

FIDUCIARY AND OTHER DUTIES IN AN LLC – WHERE DO YOU COME OUT?

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When establishing or revisiting the management of your business organization or any private business organization you invest in, it is vital that you consider what duties the owners and managers of the business will owe to each other. If you control, or even just invest in, a limited liability company formed in Ohio, now is a good time to take a hard look at the duties of various people involved in the business. Ohio LLC law is changing effective January 1, 2022, and this presents a good reason to review your operating agreement in general. If you are on the management side, you may have an opportunity to acquire more latitude. If you are an investor relying on management by others, you should be vigilant about whether the standards set for those others fit your expectations.

What are “fiduciary” duties? In corporations, partnerships, and LLCs, there have always been standards for how people acting on behalf of the organization must behave for the benefit of the organization and how controlling business owners must behave when taking action that will affect the other owners. Typically, the duties of directors of corporations and general partners in limited partnerships have included “fiduciary” duties. The term “fiduciary” has different meanings in different contexts and different areas of the law, but it generally means that a person cannot treat others at arm’s length but must consider their interests in making decisions. With respect to directors of corporations and their equivalents in other organizations, that duty has often been delineated as a duty of loyalty and a duty of care, sometimes with variants thrown in specifically, such as a duty of candor.

The duty of loyalty means fundamentally that a person must make all decisions in good faith and in what they believe to be the best interests of the organization as a whole (or at least not opposed to those interests), without being influenced by personal interests that conflict with the interests of the organization or the other owners. The duty of care generally means that the decision-maker must exercise reasonable diligence in considering and acting on a matter. That duty has often been described as the duty to act with the care that an ordinarily prudent person in a like position would use under similar circumstances.

The trend toward freedom of contract. When LLCs first became a common form of business organization, statutes and case law tended to carry these fiduciary duties over to LLC managers. But the recent trend in LLC law is to allow the parties to define the rules of their LLC as they see fit. Prior to 2016, Ohio law did not allow the members of an LLC to eliminate the duty of loyalty or the duty of care of managers, and as a result, most LLC operating agreements written before that change, and many written since, do not provide for the elimination of those duties.

With the adoption of the Ohio Revised Limited Liability Company Act, effective January 1, 2022, all parties to operating agreements should review those agreements for possible changes as a result of the Act. The duties of managers and members are fertile ground for re-evaluation. The parties may go as far as eliminating all fiduciary duties.

The “right” approach depends on your role. If you are involved in the management of an Ohio LLC, you may want to minimize or eliminate your fiduciary duties. For example, an LLC that is involved in real estate investment and is sponsored by a company that is involved in many different real estate projects may want to provide specific rules that allow the manager(s) of the LLC to be involved in other projects that could be viewed as competing with the LLC’s business. The rules on that subject could be carefully crafted to balance the interest of the sponsor in

This Client Advisory is part of a series highlighting different features of the Ohio LLC Act that goes into effect on January 1, 2022.* For other content regarding the Act, click [here](#).

**Note: The effective date has been delayed until February 11, 2022.*

engaging in other projects while not allowing certain carefully delineated forms of competition.

On the other hand, if you are a minority investor in an LLC and you are trusting the management to act in your best interests, you may want to see that full fiduciary duties are imposed, and you may even want to spell out clearly how certain situations must be handled.

Because this is not a “one-size-fits-all” situation, there can be significant tension between the desires of management and the desires of outside investors.

The nonwaivable duty of good faith and fair dealing. Under both existing law and the new statute, the parties cannot eliminate the implied covenant of good faith and fair dealing. This implied covenant is not technically a fiduciary duty, but it sometimes acts like one. The Ohio Supreme Court has noted that good faith “is a compact reference to an implied undertaking not to take opportunistic advantage in a way that could have not been contemplated at the time of drafting, and which therefore was not resolved explicitly by the parties.” The Court further stated, “[W]e have rejected the contention that a party breaches the implied duty of good faith and fair dealing merely by seeking to enforce the contract or by acting as permitted by its express terms.” The net effect on LLC agreements would seem to be that careful drafting could minimize future arguments over whether the covenant has been breached. If the parties expressly provide that a party can take certain action with impunity, the likelihood of a breach of the implied covenant is minimized; however, there is a risk that a court could find that the *way* in which a party took action is a failure of good faith. If a party acts with an intent to disadvantage another party rather than for a legitimate purpose for the business, that action may still be subject to challenge. Given the limitations of the implied covenant of good faith and fair dealing, a member who wants to be protected from actions of others should seek to preserve fiduciary duties in whole or in part.

Key takeaways. The parameters set for the duties of members and managers of an LLC can have a significant effect on economic outcomes, such as by allowing a manager to take actions that are not good for the LLC but are not in violation of the operating agreement. The desirability of any given duty depends on which side you find yourself. Parties entering into or reviewing an operating agreement should not treat language defining these duties as “boilerplate” but should think carefully about what concerns might arise and how they can be addressed by specific language, especially if the parties intend to modify or eliminate certain fiduciary duties. Of course, not every possibility can be anticipated, and then the implied covenant of good faith and fair dealing will require that a party act for the “common purpose,” not just their own interests.

ADDITIONAL INFORMATION

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