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A Selective Overview of Agency, Good Faith and Delaware Entity Law

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A SELECTIVE OVERVIEW OF AGENCY, GOOD FAITH AND DELAWARE ENTITY LAW

Thomas Earl Geu*

Friendly symbionts are everywhere. Your body is composed of perhaps a hundred trillion cells, and nine out of ten of them are not human cells! Most of these microscopic guests are either harmless or helpful.... Many of them, indeed, are valuable helpers that we inherit from our mothers and would be quite defenseless without.

* * *

[T]oxoplasma gondii ... can live in many mammals but needs to get into a cat's stomach to reproduce ... [i] when it infects rats, it has the useful property of interfering with their nervous systems ... making them hyperactive and relatively fearless — and hence much more likely to be eaten by any cats in the vicinity!

DANIEL C. DENNETT, BREAKING THE SPELL:
RELIGION AS A NATURAL PHENOMENON 86 (2006).

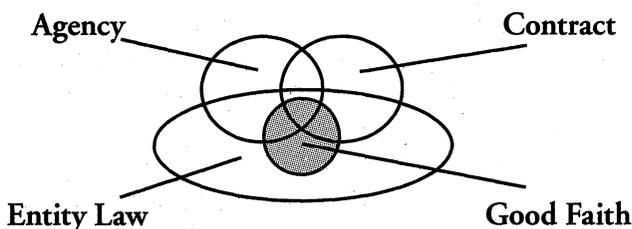
Introduction

Like the organisms that Daniel C. Dennett describes, which live in host bodies but are not human cells, agency law has an inherent connection to entity law, even though it is contained in a body of law separate from entity law. Depending on the context and how it is used, agency law can be a helpful symbiont or a detrimental parasite in the host entity ecosystem.

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The law of agency is firmly rooted in, and largely remains a creature of, the common law. Only seven states have codified their general law of agency.¹ Although agency law is a distinct body of law, it interacts with the law of entities in three general ways. First, agency is a self-executing and free-standing body of law, and its principles therefore apply whenever an agency relationship exists within an entity framework. An individual acting as a corporate officer, for example, meets the definition of an agent and is therefore subject to agency law principles unless the governing corporate law supersedes those principles. Second, agency law can be incorporated into entity statutes by explicit statutory reference. Third, in the absence of a specific statutory reference, agency law can be used as an interpretive aid to give meaning to statutory provisions that either establish relationships that meet the standards creating agency status or govern behavior that falls within the law of agency.²

One of the roles of agency law is to provide content for the concept of good faith. The concept of good faith exists independently in other legal contexts, such as in the contractual duty of good faith and fair dealing and in the form of the fiduciary duty of loyalty, which typically includes a duty of good faith. In the realm of entity law, these three sources combine to give context-dependent meaning to the concept of good faith. The relationship of agency law to these combinations can be illustrated as follows:



1. The seven states are Alabama, California, Georgia, Louisiana, Montana, North Dakota, and South Dakota. See RESTATEMENT (THIRD) OF AGENCY, *Introduction*.

2. The introduction to RESTATEMENT (THIRD) OF AGENCY, identifies five relationships between the common law of agency and statutory or regulatory law: (1) the seven codified laws of agency; (2) the incorporation of agency doctrines by courts “often ... because a statute or administrative regulation uses common-law terminology but provides no independent definition in the statute or regulation itself”; (3) the incorporation of agency law by a court “in its construction of a statute but [which] modifies or varies the doctrine in light of the court’s understanding of the statute’s purpose or broader policy context”; (4) instances where “a statute explicitly modifies an otherwise-controlling common-law doctrine to achieve a specific result”; and (5) statutes that “modify the incidents of some agency relationships, particularly incidents of ‘master-servant’ relationships.”

The illustration is all the more complex because entity law itself is the product of a combination of sources. Two of the most significant determinants are choice of entity (*e.g., inter alia*, partnership or corporation) and choice of jurisdiction (with Delaware as a leading candidate). Within each entity there are multiple roles to which agency law might apply. Examples of such roles include partner, member, manager, officer, employee, or third party agent. Further, agency law can apply to the entity itself when the entity acts as an agent or, for purposes of corporate groups, to assert liability against the parent.

The purpose of this article is to illustrate that agency law interacts with entity law with particular focus on agency law's notions of "good faith." While it does not attempt a full-scale normative assessment of what role agency law should play in any given entity or situation, it shows that agency law is, and must be, part of the legal calculus of entity law.

Part I of this article addresses the distinction between agency relationships and other types of fiduciary relationships. Therein, it discusses a recent decision by the Court of Chancery of the State of Delaware (the "Court of Chancery"), subsequently affirmed by the Supreme Court of the State of Delaware (the "Supreme Court"), which illustrates the fine distinctions that must be made when considering the two overlapping types of relationships. Part I of the article illustrates agency law operating as free-standing legal doctrine.

Part II discusses how agency law may be incorporated by reference into an entity statute. The entity statutes that typically include agency law by specific reference are those governing general partnerships, limited partnerships, and limited liability companies. This part of the article provides a non-comprehensive overview of how these statutes use agency law. It also discusses how agency law is used as a supplemental source of authority to fill gaps in entity law. The article discusses examples of the use of agency law across different types of entities.

Part III suggests that the meaning and application of "good faith" depends, in part, upon the root law from which it is derived and introduces the more nuanced meaning of "good faith" depending upon the context in which it is used.

The article concludes with summary comments in Part IV.

I. Free-Standing Agency Law

While the law of agency and the law of entities are separate and distinct, they frequently touch and overlap; perhaps nowhere more so than in the area of fiduciary relationships. Even here, however, the two subjects are distinct. Thus, while all agents are probably fiduciaries, not all fiduciaries are agents.

The *Restatement (Third) of Agency*, section 1.01, defines agency as: “[T]he fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.” The relationship is a *legal concept* and, like the determination of the existence of a general partnership, is one of “status” rather than of pure contract.³ The finding of an agency relationship, however, “depends on the presence of factual elements” and “[i]t is ... a question usually reserved to the factfinder.”⁴

Under free-standing agency law, therefore, how the parties label a relationship does not control whether agency law applies. The existence of an agency relationship instead is determined by parsing the elements of agency: (1) a consensual relationship; (2) where one person is a representative of another; (3) the representative has the “power to affect the legal rights and duties of the other person”; and (4) the “person represented has a right to control the actions of the agent.”⁵

Even though the word “fiduciary” appears in the definitions of agency found in both *Restatement (Second)* and *Restatement (Third)*, it is not itself an element of agency. Fiduciary status is rather a result of agency. Indeed *Restatement (Third)* includes a comment “to emphasize that an agency relationship creates the agent’s fiduciary obligation

3. See RESTATEMENT (THIRD) OF AGENCY § 1.02 cmt. a. The RESTATEMENT (SECOND) OF AGENCY established the same principle: “To constitute the relation, there must be an agreement but not necessarily a contract, between the parties... .” RESTATEMENT (SECOND) OF AGENCY § 1 cmt. b. Partnership is another example of a status relationship, and Delaware’s general partnership law provides an example of how that status relationship is defined:

[T]he association of two or more persons (i) to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership, and (ii) to carry on any purpose or activity not for profit, forms a partnership when the persons intend to form a partnership.

DEL. CODE ANN. tit. 6, §15-202. See also Revised Uniform Partnership Act (“RUPA”) § 202. Consistent with the status-based approach to partnership, the Delaware Court of Chancery has held that a partnership existed when the parties intended to form an LLC but failed to do so. *Ramone v. Lang*, C.A. No. 1592, 2006 WL 905347 (Del. Ch. Apr. 3, 2006) (*citing* *Acierno v. Branmar*, 1976 WL 3 (Del. Ch. Feb. 19, 1976)). The parties’ status was sufficient to create the legal relationship even though it was unintended.

4. *Lang v. Morant*, 867 A.2d 182, 186 (Del. 2005) (citations omitted).

5. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. c.

as a matter of law” once the relationship is determined to exist.⁶ The scope of the agent’s authority defines the scope of the duties between agent and principal.⁷

A Delaware case helps illuminate when an agency relationship exists and why such a determination matters. Additionally, it illustrates that agency law is not the exclusive means by which one person may become a fiduciary for another.

The case *Wal-Mart Stores, Inc. v. AIG Life Insurance Co.*,⁸ addressed the broad issue of whether insurance brokers acted as fiduciaries when selling a corporation a corporate owned life insurance policy (“COLI”). Various brokers sold Wal-Mart COLI policies on its employees. After Wal-Mart purchased the policies, the IRS asserted that the policies lacked economic substance and were an illegal tax shelter. Ultimately Wal-Mart settled with the IRS and sued the brokers on several theories including breach of fiduciary duty.

The Supreme Court affirmed the Court of Chancery’s rejection of the fiduciary causes of action as a matter of law, finding that Wal-Mart had not pled the existence of a relationship that would give rise to fiduciary duties.

‘The court is mindful of the fact that normal business dealings (such as that of an insurance broker and its client) can sometimes take on certain aspects of a fiduciary relationship, as, for example, where the broker agrees to act as agent for the customer with the power to bind the customer contractually. At the same time, however, ... it is vitally important that the exacting standards of fiduciary duties not be extended to quotidian commercial relationships.’⁹

The court affirmed the finding that, on the facts as pled, no fiduciary relationship existed because there was no alignment of interest between the parties: ‘Wal-Mart was trying to avoid paying the taxes it owed, while the broker-defendants were trying to make money by brokering the sale of the COLI policies to Wal-Mart to service those contracts.’¹⁰

6. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. e.

7. *Id.*

8. *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 901 A.2d 106 (Del. 2006).

9. *Id.* at 114 (citing *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 872 A.2d 611, 627 (Del. Ch. 2005)).

10. *Id.*

Care must be taken in analyzing this opinion. A superficial reading of the opinion which includes the phrase “broker agree[ing] to act as agent,” might suggest that agreement, not status, is the basis of agency and that not all agents are fiduciaries. The phrase, however, appears within a broader discussion of fiduciary duties that goes beyond the traditional duties of good faith that apply to an agent. The Delaware Supreme Court’s opinion clarifies this point by quoting with approval the following statement from the Court of Chancery: ““Fiduciary relationships have often been described as “special relationships,” for good reason. Generally, “[a] fiduciary relationship is a situation where one person reposes special trust in another or where a special duty exists on the part of one person to protect the interests of another.””¹¹ This language demonstrates that the Delaware courts were not focusing narrowly on an agency relationship, but, rather, were speaking broadly about other sources of fiduciary duty law such as trust law, tort law, or entity law.¹² This analysis is consistent with the balance of the opinion and avoids confusing the elements generally used to establish an *agency* relationship (including “consent”) with other relationships that give rise to fiduciary status. This interpretation is bolstered by the conclusion of the Court of Chancery: “In the end, Wal-Mart cannot show the existence of a fiduciary relationship by alleging simply that it relied on or ‘trusted in’ the assurances and expertise of the broker-defendants.”¹³ The court further pointed out that Wal-Mart also had not adequately alleged the existence of any “other” source of a potential fiduciary relationship: “Second, Wal-Mart does not allege any facts from which the court could reasonably infer that the broker-defendants exerted control or dominion over Wal-Mart. Wal-Mart does not allege that it was coerced by the broker-defendants to purchase the COLI policies.”¹⁴ From the perspective of agency law, this statement would be best interpreted as referring to the *power* of the putative agent to bind the principal as opposed to a comment about the power of the principal to control the agent, and the

11. *Id.* at 113 (quoting *Wal-Mart Stores*, 872 A.2d at 624 (brackets in original, citations omitted)).

12. See, e.g., RESTATEMENT (SECOND) OF TORTS § 874 (1979); cf. RESTATEMENT (THIRD) OF AGENCY, *Introduction, Reporter’s Notes*. Professor DeMott, Reporter, RESTATEMENT (THIRD) OF AGENCY, has recently commented on fiduciary duty torts. See Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, Research Paper No. 113 (Aug. 2006), Duke Law School Legal Studies Research Paper Series, available at <http://ssrn.com/abstract=924776>, (last visited Sept. 10, 2006).

13. *Wal-Mart Stores, Inc v. AIG Life Ins. Co.*, 872 A.2d 611, 628 (Del Ch. 2005).

14. *Id.* at 627-28.

quote also supports that “special relationships” outside agency may give rise to fiduciary duties. Indeed, the Court of Chancery concluded that there was no agency relationship between Wal-Mart and the brokers because “broker-defendants acted only as advisors to Wal-Mart; they had no power to purchase COLI policies on Wal-Mart’s behalf.”¹⁵ Later, the court noted, “[a]gain, Wal-Mart does not allege that broker-defendants could do anything except *advise* Wal-Mart on the purchase of the COLI policies.”¹⁶ These statements are consistent with *Restatement (Third) of Agency* which says: “[I]f a service provider simply furnishes advice and does not interact with third parties as the representative of the recipient of advice, the service provider is not acting as an agent.”¹⁷

The distinctions in this area of the law, however, are quite fine and not completely without conflict. For example, *Restatement (Third) of Agency* urges caution in applying the general rule that an agent must have authority to act on behalf of a principal with third parties. The comments acknowledge “[i]t has been said” that the agency relationship “contemplates” that an agency relationship requires the agent to “deal” with a third party. Nonetheless, the comment suggests that “deal” be construed broadly to include, for example, “an agent who acquires information from third parties on the principal’s behalf” even, apparently, where the agent does not have the authority to contract on behalf of the principal.¹⁸ The comment to section 1.01 continues by observing that the common law of agency, “encompasses the employment relation, even as to employees whom the employer has not designated to contract on its behalf or otherwise to interact with third parties external to the employer’s organization.”¹⁹ The scope of authority, however, would establish the activities of the agent to which duties are owed the principal.

The *Restatement (Second)* is similar to the *Restatement (Third)*.²⁰ For example, the comment to *Restatement (Second)* section 14 emphasizes that, in relationships where the existence of agency is *otherwise clear*, a contract in which the principal agrees *not* to exercise control (thereby giving the agent discretion) does not destroy the principal’s

15. *Id.* at 628 (citations omitted).

16. *Id.* at 627-28.

17. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. c.

18. *Id.*

19. *Id.* See also RESTATEMENT (THIRD) OF AGENCY, *Introduction*, “Inclusions and Exclusions” (2006).

20. See, e.g., RESTATEMENT (SECOND) OF AGENCY § 14 (and comments).

power to control the agent. Thus, in those circumstances, the agency does not fail for the absence of control. Conversely, in circumstances where the agency is *unclear*, such an agreement might lead to a determination that there is no agency because of the absence of the principal's power to control.²¹

Wal-Mart v. AIG illustrates, generally, how agency doctrine may apply to entity relationships as an independent source of law where one entity asserts that another entity is acting as its agent. Additionally, it emphasizes the importance of carefully parsing opinions that analyze more than one possible source of fiduciary duty. *Wal-Mart* analyzed both agency and special relationships as sources of such duties. Therefore, the case stands for the syllogism that, while as a matter of definition all agents are fiduciaries,²² all fiduciaries are not agents.²³ In addition, the case also stands for the proposition that typically an

21. RESTATEMENT (SECOND) OF AGENCY § 14 cmt. b. See also note 4, *supra*, and accompanying text. Cf. RESTATEMENT (THIRD) OF AGENCY § 8.06. *Restatement (Third)* collapses and reformats several sections of *Restatement (Second)*. Nonetheless *Restatement (Second)* remains instructive because it separately identifies and discusses a greater number of common relationships as a matter of blackletter text. See RESTATEMENT (SECOND) OF AGENCY §§ 14A-14O. For example, section 14H is captioned "Agents or Holders of a Power Given for Their Benefit," and it provides that under prescribed circumstances, the holder of the power is not an agent.

22. *Contra Prestancia Management Group Inc. v. Virginia Heritage Foundation, II LLC*, C.A. No. 1032, 2005 WL 1364616 (Del. Ch. May 27, 2005). The *Prestancia* opinion states in *dicta*: "The existence of a principal/agent relationship does not, in and of itself, give rise to a fiduciary relationship. A fiduciary relationship will arise when there is an element of confidentiality or a joint undertaking between the principal and agent." *Id.* at *6. The quoted portion of the opinion appears in a general discussion of whether a fiduciary relationship existed between the parties for purposes of equity jurisdiction in order to receive a constructive trust remedy. It arose from a real estate investment where plaintiff alleged it was "induced by knowingly false misrepresentations to invest in the project." *Id.* at *1. The court determined that it lacked equitable jurisdiction because: "The relationship . . . was a bargained-for commercial relationship between sophisticated parties, a relationship that does not give rise to fiduciary duties." *Id.* at *6. See also *Metro Ambulance, Inc. v. Eastern Medical Billing, Inc.*, C.A. 13929, 1995 WL 409015, *2-3 (Del. Ch. July 5, 1995) ("This is a straightforward commercial transaction with both parties fulfilling their obligations under the contract . . . I will not artificially manipulate the parties' commercial relationship to create fiduciary duties where none exist.").

In other cases where agency is established, the fiduciary duty of agents is acknowledged. See *Lazard Debt Recovery GP, LLC v. Weinstock*, 864 A.2d 955, 966 (Del. Ch. 2004) ("[A]n agent's fiduciary duty is limited by the scope of the agency. . .").

23. A more direct statement for this proposition is contained in *William M. Young Co. v. Bacon*, C.A. No. 89L-JA2, 1991 WL 89817, *5 (Del. Super. May 1, 1991) ("A fiduciary may or may not be an agent."). For a case discussing whether a fiduciary (a lawyer) is an agent for purposes of indemnification under Delaware corporate law see *Fasciana v. Electronic Data Systems*, 829 A.2d 160, 168-73 (Del. Ch. 2003).

agent will have the power to affect the legal rights and duties of the principal. Finally, it illustrates the caution with which courts approach expanding fiduciary duties to what are deemed purely *commercial* transactions.²⁴

II. Agency Law And Entity Statutes

In addition to operating as a free-standing body of law, agency law can be incorporated into entity law through its interaction with entity statutes.²⁵ The statutes governing partnerships, corporations, and limited liability companies each illustrate different means by which agency law interacts with entity law and different degrees of the relationship.

A. Agency Law and General Partnerships

Agency and partnership are closely related. Agency doctrine intersects with partnership law both as a matter of common law doctrine and as a matter referenced by statutory partnership law.

As a matter of common law, an inherent relationship exists between agency and partnership. A comment to the definition of agency in the *Restatement (Third)* states that the elements of the common law of agency are present in the relationship between a partnership and a general partner.²⁶ This is a significant improvement on *Restatement (Second)*, which contained a specific section concerning “agent and partner,”²⁷ but which

24. See generally note 23, *supra*. It may also indicate that agency is highly context dependent. For interesting theoretical discussions of agency and contractual good faith, respectively, see Ramon Casadesus-Masanell and Daniel F. Spulber, *Trust and Incentives in Agency*, 15 S. Cal. Interdisc. L.J. 45 (2005); Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 Cal. L. Rev. 1743 (2000) (including a discussion of good faith in negotiating contracts).

25. See *Rudnitsky v. Rudnitsky*, C.A. No. 17446, 2000 WL 1724234, *5 (Del. Ch. Sept. 15, 2000) (“In the general partnership context, the common law doctrine of apparent agency has been codified in the Delaware Uniform Partnership Act (“DRUPA”).”).

26. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. (c).

27. RESTATEMENT (SECOND) OF AGENCY § 14A, cmt. a, stated in part:

The law of partnership has been largely codified and the statement above is a quotation from the Uniform Partnership Act, Section 6(1). *The rules concerning the creation of a partnership and the rights of individual partners and of creditors upon the dissolution of the partnership are matters not dependent upon agency principles. However, the rights and liabilities of partners with respect to each other*

unhelpfully did nothing more than repeat the relevant part of the definition of partnership from section 6(1) of the Uniform Partnership Act ("UPA") (1914). The most relevant section of UPA (1914) for purposes of agency, however, was not section 6(1), but rather section 9(1), which stated: "Every partner is an agent of the partnership for purposes of its business... ."

It was left to a comment in *Restatement (Second)* to clarify matters. Comment a to the partnership section in *Restatement (Second)*, even though couched in general terms,²⁸ distinguished between the concurrent roles of a partner, *inter se*, as a member of the partnership for matters of internal governance and as a representative of the partnership when dealing with third parties. Much of the comment addressed the outside representation role and stated that when the partner functioned in this role she was an agent "for the other members of the group." As a result, under *Restatement (Second)*, general agency principles govern such topics as authority and liability both to third parties and "the group."

The comment to *Restatement (Second)* further stated that when the partner "is in active management of the business or is otherwise regularly employed in the business, he is a servant of the partnership."²⁹ The significance of this statement is that it recognizes the partner may be a part of "the group" for some purposes and a true servant "of the group" for other purposes. That is, "the group" may control even the physical conduct of the performance of service in a manner that subjects "the group" to vicarious tort liability under agency law theory.³⁰ Of course, the comment to section 14A of *Restatement (Second)* recognized that the liability of a partner not acting as an agent with a third party, is "li-

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and to third persons are largely determined by agency principles. Thus, if, as is usual, a partner is a general agent for the other members of the group, rules with reference to his liability and to the liability of the others because of his conduct both to third persons and to the others, are determined by the rules stated herein. *Thus, a partner who acts as an agent for the group is personally liable to third persons if he fails to bind the partnership to a contract which he purports to make for them, and he is liable to his partners for any breach of fiduciary obligation, for negligence or for other violations of the terms of the partnership.* Likewise, the members of the partnership are liable as principals both in contract and in tort for the acts of a partner which are authorized and those which bind them because the act is within the agency power of the partner.

When one of the partners is in active management of the business or is otherwise regularly employed in the business, he is a servant of the partnership.

(Emphasis added).

28. *Id.* at cmt. a.

29. *Id.*

30. *Id.* § 2.

able as [a] principal both in contract and in tort....”³¹ The “servant/employee” definition might also bear on whether the partner is an employee for purposes of other law. The term “servant” is not used by *Restatement (Third)*. It substitutes the term “employee” for the term “servant.”³²

In addition to the connection between the common law of agency and partnership concerning liability, partnership statutes expressly address a partner’s *status* as agent. For example section 301(1) of UPA (1997) (hereinafter “RUPA”) states, as a default matter: “Each partner is an agent of the partnership for the purpose of its business.”³³ Section 301(1) adds: “[a]n act of a partner ... for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership...” Section 301(2) addresses acts of partners which are “not apparently for carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership,”³⁴ and those acts not in the ordinary course of business bind the partnership only if the act was authorized by the other partners. RUPA Section 301, therefore, addresses authority issues that are addressed by the common law of agency and by the Restatements, creating duplicative, and largely consistent, principles.³⁵

The way RUPA is organized underscores the bifurcation of the inside and outside roles of partners. Section 301 of RUPA appears in Article Three, entitled “Relations of Partners to Persons Dealing With Partnership.” Provisions about other rights and duties of partners are placed in Article Four, entitled “Relations of Partners To Each Other and To the Partnership.”³⁶ This structure clearly separates outside authority and inside governance rights. Thus, for example, default provisions on voting and the admission of partners are contained in Article Four,³⁷ as are “Partner’s Rights and Duties With Respect

31. *Id.* § 14A cmt. (a).

32. *See* RESTATEMENT (THIRD) OF AGENCY § 7.07.

33. RUPA § 301(1).

34. *Id.* § 301(2).

35. *Compare generally* RUPA §301 *with, e.g.,* RESTATEMENT (SECOND) OF AGENCY, “Table of Contents.”

36. RUPA, ART. 4 (1997).

37. *Id.* § 401.

To Information.”³⁸ The provisions providing for the “general standards of a partner’s conduct,”³⁹ too, appear in the Article concerning the relations to partners with each other. In relevant part, the provision states: “[T]he only fiduciary duties *a partner owes to the partnership and the other partners* are the duty of care and the duty of loyalty set forth in subsections (b) and (c).”⁴⁰ It also states: “A partner shall discharge the *duties* to the partnership and the other partners *under this [act] or under the partnership agreement* and *exercise any rights* consistently with the *obligation of good faith and fair dealing*.”⁴¹

Relative to the current analysis, the emphasized statutory language simply means what it says: a partner owes duties to both the partnership (“the group” under *Restatement (Second)*) and the other partners. The bifurcation between the roles of partner-acting-as-agent and partner-as-partner may not be complete, however, because the categories may be further divided *vis-à-vis* the other individual partners and the partnership.⁴²

The same types of interpretive issues arise under the Delaware Revised Uniform Partnership Act (“DRUPA”), which is, generally, very similar to RUPA.⁴³ DRUPA nevertheless differs from RUPA in several significant ways that might affect its interpretation. For example, DRUPA significantly varies the constraint on the extent to which the partnership agreement may depart from the Act’s “nonwaivable provisions” by expressly referencing the “implied contractual covenant of good faith and fair dealing,”⁴⁴ by espousing a policy of giving “maximum effect to the principle of freedom of contract and the enforceability of partnership agreements,”⁴⁵ and by stating that “[t]he rule that statutes in derogation of the common law are to be strictly construed shall have no application....”⁴⁶

38. *Id.* § 403.

39. *Id.* § 404.

40. *Id.* § 404(a) (emphasis and brackets added).

41. *Id.* § 404(c) (emphasis added).

42. *E.g., compare* RUPA § 401 *with* RESTATEMENT (SECOND) OF AGENCY, “Table of Contents.” Another interpretive tipping point concerns the meaning of phrases like “to the partnership and other partners.”

43. *Compare* DEL. CODE ANN. tit. 6, Ch. 15 *with* RUPA.

44. DEL. CODE ANN. tit. 6, § 15-103(b)(3).

45. DEL. CODE ANN. tit. 6, § 15-103(d).

46. DEL. CODE ANN. tit. 6, § 15-1201.

Moreover, DRUPA, unlike RUPA, expressly includes the rules of “the law merchant” as supplemental principles of law.⁴⁷

These interpretive issues are difficult, but less so if the fiduciary duties arising from sources like “trust” relationships can be separated from those arising from specific statutory provisions. Whether it is possible to do so in all circumstances is an open question. Several commenters have attempted such a separation and they are, generally, consistent with the comment to the “partner as agent” section of *Restatement (Second)*. Professor Ribstein, for example, has written an article on the topic⁴⁸ and the issue is also discussed in a chapter of a book authored by Robert R. Keatinge and Ann E. Conaway.⁴⁹ Each of these commenters provides analysis of the seminal partnership fiduciary case *Meinhard v. Salmon*.⁵⁰

Generally, therefore, statutory law on general partnerships incorporates agency law by expressly providing that general partners are agents. This is consistent with agency law that partners are agents of the partnership as formulated by the *Restatements*. Thus, agency law is a component part of the law of general partnerships as approached from either direction (partnership law or agency law) and from either source (common law or statutory law).

B. Agency Law and Corporations

The interaction of agency law with corporate law is more difficult. To understand how agency law interrelates with corporate law it is helpful to review the basic general

47. DEL. CODE ANN. tit. 6, § 15-104. It seems the retention of “law of the merchant” is significant because it may stand for the proposition of “commercial reasonableness.” For a research gateway on “law merchant,” see Robert D. Cooter, *Structural Adjudication and the New Law Merchant: A Model of Decentralized Law*, 14 INT’L REV. L. & ECON. 215 (1994).

48. Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209 (2005). In addition, Professor Ribstein has written a fascinating paper about the historical evolution of partnership law. See Larry E. Ribstein, *The Evolving Partnership*, ILL. LAW & ECON. WORKING PAPERS SERIES (Working Paper No. LE06-025), available at <http://papers.ssrn.com/pape.tar?abstract=id=940653> (last visited Oct. 27, 2006).

49. ANN E. CONAWAY, BRUCE P. ELY, ROBERT R. KEATINGE, KEATINGE AND CONAWAY ON CHOICE OF BUS. ENTITY, DUTIES OF OWNERS AND MANAGERS 169-70 (2006).

50. *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. App. Ct. 1928).

function of the board of directors and the allocation of power and authority between the board of directors and corporate officers.⁵¹

Delaware corporate law, as does the corporate law of other jurisdictions, provides that the locus of management for a corporation is the board of directors:

The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may otherwise be provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.⁵²

In turn, the board of directors appoints officers in accordance with the corporation's organic rules (*e.g.*, by-laws).⁵³ Unlike the law of general partnerships, corporate law does not incorporate agency law by express reference.

Indeed directors, either individually or collectively, are not agents.⁵⁴ *Restatement (Second)* expressly states: "Neither the board of directors nor an individual director of

51. See, *e.g.*, ALI, PRINCIPLES OF CORP. GOV.: ANALYSIS AND RECOMMENDATIONS §3.01 (1994), stating:

The management of the business of a publicly held corporation should be conducted by or under the supervision of such principal senior executives as are designated by the board of directors, and by those other officers and employees to whom the management function is delegated by the board or those executives, subject to the functions and powers of the board under §3.02.

52. DEL. CODE ANN. tit. 8, § 141(a). The Model Business Corporation Act is similar; it states, in part:

- (a) Except as provided in section 7.32, each corporation must have a board of directors.
- (b) All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under section 7.32.

2 MODEL BUS. CORP. ACT § 8.01 (3d ed.) (hereinafter "MBCA").

53. DEL. CODE ANN. tit. 8, § 142.

54. For a catalogue of articles concerning the good faith conundrum for directors under (non-agency) Delaware law, see Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, n.1 (2006).

a business is, as such, an agent of the corporation or of its members.”⁵⁵ The comments to *Restatement (Third)* explain that neither the members of the board of directors nor shareholders are the corporation’s agents because, “[d]irector’s powers originate as the legal consequence of their election and are not conferred or delegated by shareholders,” and “shareholders ordinarily do not have the right to control directors by giving binding instructions to them.”⁵⁶ While directors and, under special circumstances, shareholders may be fiduciaries, the source of their fiduciary duty is not in agency law.⁵⁷

Officers occupy a different position. Although the board cannot be an agent under corporate law, a corporation can act only through the delegation agency authority. The officers of the corporation, therefore, must be agents.⁵⁸ The board collectively manages the principal (the corporation)⁵⁹ or at least has oversight authority over its management. Officers, as agents of the corporation, are fiduciaries. This status results from their role in the corporation under corporate law and by self-executing agency law.

Although agency law is not directly applicable to directors, it can be used to fill gaps in the law governing corporate relationships. The Delaware Court of Chancery emphasizes this point in *Unisuper*. As a way of explaining its earlier opinion dismissing several causes of action against the board, the court stated that it “employed agency law principles to illustrate *by analogy* the gap-filling nature of fiduciary duties.”⁶⁰

55. RESTATEMENT (SECOND) OF AGENCY § 14C.

56. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. f(2).

57. Compare MBCA § 8.31 with MBCA § 8.42. See generally Lyman P. Q. Johnson, David Millon, *Recalling Why Corporate Officers Are Fiduciaries*, 46 WM. & MARY L. REV. 1597 (2005) (notes 10-32 and accompanying text therein).

58. The issue of whether the business judgment rule modifies agency law in the case of officers is a separate question. See, e.g., Gregory Scott Crispi, *Should the Business Judgment Rule Apply to Corporate Officers, and Does It Matter?*, 31 OKLA. CITY U. L. REV. 237, 239 (2006).

59. The nexus of contract theory would substitute “shareholders” for “corporation” as a matter of theory. See William T. Allen, Jack B. Jacobs, Leo E. Strine, Jr., *The Great Takeover Debate: A Mediation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1075-76 (2002). An excellent discussion of this issue is Robert J. Rhee, *Corporate Ethics, Agency, and the Theory of the Firm*, 3 J. Bus. & Tech. (2008) (U. of Maryland Legal Studies Research Paper No. 2008-2, draft available at <http://ssrn.com/abstract=1083478>).

60. *Unisuper Ltd. v. News Corp.*, C.A. No. 1699, 2006 WL 207505 (Jan. 19, 2006 Del. Ch.) (emphasis added).

The facts of the *UniSuper* case involved the submission of a proposed re-incorporation to a vote of shareholders. The court analogized to agency law in granting the motion to dismiss as follows:

It makes no sense to argue that ... the board somehow disabled its fiduciary duties to shareholders by agreeing to let the shareholders vote on whether to keep a poison pill in place. Fiduciary duties exist in order to fill the gaps in the contractual relationship between the shareholders and the directors of the corporation.... Shareholders should be permitted to fill a particular gap in the corporate contract if they wish to fill it. *This point can be made by reference to principles of agency law: Agents frequently have to act in situations where they do not know exactly how their principal would like them to act.* In such situations, the law says the agent must act in the best interests of the principal. Where the principal wishes to make known to the agent exactly which actions the principal wishes to be taken, the agent cannot refuse to listen on the grounds that this is not in the best interests of the principal.⁶¹

There is little doubt that fiduciary duties in different contexts are somewhat similar and, in that regard, are appropriate for purposes of analogical reasoning. There is, of course, a risk in using such analogies because they may be as confusing as they are helpful.⁶² Nonetheless, the analogy has been used in the law and economics literature, even if shareholders are “really not” principals in the legal sense.⁶³

Corporate officers, on the other hand, can appropriately be viewed as “real” agents. The interaction between the free-standing body of agency law and corporate officers is becoming a focus of attention. Historically, corporate officers’ duties were not analyzed under agency law. Although the following quotation from a 2005 law review article is long, it clearly summarizes the absence of analysis of the actions of corporate officers under the rubric of agency law:

61. *Unisuper Ltd. v. News Corporation*, C.A. No. 1699, 2005 WL 3529317 (Del. Ch. Dec. 20, 2005), *appeal refused*, 906 A.2d 138 (Del. 2006) (withdrawn from bound volume) (emphasis added).

62. See Ed Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law and Interdoctrinal Legal Transplants*, 96 N.W. U. L. REV. 651 (2002).

63. A seminal book on corporations discusses the analogy. See FRANK H. EASTERBROOK, DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

Historically, however, for the most part, officers appear not to be sued for fiduciary wrongdoing as officers. Addressing Delaware law, a leading corporate treatise summarily states: “[f]ew authorities deal with the nature of the obligation owed by officers to the corporation and its stockholders.” [Primarily citing *R. Franklin Balotti & Jesse A. Finkelshtein*, 1 *The Delaware Law of Corporations and Business Organizations* § 4.17 at 4-36 (3d ed. Supp. 2003).] The foundational duty of loyalty case in Delaware, moreover, groups officers and directors together when discussing fiduciary obligations [citing *Guth v. Loft*, 5 A.2d 503 (Del. 1939)] neither distinguishing the differing roles of directors and officers in corporate governance nor articulating any theoretical bases for imposing a single conception of fiduciary duties on officers as well as directors [citations and substantive footnote omitted]. This approach appears predominant in commentary and case law [citation omitted]... . In the most high profile corporate case today -- Enron -- the Bankruptcy Examiner concluded: “As a general matter, corporate officers owe the same fiduciary duties to the corporation as do corporate directors.” [Citing Third Interim Report of Neal Batson, Court Appointed Examiner, app. B at 6, *In re Enron Corp.*, No. 01-16034 (AJG) (Bankr. S.D.N.Y. June 30, 2003).] Commenting on the corporate law applicable to Enron -- the law of Oregon -- the Examiner noted that “Oregon courts have referred to the fiduciary duties of officers and directors interchangeably.” [*Id.*] In short, although officers and directors occupy distinctive roles in corporate governance, most corporate law authority uncritically obliterates the distinction when it comes to fiduciary duty.⁶⁴

One possible reason for the dearth of historic agency analysis of the officer role has been the Delaware Court of Chancery’s lack of jurisdiction over officers.⁶⁵ That impediment has been removed, and effective January 1, 2004, the Delaware Court of Chancery can exercise jurisdiction over claims against officers.⁶⁶ As a result of the

64. Johnson & Millon, *Recalling Why Corporate Officers Are Fiduciaries*, *supra* note 57, and accompanying text(text in brackets added).

65. *Id.*; see also DEL. CODE ANN. tit. 10, § 3114.

66. See William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Residents of One Small State*, 152 U. PA. L. REV. 953 (2003); cf. E. Norman Veasey, *Corporate Governance and Ethics in the Post-Enron WorldCom Environment*, 38 WAKE FOREST L. REV. 839 (2003).

expansion of Chancery Court jurisdiction, there may be agency analysis of officer activity in the future.⁶⁷

There is also reason to believe that agency law may play a greater role in the corporate context independent of the Court of Chancery's expanded jurisdiction. For example, Professor Langevoort has observed that one key element in recent corporate scandals has been the general lack of candor; specifically, the lack of candor by officers with their directors. He suggests that agency law is a big part of the solution.⁶⁸ And, three business professors wrote a non-logocentric paper presenting "a theory of the allocation of authority in an organization in which centralization is limited by the agents' ability to disobey the principal."⁶⁹

In sum, agency law interacts with corporate law through the application of freestanding agency law to corporate officers and as a gap-filler to provide content to the duties of other fiduciaries, like directors, who are clearly not agents. In providing content for fiduciary duties, courts and commenters may be tempted to analogize to agency law, though doing so runs a risk of confusion.

C. Alternative Entities: Briefly, Selectively & Comparatively

Discussion of the relationship between agency law and alternative entity law in this article follows the same approach used for general partnerships and corporations. The

67. There exist, of course, other possible factors that have contributed to the lack of distinct analysis of the officer role. See Johnson & Millon, *Recalling Why Corporate Officers Are Fiduciaries*, *supra* note 57. One possible contributing factor might be the de-emphasis of agency law in law schools in the late twentieth century.

68. Donald G. Langevoort, *Agency Law Inside The Corporation: Problems of Candor and Knowledge*, in *Corporate Law Symposium: Agency Law Inside The Corporation*, 71 U. CIN. L. REV. 1187 (2003). The mere choice of such a symposium topic is evidence of a renewed interest in agency law in the context of corporations. Another author has suggested "institutional and legal differences distinguish officers from lesser agents within the corporation" but if those differences are taken into account "the reality that officers are agents of the corporation should not lead to the erroneous conclusion that officers' legal or institutional roles are the same as those of mere employees." Aaron D. Jones, *Corporate Officer Wrongdoing and the Fiduciary Duties of Corporate Officers Under Delaware Law*, 44 AM. BUS. L.J. 475, 493-94 (2007). Professor Coffee goes much further in advocating the extension (or restoration) of a principal-agent relationship to the "gatekeeper professions." JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 335-36 (2006).

69. John G. Matsusaka, Anthony M. Marino, Jan Zabochnik, *Disobedience and Authority* (June 6, 2006) USD CLEO Research Paper No. C06-11 (available at SSRN: <http://ssrn.com/abstract=914106>) (last visited Aug. 31, 2006).

first step is to identify the appropriate statutory law and determine if there are statutory references to agency law or statutory relationships that implicate agency law. The second step is to apply agency law as a freestanding doctrine. While a plethora of alternative entities exist, this article will use the Delaware limited liability company as an example.

The structure of the Delaware Limited Liability Company Act ("DLLCA") differs from the structure of DRUPA in that DLLCA does not provide separate subchapters for "inside" and "outside" relationships to the same extent as does DRUPA. Specifically, DLLCA does not contain chapters which parallel DRUPA or subchapters captioned "Relations of Partners to Each Other and to the Partnership" and "Relations of Partners to Persons Dealing with Partnership." As a result, the role of agency in DLLCA is not as clearly stated as in DRUPA. Rather than distinguishing between inside and outside relationships, DLLCA distinguishes between "members" and "managers." Subchapter III of DLLCA addresses "members," and, Subchapter IV addresses "managers." Section 18-402, "Management of limited liability company," is but a single paragraph. It provides the default rules that "management" is vested in the *members* of the LLC "in proportion" to their profit interest, and, further, that decisions may be made by owners of more than 50 percent of those interests.⁷⁰ The limited liability company agreement may provide for management by a manager, managers or may divide management between managers and members. Managers do not need to be members.⁷¹ As a default matter, both managers

70. DEL. CODE ANN. tit. 6, § 18-402. It states:

Unless otherwise provided in a limited liability company agreement, the management of a limited liability company shall be vested in its members in proportion to the then current percentage or other interest of members in the profits of the limited liability company owned by all of the members, the decision of members owning more than 50 percent of the said percentage or other interest in the profits controlling; provided however, that if a limited liability company agreement provides for the management, in whole or in part, of a limited liability company by a manager, the management of the limited liability company, to the extent so provided, shall be vested in the manager who shall be chosen in the manner provided in the limited liability company agreement. The manager shall also hold the offices and have the responsibilities accorded to the manager by or in the manner provided in a limited liability company agreement. Subject to § 18-602 of this title, a manager shall cease to be a manager as provided in a limited liability company agreement. A limited liability company may have more than 1 manager. Unless otherwise provided in a limited liability company agreement, each member and manager has the authority to bind the limited liability company.

71. DEL. CODE ANN. tit. 6, § 18-101(10). It states: "Manager' means a person who is named as a manager of a limited liability company in, or designated as a manager of a limited liability company pursuant to, a limited liability company agreement or similar instrument under which the limited liability company is formed." (Emphasis added).

and members have broad power and authority to delegate management and control of the LLC to others, expressly including agents, officers, and employees.⁷²

Section 18-402 expressly contemplates officers and states that managers have the “responsibilities accorded” them under a limited liability company agreement. The last sentence of the section addresses “outside” authority. It states: “Unless otherwise provided in a limited liability company agreement, each member and each manager has the authority to bind the limited liability company.” The broad topic of management of a series LLC is provided in Subsections 18-215(d) and (e).

These provisions raise some of the interpretive issues suggested in the *Introduction*. It is not clear from the structure or language of DLLCA the degree to which “members” or “managers” are intended to be or could be construed to be agents beyond authority to bind the LLC. The field is therefore open for application of agency principles by analogy.

DLLCA does, however, contain interpretive provisions, like those in DRUPA, that could be important for sorting out the relationship between DLLCA and agency law. First, subsection 18-1101(a) states: “[t]he rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.” Second, subsection 18-1101(b) states: “[i]t is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”⁷³ Third, subsections (c) and (e) provide expansive authority for a limited liability company agreement to *eliminate* a member’s or manager’s duties (expressly includ-

72. DEL. CODE ANN. tit. 6, § 18-407. It states:

Unless otherwise provided in the limited liability company agreement, a member or manager of a limited liability company has the power and authority to delegate to 1 or more other persons the member’s or manager’s, as the case may be, rights and powers to manage and control the business and affairs of the limited liability company, including to delegate to agents, officers and employees of a member or manager or the limited liability company, and to delegate by management agreement or another agreement with, or otherwise to, other persons. Unless otherwise provided in the limited liability company agreement, such delegation by a member or manager of a limited liability company shall not cause the member or manager to cease to be a member or manager, as the case may be, of the limited liability company or cause the person to whom any such rights and powers have been delegated to be a member or manager, as the case may be, of the limited liability company.

(Emphasis added).

73. See *Forsythe v. ESU Fund Management Co.*, C.A. No. 1091, 2007 WL 2982247, *8 (Del. Ch. Oct. 9, 2007) (applying partnership fiduciary duties and standards as contemplated in a limited partnership agreement rather than adopting corporate duties and standards as articulated and clarified in *In re Caremark* and *Stone v. Ritter*, 911 A.2d 362 (Del 2006)).

ing fiduciary duties, if any), *at law, equity, or by contract*, to the company, other members, managers, or other persons. A limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing regarding legal or equitable duties,⁷⁴ nor may it “eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.”⁷⁵ Interpreted together, these provisions seem to identify the contractual covenant of good faith as the “foundational” baseline duty and bad faith as the most restrictive standard that can be used within the Delaware scheme. A final potential opening for agency law lies in the definition of a limited liability company agreement which, among other things, expressly allows for the provision of rights to any person, even if that person is not a party to the agreement. The definition also provides that the agreement “shall not be unenforceable” against a party who did not sign the agreement.⁷⁶

It is *not* news that DLLCA is designed to be, and is, very flexible. As to provisions from which “statutory” agency could be derived, there are few rules in the DLLCA except for the clear default rule that, unless otherwise provided in the LLC agreement, both members and managers have the actual authority to bind the LLC to third parties. These provisions provide a gap for the application of “non-statutory” apparent authority under agency law.

According to RESTATEMENT (THIRD) OF AGENCY Section 2.03, “[a]pparent authority is the power held by an agent or other actor to affect a principal’s relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal’s manifestations.” The creation of apparent authority is addressed in a different section of the *Restatement (Third)*,⁷⁷ but the two sections are consistent. Apparent authority requires that the principal manifest to another that the agent has the authority in question and requires the third party to

74. DEL. CODE ANN. tit. 6, § 18-1011(c).

75. DEL. CODE ANN. tit. 6, § 18-1011(e). Subsection (d) additionally states: “unless otherwise provided in a limited liability company agreement,” a member, manager or other person is not liable for breach of fiduciary duty if they relied in good faith on the provisions of a limited liability company agreement. Query whether “good faith” in Subsection (d) contemplates a different kind of “good faith” from that contemplated by Subsection (e), “covenant of good faith and fair dealing.”

76. DEL. CODE ANN. tit. 6, § 18-101(7).

77. RESTATEMENT (THIRD) OF AGENCY § 3.03.

“reasonably believe” the agent possesses that authority.⁷⁸ The comments state bluntly: “A principal may ... make a manifestation by placing an agent in a defined position in an organization...” Further, the comments suggest that the scope of apparent authority may be delimited by the authority the position “customarily carries... but in which the organization has withheld ... from the agent.”⁷⁹ As to “officers,” apparent authority is limited to ordinary course transactions. Additional relevant comments state: “In smaller firms, it is not unusual for the president to function as the ‘general manager,’ a term used in many cases involving smaller businesses and intended to describe a person with authority to bind the organization in all matters within the ordinary scope of its business.”⁸⁰ The comments recognize the distinction between an LLC manager and a member in a manager-managed LLC.⁸¹ The bottom line, however, is that apparent authority is an agency concept that applies to DLLCA.

The statutory distinctions between the Delaware General Corporation Law (“DGCL”) and DLLCA further illuminate the scope of agency law’s role in the limited liability company context. One such comparison examines the degree to which individuals can be excused from liability. In corporate law, DGCL section 102(b)(7) permits the certificate of incorporation to *eliminate* or *limit* monetary damages for breach of a *fiduciary* duty as a *director* except for the duty of loyalty, conflict of interest, intentional misconduct or knowing violation of the law, or “for acts or omissions not in good faith.”⁸² DLLCA, too, contains liability exculpation provisions, but it is broader because it is not limited to “directors.”⁸³ Rather, it is a liability, not a remedies, provision. It states that the agreement “may provide for the limitation or elimination of any and all liabilities ... of a member,

78. *Id.* at cmt. b.

79. *Id.* at cmt. c.

80. *Id.* at cmt. e(3).

81. *Id.* at cmt. e(2).

82. The section’s permitted exculpation also applies to a “member of the governing body of a corporation which is not authorized to issue stock” and, *in that context*: “to such other person or persons, if any, who, pursuant to a provision of the certificate of incorporation ... exercise or perform any of the powers or duties otherwise conferred or imposed *upon the board of directors* by this title.” DEL. C. ANN. tit. 8, § 102(b)(7) (emphasis added). The corporate indemnification provisions, on the other hand, expressly include agents and employees. DEL. CODE ANN. tit. 8, § 145 (2006).

83. DEL. CODE ANN. tit. 6, § 18-1101(e).

manager or another person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement." The floor in DLLCA, unlike that in DGCL, is that the "agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing."⁸⁴

The difference in language is significant because the corporate exculpation provision applies only to board members (who are not agents). DLLCA goes further. Section 18-402 applies to other agents and employees and supersedes agency law. For now, the point is that the operation of this section is not limited to tasks that might be called "inside" management. Thus, the section applies to outside "agency" duties as well as "inside" management and governance activities. The two tasks come together in the prototypical member-manager much as they come together for general partners in either general or limited partnerships.⁸⁵

DLLCA sections 18-402 and 18-407, when read together, provide that management, as allocated to managers under an LLC agreement, "shall be vested in the manager," but provides that this management function may be delegated to agents, although the manager remains the manager. These provisions touch the agency topics of delegation of

84. *Id.*; compare DEL. CODE ANN. tit. 6, § 18-1101(e) (DLLCA) with DEL. CODE ANN. tit. 8, § 102(b)(7) (DGCL). The corporate provision allows the certificate of incorporation to limit the personal liability of directors for monetary damages for breach of fiduciary duty "to the corporation or its shareholders," except that it may not limit damages for director's breaches of the duty of loyalty or "for acts or omissions not in good faith." "Good faith," as used in the corporate statute, therefore, is good faith under corporate jurisprudence and is not limited to contractual good faith. Note that DGCL does provide for indemnification of directors, officers, employees or agents. DEL. CODE ANN. tit. 8, § 145.

85. See generally, Part II., B, *supra*. The distinction between "inside" and "outside" was, for example, discussed in conjunction with pre-check-the-box tax classification rulings. The distinction in the context of tax classification has been described as follows:

Under the regulations, centralized management requires a person or group of persons with "continuing exclusive authority to make the management decision" without "ratification by members" that are "necessary to the conduct of the business for which [it] was formed." "Thus, the persons who are vested with such management authority resemble in powers and functions the directors of a ... corporation" and further, their management authority must exceed the authority to merely perform ministerial acts in order to possess centralized management. Unfortunately, none of the administrative rulings really analyze this characteristic; rather, for example, Revenue Ruling 88-76 "simply concludes that the LLC possess ... [this] characteristic..."

authority and sub-agency. These topics are also implicated where the manager of an LLC is an entity which itself must act through an agent. The comments to *Restatement (Third)*, for example, state that, “a subagent is a fiduciary, as is any agent.”⁸⁶

Similarly, the *Restatement (Third)* states that an “agent who appoints a subagent delegates to the subagent power to act on behalf of the principal that the principal has conferred on agent.”⁸⁷ The agent appointing the subagent is the subagent’s principal, but the subagent has two principals: the appointing agent and the original principal. “Although an appointing agent has the right to control a subagent, the interests and instructions of the appointing agent’s principal are paramount.”⁸⁸ The appointing agent nonetheless remains responsible to its principal. Of course, the principal owes the same duties to the subagent as to the agent, but does not owe the subagent any duties created by agreement between the agent and the subagent absent contrary agreement.⁸⁹

The extent to which agency law applies to the “inside” management function (between members or managers or both) of an LLC implicates DLLCA’s interpretive provisions.⁹⁰ The discussion follows a similar approach to the one illustrated previously for DRUPA.⁹¹ The LLC Act strongly hints at the same conundrum as DRUPA’s statement of duties. DLLCA’s similar statement appears in Subsection 18-1101(e) and differs in purpose from DRUPA’s provision. Nonetheless, it seems to recognize that members or managers may have duties to both other members and the LLC (“the group”). Beyond identifying the principal, the two interpretive provisions that are most relevant for present purposes are those addressing derogation of the common law by the statute⁹² and the application of the law of the merchant.

86. RESTATEMENT (THIRD) OF AGENCY § 3.15 cmt. d.

87. *Id.* at cmt. b.

88. *Id.*; *see also id.* at cmt. d.

89. *Id.*

90. *See* DEL. CODE ANN. tit. 6, § 18-1101.

91. *See* DRUPA § 15-404.

92. DEL. CODE ANN. tit. 6, § 18-1101(a).

In summary, agency law applies to LLC law because LLC law expressly addresses, and perhaps modifies, agency relationships. Whether the modification applies to a given agency context remains, once again, an open question.⁹³

III. Agency Good Faith in Context

The role of agency in entity law introduces the agency-based notion that the *agent* must act in “good faith” as that phrase applies in *agency* jurisprudence. Simple computer aided word searches reveal that *Restatement (Third) of Agency* and its commentary use the term “good faith” 33 times and the phrase “good faith and fair dealing” (or a close proximity of it) seven times. Three questions follow: (1) When and where does the “duty” of good faith appear?; (2) What does “good faith” mean in the law of agency?; and (3) Is “agency” good faith different from “contractual” good faith?⁹⁴

In order to answer the first question, it is helpful to gain an orientation of “duties” under *Restatement (Third)*. The duties and obligations of agents and principals is asymmetrical in agency law. *Restatement (Third)*, like its predecessor,⁹⁵ divides the topic of duties into two separate topics. “Topic 1” is captioned “Agent’s Duties to Principal.” In turn, agents’ duties are subdivided into three “Titles”: “General Fiduciary Principle”; “Duties of Loyalty”; and “Duties of Performance.” “Topic 2” contains but one “Title” and is captioned “Principal’s Duties to Agent.” In “Topic 1” (“Agent’s Duties to Principal”), good faith is particularly evident in section 8.01, the “general fiduciary principle”; 8.06 (“Principal’s Consent,” a loyalty provision); 8.07 (“Duty Created by Contract,” a performance provision); and 8.10 (“Duty of Good Conduct,” another “performance” provision).

The *principal’s* duty of good faith has a dedicated section captioned “Principal’s Duty to Deal Fairly and in Good Faith.” The principal’s duty is also implicated by the section captioned “Duty Created by Contract.”

93. There are many other interesting scenarios involving agency law, but this article makes no attempt to be comprehensive or exhaustive. Nonetheless, one interesting scenario concerns assignees of a member’s limited liability company interest. See DEL. CODE ANN. tit. 6, § 18-702. As a “thought experiment,” imagine an assignee to whom a member-manager also delegates her management authority and contemplate the degree to which agency principles might or might not apply. See DEL. CODE ANN. tit. 6, § 18-407.

94 “Good faith” under Delaware corporate law has been clarified *to be* a “necessary condition to liability” under the fiduciary duty of loyalty, and, unlike unincorporated law, *not to be*, a separate and distinct duty. *Stone v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006).

95. RESTATEMENT (SECOND) OF AGENCY (table of contents).

The general fiduciary duty in agency law states that the *agent* is a fiduciary. The purpose of the general duty is to enable control by the principal. According to a comment to *Restatement (Third)*:

The general fiduciary principle facilitates a principal's ability to exercise control over an agent because it provides a benchmark standard against which the agent must interpret manifestations by the principal. . . . *An agent is not free to exploit gaps in the principals' manifestations by taking action that is self-interested or otherwise fail to serve interests of the principal that the agent knows or should know.*⁹⁶

Although good faith is frequently discussed in the context of agency fiduciary duties, only the agent is identified as a fiduciary under general agency law.⁹⁷ Moreover, even in the context of the agent, "good faith" is distinct from fiduciary duties.⁹⁸

The principal's duties to agents, on the other hand, are not fiduciary duties because the element of control by the principal does not require it. That is, the law assumes that the principal entrusts her business and property to the agent, and it is the entrustment of the business that requires the agent to be a fiduciary. *Restatement (Third)* contains three component and related ideas about the principal's duty to deal fairly and in good faith with the agent: the baseline concept of fair dealing and good faith, the duty to provide the agent with information necessary for the agent to perform, and the duty to refrain from conduct that could be harmful to the agent's "business reputation."⁹⁹

96. RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b (emphasis added).

97. RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b expressly states:

Doctrines that are distinct from an agent's fiduciary duties may also constrain the agent's right to take action. When an agent's agreement with a principal confers discretion on the agent to take action in the agent's sole discretion, the agent has a duty to exercise the discretion in good faith.

Id.; See also RESTATEMENT (SECOND) OF AGENCY § 13.

98. RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b.

99. *Id.* § 8.15 cmt. a.

Under agency law, therefore, “good faith and fair dealing” is a narrower concept than the concept of fiduciary duty.¹⁰⁰ Further, at least under the *Restatement (Third)* approach, an agent (who is by definition a fiduciary) has an obligation of good faith separate and apart from the duties described as fiduciary duties. The distinctions of duties stem from agency being a status relationship. That is, “manifestation” by each party to the *relationship*. Those manifestations do not necessarily rise to the level of a contract.¹⁰¹ If, however, a contract exists between the agent and principal, both principal and agent have a “duty to act in accordance with [the contract’s] ... express and implied terms....”¹⁰² Implied terms may be supplied by custom and usage of trade.¹⁰³

The location of the section in *Restatement (Third)* that addresses the contract is important because it appears as a duty of performance for the agent; *not* as a duty of loyalty. Even under the duties of loyalty, however, the agent may engage in conduct that would otherwise be in breach of the duty of loyalty if the principal consents.¹⁰⁴

100. An illustration from *Restatement (Third)* is helpful:

P Corporation, wishing to do business in Taiwan, engages A as its general manager in Taiwan. P Corporation designates A as its “responsible person” or legal representative in Taiwan, which requires such a designation to conduct business in the country. As P Corporation’s designated “responsible person,” A affixes A’s “chop” or signature-equivalent, to tax returns that P Corporation prepares and files in Taiwan. Having decided to cease doing business in Taiwan, P Corporation terminates A’s engagement but does not remove its designation of A as its “responsible person,” although A requests several times that P Corporation do so and tells P Corporation that A is concerned that A may be subject to liability in the event of tax-related disputes between P Corporation and Taiwan. Taiwan assesses a tax liability against P Corporation that P Corporation contests and then, following an adverse final determination, does not pay. Taiwanese authorities notify A that A is forbidden to leave the country until its tax dispute with P Corporation is resolved. P Corporation has breached its duty of good faith. P Corporation is subject to liability for loss suffered by A, including attorney’s fees paid by A to resolve A’s predicament.

Id. at Illustration 1 cmt. b.

101. See generally, Part II.A, *supra*. Comment b to the RESTATEMENT (THIRD) OF AGENCY § 8.13 (principals’ duty) states, *e.g.*, “[a]n agency relationship may exist in the absence of contract.”

102. RESTATEMENT (THIRD) OF AGENCY § 8.13 (principal), § 8.07 (2006) (agent).

103. *Id.* § 8.07 cmt. b. There is, of course, a distinction between “implied” and “supplemental,” but, this is a place where “law merchant” might be appropriately used.

104. *Id.* § 8.06 (discussed in Part II.A, *supra*).

The prerequisites for effective consent are that the agent seeking the consent act in good faith, disclose all known material facts, and deal fairly.¹⁰⁵ Using the term “good faith” in both the performance and loyalty sections is, at best, confusing.¹⁰⁶

The principal must consent to “either a specific act or transaction, or acts or transactions of a specified type that could reasonably be expected to occur in the ordinary course of the agency relationship in order to waive a breach of the duty under Restatement (Third)”¹⁰⁷ Because agency is a status relationship, “an agreement that contains general or broad language purporting to release an agent in advance from the agent’s general *fiduciary* obligation to the principal is not likely to be enforceable.”¹⁰⁸

Delaware courts seem, generally at least, to follow the common law principles delineated by *Restatement (Third)*. For example, contractual waivers of fiduciary duties must be “clear and explicit.”¹⁰⁹ For example, the *Gotham Partners*¹¹⁰ opinion discussed how statutory provisions varying the common law of agency should be interpreted in the context of DRULPA’s statutory language. The then-applicable statutory section provided that a partner’s liabilities “may be expanded or restricted by provisions in the partnership agreement.” The opinion suggested that “restricted” does not include “eliminated,” indicating that absent *explicit* statutory authority, contracts cannot eliminate fiduciary duties. Delaware subsequently modified the statutory language reviewed in *Gotham Partners* to

105. *Id.*

106. The abstract to an article by Professor Conaway also states the conundrum. It states in part:

What has resulted is a muddle of the case law caused by the similarity of terms *good faith* in the context of good faith in contract law, and the term *good faith* as is used in the law of business organizations to describe a *fiduciary duty of care or the standard of conduct for a director in a corporation*.

Ann E. Conaway, *Why No Respect? The Contractual Duties of Good Faith and Fair Dealing in Delaware*, Widener Law School Legal Studies Research Paper Series no. 08-05, <http://ssrn.com/abstract=994624> (emphasis in original).

107. RESTATEMENT (THIRD) OF AGENCY § 8.06(b).

108. *Id.* at cmt. b.

109. O’Malley v. Boris, C.A. No. 15735, 2002 WL 453928, *3 (Del. Ch. Mar. 18, 2002), *distinguished* by Weil v. Morgan Stanley, 877 A.2d 1024 (Del. Ch. 2005).

110. *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160 (Del. 2002) (the relevant *dicta* is at 167-68).

permit fiduciary duties to be eliminated and replaced with contractual duties of good faith and fair dealing.¹¹¹

The distinction between “fiduciary duties” and contractual good faith has been summarized in a general way by Professor Gold:

Fiduciary duties generally require a rigorous standard of behavior, precluding managers from acting in their own interest in place of the interests of the business entity. Like fiduciary duties, contractual good faith duties also reject opportunism; unlike fiduciary duties, they do not preclude selfish behavior. Under a contractual good faith standard, a party with discretion may act in her own self-interest, so long as she does not abuse this discretion in a way contrary to the spirit of express contractual provisions.¹¹²

In *Gotham Partners*, “fiduciary” duties were superseded by specific contractual duties in the partnership agreement (fiduciary duties established by the *words* of the agreement). The superseded duties, however, were found to be “the traditional duties of loyalty and care to the limited partnership and its partners.”¹¹³ These traditional duties are the kind *Meinhard v. Salmon* addressed.¹¹⁴ Although the case was decided under partnership law and did not address “traditional” agency principles, it helped distinguish between fiduciary and contractual duties.

Under different facts, reference to agency principles might have been appropriate. Just as the contract in *Gotham Partners* established contractual fiduciary duties, it might have established a contractual agency. This agency would not be between the partners as partners but, rather, based on functions and roles assigned to the general partner by the partnership agreement or by an employment agreement. Moreover, the agreement itself could define the agency by contract (the agreement’s express terms) or, short of that, by mutual manifestations of the type necessary to establish the agency as status or by custom. Once an agency is established, the agency duty of good faith would apply to both agent and principal as a doctrine distinct from traditional partnership fiduciary duties.

111. DEL. CODE ANN. tit. 6, § 17-1101 (as amended in 2004).

112. Andrew Gold, 41 WAKE FOREST L. REV. 123, nn. 58-61 and accompanying text (2006) (internal citation omitted).

113. *Gotham Partners*, 817 A.2d at 170.

114. *Id.* at 170 n.30.

Any analysis in this area, therefore, requires analyzing the traditional fiduciary duties of an agent in the context of partnership law, which concurrently depends on whether the source of the duties being examined is agency or entity law. A further examination of the governing statute is necessary if the duty arises from entity law, and the type of entity and the state of formation will be critical to reaching the “right” result.¹¹⁵ The latter portion of the analysis is not news. Chief Justice Myron T. Steele of the Delaware Supreme Court, for example, is well aware of the importance of distinguishing “between status relationships and contractual relationships.”¹¹⁶ The first part of the analysis is not new either. It simply echoes the analysis by others of *Meinhard v. Salmon* through the lens of agency law.¹¹⁷ Putting the two analyses together, however, may be of increasing importance in both corporate and unincorporated law.

IV. Conclusion

The purpose of this article has been to explore the structural relationship of agency law, its version of good faith, and its relationship to organizational law. It suggests that statutory duties under organizational statutes do not in all cases preempt the application of agency law. Its goal has been a modest one of suggesting that the meaning of “good faith” is dependent on the source of the law being used, be it agency, corporate, or alternative entity law. At bottom, the conceptual thesis can be illustrated using the simple graphic set forth in the introduction to this article. If agency law is acknowledged to apply in concert with organizational law, as it logically must be, the relevant inquiries concern the size, shape, and location of the representative geometric shapes in the diagram and, in turn, where to place a point or points representing the facts in a given case or planning scenario.

If nothing else, Part III of this article reiterates that “good faith is not subject to a monolithic definition.” Furthermore, the meaning of the phrase in agency law is rather

115. For an excellent discussion of the placement and meaning of good faith in the context of different types of entities, see Carter G. Bishop, *A Good Faith Revival Duty of Care Liability in Business Organization Law*, Symposium: *Disputed Concepts in Contemporary Business Association Law: Discussions on Fiduciary Duty and Capital Lock-In*, 41 TULSA L. REV. 477 (2006).

116. Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 9 (2007); see generally Elizabeth S. Miller & Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations*, 30 DEL. J. CORP. L. 343 (2005).

117. See Part II.B, *supra*.

narrow and context dependent. Modern agency law distinguishes good faith as doctrinally different from fiduciary duties. Agency is a source of both an obligation of good faith and fiduciary duties. It is a separate source of law in addition to whatever obligations arise from the organizational law. All that is required to pull agency into organizational law is the existence of a principal-agent relationship. Such a relationship may be established by contract, but because agency is status based, it may also be established by the organization law itself or the manifestations of the parties culled from the facts and circumstances of a given case.

Much of this article was devoted to a selective review of a few Delaware statutes. The purpose of the review was to identify relatively clear portals through which agency law may enter Delaware organizational law. Each type of organizational law represents a unique context for agency. Importantly, the statutory overview suggests the need for planners and courts to carefully delineate roles within an organization. Role identification is relevant because a person may act both as an agent for the organization and as part of a collective of persons which comprises the principal. The proper assignment of roles for particular purposes is, therefore, the first necessary step in analyzing the effect of agency law on relationships primarily based in organizational law.

Agency law is, thus, part of the jurisprudential ecosystem, just as the critters in the quotations at the beginning of this article are part of a biological ecosystem. Agency law may act as a symbiont or a parasite depending on its environment. It does, however, occupy appropriate niches in the world of statutory organizational law. The common law will, eventually, discover those niches.