What Standards of Conduct Should Apply to Members and Managers of Limited Liability Companies?

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WHAT STANDARDS OF CONDUCT SHOULD APPLY TO MEMBERS AND MANAGERS OF LIMITED LIABILITY COMPANIES?

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INTRODUCTION

A growing number of states have enacted statutes authorizing limited liability companies. These unique entities combine the corporate benefit of limited liability with the federal tax ad-

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vantage of treatment as a partnership, prompting commentators to observe that "the development and tax recognition of limited liability companies promises to change the law of business associations radically."  


In the long run limited liability might come to be regarded as the residual business form, with individual liability reserved for firms that make special filings. This could result not only from the wider acceptance of limited liability, but also from the reduced attractiveness to creditors of individual liability because of procedural barriers and exhaustion requirements that focus liability on the firm rather than on the individual partners. 

Id. The development of modern limited liability company statutes is traced in Rodriguez, supra, at 544-45.

The modern establishment of limited liability company statutes began in Alaska during the early 1970's. A Texas based oil company, wishing to conduct business in oil rich Alaska, sought to have a statute enacted that would enable it to conduct its business with less expenses and fewer restrictions .... The principal purpose for enactment of the act was to provide an additional source of revenue to Alaska through filing fees and annual taxes. 

Id. at 544 (footnotes omitted). The Alaska statute was not passed because of uncertainty regarding the federal tax treatment of the limited liability company: Id. While taxation as a partnership was desirable, it was not clear whether a limited liability company would be taxed as a partnership or a corporation. Id. A private letter ruling from the Internal Revenue Service ("IRS") could not be obtained before the Alaska legislature voted, and the Alaska bill was defeated. Id. Subsequently, in 1977, Wyoming enacted a limited liability company statute despite the fact that issues concerning taxation remained unsettled. Id. at 544-45. In 1982, Florida enacted a limited liability company statute. Id. at 546. Colorado and Kansas followed in 1990. Id. In 1988, the questions concerning the taxation of limited liability companies were largely resolved. Id. at 557. "[T]he Internal Revenue Service issued Revenue Ruling 88-76, 1988-2 C.B. 361 which stated that a Wyoming Limited Liability Company, none of whose members or designated managers were personally liable for any debts of the company, was to be classified as a partnership for federal income tax purposes." Id. at 558. In an effort to distinguish between a corporation and a partnership, the I.R.S. focused on the following factors: "1) [the] continuity of life, 2)
Limited liability companies are owned by "members" rather than "shareholders" or "partners." They are typically privately-

centralization of management, 3) liability for corporate debts limited to corporate property, and 4) free transferability of interests." Id. Applying the principles enunciated in Larson v. Commissioner, 66 T.C. 159 (1976) and Revenue Ruling 88-76, the IRS determined that if the entity possessed more corporate characteristics than noncorporate characteristics (i.e. if it possesses three or more of such characteristics), the entity would be taxed as a corporation rather than as a partnership. Id. at 558-59. In Revenue Ruling 88-76, the I.R.S. "found that [a] Wyoming L[imited] L[iability] C[ompany] lacked the corporate characteristic of continuity of life" since the limited liability company is "dissolved upon the death, retirement, resignation, expulsion, bankruptcy, or any other termination of a membership," unless the business is continued by the consent of all the remaining members. Id. at 558. Further, the Wyoming limited liability company lacked the corporate characteristic of free transferability of interest. Id. A member's interest may be transferred only with the consent of all remaining members. Id. Thus, the failure to possess more corporate than noncorporate features resulted in classification as a partnership for tax purposes. Id. at 559. For a discussion of the tax treatment of limited liability companies, see Mezzullo, supra, at 297-98. See also UNIFORM LIMITED LIABILITY COMPANY ACT § 801 cmt. (Discussion Draft 1993) (providing excellent explanation of tax treatment of limited liability companies).

A limited liability company is classified as a partnership for federal tax purposes because it does not possess sufficient corporate characteristics. Treas. Regs. Sec. 301.7701-2 sets forth four corporate characteristics: continuity of life, free transferability of interests, centralized management and limited liability. An unincorporated entity will be classified as a partnership unless it possesses at least three of these characteristics. Most limited liability company acts are drafted so that a limited liability company will fail the corporate classification test by lacking continuity of life and free transferability of interests. Depending on the actual organization structure of a limited liability company, it may also be possible for the entity to lack centralized management; however, all limited liability companies possess the corporate characteristic of limited liability. In order for a limited liability company to lack the corporate characteristic of continuity of life, the legal existence of the entity must be capable of suffering an involuntary dissolution.

Id. 4 See, e.g., DEL. CODE ANN. tit. 6, § 18-301 (1993) (governing admission of "members"); ARIZ. REV. STAT. ANN. § 29-632 (A)(3) (Supp. 1993) (indicating there will be two or more "members" at time limited liability company formed); CA. S.B. 469, § 17001 (t), Reg. Sess. (1993) (indicating that limited liability company or domestic limited liability company means an entity having two or more "members"); COLO. REV. STAT. ANN. § 7-80-102(7) (West Supp. 1993) (defining limited liability company as having two or more "members"); FLA. STAT. ANN. § 608.407(e) (West Supp. 1994) (providing for admission of additional "members"); KAN. STAT. ANN. § 17-7602(h) (1992) (defining "members"); LA. REV. STAT. ANN. § 12:1305 (A), (C) (West 1994) (providing for articles of organization contemplating "members"); MD. CODE ANN. CORPS. & ASS'NS § 4A-601 (1993) (providing for admission of "members"); MINN. STAT. ANN. § 322B.11 (West 1994) (imposing two "member" requirement for organization); NEV. REV. STAT. ANN. § 86.081 (Michie 1994) (defining "member" as one who owns interest in limited liability company); N.Y.S. 27, 215th Sess. § 102(q) (1993) (defining "members" as persons who have been admitted as "member" of limited liability company); OKLA. STAT. ANN. tit. 18, § 2001(15) (West Supp. 1994) (defining "member" as one with ownership inter-
held companies5 and are recommended for use in a diversity of business ventures.6 Most statutes permit management by members themselves or by professional outside managers.7 An operat-

5 Limited liability companies are privately-held largely because of federal tax consequences. See Mezzullo, supra note 3, at 297-98; Hamill, supra note 2, at 746-48. The limited liability company is desirable because it combines the dual benefits of limited liability and taxation as a partnership. See Hamill, supra note 2, at 723. Partnerships provide for flow-through tax treatment, which avoids double taxation and provides benefits such as allocation of profit and loss arrangements. See Ribstein, supra note 2, at 417; JACOB MERTENS, JR., MERTENS LAW OF FEDERAL INCOME TAXATION § 35.359.70 (1993). A limited liability company would be taxed as a corporation if it were publicly traded. See I.R.C. § 7704(a) (West 1994). Section 7704 of the Internal Revenue Code taxes publicly-traded partnerships as corporations. Id. Thus, going public would frustrate a principal purpose of forming a limited liability company.

6 Brian L. Schorr, co-chair of the Association of the Bar of the City of New York and the New York State Bar Association Joint Drafting Committee of the Proposed New York Limited Liability Company Law, indicates that limited liability companies are desirable for use in the following types of businesses: a) corporate joint ventures; b) entrepreneurial businesses; c) family businesses; d) start up businesses; e) high technology and research businesses; f) oil and gas investments; g) investments in theatrical productions; h) real estate investments; i) venture capital projects; j) professional organizations (e.g. lawyers and accountants); k) transactions involving international investors; l) management leveraged buy-outs; m) structured finance arrangements; n) commodity pools. See Schorr, supra note 3, at 32-33; see also Ribstein, supra note 2, at 427-33 (suggesting that both nonprofessional and professional firms may elect to use limited liability company form). Schorr noted that "[e]ven in closely held firms, limited liability may reduce owners' risk-bearing and monitoring costs." Id. at 428. Additionally, "[p]rofessional firms are an important category of general partnerships and potentially important users of the [limited liability] form." Id. at 433. Since several states' professional corporation acts refuse to permit professionals to limit liability for acts of co-professionals, recognition of limited liability companies could eliminate a significant barrier for professional firms which is not present for nonprofessional firms. Id.

7 See, e.g., DEL. CODE ANN. tit. 6, § 18-402 (1993). This section provides: Unless otherwise provided in a limited liability company agreement, the management of a limited liability company shall be vested in its members in proportion to the then current percentage or other interest of members in the profits of the limited liability company owned by all of the members, the decision of members owning more than 50 percent of the said percentage or other interest in the profits controlling; provided however, that if a limited liability company 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 who shall be chosen by the members in the manner provided in the limited liability company agreement.
ing or management agreement governs business operations and relationships among members of a limited liability company.\(^8\)

\(^{8}\) See, e.g., **UNIFORM LIMITED LIABILITY COMPANY ACT § 405 (Discussion Draft 1993)** (providing for optional enactment of written or oral operating agreement to provide for regulation of affairs of limited liability company); see also **DEL. CODE ANN. tit. 6, §§ 18-302, 18-402, 18-404, 18-1101(b) (1993)** (providing for voting rights and selection of management pursuant to limited liability agreement and indicating policy of chapter to give maximum effect to principle of freedom of contract); Cal. S.B. No. 469 § 17001(z)(aa) (contemplating operating agreement governing conduct of business).

The Arizona statute contains a separate section which illustrates the important role of the operating agreement in establishing guidelines for the conduct of business, management matters, voting rights, and restrictions on transfers of interests:

**A.** The members of a limited liability company may adopt an operating agreement containing provisions they deem appropriate. All or part of an operating agreement may be subsequently repealed or amended by agreement or consent of all of the members or, to the extent an operating agreement so provides, by all of the managers or a specified portion of members or managers.

**B.** An operating agreement may contain any provision that is consistent with law and that relates to the business of the limited liability company, the conduct of its affairs, its rights or powers and the rights or powers of its members, managers, officers, employees or agents including:

1. Whether the management of the limited liability company is vested in one or more managers and, if so, the powers to be exercised by managers.
2. Providing for classes or groups of members with various rights, powers and duties and providing for the future creation of additional classes or
Many commentators have provided overviews of limited liability company statutes, emphasizing the potential tax benefits.9

groups of members with relative rights, powers and duties superior, equal or inferior to existing classes and groups of members.
3. The exercise or division of management or voting rights among different classes or groups of members or managers on a per capita or other basis.
4. With respect to any matter requiring a vote, approval or consent of members or managers, provisions relating to notice of the time, place and purpose of any meeting at which the matter is to be voted on, waiver of notice, action by consent without a meeting, the establishment of a record date, quorum requirements, authorizations by proxy or any other matter concerning the exercise of any voting or approval rights.
5. Restrictions on the transfer of any option rights to acquire or sell any member's interest in the limited liability company.
6. A court may enforce an operating agreement by injunction or by any other relief that the court in its discretion determines to be fair and appropriate in the circumstances.

ARIZ. REV. STAT. ANN. § 29-682 (1993). The Colorado statute provides that operating agreement means:

... any valid written agreement of the members as to the affairs of a limited liability company and the conduct of its business. The operating agreement may contain any provisions for the affairs of a limited liability company and the conduct of its business to the extent that such provisions are not inconsistent with the law or the articles of organization.

COLO. REV. STAT. ANN. § 7-80-102(11) (West Supp. 1993); see also FLA. STAT. ch. 608.432 (West Supp. 1994) (providing for transferability of interest in accordance with operating agreement); KAN. STAT. ANN. § 17-7613 (1992) (requiring operating agreements to govern rights, duties, and obligations of members and managers which may contain provisions for regulation and management of company); LA. REV. STAT. ANN. § 12:1311 (West 1994) (providing for management in accordance with operating agreement); MD. CODE ANN. CORPS. & ASS'Ns § 4A-402 (1993) (indicating that members may enter into operating agreement to regulate or establish any aspect of affairs of limited liability company or relations of its members); N.Y.A. 8676 215th Sess. § 417(a) (mandating operating agreement for conduct of business affairs); M I N N. STAT. ANN. § 322B.603(1) (West 1994) (providing for optional operating agreement governing management of business or regulation of affairs of limited liability company); NEV. REV. STAT. ANN. § 86.101 (Michie 1994) (defining operating agreement as "any valid written agreement of ... members as to the affairs of a limited liability company and the conduct of its business"); OKLA. STAT. ANN. tit. 18, § 2001(17) (West Supp. 1994) (defining operating agreement as "any agreement of the members as to the affairs of a limited liability company and the conduct of its business"); TEX. BUS. CORP. ACT ANN. art. 1528n, § 2.09 (West Supp. 1994) (referring to "regulations" which may contain any provisions for regulation and management of limited liability company); UTAH CODE ANN. § 48-2b-126 (1994) (providing for execution of operating agreement for regulation and management of affairs of limited liability company); VA. CODE ANN. § 13.1-1023 (Supp. 1993) (authorizing option of entering into operating agreement governing conduct of business and relations of members); W. VA. CODE § 31-1A-19 (1994) (permitting operating agreement for management of limited liability company); WYO. STAT. §§ 17-15-119, 17-15-122 (Supp. 1994) (contemplating existence of operating agreement in connection with division of profits and transfer of interests).

9 See supra note 3 and accompanying text (regarding taxation of limited liability companies). The principal benefit of a limited liability company is taxation as a part-
Little attention, however, has been focused on the importance of developing a viable statutory and judicial framework for analyzing the legal relationships among members and managers. Specifically, what fiduciary duties and what standard of care do members owe each other in the conduct of the limited liability company's business? What standard of care must managers exercise? How is performance to be judged and what level of judicial scrutiny is appropriate? What effect does the adoption of a particular standard of care have on third parties—outside stakeholders, such as creditors, employees, or the public at large?

The traditional corporate approach employs a standard of due care coupled with the application of the business judgment rule. The Model Business Corporation Act provides that a director of a corporation must, in good faith, exercise the care that an ordinarily prudent person in a like position would exercise under similar circumstances in a manner that person reasonably believes to be in the best interests of the corporation. The judiciary developed the business judgment rule to insulate the director from exposure when hindsight determines that an error was made. To what extent should the standard of due care and the business judgment rule be applied to members or managers of the limited liability company?
This Article suggests that the hands-off judicial posture supported by the business judgment rule is ill-suited to the limited liability company. There are fundamental differences between the public corporation and the privately held limited liability company.\textsuperscript{14} The traditional corporate approach has created a foundation for the oppression of minority shareholders.\textsuperscript{15} There is every reason to believe that this approach would be similarly problematic if applied to the conduct of members and managers of the limited liability company.\textsuperscript{16}

Likewise, a model for behavior which defers exclusively to the contract between the parties is as troublesome as the exclusive use of the corporate model. A purely contractual approach ignores the reality of doing business on an ongoing basis. It fails to distin-

\textsuperscript{14} See infra note 26 and accompanying text (discussing IRS requirement that limited liability company be privately held).


\textsuperscript{16} See Sylvester J. Orsi, Comment, The Limited Liability Company, An Organizational Alternative For Small Business, 70 Neb. L. Rev. 150, 160 (1991). Limited Liability Company's require consent of all members before all of the attributes of ownership may be transferred, and therefore inhibit formation of an efficient market for sale of ownership interests . . . . [A] consequence of decreased state regulation is that the courts must pay greater attention to the duties owed by members to each other, and by managers to members. Because there will be no ready market for members to sell their interests, there will accordingly be no barometer to reflect member dissatisfaction with management decisions. Furthermore, managing members may attempt to freeze out non-managing members with methods developed by shareholders of close corporations. For these reasons it makes little sense to adopt the hands-off approach of the "business judgment rule," applied principally to decisions of public corporations. The better rule would be to scrutinize the decisions of managers and members with the standard of utmost good faith and loyalty often used in both the partnership and close corporation settings.

\textit{Id.} (footnotes omitted); \textit{see infra} notes 187-94 and accompanying text.
guish between a contract for the consummation of a single event and an agreement to conduct business over a long period of time. Furthermore, the contractual approach presumes an equality of bargaining power among members and that important issues will indeed be negotiated. The history of the close corporation has demonstrated that businesses evolve, generations progress, structural and ownership changes occur, formalities are ignored, and even fundamental issues may not always be negotiated or renegotiated.\textsuperscript{17} The same problems which have occurred in the context of close corporations may well be repeated in a limited liability company in which some members possess controlling interests, and others assume minority positions.

In the drive to adopt limited liability company legislation quickly, states may find it expedient to import statutory language borrowed entirely from existing partnership or corporate statutes.\textsuperscript{18} The limited liability company, however, incorporates a unique blend of corporate, partnership, contractual, and agency relationships. Accordingly, a blended approach to standards of conduct is needed to protect effectively one member of a limited liability company from the actions or inaction of another member or manager. The Discussion Draft of the Uniform Limited Liability Company Act, which incorporates both partnership and contractual standards of conduct, is a starting point.\textsuperscript{19}

\textsuperscript{17} See F. Hodge O'Neal, \textit{Close Corporations: Existing Legislation and Recommended Reform}, 33 Bus. Law. 873, 881-83 (1978). O'Neal notes: Statutory protection is needed for minority shareholders who fail to bargain for and obtain protective contractual arrangements. Although most state corporation statutes validate special charter and bylaw provisions and shareholder's agreements designed to protect minority shareholders, no statute—not even any of the separate, integrated close corporation statutes—furnishes adequate self-executing protection for minority shareholders who have failed to bargain for special charter or bylaw provisions or for protective clauses in shareholders' agreements . . . . He [the minority shareholder] may be unaware of the risks involved, or his bargaining position may be so weak that he is unable to negotiate for protection. Further, he may have been given or may have inherited his minority interest.

\textsuperscript{18} See Orsi, \textit{supra} note 16, at 152 (indicating that "because the limited liability company borrows most of its statutory language, business planners will benefit from a vast body of authority interpreting its provisions in their original corporate or partnership form").

\textsuperscript{19} See UNIF. LIMITED LIABILITY COMPANY ACT § 408 (Discussion Draft). The Discussion Draft of the Limited Liability Company Act is in the process of being developed by a committee of the National Conference of Commissioners on Uniform State Laws. The comments contained in this article are based on the Discussion Draft as of February 26, 1993.
STANDARDS OF CONDUCT

The purpose of this Article is to assist in the development of a coherent approach to standards of conduct among members and managers of the limited liability company. Part I analyzes the major features of a limited liability company which distinguish it from other legal entities. Part II discusses the duties of loyalty and the standard of care which have evolved under the corporate, partnership, contractual, and agency models. Part III reviews the standards of conduct contained in existing and proposed limited liability company legislation. It further considers the Discussion Draft of the Uniform Limited Liability Company Act as proposed by a committee of the National Conference of Commissioners on Uniform State Laws. Part IV intends to assist in developing a fresh analytical approach to standards of conduct. It reviews social policy concerns that are specific to the limited liability company. It also discusses the inadequacy of the exclusive employment of existing corporate, partnership, or contractual models.

Finally, Part V recommends a blended approach to standards of conduct which integrates agency, partnership, and contractual principles. Although the Discussion Draft of the Uniform Act may provide an excellent starting point for an integrated approach, it utilizes a gross negligence standard of conduct. The more appropriate standard is one based on agency principles of due care or ordinary negligence. The due care standard, a logical extension of agency principles, is already contained in several limited liability company statutes, and moreover, is consistent with the reasonable expectations of the parties. If not overpowered by an ex-

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20 See Restatement (Second) of Agency § 379(1) (1958) which provides:
    Unless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill that he has.

Id.; see infra notes 139-46 and accompanying text.

21 See Norwood P. Beveridge, Jr., Duty of Care: The Partnership Cases, 15 Okla. City U. L. Rev. 753, 765-66 (1990). Professor Beveridge, member of the American Bar Association Committee on Partnerships and Unincorporated Business Organizations and the Subcommittee on the Revised Uniform Partnership Act, advocates ordinary negligence as the appropriate standard of care regarding the duty of one partner to another. Id. The same arguments are equally persuasive regarding the limited liability company. A heated debate took place regarding whether the Revised Uniform Partnership Act should embrace a standard of care among partners based on gross negligence or ordinary negligence. Professor Beveridge argues that the appropriate standard should be based on ordinary care, noting:

[S]ince the provisions of the Uniform Partnership Act are default provisions which apply in the absence of a contrary agreement, they should reflect legitimate expectations of the parties. It is not likely that a partner, to the extent
pansive application of the business judgment rule, a due care standard may foster increased responsibility by members and managers of closely held business enterprises that have historically abused minority and passive owners. Against this background of dissension and abuse, a stricter standard of care should be encouraged along with an active rather than passive judicial role.

I. THE NATURE OF THE LIMITED LIABILITY COMPANY

From a legal perspective, limited liability companies are a unique construct. In some respects, they resemble corporations because they offer an umbrella of limited liability. In many

that he considers the question, would expect his co-partners to be held to a lower standard of care than employees of the partnership. If anything, the contrary would be true. A partner would naturally expect a co-partner to indemnify the partnership for loss caused by that partner's negligence and gross error of judgment before he would expect the same of an employee.


23 While it is true that express state statutory language may be borrowed from limited partnership acts or corporate statutes, the limited liability company contains a unique combination of features.  See Orsi, supra note 16, at 151-52.

The drafters of this legislation expressly intended to provide business planners with an alternative to corporations and partnerships. Typically, business planners focus on two considerations when deciding how to organize a business: The applicable nontax state law; and the income tax treatment of the business form chosen. For small business enterprises, the limited liability company possesses the best of both worlds because it combines the attractive limited liability feature of corporations with the income tax advantages of partnership classification. In addition, limited liability companies are more flexible than S corporations in accommodating various forms of ownership. Because the limited liability company borrows most of its statutory language, business planners will benefit from a vast body of authority interpreting its provisions in their original corporate or partnership form.

Id. (footnotes omitted).

24 See Ariz. Rev. Stat. Ann. § 29-651 (Supp. 1993). This section states: Except as provided in this chapter, a member, manager, employee, officer, or agent of a limited liability company is not liable, solely by reason of being a member, manager, employee, officer or agent, for the debts, obligations and liabilities of the limited liability company whether arising in contract or tort, under a judgment, decree or order of a court or otherwise.
STANDARDS OF CONDUCT

Id. (footnote omitted); COLO. REV. STAT. ANN. § 7-80-705 (West Supp. 1993) ("Members and managers of limited liability companies are not liable under a judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of the limited liability company."); DEL. CODE ANN. tit. 6, § 18-303 (1993). The Delaware statute states:

Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company; and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.

Id. For similar language see FLA. STAT. ANN. § 608.436 (West Supp. 1994); KAN. STAT. ANN. § 17-7620 (1992); LA. REV. STAT. ANN. § 12:1315 (West 1994) (authorizing limited liability if articles of organization or written operating agreement so provide); OKLA. STAT. ANN. tit. 18, § 2017A.1 (West Supp. 1994) (providing for permissive limited liability pursuant to articles of organization or operating agreement); VA. CODE ANN. § 13.1-1019 (Michie 1993); WYO. STAT. § 17-15-113 (Supp. 1994).

Some states qualify the limited liability of the members by expressly incorporating corporate rules for piercing the corporate veil of limited liability. See, e.g., MINN. STAT. ANN. § 322B.303 (West Supp. 1994). The Minnesota statute provides:

1. Limited liability rule. Subject to subdivision 2, a member, governor, manager, or other agent of a limited liability company is not, merely on account of this status, personally liable for the acts, debts, liabilities, or obligations of the limited liability company. Subdivision 2. Piercing the veil. The case law that states the conditions and circumstances under which the corporate veil of a corporation may be pierced under Minnesota law also applies to limited liability companies.

Id.; see also VA. CODE ANN. § 13.1-1025 (Supp. 1993). The Virginia statute provides:

[T]he damages assessed against a manager or member arising out of a single transaction, occurrence or course of conduct shall not exceed the lesser of: 1. The monetary amount, including the elimination of liability, specified in writing in the articles of organization or an operating agreement as a limitation on or elimination of the liability of the manager or member; or 2. The greater of (i) $100,000 or (ii) the amount of cash compensation received by the manager or member from the limited liability company during the twelve months immediately preceding the act or omission for which liability was imposed. B. The liability of a manager or member shall not be limited as provided in this section to the extent otherwise provided in writing in the articles of organization or an operating agreement, or if the manager or member engaged in willful misconduct or a knowing violation of the criminal law. C. No limitation on or elimination of liability adopted pursuant to this section may be affected by any amendment of the articles of organization or operating agreement with respect to any act or omission occurring before such amendment.

Id. A slightly different statutory approach in achieving limited liability is to provide that the members of the limited liability company shall be treated as shareholders of corporations. See, e.g., W. VA. CODE § 31-1A-33 (Supp. 1994). The West Virginia statute states:

The members of a limited liability company shall have the same rights and liabilities as shareholders of corporations organized or registered under article one (§ 31-1-1 et seq.) of this chapter, and such managers shall have the
other respects, they resemble partnerships. Like partners, members have control of management either because the limited liability company members choose to manage the business themselves, or because the members exercise their power to elect managers. Additionally, they are privately owned, governed largely according to the provisions of an operating or managing agreement, may lack formality, and are taxed as partners.

same rights and liabilities as directors of corporations so organized or registered.

Id.


The I.R.C. taxes publicly-traded partnerships as corporations. I.R.C. § 7704 (West 1994). Therefore, to avoid losing tax benefits, the limited liability company is not publicly traded.

See supra note 25 and accompanying text.

See, e.g., Del. Code Ann. tit. 6, §§ 18-101 to -1106 (1993) (illustrating relatively informal nature of limited liability company). Section 18-201 of the Delaware statute provides rules for formation, indicating that one or more authorized persons must execute a certificate of formation designating the name, address, and dissolution date, if any, of the company. Section 18-302 governs classes and voting, and broadly permits voting rights to be determined by the limited liability company agreement. Section 18-302(b) provides that the “agreement may grant to all or certain identified
members or a specified class or group of the members the right to vote separately or with all or any class or group of the members or managers . . . ." Subsection 18-302(c) permits the limited liability company agreement to establish provisions relating to notice of the time, place, or purpose of the meetings regarding the right to vote. Section 18-402 calls for management by members in proportion to their interest in profits unless otherwise provided in the limited liability agreement, and permits management by managers. Section 18-503 states that profits and losses are to be allocated in accordance with the limited liability company agreement. Absent an agreement providing to the contrary, a default rule is provided which allocates profits and losses on the basis of the agreed value of contributions made by members. Section 18-702 contains a critical prohibition on transferability of interests which deprives the limited liability company of the free transferability characteristic of corporations. The same section provides that assignees shall have no right to participate in management except upon approval of all members other than the member assigning his interest, or upon compliance with any procedure provided for in the limited liability company agreement. Section 18-801 contains rules on dissolution which prevent the limited liability company from possessing the corporate characteristic of continuity of life.

Dissolution takes place upon the first to occur of the following:

1) [a]t the time specified in a limited liability agreement, or 30 years from the date of formation . . . 2) [u]pon the happening of events specified in a limited liability company agreement; 3) [t]he written consent of the members; 4) [t]he death, retirement, resignation, expulsion, bankruptcy or dissolution of a member or the occurrence of any other event which terminates the continued membership of a member in the limited liability company unless the business of the company is continued either by the consent of all the remaining members within 90 days following the occurrence of any such event or pursuant to a right to continue stated in the limited liability company agreement; or 5) [t]he entry of a decree of judicial dissolution . . . .

Id. § 18-801.

Other states contain similar provisions, varying somewhat in the degree of flexibility. See, e.g., Cal.S.B. No. 469, 1993-94 Reg. Sess. Section 17050 of the California Senate proposal provides for the execution and filing of articles of organization with the Secretary of State, and requires the filing of an operating agreement. There must be two or more members. Id. § 17050. The articles of organization must contain the purpose of the enterprise, whether the company is a professional limited liability company, the name and address of the agent for service of process, and several other enumerated items. Section 17100 governs membership and contains a default rule requiring unanimous written consent for entrance of a new member into the limited liability company. Section 17103 permits voting pursuant to the articles of organization or the operating agreement, and contains a default rule which provides for voting in proportion to the members' interests in current profits. Specified matters require unanimous consent of all of the members including the decision to continue the business after dissolution or approval of the transfer of a membership interest and admission of the assignee as a member of the limited liability company. Id. § 17103. Section 17150 provides for management by either managers or members. Section 17250 provides for distributions in accordance with the partnership agreement, and a default rule which authorizes distributions which are a return of capital in accordance with each member's capital contribution. Under § 17350 the limited liability company dissolves upon a) the time specified in the articles of organization; b) upon the happening of events stated in the articles of organization; c) by the vote of the majority in interest of the members; d) unless otherwise provided in the articles, or operating agreement, upon the death, withdrawal, resignation, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event which terminates the continued membership of a member in the limited liability company unless the business of the company is continued either by the consent of all the remaining members within 90 days following the occurrence of any such event or pursuant to a right to continue stated in the limited liability company agreement; or 5) [t]he entry of a decree of judicial dissolution . . . .
Rather than declaring dividends, profits are typically shared in a manner not unlike a partnership.\(^{29}\)

Flexibility, favorable taxation, and limited liability are indeed the benchmarks which have spawned the proliferation of limited liability company legislation. Nevertheless, the very flexibility that makes the limited liability company an attractive business organization may ultimately lead to abuses unless the appropriate conditions for dissolution are met. Specifically, unless the business of the limited liability company is continued by a vote of all the remaining members within 90 days of the termination; or e) judicial dissolution.

Other statutes provide more extensive regulations. See, e.g., Minn. Stat. Ann. § 322B.34 (West Supp. 1994) (providing for notice procedures regarding all meetings); Id. § 322B.343 (governing electronic conferences and waiver of notice provisions); Id. § 322B.346 (setting forth rules for majority rule and voting by class); Id. § 322B.383 (authorizing rights of dissenting members); N.Y.S. 27, 215th Sess. §§ 402-04 (1993) (providing increased regulation of voting rights through § 402, and increased regulations of meetings and quorums through §§ 403-04).

\(^{29}\) See supra note 2 and accompanying text.

degrees of judicial and statutory scrutiny and regulation are present.\footnote{See Orsi, supra note 16, at 160 (observing that decreased state regulation may require increased attention by courts to duties owed by members to each other and by managers to members).}

Unlike corporations, the limited liability company lacks a board of directors. Traditionally, the role of the board of directors has been to govern the corporation independently.\footnote{See generally Bayless Manning, The Business Judgment Rule and the Director's Duty of Attention: Time For Reality, 39 Bus. Law. 1477, 1481-92 (1984) (emphasizing complex demands on Board of Directors and highlighting diversity of today's business operations). Outside directors essentially devote only part time hours to company affairs. Id.} From its inception, the corporate form has been a highly regulated legal entity. A historical review of the corporation reveals that prior to the enactment of modern corporate legislation, individuals were required to obtain a special corporate charter in order to utilize the corporate form.\footnote{See Lawrence M. Friedman, A History of American Law 446-48 (1973) (indicating that early American corporations were authorized by special charter and were involved in transportation and other functions which were traditionally within scope of state regulation); Liggett v. Lee, 288 U.S. 517, 548-64 (1933) (Brandeis, J., dissenting) (providing excellent discussion of emergence of corporate form). In Liggett, Justice Brandeis noted:

The prevalence of the corporation in America has led men of this generation to act, at times, as if the privilege of doing business in corporate form were inherent in the citizen . . . . Throughout the greater part of our history a different view prevailed. Although the value of this instrumentality in commerce and industry was fully recognized, incorporation for business was commonly denied . . . because of fear . . . . There was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations. So at first the corporate privilege was granted sparingly . . . when . . . necessary . . . to procure . . . some specific benefit otherwise unattainable. The later enactment of general incorporation laws does not signify that the apprehension of corporate domination had been overcome. The desire for business expansion created an irresistible demand for more charters; and it was believed that under general laws embodying safeguards of universal application the scandals and favoritism incident to special incorporation could be avoided. The general laws . . . were, in part, an expression of the desire for equality of opportunity.

Id. at 548-49 (citations omitted).} Under modern corporate law, virtually every facet of business operations, including corporate dissolution, remains subject to strict statutory regulation.\footnote{See Model Business Corp. Act Ann. § 2.01 (Proposed official draft 1984) (regarding filing requirements to incorporate); Id. § 8.01 (regarding requirements for and duties of board of directors); Id. § 10.01 (regarding amendment of articles of incorporation and bylaws); id. §§ 11.01-07 (regarding merger and share exchange); id. §§ 13.30-31 (regarding judicial appraisal of shares); id. §§ 14.01-.34 (regarding dissolution).} In contrast, many
limited liability company statutes lack significant formalities and provide for management by members or managers.\(^{35}\)

II. EXISTING STANDARDS OF CONDUCT

Before considering which standard of conduct is best suited to the hybrid nature of the limited liability company, it is important to fully understand the models of conduct existing in current corporate, partnership, and agency law. An analysis of the rules governing business relationships between directors and shareholders, partners, and principals and agents reveals diverse standards and levels of judicial scrutiny.

A. The Corporate Model: The Duty of Loyalty and the Duty of Care

The corporate model of governance rests upon the fundamental distinction in the roles of owners and management, and the recognition of the corporation as a separate legal entity.\(^{36}\) There is an emerging trend to contractually limit board member liability and to circumscribe judicial intervention in matters of corporate governance.\(^{37}\) Whether this trend should be reflected in the devel-

\(^{35}\) See supra note 25 and accompanying text.


Corporate forms of organized activity have developed a history with roots as ancient as the Roman Empire. In the common law scheme, doctrines of corporate-shareholder separateness evolved almost as an indirect result of the growth of the corporate form . . . . Much contemporary and historical concern with the concept of corporate-shareholder separateness has centered upon the legal theories supporting the concept and the practical ramifications of limited shareholder liability for corporate debts, duties and obligations. Specific inquiries into the conceptual nature of corporate personality have been undertaken . . . .

\(^{37}\) See Larry E. Ribstein, Unlimited Contracting in the Delaware Limited Partnership and Its Implications for Corporate Law, 16 J. Corp. L. 299, 299 (1991) (discussing new Delaware limited partnership amendment which provides for waiver of fiduciary duties in limited partnerships); see also Del. Code Ann. tit. 6, § 17-1101(d) (1993). Ribstein argues that waiver of fiduciary duty should apply to corporate law, stating: "In adopting its limited partnership fiduciary duty waiver provision, the Delaware legislature has taken a critical step that has important implications for corporate law. There is no theoretical reason why freedom of contract should not be extended to the corporation once it has been adopted in the limited partnership." Ribstein, supra, at 314; see John C. Coffee, Jr., The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role, 89 Colum. L. Rev. 1618 (1989) (discussing role of judiciary in debate between "contractarians," who favor adoption of
opment of standards of conduct for members and managers of the limited liability company remains open to question.

Traditionally, the duties of directors and officers have been divided into separate categories, including the duty of loyalty and the duty of care. As described in the Corporate Director's Guidebook, these responsibilities are as follows:

1. Duty of Loyalty

   By assuming his office, the corporate director commits allegiance to the enterprise and acknowledges that the best interests of the corporation and its shareholders must prevail over any individual interest of his own. The basic principle to be observed is that the director should not use his corporate position to make a personal profit or gain other personal advantage.

2. Duty of Care

   In addition to owing a duty of loyalty to the corporation, the corporate director also assumes a duty to act carefully in fulfilling the important tasks of monitoring and directing the activities of corporate management.  

The Model Business Corporation Act sets forth general standards of conduct for directors. Section 8.30 of the Act states:

(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

   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 he reasonably believes to be in the best interests of the corporation.

"opt-out" provisions to permit parties to contractually limit duties of care, and their opponents); Deborah A. DeMott, Limiting Directors' Liability, 66 WASH. U. L.Q. 295 (1988) (addressing substantial risks of director liability); Harvey Gelb, Director Due Care Liability: An Assessment of the New Statutes, 61 TEMP. L. REV. 13, 13 (1988) (reviewing "flood of legislation aimed at giving directors of corporations relief... from liability for breach of their duty of care").


39 MODEL BUSINESS CORP. ACT ANN. § 8.30 (Comm. on Corp. Laws of the A.B.A. 1984). The board member's duties are elaborated as follows:

(b) In discharging his duties a director is entitled to rely on information, opinions, reports, or statements... if prepared or presented by:

   (1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;
The vast majority of states "require[s] that a director of a corporation discharge the duties of [the] office in good faith and with a stated standard of care, usually phrased in terms of the care that an ordinarily prudent person would exercise under similar circumstances . . . ."40

B. A Bark Worse Than Its Bite?

Although the due care language regarding managerial powers of directors appears demanding, a number of factors significantly dilute the stringency of the director's standard of conduct.41 First, the business judgment rule has long been invoked to insulate directors from liability. Second, the American Law Institute's Principles of Corporate Governance recommends modifications which liberalize the standards for judicial review of business decisions. Third, numerous states have enacted specific opt out provisions which permit directors to contractually limit liability.42 This legislation has followed in the wake of several court decisions imposing liability on corporate directors.

The business judgment rule, an established legal doctrine, has afforded corporate directors and officers substantial protection

(2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence; or
(3) a committee of the board of directors of which he is not a member if the director reasonably believes the committee merits confidence.
(c) A director is not acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.
(d) A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.

Id.

40 Id. § 8.30 annot. 1(a) (Supp. 1993). Thirty-nine states have followed the direction of the Model Business Corporation Act and imposed a statutory standard of care on directors, including Alabama, Alaska, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Washington, Wisconsin, Wyoming, and Virginia. Id.; see also id. at annot. 3 ("Thirty-five states have laws which reduce or eliminate a director's personal liability . . . . for a breach of the director's fiduciary duty . . . .").
41 See Gelb, supra note 37, at 14 (noting that Model Business Corporation Act and many state statutes dilute directors' standard of conduct).
42 See infra notes 64-71 and accompanying text (discussing waiver provisions applicable to the duties of corporate directors).
STANDARDS OF CONDUCT

from close judicial scrutiny.\textsuperscript{43} In *Gries Sports Enterprises, Inc. v. Cleveland Browns Football Co.*, a shareholder brought a derivative action against corporate directors.\textsuperscript{44} The shareholder challenged the fairness of an acquisition of another corporation.\textsuperscript{45} The court described the business judgment rule as follows:

The business judgment rule is a principle of corporate governance that has been part of the common law for at least one hundred fifty years. It has traditionally operated as a shield to protect directors from liability for their decisions. If the directors are entitled to the protection of the rule, then the courts should not interfere with or second-guess their decisions. If the directors are not entitled to the protection of the rule, then the courts scrutinize the decision as to its intrinsic fairness to the corporation and the corporation's minority shareholders. The rule is a rebuttable presumption that directors are better equipped than the courts to make business judgments and that the directors acted without self-dealing or personal interest and exercised reasonable diligence and acted with good faith. A party challenging a board of directors' decision bears the burden of rebutting the presumption that the decision was a proper exercise of the business judgment of the board.\textsuperscript{46}

The rationale of the business judgment rule is to encourage and afford broad protection to informed business decisions, irrespective of whether these decisions prove erroneous.\textsuperscript{47} The policy underlying the rule encourages risk taking, innovation, and creative entrepreneurial activities.\textsuperscript{48}

\textsuperscript{43} As early as 1891, the U.S. Supreme Court held that the degree of care to which defendant directors were held was “that which ordinarily prudent and diligent men would exercise under similar circumstances.” *Briggs v. Spaulding*, 141 U.S. 132, 152 (1891). The history of the business judgment rule in tempering the duties of directors is discussed extensively in *DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE 4-8* (3d ed. 1989).

\textsuperscript{44} 496 N.E.2d 959 (Ohio 1986).

\textsuperscript{45} Id. at 962.

\textsuperscript{46} Id. at 963-64 (citations omitted).

\textsuperscript{47} See A. Gilchrist Sparks, III & Lawrence A. Hamermesh, *Common Law Duties of Non-Director Corporate Officers*, 48 BUS. LAW. 215, 230 (1992); see also *BLOCK ET AL.*, supra note 43, at 6-7 (stating that rationale for business judgment rule is to “encourage[ ] competent individuals to assume directorships . . . [to] provide[ ] directors the broad discretion they need in formulating . . . company policy . . . [to] keep[ ] courts from becoming enmeshed in complex corporate decision-making . . . [and to] ensure[ ] that directors rather than shareholders manage corporations”) (citations omitted).

\textsuperscript{48} See ALI, supra note 38, at 135. The policy behind the business judgment rule is described as follows:
The majority of cases relying on the business judgment rule have afforded broader protection to directors and officers than a "reasonableness" test might otherwise provide. In Auerbach v. Bennett, for example, questionable payments were made to public officials or political parties in foreign countries. An audit committee found evidence of over eleven million dollars of kickbacks. Auerbach, a shareholder, instituted a shareholder's derivative action against the directors and the corporation's auditor. A special litigation committee comprised of three disinterested directors was formed and determined that no proper interest of the corporation would be served by asserting a claim against it. The New York Court of Appeals held that the "substantive aspects of a decision to terminate a shareholders' derivative action against defendant corporate directors made by a committee of disinterested directors [were] . . . beyond judicial inquiry under the business judgment doctrine. . . ." The court, however, could inquire into

The basic policy underpinning of the business judgment rule is that corporate law should encourage, and afford broad protection to, informed business judgments (whether subsequent events prove the judgments right or wrong) in order to stimulate risk taking, innovation, and other creative entrepreneurial activities. Shareholders accept the risk that an informed business decision . . . may not be vindicated by subsequent success. The special protection afforded business judgments is also based on a desire to limit litigation and judicial intrusiveness with respect to private-sector business decision making.

Id. 49 Id. § 4.01(c) cmt. (c) at 180. Broader protection than a reasonableness test was said to exist in a large majority of cases. See, e.g., Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 289 (2d Cir. 1986) (reasoning that directors exercised "independent" judgment); Panter v. Marshall Field & Co., 646 F.2d 271, 294 (7th Cir.) ("The presumption of good faith the business judgment rule affords is heightened when the majority of the board consists of independent outside directors."); cert. denied, 454 U.S. 1092 (1981); Abbey v. Control Data Corp. 603 F.2d 724, 730 (8th Cir. 1979) ("The rule apparently applies to any reasonable good faith determination by an independent board of directors . . . ."), cert. denied, 444 U.S. 1017 (1980); Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259, 275 (3d Cir. 1978) ("Courts have some limited power to review the reasonableness of the directors' judgment . . . ."), cert. denied, 439 U.S. 1129 (1979); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (employing any rational business test); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (predicating director liability on gross negligence); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (employing rational basis test); Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966) (using bad faith or gross abuse of discretion); see also ALI, supra note 38, § 4.01(c), at 186 (citing additional cases).


51 Id. at 997.

52 Id.

53 Id.

54 Id.
the disinterested independence of the committee. The court described the business judgment doctrine as follows:

"The business judgment doctrine, at least in part, is grounded in the prudent recognition that courts are ill equipped and infrequently called on to evaluate what are and must be essentially business judgments . . . . [B]y definition the responsibility for business judgments must rest with the corporate directors; their individual capabilities and experience peculiarly qualify them for the discharge of that responsibility. Thus, absent evidence of bad faith or fraud . . . the courts must and properly should respect their determinations."

While many courts have taken a hands-off approach to directors' liability, a few courts have taken a more restrictive view of the business judgment rule. In Casey v. Woodruff, for example, involving a shareholders' derivative suit based on an unsuccessful effort to obtain certain refinancing, the court noted:

When courts say that they will not interfere in matters of business judgment, it is presupposed that judgment—reasonable diligence—has in fact been exercised. A director cannot close his eyes to what is going on about him in the conduct of the business of the corporation and have it said that he is exercising business judgment. Courts have properly decided to give directors a wide latitude in the management of the affairs of a corporation provided always that judgment, and that means an honest, unbiased judgment, is reasonably exercised by them.

The American Law Institute recognized that many courts liberally interpreted the reasonableness test when judging the conduct of corporate directors and officers. In 1992, the Institute adopted a "rational belief" standard for purposes of protecting

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55 Id.
56 Id. at 1000.
57 See, e.g., Aronson, 473 A.2d at 812 n.6 (indicating that there is "a long line of Delaware cases holding that director liability is predicated on a standard which is less exacting than simple negligence"); see also Penn Mart Realty Co. v. Becker, 298 A.2d 349, 351 (Del. 1972) (referring to gross negligence); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971) (employing fraud or gross negligence standard); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970) (referring to "gross and palpable overreaching"); Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966) (referring to "bad faith" or "gross abuse of discretion"); Allaun v. Consolidated Oil Co., 147 A. 257, 261 (Del. Ch. 1929) (referring to "reckless indifference to or a deliberate disregard of the . . . stockholders").
58 49 N.Y.S.2d 625 (N.Y. Sup. Ct. 1944)
59 Id. at 629.
60 Id. at 643.
business decisions made in good faith. Section 4.01(c) provides as follows:

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 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.\(^6\)

The rational belief standard for the judicial review of business decisions is less stringent than other approaches.\(^6\) The Corporate Director's Guidebook, for example, refers to the business judgment rule as applying only to a director who acts with a "reasonable basis" for believing that the action was in the lawful and legitimate furtherance of corporate purposes.\(^6\)

The growth of legislation permitting waivers of specific duties illustrates the trend towards limiting judicial interference with private-sector corporate decision-making. These waiver provi-
sions followed in the wake of Smith v. Van Gorkom, a decision in which directors were found personally liable for gross negligence because they failed to keep themselves informed of a merger transaction. As the cost of directors' and officers' liability insurance increased and its availability decreased, a legislative means of limiting director liability became necessary. The Delaware waiver provision eliminates or limits liability to the stockholders for monetary damages for a director's breach of a fiduciary duty. Such waivers are not permitted with respect to the duty of loyalty, acts or omissions not performed in good faith or that involve criminal or intentional misconduct, or when an improper personal benefit is derived. Other states such as Pennsylvania, New Jersey, Ohio, and Virginia have adopted various waiver provisions.

Thus, while there are some cases which reflect increased judicial oversight of the standard of care of directors and officers, the current trend lowers or otherwise contractually limits the legal standards that govern the conduct of directors and officers. This trend is illustrated by the deferential judicial interpretation of the business judgment rule, by the "rational basis" standard embraced by the American Law Institute, and by the proliferation of waiver provisions regarding the duty of care.

C. Partnership Model for General Partnerships: The Fiduciary Duty of Loyalty and Standards of Care

Traditionally, partners have been described as standing in a fiduciary relationship with one another. To what extent should

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64 488 A.2d 858 (Del. 1985).
65 Id. Several other decisions reflect a more aggressive judicial stance. See Edelman v. Fruehauf Corp., 798 F.2d 882 (6th Cir. 1986) (holding actions of board unreasonable); Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 274 (2d Cir. 1986) (noting when methodologies directors employed are so shallow in scope that they are not shielded by business judgment rule); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1985) (holding directors breached duty of care).
66 See Gelb, supra note 37, at 13 (discussing waiver provisions and flood of legislation aimed at giving directors relief for breach of duty of care).
72 See ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON PARTNERSHIP 6:67 (1992); see also Beveridge, supra note 21 (discussing duty of care of part-
limited liability company members be treated as partners and subject to standards of conduct appropriate to partners? The legal duties among partners reflect the duties owed by an agent to his principal. Indeed, partnership duties and obligations have their roots in the law of agency. Legal duties owed by one partner to another broadly include: (1) a fiduciary duty of loyalty and utmost good faith; (2) a duty to refrain from self-dealing; (3) a duty to avoid usurping partnership assets for personal use; and (4) a duty to avoid usurping partnership opportunities.

The seminal case on the fiduciary duty of partners is Meinhard v. Salmon, in which Justice Cardozo eloquently stated that "[j]oint adventurers, like copartners, owe to one another . . . the duty of the finest loyalty . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." In Salhinger v. Salhinger, an earlier case, the court dramatically articulated the fiduciary duties of partners. The case involved two brothers who were partners. One brother, in an attempt to "squeeze out" the other, incorporated the partnership without giving the other an interest in the corporation. The court observed:

[T]here is no stronger fiduciary relation known to the law than that of a copartnership, where one man's property and property rights are subject to a large extent to the control and administration of another . . . Their mutual confidence is the life blood of the concern. It is because they trust one another that they are

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73 See Weidner, supra note 72, at 459 ("[T]he law of partnerships reflects the broader law of principal and agent, which states that every agent is a fiduciary."); see also RESTATEMENT (SECOND) OF AGENCY § 14A cmt. a (1958) ("Rights and liabilities of partners with respect to each other . . . are largely determined by agency principles.").

74 RESTATEMENT (SECOND) OF AGENCY § 14A cmt. a (1958).

75 See Bromberg & Ribstein, supra note 72, at 6:68.

76 See Bromberg & Ribstein, supra note 72, at 6:73-75.

77 See Bromberg & Ribstein, supra note 72, at 6:75-77.

78 See Bromberg & Ribstein, supra note 72, at 6:77-83.

79 164 N.E. 545 (N.Y. 1928).

80 Id. at 546.

81 105 P. 236 (Wash. 1909).

82 Id.

83 Id.
partners in the first instance. It is because they continue to trust one another that the business goes on . . . .

The standard of care which partners owe one another, distinct from the duty of loyalty, has been the subject of considerable controversy among commentators and the judiciary alike. Some courts have held that partners must act with due diligence.

84 Id. at 237 (quoting PARSONS ON PARTNERSHIP, § 158 and n.2).
85 See, e.g., Weidner, supra note 72, at 465.

The Restatement position is that a paid agent is subject to a duty to the principal to act with "standard care" and skill. The leading hornbook on partnerships, on the other hand, states that partners "are not subject to the ordinary care standard applicable to a paid agent." Yet there are both old and new statements that partners are subject to an ordinary care standard.

Writing in 1841, Mr. Justice Story opined that: "good faith, reasonable skill and diligence, and the exercise of sound judgment and discretion, are naturally, if not necessarily, implied from the very nature and character of the relation of partnership."

Id. (citations omitted); see also Beveridge, supra note 21, at 756-60 (indicating that English and American case law recognize ordinarily prudent person standard as well as business judgment rule). Beveridge wrote his article in response to the proposal that the Revised Uniform Partnership Act embrace a gross negligence standard rather than a reasonable care standard. Id. at 754. Beveridge observed:

The 1988 edition of the leading text on partnership law states flatly that a general partner is not liable for negligent management. It states the general rule as follows:

"A partner may be held accountable not only for deliberately appropriating an unauthorized benefit, but also for poor management. Partners, however, are not subject to the ordinary care standard applicable to a paid agent. Thus, the partner is not liable to the partnership for the whole burden of losses caused by mere errors of judgment and failure to use ordinary skill and care in the supervision and transaction of business."

If this were a correct statement of the law, it would pose a question as to why partnership law, which is largely based on agency principles, took a detour when it came to the duty of care. It is submitted, however, that this statement of the law is not supported by the weight of authority and is no more true today than when it was first made fifty years ago.

Id. at 755 (quoting BROMBERG & RUSTEIN, supra note 72, at 6:86).

More recently, in Rosenthal v. Rosenthal, 543 A.2d 348, 352 (Me. 1988), the Supreme Court of Maine held that partners owed each other four specific fiduciary duties including the duty to act with that degree of diligence, care, and skill which ordinarily prudent persons would exercise under similar circumstances in like positions. Id. The court embraced the business judgment rule, indicating that the business judgment rule would insulate a partner from liability where informed business decisions were made, unless there is a showing of harmful conduct which was primarily motivated by fraud or bad faith. Id. at 353. However, there are a number of cases which reject the view that partners owe each other the duty to act reasonably. See infra note 86 and accompanying text.

86 See Rosenthal, 543 A.2d at 352 (indicating that partners must act with degree of diligence, care, and skill which ordinarily prudent persons would exercise under similar circumstances in like positions); see also United Brokers' Co. v. Dose, 22 P.2d 204, 205 (Or. 1933) (indicating "the law of partnership is the law of agency").
Since agency and partnership law are interwoven, there is authority for the view that partners must act with standard care and skill. However, a leading hornbook on partnerships generally indicates that partners are not subject to the ordinary care standard. In fact, a number of courts have held that partners are not liable to each other for ordinary negligence. This view was endorsed by Judge Posner in a suit by a retired attorney against his former partners for negligence in the operation of the firm.

87 See Restatement (Second) of Agency § 379 (1958). “Unless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill that he has.” Id; see also Weidner, supra note 72 at nn.108-17 (stating that partners are subject to ordinary care standard).

88 See Bromberg & Ribstein, supra note 72, at 6:85. Partners, however, are not subject to the ordinary care standard applicable to a paid agent. Thus, the partner is not liable to the partnership for the whole burden of losses caused by mere errors of judgment and failure to use ordinary skill and care in the supervision and transaction of business. Id.

89 See Johnson v. Weber, 803 P.2d 939, 941 (Ariz. Ct. App. 1990) (holding as matter of law that negligent management of general partnership or joint venture’s affairs does not create right of action against one partner by other members of partnership in absence of breach of trust); Kartage v. Interocian, 167 So. 2d 76, 76 (Fla. Dist. Ct. App. 1964) (holding that one member of joint venture is not liable to other for mere negligence); Frates v. Nichols, 167 So.2d 77, 77 (Fla. Dist. Ct. App. 1964) (holding that one member of joint venture not liable to another for ordinary negligence); Borys v. Rudd, 566 N.E.2d 310, 316 (Ill. App. Ct.) (holding that partnership losses occasioned by partner’s poor judgment or mistakes of judgment will be borne by partnership so long as decision does not involve fraud, illegality, or conflict of interest) modified, 575 N.E.2d 911 (Ill. 1991); Snell v. DeLand, 27 N.E. 183, 184 (Ill. 1891) (holding that managing partner is not to be treated as insurer and can only be liable for loss from willful disregard of duty); Horter v. Larrabee, 112 N.E. 613, 614 (Mass. 1916) (indicating that one partner’s error-ridden accounting system did not make him liable to his partner since there is no liability of one partner to another for errors of judgment not amounting to fraud, bad faith, or reckless disregard of obligations); Thomas v. Milfelt, 222 S.W.2d 389, 385 (Mo. Ct. App. 1949) (indicating in suit for accounting that partnership losses occasioned by conduct or poor judgment of one partner will not be charged against him, but will be borne by firm, in absence of fraud, culpable negligence, or bad faith); see also Knipe v. Livingston, 57 A.2d 1180 (Pa. 1940) (indicating that one partner’s unscientific method of bookkeeping was caused by error of judgment, not by fraud and was not actionable); Duffy v. Piazza, 815 P.2d 267, 268 (Wash. Ct. App. 1991) (indicating that generally there is no liability of one partner to another for negligence in management of joint venture).

90 See Bane v. Ferguson, 890 F.2d 11 (7th Cir. 1989). In Bane, Judge Posner stated:

We can find no precedent in Illinois law or elsewhere for imposing tort liability on careless managers for the financial consequences of the collapse of the firm to all who are hurt by that collapse. “The act of dissolution of a corporation is not in itself sufficient foundation for [a] tort action even if it results in the breach of contracts . . . .” The dissolution of a firm is a loss to some but a
Given these inconsistencies, it is not surprising that Donald J. Weidner, Reporter for the Revised Uniform Partnership Act, has indicated that a mixed statement in the law exists concerning the duty of care owed among partners.91

D. Rejection of Broad Statements of Partner’s Fiduciary Duties by Revised Uniform Partnership Act

The Uniform Partnership Act (“UPA”), enacted in 1914, incorporates express duties of loyalty.92 However, the UPA contains no duty of care provision.93 In contrast, the Revised Uniform Partnership Act (“RUPA”) contains three major guidelines that govern the conduct of partners including: (1) fiduciary duties specifically limited to conduct expressly enumerated;94 (2) a standard of care gain to others—competitors and their employees, suppliers, and other dependents. Unless the gainer can be forced to disgorge their gains—and they cannot—full liability to the losers will result in overdeterrence. Id. at 14 (quoting Swager v. Couri, 376 N.E.2d 456, 459 (Ill. 1978). 91 See Weidner, supra note 72, at 465. 92 See UNIF. PARTNERSHIP ACT §§ 18(e), 19 (1916). These sections provide that “[a]ll partners have equal rights in the management and conduct of the partnership business,” and that every partner has a right to inspect and copy partnership books. Id. Section 20 of the U.P.A. provides that “[p]artners shall render on demand true and full information.” Section 21(1) of the U.P.A. provides that “[e]very partner must account to the partnership for any benefit, and hold as trustee for it any profits derived without consent of the other partners . . . .” 93 See Weidner, supra note 72, at 456. 94 Rev. Unif. Partnership Act § 404 (1992). This section provides:

(a) 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 this section.

(b) 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 or appropriation by the partner of partnership property or opportunity without the consent of the other partners;

(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, without the consent of the other partners; and

(3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership without the consent of the other partners.

(c) A partner’s duty of loyalty may not be eliminated by agreement, but the partners by agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable.

(d) 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
that is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law; and (3) an obligation of good faith and fair dealing. The duty of loyalty and the obligation of good faith and fair dealing may not be eliminated by agreement. However, if the agreement is not manifestly unreasonable, the partner may agree to identify specific types of activities that do not violate the duty of loyalty.

The standards of conduct indeed "reflect[ ] the supremacy of the partnership agreement and minimize mandatory rules among partners." By limiting fiduciary duties to those expressly enumerated, RUPA turns away from the broad statements of fiduciary duty long embraced by courts. Rather, it incorporates contract law by echoing the UCC's standard of good faith and fair dealing. Moreover, by adopting a gross negligence standard,
RUPA appears to adopt a standard of conduct which is lower than some courts have employed, particularly in the context of disputes between general and limited partners.  

E. Limited Partnership Model

Some states have modeled limited liability company legislation after existing limited partnership statutes. The extent to which limited partnership statutory language is useful with respect to the development of viable standards of conduct for members of the limited liability company is unclear. Limited partnership statutes provide little express guidance regarding standards of conduct. From a statutory standpoint, the standards of conduct applicable to limited partnerships are the same as those applicable to general partnerships. A review of the case law, however, indicates a judicial willingness to protect limited partners from abuse by managing partners. Case law resulting from suits by limited partners against managing partners highlights problems which may be encountered by active and passive members of companies, as well as disputes between members and managers.

In 1916, the National Conference of Commissioners on Uniform State Laws promulgated the Uniform Limited Partnership Act ("ULPA"). ULPA was subsequently amended in 1976 and again in 1985, and is now commonly referred to as the Revised Uniform Limited Partnership Act ("RULPA").

ULPA generally imposes the same rights and powers on the general partner as are imposed on a general partnership without a limited partner. Thus, fiduciary duties owed by partners to

101 See infra note 112.
103 See Unif. Limited Partnership Act (1916).
106 See Unif. Limited Partnership Act § 9 (1916) providing:
(1) A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to:
(a) Do any act in contravention of the certificate,
(b) Do any act which would make it impossible to carry on the ordinary business of the partnership,
one another apply equally to limited partnerships. As the Supreme Court of Washington noted, "[u]nder the Washington Uniform Limited Partnership Act, the general partner has all the rights and powers, and is subject to all the restrictions and liabilities, of a partner in a partnership without limited partners. He is therefore accountable to the limited partners as a fiduciary."\textsuperscript{107}

RULPA contains similar language pertaining to the rights and powers of the general partner.\textsuperscript{108} However, RULPA qualifies this language by stating that "[e]xcept as otherwise provided in this [Act] or in the partnership agreement, a general partner of a limited partnership has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners."\textsuperscript{109} Further, RULPA expands the rights of limited partners by permitting a limited partner to institute a derivative action.\textsuperscript{110}

In interpreting the fiduciary duties of general partners in limited partnerships, there is authority supporting the view that general partners owe a greater fiduciary duty to limited partners who


\textsuperscript{109} Id.

\textsuperscript{110} Id. § 1001. Section 1001 provides: "A limited partner may bring an action in the right of a limited partnership to recover a judgment in its favor if general partners . . . have refused . . . or if an effort to cause those general partners to bring the action is not likely to succeed." Id.
do not participate in management than to partners who actively participate.111 Numerous cases demonstrate the potential for abuse by general partners and illustrate the active posture which courts have taken in protecting the rights of limited partners.112

111 See Weidner, supra note 73, at 467 n.118 ("There is authority for the general proposition that general partners owe greater fiduciary duties to limited partners who do not participate in management."") (citing Boley v. Pineloch Ass'n, Ltd., Fed. Sec. L. Rep. (CCH) 95, 407, 1990 U.S. Dist. Lexis 9912 (S.D.N.Y. 1990)).

112 Some courts have refused to apply the business judgment rule or any other grounds which might insulate general partners from negligence actions brought by limited partners. See Curley v. Brignoli Curley & Roberts Assocs., 746 F. Supp. 1208, 1220 (S.D.N.Y. 1989), aff'd, 915 F.2d 81 (2d Cir. 1990). In Curley, the court applied Delaware law and ruled that a provision in the partnership agreement which exempted general partners from liability for conduct performed in "good faith" and within the general partner's scope of authority would not preclude limited partners from recovering against the general partner for misconduct that was merely negligent. Id.; see also Roper v. Thomas, 298 S.E.2d 424, 429 (N.C. Ct. App. 1982) (holding that general partners were negligent in performance of partnership agreement and rejecting defendant's argument that general partners' conduct should be protected by business judgment rule); Shin v. Thrust IV, Inc., 786 P.2d 285, 290 (Wash. Ct. App. 1990) (refusing to apply business judgment rule to conduct of general partner). But see Wyler v. Feuer, 149 Cal. Rptr 626, 633 (Cal. Ct. App. 1979) (applying business judgment rule to insulate limited partners).

Many courts have recognized the particular vulnerability of limited partners and have assumed an active posture in protecting limited partners. See, e.g., Tucker Anthony Realty Corp. v. Schlesinger, 888 F.2d 969, 972 (2d Cir. 1989) (holding that general partners were bound by an "inflexible" rule of fidelity that excludes not only patent self-dealing, but insists on the avoidance of situations where the fiduciary's own interest brings into question the interests of those to whom he owes a duty of undiluted loyalty."); see also Birnbaum v. Birnbaum, 539 N.E.2d 574, 575 (N.Y. 1989) (holding that general partner violated fiduciary duties by hiring his girlfriend to develop partnership property without consent of his co-partners); Sherman v. Lloyd, III, 226 Cal. Rptr. 495, 498 (Cal. Ct. App. 1986) (illustrating need for strong judicial intervention in case where general partners failed to inform limited partners that proposed undertaking violated California law); M.D. Building Material Co. v. 910 Constr. Venture, 579 N.E.2d 1059, 1062-63 (Ill. App. Ct. 1991) ("The passive nature of the limited partner's role has often resulted in mismanagement and self-dealing by general partners."); Labovitz v. Dolan, 545 N.E.2d 304, 310 (Ill. Ct. App. 1989) (holding that although partnership agreement provided general partner with sole discretion regarding distribution of earnings and limited general partner's liability to gross negligence, this language did not curtail general partner's fiduciary duties to limited partners); Wartski v. Bedford, 926 F.2d 11, 20 (1st Cir. 1991) (indicating that partnership agreement cannot nullify fiduciary duty owed by partners and noting that "exculpatory provisions . . . create no license to steal.") (quoting Irwin v. West End Dev. Co., 342 F. Supp. 687, 701 (D. Colo. 1972), rev'd in part on other grounds, 481 F.2d 34 (10th Cir.), cert. denied, 414 U.S. 1158 (1974)); Glanzer v. St. Joseph Indian Sch., 438 N.W.2d 204, 211 (S.D. 1989) ("[T]he general partner, as a fiduciary, must walk a moral path above that tread by other members of the economic marketplace . . . [and] thus shoulders a heavy burden."); Bassan v. Investment Exch. Corp., 524 P.2d 233, 239 (Wash. 1974) (indicating that limited partners must be able to rely on highest
An analysis of the relationships between limited and general partners is useful in identifying potential problems confronting the limited liability company. Certain businesses, such as real estate ventures, high technology enterprises, oil and gas investments, investments in theatrical productions, and joint American and foreign ventures have long been conducted in the form of the limited partnership, but are suitable for operation in the form of limited liability companies. The history of dissension occurring in limited partnerships suggests that an active judicial posture is appropriate with regard to limited liability companies to protect minority members and those members who do not actively participate in management.

F. Contractual Model

The contractual model imposes an obligation of good faith and fair dealing. The Restatement (Second) of Contracts asserts that every contract imposes on its parties an obligation of good faith and fair dealing in its performance and enforcement. The Uniform Commercial Code ("UCC") also embraces the same standard of conduct. This contractual model serves as yet another possible standard which could be incorporated into legislation governing the conduct of members and managers of the limited liability company. The good faith and fair dealing standard is included in the standards of conduct embraced by the Discussion Draft of the Uniform Act. In addressing this standard, the threshold standard of conduct from general partner, since limited partner has no effective voice in decision-making process).

There is emerging support for legislation enabling partners to contractually limit their duties and liabilities. See, e.g., DEL. CODE ANN. tit. 6, § 17-1101(c), (d) (1993) (providing that state's policy is to give "maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements"). It provides that a general partner who has legal duties and liabilities, including fiduciary duties, shall not be liable to the limited partner or to another partner if the general partner acts in good faith reliance on a provision in a partnership agreement. Id. Additionally, the partnership agreement may expand or restrict a party's duties. Id.; see Bromberg & Ribstein, supra note 72.

113 See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); see also Deborah A. DeMott, Beyond Metaphor: An Analysis of Fiduciary Obligation, 1988 DUKE L.J. 879, 893 (discussing differences between parties' pre-agreement and post-agreement discretion due to obligation of good faith).

114 See U.C.C. § 1-203 (1992) ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.").

115 See infra note 163 and accompanying text (discussing standards of conduct for members and managers under Model Act).
questions are: (1) what does the obligation of good faith and fair dealing mean as a practical matter? and (2) how does the good faith and fair dealing standard differ, if at all, from obligations referred to as fiduciary duties?

Professor John C. Coffee, Jr. has addressed the distinction between fiduciary duties and the good faith and fair dealing standard found in contract law with regard to responsibilities of members of boards of directors. Professor Coffee makes the following observations: (1) section 2-103(1)(b) of the UCC defines good faith as honesty in fact and the observance of reasonable commercial standards; (2) the emphasis on reasonable standards seems to approximate the duty of care; and (3) "bad faith" may be easier to define than good faith, recognizing Professor Summers’s observation that good faith is essentially an excluder phrase without general meaning which serves to exclude a wide range of heterogeneous forms of bad faith. Coffee indicates that six categories of bad faith are identified, including: "evasion of the spirit of the deal, lack of diligence and slacking off, willfully rendering only ‘substantial’ performance, abuse of power to specify terms, abuse of a power to determine compliance and interference with or failure to cooperate in the other party’s performance."

In attempting to identify the fundamental distinction between fiduciary duty and the standard of good faith and fair dealing, Professor Coffee explains:

Put simply, fiduciary law is deeply intertwined with notions of morality and the desire to preserve a traditional form of relationship . . . . In contract law, a discretion-exercising party may often act in a self-interested fashion. Good faith and self-interested behavior are not mutually exclusive. Conversely, fiduciary duty’s requirement of undivided loyalty permits the fiduciary to consider only the beneficiary’s interests. Any unauthorized profit received by the fiduciary must be surrendered to the beneficiary,

116 Coffee, supra note 37, at 1648.
117 Id. at 1654 n.158.
118 Id. at 1654 n.159 (citing several cases which antedate UCC but provide guidance on duty of care, including Pillois v. Billingsley, 179 F.2d 205, 207 (2d Cir. 1950); M. O’Neil Supply Co. v. Petroleum Heat & Power Co., 280 N.Y. 50, 54, 19 N.E.2d 676, 678 (N.Y. 1939); Wigand v. Bachmann-Bechtel Brewing Co., 222 N.Y. 272, 277, 118 N.E. 618, 619 (N.Y. 1918)).
120 Coffee, supra note 37, at 1654-55.
even if the receipt in no way harms the beneficiary. In Judge Cardozo's famous statement, the fiduciary is "held to something stricter than the morals of the market-place." . . . This central conceptual difference, that a contracting party may seek to advance his own interests in good faith while a fiduciary may not, also helps explain a number of procedural differences between the two duties. For example, the burden is on the fiduciary to prove the fairness of any transaction . . . . Similarly, a party who breaches a duty of good faith is liable for damages that are essentially measured by the victim's losses, while fiduciaries are often liable for the victim's losses plus their own gains . . . .

Professor Deborah A. DeMott also observes fundamental distinctions between fiduciary duties and the contractual standards of good faith and fair dealing. Professor DeMott notes that the fiduciary's duty goes beyond mere fairness and honesty and obligates the fiduciary to further the beneficiary's best interests.

DeMott writes:

In many relationships in which one party is bound by a fiduciary obligation, the other party's vulnerability to the fiduciary's abuse of power or influence conventionally justifies the imposition of fiduciary obligation. Much of contract law, in contrast, presupposes that "a contract is the result of the free bargaining of parties who are brought together by the play of the market and who meet each other on a footing of social and approximate economic equality."

Thus, primary differences between fiduciary duties and the standard of good faith and fair dealing turn upon the ability to act in a self-interested manner, the computation of damages, the presumption that the parties operate on an equal footing, and the presence or absence of an imperative to further the beneficiary's interests.

G. Agency

The Restatement (Second) of Agency provides that "[u]nless otherwise agreed, a paid agent is subject to a duty to the principal
to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform, and... to exercise any special skill that he has."\textsuperscript{125} A due care standard is consistent with the overall treatment of limited liability company members and managers as agents. For example, a number of states, such as Arizona,\textsuperscript{126} Colorado,\textsuperscript{127} Louisiana,\textsuperscript{128}

\textsuperscript{125} \textsc{Restatement (Second) of Agency} § 379(1) (1958).

\textsuperscript{126} \textsc{Ariz. Rev. Stat. Ann.} § 29-654 (Supp. 1993). This statute provides:

A. Unless the articles of organization of a limited liability company provide that management is vested in one or more managers:

1. Each member is an agent of the limited liability company for the purpose of carrying on its business in the usual way.

2. The act of each member, including the execution in the name of the limited liability company of any instrument, for apparently carrying on in the usual way the business of the limited liability company of which he is a member binds the limited liability company unless the acting member has in fact no authority to act for the limited liability company in the particular matter and the person with whom he is dealing has knowledge of the fact that the member has no such authority.

\textit{Id.}

\textsuperscript{127} \textsc{Colo. Rev. Stat. Ann.} § 7-80-406 (West Supp. 1993). This section provides:

(4) Every manager is an agent of the limited liability company for the purpose of its business, and the act of every manager, including the execution in the limited liability company name of any instrument for apparently carrying on in the usual way the business of the limited liability company of which he is a manager, binds the limited liability company, unless such act is in contravention of the articles of organization or the operating agreement or unless the manager so acting otherwise lacks the authority to act for the limited liability company and the person with whom he is dealing has knowledge of the fact that he has no such authority.

\textit{Id.}

\textsuperscript{128} \textsc{La. Rev. Stat. Ann.} § 12:1317 (West Supp. 1994). The Louisiana revised statute provides:

A. Each member, if management is reserved to the members, or manager, if management is vested in one or more managers pursuant to R.S. 12:1312, is a mandatary of the limited liability company for all matters in the ordinary course of its business other than the alienation, lease, or encumbrance of its immovables, unless otherwise provided in the articles of organization or this Chapter or unless such member or manager lacks the authority to act for the limited liability company and the person with whom he is dealing has knowledge of the fact that he lacks such authority.

B. Persons dealing with a member, if management is reserved to the members, or manager, if management is vested in one or more managers pursuant to R.S. 12:1312, of the limited liability company shall be deemed to have knowledge of restrictions on the authority of such a member or manager contained in a written operating agreement if the articles of organization of the limited liability company contain a statement that such restriction exist.

\textit{Id.}
Maryland, Oklahoma, and Texas expressly provide that each member or manager acts as an agent of the limited liability company. Many states go further and impose upon the member or manager a duty to treat limited liability company property as if the property were held by a trustee. Thus, the conception of the member as agent is an integral part of most limited liability company statutes.

H. Current Status of Limited Liability Company Legislation

Currently, forty-five states have limited liability statutes. Many other states have either entertained or are in the process of reviewing proposed legislation. The enacted statutes contain di-

(a) In general—
(1) Except 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.
(2) Except as provided in paragraph (3) of this subsection, the act of each member, including the execution in the name of the limited liability company of any instrument, for apparently carrying on in the usual way the business of the limited liability company of which the person is a member, binds the limited liability company, unless:
(i) the member so acting has in fact no authority to act for the limited liability company in the particular matter; and
(ii) the person with whom the member is dealing has actual knowledge of the fact that the member has no such authority.

Id.

A. Every manager is an agent of the limited liability company for the purpose of its business, and the act of every manager, including the execution in the limited liability company name of any instrument for apparently carrying on the business of the limited liability company of which he is a manager, binds the limited liability company, unless the manager so acting lacks the authority to act for the limited liability company in the particular matter and the person with whom he is dealing has knowledge of the fact that he has no such authority.

Id.

133 See supra note 1 (listing states which have enacted statutes authorizing limited liability companies).
verse approaches to standards of conduct among managers and members of the limited liability company. The corporate, partnership, or contractual models discussed above are employed, and in some cases, a blended approach is utilized.

Delaware has taken the lead in deferring to the contract of the parties to determine standards of conduct. Delaware limited liability company may be managed by members or by managers. However, no express standard of care is provided. States such as Florida and Nevada yield to the contractual arrangement as the source of standards of conduct. It is noteworthy, however, that although the Florida and Nevada statutes defer to the contractual arrangement, they contain other important provisions which relate to standards of conduct. In Florida, an involuntary dissolution may be sought if the limited liability company has carried on, conducted, or transacted business in a persistently fraudulent or illegal manner, or has abused its powers contrary to the public policy. Nevada provides indemnity for managers, members, employees, and agents so long as the ques-
tioned conduct was in good faith, and the party reasonably believed the conduct was in, or not opposed to, the best interests of the limited liability company.\textsuperscript{140}

With respect to the duties of managers of limited liability companies, a number of states adopt the same standard of care applied to corporations under the Model Business Corporation Act.\textsuperscript{141} Colorado,\textsuperscript{142} Minnesota,\textsuperscript{143} Oklahoma,\textsuperscript{144} New York,\textsuperscript{145} Virginia,\textsuperscript{146} and West Virginia\textsuperscript{147} adopted a standard of care for management based on an ordinarily prudent person in a like position under similar circumstances. However, it is uncertain to what extent the business judgment rule may be invoked to insulate management decisions.

Some states appear to incorporate agency principles without expressly providing for a standard of care based on agency concepts.\textsuperscript{148} For example, Arizona essentially provides that members

\begin{footnotes}
\item[141] Model Bus. Corp. Act Ann. § 8.30 (1984). This section provides that “a director shall discharge his duties as a member of a committee: 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 he reasonably believes to be in the best interest of the corporation.” Id.
\item[142] See Colo. Rev. Stat. Ann. § 7-80-410(2)(a) (West Supp. 1993) (providing for indemnification of managers, employees, or agents if manager conducted himself in good faith and with reasonable belief that his conduct was in best interests of limited liability company).
\item[143] See Minn. Stat. Ann. § 322B.69 (West Supp. 1994) (providing that manager shall discharge his duties in good faith, in manner he reasonably believes to be in best interest of limited liability company, and with care of ordinarily prudent person in like position under similar circumstances).
\item[144] See Okla. Stat. Ann. tit. 18, § 2016 (West Supp. 1994) (providing that managers shall discharge duties in good faith with care of ordinary prudent person in like position under similar circumstances, and in manner reasonably believed to be in best interest of limited liability company); Id. § 2015 (providing that members be treated as managers in member-managed limited liability company).
\item[145] N.Y. S.B. 27, 215th Gen. Ass., 1st Sess. (1993) (introduced on Jan. 6, 1993). Section 409 of the proposed statute provides that 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 would use under similar circumstances. Id.
\item[147] See W. Va. Code § 31-1A-33 (1993) (providing that members of limited liability company shall have same rights and liabilities as shareholders of corporations and managers shall have same rights and liabilities as directors of corporations).
\item[148] See supra notes 126-32 and accompanying text.
\end{footnotes}
or managers are agents of the limited liability company.\textsuperscript{149} Maryland\textsuperscript{150} and Texas\textsuperscript{151} similarly incorporate the agency concept.

Louisiana has a unique formulation of standards of conduct which blends partnership, corporate, contractual, and agency principles.\textsuperscript{152} Virginia, while adopting a good faith and reasonable conduct standard, also employs a limitation on the liability of managers or members arising out of a single transaction, occurrence, or course of conduct.\textsuperscript{153} States such as Kansas\textsuperscript{154} and Wyoming\textsuperscript{155} are silent regarding the conduct of managers or members.

California has proposed legislation which closely parallels the standards of conduct contained in RUPA.\textsuperscript{156} The California model limits the fiduciary duties of a manager or member to the duties of loyalty and care expressly provided in the statute.\textsuperscript{157} The duty of


\textsuperscript{150} See Md. Code Ann. Corps. & Ass'ns § 4A-401 (Michie 1993) ("[E]ach member is an agent of the limited liability company for the purpose of its business.").


\textsuperscript{152} See La. Rev. Stat. Ann. § 12:1314(1) (West Supp. 1994) (providing that member or manager stands in fiduciary relationship to limited liability company and shall discharge his duties in good faith, with same diligence, care, judgment, and skill ordinary prudent person in like position would exercise under similar circumstances and in manner reasonably believed to be in best interest of limited liability company).

\textsuperscript{153} See Va. Code Ann. § 13.1-1025 A. (Michie 1993). This statute provides:

A. [T]he damages assessed against a manager or member arising out of a single transaction, occurrence or course of conduct shall not exceed the lesser of: 1) The monetary amount, including the elimination of liability . . . of the manager or member; or 2) The greater of (i) $100,000 or (ii) the amount of cash compensation received by the manager or member from the limited liability company during the twelve months immediately preceding the act or omission for which liability was imposed. B. The liability of a manager or member shall not be limited as provided in this section to the extent otherwise provided in writing in the articles of organization or an operating agreement, or if the manager or member engaged in willful misconduct or a knowing violation of the criminal law.


\textsuperscript{157} Id.
loyalty is limited to the duty to account for profits as a trustee, to refrain from dealing as or on behalf of an adverse party, and to refrain from competition, absent the consent of the members.\textsuperscript{158} Significantly, the duty of loyalty may not be eliminated by agreement, but an agreement may identify the types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable.\textsuperscript{159} The proposal prohibits the operating agreement or the articles of organization from eliminating the duty of care or the obligation of good faith and fair dealing.\textsuperscript{160}

The California proposal does not set forth a standard of care as distinguished from the duty of loyalty for members. However, the proposal does provide a standard of care for managers.\textsuperscript{161} A manager's duty of care is limited to refraining from engaging in grossly negligent or reckless conduct, intentional or reckless conduct, intentional misconduct, or a knowing violation of law.\textsuperscript{162}

\section{III. The Emergence of a Uniform Limited Liability Company Act}

Against the backdrop of the enactment of limited liability company legislation in numerous states, the National Conference of Commissioners on Uniform State Laws appointed a study committee in late 1991 to determine whether the Conference should

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  \item liability company business or from a use or appropriation by the manager of limited liability company property or opportunity. (2) To refrain from dealing with the limited liability company in the conduct or winding up of the limited liability company business, as or on behalf of a party having an interest adverse to the limited liability company without the consent of the members. (3) To refrain from competing with the limited liability company in the conduct of the limited liability company business without the consent of the members before the dissolution of the limited liability company. (c) A manager's duty of loyalty may not be eliminated by agreement, but the members may by agreement identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable. (d) A manager's duty of care to the limited liability company and its members in the conduct and winding up of the limited liability company business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.
\end{itemize}

\textit{Id.}

\textsuperscript{158} Id. § 17153(b)(1)-(3).
\textsuperscript{159} Id. § 17153(c).
\textsuperscript{160} Id. § 17005(b)(7), (8).
\textsuperscript{161} Id. § 17153(d).
\textsuperscript{162} Id.
undertake a drafting project on limited liability companies. The study committee believed that the diversity in state law would ultimately impede the predictability and utility of limited liability company business. A drafting committee was appointed and drafting sessions are currently in progress.

The Discussion Draft of the Uniform Limited Liability Company Act uses RUPA as a starting point. The Uniform Act places a premium on the contract between the parties. Although the standard of loyalty may not be eliminated, it may be modified by agreement. Broadly phrased statements of fiduciary duties are avoided and are replaced with a contractually based standard of good faith and fair dealing. The Uniform Act departs from the standard of due care imposed upon agency relationships. In its place, it embraces the lesser standard of gross negligence, unless a higher standard of care is provided in the agreement.

The Discussion Draft includes general standards of conduct for members and managers. The statutory language closely follows the language of RUPA. The only fiduciary duties a member owes to the limited liability company and other members are the duties of loyalty and care specifically contained in Section 408.

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163 See Unif. Limited Liability Company Act, Prefatory Notes & Comments (Discussion Draft 1993). The drafting committee's first drafting session was in Denver, Colorado in December, 1992, and its second drafting session was held at the end of February, 1993.

164 Id.

165 Id.

166 Id. § 408. Section 408 provides:

(a) The only fiduciary duties a member owes to the limited liability company and the other members are the duty of loyalty and the duty of care set forth in this section. (b) A member's duty of loyalty to the limited liability company and the other members is limited to the following: (1) To account to the limited liability company and hold as trustee for it any property, profit, or benefit derived by the member, without the consent of the other members, in the conduct and winding up of the limited liability company business or from a use or appropriation by the member of limited liability company property or opportunity; (2) To refrain from dealing with the limited liability company in the conduct or winding up of the limited liability company business, as or on behalf of a party having an interest adverse to the limited liability company without the consent of the other members; and (3) To refrain from competing with the limited liability company in the conduct of the limited liability company business without the consent of the other members before the dissolution of the limited liability company. (c) A member's duty of loyalty may not be eliminated by agreement, but the member control agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable. (d) A member's duty of care to the limited liability company and the other members in the conduct and
A member's duty of loyalty is limited to a duty to account to the company, to hold as trustee any property or profit without the consent of the members, to refrain from dealing with, as, or on behalf of a party having an interest adverse to the company without the consent of the other members, and to refrain from competing without the consent of the members. Like the California proposal, the Discussion Draft provides that the duty of loyalty may not be eliminated by agreement, but, if not manifestly unreasonable, the member control agreement may identify specific types or categories of activities that do not violate the duty of loyalty.

The duty of care applicable to both members and managers is limited to liability for grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law. The comments to the Uniform Act do not elaborate on this standard. Identical language, however, is contained in section 404(d) of RUPA. The comments provide insight into the rationale for the adoption of the gross negligence standard in the limited liability company winding up of the limited liability company business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law. (e) A member shall discharge the duties to the limited liability company and the other members under this Act or under the limited liability company agreement, and exercise any rights, consistent with the obligation of good faith and fair dealing. The obligation of good faith and fair dealing may not be eliminated by agreement, but the members may by the member control agreement determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable. (f) A member does not violate a duty or obligation under this Act or under the limited liability company agreement merely because the member's conduct furthers the member's own interest. A member may lend money to and transact other business with the limited liability company. The rights and obligations of a member who lends money to or transacts business with the limited liability company are the same as those of a person who is not a member, subject to other applicable law. (g) This section applies to a person winding up the limited liability company business as the personal or legal representative of the last surviving member as if the person were a member. (h) Where the management of a limited liability company is vested in managers rather than members, the managers shall be held to the same standards of conduct set forth in subsections (b) through (f).

Id.  

167 Id. § 408(b)(1).  
168 Id. § 408(b)(2).  
169 Id. § 408(b)(3).  
170 Id. § 408(c).  
171 Id. § 408(d), (h).  
172 See UNIF. PARTNERSHIP ACT § 404(d), 6 U.L.A. 228 (1992 Supp.).
context.\textsuperscript{173} These comments indicate that the standard of gross negligence is used in many partnership agreements today.\textsuperscript{174} Although absolving partners of intentional misconduct is considered per se unreasonable,\textsuperscript{175} it is left to the courts to determine the outer limit in reducing the standard of care.\textsuperscript{176}

Like RUPA, the Uniform Act imposes an obligation of good faith and fair dealing.\textsuperscript{177} Similarly, the duty of good faith and fair dealing may not be eliminated by agreement, although the member control agreement may delineate the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.\textsuperscript{178} The comments to RUPA are again instructive, observing that the obligation of good faith and fair dealing is a contract concept.\textsuperscript{179} Reference is made to the UCC, and to Summers’s explanation as follows:

Good faith, as judges generally use the term in matters contractual, is best understood as an “excluder”—a phrase with no general meaning or meanings of its own. Instead, it functions to rule out many different forms of bad faith. It is hard to get this point across to persons used to thinking that every word must have one or more general meanings of its own—must be either univocal or ambiguous.\textsuperscript{180}

Thus, the Discussion Draft of the Uniform Limited Liability Company Act does not completely jettison fiduciary duties nor totally defer to the agreement between the parties. It represents a compromise position that permits some contractual specification of the duties of loyalty and good faith, yet prohibits wholesale opting out of traditional fiduciary duties.

\textbf{IV. A Fresh Approach to the Standards of Conduct for the Limited Liability Company}

What standards of conduct are most appropriate for members and managers of the limited liability company? Should a
mandatory standard of due care be adopted? Should Delaware's lead be followed permitting virtually complete deference to the contract between the parties? Alternatively, has the Discussion Draft of the Uniform Act achieved a viable balance between mandatory standards on one hand, and self-regulating, contractual standards on the other?

To begin to answer these questions, each model must be analyzed in light of the underlying social policy considerations and the realities of doing business in the form of the limited liability company.

A. **Social Policy Considerations**

Establishing the appropriate duties of loyalty and standard of care for limited liability company members and managers requires consideration of several competing policy issues, including: (1) The utility of maintaining flexibility of organization and freedom of contract; (2) the desire for members to obtain a reasonable degree of certainty as to responsibilities; (3) the goal of encouraging risk taking and entrepreneurial undertakings; (4) the importance of providing standards which will encourage responsible behavior toward other limited liability company members, and in particular, to minority members and to members who do not actively participate; and (5) the business's responsibility to the public at large. Models for conduct should be evaluated against the backdrop of such social policy goals.

B. **The Failure of the Traditional Corporate Model to Address the Needs of Closely Held Businesses**

It is irrefutable that both the due care standard for directors and the business judgment rule are expressly designed to encourage risk taking, innovation, and entrepreneurial activities by refusing to permit courts to second-guess business decisions. Although these goals are also present in the case of businesses conducted in the form of the limited liability company, the corporate standard of due care, when combined with an expansive application of the business judgment rule, is inappropriate in the limited liability company context.

There are fundamental structural differences between the public corporation and the limited liability company. First, in a

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181 See supra note 48 and accompanying text.
member-managed limited liability company there is no separation between ownership and management. In contrast, the corporate form presupposes a separation between ownership and management. The board of directors has no true counterpart in the limited liability company. The corporation possesses a board of directors which, in an oversight capacity, collectively engages in group decision-making. Conversely, the decision-making process in the limited liability company context is largely informal and involves the hands-on, day-to-day conduct of business.

182 This separation does not exist in close corporations, and is one of the reasons why remedial legislation has been needed to address the special needs of the close corporation. See O'Neal, supra note 17, at 884 (indicating that participants in close corporations do not usually think of themselves as delegating management of their corporation to independent board of directors).

183 See supra note 25 (indicating that most limited liability company statutes provide for management by members or manager, with manager described as agent or employee of limited liability company).

184 The collective nature of the decision-making of the Board of Directors is noted by ALI, supra note 38, at 136, providing as follows:

[T]he business judgments of the Board of directors or of a committee are not decisions of individuals, and since oversight obligations rest on the board as a whole (see sec. 3.02(a)(2)), difficult causation issues will often arise. When Part IV states that a director or officer has "committed a breach" of the duty of care, no implication is intended that liability will be imposed. That question depends on whether the acts or omissions were the legal cause of any damage to the corporation.

Id.; see §§ 4.01(d), 7.18. A director who fails to perform an oversight obligation, for example, may have caused no damage to the corporation because the failure was rendered harmless by the care of other directors. See also Statement of the Business Roundtable, The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation, 33 Bus. Law. 2083, 2096-2103 (1978) (stating that there are four key board functions, including providing for management and board succession, considering decisions and actions with potential for major economic impact, considering social impacts, and establishing policies and procedures to assure law compliance).

185 See, e.g., ARiz. REV. STAT. ANN. § 29-682.B.4 (Supp. 1993) (providing that operating agreement may make provisions for any matter requiring vote, approval or consent of members or managers, provisions relating to notice of time, place, and purpose of any meeting at which matter is to be voted on, waiver of notice, action by consent without meeting, establishment of record date, quorum requirements, authorizations by proxy or any other matter concerning exercise of any voting or approval rights); Id. § 29-683 (providing for approval of actions by written consent); Del. Code ANN. tit. 16, § 18-302(c) (1993) (providing that limited liability company agreement may set forth provisions relating to notice of time, place, or purpose of any meeting at which any matter is to be voted on by any members, and to waiver of any such notice).

Some states impose minimal guidelines on meetings. See KAN. STAT. ANN. § 17-7613(b) (1992) (providing that operating agreement shall provide for meetings which may be held at such times as provided in operating agreement or upon minimum of 10 days written notice).
Limited liability companies are typically privately held entities. They resemble the close corporation more than the public corporation upon which the traditional standards of care and the business judgment rule are based. An investment in a limited liability company lacks liquidity to the extent that there is no public market to dispose of the interest. Years of experience indicate that the traditional corporate model is inadequate to meet the needs of closely held corporations, and in particular, the needs of minority owners of closely held business enterprises.

Steven C. Bahls has observed that the two legal doctrines which have historically served as barriers to removing inefficient or incompetent management include the majority rule doctrine and the business judgment rule. Bahls described the particular difficulties of the minority shareholder in combating ineffective majority control. He noted that:

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186 I.R.C. § 7704 (1988) (providing for taxation of publicly traded corporations). If a limited liability company were ever publicly traded the primary benefits of achieving taxation as a partnership coupled with limited liability would be lost. Therefore, at present the limited liability company is a vehicle solely for privately owned enterprises.

187 See Steven C. Bahls, Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy, 15 J. Corp. L. 285 (1989) (reviewing illiquidity and plight of minority shareholders, as well as legislative efforts to address dissension, and proposing standards for determining appropriate remedies for shareholder dissension); Victor B. Brudney & Marvin A. Chirelstein, A Restatement of Corporate Freezeouts, 87 Yale L.J. 1354, 1357-70 (1978) (reviewing and classifying corporate freezeouts of minority shareholders in public corporations, including discussion of going private transactions); Frank H. Easterbrook & Daniel R. Fischel, Close Corporations and Agency Costs, 38 Stan. L. Rev. 271 (1986) (reviewing cost and risk associated with management of close corporations and indicating that lack of liquidity invites exploitation); Robert W. Hillman, The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations, 67 Minn. L. Rev. 1, 75 (1982) (reviewing partners' power to dissolve partnerships and shareholders' power to dissolve close corporations, and focusing on importance of investor's expectations in close corporations); Richard A. Mann, A Critical Analysis of the Statutory Close Corporation Supplement to the Model Business Corporation Act, 22 Am. Bus. L.J. 289 (1984) (analyzing Statutory Close Corporation Supplement to Model Business Corporation Act, and indicating that while closely held corporations comprise large majority of incorporated business entities in United States, their special needs differ from those of larger public corporations and these special needs have not, until recently, received statutory protection); O'Neal, supra note 17, at 873-81 (analyzing legislation aimed at closely held corporations and indicating inadequacy of traditional corporate standards when applied to close corporations); see also John E. Davidian, Corporate Dissolution in New York: Liberalizing the Rights of Minority Shareholders, 56 St. John's L. Rev. 24 (1981) (reviewing development of New York legislation enhancing rights of minority shareholders).

188 Bahls, supra note 187, at 292.
Majority shareholders control the books and records of the company and have been known to alter them. Likewise, majority shareholders, with the benefit of hindsight, and the Business Judgment Rule, often recharacterize a questionable transaction or find new and acceptable justifications for the transaction. Ascertaining whether the shareholder-manager... has been benefited is like putting Humpty Dumpty back together again. Moreover, even if a minority shareholder wins money damages, the real root of the problem, the incompetent or dishonest controlling shareholder, remains.189

It is anticipated that a broad range of privately held businesses, including family businesses, will be conducted as limited liability companies.190 Difficulties in the relationships between majority and minority limited liability company members and the potential for dissension among members can be expected.191

Given the similarities between the limited liability company and the closely held corporation, legal standards of conduct governing limited liability company members and managers must be tailored to address the problems that have traditionally plagued closely held businesses. The hands-off judicial posture which the business judgment rule supports is not suitable for privately held

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189 Bahls, supra note 187, at 293 (citations omitted).
190 See supra note 6 and accompanying text.
191 The magnitude of dissension in family businesses should not be underestimated. See Bahls, supra note 187, at 287.

Close corporations account for most of American business. Family owned businesses alone represent ninety-five percent of all United States businesses and are responsible for nearly fifty percent of the jobs in the United States. However, in a study by Professor John L. Ward of Loyola University of Chicago, eighty percent of the Chicago area family-owned corporations that were in existence in 1924 and had at least twenty employees were no longer going concerns in 1984. Some of the major reasons for the business failure of closely held businesses are "typical family problems [such] as sibling rivalry [and] competition between the generations," that result in shareholder dissension and corporate succession problems. Costs associated with dissension include ineffective use of management time, resource-draining litigation, loss of a business's ability to obtain necessary financing, as well as the obvious costs associated with business failure.

Dissension within a company produces noneconomic losses as well. If allowed to escalate, it can destroy sound family relationships and lead to vindictiveness. In one sense, dissension in close corporations is like dissension in a marriage. In both circumstances, complex emotional and financial relationships exist that courts cannot easily dissolve without losses. Just as courts have developed standards in dissolution of the marital relationship to minimize hardship, courts also must develop standards to resolve dissension in close corporations.

Id. (alteration in original) (citations omitted).
businesses, whether in the form of a corporation or a limited liability company. The current trend in corporate law is to insulate directors from liability through waiver provisions designed to permit waivers of specified duties\(^{192}\) and through a dilution of the standard of care for judicial review of business judgments from a “reasonableness” standard to a “rational belief” standard.\(^{193}\) The resulting standards may well serve to encourage individuals to participate as members of boards of directors of public corporations; however, they fail to provide a viable approach in the arena of closely held businesses.

C. Advantages and Shortcomings of the Traditional Partnership Model

The similarities between partnerships and limited liability companies make the partnership model for standards of conduct a logical choice for the limited liability company.\(^{194}\) It is not surprising that the Discussion Draft of the Uniform Limited Liability Company Act is based on a partnership paradigm. The fiduciary duties long associated with partnerships would work well to protect all members of the limited liability company, and in particular, minority members and members who do not actively participate in management. The issue becomes which partnership standards should be adopted.

The adoption of traditional partnership notions of fiduciary duty provides critical protection for the minority shareholder of the close corporation.\(^{195}\) The seminal case for

\(^{192}\) See supra notes 67-71 and accompanying text.

\(^{193}\) See supra notes 49-61 and accompanying text.

\(^{194}\) Like partnerships, a limited liability company may be managed by members or managers. The limited liability company’s operating agreement, like a partnership agreement, is the critical document governing the conduct of business. See supra note 8 and accompanying text.

\(^{195}\) For an excellent history of the fiduciary duty majority shareholders owe minority shareholders, see Brent Nicholson, The Fiduciary Duty of Close Corporation Shareholders: A Call For Legislation, 30/3 Am. Bus. L.J. 513, 515 (1992) (noting that Southern Pac. Co. v. Bogert, 250 U.S. 483 (1919), is sometimes credited with being first case to recognize fiduciary duty owed by majority shareholders to minority shareholders). See also Helms v. Duckworth, 249 F.2d 482, 486-88 (D.C. Cir. 1957) (holding that close corporation shareholders are like joint venturers or partners in general partnership, and that majority shareholders owe fiduciary duties of good faith, honesty, and openness to minority shareholders); Jones v. H.F. Ahmanson & Co., 460 P.2d 464 (Cal. 1969). In Ahmanson, the controlling group of shareholders exchanged its control block of stock for shares in a holding company which in turn offered its stock to the public. Id. at 466-69. Minority shareholders were not offered an opportu-
applying partnership notions of fiduciary duty to the close corporation to protect minority shareholders is Donahue v. Rodd Electrotype Co. of New England, Inc. In Donahue to exchange their shares. Id. There were relatively few shares of stock in the active company in which the minority shareholders owned shares, and the price of each share was so high that they had little market appeal. Id. The holding company, on the other hand, offered numerous shares at far lower prices. Id. Because of the ready market for the holding company's shares, the controlling shareholders were able to sell part of their investment in the active company at a huge profit. Id. at 476. The court held that the majority shareholders had a duty to offer this same opportunity to minority shareholders. Id. Chief Justice Traynor's opinion describes the rigorous standards of conduct applicable to majority shareholder as follows:

A director is a fiduciary. So is a dominant or controlling stockholder or group of stockholders .... Their powers are powers in trust .... Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein .... The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside. Id. at 471 (citations omitted); see also Slattery v. Bower, 924 F.2d 6, 10 (1st Cir. 1991) (where majority breached fiduciary duty by misleading minority as to true worth of corporation and redeeming minority shareholder's stock at well below its fair value).
the majority shareholder had authorized the corporation to repurchase some of his shares. The minority shareholder requested that the corporation repurchase her shares on the same basis as the repurchase of the majority shares, but the majority shareholder refused. The minority successfully litigated to rescind the stock repurchase on the grounds that it was a violation of the majority’s fiduciary duties. The Supreme Court of Massachusetts observed that the close corporation bears a “striking resemblance to a partnership” and held that “stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.” This standard was one of “utmost good faith and loyalty.” Stockholders were prohibited from acting “out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation.

Judicially developed standards, beginning with Meinhard v. Salmon, encompass sweeping statements of strict fiduciary duty. These broad statements have been criticized for gener-

shareholders by utilizing their majority control of the corporation to their own advantage, without providing minority shareholders with an equal opportunity to benefit, such breach, absent a legitimate business purpose, is actionable”). The application of Donahue has been limited in certain cases. See, e.g., Webber Oil Co. v. Murray, 551 A. 2d 1371 (Me. 1988) (refusing to extend fiduciary duty to franchise relationship); see also Tone v. Baltimore Envelope Co., 498 A.2d 642, 652 (Md. 1985) (refusing to adopt per se rule requiring corporation to purchase minority shareholders’ nonvoting stock on same conditions as another shareholder); Waite v. Sylvester, 560 A.2d 619, 623 (N.H. 1989) (indicating that removal of partner to resolve schism in management does not violate fiduciary duty); Zidell v. Zidell, 560 P.2d 1091 (Or. 1977) (refusing to permit plaintiff to prevent another shareholder from consolidating control of corporation).

Some have criticized the application of partnership principles to protect minority shareholders. See Nicholson, supra note 195, at 530 (criticizing application of partnership analogy because it creates uncertainty); see also Bagdon v. Bridgestone/Firestone, Inc., 916 F.2d 379 (7th Cir. 1990) (criticizing partnership analogy for lack of predictability and possible inconsistency with party’s intent), cert. denied, 111 S. Ct. 2257 (1991).

197 328 N.E.2d 505 (Mass. 1975).
198 Id. at 510.
199 Id. at 511.
200 Id. at 520-21.
201 Id. at 512.
202 Id. at 515 (citations omitted).
203 Id. (quoting Cardullo v. Landau, 105 N.E.2d 843, 845 (Mass. 1952)).
204 Id.
205 164 N.E. 545 (N.Y. 1928).
206 See supra notes 79-84 and accompanying text.
The more restrained approach embraced by RUPA and by the Uniform Limited Liability Company Act attempts to curtail sweeping standards which inject undesired uncertainty in the law. At the same time, this approach retains the duty of loyalty and the contractually based standards of good faith and fair dealing. The approach is consistent with the hybrid nature of the limited liability company and provides increased certainty. Nevertheless, a continuing concern is whether the carefully circumscribed standards of conduct are comprehensive enough to protect the interests of minority members and passive investors of limited liability companies. The limitation of the duty of care to gross negligence may leave members open to the types of abuse which have been witnessed in connection with many syndications of limited partnerships.

D. The Potential Inadequacies of a Purely Contractual Model

Complete deference to the limited liability company's operating agreement is tantamount to imposing no standard of care or duty of loyalty upon limited liability company members. In light of the long-standing history of shareholder dissension in the close corporation context, and the abuse which has occurred in the context of limited partnerships, judicial intervention will invariably be needed to mediate disputes among limited liability company members. Although clothed in a different form, a business enterprise operating as a limited liability company will face many of the same conflicts as its predecessors, whether they previously operated in the form of a close corporation or a limited partnership.

If judicial intervention is indeed inevitable, then legislation providing a framework for coherent and effective judicial mediation of disputes among members of the limited liability company is clearly desirable.

The standard of good faith and fair dealing is a starting point for the development of viable standards of conduct for limited liability company members and managers; however, fiduciary duties and the good faith and fair dealing standard are distinguishable. Although contracting parties may seek to advance their

\[207 \text{ See supra notes 85-91 and accompanying text.} \]
\[208 \text{ See supra notes 94-101 and accompanying text.} \]
\[209 \text{ See supra note 101 and accompanying text.} \]
\[210 \text{ See supra notes 122-24 and accompanying text.} \]
own interests within the parameters of the good faith and fair
dealing standard, their fiduciary duties may not permit the fur-
therance of their own interests.\textsuperscript{211} Given the long history of ex-
ploitation and the abuse of power which has taken place in the
context of both close corporations and partnerships, the good faith
and reasonable care standard alone is insufficient. However, a
good faith and reasonable care standard, as proposed under the
Uniform Act, may be appropriate when coupled with fiduciary du-
ties to avoid self-interest and competition.\textsuperscript{212}

E. Consistent Treatment of Members and Managers as Agents

Given that members and managers of the limited liability
company are treated as agents in the conduct of business,\textsuperscript{213} it
logically follows that the standard of care for members and man-
agers should be determined with reference to the standard appli-
cable to agents. Presumably, agency notions of actual and apper-
cent authority will eventually be applied to limited liability
company managers and members. Managers and members are re-
sponsible for limited liability property as if they were
trustees.\textsuperscript{214} To hold managers and members to a lower standard of conduct
than that expected of agents would be inconsistent with the statu-
tory and judicial treatment of members and managers as agents.

F. The Need to Combat Oppression of the Majority by the
Minority

A due care standard imposed upon members may also assist
in combating the prospect of oppressive behavior by minority
members of limited liability companies. The landmark case illus-
trating the power of the minority to tyrannize the majority is
Smith v. Atlantic Properties, Inc.\textsuperscript{215} In Smith, a minority share-
holder continually exercised his veto power to block distributions
of dividends to shareholders of a closely held corporation. As a
result, the corporation incurred tax penalties for accumulating
earnings in excess of the business's reasonable needs.\textsuperscript{216} The

\textsuperscript{211} See supra note 123 and accompanying text.
\textsuperscript{212} See supra notes 163-80 and accompanying text (discussing Proposed Uniform
Limited Liability Company Act).
\textsuperscript{213} See supra notes 126-32 and accompanying text.
\textsuperscript{214} See supra note 132 and accompanying text.
\textsuperscript{216} Id. at 800.
court ultimately gave injunctive relief to the majority shareholders.\textsuperscript{217}

A standard of due care applicable to all members would foster the reciprocal responsibility owed by majority and minority members toward each other.\textsuperscript{218}

V. Recommendations

A. A Blended Approach Tailored to the Hybrid Nature of the Limited Liability Company

A blended approach which recognizes agency, partnership, and contractual principles is perhaps best suited to the hybrid nature of the limited liability company. At present, the Discussion Draft of the Uniform Limited Liability Company Act comes closest to integrating all three models. It imposes the contractual standard of good faith and fair dealing, which may not be eliminated.\textsuperscript{219} It also retains duties of loyalty, including a duty to account for property or profit without consent of the members, a duty to refrain from dealing with or on behalf of a party having an adverse interest without the consent of other members, and a prohibition against competition without the consent of the members.\textsuperscript{220}

While it is commendable that the Discussion Draft adopts specific duties of loyalty and the standard of good faith and fair dealing, the adoption of a gross negligence standard rather than an ordinary negligence standard is more controversial. The gross negligence standard stands in striking contrast to the requirements contained in existing limited liability company statutes.

\textsuperscript{217} Id. at 803.

\textsuperscript{218} See Donahue, 328 N.E.2d at 515 n.17 (recognizing that minority may do damage to majority's interest).

\textsuperscript{219} See supra note 178 and accompanying text. But see Coffee, supra note 37, at 1665 (recommending nonwaivable standard of good faith and fair dealing in corporate law). Professor Coffee recommended that:
\begin{enumerate}
  \item the contractual provision [permitting a waiver] may not reduce the fiduciary's obligations below the level that the duty of good faith would require;
  \item the provision must not conflict with the "plain meaning" of any statute;
  \item it must have sufficient specificity to permit the parties to "price" the difference between the provision and the normally applicable legal rule;
  \item if the provision substitutes a remedy, it must amount to an adequate substitute, rather than simply a waiver; and
  \item in the case of a charter amendment, the provision must receive disinterested shareholder approval under circumstances that were not coercive.
\end{enumerate}

\textsuperscript{220} See supra notes 166-69 and accompanying text.
that impose a standard of due care.\textsuperscript{221} RUPA's adoption of the same language employing the gross negligence standard generated considerable debate.\textsuperscript{222} Proponents defend the gross negligence standard by arguing that investors in a partnership would be likely to share losses caused by each other's ordinary negligence in a manner consistent with their overall loss-sharing ratio.\textsuperscript{223} Donald J. Weidner, the Reporter for RUPA, observed that:

\begin{quote}
[T]he Drafting Committee has attempted to craft default rules that are efficient and fair. The basic idea is that default rules should reflect what most partners would regard as implicit in their partnership agreements . . . . It is not clear what duty of care rule would be included in most partnership agreements if the matter were addressed. To the extent partners know that they vary in ability or attitude toward care, they are likely to contract. Their contracting may not take the form of an altered loss-sharing ratio. Rather, their contracting may take the form of assigning low-risk functions to high-risk partners. On the other hand, contracting for care may be far less likely when partners either know little about each other or assume they are equally skillful and careful. If they believe that negligent injuries are an inevitable series of costs that over time will be imposed randomly and equally by all partners, a contract to share losses seems a likely outcome. In such a situation, an agreement to share losses primarily affects the timing of a partner's loss, not the amount of her loss. The agreement to share losses in effect allows each partner to amortize the losses she incurs . . . . An assumption of equality, therefore, may explain the opinion of those who believe that partners tacitly agree to share the losses caused by each other's ordinary negligence. If one assumes equality, it seems likely that the partners as a group would agree either to self-insure or to purchase third party insurance. This suggests that there should not be a special default rule for the losses caused by the negligence of a partner. Stated differently, as among the partners, there should be no duty of care rule to specially allocate losses to the partners who negligently cause them.\textsuperscript{224}

However, a situation in which an assumption of equality may not always apply in the limited liability company context is in family business arrangements. In second generation businesses,

\begin{footnotes}
\item[221] See supra notes 141-47.
\item[222] See Weidner, supra note 72, at 468; see also Beveridge, supra note 21.
\item[223] See Weidner, supra note 72, at 468.
\item[224] See Weidner, supra note 72, at 468.
\end{footnotes}
children may join parents or relatives in a business enterprise. Minority interests may be inherited, and the business may be operated by a variety of relatives or acquaintances over a considerable period of time. The original bargain may indeed be personal and equal with respect to those parties who initially formed the limited liability company, but an assumption of equality may not be appropriate when there are minority members or members who do not actively participate in management.\textsuperscript{225}

Another argument which has been advanced in support of a gross negligence standard for partnerships, rather than the more exacting ordinary negligence standard, focuses on the factor of personal liability in partnerships. A noted authority has observed:

The difference between a partner, and a paid agent is, of course, that the partner is subject to individual liability for partnership debts, so that legal liability is less necessary to encourage the agent to act carefully. Because of this individual liability, perhaps a partner should also be distinguished from a corporate director.\textsuperscript{226}

Since the limited liability company shields members from personal liability, the incentive to aspire to careful conduct is absent.

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\textsuperscript{225} See Bahls, \textit{supra} note 187, at 326. This issue of whether reasonable expectations can be imputed to minority shareholders who have obtained their rights in a close corporation without bargaining for them has been discussed at length. \textit{Id}. Bahls notes:

In cases in which shareholders obtain their shares without bargaining with the majority shareholders of the corporation, courts have refused to attribute the reasonable expectation of the transferor to the transferee. The intent of original shareholders to operate the business is usually personal in nature. An expectation that one will participate in management of the business does not necessarily mean that one’s son, daughter, ex-spouse, or other transferee will have the same opportunity. In these cases, courts should apply the standard of fair dealing or fiduciary duty when evaluating the conduct of others. As a result, the court should apply the remedy most likely to stop the unfair conduct or breach of fiduciary duty. \textit{Id}. (citations omitted); \textit{see also} O’Neal, \textit{supra} note 17, at 883. O’Neal observes:

A person taking a minority position in a close corporation often leaves himself vulnerable to squeeze-out or oppression by failing to insist upon a shareholders’ agreement or appropriate charter or bylaw provisions, even if the corporation is domiciled in a jurisdiction with laws favorable to such protective arrangements. He may be unaware of the risks involved, or his bargaining position may be so weak that he is unable to negotiate for protection. Further, he may have been given or may have inherited his minority interest.

\textit{Id}.\textsuperscript{226} See Bromberg & Ribstein, \textit{supra} note 72, at 6:86.
Thus, if the rationale to support the gross negligence standard in the partnership context rests on the existence of personal liability, such a rationale has no application in the case of the limited liability company.

In the case of partnerships, it has been forcefully argued that the standard of care among partners should reflect the legitimate expectations of the parties. Professor Norwood P. Beveridge, Jr., member of the American Bar Association Committee on Partnerships and Unincorporated Business Organizations and the Subcommittee on the Revised Uniform Partnership Act, argues that one's legitimate expectations are that co-partners will exercise ordinary care—the care that employees are expected to exercise under agency principles. Professor Beveridge observes:

[S]ince the provisions of the Uniform Partnership Act are default provisions which apply in the absence of a contrary agreement, they should reflect legitimate expectations of the parties. It is not likely that a partner, to the extent that he considers the question, would expect his co-partners to be held to a lower standard of care than employees of the partnership. If anything, the contrary would be true. A partner would naturally expect a co-partner to indemnify the partnership for loss caused by that partner's negligence and gross error of judgment before he would expect the same of an employee.

It is suggested that the reasonable expectations of members of a privately held business enterprise, whether operated in the form of a partnership, a close corporation, or a limited liability company are that other members will indeed exercise due care. Further, given the lack of personal liability in a limited liability company, it may be argued that the more socially responsible legal standard of care for members and managers is ordinary negligence. Particularly in business enterprises affecting the environment or more directly, the welfare and safety of the community, the ordinary care standard may be preferable from a public policy standpoint. Further, there may be a need for the more stringent standard of ordinary care in the context of family businesses in which abuse has historically occurred and is likely to continue, despite a change in the legal entity selected.

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227 See Beveridge, supra note 21, at 765.
228 See Beveridge, supra note 21, at 765-66.
229 See Bahls, supra note 187, at 462.
Finally, the due care standard is consistent with the overall role of members and managers as agents of the limited liability company. A standard of care which departs from the agent's standard of due care may create inconsistencies in the responsibilities and duties of members and managers alike.

For the foregoing reasons, it is appropriate to assign a standard of conduct that is derived from agency principles under which due care is required. The due care standard is consistent with the concept that members and managers of a limited liability company act as agents for the enterprise. Further, it is an approach which has already been embraced by a number of states.

B. The Role of the Judiciary

In the interest of providing certainty and predictability, limited liability company legislation should provide limitations to the duty of loyalty to prevent unbridled discretion by the judiciary. This approach is best illustrated by the Discussion Draft of the Uniform Limited Liability Company Act, which limits the duty of loyalty to specified categories of conduct. Nevertheless, the importance of the judiciary in preventing abusive and oppressive conduct by members and managers should not be overlooked.

Judicial activism in interpreting the standard of care, the duty of loyalty and the standard of good faith and fair dealing has been criticized in both the partnership and corporate arenas. It

230 See supra note 125 and accompanying text.
231 See supra notes 149-51.
232 See supra notes 167-69 and accompanying text.
233 See Weidner, supra note 72, at 462. The author states: RUPA section 21(b) [regarding the statement that the duty of loyalty is limited to three rules] appears to have been motivated in part by a sense that vague, broad statements of a powerful duty of loyalty cause too much uncertainty. It was suggested that, even if there are no bad holdings, overly broad judicial language has left practitioners uncertain about whether their negotiated agreements will be voided. It was said that attorneys and their clients want to be able to negotiate transactions, reduce their agreements to writing, and have some comfort that those agreements will not be undone by "fuzzy" notions of fiduciary duties.
Id. The concern about inconsistencies and uncertainties in judicial decisions regarding standards of conduct in the corporate context is also reflected by the enactment of a flood of proposed legislation aimed at giving directors of corporations relief from liability for breach of the duty of care. See Gelb, supra note 37, at 23.

Although the factors referred to above may have caused some concern about service on a board of directors, several recent developments produced particularly deep anxieties. One of the most traumatic of the developments was the result in a case previously alluded to, Smith v. Van Gorkom, which
may be argued that judicial intrusiveness in business decisions injects undesirable uncertainty. In an effort to circumscribe judicial action, RUPA, on which the Discussion Draft relies, limits the type of conduct which may violate the duty of loyalty. In the corporate arena, the American Law Institute has recommended a statutory formulation of the business judgment rule, noting:

Confusion with respect to the business judgment rule has been created by the numerous varying formulations of the rule and the fact that courts have often stated the rule incompletely or with elliptical shorthand references. The relatively precise formulation of the business judgment rule set forth in Section 4.01(c) avoids confusion.

The provision for viable statutory remedies for members is critical in developing predictable laws which will afford members protection from personal liability. Provisions for shareholders derivative actions and for some equivalent of appraisal or disserter's rights should be considered. Actions for involuntary judicial dissolution on the basis of fraud, illegal conduct, or oppressive conduct are yet another statutory approach which may be useful in handling member dissension.

It is hoped that statutory language will be developed which provides meaningful, practical guidance to practitioners and to the courts. Although certainty in the law is clearly important, the

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234 See UNIF. LIMITED LIABILITY COMPANY ACT § 408 (Discussion Draft 1993).
235 ALI, supra note 38, at 173.
237 See MINN. STAT. ANN. § 322B.383 (West Supp. 1994) (giving disserter's rights to members of limited liability company); see also MODEL BUS. CORP. ACT ANN. § 13.01, commentary on historical background, at 1359 (indicating that Model Business Corporation Act requires corporation to buy shares of shareholders who object to identified, extraordinary corporate transactions). The statutory comparison as of November 25, 1991 indicates that 24 jurisdictions have definition provisions similar to the Model Act, including: Arkansas, Colorado, Georgia, Hawaii, Idaho, Indiana, Iowa, Kentucky, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, North Carolina, Oregon, South Carolina, South Dakota, Tennessee, Virginia, Washington, Wisconsin, and Wyoming. Eight additional jurisdictions include special definition and terms, including: California, Connecticut, Florida, Kansas, Maryland, New Jersey, and Ohio. Id. at 1362.
role of the judiciary must not be underestimated in cases involving privately held business enterprises, which have a long history of shareholder dissension and abusive and oppressive conduct. The role of the judiciary will become critical in interpreting the meaning of statutory standards of conduct of limited liability company members and managers. In connection with the movement away from mandatory corporate standards of conduct, Professor John C. Coffee, Jr. has observed the increasingly important role of the judiciary as more flexible, contractually based corporate laws have evolved. Professor Coffee notes:

A historical perspective frames the issue similarly. Even the most casual observation reveals that the fiduciary strictures of American corporate law—presumably, corporate law’s most mandatory inner core—have changed dramatically over this century. In truth, corporate law has been in flux throughout American history, and the fact that the supposedly mandatory core of corporate law has shrunk significantly presents a problem for those who wish to justify its nonwaivable status. If it has changed in the past, why should it remain static in the future? Who then is right—the contractarians or their critics? This Article answers that both are right and both are wrong, because both have misstated the problem. In this Article’s view, contractual innovation can be reconciled with a stable mandatory core of corporate law if we recognize that what is most mandatory in corporate law is not the specific substantive content of any rule, but rather the institution of judicial oversight. Judicial activism is the necessary complement to contractual freedom. In short, because such long-term relational contracting is necessarily incomplete, the court’s role becomes that of preventing one party from exercising powers delegated to it for the mutual benefit of all shareholders for purely self-interested ends. Indeed, that courts will at some point intervene is intuitively understood by the bar. In drafting the corporate contract, lawyers rely less on the model form provided by the legislature than on their expectation that courts will prevent either side from taking “opportunistic” advantage of the other.

Professor Coffee’s observation has equal application to the limited liability company.

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239 See supra notes 190-93 and accompanying text.
240 Coffee, supra note 37, at 1620-21.
241 Coffee, supra note 37, at 1620-21 (citations omitted).
C. The Importance of Dissenters’ Rights and Other Statutory Remedies

One method of curtailing judicial discretion to fashion remedies for minority oppression and other misconduct is to provide meaningful statutory remedies. Some states already provide members of limited liability companies with a right to a derivative stockholders action.\(^{242}\) Other states provide for dissenters’ rights.\(^{243}\) Still others provide for involuntary dissolution in the event of fraudulent or illegal conduct or an abuse of power that is contrary to public policy.\(^{244}\) These types of statutory remedies are recommended as a means of avoiding expansive judicial remedies which could inject undesirable uncertainty in the law.\(^{245}\)

The award of dissenters’ rights gives members the option of obtaining the fair market value of the member’s interest upon the occurrence of a specified event. Dissenters’ rights provide a viable solution to the problem of illiquidity of the member’s interest. The illiquidity of one’s investment in a privately held enterprise has long been cited as a significant factor contributing to minority oppression.\(^{246}\)

CONCLUSION

An approach which integrates agency, partnership, and contractual standards should be employed to regulate the conduct of members and managers of limited liability companies. A blend of these standards acknowledges the hybrid nature of the limited liability company and recognizes that limited liability companies are privately owned enterprises which are likely to be used by family businesses. Selected standards of conduct should have utility in resolving dissension in the context of such businesses. In this regard, the history of close corporation law and of relations between general and limited partners engaged in joint ventures is instruc-


\(^{245}\) See supra note 99 and accompanying text.

\(^{246}\) See Bahls, supra note 187, at 288-89. “In close corporations, the dominant shareholders usually double as managers, while in publicly held corporations the managers usually own a relatively small percentage of stock. Minority shareholders in a close corporation, however, face a unique set of problems because they have no ready market for their stock.” Id. (citations omitted).
tive. The Discussion Draft of the Uniform Limited Liability Company Act integrates agency, partnership, and contractual models, and is well suited to the hybrid nature of the limited liability company. However, consistent with the notion that limited liability company members function as agents of the enterprise, the agency concept of due care should be adopted. To employ a lower standard would place members in the dubious position of requiring from ordinary employees a higher standard of care than from their closest business associates or managers. Statutory remedies, such as dissenters' rights, stockholder derivative actions, and involuntary dissolution remedies, should also be considered to prevent the fashioning of broad and uncertain judicial remedies.