2007

A License to Lie, Cheat, and Steal? Restriction or Elimination of Fiduciary Duties in Arkansas Limited Liability Companies

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I. INTRODUCTION

Since its national debut in 1988,[1] the limited liability company ("LLC") has become the business organization *du jour*, at least for small businesses.[2] Certainly since its authorization by the Arkansas General Assembly in 1993,[3] the LLC has become increasingly popular in Arkansas. According to the Arkansas Secretary of State's office, of new[4] domestic filings for LLCs and corporations, LLCs represented 62.1%.[5] The vast majority of the these LLCs appear to be small businesses,[6] and many if not most of them are probably formed

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1. For the history of the LLC, see 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, LIMITED LIABILITY COMPANIES § 1.1, at 1-1 to -10 (2006) [hereinafter RIBSTEIN & KEATINGE]; Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1463 (1998) [hereinafter Hamill, *Origins*].

2. RIBSTEIN & KEATINGE, *supra* note 1, § 1.1, at 1-1.

3. The formal name of the Act is the Small Business Entity Tax Pass Through Act, ARK. CODE ANN. §§ 4-32-101 to -1401 (Repl. 2001 & Supp. 2005), reflecting its origin as a vehicle under federal income tax law by which investors could enjoy the benefits of limited liability without being subject to restrictions imposed on other corporations and limited partnerships. Hamill, *Origins*, *supra* note 1, at 1462-63.

4. January 1, 2007 - August 6, 2007 (5,202 LLC filings; 3,172 corporation filings).

5. Moreover, the number and proportion of LLC filings is trending upward. Between 1993 and 2006, of domestic for-profit corporations and LLCs, LLC filings increased from 187 (3.5% of total filings) to 7,860 (58.8% of total filings).

6. The author has been unable to locate any breakdown of businesses in Arkansas as "small" or not. Figures from the U.S. Census Bureau indicate that in Arkansas in 2005, there were 57,236 "establishments" with 19 or fewer employees, compared to 8,803 "establishments" with 20 or more employees. But "establishment" is not synonymous with "company" or "enterprise," and sole proprietors and partners in a partnership are left out of the count of "employees," leaving open the possibility that businesses run entirely by

by persons relatively unsophisticated about the legal rules which govern the operation of LLCs.[7]

The legal rules governing these business entities are, at best, unclear. There is only one reported decision concerning the substantive law governing Arkansas LLCs.[8] Moreover,

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owners are not counted at all. U.S. Census Data, *available at* http://censtats.census.gov/cbpnaic/cbpnaic.shtml (table titled "Number of Establishments by Employment-size class") (under heading titled "County Business Patterns," select "Arkansas" from drop-down box, then click "Go"; on the next page, click "Submit") (last visited Sept. 7, 2007).

In Act 143 of 2007, the General Assembly mandated that state agencies assess the impact of proposed rules on small businesses. 2007 Ark. Acts 143, Section 1, (codified as amended at ARK. CODE ANN. § 25-15-302(a)(1)). "Small business" was defined as "a for-profit enterprise consisting of no more than one hundred (100) employees regardless of whether the employees are full-time or part-time employees." 2007 Ark. Acts 143, Section 1, (codified as amended at ARK. CODE ANN. § 25-15-301(3)). The U.S. Census data referred to above indicates that in 2005 there were at least 64,601 "establishments" meeting this definition (out of a total of all establishments of 66,039). *See* U.S. Census Data, *available at* http://censtats.census.gov/cbpnaic/cbpnaic.shtml (last visited Sept. 7, 2007).

7. As Professor Ribstein has observed, LLCs (as well as close corporations and general partnerships) should be designed "to accommodate relatively unsophisticated business people . . . ." They "are likely to be used by small businesses, often with minimal planning and possibly without sophisticated legal advice." Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK U. L. REV. 927, 930, 942 (2004) [hereinafter Ribstein, *Limited Partnership Agreements*]. This was recognized by the National Conference of Commissioners on Uniform State Laws when it approved the original Uniform Limited Liability Company Act. The drafting committee "maintained a single policy vision—to draft a flexible act with a comprehensive set of default rules designed to substitute as the essence of the bargain for small entrepreneurs and others . . . . [S]mall entrepreneurs without the benefit of counsel should also have access to the Act." UNIF. LIMITED LIABILITY COMPANY ACT (1996), Prefatory Note, 6A U.L.A. 554, 555; *see also* Sandra K. Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation?*, 32 J. CORP. L. 565, 583-86 (2007) [hereinafter Miller, *Decade of Experimentation*].

8. Anderson v. Stewart, 366 Ark. 203, 211, __ S.W.3d __ (2006) (holding that the doctrine of piercing the corporate veil is applicable to LLCs). There is one unreported Eighth Circuit opinion, however, that addresses the question of fiduciary duties in Arkansas LLCs. In Ault v. Brady, 37 Fed. App'x 222 (8th Cir. 2002), the manager of an LLC terminated a member's employment with the company and attempted to force him to sell back his ownership interest to the LLC. *Id.* at 224. The court held that the manager was not liable for breach of fiduciary duty. *Id.* at 226. The court noted that under the Arkansas LLC Act, a manager is not liable to the company or the members unless he engages in "gross negligence or willful misconduct." *Id.* (quoting ARK. CODE ANN. § 4-32-402(1) (Repl. 2001)). Further, under the Operating Agreement, the manager had "broad authority to 'make all decisions regarding the management of the Company' and responsibility 'for all administrative matters affecting the Company or its business.'" *Id.* Therefore, the manager "acted well within his authority in terminating" the member, and the manager's attempt to buy back the member's ownership interest was permitted by the Operating Agreement. *Id.* Thus, there was no gross negligence or willful misconduct. *See Ault*, 37 Fed. App'x at 226. However, the court did not address the issue of whether the manager's

decisions concerning LLCs from different jurisdictions are of limited value as secondary authority, because there is tremendous variation in the limited liability company acts of different jurisdictions.[9] The result is that Arkansas business people and their lawyers are left without guidance on many important issues. This article will address one of these unresolved issues—whether, under the Arkansas LLC Act, participants in an LLC should be allowed in advance to restrict or eliminate the fiduciary duties that would otherwise be imposed upon members or managers.[10] The article concludes that courts should interpret the Arkansas LLC Act to prohibit the elimination of fiduciary duties and to permit restrictions on those duties subject to a mandatory core of minimum decencies.[11] To be upheld, those restrictions must be stated with specificity and fall within a loose ambit of reasonableness.[12]

II. FIDUCIARY DUTY IN GENERAL

Why are fiduciary duties implied, and what considerations inform the content of those duties? In a fiduciary relationship one party has power and discretion over the property or other critical resource[13] of another party with the duty to act for that

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conduct may have been a breach of his duty of good faith. The comment to the Prototype LLC Act on which the Arkansas Act is based, cited in *infra* note 160, states that "members, like other contracting parties, must exercise their powers in good faith. For example, it may be bad faith to expel a member solely or primarily in order to appropriate the value of the member's interest." 3 RIBSTEIN & KEATINGE, *supra* note 1, app. C at C-52.

9. *See* David S. Walker, *Welcome from the ULLCA Committee Chair*, http://www.llcproject.org/ULLCA/DesktopDefault.aspx?tabindex=0&tabid=1 (last visited Aug. 27, 2007).

10. There is no question that fully informed disinterested participants in a business enterprise can, on a case-by-case basis, approve or ratify specific transactions that would otherwise violate fiduciary obligations. *See, e.g.*, ARK. CODE ANN. § 4-27-831 (Repl. 2001); RESTATEMENT (THIRD) OF AGENCY § 8.06(1) (2006); Claire Moore Dickerson, *Is It Appropriate to Appropriate Corporate Concepts: Fiduciary Duty and the Revised Uniform Partnership Act*, 64 U. COLO. L. REV. 111, 116-17 (1993) [hereinafter Dickerson, *Is It Appropriate*]; *see generally* Susan Webber [now United States District Judge Susan Webber Wright], *Arkansas Corporate Fiduciary Standards—Interested Director Contracts and the Doctrine of Corporate Opportunity*, 5 U. ARK. LITTLE ROCK L.J. 39 (1982) [hereinafter Webber, *Arkansas Corporate Fiduciary Standards*].

11. *See infra* notes 151-97 and accompanying text.

12. *See infra* notes 186-97 and accompanying text.

13. Professor D. Gordon Smith coined the phrase "critical resource" to recognize that the assets at the center of the fiduciary relationship may not be "property" in the traditional sense, *e.g.*, confidential information that a client shares with a lawyer. D. Gordon Smith,

other.[14] The problem is that the dominant party, the fiduciary, may misuse that power for his own benefit and to the detriment of the weaker party, the beneficiary.

> The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that person in a legal or a practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.[15]

Fiduciary obligation, therefore, places constraints—the duties of loyalty, care, and good faith[16]—on the fiduciary's

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The Critical Resource Theory of Fiduciary Duty, 55 VAND. L. REV. 1399, 1404 (2002) [hereinafter Smith, *Critical Resource Theory*].

14. 1 RESTATEMENT (THIRD) OF TRUSTS § 2, cmt. a (2003) ("Despite the differences in the legal circumstances and responsibilities of various fiduciaries, one characteristic is common to all: a person in a fiduciary relationship to another is under a duty to act for the benefit of the other as to matters within the scope of the relationship."); *accord* Raines v. Toney, 228 Ark. 1170, 1178, 313 S.W.2d 802, 808 (1958) ("The law imposes a high standard of conduct upon an officer or director of a corporation, predicated upon the fact that he has voluntarily accepted a position of trust and has assumed the control of property of others.").

15. Hosp. Prods. Ltd. v. U.S. Surgical Corp. (1984), 156 C.L.R. 41 (Austl.), *available at* http://www.austlii.edu.au/au/cases/cth/HCA/1984/64.html (last visited Aug. 27, 2007).

16. In Arkansas, good faith in the context of a fiduciary relationship is normally treated as a fiduciary duty. *E.g.*, Cole v. Laws, 349 Ark. 177, 185, 76 S.W.3d 878, 883 (2002); Boswell v. Gillett, 226 Ark. 935, 944, 295 S.W.2d 758, 763 (1956) ("utmost good faith"); *see also* Alexander v. Sims, 220 Ark. 643, 650, 249 S.W.2d 832, 836 (1952) ("perfect fairness," "utmost frankness and honesty," "utmost . . . integrity"); *accord* In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006) (noting the duty of good faith is a subset of the duty of loyalty). Other authorities consider good faith to be an implied contractual duty less constraining than a fiduciary duty. *See, e.g.*, Daniel S. Kleinberger, *Seven Points to Explain Why the Law Ought Not Allow the Elimination of Fiduciary Duty Within Closely Held Businesses—Cardozo Is Dead: We Have Killed Him*, William Mitchell Legal Studies Research Paper No. 61, *available at* http://ssrn.com/abstract=948234 (last visited Sept. 7, 2007) ("[T]o rely on the contractual duty of good faith as a substitute for fiduciary duty is akin to replacing heavy cream with skim milk.") [hereinafter Kleinberger, *Cardozo Is Dead*]; Ribstein, *Limited Partnership Agreements*, *supra* note 7, at 938 ("Fiduciary and good faith duties, however, may blur at the margins."). Some modern business-organization statutes treat the duty of good faith as *sui generis*, neither fiduciary nor purely contractual. Among these statutes are the Arkansas Uniform Partnership Act (1996), ARK. CODE ANN. §§ 4-46-101 to -1207 (Repl. 2001), and the Arkansas Uniform Limited Partnership Act (2001), 2007 Ark. Acts 15 (to be codified as ARK. CODE ANN. §§ 4-47-101 to -1301). For purposes of this article, I will

ability to exercise his discretion in a way that might harm the beneficiary.[17]

In the context of business enterprises, the fiduciary relationship is between those parties who manage the business, on the one hand, and the business entity and its owners, on the other hand. Thus, in an Arkansas corporation, the officers and directors owe fiduciary duties to the shareholders as well as to the corporation itself.[18] In a partnership, whether general or limited, each general partner owes fiduciary duties to the other partners, because each general partner has the right to participate in the management of the business and can affect whether the business succeeds or fails.[19] LLCs are hybrid entities.[20] Therefore, fiduciary duties are generally imposed on those who manage the LLC—members in member-managed companies and managers in manager-managed companies.[21]

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treat the duty of good faith as a fiduciary duty except when a particular statute classifies it otherwise.

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> Breach of fiduciary duty involves betrayal of a trust and benefit by the dominant party at the expense of one under his influence. . . . [R]egardless of the express terms of an agreement, a fiduciary may be held liable for conduct that does not meet the requisite standards of fair dealing, good faith, honesty, and loyalty.

Cole, 349 Ark. at 185, 76 S.W.3d at 883; Key v. Coryell, 86 Ark. App. 334, 345, 185 S.W.3d 98, 106 (2004) ("Breach of fiduciary duty involves betrayal of a trust and benefit by the dominant party at the expense of one under his influence."); *see also* J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439, 442 (1997) [hereinafter Hynes, *Freedom of Contract*].

18. Wal-Mart Stores, Inc. v. Coughlin, No. 06-315 slip op. 5-6, __ S.W.3d __, 2007 WL 1098162 (Ark. Apr. 12, 2007).

19. II ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON PARTNERSHIP at § 6.07(a)(6)-(7) (2007) [hereinafter BROMBERG & RIBSTEIN ON PARTNERSHIP]; Dickerson, *Is It Appropriate*, *supra* note 10, at 121; Hynes, *Freedom of Contract*, *supra* note 17, at 446-47.

20. Charles W. Murdock, *Fairness and Good Faith as a Precept in the Law of Corporations and Other Business Organizations*, 36 LOY. U. CHI. L.J. 551, 558 (2005) ("[A]n LLC is a hybrid form of organization, having both partnership and corporate characteristics.").

21. 1 J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, LIMITED LIABILITY COMPANIES § 8.7, at 10 (2007) [hereinafter CALLISON & SULLIVAN]. Members in a manager-managed LLC are subject to fiduciary duties only in limited circumstances. *Id.* at n.7. The Arkansas LLC Act follows this pattern. *See* ARK. CODE ANN. § 4-32-402 (Repl. 2001).

III. THE PHILOSOPHICAL DEBATE

Scholars have given considerable attention to the nature of fiduciary duties in various forms of business enterprises and to the issue of whether those duties are immutable, or whether they can be generally restricted or eliminated in advance by agreement of the enterprise participants.[22] The debate had its genesis in the economic analysis of corporate law,[23] and it naturally extended to partnership law.[24] There are two major schools of thought about the place of fiduciary obligation in business enterprises, the "contractarian" and the "traditionalist."[25]

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22. "Much ink has been spilled discussing the fiduciary duties of participants in unincorporated business entities, principally partnerships and limited liability companies." Mark J. Loewenstein, *Fiduciary Duties and Unincorporated Business Entities: In Defense of the "Manifestly Unreasonable" Standard*, 41 TULSA L. REV. 411, 411 (2006) [hereinafter Loewenstein, *Manifestly Unreasonable*].

23. The economic analysis of law is the hallmark of the law and economics school of jurisprudence. *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATION LAW & ECONOMICS 18-19 (2002) [hereinafter BAINBRIDGE, CORPORATION LAW AND ECONOMICS].

> Those who practice economic analysis . . . translate some legal doctrine into economic terms. They then apply a few basic tools of neoclassical microeconomics—cost-benefit analysis, collective action theory, decisionmaking under uncertainty, risk aversion, and the like—to the problem. Finally, they translate the result back into legal terms.

Id. at 19. *See, e g.*, Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990) [hereinafter Butler & Ribstein, *Opting Out*]; Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986) [hereinafter Easterbrook & Fischel, *Close Corporations*]; Lawrence E. Mitchell, *Private Law, Public Interest?: The ALI* Principles of Corporate Governance, 61 GEO. WASH. L. REV. 871, 874 (1993) [hereinafter Mitchell, *Private Law*].

24. *E.g.*, J. William Callison, *Blind Men & Elephants: Fiduciary Duties Under the Revised Uniform Partnership Act, Uniform Limited Liability Company Act, and Beyond*, 1 J. SMALL & EMERGING BUS. L. 109 (1997) [hereinafter Callison, *Blind Men & Elephants*]; Dickerson, *Is It Appropriate*, *supra* note 10; J. Dennis Hynes, *Fiduciary Duties and RUPA: An Inquiry into Freedom of Contract*, 58 LAW & CONTEMP. PROBS. 29 (1995) [hereinafter Hynes, *Fiduciary Duty and RUPA*]; Hynes, *Freedom of Contract*, *supra* note 17; Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537 (1997) [hereinafter Ribstein, *Fiduciary Duty Contracts*]; Allan W. Vestal, *Advancing the Search for Compromise: A Response to Professor Hynes*, 58 LAW & CONTEMP. PROBS. 55 (1995) [hereinafter Vestal, *Advancing the Search*]; Donald J. Weidner, *RUPA and Fiduciary Duty: The Texture of Relationship*, 58 LAW & CONTEMP. PROBS. 81 (1995) [hereinafter Weidner, *The Texture of Relationship*].

25. The intellectual opponents of the "contractarians" have been given various names. *E.g.*, Stephen M. Bainbridge, *Book Review: Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV.

A. The Contractarian Position

The contractarians start from the premise that "[f]iduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings."[26] They stress the importance of the enforceability and reliability of contractual obligations[27] in promoting economic efficiency.[28] Each contracting party in a business enterprise should be free to bargain for his individual self-interest, because "[t]he resulting bargaining, compromise, and trade-offs would enhance the welfare of all participants (including the broader society, which would have the indirect benefit of its efficient deployment of assets)."[29] Thus, argue the contractarians, the parties should be free to decide whether the cost of fiduciary principles as applied to their enterprise outweighs the cost of dispensing with them and substituting some other mechanism to protect the welfare of the beneficiary, if any at all.[30]

856, 857 (1997) ("traditionalists" and "progressive communitarians"); Butler & Ribstein, *Opting Out*, *supra* note 23 ("anti-contractarians"); Callison, *Blind Men and Elephants*, *supra* note 24, at 117 n.53 ("fiduciarians," "paternalists," and "parentalists"); Mitchell, *Private Law*, *supra* note 23, at 871 ("regulators"); Weidner, *The Texture of Relationship*, *supra* note 24, at 86 ("paternalists"). Professor Miller identifies several other "schools of thought": the "team production theory," "game theory," "empirical study," and the "structural model." Miller, *Decade of Experimentation*, *supra* note 7, at 581-86.

26. Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993) [hereinafter Easterbrook & Fischel, *Contract and Fiduciary Duty*].

27. Contractarians view a business enterprise not as an independent entity, but rather as a "nexus of contracts" among shareholders, managers, employees, and creditors. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 23, at 27.

28. *See, e.g.*, Butler & Ribstein, *Opting Out*, *supra* note 23, at 71; Loewenstein, *Manifestly Unreasonable*, *supra* note 22, at 438-39.

29. Mitchell, *Private Law*, *supra* note 23, at 878.

30. Professor Ribstein explains:

> Whether a hypothetical fiduciary duty bargain is justified depends on whether selfless conduct by the fiduciary in a particular context is likely to be worth the price the beneficiary would have to pay. For example, if the fiduciary-to-be believes that there is a 50% chance of having to forgo a deal worth $100,000, this represents a $50,000 opportunity cost . . . of becoming a fiduciary. The fiduciary-to-be similarly would take into account the need to devote time unselfishly to the business. Before making the leap to fiduciary status, the fiduciary-to-be would want to be assured of being compensated for these sacrifices. The beneficiary, in turn, would be willing to compensate the fiduciary for forgoing self-advantage only if this would produce an adequate payoff.

Of course, often the parties fail to bargain expressly about mechanisms to constrain the potential for abuse by those actually managing the business. This is almost always the case in the arena of large, publicly held corporations;[31] it may also be the case in the arena of small businesses. Fiduciary-duty rules operate in no-actual-bargain cases as a set of "off the rack" default rules.[32] The law presumes these rules to approximate what most parties would have agreed to if they had considered the matter. In other words, the law of fiduciary obligation is viewed as expressing the terms of a hypothetical bargain.[33] But where the parties have agreed that other standards will govern their relationship, their freedom to contract as they choose, say

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Ribstein, *Fiduciary Duty Contracts*, *supra* note 24, at 543; *see also* Butler & Ribstein, *Opting Out*, *supra* note 23, at 29 ("In selecting between fiduciary duties and alternative constraints, the parties consider both the costs and benefits of fiduciary duties, and at the margin trade off fiduciary duties for other constraints.").

31. As for the argument that this lack of true bargaining could cause harm to shareholders if they unknowingly invested in a corporation that had opted out of fiduciary duties, the contractarians respond that such a shareholder is protected because the efficient securities markets takes corporate governance information into account when "pricing" the stock at the time the shareholder bought it. Butler & Ribstein, *Opting Out*, *supra* note 23, at 33-35. The "efficient market hypothesis" is described in Basic, Inc. v. Levinson, 485 U.S. 224, 248-49 (1988). This line of reasoning is inapplicable to closely held businesses, where the participants typically negotiate the terms of their deal.

32 *E.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 34 (1991) [hereinafter ECONOMIC STRUCTURE OF CORPORATE LAW]; John C. Coffee, Jr., *No Exit?: Opting Out, the Contractual Duty of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919, 932 (1988). The most extreme contractarians deny that fiduciary duties are default rules at all; they would require that parties affirmatively adopt fiduciary obligations as part of their contract.

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> [C]orporate law is a set of terms available off-the-rack so that participants in corporate ventures can save the cost of contracting. There are lots of terms, such as rules for voting, establishing quorums, and so on, that almost everyone will want to adopt. Corporate codes and existing judicial decisions supply these terms "for free" to every corporation, enabling the venturers to concentrate on matters that are specific to their undertaking. . . . Corporate law—and in particular the fiduciary principle enforced by courts—fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance. On this view corporate law supplements but never displaces actual bargains, save in situations of third-party effects or latecomer terms.

ECONOMIC STRUCTURE OF CORPORATE LAW, *supra* note 32, at 34; *see also* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 23, at 29-31.

the contractarians, should be respected and their actual bargain should be enforced.[34]

The contractarians argue that courts should enforce actual bargains in small-business enterprises as well as in large ones. Their paradigm is a partnership between parties of equal bargaining power.[35] There is no contract of adhesion.[36] Moreover, the law gives partners other protections against the possible perfidy of co-partners. For example, in a general partnership, unless they agree otherwise, partners have equal management rights in the business[37] and rights to information.[38] They have the right to leave the partnership at any time by an act of will if they believe that course is in their best interest[39]—including the right to leave on account of abusive conduct by co-partners. They have the right to sue for dissolution in proper circumstances.[40] There is no need for the law to impose fiduciary obligations that the parties have expressly disclaimed in the partnership agreement. Professor Dennis Hynes makes the point clear:

> [F]or example, if two large corporations decide to enter into a joint venture for a long-term project, they ought to be free to forego fiduciary duties in order to avoid the risk of future litigation over vague and fact-specific concepts. They do not trust each other and never will trust each other to keep the other party's interests in mind. Honesty in response to specific questions is all either party expects. The law should respect that bargain.[41]

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34. ECONOMIC STRUCTURE OF CORPORATE LAW, *supra* note 32, at 34.

35. *E.g.*, Hynes, *Fiduciary Duties and RUPA*, *supra* note 24, at 40 ("Persons entering into a partnership relationship ordinarily bargain from an approximately equal position, an equality created by the fact that each party typically has something of near-equal value to offer the other.").

36. *E.g.*, Ribstein, *Fiduciary Duty Contracts*, *supra* note 24, at 556-57.

37. Hynes, *Freedom of Contract*, *supra* note 17, at 454.

38. *Id.*

39. *Id.* Note that this was not true under the Arkansas version of the Uniform Partnership Act, if the partnership agreement limited the way in which dissolution could take place. *See* ARK. CODE ANN. § 4-42-603 (Repl. 2001) (repealed); Osborne v. Workman, 273 Ark. 538, 540-41, 621 S.W.2d 478, 480 (1981).

40. Hynes, *Freedom of Contract*, *supra* note 17, at 454.

41. Hynes, *Fiduciary Duties and RUPA*, *supra* note 24, at 40; *accord* BROMBERG & RIBSTEIN ON PARTNERSHIP, *supra* note 19, at § 6.07(h)(6) ("[P]arties to formal general and limited partnership agreements, who negotiate in detail or are participating in sophisticated,

B. The Traditionalist Position

The traditionalists, by contrast, start from the premise that fiduciary principles are grounded in moral standards that concern society as a whole.

> [A]t the heart of the debate is the purpose to be served by fiduciary analysis and its underlying social vision. The debate really is about the way we, as a society, believe that people can and should conduct themselves in business relationships and the extent to which we are willing to use the law to encourage and, if necessary, compel them to conform to that level of conduct.[42]

In other words, those with management power in business enterprises—corporate managers, general partners, and members or managers in LLCs—should be subject to a "mandatory core" of minimum decencies owed to one another within the scope of that enterprise.[43]

In the traditionalists' view, the protection afforded by fiduciary obligation is most important in small businesses. It cannot be assumed that the parties have equal bargaining power.[44] One party may have more information, and the sophistication to use it wisely, than the other.[45] There are

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idiosyncratic, tax-motivated deals, probably do not need the protection of a rule that invalidates entire categories of clauses.").

Dean Weidner argues vigorously that the relationship Hynes posits—a group composed exclusively of perfectly informed investors—is an extreme one and should not serve as the model for partnership law, which is designed for partners with extremely various attributes. To craft the law to suit perfectly informed investors would impose costs on those who would have to draft around it, or on society to pick up the pieces for those who neglected to do so. Weidner, *The Texture of Relationship*, *supra* note 24, at 101-03.

42. Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1725 (1990); *see also* Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 832 (1983) ("To the extent that the law induces fiduciaries to work for the collective good, the law helps shape desirable social trends.").

43. Miller, *Decade of Experimentation*, *supra* note 7, at 570. Professor Miller explains that "[t]his approach permits the LLC manager to contractually tailor his or her duties to the LLC but nevertheless includes a statutory articulation of mandatory minimum fiduciary duties and a standard of conduct that managers cannot completely waive." *Id.*

44. *See* Weidner, *The Texture of Relationship*, *supra* note 24, at 100.

45. As Dean Weidner observes, the fairness of the bargain process for partnerships is questionable because of "different behaviors and dramatic information asymmetries. Some 'bargainers' are unlikely to bargain. Some bargainers are less likely to attend to the language of an agreement or to appreciate the significance of language, even if their attention is directed specifically to it." *Id.*; *accord* Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523,

"cognition problems" that cause people to make irrational bargains because they are unable to assess accurately the risks they are taking; prospective partners are likely to be unduly optimistic that the good relationships they enjoy at the inception of the enterprise will continue into the future.[46] They may be inclined to trust prospective co-partners rather that to engage in hard bargaining that might "queer the deal,"[47] especially if the parties are acting in haste.[48] They may be focused on the economic aspects of the business rather than on the question of loyalty.[49] They may not have adequate legal advice, especially if one lawyer represents all the prospective participants.[50] This is more than a theoretical problem. As Professor Sandra K. Miller states:

> [E]mpirical research casts doubt on three very basic assumptions that are critical to the practical effectiveness of the contractarian theory of LLC governance. First, written LLC operating agreements are likely to be executed. Second, the operating agreements will be highly negotiated and will contain important express contractual provisions for both sides. Third, the attorneys drafting the LLC agreements will be well-educated in LLC statutory default rules and LLC governance issues. . . . The empirical research paints a picture of an imperfect and diverse contractual playing field. The LLC serves a broad constituency of businesses varying widely in sophistication, financial stature, and legal representation.[51]

In sum, to allow dilution of fiduciary obligation enables opportunistic conduct[52] by the stronger party against the weaker,

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541 (1993) ("The contractarian formulation jeopardizes unsophisticated participants, inadvertent partners, partners with insufficient resources to retain counsel and enter into lengthy negotiations, and individuals with inadequate experience to appreciate the problem.").

46. Ribstein, *Fiduciary Duty Contracts*, *supra* note 24, at 554.

47. *Id.* at 557.

48. Miller, *Decade of Experimentation*, *supra* note 7, at 573.

49. Loewenstein, *Manifestly Unreasonable*, *supra* note 22, at 436.

50. Professor Miller notes that empirical research "suggests that controlling and minority investors may not be equally represented by counsel . . . ." Miller, *Decade of Experimentation*, *supra* note 7, at 572.

51. *Id.* at 585-86.

52. A pithy definition of opportunism is "self-interest seeking with guile." Smith, *Critical Resource Theory*, *supra* note 13, at 1402 n.10.

in violation of the moral norms articulated by Justice Cardozo almost a century ago in *Meinhard v. Salmon*:[53]

> Joint adventurers, like copartners, owe to one another. . . the duty of finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.[54]

The Arkansas Supreme Court has expressly approved the rationale of *Meinhard*.[55]

IV. RESTRICTION OR ELIMINATION OF FIDUCIARY DUTIES IN ARKANSAS CORPORATIONS AND PARTNERSHIPS

In order to analyze the Arkansas LLC Act and its provisions on the restriction or elimination of fiduciary duties, this article will first examine how this issue is addressed in the law of corporations and partnerships in Arkansas.[56] This more-established body of law reflects Arkansas's general policy regarding the interplay between the contractarian and traditionalist positions in other forms of business enterprise. With this background, the analysis of the LLC Act will be more meaningful and more in context.

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53. 164 N.E. 545, 546 (N.Y. 1928).

54. *Id.* (citation omitted).

55. Johnson v. Lion Oil Co., 216 Ark. 736, 740, 227 S.W.2d 162, 165 (1950); *see also* Tex. Oil & Gas Corp. v. Hawkins Oil & Gas, Inc., 282 Ark. 268, 270, 668 S.W.2d 16, 17 (1984); Litvinko v. Downing, 260 Ark. 868, 870, 545 S.W.2d 616, 617 (1977); Raines v. Toney, 228 Ark. 1170, 1178-79, 313 S.W.2d 802, 808 (1958).

56. *See infra* notes 57-111 and accompanying text.

A. Restriction or Elimination of Fiduciary Duties in Arkansas Corporations

Under Arkansas corporation law, as under the corporation law of other states, the traditionalist philosophy holds sway with only minor exceptions.[57] There is no law permitting broad restrictions on fiduciary duties of corporate management. The fiduciary standard applicable to directors and officers is a high one, and a person who is both a director and an officer of a corporation has an even higher duty.[58]

The 1987 Arkansas Business Corporation Act expressly addresses some aspects of management's fiduciary duties.[59] It requires a director or officer to act:

1. In good faith;

2. With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

3. In a manner he reasonably believes to be in the best interests of the corporation.[60]

The 1987 Act also addresses the duty of loyalty. It identifies interested-director transactions as those where the director has a direct or indirect interest in a transaction with the corporation.[61] The Act further provides that "tainted" transactions may be upheld only if approved in advance or ratified by disinterested directors or by shareholders following complete disclosure, or if the transaction was objectively fair to

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57. *See infra* notes 58-78 and accompanying text.

58. *E.g.*, Wal-Mart Stores, Inc. v. Coughlin, No. 06-315 slip op. at 5-6, __ S.W.3d __, 2007 WL 1098162 (Ark. Apr. 12, 2007); Victor Brudney, *Contract & Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 596, 611 (1997) [hereinafter Brudney, *Contract & Fiduciary Duty*].

59. The 1965 Arkansas Business Corporation Act, ARK. CODE ANN. §§ 4-26-101 to -1204 (Repl. 2001), says nothing directly about officers' or directors' fiduciary duties. The closest it comes is the indemnification statute, which provides generally that in order to be eligible for indemnification, a director or officer (or other agent) who allegedly is guilty of misconduct must have "acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the corporation." ARK. CODE ANN.. § 4-26-814(a) (Repl. 2001).

60. ARK. CODE ANN. §§ 4-27-830(a) to -842(a) (Repl. 2001).

61. ARK. CODE ANN. § 4-27-831 (Repl. 2001).

the corporation.[62] The Act also regulates loans made by the corporation to a director[63] and authorizes the board to fix the compensation of its members.[64] In addition, under general American law, corporate managers have the duty to refrain from other kinds of disloyal conduct, including the following: 1) to refrain from wrongful competition with the corporation;[65] 2) to refrain from misappropriating corporate property or information;[66] 3) to refrain from using corporate office to secure a pecuniary benefit;[67] 4) to refrain from usurping corporate opportunities;[68] and 5) to refrain from acting primarily to entrench themselves in their corporate positions.[69]

What is most notable about the 1987 Act is its authorization of charter provisions that absolve directors of personal liability for damages to the corporation or its shareholders for certain breaches of fiduciary duty. Section 4-27-202 of the Arkansas Code provides the exclusive mechanism for restricting directors' fiduciary duties.[70] While directors can be absolved of liability

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62. ARK. CODE ANN. § 4-27-831. *Cf.* Webber, *Arkansas Corporate Fiduciary Standards*, *supra* note 10, at 48 ("[R]atification and disclosure cannot operate to validate an unfair contract.").

63. ARK. CODE ANN. § 4-27-832 (Repl. 2001).

64. ARK. CODE ANN. § 4-27-811 (Repl. 2001).

65. *E.g.*, 1 AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 5.06 (1994) [hereinafter ALI PRINCIPLES]; EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES, AND LIABILITIES § 4:15 (2006) [hereinafter BRODSKY & ADAMSKI].

66. *E.g.*, ALI PRINCIPLES, *supra* note 65, at § 5.04.

67. *E.g.*, *id.*

68. *E.g.*, *id.* at § 5.05; *see generally* BRODSKY & ADAMSKI, *supra* note 65, ch. 4.

69. *E.g.*, Hall v. Staha, 314 Ark. 71, 79, 858 S.W.2d 672, 676 (1993); BRODSKY & ADAMSKI, *supra* note 65, at § 6:1; 1 WILLIAM E. KNEPPER & DAN A. BAILEY, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 4.07, at 4-15 (7th ed. 2005).

70. Section 4-27-202(b)(3) permits inclusion in the articles of incorporation:

> a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director:
>
> (i) for any breach of the director's duty of loyalty to the corporation or its stockholders;
>
> (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
>
> (iii) under § 4-27-833 of this chapter [liability for unlawful distributions];

for monetary damages for breach of the duty of care absent "intentional misconduct or a knowing violation of law," they cannot be relieved of liability for breach of the fiduciary duties of loyalty and good faith.[71] Absolution from liability *not* within the embrace of the statute is *not* authorized.[72] In other words, the only way in which corporate directors may be absolved of liability for monetary damages for breach of those duties is by the prescribed mechanism: a provision in the articles of incorporation.[73] Thus, for example, shareholders cannot, simply by agreement among themselves, abridge the fiduciary responsibilities of directors. Restrictions on the abridgement of the fiduciary obligations of officers and directors is a fundamental premise of corporate law. The current version of the Model Business Corporation Act, unlike the 1987 Arkansas Act, expressly allows shareholders in privately held corporations to deviate from standard corporate operating procedures by agreement.[74] The Model Act does not, however, explicitly (or

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> (iv) for any transaction from which the director derived an improper personal benefit; or
>
> (v) for any action, omission, transaction, or breach of a director's duty creating any third-party liability to any person or entity other than the corporation or stockholder.

ARK. CODE. ANN. § 4-27-202(b)(3) (Repl. 2001). For a detailed analysis of this statute, see Frances Fendler Rosenzweig, *Director-Exculpation Clauses Under the Arkansas Business Corporation Act of 1987*, 15 U. ARK. LITTLE ROCK L. REV. 337 (1993) [hereinafter Fendler Rosenzweig, *Director-Exculpation*].

71. ARK. CODE ANN. § 4-27-202(b)(3)(ii).

72. *See* ARK. CODE ANN. § 4-27-202(b).

73. Additionally, by not authorizing exculpatory clauses applicable to other corporate personnel, the Act implies that exculpation of officers' or other managers' fiduciary duties is not allowed. *See* ARK. CODE ANN. § 4-27-202(b)(3).

74. Section 7.32(a) of the Model Business Corporation Act states in pertinent part:

> An agreement among the shareholders of a corporation that complies with this section is effective among the shareholders and the corporation even though it is inconsistent with one or more other provisions of this Act in that it:
>
> (1) eliminates the board of directors or restricts the discretion or powers of the board of directors;
>
> (2) governs the authorization or making of distributions whether or not in proportion to ownership of shares, subject to the limitations in section 6.40 [describe];

otherwise) authorize shareholders by such an agreement to eliminate or abridge the fiduciary duties of directors.[75] Further, lest there be any doubt, the Official Comment makes clear that such an agreement would be unenforceable on public-policy grounds:

> [A] shareholder agreement that provides that the directors of the corporation have no duties of care or loyalty to the corporation or the shareholders would not be within the purview of [the statute], because. . . such a provision could be viewed as contrary to a public policy of substantial importance. Similarly, a provision that exculpates directors from liability more broadly than permitted by [the Model Act analogue to Section 24-27-202] likely would not be validated . . . because . . . there are serious public policy

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(3) establishes who shall be directors or officers of the corporation, or their terms of office or manner of selection or removal;

(4) governs, in general or in regard to specific matters, the exercise or division of voting power by or between the shareholders and directors or by or among any of them, including use of weighted voting rights or director proxies;

(5) establishes the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation and any shareholder, director, officer or employee of the corporation or among any of them;

(6) transfers to one or more shareholders or other persons all or part of the authority to exercise the corporate powers or to manage the business and affairs of the corporation, including the resolution of any issue about which there exists a deadlock among directors or shareholders;

(7) requires dissolution of the corporation at the request of one or more of the shareholders or upon the occurrence of a specified event or contingency; or

(8) otherwise governs the exercise of the corporate powers or the management of the business and affairs of the corporation or the relationship among the shareholders, the directors and the corporation, or among any of them, and is not contrary to public policy.

2 MODEL BUSINESS CORPORATION ACT ANNOTATED (MBCA) § 7.32, at 7-237 (3d ed. Supp. 1997).

75. *See* 2 MBCA § 7.32; *e.g.*, McMinn v. MBF Operating Acquisition Corp., 164 P.3d 41, 50 (N.M. 2007) ("Although our legislature has not updated New Mexico's corporations statutes, the revisions to the MBCA provide guidance in interpreting our current statutes.").

> reasons which support the few limitations that remain on the right to exculpate directors from liability.[76]

Moreover, directors remain subject to liability for conduct that is wrongful on some basis other than breach of fiduciary duty, such as fraud, breach of contract, or violation of federal or other state laws. In addition, directors remain exposed to remedies other than monetary damages, including rescission, restitution, injunctive relief, constructive trust, disgorgement of profits, reformation, and piercing the veil.[77]

The conclusion is that fiduciary duties in Arkansas corporations are governed by the "traditionalist" position. This is subject only to the limited exculpatory-charter provision (which is contractual in nature) authorized by section 4-27-202 of the Arkansas Code.[78] Thus, in the realm of corporation law, while the contractarians have won a skirmish in section 4-27-202(b)(3), the battlefield still belongs to the traditionalists.

B. Restriction or Elimination of Fiduciary Duties in Arkansas Partnerships

Arkansas's current general-partnership act is the Arkansas Uniform Partnership Act (1996).[79] It is a near verbatim copy of the Revised Uniform Partnership Act, commonly called "RUPA," promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL").[80] Arkansas's previous partnership act was based on the Uniform Partnership Act (1914) ("UPA").[81] Arkansas UPA was repealed by Arkansas RUPA, effective January 1, 2005.[82]

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76. 2 MBCA § 7.32, at 7-243.

77. *See generally* JAMES A. FANTO, DIRECTORS' AND OFFICERS' LIABILITY § 2.2.3[A][5], at 2-30 (2d ed. 2006); Brudney, *Contract and Fiduciary Duty*, *supra* note 58, at 602-03; Fendler Rosenzweig, *Director-Exculpation*, *supra* note 70, at 345-48. *But see* Arnold v. Society for Savings Bancorp, Inc., 678 A.2d 533, 541 (Del. 1996) ("[D]irectors are free from personal financial liability whether monetary damages arise out of legal or equitable theories.").

78. *See* ARK. CODE ANN. § 4-27-202.

79. ARK. CODE ANN. §§ 4-46-101 to -1207 (Repl. 2001).

80. The full text of RUPA, together with Official Comments, appears at 6I U.L.A. 1 (2001).

81. ARK. CODE ANN. §§ 4-42-101 to -806 (Repl. 2001) (repealed).

82. 1999 Ark. Acts 1518, § 1205, at 6520.

Arkansas's most recent limited-partnership act is the Uniform Limited Partnership Act (2001) ("ULPA (2001)")[83], based on the NCCUSL act of the same name.[84] Arkansas ULPA (2001) becomes effective on September 1, 2007.[85] Even though it is not effective at the time this article is being written, I will rely on it as the best evidence of the Arkansas legislature's intent on limited-partnership governance.

Arkansas RUPA and Arkansas ULPA (2001) comprise the only Arkansas law specifically addressing restrictions or waivers of fiduciary obligations in partnerships. They contain essentially identical provisions regarding restrictions or waivers of fiduciary obligations of general partners.[86] There is no Arkansas case law on point.[87]

Arkansas RUPA and ULPA (2001) supplant the vast body of common-law fiduciary principles applicable to partners in general and limited partnerships, respectively.[88] As a result, today Arkansas courts do not have to decide the broad question of whether fiduciary obligations in partnerships may be eliminated altogether; the substantially identical provisions of

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83. 2007 Ark. Acts 15 (codified as ARK. CODE ANN. §§ 4-47-101 to -1301).

84. 6A U.L.A. 1 (2001).

85. 2007 Ark. Acts 15, § 1204, at 125.

86. This is not surprising. In a limited partnership, a general partner's duty to the partnership and the other partners is essentially the same as the duty owed by a general partner in a general partnership. Loewenstein, *Manifestly Unreasonable*, *supra* note 22, at 415-16.

87. There is one case that, at first blush, might appear to involve a waiver of fiduciary duties owed by partners to one another. *See* St. Joseph's Reg'l Health Ctr. v. Munos, 326 Ark. 605, 934 S.W.2d 192 (1996). In that case, a partnership was formed between St. Joseph's, a hospital, and five physicians to provide MRI services at a facility operated by the partnership. *Id.* at 608, 934 S.W.2d at 193. The partnership entered into a management contract with one of the physicians, Dr. Munos, to manage the MRI Center as an independent contractor. *Id.* Exercising rights spelled out in the management contract, three partners terminated the contract without allowing Dr. Munos to present evidence on his own behalf. *Id.* at 610, 934 S.W.2d at 195. While recognizing "the existence of a fiduciary duty between partners," the Arkansas Supreme Court held that the defendants did not breach their fiduciary duties to Dr. Munos *as a partner* because they were merely exercising their rights under the management contract. *Id.* "[T]here was absolutely no proof that [the defendants] acted out of a desire to expel Dr. Munos from the partnership or otherwise affect his status as a partner, his partnership interest, or his monthly partnership income." *Id.* at 616, 934 S.W.2d at 197. In other words, the management contract did not affect the fiduciary duties owed by and to the parties as partners.

88. *See generally* Loewenstein, *Manifestly Unreasonable*, *supra* note 22, at 412.

RUPA and ULPA (2001) make clear that they cannot.[89] These provisions represent a compromise between the traditionalist and contractarian schools of thought;[90] they describe the duties ordinarily imposed upon partners, and allow the parties to "opt out" of those duties up to a point, but not completely. Because the relevant provisions of ULPA (2001) are virtually identical to those of RUPA concerning the fiduciary duties of general partners, this discussion will focus on the language of RUPA.

The primary thrust of RUPA section 404[91] is to identify partners' fiduciary duties, to define them, and to make them exclusive.[92] Section 404(a) provides: "The only fiduciary duties a partner owes to the partnership and the other partners

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89. ARK. CODE ANN. § 4-46-103(b) (Repl. 2001); 2007 Ark. Acts 15, § 110(b), at 46-48.

90. Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1, 17-18 (1993) [hereinafter Weidner & Larson, *Reporters' Overview*]. As the Reporters to RUPA observe, "No amount of debate ever will close the gap between those who want powerful and immutable fiduciary duties and those who want them confined statutorily and reduced to default rules." *Id.* at 18; *see also* Allan W. Vestal, *"Assume a Rather Large Boat . . .": The Mess We Have Made of Partnership Law*, 54 WASH & LEE L. REV. 487, 488 (1997) [hereinafter Vestal, *Assume a Rather Large Boat*] ("RUPA does not fully implement either the traditional structure or the competing philosophy, but represents an uneasy and unworkable compromise between the two.").

91. The statute also eliminates the fiduciary duty to be selfless. Weidner, *The Texture of Relationship*, *supra* note 24, at 88. Section 404(e) provides that "[a] partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the partner's conduct furthers the partner's own interest." Thus, partners are no longer treated as disinterested trustees. *E.g.*, 1 RESTATEMENT (THIRD) OF TRUSTS § 5(g) & cmt. g (2003); BROMBERG & RIBSTEIN ON PARTNERSHIPS, *supra* note 19, at § 6.07(a)(1); Weidner, *The Texture of Relationship*, *supra* note 24, at 88; Donald J. Weidner, Cadwalader, *RUPA and Fiduciary Duty*, 54 WASH. & LEE L. REV. 877, 905 (1997) [hereinafter Weidner, Cadwalader]. Rather, subsection (e) recognizes that a partner, as a co-owner of the business, has legitimate self-interests that he may pursue unless that pursuit would impinge upon the duties he owes to the partnership and his other partners. *Cf. St. Joseph's*, 326 Ark. at 615, 934 S.W.2d at 197 (holding that to the extent doctor/partner acted as an independent contractor, hospital/partner owed no fiduciary duty to him and could terminate the contract according to its terms without breaching its fiduciary duty). For example, according to the comments, a partner who owns a shopping center may legitimately vote against a proposal that the partnership open a competing shopping center. RUPA § 404, 6I U.L.A. § 404, cmt. 5, at 146 (2001). *See generally* Weidner, *The Texture of Relationship*, *supra* note 24, at 89.

92. *E.g.*, Carol R. Goforth, *The Revised Uniform Partnership Act: Ready or Not, Here It Comes*, 1999 ARK. L. NOTES 47, 52 [hereinafter Goforth, *Ready or Not*]. Backing away from the contractarian ideology, several states have removed the limiting word "only" from their partnership statutes, leaving open the possibility that courts may add to or elaborate on the fiduciary duties enumerated in the statutes. Miller, *Decade of Experimentation*, *supra* note 7, at 577-78 (identifying statutes).

are the duty of loyalty and the duty of care set forth in subsections (b) and (c)."[93]

The duty of loyalty is the overarching fiduciary duty.[94] Under section 404(b), the duty of loyalty is only waived when the partnership agreement provides otherwise, or when the other partners consent.[95] Absent such a provision or consent of the other partners, a partner may not appropriate partnership property (including a partnership opportunity) or use it for non-partnership purposes, may not engage in self-dealing either for himself or as representative of another, and may not compete with the partnership. The Act explicitly provides:

> (b) A partner's duty of loyalty to the partnership and the other partners is limited to the following:
>
> > (1) to account to the partnership and hold as trustee for it 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 [without the consent of the other partners];
> >
> > (2) 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 [without the consent of the other partners]; and
> >
> > (3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership [without the consent of the other partners].[96]

In addition, RUPA section 404(c) mandates a fiduciary duty of care owed by partners. The standard is not ordinary care, but rather: "A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or

93. RUPA § 404(a).
94. Weidner, *The Texture of Relationship*, *supra* note 24, at 90.
95. *See* RUPA § 404(b).
96. RUPA § 404(b).

a knowing violation of law."[97] The effect of this provision is to allocate the risk of any partner's ordinary negligence to the partnership, to be shared by all the partners.

RUPA section 404(d) contains another innovation. It expressly imposes on partners a general obligation of good faith and fair dealing, but specifically disclaims status as a fiduciary obligation.[98] This disclaimer makes it one of the most enigmatic sections of the Act:[99] "A partner shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing."[100]

According to the comments, the obligation of good faith and fair dealing "is an ancillary obligation that applies whenever a partner discharges a duty or exercises a right under the partnership agreement or the Act."[101] RUPA gives no definition of the duty of good faith and fair dealing, preferring to leave it to the courts to shape it in the context of real cases.[102] The duty of

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97. RUPA § 404(b).

98. For a discussion of the difference between fiduciary obligations and contractual ones, see Brudney, *Contract & Fiduciary Duty*, *supra* note 58, at 629-40.

99. Weidner, Cadwalader, *supra* note 91, at 909-10; Weidner & Larson, *Reporters' Overview*, *supra* note 90, at 24; *see also* Dickerson, *Is It Appropriate*, *supra* note 10, at 119; Edwin J. Hecker, Jr., *Fiduciary Duties in Business Entities*, 54 U. KAN. L. REV. 975, 1001 (2006).

Absent from the list of duties owed by partners is the duty to provide information to co-partners, a duty that is sometimes characterized as fiduciary. Hynes, *Fiduciary Duties and RUPA*, *supra* note 24, at 33. This duty is dealt with separately, in RUPA § 403(c), and is subject to complete waiver (limited, perhaps, by the general duty of good faith and fair dealing). RUPA also mandates access to partnership books and records. RUPA § 403(b). Restriction of this access is only allowed when reasonable. RUPA § 103(b).

100. RUPA § 404(d).

101. RUPA § 404, cmt. 4, 6I U.L.A. at 145 (2001).

102. *Id.* The drafters explicitly rejected the definitions of "good faith" in the Uniform Commercial Code. *Id.* at 146. However, Arkansas courts might disagree. *See* Long v. Lampton, 324 Ark. 511, 518, 521 S.W.2d 692, 697 (1996) (adopting the UCC definition of "good faith" in the corporate context).

The drafters of ULPA (2001), which is modeled on RUPA, were more forthcoming in the comment to ULPA (2001) § 305(b), which imposes a duty of good faith and fair dealing on limited partners:

> The obligation of good faith and fair dealing is *not* a fiduciary duty, does not command altruism or self-abnegation, and does not prevent a partner from acting in the partner's own self-interest. Courts should not use the obligation to change *ex post facto* the parties' or this Act's allocation of risk and power. To the contrary, in light of the nature of a limited partnership, the obligation

good faith and fair dealing, like the duties of loyalty and care, is mandatory.[103]

These rules set out in RUPA are default rules. The partners are free to add to or broaden them. However, there are limits on the partners' ability to restrict or eliminate these duties. One of the most controversial provisions in RUPA is section 103(b), the pertinent portions of which are:

> (b) The partnership agreement may not:
>
> . . . .
>
> (3) eliminate the duty of loyalty under Section 404(b) . . . but:
>
> (i) the partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; or
>
> (ii) all of the partners or a number of percentage specified in the partnership agreement may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty;
>
> (4) unreasonably reduce the duty of care under Section 404(c) . . . .
>
> (5) eliminate the obligation of good faith and fair dealing under Section 404(d), but the partnership agreement may prescribe the standards by which the performance of the obligations is to be measured, if the standards are not manifestly unreasonable . . . .[104]

In other words, the parties have almost free rein to structure their partnership rights and duties however they choose. Hence, RUPA generally follows the contractarian model. However, through the exceptions set out in Section 103(b), RUPA adopts

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> should be used only to protect agreed-upon arrangements from conduct that is manifestly beyond what a reasonable person could have contemplated when the arrangements were made.

ULPA (2001) § 305, cmt. (b), 6A U.L.A. at 51-52. This exposition should apply generally to the duty of good faith and fair dealing imposed in other forms of business organizations.

103. RUPA § 103(b)(5).

104. RUPA § 103(b).

the traditionalists' position that fiduciary duties implicate policy concerns about minimum decencies.[105]

This compromise is largely dissatisfying to both camps.[106] To those contractarians who place great value on the reliability of contracts, RUPA is simply a bust, because it deprives parties of complete freedom to structure their relationship as they choose.[107] To those traditionalists who would make full fiduciary obligations mandatory, RUPA is equally disappointing, because it allows the parties to restrict fiduciary duties further than the traditionalists believe appropriate.[108] To those less doctrinaire than either camp, it is disquieting that decades will probably pass before case law reliably defines the limits of what is a "manifestly unreasonable" exception to the duty of loyalty, what is an "unreasonable reduction" of the duty of care, and what standards are "manifestly unreasonable" when it comes to the duty of good faith and fair dealing.[109] In addition, there are questions about what amounts to an "elimination" of the duty of loyalty and the obligation of good faith and fair dealing, and whether contractual waiver clauses are sufficiently "specific."[110] Nonetheless, one recent commentator has come to the defense of RUPA's middle-of-the-road approach, arguing that it makes practical sense because it

105. For a detailed analysis of the text of section 103, see ROBERT W. HILLMAN, ALLAN W. VESTAL, & DONALD J. WEIDNER, THE REVISED UNIFORM PARTNERSHIP ACT (2006).

106. Weidner, *Texture of Relationship*, *supra* note 24, at 86 ("RUPA is a compromise that will not fully satisfy either the paternalists or the contractarians.").

107. *See, e.g.*, Hynes, *Freedom of Contract*, *supra* note 17, at 447-52. But even contractarians, who would make fiduciary duties in partnerships fully waivable, recognize that there must be safeguards to ensure, as nearly as possible, that enforcement of a waiver would not perpetrate great injustice. For example, Professor Hynes predicts that courts will require that fiduciary waivers be clear and specific, because "partners should clearly be put on notice of an erosion of trust before a court holds them to the consequences of such an agreement." *Id.* at 457. In his opinion, broad or general language in a partnership agreement, such as "[Partner A] will have full responsibility and exclusive and complete discretion in the management and control of the business and affairs of the partnership," would not be sufficient to effect any waiver of the default fiduciary duties. *Id.* at 457-58. Professor Hynes also advocates that courts apply a broad version of the unconscionability doctrine when scrutinizing bargains involving waivers of fiduciary duties. *Id.* at 458.

108. *See, e.g.*, Dickerson, *Is It Appropriate*, *supra* note 10, at 145-46.

109. Vestal, *Advancing the Search*, *supra* note 24, at 55 ("The literature is now replete with critiques of RUPA from both the right and the left, which amply demonstrate that the uniform act does not meet either side's objectives.").

110. Callison, *Blind Men & Elephants*, *supra* note 24, at 155.

allows courts to reach fair results in hard cases without straining principles of interpretation, the doctrine of unconscionability, or other legal standards.[111]

In sum, Arkansas partnership law reflects more of the contractarian position than does Arkansas corporation law. However, RUPA and ULPA (2001) forbid outright waivers of fiduciary duties and permit restrictions only to the extent that they are specific and not manifestly unreasonable. In so doing, Arkansas RUPA and ULPA (2001) preserve the mandatory core of minimum decencies in accordance with the traditionalist position.

V. LLCs—MULTIPLE VOICES

In interpreting the Arkansas LLC Act and determining its position on the issue of whether fiduciary duties may be restricted or eliminated, this article next examines recent developments in LLC law on the national front. Because states' LLC acts are far from uniform,[112] it is impractical to examine every one. Rather, this discussion will focus on the two Uniform LLC Acts and the Delaware LLC Act as models for analysis. The following section will discuss the Arkansas LLC Act and the American Bar Association's Prototype Act upon which it is based.

A. The Uniform Limited Liability Company Acts

The first Uniform Limited Liability Company Act ("ULLCA") was adopted by the NCCUSL in 1994.[113] That Act was modeled largely on RUPA (for member-managed LLCs) and both the Revised Uniform Limited Partnership Act

111. Loewenstein, *Manifestly Unreasonable*, *supra* note 22, at 414-15, 440.

112. This is because after the Internal Revenue Service ruled that a Wyoming LLC in which all the owners had limited liability qualified as a partnership for tax treatment, other states rushed to enact LLC statutes of their own. Today, every state plus the District of Columbia has an LLC Act on the books. 3 RIBSTEIN & KEATINGE, *supra* note 1, app. A (cataloging all states' LLC Acts). Several states quickly enacted LLC legislation without waiting for the completion of a Prototype Act that was being constructed by a body under the aegis of the American Bar Association (the "Prototype Act"), or for the NCCUSL to propound a Uniform Act. The result is that across the country there is a hodge-podge of LLC enabling legislation.

113. REVISED UNIF. LIMITED LIABILITY COMPANY ACT (RULLCA), Prefatory Note, 6A U.L.A. 213, 214 (Supp. 2007).

("RULPA," the predecessor to ULPA (2001)) and the Model Business Corporation Act (for manager-managed LLCs). It was drafted with an eye to then-current tax regulations, which required that in order to avoid taxation as a corporation, the LLC had to have a structure atypical of corporations.[114] These tax regulations (called the Kintner rules) were repealed effective January 1, 1997, and replaced by a "check-the-box" rule that permits unincorporated businesses to elect whether to be taxed as a corporation or as a partnership.[115] ULLCA was revised in 1996 to reflect this change in the tax law.[116] In 2006, after more than a decade of experience with ULLCA's original and amended form and its adoption (in large part) in nine jurisdictions,[117] the NCCUSL adopted a second-generation Uniform Act, the Revised Uniform Limited Liability Company Act ("RULLCA").[118]

1. ULLCA

As to fiduciary duties, the first-generation ULLCA closely follows the RUPA model. The Act prescribes and defines the "only fiduciary duties" owed by a member in a member-managed LLC as the duty of loyalty (defined in the same terms as RUPA) and the duty of care (also defined in the same terms as RUPA).[119] ULLCA also imports the duties of good faith and

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114. For a discussion of the tax rules affecting the structure of LLCs, see LONNIE R. BEARD & CAROL R. GOFORTH, ARKANSAS LIMITED LIABILITY COMPANIES 75-105 (1994) [hereinafter BEARD & GOFORTH].

115. Treas. Reg. §§ 301.7701-1 to -3 (1996). *See* CALLISON & SULLIVAN, *supra* note 21, at 12.10.

116. RULLCA, Prefatory Note, 6A U.L.A. at 214.

117. Alabama, Hawaii, Illinois, Montana, South Carolina, South Dakota, Vermont, Virgin Islands, and West Virginia. UNIF. LIMITED LIABILITY COMPANY ACT (1996) (ULLCA), table of jurisdictions, 6A U.L.A. 553 (2003).

118. For a detailed overview of RULLCA and an explanation of how its adoption would change Arkansas law, see Carol R. Goforth, *Why Arkansas Should Adopt the Revised Uniform Limited Liability Company Act*, 30 U. ARK. LITTLE ROCK L. REV. (forthcoming 2007) [hereinafter Goforth, *RULLCA*].

119. ULLCA § 409(a)-(c) provides:

> § 409. General Standards of Member's and Manager's Conduct.
>
> (a) The only fiduciary duties a member owes to a member-managed company and its other members are the duty of loyalty and the duty of care imposed by subsections (b) and (c).

fair dealing.[120] The same standards apply to managers in a manager-managed LLC.[121] A member in a manager-managed LLC owes no duties to the LLC or to the other members simply because of his status as a member.[122] Finally, ULLCA, nearly identical in language to RUPA, allows the parties to modify these fiduciary duties by agreement, but only to a standard centered on reasonableness.[123]

> (b) A member's duty of loyalty to a member-managed company and its other members is limited to the following:
>
> > (1) to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member in the conduct or winding up of the company's business or derived from a use by the member of the company's property, including the appropriation of a company's opportunity;
> >
> > (2) to refrain from dealing with the company in the conduct or winding up of the company's business as or on behalf of a party having an interest adverse to the company; and
> >
> > (3) to refrain from competing with the company in the conduct of the company's business before the dissolution of the company.
>
> (c) A member's duty of care to a member-managed company and its other members in the conduct of and winding up of the company's business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

120. Section 409(d) provides, "A member shall discharge the duties to a member-managed company and its other members under this [Act] or under the operating agreement and exercise any rights consistently with the obligation of good faith and fair dealing." ULLCA § 409(d).

121. ULLCA § 409(h)(2).

122. ULLCA § 409(1). However, to the degree that a member exercises managerial control pursuant to the operating agreement, the member assumes the fiduciary duties of a manager, and the manager was concomitantly relieved of those duties. ULLCA § (h)(3)-(4).

123. ULLCA § 103(b)(2)-(4):

> Effect of Operating Agreement; Nonwaivable Provisions.
>
> . . . .
>
> (b) The operating agreement may not:
>
> . . . .
>
> > (2) eliminate the duty of loyalty under Section 409(b) . . . but the agreement may:
> >
> > > (i) identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; and

2. RULLCA

RULLCA, the second-generation Uniform Act, changes some of these rules. It recognizes a potentially broader range of fiduciary duties,[124] but it gives parties somewhat greater latitude

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(ii) 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;

(3) unreasonably reduce the duty of care under Section 409(c) . . . [or]

(4) eliminate the obligation of good faith and fair dealing under Section 409(d), but the operating agreement may determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable . . . .

124. RULLCA § 409. RULLCA's fiduciary duty provisions are innovative enough to warrant reproduction here:

SECTION 409. Standards of Conduct for Members and Managers.

(a) A member of a member-managed limited liability company owes to the company and . . . the other members the fiduciary duties of loyalty and care stated in subsections (b) and (c).

(b) The duty of loyalty of a member in a member-managed limited liability company includes the duties:

(1) to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member:

(A) in the conduct or winding up of the company's activities;

(B) from a use by the member of the company's property; or

(C) from the appropriation of a limited liability company opportunity;

(2) to refrain from dealing with the company in the conduct or winding up of the company's activities as or on behalf of a person having an interest adverse to the company; and

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

(c) Subject to the business judgment rule, the duty of care of a member of a member-managed limited liability company in the conduct and winding up of the company's activities is to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the company. In discharging this duty, a member may rely in good faith upon opinions, reports, statements, or other information provided by another person that the member reasonably believes is a competent and reliable source for the information.

to curtail or abridge those duties.[125] Characterizing the ULLCA approach as one that "cabins in" fiduciary duty by making the Act's express fiduciary obligations exclusive,[126] RULLCA abandons that approach in favor of one that codifies fiduciary duties—but not exhaustively.[127] The drafters believed that "it is impracticable to cabin all LLC-related fiduciary duties within a statutory formulation . . . ."[128] In the words of one of the co-reporters for the NCCUSL committee that drafted RULLCA:

> The "cabin in" approach ignores the implicit fiduciary or fiduciary-like duty of members to avoid oppressing other members, produces great difficulty in dealing with member-to-member disclosure obligations in member-to-member buy-sell transactions, and puts inordinate pressure on the concept of "good faith and fair dealing."[129]

Therefore, RULLCA *partially* codifies the duties of loyalty and care.[130] In addition, RULLCA defines the duty of care as that of ordinary care, as opposed to RUPA's gross negligence standard.[131]

> (d) A member in a member-managed limited liability company or a manager-managed limited liability company shall discharge the duties under this [act] or under the operating agreement and exercise any rights consistently with the contractual obligation of good faith and fair dealing.
>
> (e) It is a defense to a claim under subsection (b)(2) [self-dealing] and any comparable claim in equity or at common law that the transaction was fair to the limited liability company.
>
> (f) All of the members of a member-managed limited liability company or a manager-managed limited liability company may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that would otherwise violate the duty of loyalty.

RULLCA § 409. Subsection (g) contains the "switching provisions" that impose the appropriate fiduciary duties on the actors in a manager-managed limited liability company. *See* RULLCA § 409(g).

125. RULLCA § 110, reproduced *infra* note 133.

126. RULLCA, Prefatory Note, 6A U.L.A. at 214.

127. Section 409(a) of RULLCA, unlike section 409(a) of ULLCA, does not describe the "only" fiduciary duties owed by managers or members. Moreover, section 110(d)(4) of RULLCA speaks of "other [unidentified] fiduciary duties."

128. RULLCA § 409 cmt.

129. Daniel S. Kleinberger & Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act*, 62 BUS. LAW. 515, 523 (2007).

130. *Id.* at 524.

131. *Compare* RUPA § 404(c) *with* RULLCA § 409(c); *see also* Goforth, *RULLCA*, *supra* note 118.

In another section of RULLCA, the statute generally provides that the relationship among the members, managers, and LLC, as well as the conduct of the LLC's activities, are governed by the operating agreement.[132] Like ULLCA, it sets limits on the ability of the parties to curtail fiduciary duties, albeit giving the parties broader power in that regard than does ULLCA. RULLCA permits elimination of different aspects of the fiduciary duty of loyalty, but only if the elimination is not manifestly unreasonable.[133] The duty of care may not be totally

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132. RULLCA § 110(a).

133. The pertinent language is:

> SECTION 110. Operating Agreement; Scope Funtion, and Limitations.
>
> . . . .
>
> (d) If not manifestly unreasonable, the operating agreement may:
>
> (1) restrict or eliminate the duty:
>
> (A) to account to the limited liability company and to hold as trustee for it any property, profit, or benefit derived by the member in the conduct or winding up of the company's business, from a use by the member of the company's property, or from the appropriation of a limited liability company opportunity;
>
> (B) to refrain from dealing with the company in the conduct or winding up of the company's business as or on behalf of a party having an interest adverse to the company; and
>
> (C) to refrain from competing with the company in the conduct of the company's business before the dissolution of the company;
>
> (2) identify specific types or categories of activities that do not violate the duty of loyalty;
>
> (3) alter the duty of care, except to authorize intentional misconduct or knowing violation of law;
>
> (4) alter any other fiduciary duty, including eliminating particular aspects of that duty; and
>
> (5) prescribe the standards by which to measure the performance of the contractual obligation of good faith and fair dealing under Section 409(d).
>
> RULLCA § 110.
>
> In addition, following the lead of Delaware, Arkansas, and other states that have in the corporate context authorized director-exculpation charter provisions, RULLCA permits an operating agreement to provide for exculpation of members or managers from liability for monetary damages with the following exceptions:

eliminated, although it may be "altered" so long as it does not authorize "intentional misconduct or knowing violation of law," and the alterations are not "manifestly unreasonable."[134] Similarly, the parties cannot eliminate the duty of good faith and fair dealing, although they may "prescribe standards by which to measure" that duty, again subject to the "manifestly unreasonable" standard.[135] RULLCA also recognizes that there may be additional fiduciary duties; it permits elimination only of "particular aspects"of those duties.[136] Finally, RULLCA sets forth guidance for application of the "manifestly unreasonable" standard, pinning that determination to the objectives of the operating agreement.[137]

In the last analysis, both ULLCA and RULLCA, like RUPA and ULPA (2001), represent a compromise between the

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(1) breach of the duty of loyalty;

(2) a financial benefit received by the member or manager to which the member or manager is not entitled;

(3) a breach of a duty under Section 406 [liability for improper distributions];

(4) intentional infliction of harm on the company or a member; or

(5) an intentional violation of criminal law.

RULLCA § 110(g).

134. RULLCA § 110(d)(3).

135. RULLCA § 110(d)(5).

136. RULLCA § 110(d)(4).

137.

(h) The court shall decide any claim under subsection (d)(1) that a term of an operating agreement is manifestly unreasonable. The court:

(1) shall make its determination as of the time the challenged term became part of the operating agreement and by considering only circumstances existing at that time; and

(2) may invalidate the term only if, in light of the purposes and activities of the limited liability company, it is readily apparent that:

(A) the objective of the term is unreasonable; or

(B) the term is an unreasonable means to achieve the provision's objective.

RULLCA § 110(h). *Cf.* Sarah Howard Jenkins, *Contracting Out of Article 2: Minimizing the Obligation of Performance & Liability for Breach*, 40 LOY. L.A. L. REV. 401, 422 (2006) ("Under [U.C.C. Article 2's] manifestly unreasonableness test . . . [t]he focus of the inquiry is on whether the agreement has abrogated a right or remedy that is guaranteed either by a default provision or prior bargaining, or whether the agreement has merely defined when that right has been satisfied.").

contractarian and traditionalist approaches. They permit abridgement of fiduciary duties otherwise imposed on managers and members. However, they preserve a mandatory core of minimum decencies.

B. The Delaware Experience

The Delaware LLC Act,[138] based on the Delaware Revised Uniform Limited Partnership Act,[139] was enacted in 1992 and has been amended periodically since then.[140] The Delaware LLC Act places great emphasis on freedom of contract, declaring that one of its primary thrusts is "to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."[141]

The Delaware Act, unlike ULLCA and RULLCA, does not contain any default provision setting forth fiduciary duties owed by managers or members to the LLC or to other managers or members. The Act leaves the development of fiduciary principles in LLCs to the courts.[142] The Act does, however, explicitly address the question of elimination or restriction of fiduciary duties as a consequence of an amendment of the Act by the Delaware legislature.[143] The history of that amendment is instructive with respect to Arkansas law on the same point. In a case styled *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*,[144] the Delaware Supreme Court, in forceful dictum, said that the Delaware Limited Partnership Act's language that a partner's "duties and liabilities may be *expanded* or *restricted* by provisions in the partnership agreement" did *not*

138. DEL. CODE ANN. tit.6, § 18 (2005 & Supp. 2006).

139. DEL. CODE ANN. tit. 6, § 17 (2005 & Supp. 2006); *see also* CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 14.05[4][a][ii] (2006), *available at* 2001 WL 633053 [hereinafter BISHOP & KLEINBERGER].

140. ROBERT L. SYMONDS, JR. & MATTHEW J. O'TOOLE, SYMONDS & O'TOOLE ON DELAWARE LIMITED LIABILITY COMPANIES § 1.01[B]-[C] at 1-4 to -6 (2007) [hereinafter SYMONDS & O'TOOLE].

141. DEL. CODE ANN. tit. 6, § 18-1101(b) (2005 & Supp. 2006).

142. SYMONDS & O'TOOLE, *supra* note 140, at § 9.04[B] at 9-47 to -49. *See generally* DEL. CODE ANN. tit. 6, § 18-1104 (2005) ("In any case not provided for in this chapter, the rules of law and equity, including the law merchant, shall govern.").

143. DEL. CODE ANN. tit. 6, § 17-1101(d)(2) (2005 & Supp. 2006).

144. 817 A.2d 160 (Del. 2002).

authorize total elimination of a partner's fiduciary duties.[145] The court observed that the language of the statute did not expressly permit elimination of the fiduciary duties or liabilities of a general partner, and noted "the historic cautionary approach of the courts of Delaware that efforts by a fiduciary to escape a fiduciary duty, whether by a corporate director or officer or other type of trustee, should be scrutinized searchingly."[146]

The Delaware legislature responded by amending its Limited Partnership and Limited Liability Company Acts expressly to permit elimination of fiduciary and contractual duties (except the contractual duty of good faith and fair dealing) and elimination of liability for the breach of those duties.[147] The pertinent provisions of the current Delaware Act are worth setting out verbatim because of the light they may shed on the meaning of analogous provisions (or lack of analogous provisions) in the Arkansas LLC Act. Section 18-1101 of the Delaware LLC Act provides, in pertinent part:

> § 18-1101. Construction and application of chapter and limited liability company agreement.
>
> (a) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.
>
> (b) It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.
>
> (c) To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement,

145. *Id.* at 167-68 (quoting DEL. CODE ANN. tit. 6, § 17-1101(d)(2)).

146. *Id.* at 168. Chief Justice Steele wrote a scathing criticism of the Delaware Supreme Court's *Gotham Partners* decision and its exaltation of status-based duties over contractual ones. Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1 (2007). Chief Justice Steele replaced Chief Justice Veasey on the Delaware Supreme Court in 2004. William T. Quillen, *Mr. Chief Justice and the Three-Court Experience*, 22 DEL. LAWYER 24, 24-25 (2004).

147. DEL. CODE ANN. tit. 6, §§ 17-1101(d), (f), 18-1101(c), (e) (2005 & Supp. 2006); DEL. CODE ANN. § 18-1101 (Supp. 2006).

> the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.
>
> . . . .
>
> (e) A limited liability company agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement; provided that a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.[148]

These provisions tip the balance almost entirely to the contractarian position.[149] Fiduciary duties may be eliminated by agreement. Even if the duties are not eliminated, "any and all liabilities" (not just liability for monetary damages) for breach of duties (not just fiduciary duties) can be eliminated.[150] The only restrictions left are the prohibition on elimination of the implied contractual duty of good faith and fair dealing, and the prohibition on elimination of liability for bad-faith violations of that duty of good faith and fair dealing.

VI. THE ARKANSAS LLC ACT

This section of the article will demonstrate that the Arkansas LLC Act is highly ambiguous and therefore subject to judicial interpretation. The article will conclude that courts should interpret the Act to preserve a mandatory core of minimum decencies by prohibiting the elimination of fiduciary

148. DEL. CODE ANN. tit. 6, § 18-1101.

149. *See supra* notes 26-41 and accompanying text (outlining the contractarian position).

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

duties. Courts should also uphold only those restrictions that are specific and that fall within a loose ambit of reasonableness.[151]

The Arkansas LLC Act[152] is based on the Prototype Limited Liability Company Act ("Prototype Act") produced by a working group of an American Bar Association subcommittee[153] in November 1992.[154] The provisions of the Arkansas LLC Act pertinent to this discussion are:

> 4-32-402. Duties of managers and members.
>
> Unless otherwise provided in an operating agreement:
>
> (1) A member or manager shall not be liable, responsible, or accountable in damages or otherwise to the limited liability company or to the members of the limited liability company for any action taken or failure to act on behalf of the limited liability company unless the act or omission constitutes gross negligence or willful misconduct;
>
> (2) Every member and manager must account to the limited liability company and hold as trustee for it any profit or benefit derived by that person without the consent of more than one-half (½) by number of the disinterested managers or members, or other persons participating in the management of the business or affairs of the limited

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151. Prof. Miller demonstrates that courts across the country appear to be applying various state LLC Acts in accordance with this view:

> [C]ourts are central to all LLC models, including Delaware's contractarian paradigm, and are leading the way toward balancing the interest in contractual freedom with the need to constrain opportunistic and deceptive conduct through the development of a minimum mandatory core of acceptable business conduct . . . . The private business entity contract can be seen as operating within a framework of mandatory fiduciary duties that may be modified, but now wholly eliminated, and that are enforced through active judicial intervention.

Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1613 (2004) [hereinafter Miller, *Role of the Court*].

152. ARK. CODE ANN. §§ 4-32-101 to -1401 (Repl. 2001 & Supp. 2005).

153. *See* BEARD & GOFORTH, *supra* note 114, at 5. Specifically, the Prototype Act was drafted by the Working Group on the Prototype Limited Liability Company Act, Subcommittee on Limited Liability Companies, Committee on Partnerships and Unincorporated Business Organizations, Section of Business Law, American Bar Association. 3 RIBSTEIN & KEATINGE, *supra* note 1, app. C at C-1. As of this writing, the Subcommittee is revising the Prototype Act.

154. 3 RIBSTEIN & KEATINGE, *supra* note 1, app. C at C-1.

liability company, from any transaction connected with the conduct or winding up of the limited liability company or any use by the member or manager of its property, including, but not limited to, confidential or proprietary information of the limited liability company or other matters entrusted to the person as a result of his or her status as manager or member; and

(3) One who is a member of a limited liability company in which management is vested in managers under § 4-32-401 and who is not a manager shall have no duties to the limited liability company or to the other members solely by reason of acting in the capacity of a member.[155]

4-32-404. Limitation of liability and indemnification of members and managers.

An operating agreement which is in writing may:

(1) Eliminate or limit the personal liability of a member or manager for monetary damages for breach of any duty provided for in § 4-32-402; and

(2) Provide for indemnification of a member or manager for judgments, settlements, penalties, fines, or expenses incurred in a proceeding to which a person is a party because the person is or was a member or manager.[156]

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155. ARK. CODE ANN. § 4-32-402 (Repl. 2001).

156. ARK. CODE ANN. § 4-32-404 (Repl. 2001). Unlike typical corporation-law indemnification statutes, this provision does not expressly condition permissible indemnification on the indemnitee's good faith and his reasonable belief that he acted "in or not opposed to the best interests of the [entity]." ARK. CODE ANN. § 4-27-850(a)-(b) (Repl. 2001).

Nor does it expressly prohibit indemnification of one who is "adjudged to be liable to the [entity]." ARK. CODE ANN. § 4-27-850(b). It might be argued that the broad LLC indemnification statute makes the questions of waiver, restriction, or liability for breach of fiduciary duty moot, because any manager or member who is sued on that basis (even by the LLC itself) and is unsuccessful may be indemnified. However, the issues of waiver, restriction, and liability remain relevant. First, the operating agreement may not provide for a full range of indemnification rights coterminous with the statute. *See* ARK. CODE ANN. § 4-32-404. Second, and more important, courts called upon to enforce LLC indemnification agreements should refuse to do so if enforcement would vitiate the public policies behind fiduciary obligation. *Cf.* In re the Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006) ("[I]ntentional dereliction of duty, a conscious disregard for one's responsibilities . . . . is . . . misconduct . . . properly treated as a non-exculpable, nonindemnifiable violation of the fiduciary duty to act in good faith."); Karl H. Kemp, Legislative Note, *Arkansas Adopts Model Act for Indemnification of Corporate Directors*

> 4-32-1304. Rules of construction.
>
> (a) It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of operating agreements.
>
> (b) Unless displaced by particular provisions of this chapter, the principles of law and equity supplement this chapter.
>
> (c) Rules that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter . . . .[157]

The most striking feature of this statute is its stunning ambiguity.[158] First, the statute is unclear as to whether the duties described in section 4-32-402(1) and (2) are the *sole* duties owed by members or managers. Is the intent to "cabin" fiduciary duties in the same manner as RUPA, which states expressly that the duties listed there are the "only" fiduciary duties owed by a partner? Or is the intent to take the approach of RULLCA, to identify some of the fiduciary obligations imposed upon members or managers, while recognizing that there may be others? The case for the latter reading is bolstered by section 4-32-1304(b), which imports the principles of law and equity, unless they are specifically displaced by the Act.[159]

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and Officers, 27 ARK. L. REV. 754, 756 n.10 (1973) ("[I]ndemnification where the insider has actually been adjudged negligent or disloyal to the corporation, would subvert the policies behind the corporation law's duties of diligence and loyalty.").

Nor does section 4-32-404 render the issue of restriction or elimination of fiduciary duties moot. First, this provision merely affects the remedies to which the fiduciary is subject. *See supra* text accompanying note 78 (discussing the analogous corporation statute, ARK. CODE ANN. § 4-27-202(b)). Second, Robert Keatinge (co-author of the leading treatise, RIBSTEIN & KEATINGE, cited in footnote 1) has pointed out that while the fiduciary himself may be relieved of liability for monetary damages, those around the fiduciary, including lawyers, may be held liable in damages for aiding and abetting the breach. E-mail from Committee on LLCs, Partnerships and Unincorporated Entities On Behalf Of Robert Keatinge, to BL-PUBO@MAIL.ABANET.ORG (Oct. 6, 2007 4:50 PM CDT) (on file with author).

157. ARK. CODE ANN. § 4-32-1304.

158. In discussing the Arkansas LLC Act as a whole, Professor Goforth is more circumspect, saying merely that "the statute is often inartfully worded . . . ." Goforth, *RULLCA*, *supra* note 118.

159. As a matter of common law, courts have been drawing upon the principles of law and equity to "flesh out" business organization statutes from the times that those statutes first appeared. For example, the Arkansas Supreme Court in 1910 affirmed that a

For example, section 4-32-402(b) is analogous to section 21(1) of UPA, the predecessor to RUPA.[160] Arkansas courts have read UPA section 21(1) broadly to encompass the scope of the fiduciary duty of loyalty as it has developed through common law.[161] Thus understood, the section prohibits, *inter alia*, tainted self-dealing transactions, usurpation of entity opportunities, and competition.[162] In addition, it imposes a duty of candor or disclosure.[163]

Second, what about the duty of good faith and fair dealing? Is it a fiduciary duty? If so, what is the significance of its omission in section 4-32-402? Or is it a non-fiduciary contractual obligation that falls completely outside the scope of the statute?[164] If so, to what extent, if any, may it be restricted or eliminated?

Third, what is the significance of the prefatory clause to section 4-32-402, "Unless otherwise provided in an operating agreement . . . ."? Clearly this means that the parties are free to take upon themselves higher standards of care and loyalty than that provided in the statute. The question is whether it also permits the parties to set a lower standard than that provided for in the statute. Can the parties agree to eliminate the duty of loyalty altogether? Are only the duties set out in section 4-32-402(1) open to elimination, or is the full range of the duty of loyalty, as recognized at common law, open to elimination? Can

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minority shareholder had a right in equity to bring suit on behalf of a corporation against directors alleged to have abused their office—in effect recognizing the shareholder derivative suit in the absence of any statutory language on point. Red Bud Realty Co. v. South, 96 Ark. 281, 292, 131 S.W. 340, 345 (1910).

160. Prototype Act § 402 cmt.; RIBSTEIN & KEATINGE, *supra* note 1, at App. C-51. Because the Prototype Act's provisions relevant to the scope and waivability of fiduciary duties are virtually identical to those in the Arkansas Act, the drafters' commentary is instructive on how the Arkansas Act should be interpreted.

161. *See, e.g.*, Goforth, *Ready or Not*, *supra* note 92, at 51.

162. *See, e.g.*, 1 CALLISON & SULLIVAN, *supra* note 21, § 8.7, at 115.

163. *E.g.*, Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928) (approved in Johnson v. Lion Oil Co., 216 Ark. 736, 740, 227 S.W.2d 162, 165 (1950)); 1 CALLISON & SULLIVAN, *supra* note 21, § 8.7, at 116.

164. The contractual duty of good faith and fair dealing is implied in every contract governed by Arkansas law. Cantrell-Waind & Assocs., Inc. v. Guillaume Motorsports, Inc., 62 Ark. App. 66, 72, 968 S.W.2d 72, 75 (1998) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 205 with approval); *see also* ARK. CODE ANN. § 4-1-304 (Supp. 2005). Moreover, the comments to the ABA's Prototype Act states that "members, like other contracting parties, must exercise their powers in good faith." RIBSTEIN & KEATINGE, *supra* note 1, at App. C-52.

the parties agree that a manager or member may engage in willful misconduct with impunity? Is a conclusion in the affirmative compelled by the Act's stated policy "to give maximum effect to the principle of freedom of contract and to the enforceability of operating agreements,"[165] and that "[r]ules that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter"?[166]

Fourth, how should a court interpret section 4-32-404(1), the exculpation provision that expressly addresses the curtailment of fiduciary duties by permitting a written operating agreement to "eliminate or limit the personal liability of a member or manager for monetary damages for breach of any duty provided for in § 4-32-402"?[167] Once again we are faced with the significance of section 4-32-402's incomplete catalogue of fiduciary duties. Can the operating agreement eliminate or limit a manager or member's liability for monetary damages for breach of duties that are not specifically included in section 4-32-402? Or, conversely, does section 4-32-404, as the more specific section,[168] confine the "[u]nless otherwise provided in an operating agreement" language of section 4-32-402 to what is permitted by section 4-32-404? Are the parties free to eliminate duties or to limit them for purposes of remedies other than monetary damages?

Given these ambiguities with which the statute is riddled, what should a court do when faced with an argument that a given LLC operating agreement eliminates or limits fiduciary and good faith duties? First, the court should determine that the statute does not permit the total elimination of fiduciary obligation.[169] From a policy perspective, "promoting the

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165. ARK. CODE ANN. § 4-32-1304(a) (Repl. 2001).

166. ARK. CODE ANN. § 4-32-1304(c).

167. ARK. CODE ANN. § 4-32-404(1).

168 *See, e.g*, Bd. of Trs. for Little Rock Police Dept. Pension & Relief Fund v. Stodola, 328 Ark. 194, 201, 942 S.W.2d 255, 258 (1997) ("A general statute must yield when there is a specific statute involving the particular subject matter."); 2B NORMAN J. SINGER, STATUTES AND STATUTORY CONSTRUCTION § 51.05, at 244-63 (rev. 2000).

169. Professor Ribstein has stated broadly that the Arkansas LLC Act "give[s] complete power to the members to waive fiduciary duties . . . ." Larry E. Ribstein, *The Emergence of the Limited Liability Company*, 51 BUS. LAW. 1, 21 (1995-1996). He has acknowledged, however, that the statute, while it "permits elimination of all personal liability," does not permit elimination of "the duty itself". Email from Larry Ribstein, Professor and Mildred Van Voorhis Jones Chair in Law, University of Illinois College of

elimination of fiduciary duty involves more than promoting freedom of contract; it also involves shifting the law's view of power relationships within closely held business . . . ."[170] Moreover, the Arkansas Supreme Court has said that in the attorney-client context fiduciary duties cannot be eliminated by agreement of the parties.[171] If the legislature had intended to give parties broad authority to eviscerate fiduciary duties in Arkansas LLCs, it could have said so explicitly. The Delaware Supreme Court took the position that a statute permitting an operating agreement to *expand* or *restrict* partners' fiduciary duties in a limited-partnership agreement did *not* authorize *elimination* of those duties.[172] A similar approach should be taken here. Should the Arkansas legislature disagree with this outcome, it, like the Delaware legislature, could amend the statute expressly to authorize elimination of fiduciary duties. Indeed, the Arkansas statute is even less specific than the pre-amended Delaware statutes.[173] It does not even say that the parties can agree to *restrict* fiduciary duties, much less *eliminate* them; it merely says "[u]nless otherwise provided in an operating agreement . . . ."[174] Thus, interpreting the Arkansas statute in a fashion similar to the Delaware pre-amended statute is even more apt.

Moreover, the Commentary to the ABA Prototype Act upon which the Arkansas Act is based does not suggest that the parties can, by agreement, eliminate these duties. Instead, the drafters wrote:

> LLC members can *define* or *limit* the members' and managers' duties in the operating agreement or by informed consent at the time of the transaction . . . . For example, the operating agreement may enlarge or constrict the manager's duty of care, or may permit the manager to engage in

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Law, to Frances Fendler, Professor of Law, University of Arkansas at Little Rock William H. Bowen School of Law (Oct. 4, 2007, 1:15 PM CDT) (on file with author).

170. Kleinberger, *Cardozo Is Dead*, *supra* note 16.

171. Cole v. Laws, 349 Ark. 177, 185, 76 S.W.3d 878, 883 (2002) ("[*R*]*egardless of the express terms of an agreement*, a fiduciary may be held liable for conduct that does not meet the requisite standards of fair dealing, good faith, honesty, and loyalty.") (emphasis added).

172. *See supra* notes 144-46 and accompanying text.

173. *Compare* ARK. CODE ANN. § 4-32-404 *with Gotham Partners*, 817 A.2d at 167-68 (quoting the unamended Delaware statute).

174. *See* ARK. CODE ANN. § 4-32-404.

> outside activities or transactions with the LLC that would otherwise breach the duty of loyalty.[175]

The Commentary never mentions *elimination* of duties, just definition or limitation. Nor is there any indication that the statute was intended to authorize elimination of the duty of care. Instead, the Commentary to the Prototype Act merely observes that the scope of the duty of care may vary with the nature of the LLC itself.[176] Accordingly, "[while] the precise boundaries of the duty will be left to develop by case law and operating agreements rather than by statutory provision,"[177] its elimination is not contemplated.

In addition, the drafters make clear that the duty of good faith in LLCs cannot be eliminated. "[M]embers, like other contracting parties, must exercise their powers in good faith."[178] Thus, "[f]or example, it may be bad faith to expel a member solely or primarily in order to appropriate the value of the member's interest."[179]

Finally, the NCCUSL, a greatly respected body of judges, practitioners, and scholars, while having largely adopted the contractarian position in both of its Uniform LLC Acts, nonetheless decided to place constraints on the parties' ability to waive fiduciary duties. The first-generation ULLCA follows RUPA in flatly prohibiting the elimination of the duties of loyalty, care, and good faith.[180] While restrictions and agreed-upon standards are permitted, they must meet a test of reasonableness.[181] The second-generation RULLCA, while again reflecting a contractarian slant, also eschews a complete laissez-faire position.[182] RULLCA prohibits the parties from eliminating the duty of loyalty if to do so would be "manifestly unreasonable."[183] The duty of care may be "altered" but not eliminated; the parties cannot by agreement "authorize

175. RIBSTEIN & KEATINGE, *supra* note 1, app. C at C-51 (emphasis added).
176. *See id.*
177. *Id.* at C-51 to -52.
178. *Id.* at C-52.
179. *Id.*
180. ULLCA § 103(b)(2).
181. ULLCA § 103(b)(2).
182. *See* RULLCA § 110.
183. RULLCA § 110(d).

intentional misconduct or knowing violation of law."[184] Any other fiduciary duties that may exist can be altered, but only "particular aspects" of those duties may be eliminated. Finally, the duty of good faith and fair dealing is likewise not subject to waiver; instead, the parties may only "prescribe the standards by which to measure the performance" of that duty.[185]

Thus, while this evidence supports the conclusion that the Arkansas LLC Act does not permit the total elimination of fiduciary and good faith duties, the question whether and to what extent the Act permits restriction of those duties remains open. Even though the statute does not expressly provide for restriction, it is clear from the commentary to the Prototype Act that the purpose of the statute is to grant the parties the power to curtail these duties to some extent.[186] But are there limits? Are the parties free to curtail the duties to the point that functionally, they no longer exist?

To answer these questions requires a determination of legislative intent and public policy. It seems unlikely that in enacting the LLC Act, the Arkansas legislature intended to adopt the contractarian approach that would permit *unreasonable* restrictions on fiduciary obligation. Moreover, such a result would contravene the public policy exhibited in Arkansas's corporation law and in its general- and limited-partnership laws,[187] all of which display the traditionalist position that there are limits to parties' abilities to curtail fiduciary duties. The Arkansas Business Corporation Act of 1987 does not permit waivers of fiduciary duties; it merely allows the restriction of remedies against directors for breach of the duty of care.[188] Both RUPA and ULPA (2001) permit some curtailment of the

184. RULLCA § 110(d)(3).

185. RULLCA § 110(d)(5).

186. "LLC members can define or limit the members' and managers' duties in the operating agreement or by informed consent at the time of the transaction." RIBSTEIN & KEATINGE, *supra* note 1, at C- 51.

187. The court can determine public policy by looking to other statutes. *See, e.g.*, Island v. Buena Vista Resort, 352 Ark. 548, 563, 103 S.W.3d 671, 679 (2003) (concluding that the public policy against prostitution, found in state criminal statutes, prohibits an employer from firing an at-will employee in retaliation for the employee's rejection of the employer's sexual advances); BISHOP & KLEINBERGER, *supra* note 139, at ¶ 14.05[3] ("[C]ourts confronting a statutory gap [in an LLC statute] relating to fiduciary duty should fill the gap with reference to either corporate or partnership law.").

188. *See supra* notes 70-73 and accompanying text.

fiduciary duties of care and loyalty, as well as of the duty of good faith, but retain a mandatory core of minimum decencies. The Acts prohibit *elimination* of the duties of loyalty, care, and good faith.[189] They authorize restrictions on these obligations only if those restrictions are specific[190] and within a loose ambit of reasonableness.[191] It is a fair inference that the legislature intended the Arkansas LLC Act to preserve the traditionalist position at least to the extent that it is reflected in the Partnership Acts.[192]

Judging the effectiveness of a restriction of fiduciary duties in an LLC by specificity and reasonableness standards—even the apparently low-threshold reasonableness standard of RUPA and ULPA (2001)—commends itself for several reasons. First, this approach reconciles fiduciary law applicable to unincorporated business organizations in Arkansas. It makes little sense to have one set of fiduciary rules for partnerships and another set of rules for LLCs. The form of business enterprise is almost certainly chosen for reasons other than the content of fiduciary-duty rules. These include reasons having to do with individual experience with or preference for one form of organization over another, the existence of a body of case law that makes the "rules of the game" more certain, the amount of time and money required to convert an existing business to another form of organization, and tax and inheritance considerations. Second, by construing the fiduciary-duty standards for LLCs in parity with the rules for partnerships, what

189. ARK. CODE ANN. § 4-46-103(b)(3)-(5) (Repl. 2001); 2007 Ark. Acts 15, § 4-47-110(b)(5)-(7).

190. *E.g.*, RUPA § 103, cmt. 4, 6I U.L.A. § 103, at 75 (2001).

191. While "reasonableness" as a test is undeniably vague, that does not mean that it is without standards. Professor Loewenstein suggests several factors that would be material in examining a particular provision for reasonableness: (1) whether the restriction in question unambiguously relates to the conduct at issue; (2) whether, at the time the contract was made, the restriction so adversely affected a party as to raise questions about equality of bargaining power; (3) whether enforcement would damage the partnership in a way the parties could not have anticipated at the time the contract was made; and (4) whether the business entity was so widely held that the parties could not bargain in any meaningful sense. Loewenstein, *Manifestly Unreasonable*, *supra* note 22, at 432-34.

192. The Commentary to the Prototype Act states that section 402, setting forth the duties of managers and managing members, "is based on the premise that such managers and managing members are comparable in many ways to corporate officers and directors and general partners of a limited partnership in that they are the agents of the LLC and have policy-making authority." RIBSTEIN & KEATINGE, *supra* note 1, app. C at C-51.

case law evolves will be instructive to all of these forms of enterprise, outcomes should be more predictable, and transaction costs should be reduced because members and managers will need to foresee fewer eventualities. Third, the requirement of specificity ensures that the parties focus on precisely what their duties to one another to entail.[193] In addition, the requirement of specificity is consonant with Arkansas law on exculpatory clauses in general.[194]

More fundamentally, subjecting curtailments of fiduciary and good-faith duties to scrutiny for reasonableness is good policy. The contractarian position that people ought to be able to frame their own business arrangements is sensible with respect to substantive terms of the parties' deal—the financial and operational rights and obligations of the members, managers, and the LLC. However, the laissez-faire contractarian position should not be stretched to cover restrictions on or elimination of fiduciary duties. Fiduciary law evolved for a reason—to protect people against opportunistic behavior by those who have power over others' critical resources.

> The open-ended nature of fiduciary duty reflects the law's long-standing recognition that devious people can smell a loophole a mile away. For centuries, the law has assumed

193. *Cf.* Miller v. Am. Real Estate Partners, L.P., No. CIV.A. 16788, 2001 WL 1045643, at *8 (Del. Ch. Sept. 6, 2001) (observing that because drafters have great freedom, "[I]t is fair to expect that restrictions on fiduciary duties be set forth clearly and unambiguously. A topic as important as this should not be addressed coyly."); Paul M. Altman & Srinivas M. Raju, *Delaware Alternative Entities and the Implied Contractual Covenant of Good Faith and Fair Dealing Under Delaware Law*, 60 BUS. LAW. 1469, 1472 (2005) ("Over the years, the decisions by Delaware courts established that only when the terms of the LP or LLC agreement clearly, expressly and unambiguously conflict with the application of traditional fiduciary principles will the default fiduciary duties be deemed to have been effectively modified." (citing R.S.M. Inc. v. Alliance Capital Mgmt. Holdings, L.P., 790 A.2d 478, 497-98 (Del. Ch. 2001)).

194. *See, e.g.*, Jordan v. Diamond Equip. & Supply Co., 362 Ark. 142, 149, 207 S.W.3d 525, 530 (2005):

> Because of the disfavor with which exculpatory contracts are viewed, two rules of construction apply to them. First, they are to be strictly construed against the party relying on them. Second, we have said that it is not impossible to avoid liability for negligence through contract, but that, to avoid such liability, the contract must at least clearly set out what negligent liability is to be avoided.

Id. (citations omitted).

> that (1) power creates opportunities for abuse and (2) the devious creativity of those in power may outstrip the prescience of those trying, through ex ante contract drafting, to constrain that combination of power and creativity.[195]

Finally, fiduciary principles do more than reflect a moral position. They promote investor confidence and facilitate investments that benefit society as a whole by fostering "reasonable expectations of trustworthiness within the context of defined business relationships."[196] Preserving a mandatory core of minimum decencies

> conveys a critical social cue that trustworthy behavior is expected. . . . [T]he moral stench of a breach of fiduciary duty is retained to some extent by the presupposition of a mandatory dimension of minimum duties. The pay-off for misbehavior [by the fiduciary] is reduced by the possibility of punishment and guilt derived from violating the law.[197]

VII. CONCLUSION

In sum, given the absence of express statutory language to the contrary, Arkansas courts should construe the Arkansas LLC Act to prohibit elimination of fiduciary duties and to permit only specific and reasonable restrictions of them. As a policy matter, the law should recognize and enforce a mandatory core of minimum decencies in connection with the operation of the LLC and the relationships among its members and managers. This approach honors at least a century of fiduciary jurisprudence in the realm of business organizations. The need for protection against opportunistic conduct in business organizations is no less compelling today than when Justice Cardozo penned *Meinhard v. Salmon*[198] almost a century ago.

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195. BISHOP & KLEINBERGER, *supra* note 139, at ¶ 14.05[4][a][ii]; *see also* Miller, *Role of the Court*, *supra* note 151, at 1612 ("The LLC statutes are relatively new, but abusive conduct is not."); Deborah A. DeMott, *Fiduciary Preludes: Likely Issues for LLCs*, 66 U. COLO. L. REV. 1043, 1044 (1995) (referring to "the temptation to shirk one's agreed upon duties, or to cheat, lie, dissemble, expropriate another's property or, more generally, to act in ways that disappoint others' expectations").

196. Miller, *Decade of Experimentation*, *supra* note 7, at 571.

197. *Id.* at 605.

198. 164 N.E. 545 (N.Y. 1928).