



Purpura



Jackman

Avoid Creating Fiduciary Duties When Eliminating Liability

Mark V. Purpura and Kenneth E. Jackman

Delaware Business Court Insider | July 25, 2012

Pursuant to Section 18-1101(c) of the Delaware Limited Liability Company Act, a limited liability company agreement may expand, restrict or eliminate the fiduciary duties owed by a person to the company, a member, a manager or other person bound by the agreement, subject to certain limitations. Likewise, under Section 18-1101(e) of the act, a limited liability company agreement may limit or eliminate liability for breach of fiduciary duties of a person to the company, a member, manager or other person bound by the agreement, subject to certain limitations.

Members of a limited liability company often take advantage of the contractual flexibility afforded by the LLC Act to modify fiduciary duties and liabilities. However, eliminating fiduciary duties and, at the same time, limiting the liability of a person for breaches of fiduciary duty can lead to difficult interpretive questions. This is one of the issues the Delaware Court of Chancery struggled with in *Dawson v. Pittco Capital Partners*. These interpretive issues can generally be avoided, however, if fiduciary duty provisions and exculpation provisions are considered in tandem, rather than separately.

ELIMINATION OF DUTIES AND LIABILITY IN *DAWSON*

In *Dawson*, the limited liability company agreement at issue provided that no member or director had any duty to any member or the company, except as expressly set forth in the limited liability company agreement or another written contract. Furthermore, the limited liability company agreement provided that, except as expressly set forth in the LLC agreement or in another written contract, no member or director would be liable to the company or any member for any loss or damage unless the loss or damage was the result of the gross negligence, fraud or intentional misconduct of such member or director. In other words, the first sentence provided that no member or director had any duties, and the second sentence provided that a member or director could be liable for losses caused by his or her gross negligence, fraud or willful misconduct. According to the *Dawson* plaintiffs, the effect of these two sentences was that the parties to the limited liability company agreement had retained a common law fiduciary duty for members and directors to abstain from acts of intentional misconduct and gross negligence. If the second sentence did not create duties, according to the *Dawson* plaintiffs, it constituted surplusage and had no meaning.

Dawson was not the Court of Chancery's first occasion to review duty and exculpation provisions similar to those included in the *Dawson* LLC agreement. In *Fisk Ventures v. Segal*, the LLC agreement at issue provided that no member had any duty to any member or the company except as expressly set forth therein or in any other written agreements. In addition, the LLC agreement provided that no member would be liable to the company or any member for any loss or damage unless the loss or damage was the result of gross negligence, fraud or intentional misconduct by the member. Likewise, the plaintiff in *Fisk Ventures* argued that the effect of these two sentences was to create a duty to act without gross negligence, fraud or intentional misconduct.

In *Fisk Ventures*, the court concluded that the first sentence of the LLC agreement eliminated fiduciary duties, except as expressly stated otherwise, and the second sentence expressly limited liability. Because the second sentence limited liability and was not an express limitation of fiduciary duties, the court rejected the plaintiffs' argument and concluded that fiduciary duties were eliminated.

In *Dawson*, the court expressly relied upon the analysis in *Fisk Ventures* and likewise concluded that the first sentence of the LLC agreement eliminated the fiduciary duties of members and directors, and the second sentence, "in an abundance of caution," limited liability for any duties that might be found to exist. Thus, the court characterized the exculpation provision as a "just in case" provision meant to ensure that liability for a breach of any duty that was inadvertently established or retained was limited to liability for gross negligence, fraud or intentional misconduct.

However, in *Dawson*, even though the Court of Chancery determined that fiduciary duties had been eliminated and the exculpatory language constituted a "just in case" provision, the court continued its analysis and considered whether, if fiduciary or contractual duties were retained, they were breached.

THE LESSON OF *DAWSON*

To be clear, the Court of Chancery found that the exculpation provision in *Dawson* did not create any fiduciary duties on the part of the members and directors. Nevertheless, the court considered whether, if any duties had been created, they had been breached. While the fact the court chose to reason its decision in two ways could be simply a way to protect the decision if appealed, it also underscores the confusion created when parties to an LLC agreement both eliminate fiduciary duties and limit, but do not eliminate, liability for losses caused by a person whose fiduciary duties have been eliminated.

Given the similarity to the provisions at issue in *Fisk Ventures*, the exculpation provision in *Dawson* was easier for the court to analyze. Imagine instead an LLC agreement containing a sentence that eliminates fiduciary duties for members and directors, except as otherwise set forth in the agreement, and, in a second sentence, provides that members and directors are not liable for losses except for those losses caused by their gross negligence, intentional misconduct, fraud or breach of fiduciary duty. In this scenario, there would be a provision purporting to eliminate fiduciary duties and a provision expressly limiting liability, but not for a breach of fiduciary duties. While the same analysis used by the Court of Chancery in *Dawson* could result in the exculpation provision being labeled as a "just in case" provision, it may be more difficult for a court to do so when the exculpation provision expressly contemplates the existence of fiduciary duties. Although Delaware courts have noted the distinction between fiduciary duty provisions and exculpation provisions (see, e.g., *In re NYMEX S'holders Litig.*, 2009 WL 3206051 (Del. Ch. Sep. 30, 2009)), Delaware courts have also explained many times that eliminations or restrictions on fiduciary duties must be set forth clearly and unambiguously. See, e.g., *Miller v. Am. Real Estate Partners*, 2001 WL 1045643 (Del. Ch. Sept. 6, 2001).

The court's explanation of the exculpation provision in *Dawson* as a mere "just in case" provision should comfort parties to LLC agreements that seek to eliminate their duties and ensure that liability for inadvertently created or retained duties is limited. In addition, *Dawson* and *Fisk Ventures* instruct that an LLC agreement that eliminates fiduciary duties may also eliminate liability for any duty that is ever found to exist (other than a bad-faith violation of the implied contractual covenant of good faith and fair dealing). However, the practical takeaway is that drafters of LLC agreements should consider fiduciary duty provisions and exculpation provisions in tandem rather than separately.

Indeed, the interpretive issue created when a limited liability company agreement eliminates fiduciary duties for members and directors but retains the potential that members and directors could be liable for breaches of fiduciary duties is easily avoided by clarifying that the exculpation provision is not intended to create any duties under the agreement.

While *Dawson* highlighted the ambiguity that can exist when a provision of an LLC agreement eliminates fiduciary duties and another provision contemplates liability for a person without fiduciary duties, that type of ambiguity can exist in any number of provisions throughout an LLC agreement. For instance, indemnification provisions also commonly contemplate that a person will be indemnified for losses caused by such person unless such person acted contrary to certain standards of conduct. Such provisions also should be drafted to be interpreted clearly and unambiguously with fiduciary duty modifications. Accordingly, when attempting to eliminate the fiduciary duties of a person in a limited liability company agreement, drafters should consider whether other provisions of the agreement could be read to imply that some duty might exist.

Mark V. Purpura (purpura@rlf.com) is a director and **Kenneth E. Jackman** (jackman@rlf.com) is an associate at *Richards, Layton & Finger*. Purpura's diverse commercial practice includes banking and trust matters, as well as complex transactions and fiduciary matters involving Delaware limited liability companies, limited partnerships, general partnerships and statutory and common law trusts. Jackman focuses primarily on rendering advice as to matters of Delaware law relating to Delaware limited partnerships, general partnerships and limited liability companies, including formation, operation, governance and dissolution matters.

Reprinted with permission from the July 25, 2012 issue of Delaware Business Court Insider. © 2012 ALM Media Properties, LLC. Further duplication without permission is prohibited. All rights reserved.