



2006

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Recommended Citation

Callison, J. William (2006) ""The Law Does Not Perfectly Comprehend....": The Inadequacy of the Gross Negligence Duty of Care Standard in Unincorporated Business Organizations," *Kentucky Law Journal*: Vol. 94 : Iss. 3 , Article 2.
Available at: <https://uknowledge.uky.edu/klj/vol94/iss3/2>

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ARTICLES

“The Law Does Not Perfectly Comprehend...”: The Inadequacy of the Gross Negligence Duty of Care Standard in Unincorporated Business Organizations

*J. William Callison*¹

IN 1994, the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) promulgated the Revised Uniform Partnership Act (“RUPA”) and announced that it was ready for adoption by state legislatures.² Some version of the Act has since been adopted in thirty-two states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.³ The most controversial portion of RUPA has been section 404, RUPA’s codification of partner fiduciary duties.⁴ Although most of the debate has surrounded sec-

1 Partner, Faegre & Benson LLP, Denver, Colorado. I would like to thank Dean Allan W. Vestal and the faculty of the University of Kentucky College of Law for providing me the opportunity to write this article while I was a visiting professor of law there. I also thank Farrell Carfield and Keith Morgan for their valuable research contributions.

2 UNIF. P’SHP ACT (1997), 6 Pt. I U.L.A. 1 (2001) [hereinafter RUPA].

3 NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS, UNIFORM PARTNERSHIP ACT LEGISLATIVE FACT SHEET, http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-upa9497.asp (last visited Jan. 27, 2006).

4 See, e.g., J. William Callison, *Blind Men and Elephants: Fiduciary Duties Under the Revised Uniform Partnership Act, Uniform Limited Liability Company Act, and Beyond*, 1 J. SMALL & EMERGING BUS. L. 109 (1997) [hereinafter Callison, *Blind Men*]; Claire Moore Dickerson, *Is It Appropriate to Appropriately Corporate Concepts?: Fiduciary Duties and the Revised Uniform Partnership Act*, 64 U. COLO. L. REV. 111 (1993); J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439 (1997); J. Dennis Hynes, *Fiduciary Duties and RUPA: An Inquiry Into Freedom of Contract*, 58 LAW & CONTEMP. PROBS. 29 (1995); Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537 (1997); Larry E. Ribstein, *The Revised Uniform Partnership Act: Not Ready for Prime Time*, 49 BUS. LAW. 45 (1993); Allan W. Vestal, “Assume a Rather Large Boat...”: *The Mess We Have Made of Partnership Law*, 54 WASH. & LEE L. REV. 487 (1997); Allan W. Vestal, *Advancing the Search for Compromise: A Response to Professor Hynes*, 58 LAW & CONTEMP. PROBS. 55 (1995); Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523 (1993) [hereinafter Vestal, *Contractarian Error*];

tion 404(b), the "duty of loyalty" provisions,⁵ the "duty of care" provisions in section 404(c) merit similar scrutiny. RUPA section 404(c) states that a partner owes the partnership and the other partners a duty to refrain from gross negligence, reckless conduct, intentional misconduct, or knowing violation of law.⁶ This article examines the gross negligence standard and finds it wanting, particularly as it has intruded, largely unexamined and by drafting osmosis, into subsequent uniform acts governing limited partnerships and limited liability companies. After tracing the contagious nature of the RUPA standard, this article will pursue a meaningful definition of "gross negligence," a concept that has received little judicial attention in the unincorporated business organization context. It will then discuss whether a codified gross negligence standard is satisfactory for general partnerships, and whether it is appropriate to apply the standard across the spectrum of unincorporated business organizations. Concluding that a gross negligence standard is inadequate on all fronts, this article will conclude with some suggestions concerning how the drafters of unincorporated business organization statutes can rectify the situation.

Donald J. Weidner, *RUPA and Fiduciary Duty: The Texture of Relationship*, 58 LAW & CONTEMP. PROBS. 81 (1995).

5 RUPA states that:

A partner's duty of loyalty to the partnership and the other partners is limited to the following: (1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity; (2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and (3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

RUPA § 404(b), 6 Pt. I U.L.A. 143 (2001). Several states have been dissatisfied with this formulation and have adopted modified versions of RUPA § 404(b) and RUPA § 103(b) (permitting modifications to the duty of loyalty but preventing its elimination). See Allan W. Vestal, "... Drawing Near the Fastness?"—*The Failed United States Experiment in Unincorporated Business Entity Reform*, 26 J. CORP. L. 1019 (2001) [hereinafter Vestal, *Failed Experiment*].

6 RUPA § 404(c), 6 Pt. I U.L.A. 143 (2001) ("A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.").

I. DUTY OF CARE IN PRESENT UNIFORM UNINCORPORATED BUSINESS ORGANIZATION STATUTES

All three of the major uniform unincorporated business organization statutes include an identical gross negligence standard of managerial care.⁷ Beginning with RUPA, the law diverged from a common law approach, in which no statutory standard of care was established, in favor of a statutorily circumscribed standard.⁸ Before establishing the probable meaning of gross negligence in the unincorporated business organization context, and before analyzing whether a gross negligence standard is satisfactory, this article traces the historical evolution of the standard.

A. *The Revised Uniform Partnership Act*

Revised Uniform Partnership Act section 404(a) states that the only fiduciary duties a general partner owes to the partnership and the other partners are a duty of loyalty and a duty of care.⁹ RUPA section 404(c) then circumscribes the duty of care: “A partner’s duty of care to the partnership and the other partners in the conduct and winding up of the partnership business *is limited to* refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.”¹⁰ Although the partners’ duty of care can be expanded by the partnership agreement to include simple negligence,¹¹ without such an expansion the RUPA standard controls. A partner’s acts and decisions, including negligent acts and decisions, that do not rise to the level of gross negligence are not fiduciary breaches and are not actionable. RUPA section 103(b)(4) further provides that the statutory duty of care may not be eliminated by agreement, but the standard may be “reasonably reduced.”¹²

RUPA’s predecessor, the Uniform Partnership Act (“UPA”), does not specify a duty of care but instead incorporates the law of agency, including

7 RUPA § 404(c), 6 Pt. I U.L.A. 143 (2001); UNIF. LTD. P’SHIP ACT (1976 with 1985 amendments) § 403, 6A U.L.A. 177 (2005) [hereinafter RULPA]; UNIF. LTD. LIAB. CO. ACT § 409(c), 6A U.L.A. 464 (2005) [hereinafter ULLCA].

8 See RUPA § 404, 6 Pt. I U.L.A. 143 (2001).

9 RUPA § 404(a), 6 Pt. I U.L.A. 143 (2001) (“The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c).”). The RUPA formulation, particularly with regard to the duty of loyalty, is criticized in Callison, *Blind Men*, *supra* note 4.

10 RUPA § 404(c), 6 Pt. I U.L.A. 143 (2001) (emphasis added).

11 RUPA § 103(a), 6 Pt. I U.L.A. 73 (2001) (“Except as otherwise provided in subsection (b), relations among the partners and between the partners and the partnership are governed by the partnership agreement. To the extent the partnership agreement does not otherwise provide, this [Act] governs relations among the partners and between the partners and the partnership.”).

12 RUPA § 103(b)(4), 6 Pt. I U.L.A. 73 (2001) (“The partnership agreement may not ... (4)

agency-based duties of care.¹³ Although courts have long recognized a common law duty of care for partnerships existing under the UPA, the scope of that duty has been unclear. Though courts have been inconsistent with regard to duty of care standards, there has been a trend over time toward using a gross negligence standard.¹⁴

The RUPA drafters made two fundamental decisions concerning the duty of care in general partnerships. First, they decided to break the statutory code of silence in order to set forth a duty of care.¹⁵ Second, they decided that the duty of care should incorporate a deferential gross negligence

unreasonably reduce the duty of care under Section 404(c) or 603(b)(3).”). Thus, it is not possible for a partnership agreement to provide that partners have no duty of care to the partnership. It is difficult to conceive of how a contractual provision to the effect that partners do not even have a duty to avoid gross negligence would be reasonable, but that is a question for another time.

13 The UPA remains the law in those states that have not adopted RUPA. UNIF. P'SHIP ACT (1914), 6 Pt. I U.L.A. 275 (2001) [hereinafter UPA]. To the extent fiduciary duties arise from or pursuant to the UPA, they do so under § 21 or pursuant to the UPA's inclusion of agency law through § 4(3). UPA § 21(1), frequently cited as the source for general partner fiduciary duties, uses the term “fiduciary” only in its title, and states: “Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.” UPA § 21(1), 6 Pt. II U.L.A. 194 (2001). UPA § 4(3) expressly incorporates agency law into partnership law. *See* 6 Pt. I U.L.A. 386 (2001) (stating that “[t]he law of agency shall apply under this act.”). According to the RESTATEMENT (SECOND) OF AGENCY, a paid agent must “act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform” and must “exercise any special skill that he has.” RESTATEMENT (SECOND) OF AGENCY § 379(1) (1958). Comment *a* to § 379 states that “[a]n agreement with the principal that the agent is not to be liable to him for negligence not of a gross character is legal.” *Id.* § 379 cmt. a; *see also* Callison, *Blind Men*, *supra* note 4 (discussing partnership fiduciary duties and criticizing some RUPA changes to such duties).

14 *See* J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, PARTNERSHIP LAW AND PRACTICE: GENERAL AND LIMITED PARTNERSHIPS § 12:2 (2005) (“Traditionally, the courts have held partners to a *reasonable care* standard or a *good faith* standard with respect to partnership business. . . . The reasonable care standard has fallen into general disuse, and the good faith standard has become the accepted method for determining partner liability for a breach of his or her duty of care.”); Norwood P. Beveridge, Jr., *Duty of Care: The Partnership Cases*, 15 OKLA. CITY U. L. REV. 753 (1990) (arguing that partners are subject to duty to use ordinary care in the transaction of partnership business); Gerard C. Martin, *Duties of Care Under the Revised Uniform Partnership Act*, 65 U. CHI. L. REV. 1307, 1308–15 (1998) (stating that “scholars disagree vehemently regarding both what the duty of care standard is under the UPA case law and the common law of agency, and what that standard should be.”); Michael L. Keeley, Note, *Whose Partnership Is It Anyway?: Revising the Revised Uniform Partnership Act's Duty-of-Care Term*, 63 FORDHAM L. REV. 609, 612 (1994) (“The UPA, while silent on the issue of the duty of care among partners, has been interpreted by courts to impose a duty of “ordinary care” on partners in the absence of a specified term to the contrary.”). Some scholars take the rather extreme view that the ordinary care standard for agents does not apply to partners. *See* 2 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 6.07(f), at 6:141 (Supp. 2005).

15 *See supra* note 6.

standard, unless the partners specify a higher standard in their partnership agreement.¹⁶ As discussed below, although gross negligence may indeed be an appropriate standard in many partnership settings, it is inappropriate in others.¹⁷ This demonstrates the inherent difficulty in establishing a one-size-fits-all duty for a business entity form that is used in many situations and for myriad relationships. Instead of recognizing this variability, RUPA section 404(c) creates a statutory duty of care that is inconsistent with pre-RUPA case law, at least in some settings.

The effects of RUPA section 404(c) have not been confined to general partnership law but have spilled over to laws of other unincorporated business entities such as limited partnerships and limited liability companies.¹⁸ Thus, even assuming that a gross negligence standard is appropriate in many general partnership settings, it is necessary to consider whether it is appropriate in settings characterized by centralized management with passive limited partners or members.

B. Uniform Limited Partnership Acts

Limited partnerships generally exist and operate under one of two statutes. First, the Revised Uniform Limited Partnership Act (“RULPA”) was promulgated in 1976 and was adopted in 49 jurisdictions.¹⁹ It remains the current limited partnership law in the 40 enacting states that have not adopted ULPA 2001.²⁰ Second, in 2001 NCCUSL announced that a new limited partnership act, ULPA 2001, was ready for adoption by the states.²¹ ULPA 2001 has been enacted in nine states, with additional enactments likely.²² In each case, as discussed below, the duty of care for general partners in limited partnerships is based on RUPA’s gross negligence standard.²³

First, consider limited partnerships formed under RULPA. Rather than being a self-contained statute, RULPA expressly incorporates by refer-

¹⁶ See *supra* notes 6, 12.

¹⁷ See *infra* Part III

¹⁸ See *supra* note 7.

¹⁹ Uniform Laws Annotated provides a table of jurisdictions where RULPA has been adopted. RULPA, 6A U.L.A. 125–26 (2003). Louisiana was the exception. Prior to RULPA, limited partnerships generally were governed by the 1916 Uniform Limited Partnership Act (ULPA). Although one can still find ULPA limited partnerships, they are few and far between, ULPA having been eclipsed by RULPA in the 1970s.

²⁰ See *supra* note 19.

²¹ UNIF. LTD. P’SHIP ACT (2001), 6A U.L.A. 1 (2003) [hereinafter ULPA 2001].

²² Florida, Hawaii, Idaho, Illinois, Iowa, Kentucky, Maine, Minnesota, and North Dakota are the adopting states. NAT’L CONF. OF COMM’RS ON UNIF. STATE LAWS, UNIFORM LIMITED PARTNERSHIP ACT (2001) LEGISLATIVE FACT SHEET, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ulpa.asp (last visited Feb. 18, 2006) [hereinafter LEGISLATIVE FACT SHEET].

²³ There are some exceptions to this rule. Colorado, for example, has not adopted ULPA

ence various provisions of general partnership law. It does this through two provisions. The first states: "In any case not provided for in this [Act] the provisions of the Uniform Partnership Act govern."²⁴ The second deals expressly with the rights, powers, responsibilities, and duties, including the fiduciary duties, of general partners in limited partnerships:

(a) Except as provided in this [Act] or in the partnership agreement, a general partner of a limited partnership has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners.

(b) Except as provided in this [Act], a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to persons other than the partnership and the other partners. Except as provided in this [Act] or in the partnership agreement, a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to the partnership and to the other partners.²⁵

Thus, although RUPA does not apply to limited partnerships by its own terms, gaps in RULPA's coverage necessitate linkage to RUPA.²⁶ One such gap is the duty of care owed by partners in a limited partnership. RULPA is devoid of particular guidance on the subject, other than its reference to the law of "partnership[s] without limited partners."²⁷ RUPA was drafted to displace the venerable Uniform Partnership Act, and in most states that enacted RUPA, the UPA was repealed after a short transition period.²⁸ As

2001, and expressly delinks its limited partnership statute from RUPA, which it has adopted. *See* COLO. REV. STAT. § 7-62-1104 (2004) (a limited partnership may elect to have RUPA apply; otherwise the Uniform Partnership Act applies.).

24 RULPA § 1105, 6A U.L.A. 547 (2003).

25 RULPA § 403, 6A U.L.A. 403 (2003).

26 *See* Elizabeth S. Miller, *Linkage and Delinkage: A Funny Thing Happened to Limited Partnerships When the Revised Uniform Partnership Act Came Along*, 37 SUFFOLK U. L. REV. 891 (2004); Larry E. Ribstein, *Linking Statutory Forms*, 58 LAW & CONTEMP. PROBS. 187 (1995); Allan W. Vestal, *A Comprehensive Uniform Limited Partnership Act? The Time Has Come*, 28 U.C. DAVIS L. REV. 1195, 1198-1202 (1995) [hereinafter Vestal, *Comprehensive Uniform*].

27 RULPA § 403, 6A U.L.A. 403 (2003).

28 RUPA § 1205, 6 Pt. I U.L.A. 266 (2001) (repealing UPA); RUPA § 1206, 6 Pt. I U.L.A. 266 (2001) (transition period); *see* Vestal, *Comprehensive Uniform*, *supra* note 26, at 1203. With respect to the all-important RULPA § 403, which governs the fiduciary duties of general partners in RULPA-based limited partnerships, the linkage is not to the UPA, but to "partnerships without limited partners." It seems particularly difficult to argue that the reference was meant to be to the UPA, the old and repealed law governing partnerships without limited partners, rather than to RUPA, the new and current law governing partnerships without limited partners.

Some states, such as Colorado, deviated from the norm and allowed RULPA to coexist with the UPA. *See* COLO. REV. STAT. § 7-62-1104 (2004). In such cases, RUPA's gross negligence standard is inapplicable, and UPA, together with its use of common law principles, continues to apply. I submit that this would have been the appropriate model for other states, but this is water under the bridge. *See also* Allan W. Vestal, *Should the Revised Uniform Partnership Act of*

a result, for states that have adopted RUPA and RULPA but have not expressly de-linked the two statutes, the duty of care of general partners in limited partnerships is limited to refraining from gross negligence pursuant to RUPA section 404(c).²⁹ As discussed below, this is an undesirable change in limited partnership law.

Second, consider limited partnerships formed under ULPA 2001. In drafting and adopting ULPA 2001, NCCUSL was motivated by the perceived need for a freestanding limited partnership statute, de-linked from general partnership law.³⁰ On the duty of care issue, however, this “de-linking” produced no change in the general partner duty of care standard. ULPA 2001 section 408(c) mimics the RUPA section 404(c) duty of care standard by employing identical language with respect to general partners in limited partnerships: “A general partner’s duty of care to the limited partnership and the other partners in the conduct and winding up of the limited partnership’s activities is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.”³¹ ULPA 2001 further states that limited partners have no fiduciary duties of care or loyalty.³² The official comments to section 408(c) note that the source of ULPA 2001’s fiduciary care language is RUPA section 404,³³ and the incorporation of RUPA’s gross negligence standard

1994 *Really Be Retroactive?*, 50 BUS. LAW. 267 (1994).

29 Vestal, *Comprehensive Uniform*, *supra* note 26, at 1202–07.

30 According to the prefatory note to ULPA 2001:

The new Limited Partnership Act is a “stand alone” act, “de-linked” from both the original general partnership act (“UPA”) and the Revised Uniform Partnership Act (“RUPA”). To be able to stand alone, the Limited Partnership incorporates many provisions from RUPA and some from the Uniform Limited Liability Company Act (“ULLCA”). As a result, the new Act is far longer and more complex than its immediate predecessor, the Revised Uniform Limited Partnership Act (“RULPA”).

ULPA 2001, Prefatory Note, 6A U.L.A. 2–3 (2003).

31 ULPA 2001, § 408(c), 6A U.L.A. 62 (2003). ULPA 2001 also follows the RUPA model on modifying the duty of care, and the limited partnership agreement may not unreasonably reduce the duty of care. ULPA 2001, § 110(b)(6), 6A U.L.A. 23–24 (2003).

32 ULPA 2001, § 305(a), 6A U.L.A. 51 (2003) (“A limited partner does not have any fiduciary duty to the limited partnership or to any other partner solely by reason of being a limited partner.”); see J. William Callison & Allan W. Vestal, *The Want of a Theory, Again*, 37 SUFFOLK U. L. REV. 719, 729–34 (2004) [hereinafter Callison & Vestal, *Want of Theory*] (criticizing ULPA 2001’s treatment of limited partner fiduciary duties). Any limited partner duty of care would exist only as the result of express provisions in the partnership agreement creating such a duty. In addition, a duty might conceivably arise pursuant to agreement provisions creating a management or decision-making role for a limited partner; however, such role would need to be distinguished from the limited partner’s role “as a limited partner” which arises under the same agreement and is presumably subject to definition and expansion under the agreement.

33 The official comment to ULPA 2001 § 408 makes the derivative nature of ULPA 2001

into ULPA 2001 proceeded without significant debate.³⁴ Although one commentator proposes that in spite of ULPA 2001's "mimicking approach," de-linkage from RUPA invites courts to apply the duty of care differently in the limited partnership context,³⁵ it seems more likely that ULPA 2001 applies a uniform standard of care to general partners in both general and limited partnerships.

C. *Uniform Limited Liability Company Act (Round 1)*

The Uniform Limited Liability Company Act, promulgated in 1996, has also met with limited success and has been adopted in only 8 states.³⁶ Once again, NCCUSL extended the gross negligence standard to limited liability companies by mimicking RUPA's statement of fiduciary duties: "A member's duty of care to a member-managed company and its other members in the conduct of and winding up of the company's business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law."³⁷ If the LLC is member-managed, the duty to refrain from gross negligence is owed by the members.³⁸ If the LLC is manager-managed, the duty is owed by the managers.³⁹ Members who are not managers in manager-managed LLCs typically owe no duties to the LLC or the other members.⁴⁰ As explained

clear. See ULPA 2001, § 408 cmt., 6A U.L.A. 62 (2003).

34 Presumably, the drafters and NCCUSL assumed that RUPA had it right for all unincorporated organizations for all time, or they were weary of the RUPA battles and did not desire to reopen fiduciary duty issues.

35 See Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK U. L. REV. 927, 961 n.142 (2004).

36 Alabama, Hawaii, Illinois, Montana, South Carolina, South Dakota, Vermont, West Virginia, and U.S. Virgin Islands were the adopting jurisdictions. See LEGISLATIVE FACT SHEET, *supra* note 22. Statutory statements of the duty of care vary in those states that have not adopted ULLCA and have been described elsewhere. See J. William Callison & Allan W. Vestal, "They've Created a Lamb with Mandibles of Death": *Secrecy, Disclosure, and Fiduciary Duties in Limited Liability Firms*, 76 IND. L.J. 271, 282-91 (2001) [hereinafter Callison & Vestal, *Mandibles*].

37 ULLCA § 409(c), 6A U.L.A. 600 (2003). ULLCA also follows the RUPA model on modifying the duty of care, and the operating agreement may not unreasonably reduce the duty of care. ULLCA § 103(b)(3), 6A U.L.A. 567 (2003).

38 ULLCA § 409(c), 6A U.L.A. 600 (2003) ("A member's duty of care to a member-managed company and its other members in the conduct of and winding up of the company's business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.").

39 ULLCA § 409(h)(2), 6A U.L.A. 601 (2003) ("In a manager-managed company: ... (2) a manager is held to the same standards of conduct prescribed for members in subsections (b) through (f).").

40 ULLCA § 409(h)(1), 6A U.L.A. 601 (2003) ("In a manager-managed company: ... (1) a member who is not also a manager owes no duties to the company or to the other members

below, this allocation of duties borrows from RUPA without adequately considering the ways in which LLCs are structurally different from general partnerships.

D. Uniform Limited Liability Company Act (Round 2)

At this writing, a NCCUSL drafting committee is preparing a new Uniform Limited Liability Company Act. The current committee draft substantially alters the duty of care language in the original ULLCA, moving LLCs toward a “reasonableness” standard.⁴¹ Crafting an appropriate standard of care has been a contentious topic within the NCCUSL drafting committee, and the outcome is uncertain. Suffice it to say that the conversations have included some who state that RUPA correctly codified existing law and that it should be carried forward to other unincorporated business forms without deviation and others who contend that the RUPA gross negligence standard is not a correct universal statement of general partnership law and/or that other entities are sufficiently different from general partnerships that RUPA-like standards are inadequate for them. This article will establish that those who dissent from the across-the-board application of RUPA’s gross negligence standard are correct.⁴² It also remains to be seen whether the ultimate adoption of a standard other than gross negligence in a new uniform limited liability company act will cause NCCUSL to reconsider the RUPA and ULPA 2001 duty of care standards. Logic suggests that it should, but one might recall the Holmesian mantra that logic is not the

solely by reason of being a member.”); see Callison & Vestal, *Mandibles*, *supra* note 36, at 276.

41 NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS, REVISED UNIF. LTD. LIAB. CO. ACT (2005 Annual Meeting Draft), § 409(c), *available at* <http://www.law.upenn.edu/bll/ulc/ullca/2005annmtgdraft.pdf> (“In a member-managed limited liability company, a member’s duty of care to the limited liability company and, subject to Section 901(b), the other members in the conduct of and winding up of the limited liability company’s activities includes acting with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the limited liability company. In discharging duties under this subsection, a member may rely in good faith upon opinions, reports, statements, or other information provided by another person that the member reasonably believes is a competent and reliable source for the information.”). The fact that a new drafting process commenced six years after ULLCA was promulgated demonstrates that the pace of change in the unincorporated business organization arena has been fast and furious.

42 Indeed, this article has a pragmatic goal, and is intended to provide an intellectual basis for those who seek movement from a gross negligence standard of care. However, as discussed below, I am ambivalent with respect to the adoption of a simple negligence standard, as such standard also does not fit all situations. While I think simple negligence might be more satisfactory than gross negligence, I encourage the drafters to advance toward a position of silence, such as that originally taken in the venerable Uniform Partnership Act of 1914.

life of the law.⁴³ Experience with the legislative drafting process leaves me uncertain, but hopeful.

In summary, NCCUSL appears, at least for the time being, to have reached a conclusion that gross negligence is the appropriate standard of care for general partners in general and limited partnerships and for members and managers in limited liability companies. The remainder of this article will focus, first, on the meaning of gross negligence and, second, on the question of whether and to what extent gross negligence is an appropriate standard of care for contemporary unincorporated business organizations.

II. GROSS NEGLIGENCE DEFINED

It has been said that gross negligence is the same as ordinary negligence "with the addition of a vituperative epithet,"⁴⁴ but deeper inquiry is merited concerning the meaning of the term. Despite the increasing prevalence of the gross negligence standard, guidance on the meaning of gross negligence is in short supply.⁴⁵ RUPA does not define the term, and the "legislative history" surrounding RUPA's adoption casts dim light on the term's meaning.⁴⁶ There is at present no case law interpreting the gross negligence standard in the context of RUPA, ULPA 2001, or ULLCA. A handful of cases interpret the term in the unincorporated business organization duty of care setting.⁴⁷ By contrast, numerous cases elaborate on gross negligence in the context of the corporate business judgment rule.⁴⁸ The term is likewise encountered frequently in tort law. The law of agency gen-

43 Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 61, 62-63 (1897), reprinted in 110 HARV. L. REV. 991, 997-98 (1997).

44 *Wilson v. Brett*, (1843) 152 Eng. Rep. 737, 739 (Ex.).

45 See CALLISON & SULLIVAN, *supra* note 14.

46 The official comment to RUPA § 404(c) provides, in its entirety, as follows:

Subsection (c) is new and establishes the duty of care that partners owe to the partnership and to the other partners. There is no statutory duty of care under the UPA, although a common law duty of care is recognized by some courts. See, e.g., *Rosenthal v. Rosenthal*, 543 A.2d 348, 352 (Me. 1988) (duty of care limited to acting in a manner that does not constitute gross negligence or wilful misconduct).

RUPA § 404 cmt. 3, 6 Pt. I U.L.A. 145 (2001).

The standard of care imposed by RUPA is that of gross negligence, which is the standard generally recognized by the courts. See, e.g., *id.* Section 103(b)(4) provides that the duty of care may not be eliminated entirely by agreement, but the standard may be reasonably reduced. See RUPA § 103 cmt. 6, 6 Pt. I U.L.A. 75 (2001).

47 See *infra* notes 51-59 and accompanying text.

48 See, e.g., *Miller v. U.S. Foodservice, Inc.*, 361 F. Supp. 2d 470, 477-78 (D. Md. 2005); *Roselink Investors, LLC v. Shenkman*, 386 F. Supp. 2d 209, 217 (S.D.N.Y. 2004); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

erally refers to ordinary negligence rather than gross negligence.⁴⁹ Each of these sources will now be considered in an effort to pin down the meaning of RUPA's proliferating duty of care.

A. Recent Unincorporated Organization Cases

Two recent cases interpret the term “gross negligence” in defining the duty of care owed by partners and members. First, in *Gelfman v. Weeden Investors, L.P.*,⁵⁰ the Delaware Court of Chancery considered whether the act of a general partner in issuing new limited partnership interests to a variety of parties constituted a breach of a fiduciary duty where the issuance resulted in dilution of the plaintiff's ownership interests.⁵¹

The general partner's actions were judged under a limited partnership agreement provision establishing a gross negligence standard:

Whenever in this Agreement or the Operating Partnership Agreement the General Partner is permitted or required to make a decision (i) in its “sole discretion” or “discretion,” with “complete discretion” or under a grant of similar authority or latitude, the General Partner shall be entitled to consider only such interests and factors as it desires and shall have no duty or obligation to give any consideration to any interest of or factors affecting the Partnership, the Operating Partnership, the Limited Partners or the Assignees *Each Limited Partner and Assignee hereby agrees that any standard of care or duty imposed in this Agreement, the Operating Partnership Agreement or any other agreement contemplated herein or under the Delaware Act or any other applicable law, rule or regulation shall be modified, waived or limited in each case as required to permit the General Partner to act under this Agreement, the Operating Partnership Agreement or any other agreement contemplated herein and to make any decision pursuant to the authority prescribed in this Section 6.11(b) so long as such action or decision does not constitute gross negligence or willful and wanton miscon-*

49 See, e.g., RESTATEMENT (SECOND) OF AGENCY § 213 (1958) (addressing negligence by principal in agency relationship); RESTATEMENT (SECOND) OF AGENCY § 350 (1958) (“An agent is subject to liability if, by his acts, he creates an unreasonable risk of harm to the interests of others protected against negligent invasion.”).

50 *Gelfman v. Weeden Investors, L.P.*, 859 A.2d 89 (Del. Ch. 2004).

51 *Id.* at 92. The recipients of the new interests were partnership employees, former employees, non-employee directors of the corporate general partner, and other individuals favored by the directors. *Id.* at 110.

*duct and is not reasonably believed by the General Partner to be inconsistent with the overall purposes of the Partnership.*⁵²

In defining “gross negligence,” and in ruling that the general partner’s conduct did not violate the standard, Vice-Chancellor Strine held that:

Words must be taken seriously and gross negligence has a stringent meaning under our law of entities, to wit, one “*which involves a devil-may-care attitude or indifference to duty amounting to recklessness.*” For that reason, I am reluctant to conclude that decisions are grossly negligent simply because they were made with dispatch or in an ad hoc manner. Many business decisions are necessarily made in that fashion and some sloppiness is negligence, not gross negligence. Here, nothing that was done strikes me as having the quality of gross inadvertence about it.⁵³

Therefore, under Delaware limited partnership law, gross negligence is conduct that involves a “devil-may-care attitude or indifference to duty amounting to recklessness.”⁵⁴ A low standard indeed.

Second, a recent Louisiana bankruptcy case, *In re Provenza*,⁵⁵ considered an LLC member’s liability for a breach of the duty of care under a statute providing that “a member or manager shall not be personally liable to the limited liability company or the members thereof for monetary damages unless the member or manager acted in a grossly negligent manner”⁵⁶ The statute further defined gross negligence as “a reckless disregard of or a carelessness amounting to indifference to the best interests of the limited liability company or the members thereof.”⁵⁷ The court held that the member’s alleged failure to mention his tax audit, the termination of his personal line of credit, and his pending divorce when co-members

⁵² *Id.* at 111–12 (emphasis added). The court did not address the issue of whether a different standard of care would apply if the partnership agreement had not established a gross negligence standard. *See* *Cincinnati Bell Cellular Sys. Co. v. Ameritech Mobile Phone Serv. of Cincinnati, Inc.*, Civ. A. No. 13389, 1996 WL 506906, at *14 (Del. Ch. Sept. 3, 1996), *aff’d*, 692 A.2d 411 (Del. 1997) (under Delaware law, to establish gross negligence the plaintiff must plead and prove that defendant was “recklessly uninformed” or acted “outside the bounds of reason.”) Under the Delaware Revised Uniform Limited Partnership Act, a partner’s fiduciary duties may be expanded or restricted by provisions in the partnership agreement. DEL. CODE ANN. tit. 6, § 17-1101(d)(2) (2005). Chancellor Strine had some negative things to say about the drafted provision: “This is an odd construction at the very least, seemingly prepared by a member of a cold-blooded species rather than a breathing, feeling member of our species trying to capture in words an actual human state of mind.” *Gelfman*, 859 A.2d at 112.

⁵³ *Gelfman*, 859 A.2d at 114 (emphasis added).

⁵⁴ *Id.*

⁵⁵ *In re Provenza*, 316 B.R. 225 (Bankr. E.D. La. 2003).

⁵⁶ LA. REV. STAT. ANN. § 12:1314(B) (2005). The Louisiana LLC Act also establishes a reasonableness standard of care, thereby splitting the standard of care and the requirement for liability for breaching that standard into two separate parts.

⁵⁷ LA. REV. STAT. ANN. § 12:314(C) (2005).

executed promissory notes to effect the LLC's financing did not constitute gross negligence because, at the time promissory notes were signed, the member believed that he was current on his taxes, his line of credit had not yet been terminated, his divorce proceedings had not yet commenced, and the impact of these events on his personal finances was not yet known.⁵⁸

B. Business Judgment Rule

Although the corporate business judgment rule arguably has no application to organizations formed under RUPA, ULPA 2001, or ULLCA,⁵⁹ the official comment to RUPA section 404 indicates that the gross negligence standard of care originated, at least in part, with the business judgment rule.⁶⁰ The business judgment rule, which developed as a common law standard of judicial review for determining director liability for duty of care breaches, protects the broad discretion conferred on a corporate board of directors from judicial scrutiny. Under the business judgment rule, courts will not

⁵⁸ *Provenza*, 316 B.R. at 230–32.

⁵⁹ See Elizabeth S. Miller and Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations?*, 30 DEL. J. CORP. L. 343, 388 (2005) (“What is presently clear is that under those unincorporated business organizations statutes that have adopted a gross negligence standard of care, there exists no room for a further reduced standard of review.”). Several cases apply the business judgment rule to limited liability companies, at least in situations where the LLC statute expressly refers to corporate governance rules. See *In re Tri-River Trading, LLC*, 329 B.R. 252, 267 (B.A.P. 8th Cir. 2005) (business judgment rule applies when state LLC act provides that managers must discharge duties “with the care a corporate officer of like position would exercise under similar circumstances”); *Froelich v. Erickson*, 96 F. Supp. 2d 507, 520 (D. Md. 2000), *aff’d sub nom.* *Froelich v. Senior Campus Living, LLC*, 5 F. App’x 287 (4th Cir. 2001). In addition, in *VGS, Inc. v. Castiel*, No. C.A. 17995, 2000 WL 1277372 (Del. Ch. Aug. 31, 2000), *aff’d*, 781 A.2d 696 (Del. 2001), the Delaware Court of Chancery implied that the business judgment rule may be applicable to LLCs. See also *Carson v. Lynch Multimedia Corp.*, 123 F. Supp. 2d 1254, 1260 (D. Kan. 2000) (court assumed that Kansas law would follow the Delaware business judgment rule). Ironically, change in the duty of care in RUPA, ULPA 2001, and ULLCA, as suggested by this article, will require reconsideration of whether the business judgment rule should apply in the unincorporated business organization context.

⁶⁰ The comments cite to *Rosenthal v. Rosenthal*, 543 A.2d 348 (Me. 1988). RUPA, *supra* note 2, § 404 cmt. 3, 6 Pt. I U.L.A. 145 (2001). In *Rosenthal*, the court held that partners in general partnerships are held to the same fiduciary duties of care and loyalty as those owed by corporate directors under Maine law. *Rosenthal*, 534 A.2d at 352. The court ruled that the duty of care requires the degree of diligence, care, and skill that ordinarily prudent persons would exercise under similar circumstances and then held that the business judgment rule shields partners from liability for informed business decisions as long as those decisions were not motivated by fraud or bad faith. *Id.* at 353. The *Rosenthal* court concluded that “to assess the ordinary prudence of defendants’ business decisions [is] a function denied to judicial tribunals.” *Id.* at 354. A listing of partnership cases using business judgment rule analysis is contained in Miller & Rutledge, *supra* note 59, at 373–76. At least one court has held that the business judgment rule is not applicable in the general partnership context. See *Henkels & McCoy, Inc. v. Adochio*, 138 F.3d 491, 502 (3d Cir. 1998).

second-guess the business decisions made by corporate actors, as long as the actors exercised a minimum level of care in arriving at the decision.⁶¹

⁶¹ As stated in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000), the business judgment rule is:

[A] presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption.

Id. at 812 (citations omitted). There is a difference between a standard of care, which is the standard of conduct expected of decisionmakers, and the business judgment rule, which is a standard of review for determining whether decisionmakers will be held liable for their poor decisions. Standards of care continue to have value in remedial contexts, such as in injunction and rescission cases, as opposed to actions for monetary damages against directors as individuals. See William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1295–96 (2001); E. Norman Veasey et al., *Delaware Supports Directors With a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399 (1987). One statement concerning the separation of standards of care and standards of judicial review is as follows:

A judicial standard of review is a value-laden analytical instrument that reflects fundamental policy judgments. In corporate law, a judicial standard of review is a verbal expression that describes the task a court performs in determining whether action by corporate directors violated their fiduciary duty. Thus, in essential respects, the standard of review defines the freedom of action (or, if you will, deference in the form of freedom from intrusion) that will be accorded to the persons who are subject to its reach.

There exists a close, but not perfect, relationship, between the standard by which courts measure director liability (the “standard of review”) and the standard of behavior that we normatively expect of directors (the “standard of conduct”). As Professor Melvin Eisenberg expressed this idea in his thoughtful article on corporate standards of review, “[a] standard of conduct states how an actor should conduct a given activity or play a given role. A standard of review states the test a court should apply when it reviews an actor’s conduct to determine whether to impose liability or grant injunctive relief.” Standards of conduct are sometimes referred to as “conduct rules” that are addressed to corporate directors and officers, whereas standards of review are “decision rules” that are addressed to judges.

In most areas of law, standards of conduct and standards of review tend to conflate and become one and the same, but in corporate law the two standards often diverge. The reasons are rooted in policy interests. First, directors must make decisions in an environment of imperfect information. Second, given the limited investment in publicly held firms that typical corporate directors are able or willing to make, any risk of liability would likely dwarf the incentives for assuming the role. Third, courts are ill-equipped to determine after-the-fact whether a particular business decision was reasonable in the circumstances confronting the corporation.

The interplay of these considerations can be illustrated by consid-

Pursuant to Delaware's formulation of the business judgment rule, to override the rule's presumption, the plaintiff must establish:

- (1) the directors made no decision;
- (2) the directors' decision was uninformed;
- (3) the directors were not disinterested or independent; or
- (4) *the decision involved gross negligence.*⁶²

Because director liability can be established under the business judgment rule by demonstrating gross negligence, even if RUPA, ULPA 2001, and ULLCA do not themselves incorporate the business judgment rule, review of business judgment rule cases can assist in defining gross negligence for those statutes' purposes.

The Delaware business judgment rule definition of gross negligence incorporates recklessness, and proving gross negligence has been referred to as a "near-Herculean task"⁶³ and "the most difficult theory in corporate law upon which a plaintiff might hope to win a judgment."⁶⁴ In *Tomczak v. Morton Thiokol, Inc.*, the court held that "gross negligence means 'reckless indifference to or a deliberate disregard of the whole body of stockholders' or actions which are 'without the bounds of reason.'"⁶⁵ Similarly, in *So-*

ering how judges review board decisions under the business judgment standard. Where the business judgment standard applies, a director will not be held liable for a decision—even one that is unreasonable—that results in a loss to the corporation, so long as the decision is rational. In this review context, the business judgment standard ("rationality") diverges from, and becomes more lenient than, the normative standard of expected conduct ("reasonableness"). The justifications for this divergence have been thoroughly stated elsewhere, and will not be repeated here. Suffice it to say that we endorse a corporate law regime which affords substantial freedom of action to disinterested, well-motivated directors.

Allen et al., *supra*, at 1295–96 (citations omitted).

62 Miller & Rutledge, *supra* note 59, at 347 (emphasis added); see also Aronson, 473 A.2d at 812 ("[U]nder the business judgment rule director liability is predicated upon concepts of gross negligence.").

63 *In re Tower Air, Inc.*, 416 F.3d 229, 238 (3d Cir. 2005) (applying Delaware law) ("[o]vercoming the presumptions of the business judgment rule on the merits is a near-Herculean task.... [A] plaintiff must demonstrate that no reasonable business person could possibly authorize the action....").

64 *In re Caremark Int'l, Inc. Derivative Litigation*, 698 A.2d 959, 967 (Del. Ch. 1996).

65 *Tomczak v. Morton Thiokol, Inc.*, Civ. A. No. 7861, 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990) (citing *Allaun v. Consol. Oil Co.*, 147 A. 257, 261 (Del. Ch. 1929); *Gimbel v. Signal Cos.*, 316 A.2d 599, 615 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974)); see also Stanziale v. Nachtomi, 330 B.R. 56, 66 (D. Del. 2004) ("To state a claim of gross negligence, plaintiffs must allege facts to support the conclusion that the Board acted with so little information that their decision was 'unintelligent and unadvised,' or outside of the 'bounds of reason and reckless[.]'"); *Rabkin v. Philip A. Hunt Chem. Corp.*, 547 A.2d 963, 970 (Del. Ch. 1986) (taking a softer rhetorical approach; after applying the *Allaun* standard found in other cases, the court

lash v. Telex Corp., the court defined gross negligence as a decision that is "so grossly off-the-mark as to amount to 'reckless indifference' or a 'gross abuse of discretion.'"⁶⁶ In *Gagliardi v. Trifoods Int'l, Inc.*, the court held that the business judgment rule "in effect provides that where a director is independent and disinterested, there can be no liability for corporate loss, unless the facts are such that no person could possibly authorize such a transaction if he or she were attempting in good faith to meet their duty."⁶⁷ Even though Delaware courts impose a rhetorically high threshold for gross negligence, commentators have noted that Delaware courts also seem, at times, to lower that standard in reaching decisions.⁶⁸

Other state courts have defined gross negligence in similarly stringent fashion. For example, in *Weaver v. Kellogg*, a bankruptcy court stated the Texas business judgment rule standard of gross negligence as follows:

- (1) viewed objectively from the standpoint of the actor, the act or omission must involve an extreme degree of risk, considering the probability and magnitude of the potential harm to others, and
- (2) the actor must have actual, subjective awareness of the risk involved, but nevertheless proceed in conscious indifference to the rights, safety, or welfare of others.⁶⁹

stated, "[t]hese articulations arguably provide a higher threshold for liability than does the definition of gross negligence in general tort law.")

66 *Solash v. Telex Corp.*, 1988 WL 3587, at *9 (Del. Ch. Jan. 19, 1988).

67 *Gagliardi v. Trifoods Int'l, Inc.*, 683 A.2d 1049, 1052-53 (Del. Ch. 1996).

68 *Allen et al.*, *supra* note 61, at 1299 (arguing that "the Delaware Supreme Court, although purporting to apply the gross negligence standard of review, in reality [but not explicitly] applied an ordinary negligence standard."). For example, in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), the Delaware Supreme Court tagged board members with gross negligence in a corporate sale transaction when the board failed to require an independent valuation of the corporation, failed to obtain a "no shop" clause, and failed to use a decision-making process that was not monitored by the CEO—a combination of failures which may constitute ordinary negligence, but do not seem to us to constitute gross negligence under the Delaware definition. *Allen et al.*, *supra* note 61, at 1299-1300; *see also Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1994) (holding that lower court erred in adopting a reasonable person standard for determining directors' duty of care).

69 *Weaver v. Kellogg*, 216 B.R. 563, 584 (Bankr. S.D. Tex. 1997) (citations omitted). In *FDIC v. Schreiner*, 892 F. Supp 869, 877-78 (W.D. Tex. 1995), the court defined the standard in more ornate fashion:

As recently explained by the Texas Supreme Court, gross negligence involves two components: (1) the defendant's act or omission, and (2) the defendant's mental state. As defined, the act or omission element must involve behavior that endangers the rights, safety, or welfare of the person affected. Thus, gross negligence "differs from ordinary negligence with respect to both elements—the defendant must be 'consciously indifferent' and his or her conduct must 'create an extreme degree of risk'." The test for gross negligence, then, "contains both an objective and a subjective component." Subjectively, the defendant must have actual awareness of the extreme risk created by his or her conduct.

Courts defining gross negligence under the Arizona,⁷⁰ California,⁷¹ Illinois,⁷² Minnesota,⁷³ and Mississippi⁷⁴ corporate laws take substantially similar approaches.

Objectively, the defendant's conduct must involve an "extreme degree of risk," a threshold significantly higher than the objective "reasonable person" test for negligence. Extreme risk is a function of both the magnitude and the probability of the anticipated injury to the plaintiff. The "extreme risk" prong is not satisfied by a remote possibility of injury or even a high probability of minor harm, but rather "the likelihood of serious injury" to the plaintiff. An act or omission that is merely thoughtless, careless, or not inordinately risky cannot be grossly negligent. Only if the defendant's act or omission is unjustifiable and likely to cause serious harm can it be grossly negligent. In other words, the plaintiff must show that the defendant knew about the peril, but his acts or omissions demonstrated that he didn't care.

See also *FDIC v. Harrington*, 844 F. Supp. 300, 306 n.7 (N.D. Tex. 1994) (defining gross negligence as "that entire want of care which would raise the belief that the act or omission complained of was the result of a conscious indifference to the right or welfare of the person or persons to be affected by it." (quoting *Burk Royalty Co. v. Walls*, 616 S.W.2d 911, 920 (Tex. 1981)); *FDIC v. Brown*, 812 F. Supp. 722, 725 (S.D. Tex. 1992) (gross negligence involves "a total or 'entire want of care'"). The Texas business judgment rule cases rely on the Texas Supreme Court's decision in *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994), decided in the insurance context.

70 The court in *Resolution Trust Corp. v. Blasdel* discussed the relevant Arizona case law:

No Arizona decision discusses the concept of gross negligence in the context of director liability. The Arizona courts have, however, defined the term in other contexts. The Arizona Court of Appeals has stated that '[g]ross negligence differs from ordinary negligence in quality and not degree.' In another case, the Arizona Supreme Court stated that gross negligence 'is highly potent and when it is present it fairly proclaims itself in no uncertain terms. It is "in the air," so to speak. It is flagrant and evinces a lawless and destructive spirit.' The thrust of the decisions has been that a person can be very negligent, yet still not be guilty of gross negligence.

Resolution Trust Corp. v. Blasdel, 930 F. Supp. 417, 426 (D. Ariz. 1994) (citations omitted).

71 *Lamden v. La Jolla Shores Clubdominium Homeowners Ass'n*, 72 Cal. Rptr. 2d 906, 915 n.11 (Cal. Ct. App. 1998), *rev'd on other grounds*, 980 P.2d 940 (Cal. 1999) (gross negligence is the "failure to exercise even slight care").

72 *Resolution Trust Corp. v. Franz*, 909 F. Supp. 1128, 1140–41 (N.D. Ill. 1995) (gross negligence defined as recklessness).

73 *Opus Corp. v. Int'l Bus. Machs. Corp.*, 141 F.3d 1261, 1269 (8th Cir. 1998) (applying Minnesota law) (gross negligence means "negligence of the highest degree." (quoting High v. Supreme Lodge of the World, 7 N.W.2d 675, 679 (Minn. 1943))).

74 *Resolution Trust Corp. v. Scott*, 929 F. Supp. 1001, 1017 (S.D. Miss. 1996), *vacated and remanded*, 125 F.3d 254 (5th Cir. 1997) (relying on Mississippi statute in finding that gross negligence means reckless disregard of, or carelessness amounting to gross indifference to, the best interests of another, and concluding that "these terms as used to define 'gross negligence' do not describe a specific type of conduct but rather a range of conduct that lies somewhere between simple negligence and willful, intentional conduct.").

C. Tort and Agency Law

The *Restatement (Second) of Torts* takes a somewhat softer line, and equates gross negligence with reckless disregard, which it defines as an act that poses a risk “substantially greater than that which is necessary to make [the] conduct negligent.”⁷⁵ Thus, for tort law purposes, gross negligence appears to imply a quantitative, rather than a qualitative, difference in care. “Something more than negligence” is a fairly ambiguous definition to begin with, a problem that is compounded by the fact that the general tort law standard may not be applicable in the business context. The *Restatement (Second) of Agency*, which might be directly applicable since managers of unincorporated business organizations have apparent agency authority to act for the organization, establishes that paid agents are subject to a duty to act with standard care and with the skill that is standard in the locality for the kind of work which the agent is employed to perform. The *Restatement (Second) of Agency* does not contemplate or define gross negligence.⁷⁶

Although there are murmurings of a lower standard in tort law, it appears likely that courts will adopt a reckless indifference standard with respect to the gross negligence duty of care in RUPA, ULPA 2001, and ULLCA. It is uncertain whether the drafters of these statutes had this, or any other, meaning in mind when they incorporated the standard into the uniform acts. This is indeed unfortunate, as it remains uncertain whether gross neg-

75 RESTATEMENT (SECOND) OF TORTS § 500 (1965). Negligence is defined as “conduct which falls below the standard established by law for the protection of others against unreasonable risk of harm.” *Id.* § 282. The comments to RESTATEMENT (THIRD) OF TORTS § 2 (Proposed Final Draft No. 1, 2005) indicate that “gross negligence” simply means negligence that is “especially bad,” and therefore involves conduct that is less than reckless. *Black’s Law Dictionary* also takes a softer line and defines “gross negligence” as: “1. A lack of slight diligence or care. 2. A conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party, who may typically recover exemplary damages.” BLACK’S LAW DICTIONARY 1062 (8th ed. 2004).

Prosser and Keeton define gross negligence in the following manner:

Gross Negligence. As it originally appeared, this was very great negligence, or the want of even slight or scant care. It has been described as a failure to exercise even that care which a careless person would use. Several courts, however, dissatisfied with a term so nebulous... have construed gross negligence as requiring willful, wanton, or reckless misconduct, or such utter lack of all care as will be evidence thereof.... But it is still true that most courts consider that “gross negligence” falls short of a reckless disregard of the consequences, and differs from ordinary negligence only in degree, and not in kind.

W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 34, at 211–12 (5th ed. 1984).

76 RESTATEMENT (SECOND) OF AGENCY § 379 (1958).

ligence language would have been used if the drafters had attempted to determine a clear meaning for the term.

III. POLICY IMPLICATIONS

A. *Entity Rationalization and the “Structural” Model*

The expression of a gross negligence standard of care in RUPA, ULPA 2001, and ULLCA can be viewed as part of an entity rationalization process in which statute drafters attempted to identify an appropriate rule of managerial conduct and to apply the rule across the board to similarly denominated persons in different forms of unincorporated business organizations.⁷⁷ One hallmark of the “entity rationalization” movement has been its attempt to remove traditional questions from the common law realm, where the law’s direction is determined by courts, to the statutory realm, where the law’s direction is established by the legislature and in which the courts take a secondary role.⁷⁸ The enactment of detailed and exclusive fiduciary duty rules can be viewed as a prime example of this statutorification tendency, disguised as rationalization.

This rationalization process raises several questions. First, there is a question of whether drafters of a particular entity statute can identify a standard of care that applies to all managers in all settings with respect to that entity form—whether, for example, all general partners in all general

⁷⁷ See generally William H. Clark, Jr., *Rationalizing Entity Laws*, 58 BUS. LAW. 1005 (2003) (discussing current trends in entity law and pressures for uniformity); Robert R. Keatinge, *Plumbing and Other Transitional Issues*, 58 BUS. LAW. 1051 (2003) (providing a general overview of the rationalization of entity law and how it affects and is effected by different elements of an entity); Larry E. Ribstein, *Making Sense of Entity Rationalization*, 58 BUS. LAW. 1023 (2003) (questioning the current trend to rationalize entity laws by weighing the costs and benefits of entity rationalization; the movement ignores the needs of some entities, hurts the evolution of business law, and creates confusion with traditional statutes).

⁷⁸ Judge Guido Calabresi refers to the process of changing the primary source of law from the common law to specific, detailed, and well-drafted statutes as “statutorification.” GUIDO CALABRESI, *A COMMON LAW FOR THE AGE OF STATUTES* 1–7 (1982). Calabresi notes that statutorification does not occur by chance, but results from “technological and sociopolitical changes that made slow, accretional lawmaking unsatisfactory.” *Id.* at 73. He notes that there are several bases for statute-making. First, there are some statutes, such as tax statutes, that are “so detailed[,] technical, [and] specific in establishing rights, requirements, and procedures that it is unthinkable for courts to try to establish them in a common law fashion.” *Id.* at 74. Second, there are statutes designed to provide uniformity and to reduce inter-jurisdictional conflicts. *Id.* Third, some statutes “seemed needed because the common law was changing too slowly to deal adequately with rapid changes in society....” *Id.* at 75. The fiduciary duty standards contained in modern unincorporated business organization statutes were not required under any theory of statutorification.

partnerships should be subjected to an identical standard of care.⁷⁹ A related issue is whether any such standard is sufficiently general as to be capable of statutory expression. Second, there is a question as to whether identical standards should be established for managers in all unincorporated business entities regardless of whether the entity takes a general partnership, limited partnership, or LLC form or, alternatively, whether there are substantive differences between these organizational forms such that the duty of care also should be different. Stated differently, if one assumes that an appropriate standard can be identified and drafted for general partners in general partnerships, the question becomes whether that same standard should apply to general partners in limited partnerships and to members and managers in limited liability companies.

The first rationalization question is whether duty of care concepts, previously grounded in common law with respect to general partnerships and limited partnerships, are capable of precise expression and general application with respect to any particular entity form. Some commentators have argued against the creation of rigid statutes to displace common law fiduciary principles, primarily due to beliefs that legislative drafters are imperfect and may neglect to address situations which courts, operating organically, slowly, and equitably might otherwise cover.⁸⁰ The same com-

79 If it is possible to identify and specify such a standard, then it makes sense to provide a default rule, modifiable by the parties' agreement, setting forth such standard. As noted by RUPA's reporters:

Across all substantive areas, RUPA reflects the policy judgment that, with rare exceptions, partners are permitted to govern relations among themselves by agreement. Almost all of RUPA's rules governing the relations among partners are merely default rules rather than mandatory rules. That is, the statutory rules apply only in the absence of a partnership agreement to the contrary. Under the present Uniform Partnership Act (UPA), it is not clear which rules are merely default rules and which rules are mandatory rules. Under RUPA, every rule governing the relations among partners is a default rule unless it is separately listed as a mandatory rule. RUPA reflects an attempt to craft default rules that are efficient and fair. The basic idea is that default rules should reflect what most partners would regard as implicit in their partnership agreements. A default rule that accurately reflects implicit agreements generally saves people the cost of drafting detailed agreements and also tends to avoid unexpected results. Unpopular default rules add unnecessary cost to the extent they put people to the expense of drafting around them. Stated differently, the short-form contract contained in RUPA is more useful because partners are not required to incur costs to modify it. RUPA attempts to avoid burdening partners who fail to incur the modification costs with rules to which they would not have agreed.

Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1, 2-3 (1993) (citations omitted).

80 See generally Callison, *Blind*, *supra* note 4 (analyzing the RUPA and ULLCA and critiquing both Acts for their respective ways of dealing with fiduciary duties); Vestal, *Contractarian*

mentators have further argued that statutory definition masks an unfounded hostility toward judicial interpretation and activism, and that statutes may not enable temporal changes in law.⁸¹ On the other hand, acknowledging problems with rigid statutorification is not the equivalent of endorsing a complete lack of statutory guidance on important issues. Some of the same commentators that decry the rigid statutorification of fiduciary principles applaud the state legislatures that have modified the uniform act provisions to state that fiduciary obligations “include” certain behaviors.⁸² Inclusive language can provide legislative guidance to parties entering into a business relationship and to the courts, without limiting judicial power to impose social norms regulating behavior that is not specifically prohibited.

There are three fundamental questions that must be answered in determining whether it is appropriate to include a duty of care statement in an entity statute, and, if so, in determining how rigid that statement of the duty should be. The first is whether there are principles that can be derived from the case law. Second, if there are, are those principles appropriate to current situations? Third, if so, can clear and precise statutory language be crafted from those principles (or whatever principles are determined appropriate) to guide people in their business affairs? In my view, it was not appropriate for NCCUSL drafters to include a rigid and all-encompassing duty of care in RUPA.

In a previous article, Allan Vestal and I argued that drafters of unincorporated business organization statutes should adopt a “structural” model when crafting fiduciary duty terms.⁸³ This pragmatic approach would consider the actual relationships among the firm’s owners and would recognize that members can have different power and participation levels in the

Error, supra note 4 (arguing that the contractarian error is so basic to the RUPA that the drafters should withdraw and revise the Act to conform with the fiduciary duty created by common law); see also Larry E. Ribstein, *The Evolving Partnership*, 26 J. CORP. L. 819 (2001) (stating that uniform lawmaking incorrectly assumes optimal rules can be anticipated over time).

81 See *supra* note 80.

82 See Vestal, *Failed Experiment, supra* note 5, at 1027–28 (noting the variations in RUPA partnership fiduciary duty language written by various state legislatures).

83 Callison & Vestal, *Mandibles, supra* note 36, at 307. We compared the structural model with what we termed a “party autonomy” model and what we termed a “community” model. *Id.* at 292–306. The “party autonomy” model conceives of “associating parties as atomistic contracting agents engaged in individual wealth-maximizing behavior with constant recalculation of individual advantage.” *Id.* at 294. Under this model, fiduciary obligations would be determined by analogy to rules concerning parties engaged in arm’s-length commercial negotiations. *Id.* at 294–98. We noted that this model historically has not been applied to unincorporated organizations, such as general partnerships. *Id.* The “community” model conceives “associating parties as members of a [business] community who are engaged in individual wealth-maximizing behavior with temporally restricted recalculation of individual advantage.” *Id.* at 298. Under this model, which historically was adopted in partnership law, there are broad fiduciary duties. *Id.* at 298–305; see also Callison & Vestal, *Want of Theory, supra* note 32, at 719–20 (making similar arguments concerning ULPA 2001).

organization. Under the structural approach, two factors should shape the duty of care owed in a business relationship: the allocation of power among the participants and the legitimate expectations of the participants.⁸⁴ In general, fiduciary duties should correspond with the amount of power an actor has over the interests of the party to whom the duties are owed, and the duty of care should reflect both the actor's role in the organization and the other participants' roles in the organization.⁸⁵ For example, if a general partnership agreement provides that one partner is responsible for the day-to-day firm management while the other partners are passive investors, the party with management rights should owe a higher duty of care to the partnership and her co-partners and the passive partners should have a correlative reduced duty.

Under the structural approach, the duty of care would increase beyond a gross negligence threshold with respect to those participants who assume increased responsibility for the firm's business affairs relative to the responsibility assumed by other participants. Unincorporated business organizations are economic relationships,⁸⁶ and an increased duty makes sense since firms should be presumed to compensate the participant that bears increased responsibility.⁸⁷ Thus it becomes appropriate to treat the responsible person as a paid agent, and the *Restatement (Second) of Agency* provides that paid agents are held to a simple negligence standard.⁸⁸

B. General Partnerships

In this vein, RUPA's deferential gross negligence standard is arguably adequate with regard to duties owed by general partners in many traditional general partnerships. In such partnerships, all partners participate in partnership management,⁸⁹ all partners have apparent agency authority to bind

84 See generally Callison & Vestal, *Mandibles*, *supra* note 36, at 306 (stating that the structural model upholds expectations of the partners by allocating fiduciary duties according to power).

85 *Id.* at 307.

86 Partnerships are defined as "the association of two or more persons to carry on as co-owners a business for profit." RUPA § 202(a), 6 Pt. I U.L.A. 92 (2001) (emphasis added).

87 This compensation can take the form of guaranteed payments, receipt of a partnership interest for services performed, an increased profits share, or in a host of other fashions.

88

Unless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill that he has.

RESTATEMENT (SECOND) OF AGENCY § 379 (1958).

89 UPA § 18(e), 6 Pt. II U.L.A. 101 (2001) ("All partners have equal rights in the management and conduct of the partnership business."); RUPA § 401(f), 6 Pt. I U.L.A. 133 (2001) ("Each partner has equal rights in the management and conduct of the partnership

the partnership in the ordinary course of its business,⁹⁰ and all partners have personal liability for partnership debts and obligations.⁹¹ Further, in such partnerships, all partners have the power to exit the partnership and cause partnership dissolution.⁹² Therefore, in traditional general partnerships, the partners have the incentive and the power to monitor the partnership business, together with the power to dissociate if co-partners appear prone to make bad decisions, and a gross negligence standard may make sense.

In addition, if one operates under the assumption that most general partnerships are small and that partners typically have skill levels comparable to those of their co-partners, it is understandable that partners would decide to pool the risk that one of them might act negligently rather than reserve the right, with its concomitant costs, to hold each other liable for negligent acts.⁹³ The risk of a co-partner's ordinary negligence could be considered a cost of doing business to be shouldered equally by the part-

business.”).

90 UPA § 9(1), 6 Pt. I U.L.A. 553 (2001) (“Every partner is an agent of the partnership for the purpose of its business”); RUPA § 301(1), 6 Pt. I U.L.A. 101 (2001):

Each partner is an agent of the partnership for the purpose of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership, unless the partner had no authority to act for the partnership in the particular matter and the person with whom the partner was dealing knew or had received a notification that the partner lacked authority.

91 UPA § 15, 6 Pt. I U.L.A. 613 (2001) (“All partners are liable (a) Jointly and severally for everything chargeable to the partnership under sections 13 and 14 [and] (b) Jointly for all other debts and obligations of the partnership”); RUPA § 306(a), 6 Pt. I U.L.A. 117 (2001) (“Except as otherwise provided in subsections (b) and (c) [i.e., with respect to limited liability partnerships], all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.”)

92 UPA § 29, 6 Pt. II U.L.A. 349 (2001) (“The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.”); see generally Robert W. Hillman, *RUPA and Former Partners: Cutting the Gordian Knot with Continuing Partnership Entities*, 58 LAW & CONTEMP. PROBS. 7 (1995) (discussing RUPA's partner dissociation and partnership dissolution provisions).

93 Keeley, *supra* note 14, at 610–11.

ners.⁹⁴ Thus, a low standard of care may conform to the parties' expectations in many general partnership cases.⁹⁵

As stated above, partnership common law was moving to a gross negligence standard, even prior to RUPA's adoption.⁹⁶ Thus, theory and judicial practice generally merged. However, notwithstanding that a gross negligence standard may be acceptable in many (or even most) general partnerships, application of the care standard remained situational prior to RUPA. For example, partners who assumed increased management authority were held to a higher standard than were passive general partners.⁹⁷ Thus, the law's development could be seen as conforming to the "structural" model, with most partnership structures dictating a gross negligence standard of care and some structures dictating a higher standard of care.

By establishing a gross negligence standard of care that is modifiable to a higher simple negligence standard by agreement, RUPA has effectively established a rebuttable presumption that most partners in most partnerships would choose a gross negligence standard most of the time.⁹⁸

94 *Id.* at 626. Thus, in a law firm, all partners may assume the risk that any one of them will, for example, negligently miss a filing deadline. They probably do not assume the risk that a partner will act with extreme indifference to the partnership and his or her co-partners in doing so.

95 *Id.* at 626-27.

96 *See supra* notes 13-14 and accompanying text.

97 *See* CALLISON & SULLIVAN, *supra* note 14, § 9:3 ("Managing partners have additional responsibilities. Courts have held that, when a partner takes on the role of managing partner, his or her fiduciary duties to deal fairly and openly, and to disclose information completely, are heightened."); *see generally* Saballus v. Timke, 460 N.E.2d 755, 760 (Ill. App. Ct. 1983); Heller v. Hartz Mountain Indus., 636 A.2d 599, 603 (N.J. Super. Ct. Law Div. 1993). This flexibility in the imposition of general partner fiduciary duties is made possible by the fact that the UPA does not attempt to state express and exclusive standards. In our view, this silence is a virtue that should be attempted by NCCUSL drafters. *See* Keeley, *supra* note 14, at 612.

98 *See* RUPA § 404(c), 6 Pt. I U.L.A. 143 (2001); RUPA § 103(a), 6 Pt. I U.L.A. 73 (2001); J. William Callison, *Changed Circumstances: Eliminating the Williamson Presumption That General Partnership Interests Are Not Securities*, 58 BUS. LAW. 1373, 1381-84 (2003) [hereinafter Callison, *Changed Circumstances*].

A review of RUPA's "legislative history" is interesting and presages some of the issues raised in this article. In 1990, the reporter, Donald Weidner, noted that a reasonable care standard was being considered:

You will see that we have reserved, we have under further study whether there is a duty of care rule among partners But whether to say in this statute that the parties owe each other a duty of reasonable care is something that we haven't decided yet, and the authority appears to be divided.

Transcript, Nat'l Conference of Comm'rs of Unif. State Laws, Proceedings In Committee of the Whole Uniform Partnership Act (July 13-20, 1990), *microformed on Archive Publications Partnership Act 1989-1996* (William S. Hein & Co., Inc.)

Some tentative decisions were subsequently made, and the 1991 Draft of RUPA § 404(d) provided that:

A partner has a duty to act in the conduct of the business of the partner-

ship in a manner that does not constitute gross negligence or willful misconduct. An error in judgment or a failure to use ordinary skill and care does not constitute gross negligence.

UNIF. P'SHIP ACT § 404(d) (Proposed Draft 1991). The comments to the 1991 draft state:

The Committee decided that a “prudent person” liability rule should not apply among the partners. “Reasonable care” was offered as a lesser standard and also rejected by the group. The group felt from the beginning that a “gross negligence” standard was appropriate, although it only reluctantly put the term in the statute. . . . RUPA section 404(d) protects business judgments and provides as a default rule that partners share the losses caused by their ordinary negligence.

UNIF. P'SHIP ACT § 404(d) cmt. Duty of Care (Proposed Draft 1991). The 1992 draft of RUPA section 404(d) eliminated the prior draft's sentence that failure to use ordinary skill does not constitute a breach, and left the gross negligence or willful misconduct statement. UNIF. P'SHIP ACT § 404(c) (Proposed Draft 1992). The comments to the 1992 draft further note:

There is no clear right result as to the appropriate standard of care, if any. It should be emphasized that the duty of care concerns the rights of partners among themselves. The question is whether a partner should bear all the costs caused by her own negligence or whether a loss caused by a partner's negligence should be allocated among all the partners according to the same rules that allocate losses caused by the negligence of a nonpartner.

Id. Weidner, whose 1991 article is cited in the comments, put it this way:

[T]he exposure of partners to unlimited personal liability to all contract and tort creditors provides a powerful incentive to exercise due care. It also provides incentive to monitor the behavior of other partners. It therefore does not appear necessary to allocate the risk of loss inside the partnership in order to encourage either good performance or good monitoring. . . . It is not clear what duty of care rule would be included in most partnership agreements if the matter were addressed. . . . An assumption of equality, therefore, may explain the opinion of those who believe that partners tacitly agree to share the losses caused by each other's ordinary negligence. If one assumes equality, it seems likely that the partners as a group would agree either to self insure or to purchase third party insurance. This suggests that there should not be a special default rule for the losses caused by the negligence of a partner. Stated differently, as among the partners, there should be no duty of care rule to specially allocate losses to the partners who negligently cause them.

Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 *Bus. Law.* 427, 467–68 (1991). In 1992, the NCCUSL conference included a discussion of RUPA's duty of care. Commissioner Henderson took issue with the gross negligence standard, stating that no one knows what it means and that the standard should be stated in a more positive manner, such as it being limited to acting in a manner more culpable than ordinary care. Transcript, Nat'l Conference of Comm'rs of Unif. State Laws, Proceedings In Committee of the Whole Uniform Partnership Act (July 31–August 6, 1992), *microformed on* Archive Publications Partnership Act 1989–1996 (William S. Hein & Co., Inc.). Commissioner David Walker, presently the chair of the NCCUSL committee drafting a new ULLCA, encouraged NCCUSL to adopt an ordinary care standard, with a provision limiting general partner liability for violations of the duty of care to grossly negligent acts. Walker stated that RUPA's gross negligence language will be seen as “crabbed, negative, and reactionary” and that NCCUSL should not “go on record as stating the duty of care in only this negative, fearful

By making the presumption rebuttable by the partnership agreement, RUPA further assumes that partners (and not courts) will recognize situations when a higher standard is desired and be able to negotiate and craft a higher standard in their partnership agreement.⁹⁹ Rebuttable presumptions are intended to promote results that conform the probable connection of a basic fact (i.e., the existence of a general partnership) with a presumed fact (i.e., the partners agree that a gross negligence standard applies).¹⁰⁰ On this analysis, the presumption that partners in general partnerships intend a gross negligence standard of care should be reevaluated when it is no longer probable that the presumed fact links to the basic fact.¹⁰¹ In addition, presumptions can be created by legislators in order to tilt case results in favor of a desired policy.¹⁰² Thus, policy arguments concerning the desirability of a presumed gross negligence standard may affect the debate on whether a gross negligence standard is appropriate. Stated differently, the question is whether the legislature should enact as a matter of social policy a statement that general partners are shielded from responsibility as long as they do not adopt a “devil-may-care attitude or indifference to duty amounting to recklessness.”¹⁰³

Because of the substantial changes that general partnership law has undergone over the last decade, “duty of care presumptions should be abandoned in favor of a more pragmatic, fact-based approach focusing on

language, which is, frankly, expressing to me a fear of what courts might do with language that they have been applying and lawyers have been working with for a quarter of a century.” *Id.* Commissioner John Langbein expressed concern with a gross negligence standard, and encouraged recognition that partners can adopt a gross negligence standard by agreement, but that it should not be the statutory default rule. Langbein stated that, “It is one thing to have a clear understanding that people may elect to have a low standard of care among themselves. It’s quite a different thing to have that be the general rule for relatively unsophisticated people.” *Id.* Notwithstanding this discussion, the draft language was adopted, with the addition of the recklessness and knowing disregard of law provisions.

99 The rebuttal comes from the partnership agreement, rather than from judicial action.

100 For a discussion of rebuttable presumptions in the context of securities law, see Callison, *Blind Men*, *supra* note 4, at 147.

101 *See, e.g.*, Alfred L. Gausewitz, *Presumptions in a One-Rule World*, 5 VAND. L. REV. 324, 330 (1952). Gausewitz writes:

Since a presumption shifts and sometimes modifies the burdens of proof, it would seem obvious that the reasons for fixing the burdens in the first place would have to be considered in deciding whether and to what extent to change them. It would further seem that the decision to change the burdens would have to be based upon considerations similar to those which fixed them initially.

Id.

102 *See* David A. Strauss, *The Ubiquity of Prophylactic Rules*, 55 U. CHI. L. REV. 190, 193 (1988) (arguing that presumptions are created “to minimize the sum of error costs and administrative costs” of deciding cases).

103 *Gelfman v. Weeden Investors, L.P.*, 859 A.2d 89, 114 (Del. Ch. 2004) (quoting Allen et al., *supra* note 61, at 1300).

the partners' actual relationship."¹⁰⁴ To the extent one adopts the structural model in which the duty of care is linked to relative participation in firm management, duties of care would vary depending on who the partner was and how the partnership was structured. General partnerships are not unidimensional in form, and neither should be general partner duties of care.¹⁰⁵ In response to the initial question of whether drafters of a particular entity statute can identify an appropriate standard that applies to all managers in all settings, with respect to general partnerships, the answer is that they cannot. Some general partners in some general partnerships would be held to the gross negligence standard; other general partners in other general partnerships would be held to a simple negligence standard; and yet other general partners would be held to some standard between the two. It all depends.

C. Limited Partnerships

Even assuming that gross negligence is an appropriate default standard for general partnerships, the integration process whereby RUPA's standard was

104 Callison, *Changed Circumstances*, *supra* note 98, at 1381. In an earlier article, I described these "substantial changes," which include the adoption of limited liability for non-corporate business entities, the ability of partners to modify their duties by agreement, and the permissibility of filing statements of partner authority. *See id.* at 1381–84. These shifts in the law of unincorporated business forms cast doubt on the assumption that all members of a business entities should be held to the same standard of care.

105 In a dialogue in his work *Statesman*, Plato identified the inability of the human mind to apprehend universal rules amid the endless confusions of the real world:

Stranger: [T]he law does not perfectly comprehend what is noblest and most just for all and therefore cannot enforce what is best. The differences of men and actions, and the endless irregular movements of human things, do not admit of any universal and simple rule. And no art whatsoever can lay down a rule which will last for all time. Do you agree so far?

Young Socrates: I do.

Stranger: But the law, it is plain, is always striving to secure this object;—like an obstinate and ignorant tyrant, who will not allow anything to be done contrary to his appointment, or any question to be asked—not even in sudden changes of circumstances, when something happens to be better than what he commanded for someone.

Young Socrates: Certainly; the law treats us all precisely in the manner which you describe.

Stranger: A perfectly simple principle can never be applied to a state of things which is the reverse of simple.

3 PLATO, *THE DIALOGUES OF PLATO* 509 (B. Jowett trans., 4th ed. 1953) (1871). The RUPA drafters made a fundamental error in assuming that general partnerships follow a precise form, and this error is manifest in the determination that general partners always should be held to a gross negligence standard despite the chaos that in reality is built into the general partnership form. Allan Vestal has referred to the uniform acts' infinite variability as a "contractarian fetish." *See* Callison & Vestal, *Want of Theory*, *supra* note 32, at 733–34.

exported to limited partnerships and limited liability companies paid insufficient attention to differences among the various unincorporated forms. Limited partnerships are inherently different from general partnerships. Indeed, the drafters of ULPA 2001 acknowledged those differences, and claimed to have drafted a statute taking those differences into account:

The new Act has been drafted for a world in which limited liability partnerships and limited liability companies can meet many of the needs formerly met by limited partnerships. This Act therefore targets two types of enterprises that seem largely beyond the scope of LLPs and LLCs: (i) sophisticated, manager-entrenched commercial deals whose participants commit for the long term, and (ii) estate planning arrangements (family limited partnerships). This Act accordingly assumes that, more often than not, people utilizing it will want:

- strong centralized management, strongly entrenched, and
 - passive investors with little control over or right to exit the entity
- The Act's rules, and particularly its default rules, have been designed to reflect these assumptions.¹⁰⁶

As a general rule, limited partners have little ability to control general partners, and little involvement in the day-to-day partnership management.¹⁰⁷ Limited partners entrust the partnership with their assets and rely

¹⁰⁶ ULPA 2001, Prefatory Note, 6A U.L.A. 2 (2003).

¹⁰⁷ General partners have agency authority to act on the limited partnership's behalf.

Each general partner is an agent of the limited partnership for the purposes of its activities. An act of a general partner, including the signing of a record in the partnership's name, for apparently carrying on in the ordinary course the limited partnership's activities or activities of the kind carried on by the limited partnership binds the limited partnership, unless the general partner did not have authority to act for the limited partnership in the particular matter and the person with which the general partner was dealing knew, had received a notification, or had notice under Section 103(d) that the general partner lacked authority.

ULPA 2001, § 402(a), 6A U.L.A. 55 (2003); *see also* RULPA § 403, 6A U.L.A. 365 (2003) (linkage to general partnership law). General partners also have management authority:

Each general partner has equal rights in the management and conduct of the limited partnership's activities. Except as expressly provided in this [Act], any matter relating to the activities of the limited partnership may be exclusively decided by the general partner or, if there is more than one general partner, by a majority of the general partners.

ULPA 2001, § 406(a), 6A U.L.A. 58 (2003); *see also* RULPA § 403(a), 6A U.L.A. 365 (2003) (linkage to general partnership law). The official comment to ULPA 2001 § 406 acknowledges the drafters' intent to create general partner dominance:

As explained in the Prefatory Note, this Act assumes that, more often than not, people utilizing the Act will want (i) strong centralized management, strongly entrenched, and (ii) passive investors with little control over the entity. Section 302 essentially excludes limited partners from the ordinary management of a limited partnership's activities. This

on the assumption that the general partner will act in the limited partnership's (and indirectly the limited partners') best interest. As with general partnerships in which one general partner takes on increased responsibility, general partners in limited partnerships should be deemed compensated for their increased management role. The general partner being akin to a paid agent, an ordinary care standard borrowed from the common law of agency is more appropriate than the gross negligence standard.¹⁰⁸

Applied in the limited partnership context, a simple negligence standard typically would correspond with the relative power general partners have in managing the partnership business, and would conform to the limited partners' legitimate expectation of meaningful protection from general partner misconduct. Thus, ULPA 2001's adoption of a gross negligence standard is inappropriate. This is not to say that limited partnership law should flop the other way and incorporate a simple negligence standard of care in all cases. Although general partners ordinarily should be held to a simple negligence standard and limited partners ordinarily should have no duty of care, there will still be outlier cases, and a statutory norm should not eliminate the exceptions. For example, limited partners may be more sophisticated than general partners with respect to the partnership's business, and they frequently reserve to themselves robust control over certain partnership matters.¹⁰⁹ If a limited partnership agreement reduces a general partner's power to manage and control the entity, and vests some or all of that power in limited partners, a simple negligence duty of care might not be appropriate for the general partner and a no-duty-of-care standard would not be appropriate for the controlling limited partners. A structur-

subsection states affirmatively the general partners' commanding role. Only the partnership agreement and the express provisions of this Act can limit that role:

ULPA 2001, § 406 cmt. subsection (a), 6A U.L.A. 59 (2003).

[Although the August 2000 Annual Meeting Discussion Draft of RULPA ("Re-RULPA") retains the gross negligence standard of care, the Reporter's notes] draw a distinction between the degree of control of general partners in a general partnership over other general partners and the degree of control of general partners in a limited partnership over limited partners, while considering the perceived need for varying treatment between general partnerships and limited partnerships.

Kenneth M. Jacobson, *Fiduciary Duty Considerations in Choosing Between Limited Partnerships and Limited Liability Companies*, 36 REAL PROP. PROB. & TR. J. 1 (2001) (citing UNIF. LTD. P'SHIP ACT (Proposed Revisions of 1976 Act with 1985 Amendments Aug. 2000), available at http://www.law.upenn.edu/b11/ulc/ulc_frame.htm).

108 RESTATEMENT (SECOND) OF AGENCY § 379 (1958) (paid agent must "act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform ...").

109 For a more detailed discussion of situations involving limited partner assertions of power, see Callison & Vestal, *Want of Theory*, *supra* note 32, at 730–31.

al approach would match the partners' duties of care with their relative powers.

This structural approach to the duty of care comports with the standard applied to general partners in limited partnerships before the adoption of ULPA 2001 and before the linkage of limited partnerships formed under RULPA with RUPA. For example, in *Shinn v. Thrust IV, Inc.*¹¹⁰ the court held a general partner liable for failing to advance a real estate project in a timely manner, failing to use due care in selecting and supervising subcontractors, and failing to use reasonable steps in controlling project costs.¹¹¹ Slavish

110 *Shinn v. Thrust IV, Inc.*, 786 P.2d 285 (Wash. Ct. App. 1990).

111 *Id.* In *Sonet v. Timber Co.*, 722 A.2d 319, 324 (Del. Ch. 2000), the court acknowledged that a partnership agreement provision that the general partner's actions must be fair and reasonable constituted an explicit acceptance of those duty of care rules that apply in the absence of a contract to the contrary. *Compare* Davenport Group MG, L.P. v. Strategic Investment Partners, Inc., 685 A.2d 715, 721 (Del. Ch. 1996) (providing no indication that the court thought that a partnership agreement provision requiring general partners to exercise reasonable care was a modification of the common law duty), *with* Cincinnati Bell Cellular Sys. Co. v. Ameritech Mobile Phone Serv. of Cincinnati, Inc., Civ. A. No. 13389, 1996 WL 506906, at *14 (Del. Ch. Sept. 3, 1996), *aff'd*, 692 A.2d 411 (Del. 1997) (recognizing gross negligence standard as contractual modification of duty of care from negligence duty); *see also* Nolan v. Va. Inv. Fund Ltd. P'ship, 833 So. 2d 853, 855-56 (Fla. Dist. Ct. App. 2002) (modification away from common law negligence duty); *Reeve v. Folly Hill Ltd. P'ship*, 628 N.E.2d 36, 39 (Mass. App. Ct. 1994) (negligence standard); *Knopke v. Knopke*, 837 S.W.2d 907, 915 (Mo. Ct. App. 1992) (holding that management authority of general partner is subject to requirement that it act reasonably in investing limited partnership assets). There is some authority to the effect that general partner negligence does not form the basis for a breach of fiduciary duty claim. *See* *Johnson v. Weber*, 803 P.2d 939, 941 (Ariz. 1990) (holding that general partner's negligence does not create any right of action against that partner by limited partners, since "[a] general partner does not guarantee that a partnership will be profitable.").

Courts have also held that limited partners can have a duty of care. For example, in *Tri-Growth Centre City, Ltd. v. Sillardorf, Burdman, Duignan & Eisenberg*, 265 Cal. Rptr. 330, 335 (Cal. Ct. App. 1989), the court stated that although limited partners do not normally have fiduciary obligations to the other partners, there can be situations in which a limited partner is "involved in the partnership in such a manner—for example, allowing him access to confidential information—so as to create fiduciary duties." *See* S. Atl. Ltd. P'ship of Tenn. v. Riese, 284 F.3d 518, 533-34 (4th Cir. 2002) (holding that under North Carolina law, limited partners had fiduciary duties when they possessed substantial authority over partnership affairs, including control of accounting and preparation of draw requests for partnership loan); *In re Villa W. Assocs.*, 193 B.R. 587, 593 (Bankr. D. Kan. 1996), *aff'd*, 146 F.3d 798 (10th Cir. 1998) (holding that limited partners, like shareholders, have fiduciary relationships only when they take a role in management and act "to dominate, interfere with or mislead other[s] in exercising [those] rights."). Delaware courts have taken a similar approach. *See* *KE Prop. Mgmt., Inc. v. 275 Madison Mgmt. Corp.*, Civ. A. No. 12683, 1993 WL 285900, at *8-9 (Del. Ch. July 21, 1993) (holding that a limited partner empowered to remove a general partner under a partnership agreement had a fiduciary obligation to act in good faith as to other partners in exercising that power); *Bond Purchase, LLC v. Patriot Tax Credit Props., L.P.*, 746 A.2d 842, 864 (Del. Ch. 1999) (limiting *KE Property Management* to situations where limited partnership agreement gives limited partners power to participate in firm governance). Courts also have recognized that limited partners can act in concert with general partners in breaching fiduciary duties and that they are then accountable to the partnership and the other partners for the fiduciary

adherence to RUPA's gross negligence standard for the limited partnership form is both an undesirable deviation from prior law and inappropriate under the structural model.

D. Limited Liability Companies

Although there are state-by-state variations, LLC governance structures take two basic forms: member-managed and manager-managed.¹¹² In a member-managed LLC,¹¹³ each member¹¹⁴ is the LLC's agent for the purposes of its business. A member's acts will generally bind the LLC unless the member lacks actual agency authority and the third party with whom the member deals knows or has notice that the member lacks authority.¹¹⁵ Further, in a member-managed LLC, each member has an equal right to participate in managing the LLC's business, and most matters relating to the conduct of the business are decided by a majority of the members.¹¹⁶ Although the LLC's operating agreement may vary the members' partici-

breach. *See In re Sec. Groups*, 89 B.R. 204 (Bankr. M.D. Fla. 1988), *aff'd sub nom. In re Monetary Group*, 2 F.3d 1098 (11th Cir. 1993); *May v. Flowers*, 483 N.Y.S.2d 551 (N.Y. App. Div. 1984); *see generally*, Callison and Vestal, *Want of Theory*, *supra* note 32, at 729–30.

112 *See generally* Thomas E. Rutledge, *The Lost Distinction Between Agency and Decisional Authority: Unfortunate Consequences of the Member-Managed Versus Manager-Managed Distinction in the Limited Liability Company*, 93 Ky. L. J. 737 (2004–2005). The existence of this choice, and not some other choice, in LLC management structures arises from the fact that LLCs originally were partnership derivatives. Federal income tax law recognized that they could be classified as partnerships if they lacked a preponderance of four corporate characteristics: limited liability, continuity of life, free transferability of interests, and centralized management. The state law drafters of LLC statutes looked to general and limited partnership management forms with respect to the continuity, transferability, and centralized management factors. *See generally* Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 Bus. LAW. 375 (1992).

113 A "member-managed company" is "a limited liability company other than a manager-managed company." ULLCA § 101(12), 6A U.L.A. 564 (2003). A "manager-managed company" is "a limited liability company which is so designated in its articles of organization." ULLCA § 101(11), 6A U.L.A. 564 (2003). Member management therefore is the default rule and is overridden only by a specific provision in the LLC's articles of organization. Articles of organization are filed with the secretary of state or other pertinent official in order to bring the LLC into existence. ULLCA § 202(a), 6A U.L.A. 578 (2003).

114 "Member" is not defined in the ULLCA, but generally means a person having an ownership interest in an LLC with the rights and obligations specified in the state LLC act. *See, e.g.*, COLO. REV. STAT. § 7-80-102(9) (2004).

115 ULLCA § 301(a)(1), 6A U.L.A. 588 (2003). "Knowledge" and "notice" are defined in ULLCA § 102, 6A U.L.A. 566–67 (2003). *See generally* J. Dennis Hynes, *Notice and Notification Under the Revised Uniform Partnership Act: Some Suggested Changes*, 2 J. SMALL & EMERGING BUS. L. 299 (1998).

116 *See* ULLCA § 404(a), 6A U.L.A. 594 (2003). Extraordinary matters may require the members' unanimous consent. ULLCA § 404(c), 6A U.L.A. 594 (2003). These matters, as well as the unanimity requirement, can be changed in the LLC's operating agreement. *See* ULLCA § 103(a), (b), 6A U.L.A. 567 (2003).

pation rights from these default rules, such changes generally affect the rights and duties of the members only and do not affect third-party relations with the LLC or the members.¹¹⁷ Thus, in a member-managed LLC, ownership and management rights converge.

In a manager-managed LLC, one or more managers, who can also be members, control the LLC's affairs.¹¹⁸ Although ULLCA section 404(b)(3) provides that managers are designated, appointed, elected, removed, or replaced by a vote, approval, or consent of a majority of the members,¹¹⁹ this is a default rule only and the LLC's operating agreement may provide other methods for manager appointment and removal.¹²⁰ The non-ULLCA state LLC statutes contain diverse manager designation and removal methods.¹²¹ In a manager-managed LLC, the managers, not the members, are the LLC's agents for the purpose of its business and have apparent agency authority to bind the LLC.¹²² Under the ULLCA, managers have equal rights in the management and conduct of the LLC's business, and most matters relating to the business may be exclusively decided by the manager, or, if there is more than one manager, by a majority of the managers.¹²³

What should be the duty of care for LLC members and managers? As discussed above, there are two distinct types of the LLC form: member-managed LLCs and manager-managed LLCs. The control attributes of participants in the two LLC forms can be compared with the control attributes of participants in general partnership and limited partnership forms. Members of member-managed LLCs often have the control attributes of general partners in general partnerships. Similarly, managers of manager-managed LLCs often have the control attributes of general partners of limited partnerships. However, if all members are managers, managers in manager-managed LLCs might have the control attributes of general partners in general partnerships. Finally, non-manager members of manager-managed LLCs often have the control attributes of limited partners in

117 *See* ULLCA § 103(a), 6A U.L.A. 567 (2003) (stating that the operating agreement governs an LLC's affairs, except to the extent provided in Section 103(b)).

118 *See* ULLCA § 101(10), 6A U.L.A. 564 (2003) (stating that a "manager" is a person, whether or not a member, vested with agency authority to bind the LLC.)

119 ULLCA § 404(b)(3), 6A U.L.A. 594 (2003).

120 *See* ULLCA § 103(a), 6A U.L.A. 567 (2003). An operating agreement can also designate managers without the possibility of replacement or removal.

121 *See generally* J. W. CALLISON & M. A. SULLIVAN, LIMITED LIABILITY COMPANIES: A STATE-BY-STATE GUIDE TO LAW AND PRACTICE (1994) (containing manager designation and removal provisions of all state LLC statutes).

122 *See* ULLCA § 301(b), 6A U.L.A. 588 (2003).

123 ULLCA § 404(b), 6A U.L.A. 594 (2003). Section 404(c) sets forth certain extraordinary matters that require unanimous member consent, but this listing, as well as the consent requirements, can be amended by the operating agreement. *See* ULLCA § 404(c), 6A U.L.A. 594 (2003) (outlining consent requirements); ULLCA § 103(b), 6A U.L.A. 567 (2003) (including provisions concerning modification by agreement).

limited partnerships. But, as discussed below, LLC operating agreements can parcel managerial responsibilities in diverse ways. As a result of the enormous variability of the LLC form, the duty of care analysis is considerably more difficult for LLCs than it is for general and limited partnerships. As will be seen, this leads to a conclusion that ULLCA's attempt to create a one-size-fits-all gross negligence standard for LLCs is misguided.

In member-managed LLCs, the members retain control over the firm's operations.¹²⁴ Under the structural model, management participation characteristics should define the duty of care of the various LLC participants. This suggests that members in member-managed LLCs should have a duty of care akin to that of general partners in general partnerships. As demonstrated above, in the general partnership setting a gross negligence standard may frequently be appropriate, but it remains necessary to consider the relative power of the partners in the particular partnership. A similar rule should apply to member-managed LLCs. For example, a simple negligence standard might be appropriate in a member-managed LLC in which one member is denominated "managing member" with management power and agency authority and the other members are passive investors.

In manager-managed LLCs, the firm's operations are controlled by managers who, although they can be members, participate in management solely in their capacity as managers.¹²⁵ The structural model suggests that members who are also managers in manager-managed LLCs should have a duty of care that is either akin to that of general partners in general partnerships or that of general partners in limited partnerships. The distinguishing factor would be the relative power positions of the members and the managers. If all members are also managers, the linkage would be to general partnership duties of care. If only some of the members are managers, the linkage would be to limited partnership duties of care. The structural model also suggests that third-party managers should have a duty of care akin to that of a general partner in a limited partnership, at least where none of the members are managers. But in all cases, the participants' titles might not be significant and consideration needs to be given to actual substantive relationships. For example, even if all members are managers of a manager-managed LLC, the operating agreement could give superior management power and agency authority to one manager. In such cases, the dominant manager should have a heightened duty of care relative to the other managers. Similarly, if only some of the members are managers or if there is a third-party manager, the operating agreement could strip the managers of their authority in some or all cases and vest some or all authority in non-manager members. In such cases, ULLCA's statement that non-manager members in manager-managed LLCs have no duty of care would be incor-

124 See ULLCA § 404(a), 6A U.L.A. 594 (2003).

125 See ULLCA § 101(10), 6A U.L.A. 564 (2003).

rect, as is the case in limited partnerships where the limited partners are given power pursuant to agreement.¹²⁶ Given the many ways power can be distributed, it is impossible to create generalized rules of conduct.

Although there is little or no case law dealing with duties of care in the LLC context, a review of state statutory law demonstrates that there is no uniformity of approach and that ULLCA likely diverges from existing law. The states are remarkably scattered in their statutory handling of LLC duties of care, with numerous state statutes requiring managers and members to adhere to good faith and ordinary negligence standards.¹²⁷

The inclusion in ULLCA of a gross negligence standard of care, limited to certain types of participants without regard to actual organizational power structures, represents both a slavish adherence to RUPA language and an amplification of form over substance. It violates the principles of the structural model, and it is contrary to the present statutory law of many states. The gross negligence standard should not be adopted by state legislatures and should be abandoned in the next version of ULLCA.

E. Summary

NCCUSL's attempt to set forth standards of care has failed. In RUPA, it fails because it does not recognize the variability of the general partnership form and is not sufficiently malleable to fit all partnership power structures. In ULPA 2001, it fails to fit the centralized power structure of limited partnerships and fails to acknowledge that there is variability in the limited partnership form. In ULLCA, it fails to recognize the extreme variability of the LLC form and attempts to bandage a simple set of edicts onto a structure that does not lend itself to simplicity. In short, the rationalization experiment fails due to drafting hubris, and an inability or unwillingness to recognize that the correct answers to duty of care questions are specific to particular business relationships and cannot be answered by general pronouncements.

IV. HELLO DARKNESS, MY OLD FRIEND: AN ALTERNATIVE APPROACH TO DRAFTING UNINCORPORATED BUSINESS ORGANIZATION STATUTES

The Uniform Partnership Act was silent concerning partners' duties of care, and left elaboration of those duties to common law courts. In my view, the

¹²⁶ See Callison & Vestal, *Mandibles*, *supra* note 36, at 308.

¹²⁷ See *id.* The *Mandibles* article contains extensive citations to various state statutes as they existed at the time that article was written. Reiteration of these citations will not be made here. See also Miller & Rutledge, *supra* note 59, at 366-69 (similar analysis).

courts generally reached correct decisions in particular cases confronting them. Further, because the courts reacted to changes in social and business norms by adaptation, duty of care concepts evolved over time. A simple negligence standard morphed into a gross negligence standard as courts reacted to the use of the business judgment rule in corporate settings, but there always was room for a simple negligence standard in appropriate cases. There has been no hue and cry that the courts mangled the duty of care of participants in unincorporated business organizations. The common law system evinced wisdom.

When uniform act drafters entered the scene and attempted to supplant the common law with a statutory standard they did not, and indeed could not, get it right. Whatever tack they could have taken in expressing a standard of care, whether it was adoption of a simple negligence standard, a gross negligence standard, or some other standard, would have fit some situations but not others. Attempting to circumscribe the duty of care, in the name of rationalization, was a fool's errand and a desirable result could not be achieved. An attempt to impose order on chaos merely produced irrationality.

All of this points to the value of silence. When it is not possible to draft something that fits all situations, it may be better to sit silently and not draft anything at all. This may be the implicit wisdom of the 1914 Uniform Partnership Act. That is what the NCCUSL drafters should have done, and hopefully it is what they will do in the new Uniform Limited Liability Company Act and beyond. In addition, when considering RUPA, ULPA 2001, and whatever version of ULLCA emerges from the current drafting process, state legislatures should excise fiduciary duty statements from the statutes they enact, assuming that NCCUSL does not do it for them.

