RESPONSE
TO
"CRITIQUE OF THE IDAHO UNIFORM REVISED LIMITED LIABILITY COMPANY ACT"

Richard Riley
Hawley Troxell Ennis & Hawley LLP

In the September 2009 issue of The Advocate, Mr. Winston Beard published "*A Critique of the Idaho Uniform Revised Limited Liability Company Act*". The following article reviews the criticisms leveled by Mr. Beard (*identified below in italics*). The author disagrees with Mr. Beard's assertions of fundamental defects in the Act but concurs with a number of his concerns.

Background:

In 2008, Idaho became the first state[1] to adopt the Revised Uniform Limited Liability Company Act ("*RULLCA*"), drafted by the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws). The Idaho Uniform Limited Liability Company Act ("*IULLCA*")[2] initially applied to limited liability companies ("*LLCs*") first formed on or after July 1, 2008 and, following a two year transition period, has applied since July 1, 2010 to all previously formed LLCs.

1. IULLCA Provides Default Rules

WB: The 2007 Idaho Legislature wasted the opportunity "to provide Idaho with limited liability company (LLC) laws particularly suited for medium-sized entities with simple capital, management, authority, and management liability structures."

IULLCA expressly provides that, with certain enumerated exceptions[3], the statutory provisions are default rules that apply only if the operating agreement (which can be oral, written, implied, or any combination thereof[4]) does not address a particular matter.[5] As an organizing principle, the drafters designed RULLCA to provide default rules that operate only in the arena where the members fail to address a particular issue in their operating agreement. This arena is more likely to be populated by unsophisticated business partners who do not regularly consult an attorney than by more sophisticated business persons who own or operate medium or larger-sized businesses and are used to consulting lawyers. The latter, more savvy group, is much more likely to obtain legal counsel to document the agreement among the owners; in that situation the operating agreement should contain operative provisions that supersede the default rules of the statute.

In considering Mr. Beard's critique of the statute, keep in mind that he is commenting on default rules which, for the most part, can and likely will be superseded by provisions in the members' operating agreement. Accordingly, IULLCA's default rules should be viewed in the context of those situations involving relatively unsophisticated business partners who do not reduce their agreement to writing.[6] Much more important to more sophisticated business persons is the nearly complete flexibility that IULLCA allows in structuring the internal affairs of

an LLC, including flexibility in allocating distributions and tax items among members that is not readily available in the corporate form.

2. Limited Liability

WB: "Business leaders are not fiduciaries." IULLCA "undermines the very concept of limited liability by treating managers and owners like trustees.… The new law … exposes management to greater liability than exists under any other Idaho entity law, except for general partnerships."

These statements conflate the limited liability of LLC members to third parties (external liability) with the duties owed by members to the other members of a member-managed LLC and by managers to members of a manager-managed LLC (internal duties). Corporation, limited liability partnership, and LLC statutes limit liability of managers and owners to third parties. They do not limit liability of managers to owners or owners to owners. Let's consider external liability and internal duties separately.

External Liability

Like the Idaho Business Corporation Act ("*IBCA*"), IULLCA shields LLC owners from liability to third parties for company obligations.[7] In comparison to the IBCA, however, IULLCA's limited liability provisions are even more protective: IULLCA expressly shields managers, as well as members, against liability for company obligations to third parties. There is no comparable provision in the IBCA that protects corporate directors or officers. Further, in contrast to corporate law where failure to maintain formalities may result in loss of the limited liability shield and subject shareholders to liability for the corporation's obligations,[8] IULLCA expressly provides that "failure … to observe any particular formalities relating to the exercise of its powers or management of its activities is not a ground for imposing liability on the members or managers for the debts, obligations or other liabilities of the company".[9] IULLCA does not undermine, but rather reinforces, the limited liability of members and managers to third parties.

Internal Duties: Fiduciary Nature of Duties of Care and Loyalty

IULLCA fiduciary duties do not materially differ from the duties owed by management and owners of corporate entities. Under the IBCA, corporate directors and officers owe duties of care and undivided loyalty to the corporation and its shareholders.[10] Although the IBCA does not expressly provide that these duties are fiduciary in nature, the Idaho Supreme Court has held them to be fiduciary duties.[11] Similarly, managers of a manager-managed LLC owe fiduciary duties of care and loyalty to the company and its members.[12]

As for entity owners, a member of a manager-managed LLC does not have any fiduciary duty to the LLC or to any other member by reason of being a member,[13] just as a shareholder generally has no fiduciary duty to other shareholders or to the corporation.

In a member-managed LLC, in contrast, the fiduciary duties of care and loyalty are owed by each member to the other members.[14] This rule reflects the partnership law genesis of RULLCA and appears to be the source of Mr. Beard's concern that IULLCA imposes greater liability on management than any entity other than a general partnership. However, while it is true that corporation statutes do not impose fiduciary duties on shareholders, courts have

imposed such duties on controlling shareholders of closely-held corporations.[15] In the analogous context in which IULLCA's default rules are designed to operate (i.e., the small group of unsophisticated business partners who choose to operate as a member-managed LLC because of its flexibility and lack of formality), the principles of partnership law make sense and are consistent with courts' treatment of closely-held corporations.[16]

Mr. Beard's assertion that business leaders are not fiduciaries is incorrect. The duty of loyalty under the IBCA, which requires directors and officers to act in the best interests of the corporation and not their own self-interest, is clearly fiduciary, as is the duty of care.[17] Any concern that fiduciary duties imposed on business leaders could impair their willingness to take risk is vitiated by the business judgment rule, which "immunizes the good faith acts of directors when acting within the powers of the corporation and within the exercise of their honest business judgment." [18] As discussed below, the business judgment rule applies to Idaho LLCs as well.

Internal Duties: Duty of Care

IULLCA reformulates the standard of care established by Idaho's previous LLC statute (Idaho Code §§53-601 *et seq*., the "*Old Act*"),[19] conforming it to the IBCA standard -- that is, subject to the business judgment rule, a member of a member-managed LLC or a manager of a manager-managed LLC must act with the care that a person in like position would reasonably exercise under similar circumstances and in a manner the member or manager reasonably believes to be in best interests of LLC.[20] This duty does not invoke the higher duty of care imposed on trustees[21] and is consistent with the duty of care owed by directors and officers under the IBCA.

Internal Duties: Duty of Loyalty

The duty of loyalty includes three listed components:[22] (1) the duty to account and hold as trustee any property, profit or benefit derived by the member or manager from use of LLC property or appropriation of LLC opportunity; (2) the duty to avoid conflicting interest transactions with the LLC (subject to the defense that the transaction is fair to the LLC or that the transaction has been authorized or ratified by the members after full disclosure of all material facts);[23] and (3) the duty not to compete with the company. Presumably, these duties to the LLC and its members are the subject of Mr. Beard's assertion that IULLCA treats owners and managers like trustees. In particular, Mr. Beard suggests that the duty to hold as a trustee any profit derived by the member includes compensation, fringe benefits, and distributions. This is an incorrect reading of the statute: The statute is directed at a member's or manager's profit or benefit derived from personal use of LLC property or appropriation of an LLC opportunity without consent of the members, not at profit or benefit from distributions to members or compensation paid or fringe benefits provided to managers. [24]

IULLCA's default prohibitions of appropriation of LLC property or opportunities, related party transactions, and competitive activities -- the three components of the duty of loyalty specified by IULLCA -- are entirely consistent with duty of loyalty imposed on corporate directors and officers. Each of the IULLCA components finds corresponding provisions in the IBCA: The duty of loyalty of corporate directors and officers is embodied in Idaho Code §30-1-830, which provides that a director must act in good faith and in a manner the director reasonably believes

to be in the best interest of the corporation.[25] As a corollary, corporate directors and officers have a duty to account for (1) any financial benefit to which they are not entitled, (2) the use of corporate property for personal purposes, and (3) the appropriation of a corporate opportunity.[26] Similarly, the duty to avoid conflicting interest transactions is evidenced by detailed IBCA provisions defining "director's conflicting interest transaction" and providing safe harbors for such transactions approved by disinterested directors or shareholders, or otherwise proven by the interested director to be fair to the corporation.[27] The duty of loyalty of corporate directors also involves duties of confidentiality and disclosure,[28] which would likely be violated by competition with the corporation.

Most importantly, IULLCA expressly permits the members to restrict or eliminate each of these components of the duty of loyalty.[29] So, for example, the operating agreement of a family LLC would authorize family members to use the LLC's vacation cabin for personal purposes; a physician who owns a medical office building could be authorized to lease the building to the PLLC in which the physician participates in a group practice with other providers; and the manager of a real estate investment company could be permitted to devote time to management of other real estate investments, including properties that might compete in the same marketplace.

Internal Duties: Contractual Obligation of Good Faith and Fair Dealing

This obligation is not a fiduciary duty or a generalized duty of good faith, but rather arises out of the contract-based nature of LLCs.[30] It applies to members and managers alike,[31] requiring them to discharge the duties under IULLCA or the operating agreement and to exercise any rights consistently with the contractual obligation of good faith and fair dealing. It is intended to protect, but not allow the court to remake, the members' agreement.[32] The author agrees with Mr. Beard that this contract-based obligation is consistent with business practices and should not pose a problem to Idaho lawyers or their clients.

Internal Duties: "Uncabined" Duties

WB: IULLCA allows a judge to impose unspecified and unknown duties.

Whereas the Revised Uniform Partnership Act "cabins in" fiduciary duties within a statutory formulation,[33] the drafters of the Revised Uniform Limited Liability Company Act decided that RULLCA should not exhaustively codify, or "cabin in", the fiduciary duties of LLC members and managers.[34] This open-ended structure leaves uncertainty for LLC members who fail to limit the scope of IULLCA duties in their operating agreement. The Idaho Supreme Court's decision in the *Bushi* case gives credence to Mr. Beard's concern that IULLCA allows courts to impose fiduciary duties not contemplated by the LLC members when they formulated their agreement.[35]

Nevertheless, IULLCA allows the careful drafter of an operating agreement to "cabin in" the scope of these duties by contract. For the more sophisticated, medium-sized businesses that concern Mr. Beard, IULLCA allows substantial flexibility in modifying or eliminating various duties of managers and members. In contrast to the IBCA (which makes no provision for alteration of statutory duties of care and loyalty), an LLC operating agreement may, if not "manifestly unreasonable", restrict or eliminate the specifically identified components of the duty

of loyalty, identify specific types or categories of activities that do not violate the duty of loyalty, alter the duty of care, and alter any other fiduciary duty including eliminating particular aspects of that duty.[36]

IULLCA provides guidance for court application of the "manifestly unreasonable" standard: The court must consider the circumstances as of date of the operating agreement, not in hindsight at the time of complaint; and the court may invalidate a challenged term of an operating agreement only if, in light of the purposes and activities of the LLC, it is readily apparent that (1) the objective of the term is unreasonable or (2) the term is an unreasonable means to achieve the objective.[37] To date, this provision has not been applied or interpreted by an Idaho court. It remains to be seen whether this standard achieves the RULLCA drafters' objectives of curtailing any inclination by a court to re-write the members' agreement. Mr. Beard's observations that "facts and circumstances tests are common in the IULLCA" and "there are few solid guidelines for business" may prove prescient in this context.

3. Unfriendly to Business?

WB: IULLCA "adds new complexity making Idaho unfriendly to business."

Many of the IULLCA provisions are not new;[38] and, to the extent that IULLCA adds complexity, that complexity resolves questions unanswered by Idaho's earlier LLC statute[39] and enables the flexibility that makes LLCs so supremely useful for "the complex and variegated world"[40] of sophisticated financial and business deals. Far from being unfriendly to business, IULLCA provides statutory clarity that cannot be gleaned from, for example, the Delaware Limited Liability Act.

WB: IULLCA's authorization of direct actions invites suits by disgruntled members.

IULLCA authorizes direct actions by members against the LLC, managers or other members, but only to the extent of an actual or threatened injury that is not solely the result of an injury suffered by the LLC.[41] To have standing to bring a direct action, a member must be able to show a harm that occurs independently of the harm caused or threatened to be caused to the LLC.[42] Where the harm is caused or threatened to be caused to the LLC, a member may bring a derivative action to enforce a right of the LLC, following demand (or demand futility) and the opportunity for the LLC to convene a special litigation committee to investigate the claim to determine whether pursuit of the claim is in the LLC's best interest.[43]

These provisions correlate closely with the IBCA[44] and corporate case law in Delaware and other jurisdictions, which don't seem to have overly encouraged direct actions by disgruntled shareholders. They represent the norm, not some business-unfriendly innovation.

4. Operating Agreement

WB: Uncertainties result from IULLCA's allowance of operating agreements made or amended by oral agreement or course of conduct. [45]

A person becoming a member or a lender taking a pledge of a membership interest to collateralize a loan should take precautions to ascertain fully the contents of the operating

agreement and the actual authority of transaction document signatories.[46] Mr. Beard correctly notes that a written operating agreement cannot be relied upon absent a current certification of all members that there are no other oral agreements or unanimous consents changing its terms and that the business is operated in accordance with the operating agreement.

Mr. Beard points to extensive Official Comments trying to interface IULLCA's definition of operating agreement with the statute of frauds and the parole evidence rule, concluding that there are no meaningful guidelines on enforceability of a requirement that the operating agreement (or presumably any amendment of the operating agreement) be in writing. A merger clause should be included in any written operating agreement but, under general principles of contract law, will not protect against subsequent amendments by oral agreement or course of conduct.

IULLCA, however, provides that the operating agreement may specify that its amendment require satisfaction of a condition.[47] To minimize the problem of oral or implied-by-conduct amendments, consider providing in the operating agreement that it may be amended only upon written consent of a specified percentage of the members and that this provision is intended to be a "condition" that must be satisfied under IULLCA -112(1).

The problems posed by allowance of oral or implied operating agreements or amendments similarly existed under the Old Act, which defined operating agreement as "any agreement, written or oral, of all of the members."[48] Some of these problems could potentially be solved by a statutory requirement that, to be enforceable, the operating agreement must be in writing. However, such a rule would not be well-adapted to the many unsophisticated small business operators who never get around to writing up an agreement.[49]

Under the heading "Contributions", Mr. Beard observes that the Old Act provides that a promise to contribute is not enforceable unless set forth in a writing signed by the member.[50] In contrast, under IULLCA, a creditor of an LLC that extends credit or otherwise acts in reliance on a person's obligation to make a contribution to the LLC may enforce the obligation.[51] Mr. Beard is correct that the enforceability of an oral promise to contribute could be problematic for the creditor, member, and LLC.[52]

5. Capital Structure

WB: Capital is central to business persons and the IRS, but irrelevant under IULLCA. IULLCA "assumes the entity has no capital". Per capita distribution and voting rights are anathema to business.

IULLCA expressly contemplates capital contributions by the members.[53] However, Mr. Beard correctly observes that IULLCA allocates rights to distributions or to participate in management based on the relative amounts of members' capital contributions. Like the Old Act[54], IULLCA's default voting rights and distribution rights are per capita, not per capital.[55] On dissolution, the LLC's assets are distributed first to each person owning a transferable interest that reflects the member's previously unreturned contributions, and then to the members per capita.[56] Whether these default rules are more or less appropriate (*i.e.*, consistent with reasonable expectations of the unsophisticated partners for whom the default rules were designed) than rules that would allocate such rights based on invested capital is debatable; but,

from a practical standpoint, the question is moot since there will be very few LLCs where the members have not agreed, orally if not in writing, how to manage the business and divvy up the profits. In the event of a falling out among members who have only an oral agreement, Mr. Beard's view that profits, losses, and distributions should be allocated based on contributed capital may be well-taken; how management rights should be allocated in the event of a falling out is less clear.

WB: IULLCA lacks provisions coordinating with IRC 704(b) rules.

The author is unaware of any LLC statute in any state that attempts to codify IRC 704(b) capital accounting rules or the valuation of members' capital accounts or the allocation of tax items among members for federal tax purposes, or that distinguishes capital interests from profits interests of LLC members. Considering that IULLCA's default provisions are intended for the most unsophisticated business partners, the tax allocations are likely to follow the distributions to the members, and not require detailed special allocation provisions to comply with the 704(b) regulations under the Internal Revenue Code. Further, any attempt to capture the thousands of pages of federal partnership tax rules in the Idaho LLC statute would be counterproductive and likely would deprive sophisticated businesses of the flexibility to design distribution waterfalls and special allocations of tax items to meet specific needs. Mr. Beard is correct that an intimate understanding of federal partnership tax and capital accounting rules is necessary to competently draft an operating agreement for nearly any business arrangement other than a simple partnership; but a state LLC statute is not the vehicle to provide that guidance.

6. Authority

WB: Under IULLCA, apparent authority of members and managers is a facts and circumstances test.

Managers of manager-managed LLCs have actual authority to decide exclusively any matter relating to the LLC's activities.[57] IULLCA de-codifies the "statutory apparent authority" of members that existed under the Old Act.[58] With that exception, the law applicable to the authority of LLC members and managers is unchanged. Although IULLCA specifies default rules for internal management of an LLC[59], the facts and circumstances tests of actual and apparent authority under general principles of agency law continue to apply to the LLC's external activities involving third parties.

IULLCA provides for filing a statement of authority with Idaho Secretary of State to state or limit the authority of any member or manager (identified by position or specific person) to bind the LLC.[60] A filed statement of authority concerning real property provides constructive notice of authority concerning real property transactions. However, a filed statement of authority granting or limiting authority regarding matters other than real property is NOT constructive notice. Actual knowledge is required to bind a third party.

Mr. Beard advises that the only safe position is to file a statement of authority. However, a statement of authority has only marginal utility because it provides constructive notice concerning authority to conduct real property transactions, but not as to other matters. Nevertheless, actual delivery of a statement of authority can serve to disclose management

structure and as alternative to disclosure of entire operating agreement when authority is at issue.

Summary:

WB: The problems in IULLCA overwhelm its utility. Business lawyers cannot reasonably advise their clients to take the risks inherent in forming or operating an LLC under IULLCA.

The fact that LLCs continue to be the entity of choice in Idaho demonstrates that IULLCA is not unfriendly to business.

While IULLCA's default rules are more complex than the default rules under the Old Act, IULLCA's complexity enables the flexibility needed to address the myriad of business purposes and organizations – from small closely-held partnerships to sophisticated investment vehicles --- needed and used by Idaho businesses. The fiduciary duties established by the default rules do not materially differ from the fiduciary obligations owed by corporate managers to the corporation and its shareholders.

For more sophisticated business persons, IULLCA allows substantial flexibility in eliminating or altering those duties to fit the needs of any particular enterprise, flexibility that is not available to businesses conducted in corporate form. IULLCA's default rules – preservation of limited liability notwithstanding failure to observe formalities, fiduciary duties of loyalty and care, and the contractual obligation of good faith and fair dealing – are well-calibrated for the needs of unsophisticated partners who do not address these matters in their operating agreement.

IULLCA's direct / derivative action provisions essentially mirror the IBCA, where they have not proven to invite direct suits against the corporation or shareholders.

The default rules on per capita voting and distribution voting rights may theoretically be problematic; but from a practical perspective, there will be few situations where members have not reached at least oral agreement on management and profit distributions, thereby overriding the default rules.

Actual and apparent authority issues remain, but they are not new or unique to IULLCA.

In the author's experience, out-of-state lenders and investors often want to deal with a Delaware LLC. But for Idaho businesses and their attorneys, IULLCA provides a highly workable framework and substantial guidance for drafting Idaho LLC operating agreements to adapt default rules to meet clients' needs. The author respectfully disagrees with Mr. Beard's conclusion that business lawyers cannot reasonably advise clients to form or operate Idaho LLCs.[61]

---

[1] Since that time, five other states have enacted RULLCA: Iowa (2008), Nebraska (2010), Wyoming (2010), District of Columbia (2011) and Utah (2011).

[2] Idaho Code §§ 30-6-101 *et seq*. ("*IULLCA*"). For brevity, citations to IULLCA are abbreviated by dropping the reference to "Idaho Code § 30-6".

[3] The exceptions are stated in IULLCA -110(3) (a)-(k). Mr. Beard complains that these provisions impair freedom of contract. However, the business community and the bar have not suffered because of the long-standing existence of similar provisions in the Idaho Uniform Partnership Act or the Idaho Uniform Commercial Code. *See* Idaho Code § 28-9-602 (prohibiting debtor or obligor from waiving or varying certain statutory rules); Idaho Code § 53-3-103 (specifying certain nonwaivable provisions of Act which cannot be varied by a general partnership agreement).

[4] IULLCA -102(15). The Official Comment to IULLCA -110 observes that IULLCA -102(15) "delineates a very broad scope for an 'operating agreement.' As a result, once an LLC comes into existence and has a member, the LLC necessarily has an operating agreement."

[5] IULLCA -110(1) ("Except as otherwise provided in subsections (2) and (3) of this section, the operating agreement governs …."); IULLCA -110(2) ("To the extent the operating agreement does not otherwise provide for a matter described in subsection (1), this chapter governs the matter.")

[6] Even unsophisticated partners who forgo a written agreement will have a basic agreement, established orally and perhaps modified by course of conduct, on governance and profit distributions. The default rules come into play if proof problems arise when the partners have a falling out.

[7] IULLCA -304(1) ("The debts, obligations or other liabilities of a limited liability company, whether arising in contract, tort or otherwise: (a) Are solely the debts, obligations or other liabilities of the company, and (b) Do not become the debts, obligations or other liabilities of a member or manager solely by reason of the member acting as a member or manager acting as a manager.") *Compare* Idaho Code §30-1-622(2) ("Except as provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct.")

[8] *See VFP VC v Dakota Company*, 109 P.3d 714, 141 Idaho 326, 335 (Idaho 2005); *Alpine Packing Company v. H.H.Keim Company, Limited*, 121 Idaho 762, 764, 828 P.2d 325 (Idaho Ct. App. 1991).

[9] IULLCA -304(2).

[10] Idaho Code §§ 30-1-830(1), -831.

[11] *See Waters v. Double L, Inc.*, 769 P.2d 582, 115 Idaho 705, 707 (Idaho 1989) (quoting former Idaho Code § 30-1-35, which provided that a director shall perform his duties "in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances": "This is the standard of fiduciary duty by which [the director's] conduct must be measured.") *See also Mannos v. Moss*, 143 Idaho 927, 933, 155 P.3d 1166 (Idaho 2007) ("In a closely-held corporation, the corporate directors owe a fiduciary duty to one another, to the corporation and to the shareholders."). *Accord, McCann v. McCann*, 61 P.3d 585, 590, 138 Idaho 228 (Idaho 2002); *Steelman v. Mallory*, 716 P.2d 1282, 110 Idaho 510, 513 (Idaho 1986) ("That the directors of a closely held corporation owe a fiduciary duty to the minority shareholders is well recognized.)

[12] IULLCA -409(1), (2), (3), (7).

[13] IULLCA -409(7)(e)

[14] IULLCA -409(1); *see Bushi v. Sage Health Care PLLC,* 146 Idaho 764, 203 P.3d 694 (Idaho 2009). Sage Health Care PLLC was a member-managed LLC. Limited to its facts, *Bushi* does not speak to the duties of members of manager-managed LLCs. The decision does appear, however, to have expanded IULLCA's fiduciary duties to include a fiduciary duty of good faith (as opposed to the contractual duty of good faith and fair dealing), *i.e.*, a duty not to take action, even in accordance with the operating agreement, to obtain financial advantage over another member. *Id*. at 770-71.

[15] *See Steelman v. Mallory*, 716 P.2d 1282, 110 Idaho 510, 513 (Idaho 1986); *Fox v. Cosgriff*, 66 Idaho 371, 381-83, 159 P.2d 224 (Idaho 1945). The gravamen of Steelman's complaint was that the majority shareholders / directors were attempting to squeeze out a minority shareholder. The Court quoted O'Neal, Close Corporations § 8.07 (2d ed.) with approval as follows: "This view that the controlling shareholders and the directors do not owe fiduciary duties to minority shareholders appears outmoded, at least as applied to squeeze-outs and other attempts to eliminate minority shareholders or to deprive them of their proportionate rights and powers without just equivalent. Where several owners carry on an enterprise together (as they usually do in a close corporation), their relationship should be considered a fiduciary one similar to the relationship among partners." In *Fox*, the Court noted that a fiduciary duty

may arise from a relationship of confidence and trust between a majority controlling shareholder and a minority shareholder.

[16] *Bushi, supra* note 14, was decided under the Old Act, suggesting that, even without the new LLC statute, the Idaho Supreme Court would have held that the members of closely-held LLCs owe fiduciary duties to one another. Adding IULLCA to the mix at least allows the flexibility to modify the default framework in order to effectuate the members' intent and protect against judicial second-guessing.

[17] *Steelman v. Mallory*, 716 P.2d 1282, 110 Idaho 510, 513 (Idaho 1986) ("Idaho courts have recognized that a director has a fiduciary responsibility to both the corporation and to shareholders. …. As fiduciaries, corporate directors are bound to exercise the utmost good faith in managing the corporation."); *Weatherby v. Weatherby Lumber*, 492 P.2d 43, 94 Idaho 504, 507 (Idaho 1972). *Accord, McCann v. McCann*, *supra*. *See also* note 11 and accompanying text.

[18] *Steelman* , *supra* at 513; *McCann, supra* at 590.

[19] Idaho Code § 53-622 (member / manager not liable to LLC or members absent gross negligence or willful misconduct).

[20] Idaho Code § 30-1-830 (A director must discharge his duties with "the care that a person in a like position would reasonably believe appropriate under the circumstances" and act "in a manner the director reasonably believes to be in the best interests of the corporation.")

[21] *See, e.g.*, Idaho Code § 15-7-302 ("[T]he trustee shall observe the standards in dealing with the trust assets that would be observed by a prudent man dealing with the property of another ….")

[22] IULLCA -409(2) provides: "The duty of loyalty of a member of a member-managed limited liability company includes the duties: (a) To account to the company and to hold as trustee for it any property, profit or benefit derived by the member: (i) In the conduct or winding up of the company's activities; (ii) From a use by the member of the company's property; or (iii) From the appropriation of a limited liability company opportunity; (b) To refrain from dealing with the company in the conduct or winding up of the company's activities as or on behalf of a person having an interest adverse to the company; and (c) To refrain from competing with the company in the conduct of the company's activities before the dissolution of the company." These duties are imposed on the manager of a manager-managed LLC. IULLCA -409(7). In keeping with concept that duties are "uncabined" (*see* notes 34-35 and accompanying text), the Official Comment to IULLCA -110(4) indicates there may be other uncodified aspects of the duty of loyalty.

[23] IULLCA -409(5), (6).

[24] Note that these components of IULLCA's duty of loyalty are not new. The Old Act imposes virtually the same obligation on every member and manager to account for and hold as trustee any profit or benefit derived by that person without consent of disinterested members or managers. Idaho Code § 53-622(2).

[25] Corporate officers owe the same duty of loyalty as directors. Idaho Code § 30-1-842.

[26] The existence of this duty is evidenced by the express statutory exceptions to IBCA provisions authorizing exculpation and indemnification of directors. Idaho Code § 30-1-202(4)(d) (allowing exculpation of directors from liability to the corporation or its shareholders for money damages) and (e) (authorizing indemnification of directors) both except liability for receipt of a financial benefit to which the director is not entitled, intentional infliction of harm on the corporation or its shareholders, unlawful distributions, and intentional violation of criminal law. Compare IULLCA -110(7), which provides:

> The operating agreement may alter or eliminate the indemnification for a member or manager provided by section 30-6-408(1), Idaho Code, and may eliminate or limit a member or member's liability to the limited liability company for money damages except for: (a) Breach of the duty of loyalty; (b) A financial benefit received by the member or manager to which the member or manager is not entitled; (c) A breach of a duty under section 30-6-406 [liability for improper distributions]; (d) Intentional infliction of harm on the company or a member; or (e) An intentional violation of criminal law.

[27] Idaho Code §§ 30-1-860 *et seq*.

[28] *Jordan v Hunter*, 865 P.2d 990, 124 Idaho 899 (Idaho Ct. App. 1993) ("As an agent, an officer owes his principal, the corporation, the fiduciary duties of good faith and fair dealing. …Good faith and fair dealing require that the officer make a full, fair and timely disclosure of facts within his knowledge that are material to the transaction and which might affect the corporation's rights and interests or influence its actions.")

[29] IULLCA -409(4)(a).

[30] Official Comment to IULLCA -409(4)

[31] IULLCA -409(4) (applying to members of member-managed or manager-managed LLC), (7)(c) (applying to managers of manager-managed LLC).

[32] Official Comment to IULLCA -409(4).

[33] Idaho Code § 53-3-404(a) ("The fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c) of this section.")

[34] *See* Official Comment to IULLCA -409 re "uncabined" fiduciary duties of loyalty and care and other (unspecified) fiduciary duties. *See* IULLCA -110(4)(d) authorizing alteration of "any other fiduciary duty" (*i.e.*, other than the fiduciary duties of care and loyalty and the contractual obligation of good faith and fair dealing).

[35] *See* notes 14 and 16 re the *Bushi* case.

[36] IULLCA -110(4). Many other provisions of IULLCA must be read in light of IULLCA -110(3) and (4): Section -110(3) restricts the ability of the operating agreement to vary a number of provisions of the Act (including fiduciary duties and the contractual duty of good faith and fair dealing as provided in IULLCA -409); but in some cases (detailed in -110(4)) IULLCA allows elimination or restriction of certain duties if not "manifestly unreasonable". For example, IULCCA's standard of care may not be eliminated but may be altered, if (i) not "manifestly unreasonable" and (ii) except that the altered standard may not authorize intentional misconduct or knowing violation of law. IULLCA -110(3)(d) and (4)(c). Similarly, -110(3) (d) provides that the duty of loyalty may not be eliminated; but -110(4)(b) permits the operating agreement, if not manifestly unreasonable, to eliminate or restrict all listed components of the duty of loyalty (*e.g.*, to allow competition with the LLC), and also permits the operating agreement to identify specific types or categories of activities that do not violate the duty of loyalty. (The Official Comment to IULLCA -110 indicates there may be uncodified aspects of duty of loyalty that would survive.) Likewise, -110(3) (d) provides that any other fiduciary duty may not be eliminated; but -110(4)(d) provides that the operating agreement can "alter any other fiduciary duty, including eliminating particular aspects of that duty". It is unclear how courts will interpret the "manifestly unreasonable" standard or what "other fiduciary duty" might be implied by the courts. (*See* notes 14 and 16.) Nevertheless, IULLCA allows substantial leeway to LLC members or their counsel to adapt the duties among members and between managers and members to meet the members' particular needs and objectives, rather than being subject to the one-size-fits-all approach of the IBCA.

[37] IULLCA -110(8).

[38] IULLCA retains the principal features of the Old Act, such as member-management absent operating agreement provision for manager-management, limited liability of members and managers, lack of need to maintain formalities, per capita voting and distribution default rules, distinction between transferable (economic) interest and other rights of membership, charging orders, and authority to exculpate members and managers from liability for money damages for breach of duties. Cross-Reference Tables correlating the provisions of IULLCA and the Old Act and a narrative comparison of their respective provisions may be viewed at http://www.hawleytroxell.com/news-events/archives/.

[39] For example, IULLCA expressly establishes the primacy of the members' operating agreement, authorizes single member LLCs, provides for managing members and noneconomic members, spells out detailed information rights of managers and members, specifies members' remedies for oppressive conduct, authorizes direct and derivative actions and use of special litigation committees, and provides that dissociation of a member no longer constitutes an event of dissolution. A more detailed list of the new provisions may be viewed at http://www.hawleytroxell.com/news-events/archives/.

[40] Official Comment to IULLCA 409(1) and (2).

[41] IULLCA - 901.

[42] *See* Official Comment to IULLCA -901.

[43] IULLCA -905.

[44] Idaho Code §§ 30-1-740 *et seq*.

[45] Read together, IULLCA -102(15) and -110(1) define "operating agreement" to mean the agreement of the members, whether written, *oral, implied* or a combination thereof, governing the relations among the members and between the members and the LLC, the rights and duties of managers, the company's activities, and the means and conditions for amending the operating agreement.

[46] *See* Official Comment to IULLCA -110(2).

[47] IULLCA -112(1).

[48] Idaho Code § 53-601(11)

[49] For a thoughtful analysis of other problems that arise from a written agreement requirement, see Goforth, C.R., "Why Arkansas Should Adopt The Revised Uniform Limited Liability Company Act", 30 UALR 31, 33-37 (2007).

[50] Idaho Code § 53-627.

[51] IULLCA -403(2).

[52] The suggestion that a provision in the operating agreement could change the new rule back to the old one is incorrect. By statutory definition, the operating agreement affects only the relations among the members, managers and LLC. *See* note 45. The operating agreement may not restrict the rights under IULLCA of a person other than a manager or a member. IULLCA -110(3)(k).

[53] IULLCA -402, -403 (Creditor of LLC that extends credit or otherwise acts in reliance on person's obligation to contribute to LLC may enforce obligation.)

[54] Idaho Code §§ 53-623, -632. Similarly, under the default rules in the Idaho Uniform Partnership Act, each partner has an equal right to partnership profits and losses and an equal right in the management and conduct of the partnership business. Idaho Code § 53-3-401(b),(f). In contrast, unless the limited partnership agreement provides otherwise, the Idaho Uniform Limited Partnership Act allocates profits, losses and distributions among the partners on the basis of the value of unreturned contributions made by each partner. Idaho Code §§ 53-229, -230. General partners of a limited partnership, however, vote per capita unless the partnership agreement provides otherwise. Idaho Code § 53-226.

[55] IULLCA -407(2)(b) (In a member-managed LLC, each member has equal rights in management and conduct of company activities); IULLCA 407(3)(b) (In a manager-managed LLC, each manager has equal rights in management and conduct of company activities); IULLCA -404(1) (distributions must be in equal shares).

[56] IULLCA -708(2)(b).

[57] IULLCA -407(3).

[58] *Compare* IULLCA -301 ("A member is not an agent of a limited liability company solely by reason of being a member.") with Old Act 53-616(1) (providing in pertinent part that, in member-managed LLC, "every member is an agent of the limited liability company for the purpose of its business or affairs, and the act of any member … for apparently carrying on in the usual way the business or affairs of the limited liability company …binds the limited liability company …."), -617 (member's admission or representation is binding) and -618 (member's knowledge and notice to member are binding).

[59] IULLCA -407 (specifying separate management rules for member-managed LLCs and manager-managed LLCs).

[60] IULLCA -302. A statement in the certificate of organization is not effective as a statement of authority. IULLCA -201(3).

[61] Mr. Beard is a highly respected business lawyer with substantial experience in structuring LLCs and drafting operating agreements. To the extent his conclusion might be proffered as evidence of the standard of practice of Idaho lawyers, the author believes Mr. Beard's conclusion is unequivocally incorrect.