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AN OVERT DISCLOSURE REQUIREMENT FOR ELIMINATING THE DUTY OF LOYALTY

Joshua Fershée*

I'm Josh Fershée from the West Virginia University College of Law, and I am really sorry that I can't be there with you today. Some things got in the way, and there was just no way for me to make the trip, so I'm really sorry to miss out on this. This is one of my favorite things to do. Business Law Prof Blog¹ is an important part of my weekly life, and the colleagues and friends that I've made through that process have helped me both from a friendship perspective and from a scholarly and professional perspective. So I'm sorry to miss everything. I had a great experience last year at the University of Tennessee and working with the *Transactions* journal folks. So thank you for having me. Thank you for all of your efforts and, again, I'm sorry I can't be there with you.

I'll talk a little bit about some things that are near and dear to my heart—the limited liability company (LLC). Anybody who's read my blog knows that it is important to me that people recognize the difference between a corporation and a limited liability company and, particularly, not call an LLC a limited liability corporation.² This is important to me, in part, because of the simple obligation to get things right. But also because I view the LLC as a special and unique entity, and I think it has real value as a unique and integral part of the current entity options for people in business and moving forward.

I like to recommend that people focus on what it is to be an LLC, and not just view it as simply a partnership with the limited liability benefits of a corporation, or functionally a corporation with pass-through tax status. I think it's more than that, although it is all of those things, and there's no question that the value to the LLC really is that pass through tax status opportunity that lets people kind of [adopt] the traditional

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¹ L. PROFESSOR BLOGS NETWORK: BUS. L. PROF. BLOG, http://lawprofessors.typepad.com/business_law/.

² See, e.g., Joshua Fershee, *An LLC Checklist Proposal*, L. PROFESSOR BLOGS NETWORK: BUS. L. PROF. BLOG (May 30, 2018), https://lawprofessors.typepad.com/business_law/2018/05/an-llc-checklist-proposal.html (providing a checklist to help courts stop misidentifying LLCs as “limited liability corporations”).

partnership structure if they so choose. Really, the beauty of the LLC, and why I see it as so important [and] distinct from the other entities, is the flexibility. It really can be all of the things that you want it to be in terms of an entity. You can pick and choose from the whole buffet of entity options, and you can have [a] publicly traded LLC really [end] up being [a] publicly traded partnership but have the functional obligation or a master limited partnership that looks like that process. We have all these entities that give us flexibility. And, so, without going into too much of a deep dive with those because that's really not the focus, I really just want to make sure that we're clear that we're talking about limited liability companies as my primary focus.

It's well established that in Delaware, particularly, [that] the LLC is viewed as a "creature[] of contract," that the operating agreement is really what defines the entity, and that the LLC statute gives a broad latitude to anybody creating their LLC.³ So one of the things Delaware has done as a leader in this area—much to the chagrin of some and the pleasure of others—is to be very creative in allowing people to create an LLC, create an entity, that reflects what they want.

One of the big things, and the focus for me today, is the flexibility with regard to fiduciary obligations and fiduciary duties.⁴ That is, the ability to essentially disclaim or eliminate all fiduciary duties, including the duty of care and the duty of loyalty.⁵ Now, in Delaware, of course, it

³ *Kuroda v. SPJS Hldgs., LLC*, 971 A.2d 872, 880 (Del. Ch. 2009) ("Limited liability companies are creatures of contract, and the parties have broad discretion to use an LLC agreement to define the character of the company and the rights and obligations of its members."). *But see* *In re Carlisle Etcetera LLC*, 114 A.3d 592, 605 (Del. Ch. 2015) ("[T]he purely contractarian view discounts core attributes of the LLC that only the sovereign can authorize, such as its separate legal existence, potentially perpetual life, and limited liability for its members." (citing 6 Del. C. §§ 18–201, 18–303)).

⁴ This paper and presentation are based on a blog post from 2016. Joshua Fershee, *Embracing Freedom of Contract in the LLC: Linking the Lack of Duty of Loyalty to a Duty of Disclosure*, L. Professor Blogs Network: Bus. L. Prof. Blog (Feb. 2, 2016), https://lawprofessors.typepad.com/business_law/2016/02/i-have-been-giving-a-lot-of-thought-to-the-idea-of-waiving-the-duty-of-loyalty-in-llcs-in-delaware-the-more-i-think-about-it.html.

⁵ Del. Code Ann. tit. 6, § 18-1101(e) (2013) provides:

A limited liability company agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound

always remains that the contractual duty of good faith and fair dealing applies to all LLCs, and that's something that cannot be disclaimed.⁶ But the traditional fiduciary duties, particularly looking at the duty of loyalty, can be eliminated if done so expressly. As someone who believes in freedom of contract and is comfortable where we have parties, at least on the front end, negotiating for what they want, I don't have a problem with that. I think that it's good to have options as long as everybody's clear what those options are.

The main thing I want to focus on today is thinking about that concept of the fiduciary duty and eliminating the fiduciary duty and what that could mean for future parties. [When] parties A and B get together to create an LLC, if they negotiate to eliminate their fiduciary agreements as to one another, I'm completely comfortable with that. They are negotiating for what they want; they are entering into that entity and operating agreement together of their own free will. So there may be differences in bargaining power—one may be wealthier than the other or have different kinds of power dynamics—but they are entering into this agreement fully aware [of] what the obligations are and what the options are for somebody in creating this entity.

My concern with eliminating fiduciary obligations comes down the road. That is, how do we make sure that if people are going to disclaim the fiduciary duty of loyalty particularly, what happens if this change is made after the fact? And that's where I do like to look at our traditional partnership law which says there are certain kinds of decisions, at least absent an agreement to the contrary, that have to go to the entire group.⁷ That is, a majority vote is not sufficient; there is essentially a minority veto.⁸

by a limited liability company agreement; provided, that a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.

⁶ *Id.*

⁷ *See, e.g.,* Paciaroni v. Crane, 408 A.2d 946, 955 (Del. Ch. 1979) (determining that a dispute among partners that did not arise “in the ordinary course of partnership business” requires unanimity and cannot be decided by majority vote, absent agreement otherwise); *see also* Rev. Uniform Partnership Act § 401(j) (2018–2019 ed.) (“A difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership and an amendment to the partnership agreement may be undertaken only with the consent of all of the partners.”).

⁸ *See* Rev. Uniform Partnership Act § 401(j).

And when it comes to eliminating fiduciary duties, I think that would be appropriate for LLCs.

So, in Delaware where we're allowed to eliminate the fiduciary duties by agreement, as long as we do so expressly, it would be appropriate to me for Delaware to adopt a requirement that, to change or eliminate a fiduciary duty, there must be agreement of all parties or an express and clear statement as to what it requires to change that. That is, if at the beginning of the entity when you create it, you say, "we are not disclaiming our fiduciary duty of loyalty," for example, "at this point, but we reserve the right to do so in the future with a majority vote." That should be expressly stated. That is, one can't just say, "This operating agreement can be modified or changed via majority vote." [Instead,] when it comes to fiduciary duties, it must be stated expressly what that change require[s].

This is because traditional fiduciary duties of care and loyalty are so ingrained in our concept of entities and those involved with fiduciary obligations that we expect people to have them. In fact, when Delaware looked at this before it was codified, Delaware looked at the statute and said the LLC statute was silent as to whether there was a requirement for fiduciary duties, and the Delaware court said, "Of course there is. There is an expectation with entities as a general matter [that] we are going to see fiduciary duties and fiduciary obligations, so this makes sense to us that this would be there."⁹ They went on to clarify [that in the statute], however, if one chooses to have an entity that disclaims fiduciary duties, one may do so expressly, but you must do so expressly.¹⁰ You don't need to create a fiduciary duty in the operating agreement; [fiduciary duties]

⁹ Kelly v. Blum, No. CIV.A. 4516-VCP, 2010 WL 629850, at *10 (Del. Ch. Feb. 24, 2010) ("Delaware cases interpreting Section 18-1101(c) have concluded that, despite the wide latitude of freedom of contract afforded to contracting parties in the LLC context, 'in the absence of a contrary provision in the LLC agreement,' LLC managers and members owe 'traditional fiduciary duties of loyalty and care' to each other and to the company.").

¹⁰ Feeley v. NHAOCG, LLC, 62 A.3d 649, 661 (Del. Ch. 2012) "[T]he Delaware Limited Liability Company Act (the 'LLC Act') contemplates that equitable fiduciary duties will apply by default to a manager or managing member of a Delaware LLC."; see also Auriga Capital Corp. v. Gatz Properties, 40 A.3d 839, 858 (Del. Ch.), judgment entered sub nom. Auriga Capital Corp. v. Gatz Properties, LLC (Del. Ch. 2012), *aff'd*, 59 A.3d 1206 (Del. 2012) (finding the member conduct was "governed by traditional fiduciary duties of loyalty and care because the LLC Agreement does not alter them").

exist and apply unless one modifies or changes them, which was consistent with the statutory language.¹¹

Then the question comes—, if we are going to allow someone to eliminate fiduciary duties at the outset, why not be able to do it later? Well, I think the same rationale applies—that is, when you enter into an LLC, the expectation of fiduciary duties [applies] unless they’ve been removed. And if, when you enter the LLC, the fiduciary duties are there, then one has a reasonable expectation that those are going to remain unless modified. Some will say you know going in that you can modify or eliminate fiduciary duties, and the fact that it’s a Delaware LLC, alone, puts you on notice. I think because of how ingrained fiduciary duties are, the concept of them, that that’s not sufficient. That’s not consistent with what we would expect within a majoritarian bargain.

In doing so, my proposal would be this—to build on the concept of elimination of fiduciary duties in Delaware. Traditionally the fiduciary duty in Delaware statute says that if you want to eliminate fiduciary duties in Delaware, you must do so explicitly and clearly and state exactly what it is you’re doing—a statement to the effect of “we expressly disclaim and eliminate all fiduciary duties to the extent permissible by law.” So, if you want to do that in the future, I think there should be a similar statement—“we reserve the right to eliminate fiduciary duties down the road by a majority vote.”

We’ve seen, in history of entity law, various opportunities where anything can be changed by majority vote. Therefore, you’re on notice of that change. Even when we look back on those cases, that was before the opportunity to eliminate fiduciary duties was available. That is, the ability to eliminate fiduciary duties is a relatively new concept, and so I think it requires heightened awareness and heightened notice to allow this. On the flip side, I think that providing heightened notice and heightened awareness to that happening or the possibility that it could happen or might happen in a particular entity gives more support to the idea that you should be able to eliminate those duties. That is what is critical to this—this freedom to contract is the freedom to decide and do what it is that you think is best for the entity and best for your agreement without blindsiding or surprising people with new iterations [modifying] long-held beliefs.

This really goes to the idea of why it is so important to me that people recognize LLCs as unique entities. We should be looking at the LLC as something that has more flexibility, that you should be on notice

¹¹ See *Feeley*, 62 A.3d at 661.

when you work with an LLC. For example, that there may be the abilities to change things that if you had a partnership or you had a corporation wouldn't even be available by statute. That, I think, is a good thing. It has value in the LLC.

Unfortunately, the carelessness with which many courts have treated LLCs, and many practitioners for that matter, ha[s] led us to believe that they really are just a hybrid and they aren't unique. You're just pulling from one [entity form] or the other. So if your LLC is structured largely like a partnership, then we should just probably pull from the partnership rule. And if it's structured and looks largely like a corporation—you've structured with a manager-managed LLC that looks like a board [with] a similar concentrated decision making structure—[then] we should treat it like a corporation. And for any of these different pieces that are moving, we'll just look to see which one it looks more like.

There's certainly value from being able to pull from other case law and other entity law, to say, "this is really similar." I've argued in a number of places that courts, in fact, are fine to do that. They simply should say, "we're doing it. We are applying this corporate law concept to LLCs for this reason. We are extending this partnership doctrine to LLC or applying it in this case for this particular reason instead of simply saying that this is an LLC, and therefore it looks like something else so we'll just adopt it."

This is particularly problematic to me in the corporate context. What we see is corporation law being applied to limited liability companies. Almost 6,000 different court cases have referred to the limited liability company as a limited liability corporation and just adopted wholesale, at least in their particular context, the corporate law and applied it without any explanation as to why that's the right application. That brings us back to the fiduciary duties and the fiduciary duty problems.

The other part of this that I'd like to talk about is what the real value is in being able to disclaim fiduciary duties overall. If you look at a number of different businesses and business structures, we already have a whole host of businesses that are looking to narrow the scope of their fields. Traditionally, you go back to *Meinhard v. Salmon* and what was the scope of the partnership is functionally the question.¹² In *Meinhard v. Salmon*, the question for the 20-year hotel lease, the question is, was it related to the business of running that particular hotel? It was a 20-year

¹² See 249 N.Y. 458, 477, 164 N.E. 545, 552 (1928) (Andrews, J., dissenting) ("What then was the scope of the adventure into which the two men entered?").

term, so as the lease occurred, they were partners together, and [the] partnership was going to end at the end of it. Was it the idea of running a partnership to run a hotel? Could it extend to other kinds of hotels? What was the scope of that partnership? In that case they didn't really [say] it, and it wasn't entirely clear what the intent was.¹³

But in a variety of areas, in particularly in property partnership and property LLC agreements, we do see an intent to very narrowly limit the scope. That is, multiple different investors want to go into business with other different investors in potentially competing ventures. We see this all the time. We have long recognized in partnership law and early LLC law the ability to narrow the scope of the partnership, to narrow the scope of the agreement, [and] to narrow the scope of what those fiduciary obligations are. And that's okay. That's not problematic. The reality is we often don't do a very good job of explicitly disclaiming that [duty] because we weren't allowed to.¹⁴ That is, "I intend to deal with you in this particular property venture —this other business endeavor— but I intend to compete with you in vigorous ways in all other areas." It's a way, perhaps, of diversifying one's portfolio, perhaps getting in on a particular investment that they wanted to without having to give up their other investments. These are really important opportunities and we've seen them for literally decades, if not hundreds of years, the opportunity to engage in these different kinds of ventures. But we weren't able to really say, "I'm intending to compete as hard as I can with you."

My only limit here, even when I vote in my own self-interest, even in this particular endeavor, I intend to be competing with you and looking out for myself and seeking more. In many ways this is permitted, as long as you didn't violate certain norms. Those norms remain and that's why I think Delaware's actually done a really good job of providing, in a statutory way, the ability to recognize business arrangements and business agreements that have been going on for a long time; and should be recognized after the fact, after there's a dispute, that the intent of the parties was to compete vigorously, that the limit of their agreement was [to] pursue profit together in a particular venture within the confines of a very narrow scope. The duty of good faith and fair dealing is implied in the contract. What have we basically agreed to one another to enter this contract at all? Does this contract have any value or make any sense with

¹³ *See id.* at 548.

¹⁴ In fact, in most places beyond Delaware, it remains the case that one cannot eliminate the fiduciary duty of loyalty; one can only "identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable." *See* Unif. Ltd. Liability Co. Act § 103 (1996).

this particular outcome? If the answer is yes, that's sufficient. We don't need to run it back through what the fiduciary obligations were because we said there weren't any. We never intended to have any. And at various times, we can see that in some of the early cases.

I think that's a real value that Delaware is adding: being able to create contracts that recognize the practical reality of what businesses have been doing for a long time. And not providing an avenue for the party who, in essence loses—that doesn't do as well, doesn't compete as well—to have a second bite at the apple. Where the deal the whole time really was intended to provide an opportunity for profit for both of them, for all of the members to compete vigorously.

We see this if you look at some of the sports cases, where people were looking to purchase sports teams with the idea that you might want to get in with three or four different ventures. Your primary goal is to be the resulting winner who ends up with the athletic team.¹⁵ So you might want to be able to participate with Venture A and Venture B and Venture C, not really caring who wins it as long as you're on the team that wins. As long as everybody who is engaging in the endeavor understands that's the intent, well that's practical, that's reasonable, and that's understandable. And there are limits, perhaps, that we would place on one another of what you can do in the process, but maybe we have to do that by saying we don't have any fiduciary obligations to one another, that the answer is that we have to be careful about [what] we share, in terms of our information. Or we limit who has access to information that could be used to further a competing venture, because the whole point of being an investor and being part of the team was to win.

Some might say that this is better done by separating it out. [That] if you want to be an investor and don't want fiduciary dut[ies], you can't have any control or any input. That certainly works in the corporate context, right? I can own stock in Microsoft and Apple and Ford and General Motors and that's not problematic. I don't have any control. I don't have fiduciary obligations. But when we talk about concentrated opportunities, particularly in things like property law or in the sports-team example that I just discussed, you want to have control or some level of input that is higher than that of mere investor. You want to be a

¹⁵ See, e.g., *McConnell v. Hunt Sports Ent.*, 725 N.E.2d 1193, 1206 (Ohio App. 10th Dist. 1999) (stating the the operating agreement was “plain and unambiguous and allowed members” of CHL, and LLC created to secure an NHL franchise, “to compete against CHL for an NHL franchise”).

participant to some degree. Why should we not be able to contract to make that happen? In fact, by creating that opportunity, creating that obligation to one another that is limited and clearly laid out, [it] seems to me to have real value and create opportunity for proper kinds of risk taking and potentially growing the size of the pie.

That brings us back to the rationale as to why we should be allowed to do this and why we should also have protections to make sure everybody knows what those limitations are. If, going back to the sports example, we are going to look at working with a group of people for a sports group. If it is intended that the group will not compete with one another—that this is a closed group that is going to compete with outside groups—we want fiduciary duties to be available there. What we might not want is the ability for somebody in that group or the majority of that group to change it. That is, to change and eliminate fiduciary duties that were there at the time of formation so that we protect all those that come into the agreement. They know what the deal is up front and that it's expressed because we're dealing with fiduciary duties. This isn't even just voting rights. This isn't some of the other areas. We have more of a *caveat emptor* relationship.

I recognize that this is a line-drawing exercise and some people would say that, “this is just like the other cases, so why would you have to put them on notice?” I would simply say, “because fiduciary duties have historically been different.” And, in fact, Delaware had to go through a history of saying, “Yes, there are fiduciary duties in there and if you want to take them out you have to be very express in eliminating them.” There is a way in which you do that. It seems to me proper to say that, when we deal with fiduciary duties and fiduciary duty changes, not only do you have to expressly limit or expressly eliminate them in your operating agreement when you do so, but if you intend to have the ability to do so later, you also need to put them on notice. That is, people should know what they're getting into and this seems to me to balance their rights and obligations that one would expect in terms of fiduciary duties with the right to create the entity that one thinks is very best for their opportunities.¹⁶

¹⁶ In Tennessee, majority members of an LLC “stand[] in a fiduciary relationship to the minority, similar to the Supreme Court’s teaching . . . regarding a corporation Such a holding does not conflict with the statute, and is in keeping with the statutory requirement that each LLC member discharge all of his or her duties in good faith.” *Anderson v. Wilder*, E200300460COAR3CV, 2003 WL 22768666, at *6 (Tenn. App. Nov. 21, 2003). The *Anderson* opinion, I will note incorrectly refers to a “majority shareholder of an LLC” rather than a majority member, but the point still holds. *Id.*

Now, ultimately, this is challenging, but this is consistent with views that I've had in other places. My view of, if you go back to early corporate law for example, to *Dodge v. Ford*. If you look at *Dodge v. Ford*, my view of that case is not just that Henry Ford decided to run a philanthropic institution, notwithstanding the way the opinion's written, but that he changed course.¹⁷ That is, for years profit was flowing in, shareholders were being paid with major dividends, and everybody who was participating in the entity was getting wealthy. And then one day he decided to change.¹⁸ Henry Ford decided to change that. In fact, he got on the stand and said "I'd like to change that. I've decided I've done enough, you've had enough." That's a significant change in philosophy. It's not just that you're changing your view of how things work, but you're changing your view of how the business operates and what people signed up for. It goes beyond, it's pushing beyond the business judgement rule in that context.¹⁹

Fast forward to *Ebay v. Newmark*, where we see a similar situation.²⁰ My view of that [is], notwithstanding some of the challenges and some of the behavior of the craigslist owners and board members, that [eBay] had the opportunity [to negotiate change] when Ebay bought in.²¹ Ebay knew that craigslist was a modest operation. They did not charge and had not monetized craigslist in any significant way. [eBay] bought in not because they were going to monetize it (or that they expected monetization), but [because] if, in fact, craigslist did monetize, they wanted to be there and have a piece of the pie. [eBay], in fact, reserved their right to compete. They had the opportunity to compete and reserved that right.²² To later

¹⁷ Joshua P. Fershee, *The End of Responsible Growth and Governance?: The Risks Posed by Social Enterprise Enabling Statutes and the Demise of Director Primacy*, 19 TENN. J. BUS. L. 361, 367 (2017) ("Henry Ford stated clearly that he was operating the business as he saw fit and that he was changing toward supporting philanthropic purposes.").

¹⁸ *Dodge v. Ford*, 170 N.W. 668, 683-84 (Mich. 1919).

¹⁹ Fershee, *supra* note 17, at 370 ("In *Dodge v. Ford*, there seemed to be a change in the business model (and how the business was operated with regard to dividends) once the Dodge Brothers started thinking about competing. All of a sudden, Ford became concerned about community first.").

²⁰ *eBay Dom. Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010).

²¹ Fershee, *supra* note 17, at 369.

²² *eBay Dom. Holdings, Inc.*, 16 A.3d at 6 ("eBay purchased its stake in craigslist in August 2004 pursuant to the terms of a stockholders' agreement between Jim, Craig, craigslist,

complain and say “You’re running this as a philanthropic institution,” is improper.²³ [I] say, “No, it’s not. There’s nothing wrong in doing that. This is what you signed up for.”

Those cases—*Dodge v. Ford* and *Newmark* are favorites of mine—are not directly applicable other than to, say, imagine what you can do if you could eliminate those fiduciary obligations. If I can eliminate the fiduciary obligation to seek profit, shouldn’t it be allowed under Delaware law to run exactly as craigslist was operating as an LLC anyway? I would argue the answer is yes—that we should be able to create the entity that we intended as long as everybody knows what they’re signing up for. They know exactly what’s [happening] there. So the question in craigslist would be: “when you invested in craigslist, did you expect them to monetize? Did they do things the way they were going to or the way intended to?” If the answer is yes, they continued to operate their entity as they had before, you don’t get to complain about that. They don’t have a fiduciary obligation to do anything different. They’ve disclaimed that. To the extent they go beyond that and take the whole value of the contract—they violate that obligation of good faith and fair dealing—then they might have crossed that line.

If you go back to *Ebay v. Newmark*, one could even argue that they might have violated in that context. That it was not the fiduciary duty or the obligation to seek profit, as Chancellor Chandler said, but, in fact, the obligation of the failure there was that they didn’t even live up to the basic good faith and fair dealing contract they entered into in the first place. What I will leave you, in looking at this, is that, in essence, I’m of the view that it is great to have freedom of contract and expansive freedom of contract as long as everybody knows what the contract says. With regard to fiduciary duties, it’s not just careful reading, but full disclosure of knowing that, for eliminating fiduciary duties, you have to say it expressly and explicitly. If you’re retaining the option to do so by less than a unanimous [or perhaps supermajority] vote, then you have to disclose that. Make it clear not only when you reduce or eliminate fiduciary responsibilities, but also that you might or could and are maintaining that right. That seems to be the optimal way to know what you’re getting into while creating the freedom of contract and freedom of opportunity to craft the agreement and the entity that you’re really looking for.

and eBay that expressly permits eBay to compete with craigslist in the online classifieds arena.”).

²³ Fershee, *supra* note 17, at 373.

So thanks very much for your time. I look forward to feedback and finding out what others think about this concept and, again, I'm sorry I can't be there.

* * *

Addendum: The whole point of this talk was to express that changes to fiduciary duties, whether it means expanding, restricting, or eliminating the duties, could be used in a predatory manner. For example, a member with 25% of the membership interests could join an LLC that has eliminated or greatly reduced the duty of loyalty. Suppose that the Member A has competing ventures, but decided it was acceptable to join the LLC because she didn't have any conflict of interest concerns given the then-existing relaxed fiduciary-duty clauses. If the majority members decided to change the fiduciary duty clause to reinstate the duty of loyalty, it's possible that Member A could be forced to sell her interests or face a breach of fiduciary duty claim.²⁴

The duty of good faith and fair dealing²⁵ would seem to require that Member A receive fair value for her interests.²⁶ Still, the change in

²⁴ Cf. Benjamin P. Edwards, "Conflicts, Confidentiality, and Other Concerns: The Promise and Peril for Lawyers Serving on Corporate Boards," 64 *Rocky Mt. Min. L. Inst.* 3-1, 3-22 (2018). Prof. Edwards provides a relevant example when he explains that, when a lawyer also serving as a director or LLC member "does not have a fiduciary duty to the entity, there may not be a significant risk that the lawyer's ability to represent her client will be materially limited by her obligations to the entity." *Id.* (citing Model Rules of Professional Conduct 1.7(a)). However, if the entity were to reinstate or modify a fiduciary duty, it could create conflicts that did not exist prior to the modification.

²⁵ Where an LLC's managers choose to exercise a right specifically provided, that exercise cannot be deemed bad faith. *Nemec v. Shrader*, 991 A.2d 1120 (Del. 2010). However, where one uses powers and discretion granted under an operating agreement, one still must use that discretion in good faith. *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451 (Del. Ch. Apr. 20, 2009). There are those who read *Nemec* to suggest that the Delaware Supreme Court may not "permit a claim based on the implied covenant [of good faith and fair dealing] if the parties expressly bargained that management has sole discretion to determine how to operate the LLC." See Lewis H. Lazarus, *Delaware LLC's and the Implied Covenant of Good Faith and Fair Dealing*, ABA: Bus. L. Today, (June 29, 2017), https://www.americanbar.org/groups/business_law/publications/blt/2011/11/03_lazarus/. That is an overly broad reading. In *Nemec*, "the contract authorize[d] the Company to act exactly as it did . . ." *Nemec*, 991 A.2d at 1126. That is different than changing a fiduciary duty so that one can then take an opportunity not expressly provided (and contrary to) the original agreement.

²⁶ See *Gottsacker v. Monnier*, 697 N.W.2d 436, 438 (Wis. 2005) (determining that LLC members, even when they have "a material conflict of interest," are not prohibited "from voting to make the transfer [to exclude another member] so long as they dealt fairly");

fiduciary duty could be used to force a buyout that had not been otherwise negotiated. Additionally, there is authority in Delaware holding that an LLC's managers are "required to carry out [their] functions in good faith, meaning [managers] could not engage in 'arbitrary or unreasonable conduct' that had the effect of preventing [the minority LLC member] from 'receiving the fruits of the bargain.'"²⁷ Chancellor Strine explained that, like in the corporate context, "proper performance of their contractual obligations is to use the discretion granted to them in the company's organizational documents *in good faith*."²⁸

As such, I am arguing that the Delaware (and other states allowing reduction/elimination of the duty of loyalty) should require an express statement of the fiduciary duties (when modified from the default²⁹) and an express statement of how those duties can be modified, whether expanding, restricting, or eliminating the duties.³⁰ To protect against the predatory modification of fiduciary duties, I believe that states should include a statutory requirement that changes to fiduciary duties must be express. Some states have similar provisions in partnership law. Maryland, for example, provides:

(b) The partnership agreement may not:

....

(3) Eliminate the duty of loyalty under § 9A-404(b) or § 9A-603(b)(3) of this title, but:

Page v. Page, 359 P.2d 41, 44 (Cal. 1961) ("A partner may not . . . by use of adverse pressure 'freeze out' a co-partner and appropriate the business to his own use . . . unless he fully compensates his co-partner for his share of the prospective business opportunity.").

²⁷ Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC, 2009 WL 1124451 (Del. Ch. Apr. 20, 2009).

²⁸ *Id.* (emphasis added).

²⁹ Absent modification, fiduciary duties apply to a manager or managing member of an LLC. *See* Feeley v. NHAOCG, LLC, 62 A.3d 649, 661 (Del. Ch. 2012) ("[T]he Delaware Limited Liability Company Act (the 'LLC Act') contemplates that equitable fiduciary duties will apply by default to a manager or managing member of a Delaware LLC.").

³⁰ This would codify what is already the case under Delaware law. *Kelly v. Blum*, CIV.A. 4516-VCP, 2010 WL 629850, at *10 (Del. Ch. Feb. 24, 2010). ("[D]espite the wide latitude of freedom of contract afforded to contracting parties in the LLC context, 'in the absence of a contrary provision in the LLC agreement,' LLC managers and members owe 'traditional fiduciary duties of loyalty and care' to each other and to the company."); *see also In re Nantucket Island Associates Ltd. Partnership Unitholders Litigation*, 810 A.2d 351 (Del. Ch. 2002) (finding that fundamental changes to limited partnership interests should be expressly stated or else require unanimous consent).

(i) The partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty; however, the partnership agreement may not be amended to expand or add any specific types or categories of activities that do not violate the duty of loyalty without the consent of all partners after full disclosure of all material facts³¹

Thus, for LLC Acts,³² I propose something similar to the following:

Any limited liability company agreement that provides for a modification of the default rules for what constitutes a breach of duties (including fiduciary duties) of a member, manager or other person to a limited liability company, whether to expand, restrict, or eliminate those duties, must expressly state if the modifications are intended to expand, restrict, or eliminate the duties. Any limited liability company agreement that allows the modification of fiduciary duties must state expressly how those modifications can be made and by whom. Absent such any such statement, fiduciary duties may only be modified by agreement of all the members.

This could be done prospectively (for all LLC agreements made or modified after an effective date), via a phase in, or effective immediately for all LLCs. My view would be to make it prospective, with the understanding that prior agreements would be governed by the prior intent of the parties (which is essentially where we are now).

³¹ Md. Corps. & Ass'ns Code Ann. § 9A-103 (2018).

³² In Delaware, for example, this could be added to which could be added to Del. Code Ann. tit. 6, § 18-110(e).