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The Agile Virtual Corporation

Ann E. Conaway

THE AGILE VIRTUAL CORPORATION

BY ANN E. CONAWAY STILSON*

I. INTRODUCTION

In the late 1980s, U.S. industry began a self-study of the direction and demands of the global marketplace and the increasing impact of off-shore competition on American industry. The self-examination focused upon increasing competitiveness by American business.[1]

In 1991, Congress entered the deliberation by instructing the Department of Defense (DOD) to establish an inter-agency task force to investigate contemporary U.S. business practices.[2] The intent of the DOD study was to isolate those U.S. manufacturing practices which encourage global competitiveness by American industry.[3] The task force was formed in 1991 and was supervised by Dr. Richard Nagel of Lehigh University's Iacocca Institute. Dr. Nagel subsequently convened a roundtable of business leaders and Chief Executive Officers of major U.S. firms. In order to create the report commissioned by Congress, Dr. Nagel requested participating business leaders to spend half-time at Lehigh University for four months. The result of that four-month roundtable investigation — *21st Century Manufacturing Enterprise Strategy* (Overview) — was published in the fall of 1991.[4]

The Overview introduced the term "*agile*" to describe the fundamental characteristic of market competitiveness. According to the roundtable, "*agility*" is the ability of American firms to rapidly

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*Professor of Law, Widener University School of Law, Wilmington, Delaware. Professor Stilson co-chairs the Agile Legal Practices Advanced Development Group (Legal Group or Group) of the Agile Manufacturing Enterprise Forum (Agility Forum) with Anthony Fiore, Esquire, General Counsel to ComputerVision, Boston, Massachusetts. Substantial portions of this paper and the concepts contained herein are the subject of Professor Stilson's upcoming article entitled *Disclosure and Consent: A Reformist Model to Managerial Liability for Business Enterprises in the 21st Century.*

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[1] *See* J.P. Donlon, *Strategic Agility*, CHIEF EXECUTIVE, Dec. 1, 1996, at 58, *available in* 1996 WL 9565206.

[2] *Id.*; *see infra* note 4 (listing publication resulting from that task force).

[3] Donlon, *supra* note 1.

[4] IACOCCA INST., 21ST CENTURY MANUFACTURING ENTERPRISE STRATEGY (1991). The Report was published in two volumes: Volume One was directed to high-level managers and was edited by Dr. Steven Goldman of Lehigh University and Volume Two was drafted for a scientific audience and was edited by Dr. Kenneth Priess of Lehigh University.

reconfigure themselves in order to respond to market opportunities and shifting consumer demands.[5] The Overview recommended that Congress, industry, and academia combine to research, educate, and instruct American business in agile principles.[6] In order to effectuate this goal, the Overview recommended that funding be provided to establish an organization which would spearhead the next stage of self-study.[7]

In the fall of 1992, the National Science Foundation (NSF) and the Advanced Research Projects Agency (ARPA) funded a proposal for that organization — the Agile Manufacturing Enterprise Forum (now called the Agility Forum).[8] Presently, the Agility Forum proceeds through four focus groups which consist of representatives from U.S. industry, government and academia.[9] One of those focus groups — that of Business Practices — is charged with examining the legal constraints, if any, to the implementation of the agility concept nationwide. In May of 1995, the Agile Legal Practices Advanced Development Group (Legal Group or Group) of the Agility Forum convened to investigate the legal barriers to agility.[10]

The immediate difficulty encountered by the Legal Group was the inexactitude of "*agility*" and the divergent applications of "*agile business principles*." For instance, the Legal Group was advised that some U.S. firms wish to "*joint venture*" or "*partner*" themselves with other companies or competitors (or divisions within those companies or competitors) for the purpose of performing niche-market, transactional contracts. According to Group advisors, these firms wish to enter and exit these commitments as market conditions fluctuate, to streamline the time and cost of negotiating joint venture agreements, to limit their liability for the mis- or nonperformance of their co-venturers, and to contractually apportion their rights, risks, and duties *inter se*. Often these firms desire to utilize current computer and telecommunications technology to create a "wall-less" transactional joint venture — the so-

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[5]1 *id.* at 7-9.

[6]*Id.* at 43-53.

[7]*Id.* at 48-49.

[8]The first industry sponsor of the Agility Forum was Texas Instruments. The Agility Forum is centered in Bethlehem, Pennsylvania.

[9]The four focus groups include: *Operations* (Information and Controls, Process, and Equipment); *People* (Company-Union Partnerships, Skills and Mobility, Rewards and Measurements); *Virtual Enterprises* (Cooperation among Companies); and *Business Practices* (Legal, Accounting, and Marketing).

[10]The Group was comprised of attorneys with specialties in corporate, partnership, and securities law as well as high-level executives in major U.S. firms.

called *"agile virtual corporation"*[11] — on-line in order to perform these short or long-term market opportunities. To these firms, the benefit of the Legal Group is its description of the legal impediments to the *virtual corporation.*

In contrast, Group advisors suggest that other U.S. firms wish to implement agile principles *within their existing corporate structure* as a preliminary to "venturing" with other agile companies.[12] The benefit of the Legal Group to these firms is its identification of the legal obstructions to preparing a "traditional" corporate or alternative business entity to enter an agile business relationship. Such preliminary legal issues include intra-company operations which impede agility,[13] restraints

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[11]For purposes of this article, the term "agile virtual corporation" will be used interchangeably with the terms "virtual corporation," "virtual enterprise," and "virtual entity." The terms generally define a grouping of companies, or divisions within companies, with the objective of performing long or short-term *transactional* contracts by aggregating the participating firms' goods, services, information, and personnel. *See* WILLIAM H. DAVIDOW & MICHAEL S. MALONE, THE VIRTUAL CORPORATION (1992) (discussing the impact of information processing technology on the modern economy). *See generally* Michael D. Weiss, *Actually Shutting Down the Virtual Multistate Corporation*, 28 IND. L. REV. 607 (1995) (discussing the application of the commerce clause to "virtual multistate corporations").

Another, recently reported, description of a virtual corporation appeared in the July 1995 issue of *Electronic Engineering Times*:

> The idea behind virtual corporations is simple. You can define a product (or service), then organize teams and hire subcontractors to design, make, market and sell the product. A management team can be assembled in a similar manner. Once its goal has been reached, a virtual corporation could be sold, disbanded or reconstructed with new teams and subcontractors to meet a related goal or an entirely different one.
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> This contrasts with the traditional business model, under which a company must continually build on its successes, grow in size, expand in scope. Under that model, a company may end up becoming an unworkable hybrid, such as a communications concern managing hotels — a situation that ITT, for example, realized wasn't as tenable as it first thought.
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> . . . .
>
> In contrast, virtual corporations would be flexible and nimble, able to avoid situations in which they are forced to protect products and business models . . . .

Brian Santo, *The Virtual Revolution*, ELECTRONIC ENGINEERING TIMES, July 3, 1995, at 62, *available in* 1995 WL 7439876.

[12]See Anthony Fiore & David Goldman, *Legal Barriers to Agile Business Relationships, Best Agile Practice Reference Base, in* REPORT OF THE AGILE LEGAL PRACTICE GROUP 319, 319 (1994) [hereinafter 1994 REPORT] (on file with *The Delaware Journal of Corporate Law*), where the authors note that "[a]n agile partnering strategy is an attempt by a company to increase competitiveness by partnering with companies that have the existing competencies that will enable them to respond as rapidly as possible to a market opportunity." Id.

[13]In order to prepare a company to become an agile partner, a firm must engage in self-

to the negotiation process,[14] barriers to the process of receiving legal counsel,[15] and obstacles to negotiating a final agreement.[16]

With such diverse market signals from U.S. firms, the Group was unable to reach a consensus on a legal definition or structure for "agility" or the "agile virtual corporation." Yet, initial Group discussions clearly exposed the advances in computer and information technology that are drastically altering the manner in which U.S. industry conducts business. As a result, the Group conceded that market demand and technological progress will ultimately mandate legal recognition of a new business form which will permit rapid partnering[17] of firms for the purpose of creating highly individualized, niche-market products which have a short market life, which have substantial information content, and which are characterized by a continuing marketing relationship between sellers and customers. According to the Group, the market justifications for legal recognition of the *virtual corporation* include: (1) the fragmentation of mass markets into niche markets; (2) the ability of firms to produce goods and services to order; (3) the ability of firms to treat mass market customers individually; (4) shrinking product lifetimes; (5) the high cost of innovation to firms pursuing new products or services; (6) the fusion of goods, information, and services; (7) the emergence of global production systems; (8) advances in computer and information technology which encourage global commerce, production, and marketing; and (9)

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examination of its *operations* process. For example, in the 1994 Report, Chair Anthony Fiore, Esquire, general counsel to ComputerVision in Boston, Massachusetts, set forth six barriers to the agile business relationship: (1) unstable company direction, (2) lack of solid company reputation, (3) poor internal communication, (4) absence of single manager of relationship, (5) potential competition with agile partner, and (6) financial viability of the company. *See id.* at 320-21.

[14]The 1994 Report identified seven obstacles in the negotiation process: (1) a non-agile mind-set, (2) clashes of company cultures/organization, (3) differing company visions, (4) over-reaching in negotiations, (5) failure to work with needs of partners, (6) poor skills in negotiations, and (7) lack of international experience. *Id.* at 322-23.

[15]The 1994 Report identified four barriers to receiving legal counsel: (1) poor communication between attorneys and business people, (2) delayed legal involvement, (3) lack of continuous involvement by business people, and (4) lack of mutual understanding of legal and business issues. *Id.* at 323-24.

[16]The 1994 Report identified seven potential barriers to negotiating a final agreement: (1) lack of mutual trust between parties to a joint venture, (2) difficultly in agreeing to the terms and conditions of the agreement, (3) negotiating from an agreement drafted by one party to the venture, (4) difficulty in quantifying the parties' relationship, (5) negotiating additional terms and conditions, (6) translating the business relationship into a legal document, and (7) potential competition with joint venturer. 1994 REPORT, *supra* note 12, at 324-26.

[17]*See* Ann C. Stilson, *A Status Report on Select Legal Issues Concerning the Agile Virtual Enterprise* 3 (on file with *The Delaware Journal of Corporate Law*).

the expense of negotiating joint ventures in order for firms to share compatible areas of expertise.[18]

In this author's opinion, in order to advance a meaningful dialogue concerning the viability of the virtual corporation in the next century, several preliminary questions must be raised. For example, does the American legal system wish to grant recognition to the practice of computer-linked "partnerships" or is the virtual entity simply a market phenomena that should be regulated solely by the business community? Second, is it feasible for the U.S. legal system to define, quantify, regulate, or facilitate a nameless, faceless, wall-less, assetless, timeless entity? Finally, are current theories of business organization and tort law adequate to resolve any disputes that may arise between participants to a virtual corporation and/or its consumers? The author does not suggest an answer to or express an opinion on these questions.

On the other hand, if these preliminary questions are answered satisfactorily and if these market-driven objectives are considered desirable for global competitiveness by U.S. firms in the twenty-first century, the American legal system must accommodate limited liability partnering or joint venturing among venture participants (similarly-situated companies or competitors[19]) while simultaneously: (1) acknowledging a governance infrastructure which eliminates or substantially restricts fiduciary responsibilities *inter se*, and (2) authorizing immediate dissolution of the virtual corporation and its short- and long-term liabilities[20] upon the realization or conclusion of the market opportunity.

Because no single business paradigm presently characterizes both traits (1) and (2), firms which "partner" or "venture" on-line or through traditional contract negotiations will likely be jointly, or jointly and severally, liable[21] for the misconduct of each constituent entity to the

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[18] *Id.*

[19] The partnering may also occur between or among divisions within companies.

[20] Such long-term liabilities could include products manufactured by the virtual enterprise which have latent defects which could cause injury to persons or property at a foreseeable interval in the future. Cases of long-term products liability include the manufacture of asbestos, the Dalkon shield, and agricultural and chemical products. *See, e.g.*, Sanders v. Tailored Chem. Corp., 570 F. Supp. 1543 (E.D. Pa. 1983) (urea formaldehyde insulation); Ryan v. Eli Lilly & Co., 84 F.R.D. 230 (D.S.C. 1979) (Dalkon Shield); Yandle v. P.P.G. Indus., Inc., 65 F.R.D. 566 (E.D. Tex. 1974) (asbestos).

[21] Because no corporate or unincorporated ("alternative") entity reflects the characteristics of the virtual corporation, firms which "partner" on-line will likely be held to the liability standard of general partners or joint venturers. *See* UNIF. PARTNERSHIP ACT § 15 (1914) (partners are jointly liable for the debts and obligations of the partnership). The joint liability of § 15 of the UPA has been revised by § 306 of the Uniform Partnership Act of 1994.

virtual enterprise and will be powerless to maximize freedom of contract rights within the joint venture or partnership setting.[22] Hence, if the virtual corporation is a competitive economic arrangement in the approaching century, U.S. business law must create a statutory framework for the *virtual corporation* and its embodiment of global agility, market opportunism, limited liability for venturers, immediate termination of liability upon dissolution, and lack of traditional fiduciary infrastructure and internal accountability.[23]

This article seeks only to sensitize the reader to the reality of the virtual corporation, to educate the business community concerning the legal impediments to this new entity, and to suggest a statutory "safe harbor" for implementation of virtual corporations if such legal recognition is sought. Accordingly, this article is organized into five parts: Part II presents examples of past or existing virtual corporations; Part III examines a prototypical (or "generic future") virtual corporation and its business underpinnings; Part IV exposes the liability, fiduciary, and tax pitfalls of virtual corporations operating under current U.S. business organization law; and Part V suggests a legislative model for virtual corporations.

II. THE PAST AND PRESENT — RECENT OR EXISTING VIRTUAL CORPORATIONS

A. *The Virtual Olympics of 1996*

Several virtual corporations have recently operated, or are currently operating, in the United States.[24] The most prominent of these is the

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Section 306 now provides for *joint and several* liability for partnership obligations. *See* UNIF. PARTNERSHIP ACT § 306 (1994).

To date, however, only 12 jurisdictions have adopted UPA (1994): Alabama, Arizona, California, Connecticut, District of Columbia (with 1996 amendments), Florida, Montana, New Mexico, North Dakota, Virginia, West Virginia, and Wyoming. States that have introduced UPA (1994) into their state legislatures are: Colorado, Indiana, Iowa, Kansas, Maryland, Minnesota, Montana, Nebraska, New Mexico, Oklahoma, Oregon, Utah, Vermont, and West Virginia. A Few Facts About the Uniform Partnership Act (1994) (1996) (Mar. 15, 1997) (available through Nat'l Conf. of Comm'rs on Unif. State Laws).

[22]*See, e.g.*, UNIF. PARTNERSHIP ACT § 103 (1994) (setting forth those partnership provisions which are non-waivable).

[23]Because of its unique structure, a virtual corporation does not fall within the applicable statutory provisions for ordinary corporate governance. Thus, the need for a statutory framework is that much greater.

[24]Many other virtual corporations are currently operating in the United States. For example, Dainippon Screen Manufacturing Co., a precision machinery manufacturer, is

virtual corporation which produced the Olympic Games of 1996 in Atlanta.

The story of the Virtual Olympics of 1996 is an interesting one.[25] The story begins with the dream of Georgian Billy Payne to bring the Olympic Games to Atlanta. That dream was born after a church service which Payne attended in 1987 and became a possibility when Atlanta, through Payne's efforts and without government aid, won the bid for the

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attempting to create a virtual corporation on the Internet in order to offer services to design, publishing and advertising companies. The services to be offered by the Dainippon virtual corporation include "systems and hardware development and manufacturing and image and music composition." *Industry and Technology*, NIKKEI ENG. NEWS, Mar. 18, 1996, *available in* 1996 WL 10414279. The Dainippon virtual corporation will be supervised by Dainippon Screen Manufacturing Company and will market its virtual corporation management system as well as its other virtual products. *Id.*

Another example of a recent virtual corporation is Datatape Inc.'s formation of a Virtual Product Development Team which is inviting industry members to participate in the production of a Network Peripheral Adapter which will "connect the company's DCTR-LP400 tape drive to high-performance computing and digital video networks." *See Financial & Corporate: Datatape Forms Virtual Product Development Team*, TELECOMWORLDWIRE, FINANCIAL AND CORPORATE, Aug. 12, 1996, *available in* LEXIS, News Library, Nwltrs File.

In California, First Virtual, Inc. (FV), is a virtual corporation which trades digital commodities on the Internet. According to First Virtual, the virtual corporation provides an "electronic shopping mall putting sellers and buyers together on the Internet. It is a fully operational Internet payment system with thousands of electronic financial transactions taking place daily." Richard Bowers, *First Virtual Creates Corporation of Future*, NEWSBYTE NEWS NETWORK, June 28, 1995, *available in* LEXIS, News Library, Nwltrs File. As to the management infrastructure of First Virtual, Lee Stein, president and chief executive officer of FV, states: "Our corporate structure was consciously designed to copy the way the Internet was put together. From the very beginning, our original concepts were developed over and for the Internet." *Id.* Hence, the employees, management, and board of directors of FV are located on the Internet. *See id.*

Haelan Group, Inc. is another virtual corporation which boasts a "health management consulting network with nine partners in six states." Norm Heikens, *Ahead of Their Time*, INDIANAPOLIS BUS. J., June 24, 1996, at 8B. According to management of Haelan, the virtual corporation:

> muster[s] the services of a large, vertically integrated corporation. Haelan diagnoses problems, designs solutions, delivers the product or service, then analyzes the results and makes the necessary tweaks to make the integrated system work.
>
> Depending on the client's needs, Haelan may call on any or all of its affiliate companies.

Id.

The best known Indiana virtual corporation, however, is Flexcell Group, a vertically integrated manufacturing production network with four core members. Among the oldest virtual corporations the United States, Flexcell is a consulting network which incorporated itself because of pressure from participating members. *Id.*

[25]The following story and the facts stated herein are taken from David Greising, *The Virtual Olympics*, BUS. WK., Apr. 29, 1996, at 64.

Games in 1990.[26] To secure the bid, however, Payne was required to leave his law practice, take a second mortgage on his home, and sell T-shirts to raise the approximate $7 million required to present the bid to the International Olympic Committee.[27]

After winning the bid, Payne realized that he would have to form a Virtual Olympic Corporation to service and manage the Atlanta Games.[28] Payne's first step was to hire a consulting firm to aid in the structuring of the Atlanta Committee for the Olympic Games (ACOG).[29] The consulting firm was to advise on an estimated budget which ultimately approached $1.7 billion — of which $515 million was slated for construction of twelve Olympic venues and an Olympic Village.[30] These financial commitments were to be self-financed and borne by ACOG creditors — not underwritten by the City of Atlanta or the State of Georgia.[31]

To accomplish its financing goal, ACOG secured a $300 million line of credit from NationsBank and an $8 million line of credit from Atlanta banks — quite a feat considering that ACOG had no assets.[32] Additional funds were provided by sponsorships from firms such as Coca-Cola, Home Depot, UPS, and Delta Air Lines.[33] ACOG also sold the U.S. television rights to NBC for $456 million and sold engraved bricks to the public for $35 each to help defray building costs.[34] ACOG's funding was also to be used to help ACOG organize and manage the Games.[35]

Once most of the funding was in place, a management team was recruited to oversee all facets of the games, including construction, ticket sales, security, and sports management.[36] The ACOG staff, the result of aggressive recruiting efforts by Payne and his virtual corporation, approximated 2,850 with salaries of the team members being market

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[26] *Id.*

[27] *Id.*

[28] *Id.*

[29] Greising, *supra* note 25, at 64.

[30] *Id.*

[31] *Id.* The Georgia Constitution apparently bars Atlanta from entering private agreements which would bind succeeding city councils. *Id.*

[32] *Id.* at 65.

[33] Greising, *supra* note 25, at 65. Local businesses in Atlanta spent upwards of $40 million on sponsorships. *Id.*

[34] *Id.* Originally, the domestic TV rights were forecasted to sell for $600 million, which ACOG could have earned if it had waited until 1996. *Id.* at 65-66.

[35] *Id.*

[36] *Id.*

competitive.[37] By July of 1996, when the Olympic Games officially opened in Atlanta, Payne's virtual corporation was supervising 88,209 workers for *an approximate one-month interval*.[38] With the extinguishment of the flame and the close of the 1996 Olympic Games, however, the virtual corporation and all its staff vanished[39] — the business opportunity having disappeared until another Olympic year.

B. *The SO2 Allowance Tracking Virtual Corporation*

An example of an operating virtual corporation is the team of ten utilities and one software supplier which allied themselves to create and monitor the Environmental Protection Agency's (EPA) SO2 (sulphur dioxide) emission allowances.[40] The problem presented to the SO2 Allowance Tracking Virtual Corporation was the creation of a software mechanism which could track thousands of SO2 allowance serial numbers, provide information on allowance costs, issuance years and usage, and initiate the reports mandated by EPA guidelines.[41] Because the theory of successive emission supervision and allowance tracking was a novel one in 1994, affected utilities and software companies had not yet generated internal procedures to manage and organize the SO2 information. Consequently, the SO2 Allowance Tracking Virtual Corporation "virtually invented" an environmental tracking system which utilized up-to-date computer capabilities.[42]

Electric Software Products (ESP), a software designer for electric utilities, seized the opportunity to become the promotor and software producer for the "Phase I-affected" utilities.[43] As such, ESP served as the stimulus for formulating the virtual corporation which was to be responsible for motivating targeted utilities to advance proposals and research funds in return for a needed SO2 software program.[44]

The "virtual product" to be developed by the SO2 virtual corporation was a device to track and report SO2 allowances. As foreseen by ESP, this product had to evolve immediately and be tailored

[37] Greising, *supra* note 25, at 65.

[38] *Id.*

[39] *Id.* at 66.

[40] The information regarding the SO2 (sulphur dioxide) virtual corporation is taken from Karyn Plank & David Gloski, *A Virtual Corporation Tackles SO2 Allowance Tracking*, FORTNIGHTLY, Jan. 1, 1994, at 38.

[41] *Id.* at 38.

[42] *Id.* at 39-40.

[43] *Id.* at 39.

[44] Plank & Gloski, *supra* note 40, at 39.

to specific customer requirements.[45] The virtual product which ultimately resulted from the utility alliance was the Allowance Tracking Workstation TM (ATW).[46]

The virtual corporation responsible for the design and production of the virtual product is a collaboration of ten utilities known as the ATW Development Group.[47] ESP's role in the virtual corporation was to provide the managerial "glue" which held the alliance together.[48] As a result, ESP engineers were to draft software specifications, oversee testing of the software prior to its circulation to alliance members, organize informational meetings among coalition participants, and supervise and troubleshoot the issues likely to arise once the software reached the marketplace.[49] Members of the virtual corporation were to dedicate content and design information for the software's evolution.[50]

The business solution provided by the SO2 virtual corporation was its ability to address the specific SO2 tracking dilemma in a reactionary, opportunistic mode — i.e., the participants were to: (1) share costs, skills, information, and "best performance" techniques; (2) surrender a certain degree of control over the software design and production; and (3) agree to disband upon the mastery of the SO2 problem — all in an attitude of "co-destiny."[51] The business attributes of the ATW Development Group were three-fold. First, the virtual entity was to immediately ally affected utilities in order to solve a precise market challenge and then to dissolve once the solution was found.[52] Second, the SO2 virtual enterprise was to unite the "best" information, personnel, and technology of each collaborating utility to produce the "best" result at the most efficient cost.[53] Finally, for the virtual entity to succeed, the "joint venturers" were to *trust* each other to share required information and services voluntarily in order to increase cohesiveness and profitability of the alliance.[54]

This latter attribute of *trust* was the most evasive for the parties. For instance, whereas each participating utility was willing to join the

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[45] *Id.*

[46] *Id.*

[47] *Id.*

[48] Plank & Gloski, *supra* note 40, at 39.

[49] *Id.*

[50] *Id.*

[51] *Id.* at 38.

[52] Plank & Gloski, *supra* note 40, at 38. As such, the virtual corporation was a "joint venture" for a definite undertaking.

[53] *Id.*

[54] *Id.* at 39.

collaboration, they did not wish to make any firm commitment to a "virtual alliance" until all affected utilities were fully committed.[55] To gain these commitments, several telephonic conferences, negotiations and deadlines came and went.[56] When the virtual corporation finally gained the requisite commitments, an "agreement of understanding" was to be drafted which was to contain the basic terms of the alliance.[57] Not surprisingly, however, attorneys representing the various participants disagreed on the appropriateness of using a single contract to reflect the rights and liabilities of each participant.[58] What resulted was a lengthy period of legal negotiations which threatened fatal market delays in designing the needed software — delays which could easily have foreclosed the alliance's ability to respond to the SO2 market break. Fortunately, after intensive legal maneuvering, negotiation, and contract review, the SO2 allowance tracking opportunity remained and a final agreement was reached.[59] Such costly and time-consuming legal involvement by participants' attorneys is an element obviously sought to be eliminated by "virtual investors."

III. THE FUTURE — A PROTOTYPICAL (GENERIC FUTURE) VIRTUAL CORPORATION

Assume fifteen small Delaware firms which manufacture, install, and service component parts for pool vacuum systems. Individually, these firms with limited resources are unlikely to be able to compete for contracts with major hotel franchises. To become competitive, the fifteen firms may partner themselves into an *agile virtual corporation* which, by aggregating products, lines, services, information, and personnel, may bid on Ritz-Carlton, Hyatt, Holiday Inn, or Radisson contracts. The resulting virtual entity may market itself to both domestic and foreign hoteliers by advertising on the Internet or other international information systems. The agility of the generic virtual entity is reflected in the organization's

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[55] *Id.*

[56] Plank & Gloski, *supra* note 40, at 39.

[57] *Id.*

[58] *Id.*

[59] *Id.* According to this document, each utility is liable for the acts of its personnel and not for the mis- or nonfeasance of the constituent utilities. *Id.* In addition, the licensing agreement of the virtual enterprise stated that ESP was to defend any trademark, copyright, or patent infringement action which might arise against alliance members performing in the course of the virtual enterprise. *Id.* To amend or modify the final agreement or to alter a particular project specification, an 80% vote of participating firms is required. *Id.*

capability to reconfigure itself in accordance with market opportunities and/or consumer requirements.[60]

The most innovative aspect of the hypothetical virtual corporation is its dependence for its success upon principles of *trust*,[61] *disclosure*, and *consent* among the partnering enterprises. For example, if the fifteen hypothetical firms choose to form a virtual entity either in person or on-line, they must first *consent* to: (1) the rules of membership to the entity, (2) the type(s) of confidential information which will be shared by the participants in order to market themselves to bidders, (3) the standard(s) of performance to be required and enforced by the entity, (4) the managerial rights and obligations of the participants to the enterprise, (5) the method by which constituent firms are selected to perform business opportunities, (6) the right of participating firms to compete with the virtual corporation, (7) the nature and extent of liability for breaches of the membership agreement, and (8) profit-sharing arrangements based upon actual performance of contracts.[62] By negotiating these "terms and conditions of membership" at the entity's inception, the founding firms have advance *notice* of, and will *consent* to, the governing constitution of the enterprise.[63] Ideally, this founding agreement will be reduced to writing and filed at a designated location for review by all existing or prospective entity participants.

The market effect of a pre-negotiated operating agreement is the agility of the enterprise to promptly solicit new members who may be necessary in order to develop business opportunities. Firms which wish to associate with the virtual corporation subsequent to its formation will be provided *notice* of these rules and will *consent* to the rules as a

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[60]At present, an example of a "virtual corporation" is the Agile Web, Inc. in Northeastern Pennsylvania which is comprised of 19 member firms. Beth W. Orenstein, *NE PA Companies Take Part in "Agile" Manufacturing Firm*, NE. PA. BUS. J., Aug. 1995, at 9, 9. Member firms which comprise the Web will "communicate through e-mail and electronic data interchange or EDI, a computer-linked communications network." *Id.* The purpose of the Web is to aid small manufacturers to compete when "large companies consolidate[ ] their supplier bases." *Id.*

[61]*See* Charles Handy, *Trust and the Virtual Organization*, HARV. BUS. REV., May-June 1995, at 40, 44; *see generally* FRANCIS FUKUYAMA, TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY (1995) (discussing the importance of trust in creating the cooperation necessary for successful economic endeavors).

[62]This is not intended as an exhaustive listing of the terms and conditions which could be included in a virtual enterprise operating contract. These factors represent *suggestions* for discussion purposes only.

[63]*See generally* TOM PETERS, LIBERATION MANAGEMENT: NECESSARY DISORGANIZATION FOR THE NANOSECOND NINETIES (1992) (discussing the change in world economics that requires businesses to engage intimately with large numbers of temporary "network" partners).

condition of membership. The organizational charter will not, however, be exhaustive in its coverage. Instead, participating firms will be expected to *trust* each other to arbitrate or mediate foreseeable exigencies which were neither provided for, nor intended to be governed, by the founding contract.

This latter element of trust is critical to the success of the virtual entity and is the element which presently is most elusive to attorneys and the "virtual investors" whom they advise.[64] The dilemma of trust is simple. To business people, the market demands less legal advice, short and understandable contracts, liability to be assessed according to actual contract performance, contractually allocated fiduciary responsibilities, and the ability to wind up legal obligations promptly once a "virtual opportunity" is exhausted. On the other hand, lawyers wish to negotiate agreements which represent only their client's interests and to bargain for terms which restrict or eliminate their client's liability exposure and which conversely impose market risks and liability upon joint venturers. Obviously, such divergent agendas and consequent legal maneuverings threaten the cohesiveness of potential alliances and jeopardize a collaboration's capability of seizing and profiting from market openings.[65]

By contrast, if these elements of *trust, disclosure,* and *consent* are infused into the creation of the entity, the virtual corporation is nimble and able to adapt rapidly to fluctuating consumer requirements.[66]

IV. LIABILITY, FIDUCIARY, AND TAX CONCERNS OF THE VIRTUAL ENTERPRISE UNDER EXISTING LAW

A. *Available Business Forms: Fiduciary Duties and Liabilities of Members and Managers*

Several forms of business are currently available to investors who wish to test their "virtual" entrepreneurial skills. For example, investors who desire to pool their capital in an effort to receive profits but who wish a decentralized managerial structure for the business may elect to form a general partnership (GP),[67] a limited liability partnership (LLP),[68]

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[64]*See generally* Handy, *supra* note 61, at 40.

[65]*See supra* note 59 and accompanying text.

[66]It should be noted that these concepts are not novel. For example, emergency relief efforts have embodied these characteristics for years in order to advance the greater public good. Volunteers come together and agree to be under the direction of an umbrella organization solely for the purpose of completing a predetermined limited project.

[67]A general partnership is defined as "an association of two or more persons to carry on as co-owners a business for profit." UNIF. PARTNERSHIP ACT § 6 (1914).

a member-managed limited liability company (LLC)[69] or a statutory close

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[68]A limited liability partnership is defined in the Uniform Partnership Act (1996 amendments) as "a partnership that has filed a statement of qualification under Section 1001 and does not have a similar statement in effect in any other jurisdiction." UNIF. PARTNERSHIP ACT § 101(5) (1996). For ease of clarity, in the ensuing discussion of the uniform LLP, the amendments to UPA which deal with LLPs will hereinafter be referred to as ULLPA (1996) (the UNIFORM LIMITED LIABILITY PARTNERSHIP ACT). See also DEL. CODE ANN. tit. 6, § 1502(7) (Supp. 1996), which defines a "registered limited liability partnership" as

> a partnership formed pursuant to an agreement governed by the laws of this State, registered under § 1544 [filing requirement] of this title and complying with §§ 1545, 1546 and 1549 [requiring LLP or similar designation to be included in the name of partnership, requiring at least $1 million of insurance, and requiring a registered office or registered agent in the State of Delaware] of this title.

The first LLP statute was adopted by Texas in 1991. Louisiana enacted an LLP statute in 1992. Delaware, the District of Columbia, and North Carolina followed in 1993. Elizabeth G. Hester, *Practical Guide to Registered Limited Liability Partnerships, in* 5 STATE LIMITED LIABILITY COMPANY & PARTNERSHIP LAWS LLP-2 (Michael A. Bamberger & Arthur J. Jacobson eds., Supp. 1997-2). For a comprehensive discussion of LLPs, see Robert R. Keatinge et al., *Limited Liability Partnerships: The Next Step in the Evolution of the Unincorporated Business Organization*, 51 BUS. LAW. 147 (Nov. 1995).

[69]A "limited liability company" is defined in the Uniform Limited Liability Company Act (ULLCA) § 101(8) (1995) as "a limited liability company organized under this [Act]." See, e.g., DEL. CODE ANN. tit. 6, § 18-101(6) (Supp. 1996), which defines a limited liability company as "a limited liability company formed under the laws of the State of Delaware and having 1 or more members," and § 18-402 (1993 & Supp. 1996), which describes member-managed limited liability companies.

To date, all 50 states and the District of Columbia have adopted an LLC statute: Alabama, ALA. CODE §§ 10-12-1 to -61 (1994 & Supp. 1996); Alaska, ALASKA STAT. §§ 10.50.010-.995 (Michie 1966); Arizona, ARIZ. REV. STAT. ANN. §§ 29-601 to -857 (West Supp. 1996); Arkansas, ARK. CODE ANN. §§ 4-32-101 to -1316 (Michie 1996); California, CALIF. CORP. CODE §§ 17000-17705 (West Supp. 1997); Colorado, COLO. REV. STAT. ANN. §§ 7-80-101 to -913 (West Supp. 1996); Connecticut, CONN. GEN. STAT. ANN. §§ 34-100 to -242 (West Supp. 1995); Delaware, DEL. CODE ANN. tit. 6, §§ 18-101 to -1109 (1993 & Supp. 1996); District of Columbia, D.C. CODE ANN. §§ 29-1301 to -1375 (1996 & Supp. 1997); Florida, FLA. STAT. ANN. §§ 608.401-.471 (West 1993 & Supp. 1996); Georgia, GA. CODE ANN. §§ 14-11-100 to -1109 (Michie 1994 & Supp. 1996); Hawaii, HAW. REV. STAT. ANN. §§ 428, 101-1302 (Michie Supp. 1996); Idaho, IDAHO CODE §§ 53-601 to -672 (1994 & Supp. 1996); Illinois, 805 ILL. COMP. STAT. 180/1-1 to 180/60-1 (West Supp. 1997); Indiana, IND. CODE ANN. §§ 23-18-1-1 to 23-18-13-1 (Michie 1995 & Supp. 1996); Iowa, IOWA CODE ANN. §§ 490A.100-.1601 (West Supp. 1997); Kansas, KAN. STAT. ANN. §§ 17-7601 to -7709 (1995); Kentucky, KY. REV. STAT. ANN. §§ 275.001-.455 (Banks-Baldwin Supp. 1996); Louisiana, LA. REV. STAT. ANN. §§ 12:1301-12:1369 (West 1994 & Supp. 1997); Maine, ME. REV. STAT. ANN. tit. 31, §§ 601-751 (West 1996 & Supp. 1996); Maryland, MD. CODE ANN., CORP. & ASS'NS §§ 4A-101 to -1103 (1993 & Supp. 1996); Massachusetts, MASS. GEN. LAWS ANN. ch. 156C, §§ 1-68 (West Supp. 1997); Michigan, MICH. COMP. LAWS ANN. §§ 21.198, §§ 101-1200 (Law Co-op Supp. 1996); Minnesota, MINN. STAT. ANN. §§ 322B.01-.960 (West 1995 & Supp. 1997); Mississippi, MISS. CODE ANN. §§ 79-29-101 to -1204 (1996); Missouri, MO. ANN. STAT. §§ 347.010-.187 (West Supp. 1997); Montana, MONT. CODE ANN. §§ 35-8-101 to -1307 (1995); Nebraska, NEB. REV. STAT. ANN. §§ 21-2601 to -2653 (Michie 1995 & Supp.

corporation.[70] In a GP, LLP, or member-managed LLC, each "partner" or "member" is an "owner" and "manager" in the sense that each has an equal right to vote and an equal share in the profits of the business, subject to any agreement between them.[71] In a statutory close

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1996); Nevada, NEV. REV. STAT. §§ 86.011-.571 (1995); New Hampshire, N.H. REV. STAT. ANN. §§ 304-C:1 to :85 (1995 & Supp. 1996); New Jersey, N.J. STAT. ANN. §§ 42:2B-1 to -70 (West Supp. 1997); New Mexico, N.M. STAT. ANN. §§ 53-19-1 to -74 (Michie 1993 & Supp. 1995); New York, N.Y. LTD. LIAB. CO. LAW ch. 34 (McKinney 1997); North Carolina, N.C. GEN. STAT. §§ 57C-1-01 to -10-07 (1993 & Supp. 1996); North Dakota, N.D. CENT. CODE §§ 10-32-01 to -155 (1995); Ohio, OHIO REV. CODE ANN. §§ 1705.01 to .58 (Anderson Supp. 1996); Oklahoma, OKLA. STAT. ANN. tit. 18, §§ 2000-2060 (West Supp. 1997); Oregon, OR. REV. STAT. §§ 63.001-.990 (Supp. 1996); Pennsylvania, PA. STAT. ANN. tit. 15, §§ 8901-8998 (West 1995 & Supp. 1997); Rhode Island, R.I. GEN. LAWS §§ 7-16-1 to -75 (1992 & Supp. 1996); South Carolina, S.C. CODE ANN. §§ 33-43-101 to -1409 (Law. Co-op. 1994) (repealed effective Jan. 1, 2001); South Dakota, S.D. CODIFIED LAWS §§ 47-34-1 to -59 (Michie Supp. 1997); Tennessee, TENN. CODE ANN. §§ 48-201-101 to 248-606 (1995); Texas, TEX. REV. CIV. STAT. ANN. art. 1528n. art. 1.01-11.07 (West 1996); Utah, UTAH CODE ANN. §§ 48-2b-101 to -158 (1994 & Supp. 1996); Vermont, VT. STAT. ANN. tit. 11, ch. 21 (1997); Virginia, VA. CODE ANN. §§ 13.1-1000 to -1073 (Michie 1993 & Supp. 1996); Washington, WASH. REV. CODE ANN. §§ 25.15.005-.902 (West Supp. 1997); West Virginia, W. VA. CODE §§ 31B-1-101 to -13-1306 (1996); Wisconsin, WIS. STAT. ANN. §§ 183-0102 to -1305 (West Supp. 1996); Wyoming, WYO. STAT. ANN. §§ 17-15-101 to -144 (Michie 1989 & Supp. 1996).

[70] Under Delaware law, a "close corporation" is defined as:

> a corporation organized under this chapter whose certificate of incorporation contains the provisions required by § 102 of this title and, in addition, provides that:
>
> (1) All of the corporation's issued stock of all classes, exclusive of treasury shares, shall be represented by certificates and shall be held of record by not more than a specified number of persons, not exceeding 30; and
>
> (2) All of the issued stock of all classes shall be subject to 1 or more of the restrictions on transfer permitted by § 202 of this title; and
>
> (3) The corporation shall make no offering of any of its stock of any class which would constitute a "public offering" within the meaning of the United States Securities Act of 1933 [15 U.S.C. § 77a et seq.] as it may be amended from time to time.

DEL. CODE ANN. tit. 8, § 342(a) (1991).

[71] *See* UNIF. LTD. LIAB. CO. ACT § 404(a)(1) (1995) ("[E]ach member has equal rights in the management and conduct of the company's business . . . ."); *id.* § 405(a) ("Any distributions made by a limited liability company before its dissolution and winding up must be in equal shares."); UNIF. PARTNERSHIP ACT §§ 18(a), (e) (1914) (subject to any agreement between them, each partner shall share equally in the profits and surplus of the partnership and shall have equal rights in the management and conduct of the business); UNIF. PARTNERSHIP ACT § 401(b) (1994) (partners are entitled to an equal share of the partnership profits and are liable for partnership losses in proportion to the partner's share of the profits); *id.* § 401(f) (each partner has equal rights in the management of the partnership business); DEL. CODE ANN. tit. 6, § 18-302 (1993 & Supp. 1996) (permitting parties by the limited liability company agreement to provide for classes or groups of members having such rights, powers or duties

corporation, on the other hand, each "shareholder" may be an owner and manager of the firm but will share in the business profits only to the extent of *pro rata* stock holdings.[72] Thus, partnerships, member-managed LLCs, and statutory close corporations are generally characterized by a sharing of ownership and management in the absence of contractual provisions to the contrary.

In return for this unity of investment interest, partners in GPs and LLPs owe fiduciary duties to one another[73] and are jointly, or jointly and severally, liable for the debts and obligations of the partnership.[74] Conversely, members of LLCs and shareholders in close corporations are not responsible to third parties for the debts, obligations, or liabilities of the LLC or close corporation, whether those obligations arise in contract, tort or otherwise.[75] Members of LLCs or shareholders in statutory close

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as the parties determine); *id.* § 18-503 (1993) (permitting allocation of profits and losses to be determined by the limited liability company agreement).

[72]*See, e.g.*, DEL. CODE ANN. tit. 8, § 351 (1991) (stating that the certificate of incorporation of a close corporation may provide for the management of the business by the stockholders rather than the board of directors). Ostensibly, if the stockholders desire to manage the business, their rights to profits will be assessed according to their proportionate stock interest in the corporation rather than equally as provided by the default rules of UPA (1914) or (1994).

[73]*See* UNIF. PARTNERSHIP ACT § 21(1) (1914) (partners must account to the partnership for any benefit and hold, as trustee for it, any profits derived by the partner without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by the partner of partnership property). *See also* Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928) (holding that partners owe to each other the duty of finest loyalty); UNIF. PARTNERSHIP ACT §§ 103(b)(3), (4) (1994) (stating that blanket waivers of the duty of loyalty are not permitted and that the duty of care may not be unreasonably reduced); *id.* § 404(a) (stating that the "only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care"). *See generally* Elizabeth G. Hester, *Keeping Liability at Bay*, 5 BUS. L. TODAY 59 (Jan.-Feb. 1996) (discussing the liability of partners in an LLP to each other and to third parties).

The fiduciary duties of partners in LLPs arguably are identical to those of partners in GPs since LLP statutes are presently *amendments to existing GP legislation*. *See, e.g.*, DEL. CODE ANN. tit. 6, §§ 1502-1553 (1993 & Supp. 1996).

[74]*See* UNIF. PARTNERSHIP ACT § 15(b) (1914) (all partners are jointly liable for the debts and obligations of the partnership, but any partner may enter into a separate agreement to perform a partnership obligation); *id.* § 15(a) (all partners are jointly and severally liable for everything chargeable to the partnership under § 13 [partnership bound by partner's wrongful acts] and § 14 [partnership bound by partner's breach of trust]). *But see* UNIF. PARTNERSHIP ACT § 306 (1994) (all partners are jointly and severally liable for all obligations of the partnership).

[75]*See, e.g.*, DEL. CODE ANN. tit. 6, § 18-303(a) (Supp. 1996) (stating that "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"); DEL. CODE ANN. tit. 8, § 356 (1991) (applying new laws only to close corporations).

corporations will, however, likely owe fiduciary duties to one another based upon a partnership or corporate law analogy.[76]

By contrast, persons who are willing to contribute capital to a business but desire centralized managerial rights have at least four options: a limited partnership (LP),[77] a limited liability limited partnership (LLLP),[78] a manager-managed LLC,[79] or a corporation.[80] The

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[76]The issue of fiduciary duties of members in a member-managed limited liability company is treated differently under the statutes. For example, § 409 of ULLCA states that "[t]he only fiduciary duties a member owes to a member-managed limited liability company and its other members are the duty of loyalty and the duty of care imposed by subsections (b) and (c)." UNIF. LTD. LIAB. CO. ACT § 409(a) (1995).

The language of ULLCA § 409 is virtually identical to the language of § 404 of UPA (1994). See *supra* note 73 which articulates the duties of partners in a general partnership. Interestingly, UPA (1994) (and its amended language articulating duties of care and loyalty by partners) has been adopted in only 12 jurisdictions. *See supra* note 21 for a listing of these jurisdictions. Similarly, only four jurisdictions have adopted ULLCA (1995) (Hawaii, South Carolina, Vermont, and West Virginia). A Few Facts About the Uniform Partnership Act (Feb. 1, 1997) (available through Nat'l Conf. of Comm'rs on Unif. State Laws). In addition, other LLC statutes have generally not adopted the fiduciary duty language of either UPA (1994) or ULLCA (1995) and are thus not clear on the fiduciary duties of members or managers.

In a statutory close corporation, on the other hand, where shareholders choose to manage the business themselves rather than through a board of directors, the shareholders "shall be subject to all liabilities of directors." DEL. CODE ANN. tit. 8, § 351(3) (1991). The clear import of § 351(3) in Delaware is that managing stockholders will also be subject to the same *fiduciary duties* as directors.

From a case law perspective, however, courts have held that members in a closely-held corporation owe fiduciary duties to one another. *See, e.g.*, Pedro v. Pedro, 489 N.W.2d 798, 801 (Minn. Ct. App. 1992) (finding the relationship among shareholders in closely held corporations to be analogous to that of partners). Because a manager-managed LLC is, in many respects, similar to the closely-held corporation, courts will likely look to corporate law by analogy in articulating the fiduciary duties of managers in LLCs. Similarly, where an LLC is organized as a member-managed LLC, courts will probably analogize to partnership law in determining the duties of members to one another or the LLC. *See generally* Advanced Orthopedics v. Moon, 656 So. 2d 1103 (La. Ct. App. 1995) (stating that managers in an LLC owed fiduciary duties to one another — without articulating the basis for the duties); Meyer v. Oklahoma Alcoholic Bev. Laws Enforcement Comm'n, 890 P.2d 1361 (Okla. Ct. App. 1995) (holding that, for purposes of applying for a liquor license, an LLC will be deemed a corporation rather than a partnership).

[77]A limited partnership is defined as a "partnership formed by two or more persons . . . having as members one or more general partners and one or more limited partners." UNIF. LTD. PARTNERSHIP ACT § 1 (1916). Limited partners are distinguishable from general partners in that limited partners are liable for partnership debts only to the extent of their contributions to the partnership. Limited partners "shall not be bound by the obligations of the partnership." *Id.*

[78]See, e.g., § 1553 of Title 6 of the Delaware Code, which provides that "[a] domestic limited partnership may become a registered limited liability limited partnership by complying with the applicable provisions of the Delaware Revised Uniform Limited Partnership Act."

LP, LLLP, and the manager-managed LLC offer limited responsibility to contributors in return for the relinquishment by "limited partners" or "members" of control rights to "general partners" or "managers" who are thereafter accorded the contractual privilege of decision-making.[81] Shareholders in a corporation similarly relinquish "control" rights to directors.[82]

In terms of third-party accountability, the liability of a limited partner in an LP or LLLP for partnership obligations is limited to the partner's contribution to the partnership unless the limited partner "participates in the control of the business."[83] The liability of a member

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DEL. CODE ANN. tit. 6, § 1553 (Supp. 1996). *See also* DEL. CODE ANN. tit. 6, § 17-214 (Supp. 1996) (stating the procedures for creating a Delaware limited liability limited partnership). The obvious effect of the limited liability limited partnership is that the general partner of the limited partnership is shielded from liability to the same extent as the general partner in a limited liability partnership.

[79]A limited liability company is defined at *supra* note 69.

[80]A corporation is formed upon the filing of a certificate of incorporation. *See, e.g.*, DEL. CODE ANN. tit. 8, § 106 (1991). Upon the requisite filing, the corporation becomes an entity independent from its owners and managers. *See* Scott-Douglas Corp. v. Greyhound Corp., 304 A.2d 309 (Del. Super. Ct. 1973) (noting that a corporation is an entity distinct from its shareholders even if its stock is wholly owned by one person).

[81]*See* UNIF. LTD. PARTNERSHIP ACT §§ 9-10 (1916) (defining the rights of general and limited partners, respectively). Apparently, general partners owe a fiduciary duty to the limited partnership, including a duty of loyalty to limited partners. *See id.* § 9. This duty emanates from the general fiduciary principle that one who controls property of another stands in a fiduciary relationship with the other party involved and owes a duty not to use the property in a self-dealing manner. *See, e.g.*, Litman v. Prudential-Bache Properties, 611 A.2d 12, 15-16 (Del. Ch. 1992) (determining that fiduciary duty is substantially the same in both corporate and limited partnership cases).

Partnership agreements may provide for classes or groups of limited partners having such rights, powers and duties as desired by the limited and general partners. DEL. CODE ANN. tit. 6, § 17-302(a) (1993). Agreements may provide for the taking of an action, including the amendment of the partnership agreement, without the vote or approval of any limited partner or class of limited partners. *Id.* Limited partners may vote separately or with a specified group or class on a per capita, number, financial, class, group, or other designated basis. *Id.* § 17-302(b).

Pursuant to a recent amendment of the Delaware Revised Limited Liability Partnership Act (DRULPA), both limited partnerships and general partnerships in Delaware may establish a designated *series* of limited partner or partnership interests which have separate rights, powers, or duties with respect to *specific assets or obligations* of the limited partnership. DEL. CODE ANN. tit. 6, § 17-218(a) (Supp. 1996). An analogous provision was added to the Delaware Limited Liability Company Act (DLLCA) at DEL. CODE ANN. tit. 6, § 18-215(a) (Supp. 1996) (permitting the creation of series of members, managers, or LLC interests which have separate rights, powers, or duties with respect to specific assets or liabilities of the LLC).

[82]*See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (1991) (stating that every corporation shall be managed by or under the direction of a board of directors).

[83]UNIF. LTD. PARTNERSHIP ACT § 303(a) (1985).

in a manager-managed LLC or a shareholder in a corporation is likewise limited to the member/stockholder's contribution to the business.[84]

In an LP or LLLP, because managerial rights are vested in the general partner, general partners likely owe fiduciary duties both to the limited partners and to the partnership itself.[85] Limited partners may also owe fiduciary-like duties to the partnership if, pursuant to a partnership agreement, the limited partner exercises discretion in the management of the business.[86] In some circumstances, directors of corporate general partners may also owe fiduciary duties to limited partners and the partnership under principles of trust law.[87] In a manager-managed LLC, however, the law of fiduciary duties is unclear. The most likely scenario will impose fiduciary duties upon managers by analogy to corporate or partnership law.[88]

In a corporation, capital investors may own an equity interest in the corporate entity yet retain indirect managerial rights through the exercise of their voting franchise. Yet, due to the independence of the corporate

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[84]*See supra* note 75.

[85]The issue of fiduciary duties of general partners is not clear. For example, limited partnership statutes do not delineate fiduciary duties of partners. *See, e.g.*, DEL. CODE ANN. tit. 6, § 17-403 (1993 & Supp. 1996) (articulating the general powers and liabilities, but not **duties**, of general partners to the limited partners and to the partnership). *See also* UNIF. LTD. PARTNERSHIP ACT § 403 (1985) (articulating the powers and liabilities, but not the **duties**, of general partners in a limited partnership). But see DEL. CODE ANN. tit. 6, § 17-1105 (Supp. 1996), which provides that "[i]n any case not provided for in this chapter the Delaware Uniform Partnership Law (Chapter 15 of this title) and the rules of law and equity, including the law merchant, shall govern."

On the other hand, some courts have held that general partners owe fiduciary duties similar to the duties owed by directors to a corporation. *See, e.g.*, *Litman*, 611 A.2d at 15 (stating that "the duties of a general partner and a director are very similar"); Boxer v. Husky Oil Co., 429 A.2d 995, 997 (Del. Ch. 1981) (finding that the general partner in a limited partnership owes a fiduciary duty to the limited partners). *See also* Wyler v. Feuer, 149 Cal. Rptr. 626, 633 (Cal. Ct. App. 1979) (applying the business judgment rule in a limited partnership case).

[86]*See* KE Property Management Inc. v. 275 Madison Management Corp., No. 12,683, slip op. at 24 (Del. Ch. July 21, 1993), *reprinted in* 19 DEL. J. CORP. L. 805, 821 (1994) (holding that to the extent that a partnership agreement empowers a limited partner with discretion to take actions affecting the governance of the limited partnership, the limited partner may be subject to the obligations of a fiduciary). *See also* Gum v. Schaefer, 683 S.W.2d 803, 805 (Tex. App. 1984) (applying trust principles in determining the fiduciary relationship among partners).

[87]*See In re* USACafes L.P. Litig., 600 A.2d 43, 49 (Del. Ch. 1991) (stating that while the duty was likely not as broad as that of directors of a corporate trustee, it "surely entails the duty not to use control over the partnership's property to advantage the corporate director at the expense of the partnership").

[88]*See supra* note 76.

entity from its owners, corporation law requires centralized management — i.e., a board of directors.[89]

This separation of management from the corporation's owners resulted in the creation of the common law fiduciary duties of corporate managers.[90] Those duties — the duties of care, loyalty, and disclosure — ostensibly protect shareholders from the potential mismanagement and greed of directors. Increasingly, states are permitting the elimination or modification of some of these corporate duties by contract.[91]

For a virtual corporation to operate nimbly in a fluid market, the members/owners of the enterprise must be granted the option(s) of: (1) a flexible managerial infrastructure; (2) limited liability against third-party claims during the viability and at the dissolution of the enterprise; and (3) contractual reallocation or elimination of fiduciary duties *inter se*. This latter attribute — that of *freedom of contract* — is necessary in order to empower existing and/or subsequent virtual investors to apportion their risks within, and their relationship to, the business according to their managerial rights and profit interests. Precepts of contractual freedom also enable owners to allocate firm resources among marketing, research or development of personnel[92] and away from expensive internal litigation. The former attributes — administration tailored to investor requirements and limited liability during and after virtual corporate existence — are indispensable to the achievement of market flexibility, timing, and competition.

B. *Select Disadvantages to Existing Business Forms*

Each of the foregoing business forms is available for use by investors who desire a "virtual enterprise." However, the drawback to each is readily apparent. For example, the corporation, LP, LLP, LLLP, and LLC each: (1) require some written filing for creation;[93] (2) impose

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[89]*See supra* note 82.

[90]*See* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (discussing the duty of care and the duty of loyalty of corporate directors).

[91]*See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (1991 & Supp. 1996) (providing for the elimination or limitation of the personal liability of directors for breach of some fiduciary duties).

[92]This obviously does not represent an exhaustive listing of apportionment of firm resources.

[93]*See, e.g.*, DEL. CODE ANN. tit. 8, § 101(a) (1991) (requiring a corporation to file a certificate of incorporation); DEL. CODE ANN. tit. 6, § 17-201(a) (1993) (requiring limited partnerships to file); *id.* § 1544 (1993 & Supp. 1996) (requiring limited liability partnerships to file); *id.* § 1553 (Supp. 1996) (requiring limited liability limited partnerships to file); *id.* § 18-201(a) (1993 & Supp. 1996) (requiring a limited liability company to file a certificate of

managerial duties and liabilities upon supervisors by statute or by analogy to comparable areas of law, including prohibitions on self-dealing transactions among and by managing participants;[94] and (3) require a winding-up interval and accounting to existing and future foreseeable firm claimants post-dissolution.[95] Each of these requirements impedes optimal "agility" for prototypical virtual entities which seek spontaneous, transactional relationships through streamlined contract negotiations or computer networking. In addition, LLC, LP, LLP, LLLP, and corporate statutes are notoriously nonuniform in their grant of limitations or modifications to governance infrastructures and managerial liability. This nonuniformity creates conflicts of law issues for interstate or international virtual enterprises.[96]

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formation).

[94]*See supra* Part IV.A.

[95]*See, e.g.*, DEL. CODE ANN. tit. 8, §§ 280-282 (1991 & Supp. 1996); DEL. CODE ANN. tit. 6, § 17-804(b) (1993). The referenced sections require corporations or limited partnerships which have dissolved to:

> pay or make reasonable provision to pay all claims and obligations, including all contingent, conditional or unmatured claims and obligations . . . . If there are sufficient assets, such claims and obligations shall be paid in full and any such provision for payment made shall be made in full. If there are insufficient assets, such claims and obligations shall be paid or provided for according to their priority and, among claims and obligations of equal priority, ratably to the extent of assets available therefor.

Id. *See also* UNIF. LTD. LIAB. CO. ACT § 407 (1995) (governing liability for unlawful distributions); *id.* § 411 (regulating the continuation of the LLC after the expiration of a specified term); *id.* § 802 (governing the continuation of the LLC post-dissolution); *id.* § 807 (governing known claims against the LLC post-dissolution); *id.* § 808 (governing "other claims" against the dissolved LLC).

[96]For example, a conflicts of laws issue could arise if an LLC were formed in a jurisdiction which permits maximum partnership-like governance as well as limited liability for members. If the LLC were thereafter to engage in a business transaction in a jurisdiction which did not grant the same degree of LLC liability protection, the LLC members could be held accountable under the law of the jurisdiction wherein the business transaction occurred. In this manner, nonuniformity in the law of business entities creates the agency cost of uncertainty in conducting business in jurisdictions which have laws at variance with the laws of the state of enterprise formation.

An analogous conflicts of laws issue arises with LLPs. For example, if a partnership were to register as a full-shield LLP and then transact business in a limited-shield jurisdiction, the injured party in the limited-shield jurisdiction may claim that the partnership's liability exposure is limited to the same extent as the limited-shield jurisdiction in the absence of a statute which specifically recognizes foreign LLPs.

For cases interpreting related LLP conflicts issues, see Lowsley-Williams v. North River Ins. Co., 884 F. Supp. 166, 170-71 (D.N.J. 1995) (noting the need for statutory guidance concerning diversity jurisdiction involving nontraditional alternative entities); Liberty Mutual Ins. Co. v. Gardere & Wynne, L.L.P., No. CIV.A.94-10609-MLW, 1994 WL 707133 (D. Mass. Dec. 6, 1994) (holding that the law of the state of formation of an LLP governs its internal

The business forms best suited for the flexibility required by the hypothetical virtual enterprise are the GP, LLP, or the member-managed LLC. For example, the GP is the most nimble in formation since it is the only business enterprise which does not require a writing or formalistic filing for its creation.[97] From this perspective alone, the GP is well adapted for "*on-line virtual corporations*."[98]

With regard to adaptability in management, the member-managed LLC, the LLP and the GP, unlike other available business entities, are characterized by informality in governance and are accorded considerable contract flexibility by members to the business.[99] For example, the GP, LLP, and LLC each permit investors to select their managerial structure by agreement or to default into equal control powers.[100] Indeed, the present trend in LLC and LLP *legislation* reflects an attitude favoring *maximum freedom of contract* among LLC and LLP participants.[101] A prime example is Delaware's LLC statute which has expressly provided that: (1) Delaware's policy in the realm of LLCs is "to give the maximum effect to the principle of freedom of contract and to the enforceability" of investor agreements;[102] (2) owners or persons acting under an ownership agreement may be absolved from liability for that person's good faith reliance upon the applicable provisions of the firm's

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affairs); UOP v. Andersen Consulting, No. CV 95014753S, 1995 WL 784971 (Conn. Super. Ct. Dec. 21, 1995) (holding that a state long-arm statute governs foreign partnerships).

[97]*See* UNIF. PARTNERSHIP ACT § 202 (1994) (discussing the formation of a partnership).

[98]*See supra* note 24.

[99]*But see* Swanson v. Schlumberger Tech. Corp., 895 S.W.2d 719, 734 (Tex. App. 1994) (holding that a release agreement between partners to a buyout of a partner's interest in the partnership "could not destroy any fiduciary duty to them because an agreement by a fiduciary to exclude all fiduciary responsibility is against public policy").

[100]*See supra* Part IV.A for a discussion of these attributes.

[101]*See* UNIF. LTD. LIAB. CO. ACT § 409 (1995) (setting forth the general standards for members' and managers' conduct); *id.* § 103 (setting forth certain non-waivable provisions in the LLC agreement, including specified duties and obligations). *See also* UNIF. PARTNERSHIP ACT § 404 (1994) (setting forth the general standards for partners' conduct); *id.* § 103 (stating the non-waivable provisions in partnership agreements, including certain specified duties and obligations of partners). By contrast, such a *statutory* trend has yet to gain dominance in *state GP legislation* due the relatively few enactments of UPA (1994) and ULLCA (1995) as of the fall of 1996. *See supra* notes 21 & 68 for a listing of these jurisdictions.

[102]DEL. CODE ANN. tit. 6, § 18-1101(b) (1993). *See also id.* § 17-1101 (governing freedom of contract issues in Delaware limited partnerships); DEL. CODE ANN. tit. 12, § 3819 (1995), *id.* § 3821 (Supp. 1996) (governing freedom of contract issues in Delaware business trusts).

operating contract;[103] and (3) the applicable person's duties and liabilities may be expanded or eliminated by contract.[104]

Despite the developing trend towards enhanced contractual freedom in alternative entity legislation, drafters of virtual enterprises should consider three potential difficulties. First is the predicament of creating an interstate virtual enterprise in a jurisdiction which allows substantial reduction of investors' monetary liability for firm obligations while the enterprise operates in a state which lacks any legislative statement regarding such contractual power of investors. In this instance, the owners must consider whether their contract *inter se* will be binding against a third-party in the foreign jurisdiction in which the virtual entity transacted business.[105]

A related obstacle is present where an interstate virtual corporation is formed in a jurisdiction which permits maximum internal contractual flexibility, but the entity thereafter transacts business in one or more states which accord only finite authority to investors to dictate their internal destiny.[106] In either of the above scenarios, the enforceability of the investors' agreement is subject to litigation and judicial interpretation — an enhanced, and undesirable, agency cost to virtual investors.

A third concern results where conflicting legislative statements are brought into play within one virtual entity. For example, assume a Delaware limited partnership is formed for a virtual enterprise in order to gain the advantage of Delaware's managerial policy on freedom of contract as among general and limited partners.[107] If the limited partnership is created with a Delaware *corporate general partner*, Delaware case law suggests that the individual directors of the general partner will owe fiduciary-like duties to the limited partners under principles of trust law.[108] In this circumstance, if the *corporate charter* of the general partner attempts to absolve the directors from

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[103]DEL. CODE ANN. tit. 6, § 18-1101(c)(1) (1993 & Supp. 1996).

[104]DEL. CODE ANN. tit. 6, § 18-1101(c)(2) (1993 & Supp. 1996). For cases interpreting the analogous LP statute, see Cincinnati Bell Cellular Sys. Co. v. Ameritech Mobile Phone Serv. of Cincinnati, Inc., No. 13,389, 1996 WL 506906 (Del. Ch. Sept. 3, 1996), *reprinted in* 22 DEL. J. CORP. L. 688 (1997); *In re* Cencom Cable Income Partners, L.P. Litig., No. 14,634, 1996 WL 74726 (Del. Ch. Feb. 15, 1996); Davenport Group MG, L.P. v. Strategic Inv. Partners, Inc., 685 A.2d 715 (Del. Ch. 1996).

[105]*See generally* Stilson, *supra* note 17 (discussing various problematic issues with the organization of a virtual corporation).

[106]*Id.* at Part I.

[107]*See* DEL. CODE ANN. tit. 6, § 17-1101(c) (1993).

[108]*See, e.g., In re* USACafes L.P. Litig., 600 A.2d 43, 48 (Del. Ch. 1991) (applying trust law to directors of a corporate general partners); Wardell v. Railroad Co., 103 U.S. 651, 658 (1880) (comparing directors with trustees).

accountability for breaches of the duties of care and loyalty, the charter provision will be ineffective under section 102(b)(7) of the Delaware General Corporation Code (DGCL).[109] On the other hand, if the general and limited partners attempt to accomplish the same goal via a provision in the *limited partnership agreement*, it is uncertain whether the parties' stated expectation in a limited partnership contract can eliminate the liability of *corporate* directors of a general partner.[110] Simply stated, the question is whether fiduciary modification provisions of limited partnership or corporate law govern the applicable contract modifications to the corporate directors' liability.[111]

From the perspective of liability protections, the LLC and the LLP grant varying degrees of shelter from third-party contract and tort claims.[112] LLC and LLP statutes may not, however, affect the liability of the enterprise for its own obligations, shield the business from the claims of its creditors, or safeguard partners or members from their own actions, or acts of others under their supervision, during the viability of the firm or at dissolution.[113] In addition, present LLP legislation is not clear as to whether an innocent partner continues to be obligated to pay contribution to a partner who is found liable for wrongful conduct despite an LLP filing.[114]

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[109]*See* DEL. CODE ANN. tit. 8, § 102(b)(7) (1991 & Supp. 1996) (permitting the elimination of the duty of care but not the duty of loyalty in Delaware corporations).

[110]*See* UNIF. PARTNERSHIP ACT § 103(b)(4) (1994) (stating that the partnership may not "unreasonably reduce the duty of care").

[111]Of course, in Delaware one method to address this dilemma is to form a Delaware LLC as the general partner of the limited partnership, thus utilizing the analogous language of Delaware's LLC act to eliminate the LLC manager's monetary liability to the limited partners. *See* DEL. CODE ANN. tit. 6, § 18-303 (1993 & Supp. 1996) (limiting liability of members and managers of LLCs).

[112]*See, e.g.*, UNIF. LTD. LIAB. CO. ACT § 303(a) (1995) (stating the "the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the company"); UNIF. LTD. LIAB. PARTNERSHIP ACT § 306(c) (Supp. 1997) (stating that "[a]n obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership").

[113]*See supra* note 95.

[114]*See* Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065, 1067 (1995). For example, if a partnership filed for LLP status and thereafter partner A is found guilty of malpractice in the ordinary course of the partnership's business, plaintiff is entitled to seek remuneration from partnership assets as well as A's personal assets if partnership assets are insufficient to pay plaintiff's claim. If a contribution right remains after the LLP filing, then arguably A can demand contribution against her "innocent" partners for the amount paid by A in excess of her allotted share of liabilities. *See, e.g.*, UNIF. PARTNERSHIP ACT § 18(a) (1914) (stating that each partner shall share equally in profits after all liabilities, including those to partners, are satisfied and must

The most agile of the above business forms is the GP for three reasons. First, the GP requires no filing for its formation.[115] Second, the GP allows for contractual allocation of managerial powers.[116] Third, the GP may permit elimination or reduction of a partner's liability for a breach of fiduciary duty.[117] Unfortunately, the fatal flaw to the GP is the nature of partner liability to third parties.[118]

The fear of extensive personal liability by "innocent partners" for the misconduct of "guilty partners" may well be sufficient to defeat the market use of GPs as virtual enterprises. On the other hand, the so-called "limited liability" of the other business alternatives exists in form only and is subject to the well-recognized equitable principle that courts may "pierce" any entity's veil of limited liability where equity requires.[119] Yet, because American firms are apparently desirous of conducting business in the general partnership form if protections are accorded to innocent constituents, statutory reform in the area of virtual enterprises is mandated. Notably, as of the publication of this article, a dramatic transformation is occurring in the law of general partnerships — a transformation which may address significant concerns of adherents to the GP as a form of virtual enterprise. That change is the *limited liability* or *registered limited liability partnership* (LLP or RLLP).

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contribute toward the partnership losses). In this sense, the LLP filing would permit "indirect" liability by an innocent partner for the wrongful conduct of another partner. This seeming inequity is alleviated in ULLPA since the filing for LLP status under the uniform act would automatically negate contribution rights, whether preexisting by contract or statute, and would not allow reattachment of such rights absent reaffirmation of same by the partners post-LLP filing. *See* UNIF. LTD. LIAB. PARTNERSHIP ACT § 306(c) (Supp. 1997) (stating that a partner is not personally liable "by way of contribution or otherwise . . . notwithstanding anything inconsistent in the partnership agreement that existed immediately before the vote . . . to become a[n LLP]").

[115] *See, e.g.*, DEL. CODE ANN. tit. 6, §§ 1506-1507 (1993) (establishing guidelines for partnership formation).

[116] *See, e.g.*, DEL. CODE ANN. tit. 6, § 1518 (1993) (setting out the rights and duties of partners). The LLC would also permit contractual alignment of managerial powers. *See* UNIF. LTD. LIAB. CO. ACT § 112 (1995) (describing the nature of an LLC and its powers).

[117] As noted in *supra* Part IV.B, some state statutes allow investors to alter their fiduciary duties by contract.

[118] *See, e.g.*, DEL. CODE ANN. tit. 6, § 1515(a) (1993) (indicating that all partners have unlimited personal liability for partnership debts and obligations, whether incurred in the course of partnership business or after dissolution).

[119] Where a court pierces an entity's veil of limited liability, the firms' owners will be liable for the debts and obligations of the entity — liability not unlike that of general partners. *See, e.g.*, Nilsson v. Louisiana Hydrolec, 854 F.2d 1538, 1543 (9th Cir. 1988) (discussing the doctrine of alter ego); Walkovszky v. Carlton, 223 N.E.2d 6, 8 (N.Y. 1966) (stating that a principal is liable when the corporation is pierced). *But see* UNIF. LTD. LIAB. CO. ACT § 303(b) (1995) (setting forth an "anti-piercing" provision).

Although a seeming contradiction in terms, the LLP was first created in Texas in 1991 in order to provide a limitation on liability of a partner's personal assets in suits alleging negligence or malpractice by a partner over whom the "innocent" partner had no control.[120] In its original form, the Texas statute was a reaction to judgments against several law firms which arose after the collapse of the savings and loan and real estate market in Texas in the late 1980s.[121] In order to utilize the statute, however, Texas law partners must "register" a partnership as an LLP and post an insurance-like bond or create an escrow account of $100,000 to cover the types of errors, omissions, negligence, incompetence, or malfeasance of another partner or agent for which partner liability foreseeably would have resulted.[122]

Delaware responded with its version of an LLP in 1993.[123] The Delaware statute, like its Texas counterpart, created a limited shield of liability for "innocent" partners upon the registration of the partnership as an LLP and the posting of a bond or the creation of an escrow account in the amount of $1 million.[124]

Since the Delaware and Texas "first-generation" enactments, several states have adopted "third-generation"[125] LLP statutes which grant a full, corporate-like shield of liability for general partners.[126] As of August 1996, forty-eight jurisdictions have enacted some form of LLP

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[120]Hamilton, *supra* note 114, at 1066. *See* TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (West Supp. 1997).

[121]Hamilton, *supra* note 114, at 1069. *See, e.g.*, Remenchik v. Whittington, 757 S.W.2d 836 (Tex. App. 1988) (exemplifying a case where the court entered judgment against a law firm).

[122]TEX. REV. CIV. STAT. ANN. art. 6132b-3.08 (West Supp. 1997). The Texas statute did not relieve the partner from liability for the errors, omissions, negligence, incompetence, or malfeasance of agents working under the partner's supervision; for acts committed in a specific activity in which the partner was involved; or for acts of which the partner had notice or which the partner failed to take reasonable action to prevent or cure. *Id.*

[123]DEL. CODE ANN. tit. 6, § 1515 (1993) (amended 1994 & 1997).

[124]*Id.* Other jurisdictions which require some form of bond or insurance are: Alaska, California, District of Columbia, Florida, Hawaii, New Mexico, Oklahoma, Pennsylvania, South Carolina, Texas, Virginia, Washington, and West Virginia. HESTER, *supra* note 68, at 20-29.

[125]A so-called "second-generation" statute simply recognizes a foreign LLP which registers to do business in the foreign jurisdiction.

[126]*See, e.g.*, MINN. STAT. ANN. § 323-14, subd. 2 (West 1995) (stating, in part, that a "partner of a limited liability partnership is not, merely on account of this status, personally liable for anything chargeable to the partnership"). *See* Keatinge et al., *supra* note 68, at 147. Delaware has amended its LLP statute to provide a full shield of liability protection. S.B. 115, 139th Gen. Assembly (Del. 1997) (enacted).

legislation.[127] Several states, including Delaware,[128] have adopted a third-generation, full shield against partner liability.[129]

Because the substantive provisions of LLP statutes vary greatly from state to state, the National Conference of Commissioners on Uniform State Laws (NCCUSL)[130] drafted a Uniform Limited Liability Partnership Amendment to UPA 1994 (ULLPA) (1996) which was targeted for adoption by the states as of the fall of 1996. ULLPA presently reflects four policy issues. The first two issues address the scope of a partner's shield from third-party liability and the requirement of insurance for LLP status. At the publication of this article, ULLPA adopts a full, corporate-like shield of protection against partner accountability[131] and requires no insurance or escrow account for the liability limitation.

The third policy issue concerns the vote necessary to transform an existing GP into an LLP. Currently, ULLPA states that transformation occurs upon whatever vote is required by the partnership agreement for amendments or modifications to the partnership contract[132] and, in the absence of such a proviso, by the unanimous vote of the partners.[133]

The fourth policy issue involves the effect of an LLP filing upon existing conditions in a partnership agreement.[134] At present, ULLPA states that the filing to create an LLP overrides all contrary provisions in

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[127]The only states or territories that do not have LLP legislation as of July of 1996 are: Arkansas, Puerto Rico, Vermont, Wyoming, and the Virgin Islands. *See* HESTER, *supra* note 68, at 20-29.

[128]*See supra* note 126.

[129]Keatinge et al., *supra* note 68, at 178-79.

[130]Since 1989, Professor Stilson has served as one of Delaware's Commissioners to NCCUSL. Professor Stilson is also a member of the Uniform Limited Liability Partnership Act drafting committee and the partnership committee of the Delaware Bar Association.

[131]*See* UNIF. LTD. LIAB. PARTNERSHIP ACT § 306(c) (Supp. 1997). "A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner." *Id.*

[132]*Id.* § 1001(b). "The terms and conditions on which a partnership becomes a limited liability partnership must be approved by the vote necessary to amend the partnership agreement." *Id.*

[133]*Id.* § 401(j). "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." *Id.*

[134]*See generally* UNIF. LTD. LIAB. PARTNERSHIP ACT § 103 (Supp. 1997) (setting out the effect of provisions of LLP filing, including contribution rights among partners).

a partnership contract,[135] but that such contradictory provisions may be reinstated by reaffirmation of the partners post-LLP creation.[136]

Notwithstanding the flexibility of ULLPA, its disadvantages for virtual investors are several: (1) a filing requirement for formation,[137] (2) fiduciary obligations of partners (or the "virtual investors") *inter se*,[138] (3) only partial contractual flexibility among partners,[139] (4) the limited ability of partners to compete with one another or to participate in more than one partnership (or "virtual corporation"),[140] and (5) the existence of duties and liabilities for winding up a partnership upon dissolution.[141]

In sum, as of early 1997, the member-managed LLC and the evolving LLP provide somewhat agile business forms with limited liability — business forms which were not formerly available for use in spontaneous, on-line "partnering." Each of these forms, however, suffers some degree of inflexibility and judicial constraint regarding members' contractual rights and fiduciary obligations. Hence, the concerns of internal governance responsibilities and liability, competition among partners, and agility in promptly dissolving a transactional partnership are ripe for further statutory reform.

C. *Taxation of Unincorporated Domestic Virtual Enterprises*

One of the troubling questions for business practitioners has been the taxability of unincorporated domestic business entities.[142] For example, the law taxes a corporation on both its corporate income and its distributions of income to owners.[143] Partnerships, on the other hand,

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[135]*Id.* § 306(c) (stating that this section applies "notwithstanding anything inconsistent in the partnership agreement that existed immediately before the vote required to become a limited liability partnership under Section 1001(b)").

[136]*See id.* § 401(j) (indicating that unanimity is required for any act outside the ordinary course of business and an amendment to the partnership agreement).

[137]*See id.* § 1001(c) (stating that a LLP comes into existence by filing a statement of qualification).

[138]*See* UNIF. LTD. LIAB. PARTNERSHIP ACT § 404 (Supp. 1997) (suggesting the fiduciary duties partners owe the partnership and the other partners).

[139]*See id.* §§ 103, 404 (providing standards of conduct among partners).

[140]*See id.* § 103(b)(3) (stating that the partnership agreement may not eliminate the duty of loyalty but "all of the partners . . . may authorize . . . a specific act . . . that otherwise would violate the duty of loyalty").

[141]*See id.* §§ 802-804, 806 & 807 (setting out duties and procedures associated with the dissolution of a partnership).

[142]*See* Notice 95-14, 1995-14 C.B. 297 (noting that taxpayers "expend considerable resources in determining the proper classification of domestic unincorporated business organizations," some of which can be taxed as corporations).

[143]This is referred to as a "double" or "corporate" tax. *See* I.R.C. §§ 61, 63 (1995)

were granted pass-through tax treatment such that partnership income was declared solely on individual partner returns.[144] The taxation issue between the double corporate tax and the single partnership tax became complicated with the development of Master Limited Partnerships (MLPs) in the 1970s and 80s.[145]

These MLPs were formed as limited partnerships under state law.[146] Yet, unlike their more common intrastate counterparts, these limited partnerships conducted business nationally and traded their limited partnership interests on national exchanges or the over-the-counter market.[147] Because these interstate MLPs appeared to operate like corporations, the Internal Revenue Service (IRS) chose to tax *publicly-traded* limited partnerships as corporations.[148] Creative counsel thereafter sought to create national limited partnerships which could avoid the double corporate tax.[149]

(defining gross income and taxable income for both corporations and individuals). *See generally* Edward D. Biggers, *Federal Taxation — Publicly Traded Partnerships Deemed Corporations for Federal Taxation Purposes: New Internal Revenue Code Section 7704*, 19 ST. MARY'S L.J. 1158 (1988) (explaining the tax implications of doing business as a corporation or partnership).

[144] I.R.C. § 701 (1995).

[145] *See* Biggers, *supra* note 143, at 1159 (discussing the emergence of master limited partnerships).

[146] *Id.* *See, e.g.*, DEL. CODE ANN. tit. 6, § 17-201 (1993) (describing formation requirements for Delaware limited partnerships); TEX. REV. CIV. STAT. ANN. art. 6132a, § 3 (West 1987) (describing formation requirements for Texas limited partnerships).

[147] *See* Biggers, *supra* note 143, at 1159 (stating that master limited partnership units are traded like shares of stock on the open market); Patrick E. Hobbs, *Entity Classification: The One Hundred-Year Debate*, 44 CATH. U. L. REV. 437, 502 (1995) (stating that limited partnership interests of a master limited partnership are sometimes traded on established securities exchanges).

[148] *See* I.R.C. § 7704 (West 1996). Section 7704 provides in pertinent part:

> (a) General Rule. — For purposes of this title, except as provided in subsection (c), a publicly traded partnership shall be treated as a corporation.
> (b) Publicly traded partnership. — For purposes of this section, the term "publicly traded partnership" means any partnership if —
>> (1) interests in such partnership are traded on an established securities market, or
>> (2) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Id. § 7704(a)-(b). *But see* I.R.C. § 7704(c)(2) (West 1996) (stating that "[a] partnership meets the gross income requirements of this paragraph for any taxable year if 90 percent or more of the gross income of such partnership for such taxable year consists of qualifying income"); Hobbs, *supra* note 147, at 509-10 (noting that not all master limited partnerships were reclassified as corporations by § 7704).

[149] Hobbs, *supra* note 147, at 510.

At approximately the same time, Wyoming created the first LLC.[150] The ostensible purpose of the Wyoming LLC was to create an entity which could operate as a partnership, enjoy the limited liability of a corporation, but be taxed on a pass-through partnership basis.[151] Because subsequent LLC legislation was grossly nonuniform regarding the mandatory characteristics of LLCs, the IRS was unwilling to grant conduit taxation for all LLCs.[152] The debate over the "true" nature of unincorporated alternative entities for taxation purposes was thus born.

In the spring of 1995, the IRS sought public comment on a "check-the-box" entity classification for unincorporated entities.[153] In October of 1995, after debate and public hearing on the proposal, the IRS stated that the "check-the-box" regulation (Notice 95-14) would be published by year's end.[154]

The effect of the IRS regulation is that unincorporated entities may now *choose* to be taxed as either a partnership or a corporation.[155] Under a default rule, an unincorporated domestic entity that fails to make an election will be taxed as a partnership.[156] On the other hand, an unincorporated foreign entity that fails to make the election will be taxed as a corporation.[157]

Although the impact of the IRS regulation on virtual entities is unknown, the use of a traditional member-managed LLC or an LLP for an "agile" business will likely permit the tax option provided for in

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[150]*Id.* at 511. Wyoming Limited Liability Company Act, WYO. STAT. ANN. §§ 17-15-101 to -136 (Michie 1977).

[151]*See* Hobbs, *supra* note 147, at 511-16. For a discussion of the Wyoming statute, see generally Susan P. Hamill, *The Limited Liability Company: A Possible Choice for Doing Business?*, 41 FLA. L. REV. 721 (1989) (discussing the creation of the limited liability company).

[152]Rev. Rul. 88-76, 1988-2 C.B. 360, 361 (ruling that the limited liability company possesses some corporate characteristics such as limited liability and centralized management, but lacked continuity of life and free transferability). *See supra* note 148; *see generally* Hobbs, *supra* note 147 (discussing the tax definition of "corporation" and the resemblance test).

[153]For a summary of the Simplification of Entity Classification Rules, see Notice 95-14, 1995-14 C.B. 297. For an On-Line ABA Symposium on the Impact of the "Check-the-Box" or Entity Classification Rules, reply to LNET-LLC@usa.net. The On-line Symposium is sponsored by the ABA Real Property, Probate and Trust Law Section.

[154]Rob Marvin, *Release of Proposed Entity Classification Rules to be Further Delayed, Kugler Says*, 46 Daily Tax Rep. (BNA) d5 (Mar. 8, 1996), available in LEXIS, Fedtax Library, Bnadtr File IRA. Assistant Chief Counsel Paul Kugler stated on March 7, 1996, that the "check-the-box" proposal expected to be complete by March 30, 1996, was further delayed and would hopefully be issued the first half of the year. *Id.* "Check-the-box" is used to refer to the election system of taxation proposal. Notice 95-14, 1995-14 C.B. 297.

[155]Notice 95-14, 1995-14 C.B. 297, 297.

[156]*Id.* at 298.

[157]*Id.*

Notice 95-14. Consequently, some of the tax ambiguity in the use of alternate entities as virtual enterprises has been eliminated.

V. A STATUTORY PROPOSAL FOR THE VIRTUAL CORPORATION

A. *Source of Laws*

The beauty of the virtual corporation is its breadth of product, service, or information presentations without the attendant obstacles associated with large organizations. For example, the virtual corporation offers an alliance of world-class capabilities, with each constituent to the alliance concentrating on core competencies and introducing cross-fertilization of ideas, expertise and innovation in any number of virtual networks. This cross-fertilization enables the virtual corporation to produce a high quality product or service at the lowest market price.

Yet, to virtual investors, the practice of virtual networking necessarily employs mobile technology to free investors and their employees from the constraints of space and time. In short, the virtual corporation often increases revenues, raises productivity, and enhances a firm's ability to respond to consumer demands by deploying information technology to meet business requirements. As such, the virtual corporation often is formed on-line and without the "offices and walls" of a "traditional" business. As a result, the heart of the virtual corporation is not the physical aspects of a business but rather the people and technology which function within the objectives and goals of the virtual entity. From a statutory perspective, several issues are raised by the "wall-less" virtual corporation.

First is the *source of laws* which will license creation of virtual enterprises. For instance, if some, but not all, jurisdictions choose to statutorily recognize the virtual corporation yet at the same time create divergent standards for formation, internal governance, and liability protections, then the benefit of information technology and cross-fertilization of personnel and ideas via computer link-ups is lost. From this standpoint, therefore, any virtual corporate statute should be in the form of either uniform state legislation as drafted and approved by NCCUSL or federal legislation. The latter alternative is unattractive in light of the ingrained autonomy of the states in the arena of business organization regulation. The former option is, at present, not slated for action by the Executive Committee of NCCUSL. Consequently, as of early 1997, the most likely source of virtual corporation legislation is the various states with the consequent negative of nonuniform, agility-inhibiting statutory enactments.

B. *Definition*

The second statutory issue presented by the virtual corporation is that of a *definition* which, on the one hand, describes this diverse market entity yet, on the other, may limit its use to "nontraditional," transactional businesses. Such a definition must, therefore, be both sufficiently narrow to permit legitimate use of computer networking for market opportunism yet also be appropriately drafted to prohibit use by "traditional," "relational" businesses if desired.

One possible definition would focus on the "collaborative," on-line virtual enterprise which is to function for only short-term market dilemmas. Such a definition might be: "Virtual corporation" means an alliance of two or more functioning entities or persons to carry on a collaborative, definite-term business for profit which alliance will automatically terminate upon the realization, cessation or mootness of the business opportunity pursued.

An alternative definition might emphasize the virtual enterprise which is constructed by a fluctuating membership of small, singly noncompetitive organizations to operate or contract within a specified product, service, informational, or geographical area for the purpose of augmenting each affiliate's competitive base. In this sense, an alternative definition would permit a fluid, limited liability "joint venturing" of economically modest firms on-line (or with minimal contractual commitments) without the attendant requirement of operating within an exact term or market objective. Such a definition might be: "Virtual corporation" means an alliance of two or more entities or persons to carry on a collaborative business for profit in which income distributions are based upon actual work performed by constituent members of the alliance and not according to capital accounts or *pro rata* ownership interests. The purpose of the alternative definition is to permit development of long-term virtual enterprises which will not operate as traditional partnerships, LLCs, or corporations and in which participants are compensated solely on a labor-performed basis.[158]

C. *Formation*

The next issue involves a *formation* requirement for the virtual corporation. There are two options. First is a filing requirement without an accompanying insurance component. The second option would

[158]This suggested definition would not address the long-term virtual entity which wishes to convert to "traditional" status.

compel a filing as well as tangible evidence of financial security of the virtual entity.

Election one would track miscellaneous LLP, LP, LLLP, LLC, and corporate filing provisions.[159] Such a formation proviso would likely encompass the following statutory components: (1) a statement that the virtual corporation is a legal entity; (2) a statement of organization which provides for the delivery of a certificate of the virtual corporation to the office of the Secretary of State, a statement of an effective date [or a default date effective upon the filing of the certificate], and a statement that such filing is conclusive proof of the satisfaction of all conditions precedent to the formation of the virtual entity; (3) a provision setting forth the *de minimis* statutory conditions to be included in the certificate of organization including (a) the name of the virtual corporation; (b) the address of the corporation's principal office or, if no such office exists, the name and street address of any managing participant; (c) the name and street address of an agent for service of process within the state of formation who must be an individual resident of the State or any other person qualified to do business within the State;[160] (d) a statement that the entity elects to be a virtual corporation; and (e) a statement that the virtual corporation is for a specified term or, if not, for what purpose the virtual corporation is formed.

The second option would command some measure of insurance or escrow of funds for formation. Such a criterion would echo certain first-generation LLP statutes such as those in Texas and Delaware.[161] However, because a mandatory insurance standard could prove prohibitive to newly-formed or forming virtual alliances (and thus an impediment to agility), a virtual corporation statute could establish an intermediate approach to formation. That is, the statute could condition creation of the virtual entity upon evidence of economic stability as determined by an independent auditor or appraiser. The standard for review of appraiser-established insurance might be: (1) proof of actual fraud in the amount of insurance determined, and (2) evidence of the foreseeable costs and risks to be incurred by the virtual enterprise during its viability. Such an appraisal could include certified financial reports and fact-based projections which would be available for public review.

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[159]UNIF. LTD. LIAB. CO. ACT §§ 201-211 (1995); UNIF. LTD. LIAB. PARTNERSHIP ACT § 105 (Supp. 1997); UNIF. LTD. PARTNERSHIP ACT § 201 (1985); MODEL BUS. CORP. ACT § 1.20 (1984). *See also supra* note 93.

[160]Requirements (c) and (d) would be optional by the states.

[161]*See* DEL. CODE ANN. tit. 6, § 1546(a) (1993) (requiring limited liability partnerships to carry $1 million of liability insurance); TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (West Supp. 1997) (requiring $100,000, or $100,000 of designated and segregated funds).

The intermediate insurance standard, unlike current first-generation LLP statutes,[162] would accomplish a sliding scale of financial responsibility depending upon: (1) the nature of the virtual enterprise;[163] (2) whether the entity is for a fixed term or for an unspecified interval; (3) the risks inherent in achieving the market purpose of the enterprise; (4) the reasonably foreseeable hazards to potential contract and tort claimants who conduct business with the virtual enterprise; and (5) risk-sharing as contractually allocated among entity participants. In sum, an insurance requirement could reflect either a legislative monetary minimum or license a greater or lesser amount as dictated by the nature of the virtual enterprise and its market objective.

D. *Management*

A virtual corporation could be formed with either a centralized or decentralized managerial infrastructure. If *flexibility* in choice of administrative design is determinative, then a virtual enterprise statute could be based upon present LLC legislation which accords either a participant-managed or manager-managed enterprise.[164] The agility achieved by such discretion in managerial strategizing is obvious.

A possible disadvantage to an LLC-like management election is, however, reflected in the "wall-less" virtual entity which will not exist in physical form. In the circumstance of the on-line entity, decentralized management could prove problematic. Consider, for example, the prototypical virtual corporation which is formed as an alliance of several "noncompetitive" firms within a specific geographic region. If the benefit of the alliance is to gain market competitiveness by combining core competencies, personnel and information, then logically some "person" must select who among the virtual participants is best qualified to respond to a specific market opportunity. If the virtual corporation is organized with participant-management, then a conflict of interest arises each time an alliance member selects itself to execute an opportunity to the exclusion of another participant. If the virtual entity is unable to restrict or eliminate monetary liability for these potential self-dealing decisions, then the governance costs for the virtual enterprise become prohibitive.[165]

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[162] *See supra* note 161 for examples.

[163] Factors which should be considered include, e.g., large or small collaboration, existing or newly-formed participants, "wall-less" entity, or entities with a physical location.

[164] *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-215 (Supp. 1996).

[165] *See supra* Part IV.A.

Of course, with current computer capabilities, a virtual corporation could be established with a "desk-top" *computer manager.*[166] The advantage of such "virtual management" is its impartiality, its potential for "artificial learning," and its ability to "roam" into other computer databases to identify market openings.[167] Such synthetic management is, however, dependent upon current, "material" information to be supplied by alliance participants regarding their respective capacity, personnel, and best business practices.[168] If members of the virtual entity are reluctant to disclose these facts due to concerns over confidentiality or ownership rights to the information, then desk-top decision making is ineffective.

Centralized management is also mandated if participants to a virtual corporation are to be compensated on the basis of work actually performed (and not on the basis of a percentage of ownership or capital contribution) by a "subcontract unit" comprised of participants who are chosen by a "manager." In other words, if members to a virtual collaboration desire to ally themselves with other virtual entities with a minimal capital expenditure and to simultaneously achieve market competitiveness, limited liability and "profit-sharing" to the extent of the services performed by them, then a noninterested manager is necessary. In this circumstance, an impartial manager would likely minimize claims of self-dealing and would limit a nonperforming member's right to challenge either the selection of a performing constituent or a performing member's entitlement to compensation for completed projects.

In sum, if on-line virtual corporations and/or collaborative virtual "subcontract" units are practical reflections of current business conventions, then virtual corporation statutes should require centralized (possibly objective) management for "wall-less," computerized virtual entities.

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[166]The concept of "desk-top" management was first posited by William Adams at a July 1995 meeting of the Legal Group of the Agility Forum in Pittsburgh, Pennsylvania. Mr. Adams presented this thesis and the use of "artificial learning" in virtual enterprises, in his speech entitled, *A Case Study on Agility*, on July 20, 1995.

[167]In his *Case Study on Agility*, *supra* note 166, Mr. Adams suggested that present computer technology permits a computer to "roam" into other information databases for the purpose of seeking out specified market opportunities for a virtual corporation. Unlike other "roam" capabilities, however, Mr. Adams suggested that computers are presently able to "interface" with numerous information systems and "artificially learn" from the experience. The latter attribute — that of "artificial intelligence" — would allow a desk-top computer manager to search for unspecified, but related, market possibilities for a virtual enterprise. Desk-top management thus would greatly enhance the marketability and competitiveness of an on-line virtual corporation.

[168]*Id.*

E. *Fiduciary Duties of Members or Managers*

The fundamental issue of contractual freedom and fiduciary duties in virtual enterprises is simply stated: Virtual participants desire the flexibility to be allied, at any one time, with any number of divergent virtual corporations in order to broaden individual market competitiveness while simultaneously achieving the ability to eliminate the agency costs of conforming to traditional "duties of loyalty" to alliance members.

Presently, some alternative entity, and to a lesser extent corporate, legislation permits owners and managers to reduce or eliminate certain fiduciary duties via contract.[169] However, the current business practice of commingling business forms (and hence business organization legislation), as well as the reality of nonuniform state enactments for interstate or international virtual entities, impedes maximum use of such state statutes. As a result, to achieve the goal of technological agility in the twenty-first century, greater uniformity in contractual freedom is mandated.

One proposal would track UPA (1994) which clearly articulates the duties of owner/managers but which limits the parties' ability to eliminate same by agreement.[170] The advantage to UPA (1994) is its delineation of former common law obligations.[171] Its disadvantage is its restriction of contractual modification rights.[172]

An alternative to UPA (1994), or any existent state "freedom of contract" statute, would be a governance model based upon *mandatory disclosure and consent* by owners for any self-dealing conduct or failures to disclose material information. Such a "disclose and consent" managerial paradigm would serve multiple goals for a virtual corporation. For example, the suggested model permits the elimination of managerial accountability in the instance of required informational exchanges and assent by affected parties. Second, a disclosure and consent prototype encourages flexible and diverse management styles in an increasingly global, technological economy. Finally, the disclosure model encourages *ex ante* or simultaneous bargaining and curtails *ex post* judicial activism in governance and liability disputes if parties to a virtual enterprise delineate rules for "fairness" through an informed dialogue.

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[169] *See supra* Part IV.B.

[170] *See* UNIF. PARTNERSHIP ACT § 103 (1994) (stating nonwaivable provisions); *id.* § 404 (describing partners' duties of loyalty and care).

[171] *Id.* § 404.

[172] *Id.* § 103.

Such a model of disclosure and consent would further encourage pre-formation waivers of duties by operating agreements and would license post-creation waivers or ratification by affected parties as business projects arise. Under a disclose and consent paradigm, however, a default rule should be established for owners who fail to contract for, ratify or acquiesce in certain self-dealing conduct. Such a default rule should provide the parties with the fiduciary rights, obligations, and contractual independence that otherwise are available in alternative entity legislation in the state of formation.[173]

F. *Capital Structure*

A critical issue for virtual corporations is the capital composition of the entity. At present, corporate law regulates capital formation[174] and disbursements.[175] In contrast, unincorporated entities permit creation of unequal capital accounts and ownership distributions based upon contractual commitments.[176] These alternative capitalization rules are available for virtual enterprises. However, it is suggested that neither the corporate nor the alternative entity capital policies addresses the required financial flexibility of the seamless, on-line enterprise.

For example, if a virtual corporation is formed similarly to the prototypical entity set forth at Part III, then both the *pro rata* (corporate) and capital account (partnership) economic procedures reward nonperforming alliance participants to the detriment of those providing services. Consequently, an intermediate, functional approach is dictated.

Such an approach would encourage participating members to devise, by agreement, the requisite condition(s) to initial capitalization as well as each participant's rights to distributions and obligations for losses.

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[173]*See supra* Part IV.A.

[174]*See, e.g.*, DEL. CODE ANN. tit. 8, § 152 (1991) (involving the issuance of stock, lawful consideration and fully paid stock); *id.* § 153 (addressing eligible consideration for Delaware stock); *id.* § 154 (stating the rules for determining amounts of capital, surplus, and net assets); *id.* § 162 (stating the liability of shareholders for stock not fully paid); *id.* § 164 (providing remedies for a shareholder's failure to pay for stock).

[175]*See, e.g.*, DEL. CODE ANN. tit. 8, § 172 (1991) (providing for liability of directors and committee members as to dividends or stock redemptions); *id.* § 173 (regulating the declaration and payment of dividends); *id.* § 174 (setting forth the liability of directors for unlawful payment of dividends or unlawful stock purchases or redemptions).

[176]*See* UNIF. LTD. LIAB. PARTNERSHIP ACT § 103 (1994) (defining scope and effect of partnership agreement); UNIF. LTD. PARTNERSHIP ACT §§ 404, 503 (allowing distribution of profits and losses as well as initial contributions by partners to be determined by partnership agreement); UNIF. PARTNERSHIP ACT § 103 (1994) (allowing contract agreements except for specifically restricted subjects).

A functional membership agreement as is anticipated by this intermediate capitalization technique should be based upon the nature, scope, and inherent risks of the virtual enterprise.[177] In this manner, the capital structure of the virtual entity would not be determined by statute, but instead be devised solely in contract, and thus subject only to contractual defenses. The taxability of the enterprise would be controlled by Notice 95-14 where applicable.[178]

If, on the other hand, a virtual corporate statute were to license use by "traditional," "relational" businesses, then an election as among the corporate, partnership and contractual capital structures should be permitted. Under this optional economic model, a default rule should be devised for those enterprises which do not clearly articulate the bases for capital calls, mandatory or discretionary distributions, or a participant's responsibility for contribution towards business losses.

G. *Liability*

Of evident import to virtual investors is the issue of accountability to third parties for losses of the enterprise. On this question, two choices are available. First is the full, corporate shield from liability.[179] The second employs the position of first-generation LLP statutes which accord limited liability to "innocent" partners for the malfeasance of their co-partners.[180]

It is apparent that the existing trend in business legislation enhances owner and managerial security against third-party claims.[181] Such a trend is also justifiable for the virtual corporation so long as sufficient market

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[177]*See supra* note 163 and accompanying text (describing factors to be considered for insurance considerations).

[178]*See generally* Notice 95-14, 1995-14 C.B. 297 (describing the "check-the-box" proposal).

[179]*See, e.g.*, DEL. CODE ANN. tit. 8, § 325(b) (1991) (noting that officers, directors, or stockholders may not be held personally liable unless judgment against the corporation has been secured and returned unsatisfied).

[180]*See, e.g.*, TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (West Supp. 1997) (stating that a partner in a limited liability partnership is not individually liable for obligations resulting from "errors, omissions, negligence, incompetence, or malfeasance" by another partner).

A third choice of unlimited liability appears unjustified from industry experience. However, virtual investors certainly would be free to contract for greater liability than statutorily required if the market objective demanded.

[181]*See* UNIF. LTD. LIAB. CO. ACT § 303(a) (1995) (stating that members and managers are not personally liable for debts of the limited liability company); UNIF. LTD. LIAB. PARTNERSHIP ACT § 306(c) (Supp. 1997) (noting that a partner is not liable for obligations of the partnership); UNIF. LTD. PARTNERSHIP ACT § 303 (1985) (noting that a limited partner is not liable to third parties unless acting like a general partner).

protections are accorded to customers of the entity. For example, one obstacle to maximizing agility for on-line enterprises is the inability of virtual participants to dissolve the business and its immediate and long-term liabilities once a market objective is achieved or rendered moot. Under present statutory schemes, dissolution of an entity is accompanied by an indefinite winding-up interval in which the participants remain accountable for business conduct.[182] In addition, business owners and managers may well be responsible for injuries post-dissolution if the former business manufactured a product with latent defects.[183]

One suggestion for statutory reform in the area of accountability post-dissolution is a scheme which offers one of two options for investors and managers. The first option would track certain existing state legislation which requires notice of dissolution to known claimants and a statutory limitations period in which injured parties must present their claims.[184] This type of statute might also require the appointment of a guardian *ad litem* for the representation of unknown, but foreseeable, claimants who predictably will be injured as a result of defectively-produced goods.

The disadvantages of a "notice" procedure are several, including: (1) uncertainty in the notice process,[185] (2) the lack of statutory guidance on the continued applicability of equitable doctrines to impose liability on owners and/or managers notwithstanding statutory dissolution, and (3) the administrative expense of *ex post* judicial concurrence in managerial decisions pertaining to dissolution rights of known and unknown claimants.

An alternative to a "notice" statute would permit immediate dissolution of the virtual corporation, including termination of liability for

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[182]*See* Ann E.C. Stilson, *Reexamining the Fiduciary Paradigm at Corporate Insolvency and Dissolution: Defining Directors' Duties to Creditors*, 20 DEL. J. CORP. L. 1 (1995) (discussing directorial duties during corporate dissolution). *See generally* UNIF. LTD. LIAB. CO. ACT §§ 801-809 (1995) (describing dissolution of entities and responsibilities of partners during winding-up process); UNIF. LTD. LIAB. PARTNERSHIP ACT §§ 802-807 (1991); UNIF. LTD. PARTNERSHIP ACT §§ 801-804 (1976); UNIF. PARTNERSHIP ACT §§ 601-807 (1994).

[183]*See* Stilson, *supra* note 182.

[184]*See, e.g.*, DEL. CODE ANN. tit. 8, §§ 280-282 (1991 & Supp. 1996) (noting procedures for claims following dissolution of a corporation).

[185]For example, uncertainty could be created regarding to whom notice must be given; for what interval notice is required; whether the business may pay operating expenses during the notice period if such expenses will reduce amounts available for payment to the beneficiaries of post-dissolution notice; once notice is given, what weight is accorded to the amounts demanded by the claimant; whether funds must be frozen to cover alleged claims before the business is "terminated"; whether litigation must occur to permit the business and any attendant liability to owners and managers to cease.

all known and unknown post-dissolution injuries, upon the payment by the business of a bond (or escrow of funds) for the projected amount of injuries to occur for a statutory period after dissolution. The amount of insurance would be determined by an independent actuarial analysis. Such an analysis would be paid for by the virtual enterprise and would contemplate the adverse interests of the business, existing trade creditors, employees, known tort and contract claimants, and unknown, but foreseeable, plaintiffs. Certainly any "insurance" requirement to dissolution impedes the agility of virtual participants to migrate fluidly among several virtual networks at one time. However, due to the seamless, faceless nature of the developing "computer corporation," an insurance requirement is reasonable.

VI. CONCLUSION

The wall-less, faceless, assetless virtual corporation presently exists in the U.S. marketplace.[186] Whether it should exist, should be granted specific legal recognition, or should be defined, quantified, regulated, and facilitated within existing business organization or tort law are unanswered questions. What seems apparent, however, is that under current business organization law, such an entity must be organized under and regulated by state statutes which impose "traditional" governance duties and liabilities upon owners and managers. Such state regulation impedes optimalization of information and technological resources and inhibits a firm's ability to act "agilely" within an increasingly global economy.

If market flexibility, competitiveness, and agility are desirable objectives for U.S. firms in the twenty-first century and if a satisfactory resolution is achieved for the underlying policy issues, the American legal system must grant legal recognition to, and accord protections for, the "virtual corporation." Such legal accommodation must evolve in light of persistent progress in telecommunications technology as well as the reality of "faceless" interstate (and international) transactional ventures. In short, any virtual enterprise legislation must: (1) balance the fluctuating requirements of the investors to a computer-driven marketplace with the equitable necessity of affording security for consumers of the "virtual products" created by these informational networks, and (2) provide a scheme of uniform supervision of "nontraditional," computer-founded enterprises.

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[186]*See, e.g.*, Bowers, *supra* note 24; Heikens, *supra* note 24.