

**JOHN CUNNINGHAM'S LLC NEWSLETTER  
FOR TAX AND LEGAL PROFESSIONALS**

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**WHAT EVERY ACCOUNTANT SHOULD KNOW  
ABOUT LLC FIDUCIARY ISSUES**

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EXECUTIVE SUMMARY

The fiduciary provisions in the LLC agreement of a multi-member LLC are the provisions that determine the ethical rules and the “team spirit” of the LLC. They can play a key role in the success both of small, simple LLCs and large, complex ones. Accountants should make sure that their clients are aware of the importance of fiduciary provisions in LLC agreements that they are asked to sign; and they should urge their clients to ensure that their lawyers in LLC deals, if they have any, properly address these issues on their behalf.

DISCUSSION

As readers will know, the LLC agreements of multi-member LLCs are, in effect, partnership agreements among the members and managers. These agreements determine the legal and tax structures of these LLCs and define the members’ and managers’ rights, duties and liabilities.

In my experience, the issues that are by far the most likely to be neglected in the LLC agreement of a multi-member LLC are fiduciary issues. (Obviously, fiduciary provisions are *not* important in the LLC agreements of single-member LLCs; in this newsletter, I will be discussing only the LLC agreements of *multi*-member LLCs.)

Fiduciary rules are those that:

- As indicated, determine the ethical standards with which the members and managers of LLCs must comply and the LLC’s “team spirit;”
- Define the methods (e.g., arbitration by a single arbitrator) that must be used in resolving fiduciary disputes;
- Define member and manager liabilities, including liability for money damages, for fiduciary breaches;
- Provide, where appropriate, for advancement of litigation or arbitration expenses to members and managers in fiduciary disputes and for insurance against fiduciary liabilities; and
- Provide, where appropriate, for “exculpation” from fiduciary liabilities (i.e., contractual protection from these liabilities).

My 14 years' experience as an LLC lawyer have taught me that the fiduciary provisions in the LLC agreement of a multi-member LLC are very often the most important of all of the provisions in the agreement; and that the more skillfully these provisions are drafted, the more likely will be the success of the LLC. And in my experience, this truth applies not only in the case of small, simple LLCs with only two or three members and a capitalization of a few thousand dollars but also in the case of large, complex ones with dozens of members and multi-million dollar capitalizations.

In any LLC agreement, it is critical that the fiduciary rules be set forth as comprehensively as possible. Otherwise, if there is a fiduciary dispute among the members, the outcome of the dispute may be impossible to predict and its resolution by a judge or arbitrator may be radically different than that expected by the members. For example, if, in the case of a particular manager-managed multi-member LLC, a court applies the famous ruling of Judge Cardozo in a case called *Meinhard v. Salmon*, the managers of the LLC may find that they are subject to fiduciary duties of extraordinary strictness.

The most familiar fiduciary duties are those of care and loyalty. However, both of these duties can be defined in an LLC agreement in many different ways depending on the needs and interests of the LLC's members and managers.

In addition, there are many other types of fiduciary and "quasi-fiduciary" duties that also need to be defined in detail in LLC agreements and tailored to the parties' needs. These include the duty of disclosure (i.e., the affirmative duty of the members and managers to be honest with one another and to take the initiative to disclose to one another information relevant to the LLC); and duties of good faith, fair dealing, cooperation and compliance with relevant legal and ethical standards.

If you are an accountant but don't also have a law degree, you may be hesitant to raise the issue of fiduciary duties with clients of yours who are considering participation in LLC deals. However, I can assure you that you will not be engaging in the unauthorized practice of law if you merely advise these clients to make sure that the fiduciary provisions in any LLC agreement they are asked to sign are in their best interest; and you may even want to give these clients a copy of this newsletter.