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Liability Issues for Managers, General Partners, and other Agents

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Liability Issues for Managers, General Partners, and other Agents

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[1] This outline is a work in progress and the errors and typographical errors are my own. They are far fewer than they would have been without the thoughtful and patient comments of Allan G. Donn and Thomas Rutledge.

1. Introduction

a. Scope of program

This program will discuss liability issues for managers of LLCs, general partners in general and limited partnerships and other agents (collectively "actors") acting on behalf of principals for damages resulting from actions taken in their capacities as such and the economic loss rule which prevents recovery for negligence and other tort claims against the actors when the actions giving rise to the claims are the subject of a contract. The economic loss rule has been the subject of extensive judicial interpretation in Texas – some of it reflecting nuanced differences in analysis, particularly with respect the liability of actors in their capacity as such for acts that might constitute breaches of fiduciary duties or fraud. This outline attempts to collect a few of the relevant cases in Texas and elsewhere and includes extensive quotes as the best reflection of the courts' analysis of this subtle rule.

b. Background

Now that the limited liability company has passed its quadranscentennial anniversary[2] as an accepted form of organization, one would have thought that the characteristic giving the initial impetus to the development of the LLC – the absence of individual liability of members or managers with respect to parties dealing with them as such[3] – would have been fully resolved.[4]

The personal liability of members and managers in LLCs to each other and the LLC may be thought of as "internal" i.e., liability to the LLC or the other members under contractual, fiduciary, and statutory theories for breaches of duties of care and loyalty and breach of contract, and "external," under which the member or manager may be individually liable to a third party with whom the LLC is interacting. The "economic loss rule" may be applicable to both internal and external liability, but in this outline will be discussed only in the context of external liability.

It is axiomatic that an individual is liable for his own actions, so a manager of an LLC should always be responsible for damages to a third party resulting from that manager's actions. But there are cases that have held that a manager is not liable for damages to a third party even where those damages result from the action or inaction of the manager.

Further some statutes purport to limit the liability of a person solely by reason of being or acting as a member or manager – often except in cases of professional services performed by the

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[2] If one begins with the issuance of Rev. Rul. 88-76 as event that allowed the LLC to become an accepted form of business organization in the United States.

[3] See Robert B. Thompson, The Limits of Liability in the New Limited Liability Entities, 32 Wake Forest L. Rev. 1 (1997). The liability of agents, members, managers, partners and other constituents of the sort described in this outline may be thought of (and is often referred to) as "vicarious" liability. Ther term "vicarious" is probably not correct as vicarious liability generally refers to "indirect" liability for the obligation of another, generally arising by reason of the relationship between the vicariously liable person and the person directly liable, such as the liability of a general partner for the obligations of a partnership. The liabilities discussed in this outline are liabilities arising as a result of the actions of the person that the third party is seeking to charge with the liability, such as the negligence of a manager acting in his capacity as such.

[4] To the contrary, it seems 25 years on, courts still struggle to differentiate LLCs from partnerships and corporations. See, e.g., Thomas E. Rutledge, Let's Stop Describing LLCs as "Hybrids," Journal of Passthrough Entities 33(September-October, 2014).

entity. This approach is consistent with the concept that a manager's duties are those of an agent, i.e., owed to the principal – the LLC – not a third party. Thus, if the manager's negligence in performance of his or her duties to the LLC should not create a liability on the part of the manager to a third party unless the manager has an independent duty to the third party,[5] an agent's breach of a duty owed to the principal does not give rise to a claim by a third party unless the agent owed an independent duty to the third party.[6] Thus, an agent is not liable to perform a contract entered into on behalf of a disclosed principal.[7]

2. Liability of Managers and other Agents to Third Parties for Actions Taken in their Capacity as Such

a. Common law liability of agents to third parties.

i. In general.

In acting as an agent, a manager or other agent of a principal is generally considered liable to third parties for the agent's tortious conduct provided that the tort violates a duty owed by the agent directly to the third party.[8] An agent's own tortious conduct subjects the agent to liability under this rule.[9] It is necessary that the agent know, or have a duty to inquire as to, the information that gives rise to the agent's duty to third party.[10] On the other hand, the agent's

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[5] Restatement (Third) of Agency § 7.02 (2006)

[6] *Id.*

[7] This outline does not discuss contracts entered into on behalf of undisclosed or partially disclosed principal, as a result of which the agent may be individually liable, the question of whether a manager can be guilty of intentional interference with the contractual relations between the LLC and a third party, or the manager's liability for a manager's actions purporting to be on behalf of the LLC where the manager lacks the authority to so act.

[8] Restatement (Third) of Agency § 7.01 (2006) ("An agent is subject to liability to a third party harmed by the agent's tortious conduct. Unless an applicable statute provides otherwise, an actor remains subject to liability although the actor acts as an agent or an employee, with actual or apparent authority, or within the scope of employment.")

[9] Restatement (Third) of Agency § 7.01 (2006) cmt *d*. (noting in Illustration 9 that it is not necessary to "pierce the veil" of the organization to hold a corporate employee liable for using a vehicle that the employee knows is defective.") .

[10] Restatement (Third) of Agency § 7.01 (2006) cmt *d.* states,

> Similarly, an agent who makes an untrue statement to a third party based on information provided by the principal is not subject to liability to the third party simply because the principal knew the information to be untrue, provided that the agent does not have notice that the statement is untrue. In some situations, an agent may have a duty to inquire further when provided with information by the principal or by a coagent. The agent's duty of inquiry may stem from the position the agent occupies within an organization, from the agent's professional role or duties, or from circumstances that make it unreasonable to rely on the information provided without further inquiry. Unless an agent has a duty of inquiry, the agent may properly rely on the principal's statements to the same extent the agent may rely upon statements from any other source

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