The Enforceability of Fiduciary Duty Waivers

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Fiduciary duty claims involve substantial legal work given the intricate pleading requirements, intensive discovery, and extensive motion practice common to these claims. Indeed, the very existence of a fiduciary relationship is typically a hotly contested issue. While many fiduciary relationships are not challengeable as they arise by statute, agreement, or the common law, in other circumstances, the fiduciary relationship inherently involves a factual determination and requires significant discovery before a resolution is reached.

Parties have been attempting to mitigate risks against fiduciary duty claims by including exculpatory language and waivers in contracts, limited liability company (LLC) operating agreements and articles of organization, and releases. Waivers of fiduciary duties and breaches thereof, however, are not always enforced or permitted by governing law, and a number of recently issued decisions merit a discussion as to the enforceability of these waivers and related exculpatory provisions. These decisions, discussed below, provide valuable insight to the efficacy and enforceability of fiduciary duty waivers.

Fiduciary Duty Claims 101

By way of a brief background, fiduciary relationships arise from "legal relations such as attorney and client, broker and client . . . partners, principal and agent, trustee and *cestui que trust*." *Frizzell Constr. Co. v. First Citizens Bank & Trust Co.*, 759 F. Supp. 286, 290 (E.D.N.C. 1991) (*quoting Abbitt v. Gregory*, 201 N.C. 577, 160 S.E. 896, 906 (N.C. 1931)). Fiduciary obligations also can be triggered "as a [matter of] fact, in which there is confidence reposed on one side, and the resulting superiority and influence on the other." *Id.*

The elements of a fiduciary duty claim are fairly uniform nationwide. A plaintiff is required to allege that "(1) the defendant had a duty to the plaintiff, (2) the duty was breached, (3) injury to plaintiff occurred as a result of the breach, and (4) the defendant caused that injury." *Jurista v. Amended Amerinox Processing*, No. 12-3825 (NLH/JS), 2013 U.S. Dist. LEXIS 49515, at *97-98 (D.N.J. March 28, 2013).

Special attention, however, must be given to each forum's specific pleading rules as some states, like New York, have a heightened pleading requirement for breach of fiduciary duty cases. *See, e.g., Littler Mendelson, P.C. v Tavern on the Green, LP*, No. 601130/09, 2009 N.Y. Misc. LEXIS 4488, at *27 (N.Y. Sup. Ct. Aug. 27, 2009). Other jurisdictions, such as Pennsylvania, require certificates of merit to be secured in fiduciary duty breach cases that involve certificated professionals such as lawyers and accountants. *See, e.g., Stillwagon v. Innsbrook Golf & Marina, LLC*, No. 2:11-cv-1338, 2013 U.S. Dist. LEXIS 38387, at *27 (W.D. Pa. Mar. 20, 2013).

Not All Fiduciary Duties Can Be Waived

While the freedom to contract waivers and exculpatory clauses is universally accepted by our courts, certain types of fiduciary duty claims are not susceptible to waiver. By way of example, in Arizona, partnership agreements may not eliminate the fiduciary duties of the partners although certain types of conduct or standards by which the obligation is to be measured may be included in the agreement. *See* A.R.S. § 29-1003 (2012).

ERISA similarly "prohibits parties from waiving claims for breaches of fiduciary duty." *In re Schering Plough Corp. ERISA Litig.*, 589 F.3d 585, 593 (3d Cir. 2009); *see also* 29 U.S.C. § 1110(a) (2013) ("prohibits agreements that diminish the statutory obligations of a fiduciary"). "[N]umerous courts have held that under ERISA, individuals do not have the authority to release a . . . plan's right to recover for breaches of fiduciary duty." *In re Polaroid ERISA Litig.*, 240 F.R.D. 65, 75 (S.D.N.Y. 2006).

Trustees and executors are generally not permitted to benefit from prospective waivers of fiduciary duty breaches either. For example, New York's trusts and estates laws expressly prohibit "a testator from exonerating a fiduciary under a will" and provide that "a fiduciary's duty to account is not waivable." *Matter of Bruan*, 35 Misc. 3d 345, 349-350 (N.Y. Sur. Ct. 2012).

Contracting Away Fiduciary Duties and Related Claims

Fiduciary duty waivers in arms-length agreements generally have been upheld in numerous jurisdictions. In *Centro Empresarial Cempresa S.A. v. Am. Movil, S.A.B. de C.V.*, 17 N.Y.3d 269, 952 N.E.2d 995, 1002, 929 N.Y.S.2d 3 (N.Y. 2011), for example, the New York Court of Appeals held that when sophisticated commercial entities negotiate a broad release of fiduciary duties, "[t]hey cannot . . . invalidate that release by claiming ignorance of the depth of their fiduciary's misconduct." *Id.* at 278.In so ruling, the court "explicitly abrogated former decisions of lower courts" that ruled otherwise. *BNP Paribas Mortg. Corp. v. Bank of Am., N.A.*, 866 F. Supp. 2d 257, 270 (S.D.N.Y. 2012) (discussing *Centro Empresarial*); *see also Cooper v. Parsky*, 140 F.3d 433, 439 (2d Cir. 1998) (dismissing the breach of fiduciary duty claim because the waiver was sufficiently explicit and the plaintiffs "may not sue upon a duty that was expressly excluded from the agreement.").

Because "[i]t is axiomatic that a contract is to be interpreted so as to give effect to the intention of the parties as expressed in the unequivocal language employed," parties also may contract that no fiduciary relationship existed between them. *Wallace v. 600 Partners Co.*, 86 N.Y.2d 543, 548, 634 N.Y.S.2d 669, 671, 658 N.E.2d 715 (N.Y. 1995). Courts will enforce these provisions provided the disclaimer is clear and unambiguous. *See, e.g.*, *Summit Props. Int'l, LLC v. Ladies Prof'l Golf Ass'n*, No. 07-10407 (LBS), 2010 U.S. Dist. LEXIS 58444, at *20 (S.D.N.Y. June 14, 2010). Thus, parties can both contract to the fact that there was no fiduciary relationship to begin with, and contractually waive any fiduciary duty breach claims.

Exculpating LLC Managers and Members from Fiduciary Duty Claims

Delaware, a leading jurisdiction of corporate governance law, permits contractual waivers of fiduciary duties in LLC agreements. *See, e.g.*, *Feeley v. Nhaogg, LLC, et. al.*, No. 7304-VCL, 2012 Del. Ch. LEXIS 274, at *34 (Del. Ch. Nov. 28, 2012) (finding that Delaware's LLC statute "empowers the drafters of a limited liability company to . . . eliminate a member or manager's duties, including fiduciary duties."); *Kelly v. Blum*, No. 4516-VCP, 2010 Del. Ch. LEXIS 31, at *41-42 (Del. Ch. Feb. 24, 2010) (same). Delaware courts have not hesitated, however, to enforce a manager's fiduciary duties where the language was not equivocal. This was the result in *Gatz Props., LLC v. Auriga Capital Corp.*, 59 A.3d 1206 (Del. 2012). In that case, while the question of whether default fiduciary duties exist under the Delaware LLC laws was debated without resolution, the Supreme Court affirmed the substantive rulings of the Chancery Court finding that the member-manager of the LLC was not entitled to the protection of the exculpatory provisions as they did not apply to bad faith actions. *See id.* at 1217. The member-manager was

found to have acted in bad faith in the management and auction of the LLC owned property, and therefore was unable to benefit from the exculpatory provisions.

Other states also allow contractual modifications or limitations of fiduciary duties by LLC members and managers. In *Pappas v. Tzolis*, 20 N.Y.3d 228, 982 N.E.2d 576 (N.Y. 2012), three individuals formed a New York LLC to acquire and manage a long-term lease for a Manhattan building. Significant business disputes arose among the members shortly after the LLC was formed. In January 2007, Tzolis offered to buy out his partners, Infantopoulos and Pappas, for 20 times what they had contributed to the LLC only a year earlier. Both Infantopoulos and Pappas accepted and signed a certificate. Seven months later, Tzolis assigned the long-term lease to a developer for $17.5 million, more than 200 times the departing members' initial investment. Infantopoulos and Pappas subsequently sued Tzolis, alleging that Tzolis negotiated with the developer before the buy-out and that Tzolis's failure to disclose these negotiations violated his fiduciary obligations to both Infantopoulos and Pappas.

Tzolis moved to dismiss and the trial court dismissed the entire complaint relying on the operating agreement and the certificate in which the sellers attested that they conducted their own due diligence and were not relying on the buyer in any way. A divided Appellate Division modified the dismissal, reinstating the breach of fiduciary duty claim along with three other claims. The dissent argued for a full dismissal. On appeal, the New York Court of Appeals reversed and reinstated the dismissal relying on the clear and express language contained in the buy-out documents and the certifications that Infantopoulos and Pappas performed their own due diligence, retained legal counsel to advise them, and were not relying on any representation by Tzolis. Infantopoulos and Pappas even certified that Tzolis owed no fiduciary duty to them in connection with the buy-out.

In *Allen v. Devon Energy Holdings, L.L.C.*, 367 S.W.3d 355 (Tex. App. 2012), breach of fiduciary claims arose from the calculation and pay out of a member's minority LLC interest. Unlike in *Pappas*, the effective language was not entirely clear or all encompassing. While the lower court granted summary judgment, the appeals court reversed. The imperfect language, contained in the articles of organization, tracked the language from the Texas Business Organizations Code, which applied only to corporations and did not completely eliminate all fiduciary duties. The LLC's members were not bound by the restrictions of the Texas Business Organizations Code and, thus, were able to "expand or eliminate, as between themselves, any and all potential liability of [the LLC's] manager . . . as they saw fit." *Id.* at 396.

Other states equally permit fiduciary duties to be curtailed by written agreement. *See, e.g.*, *Harbison v. Strickland*, 900 So. 2d 385 (Ala. 2004) (interpreting Alabama's LLC statute to permit an operating agreement to modify certain fiduciary obligations provided that the agreement does not unreasonably restrict a member's right to information, eliminate the duty of loyalty, unreasonably reduce the duty of care, and eliminate the obligation of good faith and fair dealing). Some states only permit the waiver as long as the agreement does not eliminate or limit liability for certain enumerated acts. *See, e.g.*, *Nelson v. Alliance Hospitality Mgmt., LLC*, No. 11 CVS 3217, 2011 NCBC LEXIS 42, at *33 (N.C. Super. Ct. Nov. 22, 2011)(under Georgia LLC law, fiduciary obligations may be "eliminated by provisions in the articles of organization or a written operating agreement provided that no provision shall eliminate or limit the liability of a member or manager" for "intentional misconduct or a knowing violation of the law" or "[f]or

any transaction for which the person received a personal benefit in violation or breach of any provision of a written operating agreement").

A growing number of states—including California, the District of Columbia, Idaho, Iowa, Nebraska, Utah and Wyoming—have adopted a version of the model Uniform Limited Liability Company Act. New Jersey, the most recent state to enact a form of this model statute, used to permit expansions or restrictions to be included in the operating agreement without limitation. The revised statute, effective as of March 18, 2013, provides that an operating agreement may alter the "duty of loyalty . . . the duty of care . . . [and] any other fiduciary duty" if not "manifestly ureasonable." N.J. Stat. § 42:2C-11 (2013). It remains to be seen how the term "manifestly unreasonable" will be construed by the courts.

Conclusion

When litigating fiduciary breach cases, counsel is well advised to scour the governing agreements for any type of language that can be construed as evidence that the parties disclaimed the existence of a fiduciary relationship or intended to waive any breach of fiduciary duty claims. Thus, a careful review of the underlying agreements and organizational documents is critical before proceeding with any court action, and the clients should be appropriately advised that the court likely will conduct a comprehensive examination of the scope and clarity of the waiver provisions to determine whether the alleged conduct was intended to be forever released and waived. Even in the face of such language, counsel should diligently explore whether the provision provided a clear and unambiguous waiver and does not otherwise violate statutory authority or public policy. If the waiver issues can be resolved at the inception of a dispute, the parties can save significant time and expense.

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