February 25, 2010

Do Fiduciary Duties of Managers and Members of Limited Liability Companies Exist as with Majority Shareholders of Closely Held Corporations?

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I. Introduction

Though a matter of corporate law -- not limited liability company\(^2\) law -- *Smith v. Van Gorkom*\(^3\) was the 1985 Delaware decision that laid the groundwork for the apparently increasing ambiguity over fiduciary duties of and among managers and members of limited liability companies.\(^4\) The *Van Gorkom* court found corporate directors “grossly negligent” for failing to properly inform themselves as to the value of their corporation’s stock beyond an offered premium stock price (which price was essentially set in negotiations by the corporation’s Chairman and CEO) prior to the directors approving a cash out merger of the corporation they served (Trans Union) with another corporation which had agreed in advance to pay that premium stock price. The

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\(^2\) Limited liability companies are sometimes herein referred to as “LLC” or “LLC’s”.

\(^3\) 488 A.2d 858 (Del. 1985).

\(^4\) Note that the Delaware Supreme Court has often been at odds with the Court of Chancery on these issues: the former favoring expansion of fiduciary duties, the latter favoring a contractual model permitting elimination of fiduciary duties by agreeing members. See Chief Justice Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 Del. J. Corp. L. 1 (2007). (Steele argues for the pure contractarian model lest we turn LLC’s into corporations.) *See also* Steven M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. Rev. 547 (2002-3) (discussing a contractarian based theory of corporate governance drawn from Coase) and Sandra Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation?*, 32 Iowa J. Corp. L. 565, 591 (2007) (providing a more comprehensive discussion of fiduciary duties in limited liability company law stemming from Miller’s personal involvement and awareness of the issues contested in the National Conference of Commissioners on Uniform State Laws’ committee determining whether and what revisions should be made to the Uniform Limited Liability Company Act).
Trans Union directors were held liable for breaching their fiduciary duty to the corporation and violating the business judgment rule.

The Delaware General Assembly eventually responded to the state’s Supreme Court decision in *Van Gorkom* with revised Section 102(b) 7 of the Delaware General Corporation Law, permitting elimination or limitation of monetary damages for director liability in certain breach of fiduciary duty situations, but expressly preserving the duties of loyalty and good faith.

*Van Gorkom*, albeit regarding a public corporation and director liability, set the framework for more recent concern over fiduciary duties among members and managers of limited liability companies. In Delaware, because of *Van Gorkom* and the state legislation that followed in eventual reaction to it, we know that corporate director liability, while it can be limited in monetary terms, does indeed exist for breaches of still remaining fiduciary duties. We do not know, with certainty, what exactly these duties are – whether a duty of care is somehow included in duties of loyalty and good faith or whether each duty is disparate and care is of less import than loyalty and good faith.

Moreover, we do not know exactly which facts will indicate a breach of the remaining fiduciary duties. It might appear safest to look instead only to the business judgment rule

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5 “[Permitting] a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) for any breach of the director’s duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or knowing violation of law; (iii) under section 174 of [this title]; or (iv) for any transaction from which the director derived an improper personal benefit. No such person shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective….” DEL. CODE ANN. Tit. 8 § 102(b) 7 (2008).


7 See Rosenberg, note 6, supra, at 496-505.
as the paramount test in this grey area.\textsuperscript{8} However precisely formulated and whether distinct or overlapping, these duties are also clearly established in Delaware in the closely held corporation context (not just the public corporation context) – in lower profile subsequent case law.\textsuperscript{9} Since Van Gorkom, developments in various states lead us to question, perhaps more now than ever, whether parallel assumptions can be made with regard to duties associated with limited liability companies.

Fiduciary duties and commensurate liability are not so clear for managers and members of limited liability companies – and certainly not so well established.\textsuperscript{10} Since its recent amendment, the Delaware Limited Liability Company Act\textsuperscript{11} includes no provision expressly upholding any non-contractual fiduciary duties whatsoever -- the nearly opposite statutory provision being that any fiduciary duties are contractual and such duties can be agreed to exist or not to exist in part or totality -- by contract. It does appear, however, that a duty of good faith and fair dealing – a general commercial contract related duty – exists under any circumstances and cannot be escaped, even by way of terms in an LLC operating agreement.\textsuperscript{12}

This bare bones statutory duty of LLC principals is markedly different than the duties remaining for corporate fiduciaries – even after Section 102(b) 7. Recall, 102(b)(7) expressly leaves standing duties of loyalty and good faith relating to corporations, while Delaware’s Limited Liability Company Act lays bare all but the

\textsuperscript{8} The business judgment rule is consistently formulated in Delaware, albeit with some occasional added detail, as the presumption that a fiduciary acted on an informed basis in honest belief that the fiduciary acted in the best interest of the corporation. See Aronson v. Lewis, 473 A.2d 805 (1984). See also, Emerald Partners v. Berlin, 787 A.2d 85 (Del. 2001).
\textsuperscript{9} See, for example, Nixon v. Blackwell, 626 A.2d 1366, (Del. 1993); Riblet Products v. Ernest J., 683 A.2d 37 (Del. 1996) and Carlson v. Hallinan, 925 A.2d (Del. 2006).
\textsuperscript{10} Elizabeth S. Miller, Are the Courts Developing a Unique theory of Limited Liability Companies or Simply Borrowing from Other Forms?, 42 SUFFOLK UNIV. L. REV. 617 (2009).
\textsuperscript{11} DEL. CODE ANN. TIT. 6 § 18-101 et. seq. (2008)
\textsuperscript{12} TIT. 6 § 18-1101.
apparent Uniform Commercial Code (UCC) reference of good faith and fair dealing. This leaves us wondering whether any substance remains to the fiduciary duty of good faith relating to LLCs in Delaware and generally. Commentators have been discussing this for some time and, at least with regard to the corporate version of good faith, seem to have divided into a pejorative law and economics based contractarian camp and a more varied and humanistic contra-contractarian camp.\(^{13}\)

While the entire world does not look solely to Delaware for ultimate authority on limited liability company or corporate law, much of the business world -- and the legal world counseling it -- does look to Delaware as a leading authority in these fields. Certainly, we are not concerned with Delaware alone. This discussion will include a look at five states -- Delaware, Massachusetts, California, New York and Illinois (in order of increasingly explicit and strictly enforced fiduciary duties). I will call them the “five major states” as they are more or less commonly regarded as popular homes to businesses -- at least in terms of filings for domestic organization.

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That said, and considering each of those five states as discussed, *infra*, it certainly appears that the law on the issue of LLC manager and member duties is significantly less developed and far less uniform than the law on the duties of corporate directors or shareholders.

This not surprising discrepancy is likely for several reasons. First, limited liability companies have only existed since the late 1970’s (with Wyoming being the first state to statutorily enable their creation in 1977).\footnote{For a general introduction to the statutory creation and formation of limited liability companies, see RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES, §1.2 (1997-2009). For a densely informative brief essay on the origin of limited liability companies in the context of owner liability, see STEPHEN B. PRESSER, PIERCING THE VEIL, § 4:1. (Note that as Ribstein points out, the LLC was really born of a desire to capture both the benefit of limited liability and the benefit of pass through (not double level) taxation. Presser is keen to observe that the growth of limited liability companies can be pegged to revenue rulings allowing them to be taxed as partnerships and, subsequently, to changes in federal corporate tax rates, making the pass through LLC’s comparatively more desirable than the more traditional corporate form.) *See also*, Stephen M. Bainbridge, *Abolishing LLC Veil Piercing*, __U. ILL. L. REV. 102 (2005). (Bainbridge, in his argument against any veil piercing of LLC’s harkens back to his earlier call for the elimination of corporate veil piercing in *Abolishing Veil Piercing*, 26 J. CORP. L. 479 (2001)). (Bainbridge notes that limited liability companies are the form of choice for many small businesses and that requiring attention to formalities that establish and buttress the legal fiction of the entity are a drain on the energies of principals who could better devote their resources to the entrepreneurial ventures that they established the legal fiction for in the first place, at 125-141.)} Second, and consequently, there is a much less extensive history of common law addressing fiduciary duties in the limited liability company context than in the corporate context. Third, the very notion of limited liability companies was not to replicate the already well established legal fiction of the corporation, but to offer some alternative that would be still more advantageous to the owner(s)/member(s). This principally meant coupling often anonymous limited liability ownership with pass-through taxation (escaping the double level (C corporation) corporate burden without the constriction of subchapter S corporation parameters\footnote{Included in those parameters are; one class of stock, limited numbers of shareholders, domestic shareholders and limited entity types of shareholders.} and allowing relatively free reign as to management structure in contrast to the standardized...
officers/directors/shareholders hierarchy of corporations. These benefits do not carry with them an inherent or pronounced attunement to fiduciary duties. It is probably safe to assert that those duties were not logically at the forefront of the goals those choosing the LLC form were seeking to meet – a form that emphasizes individual protection and anonymity and not rights and responsibilities. Indeed, the flexibility of choice regarding form of taxation, ownership class, management specifics by manager(s) or member(s), is, more than with any other entity form, the hallmark of the LLC.

From statutory and common law sources, the body of law on corporations has settled into established doctrines related to or comprising a part of the broader, substantive and equitable notion of fiduciary duties. While relatively little doctrinal development has occurred on the discussion of like duties among managers and members of limited liability companies, the corporate law doctrines, including the business judgment rule (with the entire fairness test), the corporate opportunity doctrine, and duties of care and loyalty specific to directors, officers or majority shareholders – all further expanding the breadth and detail of the duties tied to corporate roles - have been an informing (if not controlling) source for the law on limited liability companies – in some states quite directly and in others more subtly.

It is clear from our look at the five major states that while corporate statutes may not so indicate, common law on corporate and LLC duties does indicate that well established fiduciary duties in the corporate context – particularly the closely held corporate context – have been a major influence on the duties in the LLC context. As in

16 RIBSTEIN and KEATINGE, supra § 1.2; PRESSER, supra § 4.1. Note that the operating agreement typically used as a contract governing management of a limited liability company gives relatively free reign as to whether traditional officer roles will be used or as to whether members or managers have agency power on behalf of the entity…all subject to the governing state statute.
Delaware, even if the standards or duties differ substantially by degree, each state’s general trend in favor of removable duties/contractarianism or mandatory duties/contrac-
contractarianism in the corporate setting has presaged the parallel trend with LLC’s – though often not to the same extreme.

Whether such an apparently causal connection should exist is open to debate. Moreover, what that influence from the corporation to the LLC is varies in the five major states. Yet, the causal link does exist and appears to indicate a trend in treating LLC’s more like closely held corporations than unique entities – diminishing their difference.

II. State Statutes and Fiduciary Duties Generally

A look at the five major states’ codes will quickly dispel any presumption that all states treat limited liability companies alike. Each state has a distinct approach to fiduciary duties – ignoring them entirely, recognizing them in some fashion, setting them out extensively in black letter, or some variation on the forgoing.

A. Corporate Law Statutes

As alluded to earlier, fiduciary duties in the corporate context are far more developed than with limited liability companies. However, these duties are not principally grounded in statutory law. Rather, as discuss infra, they are more developed from and in common law. Moreover, these duties are often addressed indirectly rather than directly in state statutes applying both to (i) public corporations where they correlate to formal director and officer duties to the corporation and its shareholders (as in Van Gorkom) and (ii) private, close corporations, where they correlate to often conflated roles of directors and shareholders and where shareholders of the corporation explicitly may exercise, or be entitled to exercise, board of director like powers in the absence of an
actual board of directors.\textsuperscript{17} The statutes pertaining to close corporation management appear to have the strongest correlation to LLC management and commensurate duties -- those in the second category just mentioned. These are our focus here.

Of the five major states that presently concern us, Delaware and Illinois both provide express statutory permission for shareholder management of close corporations in lieu of boards of directors.\textsuperscript{18} Massachusetts explicitly so provided until recently.\textsuperscript{19}

\textsuperscript{17} Note that commonly in the closely held corporation context, the roles of director, officer and shareholder are undertaken by the same few relatives or business associates. Indeed, most states recognize that closely held corporations may operate without the formality of a board of directors – but with the shareholders in effect comprising a board of directors in addition to being the actual owners of the corporation.


The certificate of incorporation of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors. So long as this provision continues in effect:

(1) No meeting of stockholders need be called to elect directors;

(2) Unless the context clearly requires otherwise, the stockholders of the corporation shall be deemed to be directors for purposes of applying provisions of this chapter; and

(3) The stockholders of the corporation shall be subject to all liabilities of directors.

Such a provision may be inserted in the certificate of incorporation by amendment if all incorporators and subscribers or all holders of record of all of the outstanding stock, whether or not having voting power, authorize such a provision. An amendment to the certificate of incorporation to delete such a provision shall be adopted by a vote of the holders of a majority of all outstanding stock of the corporation, whether or not otherwise entitled to vote. If the certificate of incorporation contains a provision authorized by this section, the existence of such provision shall be noted conspicuously on the face or back of every stock certificate issued by such corporation. (8 Del. C. 1953, § 351; 56 Del. Laws, c. 50.)

See also, 805 Ill. Comp. Stat. 5/2A.45. Management by shareholders.

\textsuperscript{a} The articles of incorporation of a close corporation may provide that the business of the corporation shall be managed by the shareholders of the corporation rather than by a board of directors. So long as this provision continues in effect:

(1) no meeting of shareholders need be called to elect directors;

(2) unless the context clearly requires otherwise, the shareholders of the corporation shall be deemed to be directors for purposes of applying provisions of this Act;

(3) shareholders shall act in the same manner as directors are required to act under Article 8 to the extent not inconsistent with this Article and unless the articles of incorporation provide otherwise; and
New York and California do not codify such permission per se. However, California does allow the board of the close corporation to delegate (with qualification) its powers to a management company or the like and further allows the reservation of significant board-like power and discretion to the close corporation shareholders through shareholder agreements that largely control the governance (including voting) among directors of the close corporation even to the extent of managing the corporation as though it were a partnership.\textsuperscript{20} This broad, partner-like governance by agreement model is statutorily recognized in Delaware as well.\textsuperscript{21}

\begin{quote}
\textsuperscript{(4)} the shareholders of the corporation shall be subject to all liabilities of directors.
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\begin{quote}
(b) A provision authorized by subsection (a) of this Section may be inserted in the articles of incorporation by amendment if all subscribers and shareholders of record, or if no shares have been issued, all incorporators and subscribers authorize such a provision. An amendment to the articles of incorporation to delete such provision shall be adopted, subsection (d) of Section 10.20 notwithstanding, by a vote of the holders of record of all the outstanding shares of each class of the corporation. If the articles of incorporation contain a provision authorized by this Section the existence of such provision shall be noted conspicuously on the face or back of every certificate representing shares issued by the corporation.
(Source: P.A. 86-1328.)
\end{quote}

\textsuperscript{19} MASS. GEN. LAWS Ch. 156B § 54 (200_): Powers of directors

The directors may exercise all the powers of the corporation, except such as by law, by the articles of organization or by the by-laws of the corporation are conferred upon or reserved to the stockholders.

(repealed effective July 23, 2004)

Under MASS. GEN. LAWS Ch. 156D (effective July 1, 2004), no directly analogous provision exists. However, MASS. GEN. LAWS Ch. 156D § 7.32 does permit shareholder agreements to eliminate boards of directors.

\textsuperscript{20}See CAL. CORP. CODE § 300. (West 2008)

(a) Subject to the provisions of this division and any limitations in the articles relating to action required to be approved by the shareholders (Section 153) or by the outstanding shares (Section 152), or by a less than majority vote of a class or series of preferred shares (Section 402.5), the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board. The board may delegate the management of the day-to-day operation of the business of the corporation to a management company or other person provided that the business and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board.

(b) Notwithstanding subdivision (a) or any other provision of this division, but subject to subdivision (c), no shareholders' agreement, which relates to any phase of the affairs of a close corporation, including but not limited to management of its business, division of its profits or distribution of its assets on
In the private, especially close corporation context, then, a significant degree of contractual or organizational freedom exists as with LLC formation and governance. Fiduciary duties not explicitly tied to distinct titles or categories of officers and directors are the duties most associated with LLCs. Of course, if not addressed statutorily,
shareholder level fiduciary duties may still exist at common law, ignoring or conflating traditional, formal corporate roles, infra. Some version of shareholder level (majority shareholder to minority shareholder) fiduciary duties are reflected in each of our five major state’s statutes inasmuch as those statutes provide express remedies for minority shareholders against majority/controlling shareholders for wrongs of oppression, freeze-out, or the like. This discussion is apart from the explicit statutory provisions that the five major states may have promulgated regarding fiduciary duties of directors and/or officers qua such formal office holders, again, so much more tied to large, public corporations. Indeed, as previously noted, while it is a commonplace in closely held corporations that shareholders, directors (if any) and officers are the same few close business associates or relations wearing multiple hats, we are giving attention to fiduciary duties tied to a corporation’s majority shareholders either directly or as a result of director-like roles, albeit not as directors per se, a distinction at times hard to bifurcate.

Certain states allow other explicit remedies to address minority shareholder rights in corporations. I mean here not to ignore entirely these other statutory means of protection, particularly dissenter’s rights, which certainly can be understood as a form of minority shareholder protection against breached fiduciary duties of majority shareholders in the closely held context, but to focus rather on the duties more tied to roles of managers’ or members’ duties in the limited liability company context. Both Delaware and New York offer statutory dissenter’s rights – generally a mechanism for a shareholder to cash out when she believes a corporation’s out of the ordinary course action is objectionable, but this does not really speak to the fiduciary duties of majority shareholders and corresponding rights of minority shareholders that states may have
legislated specifically to apply to closely held corporations – which, again, are much more analogous to most limited liability companies. Dissenter’s rights are generally more apropos of the public corporation shareholder. Of course, membership interests in limited liability companies may be public securities; but, in practice, far more private versions of the entities exist than public. Indeed, it would seem that the publicly traded limited liability company remains a relatively scarce animal. It makes sense then, to contrast duties in limited liability companies with duties in closely held corporations, not public corporations. That is what we are doing here.

As mentioned above, Delaware offers the dissenter’s rights effectively more operable in public corporations, (and it also expressly permits close corporation stockholder agreements that provide for voluntary dissolution with stockholder approval). Delaware does not, however, provide an express statutory remedy of forced dissolution for minority stockholder(s) – often a key mechanism for a minority shareholder to achieve some ultimate resolution of a dispute over the breach of majority/controlling shareholder fiduciary obligations to the minority in the closely held corporation setting.

Illinois, again evidencing perhaps the most detailed, minority favorable code, offers fair value outs in forced dissolution scenarios for minority shareholders of private (or “non-public”) corporations – clearly aimed at the closely held market. California


(a) In an action by a shareholder in a corporation that has no shares listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national or affiliated securities association, the Circuit Court may order one or more of the remedies listed in subsection (b) if it is established that:

(1) **The directors are deadlocked**, whether because of
even division in the number of directors or because of greater than majority voting requirements in the articles of incorporation or the by-laws or otherwise, in the management of the corporate affairs; the shareholders are unable to break the deadlock; and either irreparable injury to the corporation is thereby caused or threatened or the business of the corporation can no longer be conducted to the general advantage of the shareholders; or

(2) The shareholders are deadlocked in voting power and have failed, for a period that includes at least 2 consecutive annual meeting dates, to elect successors to directors whose terms have expired and either irreparable injury to the corporation is thereby caused or threatened or the business of the corporation can no longer be conducted to the general advantage of the shareholders; or

(3) The directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent with respect to the petitioning shareholder whether in his or her capacity as a shareholder, director, or officer; or

(4) The corporation assets are being misapplied or wasted.

(b) The relief which the court may order in an action under subsection (a) includes but is not limited to the following:

(1) The performance, prohibition, alteration, or setting aside of any action of the corporation or of its shareholders, directors, or officers of or any other party to the proceedings;

(2) The cancellation or alteration of any provision in the corporation's articles of incorporation or by-laws;

(3) The removal from office of any director or officer;

(4) The appointment of any individual as a director or officer;

(5) An accounting with respect to any matter in dispute;

(6) The appointment of a custodian to manage the business and affairs of the corporation to serve for the term and under the conditions prescribed by the court;

(7) The appointment of a provisional director to serve for the term and under the conditions prescribed by the court;

(8) The submission of the dispute to mediation or other forms of non-binding alternative dispute resolution;

(9) The payment of dividends;

(10) The award of damages to any aggrieved party;

(11) The purchase by the corporation or one or more other shareholders of all, but not less than all, of the shares of the petitioning shareholder for their fair value and on the terms determined under subsection (e); or

(12) The dissolution of the corporation if the court determines that no remedy specified in subdivisions (1) through (11) or other alternative remedy is sufficient to resolve the matters in dispute. In determining whether to dissolve the corporation, the court shall consider among other relevant evidence the financial condition of the corporation but may not refuse to dissolve the corporation solely because it has accumulated earnings or current operating profits.
(c) The remedies set forth in subsection (b) shall not be exclusive of other legal and equitable remedies which the court may impose.

(d) In determining the appropriate relief to order pursuant to this Section, the court may take into consideration the reasonable expectations of the corporation's shareholders as they existed at the time the corporation was formed and developed during the course of the shareholders' relationship with the corporation and with each other.

(e) If the court orders a share purchase, it shall:

(i) Determine the fair value of the shares, with or without the assistance of appraisers, taking into account any impact on the value of the shares resulting from the actions giving rise to a petition under this Section;

(ii) Consider any financial or legal constraints on the ability of the corporation or the purchasing shareholder to purchase the shares;

(iii) Specify the terms of the purchase, including, if appropriate, terms for installment payments, interest at the rate and from the date determined by the court to be equitable, subordination of the purchase obligation to the rights of the corporation's other creditors, security for a deferred purchase price, and a covenant not to compete or other restriction on the seller;

(iv) Require the seller to deliver all of his or her shares to the purchaser upon receipt of the purchase price or the first installment of the purchase price; and

(v) Retain jurisdiction to enforce the purchase order by, among other remedies, ordering the corporation to be dissolved if the purchase is not completed in accordance with the terms of the purchase order.

For purposes of this subsection (e), "fair value", with respect to a petitioning shareholder's shares, means the proportionate interest of the shareholder in the corporation, without any discount for minority status or, absent extraordinary circumstances, lack of marketability.

The purchase ordered pursuant to this subsection (e) shall be consummated within 20 days after the date the order becomes final unless before that time the corporation files with the court a notice of its intention to dissolve and articles of dissolution are properly filed with the Secretary of State within 50 days after filing the notice with the court.

After the purchase order is entered and before the purchase price is fully paid, any party may petition the court to modify the terms of the purchase and the court may do so if it finds that such changes are equitable.

Unless the purchase order is modified by the court, the selling shareholder shall have no further rights as a shareholder from the date the seller delivers all of his or her shares to the purchaser or such other date specified by the court.

If the court orders shares to be purchased by one or more other shareholders, in allocating the shares to be purchased by the other shareholders, unless equity requires otherwise, the court shall attempt to preserve the existing distribution of voting rights and other designations, preferences, qualifications, limitations, restrictions and special or relative rights among the holders of the class or classes and may direct that holders of a specific class or classes shall not participate in the purchase.

(f) When the relief requested by the petition includes the purchase of the petitioner's shares, then at any time within 90 days after the filing of the petition under this Section, or at such time determined by the court to be equitable, the corporation or one or more shareholders may elect to purchase all, but not less than all, of the shares owned by the petitioning shareholder for their fair value. An election pursuant to this Section shall state in writing the amount which the electing party will pay for the shares.

(1) The election shall be irrevocable unless the court determines that it is equitable to set aside or modify the election.

(2) If the election to purchase is filed by one or
permits a forced dissolution out for a 50% shareholder.\textsuperscript{24} Massachusetts offers a qualified forced dissolution for a minority of not less than 40% of all shareholders.\textsuperscript{25}

\begin{quote}
more shareholders, the corporation shall, within 10 days thereafter, give written notice to all shareholders. The notice must state: (i) the name and number of shares owned by the petitioner; (ii) the name and number of shares owned by each electing shareholder; and (iii) the amount which each electing party will pay for the shares and must advise the recipients of their right to join in the election to purchase shares. Shareholders who wish to participate must file notice of their intention to join in a purchase no later than 30 days after the date of the notice to them or at such time as the court in its discretion may allow. All shareholders who have filed an election or notice of their intention to participate in the election to purchase thereby become parties to the proceeding and shall participate in the purchase in proportion to their ownership of shares as of the date the first election was filed, unless they otherwise agree or the court otherwise directs.

(3) The court in its discretion may allow the corporation and all non-petitioning shareholders to file an election to purchase the petitioner's shares at a higher price. If the court does so, it shall allow other shareholders an opportunity to join in the purchase at the higher price in accordance with their proportionate ownership interest.

(4) After an election has been filed by the corporation or one or more shareholders, the proceeding filed under this Section may not be discontinued or settled, nor may the petitioning shareholder sell or otherwise dispose of his or her shares, unless the court determines that it would be equitable to the corporation and the shareholders, other than the petitioner, to permit the discontinuance, settlement, sale, or other disposition. In considering whether equity exists to approve any settlement, the court may take into consideration the reasonable expectations of the shareholders as set forth in subsection (d), including any existing agreement among the shareholders.

(5) If, within 30 days of the filing of the latest election allowed by the court, the parties reach agreement as to the fair value and terms of purchase of the petitioner's shares, the court shall enter an order directing the purchase of petitioner's shares upon the terms and conditions agreed to by the parties.

(6) If the parties are unable to reach an agreement as provided for in paragraph (5) of this subsection (f), the court, upon application of any party, shall stay the proceeding under subsection (a) and shall determine the fair value of the petitioner's shares pursuant to subsection (e) as of the day before the date on which the petition under subsection (a) was filed or as of such other date as the court deems appropriate under the circumstances.

(g) In any proceeding under this Section, the court shall allow reasonable compensation to the custodian, provisional director, appraiser, or other such person appointed by the court for services rendered and reimbursement or direct payment of reasonable costs and expenses, which amounts shall be paid by the corporation. (Source: P.A. 94-394, eff. 8-1-05; 94-889, eff. 1-1-07.) (emphasis added)

\textsuperscript{24} See \textsc{Cal. Corp. Code} §2000 (West 2008)

(a) Subject to any contrary provision in the articles, in any suit for involuntary dissolution, or in any proceeding for voluntary dissolution initiated by the vote of shareholders representing only 50 percent of the voting power, the corporation or, if it does not elect to purchase, the holders of 50 percent or more of the voting power of the corporation (the "purchasing parties") may avoid the dissolution of the corporation and the appointment of any receiver by purchasing for cash the shares owned by the plaintiffs or by the shareholders so initiating the proceeding (the "moving parties") at their fair value. The fair value shall be determined on the basis of the liquidation value as of the valuation date but taking into account the
possibility, if any, of sale of the entire business as a going concern in a liquidation. In fixing the value, the
amount of any damages resulting if the initiation of the dissolution is a breach by any moving party or
parties of an agreement with the purchasing party or parties may be deducted from the amount payable
to such moving party or parties, unless the ground for dissolution is that specified in paragraph (4) of
subdivision (b) of Section 1800. The election of the corporation to purchase may be made by the approval
of the outstanding shares (Section 152) excluding shares held by the moving parties.

(b) If the purchasing parties (1) elect to purchase the shares owned by the moving parties, and (2) are
unable to agree with the moving parties upon the fair value of such shares, and (3) give bond with sufficient
security to pay the estimated reasonable expenses (including attorneys' fees) of the moving parties if such
expenses are recoverable under subdivision (c), the court upon application of the purchasing parties, either
in the pending action or in a proceeding initiated in the superior court of the proper county by the
purchasing parties in the case of a voluntary election to wind up and dissolve, shall stay the winding up and
dissolution proceeding and shall proceed to ascertain and fix the fair value of the shares owned by the
moving parties.

(c) The court shall appoint three disinterested appraisers to appraise the fair value of the shares owned by
the moving parties, and shall make an order referring the matter to the appraisers so appointed for the
purpose of ascertaining such value. The order shall prescribe the time and manner of producing evidence,
if evidence is required. The award of the appraisers or of a majority of them, when confirmed by the court,
shall be final and conclusive upon all parties. The court shall enter a decree which shall provide in the
alternative for winding up and dissolution of the corporation unless payment is made for the shares within
the time specified by the decree. If the purchasing parties do not make payment for the shares within the
time specified, judgment shall be entered against them and the surety or sureties on the bond for the amount
of the expenses (including attorneys' fees) of the moving parties. Any shareholder aggrieved by the action
of the court may appeal therefrom.

(d) If the purchasing parties desire to prevent the winding up and dissolution, they shall pay to the
moving parties the value of their shares ascertained and decreed within the time specified pursuant to
this section, or, in case of an appeal, as fixed on appeal. On receiving such payment or the tender thereof,
the moving parties shall transfer their shares to the purchasing parties.

(e) For the purposes of this section, "shareholder" includes a beneficial owner of shares who has entered
into an agreement under Section 300 or 706.

(f) For the purposes of this section, the valuation date shall be (1) in the case of a suit for involuntary
dissolution under Section 1800, the date upon which that action was commenced, or (2) in the
case of a proceeding for voluntary dissolution initiated by the vote of shareholders representing only 50
percent of the voting power, the date upon which that proceeding was initiated. However, in either
case the court may, upon the hearing of a motion by any party, and for good cause shown, designate some
other date as the valuation date.

25 MASS. GEN. LAWS Ch. 156D § Section 14.30. GROUNDS FOR JUDICIAL DISSOLUTION.

The superior court located in the county set forth in section 14.31 may dissolve a corporation:

(1) in a proceeding by the attorney general if it is established that:

(i) the corporation obtained its articles of organization through fraud; or

(ii) the corporation has continued to exceed or abuse the authority conferred upon it by law;

(2) upon a petition filed by the shareholders holding not less than 40 per cent of the total combined
voting power of all the shares of the corporation’s stock outstanding and entitled to vote on the question
of dissolution, if it is established that:

(i) the directors are deadlocked in the management of the corporate affairs, the shareholders are unable to
break the deadlock, and irreparable injury to the corporation is threatened or being suffered; or
New York offers forced dissolution in a deadlock. Each of these – easily applied to closely held corporations – which again, are most like limited liability companies.

(ii) the shareholders are deadlocked in voting power and have failed, for a period that includes at least 2 consecutive annual meeting dates, to elect successors to directors whose terms have expired, or would have expired upon the election of their successors, and irreparable injury to the corporation is threatened or being suffered;

(3) in a proceeding by a creditor if it is established that:

(i) the creditor’s claim has been reduced to judgment, the execution on the judgment returned unsatisfied, and the corporation is insolvent; or

(ii) the corporation has admitted in writing that the creditor’s claim is due and owing and the corporation is insolvent; or

(4) in a proceeding by the corporation to have its voluntary dissolution continued under court supervision.(emphasis added)


(a) Except as otherwise provided in the certificate of incorporation under section 613 (Limitations on right to vote), the holders of shares representing one-half of the votes of all outstanding shares of a corporation entitled to vote in an election of directors may present a petition for dissolution on one or more of the following grounds:

(1) That the directors are so divided respecting the management of the corporation’s affairs that the votes required for action by the board cannot be obtained.

(2) That the shareholders are so divided that the votes required for the election of directors cannot be obtained.

(3) That there is internal dissension and two or more factions of shareholders are so divided that dissolution would be beneficial to the shareholders.

(b) If the certificate of incorporation provides that the proportion of votes required for action by the board, or the proportion of votes of shareholders required for election of directors, shall be greater than that otherwise required by this chapter, such a petition may be presented by the holders of shares representing more than one-third of the votes of all outstanding shares entitled to vote on non-judicial dissolution under section 1001 (Authorization of dissolution).

(c) Notwithstanding any provision in the certificate of incorporation, any holder of shares entitled to vote at an election of directors of a corporation, may present a petition for its dissolution on the ground that the shareholders are so divided that they have failed, for a period which includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired or would have expired upon the election and qualification of their successors.

N.Y. BUS. CORP. LAW § 1118. Purchase of petitioner's shares; valuation.

(a) In any proceeding brought pursuant to section eleven hundred four-a of this chapter, any other shareholder or shareholders or the corporation may, at any time within ninety days after the filing of such petition or at such later time as the court in its discretion may allow, elect to purchase the shares owned by the petitioners at their fair value and upon such terms and conditions as may be approved by the court, including the conditions of paragraph (c) herein. An election pursuant to this section shall be irrevocable unless the court, in its discretion, for just and equitable considerations, determines that such
These statutory closely held corporation minority shareholder rights spring from fiduciary duties – whether express or implied. That they may not all explicitly center on fiduciary duties, does not mean that they are not statutory remedies for such breaches. They derive from the less categorically formalized relationships associated with large, public corporations and more related to the closely held corporation context – very like the limited liability context.\(^\text{27}\) One cannot ground a right to forced dissolution and the subsequent possible fair value buyout of a minority shareholder by a majority shareholder without some basis in fiduciary duties owed by the majority to the minority. These duties are largely tied to deadlock or freeze-out situations – where a majority cannot carry the required vote among shareholders to carry out its intended action or where the majority, because of its voting control, effectively mistreats the minority by shutting it out of the running of the corporation. These fiduciary based obligations are what seem to have election be revocable.

(b) If one or more shareholders or the corporation elect to purchase the shares owned by the petitioner but are unable to agree with the petitioner upon the fair value of such shares, the court, upon the application of such prospective purchaser or purchasers or the petitioner, may stay the proceedings brought pursuant to section 1104-a of this chapter and determine the fair value of the petitioner's shares as of the day prior to the date on which such petition was filed, exclusive of any element of value arising from such filing but giving effect to any adjustment or surcharge found to be appropriate in the proceeding under section 1104-a of this chapter. In determining the fair value of the petitioner's shares, the court, in its discretion, may award interest from the date the petition is filed to the date of payment for the petitioner's share at an equitable rate upon judicially determined fair value of his shares.

(c) In connection with any election to purchase pursuant to this section:

1. If such election is made beyond ninety days after the filing of the petition, and the court allows such petition, the court, in its discretion, may award the petitioner his reasonable expenses incurred in the proceeding prior to such election, including reasonable attorneys' fees;

2. The court, in its discretion, may require, at any time prior to the actual purchase of petitioner's shares, the posting of a bond or other acceptable security in an amount sufficient to secure petitioner for the fair value of his shares.

\(^{27}\) Sandra K. Miller, at 584 (discussing her empirical study of limited liability company contractual practices in California, Delaware, New York, and Pennsylvania indicating lack of formality in executed contracts governing LLC’s and implying that at least a significant portion of LLC’s are organized for less sophisticated businesses).
informed, in significant part, the growing law on limited liability companies. The case law speaking to such situations, discussed *infra*, is substantial.

**B. Limited Liability Company Law Statutes**

Delaware\(^{28}\) and Illinois\(^{29}\) adopted limited liability company statutes in 1992, California\(^{30}\) and New York\(^{31}\) in 1994, and Massachusetts\(^{32}\) in 1996.

As noted earlier, Delaware’s code makes no mention upholding fiduciary duties associated with limited liability companies – expressly leaving such duties to pure contractual agreement among members and managers in articles of organization, operating agreements or the like – to be construed maximally.\(^{33}\) While allowing

\(^{28}\) HR 608 (approved July 22, 1992).
\(^{29}\) S 2361 (approved Sept. 11, 1992).
\(^{32}\) HB 4045, General Court, 1995, First Annual Session, approved Nov. 28, 1995, effective January 1, 1996.
\(^{33}\) [Del. Ltd. Liab. Co. Act § 18-1101.](#) 

Construction and application of chapter and limited liability company agreement.

Subchapter XI. Miscellaneous

(a) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.

(b) It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements. (emphasis added)

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

(d) Unless otherwise provided in a limited liability company agreement, a member or manager or other person shall not be liable 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 for breach of fiduciary duty for the member’s or manager’s or other person’s good faith reliance on the provisions of the limited liability company agreement.

(e) A limited liability company agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person to a limited liability company or to another member or manager or to another person that is a
comprehensive indemnification for managers of LLC’s, Delaware rather radically provides that duties of members or managers to a limited liability company or its manager(s) or member(s) may be “expanded or restricted or eliminated by provisions in the limited liability company agreement (excepting only “the implied contractual covenant of good faith and fair dealing”).\(^{34}\) (emphasis added)

New York’s Section 420 limits indemnification of members and managers to encompassing acts other than those “committed in bad faith” or “the result of deliberate dishonesty” that were “material to the cause of action so adjudicated or where such a person “personally gained in fact a financial profit or other advantage to which he or she was not legally entitled.”\(^{35}\) Specific to managers alone, New York Code Section 409

\(^{34}\) DEL. LTD. LIAB. CO. ACT § 18-108. Indemnification.

Subject to such standards and restrictions, if any, as are set forth in its limited liability company agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever. (68 Del. Laws, c. 434, § 1.)

\(^{35}\) N.Y. LTD. LIAB. CO. LAW § 420 (McKinney 2008).

Subject to the standards and restrictions, if any, set forth in its operating agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless, and advance expenses to, any member, manager or other person, or any testator or intestate of such member, manager or other person, from and against any and all claims and demands whatsoever; provided, however, that no indemnification may be made to or on behalf of any member, manager or other person if a judgment or other final adjudication adverse to such member, manager or other person establishes (a) that his or her acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause
requires that a manager perform the duties of manager “in good faith and with the degree of care that an ordinarily prudent person in a like position would use under similar circumstances.” In addition, New York permits members of a limited liability company to contractually limit in an operating agreement the personal liability of managers and members for breach of duties – excluding that stemming from acts made in bad faith, intentional misconduct, knowing violations of law or acts for personal gain. In this

Duties of managers.

(a) A manager shall perform his or her duties as a manager, including his or her duties as a member of any class of managers, in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances.

(b) In performing his or her duties, a manager shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by:

(1) one or more agents or employees of the limited liability company;

(2) counsel, public accountants or other persons as to matters that the manager believes to be within such person's professional or expert competence; or

(3) a class of managers of which he or she is not a member, duly designated in accordance with the operating agreement of the limited liability company, as to matters within its designated authority, which class the manager believes to merit confidence, so long as in so relying he or she shall be acting in good faith and with such degree of care, but he or she shall not be considered to be acting in good faith if he or she has knowledge concerning the matter in question that would cause such reliance to be unwarranted.

(c) A person who so performs his or her duties in accordance with this section shall have no liability by reason of being or having been a manager of the limited liability company.

(a) Subject to the provisions of this chapter, the members of a limited liability company shall adopt a written operating agreement that contains any provisions not inconsistent with law or its articles of organization relating to (i) the business of the limited liability company, (ii) the conduct of its affairs and (iii) the rights, powers, preferences, limitations or responsibilities of its members, managers, employees or agents, as the case may be.

The operating agreement may set forth a provision eliminating or limiting the personal liability of managers to the limited liability company or its members for damages for any breach of duty in such capacity, provided that no such provision shall eliminate or limit:
contractual focused provision, New York does not specifically name fiduciary duty or duties of loyalty and care. However, we might infer that the exceptions to limitation in Section 417 correspond to fiduciary duties, loyalty and care.

California’s code explicitly states “[t]he fiduciary duties a manager owes to the limited liability company and to its members are those of a partner to a partnership and to the partners of a partnership.”38

(1) the liability of any manager if a judgment or other final adjudication adverse to him or her establishes that his or her acts or omissions were in bad faith or involved intentional misconduct or a knowing violation of law or that he or she personally gained in fact a financial profit or other advantage to which he or she was not legally entitled or that with respect to a distribution the subject of subdivision (a) of section five hundred eight of this chapter his or her acts were not performed in accordance with section four hundred nine of this article; or

(2) the liability of any manager for any act or omission prior to the adoption of a provision authorized by this subdivision.

(b) The operating agreement of a limited liability company may be amended from time to time as provided therein; provided, however, that, except as otherwise provided in the operating agreement or the articles of organization, without the written consent of each member adversely affected thereby, (i) no amendment of the operating agreement or (ii) to the extent any provision concerning (A) the obligations of any member to make contributions, (B) the allocation for tax purposes of any items of income, gain, loss, deduction or credit, (C) the manner of computing the distributions of any member or (D) the compromise of an obligation of a member to make a contribution is contained in the articles of organization, no amendment of such provision in the articles of organization, shall be made that (i) increases the obligations of any member to make contributions, (ii) alters the allocation for tax purposes of any items of income, gain, loss, deduction or credit, (iii) alters the manner of computing the distributions of any member or (iv) allows the obligation of a member to make a contribution to be compromised by consent of less than all the members.

(c) An operating agreement may be entered into before, at the time of or within ninety days after the filing of the articles of organization. Regardless of whether such agreement was entered into before, at the time of or after such filing, such agreement, may be effective upon the formation of the limited liability company or at such later time or date as provided in the operating agreement; provided, however, under no circumstances shall an operating agreement become effective prior to the formation of such company.

38 CAL. LTD. LIAB. CO. LAW § 17153 (West 2008).

The fiduciary duties a manager owes to the limited liability company and to its members are those of a partner to a partnership and to the partners of the partnership.
Illinois’ Limited Liability Company Act provides in some detail that “[t]he fiduciary duties a member owes to a member-managed company and its other members include the duty of loyalty and the duty of care”. That duty of loyalty is broken down to include “a duty to account to the company” in a wind up or corporate opportunity like situation; a duty to “act fairly when a member deals with the company in a wind up or on behalf of a party with adverse interest to the company and “to refrain from competing with the company in the conduct of the company’s business”. The duty of care is “limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.” Moreover, the Illinois code requires that members discharge their duties in a manner “consistent with the obligation of good faith and fair dealing.” An obligation of “good faith and fair dealing” also remains with a member in the member-managed context. In the manager-managed context, members

39 ILL. COMP. STAT. 180/§ 15-3(a).
(a) The fiduciary duties a member owes to a member-managed company and its other members include the duty of loyalty and the duty of care referred to in subsections (b) and (c) of this Section.
40 ILL. COMP. STAT. 180/§ 15-3(b).
(b) A member's duty of loyalty to a member-managed company and its other members includes the following:

1. to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member in the conduct or winding up of the company's business or derived from a use by the member of the company's property, including the appropriation of a company's opportunity;

2. to act fairly when a member deals with the company in the conduct or winding up of the company's business as or on behalf of a party having an interest adverse to the company; and

3. to refrain from competing with the company in the conduct of the company's business before the dissolution of the company.

41 ILL. COMP. STAT. 180/§ 15-3(c).
(c) A member's duty of care to a member-managed company and its other members in the conduct of and winding up of the company's business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

42 ILL. COMP. STAT. 180/§ 15-3(d).
have no such duties based solely upon being members, but managers have the same
duties members do in the member managed context. In further detail, the Illinois code
prohibits elimination of the above referenced duties in an operating agreement.\footnote{ILL. COMP. STAT. 180/§ 15-5(b) (6), (7).} Similar
to Delaware and Massachusetts, Illinois permits extensive indemnification.\footnote{CAL. LTD. LIAB. CO. LAW § 17155}

The Massachusetts Limited Liability Company Act allows that ‘[t]he certificate of
organization or a written operating agreement may eliminate or limit the personal liability
of a member or manager for breach of any duty to the limited liability company or to

\begin{itemize}
\item[(d)] A member shall discharge his or her duties to a member-managed company and its other members
under this Act or under the operating agreement and exercise any rights consistent with the obligation of
good faith and fair dealing.

\item[(b)] The operating agreement may not:
\begin{itemize}
\item[(6)] eliminate or reduce a member's fiduciary duties, but may:
\begin{itemize}
\item[(A)] identify specific types or categories of activities that do not violate these duties, if not manifestly unreasonable; and
\item[(B)] specify the number or percentage of members or disinterested managers that may authorize or
ratify, after full disclosure of all materials facts, a specific act or transaction that otherwise would violate
these duties; or
\end{itemize}
\item[(7)] eliminate or reduce the obligation of good faith and fair dealing under subsection (d) of Section 15-3,
but the operating agreement may determine the standards by which the performance of the obligation is
to be measured, if the standards are not manifestly unreasonable.
\end{itemize}
\end{itemize}
another member or manager."\(45\) The Massachusetts code also permits indemnification of members or managers, but not “with respect to any matter as to which [such a party] shall have been adjudicated in any proceeding not to have acted in good faith in the reasonable belief [the party’s] action was in the best interest of the limited liability company.”\(46\)

This, of course, closely parrots the substance of the business judgment rule.

Of the five major states’ codes, Illinois’ version obviously offers the most explicit discussion of fiduciary duties – breaking down the duties of loyalty and care in the code itself. We already know Delaware avoids any discussion of such duties – other than expressly permitting their contractual elimination -- and we can see now that New York comes close to Illinois’ level of detail in substance if not in letter, while California imposes the broad standard of partnership like duties and Massachusetts allows freedom of contract permitting fiduciary truncation closer to Delaware.

\(45\) MASS. GEN. LAWS Ch. 156C § 8(b).

Indemnification of member or manager

Section 8. (a) Subject to such standards and restrictions, if any, as are set forth in its certificate of organization or a written operating agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever. Such indemnification may include payment by the limited liability company of expenses incurred in defending a civil or criminal action or proceeding in advance of the final disposition of such action or proceeding, upon receipt of an undertaking by the person indemnified to repay such payment if he shall be adjudicated to be not entitled to indemnification under this section which undertaking may be accepted without reference to the financial ability of such person to make repayment. Any such indemnification may be provided although the person to be indemnified is no longer a member or manager.

No indemnification shall be provided for any person with respect to any matter as to which he shall have been adjudicated in any proceeding not to have acted in good faith in the reasonable belief that his action was in the best interest of the limited liability company.

(b) The certificate of organization or a written operating agreement may eliminate or limit the personal liability of a member or manager for breach of any duty to the limited liability company or to another member or manager.

\(46\) MASS. GEN. LAWS Ch. 156C § 8(b).
Each state’s corporate code seems to indicate the like manner in which that state treats fiduciary duties tied to LLCs. If not entirely clear through a direct statutory relationship, the connection can be seen in the common law.

III. Case Law Discussion of Fiduciary Duties

A. Delaware Case Law

i. Corporate Case Law

In the corporate case law context, Delaware’s review of fiduciary duties appears to be most thorough when involving its entire fairness test – requiring greater scrutiny than the business judgment rule.

In *Nixon v. Blackwell*, the court considered a transaction involving a closely held corporation (having two classes of stock) that did not meet the statutory definition of a “close corporation.” The court, while not demanding equality of treatment among stockholders, did find that the entire fairness test was applicable. “When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain…The requirement of fairness is unflinching in its demand that where on stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.” Miller has asserted that this application of the entire fairness test has also been used with LLCs in Delaware to require certain conduct of members that might otherwise fit a fiduciary duty rubric.

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47 626 A.2d 1366 (Del. 1993).  
48 Id.  
49 Id.
In *Carlson v. Hallinan*\(^{50}\) the Delaware Court of Chancery granted forced dissolution of a closely held corporation owned by two shareholders, split 70/30. The minority shareholder prevailed upon showing a failure of the majority holders to meet the entire fairness test, and in so doing, “repeatedly breached their fiduciary duties in a continuing effort to enrich themselves at the corporation’s and [minority shareholder’s] expense.”\(^{51}\) Where directors of a corporation were involved in both sides of a transaction, the court, in its application of the entire fairness test, looked both at fair dealing and fair price. The Court found that the evidence presented demonstrated that the defendant directors failed to make “an informed, deliberate judgment, [in good faith]”.\(^{52}\)

In the leading case of *Lynch v. Vickers Energy Corp.*\(^{53}\) the Delaware Supreme Court held that directors and majority shareholders owe a fiduciary duty to minority shareholders, which requires “complete candor” in disclosing fully “all of the facts and circumstances surrounding” a transaction involving the minority.\(^{54}\) “In evaluating whether defendants satisfied their fiduciary duty of candor, the question is one of materiality.”\(^{55}\) Information which is material is “information such as a reasonable shareholder would consider important in deciding whether to sell or retain stock.” Thus, a director or majority shareholder breaches the duty of candor owed to the minority by disseminating false information or making misleading omissions. Such liability may be based on the failure to disclose income and cash flow projections and appraisals of share value.

\(^{50}\) 925 A.2d 506 (Del. 2006).
\(^{51}\) Id. at 543.
\(^{52}\) Id. at 532.
\(^{53}\) (Del. 1977) 383 A.2d 278.
\(^{54}\) Id. at 281.
\(^{55}\) Id. at 281.
ii. **LLC Case Law.**

The level of duty owed to a close corporation minority owner evidenced above does not, however, carry through consistently to the limited liability company context in Delaware.

Apparently, if not just an anomaly, where fiduciary duties have not been expressly limited or eliminated by contract, Delaware has, in fact, enforced such duties of managers or members to LLCs’ and other managers or members.

In *Metro Communication Corp. v. Advanced Mobilcomm Technologies, Inc.* 56, the Chancery Court held managers of a limited liability company to a “good faith” standard in making sure that the LLC “fulfilled its contractual duty.” The court included such obligation in a fiduciary duty of loyalty and care owed by the managers to the limited liability company. 57 The *Metro Communication Court* took a broad look at the Delaware law of fiduciary duties and saw it as an “aspect of …common law” that “has evolved to the point in which there are specific standards that govern the liability of entity fiduciaries, such as managers of LLC’s or more commonly corporate directors, for disclosures to entity owners.” 58 All of this centered around the existence of a manager’s duty to disclose or not “misdisclose” certain information to the limited liability company’s members. The duty of loyalty of managers of an LLC was also found to exist where two of three managers made merger plans without notifying the third of their

56 854 A.2d 121 (Del. Ch. 2004).
57 Id. at 153.
58 Id. at 155-156.
plans, effectively converting the third’s membership interest.\textsuperscript{59} The VGS court found that the two majority managers “failed to discharge their duty of loyalty…in good faith.”\textsuperscript{60}

In \textit{Minnesota INVCO of RSA v. Midwest Wireless Holdings, LLC} \textsuperscript{61} the Delaware Chancery Court found that directors of an LLC who proceeded to amend the LLC Agreement provisions governing rights of first refusal in the context of a pending transaction did so in accordance with the business judgment rule. The court went on to note that the director’s obtaining legal counsel and investment banking advice upon which they relied in good faith in making their decision to approve the amendment, indicated, together with trial evidence, that they did so in their belief that the action was in the best interest of the company to clarify a provision regarding refusal rights – not in breach of a duty of loyalty.\textsuperscript{62}

Yet, even with these examples of close corporation like duties evidenced in application of the business judgment rule and its heightened entire fairness test, post \textit{Van Gorkom} and its aftermath, Delaware, at least at the Chancery Court level, has made it explicit that it has chosen the contractarian approach to limited liability company fiduciary duties. Delaware’s Chancery Court has noted, “[l]imited liability companies are designed to afford the maximum amount of freedom of contract, private ordering and flexibility to parties involved.”\textsuperscript{63}

In \textit{In Re Grupo Dos Chiles, LLC}, the Chancery court relied on the terms of an LLC’s operating agreement in denying one member the right to unilaterally reinstate a Delaware LLC whose good standing with the state’s corporations division had lapsed.

\textsuperscript{60} Id. at 4.
\textsuperscript{61} 903 A.2d 786 (Del. Ch. 2006)
\textsuperscript{62} Id. at 797-798.
\textsuperscript{63} \textit{In re Grupo Dos Chiles, LLC} 2006 WL 668443 (Del. Ch.), not reported.
The Court looked to the letter of the applicable contract to resolve the issue. As that contract, the operating agreement, did not provide such a unilateral right, the court found that the consent of other members of the LLC was necessary to take such action.

Indeed, the Delaware Chancery Court has recently made most pointed policy statements on the matter. In *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC* 64, the Chancery Court looked back to *Grupo Dos Chiles* quoted in *Travel Centers of Am., LLC v. Brog* 65 to reiterate that “limited liability companies are creatures of contract…” The Court went on to repeat and emphasize language from the Delaware Limited Liability Company Act, “it is the policy of this chapter to give the maximum effect to the principle of freedom of contract.” 66 Moreover, the *R & R* Court distinguished the “uncorporate” form of organization of the LLC from all others (implicitly targeting a contrast with corporations). 67 The *R & R* Court went on further to refer extensively to Myron Steele’s, Sandra Miller’s and Larry Ribstein’s articles on the issue of LLC duties, quoting passages from each referring to the liberal contractual freedom of the LLC. 68

This propensity to look to the terms of a written operating agreement or contract went even further in the Delaware Supreme Court’s decision in *Olson v. Halvorsen* 69. In *Olson*, the court sought to construe an unwritten, unexecuted agreement governing a limited liability company on the ground that “the Delaware LLC Act seeks to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.” 70

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64 2008 WL 3846318 (Del. Ch.).
66 Id.
67 Id.
68 Steele, Miller, Ribstein, *infra*.
69 2009 WL 4846616 (Del. Supr.).
70 Id. [at 12]. (*citing* 6 Del. C. §18-1101(b)).
Yet, even in Delaware, where statutory law and the above common law requires apparently only the weakest of fiduciary duties— or most reliant on pure contract law and general good faith and fair dealing standards, courts have looked to corporate precedent to answer issues regarding the LLC. Another such recent noteworthy example occurred where the court was asked to determine whether demand futility applies in a derivative suit sought on behalf of a limited liability company.\footnote{4479-VCN (2009).} In \textit{Lola Cars International Ltd v. Krohn Racing, LLC}, the Court of Chancery allowed a cause of action including breach of fiduciary duty claims to proceed to trial where a corporate LLC member plaintiff was seeking dissolution of an apparently deadlocked joint venture under Section 18-801 of the Delaware Limited Liability Company Act. Such provision expressly turns on the “reasonable practicability to carry on business in conformity with the operating agreement of the LLC”. The Chancery Court looked to the corporate standard on demand excusal to determine whether the limited liability company demand had been properly excused.

**B. Massachusetts Case Law**

i. **Corporate Case Law.**

Massachusetts case law on close corporation fiduciary duties is anchored in \textit{Donahue v. Rodd Electrotype Co. of New England.}\footnote{Supra.} The seminal \textit{Donahue} court held that “stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.”\footnote{Id at 593.} This holding established, or reiterated, a “strict good faith standard” to which close corporation shareholders were to adhere – a duty beyond that which any shareholder of
any corporation – no matter how big or small might owe. Indeed, the Donahue court spent some time setting out the definition of just what is a close corporation. Some states offer statutory definitions, including a maximum number of shareholders. The Donahue court found a “close corporation to be typified by: (1) a small number of stockholders, (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation.”

More recent cases in Massachusetts have continued to look back to Donahue and to rely on the partnership-like duties standard in its holding. However, certain limitations on the Donahue expounded duty have been logged. In Stanley J. Wilkes v. Springside Nursing Home, Inc., the Wilkes court cautioned that the [stockholder] majority in the closely held corporation is entitled to certain “selfish ownership” rights that must be set off against the “strict good faith” they owe to the minority.” In reliance on a multitude of case law and commentary, the Wilkes Court went on to name the turning point in the would-be balancing decision, “[i]t must be asked whether the controlling group can demonstrate a legitimate business purpose for its action.” The court then continued to reason that such a demonstration then begets the minority an opportunity to show that the

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74 Id.
75 Id. at 586.
77 Id. at 851.
majority could have achieved its ends in a way “less harmful to the minority’s interest.”

The *Brodie v. Jordan* Court found majority stockholders in a close corporation in violation of fiduciary duties owed to minority stockholders when the majority excluded an executrix of her husband/stockholder’s estate from corporate employment and participation in operations in the close corporation her husband had owned. On the remedy of a stock buyout of the minority holder by the majority, the court found that the minority should not be put in a better place than she would have been in without what was determined to be the majority’s fiduciary breach and reversed and remanded on the remedy.

In *Demoulas v. Demoulas Super Markets, Inc.*, a majority stockholder was found to have breached fiduciary duties owed the beneficiaries of his deceased minority shareholder brother when that majority stockholder entered into transactions benefiting himself without disclosing the transaction(s) to the minority or obtaining disinterested

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79 Id.
80 Note also, *Zimmerman v. Bogoff*, 402 Mass. 650 (1988), “there has been no qualification upon the proposition that fiduciary obligations may arise regardless of percentage of share ownership.” at 657-8. see also *Brodie v. Jordan*, 447 Mass. 866 (2006) finding that in yet another freeze-out situation, the remedy of a forced buyout for the minority shareholder was not appropriate because as close corporation shares there was never a ready market for cashing-out. at 870-871. (One wonders whether this reasoning isn’t entirely circular as the forced buyout would not be sought at great cost and effort if there were a ready market and the illiquidity of closely held shares would seem to be the very reason for establishing such a remedy often found in the instance of a forced dissolution right by the frozen out minority triggering a buy-out option by the majority. And *O’Brien v. Pearson*, 449 Mass. 377 (2007). See *Adelson v. Adelson*, 60 Mass. App. Ct. 753 (2004) creating a personal exception for direct stockholder to stockholder transactions – holding that fiduciary duties do not extent to “personal transaction[s]” even between father and son.
82 Id.
stockholder approval of those transaction(s). Thus, corporate opportunity doctrine and self-dealing breaches were found.

ii. **LLC Case Law.**

Distinctions between the corporate and limited liability company forms are, at times, hard to decipher. Courts may either intentionally or unintentionally blur the distinction in finding and applying fiduciary duties. A recent decision by a Massachusetts court regarding a limited liability company, *Pointer v. Castellani*, appears to have conflated the corporate and limited liability forms entirely. The *Pointer* court refers to a limited liability company as a “closely held corporate entity” and a “close corporation.” The *Pointer* court goes on to look to the corporate fiduciary standards found in the cases discussed below and directly applies those standards to the alleged fiduciary breaches in the limited liability company context.

In *Billings v. GTFM, LLC*, the president of a limited liability company was found to have breached certain fiduciary duty standards of loyalty and good faith to the LLC for financial dealings that benefited him, including, *inter alia*, obtaining reimbursement from the LLC for illegitimate business expenses and misrepresenting capital contributions to the LLC on tax returns. In *Billings*, the court went on to look to Delaware corporate law standards on derivative suits in determining whether claims

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84 Id.
85 See also, *Boylan v. Boston Sand & Gravel Co.*, 212 Mass. L. Rptr. (Suffolk Super. Ct., March 16, 2007) (applying Demoulas to instant facts where a majority failed to fully disclose terms of a proposed transaction to the corporations’ board of directors.
86 SJC-10352 (2009).
87 Id.
88 449 Mass. 281 (2007)
89 Id.
brought by the LLC president were properly brought on behalf of the LLC once the
president’s status with the LLC changed.\textsuperscript{90}

In the related litigation of \textit{Genesis Technical & Financial, Inc. v. Cast Navigation, LLC},\textsuperscript{91} the Appeals Court, in determining the standard of behavior applicable to a director of a limited liability company, looked to corporate common law harkening back to \textit{Meinhard v. Salmon}\textsuperscript{92} and Cardozo’s insistence that a director’s loyalty to his organization must be “the punctilio of an honor the most sensitive”.\textsuperscript{93} The court specifically reiterated the rule of the corporate opportunity doctrine that a director must first disclose an appropriate opportunity to the board, before acting on it in his own interest.\textsuperscript{94}

Massachusetts, then, has a well developed case history recognizing fiduciary duties among shareholders in the closely held corporation context – striking a balance between legitimate interests of majority ownership and fair treatment of minority owners. This corporate common law has, in part, directly informed, if not controlled, certain decisions regarding fiduciary duties in limited liability companies.

\textbf{C. California Case Law}

\textbf{i. Corporate Case Law.}

In \textit{Singhania v. Uttarwar}\textsuperscript{95} the California Court of Appeal 6\textsuperscript{th} Appellate District reiterated the state’s rule that “the comprehensive rule of good faith and inherent fairness

\textsuperscript{90} Id.
\textsuperscript{91} 74 Mass. App. Ct. 203, 905 N.E.2d 569 (2009)
\textsuperscript{92} 249 N.Y. 458, 464, 164 N.E. 545 (1928).
\textsuperscript{93} Id at 575.
\textsuperscript{94} Id.
\textsuperscript{95} 136 Cal.App.4\textsuperscript{th} 416, 38 Cal.Rptr.3d 861 (Ca. App. Dist.6 0226).
to the minority in any transaction where control of the corporation is material properly
governs controlling shareholders in this state."96

Jones v. Ahmanson & Co.97 set the fiduciary duty standard bar high in California,
“Majority shareholders may not use their power to control corporate activities to benefit
themselves alone or in a manner detrimental to the minority. Any use to which they put
the corporation or their power to control the corporation must benefit all shareholders
proportionately and must not conflict with the proper conduct of the corporation's
business."98

In Ken Cotton v. Expo Power Systems, Inc.99, the Court of Appeals of California,
Second District, Division Five addressed the implementation of Section 2000 of the
California Corporations code permitting a buyout of minority shareholders by the
majority in a forced dissolution context. While the instant dispute centered on valuation
issues, the underlying cause of the minority/majority split was over allegations of
fiduciary breach by diversion of assets.100

ii. LLC Case Law.

California common law has repeatedly emphasized that the limited liability
company is a “hybrid business entity” with a legal existence “separate from its
members.” 101
In *PACLINK COMMUNICATIONS INTERNATIONAL, INC. v. SUPERIOR COURT OF LOS ANGELES COUNTY*102 the California Court of appeals applied the corporate derivative standards to limited liability company based causes of action. The *PACLINK* Court looked to the adoption of California’s limited liability law as a part of its corporations Code and the express language that like a corporation, a limited liability company exists separate from its members.

In *PEOPLE v. PACIFIC LANDMARK*,103 the Second District, Division 3 looked beyond the statutory provision of section 17158 of the Corporations Code stating that managers or officers of limited liability companies cannot be held personally liable “solely by reason of being a managers or officer…” to find that managers or officers may be personally liable for tortuous or criminal conduct “even while performing their duties as manager.”104 In its discussion, the Court looked to the ubiquitous general principle noted above, and aligned its reasoning with Corporations Code Section 17155, permitting LLC indemnification of managers.105

In *NORRIE v. LANE*,106 the Second Appellate District, Division Four again referred directly to statutory language in the Corporations Code, looking to Section 17153 for the express duties of a manager of an LLC, namely being those of a partner to a partnership.

Thus, while not addressing fiduciary duties head on, it appears that California courts are clearly recognizing duties of managers in limited liability companies at least

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104 Id. at 1213.
105 Id. at 1214.
106 2009 CA 0603.013.*(later reversed in part, not pertinent).
akin to the statutory standard that partners owe to a partnership – just as it has in its corporate statutory and common law.¹⁰⁷

D. **New York Case Law**

i. **Corporate Case Law.**

The general principle cited in *O'Neill v. Warburg, Pincus & Co.*¹⁰⁸, and found in further case law in New York, is that a majority shareholder in a close corporation owes a fiduciary duty to minority shareholders.¹⁰⁹ Note, however, that in New York, fiduciary relationships are "necessarily fact-specific."¹¹⁰

Directors and majority shareholders of a corporation have the power to manage the affairs of the corporation. Thus, they are in a fiduciary role as the guardians of the welfare of the corporation.¹¹¹ As fiduciaries, they are obligated to exercise their responsibilities in good faith. They must treat all shareholders, majority and minority, fairly¹¹². In issuing new stock, directors, being fiduciaries, must treat existing shareholders fairly¹¹³ "Actions that may accord with statutory requirements are still subject to the limitation that such conduct may not be for the aggrandizement or undue advantage of the fiduciary to the exclusion or detriment of the stockholders"¹¹⁴.

¹⁰⁷ Note the explicit statutory references in these decisions discussed.
¹⁰⁸ 39 A.D.3d 281 (1st Dept 2007).
¹¹³ *Katzowitz*, 24 N.Y.2d at 518; *Dunlay v Avenue M Garage & Repair Co.*, 253 N.Y. 274, 278-80 (1930) [citations omitted] ("[d]irectors may not authorize the issue of unissued stock to themselves for the primary purpose of converting them from minority to majority stockholders. Such conduct . . . is inequitable in the highest degree").
¹¹⁴ *Alpert*, 63 N.Y.2d at 569 [citations omitted].
ii. **LLC Case Law.**

In *Nathanson v. Nathanson*\(^\text{115}\) the New York Supreme Court, Appellate Division, Second Department found that an allegation of self-dealing against a manager of a limited liability company for deferring the payment of certain distributions in order to accrue interest on the undistributed funds should go to trial. The Court referred to Section 409 of the Limited Liability Company Law requiring a manager to “perform his duties in good faith and with a degree of care that an ordinarily prudent person in a like position would use under similar circumstances.”\(^\text{116}\)

Further statutory reference was made in *Wilcke v. Seaport Lofts, LLC*\(^\text{117}\) where the court found a vote of interested managers of a limited liability company to indeed be fair and reasonable as required by Section 411 of the Limited Liability Company Law.

The duties of a member of a limited liability company were said to be like a partner to other partners in a partnership in *Out of the Box Promotions, LLC v. Koschitzki*.\(^\text{118}\) Moreover, the court in *Out of the Box* liberalized the possible existence of more than one member of an LLC and allowed the issue of whether a member may bring a derivative suit on behalf of a limited liability company in New York to proceed, notwithstanding certain contrary precedent.\(^\text{119}\) Additional fiduciary claims of self-dealing (diverting opportunities to another entity) were also allowed to proceed.\(^\text{120}\)

In *DeFazio v. Wallis*\(^\text{121}\) the Supreme Court, Nassau County, in finding that allegations of a fiduciary breach had been adequately alleged to go to trial, discussed

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\(^\text{116}\) Id. at 404.
\(^\text{119}\) Id.
\(^\text{120}\) Id. at 7.
Limited Liability Company Law Section 409 and cited *Tzolis v. Wolf*\(^ {122}\) for the rule that that section “has been held to give rise to a fiduciary duty.” The court then specifically noted that “[a] majority shareholder in a close corporation owes a fiduciary duty to the minority shareholders.”\(^ {123}\) Similarly, the manager of a limited liability company may owe a fiduciary duty directly to the other members of the LLC.\(^ {124}\) The DeFazio Court also looked to corporate precedent to determine whether suit could be brought by LLC members in a derivative capacity.\(^ {125}\)

The *McGuire Children* Court, following *Willoughby* and *Out of the Box*, went on to explain that fiduciary duties are owed by LLC members directly to one another – like partners – and continued to expound that the elements for an action for breach of fiduciary duty do not include reliance.\(^ {126}\)

New York’s common law on entity relationship based fiduciary duties, then, clearly indicates the strong influence, if not utter control, of close corporation precedent on limited liability companies.

**E. Illinois Case Law**

i. **Corporate Case Law.**

In *Hagensenas v. Gaylord*\(^ {127}\) an Illinois appellate court discussed majority shareholder fiduciary duties toward minority shareholders. The court cautioned that mere status as a shareholder did not create the duty, but went on to hold that even though the instant corporation was not formed as a close corporation, it was a close corporation in


\(^{124}\) See also *McGuire Children, LLC v. Huntress*, 2009 NY Slip Op 51234 (Supr. Ct. Erie County) (“It is well-settled under New York law that managing members of an LLC owe a duty to the LLC and to their fellow members.”) and *Salm v. Feldstein*, 20 A.D.3d 469 (2nd Dept. 2005)

\(^{125}\) *DeFazio* at 10.

\(^{126}\) *McGuire Children* at 11.

effect and as such, its two shareholders owed fiduciary duties to one another like partners in a partnership.\textsuperscript{128}

In \textit{Graham v. Mimms}\textsuperscript{129} an Illinois court found that a majority shareholder owed a duty to minority shareholders even after resigning his positions with the corporation. The \textit{Graham} court noted that “[i]t is undisputed that the individuals who control corporations owe a fiduciary duty to their corporation and its shareholders.”\textsuperscript{130}

The rule that individuals who control corporations owe fiduciary duties to those corporations and their shareholders was reiterated in \textit{Doherty v. Kahn}.\textsuperscript{131} In \textit{Kahn}, where the court treated the corporation at issues explicitly as though it were a close corporation (though not formed as such) the court cautioned that the corporation itself did not owe the fiduciary duty to its shareholders.\textsuperscript{132}

\textbf{i. LLC Case Law.}

In \textit{Arnest v. Audino}\textsuperscript{133}, the Illinois Appellate Court Second District looked to the Illinois Limited Liability Company Act section 805 ILCS/15-3 (West 2000) stating that members in a member managed LLC owe one another duties of loyalty and care, but relied upon prior statutory law – in place at the time of the cause of action (804 ILCS/10-10 (West 1996)) -- which provided the standard for a manager or member ‘s liability to another member was to be found to the same extent as “a director of an Illinois business

\textsuperscript{128} Id. at __.
\textsuperscript{129} 111 Ill. App. 3d 751, 444 N.E.2d 549 (1982).
\textsuperscript{131} 289 Ill. App. 3d, 682 N.E.2d 163 (1997).
\textsuperscript{132} Id. at __.
corporation…in analogous circumstances.”

The court went on to site ample Illinois case law regarding corporations – holding that those in control of corporations owe a fiduciary duty to the corporation and its shareholders. This, of course, is a very direct example of the connection sought to be made in this article – that the corporate standard is, at least in certain states, imported virtually whole cloth into the LLC law (both statutory and common). Indeed, the Illinois court more specifically draws upon closely held corporation case law – applying a standard similar to Massachusetts’ – “shareholders in a closely held corporation owe to each other fiduciary duties similar to those of partners in a partnership.” Even more exemplary of a complete adoption of the corporate standards into the realm of the LLC is the courts subsequent discussion finding that the corporate opportunity doctrine applies to LLC’s as it does to corporations.

Notwithstanding this corporate like application, however, Illinois’ Court of Appeals for the First District, Sixth Division has held that standards of fiduciary duties set out statutorily to apply to managers of limited liability companies do not apply to members – unless those members are acting in the capacity of managers. Indeed, Katris v. Carroll is a strong argument for strict reliance on the letter of the extensive Illinois statutory law addressing fiduciary duties in the LLC context.

In Katris, the Court looked to section 15-3(g) of 805 ILCS 180 noting the existence of “fiduciary duties only a member of a member-managed limited liability company who exercises some or all of the authority of a manager pursuant to the

134 Id.
136 Id. Citing Hagshenas v. Gaylord, 199 Ill. App.3d 60, 71 (1990)
137 Id.
operating agreement.” The Court determined that the defendant did not exercise any managerial authority over the limited liability company by looking primarily to the statute and the LLC’s operating agreement, naming two other members as managers and giving members no express managerial authority.

Illinois, then, consistent with its high level of express statutory obligation, again in its common law, holds managers and members of LLC’s to a standard analogous to the highest level of obligation of closely held corporation shareholders.

IV. Conclusion.

While the express, statutory duties of members and managers of limited liability companies range from the practically nonexistent in Delaware to the substantial and detailed in Illinois, well established statutory and common law duties between majority stockholders of close corporations and minority holders exist in the five major states. The range, or continuum, from the lacking to the pronounced holds consistently in both corporate and limited liability company law from least strict in establishing and enforcing fiduciary duties in Delaware to most strict in Illinois. These duties are quite distinct from the more public corporation applicable duties, including dissenter’s rights, common in state corporate law codes and they clearly inform, if not control, the common law in the five major states on limited liability company manager and member duties. This body of statutory and common law on fiduciary duties tied to limited liability companies, though not as developed into enduring doctrines as with the corporate common law, is growing, and indicates a strong link to the predecessor parallel law on close corporations.

139 Id.

140 Id.
While we can draw the obvious and tiresome conclusion that fiduciary duties in corporations – specifically close corporations -- are more pronounced and more enforceable in the five major states generally than fiduciary duties in limited liability companies, I believe the cited case law, if not the statutory law of the five major states as well, supports a real connection between the treatment of fiduciary duties associated with close corporations and the treatment of fiduciary duties associated with limited liability companies – a connection that is increasing with the age and growth of body of law on LLCs.

This is, perhaps, a logical outcome of laws establishing a relatively new entity form created to allow relatively great contractual freedom and anonymity for owners. While corporate laws certainly allow for limited liability and variation of structure and procedure of corporate operation in articles and bylaws, LLC’s are that much less formal or standardized from their inception. Standard or general fiduciary duties would seem less likely to be expected or implied where time has not allowed them to become established through happenstance and where management form, duties and structure are so varied and open to unique agreement. Yet, over time, that would-be uniqueness has tended more and more to fit established patterns seen more and more by courts in the five major states to be like close corporations and to be treated as such.

The real question, then, is the normative one -- **should** duties like those owed by majority shareholders of close corporations to minority shareholders exist regarding limited liability company members and managers, strengthened by statute and/or enforced at common law and be treated increasingly similarly?
Our look at the five major states gives us no consensus answer to the normative question. On the treatment of duties in limited liability companies becoming increasingly similar to those in close corporations – there is a clear consensus from the five major states as a group that this is occurring (whether or not it ought)– albeit in a manner and to a degree inconsistent among those five major states.

We are left to choose from the range of approaches from the Delaware pro-contractarian model to which Massachusetts statutory law, if not common law, seems to be following – each allowing the near elimination of all fiduciary duties in the name of freedom of contract particularly applied to operating agreements to the Illinois codified duties of loyalty and due care.

Should the sort of duty enforced in Van Gorkom apply to members and managers of private limited liability companies? Should those duties rather be stripped to the near bare version of UCC like good faith and fair dealing in contract? Probably something in between.

Putting aside the economic based arguments of the contractarians, it would seem that, barring a fully free contractual agreement to the contrary, a majority with no duties to a minority would wield power so great as to enable the facile pursuit of pure self interest over the interest of the entity and/or its minority owners. Indeed, it is simply hard to believe that any parties with some equality of bargaining power would rationally contract away some fiduciary duty of the majority to the minority and the entity itself. This would be tantamount to investment without recourse. Doesn’t any investor – public or private – have some bottom line expectation of fair treatment? Shouldn’t the law recognize and enforce that expectation?
We will see as common law continues to develop in the five major states and elsewhere which way the law trends. However, we need no further rationale other than this common human reason to support duties greater than just fair dealing with members and managers of limited liability companies.

Practically, the concern of a majority owner is to avoid the hassle and expense of a proactive minority with different plans for the shared entity or different goals for her investment or different interests in the development of the venture.

Would it not make more sense to keep in place some level of fiduciary duty beyond the basic UCC contractual obligation of good faith and fair dealing while making goals and rights explicit in operating agreements? For instance, provide a call right upon certain major decision triggers where a minority member’s interests might diverge from the majority. Adept drafting of an operating agreement at the formation of the venture would go a long way toward preventing situations where minority members were likely to assert different interests from the majority, while allowing the existence of fiduciary obligations of the majority to the entity and to the minority to maintain the adequate protection of them from the pure self interest of those in control.

Ironically, then we should look to a statutory and common law encouraged contract based solution to escape the contractarian elimination of fiduciary duties in the LLC context.