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Reflections on Teaching Business Associations: The Case for Teaching More Agency and Unincorporated Business Entity Law

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REFLECTIONS ON TEACHING BUSINESS ASSOCIATIONS: THE CASE FOR TEACHING MORE AGENCY AND UNINCORPORATED BUSINESS ENTITY LAW

MARK J. LOEWENSTEIN*

INTRODUCTION

I have been teaching Business Associations since 1979, have co-authored two casebooks and a nutshell in the area,[1] written numerous articles on various related topics,[2] and devoted much of my professional career to teaching, studying, and writing about the law as it relates to business organizations. I am using this opportunity to urge greater coverage of agency law and the law of unincorporated business entities (partnerships and limited liability companies, referred to herein as UBEs) in course materials and in the classroom.

I. THE IMPORTANCE OF AGENCY LAW

A. Agency Outside the Business Associations Course

Agency law receives short shrift in courses on business associations, if it receives any shrift at all. Typically, a casebook on business associations devotes less than one hundred pages to agency, and often far less.[3] I would speculate that, in some courses, instructors skip the topic altogether. The typical casebook contains around one thousand pages, many with typefaces requiring magnification for comfortable reading. Something must be sacrificed. Why not agency, especially since there are so many sexy topics to be covered in corporate law (derivative actions, insider trading, and hostile

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1. *See* J. DENNIS HYNES & MARK J. LOEWENSTEIN, AGENCY, PARTNERSHIP AND THE LLC: THE LAW OF UNINCORPORATED BUSINESS ENTERPRISES (abr. 8th ed. 2011); DOUGLAS M. BRANSON, JOAN MACLEOD HEMINWAY, MARK J. LOEWENSTEIN, MARC I. STEINBERG & MANNING GILBERT WARREN III, BUSINESS ENTERPRISES: LEGAL STRUCTURES, GOVERNANCE, AND POLICY: CASES, MATERIALS, AND PROBLEMS (2d ed. 2012); J. DENNIS HYNES & MARK J. LOEWENSTEIN, AGENCY, PARTNERSHIP, AND THE LLC IN A NUTSHELL (5th ed. 2012).

2. *See* Mark J. Loewenstein, *Tenured and Tenure-Track Faculty: Mark J. Loewenstein*, COLO. L., http://lawweb.colorado.edu/profiles/profile.jsp?id=33 (last visited Nov. 10, 2014).

3. *See infra* Appendix.

takeovers, to name just a few)? But, these sexy topics, especially the latter two, arise rarely in the practice of the average business lawyer, and never in the practice of nonbusiness lawyers. By contrast, agency law is ubiquitous, arising in all areas of the law, in addition to being essential to an understanding of UBEs and corporate law. Indeed, at the University of Colorado, where I teach, we offer a separate course on agency, partnership, and the limited liability company.[4] It carries three hours of credit, as does our Corporations course, which is a survey course on corporate and federal securities law.[5] Agency, partnerships, and limited liability companies are not covered at all in our Corporations course. My sense is that more law schools are recognizing the importance of carving agency and UBE law out of a survey Business Associations course, and there are several books from which instructors may choose.[6]

I will address the importance of covering UBE law below,[7] but here I wish to emphasize agency law. Agency issues are ubiquitous in the law and sometimes overlooked by practicing lawyers. The recent case of *United States v. Bonds*,[8] which I have added to the forthcoming edition of my casebook on agency and UBEs,[9] provides a wonderful example of how agency issues have a way of arising in the most unusual places. The case involved our favorite baseball player to hold in contempt—Barry Bonds. I suspect that students will have an interest in the case because of his notoriety and will be surprised to see this criminal case leading off (so to speak) an exploration of agency law. Bonds was indicted for lying about his use of performance-enhancing drugs (PEDs)—he claimed he never knowingly used them.[10] Part of the government's case required it to prove that, in fact, blood and urine samples from Bonds had proved positive for PEDs.[11] The government had evidence that did establish that connection: statements made by Bonds' sometimes trainer and friend, Greg Anderson, to James Valente.[12] Valente worked for BALCO Laboratories, Inc., and, on multiple occasions, Anderson gave Valente

4. *Course Descriptions*, COLO. L., http://lawweb.colorado.edu/courses/courses.jsp (last visited Nov. 10, 2014).

5. *Id.*

6. *E.g.*, MELVIN ARON EISENBERG & JAMES D. COX, AN INTRODUCTION TO AGENCY, PARTNERSHIPS, AND LLCS (6th ed. 2012); HYNES & LOEWENSTEIN, *supra* note 1; WILLIAM A. KLEIN ET AL., AGENCY, PARTNERSHIP, AND LIMITED LIABILITY ENTITIES: UNINCORPORATED BUSINESS ASSOCIATIONS (3d ed. 2012); Larry E. RIBSTEIN & JEFFREY M. LIPSHAW, UNINCORPORATED BUSINESS ENTITIES (4th ed. 2009).

7. *Infra* Part II.A.

8. United States v. Bonds, 608 F.3d 495 (9th Cir. 2010).

9. J. DENNIS HYNES & MARK J. LOEWENSTEIN, AGENCY, PARTNERSHIP AND THE LLC: THE LAW OF UNINCORPORATED BUSINESS ENTERPRISES (9th ed. forthcoming 2015).

10. *Bonds*, 608 F.3d at 497.

11. *Id.*

12. *Id.* at 498.

blood and urine samples, telling Valente that these samples came from Bonds.[13] The records that BALCO kept did not identify the samples as coming from Bonds by name. Instead, a code was used to keep track of the samples.[14]

The government sought to introduce Anderson's statements to Valente to prove that the coded samples came from Bonds.[15] Anderson, however, refused to testify and was ultimately held in contempt of court for his refusal.[16] Valente was willing to testify as to what Anderson told him, but the defense objected that Valente's testimony would be inadmissible hearsay.[17] In response to the hearsay objection, the government argued that Anderson was Bonds' agent and Anderson's statements that the blood and urine samples came from Bonds were made by him in the course of his agency relationship.[18] If, in fact (and law), Anderson was Bonds' agent, then the government could prove that the coded samples came from Bonds. So the issue was clearly joined—was Anderson an agent for Bonds?

The Ninth Circuit opinion is a pedagogical gem. The majority, in an opinion authored by Judge Mary Schroeder, marched through the Restatement (Third) of Agency elements of the definition of an agent and reached the conclusion that Anderson was not an agent for Bonds.[19] Using the same facts, dissenting Judge Carlos Bea reached a contrary conclusion.[20] It is not necessary to deconstruct these two opinions in this Essay; suffice it to say that, together, these opinions demonstrate the importance of the issue and that, on the margin, applying the definition of agency can be challenging.

As the *Bonds* case so nicely illustrates, finding that a person is an agent of another can have profound effects on the outcome of a case. An agent's statements or admissions (as alleged in the *Bonds* case), if made in the course of the agency relationship, are imputed to the principal;[21] an agent's tortious conduct (even, in some instances, intentionally tortious conduct) can result in

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13. *Id.*

14. *Id.*

15. *Bonds*, 608 F.3d at 498.

16. *Id.*

17. *Id.* at 500.

18. *Id.*

19. *Id.* at 495, 504–05; RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

20. *Bonds*, 608 F.3d at 508–09 (Bea, J., dissenting).

21. RESTATEMENT (SECOND) OF AGENCY § 286 (1958) ("In an action between the principal and a third person, statements of an agent to a third person are admissible in evidence against the principal to prove the truth of facts asserted in them as though made by the principal, if the agent was authorized to make the statement or was authorized to make, on the principal's behalf, any statements concerning the subject matter."). *E.g.*, Big-D Signature Corp. v. Sterrett Props., LLC, 288 P.3d 72, 79 (Wyo. 2012) (providing that an admission made by an attorney can be binding on client and constitute the basis for a verdict); Alan, Sean and Koule, Inc. v. SV/CORSTA V, 286 F. Supp. 2d 1367, 1374 (S.D. Ga. 2003) (noting that statements of a ship's captain binds the owners).

liability to the principal;[22] notice to an agent can constitute notice to the principal;[23] and an agent's promises on behalf of the principal can bind the principal.[24] In each of these areas, there are complexities and nuances, and for that reason, devoting class time to them is time well spent. Few survey courses on business associations have the time to do so.

This same analysis—or, really, argument—could be made in several other areas of agency law. I will, however, consider only one other, which I include because of its inherent interest and growing importance as a focus of litigation: the adverse interest exception to the imputation doctrine.[25] Just articulating the topic is likely to deter its consideration, because I would guess that most academics, including, unfortunately, teachers of Business Associations, are unfamiliar with it. The concept is simple: an agent's actions and knowledge gained during the course of an agency relationship are imputed to the principal, unless the agent is acting adverse to the interests of the principal.[26] The cases are fairly clear that acting adverse to the principal means that the agent was acting solely in the agent's interest, without any intent to further the interests

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22. RESTATEMENT (THIRD) OF AGENCY § 2.04 ("An employer is subject to liability for torts committed by employees while acting within the scope of their employment."). *See also* Ira S. Bushey & Sons, Inc. v. United States, 398 F.2d 167, 169–70, 172 (2d Cir. 1968) (finding that a principal is liable for intentionally tortious conduct of agent).

23. RESTATEMENT (THIRD) OF AGENCY § 5.02(1) ("A notification given to an agent is effective as notice to the principal if the agent has actual or apparent authority to receive the notification, unless the person who gives the notification knows or has reason to know that the agent is acting adversely to the principal as stated in § 5.04.").

24. *Id.* § 6.01(1) ("When an agent acting with actual or apparent authority makes a contract on behalf of a disclosed principal, (1) the principal and the third party are parties to the contract . . . .").

25. *Id.* § 5.04. Section 5.04 provides the following:

> For purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is not imputed to the principal if the agent acts adversely to the principal in a transaction or matter, intending to act solely for the agent's own purposes or those of another person. Nevertheless, notice is imputed (a) when necessary to protect the rights of a third party who dealt with the principal in good faith; or (b) when the principal has ratified or knowingly retained a benefit from the agent's action. A third party who deals with a principal through an agent, knowing or having reason to know that the agent acts adversely to the principal, does not deal in good faith for this purpose.

Id.

26. *Id.* § 5.03. Section 5.03 provides the following:

> For purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is imputed to the principal if knowledge of the fact is material to the agent's duties to the principal, unless the agent (a) acts adversely to the principal as stated in § 5.04, or (b) is subject to a duty to another not to disclose the fact to the principal.

Id.

of the principal.[27] This principle of agency law arises frequently in cases involving corporate misconduct; that is, rogue corporate officers cook the corporate books, with the result that shareholders, lenders, and others suffer losses when the truth is revealed.[28] The ensuing litigation frequently involves claims by the corporation (which, presumably, has purged the bad actors) against the accountants, lawyers, and investment bankers (its "professional service providers").[29] The plaintiff argues that the negligence of these professionals allowed the scheme to succeed. Often, that assertion is factually accurate but legally insufficient. Rather, agency law is at the center of the litigation and often is outcome determinative. The agency law question is whether the rogue actors were acting *solely* in their own interests or, instead, were the corporation's interests somehow being advanced?[30] In most cases, the plaintiff is unable to demonstrate that no interest of the corporation was being served. Typically, the scheme allowed the corporation to raise equity, incur indebtedness, attract talent, or make acquisitions at favorable prices. If true, the actions of the rogue officers are imputed to the corporation (or its trustee in bankruptcy) and the defendant professional service provider can raise the *in pari delicto* defense. The corporation, they assert, is itself the bad actor and cannot sue another wrongdoer.[31] This defense is a winner.[32]

In addition to its importance to criminal law and tort law, as described above, an understanding of agency law is essential for a deep understanding of the law of UBEs and corporate law. The next section, hopefully, makes that case.

A. *Agency Law as a Basis for UBE and Corporate Law*

1. Questions of Authority

Among the topics covered in a Business Associations course are the power of partners to bind a partnership; the power of officers, directors, and corporate employees to bind the corporation; the fiduciary duties of these various actors

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27. *Id.* § 5.04 cmt. c.

28. *See* Mark J. Loewenstein, *Imputation, the Adverse Interest Exception, and the Curious Case of the Restatement (Third) of Agency*, 84 U. COLO. L. REV. 305, 308 (2013) (noting the consequences that follow revelations of truth).

29. *See id.* at 308 n.8 (providing citations to exemplary cases).

30. RESTATEMENT (THIRD) OF AGENCY § 5.04.

31. Loewenstein, *supra* note 28, at 309 (explaining the concept).

32. *See id.* at 308 n.10 (providing further explanation of the concept and a collection of cases). There is an exception to the adverse interest exception that applies when a rogue agent is the only person who can act for the principal—the so-called "sole actor exception." It is beyond the scope of this Essay to explore the nuances of this doctrine, but that exploration really brings one into the wonderful complexities of agency law. *See id.* at 326 (discussing the sole actor exception).

to the entities they serve; and whether these duties can be modified or eliminated by contract. These issues are also among the bread and butter issues covered in agency law, and, I believe, learning the relevant doctrines as part of agency law course facilitates an understanding in the context of a partnership or corporate issue. Why is it, for instance, that an officer of a corporation can or cannot bind the corporation to a contract? When is approval of the board of directors required and when it is not? Studying only corporate law cases does not give the student the deeper understanding that arises when that student has the benefit of a course on agency law. In agency law, we study express authority, implied authority, apparent authority, inherent agency authority, and estoppel, all of which are relevant to resolving questions regarding the authority of partners, LLC members and managers, and corporate officers. These concepts give the student (and legal practitioner) the necessary tools to approach a question of authority.

2. Fiduciary Duties

Regarding fiduciary duties, at some point, the student will confront Judge Cardozo's famous quote from *Meinhard v. Salmon*:

> 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.[33]

But, this quote has much more meaning if one understands the context in which it appears, and that context is partnership law. In this case, the court concluded that joint venturers were fiduciaries of one another and fiduciary duty precluded one of the venturers (to the exclusion of his co-venturer) from securing a renewal and extension of a lease held by the venture.[34] Exploring this case and the issues it raises—what was the basis for finding a fiduciary duty and why did it apply to the particular actions of the defendant—go to the very core of the law of fiduciary duties. I love the case because the answer to why the court recognized a fiduciary duty does not really emerge from the quote above, but rather from fundamental concepts of contract law. A duty would be implied because the parties implicitly understood that it would. But, did they here? What evidence suggests that they did or did not? With a good understanding of *Meinhard* and other fiduciary duty cases covered in an Agency Law course, a student is well-equipped to understand why corporate officers cannot seize corporate opportunities or compete with the corporation.

33. 164 N.E. 545, 546 (N.Y. Ct. App. 1928).

34. *Id.* at 548, 550.

Finally, consider one important and current issue in corporate law on fiduciary duties: should the corporation be able to limit or eliminate fiduciary duties of directors in its articles of incorporation? This question became an urgent one after the Delaware Supreme Court held that directors of a Delaware corporation could be held liable for money damages because they were grossly negligent in approving a corporate merger.[35] (Actually, that had long been the rule in Delaware, and in a few cases directors had been held liable. But, none of the cases had the notoriety of the case then before the court.[36]) The decision prompted an immediate reaction from the Delaware legislature, undoubtedly prompted by the influential corporate bar of Delaware, to amend the Delaware general corporation law to permit corporations to exculpate directors from the duty of care by including an appropriate provision in its certificate of incorporation.[37] Most other states quickly followed suit.[38] But, this exculpation covered only the duty of care. How about the duty of loyalty? Whether the statute should be further amended to cover the duty of loyalty involves, in part, an understanding of the origins of the duty. If Judge Cardozo's dictum is taken literally, the answer is likely no, because the duty arises from fundamental moral principles, and unless those principles have changed in the years since *Meinhard* was decided (1928), there is no reason to change the legal principle.[39] But if, as I believe, the basis is contractual, then perhaps a different result is called for. The law of UBEs is a rich laboratory for exploring the contractual freedom to modify fiduciary duties and, when the issue is considered in corporate law, will provide essential precedent. This is one of the justifications for a thorough exploration of the law of UBEs, the subject of the next section.

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35. Smith v. Van Gorkom, 488 A.2d 858, 881, 893 (Del. 1985).

36. Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099–1100 (1968) (finding only four cases over several decades in which directors of a nonfinancial corporation were held liable for damages).

37. DEL. CODE ANN. tit. 8 § 102(b)(7) (1983 & Supp. 1986).

38. *See* MODEL BUS. CORP. ACT § 2.02(b)(4) (2008); Lawrence A. Hamermesh, *Why I Do Not Teach* Van Gorkom, 34 GA. L. REV. 477, 479 (2000) ("Exculpatory charter provisions adopted pursuant to statutes, almost universally enacted since *Van Gorkom*, have rendered the damages claim for breach of the duty of care essentially non-existent.").

39. *See* Daniel F. Piar, *Morality as a Legitimate Government Interest*, 117 PENN. ST. L. REV. 139, 141–42 (2012) (discussing morals legislation and arguing its failure to serve the goals of a "pluralistic, federalist society").

II. THE IMPORTANCE OF UBE LAW

A. *Teaching the Law of UBEs*

Business Association casebooks and, therefore, Business Associations classes "underteach" the law related to UBEs. Roughly 75% of new businesses are limited liability companies (LLCs),[40] yet casebooks devote less than 25% of their pages to examining LLCs and often less than 10%, with partnerships receiving even less attention.[41] Even in Delaware, a state that to many is synonymous with the word corporation, there were 112,982 new domestic LLCs formed in 2007, as opposed to 34,144 new domestic corporations, a ratio of 3.3 to 1.[42] One reason that LLCs may be underrepresented in casebooks is that there are relatively fewer casebook-worthy LLC cases than corporate cases. Corporations have been around and generating interesting litigation for over one hundred years, while the first LLC statute appeared in Wyoming in 1977, and a significant number of appellate decisions have begun to appear only in the last ten years or so.[43] But LLC statutes draw heavily on partnership statutes, particularly the Revised Uniform Partnership Act (RUPA), which was promulgated by the National Conference of Commissioners on Uniform State Laws in 1997.[44] To the extent that a provision in a LLC statute is based on a comparable RUPA provision, precedent interpreting the RUPA provision is directly relevant to the LLC provision.

This correspondence is one reason to teach partnership law, but hardly the only reason or the most important reason. Partnership law has also had an important impact on the development of corporate law. To take one prominent example, consider the corporate law doctrine of shareholder oppression. Under this doctrine, if those in control of a closely held corporation have used their control to "oppress" minority shareholders, the minority may be able to obtain judicial relief.[45] Oppression in this context is generally interpreted to mean conduct that disappoints the reasonable expectations of the minority

40. *See* Rodney D. Chrisman, *LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004–2007 and How LLCs Were Taxed for Tax Years 2002-2006*, 15 FORDHAM J. CORP. & FIN. L. 459, 460, 460 n.2 (2010) (providing statistics of the number of LLCs formed).

41. *See infra* Appendix.

42. Chrisman, *supra* note 40, at 460 n.4.

43. Over the past decade or so, treatises on LLC law have begun to appear. For an example of a treatise on LLCs, see LARRY E. RIBSTEIN AND ROBERT B. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES (2d ed. 2004).

44. *See* REVISED UNIF. P'SHIP ACT (1997).

45. *See* DOUGLAS M. BRANSON, JOAN M. HEMINWAY, MARK J. LOEWENSTEIN, MARC I. STEINBERG, MANNING G. WARREN III, BUSINESS ENTERPRISES: LEGAL STRUCTURES, GOVERNANCE, AND POLICY 439–50 (2d ed. 2012) (discussing shareholder oppression and closely held corporations).

shareholders.[46] This widely accepted doctrine is based on the presumption that a closely held corporation is really an incorporated partnership, by which the courts mean that the shareholders considered themselves to be partners of one another and only chose the corporate form because it afforded them limited liability.[47] Since they considered themselves partners, partnership fiduciary duties ought to be implied into the relationship. At this point, an understanding of partnership becomes very helpful. One insight is that the duties that courts imply into a closely held corporation are not always found in partnership law. For instance, the seminal case of *Donahue v. Rodd Electrotype Co. of New England, Inc.*[48] involved a claim by the widow of a former shareholder/partner that if those in control redeemed the shares of one of their own, she too was entitled to have her shares redeemed at the same price.[49] The Massachusetts Supreme Judicial Court agreed, opining that shareholders in a close corporation, like partners in a partnership, owe one another the "utmost good faith and loyalty."[50] Such grand pronouncements are hardly helpful in resolving whether the failure to redeem the plaintiff's shares violated a fiduciary duty, and the court cited no partnership cases where the issue arose. In short, in this and subsequent cases, the Massachusetts court developed a body of law distinct from partnership law.[51] It is an interesting and worthwhile exercise to explore how various cases in this line of precedent would come out applying partnership law and understanding partnership law provides the advocate with a tool to litigate an oppression case.

One other observation is worth noting and considering: should the law of shareholder oppression apply to LLCs? After all, LLCs are creatures of contract, not statute, and if the parties do not contract for the fiduciary duties of partners, why should a court imply them? I am not referring here to the duties that those in control owe to the entity, to act in its best interests, but rather to the imposition of a duty to act in the *personal* interest of other members in the same way that those in control of *Donahue Electrotype* had to consider what

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46. *Id.*

47. Donahue v. Rodd Electrotype Co. of New England, Inc., 328 N.E.2d 505, 512 (Mass. 1975) ("Commentators and courts have noted that the close corporation is often little more than an 'incorporated' or 'chartered' partnership." (citation omitted)).

48. *Id.* at 505.

49. *Id.* at 510–11 ("She urges that the distribution constitutes a breach of the fiduciary duty owed by the Rodds, as controlling stockholders, to her, a minority stockholder in the enterprise, because the Rodds failed to accord her an equal opportunity to sell her shares to the corporation.").

50. *Id.* at 515 (citation omitted).

51. *See* Mark J. Loewenstein, Wilkes v. Springside Nursing Home, Inc.*: A Historical Perspective*, 33 W. NEW ENG. L. REV. 339, 361, 364–65 (2011) (describing judicial developments since 1975).

Mrs. Rodd's interests and expectations were.[52] A good argument can be made that the shareholder oppression doctrine arose from a unique set of circumstances—those forming a closely held corporation would have preferred a partnership, but could not choose that form because of the liability constraints. With the advent of limited liability companies and limited liability partnerships, where participants enjoy limited liability, those unique circumstances no longer exist.

A handful of cases have considered this issue and have generally carried over the shareholder oppression doctrine to limited liability companies with no consideration as to whether the policy justifications for the doctrine applied with equal force to LLCs.[53] In my opinion, they do not, and I expect to see a court at least grapple with the issue. Students should be aware of it, as this is a frequently litigated issue.

In addition to providing an important foundation for understanding the shareholder oppression doctrine, the study of UBE law is essential for understanding the growing and important jurisprudence relating to freedom of contract and disclaiming of fiduciary duties. Limited liability companies have become the preferred form of business organization in part because the enabling statutes privilege freedom of contract, to a greater or lesser extent.[54] The former characterizes Delaware law, which expressly provides in its LLC statute (and partnership statutes) that the policy of the statue is "to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."[55] Another provision of Delaware law permits the operating agreement for a limited liability company (and the partnership agreement for partnerships) to eliminate fiduciary duties.[56] However, Delaware law also provides that the operating or partnership agreement "may not eliminate the implied contractual covenant of good faith and fair dealing."[57] The combination of these provisions has led to an interesting evolution in LLC operating and partnership agreements, as lawyers draft to the edge of the permissible (and sometimes beyond). The agreements

52. *E.g.*, Pointer v. Castellani, 918 N.E.2d 805, 817, 822 (2009) (those in control of an LLC could not defeat the expectations of a co-member).

53. J. DENNIS HYNES & MARK J. LOEWENSTEIN, AGENCY PARTNERSHIP AND THE LLC: THE LAW OF UNINCORPORATED BUSINESS ENTERPRISES: CASES, MATERIALS, AND PROBLEMS 586–97 (8th ed. 2011).

54. *See* Myron Steele, *Freedom of Contract and Default Contractual Duties in Delaware Limited Partnerships and Limited Liability Companies*, 46 AM. BUS. L.J. 221–22 (2009) (noting that the Delaware Limited Liability Company Act provides the "ultimate contractual customization").

55. DEL. CODE ANN. tit. 6, § 18-1101 (2011). *See also* tit. 6 §§ 15-103(d), 17-1101.

56. tit. 6, §§ 15-103(f), 17-1101(f), 18-1101(c).

57. tit. 6, § 18-1101(e). *See also* tit. 6 §§ 15-103(b)(3), 17-1101(d).

are often tested in the Delaware courts, where feedback from the judicial decisions informs the next generation of agreements.

What we are witnessing is the evolution of a form of operating or partnership agreement that limits the duties of those in control and avoids the implied covenant of good faith and fair dealing. At issue in the litigation is typically a related party transaction between the LLC or partnership and another entity in which those in control have an interest.[58] If the LLC or partnership had been a corporation, the courts would impose on those in control the burden of proving that the transaction was fair to the corporation.[59] But, LLC and partnership law looks to contract—the operating or partnership agreement—to set out relevant approval process. Increasingly (according to the case law developing in Delaware) that approval process requires the approval of a "special committee," which may or may not be independent of those in control.[60] Clearly, such a process would not pass muster under corporate law, at least if the committee lacked independence.[61]

If the transaction in question appears to be unfair to the minority partners or minority members of the LLC, they have few strategies to attack the transactions. Because fiduciary duties are disclaimed in the agreement, the claimants must argue that those in control somehow breached the agreement, either because they failed to follow the procedures set out in the relevant agreement or they violated the implied covenant of good faith and fair dealing. The latter is the claim that is most often litigated, and the courts must parse the agreement to determine whether there is an implied covenant that may have been breached, thus providing a basis for relief.[62] Delaware precedent suggests that a covenant will not be implied unless it would provide an obligation that the parties did not include in the agreement but would have included had the matter been brought to their attention.[63] Courts motivated to do justice are motivated to find an implied covenant; lawyers representing promoters of limited liability companies and partnerships are motivated to craft their agreements to preclude such a finding. As a result, a fascinating jurisprudence is developing.

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58. *E.g.*, Allen v. Encore Energy Partners, L.P., 72 A.3d 93, 95–96 (Del. 2013) (describing an acquisition); Brinckerhoff v. Enbridge Energy Co., Inc., 67 A.3d 369, 370 (Del. 2013) (describing a joint venture agreement); Norton v. K-Sea Transp. Partners L.P., 67 A.3d 354, 356 (Del. 2013) (describing a merger).

59. *Allen*, 72 A.3d at 109 ("If Allen seeks the protections the common law duties of loyalty and care provide, he would be well-advised to invest in a Delaware corporation").

60. The *Gerber* case, *infra* note 73, is a typical example of cases involving "special approval."

61. *See infra* note 70 and accompanying text.

62. *See supra* note 58.

63. Nemec v. Shrader, 991 A.2d 1120, 1126 (Del. 2010).

In *Norton v. K-Sea Transp. Partners L.P.*,[64] which is typical of these cases, the Delaware Supreme Court considered a carefully drawn limited partnership agreement (LPA) in the context of a challenge to an acquisition of the partnership.[65] The plaintiff (Norton), a limited partner, complained about the way the consideration in the deal ($329 million) was divided between the general partner and the limited partners.[66] The record suggested that the general partner's interest may have been worth as little as $100,000, yet it received $18 million in the deal.[67] The LPA required, among other things, that the general partner approve such a transaction and, in doing so, act in good faith.[68] Under the LPA, the general partner acts in "good faith" if it reasonably believes that its action is in the best interest of, or at least not inconsistent with the best interests of, the partnership.[69] In accordance with a provision of the agreement, a committee of the board of directors of the partnership obtained an opinion from an investment banker that the proposed deal was fair to the limited partners, but the opinion expressly did not consider the fairness of the consideration paid to the general partner.[70] The general partner relied on this fairness opinion in recommending the deal to the limited partners, and the court concluded that the general partner was "therefore conclusively presumed to have acted in good faith" when it approved the deal and submitted it to the limited partners for their approval.[71] The court concluded its opinion with this observation:

> Norton [the plaintiff] willingly invested in a limited partnership that provided fewer protections to limited partners than those provided under corporate fiduciary duty principles. He is bound by his investment decision. Here, the LPA did not require [the general partner] to consider separately the . . . fairness [of the amount of consideration paid to it], but granted [the general partner] broad discretion to approve a merger, so long as it exercised that discretion in "good faith." Reliance on [the investment banker's] opinion satisfied this standard. By opining that the consideration Kirby [the acquirer] paid to the unaffiliated unitholders [limited partners] was fair, [the investment banker's] opinion addressed the . . . fairness [of the payment to the general partner], albeit indirectly. Kirby presumably was willing to pay a fixed amount for the entire Partnership. If [the general partner] diverted too much value to itself, at

64. 67 A.3d 354 (Del. 2013).
65. *Id.* at 367.
66. *Id.* at 357–59.
67. *Id.*
68. *Id.* at 364.
69. *Norton*, 67 A.3d at 361, 367.
70. *Id.* at 367–68, 367 n.61.
71. *Id.* at 368.

some point the consideration paid to the unaffiliated unitholders would no longer be "fair."[72]

The concept of good faith discussed in *Norton* was further refined in *Gerber v. Enter. Prods. Holdings, LLC.*[73] The Delaware Supreme Court similarly faced a fact pattern in which the general partner apparently complied with the terms of the limited partnership agreement in a related party transaction, but the transaction seemed, on its face, to be unfair to the limited partners.[74] The limited partner challenging the transaction prevailed, in part because the court distinguished between the general partner's contractual fiduciary duty of good faith (which, like the provision in *Norton*, was clearly set out in the agreement) and the implied covenant of good faith and fair dealing (which, of course, cannot be disclaimed).[75] In the course of its lengthy opinion, the court identified and delineated various concepts of good faith: the fiduciary duty of good faith (which may be limited by contract, as it was in *Norton*) and the concept of good faith that arises from the implied covenant.[76] Understanding these concepts is useful in the of study corporate law, where, increasingly, they arise as well.[77]

In *Gerber*, the court ultimately concluded that the general partner did satisfy the contractual fiduciary duty of good faith, but that the plaintiff successfully pled a violation of the implied covenant of good faith and fair dealing.[78] In short, a committee of the general partnership had approved the transaction relying on an allegedly flawed opinion of an investment banker, a procedure that a limited partner could not have anticipated and, therefore, a violation of the implied covenant of good faith and fair dealing.

CONCLUSION

The casebooks on business associations are rich with materials covering an incredibly broad range of topics. That is one of the great challenges of teaching the course. An instructor using a book exceeding a thousand pages in length, and having limited time to cover those pages, faces hard choices. I have used this opportunity to make the case that agency and UBEs ought not to be on the chopping block and, in fact, merit considerable coverage in the course materials and in the classroom.

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72. *Id.* (footnotes omitted).

73. 67 A.3d 400 (Del. 2013) (overruled on other grounds in Winshall v. Viacom Int'l. Inc., 76 A.3d 808 (Del. 2013)).

74. *See id.* at 421–22 (reciting allegations of the complaint).

75. *Id.* at 418–21.

76. *Id.* at 418–19.

77. *E.g.*, Nemec v. Shrader, 991 A.2d 1120, 1126–77 (Del. 2010) (discussing the implied covenant).

78. *Gerber*, 67 A.3d at 423–25.

APPENDIX

Page Distribution for Selected Casebooks on Business Associations

	Total Pages	Agency Pages	UBE (Unincorporated Business Entities) Pages	Corporations, Securities & other Pages	Agency % of total[79]	UBE % of total	Corp. and other % of total
1	684	26	46	612	4	7	90
2	940	50	115	775	5	12	82
3	844	34	98	712	4	12	84
4	1186	207	136	843	17	11	71
5	1026	21	89	916	2	9	89
6	634	20	115	499	3	18	79
7	1296	22	286	988	2	22	76
8	684	68	118	498	10	17	73
9	1494	17	89	1388	1	6	93
10	893	79	229	585	9	26	66
11	1162	29	160	973	3	14	84
12	474	15	31	428	3	7	90
13	1012	53	76	883	5	8	87
14	686	42	126	518	6	18	76
Median	917	32	115	744	4	12	83

1. WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION (4th ed. 2012).

2. DOUGLAS M. BRANSON ET AL., BUSINESS ENTERPRISES: LEGAL STRUCTURES, GOVERNANCE, AND POLICY (2d ed. 2012).

79. All fractions rounded to the nearest whole number.

3. ERIC A. CHIAPPINELLI, CASES AND MATERIALS ON BUSINESS ENTITIES (2d ed. 2010).

4. ALFRED F. CONARD ET AL., ENTERPRISE ORGANIZATION (4th ed. 1987).

5. MELVIN ARON EISENBERG & JAMES D. COX, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS (concise 10th ed. 2010).

6. DAVID G. EPSTEIN ET AL., BUSINESS STRUCTURES (3d ed. 2010).

7. ROBERT W. HAMILTON ET AL., CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES (11th ed. 2010).

8. LEE A. HARRIS, CASES AND MATERIALS ON CORPORATIONS AND OTHER BUSINESS ENTITIES: A PRACTICAL APPROACH (2011).

9. THOMAS LEE HAZEN & JERRY W. MARKHAM, CORPORATIONS AND OTHER BUSINESS ENTERPRISES: CASES AND MATERIALS (3d ed. 2009).

10. WILLIAM A. KLEIN ET AL., BUSINESS ASSOCIATIONS: CASES AND MATERIALS ON AGENCY, PARTNERSHIPS, AND CORPORATIONS (8th ed. 2012).

11. CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS (7th ed. 2014).

12. STEPHEN B. PRESSER, AN INTRODUCTION TO THE LAW OF BUSINESS ORGANIZATIONS (2d ed. 2008).

13. LINDA O. SMIDDY & LAWRENCE A. CUNNINGHAM, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES, MATERIALS, PROBLEMS (7th ed. 2010).

14. WILLIAM K. SJOSTROM, BUSINESS ORGANIZATIONS (2013).