OVERVIEW OF FIDUCIARY DUTIES IN TEXAS BUSINESS ORGANIZATIONS

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TEXAS BUSINESS ORGANIZATIONS:
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May 28, 2004
San Antonio

CHAPTER 4

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OVERVIEW OF FIDUCIARY DUTIES IN TEXAS BUSINESS ORGANIZATIONS

I. INTRODUCTION

Once upon a time, choice of entity involved the following choices: the sole proprietorship, general partnership, limited partnership, and corporation. If all owners were to have limited liability, the corporation was the only option (although the use of corporate general partners in limited partnerships effectively addressed the liability concern in many cases). In 1991, the Texas Legislature passed legislation that significantly expanded this menu of business entities. The Texas Limited Liability Company Act authorized the formation of a new type of entity commonly referred to as an "LLC." Additionally, amendments to the Texas Uniform Partnership Act made it possible for a general partnership to register and become a registered limited liability partnership, commonly referred to as an "LLP." Compliance with the LLP provisions gave partners liability protection from liabilities of the partnership arising from the errors, omissions, negligence, incompetence, or malfeasance of another partner or agent of the partnership. Uncertainty as to whether LLP registration was also available to a limited partnership was resolved in 1993, when the Legislature passed legislation explicitly authorizing a limited partnership to become a registered limited liability partnership. (This creature is sometimes referred to as an "LLLP" or "triple LP.") In 1993, the Legislature also cleared up any doubt as to the availability of LLCs to professionals, adding provisions to the LLC act that authorize formation of professional LLCs, or "PLLCs." In 1997, the LLP provisions were amended to expand the scope of the liability protection to include contract obligations of the partnership. Additional change in the business organizations area is on the horizon in the form of a new Texas Business Organizations Code that will become effective January 1, 2006.

Many structural features must be considered in forming a business and drafting organizational documents, and there is a great deal of flexibility under the Texas statutes governing the various business entities. Thus, it is generally possible to manipulate the general rules regarding management, transferability of interest, and continuity of life to suit the particular needs and desires of the business owners. Liability protection and tax treatment are not so manipulable. Therefore, the initial analysis typically focuses on these issues. Given that liability protection may be obtained in numerous entity structures, the tax treatment is often the driving force behind the choice of entity. The purpose of this paper is to provide an overview of the statutory and judicial treatment of fiduciary duties associated with the various entities under Texas law. Though this issue may not drive the choice of entity, it certainly is an important aspect of the governance terms.

II. THE TEXAS BUSINESS ENTITY MENU

The current menu of basic business forms available under Texas law is as follows:

1) Sole proprietorship
2) Traditional general partnership (governed by Texas Revised Partnership Act ("TRPA"), Tex. Rev. Civ. Stat. Ann. art. 6132b-1.01 et seq)
3) Registered limited liability partnership (a general partnership that has registered as an LLP) (governed by TRPA; see, in particular, art. 6132b-3.08)
5) Registered limited liability limited partnership (a limited partnership that has registered as an LLP) (governed by TRLPA; see, in particular, art. 6132a-1, § 2.14 and art. 6132b-3.08)
6) Traditional corporation (governed by Texas Business Corporation Act ("TBCA"))
7) Statutory close corporation (governed by Part 12 of TBCA)
8) Corporation governed by shareholders’ agreement under TBCA Art. 2.30-1

III. FIDUCIARY DUTIES AND VARIATION THEREOF

The fiduciary duties of corporate directors and general partners are well-established in the law. Whether limited partners in a limited partnership have fiduciary duties is not well-settled, but a number of recent cases have stated that they generally do not. Since LLCs are a recent phenomenon, and the TLLCA does not specify duties of managers and members, there is some uncertainty with regard to the duties in this area, but members in a member-managed LLC and managers in a manager-managed LLC should expect to be held to...
fiduciary duties similar to the duties of corporate directors and general partners. In each case, it is possible to vary (at least to some extent) in the entity’s governing documents the duties and liabilities of such persons. The power to define duties, eliminate liability, and provide for indemnification is addressed somewhat differently in the TBCA, TRPA, TRLPA, and TLLCA.

A. Corporations

1. Fiduciary Duties of Corporate Directors, Officers, and Shareholders

The TBCA does not attempt to define the fiduciary duties of corporate directors, but case law generally recognizes that directors owe a duty of obedience, a duty of care, and a duty of loyalty. See Gearhart Indus, Inc. v. Smith Int’l, Inc., 741 F.2d 707, 718 (5th Cir. 1984); Fed. Deposit Ins. Corp. v. Harrington, 844 F.Supp. 300, 306 (N.D.Tex. 1994); Resolution Trust Corp. v. Norris, 830 F.Supp. 351 (S.D. Tex. 1993). A detailed discussion of these duties is beyond the scope of this paper, but these duties are generally described below in order to set the stage for a discussion of the extent to which liability for these duties can be addressed in the governing documents.

Duty of obedience. The directors’ duty of obedience forbids ultra vires acts but is rarely implicated given that modern corporation laws define corporate powers broadly and permit broad purpose clauses in the articles of incorporation. In general, courts appear reluctant to hold directors liable for ultra vires acts. As one court has summed up the Texas law in this area, “Texas courts have refused to impose personal liability on corporate directors for illegal or ultra vires acts of corporate agents unless the directors either participated in the act or had actual knowledge of the act.” Resolution Trust Corp. v. Norris, 830 F.Supp. 351, 357 (S.D. Tex. 1993).

Duty of care. Until the 1990’s, Texas cases dealing with director liability for breach of the duty of care, as distinct from the duty of loyalty, had been few and far between. The Fifth Circuit analyzed a director’s duty of care under Texas law in Gearhart Indus., Inc. v. Smith Int’l, Inc., 741 F.2d 707 (5th Cir. 1984) as follows:

Under the law of most jurisdictions, the duty of care requires a director to be diligent and prudent in managing the corporation’s affairs. Ubelaker at 784. The leading case in Texas defining a director’s standard of care is McCollum v. Dollar, 213 S.W. 259 (Tex.Comm’n App.1919, holding approved). That case held that a director must handle his corporate duties with such care as “an ordinarily prudent man would use under similar circumstances.” Id. at 261. The question of director negligence is a question of fact and must be decided on a case-by-case basis. Id. Texas courts hold directors liable for negligent mismanagement of their corporations, but the decisions do not specifically refer to such acts as violations of the duty of care, preferring to speak in general terms of directors as fiduciaries. International Bankers Life Ins. Co. v. Holloway, supra; Tenison v. Patton, supra; Dowdle v. Texas Am. Oil Corp., 503 S.W.2d 647, 651 (Tex.Civ.App.—El Paso 1973, no writ); Fagan v. La Gloria Oil & Gas Co., 494 S.W.2d 624, 628 (Tex.Civ.App.—Houston [14th Dist.] 1973, no writ); Sutton v. Reagan & Gee, 405 S.W.2d 828, 834 (Tex.Civ.App.—San Antonio 1966, writ ref’d n.r.e.). Unquestionably, under Texas law, a director as a fiduciary must exercise his unbiased or honest business judgment in pursuit of corporate interests. In re Westec Corp., 434 F.2d 195, 202 (5th Cir.1970); International Bankers Life Ins. Co. v. Holloway, supra at 577. “The modern view definitely stresses the duty of loyalty and avoids specific discussion of the parameters of due care.” Ubelaker at 789.[footnote omitted]

In other jurisdictions, a corporate director who acts in good faith and without corrupt motive will not be held liable for mistakes of business judgment that damage corporate interests. Ubelaker at 775; see, e.g., Lasker v. Burks, 404 F. Supp. 1172 (S.D.N.Y.1975). This principle is known as the business judgment rule and it is a defense to accusations of breach of the duty of care. Ubelaker at 775, 790. Few Texas cases discuss the issues of a director’s standard of care, negligent mismanagement, and business judgment. An early case, Cates v. Sparkman, 73 Tex. 619, 11 S.W. 846 (1889), set the standard for judicial intervention in cases involving these issues:

[I]f the acts or things are or may be that which the majority of the company have a right to do, or if they have been done irregularly, negligently, or imprudently, or are within the exercise of their discretion
and judgment in the development or prosecution of the enterprise in which their interests are involved, these would not constitute such a breach of duty, however unwise or inexpedient such acts might be, as would authorize interference by the courts at the suit of a shareholder.


741 F.2d at 720-21.

Thus, despite the "ordinary care" standard announced in early Texas cases, the Fifth Circuit characterized the business judgment rule in Texas as protecting all but fraudulent or ultra vires conduct, which would literally protect even grossly negligent conduct and therefore provide more protection than the Delaware business judgment rule. The tension between the standard of care and standard of liability received little attention in the reported cases until federal banking regulatory agencies began seeking recovery from the directors of failed financial institutions (and their liability insurers) for their alleged mismanagement of the failed institutions. Federal district courts were then faced squarely with the issue of what degree of negligence, if any, would subject the directors to liability under Texas corporate law. These federal district courts generally rejected the argument of the FDIC or RTC that directors are liable under Texas common law for acts of mismanagement that amount to simple negligence, but concluded that the business judgment rule does not protect a breach of the duty of care that amounts to gross negligence or an abdication of responsibilities resulting in a failure to exercise any judgment. See Fed. Depositi Ins. Corp. v. Harrington, 844 F.Supp. 300 (N.D. Tex. 1994); Resolution Trust Corp. v. Norris, 830 F.Supp. 351 (S.D. Tex., 1993); Fed. Deposit Ins. Corp. v. Brown, 812 F.Supp. 722 (S.D. Tex. 1992); Resolution Trust Corp. v. Bonner, 1993 WL 414679 (S.D. Tex. 1993).

In recognition that informed decision-making by directors cannot feasibly involve personal research or expertise on the part of each director with respect to the myriad business decisions faced, Article 2.41D of the TBCA provides that a director may, in good faith and with ordinary care, rely on information, opinions, reports, or statements prepared or presented by officers or employees of the corporation, by a committee of the board of which the director is not a member, or by legal counsel, accountants, investment bankers, or others with professional or other expertise.

Duty of loyalty. The director’s duty of loyalty “demands that there shall be no conflict between duty and self-interest. The [methods] for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.” Imperial Group (Texas), Inc. v. Scholnick, 709 S.W.2d 358, 365 (Tex.App.—Tyler 1986, writ ref’d n.r.e.) quoting Guth v. Lofi, 23 Del. 255, 5 A.2d 503, 510 (1939). Common examples of transactions or conduct implicating the duty of loyalty are self-dealing and usurpation of a corporate opportunity. See Int’l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567 (Tex. 1963); Gearhart Indus., Inc. v. Smith Int’l, Inc., 741 F.2d 707 (5th Cir. 1984).

The TBCA contains provisions outlining procedures under which interested director transactions will be deemed valid notwithstanding the director’s interest in the transaction or participation in the meeting at which the transaction is approved. See Tex. Bus. Corp. Act art. 2.35-1. Generally, these procedures require full disclosure by the interested director and approval by disinterested directors or the shareholders. If one of these procedures is not followed, the transaction will nevertheless withstand challenge if it passes scrutiny for “fairness” to the corporation. Likewise, before a director can safely embark on what would be considered a corporate opportunity, the opportunity must be fully disclosed to and declined by the corporation. See Imperial Group (Texas), Inc. v. Scholnick, 709 S.W.2d 358, 365 (Tex.App.—Tyler 1986, writ ref’d n.r.e.).

Officers. As agents of the corporation, officers have duties of obedience, care, and loyalty. See generally RESTATEMENT (SECOND) OF AGENCY §§ 377-398 (1958) (dealing with an agent’s duties of service,
obedience, and loyalty). See also Johnson v. Brewer & Pritchard, P.C., 73 S.W.3d 193, 200 (Tex. 2002) (stating that agency is a special relationship giving rise to a fiduciary duty on the part of the agent to act solely for the benefit of the principal); PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 cmt. a (1994) (stating that it is relatively well-settled that officers will be held to the same duty of care standards as directors and that sound public policy supports holding officers to the same duty of care and business judgment standards as directors); PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS Part V, introductory note b (1994) (stating that courts have usually treated officers in the same category as directors when imposing and enforcing the duty of fair dealing). The application of these duties may vary somewhat from the application to directors, but often the courts speak of officers and directors in one breath when addressing duties. In terms similar to Article 2.41D (permitting directors to rely on information and expertise supplied by others), Article 2.42C of the TBCA permits officers, in the discharge of a duty, to rely on information, opinions, reports, or statements of other officers or employees, attorneys, accountants, investment bankers, or other professionals or experts. TBCA Article 2.35-1, detailing procedures for valid interested director transactions, also applies to interested officer transactions.

Shareholders. Generally, shareholders, even in a closely held corporation, do not owe one another fiduciary duties. See Hoggett v. Brown, 971 S.W.2d 472, 488 (Tex.App.—Houston [14th Dist.] 1997, pet. denied); see also Schoellkopf v. Pledger, 739 S.W.2d 914, 920 (Tex.App.—Dallas 1984), rev’d on other grounds, 762 S.W.2d 145 (Tex. 1988); Kaspar v. Thorne, 755 S.W.2d 71 (Tex.App.—Dallas 1988, no writ); Pabich v. Kellar, 71 S.W.3d 500 (Tex.App.—Ft. Worth 2002, pet. denied). A majority shareholder may owe the corporation limited fiduciary duties, and under certain circumstances a controlling shareholder may breach a duty owed directly to a minority shareholder. See Hoggett v. Brown, 971 S.W.2d at 488 n. 13; Schautteet v. Chester State Bank, 707 F.Supp. 885 (E.D. Tex. 1988); see also Patton v. Nicholas, 154 Tex. 385, 279 S.W.2d 848 (Tex. 1955); Thwysen v. Cron, 781 S.W.2d 682 (Tex.App.—Houston [1st Dist.] 1989, writ denied); Duncan v. Lichtenberger, 671 S.W.2d 948 (Tex.App.—Ft. Worth 1984, writ ref’d n.r.e.). If a majority shareholder engages in conduct that substantially defeats the reasonable expectations of a minority shareholder, the minority shareholder may have a cause of action against the majority shareholder for “oppression.” Davis v. Sherrin, 754 S.W.2d 375, 381 (Tex. App.—Houston [1st Dist.] 1988, writ denied) (awarding minority shareholder equitable buy-out at fair value as determined by jury based upon the majority’s refusal to recognize the minority’s ownership in the corporation); cf. Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (holding that firing of shareholder who was an at-will employee did not, under the circumstances of the particular case, amount to oppression). In a corporation that has modified its management structure under Article 2.30-1 or Part 12 of the TBCA to provide for operation and management directly by the shareholders, such shareholders have the duties and liabilities that would otherwise be imposed on directors. Tex. Bus. Corp. Act art. 2.30-1F; art. 12.37C.

2. Statutory Authorization to Modify Duties and Liabilities of Corporate Directors and Officers in Governing Documents

Exculpation. Article 7.06 of the Texas Miscellaneous Corporation Laws Act permits limitation or elimination of the liability of a corporate director in the articles of incorporation within certain parameters. Tex. Rev. Civ. Stat. Ann. art. 1302-7.06. Specifically, Article 7.06B provides that the articles of incorporation of a corporation may limit or eliminate the liability of a director for monetary damages to the corporation or shareholders for an act or omission in the person’s capacity as a director subject to certain exceptions. The statute does not permit elimination or limitation of liability for:

1) breach of the director’s duty of loyalty;

2) an act or omission not in good faith that constitutes a breach of duty or an act or omission involving intentional misconduct or knowing violation of the law;

3) a transaction from which the director received an improper benefit, whether or not resulting from an act within the scope of the director’s office; or

4) an act or omission for which liability is expressly provided by a statute.

This provision is sometimes summarized as generally permitting elimination of liability for duty of care violations by directors. If the standard of liability is simple negligence for a breach of the duty of care, this provision obviously provides meaningful protection from liability for such negligence. If the standard of liability for a breach of the duty of care is gross negligence or fraud, it is not clear whether a breach of the duty of care could
be in “good faith” so as to fall outside the exception in subsection B(2) above. The Texas Supreme Court has generally defined gross negligence to involve actual subjective awareness of an extreme degree of risk and conscious indifference to the rights, welfare, and safety of others. See Transp. Ins. Co. v. Moriel, 879 S.W.2d 10 (1994). Moriel was cited in Weaver v. Kellogg, 216 B.R. 563 (S.D. Tex. 1997) for the definition of gross negligence in the context of a director’s duty.

**Renunciation of Corporate Opportunity.** Note that Article 7.06 does not permit elimination of director liability for the breach of a duty of loyalty. Interested director transactions, corporate opportunity issues, etc. ordinarily must be addressed at the time they arise. Until 2003, the corporate statutes in Texas contained no specific statutory provisions indicating that a pre-emptive waiver of liability in the governing documents would be effective so as to relieve a director from the duty to disclose and adhere to fairness standards in these areas. The Delaware General Corporation Law was amended in 2000 to expressly permit a corporation to renounce, in its certificate of incorporation or by action of the board of directors, any interest or expectancy in specified business opportunities or specified classes or categories of business opportunities presented to the corporation or its officers, directors, or shareholders. Del. Code Ann. tit. 8, § 122(17). The TBCA was similarly amended in 2003. Thus, the TBCA now provides that a corporation has the power to “renounce, in its articles of incorporation of by action of its board of directors, an interest or expectancy of the corporation in being offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or one or more of its officers, directors, or shareholders.” Tex. Bus. Corp. Act art. 2.02(20).

**Shareholder Agreements.** Another approach to limiting fiduciary duties in the corporate context is to utilize a shareholder agreement under Article 2.30-1 of the TBCA. Under this provision, a corporation that is not publicly traded may be governed by a shareholder agreement entered into by all persons who are shareholders at the time of the agreement. Article 2.30-1A lists matters that may be included in a shareholder agreement even though they are inconsistent with one or more provisions of the TBCA. Included in the list is a catch-all provision that states that such an agreement is effective even though it “governs the exercise of corporate powers, the management of the business and affairs of the corporation, or the relationship among the shareholders, the directors, and the corporation, or among any of them, as if the corporation were a partnership or in a manner that would otherwise be appropriate only among partners, and is not contrary to public policy.” Tex. Bus. Corp. Act art. 2.30-1A(9). Thus, it appears that fiduciary duties of those in a management role of a corporation governed by such an agreement may be modified or waived in ways not generally permitted by corporate law so long as such provisions would be permissible in the context of a partnership. (There may be a similar argument under Article 12.32 of the TBCA for “close corporations” that comply with TBCA Part 12, the Texas Close Corporation Law.)

**Indemnification.** TBCA Article 2.02-1 outlines circumstances under which indemnification of directors, officers, and others is required, permitted, and prohibited. It is a fairly lengthy and detailed provision. A corporation is required to indemnify a director or officer who is "wholly successful on the merits or otherwise" unless indemnification is limited or prohibited by the articles of incorporation. Tex. Bus. Corp. Act art. 2.02-1H. A corporation is prohibited from indemnifying a director who is found liable to the corporation, or for improper receipt of a personal benefit, if the liability arose out of willful or intentional misconduct. Tex. Bus. Corp. Act art. 2.02-1C, E. A corporation is permitted, without the necessity of any enabling provision in the articles of incorporation or bylaws, to indemnify a director who is determined to meet certain standards. Tex. Bus. Corp. Act art. 2.02-1E. These standards require that the director (1) acted in good faith; (2) reasonably believed the conduct was in the best interest of the corporation (if the conduct was in an official capacity) or that the conduct was not opposed to the corporation’s best interest (in cases of conduct outside the director’s official capacity); and (3) in the case of a criminal proceeding, had no reasonable cause to believe the conduct was unlawful. Tex. Bus. Corp. Act art. 2.02-1B. If a director is not found liable for willful or intentional misconduct, but is found liable to the corporation or on the basis of improperly receiving a personal benefit, permissible indemnification is limited to reasonable expenses. Tex. Bus. Corp. Act art. 2.02-1E. To the extent the TBCA permits indemnification, it may be limited in the articles of incorporation or made mandatory in the articles of incorporation, bylaws, a resolution of the directors or shareholders, or a contract. Tex. Bus. Corp. Act art. 2.02-1G, U. Directors may only be indemnified to the extent consistent with the statute. Tex. Bus. Corp. Act art. 2.02-1M. Officers, agents, and others who are not also directors may be indemnified to the same extent as directors and “to such further extent, consistent with law, as may be provided by [the corporation’s] articles of incorporation, bylaws, general or specific action of its
board of directors, or contract or as permitted or required by common law.” Tex. Bus. Corp. Act art. 2.02-10, Q. Insurance providing coverage for unindemnifiable areas is expressly permitted. Tex. Bus. Corp. Act art. 2.02-1R.

In the area of indemnification, as in the area of exculpation, the TBCA sets specific limits on the extent to which directors may be protected by the governing documents. Possibly, more protective provisions could be achieved through a shareholder agreement under Article 2.30-1 of the TBCA. As noted above, Article 2.30-1 permits a corporation that is not publicly traded to be governed by a shareholder agreement entered into by all persons who are shareholders at the time of the agreement. Article 2.30-1A lists matters that may be included in a shareholder agreement even though they are inconsistent with one or more provisions of the TBCA. Included in the list is a catch-all provision that states that such an agreement is effective even though it “governs the exercise of corporate powers, the management of the business and affairs of the corporation, or the relationship among the shareholders, the directors, and the corporation, or among any of them, as if the corporation were a partnership or in a manner that would otherwise be appropriate only among partners, and is not contrary to public policy.” Tex. Bus. Corp. Act art. 2.30-1A(9). Thus, it appears that indemnification beyond that permitted under Article 2.02-1 may be achieved under such an agreement if it would be permissible in a partnership and would not offend public policy. (There may be a similar argument under Article 12.32 of the TBCA for “close corporations” that comply with TBCA Part 12, the Texas Close Corporation Law.)

B. Limited Liability Companies
1. Fiduciary Duties of Managers and Managing Members

The TLLCA does not define or expressly impose fiduciary duties on managers or members of an LLC, but implicitly recognizes that such duties may exist in Article 2.20 (discussed below). Commentators and practitioners have generally assumed that managers in a manager-managed LLC and members in a member-managed LLC have fiduciary duties along the lines of corporate directors or general partners in a partnership. These duties would generally embrace a duty of obedience, duty of care, and duty of loyalty. The TLLCA has interested manager provisions patterned after the interested director provisions of the TBCA. See Tex. Rev. Civ. Stat. Ann. art. 1528n, art. 2.17. As discussed below, LLC regulations may expand or restrict duties and liabilities of managers and members and provide for indemnification. Tex. Rev. Civ. Stat. Ann. art.1528n, art. 2.20.

In an unpublished opinion, the Dallas Court of Appeals concluded that members of an LLC do not necessarily owe other members fiduciary duties. Suntech Processing Systems, L.L.C. v. Sun Communications, Inc., 2000 WL 1780236 (Tex. App.—Dallas Dec. 5, 2000, pet. denied). The court relied on Texas case law rejecting the notion that co-shareholders of a closely held corporation are necessarily in a fiduciary relationship. That the articles of organization imposed upon members a duty of loyalty to the LLC did not mandate any such duty between the members according to the court.

In Pinnacle Data Services, Inc. v. Gillen, 104 S.W.3d 188 (Tex.App.—Texarkana 2003, no pet.), a member of an LLC sued the other two members alleging various causes of action based on the action of the other two members in amending the LLC articles of organization to change the LLC from a member-managed LLC to a manager-managed LLC and excluding the plaintiff member from management. The plaintiff member owned a 50% interest in the LLC. The regulations required the approval of 66 2/3% in interest to amend the articles of organization, while the articles of organization required the approval of 2/3 of the members. The defendant members relied on the provision in the articles of organization, and the court held that the provision in the articles controlled because the TLLCA permits the regulations to contain any provision not inconsistent with the articles of organization. The court of appeals reversed the trial court’s summary judgment in favor of the defendant members on the breach of fiduciary duty claim, however, stating that the determination that the articles of organization controlled disposed of the breach of contract claim, but not the breach of fiduciary duty-based claims. The court appeared to analogize the duties of the LLC members to those of corporate officers and directors, but the opinion is not entirely clear in this regard. The court apparently accepted that an LLC member may bring a claim for “oppression” as defined in the corporate context, but the court upheld summary judgment in favor of the defendants on this claim, stating that the plaintiff had failed to set forth any evidence in support of its oppression claim.

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2. Statutory Authorization to Modify Duties and Liabilities of Members and Managers in Governing Documents

Exculpation. Prior to 1997 amendments, Article 8.12 of the TLLCA followed the corporate approach to exculpation of liability for duties of managers by incorporating by reference Article 7.06 of the Texas Miscellaneous Corporation Laws Act (Tex. Rev. Civ. Stat. Ann. art. 1302-7.06). Old Article 8.12 of the TLLCA indicated that a manager's liability could be eliminated in the articles of organization to the extent permitted for a director under Article 1302-7.06. (Unfortunately, it was not clear under Article 8.12 that a member in a member-managed LLC could be sheltered under these provisions.) The 1997 amendments effected a significant departure from this approach. The reference to Article 1302-7.06 was eliminated from the TLLCA, and a new provision, Article 2.20B, was added as follows:

To the extent that at law or in equity, a member, manager, officer, or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited liability company or to another member or manager, such duties and liabilities may be expanded or restricted by provisions of the regulations.

This provision generally follows the approach of the Delaware LLC act and leaves the extent to which duties and liabilities may be eliminated to be determined by the courts as a matter of public policy. Compare Delaware Limited Liability Company Act § 18-1101.6 (The TLLCA does not include certain additional provisions
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found in § 18-1101 of the Delaware act that expressly emphasize the principles of freedom of contract and enforceability of LLC agreements; however, the legislative development and breadth of Article 2.20 itself strongly indicate that the intent was to provide for broad latitude in modifying duties, exculpating, and indemnifying in the LLC documents.)

Thus far, courts have appeared inclined to give effect to contractual provisions limiting fiduciary duties and specifying permissible conduct of LLC managers and members. In the first LLC case addressing issues of this sort to a significant degree, the Ohio Court of Appeals interpreted and enforced a provision of an operating agreement limiting the scope of a member’s duty not to compete with the LLC. *McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193 (Ohio App. 1999). In this case, the court stated that LLC members (of what was apparently a member-managed LLC) are in a fiduciary relationship that would generally prohibit competition with the business of the LLC. The court concluded, however, that members may contractually limit or define the scope of the fiduciary duties. Specifically, the court recognized the validity of a provision in the operating agreement of an Ohio LLC that provided as follows:

“Members May Compete. Members shall not in any way be prohibited from or restricted in engaging or owning an interest in any other business venture of any nature, including any venture which might be competitive with the business of the Company.”

Under this provision, the court found that a member was clearly and unambiguously permitted to compete against the LLC to obtain a hockey franchise sought by the LLC. The court rejected an argument that the provision only allowed members to engage in other types of businesses. The court did indicate that action related to obtaining the franchise or “the method of competing” could constitute a breach of duty if it amounted to “dirty pool,” but noted the trial court’s finding that the competing members had not engaged in willful misconduct, misrepresentation, or concealment.

**Indemnification.** Prior to the 1997 amendments, the TLLCA provided that an LLC was permitted to indemnify members, managers, and others to the same extent a corporation could indemnify directors and officers under the TBCA and that an LLC must, to the extent indemnification was required under the TBCA, indemnify members, managers, and others to the same extent. Thus, applying these provisions in the LLC context, indemnification was mandated in some circumstances even if the articles of organization and regulations were silent regarding indemnification. On the other hand, there were certain standards and procedures that could not be varied in the articles of organization or regulations. As amended, Article 2.20A of the TLLCA reads as follows:

Subject to such standards and restrictions, if any, as are set forth in its articles of organization or in its regulations, a limited liability company shall have the power to indemnify members and managers, officers, and other persons and purchase and maintain liability insurance for such persons.

The amendment generally follows the approach taken in the Delaware LLC act. It neither specifies any circumstances under which indemnity would be required nor places any limits on the types of liabilities that may be indemnified. It will be left to the courts to determine the bounds equity or public policy will place on the obligation or power to indemnify. Thus, for example, if regulations state that a manager or member “shall be indemnified to the maximum extent permitted by law,” it is not clear how far the indemnification obligation extends. Would the LLC be required to indemnify for bad faith acts or intentional wrongdoing?

**C. LLPs, Limited Partnerships, and Limited Partnership LLPs**

1. **Fiduciary Duties of Partners in General Partnership/LLP**

That general partners owe to one another and the partnership fiduciary duties is well-established by case law. Perhaps the most famous case in this area is Justice Cardozo’s opinion in *Meinhard v. Salmon*, 249 NY 458, 164 N.E. 545 (1928). Texas cases have reiterated the unyielding duty of loyalty standard set forth in that case. See *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex. 1976); *Johnson v. Peckham*, 132 Tex. 148, 120 S.W.2d 786 (1938); *Kunz v. Huddleston*, 546 S.W.2d 685 (Tex.App.–El Paso 1977, writ ref’d n.r.e.). On the other hand, the duty of care has received little attention in the case law. With the passage of the TRPA, the duties of care and loyalty were basically codified. The TRPA also attempts to clarify the extent to which contractual modification of the duties is permissible.

The now expired Texas Uniform Partnership Act addressed only certain aspects of the fiduciary duties of partners. In fleshing out the fiduciary duties of partners, courts have often spoken in broad, sweeping terms. At times, courts have even referred to partners as trustees.
The TRPA includes a more specific and comprehensive description of partner duties than the Texas Uniform Partnership Act but eschews some of the broader language found in some cases. TRPA Section 4.04 certainly describes the core of what has traditionally been referred to by the courts as partner fiduciary duties, but the Bar Committee comments reflect the Committee’s hope that the statutorily described duties will not be expanded by loose use of “fiduciary” concepts from other contexts or by the broad rhetoric from some prior cases. See Tex. Rev. Civ. Stat. Ann. art. 6132b-4.04, Comment of Bar Committee – 1993. In fact, the drafters of the TRPA quite deliberately refrained from using the term “fiduciary,” and Section 4.04 explicitly provides that a partner is not a trustee and is not to be held to such a standard. On the other hand, Section 4.04 leaves courts some flexibility because the duties are not listed or described in exclusive terms. Thus far, the courts have not addressed a case in this area that was actually governed by the TRPA. The Texas Supreme Court addressed Section 4.04 of the TRPA in one case and indicated that the law as it applied in that case was not changed by the TRPA; however, the case was actually governed by the Texas Uniform Partnership Act. See M.R. Champion, Inc. v. Mizell, 904 S.W.2d 617 (Tex. 1995). In Johnson v. Brewer & Pritchard, P.C., 73 S.W.3d 193, 199-200 (Tex. 2002), a case involving the fiduciary duty owed by an agent to a principal, the Texas Supreme Court noted that it had historically held that partners owe one another certain fiduciary duties but that it “need not consider here the impact of the provisions of the Texas Revised Partnership Act on duties partners owe to one another.”

**Duty of care.** Under Section 4.04(a) of the TRPA, a partner owes a duty of care to the partnership and the other partners. The duty is defined in Section 4.04(c) as a duty to act in the conduct and winding up of the partnership business with the care of an ordinarily prudent person under similar circumstances. An error in judgment does not by itself constitute a breach of the duty of care. Further, a partner is presumed to satisfy this duty if the partner acts on an informed basis, in good faith, and in a manner the partner reasonably believes to be in the best interest of the partnership. Tex. Rev. Civ. Stat. Ann. art. 6132b-4.04(c), (d). These provisions obviously draw on the corporate business judgment rule in articulating the duty of care. Nevertheless, it is unclear in the final analysis if the standard of care is one of simple or gross negligence. The sparse case law in this area (pre-dating the TRPA) indicates that a partner will not be held liable for mere negligent mismanagement. See Ferguson v. Williams, 670 S.W.2d 327

(Tex.App.–Austin 1984, writ ref’d n.r.e.). It is unlikely the drafters intended to up the ante in this regard. On the other hand, the TRPA stopped short of expressly setting forth a gross negligence standard (which is the standard specified in the Revised Uniform Partnership Act).

**Duty of loyalty.** Unlike the duty of care, a partner’s duty of loyalty was the subject of a good deal of case law prior to the passage of the TRPA. In the TRPA, the duty of loyalty is described as including:

1) accounting to the partnership and holding for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or from use of partnership property;
2) refraining from dealing with the partnership on behalf of a party having an interest adverse to the partnership; and
3) refraining from competing with the partnership or dealing with the partnership in a manner adverse to the partnership.

Tex. Rev. Civ. Stat. Ann. art. 6132b-4.04(b). These provisions embrace the common areas traditionally encompassed by the duty of loyalty, e.g., self-dealing and conflicts of interest, usurpation of partnership opportunity, and competition. To temper some of the broader expressions of partner duties in the case law, however, the statute specifically states that a partner does not breach a duty merely because his conduct furthers his own interest and that a partner is not a trustee and should not be held to a trustee standard. See Tex. Rev. Civ. Stat. Ann. art. 6132b-4.04(e), (f). A court has some room to find that conduct not specifically embraced in the three categories listed nevertheless implicates the duty of loyalty in a given case since the statute states that the duty of loyalty “includes” the matters set forth above.

**Duties owed to transferees of deceased partners.** Effective September 1, 2003, TRPA Section 4.04(a) was amended to provide that partners owe the duties of loyalty and care to “transferees of deceased partners under Section 5.04(b)” in addition to the other partners and the partnership. This provision was added to H.B. 1637 by Representative Will Hartnett. Prior to this amendment, some courts had held that partners owe no fiduciary duties to assignees or transferees. See Griffin v. Box, 910 F.2d 255, 261 (5th Cir.1990) (applying Texas law and stating that general partners did not owe a fiduciary duty to transferees of partnership interests who had not been admitted as substituted partners); Adams v. United States, 2001 WL 1029522 (N.D.Tex.2001) (stating that remaining partners did not
owe a fiduciary duty to assignees of the deceased partner under Texas law); but see Bader v. Cox, 701 S.W.2d 677, 685 (Tex.App.–Dallas 1985, writ ref’d n.r.e.) (stating that surviving partners owed fiduciary duties to the representative of a deceased partner under the Texas Uniform Partnership Act).

As a default rule, the TRPA provides that the partnership interest of a deceased partner is automatically redeemed by the partnership for its fair value as of the date of death of the partner; thus, the TRPA does not ordinarily give rise to transferees of a deceased partner. Rather, it appears that the deceased partner’s personal representative, surviving spouse, heirs, and devisees should be regarded as creditors until paid. If, however, a partnership agreement negates the redemption provision under the TRPA, the personal representative, surviving spouse, heirs and devisees of a deceased partner will be regarded as transferees of the deceased partner’s partnership interest to the extent they succeed to the deceased partner’s partnership interest, and Section 4.04(a) would apply.

Obligation of good faith. The TRPA imposes on a partner the obligation to discharge any duty and exercise any rights or powers in conducting or winding up partnership business in good faith and in a manner the partner reasonably believes to be in the best interest of the partnership. Tex. Rev. Civ. Stat. Ann. art. 6132b-4.04(d).

2. Fiduciary Duties of Partners in Limited Partnership or Limited Partnership LLP

General partners. The TRLPA does not address duties of partners, but case law has held general partners in a limited partnership to fiduciary standards. See Hughes v. St. David’s Support Corp., 944 S.W.2d 423 (Tex.App.–Austin 1997, writ denied) (“[I]n a limited partnership, the general partner stands in the same fiduciary capacity to the limited partners as a trustee stands to a trust.”); McLendon v. McLendon, 862 S.W.2d 662 (Tex.App.–Dallas 1993, writ denied) (“In a limited partnership, the general partner acting in complete control stands in the fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a trust.”); Crenshaw v. Swenson, 611 S.W.2d 886 (Tex. Civ.App.–Austin 1980, writ ref’d n.r.e.)(same); Watson v. Ltd. Partners of WCKT, 570 S.W.2d 179 (Tex.Civ.App.–Austin 1978, writ ref’d n.r.e.)(same).

Not only the general partner, but those in control of the general partner have been held to such standards. See In re Bennett, 989 F.2d 779 (5th Cir. 1993).

Though courts have been inclined to refer to a general partner of a limited partnership as a “trustee,” it is no longer appropriate to speak in terms of “trustee” standards for a general partner. The TRPA negates the trustee standard, and a general partner in a limited partnership has the liabilities of a partner in a general partnership to the other partners and the partnership unless the TRLPA or the partnership agreement provides otherwise. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 4.03(b); see also art. 6132a-1, § 13.03 (providing that the TRPA applies in any case not provided for by the TRLPA).

Thus, it appears that a general partner in a limited partnership would have the duties of care and loyalty set forth in the TRPA (discussed above) but no longer should be described as a “trustee.” The impact of the recent amendment to TRPA Section 4.04(a), which provides that the duties of loyalty and care are owed to transferees of deceased partners, should be considered in the context of limited partnerships. One can expect that the personal representative, surviving spouse, heirs, and devisees of a deceased limited partner whose interest is not bought out will assert that the general partner owes them fiduciary duties under TRPA Section 4.04 by virtue of the linkage of the TRPA to the TRLPA.

Limited partners. There is some uncertainty with regard to whether limited partners owe fiduciary duties to the partnership or other partners. While there is an argument that limited partners have the duties enumerated in Section 4.04 of the TRPA (by virtue of the linkage of the TRPA to the TRLPA under TRLPA Section 13.03), such an approach would not be a logical application of the statutes. Some provisions of the TRPA clearly are only applicable to general partners even though the TRLPA is silent in such regard and the TRPA acts as a gap-filler. Ordinarily, limited partners should not owe fiduciary duties as limited partners because they are merely passive investors. There is case law in other jurisdictions holding that limited partners do not have fiduciary duties, and two appellate courts in Texas concluded that limited partners do not have fiduciary duties. See Villa West Assocs. v. Kay, 146 F.3d 798 (10th Cir. 1998); In re Kids Creek Partners, 212 B.R. 898 (N.D. Ill. 1997); AON Props. v. Riveraine Corp., 1999 WL 12739 (Tex.App.–Houston [14th Dist.] January 14, 1999, no pet. hist.); Crawford v. Ancira, 1997 WL 214835 (Tex.App.–San Antonio April 30, 1997, no pet.). Unfortunately, there is a lack of precedent authority in Texas on this point because the case law is unpublished. There is an argument that limited partners should owe such duties to the extent they actually have control in management matters, e.g., because of control of the general partner. There is case law in Delaware to this effect. See RJ Assocs., Inc. v. Health Payors’ Org. Ltd. P’ship, 1999 WL 550350 (Del. Ch. 1999)
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3. Statutory Authorization to Modify Duties and Liabilities of Partners

Exculpation under Texas Revised Partnership Act. Under the TRPA, the duties of care and loyalty and the obligation of good faith cannot be eliminated by the partnership agreement. Tex. Rev. Civ. Stat. Ann. art. 6132b-1.03. However, the statute leaves room for some modification by contract.

With respect to the partners’ duty of care, the TRPA provides that the partnership agreement may not eliminate the duty of care but may determine the standards by which the performance of the obligation is to be measured if the standards are not “manifestly unreasonable.” Tex. Rev. Civ. Stat. Ann. art. 6132b-1.03(a)(3). How far then, can the partnership agreement go? If the statutory standard is simple negligence, will a gross negligence standard in the partnership agreement stand up as not “manifestly unreasonable”? One would think that it generally should. In one case decided prior to the passage of the TRPA, a court dealt with a mismanagement claim against a general partner in a limited partnership where the partnership agreement stated that the general partner would not be liable absent willful malfeasance or fraud. Grider v. Boston Co., Inc., 773 S.W.2d 338 (Tex.App.–Dallas 1989, writ denied). The court assumed the clause was enforceable to protect the general partner against the mismanagement claim. The court stated that, when the parties bargain on equal terms, a fiduciary may contract for the limitation of liability. Public policy would preclude, according to the court, limitation of liability for (1) self-dealing, (2) bad faith, (3) intentional adverse acts, and (4) reckless indifference with respect to the interest of the beneficiary. Id. at 343.

With respect to the partners’ duty of loyalty, the TRPA provides that the partnership agreement may not eliminate the duty of loyalty but may identify specific types or categories of activities that do not violate the duty of loyalty if not “manifestly unreasonable.” Tex. Rev. Civ. Stat. Ann. art. 6132b-1.03(a)(2). One obvious issue here, in addition to the meaning of “manifestly unreasonable,” is how “specific” these provisions must be in identifying types or categories of activities. The answer may depend upon the circumstances, such as the sophistication of the parties, scope of activities of the partnership, etc.

Finally, the TRPA provides that the obligation of good faith may not be eliminated by the partnership agreement, but the agreement may determine the standards by which the performance is to be measured if the standards are not “manifestly unreasonable.” Tex. Rev. Civ. Stat. Ann. art. 6132b-1.03(a)(4). Again the parameters of this provision are not readily apparent and probably will depend, at least in part, on the circumstances of any particular case.

Exculpation under Texas Revised Limited Partnership Act. The TRLPA does not address the extent to which partners’ duties and liabilities may be altered by agreement of the partners except to state in Article 4.03(b):

Except as provided by this Act or in the partnership agreement, a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to the partnership and the other partners. [Emphasis added.]

This language indicates that the partnership agreement may modify the liabilities of a general partner, but it is not clear whether it is an authorization without express limits or would link to the provisions in Section 1.03 of the TRPA that prohibit elimination of duties and set a “manifestly unreasonable” floor for contractual variation.

Indemnification under Texas Revised Partnership Act. The TRPA provides that a partnership has the power to “indemnify a person who was, is, or is threatened to be made a defendant or respondent in a proceeding and purchase and maintain liability insurance for such person.” Tex. Rev. Civ. Stat. Ann. art. 6132b-3.01(15). There are no specified limits on this power, and the partnership agreement governs the relations of the partners except to the extent provided in Section 1.03(b). Tex. Rev. Civ. Stat. Ann. art. 6132b-1.03(a). The power to indemnify is not referred to in Section 1.03(b), but it would seem that indemnification, or contractual provisions for indemnification, for liabilities arising from breaches of duty that could not have been waived under Section 1.03(b) would be of questionable validity.

Civ. Stat. Ann. art. 6132a-1, §§ 11.08, 11.21. A limited partnership is prohibited from indemnifying a general partner who is found liable to the limited partners or the partnership, or for improperly receiving a personal benefit, if the liability arose out of willful or intentional misconduct. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, §§ 11.03, 11.05. A limited partnership is permitted, if provided in a written partnership agreement, to indemnify a general partner who is determined to meet certain standards. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 11.05. These standards require that the general partner acted in good faith, reasonably believed the conduct was in the best interest of the partnership (if the conduct was in an official capacity) or that the conduct was not opposed to the partnership’s best interest (in cases of conduct outside the general partner’s official capacity), and, in the case of a criminal proceeding, had no reasonable cause to believe the conduct was unlawful. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 11.02. If a general partner is not found liable for willful or intentional misconduct, but is found liable to the limited partners or the partnership or on the basis of improperly receiving a personal benefit, permissible indemnification is limited to reasonable expenses. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 11.05. General partners may only be indemnified to the extent consistent with the TRLPA or with the “applicable reimbursement provisions” of the TRPA. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 11.13. Limited partners, employees, and agents who are not also general partners may be indemnified to the same extent as general partners and to such further extent, consistent with law, as may be provided by the partnership agreement, general or specific action of the general partner, by contract, or as permitted or required by common law. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, §§ 11.15, 11.17. Insurance providing coverage for unindemnifiable areas is expressly permitted. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 11.18.

IV. CONCLUSION
Whether the different approaches to fiduciary duties under the various Texas business entity statutes amount to a significant difference between the entities might be debated. However, subtle differences in, and the ability to vary, fiduciary duties may be an important factor in the choice and structure of a business entity in some cases. Generally, the LLC form appears to provide the greatest potential flexibility to waive fiduciary duties and liabilities and provide for broad contractual indemnification, but the statutory provisions in Texas that provide this flexibility are new and have not yet been judicially interpreted in reported cases. (LLC cases in other jurisdictions have generally respected and enforced contractual standards and waivers.) Often, the limited partnership will be the most attractive entity from a federal and state tax perspective in Texas and the tax advantages will be deemed to outweigh any other disadvantages; however, corporations and LLCs are often part of tiered structures even when the operating business is a limited partnership. Whatever entities are utilized, the matters addressed in this paper should be considered in the drafting of the governing documents.

V. CAVEAT: ATTORNEY LIABILITY FOR AIDING AND ABETTING CLIENT’S BREACH OF FIDUCIARY DUTY
When a third party knowingly participates in the breach of a fiduciary duty, the third party becomes a joint tortfeasor with the fiduciary and is liable as such. Kinzbach Tool Co. v. Corbett Wallace Corp., 138 Tex. 565, 573, 160 S.W.2d 509, 514 (1942). Should this principle apply to an attorney whose legal services facilitate the breach of a fiduciary duty by the attorney’s client to a third party? What if an attorney assists those in control of a business entity in effecting a transaction and it is determined that the action taken breached fiduciary duties owed by those in control to the other investors. Should the attorney be liable for participating in the majority’s breach of fiduciary duty to the minority? The South Dakota Supreme Court summed up the dilemma as follows:

Holding attorneys liable for aiding and abetting the breach of a fiduciary duty in rendering professional services poses both a hazard and a quandary for the legal profession. On the one hand, overbroad liability might diminish the quality of legal services, since it would impose “self-protective reservations” in the attorney-client relationship. Attorneys acting in a professional capacity should be free to render advice without fear of personal liability to third persons if the advice later goes awry. On the other hand, the privilege of rendering professional services not being absolute, lawyers should not be free to substantially assist their clients in committing tortious acts. To protect lawyers from meritless claims, many courts strictly interpret the common law elements of aiding and abetting the breach of a fiduciary duty.

Chem-Age Indus., Inc. v. Glover, 652 N.W.2d 756 (S.D. 2002) (citations omitted). The court went on to
hold that an attorney may be held liable for assisting in the breach of a fiduciary duty if (1) the fiduciary breached an obligation to the plaintiff, (2) the attorney substantially assisted the fiduciary in the achievement of the breach, (3) the attorney knew that the fiduciary’s conduct constituted a breach of duty, and (4) damages were sustained as a result of the breach. Other cases in which the court concluded that an attorney may have liability to a third party for participating in the client’s breach of fiduciary duty include Granewich v. Harding, 985 P.2d 788 (Or. 1999) (recognizing cause of action in context of claim against attorney for participating in scheme to squeeze out minority shareholder and holding that plaintiff’s allegations stated a claim) and Holmes v. Young, 885 P.3d 305 (Colo.Ct.App. 1994) (recognizing cause of action in context of claim against attorney for aiding and abetting breach of general partner’s fiduciary duty, but affirming trial court’s finding that attorney did not “knowingly” participate in partner’s breach of fiduciary duty). One Texas court of appeals, in an unpublished opinion, rejected a claim against an attorney for knowing participation in a breach of fiduciary duty in the context of a squeeze out merger. See McConnell v. Ford & Ferraro, L.L.P., 2001 WL 755640 (Tex.App.–Dallas 2001, pet. denied) (not designated for publication). The court acknowledged the rule that a party who knowingly participates in another’s breach of fiduciary duty is liable as a joint tortfeasor, but concluded that the privity requirement limits the liability of an attorney to the attorney’s clients. The court noted that the Texas Supreme Court has recognized an exception to the privity requirement in the context of an attorney’s negligent misrepresentation (see McCamish, Martin, Brown & Loffler v. F.E. Appling Interests, 991 S.W.2d 787 (Tex. 1999)), but the court of appeals declined to extend the exception to the privity requirement in the absence of supreme court precedent. See also Scherrer v. Haynes and Boone, L.L.P., 2002 WL 188825 (Tex.App.–Houston [1st Dist.] Feb. 7, 2002, no pet.) (holding lack of privity precluded shareholder’s breach of fiduciary duty claim against corporation’s attorney).

Endnotes


2. For some time, the Texas Legislature has been pursuing the process of revising and reorganizing the Texas statutes into subject matter codes. In the business entity area, a new Texas Business Organizations Code (“TBOC”) was enacted by the Texas Legislature in the 2003 session. The TBOC is effective January 1, 2006, for any entity formed on or after that date. For entities formed prior to that date, the current statutes will continue to be effective until January 1, 2010.
An entity formed prior to January 1, 2006 may elect to be governed by the TBOC prior to January 1, 2010. Among the statutes that are subsumed in the new code are the Texas Business Corporation Act, the Texas Revised Partnership Act, the Texas Revised Limited Partnership Act, and the Texas Limited Liability Company Act. The TBOC has “hub” provisions applicable to all the various entities and “spoke” provisions applicable to specific entities. The TBOC reflects a novel and ambitious approach to the codification of the business entity statutes and includes a number of substantive changes in addition to the typical semantic and organizational changes involved in the codification of Texas statutes.

3. This list does not include special forms of business for licensed professionals, i.e., the professional corporation, professional association, and professional LLC, nor does it include the various forms of non-profit organizations.

4. The statutory close corporation, available under Part 12 of the Texas Business Corporation Act, may be a variation with which the reader is not familiar. Though these provisions have been a part of the TBCA since 1981, they have not been widely utilized; most closely held corporations are not "close corporations" governed by Part 12. In general, Part 12 authorizes deviation from the traditional corporate structure if the corporation elects, by specific recital in its articles of incorporation, to be a "close corporation." Part 12 allows the shareholders to dispense with bylaws and a board of directors and operate the corporation pursuant to a shareholders’ agreement tailored to the particular concerns of the parties, resulting in a business that is technically a corporation but may function more like a partnership. The shareholders' agreement may provide in a straightforward way what is achieved in a roundabout way with super-majority quorum and voting provisions, special classes of stock, voting agreements, share transfer restrictions, etc.

5. Since 1997, the TBCA has authorized privately held corporations to utilize shareholder agreements to deviate from corporate governance norms under Article 2.30-1 without the necessity of an election to be a “close corporation” under Part 12.

6. In response to Chancery Court opinions indicating that similar language in the Delaware Limited Partnership Act permits a limited partnership agreement to eliminate fiduciary duties, the Delaware Supreme Court has called attention to the fact that the language actually states that fiduciary duties and liabilities may be expanded or restricted, but does not state that they may be eliminated. *Gotham Partners, L.P. v. Hollywood Realty Partners, L.P.*, 817 A.2d 160 (Del. 2002).