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The Fiduciary-ness of Business Associations

Joan MacLeod Heminway

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"Mandatory internal governance laws that prohibit the waiver of duties are critical in achieving investor confidence and furthering many important social policy goals of internal governance."[2]

INTRODUCTION

Fiduciary duties have historically been core elements and values of statutory business associations in the United States. However, with Delaware leading the charge, limited liability company and limited partnership statutes in some jurisdictions now allow for the elimination of equity holder and managerial fiduciary duties through private ordering.[3] In addition, state legislatures in jurisdictions like Tennessee and Wyoming have passed bills, signed into law, that allow a decentralized organization—a blockchain-based association of business venturers—to organize as a limited liability company (an "LLC")[4] and avoid the

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[2] 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, 271 (2009) [hereinafter *Fiduciary Duties*].

[3] *See, e.g.*, DEL. CODE ANN. tit. 6, § 17-1101(d) (2022) (permitting the elimination of partner fiduciary duties "by provisions in the partnership agreement" under the Delaware Revised Uniform Limited Partnership Act); *id.* § 18-1101(c) (permitting the elimination of member and manager fiduciary duties "by provisions in the limited liability company agreement" under the Delaware Limited Liability Company Act).

[4] *See* TENN. CODE ANN. §§ 48-250-101 – 48-250-115 (2022); WYO. STAT. ANN. §§ 17-31-101 – 17-31-116 (2022) (codified as the "Wyoming Decentralized Autonomous Organization Supplement").

imposition of mandatory or default statutory fiduciary duties.[5] It is the legislative enactment of these decentralized organization LLC acts that prompts this essay.

These changes are precariously situated at the intersection of law and equity. They emphasize contractarian (as opposed to fiduciarian)[6] approaches to business co-venturing and fundamentally alter the role of the common law of agency as a historical doctrinal root of business associations law. In the process, they also implicate age-old theoretical debates that strike at the core of the regulatory enterprise, including the extent to which government regulation should step in to protect those who cannot—or do not—protect themselves and, more generally, the superiority or inferiority of government regulation to market regulation. Moreover, the extent to which public policy ramifications of these legislative moves have been carefully vetted is unclear. Finally, from a lawyering perspective, these changes to business associations law add to already complex matrices applicable to choice-of-entity decision making in the for-profit business realm.[7]

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[5] *See* TENN. CODE ANN. § 48-250-109 (2022) ("Unless otherwise provided for in the articles of organization or operating agreement, a member of a decentralized organization does not have a fiduciary duty to the organization or another member; except, that the member is subject to the implied contractual covenant of good faith and fair dealing."); WYO. STAT. ANN. § 17-31-110 ("Unless otherwise provided for in the articles of organization or operating agreement, no member of a decentralized autonomous organization shall have any fiduciary duty to the organization or any member except that the members shall be subject to the implied contractual covenant of good faith and fair dealing.").

[6] *See, e.g.*, Barbara K. Bucholtz, *Symposium Foreword*, 41 TULSA L. REV. 405, 405–06 (2006) ("Debates over . . . fiduciary duties in business association law are longstanding. . . . The current version of the debate appears to create dialectic between those who favor deference to a freedom of contract model—usually dubbed "contractarians"—and those who espouse the imposition of a fiduciary restraint—sometimes called "fiduciarians.").

[7] In prior work, I have noted the evolving complexity of business associations law in the United States in recent decades.

Key, foundational questions about the advent of decentralized organization LLCs in Tennessee and Wyoming[8] deserve exploration in light of these (and other) doctrinal, theoretical, policy-based, and practice-oriented concerns with the statutory elimination of default fiduciary duties under applicable Tennessee and Wyoming law. Several of these questions, together with certain related information, are set forth below.

- What, precisely, motivated the proposal and enactment of these statutes? In his recent book entitled *Autonomous Organizations*,[9] Shawn Bayern argues that at least some states' existing LLC laws allow an autonomous entity—a blockchain-based software system—to inhabit a member-managed LLC, affording it legal

> While the architecture of each form of business entity builds off similar concepts that engage business associations, securities, and tax law, the specifics are complex and derive from a range of legal sources--statutes, agency regulations, and judicial opinions--at the federal and state levels. The substantial change and complexity presented to legal counsel by the introduction of alternative forms of business entity over the past quarter century test a business lawyer's ability to exercise ethical professional judgment at multiple junctures and in myriad ways.

Joan MacLeod Heminway, *Professional Responsibility in an Age of Alternative Entities, Alternative Finance, and Alternative Facts*, 19 TRANSACTIONS: TENN. J. BUS. L. 227, 234 (2017). *See also* Joan MacLeod Heminway, *Lawyering for Social Enterprise*, 20 TRANSACTIONS: TENN. J. BUS. L. 797, 801–02 (2019) (observing the complexity of choice-of-entity decisions for social enterprise businesses).

[8] It should be noted that Vermont law provides for blockchain LLCs in a different form—one that does not alter the fiduciary duties otherwise applicable in the general Vermont LLC context. *See* VT. STAT. ANN. tit. 11, §§ 4171 – 4176 (2022). Vermont's statute, adopted in 2017, is significantly different from the statutes adopted in Tennessee (2022) and Wyoming (2021), the latter two being based on the same general model.

[9] SHAWN BAYERN, AUTONOMOUS ORGANIZATIONS (2021).

personhood.[10] Is the objective of the Tennessee and Wyoming decentralized organization LLC acts to clarify this? How was the determination made to alter LLC law to eliminate default statutory fiduciary duties?

- To what extent did the legislatures in Tennessee and Wyoming identify and address potential perverse incentives created under LLC law, especially the potential incentive to organize a decentralized organization as (or convert an existing, traditional LLC to) a decentralized organization ("DO") or decentralized autonomous organization ("DAO") LLC[11] (sometimes denominated a limited liability autonomous organization—or LAO—but referred to in this essay generally as a "DAO LLC") merely to avoid statutory fiduciary duties? In this regard, it should be noted that, under the statutes in both states, an existing LLC can convert into a DAO LLC[12] solely or primarily to avoid the

[10] Ultimately, Professor Bayern envisions that the LLC would be memberless and continue in perpetuity managed by the code governing the blockchain. *Id.* at 59-67.

[11] The statutes in both states label LLCs organized under them as DO or DAO LLCs, with some variation in the precise related requirements. *See* TENN. CODE ANN. § 48-250-103(d) (2022) ("The registered name for a decentralized organization must include wording or abbreviation to denote its status as a decentralized organization, specifically 'DO', 'DAO', 'DAO LLC', or 'DAO LLC'."); WYO. STAT. ANN. § 17-31-104 (2022) ("The registered name for a decentralized autonomous organization shall include wording or abbreviation to denote its status as a decentralized autonomous organization, specifically 'DAO', 'LAO', or 'DAO LLC.'").

[12] *See* TENN. CODE ANN. § 48-250-103(b) ("A limited liability company formed under the Tennessee Revised Limited Liability Company Act, compiled in chapter 249 of this title, may convert to a decentralized organization by amending its articles of organization to include the statement described in subsection (c)."); WYO. STAT. ANN. § 17-31-104(b) (2022) ("A limited liability company formed under the Wyoming Limited Liability Company Act, W.S. 17-29-101 through 17-29-1102, may convert to a decentralized autonomous organization by amending its articles of organization to include the statement required by subsections (a) and (c) of this section and W.S. 17-31-106.").

strictures of the default fiduciary duties under operative principles of LLC law outside the DAO LLC context.[13]

- More broadly (and relatedly), were legislators in Tennessee and Wyoming aware of, and did they give due consideration to, public policy rationales for retaining default fiduciary duties in LLCs and for prohibiting the elimination of fiduciary duties in LLCs, especially given the ability of existing LLCs to convert to DAO LLCs? Did these lawmakers appreciate the formative role that fiduciary duties may play in incentivizing people to pool their human and financial and social capital to form and maintain businesses?

The answers to these and other similar questions may help inform a critique of DAO LLC acts by providing important factual context relevant to the treatment of fiduciary duties under LLC law specifically and business associations law more broadly.

With the foregoing observations and questions in mind, this essay offers a window and perspective on recent fiduciary-related legislative developments in business entity law and identifies and reflects in limited part on related professional responsibility questions impacting lawyers advising business entities and their equity owners. In addition—and perhaps more pointedly—the essay offers commentary on legal change and the legislative process for state law business associations amendments

[13] *See* TENN. CODE ANN. § 48-249-403(a)-(c) (2022) (providing for exclusive statutory fiduciary duties of loyalty and care); WYO. STAT. ANN. § 17-29-409(a)-(c) (2022) (providing for nonexclusive statutory duties of loyalty and care).

in and outside the realm of fiduciary duties. To accomplish these purposes, the essay first provides a short description of the position of fiduciary duties in U.S. statutory business entity law and offers a brief account of 21st century business entity legislation that weakens the historically central role of fiduciary duties in unincorporated business associations. It then reflects on these changes as a matter of theory, policy, and practice before briefly summarizing and offering related reflections in concluding.

FIDUCIARY DUTIES AND THE U.S. STATUTORY BUSINESS ENTITY

The core substantive legal principle to which this essay relates is the standard of conduct known as a fiduciary duty—the special, self-sacrificing obligation of a legal person who is acting, by mutual assent, for and on behalf of another and (under common law rules) subject to that other person's control. The controlled person, a legal actor known as an agent, is charged, by the nature of that role, with acting not in their own self-interest, but in the interest of the other—the person controlling their actions.[14] This essentially selfless commitment is fundamentally recognized in the common law of agency, which provides that "[a]gency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."[15] The concept of fiduciary duties operates in various other legal contexts, including in

[14] RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006) (defining the concept of an agent within the definition of an agency relationship).
[15] *Id.*

business associations law.[16] An essential purpose of fiduciary duties in business associations—one that is common to fiduciary relations more generally—is the establishment of a mutual and unifying element of relational trust that bonds co-venturers to the firm and each other when the actions of one venturer may have legal liability or other implications for another.[17]

Fiduciary duties in business associations are most typically owed by firm managers to the legal entity and, in some cases, also to fellow firm constituents (including equity holders). For example, under the Revised Uniform Partnership Act, now enacted in forty-five U.S. states and territories,[18] each partner—an owner-manager of the partnership—owes fiduciary duties of loyalty and care to the partnership and the other partners.[19] Tennessee has codified this rule.[20] Along similar lines, the Model Business Corporation Act provides that corporate directors and officers—managers of the corporation's business and affairs—owe fiduciary duties of loyalty and care for which they may be liable to the

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[16] *See, e.g.*, Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983) [hereinafter *Fiduciary Law*] ("[F]iduciaries are found in many areas of the law, such as criminal and labor, securities and corporations, contracts, partnerships, and trusts."); Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 J. CORP. L. 503, 524 (2017) ("The concept of fiduciary duties pervades all areas of business organization law. Agents owe fiduciary duties to their principals. Partners owe fiduciary duties to their partnership and one another. Directors and officers owe fiduciary duties to their corporation. For LLCs, managers, and potentially members, may owe fiduciary duties to the LLC.").

[17] *See* Molk, *supra* note 16, at 524 ("Fiduciary duties act as a judicial backstop for when legal rules, contractual terms, and market discipline are insufficient to deter destructive behavior.").

[18] Partnership Act, Uniform Law Commission, https://www.uniformlaws.org/committees/community-home?communitykey=52456941-7883-47a5-91b6-d2f086d0bb44.

[19] REVISED UNIFORM PARTNERSHIP ACT § 404(a) (1997).

[20] TENN. CODE ANN. § 61-1-404(a) (2022).

corporation or its shareholders.[21] Tennessee law again presents a legislatively enacted example.[22] The Delaware corporate law fiduciary duties of directors and officers are largely embodied in judicial opinions rather than legislative enactments.[23]

Moreover, shareholders who are not also directors or officers of a corporation—including in certain circumstances controlling corporate shareholders—also may owe fiduciary duties to the corporation or minority shareholders.[24] "A director is a fiduciary. So is a dominant or controlling stockholder or group of stockholders. Their powers are powers in trust."[25] In addition, in certain states, shareholders of closely held corporations may owe partnership-like fiduciary duties to their fellow

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[21] MODEL BUS. CORP. ACT §§ 8.30 & 8.31 (AM. BAR ASS'N 2016) (describing director fiduciary duties and liability for a breach of those duties); *id.* § 8.42(a) (describing officer fiduciary duties and liability for a breach of those duties).

[22] TENN. CODE ANN. §§ 48-18-301 & 48-18-403.

[23] *See, e.g.*, Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (identifying officer fiduciary duties as coextensive with director fiduciary duties); Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362 (Del. 2006) (classifying director oversight duties as subsidiary components of the duty of loyalty); *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006) (addressing claimed breaches of director and officer duties of care and loyalty); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (finding directors liable for breaching their decision-making duty of care).

[24] *See, e.g.*, Southern Pacific Co. v. Bogert, 250 U.S. 483, 487-88 (1919) ("The rule of corporation law and of equity invoked is well settled and has been often applied. The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority . . . ."); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719 (Del. 1971) (confirming that a parent corporation that enjoys dominating control over a subsidiary owes it fiduciary duties).

[25] Pepper v. Litton, 308 U.S. 295, 306 (1939) (citations omitted).

stockholders.[26] Tennessee has adopted this line of decisional law.[27] However, Massachusetts close corporation law is especially well developed in this aspect.[28]

Some tailoring or limiting of specific fiduciary duties through private ordering has long been undertaken and blessed by legislatures and the judiciary.[29] One commentator concluded over twenty-five years ago that, even in the absence of enabling statutes, "fiduciary duty can be waived down to the level of good faith, at least by ad hoc consent given

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[26] *See, e.g.*, Merola v. Exergen Corp., 423 Mass. 461, 464 (1996); Smith v. Atlantic Props., Inc., 422 N.E. 2d 798, 801 (Mass. Ct. App. 1981); Wilkes v. Springside Nursing Home, 370 Mass. 842, 848 (1976); Donahue v. Rodd Electrotype, 367 Mass. 578, 593 (1975).

> [S]tockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another. In our previous decisions, we have defined the standard of duty owed by partners to one another as the "utmost good faith and loyalty." Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation.

Donahue, 367 Mass. at 593 (citations and footnotes omitted).

[27] *See* Nelson v. Martin, 958 S.W.2d 643 (Tenn. 1997), *overruled on other grounds by* Trau-Med of Am., Inc. v. Allstate Ins. Co., 71 S.W.3d 691 (Tenn. 2002). After describing and applying the *Wilkes* case in Tennessee, the court in *Nelson* averred that "[t]he shareholders of a close corporation share a fiduciary relationship which imposes upon all shareholders the duty to act in good faith and fairness with regard to their respective interests as shareholders. Officers and directors of a corporation owe a similar duty to the corporation." *Nelson,* 958 S.W.2d at 650. A Tennessee court also has applied this close corporation fiduciary duty in the limited liability context under a predecessor limited liability company statute. *See* Anderson v. Wilder, No. E200300460COAR3CV, 2003 WL 22768666, at *6 (Tenn. Ct. App. Nov. 21, 2003) ("[W]e are of the opinion that finding a majority shareholder of an LLC stands in a fiduciary relationship to the minority, similar to the Supreme Court's teaching in *Nelson* regarding a corporation, is warranted in this case.").

[28] *See, e.g.*, sources cited *supra* note 26.

[29] *See, e.g.*, Molk, *supra* note 16, at 525 ("If parties want to soften some of a fiduciary duties' bite but not go as far as a complete waiver, another option is to exculpate owners' and managers' personal liability for violating specified fiduciary duties.").

after full disclosure."[30] Contextual statutory waivers of fiduciary duties also have been adopted in Delaware (as noted *supra*) and elsewhere.[31]

There is much more that could be said about the historical trajectory of the law of fiduciary duties in business associations. Almost 20 years ago, Mary Szto offered an illuminating history of business association fiduciary duties as part of an article she published in the *Quinnipiac Law Review*.[32] Her account still provides the reader with a variety of useful insights. Yet, the story of fiduciary duties in business associations law is still being written. One could label the most recent chapters of this fiduciary tale a narrative of erosion. While pejorative, that description is apt. And in this dark saga, the state legislatures in Delaware—and now Wyoming and Tennessee—are cast as villains.

Specifically, conventional default rules under U.S. statutory business associations law recently have been changing in ways that weaken the force of fiduciary duty in business associations. Recently adopted limited liability company statutes in Tennessee and Wyoming that reject default fiduciary duties altogether for DAO LLCs are prominent examples.[33] Although founders, promoters, and members of DAO LLCs are free to adopt fiduciary duties in their DAO LLC as a matter of private

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[30] Claire Moore Dickerson, *From Behind the Looking Glass: Good Faith, Fiduciary Duty & Permitted Harm*, 22 FLA. ST. U. L. REV. 955, 991 (1995).

[31] *See, e.g.*, *supra* note 3 and accompanying text; Molk, *supra* note 16, at 525 ("Recognizing . . . the fact that sophisticated parties may be better off eliminating fiduciary duties, Delaware and New York allow LLC parties to waive them, although fiduciary duties apply by default."); Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295, 318 (2014) ("A number of states now provide for some form of elimination of fiduciary duties.") [hereinafter *Both Worlds*].

[32] Mary Szto, *Limited Liability Company Morality: Fiduciary Duties in Historical Context*, 23 QLR 61 (2004).

[33] *See* TENN. CODE ANN. § 48-250-109 (2022); WYO. STAT. ANN. § 17-31-110 (2022).

ordering, all that remains as a default statutory means to enforce any desired or efficacious trust relationship between or among business venturers in these DAO LLCs is an immutable statutory obligation of good faith and fair dealing with unexplored and indeterminate legal contours and a relatively high threshold standard of liability.[34]

The novelty of blockchain-based business structures also plays a role in assessing the wisdom of eliminating default statutory fiduciary duties for DAO LLCs. The legislative move away from default fiduciary duties in LLCs may be especially troubling in light of the potential for information asymmetries in a machine-coded governance regime like that contemplated in the Tennessee and Wyoming DAO LLC legislation. Not every DAO LLC member is a coder or has a knowledge of software engineering relevant to the operation of DOs, DAOs, and blockchain technologies more generally. Legal counsel to DAO LLCs and their members also may be lacking relevant blockchain expertise, although they are required to have a level of competence—including in technologies—necessary to the scope of their engagement.[35] A lack of legislative expertise and engagement with these business structures and the related

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[34] *See* TENN. CODE ANN. § 48-250-109 (2022). Under a predecessor LLC act, the Tennessee Court of Appeals applied Massachusetts close corporation law to the analysis of a member expulsion, finding an issue of material fact as to an asserted breach of fiduciary duty and failure to adhere to good faith conduct. *See* Anderson v. Wilder, No. E200300460COAR3CV, 2003 WL 22768666, at *10, *11 (Tenn. Ct. App. Nov. 21, 2003). The applicability of the legal principles and analysis employed by the *Anderson* court under the current LLC Act, the Tennessee Revised Limited Liability Company Act, Tenn. Code Ann. §§ 48-249-101 – 48-250-115, is uncertain.

[35] *See* MODEL RULES OF PROF'L CONDUCT R. 1.1 (2016) ("A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."); *id.* cmt. 8 ("To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology, engage in continuing study and education and comply with all continuing legal education requirements to which the lawyer is subject.").

technologies complicates the business governance regulation of DOs and DAOs.

Moreover, at the time this essay was written, the level of commercial and societal trust in blockchain security and blockchain-based businesses is questionable because of highly publicized incidents of hacking and fraud in cryptocurrency firms.[36] The DAO Act does require that a DAO LLC include in its articles of organization "a publicly available identifier of a smart contract directly used to manage, facilitate, or operate the decentralized organization."[37] However, one might question whether that is more than a small comfort in ensuring the success of any potential enforcement action in the event of noncompliance—assuming noncompliance can be identified and documented.

FIDUCIARY THEORY, POLICY, AND PRACTICE IN U.S. STATUTORY BUSINESS ENTITIES

The conception of business entities as fiduciary relationships is relatively straightforward. Professor Tamar Frankel's formative work on fiduciary relations offers several key insights.[38] These insights explain the existence of default rules in business associations law providing for fiduciary duties.

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[36] *See, e.g.*, Khristopher J. Brooks, *Hackers stole record $4 billion in cryptocurrency last year*, CBS NEWS (Feb 7, 2023), https://www.cbsnews.com/news/cryptocurrency-hackers-stole-3-8-billion-north-korea-chainalysis-report/; Mat Di Salvo, *SEC Shuts Down '$100 Million Crypto Fraud' in Miami*, DECRYPT (March 6, 2023), https://decrypt.co/122802/sec-100-million-crypto-fraud-bkcoin-miami; *SEC Charges Samuel Bankman-Fried with Defrauding Investors in Crypto Asset Trading Platform FTX*, SEC'S & EXCH. COMM'N (Dec. 13, 2022), https://www.sec.gov/news/press-release/2022-219.

[37] TENN. CODE ANN. § 48-250-105(a)(3).

[38] *See infra* notes 39 – 42 and accompanying text.

Constituents in a business venture entrust each other with governance responsibilities they otherwise might have to bear themselves,[39] and that entrustment—through the exercise of delegated power[40]—creates opportunities for self-serving or careless conduct in the exercise of firm management or control.[41] Professor Frankel describes this conundrum lucidly.

> The two central characteristics of fiduciary relations—the substitution function and the delegation of power—pose a basic problem: while the fiduciary must be entrusted with power in order to perform his function, his possession of the power creates a risk that he will misuse it and injure the entrustor. The fiduciary cannot effectively benefit the entrustor without a delegation of power, but at the same time,

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[39] *See* Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1223 (1995) ("In light of the social benefits from fiduciary relationships and the high risk of these relationships to entrustors, entrustors must be induced to enter the relationship by assurances that overcome their concern for the safety of their assets. They must be convinced that the relationship is likely to bring them net economic benefits."); *see also* Frankel, *Fiduciary Law*, *supra* note 16, at 808 ("A central feature of fiduciary relations is that the fiduciary serves as a substitute for the entrustor.").

[40] *See* Frankel, *Fiduciary Law*, *supra* note 16 at 809 ("[T]he fiduciary obtains power from the entrustor or from a third party for the sole purpose of enabling the fiduciary to act effectively." (footnote omitted)).

[41] *See id.* at 816 ("Fiduciary relations present a problem because a fiduciary holds a delegated power that is susceptible to abuse."); *see also* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 914 (1988) ("A beneficiary in significant respects depends upon and is vulnerable to the fiduciary. The power held by the fiduciary that enables him to act to benefit the beneficiary also enables him to indulge his own interest and to injure the beneficiary." (footnote omitted)); Dickerson, *supra* note 30, at 985 ("A fiduciary, who is a trustee in classic trust law, has the highest duty because it has the power to act, and it also has the conflict to act in its own self-interest.").

> it is difficult or impossible to eliminate the fiduciary's ability to use the power for another purpose to the detriment of the entrustor. Yet if the entrustor lessens his exposure to loss by reducing the delegated power, he may also reduce the benefit expected from the relation.[42]

Students of business associations law may hear echoes of these concepts in debates about business entity fiduciary duties, the business judgment rule, and other aspects of firm governance.

Yet, the conceptualization of fiduciary duties as a response to potential abuses of power by agent-like actors is incomplete.[43] Specifically, it fails to explain why one would impose fiduciary obligations even in circumstances where the fiduciary and their beneficiary can otherwise protect their interests. Professor Deborah DeMott observes that "a general approach to fiduciary obligation needs to justify the presence of the fiduciary constraint in relationships between parties who are apparently able, at least prior to the relationship, to protect their own interests."[44]

It is in this environment that contractarian theory and approaches have gained traction, arguing (in their most extreme form) for legally permitted customization—and even the abolition—of default fiduciary

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[42] Frankel, *Fiduciary Law*, *supra* note 16 at 809.

[43] *See generally* Robert C. Clark, *Agency Costs versus Fiduciary Duties*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 55, 71-79 (John W. Pratt & Richard J. Zeckhauser, eds. 1991) (describing fiduciary duties as "sprawling and elusive" and outlining four general distinctive attributes of fiduciary relationships).

[44] DeMott, *supra* note 41, at 914.

duties in business entities (especially unincorporated ones).[45] Professor William Clayton observes that contractarian approaches to business association fiduciary duties have roots in contractarian theories of the firm itself.

> Doctrinal changes in Delaware have largely tracked contractarian theoretical developments. In the mid-1970s, Jensen and Meckling reconceptualized corporations as simply a "nexus of contracts" among various constituents. Fiduciary duties thus became mere contract terms between principal shareholders and their agent managers. Early contractarian scholars like Easterbrook and Fischel framed fiduciary duties as part of an arm's-length bargain that should thus be waivable, rather than a mandatory court-imposed duty arising out of the relationship between the parties.[46]

The earlier observed contextual ability of firm constituents to shape fiduciary duties under state statutes and decisional law through organic documents, statutorily permitted agreements, and managerial action exemplifies contractarianism in action.

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[45] *See* William W. Clayton, *High-End Bargaining Problems*, 75 VAND. L. REV. 703, 718–19 (2022) ("This contractarian premise has been endorsed by many prominent scholars over the years who have argued for greater contractual flexibility. Some have even argued that fiduciary duties should not be default obligations in LLCs and limited partnerships, instead arguing that they should be specifically contracted for." (footnotes omitted)).

[46] *Id.* at 718.

Both fiduciarian and contractarian theories thus have descriptive and explanatory power in the fiduciary duty realm of business associations law. Professor Jack Coffee noted and described the coexistence of these companion theories almost thirty-five years ago.

> The contractarians are correct in favoring greater freedom for contractual innovation, and the anticontractarians are equally correct in favoring rigid fiduciary rules. The irony is that prophylactic rules make the optimal default rules because they maximize the incentive to contract around them and, in so doing, to maximize disclosure. Default rules matter-and matter greatly—because they will establish the parties' legal entitlements whenever the transaction costs of modifying them exceed the benefits of a superior rule.[47]

An understanding of these concomitant, interactive theoretical conceptualizations of business association fiduciary duties provides a solid foundation for policy makers to engage in thoughtful decision making on the fiduciary duty default rules that may be appropriate for specific forms of business association, as those forms are archetypally used in common contexts within their state.

The process of identifying and using theory to engage policy discussions is important both to informed legislative and regulatory rulemaking and to later judicial interpretation in the context of legal

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[47] John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1690 (1989).

challenges. In Tennessee, for example, members of the Tennessee Bar Association Business Section Executive Council debated, in connection with the section's proposal to adopt the modernized version of the Revised Uniform Limited Partnership Act, whether organizers of Tennessee limited partnerships should be able to eliminate through private ordering the statutory default fiduciary duties of general partners to each other and the partnership. As a member of the Executive Council, I can attest to the fact that the debate was vigorous. Among the points raised: whether it made sense to allow for the elimination of fiduciary duties in limited partnerships without allowing for the elimination of fiduciary duties in LLCs. Eventually, the Executive Council narrowly voted against permitting the elimination of fiduciary duties in Tennessee's Revised Uniform Limited Partnership Act.[48] Fundamental to that vote was the decision to retain default fiduciary duties for the general partners of a Tennessee limited partnership.

Conversely, the Tennessee Bar Association Business Law Section Executive Council was not involved in drafting Tennessee's DAO LLC legislation or even informed of its introduction in the legislature,[49] and in informal inquiries made about the legislative process involved in the passage of Tennessee's DAO LLC law, I have found no evidence of the

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[48] *See* Joan MacLeod Heminway, *Limited Partnership Law: Should Tennessee Follow Delaware's Lead On Fiduciary Duty Private Ordering?*, BUS. L. PROF BLOG (Sept. 5, 2016), https://lawprofessors.typepad.com/business_law/2016/09/limited-partnership-law-should-tennessee-follow-delawares-lead-on-fiduciary-duty-private-ordering.html; *see also* Joshua Fershee, *Private Ordering in the Uncorporation: Modified and Eliminated Fiduciary Duties Are Often the Same Thing*, BUS. L. PROF BLOG (Sept. 6, 2016), https://lawprofessors.typepad.com/business_law/2016/09/private-ordering-in-the-uncorporation-modified-and-eliminated-fiduciary-duties-are-often-the-same-th.html.

[49] The Tennessee Bar Association Business Law Section Executive Council was not consulted about the DAO LLC act bill and only learned of the adoption of the DAO LLC act once the Governor signed the bill into law.

occurrence of a similar debate being undertaken as part of the General Assembly's consideration of the DAO LLC act. Yet, Tennessee's DAO LLC act—like the predecessor Wyoming DAO LLC act—goes a step further than merely permitting the elimination of default statutory fiduciary duties. The Tennessee DAO LLC act changes the statutory default rule completely, providing for the absence of fiduciary duties by default, but allowing for duties to be established through the LLC's operating agreement.[50] As Professor Coffee's quoted reflections above note, this reversal of default rules changes the costs associated with establishing fiduciary duties and, as a result, the legal rights and obligations of those who cannot or do not expend resources to engage in private ordering.[51] Ostensibly, the approval of the DAO LLC act resulted from representations about the business and jobs that blockchain firms might bring to Tennessee if Tennessee was perceived to have created a favorable legal climate for those businesses.[52]

CONCLUSION

Through the work that informs this essay, I aspire to illuminate and tease at several larger themes that infuse business associations law as a matter of regulation and practice. Accordingly, the intended audience for this essay is broadly inclusive, comprising legislators, regulators, and other policy makers as well as business lawyers in their many practice

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[50] *See* TENN. CODE ANN. § 48-250-109 (2022). As earlier noted, Tennessee's DAO LLC act does require LLC members to comply with an obligation of good faith and fair dealing. *Id.*; *see supra* notes 5, 33 & 34 and accompanying text).

[51] *See supra* note 47 and accompanying text.

[52] *See* Brian K. Krumm, *Comment on the Fiduciary-ness of Business Associations*, 24 TRANSACTIONS: TENN. J. BUS. L. 277, 279-80 (2023).

contexts (transactional, litigation, compliance, and general advisory), academics, and potentially other public and private actors. The essay format does not allow for a full treatment of the many possible perspectives that are implicated by the identified themes as they may be relevant to the wide-ranging group of constituents engaged with business entities and the law that governs them. In other words, each theme and each audience deserve more attention than I give any of them here.

As a result, I plan to approach these themes again in future work—work that extends beyond the realm of fiduciary duties. I also hope (and expect) that others will take up the mantle in various contexts in and outside academia as the regulation of business entities and the practice of business law continue to evolve. Several law scholars have already contributed to the academic conversation regarding mandatory and default fiduciary duties in business entities, and the published work of some of them is cited in this essay.[53] Overall, academic work focusing on the optimal structures through which business may be conducted should incentivize better substantive law—and better, more consistent legislative process in catalyzing and managing law reform.

The American Bar Association's *Model Rules of Professional Conduct* remind us that "[a]s advisor, a lawyer provides a client with an informed understanding of the client's legal rights and obligations and explains their practical implications."[54] Better law and better legislative process should

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[53] *See, e.g.*, Clayton, *supra* note 45; Coffee, *supra* note 47; Miller, *Fiduciary Duties*, *supra* note 2; Miller, *Both Worlds*, *supra* note 31, at 295; Molk, *supra* note 16; Jonathan G. Rohr, *Corporate Governance, Collective Action and Contractual Freedom: Justifying Delaware's New Restrictions on Private Ordering*, 41 DEL. J. CORP. L. 803 (2017); Megan Wischmeier Shaner, *Privately Ordered Fiduciaries*, 28 GEO. MASON L. REV. 345 (2020); Mary Siegel, *Publicly-Traded LLCs: The New Kid on the Exchange*, 68 SMU L. REV. 885 (2015).

[54] *See* MODEL RULES OF PROF'L CONDUCT Preamble ¶ 2 (2016).

facilitate compliance by legal advisors with their obligations as advisors and with other applicable rules and norms governing professional conduct and ethics. Competence,[55] diligence,[56] and candor[57] are easier to achieve, and lawyer-client communication[58] is simplified, when legislation is carefully drafted and appropriately vetted by knowledgeable members of the bar and any related governmental actors (including, in the business associations context, applicable state regulators). Straightforward business associations statutes, with clear policy underpinnings built on strong theoretical foundations, facilitate responsible, ethical lawyering in choice-of-entity and business formation engagements, including especially those involving multifaceted, multilayered fiduciary duty questions.

As a member of the practicing bar who participates in the sober and significant task of drafting and reviewing business entity legislation in the State of Tennessee, I welcome the meaningful engagement of state legislators and policy makers with their expert colleagues in state bar associations in the sponsorship and enactment of business entity legislation. The Tennessee legislation that introduced DAO LLCs did not benefit from this engagement, which I find regrettable. The best collaborative efforts in the planning and drafting of business entity

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[55] *See id.* R. 1.1 ("A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.").

[56] *See id.* R. 1.3 ("A lawyer shall act with reasonable diligence and promptness in representing a client.").

[57] *See id.* R. 2.1 ("In representing a client, a lawyer shall . . . render candid advice.").

[58] *See id.* R. 1.4(a) ("A lawyer shall: . . . (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished; . . . and (5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law."); *id.* R. 1.4(b) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.").

legislation both foster business innovation and strengthen (or at least leave intact) the positive aspects of business entity regulation that incentivize people to go into and stay in business with each other.

That is the essence of business entity law: it acts as a catalyst for collaborative business associations between and among individuals and entities. When political forces act alone or predominate in motivating business entity legislation, damage may be done to time-worn, proven business structures that serve that core objective. Ultimately, regardless of good intentions, poorly written business law is detrimental to business and damaging to the state as a commercial destination of choice. No one should desire that result.

The abandonment of default statutory fiduciary duties in the DAO LLC acts adopted in Tennessee and Wyoming represents a marked change from prior law. The change disrupts common foundations of business associations law that broadly encourage people to associate in businesses based on a threshold level of trust reinforced by statutory or common law fiduciary duties. The change also creates significant challenges for practicing lawyers and their clients as they make choice-of-entity decisions for new businesses and as they weigh the benefits and detriments of investments of human, financial, and social capital in extant businesses.

"[T]he history of organizational law—that is, the law of corporations, partnerships, LLCs, and so forth—has been the history of change."[59] It is likely that feature of business entity law will endure. That is a good thing.

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[59] BAYERN, *supra* note 9, at 170.

Economic, social, political, and other forces often presage or encourage legal change. And legal change has the capacity to foster positive economic, social, political, and other change. But sustainable, successful innovations in business law are best approached thoughtfully—in collaboration with relevant, expert constituencies in the practicing bar and state government, as well as those from private industry. (And it can't hurt to have a law professor—or two—involved, too!) If we are to abandon fiduciary duties as an essential element of business associations law, business lawyers and state regulators should be a part of the law reform process.