Fiduciary Duties of Partners and Limited Liability Company Members Under South Carolina Law: A Perspective from the Bench

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I. INTRODUCTION

The unincorporated association existed long before the United States itself. Not surprisingly, South Carolina common law contains a fairly significant partnership law tradition. Unlike Delaware’s rich corporate common law tradition, however, South Carolina’s common law contains few judicial opinions that address corporate and commercial law issues. Recently, the South Carolina Court of Appeals dealt

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** W. Bratton Riley, who currently works for Maybank Industries, LLC, was Chief Justice Toal’s Senior Law Clerk. Together, they explore how fiduciary duties function within the partnership and LLC context. The authors are very grateful for the contributions that Rebecca Hunter and Tina Cundari made to this work.

with a case about how fiduciary duties function in a general partnership and whether
any of the parties involved breached those duties.  Although the South Carolina
Supreme Court accepted a petition for a writ of certiorari and heard the parties' 
arguments, the parties settled the case before the court could issue an opinion.

While preparing for Kuznik, the court's research on fiduciary duties revealed 
a firestorm—a debate in legal academia that approximates the animosity of the 
Yankees-Red Sox rivalry. On one side of the debate are the contractarians—those
who believe that the libertarian principle of freedom of contract is sacrosanct 
because it guarantees efficiencies, thus imposing the minimal amount of societal
 costs. On the other side are the fiduciarians—those who believe that an agreement
to associate as a business, whether inadvertent, implied, or intentional, contains gap-
fillers, including moral obligations that parties cannot waive.

Within this debate exists the concern recognized by the contractarians that
moralistic dictates, such as Chief Justice Cardozo's triumphant declaration of a
partner's fiduciary duty in Meinhard v. Salmon, do little to delineate clearly the
duties. Immoral behavior in the business context, a contractarian would argue, 
compels courts to create common-law dictates that recognize illicit conduct but do
not fit the conduct within a clearly defined fiduciary duty scheme. The fiduciarian

(July 3, 2001), cert. dismissed (January 23, 2004) (orders on file at South Carolina Supreme Court).
3. Id.
4. See, e.g., Margaret M. Blair & Lynn A. Stout, Trust, Trustworthiness, and the Behavioral 
contractarians and the anticontractarians has raged for two decades and produced voluminous 
literature.").
5. We borrow this term from J. William Callison, Blind Men and Elephants: Fiduciary Duties
Under the Revised Uniform Partnership Act, Uniform Limited Liability Company Act, and Beyond,
6. Id.
7. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) provides the following famous statement
of the duty of loyalty:

[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.

Id. at 546 (citation omitted).
PA. L. REV. 1675, 1680 (1990) ("Judges continue to infuse fiduciary analysis in close corporation law 
with... ringing rhetoric... But it is increasingly rare that courts apply the principles underlying that
rhetoric.").
9. See id. at 1680–81.
would argue that the fiduciary duties themselves face extinction, with courts imposing them only upon the agreement of the parties.  

Part II of this Article explores the context of the partner’s fiduciary duties. 11 The Revised Uniform Partnership Act (RUPA), 12 which is not the law in South Carolina, is an important resource for understanding the fiduciary duties that partners owe one another. RUPA does little to temper the academic squabble over the impact of common-law fiduciary duties. 13 While RUPA is an imperfect attempt to articulate the partnership default rules, including rules creating fiduciary duties, it does provide an important contrast to the current common law of partnerships in South Carolina. In addition, RUPA provided the foundation for one of the more significant commercial statutory creatures in recent times—the Uniform Limited Liability Company Act (ULLCA). 14

Because the Limited Liability Company (LLC) has become an incredibly popular corporate form, and jurisprudence does not adequately illustrate the operation of fiduciary duties in the LLC context, 15 Part III of this Article encourages practicing attorneys and laypersons considering creating the easy-to-form, “check

10. Cf. id. at 1681 (“[I]n the course of abandoning fiduciary principles for analyses requiring less subtle evaluations, courts implicitly have rejected . . . the vision of corporate ethics . . . . The consequence is a significant dilution of fiduciary duty as an aspirational precept . . . .”).

11. The following passage by Lawrence E. Mitchell articulately encapsulates the significance of fiduciary duties:

No law or contract is likely to substitute for the trust and mutual regard of the parties. But law can be used in a way that will help to foster the development of trust and make it more rational. Trust is a device that, among other things, reduces uncertainty in an enormously complex world. Much is uncertain at the time parties enter into a partnership relationship. Although each makes assumptions or predictions, foresight is hardly perfect. Moreover, although presumably the parties trust each other to keep their basic agreement or they would likely not enter into business together in the first place, they have no way of assuring their partner’s fidelity over time. Finally, each may well have different interpretations of their mutual agreement when problems arise.

Fiduciary duty provides a means of ameliorating these difficulties by making trust rational. In the first place, fiduciary duty gives each party a reason to trust the other in a long-term relationship of unforeseeable consequences because, backed by legal sanctions, it requires each party to act as if it were trustworthy, even if circumstances incline the party to behave badly. Moreover, by instructing the partners as to the type of behavior that is required of them, it has the potential to forestall legal disputes by giving the parties an incentive to negotiate.


13. See, e.g., Callison, supra note 5, at 117 (“Few have been content with RUPA’s statement of fiduciary duties.”).


the box” LLC to contemplate the fiduciary rules that apply to the LLC at the outset, as opposed to waiting for guidance from future judicial opinions.17

Thus, the essence of this Article, in which we attempt to define the default fiduciary duties that apply in partnerships and our view of the fiduciary framework of the LLC, calls for an addition of necessary depth to the fiduciary road map of both entities. Ultimately, this Article strives to aid those selecting between the partnership and the LLC business forms.

II. FIDUCIARY DUTY WITHIN A PARTNERSHIP

Being a creature of the common law, the partnership and its concomitant rules and duties are the subjects of years of judicial opinions. In 1950, the South Carolina General Assembly adopted the South Carolina version of the Uniform Partnership Act (UPA), which included some of these judicially created rules and duties.18 For a partner’s fiduciary duties, the UPA merely states that every partner is accountable to the partnership as a fiduciary.19 This statutory language is “merely an anti-theft provision,”20 and only the pieces of the common law are left to address the fiduciary duties a partner owes copartners in a general partnership.

Some legal scholars bristle at the UPA’s failure to define fiduciary duties. This failure tends to perpetuate “galloping Meinhardism.”21 a theory under which courts enforce fiduciary duties with flamboyant prose.22 The grandiose, moralistic common-law declarations, both from this jurisdiction and others, present difficulty for drafters of partnership agreements to anticipate how the common law will define fiduciary duties in a given partnership. However, the ideas that righteous rules do not attach to the partnership scenario and that parties can contract away these duties in the partnership agreement are not appealing. This Section will provide some insight into the fiduciary rules in South Carolina and the manner in which they operate within the general partnership context.

In general, “[f]iduciary duties reflect the unspoken expectations of persons entering into a relationship of trust and thus exist in every such relationship when

16. See discussion infra Part III.
17. See 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 (2004) (providing an interesting argument for the need of common-law jurisprudence that applies a more traditional approach to fiduciary duties—an approach that attaches the fiduciary duties of care and loyalty—to the LLC).
22. See, e.g., Mitchell, supra note 8, at 1696 (arguing that Chief Justice Cardozo’s language in Meinhard, 164 N.E. at 546, “is aspirational and studiously imprecise. The very ambiguity of the language conveys its moral content ... by making it difficult for a fiduciary to determine the point at which self-serv ing conduct will be prohibited, and thus to encourage conduct well within the borders.”) (footnote omitted).

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nothing specific is said about such duties.” 23 This Article attempts to explain how fiduciary duties operate because the UPA fails to do so. This Article asserts that the fiduciary duties of care, good faith and fair dealing, and loyalty attach to every partner in a general partnership and to every general partner in a limited liability partnership. 24 In certain circumstances, partners may agree to circumscribe the fiduciary duty of care. For example, partners may limit liability only to those actions involving gross negligence. Partners may not, however, contractually alter the duty of good faith and fair dealing or the duty of loyalty.

A. Fiduciary Duty of Care

Arguably, the most fundamental difference between the partnership and every other business association is that if a partner becomes liable for an act within the ordinary course of partnership business, the partnership itself becomes liable. 25 The manner in which the default rule creating a duty of care functions to impose mutually shared liability under this agreement will have a tremendous impact on the partnership as a whole. Should the courts hold partners to the high standard of ordinary care or should they only hold partners liable for those actions which rise to the level of gross negligence? Historically, courts, 26 and some legal scholars, 27 have found that the ordinary care standard should apply. Many other scholars, 28 and RUPA itself, 29 determine that the standard should be set at gross negligence. Others assert that a “one-size-fits-all” gap-filler fiduciary duty of care standard cannot reasonably satisfy a partnership’s legitimate expectations. 30

The disagreement over the scope of the default duty of care signifies that partners have different roles within the partnership. For example, surgeons may decide to form a practice group and to select the general partnership as their form

24. In South Carolina’s codification of the Uniform Limited Partnership Act (ULPA), the powers and liabilities of a general partner of a limited liability partnership (LLP) are the same as those of a partner in a general partnership. S.C. CODE ANN. § 33-42-630 (Law. Co-op. 1990). Generally, the Article’s references to the partnership refer to the general partnership.
25. Id. § 33-41-350.
27. See, e.g., Claire Moore Dickerson, Is It Appropriate to Appropriate Corporate Concepts: Fiduciary Duties and the Revised Uniform Partnership Act, 64 U. COLO. L. REV. 111 (1993) (arguing that partnership law should not yet adopt the theories of contractarian corporate law, which seek to reduce standard fiduciary duties to mere default provisions).
29. Donald J. Weidner, the official reporter for RUPA, noted that the drafters of RUPA felt disappointed with the continued use of the word “fiduciary.” . . . The very word is troublesome, the sentiment seemed to be, because it is subject to abuse in the hands of judges, academics and others whose flow of satisfactions is derived in far too large a part from imposing their personal values on the more productive members of society.

of business association. On a daily basis and during the ordinary course of business, surgeons focus on patients. While all of the partners in this general partnership would have authority to manage the partnership’s business affairs, from hiring a nurse to diversifying partnership assets through various investment decisions, the partnership agreement might designate one or more partners as the managing partner or partners assigned to make these types of business decisions.

This example, though simple, highlights the two different roles that a partner in a general partnership may assume: the agent conducting the ordinary course of business and the manager making organizational decisions for the collective entity. Based on these two different roles, the duty should be bifurcated and attach separately to the two respective roles that partners play in a general partnership—the role of an agent and the role of a manager.31

As agents, partners owe the partnership the duty of care that an agent owes a principal.32 The Restatement (Second) of Agency states that “[u]nless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform.”33 Thus, the law holds partners acting as agents in a general partnership to the duty of care that persons in like circumstances are expected to exercise—ordinary care.34

As a manager of the general partnership, each partner makes business decisions about the direction of the partnership, and the default fiduciary duty that attaches to those business decisions should also be that of ordinary care. Thus, partners acting as managers in a general partnership should be held to the duty of care that managers in like circumstances would be expected to exercise.35

The next questions are whether the business judgment rule applies to partners acting as managers as the South Carolina Court of Appeals has ruled,36 whether the partnership agreement may amend the ordinary care standard to that of gross negligence for partners acting as managers, or whether perhaps both apply.37 In the


34. See, e.g., Rosenthal v. Rosenthal, 543 A.2d 348, 352 (Me. 1988) (delineating fiduciary obligations reflecting “the duties of care and loyalty owed under Maine law by a corporate director to the corporation and it shareholders, as well as the duties of a partner to the partnership and his fellow partners”).

35. Not surprisingly, not everyone agrees that the partners must measure up to the ordinary care standard to which agents must adhere. ALAN R. BROMBERG & LARRY E. RIBSTEIN, 2 BROMBERG & RIBSTEIN ON PARTNERSHIP § 6.07(f) at 6:141 (1997).


37. As the Delaware Supreme Court proclaimed in Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), the business judgment rule grants the presumption that the corporate director or officer makes good faith, well-informed business decisions. The business judgment rule operates as a defense to a claim of breach of a fiduciary duty of care, precluding “judicial review of actions taken by a corporate governing board absent a showing of a lack of good faith, fraud, self-dealing or unconscionable conduct.” Dockside Ass’n, Inc. v. Detyens, 294 S.C. 86, 87, 362 S.E.2d 874, 874
partnership context, the business judgment rule should not apply. Instead, the partners may agree to amend the duty of care standard to that of gross negligence.\textsuperscript{38} From a purely practical standpoint, partnerships likely would prefer to establish the gross negligence standard on the front-end rather than to wait for the judicial application of the business judgment rule on the back-end.

While not perfect, the viewpoint reflected in this Article is that this application of the fiduciary duty of care standard to the partnership gives some contractual flexibility, while maintaining the normally high fiduciary standards associated with the partnership. Those partners who want to form a partnership because of the benefits associated with the high fiduciary standards\textsuperscript{39} may maintain the default rule for manager-partners at the ordinary care level. For those who believe that partners should be able to establish a lower standard of care, they may do so for partners’ managerial decisions. For those averse to the “one-size-fits-all approach,” this method provides the partnership some flexibility to mold the fiduciary duty of care standard to fit the agent-manager bifurcation.

\textbf{B. Filling the Gaps with Moral Behavior: Cloaking the Partnership with the Moral Obligations of Good Faith and Fair Dealing and Loyalty}

While the formula for determining how the fiduciary duty of care operates in the partnership is relatively comprehensible thanks to the rich common-law standard of ordinary care, the other two fiduciary duties remain less clearly defined. Courts have had more difficulty articulating the standard for bad behavior and how parties might breach the standard of moral business behavior.

How does society inject into the law what an individual’s moral compass measures as good behavior versus bad behavior? “You just know it,” some might say; or at least one knows what the measurement is not. Society should not permit business activity conducted without honor, trustworthiness, loyalty, and good intentions. But defining mandatory moral duties that encompass these concepts in

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{1987).}


(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner he reasonably believes to be in the best interests of the corporation and its shareholders.

\emph{Id.} The official comment specifically states that the provision “does not try to codify the business judgment rule,” giving deference to the courts to continue to mold their interpretations of the common-law rule. \emph{Id.} § 33-8-300 cmt. (Law. Co-op. 1990).

\textsuperscript{38} Comment a to the \textbf{RESTATEMENT (SECOND) OF AGENCY} § 379 states that “[a]n agreement with the principal that the agent is not to be liable to him for negligence not of a gross character is legal.” \textbf{RESTATEMENT (SECOND) OF AGENCY} § 379 (1958).

\textsuperscript{39} See, e.g., Dickerson, supra note 27, at 147 (noting that while most traditional cases applying a heightened fiduciary obligation involved the duty of loyalty, some duty of care cases “reflect a high moral tone”).
\end{enumerate}
\end{footnotesize}
the law, and applying them to the general partnership, understandably frustrates contractarians because it leaves for judicial interpretation, rather than contractual agreement, the imprecise evaluation of whether or not an individual’s conduct is wrong.

The common law echoes with paradigm cases that recognize a partner’s breach of a fiduciary duty.\textsuperscript{40} On the other hand, case law that delineates each of the fiduciary obligations that attaches to partners in a general partnership is notably absent from the common law. Critics assert that this common-law development breeds a lack of uniformity that the drafters of RUPA attempted to correct.\textsuperscript{41} Notwithstanding this lack of uniformity, mandatory moral obligations must attach to the partnerships and this Article aims to deepen the two “moral” duties: (1) the duty of good faith and fair dealing, and (2) the duty of loyalty.

Initially, this Part clearly defines the differences between the duty of good faith and fair dealing and the duty of loyalty. However, as the drafters of RUPA and ULLCA failed to provide a complete understanding of the terms, this Article does not. Rather, the Article demonstrates that both duties are alive and well in South Carolina by gleaning from South Carolina common-law tradition and other bodies of common law.

1. Fiduciary Duty of Good Faith and Fair Dealing

The South Carolina Supreme Court has long recognized the partner’s fiduciary duty of good faith and fair dealing.\textsuperscript{42} The Court described the nature of a partner’s fiduciary duty of good faith and fair dealing in the following way:

The law holds each member of a partnership to the highest degree of good faith in his dealings with reference to any matter which concerns the business of the common engagement, and each partner, being the agent of the firm, must be held to the same

\textsuperscript{40} See, for example, Chief Justice Cardozo’s oft-cited prose in Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928).

\textsuperscript{41} Unlike the UPA, which does not specify the particular fiduciary duties that a partner owes copartners, Banoff, supra note 21, at 59, so that the courts have instead determined what these duties are, RUPA establishes that a partner must only exercise a fiduciary duty of care and a fiduciary duty of loyalty. UNIF. P’SHIP ACT § 404(a), 6 U.L.A. 143 (1997). RUPA defines the extent of these two duties under subsections 404(b) and (c). Id. § 404(b)–(c). Quite confusingly, RUPA states that a partner owes a mandatory duty of good faith and fair dealing under section 103(b)(5) but does not classify it as a fiduciary duty. Id. § 103(b)(5). A partner, however, must exercise the duties of care, good faith and fair dealing, and loyalty. Incidentally, just over half of the states, South Carolina excluded, have adopted RUPA. Paul Powell, Comment, Dissociating the Fiduciary: Duty Revisions and the Resulting Confusion in Idaho’s New Partnership Law, 36 IDAHO L. REV. 145, 148 (1999). Unlike the states that have adopted the UPA, the states that have adopted RUPA have not uniformly adopted all portions of the Act. Allan W. Vestal, “Assume a Rather Large Boat . . . .”: The Mess We Have Made of Partnership Law, 54 WASH. & LEE L. REV. 487, 519–20 (1997). Consequently, it appears, RUPA has failed to provide uniformity to partnership law.

\textsuperscript{42} See Few v. Few, 239 S.C. 321, 336, 122 S.E.2d 829, 836 (1961) ["[P]artners are treated as fiduciaries each to the other and [the court] characterizes their relationship as one of mutual trust and confidence, imposing upon them the usual trust requirements of loyalty, good faith and fair dealing."] (citing Whitman v. Bowden, 27 S.C. 53, 61, 2 S.E. 630, 633 (1884); Price v. Middleton, 75 S.C. 105, 112, 55 S.E. 156, 159 (1906); Badder v. Saleebey, 131 S.C. 101, 107, 126 S.E. 438, 440 (1924)).
accountability as other trustees, in all matters which affect the common interest. The relationship of a partnership is fiduciary in character and imposes on the members the obligation of refraining from taking any advantage of one another by the slightest misrepresentation or concealment.\(^{43}\)

This passage appears to describe appropriately the nature of this duty, which generally mandates that each partner act in good faith and, more specifically, suggests that a partner must conduct his actions contritely and without bad intentions that adversely affect the copartners.

Unlike the fiduciary duty of care standard, the fiduciary duty of good faith and fair dealing is not a default rule; it is mandatory. Thus, partners may not limit the fiduciary duty of good faith and fair dealing by contract. "'[A] good faith standard stands as a floor below which fiduciaries may never fall.'\(^{44}\)

Some may be highly dissatisfied with this view of the partner's fiduciary duty of good faith and fair dealing. To them, this view is a grandiose, arbitrary good-faith standard from the common law that leaves considerable room for interpretation, approximates the fiduciary duty of good faith to that of the honesty-in-fact standard,\(^{45}\) and imposes a rule that parties cannot waive. Contrasting South Carolina law with the law of the thirty-five states that have adopted RUPA\(^{46}\) and critiquing RUPA's treatment of good faith and fair dealing helps provide depth to this standard.\(^{47}\)

Curiously, RUPA provides that the only fiduciary duties that attach to partners in a general partnership are the duties of care and loyalty.\(^{48}\) While not designating good faith and fair dealing as a "duty," RUPA provides that partners must "exercise any rights consistently with the obligation of good faith and fair dealing."\(^{49}\) In the comments to RUPA, the drafters noted the following:

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45. The fiduciary duty of good faith and fair dealing does not appear to be limited to the honesty-in-fact standard.
47. This analysis only helps define what the duty is not. Professor Robert Summers wrote that the contractual covenant of good faith and fair dealing is "an 'excluder'... a phrase without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith." Robert S. Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 VA. L. REV. 195, 201 (1968) (citing Hall, Excluders, 20 ANALYSIS I (1959)).
48. UNIF. P'SHIP ACT § 404(a), 6 U.L.A. 143 (1997). Part II.B.2 will examine the difference between South Carolina law and RUPA's treatment of the fiduciary duty of loyalty.
49. Id. § 404(d), 6 U.L.A. 143 (1997).
The obligation of good faith and fair dealing is a contract concept, imposed on the partners because of the consensual nature of a partnership. See Restatement (Second) of Contracts § 205 (1981). It is not characterized, in RUPA, as a fiduciary duty arising out of the partners' special relationship. Nor is it a separate and independent obligation. It is an ancillary obligation that applies whenever a partner discharges a duty or exercises a right under the partnership agreement or the Act.\textsuperscript{50}

Clearly, in South Carolina, the fiduciary duty of good faith and fair dealing is not based on its counterpart in contract; rather, the duty, long embraced in the common-law tradition, attaches to partners precisely because of their special relationship as co-owners of an entity that shares profits and losses.

The significance of this difference between the contractual covenant of good faith and fair dealing and the fiduciary duty of good faith and fair dealing may incite more controversy in academia than it does in reality. Again, the debate arises between contractarians, who would assert that any mandatory duty or obligation of good faith and fair dealing is unnecessary, and fiduciarians, who hold fiduciary duties in the highest moral regard and would leave it to the courts to analyze and fashion remedies for breaches of these moral duties.\textsuperscript{51} It seems the drafters of RUPA made an attempt to mediate between these two factions by treating the "obligation" as one that arises in contract, thereby limiting the remedy for breach to contractual damages, as opposed to a more broad-brush fiduciary remedy.\textsuperscript{52} Conversely, in South Carolina, the non-waivable duty of good faith and fair dealing attaches to every partner in a partnership, and the remedies that arise from a breach of the duty are not confined to contractual damages.\textsuperscript{53}

2. Fiduciary Duty of Loyalty

South Carolina has a common-law tradition of recognizing that partners owe each other a duty of loyalty as well as a fiduciary duty of good faith and fair dealing.\textsuperscript{54} Like the duty of good faith and fair dealing, the duty of loyalty is easy to define by analogy but difficult to define by articulating a hard and fast rule. "The shape of the duty of loyalty only becomes clear by reference to actions that raise a

\textsuperscript{50} Id. § 404 cmt. 4, 6 U.L.A. 145 (1997).
\textsuperscript{51} See Callison, supra note 5, at 119–21.
\textsuperscript{52} This issue introduces a discussion of how the obligation applies in the LLC context, which Part III discusses.
\textsuperscript{53} In the future, supplanting the common-law tradition of recognizing the duty of good faith and fair dealing in partnership law in favor of recognizing a related concept based on contract law is unnecessary, principally because the partnership itself is a creature of common law, long recognized as an unincorporated entity prior to the UPA's creation in 1914 and adoption in South Carolina in 1950. Further, the very existence of a partnership has been an oft-litigated issue, and in South Carolina, a partnership may exist without the partners' express intention to form one. Wyman v. Davis, 223 S.C. 172, 174, 74 S.E.2d 694, 695 (1953). Precisely because potential partners do not always prenegotiate partnership agreements, these fiduciary duty "gap-fillers" are necessary to enforce moral obligations, including the duty of good faith and fair dealing.
suspicions of disloyalty.” \(^55\) Rather than taking a “you know it when you see it” approach, this Article attempts to give some definitional depth to the duty.

The Supreme Judicial Court of Massachusetts, comparing partners to stockholders in a close corporation, held that stockholders “may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation.” \(^56\) This definition is as good as any other because it incorporates the notion that a partner may not appropriate to himself something that the partnership should appropriate to copartners or to the partnership. Just as with the duty of good faith and fair dealing, partners cannot waive the fiduciary duty of loyalty. \(^57\)

Like its treatment of good faith and fair dealing, RUPA places constraints on the fiduciary duty of loyalty by limiting it to the following three circumstances:

1. to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;
2. to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and
3. to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership. \(^58\)

The fiduciary duty of loyalty should not be limited to those three categories but should include a broader range of conduct in which the self-interest of a partner has a negative impact on another partner or on the partnership as a whole. \(^59\)

3. Postscript

To many, this discussion of how a partner must adhere to rigorous fiduciary standards fills too many gaps in the partnership agreement, whether implied or written in detail. This Article reflects the view, however, that what makes a

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55. Geschke, supra note 44, at 102.
57. Contractarians and law-economists attack this principle that prevents parties from waiving their rights. See, e.g., Hynes, supra note 23, at 443 (arguing that fiduciary duties can be bargained away subject to the “customary limits on contract bargaining”); Larry E. Ribstein, The Revised Uniform Partnership Act: Not Ready for Prime Time, 49 BUS. LAW. 45, 58 (1993) (“Mandatory fiduciary duties also are bad policy because they preclude worthwhile contracts.”). This Article reflects the view, however, that society’s interest in corporate ethics, especially in light of the recent rash of corporate fraud, should trump an individual’s freedom to enter into a partnership contract free of these fiduciary obligations. Further, establishing these fiduciary duties promotes efficiency because potential partners and their lawyers will no longer need to conjecture or approximate exactly what these obligations entail.
59. An example of the broader context in which the fiduciary duty of loyalty should apply is when, in the partnership formation stage, a future partner deals with a future competitor in a manner that inhibits the future partnership’s ability to compete.
partnership a partnership is the faith partners can have in the historically recognized gap-fillers that require partners to adhere to high standards. Because courts may find that a partnership exists even when the parties did not expressly intend to create one,60 potential and present partners should understand that high, mandatory, and sometimes moral standards may attach under the common law.

Therefore, one thinking of starting a business, or an attorney evaluating the various business entity options for a client, who is intimidated by these high fiduciary standards, should not form a partnership. Many other options are available, including perhaps most prominently the United States, which the Article discusses in the next part.

III. THE LIMITED LIABILITY COMPANY

The advent and popularity of the LLC represents one of the more fascinating recent developments in corporate law. The advantages and flexibility of the LLC are many, including: (1) ease of formation,61 (2) flexibility as to taxation,62 (3) limited liability,63 and (4) continuity despite a member’s death.64 In the articles of organization, the membership may elect to have the company manager-managed, with the manager running the company in its ordinary course of business similar to a general partner, or as a corporate officer or director.65 Absent election in the articles of organization to be manager-managed, the LLC will be member-managed by default where, similar to the general partnership and subject to modification by the operating agreement, the members have equal managerial rights, duties, and obligations.66

South Carolina's Limited Liability Company Act (LLC Act),67 enacted in 1996, is the state’s version of the ULLCA, which was largely based on RUPA.68 Like RUPA, the LLC Act establishes that only two fiduciary duties apply in the LLC context—those of care and loyalty.69 Based on the fiduciary roadmap set forth in the

62. An LLC may select pass-through taxation, like a partnership, or may select taxation as a corporation. See 26 C.F.R. § 301.7701-2(b)(1), .7701-3(a) (as amended in 2003).
63. Members or managers of an LLC are not personally liable for company debts and obligations “solely by reason of being or acting as a member or manager.” S.C. CODE ANN. § 33-44-303(a) (West Supp. 2003). However, like most default rules of the Limited Liability Company Act (LLC Act), the operating agreement can modify this rule to specify that a particular member or manager will be personally liable for LLC debts and obligations. Id. § 33-44-303(c).
65. Id. §§ 33-44-203 to -44-301 (West Supp. 2003).
66. Id. §§ 33-44-203 cmt., 44-301.
67. Id. §§ 33-44-101 to -1207.
68. Id. § 33-44-101 cmt.
69. Id. § 33-44-409(a).
LLC Act, this Part provides the practicing attorney and the layperson some thoughts on how these rules might operate and how courts might interpret them.

A. Fiduciary Duty of Care

South Carolina's LLC Act clearly establishes gross negligence as the default fiduciary duty of care standard for both members of a member-managed LLC and managers of a manager-managed LLC. The Act also permits the LLC membership to alter the duty of care standard as long as the standard is not unreasonably reduced. Presumably, any reduction of this standard of care from gross negligence would be unreasonable. However, if the members prefer a higher duty of care standard than gross negligence—perhaps the ordinary care standard that applies to the partnership—they may adopt another standard.

B. Good Faith and Fair Dealing

Like RUPA, the LLC Act does not classify the duty of good faith and fair dealing as a fiduciary duty but rather characterizes it as an "obligation." This provision represents a victory for the contractarians because, presumably, this obligation is based on the implied contractual covenant of good faith and fair dealing rather than the common-law, Meinhard-influenced fiduciary duty of good faith and fair dealing. In practice, the effect of this difference may be minimal. Finally, the LLC Act forbids the elimination of this obligation.

C. Duty of Loyalty

The duty of loyalty attaches to members and managers of an LLC, but like RUPA, the LLC Act limits the duty's application to require the members and managers:

1. to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member in the conduct or winding up of the company's business or derived from a use by the member of the company's property, including the appropriation of a company's opportunity;
2. to refrain from dealing with the company in the conduct or winding up of the company's business as or on behalf of a party having an interest adverse to the company; and

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71. Id. § 33-44-103(b)(3).
72. S.C. CODE ANN. § 33-44-409(a) (West Supp. 2003) states that "[t]he only fiduciary duties a member owes to a member-managed company and its other members are the duty of loyalty and the duty of care."
73. Id. § 33-44-409(d).
74. See infra Part III.D.
(3) to refrain from competing with the company in the conduct of the company’s business before the dissolution of the company.\textsuperscript{76}

Moreover, the LLC Act also provides that, by unanimous consent, the LLC membership can ratify acts that "would otherwise violate the duty of loyalty."\textsuperscript{77} Finally, like the "obligation" of good faith and fair dealing, the parties cannot waive the fiduciary duty of loyalty.\textsuperscript{78}

\textbf{D. Practical Implications of the LLC’s Reduced Fiduciary Standards}

The fiduciary framework of the LLC Act is cut-and-dried and, like RUPA, is heavily influenced by the contractarian mandate of the 1990s. Despite the reduced fiduciary standards that the LLC Act applies—gross negligence, a contract law-based covenant of good faith and fair dealing, and a confined interpretation of the duty of loyalty—will courts have enough tools to evaluate illicit corporate actions that might not fit neatly into one of these three categories?\textsuperscript{79} In our view, since the obligation of good faith and fair dealing is not defined or constrained, it will likely become the catch-all provision that courts will apply to conduct that calls the member’s moral behavior into question.

\textbf{IV. Conclusion}

Fortunately, because the contractarian theory has not infiltrated South Carolina law, today’s South Carolina partnerships must abide by the same fiduciary rules that have applied for many decades. While the contractarian ideology provides a fascinating lens through which a business association can be analyzed, we believe the viewpoint does not encapsulate how our culture functions.

Like macroeconomic theory in general, contractarian theory fails to function properly without certain assumptions: primarily, that all parties entering into a business association have perfect knowledge and equal bargaining power. While these assumptions permit the theorist to explore the fascinating world of modeling human and economic behavior, an exploration that has contributed much to our society, in practice, these assumptions necessarily produce a sanitized viewpoint that is not representative of society’s attitudes and conduct when entering into a business association.

\textsuperscript{76} Id. § 33-44-409(b).
\textsuperscript{77} Id. § 33-44-404(c)(2). From a practical perspective, the LLC Act does not need to limit the application of the fiduciary duty of loyalty to three specific scenarios when the Act also contains a safety net provision that permits the LLC to evaluate a member’s action that violates the duty. The LLC membership’s determination of whether to let stand a member’s action that would otherwise violate the duty of loyalty seems to be a much more effective mechanism for determining whether the duty has been implicated, as opposed to the confined application provided in the LLC Act.
\textsuperscript{78} Id. § 33-44-103(b)(2).
\textsuperscript{79} See, e.g., Callison, supra note 5, at 139 (arguing that an illicit expulsion of a lawyer from a partnership would not fit within the three specified fiduciary duty of loyalty scenarios specified in RUPA whose duty of loyalty provisions are very similar to the LLC Act).
When applied to the partnership, the contractarian model seems to rely on the assumption that the partnership itself is based in contract, and since all partners had perfect knowledge and equal bargaining power, courts should limit their evaluation of the partnership to what the parties intended at the moment of partnership formation. This assumption fails to recognize the fact that the partnership is human history’s oldest business association of two or more people and that a partnership can exist without the parties so intending. Partnership law is not based on the principles of contract law; rather, it is based on a rich common law tradition that recognizes high fiduciary standards that apply regardless of perfect knowledge or equal bargaining power. South Carolina continues to recognize this tradition where, to put it simply, we let the partnership be a partnership. The partnership remains a business entity that provides the protection of fiduciary duties and demands that partners adhere to high fiduciary standards.

In South Carolina, a clear delineation exists between the high fiduciary standards of the partnership and the lower standards of the LLC. The partnership should have, in our view: (1) a mandatory duty of ordinary care that attaches to the partner’s conduct in the ordinary course and (2) a default rule of ordinary care, which can be reduced to the gross negligence standard, that attaches to the partner’s conduct as a manager of the firm. The mandatory fiduciary duties of good faith and fair dealing and loyalty also apply to the partnership.

The statutory rules that form the fiduciary foundation of the LLC are as follows: (1) a default gross negligence duty of care, (2) a mandatory obligation of good faith and fair dealing, and (3) a mandatory duty of loyalty. All three rules provide lower standards than their partnership counterparts: the default duty of care standard is reduced from ordinary care to gross negligence, the good faith standard is a contractual-based obligation and not a fiduciary duty, and the duty of loyalty is limited to three specific circumstances. Given the relaxed fiduciary framework of the LLC and the fact that the good faith and fair dealing standard is termed an obligation but not limited in its application, courts will likely broaden the implications of the obligation such that morally offensive behavior that may not neatly breach the care or loyalty standards will be deemed “bad faith” behavior resulting in a breach of the obligation of good faith and fair dealing.

80. See, e.g., J. Dennis Hynes, Fiduciary Duties and RUPA: An Inquiry into Freedom of Contract, LAW & CONTEMP. PROBS., Spring 1995, at 29, 39:

The partnership relationship is most understandably viewed as a contractual relationship in all of its respects, as developed below. This doubtless reflects the view of those who enter partnerships, that they can agree among themselves what they want their relationship to be. From this perspective, it is inappropriate for the state to interfere with a bargain freely and openly made by persons seeking to define a business relationship.

Id. See also Ribstein, supra note 57, at 52:

Fiduciary duty is a type of contractual term courts supply because the parties themselves would have contracted for the duties if it were not so costly to contract in detail. Fiduciary duties do not differ fundamentally from other types of terms the courts supply in interpreting contracts. Because fiduciary duties are contractual “gap-fillers,” the precise nature of the duties that exist in any particular contractual relationship depends on the express and implied terms of the relevant contract.

Id. (footnotes omitted) (emphasis omitted).