Fiduciary Duty and the Minnesota Limited Liability Company: Sufficient Protection of Member Interests?

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I. Introduction

To say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary?1

The Minnesota Legislature enacted The Minnesota Limited Liability Company Act in 1992. As of January 1, 1993, Minnesota busi-

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nesses can elect to form a limited liability company (LLC). The LLC is a hybrid entity that combines the limited liability of a corporation, and the tax benefits of a partnership.

Because the LLC is a relatively new entity in the United States, issues remain concerning judicial interpretation. One such issue is the fiduciary duty of LLC members. While many LLC statutes have addressed this duty, these statutes have failed to provide a uniform standard for a judicial response to breaches of fiduciary duty. This lack of uniformity will inevitably lead to confusion and judicial misinterpretation.

First, this Comment discusses the concept of fiduciary duty in the context of closely held corporations and partnerships, the two entities most likely to be supplanted by the LLC. Following a discussion of the development of the LLC, this Comment analyzes the existing LLC statutes' treatment of fiduciary duty and compares the Minnesota LLC Act's treatment of fiduciary duty to that of the other LLC

4. A partnership is taxed only at the individual level and does not pay income tax as an entity. See I.R.C. § 701 (1992); cf. I.R.C. §§ 11, 61 (1992). On the other hand, a corporation suffers the potential for double taxation. A corporation pays taxes on the entity's income, and out of that income may pay dividends to the shareholders who pay individual income taxes on that dividend income. See I.R.C. §§ 11, 61 (1992). Although a partnership provides a more favorable tax scheme, there is no limited liability. Rather, all partners are jointly or jointly and severally liable for the obligations of the partnership. Unif. Partnership Act § 15 (1914); see also Ellen Hanson, Liability Fears Inspire Twists on Partnership, Boston Bus. J., Jan. 4, 1993, at 16 (discussing Massachusetts limited liability partnership legislation as a response to the liability of partners in a partnership).
7. See infra part II.
8. See infra part III.A.
9. See infra part III.B.
Finally, this Comment proposes a foundation for developing a standard of fiduciary duty that can be uniformly incorporated in future legislation.11

II. FIDUCIARY DUTY

A. Background

Fiduciary duty is defined as "[a] duty to act for someone else's benefit, while subordinating one's personal interests to that of the other person."12 This "obligation of utmost good faith"13 includes three distinct elements:

(1) a duty of loyalty;
(2) a duty of good faith and fair dealing; and
(3) a duty of full disclosure.14

10. See infra part IV.
11. See infra part V.
12. BLACK'S LAW DICTIONARY 625 (6th ed. 1990). In Pepper v. Litton, 308 U.S. 295, 311 (1939), the United States Supreme Court stated:
He who is in such a fiduciary position cannot serve himself first and his cestuis second. He cannot manipulate the affairs of his corporation to their detriment and in disregard of the standards of common decency and honesty. He cannot by the intervention of a corporate entity violate the ancient precept against serving two masters. He cannot by the use of the corporate device avail himself of privileges normally permitted outsiders in a race of creditors. He cannot utilize his inside information and his strategic position for his own preferment. He cannot violate rules of fair play by doing indirectly through the corporation what he could not do directly. He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the cestuis. Where there is a violation of those principles, equity will undo the wrong or intervene to prevent its consummation.
Id. (footnotes omitted).
1. **Duty of Loyalty**

   In a partnership, the duty of loyalty requires "fidelity that excludes not only patent self-dealing but insists on the avoidance of situations where the fiduciary's own interests bring into question the interests of those to whom he owes a duty of undiluted loyalty." In a closely held corporation, a shareholder's duty is similar to that of a partner in a partnership.

2. **Duty of Good Faith and Fair Dealing**

   In a partnership, the duty of good faith and fair dealing requires a partner to conduct business with honesty and to be held accountable for any transaction between the partnership and the partner. In a closely held corporation, this duty prevents a majority shareholder from seizing a corporate opportunity for personal gain after having recommended that the corporation forego the opportunity.

3. **Duty of Full Disclosure**

   In a partnership, a partner must disclose all information that has a material impact on the business, without misrepresenting the extent to which the LLC may indemnify members for breaches of duty. See, e.g., Iowa Code Ann. § 490A.707 (West Supp. 1994). For an in-depth analysis of the LLC statutes' treatment of the duty of care, see Carter G. Bishop & Daniel S. Kleinberger, *Tax & Business Planning of Limited Liability Companies* (Warren, Gorham & LaMont, forthcoming 1994).

   Birnbaum v. Birnbaum, 539 N.E.2d 574, 576 (N.Y. 1989). In referring to this duty, Justice Cardozo stated: "[n]ot honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).


   **Unif. Partnership Act** § 21(1) (1914). This subsection provides:

   Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

   *Id.* See also Minn. Stat. § 323.20 (1992) (codifying this U.P.A. provision).


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formation to the partnership.20 Likewise, in a closely held corporation, a shareholder is required to disclose any known material information that is relevant to the transaction at hand.21 Any false representation or concealment of such information constitutes a breach of fiduciary duty.22

The protection afforded by a fiduciary duty is extremely important and cannot be overemphasized. A majority shareholder in a closely held corporation or a partner in a partnership has the ability and opportunity, by means of management control, to “freeze-out”23 other members of the business.24 Courts generally seek to remedy such actions.25


22. Id.

23. “Freeze-out” is defined as:

[A] process, usually in a closely held corporation, by which minority shareholders are prevented from receiving any direct or indirect financial return from the corporation in an effort to persuade them to liquidate their investment in the corporation on terms favorable to the controlling shareholders. The use of corporate control vested in the statutory majority of shareholders or the board of directors to eliminate minority shareholders from the enterprise or to reduce to relevant insignificance their voting power or claims on corporate assets. It implies a purpose to force upon the minority shareholder a change which is not incident to any other business goal of the corporation.


25. See Sugarman v. Sugarman, 797 F.2d 3, 14 (1st Cir. 1986) (recognizing that freeze-out actions are viewed as a tort); Christman v. Seymour, 700 P.2d 898, 900 (Ariz. Ct. App. 1985) (stating that duty to not freeze-out is the same for trustees as for partners or shareholders of close corporation); Page v. Page, 359 P.2d 41, 44 (Cal. 1961) (holding that freeze-out in partnership is not permitted); Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 515 (Mass. 1978) (discussing the need to protect minority shareholders in both closely held corporations and partnerships); Fought v. Morris, 543 So. 2d 167, 169 (Miss. 1989) (stating that freeze-out is a breach of fiduciary duty); Ingle v. Glamore Motor Sales, Inc., 538 N.Y.S.2d 771, 778 (N.Y. 1989) (recognizing that a minority shareholder requires special judicial protection); Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 393 (Or. 1973) (disapproving of freeze-outs).
B. Judicial Treatment of Fiduciary Duty

Although the principle of fiduciary duty is generally uniformly accepted, courts have examined a number of key issues in interpreting the duty. These issues include: (1) whether the jurisdiction applies a strict fiduciary duty rule or the lenient business judgment rule; (2) whether the plaintiff or the defendant has the burden of proof; (3) whether the rule applied is based on tort theory or contract theory; and (4) whether the breach of fiduciary duty warrants an assessment of punitive damages.

1. The Strict Fiduciary Duty Rule Versus the Business Judgment Rule

The strict fiduciary duty rule requires a majority shareholder in a closely held corporation to maintain a standard of conduct matching that required of a partner in a partnership. Thus a shareholder, holding either a majority or minority share, must conduct affairs of the corporation with the utmost good faith and loyalty. In Donahue v. Rodd Electrotype Co., the Massachusetts Supreme Court held that this rule must be applied to disputes between shareholders of closely held corporations. The court focused on the members' need to rely on each other with confidence and trust and on the need to deter freeze-out efforts by the majority shareholder.

In contrast, the more lenient “business judgment rule” is traditionally imposed on corporate officials and requires corporate officials to conduct themselves with good faith and in a manner that an ordinarily prudent person would conduct oneself given similar circumstances. Because application of the strict fiduciary duty rule

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28. Id. at 515 n.17.


30. Id. at 515.

31. Id.

32. The business judgment rule has been defined as

[A] presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is
may hinder corporate activities, courts have required a lesser showing of loyalty to the business on the part of the acting shareholder.

One year after the Donahue decision, the Massachusetts Supreme Court revisited the issue of fiduciary duty in Wilkes v. Springside Nursing Home, Inc., stating that [the] untempered application of the strict good faith standard enunciated in Donahue to cases such as the one before us will result in the imposition of limitations on legitimate action by the controlling group in a close corporation which will unduly hamper its effectiveness in managing the corporation in the best interest of all concerned.

Attempting to find some middle ground in applying the fiduciary principle, the court went on to posit a test that requires the acting shareholder to show some legitimate business purpose for the action in question. This standard would allow the corporate members the opportunity to conduct affairs with some discretion and flexibility, thereby promoting the best interests of the business. Despite Wilkes' advancement of this modified business judgment standard, courts continue to apply either the strict fiduciary duty rule or the modified business judgment rule.

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on the party challenging the decision to establish facts rebutting the presumption.


34. E.g., Nicholson v. Kingery, 261 P. 122 (Wyo. 1927). In Nicholson, the court stated: "[I]f upon a careful scrutiny of the record it appears to a court of equity that the director has been open, fair and honest in his dealing with the corporation, and has secured no advantage by his contract to the detriment of the corporation it will be upheld." Id. at 124 (citing Bently v. Zelma Oil Co., 184 P. 131 (Okla. 1919)). See also Will v. Engebretson & Co., Inc., 261 Cal. Rptr, 868, 872 (Cal. Ct. App. 1989); Toner v. Baltimore Envelope Co., 498 A.2d 642, 652 (Md. 1985); Delahoussaye v. Newhard, 785 S.W.2d 609, 612 (Mo. Ct. App. 1990); Daniels v. Thomas, Dean & Hoskins, Inc., 804 P.2d 359, 367 (Mont. 1990); DiIaconi v. New Cal Corp., 643 P.2d 1254, 1240 (N.M. Ct. App. 1982); Winter v. Bernstein, 566 N.Y.S.2d 1012, 1015 (Sup. Ct. 1991); Klinicki v. Lundgren, 695 P.2d 906, 920 (Or. 1985).


36. Id. at 663.

37. Id.

38. Id.

39. For decisions applying the strict fiduciary duty rule, see Cecconi v. Cecco, Inc., 739 F. Supp. 41, 45 (D. Mass. 1990); Orchard v. Covelli, 590 F. Supp. 1548,
The distinction between these standards is of utmost importance in light of the potential for abuse of the minority by the majority in a closely held corporation. This abuse is commonly referred to as oppression of the minority interests. Oppression of a minority shareholder leading to a breach of fiduciary duty claim often occurs in the context of a share purchase or sale on the part of the majority shareholder. Such claims also arise when majority shareholders convert corporate assets and either cause them to be wasted or to be used for personal gain. The minority shareholder has little power


40. See Kleinberger, supra note 24, at 1151 (discussing judicial response to oppression of close corporation shareholders). The ability to abuse one’s co-owners is not limited to majority shareholders. In some instances, minority shareholders find themselves in a position of power that creates the opportunity for oppression. In these cases, minority shareholders should be held to the same fiduciary duty of loyalty and good faith. See, e.g., Smith v. Atlantic Properties, Inc., 422 N.E.2d 798, 790-803 (Mass. App. Ct. 1981) (finding minority shareholder, as one of four shareholders, breached duty of loyalty in refusing to vote for dividends and this action, which resulted in tax penalties, was wrongful use of what was equivalent to veto control of corporation when corporate articles required 80 percent vote for corporate actions).

41. See Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 393-94 (Or. 1973). In discussing oppressive conduct, the court articulated:

While general definitions of ‘oppressive’ conduct are of little value for application in a specific case, perhaps the most widely quoted definitions are that ‘oppressive conduct’ for the purpose of such a statute is: “[B]urdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members; or a visual departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.” We agree, however, that the question of what is ‘oppressive’ conduct by those in control of a ‘close’ corporation as its majority stockholders is closely related to what we agree to be the fiduciary duty of a good faith and fair dealing owed by them to its minority stockholders.

Id. at 440 (citations omitted).


43. See Holden v. Construction Mach. Co., 202 N.W.2d 348, 357 (Iowa 1972) (holding that self-dealing is a breach of duty); Maschmeier v. Southside Press, Ltd., 435 N.W.2d 377, 381 (Iowa Ct. App. 1989) (wrongful use of corporate assets is op-
to influence the majority shareholder's conduct and consequently the courts must protect these interests.44

Minnesota courts have not uniformly applied fiduciary principles.45 In some recent cases, the courts have adopted the business judgment rule.46 This rule is codified in Minnesota's Business Corporation Act.47 Having recognized that members of a closely held corporation can be viewed as partners for application of the rule,48

44. See Hicks, supra note 24, at 434-35.
45. Compare Warthan v. Midwest Consol. Ins. Agencies, Inc., 450 N.W.2d 145, 148 (Minn. Ct. App. 1990) (indicating the business judgment rule applies to "partners" in a closely held corporation); Black v. NuAIRE, Inc., 426 N.W.2d 203, 209-10 (Minn. Ct. App. 1988) (recognizing applicability of business judgment rule to closely held corporation's decision to not pursue shareholder's derivative action) with PJ Acquisition Corp. v. Skoglund, 453 N.W.2d 1, 13 (Minn. 1990) (explaining, in a dissenting opinion, recent changes in Minnesota corporation statutes to evidence a legislative intent that traditional principles of corporate law do not adequately protect minority interests in closely held corporations); Fewell v. Tappan, 223 Minn. 483, 27 N.W.2d 648, 654 (Minn. 1947) (recognizing the higher duty of good faith and fairness which exists between partners of a closely held corporation); Harris v. Mardan Business Sys., Inc., 421 N.W.2d 350, 353 (Minn. Ct. App. 1988) (recognizing appropriateness of reliance on partnership principles when applying the duty to members of a closely held corporation); Evans v. Blesi, 345 N.W.2d 775, 779 (Minn. Ct. App. 1984) (holding "partners" in a closely held corporation to a standard of highest integrity in their dealings with each other).
46. See PJ Acquisition Corp., 453 N.W.2d at 14 (adopting form of business judgment rule as standard of conduct); Pedro v. Pedro, 463 N.W.2d 285, 288 (Minn. Ct. App. 1990) (recognizing from Evans v. Blesi that shareholders owe fiduciary duty but adopting only a portion of Evans' language).
47. MINN. STAT. § 302A.251(1) (1992). Subdivision 1 of this statute notes that in regard to the standard of conduct the following must occur:
   A director shall discharge the duties of the position of director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A person who so performs those duties is not liable by reason of being or having been a director of the corporation.
   Id. Furthermore, this standard is mirrored in another provision addressing the judicial remedies available for consideration in resolving disputes in closely held corporations. MINN. STAT. § 302A.751(3)(a) (1992). When considering whether to grant relief to closely held corporation shareholders, the statute provides:
   In determining whether to order equitable relief, dissolution, or a buy-out, the court shall take into consideration the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner in the operation of the corporation and the reasonable expectations of the shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other.
   Id.
the Minnesota Supreme Court nevertheless set forth a less stringent formulation of the rule for assessing the actions of a closely held corporation in *PJ Acquisition Corp. v. Skoglund*.49

However, the Minnesota Court of Appeals has also recently followed a stricter rule in *Pedro v. Pedro*.50 In *Pedro*, the court of appeals held that the members of a closely held corporation have a fiduciary duty to one another.51 The court cited an earlier Minnesota case, *Evans v. Blesi*,52 for the proposition that the duty "includes [among other requirements] dealing 'openly, honestly and fairly with other shareholders.'"53 Nevertheless, this rule does not rise to the strict partnership standard adopted in *Donahue v. Rodd Electrotype Co.*,54 which requires the "utmost good faith and loyalty."55 Such a strict fiduciary duty requires that stockholders conduct their affairs without "avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation."56 The distinction is a significant, albeit fine, one because the *Donahue* standard requires more affirmative proof by the acting party as to the validity of the transaction in question by not providing for a lesser reasonableness showing as is present in *P.J. Acquisition*.57

2. The Burden of Proof

Another issue inherent in fiduciary duty disputes is which party has the burden of proof. One line of reasoning, articulated in *Pepper v. Litton*,58 dictates that a shareholder charged with a breach of fiduciary duty has the burden of proving that the actions leading to the alleged breach were made in good faith and that the actions were fair to the corporation.59 Instead of deferring to the defendant share-

49. 453 N.W.2d 1, 19 (Minn. 1990) (stating the shareholders "owe a duty towards one another to act in good faith in an honest, fair and reasonable manner with the best interests of the corporation in mind") (emphasis added).
51. *Id.*
52. 345 N.W.2d 775 (Minn. Ct. App. 1984).
53. *Id.* at 779 (citing Fewell v. Tappan, 27 N.W.2d 648, 654 (Minn. 1947)).
55. *Donahue*, 328 N.E.2d at 515.
56. *Id.*
58. 308 U.S. 295 (1939).
holder’s actions that appear to be in good faith, if the plaintiff is able to show that the defendant had a personal interest in the action, the court will impose an affirmative burden on the defendant to establish that such conduct was not wrongful as against the corporation. 60

This burden of proof requirement has been viewed as an exception to the business judgment rule that courts generally use to examine the actions of corporate officers. 61 However, placing the initial burden of proof on the defendant shareholder better protects the interests of minority shareholders in closely held corporations.

Other jurisdictions do not place such a heavy burden of proof on the defendant shareholder. For instance, in Wilkes v. Springside Nursing Home, Inc. 62 the shareholder was only required to establish a legitimate business purpose. 63 This rule merely requires the shareholder to legitimize the questioned actions. The rule does not require an initial showing of less harmful alternatives or a showing that the actions were in good faith and not wrongful as against the corporation. 64 Minnesota has adopted this standard in fiduciary disputes occurring in closely held corporations. 65

Finally, some jurisdictions place the burden of proof on the plaintiff, usually a complaining partner. 66 This standard mirrors the leniency of the business judgment rule and is even more favorable to the alleged wrongdoer. If the plaintiff satisfies the burden by demonstrating a breach of good faith, the burden shifts to the defendant to prove the legitimacy of the action in question. 67 Minnesota employs this standard in partnership disputes. 68

60. Pepper, 308 U.S. at 306-07.
61. See Treadway Co. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980).
63. Id. at 663.
64. Id. The court explained: “[t]he majority [shareholders], concededly, have certain rights to do what has been termed ‘selfish ownership’ in the corporation which should be balanced against the concept of their fiduciary obligation to the minority.” Id. However, under the Wilkes standard when this legitimate business purpose is shown the plaintiff then has the opportunity to demonstrate that the same objective may have been reached by way of an alternative action that was less harmful to the plaintiff’s interest. Id. If this less harmful alternative is established, the court must weigh the professed legitimate business purpose against the proposed less harmful alternative to determine whether or not there has been a fiduciary duty breach. Id.
65. See PJ Acquisition Corp. v. Skoglund, 453 N.W.2d 1, 18 (Minn. 1990); see also Harris v. Mardan Business Sys., Inc., 421 N.W.2d 350, 353 (Minn. Ct. App. 1988).
66. See, e.g., Margeson v. Margeson, 376 N.W.2d 269, 272 (Minn. Ct. App. 1985) (citing Wilson v. Moline, 38 N.W.2d 201, 206 (Minn. 1949)).
67. Id.
68. Id.
3. Tort Theory Versus Contract Theory

Another issue is whether fiduciary principles should be viewed in the context of tort law or contract law. The Restatement (Second) of Torts, for example, considers a fiduciary relationship and subsequent breach thereof to be grounds for tort liability.\(^69\) This distinction relates to damage awards. Generally, contract law does not provide a basis from which to award punitive or exemplary damages,\(^70\) whereas tort law does.\(^71\)

Some courts consider a breach of fiduciary duty to be fraud because a partner or shareholder who fails to disclose material information relating to business affairs has made a material misrepresentation.\(^72\) A material misrepresentation is the cornerstone of a fraud charge\(^73\) and similarly the duty to disclose material information is a cornerstone of the fiduciary duty. Concluding that damages for a breach of fiduciary duty lie in tort is consistent with the underlying similarity of the duty and fraud.

However, some courts view a breach of fiduciary duty to be grounded in contract law.\(^74\) This view is based upon the concept of an implied duty of good faith inherent in a contract.\(^75\) Wrongful conduct is not only a breach of the contract but also a breach of that

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69. Restatement (Second) of Torts § 874 (1977). "One standing in a fiduciary relation with another is subject to liability to the other for harm resulting from a breach of duty imposed by the relation." Id.


71. See Leslie E. John, Comment, Formulating Standards for Awards of Punitive Damages in the Borderland of Contract and Tort, 74 Cal. L. Rev. 2033, 2033-34 (1986) (analyzing tort punitive damages and recent efforts to extend punitive awards to actions lying both in tort and contract).


73. "Elements of a cause of action for 'fraud' include false representation of a present or past fact made by defendant, action in reliance thereupon by plaintiff, and damage resulting to plaintiff from such misrepresentation." Black's Law Dictionary 660 (6th ed. 1990).


75. Restatement (Second) of Contracts § 205 (1979). "Every contract im-
party's fiduciary duty to the other parties to the contract.\textsuperscript{76}

Courts have applied the contract theory when an apparently actionable tort claim is barred by the statute of limitations.\textsuperscript{77} The courts have not expressly identified all possible fiduciary relationships and consequently an inherent duty of good faith is imposed on the contractual relationship to protect an apparently wronged individual's right to bring a claim.\textsuperscript{78} The disadvantage of this approach is that contract law does not generally support punitive damages\textsuperscript{79} and courts have advanced legitimate policy reasons for imposing punitive damages if warranted.\textsuperscript{80}

Furthermore, the concern for the apparent lack of duty is misplaced. This is because the concept of a fiduciary relationship is one that can be applied to protect an individual when the circumstances require such application.\textsuperscript{81} If the court is willing to adopt the longstanding definition of a fiduciary relationship as put forth in \textit{Daniel v. Tolon},\textsuperscript{82} then the court can find the existence of a fiduciary relationship poses upon each party a duty of good faith and fair dealing in its performance and its enforcement.\textsuperscript{76} \textit{Id.}

76. Hughes v. Reed, 46 F.2d 435, 441 (10th Cir. 1931).

77. \textit{Bibo}, 770 P.2d at 295; \textit{see also Hughes}, 46 F.2d at 440-41 (discussing that an action against directors is an action upon liability of the statute pertaining to implied contract and is not barred by the statute of limitations governing actions for injury to the rights of others); Wallace v. Lincoln Sav. Bank, 15 S.W. 448, 453 (Tenn. 1891) (finding a breach of fiduciary duty is actionable when claim is barred by tort statute of limitations).

78. \textit{Bibo}, 770 P.2d at 295. Some courts approach this issue on the grounds that a corporate director has an inherent duty of good faith to the shareholders while at the same time holding the director's liability to the corporation to be expressly in contract. Therefore, a breach of fiduciary duty is a contract based claim. \textit{See Boyd v. Schneider}, 131 F. 223, 227 (7th Cir. 1904) (finding an action against bank directors is an action on contract); Cooper v. Hill, 94 F. 582, 588 (8th Cir. 1899) (discussing that a fiduciary breach is maintainable either at law or in equity); \textit{Hughes}, 46 F.2d at 440-41 (citing Curtis v. Phelps, 208 F. 577 (N.D. N.Y. 1913)).

80. \textit{See supra} note 70.


Such damages are allowed not because of any special merit in the injured party's case, but are imposed by way of punishing the wrongdoer for malicious, vindictive or a willful and wanton invasion of the injured party's rights, the purpose being to restrain and deter others from the commission of like wrongs. \textit{Id.} at 1364 (citations omitted).

82. 157 P. 756 (Okla. 1916). The court defined a fiduciary as:
ship whenever the circumstances require such a finding. This allows the action to be based in tort, without the need to invoke the implied good faith contract rule.83

4. Punitive Damages

Punitive damages are an issue when the breach of duty is grounded in tort law. Despite widespread recognition as a tort action, courts may be unwilling to impose punitive damages for a breach of fiduciary duty in all instances.84 Rather, courts will seek to compensate the injured party based on the actual harm.

For instance, in a closely held corporation, the injury is often the majority shareholder's failure to provide a minority shareholder with an equal opportunity to sell shares.85 When this occurs, courts typically require the majority to provide the minority shareholder with the same opportunity.86

The broad principle on which the court acts in cases of this description is that wherever there exists such a confidence, of whatever character that confidence may be, as enables the person in which confidence or trust is reposed to exert influence over the person trusting him, the court will not allow any transaction between the parties to stand, unless there has been the fullest and fairest explanation and communication of every particular resting in the breast of the one who seeks to establish a contract with the person so trusting him.

\textit{Id.} at 758. Another court has recognized that "a confidential relationship may arise not only from the technical fiduciary relationships such as the attorney-client ... but may arise informally from 'moral, social, domestic, or personal' relationships." \textit{Thigpen v. Locke, 363 S.W.2d 247, 253 (Tex. 1962).}

83. The author recognizes that there may be significant differences in the statute of limitations for an action based in tort as opposed to one based in contract. While the implied good faith argument addresses such an issue, the author believes that as a policy consideration statutes of limitation are appropriate in these circumstances. A person who loses the right to a claim by reason of inaction in the face of oppressive conduct must be held accountable for such inaction.

84. \textit{See, e.g., Pedro v. Pedro, 463 N.W.2d 285, 288 (Minn. Ct. App. 1990).} The awarding of damages turned on the threshold question of whether or not there was a difference between the fair value of stock in the company and the amount received in the buyout. If the fair value was greater, then the measure of damages was this difference. \textit{Id. See also Orchard v. Covelli, 590 F. Supp. 1548, 1560 (W. D. Pa. 1984) (finding the buy-out offer amount adequately compensated plaintiff for majority's breach of fiduciary duty).}

85. \textit{See, e.g., Donahue v. Rodd Electrotpe Co., 328 N.E.2d 505, 508-11 (Mass. 1975).} In \textit{Donahue}, the controlling stockholders authorized the closely held corporation's purchase of their shares, while failing to allow the minority stockholder the same opportunity. \textit{Id.} This constituted a breach of fiduciary duty because the minority stockholder was effectively compelled to relinquish stock at inadequate prices. \textit{Id. at 515; see also Tillis v. United Parts, Inc., 395 So. 2d 618, 618-19 (Fla. Dist. Ct. App. 1981); Sundberg v. Abbott, 423 N.W.2d 686, 687 (Minn. Ct. App. 1988); Schumacher v. Schumacher, 469 N.W.2d 793, 798 (N.D. 1991); Crosby v. Beam, 548 N.E.2d 217, 220-21 (Ohio 1989).}

86. \textit{See Donahue, 328 N.E.2d at 518; see also Crosby v. Beam, 548 N.E.2d 217, 221 (Ohio 1989), in which the court explained:}
Likewise, in a partnership, a partner may take advantage of an opportunity for personal gain at the expense of the partnership. This constitutes a breach of fiduciary duty, and this breach is remedied by means of a judicial accounting that requires the acting partner to return any profits that were unfairly gained at the expense of the partnership. This remedy ensures that the partner does not convert partnership assets or opportunities for personal advantage to the disadvantage of the partnership.

Despite the compensatory remedies available, courts have imposed punitive damages under appropriate circumstances and other circumstances render it just and reasonable.
damage remedies may include attorney fees.92 Punitive damages are permitted "whenever the elements of fraud, malice, gross negligence, or oppression mingle in the controversy."93 Punitive damages are intended to compensate the injured party and to deter others from similar conduct.94 Because oppressive behavior is the foundation of many fiduciary duty claims, punitive damages are an appropriate judicial response.

Minnesota courts have been willing to award punitive damages in response to breaches of fiduciary duty.95 Furthermore, in Pedro v. Pedro,96 the Minnesota Court of Appeals upheld an award of attorney’s fees based on a finding that a party acted "arbitrarily, vexatiously or otherwise not in good faith."97 The hallmark of a breach of fiduciary duty is a finding that a party has not acted in good faith98 and Minnesota courts have judicial discretion to impose further damage awards when such circumstances arise.99

III. THE LIMITED LIABILITY COMPANY STATUTES

The lack of uniformity in judicial application of the aforementioned issues regarding fiduciary duty is of great significance to LLC members. Because the LLC is likely to be selected as the business entity of choice over partnerships and closely held corporations, judicial interpretation focusing on these entities is a necessary tool in drafting LLC legislation and interpreting existing statutes. Ideally, this also allows LLC members to anticipate the standard. Unfortunately, statutes enacted to date have been inconsistent in their response to judicial developments in this area.

95. See, e.g., Shetka v. Kueppers, Kueppers, Von Feldt & Salmen, 454 N.W.2d 916, 919 (Minn. 1990) (noting that partners committing wrongful acts in the ordinary course of business are liable for punitive damages); Evans v. Blesi, 345 N.W.2d 775, 781 (Minn. Ct. App. 1984) (awarding punitive damages due to oppressive behavior).
97. Id. (citing MINN. STAT. § 302A.751(4) (1992)).
A. The Origins of the LLC

Wyoming enacted the first LLC statute in 1977. Promulgated to create a business entity with the tax benefits of a partnership, more flexibility than an S corporation, and the limited liability of a corporation, the Wyoming Legislature hoped that the LLC would motivate investment in the state, thereby boosting the state's economy.

Florida was the only other state to enact an LLC statute prior to 1988. As in Wyoming, Florida adopted LLC legislation to encourage business investment from within the United States as well as from Central and South America.

Contrary to both states' expectations, the business community did not immediately accept or utilize LLCs. All of this changed, however, in 1988 when the IRS issued Revenue Ruling 88-76. This ruling stated that Wyoming LLCs qualify for partnership tax treatment. Soon thereafter, states rapidly developed LLC legislation.

As of January 1994, thirty-seven states have enacted LLC legislation. Nearly every other state is either considering or has pending

106. By one count, only 26 LLCs existed in Wyoming by 1986. Fonfara & McCool, supra note 101, at 523 n.4. Only two LLCs existed in Florida one year after the statute was enacted. Johnson, supra note 105, at 388.
108. The IRS reached this conclusion after six years of study and after finding that an LLC has more corporate characteristics than noncorporate characteristics. See id.
As the LLCs' popularity grows in the business community, the entity will inevitably become the subject of future litigation. This in turn will lead to courts interpreting LLC statutes and their fiduciary principles.

B. Existing Treatment of Fiduciary Duty in LLC Statutes

The LLC statutes' approach to the issue of fiduciary duty can be divided into five categories. These categories are (1) express fiduciary duty; (2) implied fiduciary duty by reason of indemnification provision; (3) implied fiduciary duty by reason of "account for" provision; (4) implied fiduciary duty by reason of judicial dissolution; and (5) no fiduciary duty by reason of indemnification provision.

1. Express Fiduciary Duty

Some LLC statutes expressly use the term "fiduciary" in discussing the relationship between members or managers. As of January 1994, Mississippi only recognizes LLCs originating in other states. See Miss. Code. Ann. §§ 79-6-1 to -39 (Supp. 1993). Mississippi does not allow LLCs to be formed within the state, and as such, the statute does not address the issue of fiduciary duty.

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While expressly recognizing the existence of a fiduciary duty, these statutes require that members make a good faith effort to conduct business affairs in the best interests of the LLC. These states base this standard of conduct on the business judgment rule. For example, Louisiana recognizes that a member or manager has a fiduciary duty to the business and the LLC's other members. The Louisiana statute requires a member or manager to "stand in a fiduciary relationship to the limited liability company and its members . . . ." This relationship requires the member or manager to conduct company affairs in good faith and with the diligence, care, skill, and judgment that a prudent person in like circumstances would believe to be in the best interest of the company and the members.

Likewise, Delaware incorporates the term fiduciary in that state's recognition that a member or manager of an LLC has no liability for actions resulting from good faith reliance on the provisions of a limited liability company agreement. In granting the acting party a limitation of liability, the statute expressly recognizes that such a member or manager has an existing fiduciary duty to the LLC and company members. This provision limits the acting party to lia...
bility for actions that are not in good faith.

While expressly recognizing the fiduciary duty of LLC members, Delaware is the only state that allows absolute indemnification for any breach of fiduciary duty. The Delaware LLC Act contains a provision granting the members express power to release any member or manager from any liability for any claims against that member or manager. The language of this indemnification provision on its face permits a member to be released from a violation of that member's fiduciary duty. The only restriction placed upon the members' ability to indemnify for such acts is any precondition contained in the LLC agreement that restricts the members' power of indemnification.

Louisiana appears to follow the Delaware approach. Louisiana permits an LLC to release any member or manager from liability for a breach of fiduciary duty if such power to release is recognized in the articles of organization or a written operating agreement. But the power to release a member or manager from liability in Louisiana is not as all-encompassing as in Delaware.

Louisiana's statute provides that a release of liability cannot release a member or manager from liability for receiving a financial benefit to which the member or manager is not entitled. Holding a member liable for any wrongfully obtained financial benefit is one standard contained in the general interpretation of fiduciary duty in both partnerships and closely held corporations. Therefore, while

Id.

121. Del. Code Ann. tit. 6, § 18-108 (1993). New Jersey may allow the same result, but not as a default rule as in Delaware. In New Jersey, fiduciary duties may be restricted if expressly provided for in an operating agreement. N.J. Stat. Ann. § 42:2B-66(b) (West Supp. 1994). The ability to eliminate the duty is not automatic, but rather the members must agree to such a limitation by including such in the operating agreement. Georgia has a provision similar to Delaware that allows for indemnification for "any and all claims and demands whatsoever." Ga. Code Ann. § 14-11-306 (Michie Supp. 1993). However, Georgia's provision recognizes that there may not be indemnification for certain duties or acts as expressed in section 14-11-305(4)(A)(i-ii).

122. Id. This section provides:

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

Id. (emphasis added).

123. Id.

124. "Limited liability company agreement" means a written agreement of the members as to the affairs of a limited liability company and the conduct of its business. Del. Code Ann. tit. 6, § 18-101(6) (1993). This agreement is more commonly known in other LLC statutes as an "operating agreement."


126. Id. § 12:1315(B).
appearing to follow Delaware's unique approach of allowing the release of all fiduciary obligations, the Louisiana provision in fact maintains some degree of fiduciary duty for members.127

Iowa also incorporates the term "fiduciary" into statutorily authorized limitations of an acting manager or member's liability to the company or other members.128 The Iowa statute authorizes an LLC's articles of organization to limit or eliminate a member or manager's personal liability for a breach of fiduciary duty.129 The initial impression is that the Iowa statute absolves the acting party from liability for a breach of fiduciary duty, but the exceptions to this rule belie such an impression.130

The Iowa limitation of liability is actually quite narrow because the exceptions hold that the articles of organization cannot limit a member or manager's liability for a breach of duty of loyalty, an act not in good faith, or an act that gives that person an improper personal benefit.131 These exceptions incorporate the generally recognized fiduciary duty standards. Consequently, the Iowa statute maintains a broad fiduciary duty for a member or manager to the business or other members.

2. Implied Fiduciary Duty by Reason of Indemnification Provision

Other states impliedly adopt a fiduciary duty for LLC members or managers through the LLC statute's indemnification provision. These statutes do not use the term "fiduciary" and generally impose a requirement that members or managers conduct business in good faith and in the best interests of the LLC.132 This standard of conduct is modelled after the business judgment rule.

127. The New Hampshire Act also allows for a release of liability, but, contrary to Louisiana, New Hampshire provides that the LLC may also release a member from liability for improper gains. N.H. REV. STAT. ANN. § 304-C:31(V-VI) (1993). In spite of this broad release language, the New Hampshire act does not allow for the limitation or elimination of a member or manager's liability for acts constituting gross negligence or willful misconduct. Id. § 304-C:31(V). Although that standard is more commonly discussed in relation to the duty of care, courts have found a breach of fiduciary duty based on a showing of bad faith and willful misconduct arising out of attempted freeze-outs. See, e.g., W & W Equip. Co., Inc. v. Mink, 568 N.E.2d 564, 577 (Ind. Ct. App. 1991). Consequently, one can argue that the New Hampshire statute does not release a member from all potential liability for breach of fiduciary duty.
129. Id.
130. Id. § 490A.707(1)-(3).
131. Id.
132. See, e.g., COLO. REV. STAT. § 7-80-406(1) (Supp. 1993). The Colorado statute provides:

A manager . . . shall perform his duties as a manager in good faith, in a manner he reasonably believes to be in the best interests of the limited liability company, and with such care as an ordinarily prudent person in a like position would use under similar circumstances. A person who so performs
The fiduciary duty is established by examining the language of these indemnification provisions to determine for what acts a member or manager will be indemnified. From those acts that will not be indemnified, comes the duty. While the states vary in distinguishing between acts that will and acts that will not be indemnified, regardless of where the line is drawn that line establishes the point at which the duty may be breached. There are at least seven varieties of indemnification provisions.

One variety of indemnification provision is exemplified by Alabama.\textsuperscript{133} That state's provision allows for indemnification for all acts except those in which the member or manager is found to be "liable for negligence or misconduct in the performance of duty . . . ."\textsuperscript{134} Thus, in these states the member may have fiduciary duty liability if the complaining member can establish the conduct at issue meets what is a low threshold level of misconduct even if the controlling standard of conduct is based on the business judgment rule.

Indiana represents another version of the duty arising out of the indemnification provision.\textsuperscript{135} Indiana's indemnification provision authorizes indemnification for all acts except "in the case of action or failure to act by the member, agent, or employee which constitutes willful misconduct or recklessness . . . ."\textsuperscript{136} This language creates a higher threshold for establishing the breach because of the intent element that is not present in the first group of states. While creating more difficulty for the complaining member, the intent element should not preclude a finding of a breach of the duty. Courts have found that oppressive majority conduct constituted malicious intent for purposes of imposing punitive damages in some cases.\textsuperscript{137}

Another group of statutes is exemplified by the Nevada provision that permits indemnification if the member "acted in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the company."\textsuperscript{138} This language adopts the

\begin{itemize}
  \item his duties shall not have any liability by reason of being or having been a manager of the limited liability company.
\end{itemize}

\textsuperscript{Id.}

\textsuperscript{133.} \texttt{ALA. CODE § 10-12-4(n) (Supp. 1993); see also NEB. REV. STAT. § 21-2603(11) (Supp. 1993); S.D. CODIFIED LAWS ANN. § 47-34-25 (Supp. 1993); WYO. STAT. § 17-15-104(xi) (Supp. 1993).}

\textsuperscript{134.} \texttt{ALA. CODE § 10-12-4(n) (Supp. 1993).}


\textsuperscript{136.} \texttt{IND. CODE ANN. § 23-18-2-2(14) (West Supp. 1994).}

\textsuperscript{137.} \texttt{See supra note 91.}

\textsuperscript{138.} \texttt{NEV. REV. STAT. § 86.411 (1993); see also FLA. STAT. ANN. § 608.4363(1) (West Supp. 1994); ILL. ANN. STAT. ch. 805, para. 15/10(a) (Smith-Hurd Supp. 1994). Florida and Illinois also create the fiduciary duty in another manner that may be more useful to a complaining member under certain circumstances. See infra part III.B.3.}
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business judgment rule and provides great deference to the acting member's conduct, thus creating a strong barrier to establishing a breach of the duty in these states.

Yet another variety of indemnification provision is exemplified by Colorado.139 This provision allows indemnification for all acts except those “[i]n connection with any proceeding charging improper personal benefit to the manager, whether or not involving action in his official capacity, in which he was adjudged liable on the basis that personal benefit was improperly received by him.” 140 While limiting the member's exposure to only those acts that provided the improper benefit, gaining an improper personal benefit is a hallmark act of breaching one's fiduciary duty. Therefore, this exception to indemnification provides a significant potential tool for a complaining member.

Another group of states provides indemnification on the basis of the individual state's corporate law indemnification provisions.141 These states provide that the LLC may indemnify certain LLC individuals to the extent that corporations are permitted to indemnify similar persons.142 Consequently, a complaining member in these states will need to look to the state's corporate law provisions to determine what acts will not get statutory protection.143

One state, Oregon, refers to general partnership standards of conduct in determining the line at which indemnification will no longer result.144 The statute provides that the LLC may limit, eliminate, or indemnify a member for monetary damages arising out of that mem-


142. For example, TEX. REV. CIV. STAT. ANN. art. 1528n, § 2.20(A) (West Supp. 1994) states:

A limited liability company shall have power to indemnify managers, officers, employees, agents and others to the same extent a corporation may indemnify directors, employees, agents and others under the TBCA [Texas Business Corporations Act] and shall, to the extent indemnification is required under the TBCA for directors, employees, agents and others, indemnify managers, officers, employees, agents and others to the same extent.

Id. See also W. VA. CODE § 31-1A-33 (Supp. 1993).

143. See, e.g., W. VA. CODE § 31-1-9(a) (1988) (indemnifying corporate actions if they "were in good faith and in a manner he reasonably believed to be in or not opposed to the best interest of the corporation."); see also TEX. REV. CIV. STAT. ANN. art 1996, § 222A (West Supp. 1994) (adopting similar business judgment rule standard).

144. Ch. 173 1993 Or. Laws § 34.
ber or manager's conduct. However, the LLC may not release any member from liability for breach of that member's duty of loyalty to the LLC or the other members for bad faith acts that involve intentional misconduct or transactions that provide an improper personal benefit to that member. While not expressly stating that fiduciary duties apply to the Oregon LLC, this statutory language obviously recognizes the duty.

3. Fiduciary Duty by Reason of "Account for" Provision

A number of states incorporate a provision requiring the member or manager to essentially "account to the limited liability company and hold as trustee for it any profit or benefit derived without the informed consent of the members by the manager from any transaction connected with the formation, conduct, or liquidation of the limited liability company." While there are various consent provisions and other safe harbors available for the acting party, the language is a general recognition that members or managers may not always participate in self-dealing transactions without concern for potential liability. These provisions are another avenue for asserting that a fiduciary duty exists between members when the facts present a self-dealing or corporate usurpation circumstance.

4. Implied Fiduciary Duty by Reason of Judicial Dissolution

A few states impliedly establish statutory fiduciary duties between LLC members by means of a judicial dissolution provision. This provision provides an alternative means for a complaining member to obtain judicial relief when oppression is present in the business relationship.

145. Id.
146. Ch. 173 1993 Or. Laws § 34(1)(a-c).
150. See supra note 17.
These statutes generally provide that upon application by an LLC member, a court has the power to order a dissolution of the LLC if that member can show one of two conditions. For example, in Idaho dissolution may be ordered when there is a showing of deadlocked management and this deadlock is or may cause irreparable harm to the LLC.152

Alternatively, if there is a showing that the acts of those in control of the LLC are "illegal, oppressive or fraudulent and that irreparable injury to the limited liability company is being suffered or is threatened by reason thereof" then the court may order dissolution.153

Illegal, oppressive, or fraudulent conduct is a common factor in breaches of fiduciary duty occurring in closely held corporations. By granting a remedy of dissolution, these statutes strongly imply that such conduct breaches a duty as between members of the LLC and courts should be willing to impose sanctions on such conduct. These provisions provide another avenue that LLC members in these states may pursue to protect their interest in the business.

5. No Fiduciary Duty by Reason of Indemnification Provision

Two states using similar indemnification provisions appear to impliedly bar the application of any type of fiduciary duty.154 Arizona and Arkansas have indemnification provisions that expressly provide that the LLC may indemnify a member or manager for a breach of any duty, without reserving any actions for which the acting member or manager cannot be indemnified.

For example, the Arizona provision simply states "that a domestic limited liability company may . . . [i]ndemnify a member, manager, employee, officer, or agent or any other person."155 The provision has no limitations on scope or applicability and apparently grants the LLC the power to indemnify for any and all acts.

These two states do not appear to recognize the applicability of any fiduciary duties between the owners of an LLC. The consequence is that in those states minority owners have little, if any, statutory recourse for protecting their business interests.

153. Id. at § 53-643(2).
IV. THE MINNESOTA LLC ACT AND FIDUCIARY DUTY

The Minnesota LLC Act is similar to the LLC statutes enacted in Louisiana, Delaware, Georgia, Iowa, New Hampshire, New Jersey, and North Dakota because of the express use of the term "fiduciary." The Minnesota Act differs, however, by adopting a two-pronged approach to the fiduciary duty issue.

The first prong defines fiduciary principles and sets forth the standards of conduct for an LLC governor and an LLC manager. A governor must discharge the duties of that position in a manner of care and good faith with the best interests of the LLC in mind. While an LLC may use the articles of organization to limit the governor's liability, the governor, by statute, must maintain a duty of


Minn. Stat. § 322B.663(1) (1992) states:

A governor shall discharge the duties of the position of governor in good faith, in a manner the governor reasonably believes to be in the best interests of the limited liability company, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A person who so performs those duties is not liable by reason of being or having been a governor of the limited liability company.

Id.

158. Minn. Stat. § 322B.69 (1992) states:

A manager shall discharge the duties of an office in good faith, in a manner the manager reasonably believes to be in the best interests of the limited liability company, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A person exercising the principal functions of an office or to whom some or all of the duties and powers of an office are delegated pursuant to section 322B.689 is considered a manager for purposes of this section and sections 322B.38 and 322B.699.

Id.


160. Id. § 322B.663(4). The subsection provides in part:

A governor's personal liability to the limited liability company or its members for monetary damages for breach of fiduciary duty as a governor may be eliminated or limited in the articles of organization. The articles may not eliminate or limit the liability of a governor:

(1) for any breach of the governor's duty of loyalty to the limited liability company or its members;
(2) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law;
(3) under section 80A.23 or 322B.56;
(4) for any transaction from which the governor derived an improper personal benefit; or
(5) for any act or omission occurring before the date when the provi-
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loyalty and good faith.161 Under the statute, an LLC cannot absolve a governor from liability resulting from a breach of the statutory duty.162

On the other hand, the Minnesota statute holds managers to the more lenient standard of good faith and reasonable actions in the best interests of the business.163 This is the fiduciary duty as defined by the business judgment rule.

The second prong is remedial in nature. Instead of defining the applicable standards, this prong sets forth the available remedies for breach of fiduciary duty claims in a closely held LLC.164 In determining the appropriate remedy, courts must assess the alleged breach in light of the duty which exists among members of a closely held corporation to act in an honest, fair and reasonable manner while conducting LLC operations.165

This two-pronged approach is not common in LLC legislation. While some states expressly discuss fiduciary duties, there is currently only one other LLC statute that singles out the closely held entity for special protection.166 This distinction is significant because many future users of the LLC entity may likely have otherwise formed as closely held corporations.

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162. Id.
163. MINN. STAT. § 322B.69 (1992). There is no provision for any limitation or elimination of the manager's duty of conduct under this standard. Id.
164. MINN. STAT. § 322B.833 (1992). The statute provides in relevant part:

In determining whether to order relief under this section and in determining what particular relief to order, the court shall take into consideration the duty that all members in a closely held limited liability company owe one another to act in an honest, fair, and reasonable manner in the operation of the limited liability company and the reasonable expectations of the members as they exist at the inception and develop during the course of their relationship with the limited liability company and with each other.

Id. § 322B.833(4).
165. See id. This language is adopted from MINN. STAT. § 302A.751, a corporate law provision specifically for closely held corporations that has been interpreted to provide the court with broad equitable powers to enforce fiduciary duties among shareholders in closely held corporations. See Pedro v. Pedro, 489 N.W.2d 798, 801-02 (Minn. Ct. App. 1992).
166. See N.D. CENT. CODE § 10-32-119(3) (Supp. 1993) (adopting identical language to Minn. Stat. § 322B.833(4)). The North Dakota statute is not discussed in this Comment, as the entire act is adopted almost word for word from Minnesota's act and the interpretation and application of one act's provisions should follow from the other.
V. A Proposal For Protecting Minority Interests in Limited Liability Companies

While a number of LLC statutes address the fiduciary duty of LLC members, an inherent shortcoming remains: few, if any, of the statutory provisions specifically address minority interests. This is because the vast majority of statutes adopt the business judgment rule, thereby allowing for potential abuses by the majority. Consequently, LLC statutes must adopt a more rigorous standard of fiduciary duty to protect these minority interests.

This Comment proposes a multi-faceted foundation for the adoption of a more rigorous standard. Each LLC statute should contain a separate provision expressly delineating the fiduciary duty standard and the consequences for breach of that duty. This standard would consist of at least four parts: (1) incorporating an expressed fiduciary duty provision in each statute; (2) adopting the strict fiduciary duty rule; (3) placing the burden of proof on the defendant to show with clear and convincing evidence that the challenged action is not wrongful; and (4) uniformly imposing punitive damages for breach of the duty.

By employing language stating an expressed fiduciary duty, the state would signal both the importance of the duty and clarify that this duty applies to LLCs. Explicit language would also signal to the courts that a fiduciary duty exists in LLCs. As a result, the courts will not be required to determine this threshold issue. This streamlining procedure will promote efficient use of judicial resources.

The proposal’s second facet suggests that the express fiduciary provision adopt the strict fiduciary duty rule as applied in *Donahue v. Rodd Electrotype Co.* 167 States adopting this rule would protect the interests of noncontrolling members of the LLC. Because of the limited transferability of an LLC interest, 168 LLC members are restricted in responding to oppressive conduct. A strict fiduciary rule is more likely to provide protection against such conduct.

Furthermore, incorporation of this rule would help deter oppressive conduct. Not only would an oppressed member be able to turn to the courts for relief, but the oppressor would be put on notice that any actions would be held to the strictest scrutiny. This strict scrutiny exceeds the degree of scrutiny involved in the business judgment rule currently incorporated in the LLC statutes.


168. An LLC interest is inherently limited in its transferability because of the statutory restrictions and requirements placed upon its transfer. For example, in Minnesota, an LLC member may only transfer an entire LLC interest upon written consent of all other LLC members. See MINN. STAT. §§ 322B.31, 322B.313 (1992).
While recognizing the concern the Wilkes court expressed for imposing the strict duty upon all closely held corporations, the benefits will outweigh the potential harms. The goal is to deter controlling members from acting in an oppressive manner. By imposing a strict duty, members will have to seriously consider their actions at the outset to refrain from conducting oppressive activities if they wish to avoid fiduciary duty liability.

The proposed standard's third element places the burden of proof on the challenged member. That member must show that the challenged actions were undertaken with good faith and that the member was not motivated by self-interest. To be effective, the statutory provision must incorporate this burden. In addition to guiding LLC members, this element will provide the courts with another tool to remedy oppressive conduct.

The final element provides for uniform application of punitive damages where the court finds a breach of the duty. Punitive damage awards are intended to deter others from acting in a particular manner in the future. The LLC is an entity gaining increasing acceptance throughout the country and is likely to be increasingly used as an economic vehicle in the future. Consequently, allowing the courts to impose punitive damages for breaches of the duty will serve to check abuse by controlling members that may, if unchecked, deter widespread acceptance of the entity.

VI. CONCLUSION

While a number of LLC statutes have addressed the issue of fiduciary duty, these statutes have not done so in a uniform manner. This lack of uniformity can lead to confusion and mistakes by individuals and courts. The application of a fiduciary duty is of utmost importance in protecting an individual's interest in a business entity. The lack of any statutory uniformity to date is a significant shortcoming in the development of the LLC entity.

Obviously, the adoption of this proposed statutory standard does not provide the ultimate solution. In spite of the guidance that such an expressed provision provides, the judiciary will still be required to apply this duty on a fact specific basis. Such an application is inherent in the concept of fiduciary duty.

The purpose of this proposal is not to set forth a rigid standard against which all future disputes are then to be analyzed. On the contrary, the purpose of this proposed standard is to provide distinct guideposts and to build a foundation against which a court may commence analysis. By expressly adopting a strict rule whose components include a heavy burden of proof on the defendant, a high

169. See supra notes 93-94 and accompanying text.
standard of conduct required of the challenged party, and the ability
to impose punitive damages, the statutes will leave little doubt that
the LLC will hold members to a standard of conduct intended to
protect a party's interest and to promote the effective adaptation of
this entity to the business environment.