Default Rules and Fiduciary Duty Waivers in Alternative Entities: Policy Issues and Empirical Insights

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Currently, Delaware corporate law prohibits the indemnification of violations of the duty of loyalty, acts or omissions not in good faith, intentional misconduct, knowing violation of law, and several other categories of transgressions. However, it permits the indemnification of breaches of the duty of care. In contrast, although the implied contractual covenant of good faith and fair dealing may not be waived, Delaware's alternative entity law places the duty of loyalty and the duty of care on equal footing insofar as it permits the waiver of both the duty of loyalty and the duty of care and statutorily provides indemnification for all claims. Chief Justice Leo E. Strine, Jr. and Vice Chancellor J. Travis Laster would change this scheme in part by prohibiting the waiver of the duty of loyalty in diversely-held alternative entities. Waivers of the duty of care would continue to be permitted in all Delaware alternative entities, and a duty of care waiver would be presumed in certain cases.

How well-received the Strine–Travis proposal will be depends in part on the business community's views and expectations surrounding the duty of loyalty and the duty of care. It has always been assumed that stakeholders in the business community regard duty of loyalty violations differently from duty of care violations, and believe that the law should take the former more seriously than the latter. However, legal scholars have not empirically examined these propositions. This Article begins a long overdue exploration of the business community's expectations surrounding the duty of loyalty and the duty of care with a pilot survey. The survey was sent to 117 sophisticated executives, of whom 45 replied regarding their views of default duties in private companies and their perceptions of express waivers of the duty of loyalty or the duty of care in hypothetical public and private company scenarios. The respondents displayed significantly less support for the waiver in the duty of loyalty scenarios than for the waiver in the duty of care scenarios and least support overall for a waiver of the duty of loyalty when the company posited was publicly-owned. Definitive conclusions must be avoided based upon this very limited pilot survey. However, the study makes a contribution by pointing the way toward a new avenue of empirical legal research that explores attitudes toward and comprehension levels of internal governance laws.

The Article analyzes the empirical findings against the backdrop of literature on trust, and recommends further empirical research to help gauge the business and investor community's reactions to the differential treatment of the duty of loyalty and the duty of

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care and its comprehension of waivers and indemnification rules. It explains why internal governance laws are now at a major crossroad and presents a policy analysis of alternative approaches to fiduciary duties. The Article recommends incorporating aspects of a Concession/Stakeholder vision of business entities into the Nexus-of-Contracts paradigm. Irrespective of which fiduciary duty reforms are finally adopted, it is argued that ethical training should be integrated into multiple law school courses in a coherent fashion beginning with contracts, agency law, business organizations, business planning, and estate planning. A similar integrated approach should be taken to strengthen ethics training in both the undergraduate and graduate business school curricula.

I. INTRODUCTION TO ALTERNATIVE BUSINESS ENTITY LEGISLATION POLICY QUESTIONS

Imagine a privately-owned nursing home that is operated by a Limited Liability

Company (LLC) manager with a bad gambling habit. The manager engages in several self-interested transactions, drains the facility of cash, and does a poor job of managing the facility. Patients and passive investors alike find themselves in peril. To what extent should the law protect the manager from damage suits by investors who entrusted their money to the nursing home venture? What if instead, the LLC manager had carefully managed the nursing home, but had engaged in dishonest, self-interested conduct? Should a default, built-in duty of loyalty and/or duty of care apply in the above circumstances in the absence of an LLC operating agreement? If an agreement had been executed, should the manager have the freedom to self-protect against investor lawsuits through the elimination of the duty of loyalty and the duty of care? Should the rules differ for public and private LLCs? Should stricter waiver rules apply when a manager has acted dishonestly and/or deliberately?

The above questions have assumed increased importance now that litigation experience with contractual waivers in publicly-traded LLCs and master limited partnerships (MLPs) has led Delaware Chief Justice Leo E. Strine, Jr. and Vice Chancellor J. Travis Laster to recommend an end to the ability to contractually eliminate the duty of loyalty in certain diversely held Delaware alternative business entities.[1] Chief Justice Leo E. Strine, Jr. and Vice Chancellor J. Travis Laster argue that expansive contractual freedom *has not* led to case law providing general principles that would serve as guidelines fostering predictable and reliable business practices.[2] They recommend a framework that would prohibit waivers of the duty of loyalty, permit waivers of the duty of care, and create a new presumption that in appropriate cases presumes the duty of care has been waived in diversely-held alternative entities.[3]

Is there indeed justification for treating violations of the duty of care and the duty of loyalty quite differently in alternative entities? What are the expectations of the business and investor communities regarding duty of loyalty as compared to duty of care transgressions? To gain some insight into executives' perceptions of and comprehension of the duty of loyalty, the duty of care, and waivers of these duties, a short questionnaire was sent to 117 executives, to which 45 responded. The executives were presented with a duty of loyalty and a separate duty of care scenario. The findings showed that the respondents indeed held quite different expectations of how the law should work in the duty of loyalty scenario as compared to the duty of care scenario. Respondents' support for a built-in, default duty of loyalty was significantly greater than for a built-in, default duty of care. Moreover, respondents displayed greater support for enforcement of the waiver of the duty of care than for the waiver of the duty of loyalty. The lowest level of support for waivers overall was shown where the breach involved the duty of loyalty in a hypothetical public company.

1. *See generally* Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, RES. HANDBOOK ON P'SHIPS, LLCS AND ALTERNATIVE FORMS OF BUS. ORGS., (Robert W. Hillman & Mark J. Lowenstein eds., 2015) (recommending the prohibition of contractual waivers that eliminate the duty of loyalty in certain publicly-traded entities and other entities with many investors and suggesting possible ways to define "diversely-held" which would capture publicly traded entities and others with numerous investors); Sandra K. Miller & Karie Davis-Nozemack, *Toward Consistent Fiduciary Duties for Publicly Traded Entities*, 68 U. FLA. L. REV. 263 (2016) (exposing the problems with unlimited contractual freedom in the case of publicly-traded alternative entities).

2. Strine & Laster, *supra* note 1, at 13.

3. *Id.*

The findings of rather radical differences in expectations regarding the hypothetical duty of loyalty scenario and duty of care scenario are interesting and potentially relevant to the overall policy question of whether alternative business entity legislation should treat the duty of loyalty and the duty of care differently and whether different rules should apply to privately and publicly-owned enterprises. If business entity legislation is to be efficient, the default rules and constraints on fiduciary duty waivers should be consistent with the expectations and values of the stakeholders affected—i.e., the expectations of the business and investor communities as well as the community at large.[4] Until now, scholars have not empirically studied whether investors or business executives hold different views and expectations regarding the duty of loyalty as compared to the duty of care. Such data could help gauge the business and investor community's likely reactions to proposals to treat waivers of the duty of loyalty differently from waivers of the duty of care in public and private alternative entities.

Following this introduction, Part II provides background information regarding the rise of enabling contractual legislation in the corporate and non-corporate contexts. It focuses on the problems with unfettered contractual freedom and on alternative approaches to contractual freedom in current LLC legislation. Part III presents the results of a small empirical study of executive views regarding default duties and waivers in public and private hypothetical entities. Part IV discusses the implications of the research against the backdrop of literature on trust. Part V provides a critique of the survey, formulates suggestions for future research, recommends tempering the Nexus-of-Contracts paradigm with aspects of a Concession/Stakeholder vision of business entities, and suggests changes in ethics training in the law school curriculum.

II. Contractual Freedom: A Two-Edged Sword

The drive for increased contractual freedom in business entity regulation began in a time of escalating damage awards during the 1970s.[5] In the public company corporate arena, lawyers and others were concerned that directors would resign because of escalating legal exposure.[6] In the private company context, a quiet revolution unfolded that brought with it unprecedented contractual freedom. Nearly 40 years later, this trend has continued in alternative entities. However, there is a growing sense that contractual freedom should be curtailed, at least in diversely-held Delaware alternative entities, and that predictable constraints on contractual freedom are difficult to achieve under a purely contractual model.[7]

A. The Corporate Context: The Duty of Loyalty Encompassing Good Faith Preserved

4. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 Colum. L. Rev. 1416, 1444–45 (1989) (discussing the purpose of corporate law).

5. *See generally* Faiz Ahmed, *Insurance Claims Litigation: A Historical Perspective*, CLAIMS-PORTAL.COM, http://www.claims-portal.com/nlps/story.cfm?nlpage=278#.V9A7P5MrL-y (last visited Oct. 27, 2016) (indicating that most observers agree that litigation rates began rising in the 1970s and corporations and insurance companies began fearing that runaway litigation rates would ultimately threaten the financial health of business and drain resources).

6. *Id.*

7. *See* Strine & Laster, *supra* note 1, at 13 (discussing litigation experience with contractual waivers and developing a recommendation to make the duty of loyalty non-waivable in certain diversely-held enitities).

In the corporate arena, increased control over legal liability of directors was sought largely in response to *Smith v. Van Gorkom*,[8] the landmark 1985 Delaware Supreme Court decision that held outside directors liable for gross negligence for approving a merger without informing themselves of the value of the company.[9] Delaware's response, soon followed by legislatures across the country, was to enact so-called "enabling legislation."[10] This enabling legislation did not expressly modify the director's duty of loyalty to act in the best interests of the corporation and its shareholders or to exercise care in discharging his or her duties.[11] Instead, it permitted articles of incorporation to eliminate liability for monetary damages arising from breaches of fiduciary duties except for any breach of the duty of loyalty to the corporation or its stockholders, for acts or omissions not in good faith, intentional misconduct, knowing violations of the law, and for several other designated types of serious wrongdoing delineated in the statute.[12] This duty of loyalty encompasses not only the duty to further the best interests of the corporation and to avoid self-interested conduct, but also encompasses a subsidiary element of good faith.[13] One way or another, non-exculpable conduct in the Delaware corporate arena is tied to some level of subjective wrong-doing either through deliberate, conflicted self-interested conduct or through a conscious disregard of one's duties.[14]

The pre-*Disney* decision in *In re Caremark International Derivative Litigation*, involving a failure to pick up officers' receipts of kickbacks, established that there could be liability for a sustained or systematic failure to exercise oversight over a company's information and reporting system.[15] Thereafter, in *In re Walt Disney Co. Derivative Litigation*, shareholders challenged a $130,000,000 termination payment made to a director who had served only fourteen months.[16] The Delaware Chancery Court established that a

8. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

9. *Id.* at 893.

10. *See* Douglas M. Branson, *Assault on Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 57 FORDHAM L. REV. 375, 381–82 (1988) (indicating that Delaware passed the first authoritative provision that allowed the articles of incorporation to limit or exclude corporate directors' liability for any breach of duty of care provided that the provision did not eliminate or limit the liability for a breach of loyalty, for acts or omissions not in good faith or involving intentional misconduct, or for transactions from which the director derived improper personal benefits and indicating that other states followed Delaware's lead).

11. *Id.*

12. *See generally Van Gorkom*, 488 A.2d 858 (directing the Court of Chancery to award damages where the members of a Board of Directors were not entitled to the presumption that their business decision was an informed one); *see also* DEL. CODE ANN. tit. 8, § 102(b)(7) (2015) (permitting a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of a fiduciary duty as director, provided that the provision does not eliminate or limit liability for a breach of the duty of loyalty, acts or omissions not in good faith or involving intentional misconduct or a knowing violation of law, for violations under Section 174 or for any transaction from which the director received an improper personal benefit). KY. REV. STAT. ANN. § 271B.8-510 (2015) (permitting indemnification if the director acted in good faith and honestly believed his conduct was in the corporation's best interests, and in all other cases that conduct was at least not opposed to the best interests, and in the case of a criminal proceeding with no reasonable cause to believe his conduct was unlawful).

13. *See* Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006) (involving directors who failed to learn of the bank's failure to file Suspicious Activity Reports).

14. *Id.*

15. *In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996).

16. *See In re* Disney Co. Deriv. Litig., 731 A.2d 342 (Del. Ch. 1998) [hereinafter *Disney I*], *aff'd in part, rev'd in part, remanded*, Brehm v. Eisner, 746 A.2d 244 (Del. 2000) [hereinafter *Disney II*]; *In re* Walt Disney

conscious and intentional disregard for duties, evincing a "we don't care about the risks" attitude, breaches a director's duty to act honestly and in good faith—and this view was later endorsed by the Delaware Supreme Court.[17] The Delaware Supreme Court did not define good faith, but rather indicated that conduct motivated by bad faith and conduct that amounts to a conscious disregard for one's duties, cannot be exculpated.[18] Following *Disney*, *Stone v. Ritter* established that the duty of good faith is a subsidiary element of the duty of loyalty and its violation involves an utter failure to attend to oversight responsibilities.[19] Thus, in the corporate context, Delaware corporate contractual freedom, and that of most states stops short of providing indemnification for violations of the duty of loyalty or for acts or omissions not in good faith.[20]

B. The Non-Corporate Context: The Duty of Loyalty Eliminated or Curtailed

The need to contain litigation exposure and/or to control insurance costs was widely discussed and concerns were not confined to the public corporate firm.[21] In the partnerships context, business planners were concerned that the duty of loyalty, which included a duty not to compete, might embroil real estate developers in investor lawsuits because the developer had offered arguably competing investments to multiple groups of investors. Some feared that competitors would become ensnared in lawsuits due to the duty of loyalty's prohibition on competition.[22] The cry was for freedom from judicial infringement

Co. Deriv. Litig., 825 A.2d 275 (Del. Ch. 2003) [hereinafter *Disney III*]; *In re* Walt Disney Co. Deriv. Litig., 907 A.2d 693 (Del. Ch. 2005) [hereinafter *Disney IV*], *aff'd*, *In re* Disney Co. Deriv. Litig., 906 A.2d 27 (Del. 2006) [hereinafter *Disney V*].

17. *Disney III*, 825 A.2d at 289; *Disney V*, 906 A.2d at 63; *see also* Mark J. Lowenstein, *The Diverging Meaning of Good Faith*, 34 DEL. J. CORP. L. 433, 441 (2009) (comparing the duty of good faith in the corporate arena with good faith in alternative business entities and reviewing five Disney opinions).

18. *See Disney V*, 906 A.2d at 63–68 (holding that there was no breach of fiduciary duty in the $130,000,000 severance package).

19. *See* Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006) (holding that the standard for director oversight liability was not met); *see also* Daniel Kleinberger, *Delineating Delaware's Implied Covenant of Good Faith and Fair Dealing (Contract is King Micro-Symposium)*, BUS. L. PROF. BLOG (Nov. 23, 2015), http://lawprofessors.typepad.com/business_law/2015/11/delineating-delawares-implied-covenant-of-good-faith-and-fair-dealing-contract-is-king-micro-symposi.html (exploring the doctrine of good faith in Delaware business law).

20. *See generally* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (directing the Court of Chancery to award damages where the members of a Board of Directors were not entitled to the presumption that their business decision was an informed one); *see also* DEL. CODE ANN. tit. 8, § 102(b)(7) (2015) (permitting a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of a fiduciary duty as director, provided that the provision does not eliminate or limit liability of a director for a breach of the duty of loyalty, acts or omissions not in good faith or involving intentional misconduct or a knowing violation of law, violations under Section 174 or for any transaction from which the director received an improper personal benefit).

21. Robert Hunter, *Reform Insurance, Not Liability Law; Taming the Latest Insurance Crisis*, N. Y. TIMES (Apr. 13, 1986), http://www.nytimes.com/1986/04/13/business/reform-insurance-not-liability-law-taming-the-latest-insurance-crisis.html.

22. *See generally* Paul M. Altman et al., *Eliminating Fiduciary Duty Uncertainty: The Benefits of Effectively Modifying Fiduciary Duties in Delaware LLC Agreements*, A.B.A. BUS. L. TODAY (Feb. 2013), http://www.americanbar.org/publications/blt/2013/02/05_altman.html (discussing how "[m]embers of an LLC may . . . choose to govern their relationships exclusively by contract, without regard to corporate-style fiduciary duties of loyalty and care").

on business deals carefully negotiated and formalized in contracts.[23] Other partnership planners sought relief through the regime of double taxation, as evidenced by the oil industry which sought the twin benefits of limited liability and favorable flow-through taxation.[24] A 1977 Revenue Ruling, which blessed a Wyoming statute that artfully avoided classification as a corporation under the tax classification rules then in effect, launched the LLC revolution.[25]

Initially, Delaware alternative business entities could only expand or restrict fiduciary duties, but in 2004, following the decision in *Gotham Partners, L.P. v. Hallwood Realty Partners*,[26] Delaware's alternative business entity statutes were changed to permit the expansion, restriction, or *elimination* of fiduciary duties, except for the implied contractual covenant of good faith and fair dealing.[27] In addition, liberal indemnification provisions were adopted to cover breaches where the parties had not drafted an agreement at all and were thus subject to fiduciary duties by default,[28] or where a governing document had been drafted but had not eliminated fiduciary duties. Unlike Delaware's corporate indemnification provision discussed below, which prohibits indemnification for duty of loyalty violations and for conduct not in good faith, Delaware's LLC Statute continues to permit indemnification with respect to all claims and demands.[29]

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23. *See* Dale A. Oesterle, *Subcurrents in LLC Statutes: Limiting the Discretion of State Courts to Restructure the Internal Affairs of Small Business*, 66 U. COLO. L. REV. 881, 883 (1995) (discussing the role of state courts in small business structure reform); *see also* Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 BUS. LAW. 427, 428 (1991) (expressing practitioners' concerns with vague and open-ended judicial concepts of fiduciary duty).

24. Previously there had been an unsuccessful attempt by a Texas oil company to create a flexible business entity that offered limited liability. *See* Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of a Partnership,* 70 WASH. U. L.Q. 417, 425 (1992) (detailing the issues with limited liability and flow-through tax treatment); Susan Pace Hamill, *The Limited Liability Company: A Catalyst Exposing the Integration Question*, 95 MICH. L. REV. 393, 395–96 (1996) (discussing the tax benefits of the limited liability company and the challenge it poses to the corporate regime of double taxation which taxes both the corporate entity and the shareholder's dividend income).

25. *See* Ribstein, *supra* note 24, at 425 (detailing the development issues of limited liability companies); *see also* 26 C.F.R. § 301.7701-2 (1988) (granting partnership tax status to a Wyoming limited liability company).

26. *See* Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A.2d 160, 163–64 (Del. 2002) (observing that then DEL. REV'D UNIF. P'SHIP ACT § 17-1101(d)(2) provided only that duties could be expanded or modified but not eliminated); Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1625 (2004) (discussing how statutes vary in permitting modifications).

27. *See* Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295, 311–12 (2014) (discussing fiduciary duties in Delaware LPs and LLCs); DEL. CODE ANN. tit. 6, § 17-1101(d) (2010) (permitting duties including fiduciary duties to be expanded, restricted, or eliminated in the Delaware Revised Uniform Limited Partnership Act); DEL. CODE ANN. tit. 6, § 18-1101(c) (2013) (permitting duties including fiduciary duties to be expanded, restricted, or eliminated in the Delaware Limited Liability Company Act); *see also* Paul M. Altman & Srinivas M. Raju, *Delaware Alternative Entities and the Implied Contractual Covenant of Good Faith and Fair Dealing Under Delaware Law*, 60 BUS. LAW. 1469, 1473 (2005) (discussing the increased ability to waive fiduciary duties under Delaware law and analyzing the meaning of good faith as an implied contractual duty that cannot be waived).

28. *See* Miller, *supra* note 27, at 311–12 (discussing fiduciary duties in Delaware LPs and LLCs); *see also* DEL. CODE ANN. tit. 6, § 18-1101(b), (c) (2013) (delineating the construction and application of chapter and limited liability company agreements).

29. *Compare* DEL. CODE ANN. tit. 8, § 102(b)(7) (2015) (providing that a corporation may eliminate or limit the personal liability of a director to the corporation or its stockholders for monetary damages but shall not eliminate or limit liability for any breach of the duty of loyalty, acts or omissions not in good faith or which

C. Many States Permit the Elimination of Duties but Still Limit Indemnification

Many states have embraced a highly contractual approach to duties in the non-corporate arena, a trend which began in the early 1990s with the revision of the Uniform Partnership Act.[30] As shown in Appendix C, Delaware broadly permits the waiver of duties except for the implied covenant of good faith and fair dealing, and a few other states such as Alabama and Arkansas take a substantially similar approach. Kentucky omits a statutory reference to the implied contractual covenant of good faith and fair dealing.[31] However, the omission of such a statutory reference may not necessarily foreclose case law from addressing the implied covenant of good faith and fair dealing and/or its waiver.

A growing number of states that permit waivers are following the slightly more restrictive waiver rules contained in the Uniform Limited Liability Company Act.[32] Although the Uniform Act retains a non-waivable oppression remedy,[33] it permits, *if not manifestly unreasonable*, the restriction or the elimination of the duty of loyalty including the duty to account, the prohibition on dealing with parties having adverse interests, and the duty to refrain from competing with the LLC.[34] The agreement may alter or eliminate any other duty.[35] In addition, the Uniform Act permits the duty of care to be altered, but it cannot be altered to authorize bad faith, willful or intentional misconduct, or knowing violation of law.[36]

If an LLC operating agreement has not been executed, or if the operating agreement retains fiduciary duties and there is a breach, the LLC's statutory indemnification rules take center stage. Delaware takes the most Contractarian approach by statutorily permitting the indemnification of all claims, and only a handful of states follow suit.[37] The contours of possible public policy constraints on such provisions or limitations rooted in equity remain for courts to address.[38] The indemnification rules of the Uniform Limited Liability Company Act are significantly more restrictive than Delaware's approach. The Uniform Act prohibits indemnification for conduct involving bad faith, willful or intentional misconduct, or knowing violation of the law.[39] This qualified indemnification language is similar to a corporate approach that permits indemnification for gross negligence but not for duty of loyalty violations or for conscious and intentional disregard of these duties, evincing that a "we don't care about the risks" attitude amounts to a violation of the duty

involve intentional misconduct or a knowing violation of law, certain violations under Section 174 and for transactions from which the director derived an improper personal benefit), *with* DEL. CODE ANN. tit. 6, § 18-108 (2015) (limited partnerships may indemnify any member or manager or other person from and against any and all claims and demands whatsoever), *and* DEL. CODE ANN. tit. 6, § 17-108 (2015) (a limited liability company may indemnify any member or manager or other person from and against any and all claims and demands whatsoever).

30. *See* Weidner, *supra* note 23, at 462 (expressing practitioners' concerns with vague and open-ended judicial concepts of fiduciary duty).

31. KY. REV. STAT. ANN. § 275.180 (2015); *see also infra* App. C.

32. *See* UNIF. LTD. LIAB. CO. ACT. § 105(d)(3) (UNIF. LAW COMM'N amended 2013) (describing how the duty of loyalty and duty of care can be altered).

33. *Id.* at § 105(c)(9).

34. *Id.* at § 105(d)(3)(A)–(D).

35. *Id.* at § 105(d)(3)(D).

36. *Id.* at § 105(d)(3)(C).

37. DEL. CODE ANN. tit. § 6, 18-108 (2015) (permitting indemnification of all claims).

38. *See infra* App. F.

39. UNIF. LTD. LIAB. CO. ACT § 105(c)(7) (amended 2013) (permitting indemnification in some instances).

of loyalty.[40] The vast majority of state LLC statutes provide restricted indemnification rules. For example, Georgia prohibits indemnification for intentional misconduct, knowing violation of the law, or receipt of certain personal benefits in violation of an agreement; New York prohibits indemnification for bad faith; and New Jersey bars indemnification for intentional misconduct or knowing violation of the law.[41]

As more fully discussed below, challenging problems have surfaced involving waivers of the duty of loyalty, particularly involving publicly-traded LLCs in Delaware.[42] The policy questions at stake are of nationwide significance now that many states are permitting waivers of fiduciary duties. These policy questions include but are not limited to: 1) whether different fiduciary duty waiver rules should apply to the duty of loyalty, as distinguished from the duty of care; 2) whether different waiver rules should apply to public as compared to private alternative entities; and 3) whether the investor and business communities comprehend and view waivers of the duty of loyalty differently from waivers of the duty of care in public as compared to private alternative entities.

D. Problems with the Contractual Model: Contextualizing this Empirical Study

Although the need for contractual variation of traditional fiduciary duties in some business relationships has been well-documented,[43] scholars and justices alike have begun to question the wisdom of a legislative scheme that permits the contractual waiver of the duty of loyalty.[44] As more fully discussed below, the expansive contractual model embraced by Delaware alternative entity law raises efficiency and fairness concerns, particularly in the case of publicly-traded alternative entities.[45]

1. Unlevel Playing Field, Inefficiencies, Complexity, Human Error, and Unfairness

Evidence of an unequal contractual playing field, inefficiency, excessive complexity, human error, difficulty regarding the direct versus derivative distinction, and unfairness has surfaced in connection with a number of Delaware alternative business entities.[46] Although many of the problems have been observed in connection with publicly-traded alternative business entities,[47] the issues are arguably not confined to the publicly-traded domain.

Chief Justice Strine and Vice Chancellor Laster question the premise that alternative

40. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2015) (providing that a corporation may eliminate or limit the personal liability of a director to the corporation or its stockholders for monetary damages but shall not eliminate or limit liability for any breach of the duty of loyalty, acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, certain violations under Section 174, and for transactions from which the director derived an improper personal benefit).

41. *See infra* App. E.

42. Miller & Davis-Nozemack, *supra* note 1, at 284.

43. *See* Altman, et al., *supra* note 22 (discussing the increased ability to want fiduciary duties under Delaware law).

44. Anne Tucker, *Micro-Symposium: Contract is King but Can It Govern Its Realm?*, BUS. L. PROF BLOG (Nov. 12, 2015), http://lawprofessors.typepad.com/business_law/2015/11/micro-symposium-contract-is-king-but-can-it-govern-its-realm.html.

45. *See* Strine & Laster, *supra* note 1. (discussing litigation experience with contractual waivers); Miller & Davis-Nozemack, *supra* note 1, at 320.

46. *See generally* Strine & Laster, *supra* note 1 (discussing all these issues).

47. Miller & Davis-Nozemack, *supra* note 1, at 266.

business entities are used by sophisticated parties who have bargained to structure the unique features of their relationship—the very premise on which the Contractarian Model is based.[48] A key Contractarian argument in support of the elimination of common law fiduciary duties is that it is difficult and inefficient to contract around the traditional duty of loyalty and duty of care.[49] Yet Chief Justice Strine and Vice Chancellor Laster indicate that they have seen little evidence of bargaining in alternative entity agreements, particularly when used to raise capital from ordinary investors or accredited investors such as pension funds, universities, or foundations.[50]

Empirical research provides some evidence showing a possibly unequal contractual playing field. A review of 150 publicly-available operating agreements revealed that some of the agreements bore signs of bargaining as evidenced by clauses incorporating some degree of voting control or economic protection.[51] Yet the analysis of the data also showed a relationship between modifications to the managers' duty of loyalty and very broad indemnification provisions, suggesting that managers may have substantial leverage in many of these business relationships.[52] Professors Harner and Marincic have revealed an association between modifications of the duty of loyalty and manager protections, such as indemnification and veto rights over amendments, and required consent for amendments to the Operating Agreements. Harner and Marincic found a significant association between the elimination of the managers' personal liability and the absence of buy-out rights. According to these authors, these associations suggested that many of the agreements gave managers broad discretion coupled with limited accountability.[53]

The one-sided nature of many alternative business entity agreements has been documented in other studies as well. For example, Professor Manesh examined 85 publicly-traded Delaware LPs and LLCs and concluded that these entities had either not adopted un-corporate substitutes or had adopted substitutes that only trivially constrained management.[54] The possible lack of a level contractual playing field was observed in a 2001 study of practitioners' experience with LLCs.[55] The study found that 56% of the 770 attorneys surveyed in California, Delaware, New York, and Pennsylvania reported that they had frequently represented clients owning a majority interest in an LLC, whereas only 20% reported frequently representing those with a minority interest.[56]

In addition to inequalities in the contractual playing field, inefficiency and complexity

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48. *See generally* Strine & Laster, *supra* note 1.

49. *See* Altman et al., *supra* note 22 (looking at how an LLC may structure its fiduciary duties).

50. Strine & Laster, *supra* note 1, at 1.

51. Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879, 923–24 (2012) (discussing LLCs and fiduciary duties in the contractual context).

52. *Id.* at 924.

53. *Id.* at 925.

54. *See* Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J. CORP. L. 555, 589 (2012) ("A second conclusion to draw from this study is that despite the widespread use of operating agreement provisions eliminating or exculpating for the breach of fiduciary duties, publicly-traded alternative entities have either not adopted uncorporate substitutes or, more commonly, adopted uncorporate substitutes that only trivially constrain managerial discretion."); Mohsen Manesh, *Legal Asymmetry and the End of Corporate Law*, 34 DEL. J. CORP. L. 465, 494–501 (2009).

55. *See* Sandra K. Miller, *A New Direction for LLC Research in a Contractarian Legal Environment*, 76 S. CAL. L. REV. 351, 375–76 (2003) (showing the results of a study of practitioners' experience).

56. *Id.*

have been cited as being problematic, particularly in publicly-traded entities.[57] Publicly-traded alternative entities with organizing documents containing broad fiduciary duty waivers can be readily found on the NYSE and on NASDAQ.[58] Empirical research has shown that many of these alternative entity governing documents contain contractual waivers that eliminate the duty of loyalty.[59] The contractual provisions have spawned a great deal of litigation, particularly where fiduciary duties have been waived and special committees have vetted conflicted board decisions under contractual standards.[60] Many of the cases involve special committees that have engaged advisors to render opinions on the value or fairness of the questionable transactions.[61] Limited partners have had an uphill battle in successfully challenging conflicted decisions ostensibly approved by special committees.[62]

Chief Justice Strine and Vice Chancellor Laster have observed that the governing instruments of these publicly-traded entities are extraordinarily complex, vary

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57. *See* Strine & Laster, *supra* note 1 (discussing the connection between experience and waivers).

58. *See* N.Y. STOCK EXCH., https://www.nyse.com/index (last visited Oct. 27, 2016); NASDAQ, http://www.nasdaq.com (last visited Oct. 27, 2016); PAUL COMSTOCK PARTNERS, *Master Limited Partnership Primer: "MLP 101"*, at 2 (Jan. 21, 2014), http://paulcomstockpartners.com/quarterly-webinars/master-limited-partnership-primer-mlp-101/ ("The majority of MLPs are engaged in energy businesses because the qualifying income provisions for publicly traded partnerships favor entities involved in mineral or natural resources activities as a way to encourage investment in exploration and production, and infrastructure development."); *Energy MLPs: A Suitable and Sustainable Asset Class*, Advisor Perspectives, CLEARBRIDGE INVS. (July 9, 2013), http://www.advisorperspectives.com/articles/2013/07/09/energy-mlps-a-suitable-and-sustainable-asset-class ("In aggregate, U.S. energy production is growing at 10–12% annually, and the runway for that growth is not one or two years, but a multi-decade expansion of production growth. Even if the energy companies that are involved in shale production merely maintain their current levels of drilling activity, we believe energy production will continue to grow for 20 years. All this energy production requires infrastructure to facilitate moving those increasing volumes from the wellhead to end-user.").

59. Manesh, *supra* note 54.

60. *See In re* Kinder Morgan Inc. Corp. Reorganization Litig., C.A. No. 100-VCL93, 2015 WL 4975270, at *8–9 (Del. Ch. Aug. 20, 2015) (involving a suit by limited partners in a publicly traded limited partnership challenging a reorganization that had been approved by a special committee which had made concessions, turned a blind eye to contradictory market evidence, and which had allowed the transfer of valuable tax benefits from the limited partners to the controller, but which the Chancery Court dismissed because the agreement only required that the special committee believe the reorganization was in the best interests of the partnership, not the best interests of the partners); *In re* El Paso Pipeline Partners, L.P. Derivative Litig., C.A. No. 7141-VCL, 2014 WL 2768782, at *19 (Del. Ch. June 12, 2014).

61. *See generally* Brinckerhoff v. Enbridge Energy Co., Inc., 67 A.3d 369 (Del. 2013); Norton v. K-Sea Transp. Partners L.P., 67 A.3d 354 (Del. 2013); Gerber v. Enter. Prod. Holdings, LLC, 67 A.3d 400 (Del. 2013); Allen v. Encore Energy Partners, L.P., 72 A.3d 93 (Del. 2013).

62. *See* Dieckman v. Regency GP LP, C.A. No. 11130-CB, 2016 WL 1223348, at *1 (Del. Ch. March 29, 2016) (dismissing a complaint where a conflicts committee had approved a merger, and the agreement eliminated all fiduciary duties, thus extinguishing the common law duty of disclosure), *appeal docketed*, No. 208, (Del. Nov. 16, 2016); *see generally Brinckerhoff*, 67 A.3d 369; *Norton*, 67 A.3d 354; *Gerber*, 67 A.3d 400; *Allen*, 72 A.3d 93. *But see* El Paso Pipeline Partners, C.A. No. 7141-VCL, 2015 WL 1815846, at *14 (Del. Ch. Apr. 20, 2015) (indicating that Committee members had failed to provide a credible account of their evaluation of a drop-down resulting in damages of $171 million). *See also* In re El Paso Pipeline Partners, L.P. Derivative Litigation, 132 A.2d 67, 81 (2015) (denying the General Partner's motion to dismiss based upon its argument that the Limited Partners lost standing when Kinder Morgan, Inc., El Paso Parent, El Paso MLP, and the El Paso General Partner consummated a related party merger that terminated the separate legal existence of El Paso MLP as a publicly-traded entity because the ownership of the claim and the responsibility for paying it became united in a single entity - KM Partners due to transactions subsequent to the related party merger), *appeal awaiting decision*, as of Nov. 1, 2016.

considerably, and fail to give rise to a predictable body of case law.[63] Contractual errors, conflicting provisions, and ambiguous terms have led these esteemed justices to recommend the re-instatement of mandatory fiduciary duties for certain publicly-traded entities. They observe:

> Interestingly, because contractual drafting is a difficult task, it is also not clear that even alternative entity managers are always well served by situational deviations from predictable defaults. Different language sets up the possibility of a different result, creating opportunities for litigation that otherwise might not exist . . . The difficulties drafters have in substituting their own bespoke provisions for the equitable principles that have been forged by cases over centuries should not be surprising. After all these equitable principles emerged in large measure to address the situations involving the exercise of authority by one person over another's property that could not be effectively addressed by contracting . . . the overarching dream of a complete contract cannot be realized in a world of human frailty. . . .[64]

Chief Justice Strine and Vice Chancellor Laster suggest that a mandatory duty of loyalty be re-instated in certain diversely-held alternative business entities.[65] They would prohibit diversely-held entities from waiving the duty of loyalty.[66] Interestingly, they would permit waivers of the duty of care and suggest developing a presumption that investors have waived liability for breach of the duty of care unless there is a contractual provision imposing such liability.[67] Again, no such presumption would exist for the duty of loyalty which, in effect, would be mandatory, at least for diversely-held alternative entities. This approach is more consistent with the corporate paradigm, insofar as the corporate statute contains a mandatory duty of loyalty, as discussed above in Part II.A.

2. The Value of Empirical Research on Business Community Expectations

Under the proposal put forth by Chief Justice Strine and Vice Chancellor Laster, different rules would apply to diversely-held and closely-held alternative entities. Also, different rules would operate with regard to the duty of loyalty and the duty of care. Unlike the duty of care, the duty of loyalty would become non-waivable for certain diversely-owned alternative entities. Is this scheme consistent with the expectations of the business community and with the stakeholders involved—the entity's investors and members of the business community at large? What are the expectations regarding the duty of loyalty versus duty of care? Do stakeholders regard loyalty violations involving dishonesty or deliberate misconduct differently from care violations involving unintentional but careless conduct that breaches the duty of care? Are expectations different with regard to the management of public corporations as compared with private managers? Is a higher level of responsibility expected where the entity is public as opposed to private?

Insight into stakeholder expectations is highly important if we are to craft efficient

63. Strine & Laster, *supra* note 1, at 11, 13.
64. *Id.* at 4-5, 13.
65. *See id.* at 19 (discussing Delaware Court of Chancery's suggestion about duty reinstatement).
66. *See id.* (explaining prohibitions diversely-held entities face and the reasons why).
67. *See id.* at 13 (discussing presumptions of liability waiver and factors that lead to those presumptions); Miller & Davis-Nozemack, *supra* note 1, at 305.

alternative entity legislation. As the legal community struggled to develop corporate legislation that would permit indemnification for duty of care violations, Frank H. Easterbrook posited the question of why we have corporate law and answered it as follows:

> Why not just abolish corporate law and let people negotiate whatever contracts they please? The short but not entirely satisfactory answer is that corporate law is a set of terms available off-the-rack so that participants in corporate ventures can save the cost of contracting . . . . Corporate codes and existing judicial decisions supply these terms for free to every corporation, enabling the venturers to concentrate on matters that are specific to their undertaking. Even when they work through all of the issues they expect will arise, they are apt to miss something. All sorts of complexities will arise later. Corporate law—and in particular the fiduciary principle enforced by courts—fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance. On this view corporate law supplements but never displaces actual bargains – save in situations of third-party effects or latecomer terms. [68]

In summary, the debate regarding fiduciary duties, default rules, and contractual waivers has yet to be informed by empirical data regarding stakeholder views. In order to make a start in the study of stakeholder expectations, Part III presents the results of a small empirical survey to examine executives' expectations surrounding fiduciary duty breaches and waivers in hypothetical private and public companies.

III. A Study of Executives' Views on Duties and Waivers

A small study was designed to gain insight into executives' views regarding both default fiduciary duties and express waivers of the duty of loyalty and the duty of care in private and public LLCs. The study targeted a group of highly sophisticated executives who were members of the Young Presidents Organization (YPO), an organization comprised of highly-successful corporate executives.[69] The project focused upon the executives' perceptions regarding the default duty of loyalty and the default duty of care when presented with a hypothetical duty of loyalty breach and a hypothetical duty of care breach. Two scenarios were presented. Scenario I involved a duty of loyalty breach in a retail carpet business and Scenario II presented a duty of care breach by an LLC manager who managed a nursing home. The companies in the Scenarios were first presented as private LLCs that had not entered into an LLC agreement. Then, the facts were changed to posit agreements that had either waived the duty of loyalty in Scenario I, or waived the duty of care in Scenario II, first assuming that the LLC had been private, and next assuming that the LLC had been public. More specifically, the study ascertained whether the executives would:

a) Agree or strongly agree that the law should provide a default duty of loyalty (Scenario I) and/or a default duty of care (Scenario II);

b) Agree or strongly agree that if an agreement had been entered into and contained a waiver, the waiver should be a complete defense in the case of a duty of loyalty (Scenario

68. *See* Easterbrook & Fischel, *supra* note 4, at 1444–45 (discussing the significance of terms in corporate law and the impact timing has on their inclusion).

69. *See infra* notes 72–76 and accompanying text (detailing the membership requirements of YPO).

I) or a complete defense in the case of a breach or a duty of care (Scenario II);

c) Support the waiver of the duty of loyalty (Scenario I) and to the same extent as the waiver of the duty of care (Scenario II);

d) Support the waivers to the same extent in private or public company settings; and

e) Report a willingness to invest in a public LLC in which the duty of loyalty or the duty of care had been waived.

A. The Sample

Participants were Philadelphia Chapter members of the YPO, an organization of business executives who are under 45 years of age. The sampling approach taken can be best described as Purposive Sampling.[70] That is, we selected YPO members with a purpose in mind—to study what relatively young, well-educated, and successful members of the business community believe should be the legal result when presented with Scenarios involving a manager's violation of the legal duty of loyalty or of the legal duty of care. Researchers sometimes use professional societies to obtain respondents, especially when a topic under study is relatively new.[71]

YPO presented itself as a viable predefined group since it has rigorous membership requirements. In order to become a member of YPO one must be under the age of 45 and must be the chief operator (CEO, managing director, president, chairman, or equivalent) of a company that fulfills certain minimum size and revenue requirements.[72] The membership candidate must satisfy at least one "A" requirement *and* one "B" requirement.[73] To satisfy the "A" requirement, the candidate must have either at least 50 regular, full-time employees under his control, or must pay a total compensation exceeding $2,000,000 (excluding the candidate's compensation). To satisfy the "B" requirement, the corporation must either have at least $12,000,000 in gross annual sales,[74] or an enterprise value of $15,000,000.[75] There are approximately 24,000 YPO members from 130 countries.[76]

The respondents were obtained with the help of YPO Philadelphia Chapter Chair who directed 117 members to the online survey, via an e-mail link. As an incentive for participating, gift certificates were awarded to randomly selected respondents who completed the entire survey. From a total of 52 survey responses, 45 surveys were completed for the purposes of this study. No differences were found between respondents in terms of their type of business ($X^2(3)=2.571$, p=0.463),[77] however it is important to note

70. *See* WILLIAM M. TROCHIM ET AL., RESEARCH METHODS: THE ESSENTIAL KNOWLEDGE BASE 86 (Cengage Learning ed., 2006) (indicating that purposive sampling is appropriate when studying pre-defined groups).

71. *See generally* Hugh J. Watson et al., *Current Practices in Data Warehousing,* 18 INFO. SYS. MGMT. 47 (2001); Barbara H. Wixom & Hugh J. Watson*, An Empirical Investigation of the Factors Affecting Data Warehousing Success*, 25 MIS Q. 17 (2001).

72. *Membership Criteria*, YOUNG PRESIDENTS ORG., http://www.ypo.org/join-ypo (last visited Oct. 27, 2016).

73. *Id.*

74. Financial institutions must have annual assets of at least $260,000,000 and agency-type businesses must have annual fees or commissions of at least $10,000,000. *Id.*

75. *Id.*

76. *About YPO*, YOUNG PRESIDENTS ORG., https://www.ypo.org/about-ypo/ (last visited Oct. 27, 2016).

77. ***See*** DAVID NACHMIAS & CHAVA FRANKFORT-NACHMIAS, RESEARCH METHODS IN THE SOCIAL SCIENCES 507-508 (St. Martin's Press, 4th ed. 1992) (discussing the Chi-Square calculation providing that $X^2(3)$ is a statistical test that shows df (degrees of freedom) equaling 3. The Chi-Square test indicates whether a

that of the 45 surveys completed, only two respondents were female (4.4%). The comparatively low female participation, however, is similar to that observed in the Philadelphia YPO female membership generally where only four of the 117 YPO members were female (3.4%) and the national YPO average of females is only 8%. While the survey response rate of 39% is very good, surveys have the potential of skewed results when those that respond to the survey differ in one or more ways from those who do not respond. This concern of "nonresponse" bias can be minimized by comparing results of early and late responders. For this study, there was no significant difference between the results of early and late responders. Therefore, the study results accurately represent the entire sample of 117.

B. The Survey and the Scenarios

The research instrument was an online questionnaire using SurveyMonkey. At the onset, the Chair of the YPO Philadelphia Chapter selected between one to eight members to get feedback on the questionnaire. After obtaining this initial input, the questionnaire was finalized. The data was analyzed to determine what percentage of respondents replied and how they replied. As discussed below, chi square analyses[78] were done to discover associations of LLC manager views regarding how the LLC law should work where the manager has breached the duty of loyalty or the duty of care. However, because data was not normally distributed, non-parametric tests,[79] including the Wilcoxon Signed-Rank

statistically significant relationship exists. Degrees of freedom (df) = n-1 where n is the number of business categories of types of businesses). Our survey contained the following four types of business categories: primarily family, professional manager, non-family, and other. By statistical convention we used 0.05 probability level as our critical value. If the calculated chi-square value is less than the 0.05 value, we reject the hypothesis. If the value is greater than that value, we accept the hypothesis. Therefore, because the calculated chi-square value was greater than 0.05 value (2.571) we accept the hypothesis that there are no differences in types of businesses among the respondents.

78. DAVID NACHMIAS & CHAVA FRANKFORT-NACHMIAS, RESEARCH METHODS IN THE SOCIAL SCIENCES 464–67 (St. Martin's Press, 4th ed. 1992); *see generally* EARL BABBIE, THE PRACTICE OF SOCIAL RESEARCH (4th ed. 1986); *see also* David Eck & Jim Ryan, *The Chi Square Statistic*, MATHBEANS PROJECT, http://math.hws.edu/javamath/ryan/ChiSquare.html (last visited Oct. 27, 2016) (indicating that a chi square (X^2) statistic is used to investigate whether distributions of categorical variables differ from one another. Categorical variables are exemplified by responses to such questions as "What is your major?" or "Do you own a car?" as compared to numerical variables illustrated by such questions as "How tall are you?"). In the present survey, several categorical variables were developed through questions that asked for respondents' views regarding whether a lawsuit should be allowed and whether a waiver provision should be permitted given hypothetical breaches of the duty of loyalty or the duty of care. *See infra* App. A (describing the scenarios).

79. Tanya Hoskin, *Parametric and Nonparametric: Demystifying the Terms*, MAYO CLINIC 1, 2, http://www.mayo.edu/mayo-edu-docs/center-for-translational-science-activities-documents/berd-5-6.pdf (last visited Oct. 27, 2016) ("Parametric statistical procedures rely on assumptions about the shape of the distribution in the underlying population (i.e. assume a normal distribution exists) [and] assumptions about the form or parameters (i.e. the means and standard deviations) of the assumed distribution. Nonparametric statistical procedures rely on no or few assumptions about the shape or parameters of the underlying population."); *see also* NACHMIAS & FRANKFORT-NACHMIAS, *supra* note 78, at 464–67 (discussing social testing); *see generally* EARL BABBIE, THE PRACTICE OF SOCIAL RESEARCH (4th ed. 1986); *see also* Eck & Ryan, *supra* note 78.

test[80] and the Sign Test,[81] were used for data comparison.[82]

Scenario I: Duty of Loyalty Breach

For the past twelve years Sam has owned 25% of an LLC that operates a retail carpet business and Fred owns 75%. Sam works in the business and Fred does not. Sam gets an offer to sell the business for $10 million but doesn't tell Fred. Instead, Sam offers to buy out Fred for $1 million. Fred accepts, then three months later Sam sells and makes a big profit.

Scenario II: Duty of Care Breach

For the past 12 years, Jason has been a 15% owner and the full-time manager of Orange Rehabilitation Center, LLC, a nursing home located in New Britain, Connecticut. The remaining 85% is owned by four private individuals who do not participate in the business. Over the last few years, Jason has been careless in managing the LLC. Although he works 35 hours per week, he has failed to properly supervise and manage employees. Medicare nursing home ratings have declined. The number of patient falls and patient lawsuits has risen as have instances of employee failure to follow rules and regulations. A major patient lawsuit threatens to bring the nursing home dangerously close to bankruptcy. Although Jason's conduct is hardly commendable, he has not violated any specific criminal laws and has not intentionally acted to harm the nursing home or its patients.

C. Major Findings

1. Default Built-in Duties: A Majority Agreed the Law Should Provide a Default Duty of Loyalty but not a Default Duty of Care in the Absence of an Operating Agreement.

A majority (91%) agreed or strongly agreed that the law should provide a default duty of loyalty when presented with a loyalty breach in a private LLC. In contrast, only 15%

80. *See generally* JEAN DICKINSON GIBBONS & SUBHABRATA CHAKRABORTI, NONPARAMETRIC STATISTICAL INFERENCE (5th ed. 2011). The Wilcoxon Signed-Rank Test and the Sign Test are nonparametric tests equivalent to the dependent t-test and are appropriate tests to compare two sets of data that come from the same participants when data is not normally distributed. One assumption of the Wilcoxon Signed-Rank Test requires the data sets to be symmetrical in shape and therefore when this assumption fails a Sign Test is appropriate. *Wilcoxon Signed-Rank Test Using SPSS Statistics*, LAERD STATISTICS, https://statistics.laerd.com/spss-tutorials/wilcoxon-signed-rank-test-using-spss-statistics.php (last visited Oct. 27, 2016).

81. The Sign Test is used when there is matched or paired data and determines whether the difference observed is positive or negative. One then assumes the null hypothesis that the median difference is zero and that consequently, about half of the differences would be positive and half would be negative. *See* Wayne W. LaMorte, *Tests with Matched Samples, Continious Outcomes*, B.U. SCH. PUB. HEALTH, http://sphweb.bumc.bu.edu/otlt/MPH-Modules/BS/BS704_HypothesisTest-Means-Proportions/BS704_HypothesisTest-Means-Proportions7.html (last modified June 13, 2016); *see generally* HUBERT M. BLALOCK, SOC. STATISTICS, (McGraw-Hill, 2d ed. 1979) (describing social statistics).

82. Data that has a normal distribution typically presents itself in the form of a bell curve, whereas data that is not normally distributed presents itself as skewed to the right or the left. *See* Hoskin, *supra* note 79 (observing that parametric statistical tests can be worrisome for small sample sizes, particularly where the sample is below 30). Although the present sample was not below 30, only 45 surveys were completed and the data did not have a normal distribution. Under these circumstances it was concluded that nonparametric analyses would be advisable.

agreed or strongly agreed that the law should provide a default duty of care in a hypothetical breach of the duty of care involving a private LLC.[83]

2. Waivers: Where an Agreement Was Posited, Most did not Agree that the Law Should Enforce a Waiver of the Duty of Loyalty.

When the hypothetical scenarios were varied to involve an express contractual waiver of the duty of loyalty in a private company, only 38% agreed or strongly agreed that the waiver should be enforced and 62% disagreed or strongly disagreed. When a public company was posited, only 23% agreed or strongly agreed that the law should allow the waiver of the duty of loyalty, and 77% disagreed or strongly disagreed.[84] Regardless of whether the company posited was private or public, a large majority did not think the law should use the waiver as a complete defense in Scenario I involving a breach of the duty of loyalty. As discussed below, these results were different from respondents' views regarding duty of care waivers in both the private and public company settings.

3. Waivers: Where an Agreement Was Posited, Most Agreed that the Law Should Enforce the Waiver of the Duty of Care.

Approximately 74% agreed or strongly agreed that the waiver should be a complete defense in the duty of care scenario involving a private company and 67% did so when the facts were altered to posit a public company.[85] Interestingly, one-third of respondents disagreed or strongly disagreed that the duty of care waiver should be a complete defense in a public company—a result that is surprising given that all but one Fortune 100 company has been found to contain charter modifications with regard to the exculpation of duty of care and, as noted below, approximately 92% of the respondents indicated that they had invested in a Fortune 100 company.[86] One would expect that those objecting to waivers might also have reservations about indemnification provisions. One wonders whether the respondents were aware that their investments in Fortune 100 companies contain exculpation provisions.

4. Greater Support for Waiver of the Duty of Care than for Waiver of the Duty of Loyalty in Both Private and Public Hypothetical Companies.

Approximately 74% agreed or strongly agreed that the law should allow the duty of care waiver as a complete defense in Scenario II when a private company was posited, whereas only 38% agreed or strongly agreed that the law should allow the duty of loyalty waiver as a complete defense in Scenario I when a private company was posited. A statistical analysis of this difference revealed that we are 95% confident that respondents viewed the loyalty scenario differently from the duty of care scenario.[87] The trend was the same when the facts were varied to involve a public company. Approximately 67% agreed or strongly agreed that the law should allow the waiver of the duty of care as a complete

83. *See infra* Fig. I.

84. *See infra* Fig. II and III.

85. *See infra* Fig. IV.

86. J. Robert Brown, Jr. & Sandeep Gopalan, *Opting Only In: Contractarians, Waiver of Liability Provisions, and the Race to the Bottom*, 42 IND. L. REV. 285, 309–10 (2009).

87. *See infra* Fig. II.

defense in Scenario II in the case of a public-company, however only 23% agreed or strongly agreed that the law should allow the waiver of the duty of loyalty as a complete defense in Scenario I in the case of a public company. A statistical test of this difference revealed that we are 99% confident that the difference observed between the loyalty and the care scenarios is statistically significant.[88]

5. Higher Support for Waivers in Private than in Public Company Hypothetical Scenarios

Approximately 38% of respondents agreed or strongly agreed that the waiver of the duty of loyalty should be a complete defense in the hypothetical private company, as compared to only 23% in the hypothetical public company. This difference was found to be statistically significant.[89] A similar trend could be seen for the duty of care. Approximately 74% agreed or strongly agreed that the waiver of the duty of care should be allowed as a complete defense in the private company scenario, as compared to 67% in the hypothetical public company.[90] This difference was also found to be statistically significant, although at a lower level of confidence.[91] Thus, the respondents reacted differently, depending upon whether they were told that the company was private or public.

6. Reported Willingness to Invest in Company with Waiver and Overall Astuteness with Regard to Waivers

Only 2% said they would be willing to invest in a public company that contained a duty of loyalty waiver. Approximately 31% replied "Yes" when asked whether they would have been willing to invest in a public company like the one in the duty of care hypothetical if it contained a waiver of the duty of care. As noted above, approximately 92% reported that they had acquired stock in a Fortune 100 company, most of which contain exculpatory clauses for duty of care violations. Given the widespread adoption of exculpation provisions in corporate laws, one might have expected almost all of respondents to report "Yes" regarding the willingness to invest in a public company with a duty of care waiver. However, it is difficult to draw definitive conclusions from these responses insofar as the question may have been confusing to the respondents.

7. Understanding of Director Liability

Over half of respondents indicated that board members of public companies are personally liable for gross negligence and as many as 18% indicated that they were not sure of how the law worked. As discussed above, approximately 92% of respondents

88. *See infra* Fig. III.

89. *See infra* Fig. IV. The Wilcoxon Signed Rank Test was used to analyze this difference, and we are 95% confident that the difference was statistically significant. The Wilcoxon Signed Rank Test was employed because the data presented in a manner that was not significantly shifted to the right or the left. The test revealed that, with $p<.05$, we are 95% confident that the differences observed were statistically significant. *See infra* App. G for more details on the statistical tests employed. *See* Laird Statistics, Wilcoxon Signed-Rank Test using SPSS Statistics, https://statistics.laird.com/spss-tutorials/wilcoxon-signed-rank-test-using-spss-statistics.php.

90. *See id. See also infra* Fig. IV. The Wilcoxon Signed Rank Test was used to analyze this difference, and the test revealed that, with $p<.10$, we are 90% confident that the difference was statistically significant. *See infra* App. G.

91. *See infra* App. G (finding a 90% confidence that difference was statistically significant).

reported having acquired stock in a Fortune 100 company. Again, it may be difficult to draw any conclusions from these findings. The question may have been confusing, misleading, or perhaps overly simplistic.

IV. IMPLICATIONS

As discussed in Part II, Chief Justice Strine and Vice Chancellor Laster advocate different rules for diversely-held as compared with closely-held alternative entities. Also, they recommend different default rules with regard to the duty of loyalty and the duty of care. As indicated above, they would prohibit the waiver of the duty of loyalty in diversely-held alternative entities (i.e., public alternative entities and, possibly private ones with a large number of investors or those meeting certain large asset thresholds). Waivers of the duty of care would continue to be permitted in alternative entities and, in the absence of an agreement, the alternative entity would be presumed to have waived the duty of care. Whether this proposal is consistent with the expectations of the business community and investors, with regard to fiduciary duties and waivers, is an important question if we are to develop an efficient scheme of business entity regulation.

Definitive conclusions should not be drawn based on the reactions of a small sample of respondents to just two different hypothetical situations. However, as noted in Part A below, the findings show that a small group of young executives displayed very different expectations regarding how the law should treat the duty of loyalty breach as compared to the duty of care transgression in the two scenarios presented. The respondents showed significantly less support for the waiver in the duty of loyalty scenario than in the duty of care scenario, and least support overall for the waiver of the duty of loyalty in the public company setting. While generalizations should not be made, differences were observed, and they were statistically significant. The results warrant further investigation into views toward duty of loyalty and duty of care breaches held by the business and investor communities, and by other stakeholders as well.

A. Do Values of Honesty, Candor, and Fairness Trump Contractual Freedom?

We had initially expected that a majority of respondents would have supported a default duty of loyalty, consistent with the current scheme in Delaware. Also, we expected to find support for waivers in all companies. These views would be consistent with the current Delaware scheme and the large number of LLC filings in Delaware.[92] Moreover, prior empirical research indicated that, at least among lawyers, contractual freedom was a benefit of Delaware law.[93] However, respondents were significantly more supportive of a default, built-in duty of loyalty rather than a default, built-in duty of care (91% versus 15%).[94] In addition, they were less supportive of the duty of loyalty waiver than the duty of care waiver when told that the hypothetical involved a private company scenario. Only 38% agreed or strongly agreed that the loyalty waiver should be a complete defense in Scenario I but a full 74% agreed or strongly agreed that the duty of care waiver should be

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92. CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW § 1.01[3][a] (2015).

93. *Id.*

94. *See infra* Fig. I.

a complete defense in Scenario II, again assuming the hypothetical company was private.[95] Similarly, when respondents were told that the hypothetical companies were public, only 23% agreed or strongly agreed that the loyalty waiver in Scenario I should be a complete defense, whereas 67% agreed or strongly agreed that the duty of care waiver should be a complete defense.[96]

A possible explanation is that respondents' concerns over the apparent underlying inequity of the conduct presented in Scenario I outweighed respondents' concerns regarding the importance of freedom of contract.[97] Prior research had indicated that, at least among lawyers, contractual freedom is a benefit of Delaware law.[98] However, it is open to question whether lawyers' preferences regarding the law will be consistent with the views of other stakeholder groups (i.e., executives, investors, consumers, etc.). Research findings regarding one stakeholder group may not be necessarily indicative of findings in another stakeholder group.

The greater support for the lawsuit absent an express agreement in duty of loyalty scenario than in the duty of care scenario would be consistent with the emphasis that the common law has long placed upon honesty and the duty of disclosure among owners of closely-held businesses. As stated by Justice Cardozo over 85 years ago:

> Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.[99]

The higher level of support for the duty of loyalty than for the duty of care, as reflected by respondents' views toward default duties and waivers, may be an expression of the values of honesty and candor, and may demonstrate a predilection for fairness. The findings are arguably consistent with an experimental study in which subjects displayed an aversion to inequity and a preference for fairness.[100] As noted by game theorist Mathew Rabin, who has studied fairness and altruism extensively:

> The ultimatum game consists of two people splitting some fixed amount of money *X* according to the following rules: a "proposer" offers some division of

95. *See infra* Fig. II.
96. *See infra* Fig. III.
97. Franklin A. Gevurtz, *Why Delaware LLCs?*, 91 OR. L. REV. 57, 105–17 (2013).
98. *See id.* (finding that results among lawyers differed more than results from general public).
99. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).
100. *See* Mark Fichman, *Straining Towards Trust: Some Constraints on Studying Trust in Organizations*, 24 ORG. BEHAV. 133, 137 (2003) (indicating that subjects reject self-interested choices in including the Ultimatum Game in which players A and B are given the opportunity to decide how to divide $10 between A and B and if B rejects the proposal A and B receive nothing, and noting that proposals of giving B 20% or less are rejected approximately 50% of the time).

> *X* to a "decider." If the decider says yes, they split the money according to the proposal. If the decider says no, they both get no money. The result of pure self-interest is clear: proposers will never offer more than a penny, and deciders should accept any offer of at least a penny. Yet experiments clearly reject such behavior. Data show that, even in one-shot settings, deciders are willing to punish unfair offers by rejecting them, and proposers tend to make fair offers.[101]

The lower support for a waiver of the duty of loyalty may have reflected a sense that an intentional transgression is more reprehensible than an unintentional transgression, a distinction that permeates many aspects of law including Delaware's corporate governance law.[102] In the Duty of Loyalty Scenario (Scenario I), Sam failed to disclose an offer, whereas in the Duty of Care Scenario, Jason's conduct was careless but unintentional misconduct.

Since the misconduct was not intentional in the Duty of Care Scenario, it is possible that the respondents interpreted the conduct as being insufficiently serious to amount to "gross negligence" that could provide the basis of a lawsuit for a violation of the duty of care. In fact, one might argue that the facts in the Duty of Care Scenario (Scenario II) bordered on ordinary rather than gross negligence and, as such, should not be actionable at all. Even scholars have difficulty in differentiating and agreeing with distinctions between gross negligence and ordinary negligence.[103] However, a counter argument could be that the Duty of Care Scenario should be perceived as *more*, rather than less, serious than the misconduct in the Duty of Loyalty Scenario since it implicated the personal care of a particularly vulnerable segment of the population. The Duty of Loyalty Scenario involved a retail carpet business. As noted in Part VI in the discussion of the limitations of the study, it is suggested that future studies should employ duty of loyalty and duty of care scenarios that involve businesses expressly stated to be engaged in the same type of business activity.

B. The Duty of Care Transgression: "Like Shaving Pigs—Much Squeal and Little Wool"?[104]

The relative lack of support for a lawsuit in the Duty of Care Scenario is somewhat consistent with observations made by commentators regarding directors' liability for

101. Mathew Rabin, *Incorporating Fairness into Game Theory and Economics*, 83 AM. ECON. REV. 1281, 1284 (1993); *see also* Christine Binzel & Dietmar Fehr, *Social Distance and Trust: Experimental Evidence from a Slum in Cairo*, 103 J. DEV. ECON. 99, 104–05 (2013) (finding trust higher among friends than strangers).

102. There are many examples of instances where the severity of legal consequences increases where the misconduct is intentional. *See* HENRY CHEESEMAN, THE LEGAL ENVIRONMENT OF BUSINESS AND ONLINE COMMERCE 129, 134, 208 (7th ed. 2012) (discussing intentional torts, intentional crimes, intentional or fraudulent misrepresentation); *see also* DEL. CODE ANN. tit. 8, §102 (b)(7) (2015) (providing that a corporation may eliminate or limit the personal liability of a director to the corporation or its stockholders for monetary damages but shall not eliminate or limit liability for any breach of the duty of loyalty, acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, for certain violations under Section 174, or for transactions from which the director derived an improper personal benefit).

103. *See* J. William Callison, "*The Law Does Not Perfectly Comprehend . . . .": The Inadequacy of the Gross Negligence Duty of Care Standard in Unincorporated Business Organizations*, 94 KY. L.J. 451, 460 (2006) ("It has been said that gross negligence is the same as ordinary negligence 'with the addition of a vituperative epithet,' 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.").

104. Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers,* 77 YALE L.J. 1078, 1095 (1968).

negligence, as opposed to intentional corporate director misconduct. As one commentator noted:

> The hard fact is that cases in which directors of business corporations are held liable, at the suit of stockholders, for mere negligence are few and far between. As an uncommonly frank judge put it, "it is only in a most unusual and extraordinary case that directors are held liable for negligence in the absence of fraud, or improper motive, or personal interest." . . . [T]he liability of directors for mere negligence is like the proverbial shaving of pigs—much squeal and little wool, at least for the stockholders.[105]

Although the transgression in Scenario II was meant to present a fact pattern involving gross negligence, it is possible that respondents interpreted the transgression as a less serious violation. They may have been less concerned with the duty of care transgression in Scenario II as compared with the intentional misconduct presented in Scenario I. The lower support for a default duty of care and the higher support for the duty of care waiver in Scenario II could also be an expression of a concern over our health care system including health care costs, insurance premiums, and litigation rates more generally.[106]

The lower support for a default duty of care and higher support for the enforcement of the duty of care waiver is somewhat consistent with the way existing corporate governance law addresses duty of care liability. The duty of care has been a guidepost of agency, partnership, corporate, and LLC law;[107] and the Model Business Corporation Act sets forth a standard of conduct for directors based on good faith and reasonable belief that the conduct is in the best interest of the corporation.[108] However, under the business judgment rule, the standard of judicial review presumes that, absent self-dealing, if there

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105. *Id.*

106. *See generally* David Blumenthal et al., *The Affordable Care Act at 5 Years*, 372 NEW ENGLAND J. MED. 2451 (2015) (discussing the Affordable Care Act's effects on Americans); *see also* Gerald L. Maatman, Jr. et al., *EEOC-Initiated Litigation: Case Law Developments In 2015 And Trends To Watch For In 2016*, SEYFARTH SHAW LLP (2016), http://www.seyfarth.com/dir_docs/publications/EEOC_Intro_2015.pdf (discussing trends in employment litigation); Kevin LaCroix, *The Top Ten D&O Stories of 2014*, D&O DIARY (Jan. 6, 2015), http://www.dandodiary.com/2015/01/articles/director-and-officer-liability/the-top-ten-do-stories-of-2014-2/ (observing that cyber security is a growing focal point for increased liability exposure).

107. *See* RESTATEMENT (THIRD) OF AGENCY: DUTIES OF CARE, COMPETENCE, AND DILIGENCE § 8.08 (AM. LAW INST. 2006) (recognizing the duty to act with care, competence, and diligence); *see also* PRINCIPLES OF CORP. GOVERNANCE: DUTY OF CARE OF DIRS. & OFFICERS; THE BUS. JUDGMENT RULE § 4.01 (AM. LAW INST. 2016) (providing that a director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances, subject to the business judgment rule where applicable).

108. *See* MODEL BUS. CORP. ACT: STANDARDS OF CONDUCT FOR DIRS. § 8.30 (AM. BAR ASS'N 2006) (providing in part, "(a) Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation. (b) The members of the board of directors or a committee of the board, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances"); *see also* MODEL BUS. CORP. ACT: STANDARDS OF CONDUCT FOR OFFICERS § 8.42 (AM. BAR ASS'N 2006) (providing in part, "(a) An officer, when performing in such capacity, shall act: (1) in good faith; (2) with the care that a person in a like position would reasonably exercise under similar circumstances; and (3) in a manner the officer reasonably believes to be in the best interests of the corporation").

has been a minimal level of care, the court will not second-guess the decision in question.[109] By and large, liability for negligence is exculpated under existing corporate laws, although some have argued that the present rules regarding the duty of care are wholly inadequate.[110] Respondents' lower support for a default duty of care and higher support for the waiver of the duty of care than for the waiver of the duty of loyalty seems consistent with the law's current corporate approach, which permits the exculpation of the duty of care but not the duty of loyalty, acts or omissions not in good faith, or involving intentional misconduct or knowing violation of law—an approach that regards good faith as a key element of the duty of loyalty that describes the state of mind of a fiduciary acting in the best interests of the business entity and its owners.[111]

C. Should Managers of Public Entities be Held to a Higher Standard?

Delaware corporate indemnification rules are the same for public and private corporations.[112] Delaware's alternative entity provisions make no distinction between

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109. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("The business judgment rule is an acknowledgement of the managerial prerogatives of Delaware directors . . . . It 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 courts. The burden is on the party challenging the decision to establish facts rebutting the presumption."); MODEL BUS. CORP. ACT: ARTICLES OF INCORPORATION § 2.02(b)(4)–(5) (AM. BAR ASS'N 2006) (providing in part, "(b) [t]he articles of incorporation may set forth: (4) a provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any action taken, or any failure to take any action, as a director, except liability for (A) the amount of a financial benefit received by a director to which he is not entitled; (B) an intentional infliction of harm on the corporation or the shareholders; (C) a violation of section 8.33; or (D) an intentional violation of criminal law; and (5) a provision permitting or making obligatory indemnification of a director for liability (as defined in section 8.50(5)) to any person for any action taken, or any failure to take any action, as a director, except liability for (A) receipt of a financial benefit to which he is not entitled, (B) an intentional infliction of harm on the corporation or its shareholders, (C) a violation of section 8.33 or (D) an intentional violation of criminal law"); *see generally Changes in the Model Business Corporation Act—Proposed Amendments to Sections 2.02 and 8.70 (and Related Changes to Sections 1.43, 8.31 and 8.60) Permitting Advance Action to Limit or Eliminate Duties Regarding Business Opportunity*, 69 BUS. LAW. 717 (2014) (discussing several proposed amendments including advance action to eliminate duties regarding business opportunities).

110. *See* Callison, *supra* note 103, at 452 (concluding that a gross negligence standard is "inadequate on all fronts"); *see also In re* Citygroup, Inc. S'holder Derivative Litig., 964 A.2d 106, 123 (Del. Ch. 2009) ("[T]o establish oversight liability a plaintiff must show that the directors knew they were not discharging their fiduciary obligations or that the directors demonstrated a conscious disregard for their responsibilities such as by failing to act in the face of a known duty to act. The test is rooted in concepts of bad faith; indeed a showing of bad faith is a necessary condition to director oversight liability.").

111. *See* Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law,* 98 GEO. L.J. 629, 683 (2010) (discussing the Delaware Supreme Court's reversal); *see also* DEL. CODE ANN. tit. 8, § 102(b)(7) (2015).

112. *Compare* DEL. CODE ANN. tit. 8, § 102(b)(7) (2015) (providing that a corporation may eliminate or limit the personal liability of a director to the corporation or its stockholders for monetary damages but shall not eliminate or limit liability for any breach of the duty of loyalty, acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, certain violations under Section 174, and for transactions from which the director derived an improper personal benefit), *with* DEL. CODE ANN. tit. 6, § 18-108 (1992) (providing that subject to standards and restrictions if any in the operating agreement, a limited liability company may indemnify any member or manager or other person from and against any and all claims and demands whatsoever). Additionally, the Delaware alternative entity law permits the elimination by contract of default fiduciary duties under DEL. CODE ANN. tit. 6, § 17-1101(d) and § 18-1101(c).

waivers of the duty of loyalty and waivers of the duty of care, and make no distinction between pubic or alternative entities.[113] Yet, one wonders if members of the business community expect different standards of managerial conduct in the case of public and private entities.

As discussed above, in this sample, respondents' responses to the duty of loyalty breach in Scenario I and the responses to the breach of the duty of care in Scenario II were quite different depending upon whether the hypothetical entity was public or private.[114] As noted, 38% of respondents supported the waiver of the duty of loyalty assuming a private company, but only 23% supported the loyalty waiver in the public company. Further, although 74% agreed or strongly agreed that a waiver of the duty of care should be allowed in Scenario II, when the company posited was private, only 67% agreed or strongly agreed that the law should allow the duty of care waiver when told the company was public. One wonders whether the above differences reflect differences in assessments of how much a manager of a public company can be trusted. In a private company, investors may well play an active role in the company through employment and/or a role in management, whereas in a public venture, investors merely invest.[115] They may not personally know the management of the public companies in which they are simply investors.[116] On some level, respondents may be reacting to the fact that an investor who merely invests in a public company may have fewer opportunities for gaining trust in management through personal participation as an employee or as a manager, and may therefore be more inclined to rely more on external laws to police management misconduct than on personal relationships or personal participation in the company.[117]

Studies tend to show that levels of trust might be quite variable, depending, in part, upon the social relationship between the individual and the target person to be trusted.[118] This literature tends to support what we all intuitively know—that individuals are apt to trust people with whom they are intimate more than they trust mere acquaintances or strangers.[119] In one experiment, for instance, subjects were asked whether they would trust the specific target person in six specific situations.[120] The situations varied the adverse consequences, should the target person prove untrustworthy.[121] When higher stakes were involved, intimates were deemed more trustworthy than acquaintances. If the social distance between the investor and manager of a hypothetical public company is greater than that between the investor and manager of a private company, respondents might be

113. DEL. CODE ANN. tit. 6, § 17-1101(d) & § 18-1101(c) (permitting the elimination of fiduciary duties without differentiating between waivers of loyalty as compared to waivers of the duty of care).

114. *See infra* Fig. IV.

115. *See* Douglas K. Moll, *Shareholders Oppression in Texas Close Corporations: Majority Rule (Still) Isn't What it Used to Be*, 9 HOUSTON BUS. & TAX L.J. 33, 34 (2008) (observing that in the traditional public corporation the investor merely invests, whereas in the close corporation the shareholder is likely to participate in the company as a manager or an employee).

116. *See* Sharon G. Goto, *To Trust or Not to Trust: Situational and Dispositional Determinants,* 24 SOC. BEHAV. & PERSONALITY 119, 129 (1996) (indicating that trust levels may vary with the social distance between the individual and the target person to be trusted).

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *See* Goto, *supra* note 116, at 124–25 (posing, for example, two hypothetical situations in which the subject stood to lose either $1000 or $5000 if the target person was untrustworthy).

more supportive of a waiver in a private company in which the manager may be known, as compared to a waiver in a public company, in which the manager is presumably not known.

As a practical matter, investors cannot personally negotiate the terms of an investment in a public company.[122] Literature has shown that in a variety of contexts, people strive for fair results.[123] As one scholar of behavior organization noted: "[p]eople are disposed towards fairness, a necessary condition for trust and trustworthiness."[124] Respondents may be more supportive of waivers in a context in which the waivers can be personally negotiated (i.e., the private company context) than where the waivers are unlikely to be personally negotiated (i.e., the public company context).

Professors Michelle M. Harner and Jamie Marincic have done empirical research on trust and internal governance and they suggest that there are two types of trust that are relevant in connection with internal governance.[125] The first type of trust they discuss is "affective trust" which is rooted in emotion and based on the sense that the person in question will have goodwill. The second type is referred to as "cognitive trust" which is more fact-oriented and based on an objective calculation of risks and benefits.[126] They argue that business decision-making is likely to take place on a spectrum where one or both types of trust may be operative.[127] It is possible that the respondents in the present study may have recognized that investors would have few opportunities to get to know the managers in the public than in the private company. In the words of Professors Harner and Marincic, the investors in the public company context may have been seen as not being in a position to exercise the elements of "affective trust."[128] Thus, respondents may have made the judgment that investors in the hypothetical public company would be in greater need of protection than investors in the hypothetical private company.

D. Are Indemnification Rules and Fiduciary Duty Waivers Well-Understood by the Business Community?

Approximately 31% of respondents reported that they would be willing to invest in a public company like the one in the duty of care hypothetical if it contained a waiver of the duty of care and 69% said they would be unwilling to invest in such a company.[129] Of course, there is likely to be a huge difference between how respondents *actually* behave and how they say they *would* behave, given the benefit of hindsight that an investment decision turned out to be a poor one. However, the fact that over two-thirds said they would be *unwilling* to invest in such a company is still somewhat surprising. One would have expected that nearly all of the respondents would have been willing to invest in a company with a duty of care waiver given the popularity of Delaware alternative entity law and the concept of contractual freedom and the fact that corporate law has provided for exculpation

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122. *See* Harner & Marincic, *supra* note 51, at 933 (noting that waivers cannot be negotiated in the context of public companies and recommending that fiduciary duties be mandated in LLCs other than co-active LLCs in which the parties have a chance to actively negotiate duties).

123. *See* Fichman, *supra* note 100, at 147 (discussing how people are motivated by trust).

124. *Id.*

125. Harner & Marincic, *supra* note 51, at 929 (reviewing 129 publicly available LLC operating agreements and finding widespread use of waivers (73%) and provisions authorizing competition (69%)).

126. *Id.* at 927.

127. *Id.*

128. *Id.*

129. *See infra* App. A, Scenario II, Comprehension of Duty of Care.

of duty of care violations for over thirty years. While there is a difference between the waiver of a duty of care and an indemnification provision, one might have expected respondents to have become acclimated to the overall idea of shielding directors from personal liability for duty of care violations. It is possible that the waiver rules for the duty of care are out of step with a number of respondents' views. Another possible explanation is that many respondents don't fully understand how indemnification or waivers operate, or simply didn't understand the question being asked.

A lack of understanding of the law regarding director liability is quite plausible. When asked whether directors are personally liable for gross negligence, approximately 51% of respondents replied "Yes," 31% replied "No," and 18% replied "Not Sure." As indicated above, it is difficult to draw conclusions from the responses to this question. The question itself may have been difficult for respondents to understand and overly simplistic, especially given the different ways in which forum courts choose to apply exculpatory clauses in litigation.[130]

Clearly, additional research is advisable to gain further insight into stakeholder comprehension of director liability. It would be helpful to assess comprehension levels of multiple stakeholder groups—especially that of seniors. Americans have invested over $23 trillion dollars in tax-favored retirement plans,[131] the vast majority of investors in publicly-traded partnerships are individuals, and roughly 75% are seniors over age 50.[132] The governing terms of the vast majority of publicly-traded alternative entities include provisions that eliminate the duty of loyalty and which have comparatively few investor protections.[133] Two empirical studies have already demonstrated that publicly-traded alternative entities often waive fiduciary duties without substituting compensating contractual investor protections.[134] Additionally, all but one Fortune 100 company's operating agreements contain exculpation provisions.[135] Although theoretically, market prices of investments factor in the impact of corporate governance risks, it is not entirely clear that investors, and particularly seniors, fully appreciate the significance of the legal risks associated with their investment decisions.[136]

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130. *See generally* Richard B. Kapnick & Courtney A. Rosen, *The Exculpatory Clause Defense to Shareholder Derivative Claims,* 17 BUS. TORTS J. 1 (2010).

131. Dana M. Muir, *Decentralized Enforcement to Combat Financial Wrongdoing in Pensions: What Types of Watchdogs are Necessary to Keep the Foxes Out of the Henhouse?*, 53. AM. BUS. L.J. 33, 33–34 (2016).

132. *See, e.g.*, *Written Statement of the National Association of Publicly Traded Partnerships*, NAT'L ASS'N OF PUBLICLY TRADED P'SHIPS 3 (2015), http://www.finance.senate.gov/legislation/download/?id=a9191f81-b109-4543-a342-6d0f7ba6f379; *Fact Sheet: Publicly Traded Partnerships (PTPs)*, AM. FUEL & PETROCHEMICALS MFRS., http://www.afpm.org/WorkArea/DownloadAsset.aspx?id=3877 (login required) (last visited Oct. 27, 2016) ("According to surveys done by some of our members, the vast majority of investors providing this capital are individual investors. Many of the investors are seniors—roughly 75% are over the age of 50.").

133. *See also* Miller & Davis-Nozemack, *supra* note 1, at 314 (summarizing the problems investors have holding managers accountable when the duty of loyalty has been waived).

134. *See generally* Harner & Marincic, *supra* note 51 (exploring the governance provisions included in LLC's operating agreements and the implications it has on various types of business who may choose to organize as an LLC); *see* Manesh, *supra* note 54, at 567 (summarizing how the operating agreement of every publicly traded LLC and LP in Delaware was analyzed for the article).

135. *See* Brown & Gopalan, *supra* note 86 (discussing state laws relating to "opting in" to liability waivers and their culpability).

136. *See* Christine Jolls et al., *A Behavioral Approach to Law and Economics,* 50 STAN. L. REV. 1471, 1476–77 (1998) (defining behavioral law and economics).

V. EMPIRICAL RESEARCH AND LEGAL POLICY

There are a number of weaknesses in the present study and broad generalizations to the larger population of YPO members and to stakeholders at large could be misleading. However, the analysis of the weaknesses that are discussed below in Part V.A can lead to improvements in the design of future studies. Moreover, as discussed in Part V.B below, an articulation of the open policy questions at stake can help to identify the type of empirical data that might be helpful in informing the public policy debate.

A. Limitations and Suggestions for the Design of Future Studies

The primary limitations stem from: 1) the small sample used; 2) the nature of the hypothetical scenarios used; 3) potential biases stemming from hindsight; and 4) discrepancies between what one will *actually* do versus what one *says* one would do. That said, the study presents a new empirical path for evaluating stakeholder expectations and assessing comprehension levels in order to continuously improve the scheme of internal governance law not just for those who manage LLCs, but for the many other constituencies in the business and investor communities.

Perhaps the biggest limitation of the study concerns its small size and localized population. Although sufficient for the tests administered here, the data is quite limited. Additional research should be done using a larger national sample. A larger sample would also refine some of our measures and add clarity to our results. The sample used in this study may not be highly representative of the population of investors in LLCs and LPs. Only two females responded. While gender differences have been observed in investment decision-making, it is unlikely that the gender gap in business ownership is as great as that in the present study.[137] Moreover, the sample represents young, highly successful, and well-educated executives. It is important to keep in mind that there are many other populations that have a vested interest in default fiduciary duties and waivers of duties (i.e., executives, entrepreneurs, investors of various ages and education levels, and so on). As discussed above, the National Association of Publicly-Traded Partnerships estimates that many of the investors are individuals and roughly 75% of investors are over the age of 50.[138] Given this demographic, it would be helpful to study investor perceptions and comprehension levels of fiduciary duties, waivers, and indemnification rules among populations of seniors.

Another potential weakness with the study may have been the factual patterns chosen for the Scenarios and the fact that only two basic Scenarios were used. In the Duty of Loyalty Scenario, defendant Sam had already received a specific offer from the third party prior to buying out Fred at a bargain price. The misconduct was fairly extreme and respondents may have regarded it as being tantamount to intentional fraud. One wonders how respondents would have reacted if the facts in the Duty of Loyalty Scenario were less extreme, i.e., Sam had not yet received a specific offer from a third party, but had been negotiating with a third party before buying out Fred's interest. On the other hand, in the Duty of Care Scenario that was used, the facts presented careless conduct, but the carelessness did not involve an intentional act to harm the nursing home or its patients.

137. *See* Vickie L. Bajtelsmit & Alexandra Bernasek, *Why do Women Invest Differently than Men?*, 7 FIN. COUNSELING PLAN. 1, 1 (1996) ("This paper surveys the existing literature regarding gender differences in investment and considers the policy implications of these differences.").

138. *See, e.g.*, NAT'L ASS'N OF PUBLICLY TRADED P'SHIPS, supra note 132, at 3.

Arguably the conduct in the Duty of Care Scenario was close to ordinary negligence. Thus, the Scenarios were arguably at extremes and not representative of the wide range of loyalty and care violations that might occur along a continuum of severity. Care must be taken to avoid generalizations about views toward waivers based upon a small group of respondents' reactions to two very specific Scenarios. In the future, it would be helpful to present multiple Scenarios with varying degrees of loyalty-related or care-related misconduct.

A further confounding factor may have been the failure to use Duty of Loyalty Scenarios and Duty of Care Scenarios involving enterprises in the same type of industry. The Duty of Loyalty Scenario involved a retail carpet business whereas the Duty of Care Scenario involved a nursing home. The observed differences may have been driven in part by the respondents' different views regarding the role of litigation in the context of health care. They may have thought that nursing homes are already heavily regulated or that litigation in the health care field has been problematic.

Hindsight may have colored respondents' reporting as well. Having received the benefit of hindsight, respondents may have been primed to conclude that they should be unwilling to invest and thus suffer losses similar to the investors in each hypothetical scenario. Thus, the effects of hindsight may have colored respondents' responses and may have led to skewed results. Moreover, the effect or tendency toward over-confidence may have led respondents to conclude that they would not be likely to make a poor investment decision or be naive enough to invest in a business organization that was governed by legal terms that were disadvantageous to investors.[139]

Finally, as already noted above, there are inherent biases in self-reporting. The present study focused on respondents' statements regarding their willingness to invest, and did not independently verify what types of investments investors actually owned. As indicated above, investors' self-reporting may be wholly or partly inconsistent with their actual conduct.

B. Policy Issues Ahead

There are at least three inter-related policy questions that should be addressed if we are to improve alternative business entity legislation. First, what outer limits should apply to the contractual modification or elimination of fiduciary duties, and should the rules be different for public and private entities? Should legislation follow Delaware's approach, the approach taken by the Uniform Law Commission, or a more restrictive framework for fiduciary duty alteration? Second, is the nexus of contracts conception of the business entity an appropriate paradigm given the needs that are to be served by internal governance law? Third, are law schools and business schools placing sufficient emphasis on ethics in connection with business decision-making and planning? The discussion below identifies the issues and discusses how empirical data may help to inform the discussion.

1. Different Rules for Public and Private Entities and Outer Limits on "Private

139. *See* Lawrence A. Cunningham, *Behavioral Finance and Investor Governance*, 59 WASH. & LEE L. REV. 767, 783 (2002) (citing ROBERT J. SHILLER, MARKET VOLATILITY 142 (1989)) (discussing the cognitive distortion of overconfidence and tendency for people to think they know more than they know, and to overrate their abilities).

Ordering"

As discussed above in Part II.C, Delaware goes the furthest insofar as it permits the contractual elimination of all fiduciary duties but Chief Justice Strine and Vice Chancellor Laster now recommend a re-instatement of a mandatory duty of loyalty for diversely-held Delaware alternative entities. Their proposal raises fundamental questions regarding alternative entity internal governance law not just in Delaware, but in all states, particularly now that so many states are permitting waivers of fiduciary duties.

The present empirical study does not pretend to offer definitive answers on whether tighter standards for waiving the duty of loyalty than for waiving the duty of care would be consistent with the expectations of the business and/or investor communities. However, we have learned that in a small sample of highly successful executives, a full 91% agreed or strongly agreed that the law should provide a default duty of loyalty when presented with a duty of loyalty breach in a hypothetical private company. Only 15% agreed or strongly agreed that the law should provide a default duty of care in a different hypothetical private company when presented with a duty of care breach. Similarly, support for the enforcement of the waiver was low in the Duty of Loyalty Scenario (only 38% for the hypothetical private company and only 23% for the public company) but was high in the Duty of Care Scenario (a full 74% supported the enforcement of the waiver in the private Duty of Care Scenario and 67% did so in the public company Duty of Care Scenario).

Again, while generalizations should be avoided, the above findings are somewhat consistent with the notion that the investor and business communities might well care more about breaches in the duty of loyalty, i.e., particularly the duty of candor or disclosure, than about a breach in the duty of care, and more about breaches in public than in private companies. Business executives and investors may still be reeling from the dislocation of the Great Financial Crisis of 2008, and/or before that, the Enron crisis.[140] They may have less appetite for unlimited waivers of the duty of loyalty than they did 20 years ago when "private ordering" was picking up momentum.

Siren Song's critique of waivers in diversely-held entities may ring true for a number of purely private alternative entities and raises questions as to the optimal scope of waivers in private companies.[141] Even sophisticated parties in a privately-owned enterprise may well face obstacles with a contractual approach.[142] Practitioners and clients of diversely-held entities do not have a monopoly on human failings when it comes to anticipating all future developments and contracting appropriately. In fact, investors in private entities may have considerably more at risk than investors in a publicly-traded entity. An investment in a closely-held business entity may represent the entire fortune of its owner.[143] Further,

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140. *See* Steven A. Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOY. U. CHI. L.J. 669, 700–08 (2014) (providing a detailed history of the Enron Scandal and the run-up to the 2008 Financial Crisis).

141. Strine & Laster, *supra* note 1, at 3 (discussing litigation experience and waivers).

142. *See* Daniel Kleinberger, *Careful What You Wish For—Freedom of Contract and the Necessity of Careful Scrivening*, XXIV PUBOGRAM 19, at 21 (Oct. 26, 2006), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=939009 (analyzing a trio of recent cases involving significant freedom of contract).

143. Douglas Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) From Close Corporation History*, 40 WAKE FOREST L. REV. 883, 888–89 (2005) ("[In contrast], within a close corporation, a more intimate and intense relationship exists between capital and labor."); *see generally* Thomas M. Madden, *Do Fiduciary Duties of Managers and Members of Limited Liability Companies Exist as with Majority Shareholders*

although some boilerplate language may be present in all contracts, a governing document in a privately-owned entity may be highly individualistic, and thus may give rise to the sort of inefficiency *Siren Song* identifies.[144] While the above propositions appear to be true, additional empirical evidence on contractual practices and the outcomes of disputes in privately-owned alternative entities would be helpful in assessing the accuracy of the above statements. Many disputes never culminate in litigation or a published legal opinion, either because they are arbitrated or are eventually resolved short of formal legal action. In fact, one study has revealed that more than one-third of agreements in the sample selected contained arbitration agreements.[145] Empirical studies of contractual practices and experiences with privately-held entities need not escape analysis given contemporary tools for conducting empirical research.

Additionally, further policy discussion is warranted with regard to the evaluation of the fiduciary duty and waiver framework by the Uniform Limited Liability Company Act (ULLCA). As indicated in Part II, ULLCA offers the ability to contractually eliminate fiduciary duties, takes a slightly more restrictive approach than Delaware by permitting contractual elimination of fiduciary duties only if "not manifestly unreasonable."[146] Moreover, unlike Delaware which statutorily permits the indemnification of all claims,[147] ULLCA will not permit the operating agreement to relieve or exonerate a person from liability for conduct involving bad faith, willful or intentional misconduct, or knowing violation of law.[148]

An obvious concern is that the manifestly unreasonable test may not provide the level of certainty and fairness that a traditional duty of loyalty offers. It may lack the socializing value that traditional duties may provide and may not generate the sort of general rules or pronouncements that can offer the same level of efficiency as duty of loyalty case law development. As noted by Professor Mark J. Lowenstein, the term "manifestly unreasonable" is contained in the Uniform Commercial Code.[149] Unfortunately, there is no statutory definition of "manifestly unreasonable."[150] One commentator has observed that the standard may arise in connection with terms that are contrary to usages of trade, contracts involving unequal bargaining power, and contracts that have arisen in connection with latent defects.[151] Professor Lowenstein suggests Black's definition as being "evident

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of Closely Held Corporations?, 12 DUQ. BUS. L.J. 211 (2010) (discussing the law of fiduciary duty in the five major states viewed as homes for business).

144. *See* Strine & Laster, *supra* note 1, at 2–3.

145. *See generally* Tucker, *supra* note 44.

146. *See* UNIF. LTD. LIAB. CO. ACT (NAT'L CONF. OF COMM'RS OF UNIF. STATE LAWS 2006, last amended 2013), http://www.uniformlaws.org/.

147. DEL. CODE ANN. tit.6, § 18-108 (2015) ("Subject to such standards, if any, as are set forth in its limited liability company agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever.").

148. REV. UNIF. LTD. CO. ACT § 105 (c)(7) (NAT'L CONF. OF COMM'RS OF UNIF. STATE LAWS. 2006, last amended 2013), http://www.uniformlaws.org/.

149. Mark J. Lowenstein, *Fiduciary Duties and Unincorporated Business Entities: In Defense of the "Manifestly Unreasonable" Standard*, 41 TULSA L. REV. 411, 431 (2006).

150. Memorandum from Maggie M. Tatton to Daniel Kleinberger, at 2 (Dec. 5, 2004), http://www.uniformlaws.org/shared/docs/limited%20liability%20company/ullca_manifestlyunreasonablememo_120504.pdf.

151. *Id.* at 15.

to the senses, especially to sight, obvious to the understanding . . . synonymous with open, clear, visible, unmistakable, indubitable, indisputable, evident, and self-evident."[152]

Another critical concern is that a "manifestly unreasonable" standard may be sufficient to capture only the most egregious and extreme situations. Moreover, it may be difficult to apply in cases involving equal ownership and/or evidence of bargaining. Finally, the manifestly unreasonable standard may not be an effective substitute for the duty of candor that is encompassed by a traditional duty of loyalty.[153]

It is noteworthy that some states that have mostly adopted ULLCA have rejected the waiver language and the manifestly unreasonable standard contained in Section 110(d). As noted in the notes to Appendix C, California has adopted ULLCA but does not permit the contractual elimination of duties.[154] The same is true of Vermont. [155]

At this juncture in the legislative development of alternative entities, it is of particular importance to continue the policy analysis surrounding default duties and waivers and to expand the scope of empirical data. As indicated above, additional data on seniors' comprehension of fiduciary duties and waivers would prove extremely helpful, given that Americans have more than $23 trillion invested in tax-favored retirement plans, some of which is invested in publicly-traded corporations, limited partnerships, and limited liability companies.[156] Also, Seniors may be passive investors in private placements and a variety of non-publicly-traded alternative business entities. Updated information on practitioners' contractual practices, out-of-court experiences, and arbitration outcomes would be enormously helpful to evaluate the effectiveness of fiduciary duty laws.[157]

2. Updating the Nexus of Contracts Vision: The Role of the Sovereign and Equity

Alternative entity legislation and even the corporate enabling legislation following *Smith v. Van Gorkom*[158] rest largely on the Nexus of Contracts Theory of the Firm, first advanced by Jensen & Meckling in the 1970s.[159] However, we now have over thirty years of experience with alternative entities which tells us that a purely "private" contractual conception of the firm designed solely to make profit, may fail to take into account the realities of the marketplace.[160] We have learned from experience that market asymmetries continue to occur and that there is a continuing need to have a system of governance that

152. Lowenstein, *supra* note 149, at 432.

153. *See generally* Salm v. Feldstein, 799 N.Y.S.2d 104 (N.Y. App. Div. 2005) (involving a defendant who bought out the plaintiff's 50% interest for $1.375 million and a $1.3 million consulting contract and a few days later sold the entire automobile distributorship for $16 million).

154. CAL. CORP. CODE § 17701.10(10)(c)(4) (2016); *see also* Miller, *supra* note 27, at 331 (discussing default fiduciary duties).

155. *See* VT. STAT. ANN. tit. 11, § 4003(b)(4) (2016) (stating that the law does not permit the elimination of the duty of loyalty, care, or any other fiduciary duty).

156. *See* Muir, *supra* note 131, at 34.

157. *See* David Horton & Andrea Cann Chandrasekher, *After the Revolution: An Empirical Study of Consumer Arbitration*, 104 GEO. L..J. 57, 124 (2015) (studying 5000 consumer arbitration cases between 2009–2013).

158. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

159. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976); *see* Oliver Hart, *Contractual Freedom in Corporate Law: An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757, 1765 (1989) (discussing competing economic theories of the firm).

160. *See* 1977 Wyo. Sess. Laws 577 (illustrating an early enactment of LLC legislation).

serves the interests of all stakeholders—not just stakeholders who are managers—by balancing the interest in certainty with that of fairness.[161]

Under the Nexus of Contracts Theory, the business entity is regarded as a nexus of contracts and transactions within and without the firm are regarded as being on a single continuum. The public corporation, the privately-owned LLC, and the closely-held corporation are regarded as standard form contracts and the relations between the entity and the employees, suppliers, customers, creditors, and others are considered to be contractual in nature.[162] Further, under the Nexus of Contracts approach, individual self-interest propels an optimal allocation of resources.[163] Ronald Coase, recipient of the Nobel Prize, contributed to the theory by taking the position that the entity is a vehicle that efficiently addresses transaction costs.[164] In *The Problem of Social Cost*, Coase put forth the "Coase Theorem" and focused attention on the costs of market transactions and the suboptimal results that can result from government intervention.[165] According to Coase, if transaction costs are zero, the parties will themselves develop and bargain to arrive at the most cost efficient resolution of their differences.[166] Coase's theory has invited analyses of the impact of law upon transaction costs[167] and has played an important role in supporting flexible alternative entity legislation.[168] Under Coase's approach, in a world with zero transaction costs, the parties themselves will arrive at a settlement that reflects the most efficient outcome.

The imbalances in the marketplace, as discussed in Part II, dispel the notions that

161. *See* Strine & Laster, *supra* note 1, at 11 (discussing litigation experience with contractual waivers and developing a recommendation to eliminate the default duty of care, but to make the duty of loyalty non-waivable).

162. Hart, *supra* note 159, at 1765–66 (discussing the contractarian economic theory).

163. *See* J. William Callison & Allan W. Vestal, *Contractarianism and Its Discontents: Reflections on Unincorporated Business Organization Law Reform*, 42 SUFFOLK U. L. REV. 493, 505 (2009) (discussing the contractarian revolution with regard to unincorporated business entities); Michael Bradley et al., *The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 L. & CONTEMP. PROBS. 9, 37 (1999) (discussing the working of Adam Smith's invisible hand transforming individual self-interest into optimal allocation of resources); *see generally* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF WEALTH OF NATIONS (Edwin Cannan ed., 5th ed. 1904) (explaining Adam Smith's theories on economics); Richard A. Posner, *Utilitarianism, Economics, and Legal Theory*, *reprinted in* RICHARD POSNER, 1 THE ECONOMIC STRUCTURE OF LAW 140–57 (Francesco Parisi ed., 2000) (providing an excellent analysis of utilitarianism and wealth maximization as an ethical concept).

164. Richard A. Posner, *Nobel Laureate: Ronald Coase and Methodology*, 7 J. ECON. PERSPECTIVES 195–210 (1993) *reprinted in* RICHARD POSNER, 1 THE ECONOMIC STRUCTURE OF LAW 16 (Francesco Parisi ed., Edward Elgar Publishing Limited and Edward Elgar Publishing, Inc. 2000). Transaction costs are the costs of an exchange and encompass the costs of finding, negotiating, and enforcing a bargain. ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS, 93, 98 (4th ed. 2004).

165. Ronald Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 1–44 (1960).

166. Richard A. Posner explains that Coase illustrated that to tax or regulate a polluter is not the only recourse where the victim can eliminate the cost of the pollution at a lower cost than the polluter such as where the cost of pollution to the victim is $50, the victim can move and thus eliminate the problem for ten dollars and the polluter would have to spend $20 to cure the problem—arguably a tax of $20 would be suboptimal. Posner, *supra* note 164, at 201 (observing that hostility to public intervention in markets is the "leitmotif" of Coase's work).

167. *See* Francesco Parisi, *Introduction* to RICHARD POSNER, THE ECONOMIC STRUCTURE OF LAW, at xxviii (2000) (discussing the new field of institutional economics that recognizes that the firm has production and governance functions, and credits John Commons with the view that the transaction is the fundamental unit of analysis).

168. *See* PAUL R. MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATIONS & MANAGEMENT 38–39 (1992) (providing an overview of the Coase theorem and its significance).

transaction costs can be ignored and that there will uniformly be a level playing field in alternative entities. In fact, the present study raises questions about comprehension levels of a small group of sophisticated executives, and points out the need to get more data on stakeholder comprehension.

Contemporary usage of alternative entities goes far beyond the context of the negotiated business deal designed to make private profits.[169] Experience and empirical data have shown that many LLC agreements are not agreements at all; there may be boiler-plate language and non-signatories may be bound by the LLC agreement.[170] Not all investors are highly sophisticated and a relentlessly contractual approach may not be appropriate for all parties. This point was recognized by Larry E. Ribstein who advocated the removal of restrictions on waivers of fiduciary duties in limited partnerships when these entities were used by sophisticated persons. He expressly stated that limited partnership investors may be less vulnerable than corporate shareholders, unlike investors in publicly-traded corporations.[171] Professor Ribstein indicated that it would be unlikely that limited partners would be publicly-traded and assumed that if they were, markets would efficiently discount the effects of fiduciary duty waivers.[172] However, Professor Ribstein's assumptions proved to be untrue. Unique contractual language may make it more difficult for investors to predict outcomes and to efficiently "discount" the effects of contractual waivers.[173] Contractual standards of conduct may contain subtle, slightly different meanings from one entity to the next, given the wide variety of business entity undertakings.[174] Thus, litigation and empirical data challenge the view that the alternative entity is essentially a Nexus of Contracts among private parties in which the elimination of fiduciary duties has reduced transaction costs and largely eliminated the monitoring role of the sovereign.

On still another front, the conception of the business entity solely as a vehicle to make profits for private parties is being challenged by *Burwell v. Hobby Lobby*.[175] In a clash

169. *See generally Contract is King Micro-Symposium,* BUS. L. PROF. BLOG (Nov. 19, 2015), http://lawprofessors.typepad.com/business_law/page/5/.

170. *See id.*; Francis Pileggi, *Non-Signatory LLC Members Bound by Operating Agreement*, DEL. CORP. & COMMERCIAL LITIG. BLOG (Sept. 25, 2014), http://www.delawarelitigation.com/2014/09/articles/chancery-court-updates/non-signatory-llc-and-members-bound-by-operating-agreement/ (discussing Seaport Vill. Ltd v. Seaport Vill. Operating Company et. al., C.A. No. 8841-VCL (Del. Ch. 2014)); Manesh, *supra* note 54, at 560 (discussing the fact that the "agreements" are not highly negotiated and contain many provisions that are highly protective of management).

171. *See* Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK U. L. REV. 927, 943 (2004) (arguing that restrictions on contracting regarding fiduciary duties is limiting).

172. *Id.*

173. *See generally* Miller & Davis-Nozemack, *supra* note 1 (describing the lessened fiduciary duty for LPs and LLCs under Delaware Corporate Law).

174. *See* Strine & Laster, *supra* note 1, at 5 (discussing litigation experience with contractual waivers); *see also* Norton v. K-Sea Transp. Partners LP, 67 A.3d 354, 365 (Del. 2013). Under the Special Approval process, good faith could be presumed if a Fairness Opinion was obtained. Further, the court concluded the GP was conclusively presumed to have exercised good faith by choosing to invoke the Special Approval process. There was a provision that did not require a consideration of interests other than those of the partnership. The court determined that the opinion properly addressed the Fairness as a whole, and the Fairness Opinion was not required to have addressed the fairness of certain Incentive Distribution Rights (IDR) that were payable to the GP. *Cf.* Gerber v. Enter. Prod. Holdings, LLC, 67 A.3d 400 (Del. 2013) (holding that contractual good faith did not bar a claim for breach of implied good faith and fair dealing).

175. Burwell v. Hobby Lobby Stores Inc., 134 S.Ct. 2751, 2771 (2014) (allowing the court to examine non-monetary objectives of corporations).

between the Patient Protection Affordable Care Act (ACA) and the Religious Freedom Restoration Act (RFRA), the court interpreted state corporate law to allow corporations to embrace non-monetary objectives. By so ruling, the Court determined that business corporations are indeed "persons" under the RFRA and that business practices in conformity with the owners' religious principles were among the lawful business purposes permitted under the applicable corporate statutes. Thus, the ACA was held to have burdened sincerely held religious beliefs by mandating insurance coverage for certain contraceptives.

On some level, the recognition of non-monetary business entity objectives may open the door to a broader vision of the entity than one which is a vehicle for private contractual profit-making. Professor Lyman Johnson has described the entity that emerges from *Hobby Lobby* as being more complex than the narrow profit-maximizing, shareholder-centric conception under traditional corporate theory.[176] A view of the corporation as an institution that may have nonmonetary as well as monetary goals leaves the door open to activities to discharge what one might call the exercise of corporate social responsibility. This vision of the business entity as one which may promote the public interest arguably reflects a more Stakeholder and Concession-oriented approach to the business entity and to the role of internal governance generally.[177] Under the Stakeholder approach, experts in business ethics have referred to the "social contract" and regard the corporation as an entity that should be managed for the benefit of all who are affected by corporate actions.[178] Thus, efficiency and "contractual certainty" arguably represent only one of several important public policy goals.

The Concession Theory of the firm, at least as originally conceived, rests on the notion that the entity is a concession of the state.[179] Strictly speaking, corporations and LLCs are no longer concessions of the state.[180] However, in a more general sense, the assumption of state power in the development and enforcement of internal governance law underlies both the Concession Theory and the Sovereign Involvement Theory. The need for considering the impact of internal governance rules on third parties can be readily seen in the internal governance problems presented by publicly-traded entities. Of particular concern is the fact that the vast majority of investors in these publicly-traded partnerships are individuals, approximately 75% of whom are over age 50 and seeking secure, income-oriented investments.[181] With too little judicial or legislative constraints, alternative entity law may

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176. Lyman P.Q. Johnson & David Millon, *Corporate Law After* Hobby Lobby*,* 70 BUS. L. 1, 29–31 (2015).

177. *See also* Michael Bradley et al., *supra* note 163, at 42 (discussing the communitarian approach to corporate governance); *see generally* Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications,* 20 ACAD. OF MGMT. REV. 65 (1995) (advancing a management approach that advances the stakeholder theory of the corporation).

178. *See* Timothy L. Fort, *Goldilocks and Business Ethics: A Paradigm That Fits "Just Right"*, 23 J. CORP. L. 245, 253 (1998) (observing that the social contract theory advanced by Thomas Donaldson presupposes a social contract under which there is an exchange between the corporation and society, and is rooted in the ideas of Rousseau, Hobbes, Locke, and Rawls).

179. Henry N. Butler & Larry E. Ribstein, *The Contract Clause and the Corporation*, 55 BROOK. L. REV. 767, 775 (1989).

180. Joan MacLeod Heminway*, Enron's Tangled Web: Complex Relationships; Unanswered Questions*, 71 U. CIN. L. REV. 1167, 1171 (2003).

181. Written Statement of the Nat'l Association of Publicly Traded Partnerships Submitted to the Senate Committee on Finance Tax Reform Working Group on Community Development & Infrastructure to the S. Committee on Finance Tax Reform Working Group on Bus. Income Tax 3 (Apr. 15, 2015),

provide a fertile ground for the mishandling of pension funds—a matter of broad public concern.[182]

The importance of considering the role of the sovereign in alternative entity law was recently illustrated in a case in which the Delaware Chancery Court invoked equitable powers to order a judicial dissolution.[183] *In re Carlisle Etcetera LLC* raised the question of whether a subsidiary corporation which was a mere assignee had statutory standing to sue for a judicial dissolution.[184] The Chancery Court concluded that the petitioner lacked statutory standing but given the facts and circumstances, granted standing under equity.[185] In doing so, the court explained that the General Assembly in 2013 adopted an amendment to the LLC statute that was inconsistent with the purely contractarian view of the business entity when it adopted Section 18-1104 of the Delaware Code, which provides that "[i]n any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity relating to fiduciary duties and the law merchant, shall govern."[186] In recognizing the role the state plays in alternative entity jurisprudence, the court reasoned:

> Of particular relevance to dissolution, the purely contractarian view discounts core attributes of the LLC that only the sovereign can authorize, such as its separate legal existence, potentially perpetual life, and limited liability for its members. To my mind, when a sovereign makes available an entity with attributes that contracting parties cannot grant themselves by agreement, the entity is not purely contractual. Because the entity has taken advantage of benefits that the sovereign has provided, the sovereign retains an interest in that entity.[187]

Clearly, a view of the business entity that ignores the role of both the federal and the state sovereign bears little resemblance to reality.[188] Both state and federal law including federal securities laws, play a role in the governance of business entities and the achievement of its policy objectives—both fairness and efficiency. *Siren Song* eloquently touches upon these over-arching goals and the importance of judicial monitoring in achieving them, observing:[189]

> To date, the best minds in corporate law continue to think this policy balance is the sensible one, because it remains difficult to craft more specific statutory

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http://www.mlpassociation.org/wp-content/uploads/2015/07/NAPTP_Comments_for_Finance_Business_Working_Group-1.pdf .

182. Muir, *supra* note 131, at 33–34; Miller & Davis-Nozemack, *supra* note 1, at 307.

183. *In re* Carlisle Etcetera LLC, 114 A.3d 592, 597 (Del. Ch. 2015).

184. *See generally id.* The petitioner and defendant had entered into an initial LLC operating agreement that contemplated joint management as equal business partners. In an effort to complete the final organizational structure, the petitioner/parent company had transferred its membership interest to a subsidiary, which was to become the new LLC member under the final operating agreement. The parties' relationship broke down prior to execution of the second agreement, leaving the subsidiary as a mere assignee who lacked statutory standing in law to sue for a judicial dissolution.

185. *Id.* at 607.

186. *Id.* at 605 n.8.

187. *Id.* at 605.

188. Dieckman v. Regency GP, LP, C.A. No. 11130-CBB, 2016 WL 1223348, at *11 (Del. Ch. March 29, 2016).

189. *See* Strine & Laster, *supra* note 1, at 16 (discussing the connection between experience in litigation and waiver).

> language that will balance efficiency and fairness concerns as effectively as an approach that uses an equitable overlay of fiduciary duties in combination with a more flexible enabling statute.[190]

The importance of tempering the Contractual paradigm with recognition of the role of the Sovereign was addressed early on by Professor John C. Coffee when corporate indemnification provisions were first introduced in the wake of *Smith v. Van Gorkom*.[191] Professor Coffee observed that "contractual innovation can be reconciled with a stable mandatory core of corporate law if we recognize that what is most mandatory in corporate law is not the specific substantive content of any rule, but rather the institution of judicial oversight."[192]

The empirical studies showing one-sided governing documents and the case law involving opportunistic conduct discussed in Part II underscore the important role of the Sovereign in judicial monitoring. Thus, judicial experience has taken us beyond a purely contractual vision of the alternative business entity.[193]

3. Does Private Ordering Require Increased Ethics Training in Law and Business Schools?

As discussed in Parts II and III, the move toward contractual freedom in alternative business entities has reduced or even eliminated the role that traditional fiduciary duties have played in regulating many business relationships. It is difficult to assess the degree to which this shift to a Contractarian model has caused a proliferation of sharp business practices and/or opportunistic conduct. What is known, as discussed below, is that sharp business practices abound. Effective ethical training may be even more important under a regime that permits the substantial or complete elimination of fiduciary duties than it is under those which impose mandatory fiduciary duties.

Fiduciary duties have traditionally played a central role in establishing the ethical parameters of business relationships.[194] As Professor Lyman Johnson has noted, "loyalty and fairness . . . are more than legal duties. They are important personal virtues and social norms."[195] Some have cited fiduciary duties as a "socializing force;"[196] others have described fiduciary duty violations as a critical means of branding the transgressor with a "stench of dishonesty."[197] Delaware courts are said to impart the concept of good faith through "fact-intensive, normatively saturated descriptions of manager, director, and lawyer conduct, and of process-descriptions that are not reducible to rules . . . ."[198]

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190. *See id.* at 16–17.

191. Smith v. Van Gorkom, 488 A.2d 858, 864 (Del. 1985).

192. John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1621 (1989).

193. *In re* Carlisle Etcetera LLC, 114 A.3d 592, 605–06 (Del. Ch. 2015).

194. *See* Lyman Johnson, *Dynamic, Virtuous Fiduciary Regulation* (Wash. & Lee Univ. Sch. of L., Research Paper Series, Research Paper No. 13–23, 2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2273869 (examining the recent changes in Delaware LLC fiduciary laws).

195. *Id.* at 13.

196. *See* Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1735–43 (2001) (indicating that fiduciary duties convey socializing cues as to what expectations of trustworthy conduct are).

197. Peter H. Huang, *Trust, Guilt, and Securities Regulation*, 151 U PA. L. REV. 1059, 1075 (2003).

198. Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV.

Moreover, the dicta found in fiduciary cases arguably illuminate the path toward acceptable managerial conduct.[199] The socializing function of the law should not end with the ability to modify or eliminate fiduciary duties. If anything, increased ethical training in business and law schools may be called for to promote the socializing functions of the law in an internal governance environment that presents many contractual choices.

The making of unethical choices can be seen in a wide variety of business entity contexts, whether involving a redemption of retirees' put rights on the eve of a lucrative sale,[200] an unfair buy-out of investors at a sham auction,[201] a bargain basement buy-out prior to a clandestine sale of the entire entity,[202] or an opportunistic refusal to agree to a buy-out proposal or a dissolution by unfairly taking advantage of the fact that the LLC member is an assignee.[203] The common theme that emerges is the willingness to make unethical choices.[204] Irrespective of whether traditional fiduciary duties or contractual ones apply, emerging alternative entity cases are symptomatic of a failure of law schools and business schools to effectively instill the importance of ethical decision-making. Additionally, the persistence of opportunistic conduct in the case law could be symptomatic of inadequacies in Continuing Legal Education.

The continuing parade of sharp business practices is surprising considering that the American Bar Association (ABA) requires all accredited law schools to establish learning outcomes that include the exercise of proper professional and ethical responsibilities to clients and the legal system.[205] Further, ABA Standards for accreditation require one course

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1009, 1015 (1997); *see also* Mohsen Manesh, *Damning Dictum: The Default Duty Debate in Delaware*, 39 J. CORP. L. 35, 57 (2013) (using dictum to provide direction where the law is silent).

199. Manesh, *supra* note 198, at 57.

200. *See generally* Nemec v. Shrader, 991 A. 2d 1120 (Del. 2010) (involving Booz Allen's redemption of two highly-ranking retired board members just before the sale of its government business for $2.5 billion, a move that was technically within the terms of the redemption agreement but which deprived the plaintiffs of $60 million after the defendant had reassured the plaintiffs that their rights would not be redeemed before the closing of the sale).

201. *See generally* Auriga Capital Corp. v. Gatz Props., 40 A.3d 839 (Del. Ch. 2012) (involving a defendant whose family real estate LLC held a golf course and conducted a sham auction at which the defendant had turned away credible buyers and purchased the LLC at an artificially low price).

202. *See generally* Salm v. Feldstein, 799 N.Y.S.2d 104 (N.Y. App. Div. 2005) (involving a defendant who bought out plaintiff's 50% interest for $1.375 million and a $1.3 million consulting contract and then sold the automobile dealership for $16 million).

203. *See generally In re* Carlisle Etcetera LLC, 114 A.3d 592 (Del. Ch. 2015) (granting a judicial dissolution on equitable grounds where a party had refused to buy out the member or dissolve the company even though it was clear that the parties were deadlocked and the LLC could not function as originally intended).

204. *See generally* RED Capital Investment L.P. v. RED Parent LLC, C.A. No. 11575-VCN, 2016 WL 612772 (Del. Ch. Feb. 11, 2016) (involving a refusal to provide records which plaintiff had a right to inspect); Wisniewski v. Walsh, 2015 WL 9380616, *2–3 (N.J. Sup. Ct. App. Div. Dec. 24, 2015) (involving family business dispute in which one sibling diverted opportunities from the others, discontinued payment of bills on behalf of his siblings, diverted billings and receipts, and excluded sibling from a real estate deal); Matter of Zafar, Index No. 3123/2015 (N.Y. Sup. Ct. Dutchess County Dec. 4, 2015), http://www.nybusinessdivorce.com/2016/01/articles/grounds-for-dissolution/court-dissolves-llc-due-to-managing-members-self-dealing-and-dishonest-conduct/ (links to decision) (granting dissolution where respondent accepted $100,000 in cash from rental without telling petitioner and diverted business to his own competing entities).

205. *Program of Legal Education*, ABA, http://www.americanbar.org/content/dam/aba/publications/misc/legal_education/Standards/2016_2017_standards_chapter3.authcheckdam.pdf (last visited Oct. 27, 2016).

of at least two credits on professional responsibility.[206] Moreover, the Association to Advance Collegiate Schools of Business (AACSB) International, the organization that accredits business schools worldwide, requires each AACSB-accredited business school to establish its own learning goals and to assess student progress in meeting the goals. Ethical decision-making figures prominently as an example of how the Assurance-of-Learning guidelines should work.[207] Moreover, the AACSB Ethics Education Task Force has called for a renaissance in ethics education.[208] As the Task Force noted a number of years ago, "'[m]aking the world a better place' isn't the exclusive province of business schools; but business schools can—and want to—equip their students to be ethical and successful managers and leaders."[209] In addition, a large number of business schools have become members of the Principles of Responsible Management Education (PRME), a worldwide organization that is committed to supporting the United Nations Global Compact.[210] This global compact endorses universal principles supporting human rights, labor rights, the environment, and freedom from government corruption.[211]

Clearly, more work needs to be done in both business and law schools to invigorate the role of ethics in the curricula. The introduction of PRME into the business school curricula may help business students to appreciate the ethical dimensions of business decision-making. A one- or two-credit course on ethics in law schools is arguably not enough to instill ethical decision-making in providing legal advice. Integrating ethical units into courses on contracts, business organizations, business planning, agency, and estate planning may be considerably more effective in fostering ethical sensibilities than a single law school course on ethics and professional responsibility. Similarly, in the business curriculum, integrating ethics in a coherent way in accounting, management, business law, marketing, entrepreneurship, leadership, and honors programs may prove helpful in reducing litigation in the long-run. Once again, empirical research can help to assess existing and future educational initiatives in ethical decision-making in connection with internal governance.

VI. CONCLUSION

206. *Id.* Yale University Law School requires one ethics course. *J.D. Degree Requirements*, YALE L. SCH., https://www.law.yale.edu/study-law-yale/degree-programs/jd-program/jd-degree-requirements (last visited Oct. 27, 2016). Harvard University School of Law offers a concentration in Business Law and offers a variety of business-related courses but no single special course on ethics in business planning. *Foundational Courses in Business Law*, HARV. L. SCH., http://hls.harvard.edu/dept/academics/programs-of-study/law-and-business/academic-offerings-law-and-business/ (last visited Oct. 27, 2016).

207. AACSB ASSURANCE OF LEARNING STANDARDS: AN INTERPRETATION, ASS'N. TO ADVANCE COLLEGIATE SCHS. OF BUS. INT'L., http://www.aacsb.edu/~/media/AACSB/Publications/white-papers/wp-assurance-of-learning-standards.ashx (last visited Oct. 27, 2016).

208. ETHICS EDUCATION IN BUSINESS SCHOOLS, ASS'N. TO ADVANCE COLLEGIATE SCHS. OF BUS. INT'L. (2004), http://www.aacsb.edu/~/media/AACSB/Publications/research-reports/ethics-education.ashx.

209. *Id.* at 14; *see also* Hanna Drozdowski, *The Hush-Hush Side of Business Ethics Education,* ASS'N. TO ADVANCE COLLEGIATE SCHS. OF BUS. INT'L. (June 22, 2011), http://aacsbblogs.typepad.com/dataandresearch/2011/06/the-real-inside-job-of-business-ethics-education.html (noting substantial interest and innovation in the area of business ethics).

210. PRINCIPLES FOR RESPONSIBLE MGMT. EDUC., http://www.unprme.org/ (last visited Oct. 27, 2016); *see* U.N. GLOB. COMPACT, https://www.unglobalcompact.org (last visited Oct. 27, 2016) (displaying general information about the United Nations Global Compact).

211. U.N. GLOB. COMPACT, *supra* note 210.

Against a backdrop of exceedingly complex and troubling litigation, Chief Justice Strine and Vice Chancellor Laster propose treating duty of loyalty waivers differently from duty of care waivers and would make the duty of loyalty mandatory in certain diversely-held alternative entities. Unlike Delaware corporate law, Delaware alternative entity law places the duty of care and the duty of loyalty on an equal footing with regard to waivers and indemnification provisions. This Article raises, although it does not pretend to answer, the broad questions of whether stakeholders view the duty of loyalty differently from the duty of care and whether they support waivers of the duty of care more readily than waivers of the duty of loyalty, in public and private company contexts. However, it begins a long overdue empirical investigation into business community perceptions of how the law should work. It reports the results of a pilot survey of 117 executives to which 45 responded regarding a breach in a hypothetical Duty of Loyalty Scenario and in a Duty of Care Scenario. The respondents displayed significantly less support for the waiver in the Duty of Loyalty Scenario than for the waiver in the Duty of Care Scenario and least support overall for a waiver of the duty of loyalty when the company posited was publicly-owned. Care must be taken to avoid generalizations beyond the two rather extreme scenarios that were presented in the survey. Nevertheless, the findings warrant broader research into perceptions regarding default duties, waivers in private and public company contexts, and comprehension levels of internal governance laws. The Article makes recommendations for improving the design of future studies and urges further empirical exploration of comprehension levels of fiduciary duty waivers among seniors over the age of 50—an age group which has invested in publicly-traded alternative entities with reduced legal protections. The discussion contextualizes the empirical survey by identifying the policy issues at stake, recommends updating the Nexus of Contracts paradigm in light of developing case law, and argues for an integrated approach to ethical training in business and law schools particularly now that fiduciary duties may be substantially or completely waived in a number of jurisdictions.

Appendix A: Survey Results

Scenario I

Scenario I: Duty of Loyalty Breach: For the past twelve years Sam has owned 25% of an LLC that operates a retail carpet business and Fred owns 75%. Sam works in the business and Fred does not. Sam gets an offer to sell the business for $10 million but doesn't tell Fred. Instead, Sam offers to buy out Fred for $1 million. Fred accepts, then three months later Sam sells and makes a big profit.

	Agree or Strongly Agree	**Disagree or Strongly Disagree**
DEFAULT BUILT-IN DUTY OF LOYALTY Assume there is no limited liability company agreement, just minimum filing with the state. Q10 The law should allow Fred to sue Sam because Sam never told his partner about the	91%	9%

$10 million offer.		
WAIVER OF LOYALTY PRIVATE CO. Assume that there is an agreement and it provides "The owners of this LLC expressly agree to eliminate the fiduciary duty of loyalty (i.e. the duty to act in the best interests of the business, to avoid competing, and to act with candor)." Q11a The law should let Sam use this waiver provision as a complete defense.	38%	62%
WAIVER OF LOYALTY PUBLIC CO. Q11b If the LLC Sam managed had been publicly traded and included this waiver, the law should let Sam use this waiver provision as a complete defense against an investor lawsuit.	23%	77%
WAIVER OF LOYALTY PUBLIC CO. WILLINGNESS TO INVEST Q12 If the LLC Sam managed had been publicly-traded, and included this waiver, would you have been willing to invest in the company?	Yes: 2%	No: 98%

Scenario II

Scenario II: Duty of Care Breach: For the past twelve years, Jason has been a 15% owner and the full-time manager of Orange Rehabilitation Center, LLC, a nursing home located in New Britain, Connecticut. The remaining 85% is owned by four private individuals who do not participate in the business. Over the last few years, Jason has been careless in managing the LLC. Although he works 35 hours per week, he has failed to properly supervise and manage employees. Medicare nursing home ratings have declined. The number of patient falls and lawsuits has risen as have instances of employee failure to follow rules and regulations. A major patient lawsuit threatens to bring the nursing home dangerously close to bankruptcy. Although Jason's conduct is hardly commendable, he has not violated any specific criminal laws and has not intentionally acted to harm the nursing home or its patients.

	Agree or Strongly Agree	**Disagree or Strongly Disagree**
DEFAULT BUILT-IN DUTY OF CARE **Assume there is no LLC operating agreement, just the minimal filing with the state.** Q13 The law should allow investors to sue Jason for	15%	85%

money damages.		
WAIVER OF DUTY OF CARE PRIVATE CO. The facts remain the same, except there is an LLC Agreement that that every investor had to sign when buying into the LLC. The agreement provides "The LLC manager shall not be subject to money damages except for fraud, willful misconduct, known criminal acts, deliberate intent to cause injury, and reckless disregard. Recklessness isn't defined in the agreement but it is commonly thought to be conscious indifference to the consequences of one's conduct. Q14a The law should let Jason use this waiver provision as a complete defense against an investor lawsuit.	74%	26%
WAIVER OF CARE PUBLIC CO. Q14b Assuming Jason managed a publicly traded LLC, the law should let Jason use the waiver provision as a complete defense against an investor lawsuit.	67%	33%
COMPREHENSION OF DUTY OF CARE Willingness to Invest in Company with a Duty of Care Waiver Q15 If the LLC Jason managed had been publicly traded and included this waiver, would you have been willing to invest in the company?	Yes: 31%	No: 69%

	Yes	**No**	**Not Sure**
Liability of Board Members of Fortune 100 Companies Q18 Have you acquired stock in a Fortune 100 Company (either directly or through a mutual fund) within the last few years?	92%	5%	3%
Q19 Are board members of a Fortune 100 Company usually personally liable if the directors act in a grossly negligent manner? (i.e. the Board members fail to properly inform themselves before making important business decisions, or manage the business in a careless way with a devil-may-care attitude?)	51%	31%	18%

Appendix B: LLC Statutes Nationwide

State	**Statutory Provisions**
Alabama	ALA. CODE §§ 10A-5A-1.01 to -12.05 (2014).
Alaska	ALASKA STAT. §§ 10.50.010 to .955 (2007).
Arizona	ARIZ. REV. STAT. ANN. §§ 29-601 to -857 (2008).
Arkansas	ARK. CODE §§ 4-32-101 to -1401 (2010).
California	CAL. CORP. CODE §§ 17701.01 to .17 (2014).
Colorado	COLO. REV. STAT. §§ 7-80-101 to -1101 (1990).
Connecticut	CONN. GEN. STAT. §§ 34-9 to -646 (2012). *But see* 2016 Conn. Legis. Serv. P.A. 16-97 (H.B. 5259) (Sections repealed).
Delaware	DEL. CODE ANN. tit. 6, §§ 18-101 to -1109 (2010).
District of Columbia	D.C. CODE §§ 29-801.01 to -810.01 (2011).
Florida	FLA. STAT. §§ 605.0101 to .1108 (2014).
Georgia	GA. CODE ANN. §§ 14-11-100 to -1109 (1993).
Hawaii	HAW. REV. STAT. §§ 428-101 to -1302 (2006).
Idaho	IDAHO STAT. §§ 30-25-101 to -806 (2015). Idaho Uniform Bus Org Code; effective July 1, 2015 with some provisions effective July 1, 2017.

Illinois	805 ILL. COMP. STAT. 180/1-1 to /60-1 (1994). *But see* Ill. P.A. 099-0844 (effective Aug. 19, 2016) (makes technical changes in sections).
Indiana	IND. CODE §§ 23-18-1-1 to -13-1 (1993).
Iowa	IOWA CODE §§ 489.101 to .1304 (2009).
Kansas	KAN. STAT. ANN. §§ 17-7662 to -17-76-146 (2014).
Kentucky	KY. REV. STAT. ANN. §§ 275.001 to .540 (1994).
Louisiana	LA. REV. STAT. ANN. §§ 1301 to 1370 (1990).
Maine	ME. REV. STAT. tit. 31, §§ 1501 to 1693 (2011).
Maryland	MD. CODE ANN., CORPS. & ASS'NS §§ 4A-101 to -1303 (2012).
Massachusetts	MASS. GEN. LAWS ch. 156C, §§ 1 to 72 (1995).
Michigan	MICH. COMP. LAWS ANN. §§ 450.4101 to .5200 (1993).
Mississippi	MISS. CODE ANN. §§ 79-29-101 to -1317 (2011).
Missouri	MO. REV. STAT. §§ 347.010 to .740 (1993).
Montana	MONT. CODE ANN. §§ 35-8-101 to -1307 (1993).
Nebraska	NEB. REV. STAT. §§ 21-101 to -197 (2011).
Nevada	NEV. REV. STAT. §§ 86.011 to .590 (2013).

New Hampshire	N.H. REV. STAT. ANN. §§ 304-C:1 to -C:210 (2013).
New Jersey	N.J. STAT. ANN. §§ 42:2C-1 to :2C-94 (2012).
New Mexico	N.M. STAT. ANN. §§ 53-19-1 to -74 (1999).
New York	N.Y. LTD. LIAB. CO. LAW §§ 101 to 1403 (2006).
North Carolina	N.C. GEN. STAT. §57D-1-01 – 57D-11-03 (2014).
North Dakota	N.D CENT. CODE §§ 10-32.1 to 10.32.1-101 (2015).
Ohio	OHIO REV. CODE ANN. §§ 1705.01 to .61 (2012).
Oklahoma	OKLA. STAT. tit. 18, §§ 2000 to 2060 (1992).
Oregon	ORE. REV. STAT. §§ 63.001 to .990 (2010).
Pennsylvania	15 PA. CONS. STAT. §§ 8901 to 8998 (1994).
Rhode Island	7 R.I. GEN. LAWS §§ 16-1 to -76 (1992).
South Carolina	S.C. CODE ANN. §§ 33-44-101 to -1208 (1976). *But see* 2015-2016 Senate Bill 603S (bill to Amend).
South Dakota	S.D. CODIFIED LAWS §§ 47-34A-101 to -1207 (2013).
Tennessee	TENN. CODE ANN. §§ 48-201-101 to -249-1133 (1994).
Texas	TEX. BUS. ORGS. CODE ANN. §§ 101.001 to .622 (2006).
Utah	UTAH CODE ANN. §§ 48-3a-101 to -1405 (2014).
Vermont	VT. STAT. ANN. tit. 11, ch. 25 §§ 4001 to 4163 (2015).

Virginia	VA. CODE ANN. §§ 13.1-1000 to -1087 (2016).
Washington	WASH. REV. CODE §§ 25.15. 005 to 15.905 (2016).
West Virginia	W. VA. CODE §§ 31B-1-101 to -13-1306 (2003).
Wisconsin	WIS. STAT. §§ 183.0102 to .1305 (2015).
Wyoming	WYO. STAT. ANN. §§ 17-29-101 to -1105 (2010).

*For a 2015 update on the progress of proposed legislation to follow the Uniform Limited Liability Company Act (ULLCA) (2006) (last amended in 2013), visit ULLCA on the website of the National Conference of Commissioners on Uniform State Laws (NCCUSL) < http://www.uniformlaws.org/>.

Note 1 Minnesota: The revised statute will be effective Aug. 1, 2015, and is applicable to all LLCs formed after that date. LLCs formed before Aug. 1, 2015 will not be subject to the revised statute until Jan. 1, 2018, unless the LLC elects to be governed by the New Act during the transition period.

Appendix C: Summary of Rules Permitting Some Form of Contractual Elimination of the Duty of Care and Loyalty

Note: This chart provides only a brief summary and the statutory language should be read with care.

State and Statute	Can the Duty of Care be Eliminated?	Can the Duty of Loyalty be Eliminated?	Special Notes
*Alabama ALA. CODE § 10A-5A-4.10 (2014).	Duties may be expanded, restricted, or eliminated. § 10A-5A-1.08(b)(1).	Duties may be expanded, restricted, or eliminated. § 10A-5A-1.08(b)(1).	May not eliminate or limit the liability for any act or omission that constitutes a bad faith violation of the implied covenant of good faith and fair dealing. § 10A-5A-1.08(b)(2)

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
Arkansas ARK CODE ANN. §4-32-404 (2005).	An operating agreement that is in writing may eliminate or limit the personal liability of a member or manager for monetary damages for breach of any duty provided for in Section 4-32-402 (discussing duties).	An operating agreement that is in writing may eliminate or limit the personal liability of a member or manager for monetary damages for breach of any duty provided for in Section 4-32-402 (discussing duties).	

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
Colorado COLO. REV. STAT. §§ 7-80-108 (2016).	Yes, may restrict or eliminate duties if provisions are not manifestly unreasonable; may not unreasonably restrict information and confidentiality rights.	Yes, may restrict or eliminate duties if provisions are not manifestly unreasonable; may not unreasonably restrict information and confidentiality rights.	An operating agreement may not eliminate the obligation of good faith and fair dealing, except it may prescribe standards by which the performance of the obligation is to be measured, if such standards are not unreasonable.
Delaware DEL. CODE ANN. tit. 6, § 18-1101(c) (2013).	Yes.	Yes.	Any fiduciary duty may be eliminated insofar as the implied contractual covenant of good faith and fair dealing remains.

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*District of Columbia D.C. CODE § 29-801.07 (2013).	No, but if not manifestly unreasonable, can alter the duty of care (except for intentional misconduct or knowing violation of law). § 29-801.07(d)(3).	Yes, insofar as if not manifestly unreasonable, the operating agreement may restrict or eliminate the duty to account, to refrain from dealing on behalf of a party having an adverse interest, and to compete. § 29-801.07(d) (1)(A)–(C).	May not eliminate the contractual covenant of good faith and fair dealing. § 29-801.07(c)(5); If not manifestly unreasonable may alter any other duty including eliminating aspects of the duty; consult statute for other special rules (i.e., information rights and dissolution).

*Florida FLA. CODE ANN. § 605.0105 (2015).	If not manifestly unreasonable, may alter the duty of care, but may not authorize willful or intentional misconduct or a knowing violation of law.	If not manifestly unreasonable, may alter or eliminate the aspects of the duty of loyalty regarding conduct or winding up, the use of property, or the appropriation of a company opportunity; the agreement may identify activities that don't violate the duty of loyalty.	May not eliminate the obligation of good faith and fair dealing, but the operating agreement may prescribe the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable. In the determination of whether a term is manifestly unreasonable, the court shall make its determination at the time the term became part of the agreement. The statute provides other highly-specific judicial guidelines for

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
			the determination of reasonableness.
Georgia GA. CODE ANN. § 14-11-305 (1995).	Duties may be expanded, restricted, or eliminated in the articles of organization or in a written operating agreement.	Duties may be expanded, restricted, or eliminated in the articles of organization or in a written operating agreement.	Cannot eliminate or limit liability for intentional misconduct, knowing violation of law, or for the receipt of personal benefits in violation of the written operating agreement.

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*Idaho IDAHO CODE ANN. §30-6-110 (repealed, effective July 1, 2017).	No, but if not manifestly unreasonable, can alter the duty of care (except for intentional misconduct or knowing violation of law). *See* IDAHO CODE ANN. §30-6-110 (allowing an operating agreement to alter the duty of care).	Yes, insofar as if not manifestly unreasonable, the operating agreement may restrict or eliminate the duty to account, to refrain from dealing on behalf of a party having an adverse interest, and to compete. Also may alter any other fiduciary duty, including eliminating particular aspects of that duty.	May not eliminate the contractual covenant of good faith and fair dealing. If not manifestly unreasonable, may alter any other duty including eliminating aspects of the duty; consult statute for other special rules (i.e., information rights and dissolution).

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*Illinois H.B. 4361, 99th Gen. Assemb. (Ill. 2016).	If not manifestly unreasonable, may alter the duty of care, but may not authorize willful or intentional misconduct or a knowing violation of law.	May restrict or eliminate a duty other than duty of care, but only to the extent that it is clear and unambiguous, may specify method by which a specific act or transaction that would otherwise violate the duty of loyalty may be authorized or ratified by one or more disinterested and independent persons after full disclosure of all material facts.	Subject to sections allowing the restriction or elimination of a duty other than duty of care. Indemnification not allowed for violations of the duty of loyalty to account, to act fairly when dealing with or winding up the company, or to refrain from competing; a financial benefit to which not entitled, unlawful distributions, intentional harm, or intentional violation of criminal law.

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
Kentucky KY. REV. STAT. ANN. § 275.180 (1998).	The operating agreement may eliminate or limit the personal liability for breach of duties.	The operating agreement may eliminate or limit the personal liability for breach of duties.	

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*Minnesota MINN. STAT. § 322C.0110 (2015) (subject to transition rules for companies formed before that date).	The agreement may restrict or eliminate statutorily-identified duties.	If not manifestly unreasonable, the agreement may restrict or eliminate the duty to account, to refrain from dealing with or on behalf of a party with an adverse interest, and to refrain from competing; can identify conduct that does not violate duty of loyalty.	May not vary the power of the court to decree dissolution; may not eliminate the duty of good faith and fair dealing.

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*Nebraska NEB. REV. STAT. § 21-110 (2010).	No, but it may be altered. However, it cannot be altered to authorize intentional misconduct or knowing violation of law.	Yes, insofar as if not manifestly unreasonable, the operating agreement may restrict or eliminate the duty to account, to refrain from dealing on behalf of a party having an adverse interest, and to compete. Also may alter any other fiduciary duty, including eliminating particular aspects of that duty.	May not eliminate contractual covenant of good faith and fair dealing. NEB. REV. STAT. § 21-110(b) (4). If not manifestly unreasonable may alter any other duty including eliminating aspects of the duty; consult statute for other special rules (i.e., information rights and dissolution).

State and Statute	Can the Duty of Care be Eliminated?	Can the Duty of Loyalty be Eliminated?	Special Notes
New Hampshire N.H. REV. STAT. ANN. § 304-C:107 (2016).	Yes, in that duties may be expanded, restricted, or eliminated.	Yes, in that duties may be expanded, restricted, or eliminated.	May not eliminate the implied contractual covenant of good faith and fair dealing. Section 304-C:111 provides that the implied contractual covenant of good faith and fair dealing shall include a duty to use reasonable efforts to meet the reasonable expectations of the LLC and of the members on matters within the scope of the operating agreement but not specifically addressed in it.

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*New Jersey N.J. STAT. ANN. § 42:2C-11 (2013).	No, but if not manifestly unreasonable, can alter the duty of care (except for intentional misconduct or knowing violation of law).	Yes, insofar as if not manifestly unreasonable, the operating agreement may restrict or eliminate the duty to account, to refrain from dealing on behalf of a party having an adverse interest, and to compete.	May not eliminate the contractual covenant of good faith and fair dealing. If not manifestly unreasonable may alter any other duty including eliminating aspects of the duty; consult statute for other special rules (i.e., information rights and dissolution).

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
New York N.Y. LTD. LIAB. CO. LAW § 417 (1996).	The operating agreement may eliminate or limit personal liability for damages subject to specified exceptions.	The operating agreement may eliminate or limit personal liability for damages subject to specified exceptions.	Cannot eliminate liabilities if adjudication establishes bad faith, intentional misconduct, knowing violation of law, certain personal gains, or distributions. (Consult statute for other limitations).

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*Utah UTAH CODE ANN. § 48-3a-110 (2014).	No, but if not manifestly unreasonable, can alter the duty of care (except for intentional misconduct or knowing violation of law). (Note: Also cannot relieve or exonerate a person from liability for conduct involving bad faith, willful misconduct, or recklessness).	Yes.	May not eliminate the obligation of good faith and fair dealing. May alter or eliminate indemnification except for the receipt of un-entitled financial benefits, improper distributions, or an intentional violation of criminal law. (Consult statute for other special rules).

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*Mississippi MISS. CODE ANN. § 79-29-123 (2015).	Yes.	Providing in part that duties may be expanded, restricted or eliminated.	Cannot limit or eliminate liability for financial benefits to which not entitled, intentional infliction of harm, intentional violation of criminal law, certain specified distributions, or bad faith violations of the implied contractual covenant of good faith and fair dealing.

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*North Dakota N.D. CENT. CODE § 10-32.1-13 (2016).	If not manifestly unreasonable, may alter the duty of care, except to authorize intentional misconduct or knowing violation of law. Note: RULLCA excepts not just intentional misconduct and knowing violation of law, but also excepts bad faith.	If not manifestly unreasonable may alter the duty of account, or to refrain from competing.	Detailed indemnification rules; indemnification only if acted in good faith; received no improper benefit; in a criminal proceeding had no reasonable cause to believe the conduct was unlawful, and if acting in official capacity reasonably believed the act or omission was not opposed to the best interests of the LLC. N.D. CENT. CODE § 10-32.1-40 (2016).

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
*Vermont VT. STAT. ANN. tit. 11, § 4003 (2016).	Adopted RULLCA, but does not permit the elimination of the duty of loyalty, care, or any other fiduciary duty. Unless unreasonable, the agreement may restrict these duties (Section 4003 (c)(1)) or prescribe standards for satisfying the implied covenant of good faith and fair dealing.	Adopted RULLCA, but does not permit the elimination of the duty of loyalty, care, or any other fiduciary duty. Unless unreasonable, the agreement may restrict these duties (Section 4003 (c) (1)) or prescribe standards for satisfying the implied covenant of good faith and fair dealing.	

*Washington WASH. REV. CODE ANN. § 25.15.038 (2016).	Has adopted RULLCA, but operating agreement may not eliminate or limit the duty to avoid intentional infliction of harm to the company or its members, knowing violations of law, or breaches of the implied covenant of good faith and fair dealing. Under Section 25.15.041 may not indemnify if adjudged intentional misconduct, knowing violation of law, or adjudged to have violated		

State and Statute	**Can the Duty of Care be Eliminated?**	**Can the Duty of Loyalty be Eliminated?**	**Special Notes**
	provisions on distributions.		

*States that have adopted in whole or in part the Revised Uniform Limited Liability Company Act (RULLCA).

Note that California has adopted RULLCA but does not permit the elimination of duties. As shown above, Vermont has adopted RULLCA but does not permit the elimination of the duty of loyalty, care, or any other fiduciary duty. Unless unreasonable, the agreement may restrict these duties (see 4003 (c)(1)) or prescribe standards for satisfying the implied covenant of good faith and fair dealing. See VT. STAT. ANN. tit. 11, ch. 25 § 4003 (2016).

Appendix D: Selected Indemnification Provisions Requiring Good Faith and Reasonable Belief Conduct Was in Best Interests or Not Opposed to Best Interests of the LLC

State	**Statutory Provision**
Alaska	ALASKA STAT. § 10.50.148 (2016).
Massachusetts	MASS. GEN. LAWS ch. 156C, § 8 (2016).
Minnesota	MINN. STAT. ANN. § 322B.699 (2008). MINN. 322C.0110 (8-1-15) (contains different rules).
Nevada	NEV. REV. STAT. ANN. §§ 86.411, 86.421 (2015).
New Hampshire	N.H. REV. STAT. ANN. § 304-C:116 (2013).
New York	N.Y. LIMIT. LIAB. CO. LAW § 420 (1994).
Tennessee	TENN. CODE ANN. § 48-249-115 (2012).

There is some variation in this language. The pre-August 1, 2015 Minnesota statute provides that the LLC shall provide indemnification if the person has not been indemnified by another organization or an employee benefit plan and the person acted in good faith, received no improper personal benefit or otherwise satisfied provisions concerning conflicts of interest, and reasonably believed the conduct was in the best interests of the LLC or not opposed to its best interests. See transition rules for Minnesota's Revised Uniform Limited Liability Company Act which has modified this provision. Under MINN. 322C.0110 effective August 1, 2015 different rules apply. The revised indemnification rules prohibit indemnification for breaches in the duty of loyalty, receipt of financial benefits to which not entitled, improper distributions, intentional infliction of harm, or intentional violation of law. Nevada provides that the LLC may provide indemnification if the person conducted himself in good faith and he reasonably believed that the conduct was in the best interests of the LLC or not opposed to its best interests, had no reasonable cause to believe the conduct was unlawful in the case of a criminal proceeding, and may not indemnify if the person was adjudged liable to the LLC or in receipt of an improper personal benefit. New Hampshire permits indemnification if the person conducted himself in good faith, and reasonably believed the conduct to be in the best interests of the LLC or not opposed to its best interests, and prohibits indemnification where the person is adjudged liable to the LLC or liable for a personal benefit improperly received by him. New York prohibits indemnification if it is adjudicated that the person exercised bad faith, deliberate dishonesty, or personally gained. Tennessee permits indemnification if the individual acted in good faith and reasonably believed the conduct was in the LLC's best interests or not opposed to its best interests, and had no reasonable cause to believe the conduct was unlawful in the event of a criminal proceeding.

*Appendix E: Selected Indemnification Provisions: Other Restrictions**

State	**Statutory Provision**
California	CAL. CORP. CODE § 17701.10 (g). (Jan. 1, 2016).
Colorado	COLO. REV. STAT. § 7-80-407 (2006).
District of Columbia	D.C. CODE § 29-804.08 (2013).
Florida	FLA. STAT. ANN. § 605.0105 (2015).
Georgia	GA. CODE ANN. §14-11-306 (2016).
Idaho	IDAHO CODE ANN. § 30-6-408 (2016).

Indiana	IND. CODE ANN. § 23-18-2-2(14) (2014).
Iowa	IOWA CODE ANN. § 489.110(7) (2013).
Louisiana	LA. REV. STAT. ANN. § 1314 (1999).
Maryland	MD. CODE ANN., CORPS. & ASS'NS § 4A-203(14) (2012).
Michigan	MICH. H. LAWS ANN. § 450.4216 (2010), § 450.4407 (1993).
Minnesota	MINN. STAT. § 322C.0110 (2015).
Mississippi	MISS. CODE ANN. 79-29-123 (2015).
Montana	MONT. CODE ANN. § 35-8-107 (2015).
New Jersey	N.J. STAT. ANN. § 42:2C-11(g) (2014).
New York	N.Y. LTD. LIAB. CO. LAW § 117 (2014).
North Carolina	N.C. GEN. STAT. § 57D –2-30
North Dakota	N.D. CENT. CODE 10-32.1-13.
Ohio	OHIO REV. CODE ANN. § 1705.32 (2016).
Oklahoma	OKLA. STAT. ANN. tit. 18 § 2017 (2016).
Oregon	OR. REV. STAT. § 63.160 (2016).
Pennsylvania	15 PA. CONS. STAT. ANN. § 8510 (2001), § 8945 (2001).
Rhode Island	R.I. GEN. LAWS § 7-16-4 (2016).
Texas	TEX. BUS. ORG. CODE ANN. §§ 8.101 (2006), -102 (2015).

Utah	UTAH CODE ANN. § 48-3a-408 (2016).
Vermont	VT. STAT. ANN. tit. 11, ch. 25 § 4003(f).
Washington	WASH. REV. CODE ANN. § 25.15.041 (2016).
Wisconsin	WIS. STAT. ANN. § 183.0403 (2015).

Colorado permits indemnification if liability incurred without violation of "duties to the [LLC]." Florida prohibits giving relief or exoneration for conduct involving bad faith, willful or intentional misconduct, or knowing violation of law. Mississippi contains restrictions on limiting or eliminating liability for taking financial benefits to which not entitled, intentional inflictions of harm on the LLC or members, intentional violations of criminal law, wrongful distributions, bad faith violations of the implied contractual covenant of good faith and fair dealing, and restrictions on indemnification for the above conduct and for fraudulent conduct. Montana provides for indemnification except in the case of willful misconduct or recklessness, and subject to standards and restrictions if any in the operating agreement. The Minnesota Revised Uniform Limited Liability Company Act prohibits indemnification for a breach of the duty of loyalty, receipt of a financial benefit to which not entitled, improper distributions, intentional infliction of harm or intentional violation of law. The New Mexico Revised Uniform LLC Act prohibits an agreement from relieving or exonerating for conduct involving bad faith, willful or intentional misconduct or knowing violation of law. Pennsylvania prohibits indemnification where a court has found willful misconduct or recklessness. The Rhode Island LLC statute authorizes indemnification to the same extent as its corporate counterpart. Utah places restrictions on indemnification in the case of violations of the duty of loyalty, distributions to which the party is not entitled, and intentional violations of criminal law. Vermont does not permit the agreement to alter or eliminate the indemnification of a member or manager to eliminate liability for breach of the duty of loyalty, un-entitled financial benefit, breach of the duty of good faith and fair dealing, intentional infliction of harm on the company or a member, or intentional violation of criminal law. Washington prohibits indemnification for intentional misconduct or knowing violation of law.

Appendix F: Indemnification Provisions without Express Restrictions

State	**Statutory Provision**

Alabama	ALA. CODE § 10A-5A-4.10 (2014).
Arizona	ARIZ. REV. STAT. ANN. § 29-610 (1993).
Arkansas	ARK. CODE ANN. § 4-32-404 (1993).
Connecticut	CONN. GEN. STAT. ANN. § 34-143 (1993).
Delaware	DEL. CODE ANN. tit. 6, § 18-108 (1992).
Kansas	KAN. STAT. ANN. § 17-7670 (2014).
Kentucky	KY. REV. STAT. ANN. § 275.180 (1998).
Maine	ME. REV. STAT. ANN. tit. 31, § 1557 (2011).
New Mexico	N.M. STAT. ANN. § 53-19-18 (1993).
Virginia	VA. CODE ANN. § 13.1-1009 (2013).

Appendix G: Statistical Choices for Analyses

As mentioned above, one of the overall purposes of the study was to determine whether respondents would display a tendency to perceive the duty of loyalty and the duty of care differently with regard to the questions of: 1) whether the law should supply built-in protection when the parties failed to adopt an agreement; and 2) whether the law should permit a contractual waiver if the parties had included a waiver in their agreement. As discussed below, we used the null hypothesis to frame the analysis and employed nonparametric statistical procedures due to the nature of the data that was collected.

Formulation of the Null Hypothesis: For each question that we asked, we formulated the null hypothesis to test the proposition that percentages of responses to each question would be equal as between the duty of loyalty scenario and the duty of care scenario. We tested the null hypotheses against the alternative hypotheses as discussed below. We then analyzed the data to determine whether, for each question, the null hypothesis should be rejected.[212]

Selection of a Version of the Wilcoxon Signed Rank Test to Analyze Differences:

212. *See* WILLIAM MENDENHALL & JAMES E. REINMUTH, STATISTICS FOR MANAGEMENT AND ECONOMICS 172–73(Duxbury Press, 3d ed. 1978) (discussing the null hypothesis and the development of an alternative hypothesis).

Because our sample was small, we realized that the data would not be truly representative of the larger population of investors. Were a larger sample available, we could have posited that the data reflected a normal probability distribution.[213] Normal populations typically reflect a bell curve. However, a simple test for normality revealed our sample data was not normally distributed. Therefore, we concluded that it was necessary to employ nonparametric statistical procedures. Nonparametric statistical procedures are designed to analyze differences in data where there are doubts about the assumptions underlying the standard methodology.[214]Although standard methodology for analyzing differences often uses a *t* test for determining whether there are statistically significant differences in a pair of means, the *t* test was inappropriate here because it pre-supposes a normal distribution.[215]

There are two major nonparametric statistical tests that were appropriate for our data set.[216] The first test known as the Wilcoxon Signed Rank Test is the most accurate and reliable. It is specifically meant to be used when data is not normally distributed. It assumes that two distributions, A and B, are skewed in the same direction. In those cases where two distributions A and B are not skewed in the same direction, the Sign test is the appropriate nonparametric test to see if there is a significant difference between responses to the two distributions, A and B.[217]

The Sign Rank Test or Sign Test is not as robust as the Wilcoxon Signed Rank Test, but it can be used when the data proves to be asymmetrical.[218] Most of the data collected from the present study presented distributions that were shifted over to the right or left. Therefore, in a number of instances, it was appropriate to use the Sign test. However, as indicated above, wherever the data made it possible, we used the Wilcoxon Signed Rank Test.[219]

Figure I. Support for Default Built-In Duties—Should the law allow a lawsuit although there was no express agreement?—A Private Company without an LLC agreement was posited

213. *Id.* at 187.
214. *Id.* at 660.
215. *Id.*
216. *See generally* JOSEPH DIXON ET AL., INTRODUCTION TO STATISTICAL ANALYSIS 280–86 (3d ed. 1969).
217. BRUCE L. BOWERMAN ET AL., BUSINESS STATISTICS IN PRACTICE (3d ed. 2003).
218. *See* LaMorte, *supra* note 81 (explaining how Sign Rank Test and Sign Test can be used when data proves asymmetrical).
219. *See id.* (explaining how Wilcoxon Signed Rank Test is best used when data sets allow).

Found in Survey Questions 10 and 13

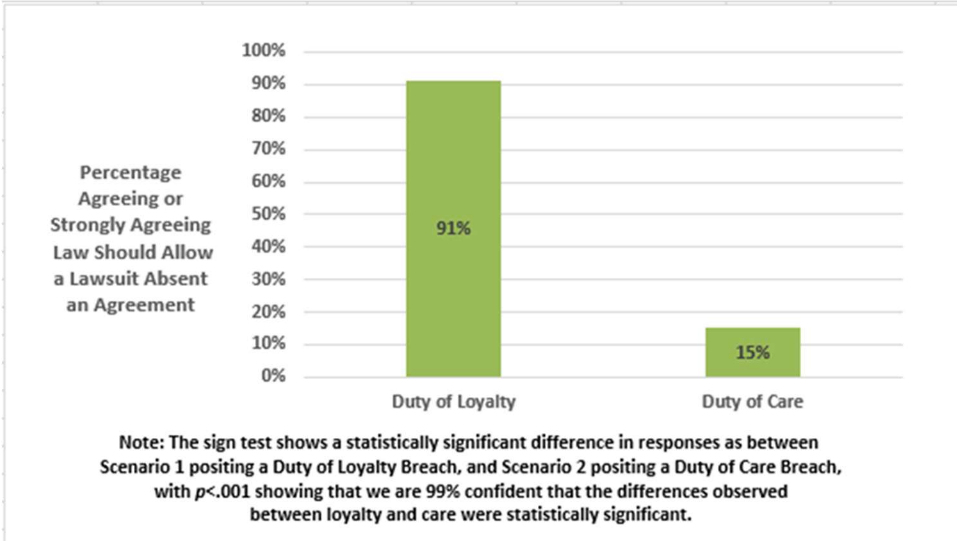


Figure II. Comparison of Private Company Loyalty Waiver and Care Waiver

Found in Survey Questions 11a and 14a

Note greater support for care waiver than loyalty waiver.

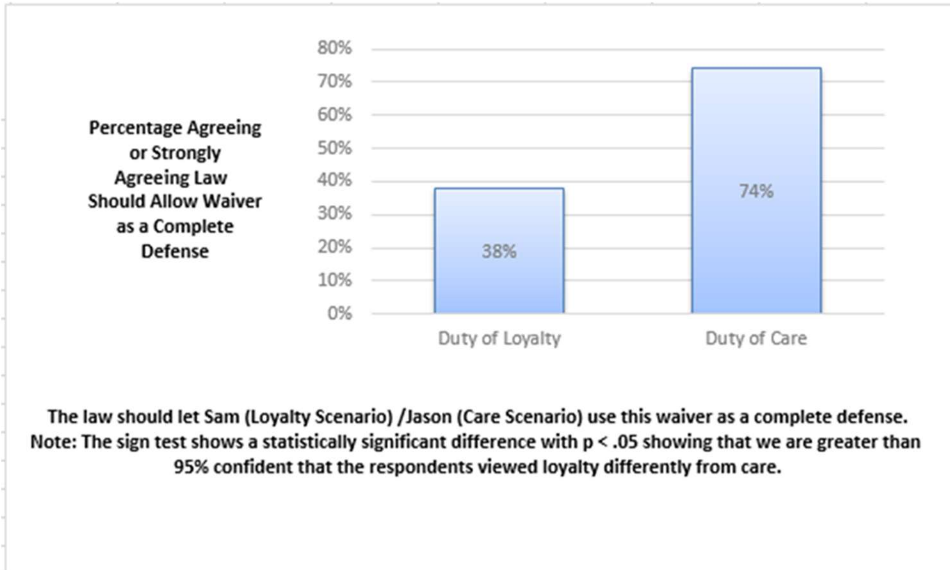


Figure III. Comparison of Public Company Loyalty and Care Waivers

Found in Survey Questions 11b and 14 b

Note that one-third of respondents *did not agree* or *strongly agree* that the duty of care waiver should be a complete defense.

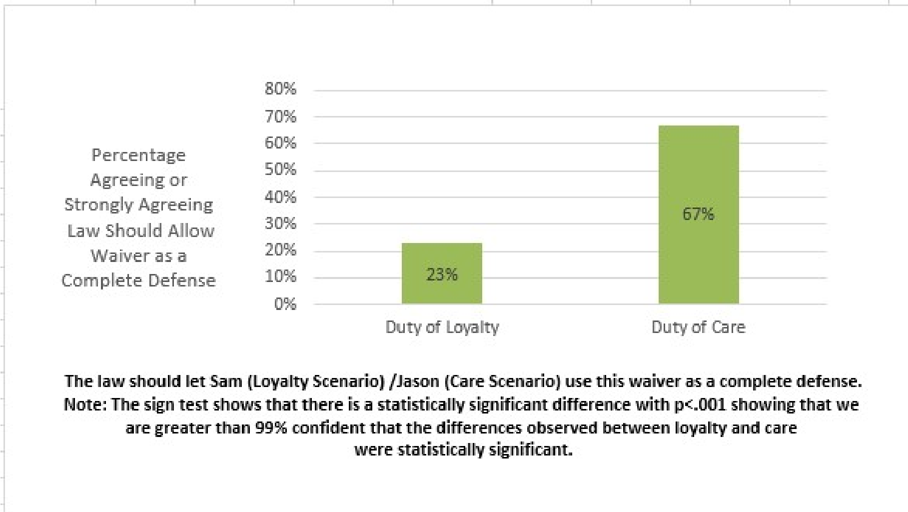
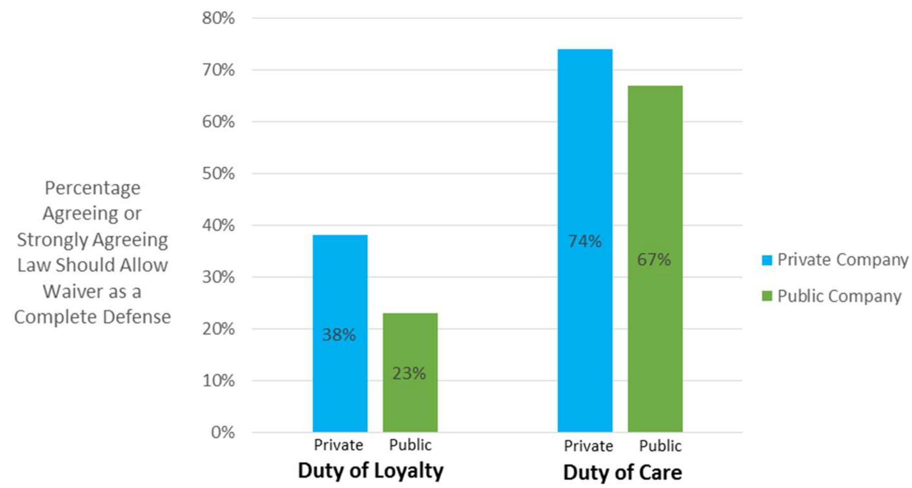


Figure IV. Waivers in Private as Compared to Public Company Scenarios



Loyalty Waiver: 38%. v. 23%: Under Wilcoxon Signed Rank Test p<.05, and we are 95% confident the difference is statistically significant.
Care Waiver: 74% v. 67%: Under The Wilcoxon Signed Rank Test with p < .10,
we are 90% confident that the differences were statistically significant. For more details see App. G.