

PRESENTED AT

**33rd Annual
LLCs, LPs and Partnerships**

July 11-12, 2024
Austin, Texas

Fiduciary Duties and LLCs

Cliff Ernst

John C. Ale

Author contact information:

Cliff Ernst
McGinnis Lochridge LLP
1111 W. 6th St., Bldg. B, Suite 400
Austin, Texas
cernst@mcginnislaw.com
512-495-6012

John C. Ale
Retired Attorney and Arbitrator
Houston, Texas
johnalelaw@gmail.com

Fiduciary Duties and LLCs

Table of Contents

	<u>Page</u>
I. Introduction and Overview	1
II. Formal Fiduciary Duties to an LLC by its Governing Persons	3
III. Fiduciary Duties Based on Agency Law	9
IV. Duties of Governing Persons to Members	10
V. Duties of Members to Other Members	15
VI. Duties Arising from or Impacted by Governing Documents.....	17
VII. Informal Fiduciary Duties.....	26
VIII. Trends.	30
IX. Summary and Conclusions	37

Fiduciary Duties and LLCs

Cliff Ernst
McGinnis Lochridge LLP
Austin, Texas

John C. Ale
Retired Attorney and Arbitrator
Houston, Texas

I. Introduction and Overview.

Under state common law, a fiduciary *i.e.*, a person charged with caring for or managing property of another person,¹ has certain duties commonly referred to as fiduciary duties. Failure to comply with these duties gives rise to a cause of action for breach of fiduciary duties. Historically, cases developing the law related to fiduciary duties involved persons such as trustees of trusts,² partners of partnerships,³ directors and officers of corporations⁴ and agents.⁵

The Texas Business Organizations Code (TBOC)⁶ is the Texas statute governing Texas business entities including Texas limited liability companies. The TBOC codifies the duties of partners of Texas general partnerships and general partners of Texas limited partnerships in detailed provisions of the TBOC,⁷ although the TBOC does not refer to these duties as “fiduciary duties.”

¹ ConsumerFinance.gov <https://www.consumerfinance.gov/ask-cfpb/what-is-a-fiduciary-en-1769/#:~:text=A%20fiduciary%20is%20someone%20who,for%20their%20benefit%2C%20not%20yours.>

² *Meyer v. Cathey*, 167 S.W.3d 327, 330 (Tex. 2005).

³ *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (N.Y. 1928); *Noell v. Crow-Billingsley Air Park L.P.*, 233 S.W.3d 408, 414 (Tex. App. – Dallas 2007, nph).

⁴ *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 549, 69 S. Ct. 1221, 1227, 83 L. Ed. 1528 (1949); *Gearhart Industries, Inc. v. Smith International, Inc.*, 741 F.2d 707, 719-721 (5th Cir. 1984).

⁵ *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 200 (Tex. 2002).

⁶ TEX. BUS. ORGS. CODE ANN. § 1.001 et seq.

⁷ TBOC § 152.204 provides:

(a) A partner owes to the partnership, the other parties, and a transferee of a deceased partner’s partnership interest as designated in Section 152.406(a)(2):

- (1) a duty of loyalty; and
- (2) a duty of care.

(b) A partner shall discharge the partner’s duties to the partnership and the other partners under this code or under the partnership agreement and exercise any rights and powers in the conduct or winding up of the partnership business:

- (1) in good faith; and
- (2) in a manner the partner reasonably believes to be in the best interest of the partnership.

(Footnote continued on the next page)

Neither the TBOC nor its predecessors expressly establishes or defines the scope of the fiduciary duties of directors, officers or other controlling persons of a corporation. Instead, courts have found those duties implied in the corporate structure.⁸

The Texas legislature enacted the original Texas Limited Liability Company Act (TLLCA) on August 26, 1991 authorizing the creation of LLCs in Texas.⁹ Since 1991, the LLC has become the entity of choice among Texas organizations.¹⁰ Despite the fact that Texas LLCs have now

-
- (c) A partner does not violate a duty or obligation under this chapter or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.
 - (d) A partner, in the partner's capacity as a partner, is not a trustee and is not held to the standard of a trustee.

TBOC § 152.205 provides:

A partner's duty of loyalty includes:

- (1) accounting to and holding for the partnership property, profit, or benefit derived by the partner:
 - (A) in the conduct and winding up of the partnership business; or
 - (B) from use by the partner of partnership property;
- (2) refraining from dealing with the partnership on behalf of a person who has an interest adverse to the partnership; and
- (3) refraining from competing or dealing with the partnership in a manner adverse to the partnership.”

TBOC § 152.206 provides:

- (a) A partnership duty of care to the partnership and the other partners is to act in the conduct and winding up of the partnership business with the care an ordinarily prudent person would exercise in similar circumstances.
- (b) An error in judgment does not by itself constitute a breach of the duty of care.
- (c) A partner is presumed to satisfy the duty of care if the partner acts on an informed basis and in compliance with Section 152.204(b).

TBOC § 153.152 provides in relevant part:

- (a) Except as provided by this chapter, the other limited partnership provisions, or a partnership agreement, a general partner of a limited partnership:
 - (1) has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners; and
 - (2) has the liabilities of a partner in a partnership without limited partners to the partnership and to the other partners.

⁸ See, e.g., cases cited n.4 *supra*.

⁹ The TLLCA was a predecessor to the TBOC, which combined and codified a host of predecessor statutes including the TLLCA, into a single, comprehensive statute. On January 1, 2010 the TBOC became mandatorily applicable to all Texas LLCs and the predecessor statutes expired and/or were repealed. 1156, 78th Texas Legislature (Regular Session), §§ 2-12, 16 (amending predecessor statutes to set expiration dates and repealing miscellaneous statutes).

¹⁰ As of early 2024 (when the office of the Secretary of State was still processing some year-end filings for 2023), the office of the Texas Secretary of State provided to the authors the following information about numbers of certificates of formation and initial LLP registrations filed for domestic entities:

2022 2023

(Footnote continued on the next page)

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

Title search: Fiduciary Duties and LLC's

First appeared as part of the conference materials for the
33rd Annual LLCs, LPs and Partnerships session
"Fiduciary Duties and LLC's"