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Agency Powers and Fiduciary Duties under the Alabama Limited Liability Company Act: Suggestions for Future Reform

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AGENCY POWERS AND FIDUCIARY DUTIES UNDER THE ALABAMA LIMITED LIABILITY COMPANY ACT: SUGGESTIONS FOR FUTURE REFORM

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I. INTRODUCTION

Alabama's Limited Liability Company Act (Alabama LLC Act)[1] brought Alabama into the age of new business forms. From 1988 to the present, the limited liability company (LLC), a hybrid business organization combining partnership and corporation characteristics, swept the country in leaps and bounds.[2]

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1. Alabama Limited Liability Company Act, ALA. CODE §§ 10-12-1 to -61 (1994) [hereinafter Alabama LLC Act].

2. In 1988, when the IRS recognized the LLC's right to be a partnership, only Wyoming and Florida had LLC statutes on their books. By the close of 1996, all fifty states and the District of Columbia recognized the right to do business as an LLC. For a complete discussion of LLC legislation through 1994, see Susan Pace Hamill, *The Taxation of Domestic Limited Liability Companies and Limited Partnerships: A Case For Eliminating the Partnership Classification Regulations*, 73 WASH. U. L.Q. 565, 566 n.4 (1995).

In 1991, a related business entity, the limited liability partnership (LLP) began percolating through the states. LLPs were created to provide partners with liability protection from the negligence committed by their fellow partners, normally in a professional malpractice setting. The level of liability protection provided by LLPs varies somewhat from state to state and is defined explicitly in the relevant

The LLC represents the first nationally accepted domestic entity offering partnership business characteristics and tax classification with the hallmark corporate trait of limited liability protection for all owners.[3] In 1993, the year when 18 states,[4] more states than any other year, passed LLC legislation, Alabama adopted the Alabama LLC Act.[5] In August 1995, the National

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statute. In all other business respects, LLPs, unlike LLCs, are general partnerships. For an excellent discussion of the consequences of the varying degrees of liability protection offered by LLPs, see Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065 (1995). For an exhaustive discussion of LLPs in general, see Robert R. Keatinge et al., *Limited Liability Partnerships: The Next Step in the Evolution of the Unincorporated Business Organization*, 51 BUS. LAW. 147 (1995); Jennifer J. Johnson, *Limited Liability for Lawyers: General Partners Need Not Apply*, 51 BUS. LAW. 85 (1995).

3. For an early discussion of LLCs, focusing primarily on their tax classification, see Susan Pace Hamill, *The Limited Liability Company: A Possible Choice For Doing Business?*, 41 U. FLA. L. REV. 721 (1989). For an overall discussion of the business and tax issues confronting LLCs, see Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375 (1992). For a general discussion of LLCs from a business perspective with an emphasis on fiduciary duty problems, see Deborah A. DeMott, *Fiduciary Preludes: Likely Issues for LLCs*, 66 U. COLO. L. REV. 1043 (1995); Claire Moore Dickerson, *Equilibrium Destabilized: Fiduciary Duties Under the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 417 (1995); Steven C. Bahls, *Application of Corporate Common Law Doctrines to Limited Liability Companies*, 55 MONT. L. REV. 43 (1994); Sandra K. Miller, *What Standards of Conduct Should Apply to Members and Managers of Limited Liability Companies?*, 68 ST. JOHN'S L. REV. 21 (1994); S. Mark Curwin, *Fiduciary Duty and the Minnesota Limited Liability Company: Sufficient Protection of Member Interests?*, 19 WM. MITCHELL L. REV. 989 (1993). For an excellent discussion of fiduciary obligations toward an LLC in the context of attorneys representing LLCs, see Robert R. Keatinge, *The Implications of Fiduciary Relationships in Representing Limited Liability Companies and Other Unincorporated Associations and Their Partners or Members*, 25 STETSON L. REV. 389 (1995).

For exhaustive treatises covering all legal problems confronting LLCs with extensive statutory summary lists and sample operating agreements, see 1-4 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES (1992 & Supp. 1996); CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW (1994 & Supp. 1996).

4. *See* Hamill, *supra* note 2, at 566 n.4.

5. On April 22, 1993, the Senate passed the Alabama LLC Act. *See* S. 549, 1993 Reg. Sess., 1993 S.J. Ala. 1293-94. On May 17, 1993, the House of Representatives passed the Act. *See* S. 549, 1993 Reg. Sess., 1993 H.J. Ala. 4141-42. On that same day, the Act was signed by both houses. *See* 1993 S.J. Ala. 2845-46; 1993 H.J. Ala. 4165-66. Governor Jim Folsom signed the Alabama LLC Act on May 20, 1993, with an effective date of October 1, 1993. *See* 1993 Ala. Acts 1425. For an excellent discussion of all the provisions in the Alabama LLC Act, see Bradley J. Sklar & W. Todd Carlisle, *The Alabama Limited Liability Company Act*, 45 ALA. L. REV. 145 (1993).

Conference of Commissioners on Uniform State Laws approved the final version of the Uniform Limited Liability Company Act (the Uniform LLC Act).[6] Prompted by the experience reflected in the Uniform LLC Act and its commentary, at some point in the future, Alabama, like most other states, should carefully examine its current statute and consider refining certain provisions and the commentary.

At the time of its enactment, the Alabama LLC Act reflected a state of the art, mainstream statute. Like most state LLC statutes enacted before completion of the Uniform LLC Act, the Alabama LLC Act does not expressly address the fiduciary duties owed by members and managers.[7] The Alabama LLC Act's governance and agency provisions, like virtually all other state LLC statutes, creates two regimes hinging on whether or not the LLC appoints managers.[8] If the LLC appoints no managers, the Alabama LLC Act grants each member broad apparent authority to bind the LLC; however, if the LLC appoints managers, only the managers statutorily possess broad apparent authority and members as such have no statutorily granted apparent authority.[9] The Alabama LLC Act allows members to use the operating agreement to either create authority to bind the LLC where none exists under the statute or remove authority otherwise contemplated by the statute.[10]

Rather than attempting to comment on all aspects of the Alabama LLC Act which the Alabama Legislature may consider refining, this Article confronts two main issues. The Article points out certain problems when defining the scope of the members' and managers' power to bind the LLC and discusses

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6. *See* UNIF. LTD. LIAB. CO. ACT (1995) [hereinafter ULLCA]. Because the IRS intends to allow all domestic unincorporated businesses to choose partnership tax status without regard to the four-factor partnership classification test, *see* Prop. Treas. Reg. §§ 301.7701-1 to -361, 61 Fed. Reg. 21,989 (1996), the National Conference of Commissioners on Uniform State Laws is in the process of revising the Uniform LLC Act. The provisions dealing with management and fiduciary duties are not expected to be affected by this revision. *See* Carter G. Bishop, *The Uniform Limited Liability Company Act: Summary & Analysis*, 51 BUS. LAW. 51 (1995), and Larry E. Ribstein, *A Critique of the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 311 (1995), for a general discussion of the Uniform LLC Act.

7. *See* 1 RIBSTEIN & KEATINGE, *supra* note 3, § 9.01.

8. *See* ALA. CODE §§ 10-12-21 to -22 (1994).

9. *See id.*

10. *See id.* § 10-12-24 (1994).

the necessity of codifying the boundaries of fiduciary duty protections in the statute and the commentary. Section II first notes that the legislature need only make conforming revisions to the Alabama LLC Act's provisions addressing the power to manage and bind the LLC to reflect changes made to Alabama's general partnership law after the legislature adopted the Revised Uniform Partnership Act (RUPA).[11] Section II then explores the difficulty in ascertaining the scope of a member's apparent authority if that member acquires actual authority in the operating agreement to bind the LLC even though managers have been appointed. The Alabama Legislature should provide guidance in the commentary determining the scope of such member's apparent authority. The primary factors identified in the commentary should include the extent of the actual authority granted by the operating agreement, as well as the LLC's relative size and the degree of centralized management it maintains on a practical level.[12]

Section III discusses the internal protection LLC members should receive under the revised Alabama statute through fiduciary duties owed by the members of member-managed LLCs and the managers of manager-managed LLCs. The appropriate level of fiduciary duty protection, which looks at the level of trust, dependency, and power relationships between the parties, cannot be properly defined without ascertaining the members' and managers' legal and actual rights the members and managers have to bind and participate in the control of the LLC. Stated differently, the level of authority to bind the LLC created by both the statute and the operating agreement is highly related to the proper degree of fiduciary duties imposed by the statute.[13] If the members choose not to appoint managers, thus retaining their statutorily granted power to bind the LLC, the Alabama LLC Act should statutorily impose on all members the same general fiduciary duties general partners owe each other.[14] If the LLC appoints managers, only the manager should statutorily owe significant fiduciary duties reflecting the same

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11. *See* Alabama Uniform Partnership Act (1996), ALA. CODE §§ 10-8A-101 to -1109 (Supp. 1996) (effective Jan. 1, 1997) [hereinafter Ala. RUPA].

12. *See infra* notes 19-70 and accompanying text.

13. *See infra* notes 71-75 and accompanying text.

14. *See infra* notes 85-93 and accompanying text.

standard applied to general partners and members of a member-managed LLC.[15] These statutory fiduciary duties will work best in manager-managed LLCs where the operating agreement creates no authority and management powers for the members and takes no power away from the managers.

However, once the operating agreement starts vesting management powers in nonmanaging members or divesting powers away from managers, it becomes impossible to statutorily define the scope of fiduciary duties owed by both the nonmanaging members and the managers.[16] To address these situations, the Alabama Legislature should provide extensive commentary outlining the possible boundaries on fiduciary duties owed by the nonmanaging members and managers when the operating agreement alters the basic statutory management structure which vests no powers to the members but all powers to the managers.[17] The vast flexibility allowed in the operating agreement prevents the commentary from providing precise guidance to all LLCs. The commentary should therefore generally state that nonmanaging members acquiring rights to participate in the business of closely-held LLCs more easily owe full fiduciary duties covering the entire business than comparable nonmanaging members of widely-held LLCs operating as a centralized management unit. The commentary should also address the fiduciary duties owed by managers who do not possess full powers to manage and bind the LLC under the operating agreement. Before releasing these managers from the full fiduciary duties imposed by the statute, the facts and circumstances should strongly indicate that the members do not depend on them to oversee the entire business.[18]

15. *See infra* notes 94-119 and accompanying text.
16. *See infra* notes 80-85 and accompanying text.
17. *See infra* notes 80-85 and accompanying text.
18. *See infra* notes 106-119 and accompanying text.

II. THE POWER TO BIND THE LLC

A. Member-Managed LLCs

Originating from agency and partnership law,[19] the Alabama LLC Act and the Uniform LLC Act confer management rights to all members[20] and deem every member an agent of the LLC, cloaking them, by virtue of their member status alone, with agency power to bind the LLC for transactions "apparently carrying on in the usual way the business or affairs of the limited liability company."[21] Consequently, third parties dealing with members of member-managed LLCs can generally assume that these members have authority to bind the LLC as long as the member is acting within the scope of the LLC's usual business.[22] These LLC members have apparent authority extending

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19. *See* RESTATEMENT (SECOND) OF AGENCY §§ 1, 3, 6, 7, 8, 8A (1959). For extensive coverage of all aspects of partnership law, see 1-4 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP (1996), and J. WILLIAM CALLISON, PARTNERSHIP LAW AND PRACTICE (1992). *See also* BISHOP & KLEINBERGER, *supra* note 3, §§ 7.01-.08.

20. *See* ALA. CODE § 10-12-22 (1994); ULLCA § 404 (1995). All members have the right to participate in the business decisions concerning the LLC, and the commentary indicates that the members vote per capita unless they agree to a different voting formula. *See* ALA. CODE § 10-12-22 commentary (1994); ULLCA § 404 cmt. (1995). The Alabama LLC Act does not indicate which business decisions require unanimous approval, and which require only majority approval. By setting out an exclusive list of matters requiring unanimous approval, the Uniform LLC Act implicitly requires the members to define in the operating agreement business decisions not on this list but nevertheless important enough to warrant a unanimous vote; otherwise, a majority carries the decision. *See* ULLCA § 404(c) (1995). However, the partnership statutes state that ordinary decisions need only majority approval while extraordinary decisions require unanimity, leaving it up to the courts to draw the line between the two. *See* UNIF. PARTNERSHIP ACT § 18(h) (1914) [hereinafter UPA]; REVISED UNIF. PARTNERSHIP ACT § 401(j) (1994) [hereinafter RUPA]; Ala. RUPA, ALA. CODE § 10-8A-401(j) (Supp. 1996). Although the management portion of this Article focuses on the power to bind rather than voting standards, when the Alabama Legislature revises the Alabama LLC Act, they should add conforming language which reflects the Alabama RUPA position regarding voting standards for ordinary and extraordinary business decisions. *See infra* notes 30-32 and accompanying text.

21. *See* ALA. CODE § 10-12-21(a); ULLCA § 301(a).

22. Because members of member-managed LLCs, like partners in general partnerships, presumably act as co-owners actively participating in the business, public

to the borders of the LLC's usual business even if the LLC member acts beyond the scope of his or her actual authority, because, for example, the operating agreement restricts that member's actual authority.[23] By treating all members of a member-managed LLC as general agents to carry on the LLC's usual business, the statute assumes that for this purpose LLC members are tantamount to general partners.[24]

As noted, the members of a member-managed LLC may use the operating agreement to restrict the scope of a particular member's actual authority to bind the LLC. Although this agreement will be fully enforceable among the members internally, within the boundaries of contract law, third parties without knowledge of the restriction are entitled to rely on the particular member's apparent authority as long as that member acted within the scope of the LLC's usual business.[25] Borrowing from language of UPA, the Alabama LLC Act only extinguishes the third party's right to rely on the member's apparent authority when the third party "has knowledge of the fact that the member has no such authority."[26] Over the years the case law has

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policy supports protecting third parties by broadly defining each partner or member's apparent authority to cover all aspects of the partnership's or LLC's business. *See* 1 BROMBERG & RIBSTEIN, *supra* note 19, § 4.01(b).

23. *See* ULLCA § 301 cmt.; *see also* 1 BROMBERG & RIBSTEIN, *supra* note 19, § 4.02(c); 1 RIBSTEIN & KEATINGE, *supra* note 3, §§ 8.08-.09.

24. The statutory language of the Alabama LLC Act addressing the power of members to bind the LLC essentially follows the language of the Uniform Partnership Act (UPA). *See* UPA § 9(1). The comparable language of the Uniform LLC Act tracts the language of RUPA. *See* RUPA § 301 cmt. 2. Although RUPA made minor language changes to § 9(1) of UPA, the drafters intended no substantive change altering years of precedent defining the scope of partnership's business. *See* RUPA § 301 cmt. 2. Because Alabama has now adopted RUPA, when the Alabama Legislature revises the Alabama LLC Act, it should change the language of ALA. CODE § 10-12-21 to reflect RUPA rather than UPA.

25. Alabama operating agreements must be in writing and unless the initial written agreement authorizes oral amendments, all amendments must be in writing. *See* ALA. CODE § 10-12-24 (1994). Although strong arguments can be made to the contrary, it seems that the requirement of a writing unduly hampers small, informal LLCs. Moreover the law of contracts contains enough precedent to deal with oral agreements. *See* ULLCA § 103(a) cmt.; *see also* ADVISOR'S REPORT ON THE UNIFORM LIMITED LIABILITY COMPANY ACT 15-16 (1995) (supporting oral operating agreements generally but stating matters addressing contribution, dissolution, and new members should require a writing).

26. ALA. CODE § 10-12-21(a) (1994). The Alabama Legislature took this language verbatim from the comparable provision in UPA. *See* UPA § 9(1).

interpreted "actual knowledge" as requiring a cognitive awareness of the restriction imposed on the member's or the partner's authority.[27] Borrowing from RUPA, the Uniform LLC Act, in addition to making minor changes to UPA's standard focusing on notice, provides an elaborate "notification procedure" where a third party can be deemed to have constructive knowledge of a restriction on a member's authority.[28] With the exception of restrictions governing which members have the authority to transfer the LLC's real property, the notification procedure requires much more than a mere filing in a central, public location.[29] The notification procedure provides an avenue, unavailable under UPA or the current Alabama LLC Act, to cut off apparent authority.

The Alabama LLC Act properly treats members of a member-managed LLC as general partners when defining their rights to manage and the scope of their power to bind the LLC.[30] Although the law governing LLC members and general partners clearly contains one glaring difference, the limited liability enjoyed by LLC members compared with the personal liability exposure of general partners,[31] no valid policy reason exists to treat the two groups differently when defining their scope of apparent authority to bind the partnership or LLC. While personal liability of the owners may increase the assets available to satisfy the obligations of the organization, questions of apparent authority focus on the initial determination of whether a particular action of an owner or agent gives rise to an obligation of the organization.[32]

Consequently, the default provisions and the commentary

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27. *See* 1 BROMBERG & RIBSTEIN, *supra* note 19, § 4.02(c); *see also* ULLCA § 102 cmt.

28. *See* ULLCA § 102; RUPA § 102.

29. In order to effectively extinguish a member's or a partner's apparent authority by providing notification of a restriction on actual authority, the LLC members or partners must either make the third party aware of the restriction or duly deliver the notification document to the third party's place of business. *See* ULLCA § 102. Although the notification procedure obviously offers third parties greater protection than central filings, it nevertheless requires the third party to possess a lesser degree of awareness than the knowledge standard under UPA. *See* ULLCA § 102 cmt.

30. *See* ALA. CODE §§ 10-8-49(a), -12-21, -12-22 (1994).

31. *See* ALA. CODE §§ 10-8-52, -12-20.

32. *See* 1 JAMES D. COX ET AL., CORPORATIONS § 8.2 (1995).

governing the power to bind the LLC should continue to mirror the comparable provisions under Alabama's general partnership law.[33] The Alabama Legislature should conform the language defining the scope of apparent authority to reflect Alabama's RUPA and adopt RUPA's standard of third party notice with a notification procedure allowing Alabama LLC members the same ability as general partners to cut off a particular member's apparent authority. The broad apparent authority of all members to bind the LLC, combined with the ability to destroy that authority through the notification procedure, balances the needs of third parties and LLC members. Moreover, the precedent applicable to partners and partnerships will be available to help LLC members and third parties dealing with LLCs ascertain the boundaries of a particular member's authority.[34]

B. Manager-Managed LLCs

If the LLC's articles of organization designate managers, then only the managers have the power to manage and make business decisions on behalf of the LLC[35] and only the managers enjoy agency power to bind the LLC for transactions "carrying on in the usual way the business affairs of the LLC."[36] Third parties dealing with the LLC can only rely on the apparent authority of a manager acting within the scope of the LLC's usual business.[37] The LLC's managers can be likened to general partners of limited partnerships[38] or the combined roles of cor-

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33. Because Alabama is now a RUPA jurisdiction, the revised Alabama LLC Act's provisions dealing with management and power to bind should reflect the language of the Alabama RUPA for consistency purposes. *See supra* note 24 and accompanying text.

34. *See* ULLCA § 104(a) & cmt.

35. *See* ALA. CODE § 10-12-22(b) (1994); ULLCA § 404(b).

36. *See* ALA. CODE § 10-12-21(b)(2). The language in the Uniform LLC Act addressing the manager's apparent authority to bind the LLC uses the technical language of RUPA. *See* ULLCA § 301(b).

37. *See* ALA. CODE § 10-12-21(c); *cf. supra* notes 20-34 and accompanying text (pertaining to reliance by third parties on apparent authority of members acting within the scope of the business of the member-managed LLC).

38. *See* REVISED UNIF. LTD. PARTNERSHIP ACT § 403(a) (1985) [hereinafter RULPA]. Only the general partners in a limited partnership possess the ability to manage and control and the agency power to bind the partnership. *See also* 4 BROMBERG & RIBSTEIN, *supra* note 19, § 14.01(b).

porate directors and officers.[39] On the other hand, the LLC's members, enjoying no statutorily sanctioned powers to manage and make business decisions on behalf of the LLC or bind the LLC in transactions with third parties, share similar traits with limited partners[40] and corporate shareholders.[41] Using the operating agreement, the members and managers enjoy virtually unlimited flexibility[42] to restrict the degree of actual authority possessed by managers,[43] to bind the LLC, or to grant certain members actual authority to bind the LLC in designated transactions.[44]

In a manager-managed LLC, if the operating agreement does not alter the statutory management and agency provisions, the third parties should only be able to rely on a manager's apparent authority to bind the LLC. Unlike a general partner

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39. *See* ALA. CODE §§ 10-2B-8.01, .41 (1994) (setting out general duties of directors and officers). Directors as a group are responsible for making the major policy decisions concerning the corporation, but individually possess no agency powers to bind the corporation. *See* 1 COX, *supra* note 32, § 8.4. Officers are high-level corporate employees appointed by the directors and individually derive agency authority to bind the corporation from their status as employees. *See id.* §§ 8.4, .13; RESTATEMENT (SECOND) AGENCY §§ 220, 228 (1957).

40. *See* RULPA § 303(a). Like LLC members, limited partners in the limited partnership have no statutorily sanctioned powers to bind the limited partnership or make business decisions concerning the limited partnership. *See generally* 4 BROMBERG & RIBSTEIN, *supra* note 19, § 14.01(c) (setting forth the powers of limited partners to act as agents).

41. *See* ALA. CODE §§ 10-2B-7.01 to .32 (1994) (detailing provisions setting out shareholders rights containing no express agency powers); 2 COX, *supra* note 32, §§ 13.1, .3 (shareholders' statutory powers limited to voting rights, rights to sue, and rights to information).

42. Persons using the corporate form possess vast flexibility to enhance rights of shareholders to manage and bind the corporation through shareholder agreements. *See* ALA. CODE § 10-2B-7.32. However, persons using limited partnerships, do not enjoy the same degree of flexibility to allow limited partners rights to manage and bind the limited partnership because the statute treats limited partners whose activities rise to the level of controlling the business as general partners with full personal liability exposure. *See* RULPA § 303(b). *See generally* 4 BROMBERG & RIBSTEIN, *supra* note 19, § 14.01(b).

43. *See infra* notes 54-55 and accompanying text.

44. *See supra* note 20 and accompanying text. The operating agreement can also restrict the managers or enhance the members' power to participate in the internal business decisions of the LLC. For example, they can alter the statutory defaults concerning per capita voting or expand or restrict the types of decisions requiring unanimity. The members' agreement also can partially or wholly take away the manager's power to make certain business decisions. *See supra* note 20 and accompanying text.

who gave up the statutorily conferred authority to bind the partnership, members of an LLC with managers never statutorily possessed the power to bind the LLC in the scope of its business.[45] Consequently, absent evidence that the operating agreement grants a nonmanaging member the power to bind the LLC,[46] it would be unreasonable to hold the LLC responsible for truly unauthorized acts of a member by creating apparent authority using a theory that would have to disregard the core purpose of a manager-managed LLC—the ability to centralize management by separating ownership and control of the LLC. Consequently, the Alabama Legislature need not alter the basic statutory structure addressing the power to bind the LLC for manager-managed LLCs that maintain complete separation of ownership and control in a highly centralized managed structure.

The members of a LLC can use the operating agreement to restrict the scope of a manager's actual authority to bind the LLC.[47] The restrictions can be of limited scope[48] or cover more extensive aspects of the LLC's business.[49] The operating agreement can even relegate the manager to a mere ministerial agent with duties confined to keeping the LLC's books and filing the necessary tax returns and other elections.[50] Regardless of the

45. *See* ALA. CODE § 10-12-21(b)(2) (1994); ULLCA § 301(b)(1) (1995).

46. In a manager-managed LLC, under both the Uniform and the Alabama LLC Acts, the statute removes nonmanaging members' apparent authority; the existence of actual authority remains a question of fact. Serious injustices to third parties can result due to Alabama's requirement that the operating agreement be in writing. Although the written operating agreement confers no authority for a nonmanaging member to bind the LLC, members can, by course of conduct which is acquiesced to by others, hold themselves out as having the power to bind. Third party creditors, understandably through observing the conduct, will assume the member has actual authority to bind the LLC. Because Alabama requires a written operating agreement, the LLC can attempt to deny the existence of that authority by arguing that the agreement, in failing to meet the writing requirement, never granted the authority. If Alabama allows oral operating agreements, that course of conduct would be considered a grant of actual authority, entitling the third party to enforce the transaction against the LLC. *See supra* note 25.

47. *See* 1 RIBSTEIN & KEATINGE, *supra* note 3, § 8.08.

48. *See infra* notes 65-69 and accompanying text.

49. *See infra* notes 63-64 and accompanying text.

50. Depending on the degree of the manager's absence from the LLC's day-to-day business and transactions involving the LLC, third parties may more easily obtain knowledge or notice of the restrictions.

limited or extensive nature of the manager's role, third parties without knowledge or notification should be entitled to assume that a manager has the authority to bind the LLC within the scope of its business.[51] The manager, identified as such in the articles, plays a role indistinguishable from members in a member-managed LLC or general partners; therefore, the internal operating agreement alone should not be capable of destroying the apparent authority created by the statute.[52] Consequently, the Alabama Legislature need not alter the basic statutory structure addressing the apparent authority of managers even if the internal operating agreement removes part or most of the manager's rights to control and bind the LLC.

As already noted, the operating agreement of manager-managed LLCs can vest actual authority in members, not designated as managers, to engage in transactions with third parties.[53] Nonmanaging members can also acquire actual authority to bind the LLC by becoming agents, employees or independent contractors. The scope of the actual authority will depend on the terms of the agency, employment or contractual relationship.[54] Because the statute never granted full apparent authority to nonmanaging members, third parties cannot automatically assume that this member possesses authority to bind the LLC in all aspects of its business.[55]

Like most LLC statutes, the Alabama statute and commentary provide no guidance on the scope of the nonmanaging member's apparent authority.[56] Existing agency law, however, determines the scope of this member's apparent authority. De-

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51. *See* ULLCA § 102 cmt. (1995).

52. As a practical matter, in the limited partnership context, the need to interpret the scope of the general partner's apparent authority will not come up. Limited partnerships possess no ability to extensively restrict the general partner's authority because these restrictions may require limited partners to assume more authority than the statute will tolerate, while allowing them to retain limited liability protection. *See supra* note 42.

53. *See supra* note 44 and accompanying text.

54. *See* ALA. CODE § 10-12-24 (1994); ULLCA § 103 cmt.

55. *See* ALA. CODE § 10-12-21(b); ULLCA § 301(b).

56. *See generally* 1 RIBSTEIN & KEATINGE, *supra* note 3, § 8.09 (noting the ambiguity as to a member's authority under LLC statutes, in that "a member does not have any agency power as such, although a member may be empowered to act for the firm").

pending on the facts and circumstances,[57] the member will either be treated as a general agent or a special agent of the LLC.[58] The actual authority of a special agent, involving a single transaction or a series of transactions not involving a continuity of service, will carry with it a more limited veil of apparent authority protecting third parties.[59] On the other hand, general agents, receiving actual authority to conduct a series of transactions involving a continuity of service, obtain considerably broad apparent authority, which provides greater protection for third parties.[60] Members of member-managed LLCs, managers of manager-managed LLCs, and general partners of partnerships are all general agents of their respective businesses with apparent authority to bind covering the extent of the entity's usual or ordinary business.[61]

Numerous facts and circumstances developed over time in agency law can clearly be tailored to the LLC situation and used to help distinguish which members that receive actual authority solely from the operating agreement should be deemed general agents versus special agents of the LLC. These factors, which look to the degree of the actual authority granted to the member, include the relationship between the member and the LLC entity, the extent of the member's service to the LLC, the number of acts performed by the member, the number of people the member must deal with, and the length of time the member needs to accomplish the act.[62] In addition to these factors, the practical manner in which the particular LLC operates, as a centralized or decentralized unit, should also independently help determine whether or not the member is deemed a special or general agent.[63] Simple hypotheticals illustrate how the extent

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57. *See infra* notes 63-69 and accompanying text.

58. *See* RESTATEMENT (SECOND) OF AGENCY § 3 (1958) (defining general and special agent).

59. *See id.* § 161(A) (stating a special agent can only bind the principal pursuant to the limited circumstances prescribed by the principal).

60. *See id.* § 161 cmt. a.

61. *See id.* § 3 cmt. a (stating "continuity of service rather than the extent of discretion or responsibility is the hallmark of a general agent"). Because general partners, LLC members (of member-managed LLCs) and LLC managers (of manager-managed LLCs) are statutorily presumed to serve the entity continuously by virtue of their powers to manage and control, they meet this definition of general agent.

62. *See id.*

63. The law addressing a limited partner's special or general agent status will

of the actual authority granted to the nonmanaging member can work together with the degree of the LLC's centralization of management to distinguish between special and general agents.

The first hypothetical presents a closely-held, manager-managed LLC operating as a decentralized unit where a nonmanaging member receives significant actual authority.

> The members of Mom and Pop's Grocery LLC properly appoint members *X* & *Y* as the LLC's managers. The LLC, consisting of five members, unanimously grants member *Q* actual authority under the written operating agreement to purchase meat from the local butcher, fish from an independent fishery market and paper products, cleaning products, and refrigeration supplies from the local distributor. Over time, while observing the transactions between *Q* and these third parties, local fruit supplier concludes *Q* has general agency authority to bind the LLC. Soon thereafter, local fruit supplier, approaches member *Q*, and contracts with *Q* in the name of the LLC to deliver $10,000 worth of fruit to Mom and Pop's Grocery, LLC. Upon delivery, Mom and Pop, LLC, refuses to accept and pay for the fruit. Local fruit supplier sustains losses of $10,000 and sues Mom and Pop, LLC. Who will prevail?

Q clearly had no actual authority to purchase the fruit from the fruit supplier nor does the statute grant him apparent authority covering the LLC's entire business. *Q*'s ability to bind the LLC depends on whether *Q*'s apparent authority, created by *Q*'s actual authority under the operating agreement, to deal with the butcher, fishery market, and distributor, is broad enough to encompass transactions with the fruit supplier. Under these facts and circumstances, *Q* should be considered a general agent, tantamount to a manager, and thus able to bind the LLC with the fruit supplier. *Q* has received extensive actual authority to bind the LLC on a continuing basis with other highly visible third parties, such as the butcher, the fisherman, and the distributor, who are similar to the fruit supplier. Moreover, despite the formal designation of managers, this LLC on a practical level operates more as a decentralized business, similar to a

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not be very helpful because limited partners will not often participate in the business enough to be deemed general agents due to the fear of being held personally liable as general partners. *See supra* note 42.

closely-held corporation, general partnership, or member-managed LLC. Consequently, the fruit supplier in this situation would reasonably conclude that *Q* has general agency status covering the LLC's business. If *Q*'s apparent authority were interpreted more narrowly under the special agency principles, *Q*'s contract with the fruit supplier would likely be outside this level of apparent authority, creating an intolerable burden for third parties to determine the details of the operating agreement.[64]

The second hypothetical presents a management model on the other side of the spectrum when compared to the first hypothetical. This hypothetical involves a more widely-held, manager-managed LLC operating as a highly centralized unit, where the operating agreement grants a nonmanaging member very limited actual authority to perform a specific task.

> The fifty members of John Doe's Cattle farm, LLC, properly appoint *A* and *B*, each of whom own only one percent of the LLC's profits, losses, and capital, as managers of the LLC. The written operating agreement properly grants member *F* actual authority to purchase 100 head of cattle at $300 per head from cattle seller *G* and *H*. It takes member *F* four months to complete the task and during this period *F* is not otherwise an employee of the LLC nor has any other involvement in the LLC's business. The managers handle all aspects of the LLC's business. Over the four months, while observing the activities of *F* and the LLC, feed seller *I* concludes *F* has agency authority to bind the LLC. Soon thereafter, seller *I* approaches member *F* and contracts with *F* to buy $4,000 worth of feed for John Doe's Cattle Farm, LLC. Upon delivery, John Doe's Cattle Farm, LLC, refuses to accept and pay for the feed. Feed seller *I* sustains losses of $4,000 and sues the LLC. Who will prevail?

F clearly had no authority to purchase the feed from *I* nor did she possess apparent authority under the statute covering the LLC's business. *F*'s ability to bind the LLC depends on whether the limited task of purchasing 100 head of cattle con-

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64. *See* 2 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 8.04, at 21 (3d ed. 1994) (noting that some courts interpret the apparent authority of corporate officers more broadly with closely-held as opposed to public corporations because the closely-held corporate setting involves a business operated more informally with the same persons serving in multiple capacities).

fers general or special agency status with respect to the LLC's business. Member *F* should be considered a special agent, having no apparent authority to bind the LLC with *I*, because the contract to buy feed from *I* extends well beyond the specific task of purchasing the cattle.[65] The actual authority granted to *F* more properly fits that of a special agent, a narrowly defined task with no continuity of service.[66] Moreover, because the LLC operates as a highly centralized unit, the managers *A* and *B* clearly represent the only persons who can be viewed as general agents with broad apparent authority to bind the LLC in the scope of its usual business. Although treating *F* as a special agent may seem harsh to third parties in *I*'s situation, strong arguments support forcing the third parties to absorb the loss in this situation. If the LLC's management operates in a highly centralized manner, essentially similar to a limited partnership or a traditional corporation, third parties should have the affirmative duty to ascertain who the managers are and the extent of the actual authority granted to any persons not part of the management group.[67]

Although these hypotheticals provide useful guidelines on opposite ends of the spectrum for determining special or general agency status when a nonmanaging member receives actual authority, many situations will arise in between the relatively straightforward closely-held, decentralized LLC granting extensive authority and the widely-held, highly centralized LLC granting limited authority. For example, in hypothetical two, if the LLC were closely-held, arguably at least, some third parties dealing with *F* should be protected under general agency principles, not because of the degree of *F*'s actual authority, which remains limited, but because of the closely-held, decentralized management style in which the LLC operates.[68] Moreover, in

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65. *See* RESTATEMENT (SECOND) OF AGENCY § 161A cmt. b (1958).

66. *See id.*

67. *See* PROTOTYPE LTD. LIAB. CO. ACT § 301 (1992) (clarifying in commentary that, once the articles of organization specify that the LLC is manager-managed, third parties have the burden to determine who the managers are); *see also* 1 RIBSTEIN & KEATINGE, *supra* note 3, § 8.09 (advising third parties to ascertain first if the LLC is manager-managed, and if so, who the managers are and, finally, whether any nonmanaging members attempting to deal with the third party possess actual authority to bind the LLC in the specific transaction).

68. Because of the limited duration of *F*'s task, agency law alone will never

the closely-held, decentralized setting, as the number of or duration of *F*'s tasks increase, the argument for treating *F* as a general agent grows stronger.[69] On the other hand, if the LLC in hypothetical one has widely-held owners and operates using a centralized management structure, the fruit supplier may have a weaker argument for treating *Q* as a general agent because the widely-held, centralized nature of the LLC should alert third parties that the member's authority may have boundaries. The fruit supplier's argument grows even weaker as *Q*'s tasks or their duration diminish.

When the Alabama Legislature refines the Alabama LLC Act, the commentary accompanying the management and agency provisions should extensively discuss the special or general agency status of nonmanaging members acquiring actual authority to bind a manager-managed LLC. In most cases, whether or not a particular member crosses over from special to general agency status will be a facts-and-circumstances determination to be decided by courts on a case-by-case basis. However, the commentary can provide guidance to LLC users, hopefully cutting down the need to use the courts when disputes arise.

The comments should identify the two independent factors bearing on special and general agency status: (1) the factors provided by agency law which in summary identify the degree of actual authority granted and (2) whether the LLC's level of ownership is widely-held with a centralized management structure or closely-held with most or all of the members participating at least to a limited degree. The commentary could use examples similar to hypotheticals one and two illustrating the opposite sides of the spectrum.[70] The commentary should indicate that members of a closely-held LLC operating in a decen-

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cause *F* to become a general agent. *See* RESTATEMENT (SECOND) OF AGENCY § 3(2). Consequently, only the characteristics of the business itself (as closely-held with participants performing multiple roles) would justify labeling *F* as a general agent.

69. The degree of authority assumed, albeit still very limited, at some point should cause nonmanaging members of closely-held LLCs to become general agents even though agency law alone would still deem them special agents. The LLC's similarity to a general partnership or closely-held corporation with shareholders performing multiple roles justifies imposing general agency status on all owners involved in the business solely because of the nature of the business. *See* RESTATEMENT (SECOND) OF AGENCY § 161(A) & commentary (1958).

70. *See supra* notes 63-67 and accompanying text.

tralized management style more easily become general agents, even if the degree of actual authority would otherwise confer only special agent status under pure agency law. In other words, it should require less tasks both in number and duration to transform a member out of special agency status if the LLC operates as a closely-held unit similar to a general partnership or closely-held corporation. On the other hand, members of more widely-held LLCs operating in a centralized management structure should have the ability to take on more tasks without losing their special agency status. Consideration of the LLC's management operation when determining a nonmanaging member's special or general agency status helps fairly balance the need to protect third parties from the unauthorized acts of members while allowing the other members of the LLC to avoid the consequences of unauthorized contracts that third parties should have reasonably avoided.

III. FIDUCIARY DUTY PROVISIONS

The fiduciary duties imposed by law on participants in business organizations are needed to ensure that those with power do not take advantage of others.[71] Some commentaries have suggested that the fiduciary duties owed in business organizations, corporations and partnerships being the most common, originated in the context of trusts, where the settlor and beneficiary are clearly dependent on the trustee to act in their best interests.[72] A fundamental, early interpretation of fiduciary duties owed in the context of a business relationship extending beyond a mere contract identifies the extent of the participants' dependency on each other as a critical factor in defining the scope and strength of the fiduciary duties owed.[73] Because the relationships in many business organizations will be more complex than a simple trust, it may be difficult to clearly determine which participants are fiduciaries, to whom they owe fiduciary

71. *See* LAWRENCE E. MITCHELL & LEWIS D. SOLOMON, CORPORATE FINANCE AND GOVERNANCE (1992).

72. *See* Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1407-08 & n.15 (1985).

73. *See* Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928) (Cardozo, C.J.).

duties, and the actual obligations owed.[74]

Based on the assumption that the partners have joined together and pooled all or most of their economic efforts toward making a profit, RUPA's duty of loyalty continues UPA's requirement that partners account for any profits of the partnership and refrain from usurping any profit properly belonging to the partnership.[75] Presumably, in response to the increased complexity of partnership business relationships, RUPA further states that a partner's pursuit of self-interest does not per se indicate a violation of a duty or obligation.[76] Moreover, RUPA's fiduciary duties are not exclusive because the language allows the partners considerable leeway to alter the fiduciary duties in the operating agreement.[77] Unlike UPA, RUPA also establishes an explicit duty of care to refrain from acting in a manner that constitutes gross negligence or willful misconduct.[78] The drafters presumably created a statutory, gross negligence-based duty of care because the partners on a practical level do not possess total ability to control each other.[79]

As noted, the Alabama LLC statute contains no provisions expressly addressing the fiduciary duties owed by members and managers.[80] Using the language from RUPA, the Uniform LLC Act imposes on all members of a member-managed LLC and all managers of a manager-managed LLC duties of loyalty and care based on partnership principles.[81] Nonmanaging members of a

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74. *See* Frank H. Easterbrook & Daniel A. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 700-03 (1982).

75. *See* RUPA § 404(b) cmt. 2 (1994).

76. *See id.* § 404(e).

77. *See id.* §§ 404(a), 404(e), 103(b)(3)-(4). Contractual limitations of the duties of loyalty and care will be upheld as long as the agreement is not manifestly unreasonable. This statutorily sanctioned ability to severely limit fiduciary duties represents a major change from UPA.

78. *See id.* § 404(c) & cmt. 3.

79. *See id.* Although UPA recognized no statutory duty of care, some courts implied a gross negligence-based duty of care, *see* Rosenthal v. Rosenthal, 543 A.2d 348, 352 (Me. 1988), while others read the statute literally finding no duty of care at all between the partners, *see* Ferguson v. Williams, 670 S.W.2d 327, 331 (Tex. Ct. App. 1984).

80. *But see* BISHOP & KLEINBERGER, *supra* note 3, § 10.01[2][a] (suggesting that ALA. CODE § 10-12-19, which allows members to deal as third parties with the LLC, functions as a quasi duty of loyalty which does not restrict self-dealing or competition with the LLC).

81. *See* ULLCA § 409 (1995).

manager-managed LLC generally owe no fiduciary duties at all.[82] If the member takes on responsibilities of the LLC's business normally held by the manager, or if the manager relinquishes its managerial responsibilities, the Uniform LLC Act contains general statutory language imposing fiduciary duties commensurate with the member's responsibilities and removing fiduciary duties to reflect the manager's decreased responsibilities.[83] In order to maintain a competitive statute, the revised Alabama LLC statute must adopt express fiduciary duty provisions. Moreover, the vast flexibility allowed by the operating agreement to vary the basic structures of both member-managed and manager-managed LLCs makes extensive commentary imperative in order to help define fiduciary duties that need to vary from these default provisions.[84]

A. Member-Managed LLCs

By statutorily conferring management rights to all members, the member-managed LLC presumes that the members have joined together to pool their economic resources and make a profit as would occur in a general partnership. Following the spirit of the Uniform LLC Act, Alabama's revised LLC Act should use the language of Alabama's RUPA and impose the same fiduciary duties of loyalty and care that general partners owe each other.[85] LLC members, like general partners, need a

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82. *See id.* § 409(h)(1).

83. *See id.* § 409(h)(3)-(4); *see also* Dickerson, *supra* note 3, at 458 (labeling the Uniform LLC Act's statutory alternation of fiduciary duties when members take on more or managers take on less responsibility as a "sliding scale for the standards of performance").

84. Commentators recognize that fiduciary duties owed in many LLCs cannot be simply defined by pure references to either partnership or corporate law. *See generally* DeMott, *supra* note 3, at 1043-45; Dickerson, *supra* note 3, at 417-20; Bahls, *supra* note 3, at 45-46; Miller, *supra* note 3, at 28-30; Curwin, *supra* note 3, at 989-91.

85. *See* BISHOP & KLEINBERGER, *supra* note 3, §§ 10.03[1][a][i] (nine states contain statutory language imposing a partnership duty of loyalty on LLC members and managers), 10.02[1][b] (four states contain statutory language imposing a gross negligence based duty of care on LLC members and managers), 10.02[1][a] (eight states contain statutory language using the revised model business corporation act to craft the duty of care owed by LLC members and managers); *see also* Bahls, *supra* note 3, at 80-81 (recognizing that the fiduciary duties imposed by partnership rules

strong duty of loyalty because the members are likely devoting a substantial amount of time and resources to that one business.[86] Similarly, because LLC members possess the same ability to monitor each other's performance as general partners they should enjoy the same gross negligence-based duty of care. Moreover, members of LLCs in business ventures that do not require these partnership-based fiduciary duties will have the flexibility to alter and, if necessary, weaken the fiduciary duties in the operating agreement.[87]

The limited liability protection LLC members enjoy should not affect the fiduciary duties the members owe each other despite the fact that general partners are personally liable for all debts of the partnership. The policy behind the necessity of fiduciary duties has nothing to do with the presence or absence of limited liability. Rather the need for and the scope of fiduciary duties looks to the degree of trust, dependency, and imbalance of power between the parties.[88] In the context of business organizations, the extent the participants possess the power to and actually participate in the business helps determine the trust, dependency, and power imbalances between the parties. Partnerships and close corporations impose strong fiduciary duties between the partners and shareholders because the closely-held nature of the business, and the high degree of participation and investment in the enterprise by each individual indicates a high level of trust and dependency among the parties with the potential for abuse of power.[89] Because members of a member-managed LLC essentially act like general partners or close corporation shareholders, the default fiduciary duties should reflect partnership law.[90]

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are better suited to the informed management typical of LLCs than are the complex corporate rules).

86. *See generally* PROTOTYPE LTD. LIAB. ACT § 401 commentary (Report of Nov. 19, 1992) (recognizing that "because LLC interests are not freely transferable, members who are dissatisfied with their investments must resort to active involvement rather than simply exiting the firm").

87. *See supra* note 77 and accompanying text.

88. *See generally supra* notes 71-78 and accompanying text.

89. *See generally* Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 512-15 (Mass. 1975); Henricksen v. Big League Game Co., No. CO-95-388, 1995 WL 550935, at *1 (Minn. Ct. App. Sept. 19, 1995); PROTOTYPE LTD. LIAB. CO. ACT § 402 commentary at 26-28.

90. *See* Bahls, *supra* note 3, at 80-81; *see generally* PROTOTYPE LTD. LIAB. CO.

Ascertaining a particular member's fiduciary duties becomes more complicated if the operating agreement vests the ability to manage and bind the LLC in less than all the members. Questions arise concerning the duties of loyalty and care owed between the members with more business responsibilities and those members with less or no business responsibilities. Because partners in general partnerships often use the partnership agreement to create management committees,[91] partnership law addresses the fiduciary duties owed when partners in fact exercise either more or less control than contemplated by the statute. Partners vested with greater responsibility to manage and control the partnership owe heightened fiduciary duties because they are depended on by and enjoy more power over the other partners not part of the management committee.[92] Consequently, the Alabama Legislature need not add any special statutory provisions to deal with fiduciary duties when member-managed LLCs adopt management committees. The commentary should incorporate by analogy the partnership law precedents addressing these situations.[93]

B. Manager-Managed LLCs

As noted, manager-managed LLCs vest statutory authority to manage and control the LLC in the managers, essentially like general partners in a limited partnership. General partners of a limited partnership owe the same fiduciary duties of loyalty and care that partners in a general partnership owe each other while limited partners owe no fiduciary duties by virtue of their status as limited partners.[94] Limited partnership law assumes that

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ACT §§ 401-402 & commentary at 26-30.

91. *See* 2 BROMBERG & RIBSTEIN, *supra* note 19, § 6.03(b).

92. *See* Belcher v. Birmingham Trust Nat'l Bank, 348 F. Supp. 61, 99 (N.D. Ala. 1968); Burgess Mining & Constr. Corp. v. Lees, 440 So. 2d 321, 334 (Ala. 1983); 68 C.J.S. *Partnership* § 76 (1950); *see also* Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928). The partners not on the management committee should still owe the same fiduciary duties unless the facts strongly suggest that they enjoy no participation in or control over the business. *See* 2 BROMBERG & RIBSTEIN, *supra* note 19, § 6.03(b).

93. *See* Dickerson, *supra* note 3, at 442-43 (suggesting that members of a member-managed LLC with a management committee are similar to general partners or shareholders in a closely-held corporation).

94. *See* RULPA §§ 303, 403, 1105 (1985).

the partnership and the limited partners trust and depend on the general partners, who possess exclusive power over the business.[95] Following the spirit of the Uniform LLC Act which imposes fiduciary duties consistent with the limited partnership approach, Alabama's revised LLC Act should use the language of the Alabama RUPA and impose on the managers the same fiduciary duties of loyalty and care that general partners owe. Nonmanaging members of manager-managed LLCs, generally trust and depend on the managers similar to the manner limited partners trust and depend on the general partners.[96] Nonmanaging members, who are tantamount to limited partners, should owe no fiduciary duties at all except a limited duty of loyalty to avoid taking LLC business opportunities the member has learned about by having access to confidential information.[97]

In the corporate context, directors owe a weaker duty of loyalty embodied in the corporate opportunity doctrine because the law assumes that directors, who individually possess no statutory power to bind the corporation, participate in more business activities than simply serving that one corporation.[98] The corporate duty of care, an elaborate set of legal doctrines revolving around the conflict of interest provisions and the business judgement rule, balances the needs of directors to make business decisions without fear of being second guessed and of shareholders to challenge poor performance.[99]

Because LLC managers more closely resemble general partners, the default fiduciary duty provisions applied to managers should be partnership rather than corporate based. Unlike general partners, corporate directors have no ability to bind the corporation with third parties.[100] The policy oriented role of corporate directors removes them from the day-to-day running of the business justifying the weaker duty of loyalty and the more complex standards embodied in the duty of care.[101] Even direc-

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95. *See* 4 BROMBERG & RIBSTEIN, *supra* note 19, § 14.04(a)-(b).

96. *See* PROTOTYPE LTD. LIAB. CO. ACT §§ 401-402 & commentary at 26-30.

97. *See* RESTATEMENT (SECOND) AGENCY § 387 cmt. b (1957).

98. *See* Burg v. Horn, 380 F.2d 897, 901 (2d Cir. 1967); *see also* COX, *supra* note 32, §§ 10.11, .13, .15.

99. *See* COX, *supra* note 32, § 10.2.

100. *See id.* §§ 8.3, 9.10.

101. *See* ROBERT C. CLARK, CORPORATE LAW § 3.2 (1986); COX, *supra* note 32,

tors, who also serve as officers thus possessing the ability to bind the corporation,[102] cannot be completely analogized to general partners because their management powers come from the corporation's by-laws, a resolution of the Board, or their status as employees rather than from corporate law.[103]

Like general partners, LLC managers receive the combined power to make major policy decisions and run the day-to-day aspects of and bind the business directly from the statute.[104] The statutory management structure of a limited partnership and manager-managed LLC assumes that the limited partners and members place a higher level of trust in the general partner or manager thus justifying imposing the stronger duty of loyalty.[105] When analyzing the duty of care, limited partners, members, and shareholders of traditional corporations probably equally depend on their respective fiduciaries to competently run the business. However, it nevertheless seems more reasonable to use the partnership legal precedents to define the duty of care owed by managers because legally they more closely resemble general partners.[106]

Although the refined Alabama LLC statute should establish partnership based fiduciary boundaries aimed at the simplest manager-managed LLCs, the commentary should clearly state and extensively discuss with examples, situations where it would not be appropriate to apply the literal statutory provisions discussed above. Because the operating agreement allows unlimited flexibility to restrict the manager's management powers or

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§§ 9.1, .2.

102. *See* CLARK, *supra* note 101, § 3.3; COX, *supra* note 32, § 8.2.

103. *See* COX, *supra* note 32, §§ 8.2, .7.

104. *See supra* notes 35, 36, and 38.

105. *See* PROTOTYPE LTD. LIAB. CO. ACT §§ 401-402 & commentary (Report of Nov. 19, 1992).

106. *See supra* notes 98-103 and accompanying text. The core substance defining the duty of care owed by corporate and partnership fiduciaries uses the same standard, gross negligence. *See* Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) (stating that directors must act grossly negligent in order for their actions to be beyond the business judgement protection thus resulting in a breach of the duty of care). Although both corporate and partnership duty of care tests focus on gross negligence, vast procedural differences exist. The partnership standard more directly tests the conduct for gross negligence. *See* RUPA § 404(c) and cmt. 3. The corporate standard contains a vast layer of analysis applying conflict of interest provisions and the business judgment rule presumption. *See supra* note 99 and accompanying text.

enhance the members' powers, the basic boundaries outlined above will not always fit when interpreting the appropriate fiduciary duties owed by managers and members in a manager-managed LLC.[107] Moreover, the precedent applicable to limited partnerships will be of little use because legal and practical constraints prevent limited partners from assuming and general partners from relinquishing control over the partnership's business.[108] When the Alabama Legislature revises the LLC Act, the statute should only acknowledge that the general fiduciary duties may vary if the operating agreement allows nonmanaging members the ability to participate in the business or takes away some of the manager's statutory powers. Only the commentary can more specifically define the possible variations in the fiduciary duties and ultimately the courts will have to establish the standards of fiduciary duties owed in many of the hard cases.[109]

For example, hypothetical one involves a manager-managed LLC where a nonmanaging member should clearly owe far greater fiduciary duties than the almost nonexistent duties imposed by the simple manager-managed LLC.[110] Under the facts, member *Q* of a five-member, closely-held LLC, consisting of managers *X* and *Y* and two other members, receives actual authority through the operating agreement to perform a number of important, ongoing business transactions.[111] The commentary should clearly indicate that, because *Q* serves as a general agent for the LLC, *Q* owes the same fiduciary duties as a formally appointed manager. The combination of *Q*'s extensive business activities and the closely-held, informal nature of the LLC, despite the formal presence of managers, justifies extending the fiduciary duties to cover the whole business rather than being confined to the specific tasks, consistent with special agen-

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107. *See supra* note 23 and accompanying text.

108. *See supra* note 42 and accompanying text (stating limited partners are unable to control the business because of possible personal liability exposure and general partner is unable to relinquish power because as a practical consideration, limited partners are unavailable to assume the responsibility); *see also* 4 BROMBERG & RIBSTEIN, *supra* note 19, §§ 14.01(a)-(c), .02(a)-(c).

109. *See supra* note 42 and accompanying text.

110. *See* Dickerson, *supra* note 3, at 457 (commentator states that greater control over the business requires greater fiduciary duties).

111. *See supra* notes 63-64 and accompanying text.

cy law. Because *Q* performs significant, ongoing business transactions for a closely-held, informal LLC that resembles a general partnership or closely-held corporation,[112] the members probably trust and depend on *Q* more than special agency law would recognize. Furthermore, *Q*, as a practical matter, from the perspective of the other LLC members depending on him, possesses power more like a general than a special agent.

The commentary cannot precisely define the level of fiduciary duties owed by a nonmanaging member assuming business responsibilities in all cases. For example, in hypothetical one the extent of *Q*'s fiduciary duties will be much harder to define if *Q* only has authority to conduct ongoing business transactions with the distributor. Arguably, the more limited nature of *Q*'s authority, justifies using special agency law to limit the fiduciary duties owed by *Q* to only cover the transactions with the distributor rather than covering the whole business. Because *Q* possesses far less power to bind or otherwise control the business it seems reasonable to assume the other members do not trust and depend on him to the heightened degree of a general agent. On the other hand one can argue that the strong resemblance of this LLC to a general partnership or closely-held corporation justifies treating *Q* as a general agent for the whole business despite his more limited authority because in closely-held businesses the participants trust and depend on each other more intensely.[113] Ultimately, courts will have to decide the level of fiduciary duties owed in these borderline cases.[114] The commentary should clearly state that nonmanaging members of closely-held, manager-managed LLCs more easily acquire the fiduciary duties of a general agent than nonmanaging members performing comparable duties for widely-held LLCs using a centralized management structure. Because on a practical level closely-held LLCs are functioning like general partnerships or closely-held corporations,[115] the remaining members will base a

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112. *See* 1 O'NEAL & THOMPSON, *supra* note 64, §§ 1.05, .08 (explaining that closely held corporations tend to operate like partnerships using the corporate form solely to achieve limited liability); *supra* note 89.

113. *See Bahls*, *supra* note 3, at 67.

114. *See id.* (urging courts to refrain from adopting partnership or corporate fiduciary duties in all cases and to maintain flexibility on a case-by-case basis).

115. *See id.* at 49.

higher level of trust and dependency on the performance of fewer transactions by the nonmanaging members.

The commentary should also address the fiduciary duties owed by the managers if nonmanaging members assume responsibilities over the business. In hypothetical one, arguably, the nature of the responsibilities assumed by managers *X* and *Y* justifies leaving the full fiduciary duties of loyalty and care covering the entire business in place. The facts of hypothetical one strongly suggest that *X* and *Y* have not abrogated their general business responsibilities and, therefore, have the ability to monitor *Q*'s performance and the power to remove *Q* if *Q* proves to be incompetent.[116] Consequently, under these facts the members of the LLC probably still totally trust and depend on *X* and *Y* to maintain the entire business.

However, as *X* and *Y*'s level of responsibility and power decreases, at some point it will not seem fair to hold them to full fiduciary duties covering the scope of the entire business solely because of their token status as managers. Unlike third party creditors, who rely on the articles identifying the managers for purposes ascertaining the existence of authority to bind the LLC, members of the LLC should be fully aware of a manager's extremely limited role in conducting the LLC's business. Once the manager's role diminishes below a certain level, it no longer seems reasonable for the members to trust and depend on that manager to maintain the entire business. For example, if *X* and *Y* have been relegated to the role of mere ministerial agents, like filing tax returns and keeping books, it seems more appropriate to center the fiduciary duties around those activities under special agency law. Nevertheless, to the extent *X* and *Y* play a larger role than that of mere ministerial agents, their ability to avoid manager-based fiduciary duties should still be very difficult even if they assume less responsibility over the business than suggested by the facts of hypothetical one. Because *X* and *Y* have agreed to be managers, placing themselves in the fiduciary position over the business, the commentary should state that *X* and *Y* must carry a heavy burden of proof that it is no longer reasonable for the other members to trust and depend on them to maintain the entire business because they have relinquished

116. *See supra* notes 63-64 and accompanying text.

significant responsibilities over the most important aspects of the business and in fact have no practical control over those transactions.

Hypothetical two also provides a useful starting point when exploring how the commentary should alter the fiduciary duties owed by the members and managers when widely-held LLCs change the statutory management structure. In hypothetical two, member *F*, who takes on limited authority to conduct one transaction, should owe duties of loyalty and care covering that one transaction only under the laws governing special agency.[117] The law of special agency will properly confine *F*'s duty of care to the purchase of the cattle and will leave *F* free to pursue business activities unrelated to this one transaction without regard to the duty of loyalty. The limited nature of *F*'s involvement combined with the widely-held structure of the LLC makes special agency principals the most appropriate standard to define the scope of *F*'s fiduciary duties.

As member *F* assumes more of a role in the LLC's business, it becomes more difficult to define *F*'s fiduciary duties. At some point, if *F* assumes significant business responsibilities on an ongoing basis, *F* will be treated as a general agent of the LLC's business for purposes of ascertaining the degree of F's apparent authority to bind the LLC with third parties. However, as previously discussed, *F* should be able to assume a fair degree of authority and responsibility without crossing over from special to general agency status due to the widely-held and centralized management structure of the LLC.

When ascertaining the degree of *F*'s fiduciary duties, the commentary should consider both the degree of *F*'s responsibilities and the widely-held and centralized management structure of the LLC. Because this LLC has many members and a formal centralized management structure, it is not reasonable for the other members or managers *A* and *B* to depend and trust *F* to maintain the entire business unless *F* takes on a substantial level of responsibility rendering her indistinguishable from managers *A* and *B*. Consequently, it should be extremely difficult for nonmanaging members like *F* in hypothetical two to cross over from special to general agency status for fiduciary duty purpos-

117. *See supra* notes 64-69 and accompanying text.

es. The commentary should state that nonmanaging members of LLCs similar in structure to hypothetical two can assume substantially more business responsibilities than comparable members of LLCs like hypothetical one and still have their fiduciary duties confined to the responsibilities assumed rather than covering the whole business.[118]

If the LLC in hypothetical two uses the operating agreement to adopt a business structure more closely resembling a traditional corporation, arguably it becomes unfair to impose the more stringent partnership based duty of loyalty on the managers. If the managers use the operating agreement or employment contracts to shift the bulk of the day-to-day management decisions and transactions to members or others that essentially function as corporate officers, the managers now more closely resemble a corporate board and probably are involved in a number of other business activities. The commentary should state that this situation may justify using the weaker corporate opportunity doctrine to define the managers' duty of loyalty. Moreover, if the LLC truly operates as a traditional corporation with the three-layered separation of ownership and control, it may be appropriate to grant the protection of the business judgment rule to the managers when applying the duty of care.[119]

IV. CONCLUSION

When the legislature re-examines Alabama's LLC Act, the refinement to the actual statutory provisions addressing the LLC's management need only make conforming changes to reflect Alabama's adoption of RUPA. With manager-managed LLCs where the operating agreement vests actual authority to a nonmanaging member to perform specified business activities, the commentary should be expanded to help practitioners and

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118. The managers of the LLC in hypothetical two should still owe the same fiduciary duties of loyalty and care even if *F* takes on significant responsibilities. Because this LLC is widely held, the other members probably have little or no knowledge of *F*'s responsibilities, and therefore, will continue to depend on the managers to maintain the entire business. *But see* ULLCA § 404(h) (1995). The Uniform LLC Act's statutory removal of manager's fiduciary duties makes no reference to the closely-held or widely-held nature of the LLC.

119. *See supra* note 106.

the courts determine the scope of the nonmanaging member's apparent authority to bind the LLC.

The list of determinative factors identified in the commentary should include the extent of authority granted to this member, a criterion which encompasses a number of considerations used in agency law to distinguish special and general agents. The member's assumption of fewer responsibilities with a limited duration suggests a special agency relationship with the LLC conferring a limited scope of apparent authority only extending to the specific responsibilities performed by the nonmanaging member. On the other hand, as responsibilities increase and the duration becomes continuous, at some point the member crosses over to general agency status and acquires broad apparent authority covering the scope of the LLC's business.

The commentary should further identify the LLC's actual management structure as a separate factor to determine whether the nonmanaging member's apparent authority covers the whole business under general agency principals. If the LLC operates as a closely-held business with essentially a decentralized management structure in practice, third parties more easily conclude that members possess authority to bind the LLC; therefore it should require fewer business responsibilities to cause a nonmanaging member to become a general agent, tantamount to a manager. On the other hand, if the LLC operates as a widely-held business, with centralized management, third parties have less basis to conclude that a particular member possesses broad authority to bind the LLC; therefore it should take significantly more business responsibilities to cause a nonmanaging member to acquire general agency status with broad apparent authority covering the scope of the LLC's business.

The revised Alabama Act's fiduciary duty provisions should use the language in the new Alabama RUPA and impose partnership based duties of loyalty and care on all the members of member-managed LLCs and all the managers of manager-managed LLCs. Extensive commentary should discuss the appropriate fiduciary duties owed in the manager-managed LLCs when the operating agreement either vests power in nonmanaging members or removes powers from the managers. Nonmanaging members who take on responsibilities related to the LLC's busi-

ness should clearly owe fiduciary duties related to those responsibilities. At some point, however, the level of responsibility becomes so great that the other members may reasonably trust and depend this nonmanaging member to maintain the entire business. In these situations, it arguably becomes reasonable to impose fiduciary duties on the nonmanaging member covering the entire scope of the LLC's business even though this member has not been formally appointed as a manager.

In addition, the size and the management structure of the LLC should also be a factor determining if the fiduciary duties should narrowly cover only the responsibilities assumed or broadly cover the whole business. A nonmanaging member of a closely-held, manager-managed LLC essentially operating as a general partnership or closely-held corporation should more easily acquire fiduciary duties covering the whole business. Members of closely-held LLCs where all of them participate to at least a limited degree, will tend to trust and depend on each other more intensely and more readily conclude that the assumption of responsibilities rather than the formal management status implies a promise to maintain the entire business. Consequently, the commentary should require nonmanaging members of closely-held, manager-managed LLCs to assume fewer business responsibilities before imposing fiduciary duties covering the whole business. However, the same nonmanaging member of a widely-held, centrally-managed LLC should be able to perform considerably more business transactions without acquiring fiduciary duties covering the entire business. Members of widely-held, centrally-managed LLCs will trust and depend on the managers to maintain the business. It is not reasonable for them to assume that a nonmanaging member, even one performing a significant number of tasks, has agreed to maintain the entire business. Consequently, the commentary should require the nonmanaging member to possess substantial control over the LLC before imposing fiduciary duties covering the whole business.