Polishing Up Wisconsin's Fiduciary Duties in LLC Law to Attract New Suitors

Collin D. Brunk

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POLISHING UP WISCONSIN’S FIDUCIARY DUTIES IN LLC LAW TO ATTRACT NEW SUITORS

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I. INTRODUCTION

Should individuals be allowed to waive fiduciary duties in a limited liability company (LLC)? Why do these fiduciary duties matter? These questions pervade scholar’s discussions when looking to improve a state’s LLC provisions. Many states permit the contractual alteration and elimination of fiduciary duties in an LLC through waiver.1 However, many states fail to provide clear default fiduciary duties owed by members or managers of the LLC, nor do they provide a clear upholding of waived duties.2 Without a clearly articulated waiver policy3 and list of default duties, members and potential

2. See id. at 1094–95.
3. For a discussion of the alteration and elimination (waiver) of fiduciary duties, see infra Section III.B.1.
investors may experience higher transaction costs upon LLC formation and shy away from forming an LLC in that state.⁴ Allowing such issues to persist directly contradicts the policy behind LLC formation. As one scholar stated, “[T]he overall social policy goal of business entity governance [is] to foster investor confidence while keeping transaction costs at a minimum.”⁵ Thus, a state’s LLC statute and related provisions should reflect this sentiment.

Since Wisconsin’s adoption of the LLC in 1994⁶ little discussion has occurred regarding the default fiduciary duties members owe to the LLC and each other.⁷ Such lack of discussion leaves Wisconsin courts, attorneys, members of the LLC, and third parties to guess at the baseline fiduciary duties owed by members and managers. This topic must be tackled because the Wisconsin LLC statute ambiguously lists the default duties.⁸ The ambiguity in the current statute and lack of discussion leaves scholars debating whether common law fiduciary duties are owed if not contractually altered in the operating agreement.⁹

Wisconsin courts waver on their implementation of the “common law” fiduciary duties to members of an LLC, creating great uncertainty for members, managers, and investors in LLCs.¹⁰ The only certainty that parties in Wisconsin rely on is that fiduciary duties may be altered or waived by the contractual language of the operating agreement.¹¹ However, this waiver of fiduciary duties has not yet been upheld by Wisconsin courts,¹² creating many issues as parties are uncertain if their waiver will be enforced.

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⁵ Pace, supra note 1, at 1087 (alteration in original) (quoting Sandra K. Miller, The Duty of Care in the LLC: Maintaining Accountability While Minimizing Judicial Interference, 87 Neb. L. Rev. 125, 170–71 (2008)).


⁷ Id. at 27.


⁹ See generally Willenbrink, supra note 6, at 28–29.


¹¹ Kasten v. Doral Dental USA L.L.C., 2007 WI 76, ¶ 24, 301 Wis. 2d 598, 733 N.W.2d 300 (quoting JOSEPH W. BOUCHER ET AL., LLCs AND LLPs: A WISCONSIN HANDBOOK § 1.11 (rev. ed. 1999)).

¹² Pace, supra note 1, at 1112 & n.227.
Part II of this Comment examines the national rise of LLCs. Additionally, it explores the purpose of fiduciary duties as well as why they apply to certain individuals. This discussion puts into perspective the need to revise Wisconsin’s current LLC Act or enact a new LLC statute. Part III looks at the two most popular LLC regulatory methods, the Revised Uniform Limited Liability Company Act (RULLCA) and the Delaware method. Critiquing and examining these methods allows one to find the best practices to apply in Wisconsin. In addition, this part examines Wisconsin’s current LLC Act and the surrounding provisions, noting significant gaps in the current provisions. Part IV provides how Wisconsin can fill the gaps in its LLC provisions by enacting a new LLC statute that explicitly creates the default fiduciary duties of loyalty and care, but allows for the contractual waiver of these duties. The benefits derived from enacting this statute will increase investment in LLCs or promote additional LLC formations by fostering member and investor confidence.

II. EXPLORING THE HISTORY OF LLCs AND FIDUCIARY DUTIES

The LLC is a relatively new business entity that was first established in Wyoming in 1977.13 Wyoming’s legislature created this statutory entity “to encourage investment and to attract business and investment from outside the state of its organization.”14 To embody these attributes, the LLC drafters focused on providing freedom from cumbersome corporate taxation, while providing the limited liability protection found in corporations.15 This was the start of a revolution in business organization law that forever reshaped the landscape of business formations.

A. Formation and Structures of LLCs

LLCs are a hybrid business entity, combining the single-level flow-through taxation and flexibility of a partnership with the limited liability ownership concept found in corporations.16 Providing single-level flow-through taxation incentivizes investment in the entity, because the LLC’s profits will be taxed

14. Geu, supra note 13, at 50.
solely at the individual level, not at both the individual and entity level like a corporation’s profits. Similarly, the limited liability of ownership, plucked from corporate law, severs the traditional partnership concept of “joint and several” liability between members or managers of the business. Limited liability shields these individuals from the debts and obligations of the company, allowing members or managers to protect their personal assets in the event of bankruptcy or litigation. Perhaps the single most valuable aspect of an LLC is its flexibility as an entity. An LLC allows members to “creatively structure profits, losses, allocations and distributions, and many other elements of their relationship in ways that are unavailable to some other entity forms.” LLCs offer an attractive formula by decreasing taxation, mitigating the risks assumed by members, and allowing the greatest flexibility within the organization, making LLCs a nationally popular business formation.

LLCs are statutory entities, and each state provides a unique statutory provision for the creation of an LLC within its borders. Each governing statute offers two different categories of provisions: mandatory provisions and default provisions. Mandatory provisions cannot be contractually altered in the operating agreement. Alternatively, default provisions only apply when the operating agreement doesn’t contain a conflicting provision or no operating agreement exists. Mandatory and default provisions often include fiduciary duties that are owed to other members or managers of the LLC, or to the LLC itself.

17. See Geu, supra note 13, at 45; see also Jay E. Grenig, 2 WIS. LEGAL FORMS § 13:31 (2018) (“The chief advantage of [pass-through taxation] is avoidance of double taxation of the earnings . . . ”).
18. Geu, supra note 13, at 50–51.
19. See id. at 52–54. However, in certain circumstances, courts may “pierce the veil” of limited liability. See id. at 52 n.55 (providing examples of when courts have pierced the corporate veil of limited liability).
20. Laurie A Ronholdt & Alex Pederson, Tips for Drafting and Issues Presented by LLC Operating Agreements, PRAC. TAX LAW., Fall 2008, at 7.
22. Ronholdt & Pederson, supra note 20, at 7–8.
23. Id. at 8.
24. Id.
25. See id.
26. See id.
Every state statute requires filing a general document—called the “articles of organization”—to form an LLC. In member-managed LLCs, the members can appoint managing members, but if none are appointed, then each member is considered an agent of the LLC. Generally, members in a manager-managed LLC do not owe fiduciary duties to either the LLC or to other members. Manager-managed LLCs, however, require a much more structured approach, with the duties defined in either an operating agreement or enacted in a set of bylaws. The decision of how the entity will be managed is an important distinction because different duties may be owed by managers and members in a manager-managed LLC. The duties for either management structure shall be defined in the operating agreement.

While LLCs are statutorily created entities, they are often subject to contractual alteration through the operating agreement. The operating agreement lists information about the operating affairs and business conduct of members or managers in the LLC. The operating agreement also governs LLC members’ relationships to each other and the LLC, which includes fiduciary duties. Operating agreements only operate inside the allowable scope of the governing statute; thus, the operating agreement may alter default provisions, but not mandatory provisions. Additionally, through the governing statute the operating agreement may allow for increasing, decreasing, or even eliminating fiduciary duties. Overall, the operating agreement provides the flexibility desired in an LLC by allowing members to clearly set expectations and define duties owed.

27. Geu, supra note 13, at 56.
28. Id.
29. Ronholdt & Pederson, supra note 20, at 11.
31. Ronholdt & Pederson, supra note 20, at 11.
32. See id. at 12.
33. Id. at 11.
34. See Pace, supra note 1, at 1086.
35. See Ronholdt & Pederson, supra note 20, at 7.
37. Id. ¶ 5.06[2][a][i].
38. Id. ¶ 5.06[2][d][i].
B. Overview of Fiduciary Duties

Most LLC statutes contain provisions outlining members’ and managers’ fiduciary obligations to each other and the LLC. But before delving into what these provisions obligate parties to do, one must first understand what fiduciary duties are, as well as the purpose of fiduciary duties. To accomplish this task, the following discussion will touch on fiduciary duties in the context of both corporations and LLCs.

Fiduciary duties are obligations owed to a beneficiary due to the vulnerability of their position. It is this vulnerability that creates a fiduciary relationship, which in turn imposes fiduciary duties upon individuals entrusted with decision-making power. An example of this relationship exists between managers and shareholders in a corporation. The managers owe fiduciary duties to the shareholders because the manager is in a position of power over the shareholders, who wield little day-to-day decision-making power in the corporation. If fiduciary duties were not imposed in this instance, managers could derive personal profit from the company while not serving the shareholders’ best interests.

Additionally, fiduciary duties function “as a response to the impossibility of contracting for all [future] contingencies due to limited information and high transaction costs.” Not all problems are foreseeable when starting a company, and contractually eliminating all the potential problems proves time intensive and costly for parties. Thus, fiduciary duties plug the holes that arise in contracts, particularly for items that were not explicitly contracted for. Further, fiduciary duties help determine what the parties would have agreed to had they actually negotiated the terms. Without fiduciary duties, parties are left contracting for all duties, and beneficiaries may not be able to trust the actions of members or managers of the LLC. This trust is instrumental in

39. CALLISON & SULLIVAN, supra note 30.
41. Id. at 244–45.
42. Id. at 245.
43. See id. at 241.
44. Pace, supra note 1, at 1086.
46. Alces, supra note 40, at 242.
47. Id.
48. Id. at 245.
attracting funding from beneficiaries. Additionally, fiduciary duties may be contractually imposed even when no fiduciary relationship exists, often through an LLC’s operating agreement. Implementing fiduciary duties on individuals allows those individuals entrusted with power to make flexible decisions, address unpredictable problems, and protect beneficiaries’ interests without incurring high contracting costs. However, if parties are not allowed to contractually alter fiduciary duties, they may experience higher costs as well.

Two fiduciary duties are often implemented within companies—the duties of loyalty and care. The most impactful of the fiduciary duties is the duty of loyalty. The duty of loyalty generally provides that fiduciaries may not engage in self-dealing or be motivated by their own self-interest in their work for the company. It is vital that managers or owners work toward benefitting the entity and not enriching themselves at the expense of the business. If managers could enrich themselves, companies would cease to serve the best interests of the beneficiaries, creating a public harm. The second fiduciary duty, the duty of care, provides that fiduciaries must reasonably inform themselves regarding business decisions and must monitor the entity. This is not a high standard, as parties must only act reasonably to fulfill their duty. Together, these fiduciary duties provide security for beneficiaries absent a contractual agreement.

While lower taxes, flexibility, and limited liability draw individuals toward forming LLCs, uncertainty regarding whether fiduciary duties exist may dissuade potential members. Since LLCs are statutorily created, fiduciary

50. See Alces, supra note 40, at 244.
51. CALLISON & SULLIVAN, supra note 30 (stating how operating agreements may “impose fiduciary duties on members who might not otherwise have them”).
52. Alces, supra note 40, at 241.
54. Miller, supra note 15, at 569.
55. Alces, supra note 40, at 249.
56. See id. at 247.
57. Id. at 251.
58. Id.
59. See supra Section II.A.
60. CALLISON & SULLIVAN, supra note 30.
duties are defined in each state’s LLC act. 61 Each state’s LLC statute describes whether fiduciary duties are mandatory or default provisions. 62 If fiduciary duties are default provisions, they may be contractually altered or even eliminated (in certain states) through the operating agreement. 63 However, many state statutes provide unclear language regarding which fiduciary duties are owed, and others are completely silent. 64 Legal uncertainty also adds cost by complicating business planning, promoting costly litigation, and impeding managerial discretion. 65 This creates uncertainty for individuals desiring to form an LLC, 66 and may cause them to consider organizing their business in a state where fiduciary duties are established. The absence of an explicit court holding regarding the waiver of fiduciary duties, as well as what fiduciary duties are owed when the statute is silent, will “add costs and inefficiencies to an LLC and its operations.” 67

III. APPLICABLE LLC METHODS

States approach the uncertainty surrounding default fiduciary duties and the waiver of fiduciary duties in a variety of ways. Several states adopted the Revised Uniform Limited Liability Company Act (RULLCA), which provides that members of an LLC owe the duty of care and loyalty as a default, which cannot be contractually altered in the operating agreement. 68 A majority of states, however, adopted the Delaware method. 69 In the Delaware method, managers likely owe default fiduciary duties when the operating agreement is silent, 70 but can certainly eliminate fiduciary duties through the operating

61. See Miller, supra note 15, at 568.
62. See id.
63. See Pace, supra note 1, at 1092–94.
64. See id. at 1094–1113.
66. See id.
67. Id.
68. See Campbell, supra note 4, at 32.
69. Pace, supra note 1, at 1092 n.46 (noting that Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Idaho, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, North Carolina, Nevada, New Hampshire, New Jersey, New Mexico, New York, Texas, Washington, and Wisconsin follow the Delaware approach).
70. Feeley v. NHAOCG, L.L.C., 62 A.3d 649, 659, 663 (Del. Ch. 2012); Altman et al., supra note 65.
agreement. In Delaware, the lower Court of Chancery initially held that managers owe default duties of loyalty and care when the operating agreement is silent concerning the existence of such duties. The Supreme Court of Delaware, however, disagreed with the lower court, taking no position on whether default fiduciary duties are owed. Further, the Delaware legislature enacted a new statute, which only clouded Delaware’s stance on default fiduciary duties. Additionally, Delaware allows for the complete elimination of all fiduciary duties in the operating agreement, but requires that members or managers act in good faith. States that have adopted these methods partially cured the default fiduciary duty and waiver dilemma; however, many states (including Wisconsin) have not taken such action.

A. Revised Uniform Limited Liability Company Act

The National Conference of Commissioners on Uniform State Laws (NCCUSL) created the Uniform Limited Liability Company Act (ULLCA) in 1994 to try and articulate a singular entity form that could be adopted by all fifty states. The NCCUSL felt that a uniform LLC statute provided fairness and ease of formation for individuals desiring to form LLCs. Just two years

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71. Del. Code Ann. tit. 6, § 18-1101(c) (2017); Altman et al., supra note 65.
73. Altman et al., supra note 65.
75. Id. § 18-1101(c).
76. Pace, supra note 1, at 1098–1108. Georgia addressed and accepted the enforceability of fiduciary waivers. Stoker v. Bellemade, L.L.C., 615 S.E.2d 1, 10 (Ga. Ct. App. 2005), rev’d in part on other grounds, 631 S.E.2d 693 (Ga. 2006); Ledford v. Smith, 618 S.E.2d 627, 636 (Ga. Ct. App. 2005). North Carolina likewise looked at and enforced the waiver of fiduciary duties in Kaplan v. O.K. Technologies, L.L.C., 675 S.E.2d 133, 137, 140 (N.C. Ct. App. 2009). Massachusetts courts waver on their implementation of the waiver of fiduciary duties, however, in Pointer v. Castellani, the highest court in Massachusetts enforced the waiver of fiduciary duties. 918 N.E.2d 805, 810 (Mass. 2009). Kansas courts have discussed but have yet to come to a conclusion on the issue of fiduciary waivers, even though the surrounding federal courts have enforced the waiver of fiduciary duties. See Pace, supra note 1, at 1101–02. While no Nevada case enforces the waiver, the Nevada LLC Act imitates that of Delaware by allowing for contractual elimination of fiduciary duties. Id. at 1108–09.
later, in 1996, the ULLCA was revised to take into account the recently adopted “check-the-box” federal tax regulation for LLCs. This regulation allowed members of LLCs to decide if they would be taxed as a partnership, creating the national LLC boom. Through the 1996 amendment, only five states adopted the ULLCA. By 1997 LLCs became increasingly popular amongst states, but, as little law existed on LLCs, states individually patched their statutes as issues developed. As states individually patched their LLC statutes and LLCs became more popular, a lack of uniformity arose between the statutes.

As the uniformity gaps widened, the NCCUSL resolved to examine and package together the best practices and innovations among the states to create a superior uniform LLC act. The Revised Uniform Limited Liability Company Act (RULLCA) resulted from these examinations and innovations, in 2006. The drafters of RULLCA made the most significant revisions in several areas, such as: (1) the operating agreement; (2) fiduciary duties; (3) indemnification; (4) initially forming an LLC without a member; (5) the rights of oppressed minority members; (6) default rules on management structure; and (7) creditor charging orders. As of the most recent publication in 2013, a total of eighteen jurisdictions adopted RULLCA.
The operating agreement and fiduciary duty revisions are most significant in RULLCA. RULLCA states that an operating agreement may be oral, written, or implied, as opposed to the strict written requirement found in several state statutes. This change allows for greater freedom to contract while creating the operating agreement, lowering transaction costs because the operating agreement can be created electronically. Further, RULLCA governs any matter not addressed in the operating agreement. In other words, when a state adopts RULLCA and “the members have not agreed on an issue, then the RULLCA governs any such issue.” RULLCA provides several defaults, absent contractual alteration. RULLCA states, in the absence of contractual alteration, that an LLC is a member-managed entity and provides the default fiduciary duties of loyalty and care, as well as the contractual promise of good faith and fair dealing.

In respect to the waiver of fiduciary duties, RULLCA states that members may alter, but not eliminate, certain duties. This mandatory list includes the duty of loyalty and care, as well as the contractual obligation of good faith and fair dealing. Preventing the elimination of any of these fiduciary duties heightens the fiduciary duty standard above that found in most state statutes. However, raising default duties diminishes parties’ ability to contract because fewer terms can be contracted for. Not allowing parties to contractually alter every provision may lower the initial contracting cost, but could deter potential members who desire full contractual freedom.


88. RULLCA § 102(13).
89. Karambelas, supra note 77. The District of Columbia, Minnesota, and Wisconsin LLC Acts all require the operating agreement to be in writing. Id.
90. See id.
91. Id.
92. Id.
93. Why Your State Should Adopt, supra note 78.
94. Id.
95. RULLCA § 110.
96. Id. § 110(c)(4)–(5).
97. Pace, supra note 1, at 1093 & n.54 (listing twenty-four states that enacted statutory language similar to the Delaware LLC Act, thus mandating fewer fiduciary duties than RULLCA).
B. Delaware LLC Method

Numerous parties choose to form LLCs in Delaware because of the legal benefits and “predictable business friendly laws.” These legal benefits and business-friendly laws were put in place to encourage business formations, often drawing businesses from other states. Currently, twenty-six states have adopted the Delaware approach, making it the most common LLC formation methodology in America.

Delaware’s LLC statute is the foundation of Delaware’s LLC law. The primary focus of, and draw to, the Delaware LLC statute is total freedom of contract. Delaware allows an individual’s duties to be expanded, restricted, or even eliminated through the applicable operating agreement. The contractual covenant of good faith and fair dealing, however, may not be eliminated. This covenant is not a fiduciary duty (as it is contractually formed), but rather provides a pseudo-fiduciary duty. The total freedom to contract allows members of an LLC to govern all relationships through contract, often without requiring the traditional fiduciary duties of care and loyalty. Additionally, the statute makes no distinction between member-managed and manager-managed LLCs, so each action described in the statute explicitly applies to both management structures. This alleviates some of the ambiguity found in other state statutes, and eliminates uncertainty as to whether different duties apply to the members or managers in the differing management structures. Although the Delaware method is ambiguous on whether default fiduciary duties are owed, it is in fact likely that these duties are owed.

99. Pace, supra note 1, at 1092–93, 1112 (categorizing, under the Delaware approach, the following states: Alabama, Arkansas, California (until 2015), Colorado, Connecticut, Delaware, Georgia, Idaho, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, North Carolina, Nevada, New Hampshire, New Jersey, New Mexico, New York, Texas, Washington, and Wisconsin).
100. DEL. CODE ANN. tit. 6, § 18-101 (2017).
101. Altman et al., supra note 65.
102. DEL. CODE ANN. tit. 6, § 18-1101(c) (“[T]he member’s or manager’s or other person’s duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement.”).
103. Id. (“[T]he limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.”).
104. Altman et al., supra note 65.
105. DEL. CODE ANN. tit. 6, § 18-1101(c)–(d).
106. See infra Section III.B.2.
1. Delaware’s contractual waiver of duties

Contracting out of duties is important and often useful. In the present day individuals often engage in more than one business venture, and this action can prove hairy without waiving the duty of loyalty. Without such waiver, members or managers of an LLC may be unable to fully participate in multiple businesses without violating the duty of loyalty. Allowing members to define their own duties and expectations not only provides for greater participation, but protects members through the narrowly defined expectations created by the parties themselves. Moreover, contracting parties eliminate the uncertainty that arises from unclear LLC statutory language. Creating certainty among the parties reduces costs when negotiating a contract and in potential litigation, which is a benefit for any business entity. Statistics show that allowing for complete contractual elimination of duties, like in Delaware, increases the value of LLCs.

Delaware recognized the changing structure of LLCs from privately held to publicly held entities, and shifted its policy to address this change. In addition, the amount of investment in publicly held LLCs outpaced traditional investments by three times over the past ten years. The contractual alteration and elimination of duties allows Delaware public LLCs to broadly appeal to investors. This waiver of fiduciary duties allows for LLCs to “raise capital, build efficient investor bases, and secure optimal management arrangements.” While the waiver of fiduciary duties may eliminate protections that investors desire, carefully reading the operating agreement provides certainty as to what duties are owed to investors. Therefore, investors are certain of the duties owed to them, even if they do not receive all desired

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107. See Pace, supra note 1, at 1090.
108. See id.
109. See id.
110. Altman et al., supra note 65.
111. Pace, supra note 1, at 1088.
112. See Rauterberg & Talley, supra note 49, at 1121 (showing that public LLCs realized an average positive stock return of one or one and a half percent in Delaware).
113. See Eisenhofer & Moyna, supra note 21.
114. Id.
115. Rauterberg & Talley, supra note 49, at 1079 (“Public companies have an enormous appetite for tailoring the duty of loyalty when freed to do so.”).
116. Id.
117. See Eisenhofer & Moyna, supra note 21.
fiduciary duty protections and can make an informed business decision whether to invest.

In order for the waiver of fiduciary duties to prove effective, certainty must exist that the waiver will be enforced. Delaware courts addressed the enforceability of a waiver of fiduciary duties more than any other state court system and upheld the enforceability of such waivers. The most indicative case showing Delaware courts’ acceptance of the waiver of fiduciary duties is Fisk Ventures, LLC v. Segal.

In Fisk, two doctors created a biomedical technology company, Gentrix, as an LLC. When financing ran tight for the company, one of the doctors sought to acquire further capital through investors, and the other doctor refused to allow such action. The refusing doctor sought to dissolve the company, and the other doctor brought claims against him for breach of contract and breach of fiduciary duties. The court, in deciding upon these claims, held that LLCs in Delaware “are creatures not of the state but of contract” and any duties or obligations must exist in the LLC’s operating agreement or other enforceable contract. However, neither of the doctors owed any fiduciary duties to the other, as all fiduciary duties were waived in Gentrix’s operating agreement. The court ruled that because no fiduciary duties were expressly set forth in the operating agreement, no fiduciary duties existed between the parties; therefore, no breach of fiduciary duty could exist. Thus, Delaware courts permit the waiver of any fiduciary duties in LLCs.

2. Delaware’s ambiguous default duties

While the waiver of fiduciary duties is clearly articulated in Delaware, the state failed to synthesize an unambiguous rule for default fiduciary duties. The question of what default fiduciary duties were owed by LLC members was

118. See Pace, supra note 1, at 1112–13.
119. Id. at 1095 & n.64.
120. See No. 3017-CC, 2008 WL 1961156 (Del. Ch. May 7, 2008).
121. Id. at *2.
122. Id. at *3–4.
123. Id. at *6.
124. Id. at *8.
125. Id. at *9 (“No Member shall have any duty to any Member of the Company except as expressly set forth herein or in other written agreements.”).
126. Id. at *11–12.
clear in Delaware until 2012, when the Delaware Supreme Court cast doubt upon the issue in *Gatz Properties v. Auriga Capital Corp.* The Delaware General Assembly attempted to resolve the default duty question, but only offered ambiguous legislation.

In *Gatz*, the Delaware Supreme Court disagreed with, and seemed to scorn, the Court of Chancery’s holding that parties to LLCs owe default fiduciary duties. The defendant in *Gatz* sought to eliminate the minority investors of an LLC, of which the defendant was the sole manager. To accomplish this goal, the manager-defendant forced the LLC to undertake a squeeze-out merger under false pretenses, leaving minority members and investors with no return on their investment. The minority members and investors promptly sued the manager-defendant under both breach of fiduciary duty and breach of contract claims. The court looked to the operating agreement, which did not explicitly eliminate the fiduciary duties. The chancellor found that absent the contractual elimination of fiduciary duties, the common law fiduciary duties apply as a default.

*Gatz Properties, Inc.* then appealed this case to the Delaware Supreme Court. The Delaware Supreme Court disagreed with the chancellor’s finding that default fiduciary duties are owed in the absence of contractual alteration, holding that the LLC statute was ambiguous. Following the court’s lead in *Gatz Properties, LLC v. Auriga Capital Corp.*, the Delaware legislature amended its LLC statute in the “2013 amendment.” This amendment attempted to confirm the existence of default common law fiduciary obligations. Instead, the amendment only stated that fiduciary duties may be eliminated, implying that default fiduciary duties exist. Thus, the

128. See generally 59 A.3d 1206 (Del. 2012); see also *Dictum, supra* note 127, at 37–38.
132. See *id.* at 842–43.
133. *Id.* at 848.
134. *Id.* at 849–52.
135. *Id.* at 849–56.
137. *Id.* at 1219.
amendment to the LLC statute only offered further ambiguity on the subject, as no default fiduciary duties were explicitly provided for.

Delaware, through its courts and legislature, created an attractive environment in which to form an LLC by eliminating uncertainty for potential LLC members.\(^{141}\) It did so by creating a system that allows for the waiver of all fiduciary duties, but harmed itself by failing to clarify whether default fiduciary duties are owed in an LLC.

C. Wisconsin’s Adoption of LLCs

Since Wisconsin’s adoption of the LLC business model in 1994, LLCs have surpassed all other business formations in the state.\(^ {142}\) From 2011–2016, LLCs accounted for over eighty-four percent of all new business entity filings each year.\(^ {143}\) This easily makes LLCs the most popular business model in Wisconsin. Before discussing the present state of Wisconsin’s LLC law and its impact, the law’s history must be delved into.

The history of LLCs in Wisconsin began January 1, 1994, with the passing of the 1993 Wisconsin Act 112 (the Wisconsin LLC Act).\(^ {144}\) The Wisconsin LLC Act provides the governing LLC statute for Wisconsin, laying out the fiduciary duties that members and managers owe if not contractually altered in

\(^ {141}\) See supra Section III.B.


the operating agreement.\textsuperscript{145} The drafters’ goal in creating the Wisconsin LLC Act was to provide limited liability, pass-through taxation, and simplicity to individuals to attract business formations in Wisconsin.\textsuperscript{146} In order to accomplish these goals the drafters emphasized the importance of flexibility and freedom to contract,\textsuperscript{147} concepts which exist in Wisconsin’s current LLC Act.\textsuperscript{148}

The Wisconsin LLC Act provides several default duties that may be contractually altered through the operating agreement.\textsuperscript{149} First, the Wisconsin LLC Act states that members and managers have a duty to not act with a willful failure to deal fairly with the LLC or members if the member or manager in connection with the matter has a material conflict of interest.\textsuperscript{150} Members or managers may deal with parties on a matter in which they have a material conflict of interest, so long as they do so fairly.\textsuperscript{151} Second, in a Wisconsin LLC a party cannot violate criminal law unless the individual had reasonable cause to believe that the conduct was lawful.\textsuperscript{152} Third, the Wisconsin LLC Act provides that a member or manager shall not engage in a “transaction from which the member or manager derived an improper personal profit.”\textsuperscript{153} Fourth and finally, the Wisconsin LLC Act forbids a member or manager to act in a manner that constitutes willful misconduct against the LLC or other members.\textsuperscript{154} The preceding provisions seemingly create the default duty of loyalty for LLC members or managers, but, without explicit language, individuals cannot be certain. The same statute holds that these duties may be waived by the parties,\textsuperscript{155} ensuring that contractual freedom exists in Wisconsin.

\begin{itemize}
\item \textsuperscript{145} Wis. Stat. § 183.0402(1) (2015–2016).
\item \textsuperscript{146} Gottsacker v. Monnier, 2005 WI 69, ¶ 19, 281 Wis. 2d 361, 697 N.W.2d 436 (citing JOSEPH W. BOUCHER ET AL., LLCs AND LLPs: A WISCONSIN HANDBOOK, at v (rev. ed. 1999)).
\item \textsuperscript{147} Id.
\item \textsuperscript{148} Wis. Stat. § 183.0402 (2015–2016) (allowing for contractual alteration in the operating agreement).
\item \textsuperscript{149} See id.
\item \textsuperscript{150} Id. at § 183.0402(1)(a). Parties are said to have a material conflict of interest in a business dealing when they derive personal profit from a dealing, at the expense of the company. See id. § 183.0402(2).
\item \textsuperscript{151} Id. § 183.0402(1)(a).
\item \textsuperscript{152} Id. § 183.0402(1)(b).
\item \textsuperscript{153} Id. § 183.0402(1)(c).
\item \textsuperscript{154} Id. § 183.0402(1)(d).
\item \textsuperscript{155} See id. § 183.0402.
\end{itemize}
1. Waiver of fiduciary duties

While fiduciary duties are statutorily provided, they may be waived through the operating agreement if the state permits. Through an operating agreement, the Wisconsin LLC Act states that a member of an LLC can alter virtually every duty for members and managers, giving incredible flexibility to LLC formation.\textsuperscript{156} Thus, Wisconsin adopted the waiver standard found in the Delaware LLC Act,\textsuperscript{157} but failed to take additional business-friendly actions that make Delaware such an attractive state for LLC formations.\textsuperscript{158}

In Wisconsin, however, the courts have not yet addressed whether the waiver of fiduciary duties is enforceable.\textsuperscript{159} This creates a tremendous amount of uncertainty for parties wishing to form an LLC, and for parties desiring to modify or even eliminate fiduciary duties of an LLC.\textsuperscript{160} While the statute’s language appears to permit all waivers,\textsuperscript{161} parties may have to spend additional time and resources predicting and defining the specifics of each duty. Even with these duties defined clearly in the operating agreement, parties may experience additional litigation costs.\textsuperscript{162} Such uncertainty and the resulting increase in cost could drive potential LLC formations out of Wisconsin, to more business-friendly states like Delaware.

2. Default common law fiduciary duties in Wisconsin

Not only have the Wisconsin courts not addressed the enforceability of waivers, they also have failed to explicitly state whether default common law fiduciary duties are owed by LLC members. The Wisconsin LLC Act ambiguously provides that members and managers owe the fiduciary duty of loyalty\textsuperscript{163}—one of the “common law” fiduciary duties that courts apply to both

\textsuperscript{156} See id.
\textsuperscript{157} Pace, supra note 1, at 1093 & n.54, 1112.
\textsuperscript{158} Delaware’s courts upheld the waiver of fiduciary duties and implementation of common law fiduciary duties absent contractual language. See supra Section III.B.
\textsuperscript{159} Pace, supra note 1, at 1112 & n.227 (noting that Wisconsin is one of fourteen states allowing waivers, but has no existing case law establishing the enforceability of such waivers).
\textsuperscript{160} Id. at 1112–13.
\textsuperscript{161} WIS. STAT. § 183.0402 (referring to the phrase, “Unless otherwise provided in an operating agreement[,]” which seemingly permits any waiver of fiduciary duty).
\textsuperscript{162} Litigation is likely because no precedent exists on the issue.
\textsuperscript{163} See supra Section III.C.
corporations and partnerships.\textsuperscript{164} The Wisconsin LLC Act, however, does not speak to the additional common law fiduciary duties,\textsuperscript{165} which often apply to LLCs in other states. The common law fiduciary duties often include the duty of loyalty and the duty of care,\textsuperscript{166} leaving Wisconsin LLC members without the duty of care. Wisconsin courts considered this issue twice but did not publish an applicable ruling.\textsuperscript{167}

LLC case law in Wisconsin began in 2005 with \textit{Gottsacker v. Monnier}.\textsuperscript{168} In \textit{Gottsacker}, the court sought to determine whether Mr. Monnier, a member of the LLC, breached his fiduciary duty of loyalty when he sold company property and received large personal benefits.\textsuperscript{169} The plaintiffs, members of the LLC, offered that Mr. Monnier had a material conflict of interest in the transaction, which prevented him from dealing in the transaction fairly.\textsuperscript{170} The court held that it could not determine whether Mr. Monnier engaged in the transaction fairly, because the appellate court incorrectly determined that the transaction was unfair.\textsuperscript{171} Thus, the court reversed the decision of the court of appeals and remanded the case back to the circuit court for further ruling.\textsuperscript{172} In doing so, the court failed to address whether the duty of loyalty was strictly upheld or if LLC members and managers must only deal fairly with the other members.\textsuperscript{173}

While this case holding illuminates the deflection by Wisconsin courts of LLC fiduciary duty cases, the concurring opinion written by Justice Roggensack provides the first fiduciary ambiguity in Wisconsin.\textsuperscript{174} Justice Roggensack determined that the rights and obligations of members and managers are set solely by the Wisconsin LLC Act.\textsuperscript{175} She further stated that the “\textit{c}ommon law concepts such as the fiduciary duty of a majority


\textsuperscript{165} See WIS. STAT. § 183.0402 (referring only to the fiduciary duty of loyalty).

\textsuperscript{166} See \textit{Alces}, supra note 40, at 249–52.


\textsuperscript{168} 2005 WI 69, ¶ 13.

\textsuperscript{169} \textit{Id.} ¶ 2, 7–9.

\textsuperscript{170} \textit{Id.} ¶¶ 9–10.

\textsuperscript{171} \textit{Id.} ¶ 35. Appellate courts may not determine factual issues. \textit{Id.} That job is reserved for the circuit court in Wisconsin. See \textit{id}.

\textsuperscript{172} \textit{Id.} ¶ 37.

\textsuperscript{173} \textit{Id.}

\textsuperscript{174} \textit{Id.} ¶ 38–57 (Roggensack, J., concurring).

\textsuperscript{175} \textit{Id.} ¶¶ 45, 48.
shareholder of a corporation to a minority shareholder are replaced by statutory obligations.176 These statements, while made in a concurring opinion, created great ambiguity as to whether members and managers of a Wisconsin LLC owe common law fiduciary duties. This uncertainty would not be revisited until six years later in Executive Center III, L.L.C. v. Meieran.177

The Executive Center case centered on a dispute between a member of the BRIC Executive, LLC, Andrew Meieran, and the Executive Center leaseback company.178 When the BRIC LLC approached numerous investors about selling a small portion of BRIC’s membership, one of the executive members, Meieran, chose to invest in the hope of reviving the dying company.179 The company eventually filed for bankruptcy and sold off its office building, using some of its proceeds from the sale to satisfy the debt with Meieran.180 This created an issue, as Meieran was an executive of the company and should have owed fiduciary duties. Executive Center sued Meieran, alleging that he violated the common law fiduciary duties owed to the leaseback company.181 Meieran argued that common law fiduciary duties do not apply to members of an LLC under Wisconsin law, relying primarily on the concurring opinion of Judge Roggensack in Gottsacker.182 The court disagreed, holding that common law fiduciary duties apply to Wisconsin LLCs183 and refused to grant summary judgment to Meieran.184 Further, the court reasoned that the Wisconsin Supreme Court’s holding in Gottsacker did not include Judge Roggensack’s statement because it was made in a concurring opinion.185

While the Executive Center case should have ended the debate as to whether common law fiduciary duties apply to Wisconsin LLCs, it failed to do so.186 Since Executive Center is a federal case, its holding does not bind Wisconsin’s

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176. Id. ¶ 45 (construing Wis. Stat. §§ 183.0402, 183.1302(3) (2003–2004)).
178. See id. at 884.
179. Id. at 885–86.
180. Id.
181. Id. at 887.
182. See id. at 890; Gottsacker v. Monnier, 2005 WI 69, 281 Wis. 2d 361, 697 N.W.2d 436 (Roggensack, J., concurring).
184. Id. at 892.
185. Id. at 891.
186. Willenbrink, supra note 6, at 29 (stating that federal court decisions are not binding on Wisconsin’s state courts, and further, the case was settled, which deprived the Seventh Circuit the opportunity to refer the case to the Wisconsin Supreme Court).
state courts. Further, the case ended in a settlement, depriving the circuit court the opportunity to refer the case to the Wisconsin Supreme Court. Thus, the question of whether common law fiduciary duties apply to LLCs in Wisconsin remains unanswered, allowing uncertainty to persist.

IV. INCREASING THE ATTRACTIVENESS OF WISCONSIN LLCS

While LLC formations increased in Wisconsin over the past five years, the Wisconsin legislature should create and enact a new LLC statute to increase investor confidence and draw LLC formations to Wisconsin. The current Wisconsin LLC Act and related court holdings create uncertainty regarding fiduciary duties. This uncertainty is shaped by unclear statutory language and inconsistent decisions in Wisconsin’s courts regarding the waiver of duties and applicable default fiduciary duties.

When uncertainty exists in a particular state due to unclear or confusing regulation, parties are less likely to form an LLC in that state and costs rise for all parties involved. This rise in cost is most often felt in the initial contracting due to high information costs, but may also arise in resulting transactions. Contracting costs rise because extensive amounts of time will be taken to clarify the uncertainty regarding the waiver of fiduciary duties, as well as the implementation of default common law fiduciary duties. Additionally, these problems increase costs due to future litigation costs. The resulting negative impact of these costs and complications may have steered LLC formations to other states or decreased investment potential in Wisconsin LLCs. In order to cure these issues and increase LLC formations in Wisconsin, the Wisconsin legislature should enact a new LLC statute that explicitly provides for the default duties of loyalty and care, while permitting the waiver of these fiduciary duties.

Were Wisconsin to adopt RULLCA, it would yield a positive impact on LLC formations and investment in the state but would not create the greatest

187. Id.
189. See supra Section III.C.
190. See supra Section III.C.
191. See generally Altman et al., supra note 65.
193. See Altman et al., supra note 65.
194. Pace, supra note 1, at 1088.
positive impact. Adopting RULLCA would prove beneficial by eliminating the uncertainties surrounding fiduciary duties in Wisconsin. However, implementing RULLCA would not best serve Wisconsin. RULLCA prohibits the contractual elimination of fiduciary duties, eradicating the total freedom of contract that parties desire. While the adoption of RULLCA would provide a one-stop shop for the legislature (as it could adopt the entire act), the benefits found from enacting a new statute cannot be outweighed by the simplicity of adopting RULLCA. Further, Wisconsin attorneys proposed an overhaul of the Wisconsin LLC Act and adoption of RULLCA in 2013. This proposed overhaul has yet to occur in over four years, leading to the belief that a different approach would better serve Wisconsin.

While Wisconsin’s LLC statute permits the waiver of fiduciary duties, similar to the Delaware method, it should not adopt the language of Delaware’s LLC Act and the surrounding provisions. The certainty surrounding Delaware LLC’s ability to eliminate fiduciary duties would decrease costs and attract more LLC formations, but Delaware fails to provide default fiduciary duties for LLCs. Without the imposition of default fiduciary duties on LLCs, “unscrupulous businesspeople may legally use the LLC form to operate in a dishonest manner.” Further, it would take years for the necessary court decisions to exist in order to provide the business-friendly environment found in Delaware.

To provide certainty for potential LLC members and investors, the Wisconsin legislature should create a new LLC statute. Instead of allowing courts to impose default fiduciary duties and uphold waivers, the Wisconsin legislature should proactively create a new LLC statute because the court system is largely reactionary. This statute would impose clear statutory language allowing for the waiver of fiduciary duties and implementing common law fiduciary duties in the absence of conflicting language in the operating agreement. While the Wisconsin LLC Act ambiguously states that the duty of

196. See Gottsacker v. Monnier, 2005 WI 69, ¶ 19, 281 Wis. 2d 361, 697 N.W.2d 436 (citing JOSEPH W. BOUCHER ET AL., LLCS AND LLP: A WISCONSIN HANDBOOK § 1.11 (rev. ed. 1999)).
198. WIS. STAT. § 183.0402 (2015–2016); Pace, supra note 1, at 1092–95.
199. See supra Section III.B.2.
200. Willenbrink, supra note 6, at 30.
loyalty is provided, the duty of care is absent. Rectifying this issue, the new statute would explicitly provide for the default duties of loyalty and care for LLC members and managers. This new statute aligns with the Seventh Circuit’s holding in Executive Center that common law fiduciary duties apply to LLCs in Wisconsin, which had no authority over Wisconsin state courts. This case demonstrated that the court, albeit a federal court, in Wisconsin believes that common law fiduciary duties should apply.

Wisconsin could thus eliminate ambiguity regarding the waiver of fiduciary duties and imposition of default fiduciary duties in LLCs. This action will create a two-part balanced statute that eliminates the uncertainty that currently persists under the Wisconsin LLC Act and surrounding case law. Such action would provide potential investors and members with the confidence they desire, attracting additional LLC formations and increasing investment in Wisconsin LLCs.

Critics, traditionalists, and Wisconsin attorneys in favor of adopting RULLCA would likely argue that minority shareholders are not offered adequate protection due to the ability to waive all fiduciary duties. The debate regarding adequate minority shareholder protections surrounded Delaware LLCs for years between the traditionalists and contractarians, because, in theory, an LLC could eliminate all fiduciary duties that protect minority shareholder interests. Traditionalists argue that social values of fairness and trust are substituted for efficiency when LLCs are permitted to waive fiduciary duties. These scholars, in part, fail to recognize parties’ ability to adequately contract, which enables parties to implement adequate protections and realize efficiencies. Contractarians embrace the viewpoint that parties should be allowed to contractually eliminate fiduciary duties, as the social benefits suggested by the traditionalists come at a cost that often outweighs the

202. See supra Section III.C.
203. See Manesh, supra note 53, at 562–66.
protective benefits. This contractarian view has guided LLC reform over the past two decades, and drives LLC formations to Delaware where parties freely waive fiduciary duties. Further, the waiver of fiduciary duties should exist as a business decision that either attracts or deters investment.

V. CONCLUSION

The current Wisconsin LLC Act and the supporting case law present an unclear position regarding whether parties owe common law fiduciary duties, and if these duties may be contractually waived. Wisconsin’s courts have had twenty-two years to rectify this situation but have failed to do so. Allowing such uncertainty to persist has diminished formation of, and investment in, Wisconsin LLCs. Thus, the task of eliminating these concerns falls to the legislature. The Wisconsin legislature should create and enact a new Wisconsin LLC Act that clearly provides for the waiver of fiduciary duties, and the imposition of the common law fiduciary duties of loyalty and care. Additionally, the new Wisconsin LLC Act would provide additional protections, such as the contractual requirement of good faith and fair dealing, as well as other protections not contemplated in this Comment. By following these steps Wisconsin will increase the attractiveness of forming an LLC in the state, which will increase the amount of LLC formations and investment in LLCs within Wisconsin.

COLLIN D. BRUNK*


207. Callison & Vestal, supra note 205, at 501–02.

208. Manesh, supra note 53, at 573.

* Articles Editor of the Marquette Law Review, J.D. 2018, Marquette University Law School, B.S., 2015, Indiana University Bloomington. I thank my parents for their endless love, support, and guidance throughout my academic career. I also thank the editors and staff of the Marquette Law Review for their hard work on this Comment.