gevurtz has questioned exclusive reliance on correlation studies in this context and, instead, has conducted surveys of practitioners. Franklin A. Gevurtz, *Why Delaware LLCs?*, 91 OR. L. REV. 57 (2012). He concluded that "the top two reasons for forming LLCs in Delaware were the freedom of contract (including the ability to waive fiduciary duties) . . . and Delaware's judicial infrastructure." *Id.* at 105. These results are consistent with those reached by Ribsten and Kobayashi. *See,* Kobayashi & Ribstein at 135–36.

168. Manesh, *Market for LLC Law, supra* note 20, at 234–35 (2011).

169. DEL. CODE ANN. TIT. 6, § 17-1109 (2017) (for LPs); DEL. CODE ANN. TIT. 6, § 18-1107 (2017) (for LLCs).

170. *See* Manesh, *Market for LLC Law, supra* note 20, at 198–200 (2011).

well as an annual franchise tax calibrated according to size.[171] For publicly traded corporations (those that likely place the most value on organizing in Delaware), this amount can be quite high—the Delaware General Corporation Law sets a ceiling of $180,000 on the annual franchise tax.[172] Other states charge significantly less to incorporate and remain organized there.[173] Assuming that Delaware would charge a similar premium for alternative entities if it were possible to do so, its pricing approach to alternative entities implies that it enjoys less power in the market for alternative entities than it does in the market for corporate charters.[174]

For Delaware lawmakers evaluating a departure from the state's commitment to contractual freedom, the relevant question appears to be whether other aspects of organizing in Delaware, like its judicial infrastructure, are enough on their own to attract the lion's share of large, out-of-state alternative entities. They might be, but not necessarily. After all, "[o]ther states have shown that they can take over submarkets for specific types of publicly held firms."[175] Maryland, for example, has had overwhelming success in attracting real estate invest-

171. *See* 1 Balotti & Finkelstein, DEL. L. OF CORP. AND BUS. ORG. § 18.7 (2017).

172. DEL. CODE ANN. TIT. 8, § 503(C) (2017).

173. *See, e.g.*, Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1219–21 (2001).

174. Manesh, *Market for LLC Law*, *supra* note 20, at 198–200. Professor Manesh raises the possibility that, in light of the meager amounts at stake, states are simply not competing for LLCs. *Id.* at 256–57. This is an interesting possibility, and may very well be true with regard to small, closely-held entities. With regard to larger entities and certainly publicly traded ones, franchise tax revenue is only part of what is at stake. These firms are more likely to require extensive legal services at the formation stage, need legal advice on an ongoing basis, and face litigation brought by their investors. All of these provide valuable economic benefits to Delaware and its citizens and provide the state's lawmakers with a reason to compete for such entities. *See, e.g.*, Kahan & Kamar, *Price Discrimination*, *supra* note 171. The low, flat LLC and LP tax may also indicate that the organizers of these entities are more price sensitive than those of corporations. Again, this may be true with regard to small, closely held LPs and LLCs. With regard to publicly traded firms (which are organized by sponsors who are themselves publicly traded corporations), this seems less likely to be the case. Companies holding hundreds of millions worth of natural resource related assets can most likely afford significantly more than a $300 annual tax.

175. Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 705 (2008)

ment trusts (REITs),[176] in large part by offering a statute designed specifically for them.[177] For Delaware lawmakers who want to maintain the state's success in attracting publicly traded LPs and LLCs, the prudent course of action, at least from a state competition perspective, appears to be continuing to offer contractual freedom.

B. *The Delaware Bar's Influence*

Of course, jurisdictional competition is not the only force that shapes the content of state business law. Particularly in Delaware, interest group dynamics play a significant role in determining the content of the state's business law, and many features of the state's corporate law appear to protect and facilitate the politically powerful corporate bar's interest in maximizing the demand for their services.[178] Perhaps this is unsurprising given the bar's outsized influence over regular amendments to the statutes that govern business entities organized in the state. Committees comprised of members of the Delaware bar are responsible for drafting amendments,[179] which are routinely adopted by the legislature, often unanimously. The bar's influence is not limited to legislation; even a cursory analysis of the interest dynamics at play in Delaware corporate lawmaking point out that many of the state's judicial decisions advance the interests of the state's bar.[180]

Typically, it will be in the interest of the Delaware bar to "go with the flow" created by jurisdictional competition: whether the race is to the top or bottom, attracting business entities is the best way for the Delaware bar to maintain demand for their services.[181] In this regard, the incentives of the

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176. *Id.*; *see also* David M. Einhorn et al., *REIT M&A Transactions—Peculiarities and Complications*, 55 BUS. LAW. 693 (2000).

177. MD. CODE, CORPS. & ASS'NS §§ 8-101-801 (2013). Maryland enacted its first statute to govern REITS in 1967.

178. Macey Miller, *supra* note 160 (offering interest group theory of Delaware law and arguing that the "bar is the most important interest group within this equilibrium").

179. Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749 (2006).

180. Macey & Miller, *supra* note 160.

181. Macey & Miller, *supra* note 160, at 503 ("All groups prefer, other things being equal, that the state provide a legal regime that is highly desired by corporate managers. Accordingly, the groups will tend to support the kinds of provisions that appeal to corporate managers and those that

bar and the state government are generally aligned.[182] Both benefit from attracting additional entities and retaining the ones that have already opted for Delaware. There are, however, instances in which the interests of the bar and those of the state diverge.[183] A legal rule or framework that will lead to fewer business entities may nevertheless be in the best interests of the bar if it would lead to an increase in legal fees sufficient to offset any loss resulting from fewer entity formations in the state.[184] Indeterminacy, such as that created by reliance on judges' *ex post* application of fiduciary principles to generate many of the applicable legal rules,[185] benefits the Delaware bar by generating additional legal work even though indeterminate law may negatively impact the value of organizing in Delaware.[186] While litigators have incentives to prefer

influence them: rules promoting economic efficiency; safeguards of incumbent managers; and provisions favored by lawyers, investment bankers, or others with influence on the incorporation decision.").

182. *See, e.g.*, Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 874 (2016) ("In most cases, the interests of Delaware lawyers and those of the state government are aligned. Just as the State wants to maximize the number of firms incorporated in Delaware, so as to maximize franchise and other tax revenues, Delaware lawyers also want to maximize in-state incorporations, because all else being equal, an equal number of firms will generate an increasing volume of legal work.").

183. This divergence results from the bar's ability to capture a large proportion of the indirect costs that are paid by Delaware entities. Macey & Miller, *supra* note 160, at 492 ("the fees paid to lawyers, accountants investment bankers, and corporation services companies . . . .").

184. Macey & Miller, *supra* note 160, at 504 ("[T]he bar could also benefit from legal rules that increase the amount of expected legal fees per corporation, even if such rules, by imposing additional costs on Delaware corporations, reduced the absolute number of firms chartered in the state. If the legal fees gained exceed the fees lost by deterring Delaware incorporation, the bar would prefer to adopt rules that did not serve the interests of the other interest groups within the state. In this respect, the bar's interests are opposed to the interests of all other groups."). At least one prominent commentator has argued that Delaware's recent prohibition of fee-shifting bylaws is an example. Bainbridge, *Fee-Shifting*, *supra* note 180.

185. *See* Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 87 (1990) (arguing that "indeterminacy describes the state of corporate law generally").

186. Macey & Miller, *supra* note 167, at 504 (Advisory work and litigation "are also functions of the clarity of the applicable legal rules, because an unclear rule is likely to generate both a greater need for legal advice and a greater likelihood of litigation"); William W. Bratton, *Delaware Law As Applied Public Choice Theory: Bill Cary and the Basic Course After Twenty-Five Years*,

mandatory indeterminacy (i.e., indeterminacy out of which parties cannot contract) because it increases demand for their services, transactional attorneys have strong reasons to favor indeterminacy that is contractible,[187] (i.e., indeterminacy that can be reduced or eliminated through private ordering). The possibility of implementing private ordering to escape indeterminacy creates demand for legal services related to planning, drafting, and providing advice relating to obligations created by private ordering.[188] Delaware's current approach to uncorporate fiduciary duties is one of contractible indeterminacy: fiduciary duties apply as default rules, but parties are free to contract out of them. Thus, reintroduction of a mandatory duty of loyalty would represent a shift in the portion of the Delaware bar whose interests are served by the species of indeterminacy present in uncorporate entity law. This would, of course, require legislative action, and in the past, legislative changes have often reflected the interests of the transactional bar in this regard.[189]

Furthermore, it is not clear that Delaware litigators would even benefit from this shift. Although there may not be as much MLP-related litigation now as there would be under a mandatory fiduciary duty regime, Delaware's litigators *do* experience some demand for their services under the current regime of contractible indeterminacy.[190] There is at least some demand for litigation over compliance with the contractual provisions (which courts can interpret to incorporate fiduciary

34 GA. L. REV. 447, 469 (2000) ("[I]ndeterminate law triggers more litigation . . . ."). Other explanations of indeterminacy exist. *See, e.g.*, Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 Colum. L. Rev. 1908 (1998).

187. Stephen Bainbridge, *Interest Group Analysis of Delaware Law: The Corporate Opportunity Doctrine As Case Study*, (UCLA School of Law, Law-Econ Research Paper No. 17-01, 2017).

188. *Id.*

189. *Id.* As Professor Bainbridge points out, the Delaware judiciary is often hostile toward private ordering and therefore appears to favor the litigation bar. *Id.* Strine & Laster's proposal to reintroduce a mandatory duty of loyalty is another example of what may be a judicial tendency to advance the interests of litigators. Nevertheless, as Professor Bainbridge points out, reputational considerations, rather than sympathy with a particular segment of the Delaware bar, may be the reason. *Id.*

190. Three major MLP opinions released in 2017 so far.

standards),[191] and the Delaware courts have recently looked to the covenant of good faith and fair dealing to police the behavior of MLP management.[192] Reintroduction of a mandatory fiduciary duty of loyalty would benefit Delaware's litigators only if increased litigation is not offset by the consequences resulting from having fewer entities formed in the state. If reintroduction of a mandatory fiduciary duty were to prompt MLPs to leave or avoid Delaware (and there are strong reasons to think that this is a real risk), the litigators themselves would not ultimately benefit from reintroduction of mandatory indeterminacy. This does not appear to be a situation in which the losses caused by fewer entity formations will be offset by the increased demand for legal services.

C. *The Federal Threat and Its Effect on Delaware Lawmaking*

In addition to facilitating interstate competition for corporate charters, the current balance of corporate federalism empowers the federal government to act as a constraint on the content of state law. The federal government has utilized legislative, regulatory, and more informal, but no less effective, methods to displace state corporate law, and state lawmakers have indicated both an awareness of this threat and a willingness to act in ways that are inconsistent with the pressures of state competition on account of it. As the state of incorporation for the majority of publicly traded companies, Delaware has the most to lose from federal displacement of state corporate law. The state's lawmakers are aware of the threat posed by the federal government and expressly acknowledge the need to be cognizant of federal preferences.[193] In the words of Chief Justice Strine (then-Vice Chancellor), "the capacious constitutional authority of Congress over interstate commerce is something that Delaware and other state corporate lawmakers have constantly had to take into account ."[194]

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191. *See, e.g.*, Brinckerhoff v. Enbridge Energy Co., Inc., 2017 WL 1046224 (Del. 2017).

192. Dieckman v. Regency GP LP, 2017 WL 243361 (Del. Sup. Jan. 20, 2017); Gerber v. Enterprise Holdings, LLC, 67 A.3d 400 (Del. 2013).

193. *See, e.g.*, William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 958–59 (2003).

194. Leo E. Strine, Jr., *Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward*, 63 BUS. LAW.

Although Congress has refrained from total preemption of state law, it has reached into the traditional realm of state corporate law on a piecemeal basis.[195] Recent examples include both the Sarbanes-Oxley Act of 2002 ("SOX") and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Both pieces of legislation include a variety of provisions that reach into areas traditionally within the purview of state law. Some examples include requiring certain board committees and compositions,[196] authorizing a new category of derivative suit,[197] and creating new rules applicable to executive compensation.[198]

In addition to congressional action, the SEC also takes steps to override problematic aspects of state law. It has wielded its rulemaking authority in the past to "overrule" decisions by state courts on important corporate topics: Rule 14d-10, for example, requires that bidders open their tender offers to all holders of the securities subject to the offer,[199] and was adopted in response to a Delaware Supreme Court case upholding a corporation's decision to exclude a large shareholder from its offer to buy back shares of the corporation's stock.[200] The SEC also has authority under Section 19(c) of the 1934 Act to compel exchanges to change their rules so as to achieve particular aims,[201] and even when limits on its statu-

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1079, 1081 (2008). After passage of SOX, two members of the Chancery Court explained that the legislation represented a federal determination that state law placed insufficient constraints on executive compensation and predicted that state lawmakers would "be responsive to this expression of concern and . . . use it as an opportunity to reflect more deeply on whether their own policies need adaptation to better protect stockholders." William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 1001 (2003).

195. *See, e.g.*, BAINBRIDGE, *supra* note 141.

196. 15 U.S.C. § 78j-1(m); 17 C.F.R. § 240.10A-3; *see also* 15 U.S.C. § 78j-3 (Dodd–Frank provision requiring a fully independent compensation committee).

197. 15 U.S.C. § 7244(a)(2)(B) (authorizing derivative cause of action to recover profits received by directors and officers who violate the statute's prohibition on trading in the corporation's securities when its pension plan participants cannot).

198. 15 U.S.C. § 78n-1; 15 U.S.C. § 78j-4.

199. 17 C.F.R. § 240.14d-10.

200. Unocal Corp. v. Mesa Petroleum Corp., 193 A.2d 946 (Del. 1985).

201. 15 U.S.C. § 78s(c) (2010).

tory power bar the SEC from compelling a change in listing standards, its "raised eyebrow power" can prompt cooperating exchanges into voluntary compliance.[202]

Importantly, this threat has caused Delaware's judges and legislators, as well as the Corporation Law Section of the Delaware State Bar Association and its Council[203] to take into account federal preferences, even when they are incompatible with the pressures of interstate competition.[204] Delaware's adoption of a moderate anti-takeover statute in the late 1980s was, at least in part, an attempt to avoid provoking the federal government into pre-empting the field with its own statute.[205] Given the horizontal competitive pressures created by other states' passage of more management-protective anti-takeover

202. Donald E. Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545, 571 (1984). For example, after Delaware and other states upheld the validity of dual class recapitalizations, Williams v. Geier, 671 A.2d 1368 (Del. 1996), the SEC promulgated a rule pursuant to Section 19(c) to prohibit dual class recapitalizations by companies listed on a public exchange. 17 C.F.R. § 240.19c–4 (2005). The D.C. Circuit, however invalidated this rule as beyond the scope of the SEC's Section 19(c) authority. Bus. Roundtable v. Sec. and Exch. Comm'n, 905 F.2d 406 (D.C. Cir. 1990). Nevertheless, within a few years, the stock exchanges adopted listing standards prohibiting dual class recapitalizations under pressure from the SEC. *See* Stephen M. Bainbridge, *Revisiting the One Share/One Vote Controversy: The Exchanges' Uniform Voting Rights Policy*, 22 SEC. REG. L.J. 175, 176 (1994) ("Chairman Levitt has asked the three principal domestic securities exchanges—the New York Stock Exchange (NYSE), the American Stock Exchange (Amex), and the National Association of Securities Dealers (NASD)—to adopt a uniform voting policy that essentially tracks Rule 19c-4.").

203. Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1754 (2006).

204. *See, e.g.*, *Id.* at 1768 ("At the most basic level, Roe is absolutely right . . . . All we can do is hope that paroxysms of populist pressure for such federal intervention are few and far between, and try not to make law that will induce such paroxysms, so that the not unimportant role of Delaware's courts and legislature in the making of corporate law can continue to be played and so that our state can continue to enjoy the resulting benefits.").

205. *See* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 625 (2003) ("Other states were producing one pro-managerial anti-takeover law after another . . . . Delaware, meanwhile, waited and passed only a mild anti-takeover law late in the decade."); Mark J. Roe, *Delaware and Washington as Corporate Lawmakers*, 34 DEL. J. CORP. L. 1 (2009); Hamermesh, *supra* note 201, at 1764.

legislation at the time, the drafters of Delaware's statute must have seen federal preemption as a significant threat.[206]

At first glance, a threat of federal action seems like a potential reason for state lawmakers to consider reintroducing a mandatory duty of loyalty into the governance of publicly traded uncorporate entities. Until recently, federal securities laws have operated alongside the state law governing internal affairs. If state lawmakers allow themselves to be taken out of the regulatory framework applicable to a segment of publicly traded firms, the federal government may perceive a good reason to expand its activities.

Nevertheless, there is no real indication that Congress or the SEC is paying much attention to MLPs and their investors. If anything, federal lawmakers have shown an interest in expanding the use of this structure by attempting to broaden the definition of qualifying income. Furthermore, past federal actions to displace state corporate law have usually been in response to populist outcry following some sort of large-scale financial crisis or scandal.[207] Currently, these conditions do not exist with regard to MLPs. The federal threat does not seem to be a significant one.

Thus, Delaware's lawmakers are unlikely to perceive a federal threat that is significant enough to justify moving against the pressures of state competition. In fact, even if Delaware lawmakers did perceive some threat, they might have a reason to prefer federal action, provided they do not anticipate complete preemption of state law. Some narrow, mandatory, federal duty or governance requirement imposed by the SEC or stock exchanges would apply without regard to an entity's state of formation and might even take the form of a requirement that all publicly traded entities be subject to some sort of state

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206. Dale Arthur Oesterle, *Delaware's Takeover Statute: Of Chills, Pills, Standstills, and Who Gets Iced*, 13 DEL. J. CORP. L. 879, 889 n.51 (1988). One SEC Commissioner, Joseph Grundfest, testified against the statute before the House Judiciary Committee of the Delaware State Legislature.

207. *See, e.g.*, STEPHEN BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 37 (2012) ("[F]ederal interventions tend to be episodic. The most important almost always follow some major economic crisis."). For example, Securities Act of 1933, Securities Exchange Act of 1934, Sarbanes–Oxley Act of 2002, and the Dodd–Frank Wall Street Accountability and Consumer Protection Act of 2010 were all enacted in response to major financial crises.

law governance feature. In sum, any threat of federal action is presently insufficient to force state lawmakers to act in opposition to the pressures of state competition.

IV.
A TERMS-BASED APPROACH

Given the inconsistency between the reintroduction of a mandatory duty of loyalty and the forces that shape state business lawmaking, this Part explores an alternative approach. In short, it demonstrates that state lawmakers can use a statutory menu of standardized terms to encourage adoption of measures that are intended to provide investors with additional protection where it is needed and achieve higher degrees of standardization with regard to MLP governance. By looking at trends and patterns in the governance arrangements adopted by these entities (*e.g.*, the nearly universal adoption of conflict-of-interest provisions), state lawmakers can identify the terms that would benefit from standardization. In designing the terms, however, state lawmakers can also take into account the need to provide investors with additional protection in the areas where sponsors and organizers are able to impose one-sided terms.

This approach offers two advantages over reinstatement of a mandatory fiduciary duty. First, with standardized terms that are based on actual contracting practices (but which have been adjusted to incorporate increased levels of investor protection), states can offer terms that are tailored more appropriately to the needs of these firms than a mandatory duty of loyalty while facilitating increased standardization and investor protection. Importantly, this approach can be implemented in a way that is consistent with the pressures created by jurisdictional competition. Recent empirical and theoretical work indicates that standardized terms, such as those being proposed by this Article, do not have to be mandatory to be adopted.

Part A is a short discussion of considerations relevant to designing these terms and uses the recently enacted Dodd-Frank regime for swap trading as a model of standardization based on data about actual contracting practices. Part B provides an illustration using the commonly adopted conflict-of-interest provision as an example. Finally, Part C argues that standardized terms do not have to be mandatory for MLPs to adopt them.

A. *Devising the Terms*

Both empirical research as well as the observations of judges who regularly hear cases involving large, publicly traded uncorporations indicate that their operating agreements have begun to coalesce around certain types or categories of terms and governance arrangements.[208] This is unsurprising, particularly in light of the favorable tax treatment that motivates the creation of these entities and the conditions that must be met to secure that status.[209] MLPs operate in the same set of industries, hold the same general types of assets, and were organized by their sponsor to achieve the same financial objectives.

Terms which have become common, like conflict-of-interest provisions as well as cash distribution and mandatory liquidation provisions, are the most obvious candidates for standardization.[210] Presumably, their regular adoption indicates their usefulness. The ubiquity of conflict-of-interest provisions, for example, is unsurprising given the regularity (and desirability) of transactions between the MLP and its sponsor. With information about these contracting practices, state lawmakers are able to design standardized versions of these terms in a way that captures their usefulness to MLPs and facilitates the common business practices that led to widespread adoption of particular types or varieties of terms.

In devising standardized terms, state lawmakers should also take into account the need for increased investor protection in the areas where MLP sponsors and organizers impose one-sided terms. In this regard, the terms will depart to some degree from actual contracting practices, and their viability will depend on the degree to which they can incorporate additional investor protection without destroying the usefulness of the bespoke versions on which they are based. Again, the con-

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208. *See supra* Part II.

209. I.R.C. § 7704 (2008).

210. Specific mention of these terms is not intended to imply that they are the only ones that are suitable for standardization. Indemnification and exculpation provisions may also be good candidates for standardization, as might other common arrangements like incentive distribution rights.

flict-of-interest provision is relevant. In designing a standardized conflict-of-interest term, state lawmakers can preserve the overall structure, intent, and utility of the conflict-of-interest provisions by providing a streamlined method for sanitizing interested transactions through committee approval, but also build in protection for investors in the areas where it is needed. In other words, there is a need for balance—measures intended to increase investor protection should be included in a way that does not destroy the usefulness of the bespoke terms on which the standardized terms are based. If this is not the case (*i.e.*, investor protection is incorporated in a way that destroys the usefulness of the standardized term such that adoption would overly inhibit the legitimate business practices of MLPs), they will not be adopted.

This "bottom-up" approach to devising standardized terms is similar to the Dodd-Frank regime for regulating swap contracts and pushing them toward increased standardization. Prior to the 2008 financial crisis, these financial instruments were bought and sold in a virtually unregulated and untracked over-the-counter market.[211] Dodd-Frank requires many swap transactions to go through an authorized exchange (in the parlance of Dodd-Frank, a "swap execution facility" (SEF) or designated contract market (DCM)),[212] provided one of these facilities has issued a determination that the particular type of swap has been "made-available-to-trade" (MAT).[213] MAT determinations identify categories of swaps based on their terms: in

211. Sec. Indus. and Fin. Markets Ass'n v. U.S. Commodity Futures Trading Comm'n, 67 F.Supp.3d 373, 385 (D.D.C. 2014); Reed T. Schuster, *Sacrificing Functionality for Transparency: The Regulation of Swap Agreements in the Wake of the Financial Crisis*, 62 SYRACUSE L. REV. 385, 391 (2012) ("Swaps in the OTC market . . . are negotiated bilaterally in a largely confidential, decentralized system that includes many instruments that are non-standardized.").

212. 7 U.S.C. § 2(h)(8)(A). Determining which swaps are subject to mandatory exchange trading is a convoluted process. Dodd–Frank imposes a broad requirement that swaps undergo clearing, unless they fall within an exception. 7 U.S.C. §§ 2(h)(1), (7). This clearing requirement is not relevant here, but at a high-level, it operates to reduce counterparty risk by dividing a swap into two transactions and substituting the clearinghouse for one of the parties in each of the two transactions. All swaps that must be cleared are subject to mandatory trading on an SEF or DCF as long as they have been "made-available-to-trade."

213. 17 C.F.R. § 37.10; 17 C.F.R. § 38.12.

the case of an interest rate swap, for example, the MAT determination describes the interest rate to which a swap is tied, the tenor, the payment schedule, etc.[214] Swaps that exhibit these attributes are subject to the mandatory exchange trading requirement. The MAT process is relevant here because it represents an attempt to look at actual contracting behavior and, *based on that behavior*, identify contractual arrangements that occur regularly enough to allow for standardization.[215] In making MAT determinations, SEFs/DCMs are required to consider various factors which lead them to identify categories of swaps with common characteristics and which, therefore, lend themselves to exchange trading.[216] The benefits of exchange trading (easier clearing, more liquidity, transparent and competitive pricing, and lower transaction costs) provide market participants with an incentive to fit their desired transaction into a standardized swap that is subject to an MAT determination.[217] Obviously, units in publicly traded alternative entities

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214. Bloomberg SEF LLC - Made Available to Trade ("MAT") Submission of Certain Credit Default Swaps ("CDS") and Interest Rate Swaps ("IRS") Pursuant to Commodity Futures Trading Commission Regulation 40.6 (submission #2013-R-9), (Dec. 5, 2013), http://www.cftc.gov/stellent/groups/public/@otherif/documents/ifdocs/bsefmatdetermltr120513.pdf.

215. In making MAT determinations, SEFs/DCMs are required to consider various factors, most of which are liquidity related. 17 C.F.R. § 37.10; 17 C.F.R. § 38.12. These factors are (1) whether there are ready and willing buyers and sellers; (2) the frequency or size of transactions; (3) the trading volume; (4) the number and types of market participants; (5) the bid/ask spread; and (6) the usual number of resting firm or indicative bids and offers.

216. See, for example, a MAT determination submitted by Bloomberg SEF LLC in which they explain that they are making MAT determinations with respect to "those swaps that are the most standardized . . . ." Bloomberg SEF LLC - Made Available to Trade ("MAT") Submission of Certain Credit Default Swaps ("CDS") and Interest Rate Swaps ("IRS") Pursuant to Commodity Futures Trading Commission Regulation 40.6 (submission #2013-R-9), (Dec. 5, 2013) at 3, http://www.cftc.gov/stellent/groups/public/@otherif/documents/ifdocs/bsefmatdetermltr120513.pdf.

217. Annette Nazareth & Gabriel Rosenberg, *Swap Reporting Clearing & Trading: A Timing Guide*, FUTURES INDUSTRY 34, 36 (June 2012) ("Market participants will also need to monitor which swaps are 'made available to trade' and choose whether to use these standardized swaps or, instead, opt for more customized bilateral swaps *that do not need to be traded on SEFs or DCMs but may be subject to higher margin and capital requirements.*") (emphasis added). In response to this new regulatory landscape, Market Agreed Coupon (MAC) swaps have begun to trade on SEFs. These are recently developed,

are not swaps and cannot be regulated as such. Nevertheless, the Dodd-Frank model is instructive insofar as it illustrates a "bottom-up" approach in which actual transactions form the basis of efforts to standardize terms, and parties have a strong incentive to fit their transactions into a particular form.

B. *An Example: A Standardized Conflict of Interest Provision*

The vast majority of MLP operating agreements include a conflict-of-interest provision specifying both how conflicted transactions (usually between the MLP and its sponsor or an affiliate of the sponsor) can be approved and the standard of review under which the provision will be evaluated if challenged.[218] Usually, these provisions specify that a conflicted transaction is deemed to be approved by all partners if it is fair to the MLP, was made on terms equivalent to those available in an arm's length transaction, received "Special Approval" (which means that the transaction was approved by a conflicts committee acting in good faith) or was approved by a majority of public unitholders.[219]

The almost universal adoption of conflict-of-interest provisions that include a Special Approval prong makes sense in light of the regularity with which MLPs enter into transactions with their sponsors or other entities in the same group.[220] In a

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"fully standardized swap contract[s]" that have pre-set terms which are designed to make exchange trading easier for market participants. Terry Flanagan, *Bloomberg's SEF Executes Electronic MAC Trade*, MARKETSMEDIA, Nov. 25, 2013, http://marketsmedia.com/bloombergs-sef-executes-electronic-mac-trade.

218. Strine & Laster, *supra* note 21, at 21; *see also* Horton, *Modifying Fiduciary Duties in Delaware, supra* note 23, at 922 ("Successful uncorporations . . . appear to be coalescing around a standardized approach: approval by a special committee, coupled with a good faith standard."); Miller & Davis-Nozemack, *supra* note 21, at 280.

219. Strine & Laster, *supra* note 21, at 17; Lonergan v. Epe Holdings, LLC, 5 A.3d 1008 (Del. Ch. 2010); Brinckerhoff v. Enbridge Energy Co., 2011 WL 4599654 (Del. Ch. Sept. 30, 2011); *In re* Encore Energy Partners LP Unitholder Litig., 2012 WL 3792997 (Del. Ch. Aug. 31, 2012); Norton v. K-Sea Transp. Partners, L.P., 67 A.3d 354 (Del. 2013).

220. *See, e.g.*, Brinckerhoff v. Enbridge Energy Co., 159 A.3d 242, 245 (Del. 2017) ("MLPs are typically families of entities that often engage in internal business transactions, referred to as dropdowns, rollups, insider financings, incentive distribution rights, and equity investments."); *In re* El Paso Pipeline Partners, L.P. Derivative Litig., No. 7141-VCL, 2014 WL 2768782 (Del. Ch. June 12, 2014) (recounting history of eight drop downs between MLP and

drop-down transaction, for example, the sponsor sells additional Section 7704 qualifying assets to the MLP.[221] These transactions are a common growth tool for MLPs and, in many instances, are accretive, meaning that they increase cash flow to investors.[222] For the sponsor, they provide the opportunity to monetize additional assets beyond those which were sold to the MLP at its formation. When it comes to drop-downs, everyone can win. Thus, while MLP unitholders certainly do not want transactions to unfairly benefit the sponsor or the sponsor's affiliate at the expense of the MLP, they also do not want a rule that makes these transactions prohibitively risky or excessively expensive to undertake.

The usefulness of conflict-of-interest provisions and, in particular, special approval prongs becomes evident after consideration of how these transactions would be treated if evaluated under Delaware's current duty of loyalty framework. The contractarian criticism of mandatory fiduciary duties as potentially chilling legitimate business practices carries some weight here. As self-dealing transactions with a de facto controller,[223] drop-downs would be presumptively subject to entire fairness review.[224] This entails judicial review of both substantive and procedural aspects of the transaction, and significantly, places the burden of proving fairness on the defendant.[225] The de-

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sponsor over four years); Eduardo Gallardo et al., *Implications of Recent Delaware Court of Chancery Decisions on MLP-Related Party Transactions,* 18 M&A LAW. 7 (2014) ("Drop-down transactions are inherently conflict transactions, but are not uncommon in the life of an MLP.").

221. Matthew J. McCabe, Comment, *Master Limited Partnerships' Cost of Capital Conundrum,* 17 U. PA. J. BUS. L. 319, 325 (2014).

222. Even the "bad" deals at issue in *El Paso* were accretive. *In* re *El Paso Pipeline Partners,* 2014 WL 2768782. The Court, however, rejected the proposition that subjective good faith was demonstrated by the fact that the drop-down would be accretive. *Id.* Other aspects of the deal were not in the best interests of the partnership. *Id.*

223. *See, e.g.*, Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1114 (1994) (finding that shareholder had de facto control notwithstanding the fact that its holding was less than 50%).

224. Solar Cells, Inc. v. True North Partners, LLC, No. Civ.A. 19447, 2002 WL 749163, at 3–4 (Del. Ch. Apr. 25, 2002); *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1204 (Del. Ch. 1995); *see also* Stroud v. Grace, 606 A.2d 75 (1992).

225. J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny,* 40 WM. MITCHELL L. REV. 1443, 1447 (2014) ("Under entire fairness, the defendant directors have the burden to demonstrate that the challenged act

fendant can, however, utilize procedural protections to "sanitize" the transaction: if the transaction is negotiated and approved by a disinterested special committee *or* if the transaction is approved by a majority of the minority shareholders after disclosure of all material information, the burden is shifted within the entire fairness review. The plaintiff will have to prove that the transaction was unfair.[226]

However, after a recent Delaware Supreme Court case, controlling shareholders and their advisors can structure the transaction in a way that will activate the business judgment rule, thereby foreclosing meaningful substantive review.[227] If the transaction is conditioned on both procedural protections—(1) negotiation and approval by a special committee *and* (2) the approval by a majority of minority shareholders after disclosure of all material facts—the business judgment rule will apply.[228] Delaware's duty of loyalty approach to controlling shareholder transactions can be conceived of as striking a balance between procedural fairness and substantive review at various points along a spectrum. On one end exists "naked" self-dealing transactions (those which are not subject to any procedural protections), which are subject to entire fairness review with the burden on the defendant to prove fairness. On the other end of the spectrum exists the fully pro-

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or transaction was entirely fair to the corporation and its shareholders. To meet this test, they must show that the action they took was both procedurally and substantively fair by establishing to the court's satisfaction that the transaction was the product of both fair dealing and fair price.") (internal citations and quotations omitted).

226. *In re Wheelabrator*, 663 A.2d 1194; *see also Stroud*, 606 A.2d 75, at 90; Laster, *supra* note 223, at 1462. Some commentators have questioned applicability of this framework outside of the freeze-out context. *See, e.g.*,Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions*, 36 DEL. J. CORP. L. 903 (2011).

227. *See, e.g.*, *In re* Books-A-Million, Inc. Stockholders Litig., No. 11343-VCL, 2016 WL 5874974 (Del. Ch. Oct. 10, 2016), *aff'd*, No. 515, 2017 WL 2290066 (Del. May 22, 2017).

228. Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014); *Books-a-Million*, 2016 WL 5874974; J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1463 (2014). This standard was first announced in the context of a controlling shareholder merger, but Delaware courts have since indicated that it applies more generally to any transaction involving a controlling shareholder. *In re* Ezcorp. Consulting Agreement Derivative Litigation, No. 9962-VCL, 2016 WL 301245, at *11 (Del. Ch. Jan. 25, 2016).

tected transaction that is conditioned on both special committee participation and on shareholder approval. These transactions receive the protection of the business judgment rule, which effectively forecloses any meaningful substantive review. This framework sets up an inverse relationship between procedural protection and substantive review.

It is particularly important for MLPs that, under the framework discussed above Delaware's corporate law approach, escaping entire fairness completely requires a shareholder vote.[229] Under this paradigm, an MLP seeking to enter into a drop down or other transaction with its sponsor or an affiliate would either have to activate the notoriously expensive investor voting machinery or potentially face entire fairness review of the transaction. Subjecting each transaction between MLPs and their sponsors or affiliates to either an expensive and cumbersome unitholder vote or the possibility of litigation involving entire fairness review[230] would make these transactions a less attractive option for MLP sponsors and affiliates looking to sell accretive assets. Either scenario (regular entire fairness review resulting from litigation or holding a shareholder vote to bring these transactions into the business judgment rule) would likely lead to fewer drop down transactions and potentially cause the drop downs that do take place to be less valuable. With conflict-of-interest provisions that include special approval language, MLPs are adopting a mechanism that allows them to insulate transactions with controllers from substantive review with fewer procedural protections than those currently required under Delaware corporate law. In other words, they are adopting a balance between procedural protection and substantive review that is currently unavailable under Delaware corporate law.

A problem appears to lie, however, in the ability of management to seek approval of such transactions from committees comprised of individuals whose independence is question-

229. Under the framework announced in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014), escaping entire fairness review requires both approval from a committee of independent directors and a majority of the minority shareholders.

230. Vice Chancellor Laster has described Delaware's entire fairness standard as existing on the top tier of a "pyramid of narrowing deference to corporate decision making and increasing judicial intrusiveness." Laster, *supra* note 226, at 1446–47.

able,[231] utilize opinion letters issued by repeat-player financial advisors to conclusively establish good faith, and secure unitholder approval without disclosing material facts to unitholders (in the event unitholder approval is needed or otherwise sought).[232] When challenging Special Approval by a committee, unitholders are usually required by language found in the operating agreement to show that the committee members failed to act in subjective good faith.[233] Operating agreements often include a provision specifying that if the committee obtains a fairness opinion from a financial advisor, it will conclusively establish "good faith," making challenge effectively impossible.[234]

A standardized version of this term should reflect both the need for additional protection against self-dealing and the fact that MLPs and their controllers have a legitimate need for a streamlined and reliable way to secure approval for transactions between them. It can do this by recognizing that holding a unitholder vote to sanitize each drop down is impractical, but requiring that the Special Approval process include greater procedural protections. For example, a Special Approval provision could still incorporate a good faith standard[235] (making challenge difficult after the transaction is approved, functioning similarly to the business judgment rule in corporate law), but increase the protection offered through the negotiation and approval process by requiring (1) that the committee be comprised of independent, disinterested individuals who remain independent throughout the negotiation

231. *See, e.g.*, Dieckman v. Regency GP LP, No. 11130-CB, 2016 WL 1223348 (Del. Ch. Mar. 29, 2016); *In re* El Paso Pipeline Partners, L.P. Derivative Litigation, No. 7141-VCL, 2014 WL 2768782 (Del. Ch. June 12, 2014).

232. *Dieckman*, 2016 WL 1223348, at *8.

233. *See, e.g.*, Allen v. Encore Energy Partners, L.P., 72 A.3d 93, 106 (Del. 2013) ("Therefore, to plead a breach of the LPA's contractual duty of subjective good faith, Allen must plead facts that enable a court reasonably to infer that the Conflicts Committee members did not subjectively believe that the Merger was in Encore's best interests. Allen can meet this standard by showing that the Conflicts Committee believed that it was acting against Encore's best interests when approving the Merger. He can also do that by showing that the Conflicts Committee consciously disregarded its duty to form a subjective belief that the Merger was in Encore's best interests."); *El Paso Pipeline Partners*, 2014 WL 2768782, at *11–12.

234. Norton v. K-Sea Transp. Partners L.P., 67 A.3d 354, 366 (Del. 2013).

235. Either subjective or objective bad faith.

of the transaction, and (2) that the committee be empowered to negotiate with the sponsor, retain relevant advisors, and walk away from the deal.[236] There is no doubt that unitholders would be more vulnerable to self-dealing than they would be if activation of a deferential standard of review required approval by an informed majority of the minority unitholders, but this may be where market expectations related to cash distribution play a role in disciplining sponsors and other affiliates. If such transaction are generally expected to lead to an increase in cash distributions, any self-dealing will be limited to the extent that it does not disappoint market expectations related to cash distributions.

Similarly, additional procedural protection should be included in any prong allowing sanitization by a vote of the minority unitholders by requiring disclosure of all material information for a vote to be effective. Again, this requirement appears in the corporate context and is meant to ensure that the shareholder votes that activate a more deferential standard will be informed. The standardized term should also specify that no action will create a conclusive presumption of "good faith" (e.g., opinion letters). With this approach, MLPs and their sponsors would still be able to take advantage of a faster and less risky means of entering into what are oftentimes advantageous transactions, but unitholders would receive additional protection in the form of more robust procedural safeguards.

If a standardized version of this term is adopted on a widespread basis, the benefits of standardization will follow. A body of case law will develop interpreting it. Attorneys and other advisors will be better able to translate their experiences on one deal or litigation to others that are subject to the standardized term. Drafting costs and uncertainty would decrease. Investors will have an easier time understanding their investments, likely leading to an increase in the informational efficiency of the market for MLP units.

Thus, by offering to publicly traded uncorporations standardized terms that have been drafted to reflect the common

236. This is not the only possible balance of available review and procedural protection. A case could be made for utilization of a standard that allows for more review than that allowed by the subjective good faith standard (still less than entire fairness) but less stringent procedural protections than those outlined above.

contracting practices, state lawmakers may be able to offer the best of both worlds: the benefits of contractability *and* the advantages of standardization. Provided the benefits of standardization or other pressures outweigh any perceived costs created by the incorporation of measures intended to increase investor protection (and are, therefore, departures from current contracting practices), organizers of these entities will have a reason to adopt the standardized forms. The following Part addresses the likelihood of adoption if the terms are not mandatory, *i.e.*, whether this solution can be implemented effectively in a manner that is consistent with the pressures of interstate competition.

C. *Statutory Menus – A Viable Implementation*

Many of the benefits promised by standardized MLP terms require widespread adoption. MLP investors, as a class, can only enjoy the benefits of these terms if adopted by a large number of MLPs; similarly, the standardization-related advantages, such as increased certainty and a body of well-developed case law, are a function of the degree to which the terms are adopted. The easiest way to ensure widespread adoption is by making the terms mandatory for publicly traded alternative entities that opt out of governance features traditionally associated with publicly traded corporations, like fiduciary duties. A state legislature adopting this approach would be offering its alternative entities a "close-ended" menu—they could either adopt traditional, corporate style fiduciary duties or the standardized terms, but not some other option. Because this entails a limitation on contractual freedom,[237] a closed menu is unlikely to gain much traction.

This does not mean that widespread adoption is impossible. Instead, non-mandatory implementations, such as including the terms as an option on an "open-ended menu" (i.e., a statutory menu that provides terms designed for these entities but does not prohibit adoption of bespoke terms), can lead to widespread adoption. In the corporate context, many firms voluntarily adopt non-mandatory standardized terms[238] on ac-

237. Ayres, *supra* note 33, at 10.

238. *See, e.g.*, Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779 (2006); Hansmann, *supra* note 128, at 4 ("While closely held business firms commonly have detailed, specifically tai-

count of lowered "transaction costs of drafting and negotiating, the high salience or presumptive legitimacy of governmentally provided terms, [and] the need for standardization."[239] For MLPs, adopting the standardized terms would likely lower the costs faced by organizers at the formation stage. Over time, as more firms adopt them and case law construing the standardized terms develops, adopting firms would be able to minimize uncertainty and much of the potential for the surprising results managers and sponsors now face when litigating over the interpretation of customized provisions.[240]

Furthermore, adoption of the standardized terms would serve as an inexpensive and credible way for MLPs to send signals to investors about the quality of the investment they offer. The current lack of standardization leaves investors without any straightforward way to sort these entities according to their governance terms. Currently, even if an MLP offers favorable governance terms and attempts to signal this to investors, those investors have no way to confirm whether those terms are indeed favorable without undertaking a similarly expensive and time-consuming verification effort. However, the availability of government-endorsed, standardized terms that have been designed to protect investors' interests in the areas where other forces are insufficient to do so would provide investors with a virtually costless way to evaluate investment opportunities—whether or not that MLP has adopted the standardized terms. A decision by an MLP not to adopt the terms would send investors a strong signal of "buyer-beware."[241] The creation of a reliable and inexpensive sorting mechanism could easily lead to lower capital costs for adopting MLPs, which would provide another reason for firms to consider their adoption notwithstanding their ability to contract out of them. Ad-

lored charters, the charters of publicly traded corporations are remarkably empty. . . . They effectively defer to the default terms of the state corporation law in virtually all matters of significance.").

239. Hansmann, *supra* note 128, at 4.

240. Strine & Laster, *supra* note 21, at 12; Horton, *Modifying Fiduciary Duties in Delaware, supra* note 23, at 922.

241. Ayres, *supra* note 33, at 6–7. Professor Ayres argues persuasively that the use of statutory menus can have a significant impact in a variety of areas, including civil rights. According to Professor Ayres, companies offered a statutory option to extend their employees additional protection against discrimination in the workplace would make it difficult for many employers to refrain from opting in.

ditionally, an increased institutional investor presence in the future may also lead to increased pressure for adoption of standardized terms if they are perceived as offering investors additional protection. Widespread adoption will ultimately come down to whether the benefits of adopting the standardized terms (whether on account of network benefits or the signaling power of the terms) outweigh any perceived costs imposed by the inclusion of additional measures to further investor protection.

A recent study conducted by Professor Yair Listokin provides empirical support for the feasibility of this approach. Listokin compared the adoption of fair-price protection by publicly traded companies organized in states in which (1) fair-price protection *could* be included in the corporate charter but was not included in the state's corporate statute; (2) fair-price protection was included as an item on a statutory menu (opt-in statute); (3) fair protection was the default rule (requiring companies to opt-out).[242] He found that a company organized in a state with an opt-in fair-price protection statute has a 22% greater chance of including it than a company organized in a state without a statutory provision (i.e., a state in which fair price protection can be implemented, but only through adoption of a bespoke term). Companies organized in states whose statutes establish fair price protection as a default rule (requiring opt-out) have a 67% greater chance of including fair price protection over companies organized in a state with no fair price statute and a 45% greater chance than corporations formed in states that have opt-in statutes.[243] Listokin's findings suggest that the inclusion of terms on a statutory menu will lead more firms to adopt those terms because they "provid[e] imprimatur of the state, facilitate[e] network effects, and reduc[e] the cost of continually updating corporate charters to reflect changes in the law and the economy."[244] In the words of Professor Ian Ayres, "menus matter."[245]

Thus, Listokin's findings indicate that standardized MLP terms do not have to be a *mandatory* alternative to corporate

242. Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Analysis*, 6 J. EMPIRICAL L. STUD. 279 (2009).
243. *Id.* at 300–02.
244. *Id.* at 307.
245. Ayres, *supra* note 33.

style fiduciary duties to enjoy widespread adoption. Rather, state legislatures could maintain their commitment to contractual freedom and still facilitate adoption of standardized MLP terms by including them as part of a statutory menu.[246] Listokin's findings suggest that merely making them available and requiring opt-in can encourage adoption, but they also indicate that state legislatures can choose to put a thumb on the scale in favor of adoption by implementing the standardized terms as defaults that automatically apply to MLPs that eliminate fiduciary duties. This implementation would require MLP organizers to opt-out, and Listokin's research suggests that requiring opt-out is a particularly effective way of encouraging the adoption of terms that management may prefer to avoid.[247]

As the state of almost all publicly traded alternative entities, Delaware is the obvious state for implementation of these terms. But this does not mean that other states do not have something to gain from implementation of standardized terms for MLPs. Maryland has long enjoyed a competitive advantage over Delaware in attracting real estate investment trusts (REITs),[248] in large part on account of the menu option of specially-tailored terms that has been available to REITS under Maryland law for several decades.[249] It is not implausible that a state wishing to compete with Delaware for MLPs could do so with a well-designed set of standardized terms.

D. *Why the Legislature and Not a Private Party*

Thus far, this Article has assumed that the standardized terms should be promulgated by a state legislature (most likely Delaware's) rather than some private party or organization. Of course, private-sector organizations also offer menus of standardized terms, and it would be completely plausible for a

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246. For many of the same reasons, Professor Brian JM Quinn has advocated in favor of including a standardized in forum selection provision as a statutory menu option for corporate charters. He argues that "opt-in menus are . . . a valuable mechanism for overcoming contractual inertia and assisting contracting parties reach more optimal results." Brian J. M. Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137, 190 (2011).

247. Listokin, *supra* note 241.

248. Ribstein & O'Hara, *supra* note 173, at 705–06.

249. Maryland first passed a statute specifically for REITs in the 1960s.

trade organization, such as the Master Limited Partnerships Association, to offer standardized MLP terms that can be adopted by MLPs or their organizers. While it is not possible to rule out the possibility that such terms would be frequently adopted, legislative production of these terms is preferable and more likely to lead to widespread adoption. As discussed above in Part IV.C, one of the likely motivations for adopting the standardized terms will be the market and reputational consequences that will flow from an MLP's failing to adopt the terms when investors know that they are available. These consequences, of course, will depend on the market's perception of the terms as offering investors a more appropriate degree of protection than is likely to be offered by individually drafted versions of the standardized terms. As discussed above in Part I, MLP operating agreements are not the subject of negotiation. Investors will be looking to the drafter of the terms to represent their interests, and for this reason, the provenance of the terms will matter. Terms that have government imprimatur are more likely to be viewed as striking a balance between the relevant parties than terms which have been promulgated by a private party (particularly one that is associated specifically with MLPs, their sponsors, and their organizers) and for this reason, are more likely to lead to market pressures in favor of adoption.[250] This is especially the case with regard to terms adopted by the Delaware legislature in light of the process by which Delaware legislates business law – legislation is drafted by members of the Corporate Council of the Delaware Bar Association and must be approved by the Corporate Council prior to being submitted to the legislature.[251] These groups will typically include both transactional attorneys and litigators as well as members of both the plaintiffs' and defense bars. Accordingly, terms that have been drafted and approved by this group are likely to have a veneer of legitimacy and even-handedness that terms generated by the private sector will not have.

250. *See, e.g.*, Ayres, *supra* note 33, at 8 (arguing that "privatized menu option[s] do not have nearly the same salience as a legislative menu option").
251. Hamermesh, *supra* note 201, at 1756.

Conclusion: Contractual Freedom, Now What?

With the rise of uncorporations, American business law has entered an era of contractual freedom. In increasing numbers, state legislatures are committing to this principle and extending the ability to waive and eliminate traditional fiduciary duties to unincorporated entities, even ones that are publicly traded. But what are state lawmakers to do if they perceive a need to address problems that result from this degree of contractual freedom? Are their only options either to reinstate mandatory terms (something that would require them to buck the trend of increasing contractabiltiy in this context) or to sit on the sidelines? This Article suggests that there is a robust role for the state legislature to play in jurisdictions that have made commitments to contractual freedom, and that this role does not require them to readopt mandatory terms. Instead, well-designed enabling menus present the opportunity for state lawmakers to combine the benefits of contractual freedom with the advantages of standardization, while also steering contracting outcomes toward increased levels of investor protection. Contractarians have long maintained that state business law statutes are best understood as off-the-rack contracts. As this Article argues, in an era of virtually unlimited contractibility, state lawmakers can go a long way toward addressing the negative consequences of unrestrained contractual freedom by offering a wider variety of off-the-rack contracting products which have been carefully calibrated to serve the needs of particular types of firms and their investors. This suggests an ongoing role for the state legislative in corporate lawmaking, even in jurisdictions that have committed to contractual freedom. Once contracting trends emerge, state lawmakers can implement standardized versions and, in doing so, take into account the need (if any) to accommodate other interests, such as the need for increased investor protection.