Note

PLANK V. CHERNESKI: MARYLAND OPTS IN TO "OPT-OUT" IN THE LLC FIDUCIARY DUTY DEBATE

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In *Plank v. Cherneski*,[1] the Maryland Court of Appeals considered whether the managing member of a Maryland Limited Liability Company ("LLC") breached his fiduciary duties to the LLC and its minority members by engaging in unlawful actions that exposed the LLC to potential regulatory violations and lawsuits.[2] As a relatively new business entity,[3] the LLC is surrounded by an underdeveloped legal environment,[4] particularly with regard to fiduciary duties.[5] In Maryland, it remained unclear whether fiduciary duties between LLC managing members and minority members existed as a matter of common law[6] and whether breach of fiduciary duty claims could even be brought as independent causes of action.[7] The Court of Appeals decided the case by answering these two legal questions, holding that the managing members of an LLC owe common law fiduciary duties to

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1. 469 Md. 548, 231 A.3d 436 (2020).

2. *Id.* at 564, 231 A.3d at 445.

3. Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879, 886 (2012).

4. *See* Jeffrey S. Quinn, Allen v. Dackman*: Doing Away with Limited Liability in Maryland*, 70 MD. L. REV. 1171, 1186 n.127 (2011) ("The case law regarding LLCs tends to be underdeveloped because LLCs are a relatively recent creation.").

5. Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 538 (1997) ("[T]he development and rapid spread of new unincorporated business forms, including the limited liability company (LLC) . . . have not only raised many new issues, but have also breathed new life into old ones. One of the most important of the latter is the extent to which fiduciary duties may be waived or modified by contract.").

6. *Plank*, 469 Md. at 572, 231 A.3d at 450.

7. *Id.* at 558, 231 A.3d at 441.

the LLC and its minority members[8] and that claims for breach of fiduciary duty may be brought as independent causes of action.[9]

Even though the court recognized that breach of fiduciary duty claims can be actionable alone—generating significant discussion by its resolution of over two decades of conflicting fiduciary duty jurisprudence[10]— the more impactful, albeit brief holding recognized common law fiduciary duties between LLC managing members and minority members.[11] By its recognition of common law fiduciary duties in the LLC context, this landmark case effectively generated an opt-out system in Maryland, where default common law fiduciary duties apply unless the parties opt out of such duties in their operating agreements.[12] The court correctly recognized common law fiduciary duties in the LLC context not only in affirmance of precedent,[13] but also because such duties comport with traditional common law principles of equity, protect unsophisticated parties and parties with unequal bargaining power, and serve broad policy goals for Maryland's business environment at large.[14]

However, the court's holding should have gone further by clarifying the extent to which parties may waive these common law fiduciary duties by operating agreement.[15] This Note calls on Maryland, either through legislative action or future judicial decision, to allow parties to waive both the fiduciary duties of care and loyalty, effectively allowing parties to waive all their fiduciary duties.[16] By affording flexibility to LLC parties within an opt-out protectionary system, Maryland would retain its business-friendly environment and protect itself against jurisdictional competition while also ensuring the protection of Maryland LLCs and their minority members.[17]

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8. *Id.* at 572, 231 A.3d at 450.

9. *Id.* at 559, 231 A.3d at 442.

10. *See id.* at 558, 231 A.3d at 441 ("Courts and commentators have been asking [whether Maryland recognizes an independent cause of action for breach of fiduciary duty] for 23 years . . . .").

11. *Id.* at 572, 231 A.3d at 450.

12. *See* Nicole M. Sciotto, *Opt-In vs. Opt-Out: Settling the Debate Over Default Fiduciary Duties in Delaware LLCs*, 37 DEL. J. CORP. L. 531, 534–35 (2012) (describing the difference between the opt-in and opt-out systems). In "sharp contrast," an opt-in system requires that parties affirmatively opt in to the application of fiduciary duties in their operating agreements. *Id.*

13. *Plank*, 469 Md. at 572, 231 A.3d at 450.

14. *See infra* Section IV.A.

15. *See infra* Section IV.B.

16. *See infra* Section IV.B.

17. *See infra* Section IV.B.

I. THE CASE

In April 2011, former professional soccer player James Cherneski formed Trusox, LLC ("Trusox" or the "company") to produce and sell a non-slip athletic sock.[18] Trusox accepted investments from Sanford Fisher, Jeff Ring, and William Plank, who together amassed a thirty-five percent membership interest in the company.[19] Cherneski retained legal control of Trusox with a sixty-five percent membership interest.[20] Pursuant to this interest allotment, the three investors, Fisher, Ring, and Plank, were minority members of Trusox and Cherneski was its managing member.[21] In 2013, the four members of Trusox entered into an operating agreement (the "Operating Agreement") which granted Cherneski "general authority over most decisions relating to Trusox" consistent with his role as President and CEO.[22]

Trusox struggled to develop into a successful business.[23] Fisher and Plank (the "Minority Members") grew increasingly frustrated and dissatisfied with Cherneski's leadership of the company.[24] In June 2016, the Minority Members filed suit against Cherneski and Trusox, alleging that Cherneski violated the Operating Agreement and breached his contractual and fiduciary duties to the company and its members when he engaged in unlawful actions that exposed Trusox to potential damages claims.[25] These actions, Fisher and Plank claimed, placed their investments at risk.[26]

The Circuit Court for Anne Arundel County held in favor of the Minority Members on the breach of contract claims.[27] However, the circuit court held in favor of Cherneski on the breach of fiduciary duty claim, citing "insufficient evidence to show that there [had] been a breach of fiduciary duty."[28] Notably, the circuit court recognized Maryland's posture on breach

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18. *Plank*, 469 Md. at 560–61, 231 A.3d at 443.
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.* at 561–62, 231 A.3d at 443–44.
23. *Id.* at 562, 231 A.3d at 444.
24. *Id.* at 563, 231 A.3d at 444–45.
25. *See id.* at 564–65, 231 A.3d at 445 ("Specifically, the Minority Members alleged that Mr. Cherneski breached his fiduciary duties by: (1) violating Maryland's wage laws by paying employees late on multiple occasions; (2) refusing to provide the Minority Members with reasonable access to the Company's books and records despite their written demand for the same; (3) exposing the Company to liability by selling unregistered securities in violation of securities laws and misleading potential investors by presenting inflated and unrealistic financial projections and failing to disclose the existence of this lawsuit; and (4) violating trademark and right to publicity laws by failing to obtain appropriate permission before using certain images and logos in promotional materials.").
26. *Id.* at 564, 231 A.3d at 445.
27. *Id.* at 565, 231 A.3d at 446.
28. *Id.* at 566, 231 A.3d at 446.

of fiduciary duty claims—"that there is no stand-alone tort for a breach of fiduciary duty"—but ultimately concluded that the evidence did not sufficiently support a finding of breach.[29]

The Minority Members appealed to the Maryland Court of Special Appeals, and after oral arguments, the panel decided that the legal questions implicated in the case should be certified to the Court of Appeals.[30] On August 15, 2019, the Court of Special Appeals certified the matter to the Court of Appeals with two legal questions: first, whether minority members of an LLC may bring a stand-alone cause of action for breach of fiduciary duty against the managing member of the LLC when the managing member engages in unlawful actions that place the investments of the minority members at risk; and second, if so, whether such a claim is limited to allegations supporting other viable causes of action, allegations not supporting other viable causes of action, or unlimited by the availability of another viable cause of action addressing the same unlawful actions.[31] The Court of Appeals granted the certification to determine these two legal questions.[32]

II. LEGAL BACKGROUND

In *Plank v. Cherneski*, the Maryland Court of Appeals held that LLC managing members owe common law fiduciary duties to the LLC and its members.[33] The court further established that breach of fiduciary duty claims can be brought as independent causes of action, clarifying over two decades of ambiguity in fiduciary duty jurisprudence.[34] Section II.A provides a primer on Maryland LLCs.[35] Section II.B examines fiduciary duties and their common law and statutory sources in the LLC context.[36] Section II.C surveys LLC fiduciary duty law in Delaware and Nevada,[37] two prominent business-friendly states.[38] Finally, Section II.D recounts the genesis of breach of fiduciary duty jurisprudence in Maryland and pinpoints the sources of perplexity in the case law.[39]

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29. *Id.*

30. *Id.* at 567, 231 A.3d at 447.

31. *Id.* at 567–68, 231 A.3d at 447.

32. *Id.* at 568, 231 A.3d at 447.

33. *Id.* at 572, 231 A.3d at 450.

34. *Id.* at 558–59, 231 A.3d at 441–42.

35. *See infra* Section II.A.

36. *See infra* Section II.B.

37. *See infra* Section II.C.

38. *See* Russell K. Smith, *Utah Should Adopt a Modified Version of the Revised Uniform Limited Liability Company Act*, 2013 UTAH ONLAW 12, 17 (2013) (noting Delaware and Nevada as among the states having business-friendly LLC acts).

39. *See infra* Section II.D.

A. A Primer on Maryland LLCs

An effective evaluation of LLC laws first requires an understanding of LLC business entity fundamentals. In the most general sense, an LLC is "essentially a cross between a corporation (for limited liability purposes) and partnership (for tax purposes)."[40] This combination has bolstered the rise in popularity of the LLC entity as it provides members with the corporate protection against personal liability while also bypassing the corporate double-tax methodology, allowing individuals to pay a less burdensome pass-through tax at only the individual level rather than also at the entity level.[41] To be sure of its importance, Columbia University's past president Nicholas Murray Butler once famously noted of the LLC, "I weigh my words, when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times . . . . Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it."[42]

Though LLC statutes vary by state, many features of LLC law are similar across state lines. According to the Maryland Limited Liability Company Act (the "Maryland LLC Act"), LLCs are unincorporated business organizations[43] that are formed by filing articles of organization with the appropriate state department.[44] The owners of LLCs are called members.[45] LLCs are governed by operating agreements, contracted into by the members, which may regulate such matters as the relationship between members and the business affairs of the LLC.[46]

B. Fiduciary Duties in Maryland LLCs

As a relatively new business entity, the LLC is accompanied by a woefully underdeveloped legal framework,[47] where "[u]nlike the corporate and general partnership context, there is no statute in Maryland expressly addressing LLC members' fiduciary duties."[48] Though the Maryland LLC Act does not explicitly address fiduciary duties, such duties are not born of

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40. George Wasserman & Janice Wasserman Goldsten Family LLC v. Kay, 197 Md. App. 586, 615, 14 A.3d 1193, 1210 (2011).

41. Gould v. City of Stamford, 203 A.3d 525, 539 (Conn. 2019).

42. Nicholas Murray Butler, President, Colum. Univ., Politics and Business, 143rd Annual Banquet of the Chamber of Commerce of the State of New York (Nov. 16, 1911), https://babel.hathitrust.org/cgi/pt?id=coo.31924093105660&view=1up&seq=59&skin=2021.

43. MD. CODE ANN., CORPS. & ASS'NS, § 4A-101(l) (West 2020).

44. *Id.* § 4A-202(a).

45. *Id.* § 4A-101(n).

46. *Id.* § 4A-101(q).

47. *See supra* note 4 and accompanying text.

48. George Wasserman & Janice Wasserman Goldsten Family LLC v. Kay, 197 Md. at 616, 14 A.3d at 1210 (2011).

statutory language but instead arise from well-developed common law pre-existing such statutes.[49] In fact, common law fiduciary duties exist unfettered in the corporate and partnership context unless restricted by statute.[50] In Maryland, the same is true for LLCs.[51] But for LLCs, in addition to statutory limitations, Maryland courts have interpreted the Maryland LLC Act as permitting such limitation of duties by operating agreement.[52] The Maryland LLC Act states that "members may enter into an operating agreement to regulate or establish any aspect of the affairs of the limited liability company or the relations of its members."[53] As a matter of statutory interpretation, Maryland courts have construed this language to suggest "that provisions within operating agreements could alter existing [fiduciary] duties or create other [fiduciary] duties that would not otherwise exist."[54]

Courts have often analyzed managing members of LLCs as acting in an agency capacity on behalf of the LLC and its minority members.[55] Indeed, where agency is defined as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act,"[56] it is clear that managing members are agents for the LLC and its minority members.[57] As agency is a fiduciary relationship under common law, this categorization thereby binds managing members to common law fiduciary duties under classical principles of agency if left unrestricted by statute or operating agreement.[58]

The statutory obligations and duties of Maryland LLCs arise from the Maryland LLC Act,[59] written with the intent "to give the maximum effect to the principles of freedom of contract and to the enforceability of operating agreements."[60] A provision written into numerous state statutes, this "maximum effect" language functions to prioritize the role of party contracting and to delineate such freedom of contracting to parties

49. *Id.*, 14 A.3d at 1210–11.

50. *Id.*

51. *Id.*

52. *Id.* at 616, 14 A.3d at 1211.

53. MD. CODE ANN., CORPS. & ASS'NS, § 4A-402(a) (West 2020).

54. *Wasserman*, 197 Md. at 616, 14 A.3d at 1211.

55. *Id.*, 14 A.3d at 1210.

56. Green v. H.R. Block, Inc., 355 Md. 488, 503, 735 A.2d 1039, 1047 (1999) (citing RESTATEMENT (SECOND) OF AGENCY § 1 (1958)).

57. *Wasserman*, 197 Md. at 616, 14 A.3d at 1210.

58. *Id.*

59. MD. CODE ANN., CORPS. & ASS'NS § 4A (West 2020).

60. *Id.* § 4A-102(a).

uninhibited by burdensome state-imposed restrictions and laws.[61] Placing significant emphasis on the party-contracted terms of operating agreements, the LLC Act does not specify what, if any, fiduciary duties exist in the LLC context.[62] With the Maryland LLC Act silent on fiduciary duties, such duties are unrestricted by statute.[63] However, LLC fiduciary duties may still be precluded by operating agreement,[64] though the extent to which these duties may be altered or waived by such operating agreement in Maryland remains unanswered by statute or by case law.

C. Fiduciary Duties in Delaware and Nevada LLCs

To contextualize Maryland's LLC laws, this Section explores the LLC legal landscape in the renowned business-friendly states of Delaware and Nevada.[65] In Delaware, LLC fiduciary duties are largely demarcated by statute.[66] The Delaware Limited Liability Company Act (the "Delaware LLC Act") allows parties to limit or eliminate breach of fiduciary duties by way of operating agreement, barring only the elimination of the covenant of good faith and fair dealing.[67] Despite the Delaware LLC Act's clarity on elimination, a question of scope persisted: whether fiduciary duties existed by default in the Delaware LLC context, or in other words, whether a Delaware LLC with an operating agreement silent on fiduciary duties was bound to such duties.[68] The Delaware Supreme Court declined to answer this question during the infancy of the Delaware LLC Act, punting the inquiry to the state's legislature.[69] A year after the Delaware LLC Act's enactment, Delaware's legislature amended the Delaware LLC Act with a clarifying sentence, that "[i]n any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity relating to fiduciary duties and the law merchant, shall govern."[70] This amendment, and subsequent court interpretations, solidified the presence of default fiduciary duties in Delaware.[71] To summarize, there are default fiduciary duties in the Delaware

61. *See, e.g.*, *In re* Grupo Dos Chiles, LLC, No. 1447-N, 2006 WL 668443, at *2 (Del. Ch. Mar. 10, 2006) ("Limited liability companies are designed to afford the maximum amount of freedom of contract, private ordering and flexibility to the parties involved.").

62. *Wasserman*, 197 Md. at 616, 14 A.3d at 1211.

63. *Id.*

64. *Id.*

65. *See supra* note 38.

66. *See generally* DEL. CODE ANN. tit. 6 (West 2013).

67. *Id.* § 18-1101.

68. Gatz Properties, LLC v. Auriga Capital Corporation, 59 A.3d 1206, 1219 (Del. 2012).

69. *Id.*

70. DEL. CODE ANN. tit. 6, § 18-1104 (West 2013).

71. *Id.*

LLC context but parties may limit or eliminate such duties affirmatively by way of operating agreement.

Nevada, on the other hand, recognizes no such default fiduciary duties in the LLC context. The statutory language in Nevada provides that the duties of LLC managing members are limited only to the implied contractual covenant of good faith and fair dealing, and to "[s]uch other duties, including, without limitation, fiduciary duties, if any, as are expressly prescribed by the articles of organization or the operating agreement."[72] This 2019 update was subsequently interpreted by Nevada courts to mean that no fiduciary duties should be imposed upon LLCs, except the implied contractual covenant of good faith and fair dealing, unless such duties are specifically written into the LLC's operating agreement.[73] Thus, parties to a Nevada LLC may agree to contract into fiduciary duties by operating agreement, but when an operating agreement is silent on fiduciary duties, the parties remain unbound.[74] This yields a technical but significant distinction between Delaware and Nevada LLC fiduciary duty law: Parties that wish to be bound by fiduciary duties must actively insert fiduciary duties in a Nevada LLC agreement, while such duties exist by default in a Delaware LLC agreement.[75]

D. The Genesis of Maryland Breach of Fiduciary Duty Case Law and Subsequent Interpretations

In Maryland's seminal breach of fiduciary duty case, *Kann v. Kann*,[76] a trustee filed a complaint against his father's surviving spouse and beneficiary seeking a declaration of the rights and obligations of parties with respect to misappropriated funds.[77] The beneficiary brought a counterclaim, alleging breach of fiduciary duty by way of the trustee's conflicting roles as personal representative of his father's estate and trustee of his father's trust.[78] The beneficiary argued that the Court of Appeals should "substantially alter existing Maryland law by declaring that a breach of any fiduciary duty constitutes a tort."[79] However, the Court of Appeals rejected the

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72. NEV. REV. STAT. ANN. § 86.298 (West 2019).

73. Israyelyan v. Chavez, No. 78415, 2020 WL 3603743, at *4 (Nev. July 1, 2020) ("The Legislature's use of 'if' supports our interpretation of the statutory scheme as a whole: that while members of an LLC can contract to fiduciary duties, such duties do not necessarily exist otherwise, aside from the implied covenant of good faith and fair dealing.").

74. *Id.*

75. *Compare* DEL. CODE ANN. tit. 6, § 18-1101 (West 2013), *with* NEV. REV. STAT. ANN. § 86.298 (West 2019) (showing that while Delaware recognizes default fiduciary duties in LLC operating agreements, Nevada does not).

76. 344 Md. 689, 690 A.2d 509 (1997).

77. *Id.* at 695, 690 A.2d at 512.

78. *Id.*

79. *Id.* at 706, 690 A.2d at 517.

beneficiary's contentions for "wholesale changes in Maryland law" and held that "there is no universal or omnibus tort for the redress of breach of fiduciary duty by any and all fiduciaries."[80] Yet, the court added, "[t]his does not mean that there is no claim or cause of action available for breach of fiduciary duty,"[81] in order to promote case-by-case consideration by courts analyzing breach of fiduciary duty claims.[82]

Under *Kann*, Maryland courts proceeded to recognize "independent claims for breach of fiduciary duty in various contexts," including between partners and between shareholders and directors.[83] Yet, uncertainty in Maryland's jurisprudence remained by way of two conflicting footnotes. Despite consistent case law to the contrary,[84] the Court of Appeals in *International Brotherhood of Teamsters v. Willis Corroon Corporation of Maryland*[85] provided that under *Kann*, "although the breach of a fiduciary duty may give rise to one or more causes of action, in tort or in contract, Maryland does not recognize a separate tort action for breach of fiduciary duty."[86] However, seven years later, in yet another footnote, the Court of Appeals in *Shenker v. Laureate Education, Inc.*[87] maintained "that breach of fiduciary duties is a cognizable tort in Maryland."[88] In complete confliction, *Teamsters* recognized no independent cause of action for breach of fiduciary duty while *Shenker* noted that breach of fiduciary duties may actually stand as independent tort actions.[89] Accordingly, "[t]hese footnotes created problems for courts attempting to understand *Kann* and to follow the outlined

80. *Id.* at 713, 690 A.2d at 520–21.

81. *Id.* at 713, 690 A.2d at 521.

82. Plank v. Cherneski, 469 Md. 548, 592, 231 A.3d 436, 462 (2020).

83. *Id.* at 583–84, 231 A.3d at 457 (citing Ins. Co. of N. Am. v. Miller, 362 Md. 361, 765 A.2d 587 (2001)) (identifying and permitting a breach of fiduciary duty claim arising between an insurer and an agent under principles of agency); *see, e.g.*, Della Ratta v. Larkin, 382 Md. 553, 856 A.2d 643 (2004) (upholding the circuit court's injunction based on a breach of fiduciary duty claim arising in the partnership context); Shenker v. Laureate Educ., Inc., 411 Md. 317, 983 A.2d 408 (2009) (holding that shareholders could pursue direct claims against directors for breach of common law fiduciary duties).

84. *Plank*, 469 Md. at 584, 231 A.3d at 457.

85. Int'l Brotherhood of Teamsters v. Willis Corroon Corp. of Md., 369 Md. 724, 802 A.2d 1050 (2002).

86. *Id.* at 727 n.1, 802 A.2d at 1051 n.1.

87. *Shenker*, 411 Md. at 317, 983 A.2d at 408.

88. *Id.* at 351 n.16, 983 A.2d at 428 n.16.

89. *Compare Teamsters*, 369 Md. at 727 n.1, 802 A.2d at 1051 n.1, *with Shenker*, 411 Md. at 351 n.16, 983 A.2d at 428 n.16.

analysis,"[90] both in the Court of Special Appeals[91] and in federal court.[92] The conflicting language in *Kann* combined with the contradictory footnotes provided in *Teamsters* and *Shenker* left fiduciary duty law in Maryland in disarray.[93]

III. THE COURT'S REASONING

The Maryland Court of Appeals granted the certification to provide clarity on twenty-three years of ambiguity in Maryland jurisprudence as to whether breach of fiduciary duty may be actionable as an independent cause of action.[94] The court held in the affirmative, finding that breach of fiduciary duty can stand alone as an independent cause of action where the plaintiff demonstrates the existence of a fiduciary relationship, a breach of the duty owed by the fiduciary to the beneficiary, and harm to the beneficiary.[95] In arriving at this decision, the court further recognized that managing members of Maryland LLCs owe fiduciary duties to the LLC and to all other members as a matter of common law principles of agency.[96]

The Court of Appeals had not previously decided whether a managing member of an LLC owes common law fiduciary duties to its minority members.[97] The court began its analysis asserting that fiduciary duties may arise in one of three ways: by contract, by statute, or by common law.[98] The court analyzed these possibilities in turn, beginning with the operative contract, the Operating Agreement,[99] and the relevant statute, the Maryland LLC Act.[100] However, the court found both the Operating Agreement and the Maryland LLC Act silent as to whether managing members owed fiduciary duties to minority members.[101] With no contractual or statutory provision establishing fiduciary duties between Cherneski and the Minority

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90. Plank v. Cherneski, 469 Md. 548, 584, 231 A.3d 436, 457 (2020).

91. *Id.* at 585, 231 A.3d at 458 ("[T]he intermediate appellate court has 'held in some cases that there is no stand-alone claim for breach of fiduciary duty; in others that such a cause of action may exist, but only for equitable relief; and yet in others that such a cause of action may exist, without necessarily restricting the type of relief available.'").

92. *Id.* at 589, 231 A.3d at 460 ("[F]ederal judges also have been understandably inconsistent in their efforts to reconcile 'a split of authority . . . as to whether the Court of Appeals rejected breach of fiduciary duty as an independent tort.'" (citation omitted)).

93. *Teamsters*, 369 Md. at 727 n.1, 802 A.2d at 1051 n.1; *Shenker*, 411 Md. at 351 n.16, 983 A.2d at 428 n.16.

94. *Plank*, 469 Md. at 558, 231 A.3d at 441.

95. *Id.* at 599, 231 A.3d at 466.

96. *Id.* at 572, 231 A.3d at 450.

97. *Id.*

98. *Id.* at 571–72, 231 A.3d at 449–50.

99. *See supra* note 46 and accompanying text.

100. *Plank,* 469 Md. at 571–74, 231 A.3d at 449–51.

101. *Id.*

Members, the court resorted to the final possibility and analyzed whether such fiduciary relationships exist under common law.[102] Relying primarily on *George Wasserman & Janice Wasserman Goldsten Family LLC v. Kay*,[103] the court clarified its stance on whether such fiduciary relationships exist and held, based on principles of agency, that managing members of an LLC do owe common law fiduciary duties to the LLC and to the other members.[104] Under principles of common law agency, a fiduciary duty arises implicitly, as "[m]anaging members are clearly *agents* for the LLC and each of the members, which is a fiduciary position under common law."[105] Underpinning the court's analysis is an understanding that managing members of an LLC are agents for the LLC and its members.[106] This principal-agency relationship to which the court drew a parallel is a fiduciary position under common law.[107] Therefore, the court held that Cherneski, as Trusox President, CEO, and majority interest member, owed fiduciary duties to the Minority Members under common law principles of agency.[108]

After establishing that a fiduciary relationship does exist between LLC managing members and minority members, the court addressed whether Maryland law recognizes breach of fiduciary duty as an independent cause of action and, if so, what limits exist on the cause of action.[109] The court categorized the conflicting footnotes in *Teamsters* and *Shenker* as dicta and clarified that breach of fiduciary duty may indeed be actionable as an independent cause of action.[110] To establish breach of fiduciary duty as an independent cause of action, the court explained that a plaintiff must show the existence of a fiduciary relationship, a breach of the duty owed by the fiduciary to the beneficiary, and harm to the beneficiary.[111]

The Court of Appeals held that breach of fiduciary duty claims may stand alone as independent causes of action in Maryland.[112] In doing so, the court ultimately upheld the holding of the lower court, reasoning that the

102. *Id.*

103. 197 Md. App. 586, 616, 14 A.3d 1193, 1210 (2011) (explaining that because no Maryland statute precludes, or even limits, managing members' fiduciary duties under common law, those underlying duties apply).

104. *Plank*, 469 Md. at 572, 231 A.3d at 450.

105. *Wasserman*, 197 Md. App. at 616, 14 A.3d at 1210 (citing Ins. Co. of N. Am. v. Miller, 362 Md. 361, 765 A.2d 587 (2001)).

106. *See Plank*, 469 Md. at 572, 231 A.3d at 450 ("For the reasons so aptly explained in *Wasserman*, we join these courts and hold that managing members of an LLC owe common law fiduciary duties to the LLC and to the other members based on principles of agency.").

107. *Wasserman*, 197 Md. App. at 616, 14 A.3d at 1210.

108. *Plank*, 469 Md. at 573–74, 231 A.3d at 450.

109. *Id.* at 574, 231 A.3d at 451.

110. *Id.* at 594, 231 A.3d at 463.

111. *Id.* at 559, 231 A.3d at 466.

112. *Id.* at 626, 231 A.3d at 482.

circuit court's resolution of the breach of fiduciary duty claim was based upon a factual determination that there was no breach, unrelated to any legal analysis or interpretation of whether an independent cause of action existed.[113] Agreeing with the circuit court's factual determination finding no breach of fiduciary duty, the Court of Appeals concluded that the circuit court did not err in entering judgment in favor of Cherneski on the breach of fiduciary duty count.[114]

IV. ANALYSIS

In *Plank v. Cherneski*, Maryland's highest court held that breach of fiduciary duty may be brought as an independent cause of action (the "breach of fiduciary duty holding").[115] The Maryland Court of Appeals also held that managing members of an LLC owe fiduciary duties to the LLC and its minority members (the "default fiduciary duty holding").[116] While appreciating the importance of the breach of fiduciary duty holding on LLC law in Maryland, this Part focuses primarily on the default fiduciary duty holding.

The Court of Appeals correctly acknowledged default fiduciary duties in the LLC context because such default duties comport with traditional common law principles of equity, protect unsophisticated parties and parties with unequal bargaining power, and serve broad policy goals in the state's business environment at large.[117] However, the court's default fiduciary duty holding should have gone further by specifying the extent to which parties may waive their default fiduciary duties by operating agreement.[118] Moving forward, it is important that the Court of Appeals or the Maryland General Assembly clarifies this extent. This Note proposes that Maryland allow parties to waive their fiduciary duties of care and loyalty in order to retain a business-friendly environment that protects Maryland against jurisdictional competition, while simultaneously protecting LLCs and their minority members with an equitable judicial backdrop.[119] This Part will proceed in two Sections. First, Section IV.A will discuss the legal accuracy of the court's default fiduciary duty holding, while also outlining supporting policy arguments.[120] Then, Section IV.B will explore the rationale underpinning the

113. *Id.*
114. *Id.*
115. *Id.* at 559, 231 A.3d at 442.
116. *Id.* at 572, 231 A.3d at 450.
117. *See infra* Section IV.A.
118. *See infra* Section IV.B.
119. *See infra* Section IV.B.
120. *See infra* Section IV.A.

ability of parties to waive their fiduciary duties of care and loyalty in the context of an LLC operating agreement.[121]

A. Plank*'s Default Fiduciary Duty Holding Was Correctly Decided*

While freedom of contract is integral to the hailed flexibility of the LLC,[122] courts have often grappled with striking a balance between this flexibility and judicially injected fiduciary duties.[123] Though some argue that "'intrusive' judicial doctrine" is unnecessary in a setting where parties have "such a broad ability to privately order their affairs,"[124] some jurisdictions have nevertheless recognized default fiduciary duties.[125] Succeeding *Plank*, Maryland is one of these jurisdictions.[126] The alternative is a jurisdiction like Nevada, where no default fiduciary duties are recognized, leaving parties to shoulder the responsibility of explicitly contracting into such duties by operating agreement.[127]

Moving forward, this Note will use the terms "opt-in" and "opt-out" to refer to two main approaches of imposing fiduciary duties on LLCs.[128] Opt-in states, such as Nevada, require parties who wish to be bound by fiduciary duties to include a clause in their operating agreements affirmatively contracting into such duties.[129] By contrast, in opt-out states, such as Delaware, and most recently Maryland, default common law fiduciary duties apply to the parties of the agreement unless the parties include a clause in their operating agreements removing such duties.[130] Put simply, parties to an operating agreement silent on fiduciary duties will not be held to fiduciary duties in an opt-in state, but the same parties will be held to common law fiduciary duties in an opt-out state.[131] This Section will argue why an opt-

121. *See infra* Section IV.B.

122. Peter Molk, *Protecting LLC Owners While Preserving LLC Flexibility*, 51 U.C.D. L. REV. 2129, 2131 (2018); Haley v. Talcott, 864 A.2d 86, 88 (Del. Ch. 2004) ("[A] principle attraction of the LLC form of entity is the statutory freedom granted to members to shape, by contract, their own approach to common business 'relationship' problems.").

123. Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1613 (2004).

124. Douglas K. Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) From Close Corporation History*, 40 WAKE FOREST L. REV. 883, 958 (2005).

125. *See supra* text accompanying note 71.

126. Plank v. Cherneski, 469 Md. 548, 231 A.3d 436 (2020).

127. *See* NEV. REV. STAT. ANN. § 86.298 (West 2019) ("The duties of a manager or managing member . . . are only: (1) [t]he implied contractual covenant of good faith and fair dealing; and (2) [s]uch other duties, including, without limitation, fiduciary duties, if any, as are expressly prescribed by the articles of organization or the operating agreement.").

128. Sciotto, *supra* note 12, at 535.

129. *Id.* at 534–35.

130. *Id.* at 535.

131. *Id.* at 534–35.

out system is preferable and explain how the Court of Appeals in *Plank* correctly maintained a minimum "threshold level of mandatory fiduciary duty."[132]

1. Common Law Principles of Equity Necessitate Default Fiduciary Duties

The arguments for and against default fiduciary duties split along the lines of traditionalists and contractarians.[133] Traditionalists are proponents of default fiduciary duties, "focusing on the extracontractual nature of fiduciary duties, their grounding in equity, and their foundational doctrinal existence in business law."[134] On the other hand, contractarians see no room for default fiduciary duties, arguing that LLC agreements should be treated as pure contracts, leaving intact only the provisions contracted into by parties.[135]

While the contractarian argument is tempting, given that LLCs are primarily creatures of contract, the fiduciary relationship that underlies the association between LLC members is not purely contractual,[136] and though "LLC statutes are relatively new . . . abusive conduct is not."[137] Indeed, fiduciary duties are engrained in common law principles of equity and aimed at alleviating the "perennial" potential for abuse of delegated power present in relationships where one is entrusted with the assets of another.[138] It is self-evident how LLCs fit into this framework, as managing members are responsible for the assets of their fellow members and of the LLC. Thus, the "legal reality is that the manager of an LLC . . . *is* in a fiduciary relationship," and to label the relationship otherwise would be a "significant departure from [the] established doctrine" founded in equity.[139] The resulting implication is best captured by Professor Daniel Kleinberger, who aptly explains:

> Once courts stop thinking about managers as handling other people's money, the way is open to abandon "the punctilio of an honor the most sensitive" and decay into "the morals of the market place." . . . "[D]og eat dog" among firms may make for a

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132. Harner & Marincic, *supra* note 3, at 883.

133. Sciotto, *supra* note 12, at 534–35.

134. Winnifred A. Lewis, *Waiving Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 82 FORDHAM L. REV. 1017, 1044 (2013).

135. *Id.* at 1046.

136. *See* Reza Dibadj, *The Misguided Transformation of Loyalty into Contract*, 41 TULSA L. REV. 451, 458 (2006) ("[T]ransforming fiduciary obligations into waivable contractual terms is simply inconsistent with a long-standing understanding of what fiduciary duties are.").

137. Miller, *supra* note 123, at 1612.

138. Dibadj, *supra* note 136, at 451.

139. Lewis, *supra* note 134, at 1045 (footnote omitted).

competitive market. "Dog eat dog" within an entity undercuts capitalism.[140]

There are other fallacies underlying the contractarian argument that will be discussed in the following sections. For example, to treat LLC formation as purely contractual rests on an idealistic assumption of the contract formation process where all parties are sophisticated and have equal bargaining power.[141] By the same token, the contractarian argument ignores the persisting need for regulating managerial conduct, an issue exacerbated by the lack of market regulation because LLCs are largely privately held and are not required to disclose audited financial statements.[142] Further, without a developed capital market with share prices[143] and reputational concerns[144] to keep management held to some standard, LLCs generally lack the "market constraints on opportunistic conduct" that limit opportunism in larger ventures.[145] Even more, the contractarian approach effectuates worrisome public policy in the business environment at large because it disregards necessary limitations on managerial control and contributes to an already imbalanced dynamic between managing members and minority members where the often unequal bargaining power produces an inherently unfair contract formation process.[146]

2. *Default Fiduciary Duties Protect Unsophisticated Parties and Parties with Unequal Bargaining Power*

While the LLC entity provides parties with great contracting flexibility, the mere "ability to contract does not necessarily translate into the actual occurrence of effective contracting."[147] Indeed, "[f]iduciary duties are perhaps best understood as a response to the impossibility of contracting for all contingencies due to limited information and high transaction costs."[148] A

140. Daniel S. Kleinberger, *Delaware Dissolves the Glue of Capitalism: Exonerating from Claims of Incompetence Those Who Manage Other People's Money*, 38 WM. MITCHELL L. REV. 737, 767 (2012) (footnote omitted).

141. *See infra* Section IV.A.2.

142. Miller, *supra* note 123, at 1619.

143. Deborah A. DeMott, *Fiduciary Preludes: Likely Issues for LLCs*, 66 U. COLO. L. REV. 1043, 1044 n.3 (1994) ("The opportunism of a smaller enterprise may not be communicated as quickly, or as readily, as that of an enterprise tied to underwriters, stock analysts and other participants in public capital markets who collect, process and disseminate information.").

144. *Id.* (explaining that "anticipated impact on reputation" is a weaker constraint on opportunistic behavior in smaller enterprises because bad reputations in such a context do not limit the enterprise's access to public capital markets).

145. *Id.* at 1044.

146. *See infra* Section IV.A.3.

147. Moll, *supra* note 124, at 960–61.

148. H. Justin Pace, *Contracting Out of Fiduciary Duties in LLCs: Delaware Will Lead, but Will Anyone Follow?*, 16 NEV. L.J. 1085, 1086 (2016).

variety of factors may hinder effective bargaining, including lack of sophistication, over-trusting family and friends, lack of foresight,[149] and optimism bias.[150] Further, "involuntary" owners—individuals that receive ownership interests through gift or inheritance—are absent during initial contracting and thus are left without any bargaining power.[151]

Contract law often differentiates between sophisticated parties and unsophisticated parties.[152] It presumes that sophisticated parties know what to bargain for, can read and understand the terms of a written agreement, and can negotiate competently.[153] Contractarians base much of their argument on the assumption that only sophisticated parties enter into LLCs.[154] So, the argument goes, these sophisticated parties are able to tailor their operating agreements according to their business needs.[155] This assumption necessarily relies on a further supposition of a level playing field that permits free bargaining and effective contracting.[156] Yet, the research indicates that there is a lack of sophistication and free bargaining in the drafting of LLC operating agreements.[157]

A 2006 survey found that forty percent of LLCs were formed without an operating agreement,[158] indicating a lack of sophistication. Further, small businesses are increasingly being formed as LLCs using online, ready-made forms.[159] These "one-size-fits-all" forms are regularly inadequate at capturing the individual needs of a new business and can lead to the acceptance or waiver of crucial provisions by unsophisticated or unwary business owners.[160] For example, RocketLawyer provides a free LLC

149. Moll, *supra* note 124, at 961.

150. *See* Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295, 323 (2014) (defining optimism bias as "a cognitive bias under which people underestimate the likelihood of their own risks of an adverse event taking place").

151. Moll, *supra* note 124, at 961–62.

152. *See* Meredith R. Miller, *Contract Law, Party Sophistication and the New Formalism*, 75 MO. L. REV. 493, 494 (2010) ("Courts mention party sophistication in determining whether the parties intended to form a contract and what they meant by the terms they used. They determine the enforceability of reliance disclaimers, exculpatory clauses and liquidated damages provisions based, at least in part, on party sophistication." (footnotes omitted)).

153. *Id.* at 495.

154. *See, e.g.*, Arby Partners V, L.P. v. F & W Acquisition LLC, 891 A.2d 1032, 1063 (Del. Ch. 2006) ("In the alternative entity context . . . it is more likely that sophisticated parties have carefully negotiated the governing agreement . . . .").

155. Sciotto, *supra* note 12, at 545.

156. Claire Moore Dickerson, *Equilibrium Destabilized: Fiduciary Duties Under the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 417, 454 (1995).

157. *See infra* notes 158–165 and accompanying text.

158. Miller, *supra* note 150, at 322–23.

159. Derek Terry, *The Pitfalls of Fiduciary Duty Waivers in Do-it-Yourself LLC Formation*, 20 TENN. J. BUS. L. 1001, 1002 (2019).

160. *Id.*

operating agreement that alarmingly automatically waives the fiduciary duties of members.[161]

Studies have also revealed the prevalence of unequal bargaining power, finding that managers often have substantial leverage in setting the terms of operating agreements[162] and that majority members of LLCs are more likely to have legal representation than minority members.[163] Moreover, a study by Professor Peter Molk revealed that LLCs with vulnerable minority owners actually adopt considerably fewer owner safeguards than LLCs with more sophisticated owners.[164] This suggests that "LLCs may instead be using their contractual freedom to set up later opportunism by managers and majority owners."[165]

When LLCs are formed without operating agreements, parties never have the chance to contract into (or out of) of fiduciary duties.[166] Even when an operating agreement is drafted, minority members often lack the ability to contract into their preferred provisions due to unequal bargaining power, amplified not only by their more junior organizational position, but also by their lack of legal representation.[167] When minority members lack legal representation, their already attenuated position is exacerbated, spreading the bargaining power imbalance even wider.[168] Finally, the rise of ready-made LLC agreements may lead to the unintended or invalid waiver of fiduciary duties, which could result in unsophisticated parties creating operating agreements with inadvertent consequences or agreements that are wholly unenforceable in court.[169] Particularly to unsophisticated, uncounseled parties, the "LLC in ten minutes" model of these online platforms fails to "impart to the start-up owner the importance of considering and negotiating an operating agreement."[170]

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161. *Id.* at 1003–04.

162. *See, e.g.*, Harner & Marincic, *supra* note 3, at 924 (finding a relationship between duty waivers and pro-management rights like indemnification in operating agreements).

163. Miller, *supra* note 150, at 322.

164. Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 J. CORP. L. 503, 507 (2017).

165. *Id.*

166. *See* Miller, *supra* note 150, at 324 (explaining that where the vast majority of LLCs are formed without operating agreements or with "simple, no-frills agreements," the default environment becomes increasingly important).

167. *Id.* at 322.

168. Sandra K. Miller, *Fiduciary Duties in the LLC: Mandatory Core Duties to Protect the Interests of Others Beyond the Contracting Parties*, 46 AM. BUS. L.J. 243, 262 (2009) (explaining that "possible inequalities in legal representation between controlling and noncontrolling LLC investors" may contribute to "inequalities in the contractual playing field").

169. Terry, *supra* note 159, at 1004.

170. *Id.*

Not only do these concerns regarding party sophistication and bargaining power draw into question the contractarian assumption of sophisticated and free bargaining, but they also make particularly salient a state's default rules when inefficient bargaining occurs.[171] Indeed, these issues demand default fiduciary duties to protect a range of parties that contract into LLCs.[172] These parties include: parties that fail to create an operating agreement during business formation, involuntary owners that are not present during the initial contracting period, parties that create fill-in-the-blank agreements online, parties that are unable to effectuate their wants and needs into an operating agreement due to weak bargaining power or lack of sophistication, and parties that lack legal representation.[173] To not protect these members would be to turn a blind eye to the real possibility that when "LLCs modify default owner protections, it may on average be more with an eye to potential undesirable opportunism, rather than in pursuit of economic efficiency."[174]

3. Public Policy Goals are Effectuated by Default Fiduciary Duties

From a public policy perspective, fiduciary duties incentivize "honesty, good faith, prudence, and care."[175] A system with no default fiduciary duties may be understood as implicitly incentivizing the opposite, motivating self-interested practices over the obligations of a fiduciary to act on behalf of others and the business itself.[176] It is in the best interest of the business environment at large to incentivize integrity, where managers, who often exercise control over the assets of others, are held to a vigorous standard of honesty and reliability.[177] First, a robust business environment hinges on investment, which itself necessarily hinges on an intrinsic trust in the business environment.[178] How this trust might be fostered in a system that does not recognize default fiduciary duties is difficult to imagine. Second, managerial responsibility is fundamental to healthy businesses, which is the foundation of a strong business marketplace.[179] Therefore, contractual

171. Miller, *supra* note 150, at 324.

172. Terry, *supra* note 159, at 1006.

173. *See supra* text accompanying notes 166–167.

174. Molk, *supra* note 164, at 557.

175. Michael Despres, *Alternative Entities and Fiduciary Duty Waivers in Delaware*, 2015 BYU L. REV. 1347, 1373 (2015).

176. *Id.*

177. *See* Sandra K. Miller, *The Duty of Care in the LLC: Maintaining Accountability While Minimizing Judicial Interference*, 87 NEB. L. REV. 125, 132 (2008) ("The ultimate goal is to foster investor confidence through a legal regime that creates and enforces reasonable expectations of responsible management conduct.").

178. *Id.*

179. Kleinberger, *supra* note 140, at 738–39.

freedom must be balanced with "the need to constrain opportunistic and deceptive conduct through the development of a minimum mandatory core of acceptable business conduct."[180]

Fiduciary duties serve to encourage fiduciary relationships while reducing the risks associated with such relationships where one party has control over the assets of another.[181] However, when fiduciaries can waive their fiduciary duties without any real bargaining, "the practical alternatives for a skeptical investor are often stark: invest without adequate protection against self-dealing or avoid the asset class altogether."[182] If a manager is able to convince investors to sign an operating agreement without fiduciary protections, and if issues later arise, not only will the investors lose money on their investment, but they may also be deterred from investing in the future or they may turn to hiring legal representation, "either of which systematically raises the cost of capital and reduces economic activity."[183] As such, default fiduciary duties serve to safeguard and incentivize a flow of investment pivotal to business growth and success.[184]

For similar reasons, there must be some minimum standard of accountability to which managers are held in their fiduciary capacities. Firms are weakened by low managerial responsibility.[185] Ultimately, safeguarding investments and holding managers accountable through a default fiduciary duty regime go hand in hand and are central to achieving public policy efforts as they serve as "prerequisite[s] to a healthy market economy."[186] Overall, fiduciary duties not only comport with traditional common law principles of fairness and equity, but also protect unsophisticated parties, level the playing field, and serve broad policy goals in the business environment at large. As such, the court's default fiduciary duty holding comports with precedent, protects unsophisticated parties to the most popular business entity of our

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180. Miller, *supra* note 123, at 1613.

181. Despres, *supra* note 175, at 1351–52; *see* Ribstein, *supra* note 5, at 542 ("The beneficiary is willing to trust the fiduciary's discretion because the fiduciary's skills can enhance the value of the beneficiary's property.").

182. Despres, *supra* note 175, at 1375 (quoting Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, *in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 11, 12 (Mark J. Loewenstein & Robert W. Hillman eds., 2015)).

183. Molk, *supra* note 122, at 2133.

184. *See* Despres, *supra* note 175, at 1375 (explaining that bargaining often does not occur in alternative entity formation, which makes fiduciary duties pivotal in encouraging and protecting investment).

185. *See* Surendra Arjoon, *Virtue Theory as a Dynamic Theory of Business*, 28 J. BUS. ETHICS 159, 159 (2000) (finding that ethics-driven strategies improve a company's financial performance more than profit-driven strategies).

186. Kleinberger, *supra* note 140, at 738–39.

time, and maintains a more equitable, and therefore more robust, business environment for Maryland.

B. The Maryland Court of Appeals or the Maryland General Assembly Should Clarify the Extent to Which Parties May Opt Out of Default Fiduciary Duties by Operating Agreement

The Court of Appeals used *Plank* to correctly recognize default fiduciary duties in the LLC context and to permit parties to opt out of such duties by way of operating agreement.[187] However, the court came short of clarifying the extent to which parties may validly opt out of such fiduciary duties. Where the duty of loyalty, duty of care, and implied covenant of good faith all exist by default in the legal backdrop, it is imperative that parties know which of these duties may be waived.[188] Parties can rely on this affirmative knowledge during contracting to ensure that their operating agreements are enforceable.[189] Further, this clarification would prevent upsetting party expectations and decrease future litigation costs from disputes based on interpretive errors.[190] This Note proposes that in its clarification, the Court of Appeals or the Maryland General Assembly should make waivable by operating agreement the fiduciary duties of care and loyalty, while leaving immutable the implied covenant of good faith and fair dealing.[191] In doing so, Maryland would preserve a business-friendly environment and avoid jurisdictional competition with Delaware while balancing an equitable business environment for Maryland parties and their LLCs.[192]

1. The Fiduciary Duties of Care and Loyalty Should Be Waivable

Both the fiduciary duties of care and loyalty should be waivable by parties in an LLC operating agreement in Maryland. As argued below, there is strong reason to allow for such broad waiver powers. First, the duty of care is largely toothless and rarely litigated, greatly reducing any real impact of permitting its waiver.[193] Second, the duty of loyalty, though important, poses a pricey risk for business structures that do not need it.[194] Because

187. Plank v. Cherneski, 469 Md. 548, 231 A.3d 436 (2020).

188. *See infra* Section IV.B.1.

189. *See infra* Section IV.B.1.

190. *See* Harner & Marincic, *supra* note 3, at 884 ("The divergent views about the fiduciary nature of LLCs create uncertainty and additional cost for parties electing to do business in the LLC form.").

191. *See infra* Section IV.B.1.

192. *See infra* Section IV.B.2.

193. *See infra* Section IV.B.1.i.

194. *See infra* Section IV.B.1.ii.

there is greater flexibility in LLCs, the "costs and benefits of fiduciary duties vary from firm to firm" and parties are better positioned than the courts to decide which duties suit their business needs.[195] Indeed, to have "[o]verly burdensome mandatory rules" would be to "undermine the key comparative advantage of the LLC organizational form."[196] Finally, in maintaining the implied covenant of good faith and fair dealing, parties would still have an instrument by which to litigate, maintaining a last-resort option for aggrieved parties, even in the absence of the duties of care and loyalty.[197]

i. Waiving the Duty of Care

The duty of care requires fiduciaries to manage the business "with the care which ordinarily careful and prudent men would use in similar circumstances"[198] by requiring managers to consider "all material information reasonably available" before making business decisions.[199] However, the duty of care is largely considered toothless due to the business judgement rule.[200] Under the business judgement rule, courts must presume that decisions are made by fiduciaries "who have become duly informed before exercising judgement, and who exercise judgment in a good-faith effort to advance the company's interests."[201] Thus, only evidence meeting the high bar of self-dealing or gross negligence in the decision making process can rebut the business judgement rule, resulting in a trend where duty of care breaches are litigated far less often than duty of loyalty breaches.[202]

The duty of care has in many ways developed in this manner to avoid holding managers to a level of unachievable perfection.[203] As a practical matter, without the business judgement rule, every business decision made by management would be vulnerable to suit wholly dependent on the

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195. Ribstein, *supra* note 5, at 594.

196. Molk, *supra* note 122, at 2137.

197. *See infra* Section IV.B.1.iii.

198. Daniel Buchholz, *Eliminating Fiduciary Duties in Delaware LLCs: A Process Focused Approach to the Analysis of Waiver Provisions*, 16 FLA. ST. U. BUS. REV. 153, 158 (2017) (internal quotation marks omitted).

199. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (citation omitted).

200. *See* Buchholz*, supra* note 198, at 158 (explaining that "management is often shielded from liability under the business judgement rule" because "[o]nly evidence of gross negligence in the decision-making process on the part of the defendants will rebut the business judgement presumption of due care").

201. *Id.*

202. *See id.* at 159 (noting that the duty of care is litigated "far less often" than the duty of loyalty due to the "wide array" of common law and statutory protections afforded to management).

203. Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 85 (2004) (emphasizing the value of the business judgement rule in protecting the authority of managers, which in turn enables businesses to "adopt efficient decision-making systems and processes").

opinions of the other members.[204] In fact, one of the most prevalent justifications of the business judgement rule is that its deference allows managers to confidently make decisions based on their position and expertise, even when such decisions may implicate risk, because risky endeavors are often financially rewarding.[205] As a duty built in many ways on the foundational principle of managerial protection, the duty of care generally lacks bite and is almost never litigated, which leaves little consequence to permitting its waiver.

ii. Waiving the Duty of Loyalty

Waiving the duty of loyalty is more complex. In essence, the duty of loyalty requires management to avoid conflicts of interest.[206] But there are legitimate reasons for LLCs to waive the duty of loyalty, particularly where the firm does not fit the mold of a typical LLC entity.[207] For example, as the diversification of business ventures increases in popularity, so do the odds of violating the duty of loyalty.[208] This largely follows the rise of "emerging sources of capital, such as private equity, venture capital, or spin-off transactions, [that] may subject their financial sponsors to fiduciary duties in profound conflict with either their larger business plans or with fiduciary obligations they owe to other business entities."[209] These innovative and complex structures have catalyzed "overlapping lines of business," such as between a parent company and its subsidiaries, which have in turn stressed the "canonical 'undivided-loyalty' model" that underpins the traditional notions of business associations.[210] Ultimately, the duty of loyalty creates an expensive regime riddled with litigation[211] and inefficiencies[212] for business

204. *Id.*

205. *Id.*

206. Buchholz, *supra* note 198, at 159.

207. *See* William J. Moon, *Delaware's Global Competitiveness*, 106 IOWA L. REV. 1683, 1726 (2021) (noting, in the corporate context, that Chinese corporations prefer to avoid Delaware law because the self-dealing prohibition under Delaware's fiduciary duty regime conflicts with the way business is done in China, often through intricate social networks that are likely to trigger self-dealing violations under American law).

208. Pace, *supra* note 148, at 1090.

209. Gabriel Rauterberg & Eric Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075, 1080 (2017).

210. *Id.* at 1093.

211. *See, e.g.*, Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 29–30 (1990) (recognizing that "fiduciary duties . . . expose the corporation to costly litigation").

212. Molk, *supra* note 122, at 2139 ("The mandatory duty of loyalty provides a remedy for self-dealing by management, but that remedy comes at the cost of expensive litigation and deterring actions that can benefit the firm. In these instances where the costs of the protection exceed its benefits, mandatory rules from corporate law saddle firms with inefficient provisions that increase their costs of doing business." (footnote omitted)).

structures that simply do not need it.[213] Because parties can shop for LLC law,[214] parties that attach a high cost to the imposition of fiduciary duties, particularly the duty of loyalty, will avoid forming in jurisdictions that levy such mandatory duties.[215]

iii. Leaving Intact the Implied Covenant of Good Faith and Fair Dealing

As its name suggests, the implied covenant of good faith and fair dealing is implied in every contract,[216] entailing an "obligation that neither party will do anything to injure or destroy the right of the other party to receive the benefits of the agreement."[217] Agreements between parties are only enforceable as contracts if there is consideration, or a "mutual intent to benefit."[218] Otherwise, the agreement is merely a gift, unenforceable as a contract without the vital element of consideration.[219] In the highly contractual LLC context, it is pivotal that a strong covenant of good faith and fair dealing exist. To be sure, without a robust implied covenant of good faith and fair dealing, LLC agreements would "resemble a gift of members' property to those in control of the enterprise who would be free to use the entity's property as they saw fit."[220] Thus, it is important that the implied covenant of good faith and fair dealing remain immutable in LLC operating agreements.

Courts have discretionary authority in applying the covenant, and the implied obligation of one party grows with the dependence of the other.[221] In other words, when one party is heavily dependent or reliant on the other, courts can imply "promises or terms imposing fiduciary duties or quasi fiduciary duties" through the covenant of good faith and fair dealing.[222] This malleability and consideration of dependency positions the covenant of good faith and fair dealing as not only a safeguard for unsophisticated and highly

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213. Pace, *supra* note 148, at 1088.

214. *See infra* note 228 and accompanying text.

215. *See infra* Section IV.B.2.

216. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.").

217. SAMUEL WILLISTON & RICHARD A. LORD, WILLISTON ON CONTRACTS § 63:22 (4th ed. 1990).

218. DeMott, *supra* note 143, at 1060.

219. *Id.* at 1061 ("Anglo-American contract doctrine has not enforced executory promises to make gifts because such promises do not contemplate an exchange.").

220. *Id.*

221. WILLISTON & LORD, *supra* note 217, § 63:21.

222. *Id.* ("[D]epending on the surrounding circumstances—the most significant being the extent to which one party is dependent on the other, or to which the parties are mutually interdependent—the courts will imply one or more terms to supplement the parties' contractual undertakings . . . .").

dependent parties, but also a doctrinal protection that possesses a flexibility that well-matches that inherit of the LLC entity.

Where the implied covenant of good faith and fair dealing remains immutable, afflicted parties will still have a "catch-all" claim to litigate extreme harms—though concededly under a breach of contract claim rather than under a breach of fiduciary duty claim.[223] This last-resort option maintains an equitable judicial remedy for parties, even where their operating agreement is devoid of the protectionary duties of care and loyalty.[224] As such, its undisputable importance makes clear that allowing a full waiver of the fiduciary duties of care and loyalty must be supported by a strong covenant of good faith and fair dealing. Indeed, "[i]t is the unwaivable protection of the implied covenant that allows the vast majority of the remainder of the LLC Act to be so flexible."[225]

2. *The Internal Affairs Doctrine and LLCs*

Delaware is perhaps best known for its domination of the corporate legal market in the United States.[226] Delaware's grasp on corporate law is bred by an acceptance of a conflict of laws principle called the internal affairs doctrine, a doctrine that "enables corporations to opt into any state's corporate law simply by incorporating in that state."[227] Though the internal affairs doctrine was born of case law in the corporate law context, it is now well recognized that the internal affairs doctrine also applies to LLCs.[228] In the LLC context, the internal affairs doctrine allows LLCs to opt into the LLC state law of their choice by simply forming in the jurisdiction that has the laws they prefer. Because parties can effectively shop for the most business-friendly laws to apply to their LLCs, states face jurisdictional competition as

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223. Examples of breaches that can be held to be violations of the covenant of good faith and fair dealing include fraud and inequitable conduct, acting in bad faith, and dishonesty. Douglas M. Branson, *Alternative Entities in Delaware—Re-introduction of Fiduciary Concepts by the Backdoor?*, *in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 55, 61 (Mark J. Loewenstein & Robert W. Hillman eds., 2015)).

224. *See* Pace, *supra* note 148, at 1140 (supposing that a court could construe the contractual covenants of good faith and fair dealing broadly to effectively bypass any waiver or absence of fiduciary duties).

225. R&R Cap., LLC v. Buck & Doe Run Valley Farms, LLC, No. CIV.A.3803-CC, 2008 WL 3846318, at *20 (Del. Ch. Aug. 19, 2008).

226. *See* William J. Moon, *Delaware's New Competition*, 114 NW. U. L. REV. 1403, 1418 (2020).

227. *Id.*

228. *See* Matthew G. Dore, *Déjà Vu All Over Again? The Internal Affairs Rule and Entity Law Convergence Patterns in Europe and the United States*, 8 BROOK. J. CORP. FIN. & COM. L. 317, 347 (2014) ("As more and more states adopted LLC and LLP laws through the 1990s, and certainly as more and more LLC and LLP statutes expressly embraced the internal affairs rule through foreign qualification provisions, concerns ultimately subsided about application of the internal affairs rule to foreign LLCs and LLPs . . . .").

they seek to maintain a favorable legal environment that encourages LLC formation within their state.[229]

Research shows that the landscape for jurisdictional competition for LLCs resembles that of corporations: Delaware versus all other states.[230] In the LLC context, most firms are formed in the state where their principal place of business is located.[231] However, research shows that the larger an LLC is, the more likely the LLC is to be formed outside of the LLC's principal place of business, with Delaware as the primary destination of choice.[232] This reveals an important point: If it is presumed that smaller LLCs are relatively unsophisticated, and that LLCs increase in sophistication as they increase in size, then it appears that unsophisticated parties likely do not know about the internal affairs doctrine or their related ability to shop for more favorable LLC state law. This highlights the importance of an opt-out regime that recognizes fiduciary duties where unsophisticated parties are simply filing in the state of operation because they are unaware of the alternatives. On the other hand, sophisticated LLCs do have a choice, and they know it.

As such, Maryland is competing with Delaware because sophisticated Maryland LLCs know that they can shop for more favorable laws elsewhere. While this competition is best described as "defensive," as given Delaware's dominance, states are more focused on retaining local business than luring businesses away from Delaware, the choice for LLCs searching for a place of incorporation is once again clear: home state versus Delaware.[233] But if Maryland maintains a default fiduciary duty regime that allows parties to opt out of the fiduciary duties of loyalty and care, it will create an LLC regime parallel to that of Delaware. By doing so, Maryland would likely be able to alleviate jurisdictional competition concerns by emulating the LLC laws of Delaware and thus leaving nothing to be desired or "shopped" for in other state laws.

3. *Striking the Balance Between Parties and Businesses*

A party's ability to waive its fiduciary duties is not hindered by the presence of default fiduciary duties. With an already large portion of LLCs contracting out of fiduciary duties, the sophisticated party clearly holds the

229. *See id.* (noting briefly that the internal affairs rule facilitates jurisdictional competition).

230. Bruce H. Kobayashi & Larry E. Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91, 94 (2011).

231. Jens Dammann & Matthias Schundeln, *Where Are Limited Liability Companies Formed? An Empirical Analysis*, 55 J.L. & ECON. 741, 743 (2012).

232. *Id.* at 773.

233. Roberta Romano, *The Market for Corporate Law Redux* 9 (European Corp. Governance Inst., Working Paper No. 270/2014, 2014).

power and knows how to wield it.[234] If it can be generally assumed that the party favoring the waiver of duties is the party with higher bargaining power and greater sophistication, then their ability to waive such duties is not impeded by the default laws of the jurisdiction.[235] However, unsophisticated parties may not necessarily know the full scope of their options, or how to bargain into favorable terms, augmented by their lack of legal representation.[236] Thus, an opt-out system strikes an impressive balance between ensuring a business-friendly environment, while protecting parties and investors.

There is a demonstrated need for Maryland to protect unsophisticated parties to LLC transactions. There is also a demonstrated need for Maryland to retain an LLC-friendly regime to combat jurisdictional competition, namely with Delaware. This Note suggests that the solution to this apparent paradigm is to allow for the maximum extent of contracting in a default fiduciary duty or opt-out system. The combination of default fiduciary duties and the full freedom to contract out of all such duties effectuates a system that offers compelling and satisfactory prospects to both the state and to all players in an LLC transaction.

V. CONCLUSION

In *Plank v. Cherneski*, the Maryland Court of Appeals correctly held that managing members of an LLC owe common law fiduciary duties to the LLC and its minority members and that breach of fiduciary duty claims may be brought as independent causes of action.[237] The court's recognition of default fiduciary duties in the Maryland LLC context is pivotal to protecting unsophisticated parties and effectuating broad business policy goals.[238] However, the court's holding did not go far enough as it failed to delineate the extent to which parties to an LLC may waive their fiduciary duties by operating agreement.[239] This gap creates room for Maryland to match the business-friendly policies of Delaware. To do so, Maryland should allow parties to waive their fiduciary duties of care and loyalty by operating agreement.[240] This clarification could be effectuated either by the state

234. *See, e.g.*, Harner & Marincic, *supra* note 3, at 924 (finding that managers "may hold substantial leverage in negotiating the Operating Agreements").

235. *See* Miller, *supra* note 152, at 495 (explaining the presumption that sophisticated parties are able to effectively read, understand, and negotiate the terms of a written agreement).

236. Miller, *supra* note 150, at 322.

237. 469 Md. 548, 231 A.3d 436 (2020).

238. *See supra* Section IV.A.

239. *See supra* Section IV.B.

240. *See supra* Section IV.B.

legislature through the Maryland LLC Act,[241] or by the judiciary clarifying the holding in *Plank*.[242] Doing so will not only maintain a business-friendly approach and reduce the risk of jurisdictional competition, but it will also uphold a default regime fundamental to an equitable judicial environment, crafting the perfect balance between business-friendly and party-friendly.

241. MD. CODE ANN., CORPS. & ASS'NS, § 4A-101(l) (West 2020).
242. 469 Md. 548, 231 A.3d 436 (2020).