

# Essential Issues for LLCs and Other Limited Liability Entities

## Fiduciary Duties of Managers and Members

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## Overview of Fiduciary Duties in LLCs

- Statutory Basis for Fiduciary Duties—ORS 63.155
- Existence of Duties Turns on Whether Member-Managed or Manager-Managed LLC
- Duties of Care, Loyalty, and Good Faith and Fair Dealing
- No Case Law in Oregon on LLC Fiduciary Duties—Look to Corporate Law and Partnership Law as Analogy



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## Member-Managed v. Manager-Managed

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- Member-Managed LLC: All Members Owe Fiduciary Duties to Other Members and LLC
- Manager-Managed LLC: Only “Manager” Owes Fiduciary Duties to Members and LLC
- Exception: Member in Manager-Managed LLC May Owe Fiduciary Duties To the Extent Member “Exercises Managerial Authority”—ORS 63.155(9)(c)



## Duty of Loyalty—Generally

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- Forbids Manager/Member from Engaging in Conduct Furthering Private Interests at Expense of LLC
- Business Judgment Rule Inapplicable to Conflict or Self-Dealing Transactions
- “Entire Fairness” Standard of Review



## Duty of Loyalty—ORS 63.155(2)

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- To “Account and Hold” for the LLC “Any Property, Profit or Benefit” Derived by the Member in Conducting Business of LLC
- Corporate Opportunity Doctrine
- Refrain From Dealing Adverse to LLC—Conflicted Transactions
- Refrain from Competing with LLC
- Exceptions—ORS 63.155(5)-(6)



## Duty of Care—Generally

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- “[Member/Manager must] use that amount of care which ordinarily careful or prudent men would use in similar circumstances” and “consider all material information reasonably available” in making business decisions. *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963).
- Business Judgment Rule Applies If Challenged Decision Was Product of Deliberate, Rational Process—*In re Caremark Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).
- Violation of Duty of Care if “Sustained or Systematic Failure of a Director to Exercise Reasonable Oversight”—Gross Negligence



## Duty of Care—ORS 63.155(3)

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- Gross Negligence—*Caremark* Standard
- Reckless Conduct
- Intentional Misconduct
- Knowing Violation of the Law



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## Duty of Good Faith and Fair Dealing—Generally

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- Purpose: To Enforce the Reasonable Expectations of the Parties When Situations Arise That Are Not Expressly Contemplated in the Contract
- Fuzzy in Business Entity Context—*"The good faith required of a corporate fiduciary includes not simply the duties of care and loyalty, in the narrow sense . . . but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders."* *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005).
- Define "Good Faith" by Defining "Bad Faith"—Action for Purpose Other than Genuine Attempt to Benefit Corporation
- Catch-All Provision



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## Duty of Good Faith and Fair Dealing— ORS 63.155(5)

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- Member/Manager shall discharge duties to the LLC and its members under the statute and operating agreement “consistent with the obligation of good faith and fair dealing.”



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## Actions for Breach of Fiduciary Duty

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- Derivative Proceedings—ORS 63.801
- Standing Requirement—Member When Transaction Complained of Occurred
- Demand Requirement
- No Dismissal or Settlement Without Court Approval



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## Fiduciary Duties Under Other States' LLC Statutes—Delaware

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- No Codification of Fiduciary Duties
- Delaware Courts Have Found Duties Implied by 6 Del. Code Sec. 18-1101(d) and (e).
- Case Law in Delaware Finds Manager or Members With Control Owe Fiduciary Duties of Loyalty and Care



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## Fiduciary Duties Under Other States' LLC Statutes—Washington

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- Applies to All Members and Managers Unless Agreed Otherwise
- Duty of Care—“Gross Negligence,” “Intentional Misconduct,” “Knowing Violation of Law.” RCW 25.15.155(1)
- Duty of Loyalty—RCW 25.15.155(2)
- No Codification of Duty of Good Faith and Fair Dealing



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## Fiduciary Duties Under Other States' LLC Statutes—California

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- “The fiduciary duties a manager owes to the limited liability company and to its members are those of a partner to a partnership and to the partners of the partnership.” Cal. Corp. Code Sec. 17153
- Partners Owe Duties of Loyalty and Care to Each Other and Partnership. Cal Corp. Code Sec. 16404
- If Member-Managed, Each Member Owes Fiduciary Duties of a Partner in a Partnership. Cal. Corp. Code Sec. 17150



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## Varying Fiduciary Duties By Agreement—Oregon

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- Oregon Law Very Restrictive—ORS 63.155(10)
- May Not Eliminate Duty of Loyalty but May Identify Specific Types of Activities That Do Not Violate Duty—ORS 63.155(10)(a)(A)
- May Set Forth Procedures for Ratification of Conflict Transactions—ORS 63.155(10)(a)(B)
- May Not “Unreasonably Reduce” Duty of Care
- May Not Eliminate “Good Faith and Fair Dealing Duty” But Agree to “Standards”



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## Varying Fiduciary Duties by Agreement—Delaware

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- Maximum Flexibility— *“It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”* 6 Del. Code Sec. 18-1101
- Permits parties in LLC agreement to eliminate all fiduciary duties except “a bad faith violation of the implied contractual covenant of good faith and fair dealing.”
- Common to Recommend Forming LLC in Delaware Due to Flexibility



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## Varying Fiduciary Duties by Agreement—Washington

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- Freedom of Contract Principles
- Maximum Flexibility— *“It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”* RCW 25.15.800
- Purports to Permit Parties to Eliminate All Fiduciary Duties by Agreement. RCW 25.15.155
- Other Provisions in Washington LLC Statute Are Not Desirable—*E.g.*, No Conversion Rights



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## Questions?

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