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Comments: Uncertainty for Practitioners and the Judiciary as Well as the Need for a Minimum Standard Demonstrate That Fiduciary Duties Should Be Incorporated into Maryland's LLC Act

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UNCERTAINTY FOR PRACTITIONERS AND THE JUDICIARY
AS WELL AS THE NEED FOR A MINIMUM STANDARD
DEMONSTRATE THAT FIDUCIARY DUTIES SHOULD BE
INCORPORATED INTO MARYLAND'S LLC ACT

I. INTRODUCTION

Suppose an individual decides to sue members or managers in a Maryland Limited Liability Company (LLC) for breach of their duty of care or duty of loyalty.¹ If the LLC operating agreement did not include written fiduciary duties, then Maryland courts would rely on Maryland's LLC statute.² However, upon referencing Maryland's LLC statute, the court would discover that the statute does not contain an express provision regulating the fiduciary duties of members or managers in an LLC.³ Therefore, the court would be left to its own discretion to determine whether there was a breach of fiduciary duty.⁴ Lawyers advising clients who seek to sue for breach of fiduciary duty in a Maryland LLC face this same uncertainty because the Maryland LLC statute does not contain an express fiduciary standard.⁵ In addition, there is uncertainty as to whether an operating agreement that includes an exculpatory provision would be upheld by the courts.

Over the past three decades, the LLC has become a popular business form to utilize because of its extreme flexibility.⁶ This extreme flexibility is encompassed in four main characteristics of the LLC: "(i) limited liability; (ii) partnership tax features; (iii) *chameleon* management—that is, the ability to choose between centralized and direct member-management; and (iv) creditor-protection provisions."⁷

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1. See, e.g., *Froelich v. Erickson*, 96 F. Supp. 2d 507 (D. Md. 2000).
 2. See, e.g., *id.* at 520.
 3. See, e.g., *id.*
 4. See, e.g., *id.* at 526–27.
 5. See Elizabeth S. Miller, *Are the Courts Developing a Unique Theory of Limited Liability Companies or Simply Borrowing from Other Forms?*, 42 SUFFOLK U. L. REV. 617, 632 (2009).
 6. See Larry E. Ribstein, *The Emergence of the Limited Liability Company*, 51 BUS. LAW. 1, 2 (1995).
 7. *Id.*

Because the LLC is a relatively new business entity, issues linger regarding judicial interpretation of fiduciary duties for LLC members and managers.⁸ When discussing fiduciary duties in LLCs, it has been commented that “[f]ew undertakings in the area of business associations law seem to generate quite as much controversy as does attempting to codify rules of fiduciary duty.”⁹

Upon reviewing various LLC statutes, it becomes clear that there is a lack of uniformity with respect to fiduciary duty provisions.¹⁰ For example, while the Revised Uniform Limited Liability Company Act (RULLCA) and many state LLC statutes contain statutorily enumerated fiduciary duties, some provisions mirror partnerships, others mirror corporations, and some mirror both.¹¹ However, there are some state statutes, including Maryland’s, which do not contain an express fiduciary duty provision.¹²

In 1992, the Maryland Legislature enacted the Maryland Limited Liability Company Act.¹³ As of January 1, 1993, Maryland businesses could elect to form an LLC.¹⁴ LLC statutes such as Maryland’s can present problems for the judiciary because it forces courts to interpret the statute, creating an outcome that the legislature may not have intended when drafting the statute.¹⁵ The state of Delaware has dealt with this very situation.¹⁶ In *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, the Delaware court’s interpretation of the LLC statute led to its later amendment by the legislature.¹⁷ The incorporation of express fiduciary duties into the Maryland LLC Act would remove potential judiciary interpretation problems.¹⁸ It could also create a minimum standard by which

8. S. Mark Curwin, Comment, *Fiduciary Duty and the Minnesota Limited Liability Company: Sufficient Protection of Member Interests?*, 19 WM. MITCHELL L. REV. 989, 990 (1993).

9. Franklin A. Gevurtz, *California’s New Limited Liability Company Act: A Look at the Good, the Bad, and the Ambiguous*, 27 PAC. L.J. 261, 267 (1996).

10. See Miller, *supra* note 5, at 634 (“The LLC statutes across the country reflect a variety of approaches toward fiduciary duties of members and managers.”); see also Mary Szto, *Limited Liability Company Morality: Fiduciary Duties in Historical Context*, 23 QUINNIPIAC L. REV. 61, 65 (2004) (“LLC statutes take three main approaches in terms of fiduciary duties.”).

11. See *infra* Part IV.

12. See generally MD. CODE ANN., CORPS. & ASS’NS § 4A (LexisNexis 2007).

13. H.D. 373, 1992 Leg., 406th Sess. (Md. 1992).

14. *Id.*

15. See, e.g., *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160 (Del. 2002).

16. See *id.*

17. *Id.* at 167–68.

18. See *infra* Part VI.A.

members and managers can be held to without frustrating the purpose behind LLCs.¹⁹

Part II of this Comment will provide a brief history of the LLC, detailing the purpose behind the formation of the LLC.²⁰ Part III will analyze how partnership acts, particularly the Revised Uniform Partnership Act (RUPA),²¹ and corporation acts, specifically the Model Business Corporation Act (MBCA),²² have handled fiduciary duties.²³ Part III will also compare and contrast the partnership and corporate fiduciary models.²⁴ Part IV will focus on four different approaches to fiduciary duties in LLC statutes: (1) the partnership approach, (2) the corporate approach, (3) the hybrid approach, and (4) the Delaware approach.²⁵ Part V will analyze Maryland's approach to fiduciary duties and the reasons behind its approach.²⁶ Part VI will articulate the reasons for incorporating statutorily defined fiduciary duties into the Maryland LLC Act.²⁷ Finally, part VII will provide a proposed four-part fiduciary standard for Maryland LLCs.²⁸ The overarching goal of this comment is to demonstrate the need for an express fiduciary duty provision to be incorporated into the Maryland LLC Act.

II. A BRIEF HISTORY OF THE LLC

The LLC came into existence as a response to the growing demand for a business organization that afforded owners limited liability

19. See *infra* Part VI.B.

20. See *infra* Part II.

21. See *infra* Part III.A; UNIF. P'SHIP ACT (1997), 6 U.L.A. Even though the word "revised" is not in the official title to the 1997 Act, it is referenced as RUPA in literature on the Act and will be referred to as RUPA in this Comment. The 1997 version of RUPA was promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and has been adopted by thirty-six states. *A Few Facts About the Uniform Partnership Act (1994)(1997)*, NCCUSL, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-upa9497.asp (last visited Jan. 10, 2011).

22. See *infra* Part III.B. The Model Business Corporations Act was prepared by the Committee on Corporate Laws of the American Bar Association (ABA) and has been adopted by approximately thirty-two states. *Corporate Laws*, ABA, <http://www.abanet.org/dch/committee.cfm?com=CL270000> (last visited Jan. 10, 2011).

23. See *infra* Part III.B.

24. See *infra* Part III.C.

25. See *infra* Part IV.

26. See *infra* Part V.

27. See *infra* Part VI.

28. See *infra* Part VII.

without the double tax regime of the corporation.²⁹ The first state LLC statute was adopted by Wyoming in 1977; it integrated provisions from the Model Business Corporation Act (MBCA), the Uniform Limited Partnership Act (ULPA), and the Uniform Partnership Act (UPA).³⁰ In 1988, the Internal Revenue Service (IRS) issued Revenue Ruling 88-76, which stated that a Wyoming LLC would be subject to partnership taxation.³¹ Once the IRS recognized the LLC as a partnership for tax purposes, interest in the LLC soared.³² Many states quickly adopted LLC statutes to take advantage of the LLC's flexibility, and by 1995 all fifty states had adopted LLC statutes.³³ A recent survey indicated that thirty-seven state LLC statutes have express provisions articulating a fiduciary standard for members.³⁴

As a result of the increase in use of the LLC, the IRS spent an increased amount of time and energy fielding questions regarding the specific classification of LLCs for tax purposes.³⁵ In order to simplify the LLC's determination of classification for tax purposes, the IRS issued the 1997 "check-the-box" procedure.³⁶ This procedure allowed an LLC to elect partnership tax status.³⁷ Prior to 1997, an LLC was taxed as a corporation if it contained more than two of the four corporate attributes, which consisted of: (1) continuity of life; (2) centralized management; (3) limited liability; or (4) free transferability of interests.³⁸

The LLC was created as a hybrid entity combining the liability protection of a corporation with the tax advantages of a partnership and allowing for either centralized or decentralized management.³⁹ The purpose behind the creation of the LLC was to provide greater

29. LARRY E. RIBSTEIN & ROBERT R. KEATINGE, *RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES* § 1:2 (Thomson Reuter/West 2010).

30. Szto, *supra* note 10, at 64.

31. Rev. Rul. 88-76, 1988-2 C.B. 360.

32. RIBSTEIN & KEATINGE, *supra* note 29, § 1:2.

33. ROBERT W. HAMILTON & JONATHAN R. MACEY, *CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES*, 1183 (11th ed. 2010).

34. RIBSTEIN & KEATINGE, *supra* note 29, app. 9-7.

35. *Id.* § 1:2.

36. HAMILTON & MACEY, *supra* note 33, at 1185.

37. See Treas. Reg. § 301.7701-3 (1997).

38. See Treas. Reg. § 301.7701-2(a)(3) (1996); see also Szto, *supra* note 10, at 65 (summarizing the federal regulations).

39. Sandra K. Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More than a Decade of Experimentation?*, 32 J. CORP. L. 565, 567 (2006).

flexibility in tax and business planning.⁴⁰ Additionally, the LLC was created as a response to business owners' desire for a framework that prevented judicial intervention into business transactions that they had negotiated.⁴¹

The LLC not only offers business owners limited liability with partnership tax features, but it also allows flexibility in the management and control of the LLC.⁴² There are two distinct management forms that LLC business owners typically utilize: the member-managed model and the manager-managed model.⁴³ In a member-managed LLC, members have authority to act on behalf of the LLC in the ordinary course of business.⁴⁴ This agency authority to act on behalf of the LLC is similar in nature to the decentralized management found in partnerships.⁴⁵ Thus, member-managed LLCs are sometimes referred to as the "partnership model."⁴⁶

Unlike a member-managed LLC, in a manager-managed LLC, the managers, and not the members, have the authority to act on behalf of the LLC.⁴⁷ Because there is no requirement that the managers be members, a manager-managed LLC provides the ability to separate ownership from authority.⁴⁸ Therefore, because of their centralized management, manager-managed LLCs have, at times, been referred to as the "corporate model."⁴⁹ In most cases, statutes will provide that the election for either member-managed or manager-managed must be stated in the articles of organization.⁵⁰ Generally, if the parties do not specifically state in the LLC operating agreement that

40. Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1610 (2004).

41. *Id.*

42. *See id.* at 1609–11; Ribstein, *supra* note 6, at 10; *see also* Thomas E. Rutledge, *The Lost Distinction Between Agency and Decisional Authority: Unfortunate Consequences of the Member-Managed Versus Manager-Managed Distinction in the Limited Liability Company*, 93 KY. L.J. 737 (2004) (discussing the differences between member-managed and manager-managed LLCs).

43. Rutledge, *supra* note 42, at 737.

44. *Id.* at 739–40.

45. *Id.* at 740.

46. *Id.* at 740–41.

47. *Id.* at 741.

48. *Id.* at 741–42.

49. *Id.* at 742 ("This model is sometimes referred to as the 'corporate model' because ownership (member or shareholder) is entirely separated from agency authority (manager or officer).").

50. *Id.* at 737.

managerial authority is vested in a manager, then the authority is vested in the members by default.⁵¹

As a result of the LLC's flexibility, members are able to establish almost any economic and management structure they desire.⁵² However, this flexibility does not come without a cost.⁵³ Members must think through more aspects of the organizational relationship than in more restrictive organizational forms, such as the partnership or the corporation.⁵⁴

III. PARTNERSHIP AND CORPORATE APPROACHES TO FIDUCIARY DUTIES

The LLC combines the features of both a partnership and a corporation, allowing for limited liability, the option of partnership tax status, and the choice of either centralized or decentralized management.⁵⁵ Fiduciary duties in LLC statutes likewise reflect aspects of a corporation and a partnership; therefore, it is necessary to review both approaches to fiduciary duties in order to understand the basis for many statutory LLC fiduciary duty provisions.⁵⁶

Generally, in both partnership and corporate law, fiduciary duties include both a duty of loyalty and a duty of care.⁵⁷ RUPA provides an example of fiduciary duties in a partnership.⁵⁸ The MBCA provides an example of fiduciary duties in the corporate context.⁵⁹

A. RUPA's Approach to Fiduciary Duties

RUPA represents a model that permits for limited contractual freedom because of statutorily provided default rules that apply in the absence of an agreement between the parties.⁶⁰ Section 404(a) of RUPA provides that a partner's only fiduciary duties to the partnership and other partners are the duty of loyalty and the duty of

51. Gevurtz, *supra* note 9, at 263–64.

52. RIBSTEIN & KEATINGE, *supra* note 29, § 1:3.

53. *See id.*

54. *See id.*

55. *See id.* § 2:1.

56. *See* Miller, *supra* note 39, at 567.

57. Miller, *supra* note 40, at 1622.

58. J. Dennis Hynes, *Fiduciary Duties and RUPA: An Inquiry into Freedom of Contract*, 58 LAW & CONTEMP. PROBS. 29, 29 (1995).

59. *See* Thomas E. Rutledge, *External Entities and Internal Aggregates: A Deconstructionist Conundrum*, 42 SUFFOLK U. L. REV. 655, 663 (2009) (noting that “the MBCA [is] the most broadly accepted model for corporation laws”); *see also* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 844 (2005).

60. Miller, *supra* note 40, at 1616.

care.⁶¹ When writing section 404(a), the drafters of RUPA intended to limit the scope of fiduciary duties that partners would owe to each other.⁶² The drafters of RUPA were able to achieve this by clearly incorporating into section 404(a) statutorily enumerated fiduciary duties.⁶³ In addition, the drafters wanted to prevent the possible expansion or alteration of fiduciary duties by courts.⁶⁴ By narrowing the fiduciary duties in section 404(a), the drafters of RUPA sought to increase the dependability of the partnership agreement.⁶⁵ This, in a sense, gave greater freedom of contract to those drafting the partnership agreement, but there is a limitation to this freedom.⁶⁶ While partners are afforded freedom of contract in drafting the partnership agreement, they are limited by the inability to completely eliminate certain fiduciary duties.⁶⁷

Section 404(c) of RUPA defines a partner's duty of care as refraining from engaging in "grossly negligent conduct."⁶⁸ The official comment to section 404, states that "grossly negligent conduct" is generally what many courts have recognized when analyzing a partner's duty of care.⁶⁹ In order to avoid grossly negligent conduct, a partner must perform his duty with some degree of skill.⁷⁰ In *Rosenthal v. Rosenthal*,⁷¹ the Supreme Court of Maine stated that a partner's duty of care to the other partners and the partnership is to refrain from grossly negligent or willful misconduct.⁷²

61. UNIF. P'SHIP ACT § 404(a), 6 U.L.A. 143 (1997).

62. See Hynes, *supra* note 58, at 32 ("[O]ne would expect to see a word like 'includes' instead of 'only' in recognition of the inherent inability of the law to draw clear lines in defining fiduciary duties. Such wording would leave room for modification and expansion of fiduciary duties as circumstances present themselves.").

63. See *id.*

64. *Id.* at 32–33 ("One source of this uncertainty is the fear that courts may create new fiduciary duties or stretch existing fiduciary duties into unrecognizable form, undermining the parties' true understanding as expressed in the partnership agreement.").

65. *Id.* at 34.

66. *Id.*

67. *Id.*

68. "A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law." UNIF. P'SHIP ACT § 404(c), 6 U.L.A. 875 (1997).

69. *Id.* § 404 cmt. 3.

70. See *id.* § 404(c).

71. 543 A.2d 348 (Me. 1988).

72. See *id.* at 352.

Section 404(b) articulates a partner's duty of loyalty to the partnership.⁷³ A partner's entire duty of loyalty is divided into three distinct rules: (1) to account to the partnership and hold as trustee for it any benefit that the partner derives from it and refrain from taking a partnership opportunity for oneself, (2) engaging in conduct that is adverse to the partnership, and (3) to refrain from competing with the partnership.⁷⁴ The first rule allows the partnership to recover any money or property that can be traced to the partnership from a partner who has seized a partnership opportunity.⁷⁵ Pursuant to the second rule, a partner has a duty to refrain from engaging in conduct adverse to the partnership until the partner dissociates.⁷⁶ Finally, under the third rule, a partner has a duty not to compete with the partnership.⁷⁷

As with most of the RUPA provisions, fiduciary duties can be altered in the partnership agreement, but they cannot be completely eliminated, as provided in section 404(a).⁷⁸ Section 103(b), titled "Nonwaivable Provisions," prevents the complete elimination of the duty of loyalty and the duty of care.⁷⁹ Section 103(b)(3) prevents the partnership agreement from completely eliminating the duty of loyalty, but allows partners to reduce it by specifying categories that do not violate the duty, so long as they are not unreasonable.⁸⁰ Similarly, section 103(b)(4) prevents the partnership agreement from

73. A partner's duty of loyalty to the partnership and the other partners is limited to the following: (1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity; (2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and (3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

UNIF. P'SHIP ACT § 404(b).

74. *Id.*

75. *Id.* § 404 cmt. 2.

76. *Id.*

77. *Id.*

78. *Id.* § 103(b)(3)–(4).

79. *Id.*

80. *Id.* § 103(b)(3)(i) ("The partnership agreement may not: eliminate the duty of loyalty under Section 404(b) . . . , but: (i) the partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable . . .").

unreasonably reducing the duty of care.⁸¹ The official comment to section 103 explains that a need to protect against “unequal bargaining power, information, or sophistication” is a reason for having mandatory fiduciary duties.⁸²

Maryland's partnership statute is generally consistent with RUPA.⁸³ Specifically, Maryland's partnership statute has language in the duty of care,⁸⁴ duty of loyalty,⁸⁵ and exculpatory⁸⁶ provisions that are similar to RUPA.⁸⁷

81. *Id.* § 103(b)(4) (“The partnership agreement may not: (4) unreasonably reduce the duty of care under Section 404(c) . . .”).

82. *Id.* § 103 cmt. 4; *see also* Hynes, *supra* note 58, at 37. In a letter to the drafters of RUPA, which played a prominent role in incorporating mandatory fiduciary duties, Professor Eisenberg argued:

[T]hat owing to the uncertain and fluid nature of many partnerships, it is almost impossible to anticipate ways in which a provision overriding fiduciary duties can be abused by an opportunistic partner, and thus either section 103 should be dropped altogether, returning to the format of the UPA, or fiduciary rules should be included as mandatory duties under section 103.

Hynes, *supra* note 58, at 47. Other commentators have noted that allowing a total waiver of fiduciary duties creates the possibility of deadlock during negotiations. *See e.g.*, Richard A. Booth, *Fiduciary Duty, Contract, and Waiver in Partnerships and Limited Liability Companies*, 1 J. SMALL & EMERGING BUS. L. 55, 61 (1997). By allowing a total waiver of fiduciary duties, parties may never reach an agreement because they cannot be sure of the degree to which they must give up other opportunities they may wish to protect. *Id.*

83. *See* MD. CODE ANN., CORPS. & ASS'NS §§ 9A-103(b)(3)–(4), 9A-404(a)–(c) (LexisNexis 2007).

84. Compare UNIF. P'SHIP ACT § 404(c), 6 U.L.A. 875 (1997), with MD. CODE ANN., CORPS. & ASS'NS § 9A-404(c) (LexisNexis 2007), which provides, “[a] partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of the law.”

85. Compare UNIF. P'SHIP ACT § 404(b), with MD. CODE ANN., CORPS. & ASS'NS § 9A-404(b) (LexisNexis 2007), which provides that

[a] partner's duty of loyalty to the partnership and the other partners is limited to the following: (1) To account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity; (2) To refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and (3) To refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

B. *MBCA's Approach to Fiduciary Duties*

The MBCA represents a model of fiduciary duties in the corporate context.⁸⁸ Subchapter C of the MBCA lays out the fiduciary duties that a director owes to the corporation, which includes the duty of care and the duty of loyalty.⁸⁹ A director is expected to act in the best interest of the corporation when fulfilling his duties to the corporation.⁹⁰

Section 8.30(b) requires directors, as they become informed with their decision-making function and oversight responsibility, to carry out these duties with the care of a reasonably prudent person in the same or similar circumstances.⁹¹ The official comment to section 8.30(b) notes that the general standard of conduct is focused on the manner in which the director becomes informed with respect to his oversight and decision-making function, and not the correctness of the decision itself.⁹² The official comment to section 8.30(b) also provides that in exercising a director's duty of care, it is not what a particular director would believe to be appropriate, but what a person in a similar position acting under similar circumstances would reasonably believe to be appropriate.⁹³

Related to a director's duty of care is the business judgment rule, which creates a rebuttable presumption that the directors are acting on an informed basis.⁹⁴ The business judgment rule, for the most

86. Compare UNIF. P'SHIP ACT § 103(b)(3)–(4) (stating that a partnership may not unreasonably reduce the duty of care or eliminate the duty of loyalty), with MD. CODE ANN., CORPS. & ASS'NS § 9A-103(b)(4) (LexisNexis 2007) (“The partnership agreement may not: (4) [u]nreasonably reduce the duty of care under § 9A-404(c) . . . of this title.”), and MD. CODE ANN., CORPS. & ASS'NS § 9A-103(b)(3) (LexisNexis 2007) (“The partnership agreement may not: (3) [e]liminate the duty of loyalty under § 9A-404(b) . . . of this title, but: (i) [t]he partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty . . .”).

87. Compare UNIF. P'SHIP ACT § 404(a), with MD. CODE ANN., CORPS. & ASS'NS § 9A-404(a) (LexisNexis 2007) (“The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c) of this section.”).

88. See *supra* note 22.

89. MODEL BUS. CORP. ACT § 8.30(a)–(b) (2008).

90. *Id.* § 8.30(a) (“Each member of the board of directors, when discharging the duties of the director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interest of the corporation.”).

91. *Id.* § 8.30(b).

92. *Id.* § 8.30(b) cmt. 2.

93. *Id.*

94. See *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). Some state statutes, such as Maryland's, have chosen to codify the business judgment rule, but others still

part, is not codified in statute but is instead well established in case law.⁹⁵ Pursuant to the duty of care and business judgment rule, the director will not be held liable even though the decision itself was not that of a reasonably prudent person, so long as the director acts in good faith and with due care in the "process sense."⁹⁶ Courts and commentators have noted specific policy reasons supporting the application of the business judgment rule, which include (1) avoiding judicial intrusion into business decisions, (2) encouraging directors to take risks without looking over their shoulder's, and (3) not deterring individuals from taking director positions.⁹⁷ Judges are not as well-versed in the difficult business decisions that directors are faced with and have readily admitted it.⁹⁸ In *Shlensky v. Wrigley*, the court clearly stated that "judges are not business experts."⁹⁹ In addition, judges typically lack the ability to fully understand the specific circumstances that confront a business.¹⁰⁰ Another reason supporting the application of the business judgment rule is that directors need to be given the freedom to take risks on behalf of a corporation.¹⁰¹ Shareholders and corporations benefit from directors being able to take various business risks, such as diversifying the corporation's stock portfolio.¹⁰² Finally, the application of the business judgment

follow the common law. MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(a) (LexisNexis 2007); see, e.g., *Smith*, 488 A.2d at 872.

95. Janet E. Kerr, *Sustainability Meets Profitability: The Convenient Truth of How the Business Judgment Rule Protects a Board's Decision to Engage in Social Entrepreneurship*, 29 CARDOZO L. REV. 623, 636 (2007). For a codified version of the business judgment rule, see PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(c) (1994):

A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer: (1) is not interested [§ 1.23] in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.

96. Charles Hansen, *The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule, a Commentary*, 41 BUS. LAW. 1237, 1238 (1986).
97. See, e.g., *Shlensky v. Wrigley*, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968); Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439, 455 (2005).
98. *Shlensky*, 237 N.E.2d at 780.
99. *Id.*
100. Johnson, *supra* note 97, at 456.
101. *Id.*
102. *See id.*

rule prevents the possibility of deterring people from taking director positions with the corporation.¹⁰³ If a poor business decision results in a corporation losing money, a rule that too readily holds directors liable would certainly deter people from taking director positions.¹⁰⁴

A director's duty of loyalty includes the duty to neither engage in a self-dealing transaction nor usurp a corporate opportunity.¹⁰⁵ A self-dealing transaction is defined by section 8.60(1) as a transaction where the director is a party to the transaction or where the director has a material financial interest in the transaction.¹⁰⁶ However, section 8.61(b), which is considered the "safe harbor" provision, affords a director's self-dealing transaction protection in certain circumstances.¹⁰⁷ Pursuant to section 8.61(b), a self-dealing transaction is not considered voidable by the corporation if it has been approved by disinterested shareholders or directors, or the interested director establishes the fairness of the transaction to the corporation.¹⁰⁸

Another situation that can trigger a director's duty of loyalty is usurping a corporate opportunity.¹⁰⁹ The official comment to section 8.70 defines the common law doctrine of corporate opportunity as the right a corporation has prior to its directors to act on certain business opportunities.¹¹⁰ If a director acts on that opportunity without first presenting it to the corporation, the director is held to have "usurped" the right of the corporation.¹¹¹ Section 8.70(a) is a safe harbor provision that affords a director protection when taking a corporate opportunity.¹¹²

103. *Id.* at 455–56.

104. *Id.* at 455.

105. MODEL BUS. CORP. ACT §§ 8.60(1), 8.70 (2009).

106. *Id.* § 8.60(1).

107. A director's conflicting interest transaction may not be the subject of equitable relief, or give rise to an award of damages or other sanctions against a director, in a proceeding by a shareholder or by or in the right of the corporation, on the ground that the director has an interest respecting the transaction, if: (1) directors' action respecting the transaction was taken in compliance with section 8.62 at any time; or (2) shareholders' action respecting the transaction was taken in compliance with section 8.63 at any time; or (3) the transaction, judged according to the circumstances at the relevant time, is established to have been fair to the corporation.

Id. § 8.61(b).

108. *Id.*

109. *Id.* § 8.70.

110. *Id.* § 8.70 cmt.

111. *Id.*

112. A director's taking advantage, directly or indirectly, of a business

The American Law Institute (ALI) defines a corporate opportunity as (1) an opportunity to engage in a business activity that a director becomes aware of either (a) in connection with the performance of their job or under circumstances that would lead a reasonable director to believe that the person offering the opportunity expects it to be offered to the corporation, or (b) through the use of corporate information or property, if the resulting opportunity is one in which the director should reasonably believe would be of interest to the corporation; or (2) any opportunity to engage in a business activity that a director becomes aware of and knows is closely related to the business in which the corporation is engaged or expects to be engaged in.¹¹³ If it is established that an opportunity is a corporate opportunity, a director may not take advantage of a corporate opportunity unless (1) the director first offers the corporate opportunity to the corporation making full disclosure concerning the conflict or interest; (2) the opportunity is rejected by the corporation; and (3) either the rejection is fair to the corporation, or the rejection is made in advance by disinterested directors or by disinterested shareholders.¹¹⁴

*Northeast Harbor Golf Club, Inc. v. Harris*¹¹⁵ serves as an example of a court applying the corporate opportunity doctrine.¹¹⁶ In that case,

opportunity may not be the subject of equitable relief, or give rise to an award of damages or other sanctions against the director, in a proceeding by or in the right of the corporation on the ground that such opportunity should have first been offered to the corporation, if before becoming legally obligated respecting the opportunity the director brings it to the attention of the corporation and: (1) action by qualified directors disclaiming the corporation's interest in the opportunity is taken in compliance with the procedures set forth in section 8.62, as if the decision being made concerned a director's conflicting interest transaction, or (2) shareholders' action disclaiming the corporation's interest in the opportunity is taken in compliance with the procedures set forth in section 8.63, as if the decision being made concerned a director's conflicting interest transaction; except that, rather than making "required disclosure" as defined in section 8.60, in each case the director shall have made prior disclosure to those acting on behalf of the corporation of all material facts concerning the business opportunity that are then known to the director.

Id. § 8.70(a).

113. AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.05(b) (1994).

114. *Id.* § 5.05(a).

115. 661 A.2d 1146 (Me. 1995).

116. *Id.* at 1146.

the plaintiff, Northeast Harbor Golf Club, alleged that the defendant, the former president of the corporation, usurped a corporate opportunity when the defendant purchased and developed real estate adjacent to the golf club.¹¹⁷ In reaching its holding, the Supreme Court of Maine applied the ALI approach to the corporate opportunity doctrine.¹¹⁸ First, the court held that if the fact-finder believed that the property was offered to the defendant specifically in her capacity as the president of the Golf Club, then it would be considered a corporate opportunity.¹¹⁹ Second, the court held that if the defendant had failed to offer the opportunity at all to the corporation, then she could not claim that the taking of the opportunity was, in fact, fair.¹²⁰ The court was forced to remand the case for further factual findings.¹²¹

The MBCA allows fiduciary duties to be altered in the articles of incorporation, but the articles cannot completely eliminate a director's fiduciary duties.¹²² Section 2.02(b)(4) enumerates specific instances in which the articles prohibit the limiting or elimination of liability on behalf of a director to the corporation.¹²³ The articles cannot limit or eliminate a director's liability to the corporation for (1) a financial benefit received by the director which he is not entitled to, (2) intentional infliction of harm on the corporation or shareholders, (3) an unlawful distribution, and (4) intentional violation of a criminal law.¹²⁴

Maryland's corporation statute is, in principle, consistent with the MBCA.¹²⁵ A leading commentator in Maryland corporate law, James J. Hanks, has noted that the duty of care¹²⁶ and the business judgment

117. *Id.* at 1148.

118. *Id.* at 1152.

119. *Id.* at 1151.

120. *Id.* at 1151–52.

121. *Id.* at 1152.

122. *See* MODEL BUS. CORP. ACT § 2.02(b)(4) (2009).

123. *Id.*

124. *Id.*

125. *Compare, e.g.,* MD. CODE ANN., CORPS. & ASS'NS § 2-405.2 (LexisNexis 2007) (permitting the corporation to limit or expand a director's or officer's liability), *with* MODEL BUS. CORP. ACT § 2.02(b)(4) (providing that articles of incorporation may limit or expand a director's liability).

126. *Compare* MODEL BUS. CORP. ACT § 8.30(a)–(b) (2009), *with* MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(a) (LexisNexis 2007):

A director shall perform his duties as a director, including his duties as a member of a committee of the board on which he serves: (1) [i]n good faith; (2) [i]n a manner he reasonably believes to be in the best interests of the corporation; and (3) [w]ith the care that an ordinarily prudent person in a like position would use under similar circumstances.

rule¹²⁷ in Maryland's corporate statute are similar to the MBCA.¹²⁸ Similar to the MBCA duty of care provision, Hanks notes that Maryland's duty of care provision is aimed at the manner or process by which a director makes a decision and not the result of those decisions.¹²⁹ Hanks further notes that section 2-405(e) serves as a codified version of the business judgment rule.¹³⁰ Also, the language contained in Maryland's corporate statute for self-interested transactions is similar to the MBCA.¹³¹ Maryland, like the MBCA, also follows the corporate opportunity doctrine.¹³² According to Hanks, the corporate opportunity doctrine stands for the proposition that corporate personnel are prohibited from diverting corporate opportunities for themselves.¹³³ Also, Maryland has adopted the

127. MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(e) (LexisNexis 2007) ("An act of a director of a corporation is presumed to satisfy the standards of subsection (a) of this section.").

128. JAMES J. HANKS, JR., MARYLAND CORPORATION LAW §§ 6.6(b), 6.8 (Supp. 2008).

129. *Id.* at § 6.6(b).

130. *Id.* at § 6.8 (Supp. 2007).

131. Compare MODEL BUS. CORP. ACT § 8.60(1), with MD. CODE ANN., CORPS. & ASS'NS § 2-419(a) (LexisNexis 2007), which provides that

[i]f subsection (b) of this section is complied with, a contract or other transaction between a corporation and any of its directors or between a corporation and any other corporation, firm, or other entity in which any of its directors is a director or has a material financial interest is not void or voidable solely because of any one or more of the following: (1) [t]he common directorship or interest; (2) [t]he presence of the director at the meeting of the board or a committee of the board which authorizes, approves, or ratifies the contract or transaction; or (3) [t]he counting of the vote of the director for the authorization, approval, or ratification of the contract or transaction.

and MD. CODE ANN., CORPS. & ASS'NS § 2-419(b), which provides that

[s]ubsection (a) of this section applies if: (1) [t]he fact of the common directorship or interest is disclosed or known to: (i) [t]he board of directors or the committee, and the board or committee authorizes, approves, or ratifies the contract or transaction by the affirmative vote of a majority of disinterested directors, even if the disinterested directors constitute less than a quorum; or (ii) [t]he stockholders entitled to vote, and the contract or transaction is authorized, approved, or ratified by a majority of the votes cast by the stockholders entitled to vote other than the votes of shares owned of record or beneficially by the interested director or corporation, firm, or other entity; or (2) [t]he contract or transaction is fair and reasonable to the corporation.

132. See HANKS, *supra* note 128, at § 6.23 (Supp. 2007).

133. *Id.*

“interest or reasonable expectancy” test for determining whether a director has usurped a corporate opportunity.¹³⁴ Finally, Maryland’s corporate statute contains exculpatory language that is consistent with the MBCA.¹³⁵

C. *Similarities and Differences Between Partnership and Corporate Approaches to Fiduciary Duties*

Partnerships and corporations are governed by express fiduciary standards. While there are some notable similarities, there are also some differences.¹³⁶ One similarity between the partnership and corporate approaches to fiduciary duties is that both business entities recognize the duty of care and the duty of loyalty.¹³⁷ Another similarity between the partnership and corporate approach to fiduciary duties is the inability to completely eliminate fiduciary duties.¹³⁸

134. *Id.*

135. Compare MODEL BUS. CORP. ACT § 2.02(b), with MD. CODE ANN., CORPS. & ASS’NS § 2-405.2 (LexisNexis 2007) (“The charter of the corporation may include any provision expanding or limiting the liability of its directors and officers to the corporation or its stockholders as described under § 5-418 of the Courts and Judicial Proceedings Article.”).

136. One can attribute the difference between partnership and corporate fiduciary standards to the polar-opposite management and control styles. Compare UNIF. P’SHIP ACT § 401(f), 6 U.L.A. 133 (1997) (“Each partner has equal rights in the management and conduct of the partnership business.”), with MODEL BUS. CORP. ACT § 8.01(b) (“All corporate powers shall be exercised by or under the authority of the board of directors” and the “business and affairs of the corporation shall be managed by or under the direction” of the board of directors.). Most partnerships have decentralized management, meaning that all the partners have an equal share in the management and control of the partnership. UNIF. P’SHIP ACT § 401(e)–(f); see also RIBSTEIN & KEATINGE, *supra* note 29, § 8:16. The decentralized management structure of a partnership plays a role in allowing partners more leeway in acting in their own best interests. See *infra* notes 150–51 and accompanying text. Corporations on the other hand usually have centralized management to separate out those with ownership, the shareholders, from those with authority to act on behalf of the corporation, the directors, or officers. MODEL BUS. CORP. ACT § 8.01(b); see also RIBSTEIN & KEATINGE, *supra* note 29, § 8:15. The centralized management structure of a corporation places a more stringent requirement on the directors to not act in their own self-interest when it conflicts with the best interests of the corporation. See *infra* note 153 and accompanying text.

137. Compare UNIF. P’SHIP ACT § 404(a) (stating that a partner has the duty of care and the duty of loyalty), with MODEL BUS. CORP. ACT § 8.30(a)–(b) (establishing the duty of care and the duty of loyalty for directors).

138. Compare UNIF. P’SHIP ACT § 103(b)(3)–(4) (prohibiting a partnership agreement from eliminating the duty of loyalty or unreasonably reducing the duty of care), with

The duty of care standard itself does not differ much between a partnership and a corporation. But unlike corporations, the uncertainty surrounding the application of the business judgment rule to partnerships is a notable difference.¹³⁹ In a partnership, the duty of care standard is to refrain from “grossly negligent” conduct, meaning that a partner must perform his responsibilities to the partnership and other partners with some degree of skill.¹⁴⁰ By contrast, in a corporation, the duty of care standard for a director is to act with the care of a reasonably prudent person in the same or similar circumstances in becoming informed in connection with their oversight duties and decision-making function.¹⁴¹ Also in the corporate context, the duty of care is subject to the business judgment rule.¹⁴² Some courts and commentators have found that the business judgment rule does not apply in the partnership context.¹⁴³ For example, the United States Court of Appeals for the Third Circuit in *Henkels & McCoy, Inc. v. Adochio* agreed that application of the business judgment rule is inappropriate in the partnership context because its protection is restricted to the corporate setting.¹⁴⁴ Thus, it could be argued that it is much more difficult to show a violation of the duty of care in the corporate context because there is a presumption that the directors are acting in the best interest of the corporation.¹⁴⁵

However, courts in other jurisdictions have applied the business judgment rule to general partnerships.¹⁴⁶ For instance, the Court of Appeals of South Carolina in *Kuznik v. Bees Ferry Assocs.* held that the business judgment rule may apply to partnerships.¹⁴⁷ In order for

MODEL BUS. CORP. ACT § 2.02(b)(4) (restricting the ability to eliminate or limit the liability of a director).

139. Compare UNIF. P'SHIP ACT § 404(c) (stating that a partner may not engage in “grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law”), with MODEL BUS. CORP. ACT § 8.30(b) (requiring that directors “discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances”).

140. See UNIF. P'SHIP ACT § 404(c).

141. MODEL BUS. CORP. ACT § 8.30(b) cmt. 2.

142. *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985).

143. See, e.g., *Henkels & McCoy, Inc. v. Adochio*, 138 F.3d 491, 502 (3rd Cir. 1998); Elizabeth S. Miller & Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations?*, 30 DEL. J. CORP. L. 343, 343 (2005).

144. *Henkels*, 138 F.3d at 502.

145. See Miller & Rutledge, *supra* note 143, at 345–46.

146. See, e.g., *Kuznik v. Bees Ferry Assocs.*, 538 S.E.2d 15, 26 (S.C. Ct. App. 2000).

147. *Id.* at 27.

the business judgment rule to apply, “the allegedly violating partner must show he acted: (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the partner reasonably believes to be in the best interests of the partnership.”¹⁴⁸ However, the court held that the business judgment rule would not apply where the partner had engaged in self-dealing transactions, fraud, or other unconscionable conduct.¹⁴⁹

A subtle difference can be found in the duty of loyalty standards of a partnership and a corporation.¹⁵⁰ In a partnership, a partner is given more leeway in carrying out his duty of loyalty.¹⁵¹ While a partner must refrain from self-dealing transactions and usurping a partnership opportunity,¹⁵² RUPA section 404(e) permits a partner to act in his own best interests without violating his fiduciary duties to the other partners or the partnerships.¹⁵³ By contrast, in a corporation, a director’s duty of loyalty to the corporation ensures that a director’s self interests do not conflict with the interests of the corporation.¹⁵⁴

IV. VARIOUS STATUTORY APPROACHES TO FIDUCIARY DUTIES IN THE LLC CONTEXT

A problem that has continued to plague the LLC during its development has been the lack of uniformity regarding a statutorily defined fiduciary standard.¹⁵⁵ This can be attributed, in part, to conflicting IRS rulings that were issued during the early development stages of the LLC.¹⁵⁶ Both partnership and corporate statutes contain express fiduciary duties.¹⁵⁷ The LLC combines the features of both a

148. *Id.*

149. *Id.*

150. Compare UNIF. P’SHIP ACT § 404(b), 6 U.L.A. 143 (1997) (requiring partners to hold any profit, property, or benefit acquired in the course of partnership business in trust for the partnership; refrain from dealing with the partnership as an adverse party; and not compete with the partnership), with MODEL BUS. CORP. ACT § 8.30(a) (2009) (requiring directors to act in good faith and in the best interests of the corporation).

151. UNIF. P’SHIP ACT § 404(e).

152. *Id.* § 404(b)(1).

153. *Id.* § 404(e).

154. See *supra* notes 89–90 and accompanying text.

155. Szto, *supra* note 10, at 63.

156. *Id.* (“Because of early conflicting IRS rulings, however, LLCs did not become popular until several years after the first LLC statute was passed. Also, conflicting IRS rulings led to varied LLC statutes and fiduciary standards.”).

157. See UNIF. P’SHIP ACT § 404(a); MODEL BUS. CORP. ACT §§ 8.30(a)–(c), 8.62(a)–(b) (2009).

partnership and a corporation.¹⁵⁸ Therefore, many LLC statutes have incorporated fiduciary standards that mirror a partnership, a corporation, or even both.¹⁵⁹

Many LLC statutes contain some form of statutorily enumerated fiduciary duties.¹⁶⁰ Illinois and California LLC statutes more closely reflect the fiduciary duties found in a partnership.¹⁶¹ By contrast, Virginia and New York LLC statutes reflect the corporate fiduciary standard.¹⁶² The Revised Uniform Limited Liability Company Act (RULLCA)¹⁶³ applies principles found in both partnership and corporate statutes.¹⁶⁴ Finally, Delaware's LLC statute allows for the operating agreement to control, either expanding or even completely eliminating fiduciary duties.¹⁶⁵

A. *LLC Statutes Adopting the Partnership Approach to Fiduciary Duties*

Some LLC statutes have followed the partnership approach to fiduciary duties.¹⁶⁶ This comment will analyze Illinois's and California's LLC statutes, both of which draw a distinction between member-managed and manager-managed LLCs and incorporate an expressed fiduciary duty provision.

1. Illinois's Approach to Fiduciary Duties

Illinois's LLC statute clearly draws a distinction between a member-managed and a manager-managed LLC.¹⁶⁷ Illinois's

158. Miller, *supra* note 39, at 567.

159. Miller, *supra* note 5, at 635 ("Statutory articulations of duties and standards that show up in the state LLC statutes include provisions based on standards of conduct applicable to corporate directors found in the [MBCA], provisions based on duties and standards set forth in the [RUPA] . . .").

160. See RIBSTEIN & KEATINGE, *supra* note 29, app. 9-7.

161. See CAL. CORP. CODE § 17153 (West 2006); 805 ILL. COMP. STAT. ANN. 180/15-3(a) (West 2004).

162. See N.Y. LTD. LIAB. CO. LAW § 409(a) (McKinney 2007); VA. CODE ANN. § 13.1-1024.1 (2006).

163. The Revised Uniform Limited Liability Company Act has multiple abbreviations, but for purposes of this comment, it will be referred to as RULLCA. On July 13, 2006, the National Conference of Commissioners on Uniform State Laws (NCCUSL) promulgated the enactment of RULLCA in all states. Daniel S. Kleinberger & Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act*, 62 BUS. LAW. 515, 516 (2007).

164. See *id.* at 519.

165. See DEL. CODE ANN. tit. 6, § 18-1101(c) (2005).

166. See *id.*

167. 805 ILL. COMP. STAT. ANN. 180/15-1(a)-(b) (West 2004).

approach to LLC fiduciary duties incorporates language virtually identical to that contained in RUPA.¹⁶⁸ The Illinois LLC Act provides that the duty of care and the duty of loyalty apply to both members and managers in an LLC.¹⁶⁹

The language in Illinois's duty of loyalty provision for members in a member-managed LLC is almost identical to RUPA.¹⁷⁰ Also, Illinois's duty of care provision is similar to RUPA, applying a gross negligence standard of care to members in a member-managed LLC.¹⁷¹

168. Compare UNIF. P'SHIP ACT § 404(a), 6 U.L.A. 143 (1997) ("The only fiduciary duties a partner owes to the partnership and other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c)."), with 805 ILL. COMP. STAT. ANN. 180/15-3(a) (West 2004) ("The fiduciary duties a member owes to a member-managed company and its other members include the duty of loyalty and the duty of care referred to in subsections (b) and (c) of this Section.").

169. 805 ILL. COMP. STAT. ANN. 180/15-3(a) (West 2004).

170. Compare UNIF. P'SHIP ACT § 404(b), which provides that

[a] partner's duty of loyalty to the partnership and the other partner's is limited to the following: (1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity; (2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and (3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

with 805 ILL. COMP. STAT. ANN. 180/15-3(b) (West 2004), which provides that

[a] member's duty of loyalty to a member-managed company and its other members includes the following: (1) to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member in the conduct or winding up of the company's business or derived from a use by the member of the company's property, including the appropriation of a company's opportunity; (2) to act fairly when a member deals with the company in the conduct or winding up of the company's business as or on behalf of a party having an interest adverse to the company; and (3) to refrain from competing with the company in the conduct of the company's business before the dissolution of the company.

171. Compare UNIF. P'SHIP ACT § 404(c) ("A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law."), with 805 ILL. COMP. STAT. ANN. 180/15-3(c) (West 2004) ("A member's duty of care to a member-managed company and its other members in the conduct of a winding up of the company's business is

In a manager-managed LLC, a manager is held to the same duty of loyalty and duty of care standards as a member in a member-managed LLC.¹⁷² But members in a manager-managed LLC do not owe any duties to the company or to other members because of their status as members.¹⁷³ However, if a member exercises managerial authority, then he or she is held to the same duties as a manager.¹⁷⁴

Finally, similar to the RUPA model of fiduciary duties, the Illinois LLC statute contains a provision that prevents the complete elimination of fiduciary duties.¹⁷⁵ However, parties may list categories or specify types of activities that do not violate the duties.¹⁷⁶ The District Court for the Northern District of Illinois referenced the nonwaivable provision in *Thorpe v. Levenfeld*,¹⁷⁷ where a member of an LLC was suing another member and the LLC for breach of fiduciary duties.¹⁷⁸ The court held that while parties could contract around provisions in the LLC, they could not completely eliminate a member's fiduciary duties.¹⁷⁹ The court reasoned that the defendants were unable to point to any provisions in the operating agreement that set out "specific types of categories or activities" that did not violate fiduciary duties.¹⁸⁰ Therefore, the plaintiff's claim for breach of fiduciary duty was not dismissed.¹⁸¹

2. California's Approach to Fiduciary Duties

The California LLC statute draws a clear distinction between a member-managed and a manager-managed LLC.¹⁸² A California

limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.").

172. 805 ILL. COMP. STAT. ANN. 180/15-3(g)(2) (West 2004).

173. *Id.* 180/15-3(g)(1).

174. *Id.* 180/15-3(g)(3).

175. Compare UNIF. P'SHIP ACT § 103(b)(3)(i) ("The partnership agreement may not: . . . (3) eliminate the duty of loyalty under Section 404(b) . . . but: (i) the partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable . . ."), with 805 ILL. COMP. STAT. ANN. 180/15-5(b)(6)(A) (West 2004) ("The operating agreement may not: . . . (6) eliminate or reduce a member's fiduciary duties, but may: (A) identify specific types or categories of activities that do not violate these duties, if not manifestly unreasonable . . .").

176. 805 ILL. COMP. STAT. ANN. 180/15-5(b)(6)(A) (West 2004).

177. No. 04 C 3040, 2005 WL 2420373, at *4 (N.D. Ill. Sept. 29, 2005).

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. CAL. CORP. CODE § 17150 (West 2006).

LLC will only be considered manager-managed if the parties expressly state so in the operating agreement.¹⁸³

California took an approach similar to Illinois in articulating a fiduciary standard.¹⁸⁴ While California's LLC statute does not contain identical fiduciary duty language to that found in RUPA, California's statute does state in plain terms that the fiduciary duties owed in an LLC are the same as those owed in a partnership.¹⁸⁵

Some commentators have noted that the likely purpose behind articulating a fiduciary standard such as the one California follows is due to the small amount of case law that is available for the LLC.¹⁸⁶ By articulating a fiduciary standard that is based on another business entity's approach, there is much more case law available for courts to rely upon when making a decision.¹⁸⁷ In addition, applying a partnership fiduciary standard to the LLC seems proper because the LLC in many respects is similar to the partnership.¹⁸⁸ Like partnerships, an LLC is likely to be closely held and have substantial participation by members in the management of the LLC.¹⁸⁹

B. LLC Statutes Adopting the Corporate Approach to Fiduciary Duties

Other state LLC statutes have fashioned their fiduciary duty provisions after the corporate model.¹⁹⁰ This comment will analyze Virginia and New York's LLC statute, both of which draw a distinction between a member-managed and a manager-managed LLC and incorporate an express fiduciary duty provision.

183. *Id.*

184. *See id.* § 17153.

185. *Id.* § 17150 ("If management is vested in the members, each of the members shall have the same rights and be subject to all duties and obligations of managers as set forth in this title."); *id.* § 17153 ("The fiduciary duties a manager owes to the limited liability company and to its members are those of a partner to a partnership and to the partners of the partnership.").

186. *See, e.g.,* Andrew J. Glendon, *California's Limited Liability Company Act Gets a Facelift*, 28 PAC. L.J. 635 (1997).

187. *Id.* at 640 ("These partnership fiduciary duties [in California's LLC Act] are governed by the Uniform Partnership Act (UPA) Although this fiduciary rule may seem unable to address all of the potential issues that may arise, much partnership case law exists that speaks to many, if not most, of the possible issues that may arise.").

188. *Id.*; *see also* Gevurtz, *supra* note 9, at 268 ("Generally, the decision to incorporate partnership, rather than corporate, law rules of fiduciary duty seems sensible.").

189. Glendon, *supra* note 186, at 640.

190. *See* RIBSTEIN & KEATINGE, *supra* note 29, app. 9-7.

1. Virginia's Approach to Fiduciary Duties

Virginia's LLC statute draws a clear distinction between a member-managed and a manager-managed LLC.¹⁹¹ Pursuant to section 13.1-1022(A) of Virginia's LLC statute, the default management structure for an LLC is member-managed unless the parties state otherwise in the articles of organization or the operating agreement.¹⁹² Because the default management structure is member-managed, the same fiduciary duties that apply to managers in a manager-managed apply to members in a member-managed LLC.¹⁹³

The Virginia LLC statute favors the corporate approach to fiduciary duties, combining the codified best interests language from the MBCA with the common law business judgment rule.¹⁹⁴ Section 13.1-1024.1 articulates that the decision of a manager of an LLC must be in the best interest of the LLC and is subject to the business judgment rule.¹⁹⁵

The Virginia courts, in applying section 13.1-1024.1, have drawn analogies to the fiduciary duty standard in corporations.¹⁹⁶ In *Flippo v. CSC Assocs. III, LLC*,¹⁹⁷ the LLC at issue, Flippo Land & Timber Co., LLC (FLTC), consisted of three members: Arthur Flippo, Carter Flippo, and CSC Associates III, L.L.C., which was formed to hold the Flippos' sister Lucy's children's interest.¹⁹⁸ When Carter and Arthur's attempt to create separate LLCs to hold their interest was rejected by CSC Associates, Carter decided to enter a joint venture with a corporation and transfer all of his assets to the new LLC, called Timber Enterprises.¹⁹⁹ Carter also informed CSC Associates that under the terms of the operating agreement, his actions would lead to the dissolution of FLTC.²⁰⁰ The Virginia Supreme Court

191. VA. CODE ANN. § 13.1-1022(A) (2006).

192. *Id.*

193. *Id.*

194. Compare MODEL BUS. CORP. ACT § 8.30(a) (2009) ("Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation."), with VA. CODE ANN. § 13.1-1024.1 (2006) ("A manager shall discharge his or its duties as a manager in accordance with the manager's good faith business judgment of the best interests of the limited liability company.").

195. VA. CODE ANN. § 13.1-1024.1(A) (2006).

196. Szto, *supra* note 10, at 69 (discussing that Virginia courts have shown a preference for a corporate duty of care standard for LLCs).

197. 547 S.E.2d 216 (Va. 2001).

198. *Id.* at 219–20.

199. *Id.* at 220.

200. *Id.*

found that Carter had acted for his own personal benefit and not in the best interest of FLTC.²⁰¹ Therefore, the court found that the defendant, as manager of the LLC, had breached his statutory fiduciary duty.²⁰²

2. New York's Approach to Fiduciary Duties

New York's LLC statute draws a clear distinction between a member-managed and a manager-managed LLC.²⁰³ Pursuant to section 401(a), it is presumed that the LLC will be member-managed unless the parties clearly state in the operating agreement that the LLC will be manager-managed.²⁰⁴

The New York LLC Act also incorporates a fiduciary duty standard that encompasses features from the corporate model.²⁰⁵ New York's LLC statute contains express fiduciary duties that were intended to follow the corporate model.²⁰⁶ The language from section 409(a) of New York's LLC Act holds managers of an LLC to an objective good faith standard.²⁰⁷

The New York Supreme Court applied this standard in *Nathanson v. Nathanson*.²⁰⁸ In that case, a member sued the manager of his LLC claiming that the manager had entered into a transaction that was for his own personal benefit and not in the best interests of the LLC.²⁰⁹ The court cited section 409(a), finding that a manager of an LLC must perform his duties in good faith and with the care of an ordinarily prudent person in a similar position.²¹⁰

201. *Id.* at 221 (“A manager, like a corporate director, is required to discharge his duties in accordance with his ‘good faith business judgment of the best interests of the limited liability company.’” (quoting VA. CODE ANN. § 13.1-1024.1(A) (2006))).

202. *Id.* at 222.

203. N.Y. LTD. LIAB. CO. LAW § 401(a) (McKinney 2007).

204. *Id.*

205. *See id.* §§ 409(a), 417(a).

206. Compare MODEL BUS. CORP. ACT § 8.30(a) (2009) (“Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith . . .”), and MODEL BUS. CORP. ACT § 8.30(b) (“The members of the board of directors or a committee of the board . . . shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.”), with N.Y. LTD. LIAB. CO. LAW § 409(a) (McKinney 2007) (“A manager shall perform his or her duties as a manager, including his or her duties as a member of any class of managers, in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances.”).

207. N.Y. LTD. LIAB. CO. LAW § 409(a) (McKinney 2007).

208. 799 N.Y.S.2d 83 (N.Y. App. Div. 2005).

209. *Id.* at 85.

210. *Id.* at 84–85.

Additionally, New York's LLC statute contains a provision that prevents the contractual elimination of fiduciary duties, which is similar to the provision found in the MBCA.²¹¹ Like the MBCA, the parties may specify particular acts that will not be considered violations of the duties, but they may not completely eliminate their fiduciary duties.²¹²

C. *LLC Statutes Adopting the Hybrid Approach to Fiduciary Duties*

Some state LLC statutes have incorporated a fiduciary standard that combines features from both the partnership and corporate models.²¹³ This comment will analyze the LLC model act (RULLCA), which draws a distinction between member-managed and manager-managed LLCs and incorporates an express fiduciary duty provision.

1. RULLCA's Approach to Fiduciary Duties

RULLCA was developed in response to the growing concern that diversity in state LLC laws might create problems for interstate LLCs.²¹⁴ As a result, an attempt to develop a uniform state LLC statute began immediately following the recognition of the LLC's tax status.²¹⁵ Unfortunately, many states had already adopted LLC statutes prior to the development of a standardized LLC statute.²¹⁶

The National Conference of Commissioners on Uniform State Laws (NCCUSL) promulgated the first standardized LLC statute, entitled the Uniform Limited Liability Company Act (ULLCA),²¹⁷ in 1996.²¹⁸ ULLCA was revised on July 13, 2006,²¹⁹ when the

211. Compare MODEL BUS. CORP. ACT § 2.02(b)(4) (2009), with N.Y. LTD. LIAB. CO. LAW § 417(a) (McKinney 2007) ("The operating agreement may set forth a provision eliminating or limiting the personal liability of managers to the limited liability company or its members for damages for any breach of duty in such capacity . . .").

212. N.Y. LTD. LIAB. CO. LAW § 417(a) (McKinney 2007).

213. See Ribstein, *supra* note 6, at 17–18 (describing the various components LLC statutes borrow from partnership and corporate models).

214. HAMILTON & MACEY, *supra* note 33, at 1183.

215. *Id.*

216. *Id.*

217. The NCCUSL is responsible for circulating uniform state laws for partnerships (RUPA), limited partnerships (RULPA), and limited liability companies (RULLCA). See NCCUSL, <http://www.nccusl.org> (last visited Jan. 10, 2011).

218. HAMILTON & MACEY, *supra* note 33, at 1183.

219. *Revised Uniform Limited Liability Company Act*, NCCUSL, http://www.law.upenn.edu/bll/ulc/ullca/2006act_final.htm (last visited Jan. 10, 2011).

NCCUSL approved the enactment of RULLCA.²²⁰ Presently, only two states have adopted RULLCA.²²¹

RULLCA contains statutorily enumerated types of fiduciary duties that are identical to the types of fiduciary duties contained in RUPA.²²² In applying fiduciary duties, RULLCA also draws a clear distinction between a member-managed and a manager-managed LLC.²²³ Under section 407(a) of RULLCA, an LLC is considered to be member-managed unless the parties expressly state in the operating agreement that the LLC will be manager-managed.²²⁴

RULLCA's duty of loyalty provision for a member-managed LLC is also identical to RUPA in that it prohibits or limits four specific types of conduct.²²⁵ First, fiduciaries are not to take profits for themselves that were earned by the LLC.²²⁶ Second, fiduciaries

220. *Id.*

221. HAMILTON & MACEY, *supra* note 33, at 1183.

222. Compare UNIF. P'SHIP ACT § 404(a), 6 U.L.A. 143 (1997) ("The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c)."), with REVISED UNIF. LTD. LIAB. CO. ACT § 409(a), 6B U.L.A. 488 (2006) ("A member of a member-managed limited liability company owes to the company and, subject to Section 901(b), the other members the fiduciary duties of loyalty and care stated in subsections (b) and (c).").

223. REVISED UNIF. LTD. LIAB. CO. ACT § 407(a).

224. *Id.*

225. Compare UNIF. P'SHIP ACT § 404(b), which provides that

[a] partner's duty of loyalty to the partnership and the other partners is limited to the following: (1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity; (2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and (3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership,

with REVISED UNIF. LTD. LIAB. CO. ACT § 409(b), which provides that

[t]he duty of loyalty of a member in a member-managed limited liability company includes the duties: (1) to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member . . . (2) to refrain from dealing with the company in the conduct or winding up of the company's activities as or on behalf of a person having an interest adverse to the company; and (3) to refrain from competing with the company in the conduct of the company's activities before the dissolution of the company.

226. REVISED UNIF. LTD. LIAB. CO. ACT § 409(b)(1)(A).

cannot take an LLC opportunity for themselves.²²⁷ Third, a fiduciary must refrain from dealing with the LLC when their interests are adverse to the LLC's interests.²²⁸ Finally, a fiduciary must refrain from directly competing with the LLC.²²⁹ RULLCA's duty of loyalty provision in a manager-managed LLC applies the same standard as that contained in a member-managed LLC, except that the duties only apply to the managers and not to members.²³⁰

RULLCA's duty of care provision in a member-managed LLC combines the common law business judgment rule with the codified duty of care provision found in the MBCA.²³¹ As with the corporate duty of care, managers of LLCs following RULLCA are held to act with reasonable care and in the best interests of the company in becoming informed of their monitoring and oversight duties.²³² RULLCA's duty of care provision for a manager-managed LLC incorporates the same fiduciary standard applied to members in a member-managed LLC, except that only managers, and not members, are held to the fiduciary standard.²³³

There has been some criticism over RULLCA's duty of care provision.²³⁴ One commentator felt that adopting the business judgment rule as part of the duty of care "[r]isks infecting the LLC

227. *Id.* § 409(b)(1)(C).

228. *Id.* § 409(b)(2).

229. *Id.* § 409(b)(3).

230. *Id.* § 409(g)(1)–(2) (“In a manager-managed limited liability company, the following rules apply: (1) [s]ubsections (a), (b), (c), and (e) apply to the manager or managers and not the members. (2) [t]he duty stated under section (b)(3) continues until the winding up is completed.”).

231. Compare MODEL BUS. CORP. ACT § 8.30(b) (2009), which provides that [t]he members of the board of directors or a committee of the board, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances,

with REVISED UNIF. LTD. LIAB. CO. ACT § 409(c), which provides that [s]ubject to the business judgment rule, the duty of care of a member-managed limited liability company in the conduct and winding up of the company's activities is to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the company.

232. Rutherford B. Campbell, Jr., *The “New” Fiduciary Standards Under the Revised Uniform Limited Liability Company Act: More Bottom Bumping from NCCUSL*, 61 ME. L. REV. 27, 37 (2009).

233. *See* REVISED UNIF. LTD. LIAB. CO. ACT § 409(g).

234. *See* Campbell, Jr., *supra* note 232, at 35–42.

duty of care with other misdirected concepts that courts (principally Delaware courts) have layered on the business judgment analysis.”²³⁵ Instead, according to this commentator, a better approach would be to modify RULLCA’s duty of care and adopt a clearly articulated negligence standard of care.²³⁶

However, not everyone has criticized RULLCA’s duty of care provision; there are some who feel that RULLCA’s approach provides the “best of both worlds” by incorporating a reasonable care in the becoming informed standard with the business judgment rule.²³⁷ The content and force with which the business judgment rule is applied will vary from jurisdiction to jurisdiction, but this was the intent of the drafters since the rule’s application will vary depending on the nature of the challenged conduct.²³⁸ Furthermore, the business judgment rule, under the law of several jurisdictions, applies to the various business organizations in a similar manner.²³⁹ Therefore, the rule is broad enough so that the formality of the organizational choice is less important in shaping the application of the rule than is the nature of the conduct challenged.²⁴⁰

RULLCA does contain a provision that allows parties to limit or specify activities that will not violate the duty of care or loyalty.²⁴¹ However, there are limitations on the opt-out provision similar to RUPA, mainly the prevention of completely eliminating the duty of care or the duty of loyalty.²⁴²

D. Delaware’s Approach to Fiduciary Duties

The Delaware LLC statute draws a distinction between a member-managed LLC and a manager-managed LLC.²⁴³ The default

235. *Id.* at 39.

236. *Id.* at 42.

237. Kleinberger & Bishop, *supra* note 163, at 528.

238. *Id.*

239. *Id.*

240. *Id.*

241. REVISED UNIF. LTD. LIAB. CO. ACT § 110(d), 6B U.L.A. 443 (2006) (“If not manifestly unreasonable, the operating agreement may: . . . (2) identify specific types or categories of activities that do not violate the duty of loyalty; (3) alter the duty of care . . . (4) alter any other fiduciary duty, including eliminating particular aspects of that duty . . .”).

242. “An operating agreement may not: . . . (4) subject to subsections (d) through (g), eliminate the duty of loyalty, the duty of care, or any other fiduciary duty . . .” *Id.* § 110(c).

243. Unless otherwise provided in a limited liability company agreement, the management of the limited liability company shall be vested in its members in proportion to the then current percentage . . . if a limited liability company

management authority is vested in the members unless the LLC agreement confers management authority in a manager.²⁴⁴

Delaware's LLC statute does not contain express fiduciary duties; instead, it embraces the idea of complete freedom of contract.²⁴⁵ Section 18-1101(c) articulates the duties that a member or a manager owes to the LLC.²⁴⁶ The express language in the Delaware statute allows for the expansion, restriction, or even complete elimination of fiduciary duties.²⁴⁷ The Delaware LLC Act was amended in August 2004 to include the express power to contractually eliminate fiduciary duties.²⁴⁸ A reason for the amendment was in response to

agreement provides for the management, in whole or in part, of a limited liability company by a manager, the management of the limited liability company, to the extent so provided, shall be vested in the manager

DEL. CODE ANN. tit. 6, § 18-402 (2005).

244. *Id.*

245. *Id.* § 18-1101(b) ("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.").

246. *Id.* § 18-1101(c). Section 18-1101(c) provides that

[t]o the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

Id.

247. *Id.*

248. DEL. CODE ANN. tit. 6, § 18-1101(c)(2) (1999), *amended by* DEL. CODE ANN. tit. 6, § 18-1101(c) (Supp. 2004), provides that

[t]o the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement[.]

See also Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 14–15 (2007) (discussing the August 2004 amendment to Delaware's Revised Uniform Limited Partnership Act and the impact it would have on the LLC Act); Miller, *supra* note 39, at 578 (discussing that the Delaware Legislature revised its Limited Liability Company Act to permit parties to not only expand or restrict, but also eliminate duties including fiduciary duties at law or in equity).

the Delaware Supreme Court's restrictive interpretation of the Delaware Revised Uniform Limited Partnership Act.²⁴⁹

Prior to the August 2004 amendment, the Delaware Supreme Court held in *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*²⁵⁰ that a limited partnership agreement could not completely eliminate the fiduciary duties of a general partner.²⁵¹ In its holding, the Delaware Supreme Court strongly criticized the lower court for its lack of reliance on the plain language of the statute.²⁵² The lower court relied on section 17-1101(d)(2), which stated, "[T]he partner's or other person's duties and liabilities may be expanded or restricted by provisions in the partnership agreement."²⁵³ The Delaware Supreme Court reasoned that nowhere in section 17-1101(d)(2) or in the rest of the statute does it state that a limited partnership agreement may eliminate the fiduciary duties of a general partner.²⁵⁴

The *Gotham* case serves as an example where both the lower and higher courts believed that they were giving effect to the legislature's intent, but in the end reached different results.²⁵⁵ While the *Gotham* case did not deal with LLCs, the fiduciary duty language contained in the LP statute was identical to the language in the LLC statute.²⁵⁶ Therefore, when the Delaware legislature amended the language in the limited partner statute, the identical language in the LLC statute was also amended.²⁵⁷

V. THE MARYLAND LLC AND FIDUCIARY DUTIES

In many ways, Maryland's LLC statute is different from other LLC statutes because it neither distinguishes between a member-managed and a manager-managed LLC nor includes an express fiduciary duty provision.²⁵⁸

Maryland's LLC statute does not draw a clear distinction between a member-managed and a manager-managed LLC.²⁵⁹ Instead, section

249. Steele, *supra* note 248, at 11.

250. 817 A.2d 160 (Del. 2002).

251. *Id.* 167-68.

252. *Id.*

253. *Id.*

254. *Id.*

255. *Id.*

256. See Miller, *supra* note 39, at 578.

257. See *id.*

258. See generally MD. CODE ANN., CORPS. & ASS'NS § 4A (LexisNexis 2007) (omitting any distinction between a member-managed and manager-managed LLC as well as any express fiduciary duty provision).

259. See generally *id.* (reviewing Maryland's LLC statute reveals that there is no mention of member-managed or manager-managed anywhere).

4A-402(a)(1) states that members may enter into an operating agreement to regulate the manner in which the LLC will be managed, controlled, and operated, which may include granting authority to manage to other persons who are not members.²⁶⁰ This provision effectively provides for something very similar to the member-managed or manager-managed models because the provision allows for the articles of organization to remove general agency authority from the members.²⁶¹ Therefore, while the express language of the statute does not refer to the member-managed and manager-managed distinction, the ability to take away express authority in the articles of organization allows a Maryland LLC to operate as member-managed or manager-managed.²⁶²

Maryland's approach to fiduciary duties is unlike that contained in partnership or corporate statutes and various other LLC statutes.²⁶³ In fact, Maryland's LLC statute does not even contain the term *fiduciary duty*.²⁶⁴ The closest provision in this regard is section 4A-405, entitled "Business transactions of member with limited liability company."²⁶⁵ It states that "[e]xcept as provided in the operating agreement, a member may lend money to and transact other business with the limited liability company and, subject to other applicable law, has the same rights and obligations with respect to the transaction as a person who is not a member."²⁶⁶ It could be argued that this language serves as a fiduciary duty provision; however, it

260. *Id.* § 4A-402(a). Section 4A-402(a) provides that

[e]xcept for the requirement set forth in § 4A-404 of this subtitle that certain consents be in writing, members may enter into an operating agreement to regulate or establish any aspect of the affairs of the limited liability company or the relations of its members, including provisions establishing: (1) [t]he manner in which the business and affairs of the limited liability company shall be managed, controlled, and operated, which may include the granting of exclusive authority to manage, control, and operate the limited liability company to persons who are not members. . . .

Id.

261. *See id.*

262. *See id.*

263. RIBSTEIN & KEATINGE, *supra* note 29, app. 9-7.

264. *See generally* MD. CODE ANN., CORPS. & ASS'NS § 4A (reviewing the entire Maryland LLC statute reveals that the term "fiduciary duty" is not found anywhere); *see also* RIBSTEIN AND KEATINGE, *supra* note 29, app. 9-7 (providing an overview of each state's approach to member's duties).

265. MD. CODE ANN., CORPS. & ASS'NS § 4A-405.

266. *Id.*

does not clearly articulate any type of fiduciary standard to which members are held.²⁶⁷

Another provision that discusses the authority of LLC members is found in Section 4A-401(a)(1), which states that “[e]xcept as provided in paragraph (3) of this subsection or in the operating agreement, each member is an agent of the limited liability company for the purpose of its business.”²⁶⁸ This provision, like 4A-405, does not articulate a clear fiduciary standard; instead it applies agency law to the members.²⁶⁹

While it is clear that Maryland’s LLC statute does not contain an express fiduciary duty provision, an argument could be made that Maryland’s statute relies on the principles of agency law.²⁷⁰ Prior to its enactment, the Maryland LLC Act included section 4A-401(E), which clearly laid out the agency relationship.²⁷¹ Section 4A-401(E) stated the following:

(E) Except as otherwise agreed, a member, to the extent the member acts as an agent of the limited liability company, shall hold as trustee for it, any profits that the member derives without the consent of the limited liability company from a transaction connected with the formation, conduct or liquidation of the limited liability company or from the member’s use of its property.²⁷²

The House Bill, as finally enacted, struck out 4A-401(E) entirely.²⁷³ Commentary to section 4A-401 mentions that subsection (E) was deleted from the Act prior to enactment because the Committee believed that the usual rules of the agency relationship would be applicable to members of the LLC when acting as agents.²⁷⁴

267. *See id.*

268. *Id.* § 4A-401(a)(1).

269. *Id.* §§ 4A-401(a)(1), 4A-405.

270. *See* ROBERT M. ERCOLE, STUART LEVINE, MARSHALL B. PAUL & DARYL J. SIDLE, MARYLAND LIMITED LIABILITY COMPANY FORMS AND PRACTICE MANUAL app. G2, at 28–29 (3d ed. 1999).

271. Maryland Limited Liability Company Act, ch. 536, § 4A-401(E), 1992 Md. Laws 3286, 3300.

272. *Id.*

273. *Id.*

274. ERCOLE ET AL., *supra* note 270, app. G-2, at 28–29. The Restatement of Agency Law defines agency as “[t]he fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.” RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

Furthermore, the Committee believed that the fiduciary obligations of the members would not be altered by the deletion of subsection (E).²⁷⁵ An October 30, 1991, draft of section 4A-401(E) included the heading "Fiduciary Obligations of Member"; however, the heading was crossed out and ultimately dropped along with the entire section.²⁷⁶ As such, it could be argued that the commentary discussing the reasons for striking section 4A-401(E) and the ultimate decision to remove the term "fiduciary" from the heading of section 4A-401(E) demonstrated that the principles of agency law would be sufficient for establishing the fiduciary duties among members in a Maryland LLC.²⁷⁷

The agency relationship includes an express fiduciary standard.²⁷⁸ Section 8.01 of the Restatement of Agency Law articulates the general fiduciary principle: "An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship."²⁷⁹ Thus, under agency law, the agent at a minimum owes a duty of loyalty to the principal.²⁸⁰

Two Maryland cases that address fiduciary duties in the Maryland LLC context include *Froelich v. Erickson*²⁸¹ and *Robinson v. GEO Licensing Co.*²⁸² In *Froelich*, the United States District Court for the District of Maryland upheld an operating agreement that assigned its LLC directors the same fiduciary duties as corporate fiduciaries under Maryland law.²⁸³ The court rationalized that the LLC board's decisions were protected from second-guessing by the business judgment rule.²⁸⁴ The only way that the court would overturn the

275. ERCOLE ET AL., *supra* note 270, app. G-2, at 28–29.

276. H.D. 373, 1992 Leg. (Md. 1992). The draft, as edited, provided as follows:
Section 4A-401(E) ~~Fiduciary Obligations of Member~~ – Except as otherwise agreed, a member, to the extent the member acts as an agent of the limited liability company, shall account to the limited liability company for any benefit and hold as trustee for it, any profits the member derives without the consent of the limited liability company from ~~any~~ transaction connected with the formation, conduct, or liquidation of the limited liability company or from the member's use of its property.

Id.

277. See ERCOLE ET AL., *supra* note 270, app. G-2, at 28–29.

278. RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006).

279. *Id.*

280. *Id.*

281. 96 F. Supp. 2d 507 (D. Md. 2000).

282. 173 F. Supp. 2d 419 (D. Md. 2001).

283. *Froelich*, 96 F. Supp. 2d at 520.

284. *Id.* at 521.

LLC board's decision would be if there was proof that the board had acted in bad faith.²⁸⁵ The court accepted the parties' contractual corporate fiduciary standard and found that the LLC board had acted in the best interest of the LLC, thus not violating its fiduciary duties.²⁸⁶

In *Robinson*, the United States District Court for the District of Maryland, citing *Froelich*, would again hold that a majority-interest holder owes a fiduciary duty to an LLC's minority interest holders because the operating agreement adopted corporate fiduciary duties like in *Froelich*.²⁸⁷ *Froelich* and *Robinson* demonstrate that Maryland courts will give full effect to the fiduciary duties stated in the operating agreement. However, there is uncertainty as to what the court will do in situations where the operating agreement does not contain express fiduciary duties.

VI. FIDUCIARY DUTIES NEED TO BE WRITTEN INTO THE MARYLAND LLC ACT

The view that Maryland's LLC statute does not need an express fiduciary standard because it relies on the principles of agency law is flawed.²⁸⁸ When comparing the fiduciary duty provision in Maryland's LLC statute to various other LLC statutes, it becomes clear that the Maryland judiciary and LLC owners face potential statutory interpretation problems in the future.²⁸⁹ Not only does the lack of statutory rules regarding fiduciary duties present problems for the judiciary and LLC owners, but incorporating an express standard would create a clear minimum standard to follow that would not frustrate the purpose behind the LLC.²⁹⁰

A. *Maryland Courts and LLC Owners Face Potential Statutory Interpretation Problems*

Without express fiduciary duties, the Maryland courts face greater statutory interpretation problems than courts in Delaware have faced.²⁹¹ Cases such as *Froelich* and *Robinson* demonstrate that Maryland courts will rely on the express fiduciary standard contained

285. *Id.*

286. *See id.*

287. *Robinson*, 173 F. Supp. 2d at 427 (“Geophone is organized as an LLC and Robinson is a member of the LLC. Robinson, as Geophone’s majority interest holder, owes a fiduciary duty to Geophone’s minority interest holders.”).

288. *See supra* Part V.

289. *See supra* Part III–IV.

290. *See infra* Part VI.B.

291. *See supra* notes 234–36 and accompanying text.

in the operating agreement in determining if there was a breach of fiduciary duty.²⁹² The problem lies in what Maryland courts will do when an LLC operating agreement does not contain an express fiduciary duty provision. Commentators have noted that Maryland courts are at liberty to apply the law of agency generally and to analogize to partnership or corporate law as they see fit, depending on the circumstances.²⁹³ Although Maryland courts are free to apply agency law, it is unclear what specific duties agency law calls for, whether that be a partnership or a corporate fiduciary standard.

This uncertainty can create problems for lawyers advising clients on the potential outcomes in a given case.²⁹⁴ It can also create outcomes that the legislature did not intend when drafting the statute.²⁹⁵ The *Gotham* case serves as an example of this type of situation where the statutory language was unclear, and courts were left to wrestle with its true meaning, ultimately leading the legislature to amend the statute.²⁹⁶

In contrast to both Delaware and Maryland, courts applying the model act or following Virginia, Illinois, California, and New York law are not left to their own judgment.²⁹⁷ Instead, these statutes supply clear language that the court can use to determine whether the possible violation falls within the statute.²⁹⁸ Also, by having an express fiduciary duty provision, courts in Virginia, Illinois, California, and New York are able to determine from the language of the statute whether it is necessary to apply partnership or corporate common law to a given case.²⁹⁹

Another potential problem facing Maryland's LLC statute is the uncertainty that exists with a provision in the operating agreement that either eliminates or reduces any agency fiduciary duties. Because there is no explicit provision in Maryland's LLC statute that permits or prevents the raising or lowering of fiduciary duties, practitioners face the potential problem of predicting whether the courts will uphold such a provision.³⁰⁰ Unlike partnerships and

292. See *supra* notes 234–36 and accompanying text.

293. See, e.g., Miller, *supra* note 5, at 634–35 n.85.

294. *Id.* at 632.

295. *Id.*

296. See *supra* Part IV.D.

297. See *supra* notes 160–62 and accompanying text.

298. See *supra* notes 160–62 and accompanying text.

299. See *supra* notes 160–62 and accompanying text.

300. See generally MD. CODE ANN., CORPS. & ASS'NS § 4A (LexisNexis 2007). Maryland's LLC statute does not contain any language allowing for the raising or lowering of fiduciary duties. See *id.*

corporations, drafters of LLCs lack certainty as to what they can and cannot do.³⁰¹ Therefore, in order for Maryland courts to avoid statutory interpretation problems, the Maryland General Assembly should amend the Maryland LLC Act to incorporate an express fiduciary duty provision.

B. Writing Statutorily Enumerated Fiduciary Duties into the Maryland LLC Act Creates a Minimum Standard or Duty That Does Not Frustrate the Purpose Behind the LLC.

Incorporating statutorily enumerated fiduciary duties into the Maryland LLC Act would also serve to create a minimum standard or duty by which members and managers could be held to.³⁰² This standard would not detract from the flexibility offered by the LLC because the standard could still be raised or lowered, similar to a partnership.³⁰³ Currently, it is unclear whether there is any minimum fiduciary standard contained in Maryland's LLC statute.³⁰⁴ While the legislative history of Maryland's LLC statute references agency law, it is uncertain whether Maryland courts would follow this.³⁰⁵ Even if Maryland courts do decide to follow agency law, LLCs may nevertheless be able to completely eliminate the duties. The official commentary to RUPA section 103(b)(3)-(5) notes that the inability to completely eliminate fiduciary duties creates a fundamental core fiduciary responsibility for partners.³⁰⁶ Another commentator has noted that the inclusion of a minimum standard serves to protect the unsophisticated and inexperienced participant.³⁰⁷ By having a minimum standard of fiduciary duties contained in the agreement, business owners unaware of this problem can still enter an agreement and have their interests protected.³⁰⁸

The purpose behind the creation of the LLC was to create a new entity that offered the taxation benefits of a partnership with the limited liability of a corporation.³⁰⁹ Both partnerships and

301. Compare UNIF. P'SHIP ACT § 404, 6 U.L.A. 143 (1997) (outlining the general standards of partners' conduct within a partnership), and MODEL BUS. CORP. ACT § 8.30 (2009) (outlining the standards of conduct for directors within a corporation), with MD. CODE ANN., CORPS. & ASS'NS § 4A (LexisNexis 2007) (providing no specific standards of conduct for members of an LLC).

302. See *supra* Part IV.

303. See, e.g., UNIF. P'SHIP ACT § 103(b)(3)-(4).

304. See *supra* Part IV.

305. See *supra* notes 272-75 and accompanying text.

306. UNIF. P'SHIP ACT § 103(b)(3)-(5), cmt. 4.

307. Hynes, *supra* note 58, at 45.

308. See *id.*

309. See *supra* Part II.

corporations include statutorily enumerated fiduciary duties; thus, incorporating statutorily enumerated fiduciary duties into Maryland's LLC statute is consistent with, and does not frustrate, the purpose of the LLC.³¹⁰

Another primary reason for the creation of the LLC was to allow business owners the flexibility to develop a management style that suited their personal business needs.³¹¹ This flexibility is still available even when incorporating an express fiduciary standard.³¹² Thus, the inclusion of a minimum fiduciary duty provision does not hinder the flexibility of the LLC; instead, it creates a minimum standard for LLC members and managers to be held.³¹³

VII. A SUGGESTED APPROACH TO FIDUCIARY DUTIES FOR MARYLAND LLCs

This comment proposes a multi-faceted express fiduciary standard that creates a minimum duty to which members or managers must adhere to, while not compromising the flexibility of the LLC. This standard will consist of four parts: (1) incorporating an express fiduciary duty provision; (2) allowing for the election in the articles of organization a fiduciary standard that is similar to duties found in a partnership or a corporation;³¹⁴ (3) allowing for the chosen standard to be raised or lowered, but not completely eliminated,³¹⁵ and (4) applying the fiduciary duties to all those acting with managerial power.³¹⁶

By utilizing language that clearly articulates a fiduciary standard, Maryland would signal the importance of fiduciary duties in the LLC and that fiduciary duties do in fact apply to Maryland LLCs.³¹⁷ As a result, courts would not need to waste time determining this issue, and it would provide a degree of certainty for LLC owners in forming and operating an LLC.³¹⁸ Under the first element, similar to a

310. See UNIF. P'SHIP ACT § 404; MODEL BUS. CORP. ACT § 8.30 (2009).

311. Miller, *supra* note 40, at 1610.

312. See, e.g., 805 ILL. COMP. STAT. ANN. 180/15-5(b)(6) (West 2004).

313. See Miller, *supra* note 40, at 1653–54.

314. See generally *supra* Part IV.A–B (describing partnership and corporate approaches to fiduciary duties in the context of an LLC).

315. See generally *supra* notes 78–82 and accompanying text (describing the restrictions on eliminating the duties of care and loyalty under RUPA).

316. See *supra* notes 172–74 and accompanying text (describing the application of fiduciary duties to those with managerial power in an LLC context).

317. See, e.g., Curwin, *supra* note 8, at 1016.

318. *Id.*

partnership, the fiduciary standard would include the duty of care and the duty of loyalty.³¹⁹

Under the second element of the standard, business owners would be given the freedom to choose to incorporate a fiduciary standard that contains language similar to the duties in a Maryland partnership³²⁰ or a Maryland corporation,³²¹ any of which would eliminate the confusion for members of an LLC, the judiciary, and practitioners.³²² If the contracting parties choose not to specify fiduciary duties in their operating agreement, then pursuant to the first element of the standard, the express statutory fiduciary duties from a partnership would apply.³²³ Incorporating a fiduciary standard that emulates the standard found in a partnership or a corporation serves to create more predictability and efficient interpretation and application of the statute for judges and lawyers.³²⁴ Commentators have noted that when judges and practitioners are faced with a rule they recognize from the partnership or corporate context, they are not forced to formulate an analysis on a blank slate; instead, they can refer to precedent.³²⁵ However, this does not mean that judges and practitioners must rely solely on partnership and corporate law in analyzing an LLC.³²⁶ Instead, in order for LLC law to further develop, judges and lawyers must think outside the partnership and corporate box.³²⁷

The proposal's third element still allows for the flexibility enjoyed by the LLC, but prevents the complete elimination of fiduciary duties. Similar to a partnership, creating a statutory fiduciary duty that can either be raised or lowered, but not eliminated, allows the contracting parties the freedom to determine what type of fiduciary standard will apply, but also provides for a minimum duty.³²⁸ The parties can choose to have a heightened fiduciary standard.³²⁹ In the alternative, where the parties want a more relaxed fiduciary standard and if the parties choose the partnership standard, then the parties can specify certain categories that do not violate the fiduciary

319. See *supra* notes 84–85 and accompanying text.

320. See *supra* notes 83–87 and accompanying text.

321. See *supra* notes 125–35 and accompanying text.

322. Miller, *supra* note 5, at 631–32.

323. See *supra* note 316 and accompanying text.

324. Miller, *supra* note 5, at 631–32.

325. *Id.*

326. *Id.*

327. *Id.* at 632.

328. See *supra* note 86 and accompanying text.

329. See *supra* note 86 and accompanying text.

provision.³³⁰ If the parties choose the corporate standard, then they can expand or limit but not completely eliminate the fiduciary duties.³³¹ Preventing the complete elimination of fiduciary duties serves to create a minimum standard of conduct that does not inhibit the flexibility offered by the LLC.³³²

The fourth element of the proposed standard applies the fiduciary standard to all those acting with managerial authority.³³³ The Illinois LLC Act serves as an example of this standard, where it applies the fiduciary duties to all those members acting with managerial authority in a manager-managed LLC.³³⁴ The Maryland LLC statute does not clearly distinguish between a member-managed and a manager-managed LLC, thus it should incorporate a standard similar to Illinois's LLC statute, which applies fiduciary duties to all those acting with managerial authority.³³⁵

VIII. CONCLUSION

While thirty-seven state LLC statutes have incorporated an express fiduciary duty provision, other LLC statutes, such as Maryland's, have not.³³⁶ The inclusion of an express fiduciary duty provision in the Maryland LLC Act will aid in preventing uncertainty,³³⁷ develop a minimum standard to hold LLC members and managers accountable to, and not frustrate the purpose behind the LLC.³³⁸ All of these reasons are consistent with partnership and corporate statutes and various other LLC statutes.³³⁹ The purpose of this proposed

330. See *supra* note 86 and accompanying text.

331. See *supra* note 135 and accompanying text.

332. See *supra* notes 303–05 and accompanying text. However, some commentators object, noting that the requirement of a minimum standard of fiduciary duty restricts the freedom the parties have to define their relationship in a way they see fit. See, e.g., Hynes, *supra* note 58, at 40. One commentator has noted that inclusion of a minimum standard in partnerships does have a drawback, which is to interfere with the rights partners have to define their relationship as they wish. *Id.* This commentator argues that persons entering a partnership relationship bargain from roughly equal positions, since each party usually has something the other desires. *Id.* This equal positioning should thus give presumptive validity to the bargain between the parties. *Id.*

333. However, in the alternative, the fiduciary standard could apply to everyone in the LLC, similar to a partnership. See, e.g., UNIF. P'SHIP ACT § 404, 6 U.L.A. 143 (1997).

334. See *supra* notes 169–71 and accompanying text.

335. See *supra* notes 169–71 and accompanying text.

336. See RIBSTEIN & KEATINGE, *supra* note 29, app. 9-7.

337. See *supra* Part VI.A.

338. See *supra* Part VI.B.

339. See *supra* Part III–IV.

standard is to assist in the continued development of Maryland LLC law by providing a flexible express fiduciary standard that incorporates existing language from either Maryland partnership or corporate law.³⁴⁰

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340. *See supra* Part VII.

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