

COMPANY GOVERNANCE UNDER FLORIDA'S
LIMITED LIABILITY COMPANY ACT

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I. INTRODUCTION

Lawyers and accountants, the transactional engineers of American business, are accustomed to thinking of different forms of business organization as planning opportunities. If they are savvy, they also see them as marketing opportunities. Clients may be persuaded to trade in their old forms for a new and improved model. These sophisticated form entrepreneurs see what state legislatures have always known but rarely articulated: organizational forms are products that trade in a market. The law is for sale, not that there's anything wrong with that.¹

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1. Over the years, a number of commentators have thought something was very wrong with that. Delaware, which has been particularly successful in this market, has been the most frequent target for criticism. *See, e.g.*, William W. Bratton, *Delaware Law As Applied Public Choice Theory: Bill Cary and the Basic Course After Twenty-Five Years*, 34 GA. L. REV. 447 (2000); William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 705 (1974) (characterizing Delaware as the winner of the “race for the bottom”); Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861 (1969). Those critiques have in turn provoked defenses. *See, e.g.*, John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 271 (2000); several pieces by Roberta Romano, but particularly *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) and *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843 (1993); and Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

Until fairly recently, the options available in the business organizations market were somewhat limited. Sole proprietorships existed as a default choice, but—at least for form merchants—such businesses were simply targets of opportunity; sole proprietorships were corporations-in-waiting.² Limited partnerships were primarily used for tax shelters (remember tax shelters?) and continued to be sold to that segment of the market involved with real estate. For most other businesses, however, the forms market consisted of partnership or incorporation, although the availability of out-of-state incorporation did at least offer variations on the latter theme.

Those forms had both advantages and disadvantages. The partnership form offered flexibility, informality, and pass-through taxation, but exposed the partners' personal assets to the risks of the business³ and could not be used by sole proprietors.⁴ The limited partnership conferred its liability shield at the price of active participation in management.⁵ The corporation required adherence to statutory norms; a casual approach to corporate formalities could result in the loss of limited liability⁶ or the inability to enforce a shareholder agreement.⁷ In any event, incorporation introduced tax complications. In short, there was no such thing as the perfect transactional vehicle.

Of course, business lawyers and accountants were fully aware of these imperfections and put their considerable talents to work in trying to cure them. Some of those efforts resulted in a major overhaul of an "old" form, the partnership.⁸ However, that overhaul did not

For purposes of this Article, whether the law "ought" to be a product which trades in a market is not at issue. Both the critics and the defenders agree that, as things stand, it is a product and that form consumers have opportunities for form shopping.

2. Incorporated sole proprietors who wanted to avoid double taxation at the federal level could do so with planning. State tax avoidance sometimes required more complex strategies, but this just increased the need for the planners' services. I am indebted to my colleague Steve Bank for sharing with me his experiences in such planning and his wry observation that clients were at times amazingly willing to spend large amounts of money on legal fees to avoid small amounts of taxes or filing fees. Behavioral economists studying bounded rationality might usefully consider adding a "government aversion effect" to their list of cognitive biases.

3. U.P.A. §§ 13-15 (1914) (making partners jointly and severally liable for a partner's tort or breach of trust and jointly liable on partnership contracts).

4. *Id.* § 6 (defining partnership as an "association of two or more persons").

5. U.L.P.A. § 7 (1916); R.U.L.P.A. (1976) (amended 1985). RULPA permits limited partners to do quite a lot without losing their liability shield, but they still may not participate in control. A proposed revision to RULPA would eliminate that restriction. R.U.L.P.A. § 303 (Tentative Draft, 2001).

6. Failure to observe corporate formalities frequently appears on the list of reasons to pierce the corporate veil, although it is difficult to tell whether that—or any other stated reason—actually produces the result. *See, e.g.*, Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991).

7. *See, e.g.*, *McQuade v. Stoneham*, 189 N.E. 234 (N.Y. 1934) and its progeny.

8. R.U.P.A. (1996) (amended 1997). Although the formal title of the statute does not include the word "revised," the new model statute is universally referred to and usually

solve the problem of the partners' unlimited personal liability, nor did it afford total flexibility in structuring the deal.⁹ The search for the perfect transactional form continued.

Perfection is an elusive goal. So far, at least, no one has invented a form that meets everyone's needs.¹⁰ Instead, over the last several years, we have seen a proliferation of business forms that has dramatically altered the landscape. Now, in addition to partnerships, limited partnerships, and corporations, we have limited liability partnerships (LLPs), limited liability limited partnerships (LLLPs), and limited liability companies (LLCs). State-to-state variation in those new forms makes life even more exciting for those who thrive on complexity.

Although Florida was an early entrant in the forms market, it has only recently become competitive. Florida was fairly quick to adopt RUPA, albeit with some tinkering.¹¹ However, it was not until 1999 that Florida adopted LLP provisions¹² and an LLC statute¹³ that had any hope of being widely used.

The new LLP provisions are not all that different from anyone else's. They constitute, if you like, a generic. That generic will be bought in Florida by people who want to do business in that form, and Florida will collect the filing fees. The new LLC statute, how-

cited as the Revised Uniform Partnership Act, or "RUPA." As of 2001, the Revised Uniform Partnership Act had been adopted, with occasional variations, in 30 states (including Florida) and the District of Columbia.

9. RUPA's drafters considered, but ultimately rejected, giving the parties complete freedom of contract. See *infra* text accompanying note 32.

10. Although one author claims that Texas has done so. Thomas F. Blackwell, *The Revolution is Here: The Promise of a Unified Business Entity Code*, 24 J. CORP. L. 333 (1999). I might consider this to be just another example of Texan *hubris*, were it not that (1) Mr. Blackwell might be right, my doubts to the contrary notwithstanding, and (2) no one who starts an article with a citation to a Beatles song can be fairly accused of taking himself too seriously.

11. FLA. STAT. §§ 620.81001-620.9902 (adopted in 1995). The legislature was undoubtedly assisted in its deliberations by the fact that RUPA's Reporters were both on the faculty at Florida State University. For a comprehensive discussion of the process and its results, see John W. Larson, *Florida's New Partnership Law: The Revised Uniform Partnership Act and Limited Liability Partnerships*, 23 FLA. ST. U. L. REV. 201 (1995).

12. Florida adopted LLP provisions in 1995, but they were not "full shield." Partners were protected from tort liability but not from obligations arising from contracts. Florida also required professionals either to buy liability insurance or post a bond. Foreign LLPs could register in the state, although they had to comply with the insurance requirements for Florida partners. Nevertheless, since most foreign statutes provided a full liability shield, those Florida partnerships that wanted completely limited liability bought the foreign product. Those competitive disadvantages were eliminated in 1999; Florida LLPs are now full shield and insurance is not required. FLA. STAT. § 620.8306 (2001).

13. Although Florida was the second state to adopt an LLC statute, Florida Limited Liability Company Act, FLA. STAT. §§ 608.401-608.514 (1982), that statute was the business form version of an Edsel. Nobody bought it. Single member LLCs were not permitted and (the *coup de grace*) LLCs were taxed as corporations. While Florida rejoices in the absence of a personal income tax, it does have a corporate income tax. In 1997-98 those impediments were removed, setting the stage for a more thoroughgoing revision.

ever, is a brand new product. In fact, it is unique. No other state has produced anything exactly like it. For that reason, it is worth exploring in some depth. Has Florida built a better organizational form, and if so, how is it better? And what does “better” mean?

For the purposes of this Article, I assume that form consumers (business people) already know they want limited liability¹⁴ and pass-through taxation. I also assume that they can get both through any one of several forms.¹⁵ While some professionals may face regulatory constraints on their choice of form (for example, lawyers may not be permitted to organize under the general corporation law),¹⁶ nevertheless, for most form consumers, external relationships, with creditors or the government, will not drive the choice of form.

What, then, does? Why should form consumers buy, or form entrepreneurs recommend, the Florida LLC? Or, conversely, why might they prefer to shop elsewhere? The answer to those questions, it seems to me, may lie in the governance provisions of the statute which regulate the distribution of power within businesses using that form.¹⁷

Participants in a firm¹⁸ know that business life is uncertain and that contingency planning is expensive and in any event only works

14. Not all business people do want limited liability. Although accounting firms have apparently converted to LLPs *en masse*, not all law firms have done so. The reason for that is surely not that they do not know they could. Instead, staying a full-liability partnership may serve as a signal to the market for legal services that the partners stand behind the quality of their work. It is, in effect, a bonding mechanism in a lemons market. See Charles R. O’Kelley, Jr., *Opting In and Out of Fiduciary Duties In Cooperative Ventures: Refining the So-Called Coasean Contract Theory*, 70 WASH. U. L.Q. 353 (1992).

15. There are still some federal tax wrinkles lurking in “check the box,” and there are also tax implications in converting from a previous form to a new one. See, e.g., Treas. Reg. § 301.7701-3(g)(1) (2001) and proposed amendments thereto. State taxes may also make a difference; for example, Florida’s intangibles tax applies to interests in an LLC but not a limited partnership. Tax law may therefore drive the choice of form at the margin, but should not affect the decision to become a Florida LLC as opposed to, say, a Delaware LLC. Filing fees may also drive choices at the margin, even when, rationally, they should not. See *supra* note 2.

16. While these professional restrictions strike me as somewhat silly once full shield limited liability is deemed acceptable, they do exist.

17. A sole proprietor does not have to worry about intra-firm governance unless she foresees bringing in equity participants in the future, and she can always switch forms later. I assume, therefore, that the sole proprietor’s decision to form an LLC rather than an S corporation will be made solely by reference to their relative transaction costs and tax differentials, and the advantage seems clearly to be with the LLC.

Many large corporations are also using the LLC for their wholly-owned subsidiaries. Single member LLCs are disregarded entities for tax purposes, so the parent corporation achieves de facto consolidation without having to comply with the tax regulations governing consolidated returns.

In any event, it does not really matter which state’s LLC form the sole proprietor or corporate parent chooses unless that state is particularly prone to veil piercing. Thus, those form consumers might as well shop at home.

18. I use the word “firm” in its economic sense to describe an enterprise that requires team production. Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937), *re-*

when contingencies can be foreseen. Decisions will have to be made in the future about products, services, assets, production or provision methods, and the allocation of benefits or burdens.¹⁹ Statutory governance provisions in turn tell us a lot about who gets to make the decisions, who gets to complain about them, and whose complaints have teeth. To the extent that firm organizers do not like the answers the statute provides, they may be permitted to draft around it (although this in itself incurs costs), or they may choose another form.

This Article focuses on the governance provisions of Florida's Limited Liability Company Act and compares them to the governance provisions generally available in other business forms. As will be seen, the statutory language is not always clear, so alternative interpretations are explored. The Article concludes that the new Florida statute is a major improvement over its predecessor. It will suit form consumers and form merchants in the vast transactional middle, the world of the "plain vanilla" deal. However, (1) it is likely to serve as a trap for the unwary who form an LLC without professional assistance, and (2) it is unlikely to displace its out-of-state competition for high stakes, complex deals in which the parties need (or think they need) unlimited freedom to contract.

II. THE FLORIDA LIMITED LIABILITY COMPANY ACT

Limited liability companies are often referred to as "hybrid" business forms. They look a little like both of their parents, partnerships and corporations, but are not quite either one.²⁰ Like corporations, a filing is required; an LLC may not be formed with a handshake.²¹

printed in R. H. COASE, *THE FIRM, THE MARKET, AND THE LAW* 33 (1988). Some or all participants may supply human capital; some or all may supply money or other property. A central problem with firm production is that team members have incentives to prefer their own self-interest to that of the team if they can do so without paying the full costs of self-prefering behavior. A vast literature has grown up around the "theory of the firm" and its associated agency costs. For starters, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). At the moment, an interesting debate has sprung up over who "counts" as a member of the team. See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); Symposium, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743 (1999). While I find all this fascinating (I am, after all, an academic), for purposes of this Article the only team members who count are those with the power to choose the organizational form.

19. Business enterprisers may have a cognitive bias that makes them happy to think about benefits (profits) and disinclined to think about burdens (losses). Lawyers who insist on planning for the down side may therefore be seen as "deal killers," but it goes with the territory.

20. They also sometimes look a lot like limited partnerships, themselves a "hybrid."

21. Or by accident. The fact that there is no such thing as an "inadvertent" LLC may justify some departures from the partnership model. Claire Moore Dickerson, *Equilibrium Destabilized: Fiduciary Duties Under the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 417, 425, 434-35 (1995).

Like partnerships, an LLC can be “member managed,” although participants may choose to be “manager managed.”²² Hybrids can be both vigorous and useful, as Luther Burbank discovered. On the other hand, taking some of this and some of that can produce some startling results.

Florida’s LLC governance provisions take managers’ duties from partnership law, albeit with a twist. They add the protections against liability for breach of those duties granted by Florida’s corporation statute, along with that statute’s procedures for “sanitizing” conflict of interest transactions and for indemnification.²³ Finally, voting and withdrawal rights parallel such rights in corporations rather than partnerships. The following sections examine each provision, its apparent provenance, and its interaction with the other provisions.

A. Duties and Obligations of Managers

As noted above, the duties of managers in a Florida LLC were drawn from the Florida version of RUPA, but with some changes. FRUPA in turn adopted RUPA’s codification of fiduciary duties, but also with some changes. The final product presents a puzzle: do LLC managers have more fiduciary duties than do partners, or the same, or fewer, or (perhaps) none at all?

In order to see the contours of the puzzle, some history is required. The LLC statute has no legislative history of its own. When courts interpret borrowed language, they frequently look to the history of the statute from which it is borrowed. Thus, the Official Comments to RUPA become an important resource for planners and potential litigants.²⁴

1. RUPA

The Revised Uniform Partnership Act’s treatment of fiduciary duties was by far the most controversial issue in the revision.²⁵ Its predecessor, the Uniform Partnership Act, made no attempt to codify fiduciary duties. In fact, the word “fiduciary” appears in the UPA only once, in the title to section 21, which provides that a partner must “account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other

22. In a partnership, the default rule is that all partners have equal rights in the management of the business, so that all partners are also managers. However, partners may, by agreement, delegate management to fewer than all partners, and that is quite common in large partnerships.

23. FLA. STAT. §§ 608.4223, 608.4225-608.4226, 608.4235 (2001).

24. STUART R. COHN & STUART D. AMES, *FLORIDA BUSINESS LAWS ANNOTATED* 201 (2002) [hereinafter COHN & AMES].

25. ROBERT W. HILLMAN ET AL., *THE REVISED UNIFORM PARTNERSHIP ACT* §§ 201-202 (2000).

partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.”²⁶

Courts did not find it necessary to rely on this language in constructing an elaborate and open-ended structure of fiduciary duties. In erecting that structure, judges enlarged upon, and then embroidered, the basic themes of care, loyalty, good faith, and disclosure.²⁷ Indeed, it has sometimes seemed that “fiduciary” was something a judge called a defendant just before the defendant lost, usually citing *Meinhard v. Salmon*.²⁸

Whether in fact what might be called “galloping Meinhardism” produced tough liability standards or merely tough rhetoric, and whether fiduciary duties should be all that tough in the first place, was and is open to debate.²⁹ That debate pits the traditionalists, who see fiduciary duties as a moral mandate,³⁰ against the contractarians, who see them as default terms in a standard form contract which the parties should be free to vary.³¹ The drafters of RUPA decided to steer a middle course, thus guaranteeing that it would be shot at by the partisans of both camps.³²

26. U.P.A. § 21 (1914).

27. Courts did not create these duties out of whole cloth. The law of agency furnished the basic material.

28. 164 N.E. 545 (N.Y. 1928). Judge Cardozo announced in ringing language that fiduciaries must behave with a “punctilio of an honor the most sensitive” and that the “relentless and supreme” duty of undivided loyalty requires that “thought of self” be renounced. *Id.* at 546, 548. His language has acquired a life of its own. For example, at least one Florida judge has thought that the mere invocation of *Meinhard*, a 74 year old, 4-3 decision about a partnership opportunity, sufficed to resolve a much different issue—the decision of a New York law firm to close its Florida office. *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 “AJ,” 1996 WL 438777, at *5 (Fla. Cir. Ct. July 23, 1996), *aff’d in part and rev’d in part*, 728 So. 2d 253 (Fla. 4th DCA 1998). For two quite different academic views of the *Beasley* case, compare Allan W. Vestal, “Assume a Rather Large Boat...”: *The Mess We Have Made of Partnership Law*, 54 WASH. & LEE L. REV. 487 (1997) (supporting the trial judge’s opinion), with Donald J. Weidner, Cadwalader, *RUPA and Fiduciary Duty*, 54 WASH. & LEE L. REV. 877 (1997) (critiquing the trial judge’s opinion).

29. Robert W. Hillman, *Business Partners as Fiduciaries: Reflections on the Limits of Doctrine*, 22 CARDOZO L. REV. 51 (2000).

30. The “moral mandate” characterization is Hillman’s. *Id. passim*.

31. This view is associated with the “law and economics” movement. One hallmark of this mode of thinking is a preference for contract over tort (or in this case, the “tort like,” since fiduciary duties are creatures of equity rather than law). As will no doubt become clear, my own perspective is strongly contractarian.

32. More recently, a new camp has emerged. This camp might be called the “communitarian instrumentalists.” Members of this group do not reject economic analysis, but seek to use the insights of behavioral economics to support other-regarding legal norms. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001). Professors Blair and Stout have been in the vanguard of this group, and their work has attracted considerable attention. *See, e.g.*, Symposium, *supra* note 18. It has not, however, achieved universal approbation. The contractarians have not jumped on board and are unlikely to do so, while at the other end of the spectrum, their work has been critiqued as insufficiently progressive.

RUPA attempts to limit judicial inventiveness by stating that there are only two fiduciary duties owed by partners to each other: the duty of loyalty and the duty of care.³³ Those duties are exclusive; there are two, count them, two. The duties of disclosure and good faith have been demoted (or, for contractarians, appropriately confined) to mere “obligations,” of which more anon.

The duties of care and loyalty are both exclusive and exclusively defined. First, they are temporally limited to the “conduct and winding up” of the partnership’s business and do not apply to the pre-formation negotiation period.³⁴

Second, the duty of care is limited to refraining from grossly negligent conduct,³⁵ reckless conduct (which seems superfluous),³⁶ and intentional misconduct or knowing violation of law (which merely seems odd).³⁷

David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001 (2000).

33. R.U.P.A. § 404 (a) (1996) (amended 1997).

34. *Id.* § 404(b)(1). Under the UPA, the duty to account extends to misconduct in connection with the “formation” of a partnership. U.P.A. § 21 (1914). Under the UPA, therefore, “pre-partners” have fiduciary duties to each other during the negotiation process that “pre-agents” generally do not have to potential principals, RESTATEMENT (SECOND) OF AGENCY § 390 (1958), and “pre-incorporators,” a.k.a. promoters, have only sometimes, and then only if the corporation is actually formed.

Courts have sometimes, but not invariably, used pre-formation duties to impose liability on partners who personally benefitted from information obtained in the negotiation process or failed to disclose something important, at least in hindsight, about contributed property. *See, e.g., Corley v. Ott*, 485 S.E.2d 97 (S.C. 1997). Thus, information that is voluntarily disclosed during pre-partnership negotiations may be subject to a duty of confidentiality, even if the parties have not signed a confidentiality agreement. Conversely, disclosure may be compelled even when parties dealing at arm’s length would be free to remain silent.

Like almost everything else in RUPA’s treatment of fiduciary duties, the elimination of pre-formation duties has been both attacked and defended. For what it is worth, it has always seemed a trifle odd to me that parties negotiating a deal may have fiduciary duties while negotiating (or not), depending on the business form ultimately chosen for that deal, which may itself be the subject of negotiation. Since, *ex ante*, the parties cannot know whether they are fiduciaries, it seems to me that any sensible business person would refuse to disclose valuable information without a confidentiality agreement in place. While demanding such an agreement may erode trust, it may also usefully prevent mistakes as to the existence of a legally enforceable trust relationship.

35. R.U.P.A. § 404(c). It is important to note that this section refers to the duty owed by partners to the partnership and to each other, not to the world at large. However, the duty of care as between partners is not the same thing as the duty of care owed by the directors of a corporation. Corporate lawyers are accustomed to thinking of the duty of care as relating solely to firm management. Indeed, it is impossible to think of the duty of care in the corporate context without immediately thinking of the business judgment rule. On the other hand, directors-qua-directors are not agents and therefore do not expose the corporation to personal liability for their own torts, nor do they engage in the sort of hands-on interaction with corporate property which risks physically damaging it.

In contrast, RUPA’s duty of care is not limited to management and oversight, although partners do occasionally sue each other for negligent business management, and courts may then apply a partnership version of the business judgment rule. *Bane v. Ferguson*, 890 F.2d 11 (7th. Cir. 1989). *But see Shinn v. Thrust IV, Inc.*, 786 P.2d 285 (Wash. Ct. App. 1990). Beyond poor management, however, the ordinary negligence of a partner may create

tort liability to others and hence losses to the partnership. Under RUPA's default rule, such losses are shared by the partners in the same ratio as they share profits, which means (unless otherwise agreed) equally. Indeed, if a tort victim were to sue the ordinarily-negligent partner without naming the partnership, that partner would appear to have a claim against the partnership in the nature of indemnification or contribution.

In addition, at least one of the concerns animating RUPA's drafters was the problem of broken equipment. This is not a trivial problem in a small partnership. If a doctor drops an expensive microscope, or an accountant drops a computer, who pays for it? In practice, the answer to that varies from firm to firm, so the drafters opted for "gross" negligence as the default rule, which means that the firm pays for "ordinary" clumsiness unless otherwise agreed.

I attempted to persuade my colleague, the Reporter, that it was unnecessary, and indeed unwise, to create a mandatory fiduciary duty of care at all. Partners are profit-sharers and therefore have plenty of incentives to take cost-justified precautions and to monitor each other. If they know each other, they can account for differences in attention or dexterity by assigning high-risk partners to low-risk tasks. If they believe that they are all equally careful, then they will foresee that they will all have accidents at about the same rate over time and will agree to internal loss-spreading. I succeeded only in persuading him that it was possible for reasonable people to take that position, *see* Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 BUS. LAW. 427, 467-68 (1991), but remain convinced that I was right (for all the good that does).

36. At first blush, even a gross negligence standard may seem too low, since it converts a command to "be careful" into a command not to be really, really careless. Lawyers drafting contractual liability clauses (and the clients who sign such contracts) nevertheless routinely limit liability to gross negligence under the apparent assumption that a jury exercising 20-20 hindsight will be able to distinguish "ordinary" lapses from "gross." Still, "reckless" conduct is something even more egregiously faulty than gross negligence, and could probably have been omitted from the statute without losing anything. At least, I have difficulty imagining a fact pattern in which a defendant charged with gross negligence would argue, as an odd kind of affirmative defense, that his or her conduct was actually reckless and therefore exempt from liability because recklessness is not covered by the duty of care.

37. It is not at all clear what "care" has to do with intentionally wrongful conduct. In fact, a partner's intentional tort against a third party might not even create partnership liability precisely because it is intentional. *See, e.g.,* Wheeler v. Green, 593 P.2d 777 (Or. 1979). *See generally* ALAN BROMBERG & LARRY E. RIBSTEIN, PARTNERSHIP § 4.07 (1996). In any event, the intentionally-tortfeasor partner is always liable for his or her own torts. Such a partner has no right to indemnification or contribution from the partnership, so partnership liability is a backup, not a substitute. If the intentional tortfeasor does not have enough assets to pay a judgment directly to the plaintiff, then giving the other partners a right to sue for breach of fiduciary duty does not seem particularly useful.

The reference to a knowing violation of law is also puzzling. Remember that this is the duty of care; a crime against the partnership itself, like embezzlement, would violate the duty of loyalty. Perhaps the drafters envisioned a situation in which some, but not all, partners caused the partnership to engage in an illegal act intended to increase the partnership coffers, but which, after discovery and prosecution, resulted in a loss. In that case, if the non-violating partners sue, this provision would not allow the violation-causing partners to argue that their lawbreaking was efficient *ex ante*, nor that, as the anticipated gain from the violation would have been shared, so should be the loss.

However, subsuming law violations under "care" creates an anomaly. Were the non-participating partners themselves "grossly negligent" in failing to detect and prevent the violation? The argument that they were is not as far-fetched as it seems. *See In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996) (board of directors has an obligation to monitor law compliance). If they were, then in any intra-partner litigation there will be enough issues of contributory or comparative negligence (not to mention problems of inquiry notice for purposes of laches or the statute of limitations) to gladden the heart of any torts teacher.

Third, the duty of loyalty, like all Gaul, is divided into three parts: (1) the duty to account for property, profits, or benefits derived from the partnership's business or the use of partnership property, which includes partnership opportunities;³⁸ (2) the duty not to deal with the partnership as an adversary or on behalf of adverse interests;³⁹ and (3) the duty not to compete with the partnership.⁴⁰

Standing alone, these three open-ended definitions of the duty of loyalty might have satisfied all but the most ardent of the traditionalists. They do not, however, stand alone. First, section 404(e) states that “[a] partner does not violate a duty or obligation . . . merely because the partner's conduct furthers the partner's own interest”; it is no sin to be selfish.⁴¹

Finally, as noted above, the drafters were concerned with broken equipment. Perhaps the inclusion of “intentional misconduct” in the duty of care was addressed to the accountant or doctor on a rampage. While I find the image curiously entrancing—Casper Milque-toast with a sledgehammer—I cannot believe that any such partner would think that the firm should absorb the damage and therefore refuse to pay the bill once he'd sobered up.

38. R.U.P.A. § 404(b)(1). According to the Official Comments, the reference to misappropriation of a partnership opportunity is intended to codify case law, including that omnipresent classic, *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928). RUPA does not offer any bright line guidance as to just what constitutes a partnership opportunity, although it does give partners the ability to do that themselves—maybe. See *infra* note 45. In any event, if a partner withdraws (“dissociates” in RUPA-speak) and the business either is not wound up, or the withdrawing partner does not participate in winding up, the dissociated partner is free to appropriate any new opportunities that float by. R.U.P.A. § 603(b)(3).

39. R.U.P.A. § 404(b)(2). Once a partner withdraws from the partnership, the dissociated partner may deal with the partnership as an adversary with respect to new matters. *Id.* § 603(b)(3).

40. *Id.* § 404(b)(4). The duty not to compete ceases on withdrawal, whether or not the business is wound up, *id.* § 603(b)(2), although the Official Comments note that a competing former partner may not use confidential information of the partnership and that trade secret law may also apply.

The question whether information “belongs” to the partnership or is simply an accretion to human capital and therefore the property of the partner is as complex as the law is confused. A full discussion of property rights in information is far beyond the scope of this Article; indeed, the topic consumes whole treatises. However, woe to the partner who gets it wrong or who “usurps” an opportunity. That partner has more to worry about than constructive trusts or even punitive damages. If the mails or a telephone or modem have been used along the way—and when will they not have been?—the partner may become an involuntary guest of the U.S. government. The federal mail and wire fraud statutes apply to the deceitful misappropriation of confidential information, even if it does not result in any quantifiable harm to the “owner.” *Carpenter v. United States*, 484 U.S. 19 (1987). Full disclosure before the fact eliminates the risk of jail time, *United States v. O'Hagan*, 521 U.S. 642 (1997), although not the risk of damages.

41. R.U.P.A. § 404(e). So much for partnership as “a position in which thought of self [is] . . . to be renounced, however hard the abnegation.” *Meinhard*, 164 N.E. at 548. The Official Comments state that this section is “new” and “deals expressly with a very basic issue.” Official Comments to R.U.P.A. § 404(e). The explanation goes on to point out that partners are not trustees, and that a partner's rights as an owner of a business exist as a counter-balance to his or her fiduciary duties and obligations: “For example, a partner who, with consent, owns a shopping center may . . . legitimately vote against a proposal by the partnership to open a competing shopping center.” *Id.*

In their treatise, Professors Hillman and Vestal and Dean Weidner argue that it is possible to read 404(e) narrowly. HILLMAN ET AL., *supra* note 25, at 204-05. Under a narrow

Second, both of the fiduciary duties in section 404—care and loyalty—can be varied, within limits, by the partnership agreement. Under section 103, the duty of care cannot be “unreasonably reduce[d]”⁴² and the duty of loyalty cannot be “eliminate[d].”⁴³ However, the partnership agreement may “identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable,”⁴⁴ and may also set forth a mechanism for authorizing or ratifying specific transactions that otherwise would violate that duty. Over-broad categorical waivers are thus forbidden, but some categorical waivers are permitted, and the border between the two is deliberately hazy.⁴⁵

reading, it is merely an evidentiary rule which requires something more than proof of a partner's direct personal benefit to establish a violation of duty but does not legitimate the immediate pursuit of self interest. Under a broader reading, however, the section would mean that a partner is free to be selfish, subject only to the specific restrictions contained in 404(b)'s duty of loyalty. They conclude, with apparent regret, that the drafting history favors the broad reading and the “sea change” in partnership law implicit in it. *Id.* at 205.

I have used the pronoun “they” in the previous paragraph because the treatise has three authors and the commentary is labeled “Authors’ (plural) Comments.” It is, however, clear to me, and I would think to anyone familiar with their collected works, that this section was written by Professor Vestal, with whom neither of his coauthors agree on almost anything. Co-authorship, like politics, makes strange bedfellows.

42. R.U.P.A. § 103(b)(4). Given a standard of care limited to gross negligence, it is hard to imagine a reduction which would not be unreasonable. The Official Comments suggest that a pure heart/empty head standard might pass muster; on the other hand, according to the Comments, “absolving partners of intentional misconduct is probably unreasonable.” Official Comments to R.U.P.A. § 103(b)(4). Only probably?

One possible response to all this, at least for partners who want to get out of liability for violations of the duty of care altogether, might be to leave the standard in place but change the remedies for breach. After all, if a partner cannot be sued for damages, does it matter what the “duty” is? The relationship between duties and remedies is discussed more fully *infra* Section II.B.

43. R.U.P.A. § 103(b)(3).

44. *Id.* § 103(b)(3)(i).

45. The Official Comments to subsections (b)(3) through (5) state: “It is intended that the risk of judicial refusal to enforce manifestly unreasonable exculpatory clauses will discourage sharp practices while accommodating the legitimate needs of the parties in structuring their relationship.” Official Comments to R.U.P.A. § 103. It is not at all clear how this fits with the statement just a few paragraphs earlier in the Comments that “RUPA attempts to provide a standard that partners can rely upon in drafting exculpatory agreements.” *Id.*

I do not intend to expound at length here on the difference between a standard and a rule, and there is obviously a continuum of legal formulation which runs from the hopelessly vague to the tediously specific. Nevertheless, as a general matter, the problem with standards, as opposed to rules, is that they cannot be relied on. It is for precisely this reason that the ABA's Committee on Corporate Laws adopted a bright line test for directors' conflict of interest transactions in Subchapter F of the Revised Model Business Corporation Act (RMBCA):

An inevitable feature of any bright-line statute or regulation is that, no matter where the line may be set, some situations that fall outside the line will closely resemble other situations that fall inside it. Some observers find that outcome anomalous and argue that a bright-line approach is inferior to a statement of broad principles. But the legislative draftsman who chooses to suppress marginal anomalies by resorting to generalized statements of principle will pay a cost in terms of predictability. The choice between these two drafting approaches is a

In short, RUPA provides “mandatory minima”⁴⁶ fiduciary duties. That they are mandatory explains why contractarians do not like RUPA; that they are minima explains why the traditionalists don’t like it either.⁴⁷

As noted earlier, under RUPA there are just two fiduciary duties: loyalty and care. Before RUPA, some courts had held that “good faith” is a free-standing, independent fiduciary duty whose contours and content are unclear but which can be used to punish partners whose conduct the court does not like.⁴⁸ One of the major changes made by RUPA was to remove “good faith” from the category of fiduciary duties and convert it to an apparently contractual “obligation” of good faith and fair dealing in the discharge of a partner’s other rights or duties.⁴⁹

While the obligation sounds innocuous enough—who, after all, is in favor of bad faith or unfair dealing?—it is not at all clear what it

matter of judgment; an experienced legislative draftsman would never write a bright-line constitutional “due process” clause, nor would he provide, in a business corporation act, for a “reasonable period” of notice for a shareholder’s meeting.

Of course, that bright-line test in the RMBCA has itself been criticized, and in any event deals with clearance procedures for discrete transactions and not with categorical get-out-of-jail-free cards (except to the extent that it does exclusively define what is or is not a conflict).

RUPA does permit the partnership agreement to include clearance procedures for authorizing or ratifying particular transactions when an up-front, blanket grant of permission might violate the “manifestly unreasonable” standard. Official Comments to R.U.P.A. § 103(b)(3)(ii). Thus, nothing in RUPA would prevent a partnership from adopting its own version of Subchapter F. The net result is to prefer transaction-by-transaction authorization over up-front categorical permission, in spite of the burdensomeness (including rebargaining costs) this may entail.

46. The phrase is Dean Weidner’s. Donald J. Weidner, *RUPA and Fiduciary Duty: The Texture of Relationship*, 58 J.L. & CONTEMP. PROBS. 81, 82 (1995).

47. On the other hand, according to the Official Comments to subsection (b)(4), partners can always volunteer for liability by increasing the standard to ordinary care “or an even higher standard of care,” whatever that is. Official Comments to R.U.P.A. § 103(b)(4). One does not usually think of a guarantee as involving a “higher standard of care,” but it is certainly possible that a partnership concerned with, for example, broken equipment might adopt a policy of “you break it, you’ve bought it” without inquiring into fault at all.

48. The duty has most often been litigated in the context of a partial or complete breakup of the partnership. When a partner is expelled without cause under an agreement that does not require it, the involuntarily departing partner sometimes claims that the expulsion is not in “good faith.” *See, e.g., Bohatch v. Butler & Binion*, 977 S.W.2d 543 (Tex. 1998). Similarly, in an at-will partnership, the voluntary departure of a partner requires the liquidation of the partnership unless otherwise agreed. Some courts have superimposed a “good faith” requirement on the exit decision, thus converting an at-will relationship into something else. *See, e.g., Page v. Page*, 359 P.2d 41 (Cal. 1961).

The fiduciary duty of “good faith” has long existed in corporate law, although without much explication. For example, in Delaware, good faith, care, and loyalty are the three ostensibly co-equal parts of a director’s “unitary” fiduciary duty. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994) (*Technicolor II*). *But see Orman v. Cullman*, 794 A.2d 5 at n.3 (Del. Ch. 2002) (treating good faith as a subset of loyalty).

49. R.U.P.A. § 404(d).

means in practice. The Official Comments tell us something about what the obligation is not. It is not intended to be free-standing, but rather is “ancillary.”⁵⁰ Further, although the obligation takes its genesis from contract law, it is a mandatory term which may not be eliminated.⁵¹ The partnership agreement may, however, prescribe standards for measuring its performance if those standards are not “manifestly unreasonable.”⁵²

On the most important question, however, the statute is silent. The meaning of “good faith and fair dealing” was left undefined; vagueness was a deliberate choice.⁵³ Further explication is left to the courts.

It remains to be seen whether the judiciary is more likely to achieve clarity than the drafters were. As written, the obligation is a prettily wrapped empty box into which traditionalist judges can put the leftovers from the fiduciary banquet on which they used to feast.⁵⁴ However, they cannot change the wrapping itself; presumably constructive trusts and punitive damages will not attend breaches of a mere “obligation.”⁵⁵

It also remains to be seen whether judges will be given much opportunity to try. Here, the crucial change may be the change in available remedies for breach. Incentives to litigate depend very much on possible outcomes. The smaller the pot, the fewer lawsuits. Damages for breach of contract come in a much smaller pot.

50. Hillman, Vestal, and Weidner say that this treatment “downgrades” the common law, HILLMAN ET AL., *supra* note 25, at 201, and was “motivated by a desire to thwart plaintiffs’ recoveries and judicial innovation.” *Id.* at 203. Once again, I detect the unalloyed hand of Professor Vestal, since the only citations are to his previously-written attacks on RUPA. His co-authors have been more generous elsewhere.

51. R.U.P.A. § 103(b)(5).

52. *Id.* § 103(b)(3)(i). Here, at least, there is some guidance as to meaning with which commercial lawyers are familiar. According to the Official Comments, this provision is based on UCC § 1-102(3), and is meant to include procedural provisions like specific time periods that constitute “adequate” notice (5 days in the Comments example). Official Comments to R.U.P.A. § 103(b)(3)(i). Of course, lawyers familiar with the UCC’s treatment of standards for performance are probably also familiar with the UCC’s definition of good faith and fair dealing; that is, as honesty in fact and, in the case of merchants, the observance of reasonable standards of fair dealing in the trade. However, that definition was rejected by RUPA’s drafters as “too narrow.”

53. It seems to me that this intentionally amorphous obligation was a political bone thrown to the traditionalists unhappy with RUPA’s narrowing of fiduciary duties. The drafting history suggests as much. HILLMAN ET AL., *supra* note 25, at 47-49. Of course, it is also possible that the deliberate vagueness surrounding this obligation reflects a punt rather than a tossed bone. Perhaps the drafters simply could not reach consensus on specifics and so left that chore to judges.

54. For an illustration of this form of argument, see Claire Moore Dickerson, *Cycles and Pendulums: Good Faith, Norms, and the Commons*, 54 WASH. & LEE L. REV. 399 (1997).

55. Weidner, *supra* note 28, at 908-10.

2. *FRUPA*

RUPA was adopted in Florida with its treatment of the duties of care and loyalty and the obligation of good faith nearly intact. The one change was in the definition of the duty of loyalty. While RUPA says the duty of loyalty “is limited to” its three exclusive categories, FRUPA says the duty of loyalty “includes” them “without limitation.”⁵⁶ The legislature was concerned that RUPA narrowed the duty of loyalty too severely, and wanted courts to be able to fashion other categories of loyalty violation.⁵⁷

Nevertheless, partners remain free to enter into agreements that give categorical permission to engage in some kinds of activities (if not “manifestly unreasonable”) and which set forth procedures for authorizing or ratifying discrete transactions.⁵⁸ Further, the standard of care remains gross negligence; good faith remains an obligation, not a fiduciary duty; and both are “mandatory minima” subject to some variation by agreement.

3. *The FLLCA*

Now comes the first puzzle. The drafters of Florida’s LLC Act borrowed FRUPA’s “[g]eneral standards of partner’s conduct” for the section denominated “general standards for managers and managing members”⁵⁹ almost verbatim—with one important exception. The words “only fiduciary” have been omitted. Thus, instead of saying

56. Section 620.8404(2), *Florida Statutes*, states:

A partner’s duty of loyalty to the partnership and the other partners includes, without limitation, the following:

(a) To account to the partnership and hold as trustee for the partnership any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;

(b) To refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership, and

(c) To refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

57. COHN & AMES, *supra* note 24, at 242; Larson, *supra* note 11.

58. FLA. STAT. § 620.8103 (2001). Because FRUPA has broadened the potential number of activities that could violate the duty of loyalty, it is difficult to know what kinds of activities require advance permission, whether categorical or discrete. However, the areas most likely to require focused attention from the parties and their counsel are those already specified.

59. Non-managing members in a manager-managed LLC do not have duties under the statute. In this sense, they are “more like” shareholders or limited partners than partners. I suspect, however, that a court would treat a non-managing member with voting control like a controlling shareholder, and that such a member would therefore have duties (whether or not denominated “fiduciary”) by virtue of control. The fact that the FLLCA is silent on the issue is unlikely to present much of an impediment. After all, corporate statutes are silent on the duties of controlling shareholders, but that has not prevented courts from imposing them.

“the only fiduciary duties” are the duties of loyalty and care, the statute says each manager “shall owe a duty of loyalty and a duty of care.”⁶⁰

According to the Chair of the drafting committee, Louis Conti, the omission was deliberate.⁶¹ In his view, if managers are not called “fiduciaries,” then their duties are merely contractual.⁶² Care and loyalty thus have the same status as good faith.

Of course, even if care and loyalty are contractual obligations rather than fiduciary duties, the statute explicitly states that they cannot be totally eliminated.⁶³ As much as Mr. Conti (and I) would

60. Section 608.4225, *Florida Statutes*, states:

(1) Subject to ss. 608.4226 and 608.423, each manager and managing member shall owe a duty of loyalty and a duty of care to the limited liability company . . .

(a) The duty of loyalty includes, without limitation:

1. Accounting to the limited liability company and holding as trustee for the limited liability company any property, profit, or benefit derived by such manager or managing member in the conduct or winding up of the limited liability company business or derived from a use by such manager or managing member of limited liability company property, including the appropriation of a limited liability company opportunity.

2. Refraining from dealing with the limited liability company in the conduct or winding up of the limited liability company business as or on behalf of a party having an interest adverse to the limited liability company.

3. Refraining from competing with the limited liability company in the conduct of the limited liability company business before the dissolution of the limited liability company.

(b) The duty of care is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

61. Louis T.M. Conti, Esq., Remarks at the Florida Bar Continuing Legal Education Committee and the Business Law and Tax Sections Program, *New And Improved LLCs and LLPs in Florida: Understanding and Using the New Laws* (Nov. 5, 1999) [hereinafter Remarks]. I am grateful to Mr. Conti and to the other participants in the program for welcoming me into their midst as a last-minute substitute for Dean Weidner, who was unable to attend that day.

62. *Id.*

63. Section 608.423, *Florida Statutes*, which provides the same “non-waivable” provisions as FRUPA, states:

(1) Except as otherwise provided in subsection (2), all members of a limited liability company may enter into an operating agreement, which need not be in writing, to regulate the affairs of the company and the conduct of its business, establish duties in addition to those set forth in this chapter, and to govern relations among the members, managers, and company. Any inconsistency between written and oral operating agreements shall be resolved in favor of the written agreement. The members of a limited liability company may enter into an operating agreement before, after, or at the time the articles of organization are filed, and the operating agreement takes effect on the date of the formation of the limited liability company or on any other date provided in the operating agreement. To the extent the operating agreement does not otherwise provide, this chapter governs relations among the members, managers, and limited liability company.

(2) The operating agreement may not:

(a) Unreasonably restrict a right to information or access to records under s. 608.4101

(b) Eliminate the duty of loyalty under s. 608.4225, but the agreement may:

1. Identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; and

2. Specify the number or percentage of members or disinterested managers that may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty

(c) Unreasonably reduce the duty of care under s. 608.4225;

....

Thus, like FRUPA, the statute permits the operating agreement to set forth “sanitizing” clearance provisions for conflict of interest transactions. However, another part of the statute, this time drawn from Florida’s corporation statute, makes it unnecessary for the organizers to do so. Section 608.4226, *Florida Statutes*, provides:

(1) No contract or other transaction between a limited liability company and one or more of its members, managers, or managing members or any other limited liability company, corporation, firm, association, or entity in which one or more of its members, managers, or managing members are managers, managing members, directors, or officers or are financially interested shall be either void or voidable because of such relationship or interest, because such members, managers, or managing members are present at the meeting of the members, managers, or managing members or a committee thereof which authorizes, approves, or ratifies such contract or transaction, or because their votes are counted for such purpose, if:

(a) The fact of such relationship or interest is disclosed or known to the managers or managing members or committee which authorizes, approves, or ratifies the contract or transaction by a vote or consent sufficient for the purpose without counting the votes or consents of such interested members, managers, or managing members

(b) The fact of such relationship or interest is disclosed or known to the members entitled to vote and they authorize, approve, or ratify such contract or transaction by vote or written consent; or

(c) The contract or transaction is fair and reasonable as to the limited liability company at the time it is authorized by the managers, managing members, a committee, or the members.

(2) For purposes of paragraph (1)(a) only, a conflict of interest transaction is authorized, approved, or ratified if it receives the affirmative vote of a majority of the managers or managing members, or of the committee, who have no relationship or interest in the transaction described in subsection (1), but a transaction may not be authorized, approved, or ratified under this section by a single manager of a manager-managed company or a single managing member of a member-managed company, unless the company is a single member limited liability company. If a majority of the managers or managing members who have no such relationship or interest in the transaction vote to authorize, approve, or ratify the transaction, a quorum is present for the purpose of taking action under this section. The presence of, or a vote cast by, a manager or managing member with such relationship or interest in the transaction does not affect the validity of any action taken under paragraph (1)(a) if the transaction is otherwise authorized, approved, or ratified as provided in that subsection, but such presence or vote of those managers or managing members may be counted for purposes of determining whether the transaction is approved under other sections of this chapter.

(3) For purposes of paragraph (1)(b) only, a conflict of interest transaction is authorized, approved, or ratified if it receives the vote of a majority-in-interest of the members entitled to be counted under this subsection. Membership interests owned by or voted under the control of a manager or managing member who has a relationship or interest in the transaction described in subsection (1) may not be counted in a vote of members to determine whether to authorize, approve, or ratify a conflict of interest transaction under paragraph (1)(b). The vote of those membership interests, however, is counted in determining whether the transaction is approved under other sections of this act. A majority-in-interest of the members, whether or not present, that are entitled to be counted in a vote on the transaction under this subsection constitutes a quorum for the purpose of taking action under this section.

have preferred total freedom of contract,⁶⁴ the statute continues to provide “mandatory minima.” At least, however, Mr. Conti believes the statute as written moves in the right direction.

I respect Mr. Conti, and I am fully sympathetic with his contractarian viewpoint. Nevertheless, I do not think leaving out the f-word makes managers “unfiduciaries.” For one thing, the statute makes them agents of the LLC⁶⁵ and agents are by definition fiduciaries.⁶⁶ For another, there is not the slightest indication that the legislature noticed the omission.⁶⁷ Indeed, it appears to have been overlooked by several members of the drafting committee.⁶⁸

In short, I think judges will continue to speak of the “fiduciary” duties of care and loyalty, and will continue to make “fiduciary” remedies available to the extent permitted by other provisions in the

Under FRUPA, the default rule is that conflict of interest transactions can only be authorized or ratified by unanimous vote. Under FLLCA, the default rule is that a conflict of interest transaction can be authorized by majority vote. That default rule can then be modified, either to specify categories or types of activities which do not require sanitization (if not “manifestly unreasonable”) or to set a different percentage for approval. COHN & AMES, *supra* note 24, at 368.

64. Remarks, *supra* note 61.

65. Section 608.4235, *Florida Statutes*, states:

(1) Subject to subsections (2) and (3):

(a) In a member-managed company, each member is an agent of the limited liability company for the purpose of its business, and an act of a member, including the signing of an instrument in the limited liability company’s name, for apparently carrying on in the ordinary course the limited liability company’s business or business of the kind carried on by the company binds the limited liability company, unless the member had no authority to act for the limited liability company in the particular matter and the person with whom the member was dealing knew or had notice that the member lacked authority.

(2) Subject to subsection (3), in a manager-managed company:

(a) A member is not an agent of the limited liability company for the purpose of its business solely by reason of being a member. Each manager is an agent of the limited liability company for the purpose of its business, and an act of a manager, including the signing of an instrument in the limited liability company’s name, for apparently carrying on in the ordinary course the limited liability company’s business or business of the kind carried on by the company binds the limited liability company, unless the manager had no authority to act for the limited liability company in the particular matter and the person with whom the manager was dealing knew or had notice that the manager lacked authority.

66. RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

67. It seems unlikely that a legislature which broadened the definition of “loyalty” in FRUPA because RUPA’s definition was deemed too narrow would turn around and casually eliminate all fiduciary duties in the LLC statute. Of course, the 1999 legislature was not composed of the same people as the 1995 legislature; term limits have created a revolving door at the Capitol. On the other hand, the 1999 legislature revisited FRUPA in order to change the LLP provisions, but did not alter FRUPA’s fiduciary duties.

68. The members of the drafting committee served as the “faculty” for the aforementioned Continuing Legal Education program. In their prepared materials, four of them referred to the “fiduciary” duties of managers: Mssrs. Felman, Weidner, Ames, and, curiously, Conti. (I assume that the word crept into Mr. Conti’s materials by way of an assistant.) Two of the members also use the f-word in their treatise. COHN & AMES, *supra* note 24, at 367.

statute.⁶⁹ It is even possible that they will ignore the missing f-word but seize on the missing o-word: “only.” Courts might take that as an invitation to return to the halcyon days—halcyon for traditionalists, anyway—of the galloping moral mandate with its ever-expanding, open-ended structure of fiduciary duties. The missing o-word might even lead courts to return “good faith” to its previous position in the fiduciary pantheon.⁷⁰ Thus, a well-intentioned⁷¹ effort to restrict the scope of fiduciary duties could wind up expanding them, thereby proving the continuing power of the law of unintended consequences.

So if the question is, “do managers of a Florida LLC have more fiduciary duties than do partners, the same, fewer, or none at all,” then the answer is that they probably have the same duties as partners, although I offer that answer with neither joy nor certainty.

B. Wrongs Without A Remedy

This leads us to a second puzzle: why require “mandatory minimum” fiduciary duties and obligations but deny any effective remedy for their breach? This puzzle exists because the process of “hybridization” melded FRUPA’s standards of conduct with the Florida Business Corporation Act’s (FBCA) exculpation and indemnification provisions.

1. An Overview of Exculpation

Once upon a time (but not so very long ago) in the world of corporate law, the only fiduciary duty that really mattered was the duty of loyalty. The duty of care might be a theoretical concern, but the business judgment rule protected directors against the consequences of allegedly improvident decisionmaking or faulty oversight.⁷² Then

69. Under the statute, not all wrongs have a remedy. *See infra* Part II.B.

70. As noted earlier, one of RUPA’s major changes, carried over into FRUPA, was the distinction between the “fiduciary” duties of care and loyalty and the mere “obligation” of good faith and fair dealing. Under the FLLCA, good faith is still an “obligation” and is in its own subsection, Section 608.4225(c), *Florida Statutes*:

Each manager and managing member shall discharge the duties to the limited liability company and its members under this chapter or under the articles of organization or operating agreement and exercise any rights consistent with the obligation of good faith and fair dealing.

However, if care and loyalty are not the “only fiduciary” duties, then there is some risk that a court could fail to perceive the delicate—one might even say gossamer—distinction between a “duty” and an “obligation” in the same statutory section.

71. At least from the contractarian perspective. Traditionalists would not characterize it so benignly.

72. The business judgment rule is a presumption that directors act in good faith and with reasonable care. While in theory it does not shield directors from charges of waste or gross negligence, in practice there were almost no cases before 1985 in which a “care” case got past the pleading stage, let alone resulted in a remedy. *Gagliardi v. Trifoods Int’l, Inc.*, 683 A.2d 1049, 1051-52 (Del. Ch. 1996); Joseph W. Bishop, Jr., *Sitting Ducks and Decoy*

along came *Smith v. Van Gorkom*,⁷³ in which the Delaware Supreme Court held outside directors liable for “gross negligence” in approving a premium bid for their company’s shares, and the corporate world went into shock.⁷⁴ Insurance premiums went up⁷⁵ and there were stories of mass resignations from the boards of publicly held corporations.⁷⁶ Even worse, at least from Delaware’s point of view, a number of corporate decision-makers started to consider reincorporating in other states.⁷⁷

The Delaware Legislature could not do anything about the folly⁷⁸ of its supreme court, but it could do something—or try to—about its consequences. In 1986, Delaware’s corporation statute was amended to permit the articles of incorporation to include a provision “eliminating or limiting the personal liability of a director . . . for monetary damages for breach of fiduciary duty . . . [except not] for any breach of the director’s duty of loyalty . . . [or] for acts or omissions not in

Ducks: New Trends in the Indemnification of Corporate Directors and Officers, 77 YALE L.J. 1078, 1099 (1969).

Again theoretically, the business judgment rule protected board decisions, not board non-decisions, and therefore did not apply to “oversight” cases in which the board (or one of its members) was charged with a failure of attention. However, those complaints were also rejected, either for failure to prove causation, *Barnes v. Andrews*, 298 F. 614 (S.D.N.Y. 1924), or for failure to allege that the board was on notice of the need for attention, *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125 (Del. 1963).

Since the mid-1980s, the business judgment rule in Delaware has gone through a number of contortions that have diminished its protectiveness. The process was sparked by an increase in hostile takeover attempts and the resistance of target boards, *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), then spread to negotiated acquisitions, *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), and now, apparently, to executive compensation, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). A full discussion of the current state of the law is beyond the scope of this Article.

73. 488 A.2d 858 (Del. 1985).

74. The reaction and response is reported in Robert W. Hamilton, *Reliance and Liability Standards for Outside Directors*, 24 WAKE FOREST L. REV. 5 (1989).

75. The rise in premiums for D & O insurance was blamed on *Van Gorkom*, see, e.g., Dennis J. Block et al., *Advising Directors on the D&O Insurance Crisis*, 14 SEC. REG. L.J. 130 (1986), although a subsequent study suggests that other factors were at work. Roberta Romano, *What Went Wrong With Directors’ and Officers’ Liability Insurance?*, 14 DEL J. CORP. L. 1 (1989).

76. Laurie Baum & John A. Byrne, *The Job Nobody Wants*, BUS. WK., Sept. 8, 1986, at 56-61.

77. Delaware derives a very large proportion of its state budget from incorporation there. See *supra* note 1.

78. *Smith v. Van Gorkom* has been described as “one of the worst decisions in the history of [Delaware] corporate law.” Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437, 1455 (1985). The Delaware Supreme Court has since come down with two more that are at least as bad, *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140 (Del. 1989), and *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), and one that may join them in infamy if it means what it appears to say, *Emerald Partners v. Berlin*, 726 A.2d 1215 (Del. 1999). (A subsequent opinion suggests that it does, *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001), although Chancellor Chandler has made a valiant attempt to distinguish it. *Orman v. Cullman*, 794 A.2d 5, 20 n.36 (Del. Ch. 2002).)

good faith . . . [or] from which the director derived an improper personal benefit.”⁷⁹

At that point, corporate decision-makers stopped talking about emigration from Delaware and started a wave of immigration to it. In the next proxy season, a large number of publicly held corporations incorporated in other states sought shareholder approval to reincorporate in Delaware.⁸⁰

Naturally, that did not sit well with the legislatures of the other states, to whom *Van Gorkom* had given such hope of gaining market share at Delaware's expense. Now, thanks to the Delaware legislature, they were not only not gaining market share, they were losing it. Accordingly, most states quickly provided some version of exculpation from damages, either by giving permission to “opt in” or “opt out” of liability in the corporate articles, or, less frequently, by a direct grant of protection by statute.⁸¹

2. Exculpation in Florida

Florida not only jumped on that bandwagon early, but also adopted one of the most protective statutory exculpation provisions around. Florida directors are not liable⁸² to the corporation, its

79. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). Most Delaware corporations have amended their charters to take advantage of the provision. However, exculpation in Delaware has not turned out to protect directors as much as its drafters perhaps intended. The statute does not define the duty of loyalty, but apparently it means something more than just improper receipt of a personal benefit (since that is a separate category). Under Delaware law, conflict of interest and controlling shareholder transactions remain “loyalty” cases even if they have been approved by independent directors, *Kahn v. Lynch Communications Sys., Inc.*, 638 A.2d 1110 (Del. 1994), and those directors may be personally liable for improperly approving them. *Emerald Partners*, 726 A.2d at 1215. Further, “good faith” is one of the triad of a director's fiduciary duties, *Cede & Co.*, 634 A.2d at 361, and the statute does not permit exculpation for its breach. This has focused the attention of the plaintiff's bar, and therefore of the courts, on the meaning of good faith (although more attention has not resulted in greater clarity).

Finally, the Delaware Supreme Court recently held that exculpatory charter provisions are not self-executing; the burden of proof is on the director claiming protection to show that the challenged conduct is entitled to it. *Emerald Partners*, 726 A.2d at 1223-24. Since two of the major components of the settlement value of any case are the length of time it will take to get rid of it and legal uncertainty as to the outcome, the price of settlement in Delaware has presumably gone up.

It will be interesting to see if the Delaware legislature responds to this. Corporations are now the only business form in Delaware for which fiduciary duties are mandatory, so the legislature is obviously not enamored of them. On the other hand, Delaware has some interest in maintaining the incomes of its litigators. The line between too much litigation and too little has to be drawn with a careful hand.

80. Such shareholder approval was readily forthcoming, proving either that shareholders are rational and did not want managers to be overly risk-averse, or that management control of the proxy machinery proved an insuperable barrier to free shareholder choice.

81. James J. Hanks, Jr., *Evaluating Recent State Legislation On Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207 (1988).

82. The statute does not preclude non-monetary equitable relief.

shareholders, or to third parties for any act or failure to act, unless the director engaged in a violation of criminal law;⁸³ derived an improper personal benefit from a transaction;⁸⁴ carelessly approved an unlawful dividend or other distribution; or (in a derivative or direct action by a shareholder) acted in “conscious disregard for the best interest of the corporation, or [engaged in] willful misconduct.”⁸⁵

The FLLCA changes the terminology from that used for corporations to that used in LLCs—for example, the word “directors” is changed to “manager” or “managing member”—but otherwise adopts the corporate exculpatory provisions in their entirety.⁸⁶ Managers

83. Unless the director reasonably believed it was not a violation at the time, or at least had no reasonable cause to believe otherwise.

84. The statute does not define the term “improper personal benefit,” but it does say that transactions that have been cleared by disinterested directors or shareholders are “deemed” not to confer an improper benefit. It also states that the clearance procedures are not exclusive and that other forms of personal benefit may not be improper.

85. FLA. STAT. § 607.0831(1)(b)(4) (2001). In an action brought by a third party, the standard is recklessness, bad faith, a malicious purpose, or wanton and willful disregard of human rights, safety, or property.

Generally, in corporate law, directors do not have fiduciary duties to third parties at all, so it seems somewhat strange to find third party suits included in the exculpation provision. However, two early Florida cases held that directors could be liable to creditors in some circumstances, *Beach v. Williamson*, 83 So. 860, 863 (Fla. 1919), and *Forcum v. Symmes*, 143 So. 630, 632 (Fla. 1932), so perhaps the legislature had suits by creditors in mind.

86. Section 608.4228, *Florida Statutes*, states:

(1) A manager or a managing member shall not be personally liable for monetary damages to the limited liability company, its members, or any other person for any statement, vote, decision, or failure to act regarding management or policy decisions by a manager or a managing member, unless

(a) The manager or managing member breached or failed to perform the duties as a manager or managing member; and

(b) The manager's or managing member's breach of, or failure to perform, those duties constitutes any of the following:

1. A violation of the criminal law, unless the manager or managing member had a reasonable cause to believe his or her conduct was lawful or had no reasonable cause to believe such conduct was unlawful. A judgment or other final adjudication against a manager or managing member in any criminal proceeding for a violation of the criminal law estops that manager or managing member from contesting the fact that such breach, or failure to perform, constitutes a violation of the criminal law, but does not estop the manager or managing member from establishing that he or she had reasonable cause to believe that his or her conduct was lawful or had no reasonable cause to believe that such conduct was unlawful.

2. A transaction from which the manager or managing member derived an improper personal benefit, either directly or indirectly.

3. A distribution in violation of s. 608.426.

4. In a proceeding by or in the right of the limited liability company to procure a judgment in its favor or by or in the right of a member, conscious disregard of the best interest of the limited liability company, or willful misconduct.

5. In a proceeding by or in the right of someone other than the limited liability company or a member, recklessness or an act or omission which was committed in bad faith or with malicious purpose or in a manner exhibiting wanton and willful disregard of human rights, safety, or property.

(2) For the purposes of this section, the term “recklessness” means acting, or failing to act, in conscious disregard of a risk known, or so obvious that it should

and managing members may have a mandatory duty to refrain from gross negligence and a mandatory obligation of good faith and fair dealing, but they cannot be sued for money damages for breach of those duties.⁸⁷

have been known, to the manager or managing member, and known to the manager or managing member, or so obvious that it should have been known, to be so great as to make it highly probable that harm would follow from such action or failure to act.

(3) A manager or managing member is deemed not to have derived an improper personal benefit from any transaction if the transaction and the nature of any personal benefit derived by the manager or managing member are not prohibited by state or federal law or the articles of organization or operating agreement and, without further limitation, the transaction and the nature of any personal benefit derived by a manager or managing member are disclosed or known to the members, and the transaction was authorized, approved, or ratified by the vote of a majority-in-interest of the members other than the managing member, or the transaction was fair and reasonable to the limited liability company at the time it was authorized by the manager or managing member, notwithstanding that a manager or managing member received a personal benefit.

(4) The circumstances set forth in subsection (3) are not exclusive and do not preclude the existence of other circumstances under which a manager will be deemed not to have derived an improper benefit.

The previous (largely unused) LLC statute, which had adopted the corporate model for managers' duties, also adopted the corporate exculpation provisions. The revised statute kept the exculpatory provisions while changing the duties to the partnership model. In addition to exculpation, the statute permits LLCs to indemnify managers or managing members against expenses or liability under circumstances which parallel the exculpatory provisions. Managers and managing members may not be indemnified if they are "adjudicated" to have acted in (more or less knowing) violation of criminal law, to have derived an improper personal benefit, to have authorized an unlawful distribution, or to have engaged in willful misconduct or acted with conscious disregard for the best interests of the company. FLA. STAT. § 608.4229. However, they may be indemnified for amounts paid in settlement of a derivative action, although this obviously creates a circularity (manager writes check to company to settle lawsuit, company writes check to manager as indemnification). That section also permits the company to indemnify officers, employees, and agents who are not covered by the exculpatory provision.

Although the statutory default rule is permissive indemnification, the articles of organization or the operating agreement can presumably make it mandatory. In either case, plaintiff members of the company are likely to find themselves financing the litigation expenses of their opponents, at least to the extent of the plaintiffs' interest in the LLC's profits.

87. There is a very real question whether partners could adopt such exculpatory provisions in a partnership agreement. Under RUPA and FRUPA, the partnership or individual partners may sue partners who breach their duties or obligations. R.U.P.A. § 405 (1996) (amended 1997); FLA. STAT. § 608.8405 (2001). According to RUPA's Official Comments, the partners may limit or contract out of their statutory remedies, but may not "eliminate entirely the remedies for breach of those duties that are mandatory under § 103(b)." Official Comments to R.U.P.A. § 405. The Official Comments to section 103 in turn state that restrictions on limiting the rights and remedies for breach of duty are "implicitly" included in the list of non-waivable duties.

Thus, the commentary is vague as to the extent of the partners' power to modify remedies. HILLMAN ET AL., *supra* note 25, at 218. Can partners include an enforceable provision eliminating money damages for breach of the duty of care or the obligation of good faith? At the very least, the question is litigable, although the existence of exculpation-by-statute in the FBCA and FLLCA may buttress an argument that such an agreement is not contrary to public policy or "manifestly unreasonable."

This leads to a question that is perhaps of more interest to jurists than to practitioners: what do we call a “legal” rule that is unenforceable? Is it still “law,” or is it something else—a “norm,” perhaps? There is a burgeoning literature on the role of “norms” and extra-legal sanctions in shaping behavior, and I do not propose to replicate here the discussion of a topic which is consuming whole issues of law reviews.⁸⁸ It is enough to note that the duty of care and the obligation of good faith are, for all practical purposes, unenforceable.⁸⁹

Since I would cheerfully eliminate the duty of care and the overly amorphous obligation of good faith and fair dealing anyway, or at least keep them around only as default rules,⁹⁰ I have no objection to this. In any event, if the firm’s organizers want to volunteer for liability, they are free to do so.⁹¹

C. Self Help: Voting and Leaving

1. The Approach of Partnership Law

Strong fiduciary duties are less important when self-help is easily available. In a partnership, the default rules provide that every partner has an equal voice and an equal right to participate in management. More importantly, every partner has the power to walk out and take a fair share of the assets with her, either immediately (if the partnership is at will) or eventually (if the partnership is for a term or undertaking).⁹² If the partner has made (or will make) an

88. See, e.g., Symposium, *Norms and Corporate Law*, 149 U. PA. L. REV. 1607 (2001).

89. COHN & AMES, *supra* note 24, at 367.

90. Default rules do at least serve an information forcing function. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989). On the other hand, contracting out increases transaction costs. I am not convinced that the duty of care confers any benefits that outweigh those costs, and I would be content to leave good faith to its appropriate role as an aid to the interpretation of contracts whose drafters left gaps which require filling.

91. Section 608.4227, *Florida Statutes*, provides that a member’s or manager’s duties and liabilities may be expanded by the articles of organization or operating agreement. Thus, a limited liability company may “opt out” of the statutory exculpation provisions in whole or in part. In contrast, the FBCA does not, on its face, allow the organizers of a corporation to opt out of the exculpatory provisions. According to COHN & AMES, *supra* note 24, at 104, this means that they may not do so. (I should note that my colleague John Larson does not agree with Messrs. Cohn & Ames on this point, and I remain agnostic on the issue.)

A note of caution for those drafting operating agreements: Counsel accustomed to preparing limited partnership agreements routinely include provisions limiting liability for breach of the duty of care to “gross negligence.” If such a provision is unthinkingly inserted in an LLC operating agreement, it may well result in the assumption of liability, rather than protection against it.

92. Under RUPA’s default rules, the manner of departure makes a difference. Voluntary departure from an at will partnership gives the dissociating partner the right to force the winding up and liquidation of the partnership. Involuntary departure, whether by death or judicial decree, gives the withdrawing partner or her estate the right to the fair

important contribution to the firm, the other partners have a strong incentive to treat her well.⁹³

2. *The Approach of Corporate Law*

In a closely held corporation, in contrast, the default rules provide that a majority shareholder rules and that a corporation, like a diamond, is forever. Minority shareholders cannot sell their shares and walk away because, by definition, there is no market for the shares. They are thus locked in (unless, of course, they are frozen out) and may be subjected to various forms of oppression.⁹⁴

The minority shareholder's only leverage is a lawsuit (or the credible threat of one). If oppression takes the form of a cognizable breach of duty,⁹⁵ then the victim may sue for damages.⁹⁶ The oppressed shareholder may also petition for dissolution of the corporation in a state whose statute permits dissolution on that ground.⁹⁷

In Florida, however, the exculpatory provisions of the FBCA mean that a suit for damages is doomed to failure unless the majority shareholder has been stealing from the corporation. Further, the only

value of her interest in the partnership. Both the liquidation and the buyout rights are subject to contrary agreement, and withdrawal in contravention of the agreement may give rise to damages. However, a court may not enforce an agreement which sacrifices the partner's entire economic interest without any reference to actual damages; the common law disfavors forfeiture, *see, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 227(1), 229 (1979) and RUPA's Official Comments.

Further, the right to walk cannot be eliminated by agreement; there is no such thing as an indissoluble partnership. A partner may face disincentives to leave, but she cannot be trapped in the partnership even if she volunteers for the trapping. One noted contractarian critic of RUPA added this departure from freedom of contract to his list of RUPA defects, Larry E. Ribstein, *The Revised Uniform Partnership Act: Not Ready for Prime Time*, 49 BUS. LAW. 45 (1993), but it received far less fire from the contractarians than did mandatory fiduciary duties.

In this connection, it should be noted that one apparent reason for RUPA's non-waivable power to withdraw was the personal liability of partners. HILLMAN ET AL., *supra* note 25, at 271. If a partnership adopts limited liability provisions, thus becoming an LLP, this reason disappears. Nevertheless, the withdrawal provisions were not changed when the LLP provisions were added to the statute.

93. *See* HILLMAN ET AL., *supra* note 25, § 602. Thus, exit rights are a governance mechanism.

94. There are enough ways to oppress minority shareholders to fill a treatise. F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS (3d ed. 1996).

95. Some forms of oppression come in the guise of business judgments, and courts not attuned to the special problems of the close corporation may reflexively use the business judgment rule to protect the majority.

96. If the friction between or among the parties is sufficiently severe, lawsuits may have to be filed seriatim.

97. The action for "oppression" is recognized in a majority of states. Some of those states do not require that the complaining shareholder prove fraud or a breach of fiduciary duty; it suffices if the majority has acted in a way that frustrates the plaintiff's "reasonable expectations" by, for example, excluding the plaintiff from management. Douglas K. Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VAND. L. REV. 749 (2000); Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699 (1993).

grounds for involuntary dissolution are deadlock, waste (and not just any old waste, but “material” waste), illegality, or fraud.⁹⁸ The Florida courts have shown no inclination to stretch the definition of illegality to include seriously unfair conduct,⁹⁹ let alone to enforce the reasonable expectations of the parties.¹⁰⁰

In any event, litigation requires fault on the part of the majority and will not assist the shareholder who merely decides that her time and money would be better spent elsewhere.¹⁰¹ Sensible attorneys therefore draft shareholder agreements that permit a “no fault” divorce and, perhaps, assure the minority shareholder a greater voice in the firm before divorce becomes necessary.¹⁰²

3. *The FLLCA*

Attorneys advising parties who will have minority interests in a Florida LLC had better dig out the forms they used to use for closely held corporations, because the voting and exit provisions of the FLLCA are taken more or less directly from the corporate model.¹⁰³ In one respect, being a minority member is even worse than being a minority shareholder. Shares can be sold if anyone is fool enough to buy them,¹⁰⁴ or at least left to one's heirs, which may be particularly useful if one dislikes one's heirs. LLC memberships are not transferable, period.¹⁰⁵

98. FLA. STAT. § 607.1430(3) (2001).

99. COHN & AMES, *supra* note 24, at 6, 167-68.

100. The FBCA also gives the corporation or the other shareholder(s) the option to buy out the dissolution-seeking dissident for “fair value,” a term which is not defined. FLA. STAT. § 607.1436. If it means “liquidation value,” then the majority shareholder(s) can appropriate the going concern value, unless liquidation value includes the possibility that the entire corporation could be sold as a going concern. COHN & AMES, *supra* note 24, at 171-72.

In any event, this buyout right operates solely at the election of the shareholder(s) resisting liquidation. The unhappy shareholder who petitions for dissolution is writing a call option with an uncertain strike price and does not even get an option premium.

101. J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1 (1977).

102. Hunter J. Brownlee, *The Shareholders' Agreement: A Contractual Alternative to Oppression as a Ground for Dissolution*, 24 STETSON L. REV. 267 (1994). On the other hand, for some kinds of businesses, for example high-tech startups, a no-exit rule may make sense. Edward B. Rock & Michael L. Wachter, *Waiting for the Omelet to Set: Match-Specific Assets and Minority Oppression in Close Corporations*, 24 J. CORP. L. 913 (1999).

103. Instead of one share/one vote, the default rule in the FLLCA is voting in proportion to the profit interest. Thus, the “majority-in-interest” rules. FLA. STAT. § 608.4231. This is certainly a substantial improvement over the previous FLLCA rule, in which the defaults were set by capital contribution. FLA. STAT. § 608.4231 (pre-1999). However, it stands in sharp contrast with Section 404 of the Uniform Limited Liability Company Act, which gives each member equal rights in the management and control of the business.

104. Assuming no restrictions on transfer.

105. A member may assign an interest in the membership, but that does not carry with it the right to become a member. Assignees have no rights other than the right to receive distributions.

Sanguine though I am about the FLLCA's treatment of fiduciary duties and remedies for breach, I do not agree with the choice of the corporate model as the default rule for exit. The drafters appear to have been influenced by the estate planners in their midst.¹⁰⁶ Nevertheless, I think the Uniform Limited Liability Company Act, which adopted partnership dissociation as its default model,¹⁰⁷ is much better.

III. CONCLUSION

If Florida's old LLC statute was an Edsel, the new one is a Taurus. Lots of consumers are buying it, and for good reason: it's a fine vehicle for ordinary small business enterprisers with reasonably competent lawyers or accountants who can tailor the default rules to suit the parties. These "plain vanilla" form consumers probably need not be overly worried about whether or not the statute's mandatory duties are "fiduciary" or merely contractual; if they are lucky, someone who used the Florida statute for a more complicated deal will wind up spending the money to procure an authoritative opinion from the Florida courts. The statute's mismatch between mandatory duties and the remedies for breach is not a problem so long as it is brought to the parties' attention. After all, properly advised parties can volunteer for potential liability and its associated leverage if they want. Further, such parties will not be stuck with the default rules on voting and exit; their operating agreement will include a buy-out mechanism and, if necessary, custom-made voting rights.

However, while the Florida statute is fine for the mass market, it is not well-suited to consumers at either end of the spectrum: (1) those with high stakes, complex deals, particularly when some or all of the parties are also engaged in other, possibly competing businesses, and (2) those with simple deals but no professional assistance.

A. The High Stakes Deal

As written, the statute provides mandatory minima duties which are probably fiduciary—but maybe not. It provides an amorphous obligation of good faith, which is probably not a fiduciary duty—but maybe it is. It provides exculpatory provisions which nevertheless

106. I am indebted to my colleague David Powell for informing me that the "no exit/no buyback on death" default rule is necessary to use the LLC as an estate planning device. See also Andrew J. Willms, *Discounting Transfer Taxes with LLCs and Family Limited Partnerships*, 13 J. TAX'N INVESTMENTS 210 (1996).

107. Articles 6-8 of the Uniform Limited Liability Company Act track RUPA's distinctions between an at will organization and a term organization, and between "rightful" and "wrongful" dissociation, but in either case, exit is easy and liquidity—either immediate or eventual—is assured.

leave plenty of room for litigation about loyalty. One way around all this is to contract out of these duties entirely, which the statute does not permit.

Form entrepreneurs whose clients really want to contract out of fiduciary duties, and who want to be sure that a court will respect that choice, do have another option: Delaware. In a Delaware LLC,¹⁰⁸ fiduciary duties are default rules that may be varied or eliminated in the operating agreement.¹⁰⁹ If the parties anticipate the possibility of litigation in the future (as well they might, since they want to contract out of a trust relationship and the opportunities for litigation it provides), and do not want to travel to Delaware, in spite of its many charms, they may always include a choice of forum clause¹¹⁰ or an arbitration clause specifying Florida as the arbitral venue.¹¹¹

If enough form consumers buy the Delaware product, then perhaps the Florida statute will be amended to make it clear that contracting out is permitted. That is certainly the route I would recommend.

B. The "Do-it-Yourselfers"

One way for an organizational form to create value is by setting default rules that most parties would choose if they bargained. Form consumers shopping for an economy model probably would not contract out of the duty of loyalty even if they could,¹¹² so the default rules on duty serve them reasonably well. The FLLCA's no exit default rule is another matter entirely. That rule must—and I believe will—be bargained around if parties are represented by reasonably sophisticated professionals. If it turns out, as I think it will, that most competently-represented form consumers are bargaining around the no exit default, then the statute should be amended by adopting the Model Act's exit provisions. As things stand, parties

108. Or, for that matter, a Delaware limited partnership. *See, e.g.,* *Sonet v. Timber Co.*, 722 A.2d 319 (Del. Ch. 1998).

109. Counsel should recognize, however, that it is important to make sure the parties fully understand, and acknowledge that they understand, both the fact and the consequences of contracting out. In this regard, the parties should also realize that full disclosure assumes additional importance in the absence of fiduciary duties. *Sonet v. Plum Creek Timber Co.*, No. 16931, 1999 WL 160174 (Del. Ch. 1999).

110. While making it clear that Delaware's substantive law is to apply, of course. I leave it to counsel to decide whether they really want to explain Delaware law to an already overburdened Florida judge.

111. Delaware has already held that such arbitration agreements are enforceable. *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 293 (Del. 1999).

112. Nor, in my opinion, would they contract around the statutory impediments to enforcing the duty of care or the obligation of good faith, since those duties serve no particularly useful purpose.

who try a “do-it-yourself” approach,¹¹³ or who use the services of a general practitioner unaware of the need for a buyout agreement, are likely to find themselves unpleasantly surprised, and quite possibly involved in litigation, down the road.

My preference for the Model Act provisions is based only in part on efficiency (reducing transaction costs). There is also a non-efficiency based normative component.

First, as written, the statute imposes a transaction cost tax on everyone who uses it, either in the form of up-front fees to professionals or in the discounted cost of anticipated future litigation expenses.¹¹⁴ Second, the discounted cost of future litigation must be higher than the cost of planning to avoid it, or no one would make planning expenditures.

Thus, people who do not use professional assistance are paying a higher tax than those who do use professionals, although it is a hidden tax in the sense that they do not know that they are paying it when they buy a Florida LLC. Further, I assume that many, and probably most, of the people buying this product without professional assistance are doing so because they are sufficiently poor to make fee payment problematic.

The only apparent reason for the statute’s no exit default is to facilitate estate planning. I do not begrudge form entrepreneurs a return on their investment.¹¹⁵ Nevertheless, it is regressive to impose a tax on all form consumers, and a higher tax on those relatively poor consumers who “do it themselves,” in order to benefit people wealthy enough to need estate planning. In my view, regressive taxes are seriously unfair. For that reason alone, the statute should be amended to provide either a buyout or a liquidation right (or both) as the default.

113. This assumes, of course, that unrepresented parties will not negotiate a buyout agreement because they will either not know what the default rule is or will not understand why it matters.

114. Everyone incurs this cost, whether or not they actually wind up litigating. Discounting requires only the possibility of litigation, not the certainty.

115. While economists see transaction costs as a deadweight loss, lawyers and accountants see them as a livelihood.