

ON THE ELIMINATION OF FIDUCIARY DUTIES:
A THEORY OF GOOD FAITH FOR
UNINCORPORATED FIRMS

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Post-Enron, it might seem strange to relieve the managers of a business from their fiduciary duties. In fact, Delaware limited partnerships and limited liability companies (“LLCs”) are now permitted to completely eliminate fiduciary duties.¹ And, contrary to recent commentary, this option is desirable.²

Eliminating fiduciary duties is preferable for some business relationships as a means to allocate risks before disputes arise. Judicial error, with the moral hazard that it encourages, has real costs when it comes to an optimal exercise of business judgment. If the parties to an agreement conclude that they can better manage the risks of opportunism within their business than the courts—i.e., that the costs of judicial oversight exceed the benefits—fiduciary duties are a potential obstacle to their goals.

Given the option of eliminating fiduciary duties, the question becomes, what duties are left? Some contend that fiduciary duties are contractual in nature and subject to extensive modification.³

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1. See DEL. CODE ANN. tit. 6, §§ 17-1101(d), 18-1101(c) (2005).

2. Cf. 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, 1620 (2004) (“Ultimately, the wisdom of the contractarian vision of corporate law, and its influence on business culture, may well be questioned in the wake of the Enron debacle and subsequent accounting scandals.”).

3. See, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 1-39 (1991); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993) [hereinafter Easterbrook & Fischel, *Contract and Fiduciary Duty*].

Fiduciary duties are often defined as hypothetical bargains between the parties to an agreement, reflecting the terms the parties would have adopted if they had foreseen the dispute at issue.⁴ Others claim that fiduciary law should include mandatory standards of conduct.⁵ Even without fiduciary duties, however, contractual obligations still remain.⁶ These residual obligations are the focus of this Article.

Delaware recently amended its Limited Liability Company Act and its Limited Partnership Act to allow the elimination of fiduciary duties owed to members of the firm and to the firm itself.⁷ This

4. See, e.g., Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 3, at 431 (“A court setting out to protect principals from their agents *must* use the hypothetical contract approach; the only alternative is to injure the persons the rule makers want to help.”). There is some dispute within the contractual understanding as to when a hypothetical bargain analysis is appropriate. See Butler & Ribstein, *supra* note 3, at 17 (supporting a contractual understanding of fiduciary law, but contending that it is “a mistake to identify the hypothetical bargain approach with the contract theory of the corporation”).

5. See, e.g., John C. Coffee, *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618 (1989); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879 (1988) [hereinafter DeMott, *Beyond Metaphor*]; Claire Moore Dickerson, *From Behind the Looking Glass: Good Faith, Fiduciary Duty & Permitted Harm*, 22 FLA. ST. U. L. REV. 955 (1995); Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1462 (1989); Scott FitzGibbon, *Fiduciary Relationships are Not Contracts*, 82 MARQ. L. REV. 303 (1999); Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983); Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675 (1990). See also *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (“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.”).

6. For discussion of good faith requirements in place of fiduciary duties for LLCs, see Deborah A. DeMott, *Fiduciary Preludes: Likely Issues for LLCs*, 66 U. COLO. L. REV. 1043, 1057-62 (1995) [hereinafter DeMott, *Fiduciary Preludes*]; Miller, *supra* note 2, at 1643-45. In the limited partnership context, see Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK L. REV. 927, 938 (2004) [hereinafter Ribstein, *Limited Partnership Agreements*].; see also J. Dennis Hynes, *Fiduciary Duties and RUPA: An Inquiry into Freedom of Contract*, 58 LAW & CONTEMP. PROBS. 29, 46-49 (1995) (discussing good faith requirements for partnerships); Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 544, 583-84 (1997) [hereinafter Ribstein, *Unincorporated Firms*] (discussing good faith for unincorporated firms); cf. Coffee, *supra* note 5, at 1664-65 (describing contractual duty of good faith as a limitation on corporate waivers of fiduciary duty).

7. The new provisions allow fiduciary duties to be “expanded or restricted or eliminated” by provisions in the parties’ agreement, provided that the

legislation clarifies the right to entirely remove fiduciary duties for these business entities.⁸ Fiduciary duties for Delaware limited partnerships and LLCs are contractual default terms, subject to the parties' decision to opt out of their ambit.⁹

As a result of these changes, correctly interpreting limited partnership and LLC agreements as a matter of contract law will grow in importance. Limited partnerships and LLCs are frequently formed in Delaware,¹⁰ and Delaware shows the potential to acquire

agreement "may not eliminate the implied contractual covenant of good faith and fair dealing." See Delaware Revised Uniform Limited Partnership Act, DEL. CODE ANN. tit. 6, § 17-1101(d) (2005) (permitting elimination of fiduciary duties for limited partnerships); Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, § 18-1101(c) (2005) (permitting elimination of fiduciary duties for LLCs). Each Act will be referred to as the "DRULPA" and "DLLCA", respectively. The amendments in both cases were effective August 1, 2004. Although the statutes are distinct in many respects, both statutes contain nearly identical language respecting contractual modifications, and the Delaware courts apply the same principles of interpretation to both entities. Cf. *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 291 (Del. 1999) (citing authority on contractual freedom within limited partnerships as applicable in an LLC case); see also Joseph L. Lemon, *Just How Limited Is That Liability?: The Enforceability of Indemnification, Advancement, and Fiduciary Duty Modification Provisions in LP, LLP, and LLC Agreements in Delaware Law*, 8 STAN. J.L. BUS. & FIN. 289, 312 (2003) ("Elf Atochem illustrates the congruence of Delaware courts' interpretation of Limited Liability Company law with that of Limited Partnership law.").

8. See *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 167-68 (Del. 2002) (casting doubt, in dictum, on the idea that fiduciary duties for a limited partnership could be eliminated under prior law). Compare Miller, *supra* note 2, at 1640 ("Based on the principles enunciated in *Gotham* and *Omnicare*, and the similarity between Delaware's limited partnership and LLC statutes, one would expect that the Delaware Supreme Court will not permit a broad and/or complete elimination of fiduciary duties in the LLC.") with Ribstein, *Limited Partnership Agreements*, *supra* note 6, at 959 ("Delaware law, while not taking contractual freedom to its theoretical limit, permits a significant amount of flexibility.").

9. See *Kahn v. Icahn*, No. CIV. A. 15916, 1998 WL 832629, *2 (Del. Ch. Sept. 10, 1998) (describing these fiduciary duties as defaults). This contractual resemblance is not solely limited to the ability to modify fiduciary duties, but also exists in terms of negotiation. See Ribstein, *Unincorporated Firms*, *supra* note 6, at 550 ("The antiwaiver argument is a harder sell in most closely held unincorporated firms in which terms are often negotiated or voted on face-to-face and approved unanimously. Fiduciary waivers in unincorporated firms closely resemble the sort of 'real' contracts that anticontractarians have held out as models in the public corporation debate.").

10. See David Rosenberg, *Venture Capital Limited Partnerships: A Study in Freedom of Contract*, 2002 COLUM. BUS. L. REV. 363, 370 (2002) ("Although systematic data are not yet available, evidence suggests that venture capital contracts are routinely organized under Delaware law, and that such contracts

jurisdictional dominance here, akin to its role in corporate law.¹¹ Whether or not the Delaware model gains popularity in other jurisdictions, Delaware's explicit allowance for eliminating fiduciary duties formally changes the business structures available to investors.¹²

The contractual duty of good faith and fair dealing is especially important in this context. Delaware law leaves intact the implied covenant of good faith and fair dealing for firms that choose to eliminate fiduciary duties.¹³ Indeed, contractual good faith is mandatory under the new statutory provisions.¹⁴ Accordingly, some portion of traditional fiduciary duties could be preserved through the enforcement of good faith duties.

Yet the statutes also provide that limited partnership and LLC agreements should be interpreted "to give the maximum effect to the principle of freedom of contract and to the enforceability of . . . agreements."¹⁵ This policy qualifies the available meanings for contractual good faith—the good faith mandate should be

make use of the law's flexibility to waive many of the default duties that otherwise would apply.").

11. See Jack B. Jacobs, *Entity Rationalization: A Judge's Perspective*, 58 BUS. LAW. 1043, 1044 (2003) (describing proliferation of alternative entity cases in Delaware); see also *Cont'l Ins. Co. v. Rutledge & Co.*, 750 A.2d 1219, 1236, n.37 (Del. Ch. 2000) ("[P]arties, otherwise unwilling to shoulder fiduciary burdens, maintain the opportunity to form limited partnerships precisely because the parties can contract around some or all of the fiduciary duties the general partner typically owes the limited partners."); *Kahn*, 1998 WL 832629 at *2 ("This flexibility is precisely the reason why many choose the limited partnership form in Delaware.").

12. Cf. Larry E. Ribstein, *Unlimited Contracting in the Delaware Limited Partnership and its Implications for Corporate Law*, 16 J. CORP. L. 299, 302 (1991) ("Because contractual freedom has been accepted in the limited partnership, no theoretical justification exists for refusing to extend it to the corporation.").

13. See DEL. CODE ANN. tit. 6, § 17-1101(d) (2005); DEL. CODE ANN. tit. 6 § 18-1101(c) (2005) (allowing for the elimination of fiduciary duties for these entities "provided that the . . . agreement may not eliminate the implied contractual covenant of good faith and fair dealing."). Another provision under both statutes provides a defense against fiduciary liability where there is good faith reliance on contractual provisions. § 17-1101(e), (f); § 18-1101(d), (e). Bad faith, in this context, has been interpreted by the Delaware Supreme Court to require a "tortious state of mind." See *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1208 (Del. 1993). However, the defense only applies where the agreement is found to be ambiguous. See *Cont'l Ins. Co.*, 750 A.2d at 1240 (Del. Ch. 2000). On the interaction of the good faith reliance provision with contractual good faith requirements, see DeMott, *Fiduciary Preludes*, *supra* note 6, at 1050.

14. § 17-1101(d); § 18-1101(c).

15. § 17-1101(c); § 18-1101(b).

understood in terms of contractual freedom. In tandem, good faith and contractual freedom determine what obligations remain when fiduciary duties no longer control the contracting parties' relationship.

Under freedom of contract principles, good faith functions as an interpretive doctrine, not as a source of mandatory obligations.¹⁶ Rather than mandating standards of business conduct, good faith terms are implied in light of the explicit text of an agreement, as an interpretation of the text. Good faith duties are therefore contractual gap-fillers: they are a means of filling in implied terms where the contract is silent as to specific contingencies.¹⁷ In those cases where contracts do not expressly address a future contingency, good faith doctrine looks to enforce the parties' reasonable expectations based on the text of their agreement.¹⁸

Thus, the crucial good faith inquiry is whether contractual text fully addresses the exercise of discretion at issue. In some cases, discretion-granting terms are quite broad. A limited partnership or LLC agreement may, and often does, provide individuals with absolute discretion over the management of certain firm decisions. Such grants of discretion are rational choices for some businesses, especially venture capital firms.¹⁹ When they are sufficiently clear, these terms also implicate the scope of good faith duties.

Contracts are drafted to resolve a variety of concerns, including the concern that courts will intervene in the parties' business relationship.²⁰ Typically, when fiduciary duties are eliminated, the scope of managerial discretion will be limited by the parties (or, in cases of contractual silence, provided by default terms). But barring egregious cases, such as unconscionability, fraud, or

16. David Rosenberg, *Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 491, 499-500 (2004).

17. *Id.*

18. See Steven J. Burton & Eric G. Andersen, *The World of a Contract*, 75 IOWA L. REV. 861, 869 (1990) (stating that "[i]n every contract there is an implied covenant of good faith and fair dealing," and that good faith should be "understood with attention to the intention of the parties and their reasonable expectations") (internal citations omitted).

19. See generally Rosenberg, *supra* note 10 (describing reliance on contract law and extrajudicial constraints in venture capital context). As Rosenberg notes, the fiduciary waiver "permits the venture capitalist to conduct his business with the kind of broad authority needed to function in his multiple roles as company officer, advisor and source of funding." *Id.* at 382.

20. On the use of contractual language to alter the course of future litigation, see generally Robert E. Scott & George G. Triantis, *Principles of Contract Design*, 115 YALE L.J. (forthcoming 2006), available at <http://ssrn.com/abstract=722263>.

misappropriation of assets, contract doctrine mandates few restrictions on the discretion of non fiduciaries.²¹

Courts usually interpret contracts with the object of enforcing the parties' intentions when they signed their agreement. Once fiduciary duties are eliminated, however, judicial efforts to construct a hypothetical intent for unforeseen contingencies are highly speculative. Aside from contractual absurdities, the most reliable indication of intent in this context is the explicit text of the agreement. The text is the means by which the parties chose to memorialize their understanding. Notwithstanding the contractual duty of good faith, this text need not reflect external norms of business conduct.

A strict adherence to contractual text permits agreements that do not resemble classic fiduciary relationships. Removal of fiduciary duties thus allows for a de facto expansion of business-judgment-rule protections by altering the underlying standard of conduct.²² Under the new laws, contracting parties have the ability to substantially restrict the scope of judicial oversight by adjusting their default obligations to the firm and to their business partners.²³ As will be developed below, these broad grants of discretion are consistent with legitimate business purposes and should be respected under principles of contractual freedom.

The first three Parts of this Article offer an analysis of current Delaware law in light of judicial precedent. Part I of this Article provides an overview of fiduciary duties and the implied contractual covenant of good faith, and Part II reviews the history of fiduciary opt-outs for Delaware limited partnerships and LLCs. Part III reviews the implied covenant of good faith as it is enforced in Delaware. This Part explains how good faith is best understood as

21. An example of a mandatory contract doctrine is the requirement of consideration. *Cf.* DeMott, *Fiduciary Preludes*, *supra* note 6, at 1060-61 (suggesting the contract doctrine of consideration limits the scope of fiduciary waivers absent a robust good faith duty).

22. The contractual provisions at issue address standards of conduct, rather than standards of review. However, where fiduciary duties such as the duty of loyalty are removed, they have a consequent impact on the scope of judicial oversight. *Cf.* Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 *FORDHAM L. REV.* 437 (1993) (describing a divergence between fiduciary duty as a standard of conduct and the business judgment rule as a standard of review). It is also arguable that substitution of contractual duties in this context might remove business-judgment-rule protections in some cases. *See* Elizabeth S. Miller & Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations?*, 30 *DEL. J. CORP. L.* 343 (2005).

23. *See supra* notes 7-9 and accompanying text.

an interpretive measure rather than a source of mandatory substantive duties.

The remaining Parts of the Article address contract doctrine generally and seek to demonstrate that Delaware courts' understanding of contractual good faith is appropriate in this context. Part IV assesses the meaning of contractual gaps and describes how a decision to eliminate fiduciary duties and avoid judicial oversight is consistent with a rational effort to allocate risk. Part V discusses the content of judicially implied terms in the context of fiduciary opt-outs. This Part will argue that judicially constructed hypothetical bargains are not a reliable method for determining the parties' intent in cases of fiduciary opt-outs, supporting the view that courts should strictly follow the objective meaning of contractual text. Part VI suggests that an expansive role for good faith doctrine is unnecessary to protect most parties to fiduciary opt-out agreements.

Part VII discusses the import of contractual freedom when courts interpret agreements that displace fiduciary duties. This Part will contend that, in order to avoid redistributing preexisting contractual commitments and ensure the greatest breadth of contractual choice, courts should strictly enforce limited partnership and LLC agreements, even in cases that significantly restrict the judicial role. The effect of strict enforcement of the text would permit substantially more freedom from judicial review than is available under traditional fiduciary relations.

I. DEFINING FIDUCIARY DUTIES AND THE DUTY OF GOOD FAITH

Contracts that eliminate fiduciary duties still retain residual good faith obligations. In order to make sense of good faith and fair dealing obligations for agreements that have eliminated fiduciary duties, one must first define these concepts.²⁴ The basic scope of these doctrines is set forth below, with emphasis on the similarities and distinctions between fiduciary duties and contractual good faith duties.

24. As the focus of this Article is the effect of good faith doctrine on contracts that have eliminated fiduciary duties, it is beyond the scope of this Article to define precisely the circumstances that cause fiduciary duties to come into existence. There are several explanations which might fit comfortably with the analysis in this Article. See, e.g., Easterbrook & Fischel, *Contract & Fiduciary Duty*, *supra* note 3; D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399 (2002); Larry E. Ribstein, *The Structure of the Fiduciary Relationship* (2003), <http://home.law.uiuc.edu/~ribstein/structureofthefiduciaryrelationship9.doc>.

A. *The Fiduciary Duties of Loyalty, Care, and Good Faith*

Limited partnerships and LLCs both implicate fiduciary duties for managers of the firm.²⁵ A limited partnership has many of the characteristics of a general partnership, albeit with several unique features. Limited partners have limited liability, and are passive members of the firm,²⁶ while general partners are personally liable for the limited partnership's obligations and have active control over the business.²⁷ In contrast, LLCs generally offer default management by the firm's owners,²⁸ though it is possible to structure the LLC so that it is controlled by a group of managers.²⁹ In each case, common law fiduciary duties govern managerial discretion.³⁰

Fiduciary duties generally arise where one party is given discretionary authority over property³¹ or a "critical resource"³² owned by another party. In broad terms, the fiduciary must act selflessly and in the best interest of the beneficiary.³³ These obligations are commonly viewed as implied contract terms governing a party's discretion.³⁴

25. For a useful comparison of the two business forms, see Ribstein, *Limited Partnership Agreements*, *supra* note 6, at 931-32.

26. *See id.* at 931. Limited partnerships are also characterized by finite duration. On the significance of this aspect for venture capital, see Rosenberg, *supra* note 10, at 378-79.

27. *See* Ribstein, *Limited Partnership Agreements*, *supra* note 6, at 931.

28. *See id.* at 932.

29. *See id.*

30. *See, e.g.*, Rosenberg, *supra* note 10, at 388-89 ("Under common law, as well as the uniform partnership laws in most states including Delaware, the general partners in a limited partnership owe a fiduciary duty to the limited partners in much the same way that corporate officers owe a duty to shareholders.").

31. *See* Ribstein, *The Structure of the Fiduciary Relationship*, *supra* note 24, at 8 (describing fiduciary duty as a contractual term which applies "where an 'owner' who controls and derives the residual benefit from property delegates open-ended management power over property to a 'manager'"). Not all fiduciary relationships involve property in the standard sense. For example, fiduciary claims based upon the taking of confidential information do not implicate traditional concepts of property. *Cf.* Easterbrook & Fischel, *Contract & Fiduciary Duty*, *supra* note 3, at 435 (critiquing a property-based definition of fiduciary duties).

32. *See* Smith, *supra* note 24, at 1403-04 (explaining fiduciary theory in terms of critical resources, including confidential information).

33. *See* DeMott, *Beyond Metaphor*, *supra* note 5, at 882 ("The fiduciary's duties go beyond mere fairness and honesty; they oblige him to act to further the beneficiary's best interests. The fiduciary must avoid acts that put his interests in conflict with the beneficiary's.").

34. *See, e.g.*, Easterbrook & Fischel, *Contract & Fiduciary Duty*, *supra* note

If there is a residual duty of good faith in agreements where fiduciary duties are eliminated, it must be substantively distinct from fiduciary duties, at least in some cases. Otherwise, a contractual clause eliminating fiduciary duties would be illusory, and the recent statutory amendments would be meaningless. When locating a distinction between fiduciary duties and good faith duties, it is helpful to compare the standard content of fiduciary duties with that of contractual good faith duties.

Delaware courts describe a triad of fiduciary obligations: the duties of loyalty, care, and good faith.³⁵ There are a variety of explanations for this set of duties, ranging from contractual analysis,³⁶ to the view that these obligations have ethical and moral underpinnings.³⁷ Some commentators allege that fiduciary duties are (at least partially) status-based, mandatory obligations that exist whenever certain types of relationships exist.³⁸

Given the statutory backdrop at issue here provides a right to eliminate fiduciary duties, a contractual default theory provides a better descriptive fit than a theory of mandatory duties.³⁹ The

3, at 436 (“No noneconomic rationale does very well at explaining even the outlines of fiduciary duties. The implied contract approach can and does.”).

35. See, e.g., *Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001) (“The directors of Delaware corporations have a triad of primary fiduciary duties: due care, loyalty, and good faith.”); see also *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

36. See *Butler & Ribstein*, *supra* note 3, at 28-30; *Easterbrook & Fischel, Contract & Fiduciary Duty*, *supra* note 3.

37. Cf. *DeMott, Beyond Metaphor*, *supra* note 5, at 879 (“Applicable in a variety of contexts, and apparently developed through a jurisprudence of analogy rather than principle, the fiduciary constraint on a party’s discretion to pursue self-interest resists tidy categorization.”). *But cf. Smith*, *supra* note 24, at 1400 (attempting to provide a unified theory of fiduciary duty).

38. See, e.g., *Tamar Frankel, Fiduciary Law*, 71 CALIF. L. REV. 795, 801 (1983) (“[F]iduciary relations combine the bargaining freedom inherent in contract relations with a limited form of the power and dependence of status relations.”); *Allan W. Vestal, Advancing the Search for Compromise: A Response to Professor Hynes*, 58 LAW & CONTEMP. PROBS. 55, 70 (1995) (“I view the partnership relation as fundamentally one of status, with contractual bargaining at the periphery.”).

39. This aspect of fiduciary duties, and more broadly, business entities, has not always been apparent. Cf. *Eisenberg*, *supra* note 5, at 1485-86 (contending that the theories of the corporation as a nexus of contracts, and of corporate law as a standard form contract, are “descriptively erroneous”). The ability to adjust the internal governance terms for Delaware limited partnerships and LLCs is pervasive, however. See *Elf Atochem N. Am., Inc., v. Jaffari*, 727 A.2d 286, 290 (Del. 1999). In addition, even if the agreement is similar to a form contract, this does not vitiate consent. On the merits of enforcing form contracts, see generally *Randy E. Barnett, Consenting to Form Contracts*, 71 *FORDHAM L. REV.* 627 (2002) (contending that form contracts can be seen as

duties themselves are clearly defaults under Delaware law,⁴⁰ and the new statutory language limits the right to opt out of fiduciary duties pursuant to the implied covenant of good faith and fair dealing.⁴¹ This Article will therefore discuss fiduciary duties as default duties, subject to modification by agreement.

The fiduciary duty of loyalty is often described as a duty of unselfishness.⁴² Judge Cardozo famously described this duty in the joint venture context as “[n]ot honesty alone, but the punctilio of an honor the most sensitive”⁴³ and noted that the duty required “something stricter than the morals of the market place.”⁴⁴ This understanding of the duty of loyalty means that a managing member of a limited partnership or LLC would owe the other members, or the entity itself, a strict duty not to act contrary to their interests.⁴⁵

The duty of care requires that the business manager follow a decisionmaking process that is not grossly negligent and consider all material information that is reasonably available.⁴⁶ It has been suggested that the duty of care is not “distinctively fiduciary,” since similar duties exist in other types of contracts.⁴⁷ Even so, the duty of care is traditionally grouped under the category of fiduciary duties, and parties to a limited partnership or LLC may eliminate it from their relationship under Delaware’s new statutory provisions.

entirely legitimate under a consent theory of contract).

40. *See* Cont’l Ins. Co. v. Rutledge, 750 A.2d 1219, 1235 (Del. Ch. 2000) (“In the limited partnership context, Delaware law resolves this conflict in favor of contract law, rendering fiduciary duties default rules.”).

41. The statutes are explicit that the “agreement may not eliminate the implied *contractual* covenant of good faith and fair dealing.” DEL. CODE ANN. tit. 6, § 17-1101(d); DEL. CODE ANN. tit. 6, § 18-1101(c) (emphasis added). This makes clear that the good faith duty at issue is grounded in contract law.

42. *See* Ribstein, *Unincorporated Firms*, *supra* note 6, at 542.

43. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

44. *Id.*

45. *See, e.g.*, VGS, Inc. v. Castiel, 2000 WL 1277372, at *4 (Del. Ch. Aug. 31, 2000) (finding that managers on LLC board owe a duty of loyalty); *In re Boston Celtics Ltd. P’ship S’holders Litig.*, 1999 WL 641902, at *4 (Del. Ch. Aug. 6, 1999) (stating that general partner duties to limited partners are “no less than that owed by a director to a shareholder”).

46. *See, e.g.*, *In re Caremark International Inc. Deriv. Litig.*, 698 A.2d 959, 970-71 (Del. Ch. 1996); *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). The duty may also apply in cases where the fiduciary acts contrary to the interests of the business entity, but does not actually act out of self-interest. *See* Smith, *supra* note 24, at 1410-11 n.46. This type of breach could also be described in fiduciary good faith terms, however.

47. *See id.* at 1409 (noting that a duty of care exists within nonfiduciary relationships); DeMott, *Beyond Metaphor*, *supra* note 5, at 915 (same); Ribstein, *The Structure of the Fiduciary Relationship*, *supra* note 24, at 15.

The fiduciary duty of good faith is a source of potential confusion. This area of the law is still developing, and the doctrine may have different meanings in different contexts.⁴⁸ It is questionable whether a fiduciary duty of good faith is not simply the implied covenant of good faith and fair dealing in a fiduciary setting,⁴⁹ and courts differ in interpreting this obligation as a distinct fiduciary duty.⁵⁰ For purposes of clarity, this Article will refer to “fiduciary good faith” when addressing the good faith duties that fiduciaries owe and “contractual good faith” when addressing the duty of good faith that inheres in contracts generally.

The Delaware Supreme Court views the fiduciary good faith duty as a freestanding fiduciary duty that can be violated independently from a violation of the duties of loyalty or care.⁵¹ Although the precise meaning of an independent fiduciary duty of good faith is not yet fully clear, this duty may cover instances where a fiduciary acts egregiously, intentionally abdicating their obligations in ways that do not implicate gross negligence or conflicts of interest.⁵² For example, where a duty of candor is intentionally violated, without the existence of a conflict of interest, this could be a breach of the fiduciary’s duty of good faith.⁵³

48. For a thorough analysis of recent fiduciary duty of good faith decisions in Delaware, see Hillary A. Sale, *Delaware’s Good Faith*, 89 CORNELL L. REV. 456, 463-82 (2004). One reason for the recent emphasis on this branch of fiduciary law may be the effect of Delaware’s exculpatory provision for corporate directors, which permits directors to avoid liability for duty of care violations, but not for loyalty or good faith violations. See DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

49. See Rosenberg, *supra* note 16, at 513 (“There is no line connecting good faith and fiduciary duties. Rather, good faith is a circle around which all duties, corporate or contractual, are surrounded.”).

50. Put simply, duty-of-loyalty violations are not in good faith, nor is the gross negligence that comes with a breach of the duty of care. The role for a free standing fiduciary duty of good faith depends, then, upon forms of bad faith that are neither disloyal nor lacking due care. Sale suggests that non-procedural flaws in decision making that do not implicate conflicts of interest are an example in this category. See Sale, *supra* note 48, at 494.

51. See, e.g., *Emerald Partners v. Berlin*, 787 A2d. 85, 90 (Del. 2001) (“The directors of Delaware corporations have a triad of primary fiduciary duties: due care, loyalty, and good faith.”).

52. See Sale, *supra* note 48, at 494 (“The value of a separate good faith duty, then, is in its potential for addressing those outrageous and egregious abdications of fiduciary behavior that are not simply the results of bad process or conflicts.”). For a recent judicial effort to define fiduciary good faith duties, see *In re The Walt Disney Co. Derivative Litig.*, No. CIV. A. 15452, 2005 WL 1875804, at *36 (Del. Ch. Aug. 9, 2005). The *Disney* opinion emphasizes intent as a requirement for good faith violations. *Id.*

53. See Sale, *supra* note 48, at 492. However, Sale’s definition arguably

B. *The Implied Covenant of Good Faith and Fair Dealing*

Fiduciary duties exist along the same continuum as contractual duties of good faith and fair dealing.⁵⁴ They are depicted as variations on a theme,⁵⁵ or distinguished “with a blur and not a line.”⁵⁶ Overlap between these doctrines is unsurprising since both types of duties seek to prevent opportunism where a contract is silent.⁵⁷

As a practical matter, the difference between fiduciary duties and terms implied under the contractual covenant of good faith and fair dealing is the scope of the obligation.⁵⁸ Fiduciary duties

depends upon the content of the duties of loyalty and care. See Rosenberg, *supra* note 16, at 508-09 (noting as an example that Sale contends that a failure to comply with one’s fiduciary duties is likely to result in a breach of good faith). The strength of Rosenberg’s argument is contingent upon how strictly one confines the meaning of due care or loyalty.

54. See, e.g., Dickerson, *supra* note 5, at 991-93. Dickerson contends that “[t]radition and formalism alone defend the current view that fiduciary duty and good faith are wholly separate concepts.” *Id.* at 993. She argues that the same concerns with power and conflicts of interest that call for fiduciary duties also call for good faith duties, and the distinction is purely one of degree. See also Easterbrook & Fischel, *Contract & Fiduciary Duty*, *supra* note 3, at 438 (“When transactions costs reach a particularly high level, some persons start calling some contractual relations ‘fiduciary,’ but this should not mask the continuum.”); Smith, *supra* note 24, at 1488-89 (comparing good faith and fiduciary duty in terms of the “range of opportunistic behavior possible in each context”); cf. Coffee, *supra* note 5, at 1653 (“Suppose one were to start with a devil’s advocate assertion that the core fiduciary duties of corporate law are essentially context-specific applications of contract law’s duty of good faith . . .”).

55. Smith, *supra* note 24, at 1487-88 (describing contractual good faith duties as a loyalty obligation and contending that “[f]iduciary duty and the duty of good faith and fair dealing are variations on a theme”).

56. Easterbrook & Fischel, *Contract & Fiduciary Duty*, *supra* note 3, at 438.

57. See *id.*; see also *Mkt. Street Assoc. Ltd. P’ship v. Frey*, 941 F.2d 588, 595 (7th Cir. 1991) (“The concept of the duty of good faith like the concept of fiduciary duty is a stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to their dispute.”). *But cf.* Smith, *supra* note 24, at 1492 (“That parties to a fiduciary relationship define the contours of their relationship through contract does not mean that fiduciary duties are simply contractual gap-fillers. As emphasized repeatedly throughout this Article, the critical resource theory of fiduciary duty holds that fiduciary relationships are distinctive.”). Even from a non-contractual perspective on fiduciary relations, the two doctrines are easily linked. Cf. DeMott, *Beyond Metaphor*, *supra* note 5, at 892-902 (comparing the two doctrines).

58. See *Frey*, 941 F.2d at 595 (“This duty [of good faith] is, as it were, halfway between a fiduciary duty (the duty of *utmost* good faith) and the duty merely to refrain from active fraud. Despite its moralistic overtones, it is no

generally require a rigorous standard of behavior, precluding managers from acting in their own interest in place of the interests of the business entity.⁵⁹ Like fiduciary duties, contractual good faith duties also reject opportunism; unlike fiduciary duties, they do not preclude selfish behavior.⁶⁰ Under a contractual good faith standard, a party with discretion may act in her own self interest, so long as she does not abuse this discretion in a way that is contrary to the spirit of express contractual obligations.⁶¹

The content of contractual good faith has not been easy to define in the abstract, in part because context is so significant to its application.⁶² The scope of good faith duties and the circumstances under which they apply vary with the terms of each agreement. Differences in interpretive philosophy also impact the meaning of contractual good faith.

An early contribution to the debate over this duty provided a

more the injection of moral principles into contract law than the fiduciary concept itself is.”).

59. See generally DeMott, *Beyond Metaphor*, *supra* note 5, at 882 (discussing general principles of fiduciary relationships). As Gordon Smith notes, there is some overlap even here. Smith, *supra* note 24, at 1409-10 (“In the fiduciary context, the duty of loyalty requires the fiduciary to adjust her behavior on an ongoing basis to avoid self-interested behavior that wrongs the beneficiary. By contrast, the implied obligation of good faith and fair dealing requires loyalty to the other contracting party only to the extent that the terms of the contractual relationship reasonably contemplate the actions in question. Stated another way, both contracting parties and fiduciaries may be allowed to engage in self-interested behavior.”).

60. See DeMott, *Beyond Metaphor*, *supra* note 5, at 900 (“Most importantly, if a fiduciary obligation constrains a person’s discretion in a particular matter, the obligation is breached if the person acts self-interestedly. Good faith obligation, on the other hand, permits actions that are self-interested; the key question is abuse, not benefit to the actor.”); Coffee, *supra* note 5, at 1658 (“In contract law, a discretion-exercising party may often act in a self-interested fashion. Good faith and self-interested behavior are not mutually exclusive. Conversely, fiduciary duty’s requirement of undivided loyalty permits the fiduciary to consider only the beneficiary’s interests.”); see also DeMott, *Beyond Metaphor*, *supra* note 5, at 882 (“The fiduciary’s duties go beyond mere fairness and honesty; they oblige him to act to further the beneficiary’s best interests. The fiduciary must avoid acts that put his interests in conflict with the beneficiary’s.”).

61. See DeMott, *Beyond Metaphor*, *supra* note 5, at 900 (discussing example of a requirements contract where the buyer can make profit-maximizing decisions).

62. See Robert S. Summers, “Good Faith” in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 201, 206 (1968) (contending that “good faith” does not have a general meaning, but takes on a specific meaning in a particular context).

list of categories in which courts found “bad faith.”⁶³ Robert Summers contended that the phrase “good faith” was an “excluder,” which could not itself be clearly defined, but could be recognized by those instances when the absence of good faith is found.⁶⁴ Categories of bad faith conduct include evasion of the spirit of the deal, lack of diligence and “slacking off,” willful rendering of only “substantial” performance, abuse of a power to specify terms, abuse of a power to determine compliance, and interference with or failure to cooperate in performance by the other party.⁶⁵

Summers also proposed that the duty of good faith contains a moral component, suggesting that it is in a category of doctrines which create liability “independent of contract.”⁶⁶ Good faith is, under this theory, “a piece with explicit requirements of ‘contractual morality’ such as the unconscionability doctrine and various general equitable principles.”⁶⁷ As a result, the text of a contract might actually conflict with the good faith duty. This latter thesis proved controversial.

Good faith conduct is generally understood in light of the parties’ agreement. As one critic of Summers’ thesis noted, “it is hard to see what justifies a court in disregarding the agreement of the parties on grounds of ‘contractual morality’ when the intentions of the parties or their reasonable expectations can be reasonably ascertained,” and doctrines such as unconscionability are not invoked.⁶⁸ If one seeks to have maximum freedom of contract, which is the express interpretive guidance of the applicable Delaware statutes, the ability of moral concerns to trump contract terms is problematic.⁶⁹

An additional concern raised by Summers’ understanding of

63. *Id.* at 232-43.

64. *Id.* at 201.

65. *Id.* at 232-43.

66. *Id.* at 198 (providing examples such as fraud, negligence, and estoppel, and noting “[t]hese doctrines supplement, limit and qualify specific legal rules and contract terms, and some of them also serve as substantive bases of liability independent of contract”).

67. See Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 811 (1982) (describing good faith under Section 205 of the Restatement (Second) of Contracts in these terms).

68. See Steven J. Burton, *More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497, 499-500 (1984).

69. See DEL. CODE ANN. tit. 6, § 17-1101(d) (2005); DEL. CODE ANN. tit. 6, § 18-1101(c) (2005). Good faith, even as an interpretive measure, can have an impact on freedom of contract, see *infra* notes 15-19 and accompanying text, but it need not do so. Viewed as an affirmative limit on the availability of contract terms, however, it is hard to see the consistency with individual autonomy.

good faith is that it does not provide a unifying theory for when good faith is violated that can be readily assessed *ex ante* by the contracting parties.⁷⁰ The excluder analysis focuses on cases of “bad faith,” without sufficient emphasis on what qualifies as “good faith.”⁷¹ This is not to say that good faith is a model of predictability under other definitions: it is, however, especially hard to define *ex ante* under an excluder approach.⁷²

Steven Burton suggested an alternative understanding of the duty of good faith, in an attempt to provide a model that would better aid analogical reasoning.⁷³ Under his formulation, a violation of the duty of good faith occurs when a party to a contract attempts during the course of the contract to recapture an opportunity foregone at contract formation.⁷⁴ Bad faith is found when discretion is used to recapture such opportunities—a refusal to pay “the expected costs of performance.”⁷⁵ Good faith, in contrast, is found when a party’s discretion is exercised “for any purpose within the reasonable contemplation of the parties at the time of formation.”⁷⁶

Good faith analysis then raises two questions: (1) “what was the discretion-exercising party’s purpose in acting?” and (2) “was that purpose within the reasonable contemplation of the parties?”⁷⁷ This theory permits a contracting party to perform in ways contrary to what the promisee had subjectively hoped for, but not if doing so

70. See Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 369-70 n.5 (1980) (“No effort is made to develop a unifying theory that explains what these categories have in common. Indeed, the assertion is made that one cannot or should not do so.”).

71. See Burton, *supra* note 68, at 508 (“My principal difficulty with excluder analysis is its singular focus on cases of bad faith. Most of the relevant performance cases hold that a party acted in good faith. . . . One need not develop a ‘positive definition’ to consider analogically whether a particular case is more like those precedents finding good faith performance or more like those finding bad faith performance.”).

72. *Cf. id.* at 509 (“To say, for example, that one should consider ‘all things’ in a case, as Professor Summers advocates, is of limited practical utility. . . . We want our language to call our attention to the facts that matter—those that legitimately establish significant similarities with or significant differences from the precedents.”); see also Larry T. Garvin, *Adequate Assurance of Performance: Of Risk, Duress, and Cognition*, 69 U. COLO. L. REV. 71, 120 (1998) (“Professor Summers sees no real meaning in good faith as such. Rather, he sees the concept as something of a safety-valve, allowing the courts to police agreements and performance for fairness.”).

73. See Burton, *supra* note 68, at 509-11.

74. Burton, *supra* note 70, at 385-87.

75. *Id.* at 387.

76. *Id.* at 373.

77. *Id.* at 386.

interferes with what the parties objectively contemplated.⁷⁸ As noted, the foregone-opportunity theory eschews reliance on questions of “contractual morality,” instead looking to the expectations of the parties in light of the promises in their agreement.⁷⁹

A textually grounded explanation is set forth in *Kham & Nate’s Shoes No. 2, Inc. v. First Bank*.⁸⁰ In that opinion, Judge Easterbrook addressed good faith duties in the context of a bank’s refusal to advance funds to a shoe store under an agreement that expressly permitted the bank to cease making advances.⁸¹ In light of the contractual text, good faith conduct did not require an advance. The court explained that “[g]ood faith’ is a compact reference to an implied undertaking not to take opportunistic advantage in a way that could not have been contemplated at the time of drafting, and which therefore was not resolved explicitly by the parties.”⁸²

Good faith is thus a contractual gap-filler where the agreement is silent, but the possibility of finding gaps is limited by explicit text.⁸³ Under this reading, the principles of good faith “do not block use of terms that actually appear in the contract,”⁸⁴ and parties may enforce negotiated terms “to the letter.”⁸⁵ This formulation

78. *Id.* at 391-92 (“[T]he relevant and distinct set of facts is that subset of the totality of the circumstances (1) at formation, bearing on the expected costs to a discretion-exercising promisor; and (2) at performance, bearing on whether the promisor exercised its discretion in performance to recapture a foregone opportunity. That the dependent promise did not receive benefits under the contract as it had hoped simply is not dispositive.”).

79. The sources of the expectations—whether they are located solely in the text, or should be based on a broader context—are not agreed upon. *See, e.g.*, Michael P. Van Alstine, *Of Textualism, Party Autonomy, and Good Faith*, 40 WM. & MARY L. REV. 1223, 1256-57 (1999).

80. 908 F.2d 1351 (7th Cir. 1990).

81. *See id.* at 1353-54.

82. *Id.* at 1357.

83. *See id.* (“When the contract is silent, principles of good faith . . . fill the gap.”).

84. *Id.*

85. *Id.* (“Firms that have negotiated contracts are entitled to enforce them to the letter, even to the great discomfort of their trading partners, without being mulcted for lack of ‘good faith.’”); *see also* L.A.P.D., Inc. v. Gen. Elec. Corp., 132 F.3d 402, 404 (7th Cir. 1997) (“More often than we care to recall, we have reminded litigants that . . . [they] may not seek to litigate issues of ‘good faith’ in lieu of abiding by explicit provisions of contracts.”); *Kham & Nate’s*, 908 F.2d at 1357 (“[K]nowledge that literal enforcement means some mismatch between the parties’ expectation and the outcome does not imply a general duty of ‘kindness’ in performance, or of judicial oversight into whether a party had ‘good cause’ to act as it did. Parties to a contract are not each others’ fiduciaries; they are not bound to treat customers with the same consideration

emphasizes predictability.⁸⁶

Kham & Nate's is an example of good faith viewed as an interpretive measure, with no room for implied terms where express terms are clear.⁸⁷ Good faith duties only address contractual language where the parties have left something unresolved; their contract must in some sense be incomplete.⁸⁸ Pursuant to this understanding, a discretion-granting term is viewed as complete, without gaps, except when the intent of the parties could not reasonably be read to permit the exercise of discretion under dispute.

As the above examples indicate, there is disagreement over the precise meaning and source of “good faith” duties. Delaware case law, however, supports the idea that good faith duties must be understood in light of the parties’ agreement. This Article will accordingly address the conception of good faith as an interpretive device, consistent with the idea that when courts interpret contracts they should attempt to effectuate the intent of the parties, and with Delaware’s emphasis on maximum freedom of contract. Under this

reserved for their families.”).

86. As Judge Easterbrook noted in that case, “[a]ny attempt to add an overlay of ‘just cause’ . . . to the exercise of contractual privileges would reduce commercial certainty and breed costly litigation.” *Kham & Nate's*, 908 F.2d at 1357. For a spirited critique of *Kham & Nate's*, see Dennis M. Patterson, *A Fable from the Seventh Circuit: Frank Easterbrook on Good Faith*, 76 IOWA L. REV. 503 (1991). Michael Van Alstine argues that the good faith doctrine reflects the idea that “some expectations may be so fundamental or obvious to the parties that neither sees a necessity to raise them in negotiations . . . nor certainly to demand that they be reduced to writing.” Van Alstine, *supra* note 79, at 1274. He suggests the good faith duty should therefore “direct attention to the spirit of the parties’ deal,” and look to expectations that do not necessarily find expression in the formal agreement. *Id.* *But cf. Kham & Nate's*, 908 F.2d at 1357 (“Unless pacts are enforced according to their terms, the institution of contract, with all the advantages private negotiation and agreement brings, is jeopardized.”).

87. Van Alstine has raised doubts about the *Kham & Nate's* analysis, suggesting that its reasoning would result in a duty which “only rarely applies” and “is of limited force when it does.” See Van Alstine, *supra* note 79, at 1269. Van Alstine’s argument ultimately goes to the question of how much non-textual expectations should be incorporated into the interpretation of contracts. See *infra* Part IV. For a defense of textualist contract analysis, see Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 568 n. 50 (2003) (proposing textualism for interpretation of contract between commercial parties); see also Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 826-27 (1992) (proposing default rules based on conventional understandings of contractual language).

88. See *Kham & Nate's*, 908 F.2d at 1357 (addressing the applicability of good faith doctrine “when the contract is silent”).

rubric, the justification for recognizing a good faith obligation is that the agreement implicitly included the obligation, even if the parties did not do so explicitly.

As will be developed below, the objective meaning of contractual text is the most reliable evidence of the parties' intent where parties have eliminated fiduciary duties.⁸⁹ If the text is clear, a discretion-granting contract term should be enforced to the letter. From this perspective, a grant of discretion should be limited by good faith considerations if the parties must have intended such a limitation.⁹⁰

II. DELAWARE'S PROVISIONS FOR ELIMINATING FIDUCIARY DUTIES

There are a number of ways in which parties place limits on fiduciary duties. In several jurisdictions, courts have recognized the validity of fiduciary opt outs that permit firm members to compete with the firm,⁹¹ allow parties to take business opportunities that were available to the firm,⁹² permit self-interested transactions,⁹³ or limit duties of disclosure.⁹⁴ Delaware's recent allowance for the elimination of fiduciary duties should permit each of these results.

Before the recent statutory changes, Delaware statutes provided a broad power to "restrict" fiduciary duties for limited partnerships and LLCs.⁹⁵ Courts determined that contract terms

89. See *infra* notes 185-231 and accompanying text.

90. As Larry Ribstein has recently noted, good faith within partnerships can be seen as either an interpretive rule or as a source of substantive terms. The substantive understanding of good faith would involve "a distinct set of *nonfiduciary* duties to protect others from harm that are sometimes applied to people who may or not also be fiduciaries." Ribstein, *The Structure of the Fiduciary Relationship*, *supra* note 24, at 17-18. For example, good faith may include a duty to make disclosures of information in certain circumstances. *Id.* at 18. To the extent contractual good faith entails mandatory substantive duties, however, such a form of good faith duty would be in tension with the freedom of contract endorsed by Delaware statute. An interpretive rule need not raise these concerns.

91. See, e.g., *Lynch Multimedia Corp. v. Carson Commc'ns, L.L.C.*, 102 F. Supp. 2d 1261, 1264 (D. Kan. 2000); *McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193, 1206 (Ohio Ct. App. 1999).

92. See, e.g., *Kahn v. Icahn*, No. CIV. A. 15916, 1998 WL 832629, at *4 (Del. Ch. 1998).

93. See, e.g., *Sonet v. Timber Co.*, 722 A.2d 319, 327 (Del. Ch. 1998).

94. See Ribstein, *Unincorporated Firms*, *supra* note 6, at 576-77 (citing *Exxon Corp. v. Burglin*, 4 F.3d 1294, 1298-99 (5th Cir. 1993) (noting explicit authority supporting enforcement of waiver of disclosure duties).

95. The Delaware language originally stated that "the partner's duties and liabilities may be expanded or restricted by provisions in a partnership agreement." Larry E. Ribstein, *Unlimited Contracting in the Delaware Limited Partnership and its Implications for Corporate Law*, 16 J. CORP. L. 299, 300 n.2, 301-02 (1991) (describing limited partners' ability to expand or restrict duties

could displace fiduciary duties, either through explicit terms or through an agreement's structure.⁹⁶ In the late 1990s, several Delaware Chancery Court decisions in the limited partnership context concluded that fiduciary duties were subject not only to restriction, but to elimination.⁹⁷

For example, in *Sonet v. Timber Co.*,⁹⁸ the chancery court addressed a claim by a holder of limited partner interests that a general partner had engaged in a self-dealing transaction.⁹⁹ The plaintiff claimed that the general partner unfairly received shares in a real estate investment trust pursuant to a merger.¹⁰⁰ The court, however, "decline[d] to rely unnecessarily on this Court's traditional analyses involving fiduciary duties in the corporate context."¹⁰¹ Instead, the court looked to principles of contract interpretation to resolve the case.

under Delaware law); *cf.* *Gotham Partners v. Hallwood Realty Partners*, 795 A.2d 160, 167-68 (Del. 2002).

96. *See Sonet*, 722 A.2d at 327 (holding that fiduciary duties were displaced by the express terms of the agreement). The parties may also supplant fiduciary duties by the structure of their agreement, which limits judicial enforcement of fiduciary duties by adopting procedural remedies in their stead. *See, e.g., R.S.M., Inc. v. Alliance Capital Mgmt. Holdings, L.P.*, 790 A.2d 478, 498 (Del. Ch. 2001) (default fiduciary duties will be eschewed where contractual mechanisms apply; in this case a ratification procedure); *In re Cencom Cable Income Partners, L.P. Litig.*, No. 14634, 1997 WL 666970, at *12 (Del. Ch. 1997) (compliance with voting procedure sufficient to avoid liability); *cf. Wilmington Leasing, Inc. v. Parrish Leasing Co.*, Civ. A. No. 15202, 1996 WL 752364, at *14 (Del. Ch. 1996) ("Where, as here, a Partnership Agreement specifically addresses the rights and duties of the partners, any fiduciary duty that might be owed by the Limited Partners is satisfied by compliance with the applicable provisions of the partnership agreement.").

97. *See, e.g., Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, No. CIV. A. 15754, 2000 WL 1476663, at *10 (Del. Ch. Sept. 27, 2000), *aff'd in part rev'd in part*, 817 A.2d 160 (Del. 2002); *see also Sonet*, 722 A.2d at 327. For an in-depth discussion of limited partnership cases permitting restriction of fiduciary duties, see Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK U. L. REV. 927, 953-60 (2004). Expressions of the freedom of contract principle were also made in the LLC context. *See, e.g., Walker v. Resource Dev. Co.*, 791 A.2d 799, 813 (Del. Ch. 2000) (stating in the LLC context, "[o]nce members exercise their contractual freedom in their limited liability company agreement, they can be virtually certain that the agreement will be enforced in accordance with its terms") (quoting 2 R.F. BALOTTI & J.A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS* § 20.4 (2000)); *Elf Atochem N. Am. Inc. v. Jaffari*, 727 A.2d 286, 291 (Del. 1999).

98. 722 A.2d 319.

99. *Id.* at 321.

100. *Id.*

101. *Id.* at 323.

The limited partnership agreement in *Sonet* provided the general partner with discretion “to manage virtually all of the affairs of the [p]artnership.”¹⁰² With respect to day-to-day affairs, the general partner’s discretion was subject to a requirement that its “actions be fair and reasonable to the [p]artnership.”¹⁰³ But for extraordinary acts, such as mergers, the general partner was given “sole discretion”¹⁰⁴ checked by a requirement that a supermajority of unitholders approve the transaction.¹⁰⁵ In light of this agreement and the provision that the general partner had sole discretion over the decision at issue, the court granted the defendants’ motion to dismiss.¹⁰⁶

In deciding the case, the *Sonet* court’s analysis referred to the Delaware statute’s “apparently broad license to enhance, reform, or even *eliminate* fiduciary duty protections.”¹⁰⁷ Subsequent Delaware cases elaborated on the ability of limited partnership or LLC agreements to replace fiduciary duties with contractual alternatives.¹⁰⁸ These cases suggested fiduciary duties could not only be restricted by an agreement, but eliminated altogether.¹⁰⁹

In 2002, however, the Delaware Supreme Court weighed in on the elimination of fiduciary duties for limited partnerships and reached a different conclusion. In *Gotham Partners v. Hallwood*

102. *Id.* at 324.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.* at 327.

107. *See id.* at 323 (citing DEL. CODE ANN. tit 6, § 17-1101(d) (2005)) (emphasis added).

108. *See, e.g.,* Miller v. Am. Real Estate Partners, No. Civ. A. 16788, 2001 WL 1045643 (Del. Ch. Sept. 6, 2001); Gelfman v. Weeden Investors, L.P., No. Civ. A. 18519, 792 A.2d 977 (Del. Ch. Aug. 23, 2001); R.S.M. Inc. v. Alliance Capital Mgmt. Holdings L.P., 790 A.2d 478 (Del. Ch. Apr. 10, 2001); Gotham Partners, L.P. v. Hallwood Realty Partners, L.P. (*Gotham I*), No. Civ. A. 15754, 2000 WL 1476663 (Del. Ch. Sept. 27, 2000); *see also In re Cencom Cable Income Partners*, No. Civ. A. 14634, 1996 WL 74726 at *4 (Del. Ch. Feb. 15, 1996) (“[DRULPA] recognizes [that] partners may modify fiduciary duties through contract. In other words, whether a general partner operates in good faith, with due care or with requisite loyalty may be determined by the consistency to which the general partner adheres to its contractual obligations. Put another way, the limited partnership agreement may authorize actions creating a ‘safe harbor’ for the general partner under circumstances that might otherwise be questionable or impose a stricter standard of scrutiny than the norm.”).

109. *But cf. Ribstein, Limited Partnership Agreements, supra* note 6, at 960 (“It is not clear whether the courts would have allowed replacement of the fiduciary standard with a significantly weaker contractual standard had the waiver been sufficiently clear.”).

Realty Partners,¹¹⁰ the court addressed an appeal from a chancery court opinion that suggested fiduciary duties could be eliminated, much as in *Sonet*.¹¹¹ The Delaware Supreme Court disagreed.¹¹²

The *Gotham Partners* court expressly cast doubt on dictum from the chancery court opinion which had stated that Delaware law permitted elimination of fiduciary duties.¹¹³ The Delaware Supreme Court noted that there was nothing in the statute which mentioned “that a limited partnership agreement may *eliminate* the fiduciary duties or liabilities of a general partner.”¹¹⁴

The *Gotham Partners* decision was short-lived.¹¹⁵ As of August, 2004, the Delaware legislature has opened up the possibility of completely removing fiduciary duties. Under the new version of the LLC statute:

To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member’s or manager’s or other person’s duties may be expanded or restricted *or eliminated* by provisions in the limited liability company agreement; provided that the . . . agreement may not eliminate the implied contractual covenant of good faith and fair dealing.¹¹⁶

With appropriate changes, the limited partnership statute says the same for limited partnerships.¹¹⁷ Accordingly, any limitations on the

110. 817 A.2d 160 (2002) (*Gotham II*).

111. See *Gotham I*, 2000 WL 1476663, at *10 (“But § 17-1101(d)(2) of DRULPA expressly authorizes the elimination, modification, or enhancement of these fiduciary duties in the written agreement governing the limited partnership.”).

112. *Gotham II*, 817 A.2d at 167-68.

113. *Id.* at 167 (noting that the issue was not before the court for review, but that “this dictum should not be ignored because it could be misinterpreted in future cases as a correct rule of law”).

114. *Id.* at 168.

115. This does not mean that the amendments return matters to the status quo before the *Gotham II* opinion. Recognition in chancery court opinions that fiduciary duties *might* be eliminated is different from a statute which guarantees that possibility. Cf. Lemon, *supra* note 7, at 304 (suggesting ambiguity on this question in cases prior to *Gotham II*). Parties may now be certain that such duties are eliminated in particular cases by referencing the statutory provision in their contracts.

116. DEL. CODE. ANN. tit. 6, § 18-1101(c) (2005) (emphasis added).

117. DEL. CODE. ANN. tit. 6, § 17-1101(d) (2005) (stating the same text in the relevant part as the LLC statute).

effect of fiduciary waivers must be found in contract doctrine alone, and not in fiduciary relations as such.

III. CONTRACTUAL GOOD FAITH DUTIES IN DELAWARE

The impact of these developments in fiduciary law depends upon the applicability and content of contractual good faith duties. Delaware's understanding of contractual good faith fills contractual gaps based upon what the parties would have contracted for if they had addressed the contingency at issue.¹¹⁸ Where the contract has addressed the contingency, implied contractual good faith terms are preempted by the agreement's text.

In *Katz v. Oak Industries*,¹¹⁹ for example, Chancellor Allen provided the following formulation of the court's analysis:

[I]s it clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of the implied covenant of good faith—had they thought to negotiate with respect to that matter. If the answer to this question is yes, then, in my opinion, a court is justified in concluding that such act constitutes a breach of the implied covenant of good faith.¹²⁰

The *Katz* formulation looks to the express contractual text when considering whether a hypothetical bargain should be inferred.

Subsequent discussions of the implied covenant of good faith and fair dealing by the Delaware Supreme Court confirm the narrow coverage of the covenant in Delaware, including in the context of limited partnerships.¹²¹ Arguably, the Delaware courts have restricted the coverage of good faith duties since *Katz* was decided.

In *Cincinnati SMSA Limited Partnership v. Cincinnati Bell Cellular Systems Co.*,¹²² the Delaware Supreme Court explained that “[i]n cases where obligations can be understood from the text of a written agreement but have nevertheless been omitted in a literal sense, a court's inquiry should focus on ‘what the parties likely

118. See, e.g., *DuPont v. Pressman*, 679 A.2d 436, 443 (Del. 1996); *PAMI-LEMB I Inc. v. EMB-NHC, L.L.C.*, 857 A.2d 998, 1016 (Del. Ch. 2004).

119. 508 A.2d 873 (Del. Ch. 1986). Note that the *Katz* formulation addresses the content of good faith duties in terms of the parties' hypothetical bargain, but also makes reference to the express terms of the contract for guidance.

120. *Id.* at 880.

121. See, e.g., *Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co.* 708 A.2d 989, 990 (Del. 1998) (discussing a limited partnership); *Cont'l Ins. Co. v. Rutledge & Co.*, 750 A.2d 1219, 1223 (Del. Ch. 2000) (discussing a limited partnership).

122. 708 A.2d 989 (Del. 1998).

would have done if they had considered the issues involved.”¹²³ The court emphasized, however, that such implied terms “should be rare and fact-intensive, turning on issues of compelling fairness.”¹²⁴ Under this approach, implying obligations based on good faith “is a cautious enterprise.”¹²⁵ As the court explained, in order to properly plead a claim of breach of the implied covenant, a plaintiff must allege “an aspect of fraud, deceit, or misrepresentation.”¹²⁶

The *Cincinnati Bell* court also concluded that courts “should be no less cautious or exacting when asked to imply contractual obligations from the written text of a limited partnership agreement.”¹²⁷ This last conclusion suggests that the contractual duty of good faith is not qualitatively different depending on whether the context is a limited partnership or LLC, as opposed to a run of the mill contract. Contractual duties of good faith involve the same doctrine in both cases.

As the Delaware Chancery Court explained in the same case, “[t]erms are to be implied in a contract not because they are reasonable but because they are necessarily involved in the contractual relationship so that the parties *must have intended them* and have only failed to express them because they are too obvious to need expression.”¹²⁸ The obligation thus applies when the parties could not have contemplated the exercise of discretion which is the subject of dispute.¹²⁹

123. *Id.* at 992 (citing *DuPont*, 679 A.2d at 443; *Schwartzberg v. CRITF Assocs.*, 685 A.2d 365, 376 (Del. Ch. 1996)). The court also observed that “it is not the proper role of a court to rewrite or supply omitted provisions to a written agreement.” *Id.*

124. *Id.*

125. *Id.*

126. *Id.* at 992-93 (citing *Merrill v. Crothall-American, Inc.*, 606 A.2d 96, 101-02 (Del. 1992)); *see also* *Cont'l Ins. Co. v. Rutledge & Co.*, 750 A.2d 1219, 1234 (Del. Ch. 2000) (citing *Merrill*, 606 A.2d at 101) (noting that in a limited partnership case “[t]he Delaware Supreme Court has explicitly held that a claimant must demonstrate that the conduct at issue involved fraud, deceit, or misrepresentation in order to prove a breach of the implied covenant”).

127. *See Cincinnati Bell*, 708 A.2d at 993. Deborah A. DeMott has contended that, rather than the standard described in *Katz*, Delaware LLCs should fall under a robust “best efforts” type standard. *See DeMott, Fiduciary Preludes*, *supra* note 6, at 1058-62. Her argument relies on drawing a distinction between different contexts for good faith, depending upon how contingent the contract is. This is a distinction which Delaware courts do not appear to have adopted.

128. *Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co.*, No. C.A. 15388, 1997 WL 525873, at *5 (Del. Ch. Aug. 13, 1997) (emphasis added) (quoting *Danby v. Osteopathic Hosp. Ass'n of Delaware*, 101 A.2d 308, 313-14 (Del. Ch. 1953)), *aff'd*, 708 A.2d 989 (Del. 1998).

129. *But cf. Schwartzberg v. CRITF Assocs.*, 685 A.2d 365, 376 (Del. Ch.

Express terms that affirmatively address the parties' obligations are decisive when construing the content of good faith. A good faith term may supplement a contract where the text does not explicitly address an issue, but implied terms are rejected when they conflict with the express contract.¹³⁰ Accordingly, in looking to the parties' apparent or presumed intent, the contractual duty of good faith is a method of enforcing the actual agreement.¹³¹ Rather than a means to enforce a mandatory norm of business conduct, the good faith duty is a means by which courts interpret contracts that are silent as to specific contingencies.¹³²

A discretion-granting provision may be silent as to the standard that governs that discretion.¹³³ However, an agreement may also address the precise conduct at issue: thus, it is not a breach of good faith to compete with an LLC if the LLC agreement contains a clause that expressly permits such competition. Similarly, a term granting "sole" or "absolute" discretion, while eliminating fiduciary duties, leaves little room for implied terms respecting that

1996) (suggesting that the Katz requirement that it be "clear" that the parties would have proscribed the conduct at issue is "probably too high"). The *Schwartzberg* court instead suggested that a claim should succeed when "it is more likely than not" that if the parties had thought to address the subject, they would have agreed to create the obligation at issue. *Id.* *Schwartzberg's* formulation is difficult to square with the strict standard set forth in subsequent Delaware Supreme Court opinions, discussed *supra*.

130. See *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1143 (Del. 1990) (noting that implied good faith standards cannot override literal terms of an agreement); see also *Cont'l Ins. Co.*, 750 A.2d at 1234 (rejecting a bad faith claim based on the limited partnership provisions agreed to).

131. See, e.g., *Burton, Breach of Contract*, *supra* note 70, at 371 ("The good faith performance doctrine establishes a standard for contract interpretation and a covenant that is implied in every contract. . . . [T]he courts employ the good faith performance doctrine to effectuate the intentions of parties, or to protect their reasonable expectations."); Ribstein, *The Structure of the Fiduciary Relationship*, *supra* note 24, at 20 ("[G]ood faith is an interpretation rule . . . its application in a particular case ultimately depends on the terms of the parties' contract."); Rosenberg, *supra* note 16, at 513 ("Good faith is merely a way of interpreting whether the parties adhered to the duties imposed upon them by the corporate charter or by contractual agreement.").

132. See *supra* note 130 and accompanying text.

133. See, e.g., *Arvida/JMB Partners v. Vanderbilt Income and Growth Assocs.*, No. CIV. A. 15238-NC, 1997 WL 294440, at *5 (Del. Ch. 1997) (rejecting review of absolute discretion for abuse, but noting that "a discretionary right must nonetheless be exercised in good faith."); see also *Van Alstine*, *supra* note 79, at 1287 ("The parties may well have agreed that the discretionary power was to be absolute and unrestricted; indeed, in some circumstances it may be in the best interest of both parties to do so. To say that this follows from the mere fact of discretion, however, is to begin the analysis with its own conclusion.").

discretion.¹³⁴

Sandra Miller has recently argued—in a pre-amendment article—that Delaware recognizes a mandatory minimum of acceptable conduct for LLCs under the doctrine of good faith.¹³⁵ In contrast with the default good faith obligations described above, Miller proposes a contractual standard of good faith that would create a “mandatory core of acceptable business conduct.”¹³⁶ From this perspective, equitable concepts of fairness would be a part of the interpretation of LLC and limited partnership agreements.¹³⁷

As a potential source for these duties, Miller looks to the chancery court decision in *Solar Cells, Inc. v. True North Partners*.¹³⁸ The *Solar Cells* case involved an attempt to merge an LLC, First Solar, into a subsidiary of the defendant, True North, in a manner that diluted the holdings (and harmed the interests) of minority managers of the LLC.¹³⁹ However, although the issue of good faith duties arose in the *Solar Cells* decision, it was not a contractual good faith case. The *Solar Cells* court implicitly found that the LLC

134. See, e.g., *Sonet v. Timber Co.*, 722 A.2d 319, 325 (Del. Ch. 1998) (finding that in light of terms of agreement that permitted the general partner to act according to its own discretion, “there is no requirement that the General Partner consider the interests of the limited partners in resolution of a conflict of interest”). Even nontextualist theories have recognized that explicit language may suffice to remove discretionary acts from good faith challenges. Cf. Van Alstine, *supra* note 79, at 1301 (calling for sufficient notice to the other party, but concluding that “[a] negotiated deal between sophisticated parties may require little (or no) affirmative actions from the party seeking discretion, beyond the appropriately explicit agreement on her unrestricted discretion”).

135. See Miller, *supra* note 2, at 1643-45; see also DeMott, *Fiduciary Preludes*, *supra* note 6, at 1057-62 (describing contractual good faith as a limit on conduct within the LLC). As Miller notes, the Delaware limited partnership and LLC statutes are virtually identical in this context, such that precedents for the one are relevant to the other. Miller, *supra* note 2, at 1636. Accordingly, this Article will cite cases involving either entity for purposes of the analysis below.

136. Miller, *supra* note 2, at 1646, 1653.

137. See *id.* at 1654 (“Regardless of how courts articulate their judicial tests, reverence for the written contract must be tempered with the recognition that judicial review is a good and essential thing, as is a mandatory core of acceptable manager and/or member conduct.”). It is not at all clear how this conception can be squared with the Delaware requirement that courts give maximum effect to the principle of contractual freedom.

138. No. Civ. A. 19477, 2002 WL 749163 (Del. Ch. Apr. 25, 2002); see Miller, *supra* note 2, at 1644-45 (citing *Solar Cells* under section of article on contractually-based good faith standards, but noting that “[t]he court did not distinguish between good faith as an express contractual standard and good faith in a fiduciary sense”).

139. *Solar Cells*, 2002 WL 749163, at *2.

agreement had not waived all *fiduciary* duties,¹⁴⁰ and expressly noted that the majority managers' actions were unacceptable because they "do not appear to be those of fiduciaries acting in good faith."¹⁴¹

Thus, the outcome in *Solar Cells* should not predict outcomes in purely contractual, nonfiduciary cases.¹⁴² As noted above, the good faith duties of fiduciaries are not the same as the contractual good faith duties of nonfiduciaries.¹⁴³ Where a contract has eliminated fiduciary duties, implied contractual good faith duties are potentially narrower in scope than the fiduciary duties they replace.¹⁴⁴ Because of these differences, contractual good faith

140. *Id.* at *4 ("Even if waiver of liability for engaging in conflicting interest transactions is contracted for, that does not mean that there is a waiver of all fiduciary duties to Solar Cells.").

141. *See id.* It should be noted that another LLC case of this type also involved fiduciary good faith duties. *See VGS, Inc. v. Castiel*, No. C.A. 17995, 2000 WL 1277372, at *4 (Del. Ch. Aug. 31, 2000) (describing failure to discharge duty of loyalty in good faith).

142. In some nonfiduciary contexts, Delaware courts have been notably unsympathetic to claims of investor interests harmed by a merger. *See, e.g., Benchmark Capital Partners IV v. Vague*, No. Civ. A. 19719, 2002 WL 1732423 at *16 (Del. Ch. July 15, 2002) (rejecting injunctive relief for preferred stockholders that sought to block merger); *cf. Nixon v. Blackwell*, 626 A.2d 1366, 1379-81 (Del. 1993) (rejecting creation of "special, judicially-created rules" to protect minority stockholders of closely held corporations). It also bears mention that the entire fairness standard is not a source of mandatory standards in this context. Entire fairness review is a creature of corporate fiduciary law. *See, e.g., Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983). Should the parties choose to eliminate fiduciary duties, then entire fairness could cease to be the applicable standard. *See, e.g., Gelfman v. Weeden Investors, L.P.*, 859 A.2d 89, 121 (Del. Ch. 2004); *In re Cencom Cable Partners, L.P.*, No. 14634, 1997 WL 666970, *4 (Del. Ch. Oct. 15, 1997). *But see Miller, supra* note 2, at 1641-43 (proposing entire fairness review as source of mandatory standards of business conduct); *cf. Robert A. Ragazzo, Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L.Q. 1099, 1142-44 (1999) (discussing entire fairness test in context of squeeze outs).

143. *See Burton, Breach of Contract, supra* note 64, at 372, n.17 ("Good faith performance also should not be equated with 'good faith' . . . as a fiduciary duty, because the doctrine obviously could not mean that every contract requires 'something stricter than the morals of the marketplace.'"). The distinction was also recently noted by Chancellor Chandler in the Disney litigation. *See In re Walt Disney Co. Derivative Litig.*, No. Civ.A. 15452, 2005 WL 2056651, at *35 n.449 (Del. Ch. Aug. 9, 2005). The conclusion that cases like *Solar Cells* are not on point flows from more than just the distinction between good faith and fiduciary relations, however. It is also because the provision eliminating fiduciary status is a term which indicates the parties' contractual intent.

144. Most notably, contractual good faith duties do not preclude selfish behavior. *See Coffee, supra* note 5, at 1658 (describing substantive differences between implied contractual good faith duties and fiduciary duties); DeMott,

should not be conflated with good faith in the fiduciary context.¹⁴⁵

In addition, contractual good faith duties implied under a limited partnership or LLC agreement are not mandatory, even in cases that implicate concerns similar to those in *Solar Cells*. For example, consider the recent analysis of contractual good faith duties in *Gelfman v. Weeden Investors, L.P.*¹⁴⁶

In *Gelfman*, the Delaware Chancery Court addressed a limited partnership agreement which had been amended such that outside investors were squeezed out for less than the market value of their units.¹⁴⁷ Insiders, on the other hand, were able to receive a much better value for their units.¹⁴⁸ The partnership agreement required the general partner to act on behalf of the partnership.¹⁴⁹ However, the agreement also included a provision that granted the general partner broad discretion to resolve conflicts of interest and insulated the general partner from liability for such acts if taken in the absence of bad faith.¹⁵⁰

The court determined that the insiders had consciously chosen to deprive the outsiders of their units for less than fair market value, and that there was no rational justification for their actions.¹⁵¹ The conduct in *Gelfman* clearly conflicted with fiduciary duties. However, the court's opinion was also premised on a failure to meet contractual good faith duties.¹⁵²

Beyond Metaphor, supra note 5, at 892-901 (same).

145. This is the case regardless of whether fiduciary good faith is viewed as a freestanding duty, a subsidiary subpart of loyalty, or as an interpretive measure. A partnership agreement that eliminates fiduciary duties eliminates the fiduciary duty of good faith. It also alters the impact of how one interprets the discretion contractually granted. *Cf. Rosenberg, supra* note 16, at 512:

Fiduciary duties are substantive obligations which must be honored in good faith in the same way that contractual obligations must be honored in good faith. If the intensity of that obligation is stronger in a corporate relationship, it is not because the notion of good faith is different, it is because the loyalty demanded from a fiduciary is different from the loyalty demanded of a "garden-variety" contractual agreement.

Id. If the duty of loyalty is restricted, then what it means to honor the remaining contractual obligations in good faith changes.

146. 859 A.2d 89 (Del. Ch. 2004).

147. *Id.* at 93-94.

148. *Id.*

149. *Id.* at 110-11.

150. *Id.* at 110-12.

151. *Id.* at 122.

152. *Id.* at 124. Other types of harm to minority interests also trigger contractual good faith concerns, if sufficiently egregious. Misappropriation of assets, for example, is hard to square with contractual good faith. *Cf. Walker v. Resource Dev. Co.*, 791 A.2d 799, 817 (Del. Ch. 2000) (rejecting the application

In *Gelfman*, contractual good faith duties do not reflect mandatory standards of business conduct, and the chancery court made this point clearly:

[I]f the future of the firm as a profit-generating entity requires the departure of some owners, the minimally acceptable standard of good faith action would seem to require, *in the absence of a contractual right to force out certain owners at a different price*, that the firm pay any equity owner being forced out fair market value for their equity share.¹⁵³

The *Gelfman* opinion, forceful as it was in condemning the actions of the partnership insiders, indicates that contractual good faith requirements did not inherently mandate conduct.

As the above cases demonstrate, Delaware's LLC and limited partnership law emphasizes contractual freedom. Where LLC or limited partnership agreements are clear, they are able to eliminate fiduciary duties. Contractual good faith duties may fill a gap in an agreement, if there is one, but contract law does not mandate that these implied duties be included in an agreement. Instead, the role of the covenant of good faith and fair dealing is consistently circumscribed by contractual text.

IV. GOOD FAITH DUTIES AND CONTRACTUAL SILENCE: THE PROBLEM OF CONTRACTUAL GAP-FILLING AND THE PARTIES' REASONABLE EXPECTATIONS

A requirement that specific good faith duties must give way to the parties' express agreement is largely accepted.¹⁵⁴ Parties are generally capable of deciding how to govern their relationship if their contract is not unconscionable or otherwise unenforceable.¹⁵⁵

of a provision limiting liability for members of LLC that relied in good faith on the terms of the operating agreement and finding "no doubt that the legislature never intended this provision to allow the members of an LLC to misappropriate property from another member and avoid returning that property or otherwise compensating the wronged member").

153. *Gelfman*, 859 A.2d at 124 (emphasis added).

154. For example, Van Alstine notes that "[t]here is persuasive force in the argument that informed parties should be able to agree at the formation stage on a contractual power whose exercise is not subject to subsequent review under external standards of 'fair' and 'reasonable' conduct." Van Alstine, *supra* note 79, at 1292. The debate over what it takes to reach an enforceable limitation of implied terms on this basis is a separate question. Compare Van Alstine, *supra* note 79, at 1292, and Patterson, *supra* note 86 at 524, with *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351 (7th Cir. 1990).

155. See Burton, *A Reply*, *supra* note 68, at 499-500 (arguing that absent unconscionability, estoppel, or impossibility/impracticability, "it is hard to see what justifies a court in disregarding the agreement of the parties on grounds of

Disagreement focuses on the question of when express terms are sufficient to close contractual gaps.¹⁵⁶

Contractual incompleteness is at the heart of good faith duties; courts repeatedly note that the good faith duty does not permit courts to imply terms that conflict with contractual text.¹⁵⁷ As Ian Ayres and Robert Gertner explain, however, the “question of when a contract is incomplete is identical to the question of what is sufficient to contract around a default.”¹⁵⁸ In other words, background principles of interpretation are crucial in determining whether there is a gap to be filled by substantive terms.¹⁵⁹

It is certainly true that long-term relational contracts cannot explicitly address every future contingency.¹⁶⁰ All such contracts are open to the interpretation that they are incomplete with respect to future events. But one need not define contractual incompleteness based on whether the parties have explicitly addressed each conceivable circumstance affecting their relation. Parties can contractually pre-commit themselves to an outcome even where they have difficulty predicting future disputes. Since humans are not able to predict the future, there is a limitless potential for locating contractual gaps, but incompleteness (like ambiguity) remains

‘contractual morality’ when the intentions of the parties or their reasonable expectations can be ascertained.”); see also Patterson, *supra* note 86, at 522 (disagreeing with the textualism in *Kham & Nate’s*, yet noting that “it is important to recall that one acts in good faith *relative to the agreement of the parties*”).

156. Cf. Van Alstine, *supra* note 79, at 1292-93 (proposing a substantial burden in terms of clarity and notice for parties that seek to provide for discretion that would close off good faith duties).

157. See, e.g., *Cincinnati SMSA Ltd. P’ship v. Cincinnati Bell Cellular Sys.*, 708 A.2d 989, 992 (Del. 1998) (“Delaware observes the well-established principle that (absent grounds for reformation which are not present here) it is not the proper role of a court to rewrite or supply omitted provisions to a written agreement.”); see also *L.A.P.D., Inc. v. Gen. Elec. Corp.*, 132 F.3d 402, 404 (7th Cir. 1997) (stating that good faith cannot interfere with “explicit provisions of contracts.”). For a list of cases along these lines, see Van Alstine, *supra* note 79, at 1261-62, n.154.

158. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 120 (1989).

159. It is arguable that background rules sometimes make it too difficult for certain investors to protect their interests. See D. Gordon Smith, *Independent Legal Significance, Good Faith, and the Interpretation of Venture Capital Contracts*, 40 WILLAMETTE L. REV. 825 (2004).

160. See Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1641 (2003) (“There are infinite states of the world and the capacities of contracting parties to condition their future performance on each possible state are finite.”).

dependent upon one's interpretive approach.¹⁶¹

A contractual governance mechanism for resolving business decisions can be read to address any contingency within the scope of that governance. As John Coffee, Jr. has noted in a similar context:

[I]t is something of a misnomer to speak of terms that are "missing" or "omitted" from the corporate contract. Although omissions can sometimes occur, the corporate charter has its own default rule: Except as specified to the contrary, everything is to be decided by the board (subject possibly to the check of shareholder ratification).¹⁶²

By extension, the gap-filling dilemma can be fully addressed by the discretion granted under a limited partnership or LLC agreement.¹⁶³ Arguably, no terms are missing from an agreement when each potential contingency is delegated for a subsequent determination by the firm's management. When this is so is the interpretive issue.

Whatever one's perspective on the content of good faith duties, certain categories of conduct are clear examples of bad faith conduct.¹⁶⁴ It does not take any stretch of the imagination to conclude that these instances conflict with the parties' implicit agreement, even where the agreement is otherwise complete. A party that intentionally hinders the performance of other parties to a contract violates his duty of good faith.¹⁶⁵ A party that engages in

161. Cf. Ayres & Gertner, *supra* note 158, at 119 ("The litigants in many cases will argue not only about how the gap should be filled but also about whether there is a gap at all.").

162. See Coffee, *supra* note 5, at 1682. Coffee notes that the "gap" respecting how board power is used has been filled by fiduciary duty, "unless the parties can and do opt out from it." *Id.*

163. Arguably, this is really a problem of ambiguity rather than gap-filling, to the extent that the discretion-granting provision is seen as addressing the relevant conduct. The ambiguity is then what the meaning of "discretion" is. On the other hand, the absence of a discretion-governing term can also be described as a gap. See Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1586 (2005) (describing the distinction between a gap and an ambiguity). The distinction can have interpretive relevance. As Judge Posner has noted, gap-filling cases call for a different analysis from ambiguity cases: "In the case of ambiguity the court cannot just lift a ready-made clause off the shelf and plug it into the case to decide the interpretive question, reasonably confident that if the rule didn't fit the parties would have excluded it from their contract." *Id.* at 1589.

164. Cf. Summers, *supra* note 62, at 232-43 (listing categories of bad faith recognized by courts). Among the examples of bad faith conduct described by Summers, certain instances would be hard to contract around. For example, it is difficult to conceive of the contract which creates a reasonable expectation of fraud in performance.

165. Cf. Van Alstine, *supra* note 79, at 1309 (noting that the good faith duty

fraud in connection with the exercise of discretion does so as well.¹⁶⁶ Regardless of one's theory of good faith, the result should be the same in these instances.

Beyond these more obvious examples, the nature of good faith is fact intensive, varying from case to case.¹⁶⁷ Commentators have had difficulty defining the precise contours of good or bad faith conduct outside the parameters of specific contexts.¹⁶⁸ Consequently, there is uncertainty as to precisely when an implied good faith term will preclude conduct otherwise covered by fiduciary duties.¹⁶⁹ Uncertainty over the content of implied good faith terms is mirrored by uncertainty over when implied terms are contractually superseded by a fiduciary waiver.

A provision clear enough to supplant fiduciary duties may supplant terms otherwise implied under the covenant of good faith and fair dealing.¹⁷⁰ The more tailored the fiduciary opt-out, the easier it is to determine whether it covers the conduct at issue.¹⁷¹ In some cases, parties may prefer a vague standard to govern their conduct, yet still choose to remove fiduciary duties.¹⁷² In other cases,

would exist even in cases of unrestricted discretionary power). Van Alstine proposes as examples "any affirmative actions by a party to prevent or interfere with performance by the other," and also acts of deception that occur prior to, or in connection with, an exercise of discretion. *Id.*

166. *Cf. id.* at 1309 nn. 350-51 (listing cases in which deception resulted in a determination of bad faith in connection with grant of discretion).

167. *See supra* notes 62-65 and accompanying text.

168. *See, e.g.,* Summers, *supra* note 62, at 201; *see also* DeMott, *Beyond Metaphor*, *supra* note 5, at 892 (suggesting that both fiduciary duties and good faith resist "attempts to capture their meanings in general definitions").

169. *Cf.* Deborah A. DeMott, *Fiduciary Obligation Under Intellectual Siege: Contemporary Challenges to the Duty to be Loyal*, 30 OSGOOD HALL L.J. 471, 490 (1992) (discussing unanswered questions when applying good faith standards to corporate actors).

170. *Cf.* R.S.M. v. Alliance Capital Mgmt. Holdings, 790 A.2d 472, 498 (Del. Ch. 2001) (explaining that irreconcilability of contract terms "can itself be evidence of the clear intention of the parties to preempt fiduciary principles"); *Sonet v. Timber Co.*, 722 A.2d 319, 326 (Del. Ch. 1998).

171. This is significant given the courts' reluctance to find a waiver of fiduciary duty unless it is clear, and the fact that even a clear waiver may only be found to apply to a narrow context. Taking this concept further, John Coffee has supported a transaction specificity requirement to guarantee that parties can price the risks of their agreement. *See* Coffee, *supra* note 5, at 1667-71. Coffee's proposal, however, is not grounded in good faith doctrine, and in any event is inconsistent with the maximum freedom of contract. *See generally infra* Part VII.

172. *See, e.g.,* Gotham Partners v. Hallwood Realty Partners, 795 A.2d 160, 163-64 (Del. 2002) (replacing fiduciary standard with entire fairness); *Gelfman v. Weeden Investors*, 792 A.2d 977, 985 (Del. Ch. 2001) (replacing fiduciary duty with duty of good faith). On the efficiency benefits of contractual vagueness, see

they may desire a gapless contract, and choose to get rid of fiduciary duties and grant absolute discretion to a manager. Intermediate options also exist, as firms often remove fiduciary duties for a specific type of transaction, while leaving them intact elsewhere. Unsurprisingly, the fiduciary opt-out language affects the contractual interpretation.¹⁷³

The meaning of these provisions is ultimately dependent on a court's interpretive predilections. Courts may read a discretion-granting provision as textually closing off implied limitations on that discretion, as occurs in good faith cases like *Kham & Nate's*. Under this rubric, good faith duties are only necessary when an exercise of discretion is an unreasonable interpretation of the contractual text.

However, as Michael Van Alstine explains, it is also possible to view broad grants of contractual discretion as incomplete:

The observation that one of the parties has "reserved a privilege" to take a certain action merely begs the question of what standards (if any) should govern the exercise of such discretion. The parties may well have agreed that the discretionary power was to be absolute and unrestricted; indeed, in some circumstances this may be in the best interest of both parties to do so. To say that this follows from the mere fact of discretion, however, is to begin the analysis with its own conclusion.¹⁷⁴

Any discretion-granting provisions could leave open the possibility of a gap. The interesting question is what it should take for parties to avoid this result.

A. *The Absolute Discretion Term*

Just as good faith duties are protean, so too are the potential contract terms that delimit fiduciary and good faith duties. The parties to LLC and limited partnership agreements often draft reticulated, intricate terms to describe their respective duties.¹⁷⁵

generally George G. Triantis, *The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2*, 62 LA. L. REV. 1065 (2002).

173. See Ribstein, *Unincorporated Firms*, *supra* note 6, at 584 ("[T]he fiduciary duty waiver would be one of the partnership terms to which courts must give independent effect in interpreting the partnership agreement under a 'good faith' analysis.").

174. Van Alstine, *supra* note 79, at 1287.

175. See Rosenberg, *supra* note 10, at 381 ("The agreements can be terribly complex, often extending for hundreds of pages."). The complexity of these terms may also be relevant to interpretation, as they may suggest that the

They also draft novel formulations of contractual obligations. In the *Gelfman* case, the chancery court noted with evident frustration that the terms it interpreted were “seemingly prepared by a member of a cold-blooded species rather than a breathing, feeling member of our species trying to capture in words an actual human state of mind.”¹⁷⁶

In light of the potential variations, one reasonably established term bears emphasis: the contractual grant of “sole” or “absolute” discretion.¹⁷⁷ This provision is of particular interest because it provides, in general terms, for the greatest scope of managerial discretion.¹⁷⁸ A number of contracts replace fiduciary duties with standards of behavior, such as good faith or entire fairness; these agreements, even read narrowly, call for judicially implied terms. An absolute discretion term is different, and implicates the full extent to which contract doctrine differs from fiduciary doctrine.

The mere declaration of absolute discretion in a limited partnership or LLC agreement could plausibly mean absolute discretion, subject to fiduciary constraints.¹⁷⁹ However, in many cases, parties to a limited partnership or LLC will choose to waive all default duties.¹⁸⁰ When coupled with a contractual clause or

contractual language chosen reflected careful consideration. *See generally* Karen Eggleston, Eric A. Posner, & Richard Zeckhauser, *The Design and Interpretation of Contracts: Why Complexity Matters*, 95 NW. U. L. REV. 91 (2000).

176. *Gelfman v. Weeden Investors, L.P.*, 859 A.2d 89, 112 (Del. Ch. 2004).

177. The words “sole” and “absolute” will be used interchangeably for purposes of this Article. Both terms are applied to similar effect by contracting parties. For examples of cases interpreting these types of terms, see, e.g., *Miller v. American Real Estate Partners, L.P.*, No. Civ. A. 16788, 2001 WL 1045643 (Del. Ch. Sept. 6, 2001); *Gelfman*, 792 A.2d 977; *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, No. Civ. A. 15754, 2000 WL 1476663 (Del. Ch. Sept. 27, 2000); *Sonet v. Timber Co.*, 722 A.2d 319 (Del. Ch. 1998).

178. By way of comparison, prior approaches to these issues have required greater specificity in a fiduciary opt-out. *Cf.* Unif. P’ship Act § 103, 6 U.L.A. 73 (1997) (stating that the duty of loyalty may not be eliminated, but parties may “identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable”); *see also* Coffee, *supra* note 5, at 1667-71.

179. *Cf. Miller*, 2001 WL 1045643, at *9 (holding that a grant of sole and complete discretion did not preclude fiduciary duties); *see also* *Labovitz v. Dolan*, 545 N.E.2d 304, 310 (Ill. App. Ct. 1989) (finding that a grant of sole discretion did not waive fiduciary duties). *Labovitz* has proven controversial for its suggestion that the parties could not have removed the fiduciary character of the limited partnership. That concern is no longer an issue for purposes of Delaware law.

180. *See* Rosenberg, *supra* note 10, at 382 (“In addition to the covenants that *limit* the scope of behavior available to the general partners, the limited

structure that precludes fiduciary duties, absolute discretion on its face provides unfettered discretion over the subject matter it covers.¹⁸¹

As a result of this broad scope, the absolute discretion term is ideal for purposes of analyzing contractual good faith duties. If courts enforce absolute discretion terms to the letter, there is little room for judicially implied standards of acceptable business conduct. If, on the other hand, there are substantial limits on discretion even in this context, then those limits will often be impractical to contract around.

Interpretation of the absolute discretion term is therefore a proxy for determining how much contractual freedom is available for limited partnerships and LLCs.¹⁸² Strictly interpreted, an absolute discretion term only permits judicial oversight in egregious cases.

B. Interpreting Agreements that Restrict Judicial Enforcement: The Rationale for a Textualist Approach

As will be developed, textualism is the appropriate interpretive method for contract terms that replace fiduciary duties. For statutes, this means that the objective meaning of a statutory text, as understood by a reasonable, competent user of the language, is the correct interpretation.¹⁸³ Recent scholarship has promoted a

partnership agreement usually includes a waiver of all default duties under the applicable law of limited partnerships (usually Delaware).”).

181. This presumes that the absolute discretion term is understood to cover the subject matter at issue. Ambiguity as to that question could limit the applicability of the discretion, however absolute it may be. See Ribstein, *Limited Partnership Agreements*, *supra* note 6, at 948 (“Even clear fiduciary duty waivers do not necessarily cover all potential fiduciary breaches. Courts understandably hold that conduct outside the waiver is covered by default fiduciary duties.”).

182. And, given that this term is already in use and occupies one end of the discretionary spectrum, it shows promise for the development of standardized meanings. Other terms are also significant, such as a term which replaces fiduciary duties with good faith. I will not here pursue what it might mean to perform under a good faith clause in good faith. Cf. Rosenberg, *supra* note 16, at 510 n.83 (“The author will resist the temptation to speculate on the obligation to carry out the [fiduciary] duty of good faith in *good faith*.”). For alternate terms, the interaction of the structure and context of the agreement might require a different understanding of contractual completeness. DeMott has noted the interpretive confusion which new formulations may cause. DeMott, *supra* note 169, at 491-92.

183. See, e.g., ANTONIN SCALIA, A MATTER OF INTERPRETATION 17 (Princeton Univ. Press 1997) (“We look for a sort of ‘objectified’ intent—the intent that a reasonable person would gather from the text of the law, placed alongside the remainder of the corpus juris.”); Frank H. Easterbrook, *The Role of Original Intent in Statutory Construction*, 11 HARV. J.L. & PUB. POL’Y 59, 61 (1988)

similar approach in contract interpretation.¹⁸⁴

Under a textualist approach, contracts should be interpreted according to the objective meaning of express contractual language, based on the reasonable understanding of a competent reader.¹⁸⁵ Courts should assume that the contract is written in “majority talk” rather than private meanings shared by the parties.¹⁸⁶ The parol evidence rule should be followed, unless the contract is ambiguous,¹⁸⁷ and ex post fairness concerns should not trump binding contract language.¹⁸⁸

(explaining that courts should look to “the ring the words [of a statute] would have had to a skilled user of words at the time, thinking about the same problem.”). Helpful analyses of textualist thought are set forth in William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. REV. 621 (1990); John F. Manning, *The Absurdity Doctrine*, 116 HARV. L. REV. 2387, 2456-67 (2003); Caleb Nelson, *What is Textualism?*, 91 VA. L. REV. 347 (2005); see also Frank H. Easterbrook, *Statutes’ Domains*, 50 U. CHI. L. REV. 533 (1983) (setting forth a textualist theory of interpretation).

184. See, e.g., Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749, 769-70 (2000) (suggesting the benefits of formalism as a way to avoid opportunistic suit and arguing that formalism makes sense if one assumes judicial incompetence); Schwartz & Scott, *supra* note 87, at 568-69 (proposing textualism for the interpretation of contracts between sophisticated parties that do not create externalities); Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847 (2000) (proposing formalism in contract law based on the reliability of interpretation and promotion of standardized terms). *But cf.* Juliet P. Kostritsky, *Taxonomy for Justifying Legal Intervention in an Imperfect World: What to Do When Parties Have Not Achieved Bargains or Have Drafted Incomplete Contracts*, 2004 WIS. L. REV. 323 (2004) (taking issue with formalism as a response to the concerns these authors raise).

185. See, e.g., Schwartz & Scott, *supra* note 87, at 569 (“We will argue here that the majoritarian default is Willistonian: Typical firms prefer courts to make interpretations on a narrow evidentiary base whose most significant component is the written contract.”). See generally *id.* at 570-94 for a detailed analysis supporting this conclusion.

186. See *id.* at 570, 585-86 (explaining why a plain-meaning, “majority talk” interpretation of a contract would reduce strategic behavior).

187. *Cf.* Scott, *supra* note 184, at 866 (“A rigorous application of the common-law plain meaning and parol evidence rules would preserve the value of predictable interpretation and encourage parties to take precautions in selecting terms with well-defined meanings.”); see also Schwartz & Scott, *supra* note 87, at 591-92.

188. See Schwartz & Scott, *supra* note 87 at 597 (explaining on efficiency grounds why fairness-based defaults would not work). The authors suggest that “[p]arties have the incentive (and often the ability) to contract out of even fair defaults that do not maximize surplus.” *Id.* As Schwartz and Scott note, “firms want the state to enforce the contracts that they write, not the contracts that a decisionmaker with a concern for fairness would prefer them to have written.” *Id.* at 618; *cf.* Ribstein, *Unincorporated Firms*, *supra* note 6, at 560

Courts that decline to find implied terms unless the text requires them also apply a form of textualism.¹⁸⁹ Rejection of implied terms in this fashion means that the terms governing the parties' relationship are solely those terms that the parties chose to put into writing. Good faith still plays a role in such cases; express contractual terms are sometimes premised on an implied standard of conduct.¹⁹⁰ The contractual textualist, however, is reluctant to find such occasions unless the contractual language itself calls for this result.

This last sense of textualism (respecting implied terms) will be the primary focus of the discussion that follows. This Article does not take the position that judicial nonintervention is desired by the members of all, or even most, firms that waive fiduciary duties. Rather, it makes the more modest claim that when an LLC or limited partnership agreement replaces fiduciary duties, courts should take the contractual language at face value. As a consequence, absolute discretion terms should generally be interpreted as gap-free.

Some commentators have questioned the rationality of a decision to eliminate fiduciary duties unless there is a robust form of good faith duty.¹⁹¹ In addition, parties do not readily enter agreements which place them entirely at the mercy of others.¹⁹²

("Commentators also have suggested that mandatory fiduciary duty rules force managers to engage in behavior that is appropriate because it is ethical, instills trust in beneficiaries, or complies with generally accepted business norms. But it is not clear what the 'right' behavior is. Commentators' own conclusions are wholly subjective."); J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439, 464 (1997) ("[W]ho decides what is the 'collective good'? What fairness is achieved by imposing this external and vague standard upon two parties to a private fiduciary relationship who are bargaining for their own interests and have no interest in or even understanding of the collective good?").

189. See, e.g., Van Alstine, *supra* note 79, at 1224 (describing "the rise of a new textualist approach to the contractual duty of good faith.").

190. This analysis arguably goes beyond gap-filling. It is beyond the scope of this article to assess whether such cases raise the issue of "gaps" or of ambiguities. In either event, textualists read contractual language in context, and this includes room for implicit meanings of the text.

191. See DeMott, *Fiduciary Preludes*, *supra* note 6, at 1061 ("[A]n LLC or limited partnership agreement that completely abjured fiduciary obligation would, in the absence of a robust implied obligation of good faith, resemble a gift of members' property to those in control of the enterprise who would be free to use the entity's property as they saw fit. . . [I]t strains credulity excessively to characterize membership in an LLC or a limited partnership, once formed, as indicative of intention to execute a gift transaction.").

192. See Van Alstine, *supra* note 79, at 1295 (explaining that an expectation of reasonableness when exercising a discretionary power "is a refined reflection

Given the degree of control that fiduciary-type relationships provide over critical resources, it is necessary to explain why people would enter into a limited partnership or LLC without contract doctrines that at least resemble fiduciary obligation. There are several reasons.

Fiduciary duties carry a variety of costs that counterbalance their benefits.¹⁹³ For example, an overbroad enforcement of the duty of care negatively affects a fiduciary's willingness to take risks.¹⁹⁴ Doctrines like the business judgment rule protect against these concerns in many cases.¹⁹⁵ When the business judgment rule applies, courts presume that managers are acting in good faith, with due care, and in the best interests of the firm.¹⁹⁶ But the business judgment rule will not always address investors' concerns satisfactorily, especially to the extent that it permits judicial second-guessing of business decisions.¹⁹⁷

of the traditional maxim that the law should not assume that one party has put itself at the mercy of another.”); see also *Wood v. Lucy, Lady Duff-Gordon*, 118 N.E. 214 (N.Y. 1917) (Cardozo, J.) (concluding that the law should not “suppose that one party was to be placed at the mercy of the other”).

193. See Hynes, *supra* note 6, at 44 (“[A] lack of foreseeability is what drives partners to draft provisions qualifying or eliminating fiduciary duties. Foreseeability in this context relates not to opportunistic behavior but rather to what courts may do in interpreting and applying mandatory fiduciary duties.”).

194. See Ribstein, *Unincorporated Firms*, *supra* note 6, at 549 (“[A] duty of care may force the fiduciary to refrain from conduct that may be construed to have been unduly risky if, ex post, the conduct is unprofitable. This is particularly a problem in firms that have passive, limited liability investors whose investment in the firm is part of a diversified portfolio.”).

195. Cf. *Joy v. North*, 692 F.2d 880, 886 (2d Cir. 1982) (“[B]ecause potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions.”); see also Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 110-17 (2004) (describing the business judgment rule as partially justified by encouraging risk taking). It should be noted that the business judgment rule has been adopted for Delaware limited partnerships. See *In re Boston Celtics Ltd. P’ship S’holders Litig.*, No. C.A. 16511 1999 WL 641902, at *4 (Del. Ch. Aug. 6, 1999) (recognizing the business-judgment-rule protections for actions of general partners).

196. See, e.g., *Boston Celtics*, 1999 WL 641902, at *4 (“[T]he business judgment rule generally protects the actions of general partners, affording them a presumption that they acted on an informed basis and in the honest belief that they acted in the best interest of the partnership and the limited partners.”).

197. As Stephen Bainbridge has noted, recent judicial decisions interpreting the business judgment rule have left open greater possibilities for judicial intervention. In *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 350-51 (Del. 1993), the Delaware Supreme Court appeared to endorse a rebuttal of the business judgment rule by showing a breach of the duty of care, rather than

Broad managerial discretion is particularly important to some businesses (and some managers), and these firms will want to remove hindrances from the free exercise of business judgment.¹⁹⁸ Fiduciary duties are especially costly for certain types of investors, such as those who are likely to have conflicts with other businesses in which they own interests.¹⁹⁹ In addition, judicial review can interfere with the internal relations among the firm's managers.²⁰⁰

Investors may also fear judicial error. Skepticism over whether courts are reliable interpreters of contractual intent has received increased attention in contracts scholarship. Eric Posner proposes that many elements of our legal system may be understood as a response to judicial error in the enforcement of contracts.²⁰¹ Courts

judicial abstention within certain decisional contexts. See Bainbridge, *supra* note 195, at 127 ("If the business judgment rule is treated as a standard of liability, rather than as an abstention doctrine, judicial intervention readily could become the norm rather than the exception. This is why *Technicolor* is so problematic."). Bainbridge's understanding of a business judgment rule based on judicial abstention unless certain circumstances are shown (e.g., self-dealing), bears some resemblance to the treatment of absolute discretion terms proposed in this Article. However, the exceptions to judicial abstention would be fewer: fraud, misappropriation, and waste. The underlying standard of conduct is also different: a fiduciary waiver alters the standard of conduct required within the firm.

198. See, e.g., David Rosenberg, *The Two "Cycles" of Venture Capital*, 28 J. CORP. L. 419, 439 (2003) ("The modification of broad fiduciary duties allows the venture capitalist the necessary freedom to make decisions on behalf of possibly dozens of businesses in related areas without having to fear the possibility of breaching his fiduciary duties to the investors of any single fund."). Doubts that managers will be overcautious could exist for any firm, however. Bainbridge, *supra* note 195, at 123 ("As long as there is some non-zero probability of erroneous second-guessing by judges, however, the threat of liability will skew director decision making away from optimal risk taking. That this result will occur even if the risk of judicial error is quite small is suggested by the work of behavioral economists on loss aversion and regret avoidance."); see also Ribstein, *Unincorporated Firms*, *supra* note 6, at 549 (explaining that the duty of care may force a fiduciary to refrain from unduly risky conduct).

199. For a summary of other possible costs of fiduciary duties, depending on the type of firm and investor, see Ribstein, *Unincorporated Firms*, *supra* note 6, at 548-50. Ribstein notes various ways in which features of the business relation might justify a fiduciary waiver. The existence of specific categories in which fiduciary duties are less desirable for the management of a business does not mean that courts should pick and choose when to enforce fiduciary waivers based upon apparent need, however. It is easy to conceive of advantages which would be visible to the parties but not to courts.

200. See Bainbridge, *supra* note 195, at 124-27 (describing the disruptive effects of sanctions on team behavior).

201. See Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749, 754 (2000) (assuming that "parties lack the clairvoyance needed to give courts the proper guidance if a

may not be very good at deterring opportunistic conduct, while the parties are.²⁰² Posner suggests that there is “no evidence for the modern conviction that judges can reliably determine intentions.”²⁰³ As he notes: “Skepticism about the quality of judicial decision-making is reflected in many legal doctrines, including the business judgment rule in corporate law, which restrains courts from second-guessing managers and directors, and the many contract law doctrines that restrain courts from second-guessing parties to contracts.”²⁰⁴

Alan Schwartz and Robert Scott raise doubts over whether risk-neutral parties should desire the incorporation of state-created default terms into commercial contracts.²⁰⁵ As they point out, the vaguer a legal standard is, the more it is subject to opportunistic abuse.²⁰⁶ Moral hazard arises under these conditions:

When a standard governs, the party who wants to behave strategically must ask what a court will later do if the party is sued. The vaguer the legal standard and the more that is at stake, the more likely the party is to resolve doubts in its own favor. A party that resolves doubts in this way will attempt to maximize private gains at the expense of joint welfare maximization.²⁰⁷

Schwartz and Scott contend that where a “gap” exists which could be filled by a standard, “the best inference for a decisionmaker to

dispute arises, and courts lack the genius that would be needed to enforce contracts properly in the absence of such guidance”).

202. *Id.* at 758. Posner proposes that parties enter into contracts with the understanding that courts are able to deter certain high-value forms of opportunism, however. *Id.* at 762.

203. *Id.* at 770.

204. *Id.* at 758.

205. *See* Schwartz & Scott, *supra* note 87, at 618-19 (“A default standard is efficient only when parties can live with vague definitions of their contracting obligations. Because standards confer considerable discretion on parties, a standard will be unsatisfactory if, as a result of that discretion, parties are likely to behave strategically under it.”); *see also id.* at 608-09 (“It is appropriate for courts to apply a default standard as long as that standard does not create moral hazard.”).

206. *But cf.* Triantis, *supra* note 172, at 1073-76 (2002) (offering justifications for the uncertainty in vague terms). Also note that Delaware limited partnerships and LLCs often adopt vague terms as part of their allocation of duties within the firm. The existence of these standards indicates the variety of potential judicial roles which parties might prefer.

207. Schwartz & Scott, *supra* note 87, at 603. As noted *supra* note 172, there may be circumstances when parties prefer a vague legal standard, however. *See, e.g.,* Scott & Triantis, *supra* note 20 (theorizing that vague contract terms do not necessarily lead to higher litigation costs).

draw is not that the standard is ‘missing’ from these contracts, but rather that the standard has been rejected.”²⁰⁸

Although Schwartz and Scott are writing about a different type of agreement, their insights are relevant here. The indeterminacy of fiduciary duties is well-known, and has long had proponents.²⁰⁹ This indeterminacy, however, suggests that judicial enforcement of fiduciary duties—or even implied good faith standards—will not be sufficiently predictable for some firms.²¹⁰ Scott has noted “the empirical condition that must be satisfied in order to pursue successfully an activist strategy of ex post adjustment: informed and capable courts and uninformed parties.”²¹¹ These conditions do not always arise in complex contracts, and certainly not in the case of limited partnerships and LLCs.

Parties may anticipate several sources of unpredictability when fiduciary duties are removed. Courts cannot easily tell which individual bargains produced a text acceptable to all members of the business organization.²¹² Some courts will show a bias toward the standard fiduciary-based defaults, even in light of contract language that modifies those duties.²¹³ Other courts will instead try to make

208. Schwartz & Scott, *supra* note 87, at 604.

209. As one commentator has noted:

The language expressing these [fiduciary] norms is aspirational and studiously imprecise. The very ambiguity of the language conveys its moral content as the court’s refusal to set lines is designed to discourage marginal conduct by making it difficult for a fiduciary to determine the point at which self-serving conduct will be prohibited, and thus to encourage conduct well within the borders.

Lawrence Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1696 (1990). *Cf.* Miller, *supra* note 2, at 1654 (“I have suggested that the uncertainty of the law, and the corresponding specter of judicial intervention, are not unfortunate consequences to be avoided by the creation of a perfect statutory phrase or judicial test.”).

210. *Cf.* Hynes, *supra* note 188, at 447 (“People may want to make such agreements [restricting fiduciary duties] in order to avoid the risks of judicial interference in this aspect of their relationship. As noted, fiduciary duties are necessarily vague and open-ended, applying to a wide variety of relationships and fact situations. Courts can sometimes misunderstand situations.”).

211. Scott, *supra* note 184, at 865. As Scott notes, there is disagreement on the extent to which this empirical condition exists.

212. This is so even given Delaware’s notable expertise. *Cf.* Bainbridge, *supra* note 195, at 120-21 (noting expertise acquired by Delaware courts in area of corporate law). Even expert judges will not always be able to distinguish breaches of fiduciary duty from permitted actions in cases where fiduciary duties are reduced. Parties whose business calls for a different standard of conduct could readily conclude that a more complete judicial abstention is the safer bet.

213. *Cf.* Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions between Express and Implied Contract Terms*, 73

an educated guess of the parties' intent, while still others will seek what they consider the fairest result after the fact.

At the same time, contracting parties will often be able to limit opportunism without resort to judicial enforcement. The availability of alternative remedies lowers the risks associated with the elimination of fiduciary duties. Recent scholarship regarding Delaware limited partnerships suggests that reputational concerns play a major role in the extra-judicial enforcement of fiduciary-type obligations, as do financial incentives.²¹⁴

Venture capital firms, which frequently make use of the limited partnership form, are characterized by the central role of reputation as a constraint on the improper exercise of discretion. Venture capital involves cycles: funds are raised, the investment proceeds, investors receive capital from the venture, and the venture capitalist raises new funds.²¹⁵ At the end of the limited partnership's term, investors reap their profits, and the process then repeats with the formation of new limited partnerships.²¹⁶

Even though there are numerous opportunities for self-interested behavior, venture capital firms often take advantage of Delaware law to restrict fiduciary duties.²¹⁷ The lack of litigation in this context may indicate that extrajudicial constraints are sufficient to protect passive investors.²¹⁸ Further, the parties to these agreements can structure their obligations to invite judicial oversight in those areas where it is needed.²¹⁹

CAL. L. REV. 261, 263 (1985) (“[T]he courts’ tendency to treat state-created rules as presumptively fair often leads to judicial disapproval of efforts to vary standard implied terms by agreement.”); *id.* at 305 (“State support for the entrenched forms produces an inherent, but unwarranted, institutional bias against unconventional expression.”).

214. See Smith, *Team Production in Venture Capital Investing*, 24 J. CORP. L. 949, 969-72 (1999) (describing the importance of reputation for venture capitalists). See generally Rosenberg, *supra* note 10 (exploring the importance of reputation to venture capitalist investment funding).

215. *Id.* at 371 (citing PAUL GOMPERS & JOSH LERNER, *THE VENTURE CAPITAL CYCLE* 5 (2000)).

216. See *id.* at 371-72.

217. See *id.* at 369-72.

218. See *id.* at 372-73. In addition, extralegal constraints may be undermined by judicial intervention. Cf. Ribstein, *The Structure of the Fiduciary Relationship*, *supra* note 24, at 35 (contending that “fiduciary-type duties do not merely complement extra-legal incentives but may actually weaken them”) (citing Edward B. Rock & Michael L. Wachter, *Islands of Conscientious Power: Law Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619 (2001)).

219. Evidence suggests that over time, parties to venture capital limited partnerships focused only on areas where experience indicated selfish behavior was likely. See Rosenberg, *supra* note 10, at 392. Venture capital agreements

In this regard, concerns with predictability may apply not only to fiduciary duties, but also to contractual good faith duties.²²⁰ Fiduciary duties call for the utmost good faith and loyalty, occupying one end of the spectrum of obligations within a firm.²²¹ The legal significance of fiduciary duties is somewhat standardized with respect to certain transactions, such as self-dealing transactions.²²² The duty of good faith is harder to pin down because it occupies a middle ground: substantively, good faith duties provide something less than fiduciary duties, yet provide something greater than caveat emptor.²²³

In light of the concerns described above, there are legitimate business reasons for contracting parties to agree to discretion that is largely free of judicial oversight.²²⁴ The replacement of fiduciary duties with substantially less rigorous standards of behavior should be understood in light of the relative costs and benefits of judicial enforcement; by closing off implied contract terms through sufficiently explicit language, contracting parties circumscribe the role of courts.²²⁵ In short, even absolute discretion terms are

often provide for terms that amount to the duty of care, while curtailing the duty of loyalty. See Rosenberg, *supra* note 198, at 434.

220. Cf. DeMott, *Fiduciary Preludes*, *supra* note 6, at 1059-62 (suggesting that good faith duties for LLCs might actually exceed the rigor of the fiduciary duty of loyalty in some cases).

221. Fiduciary duty is often described as requiring the "utmost good faith." Several commentators have noted the greater intensity of fiduciary obligation when compared to contractual good faith duties. See, e.g., Smith, *supra* note 24, at 1488-89; Coffee, *supra* note 5, at 1658-59. DeMott has also provided a helpful comparison of the two types of duty in terms of case law. See DeMott, *Beyond Metaphor*, *supra* note 5, at 892-908.

222. For example, in cases of an interested transaction, Delaware courts will reject the business judgment rule, instead applying an "entire fairness" analysis which shifts the burden to the fiduciary party. See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701, 710-11 (Del. 1983).

223. See *Mkt. Street Assocs. Ltd. P'ship v. Frey*, 941 F.2d 588, 595 (7th Cir. 1991) (Posner, J.) ("This duty is, as it were, halfway between a fiduciary duty (the duty of *utmost* good faith) and the duty merely to refrain from active fraud. Despite its moralistic overtones it is no more the injection of moral principles into contract law than the fiduciary concept itself is.").

224. An alternate means to avoid judicial intervention, with its own risks, would be to add an arbitration clause. Delaware courts have shown a similar readiness to respect contract terms which provide for arbitration in place of litigation for LLCs. See *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 292 (Del. 1999) (applying the terms of an LLC agreement such that a derivative action in Delaware Chancery Court would be unavailable because the parties had chosen arbitration to resolve their dispute).

225. See Scott & Triantis, *supra* note 20 (discussing the role of contractual rules and standards as a means of controlling litigation).

rational, and for some parties they may be wise.²²⁶

The recent statutory amendments suggest a demand for business forms that permit the elimination of fiduciary duties. Delaware judges repeatedly emphasize the contractual flexibility of LLCs and limited partnerships.²²⁷ The courts have also been explicit about the interpretive consequences of choosing Delaware limited partnerships and LLCs: the text is binding, and “effectively constitutes the entire agreement among the partners.”²²⁸ Despite the risks to which parties are exposed when they eliminate fiduciary duties, the option is apparently an appealing one.²²⁹

226. For an extended discussion of potential inefficiencies produced by non-textualist interpretive methods, see generally Schwartz & Scott, *supra* note 87; Scott, *supra* note 184, at 853-58.

227. See *Sonet v. Timber Co.*, 722 A.2d 319, 323 (Del. Ch. 1998) (explaining the appeal of Delaware limited partnerships in terms of modification to fiduciary duties); *Kahn v. Icahn*, No. Civ. A. 15916, 1998 WL 832629, *2 (Del. Ch. Sept. 10, 1998) (“This flexibility is precisely the reason why many choose the limited partnership form in Delaware.”); see also Rosenberg, *supra* note 198, at 432. Delaware courts emphasize the same flexibility for LLCs. The Delaware Supreme Court recently cited the following as a template for LLCs:

Truly, the partnership agreement is the cornerstone of a Delaware limited partnership, and effectively constitutes the entire agreement among the partners with respect to the admission of partners to, and the creation, operation and termination of, the limited partnership. Once partners exercise their contractual freedom in their partnership agreement, the partners have a great deal of certainty that their partnership agreement will be enforced in accordance with its terms.

Jaffari, 727 A.2d at 291 (quoting MARTIN I. LUBAROFF & PAUL ALTMAN, DELAWARE LIMITED PARTNERSHIPS § 1.2 (1999)). Although the quoted reference involved limited partnerships, the court noted that the statutes for both business entities provide for the same freedom of contract.

228. In *Sonet v. Timber Co.*, for example, the chancery court rejected an analysis based upon a “highly generalized interest of equity” and declared:

[U]nder Delaware limited partnership law a claim of breach of fiduciary duty must first be analyzed in terms of the operative governing instrument—the partnership agreement—and only where that document is silent or ambiguous, or where principles of equity are implicated, will a Court begin to look for guidance from statutory default rules, traditional notions of fiduciary duties, or other extrinsic evidence.

722 A.2d at 324.

229. Cf. DeMott, *supra* note 169, at 491-92 (describing the benefits of mandatory fiduciary duties in terms of standardized terms that reduce the need for particularized investigations).

V. INTENT SKEPTICISM AND JUDICIAL COMPETENCE: TEXTUALISM
AS THE MOST RELIABLE MEANS TO ENFORCE THE PARTIES' INTENT

A. *Judicial Interpretations of Hypothetical Bargains are
Unreliable in Fiduciary Waiver Cases*

The ability to correctly divine the parties' intent is an integral goal of interpretive doctrine.²³⁰ Fiduciary waivers, however, raise daunting problems for an ex post assessment of these intentions, at least to the extent that those intentions are independent of the explicit text. The creation of appropriate default terms can be difficult, especially where the goal is to ascertain what the parties would have done if they had expressly addressed the subject of their dispute.²³¹ In many cases where fiduciary duties are eliminated, an implicit contractual understanding respecting contingent events will be unverifiable.

As noted, Delaware treats the covenant of good faith and fair dealing as a contractual gap-filler.²³² If an agreement is silent on an issue under dispute, the courts apply a hypothetical bargain analysis to determine the content of implied terms.²³³ This method seeks to provide terms the parties would have chosen ex ante in a world with no transaction costs.²³⁴

The appropriate content of hypothetical bargains is controversial, however, even when judges broadly agree on a hypothetical bargain methodology.²³⁵ As David Charny has noted,

230. Cf. Scott, *supra* note 184, at 865-66 ("What, then, is the most efficacious role for state regulation in a thick environment of many heterogeneous parties who enter into subtly complex, but incomplete, relational contracts? Both heterogeneity of contracting behavior and heterogeneity of contracting parties argue for a single-minded insistence on preserving the quality of the signals used by contracting parties to allocate risk.").

231. See Easterbrook & Fischel, *Contract & Fiduciary Duty*, *supra* note 3, at 445 ("Creating hypothetical contracts is difficult. Judges have less information than the parties. Although judges can examine the contracts people have reached when the stakes were high enough to overcome the transaction costs, big-stakes negotiations may be special cases rather than models on which to base presumptive rules for other parties.").

232. See *DuPont v. Pressman*, 679 A.2d 436, 443 (Del. 1996); *PAMI-LEMB I Inc. v. EMB-NHC, L.L.C.*, 857 A.2d 998, 1016 (Del. Ch. 2004).

233. See, e.g., *Katz v. Oak Indus.*, 508 A.2d 873, 880 (Del. Ch. 1986).

234. An effort to provide a tailored result—what the parties would have chosen—will frequently be as difficult as majoritarian hypothetical bargain analysis. The intent as to undescribed contingencies will in many cases be unknowable.

235. See, e.g., *Jordan v. Duff & Phelps, Inc.*, 815 F.2d 429 (7th Cir. 1987). In that case, both Judge Easterbrook and Judge Posner held the same view that fiduciary duties are "a standby or off-the-rack guess about what parties would

there are a range of different approaches:

I: Choose the best rule for this transaction type (general and idealizing);

II: Choose the rule that these particular parties most likely would have negotiated to (particular and nonidealizing);

III: Choose the rule that parties in this situation would have chosen if they were rational and perfectly informed (particular and idealizing);

IV: Choose the rule that parties to this transaction type would most likely choose in the general run of situations (general and nonidealizing).²³⁶

Which option is chosen may depend upon the court's goals as far as individual autonomy, reciprocity within the agreement, economic efficiency, and other instrumental effects of the chosen default rule.²³⁷ None of these approaches provides an easy answer where

agree to if they dickered about the subject explicitly." *Id.* at 436, 446-47. However, they reached very different conclusions about the applicability of that duty on this basis. *Id.* at 446-47. This disagreement has been used to challenge the validity of the hypothetical bargain method for determining the scope of fiduciary duty. *See, e.g.,* Coffee, *supra* note 5, at 1681 ("Jordan suggests that hypothetical bargaining supplies only a vague and shifting guide."); DeMott, *Beyond Metaphor, supra* note 5, at 885 (arguing against hypothetical bargain conception in *Jordan* and noting "[t]hat two opinions, applying the same conception of fiduciary obligation, reach opposite conclusions on identical facts is a good reason to examine their initial premise"); *see also* Ayres & Gertner, *supra* note 158, at 117-18 (using the *Jordan* case as evidence that the "costs of determining what the particular parties would have contracted for can be significant."); *cf.* Butler & Ribstein, *supra* note 3, at 30-31 n.129 (suggesting that Judge Easterbrook applied a hypothetical bargain approach, while Judge Posner applied the actual contract).

236. David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815, 1821 (1991). Courts might also choose minoritarian defaults. *See generally* Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591 (1999) (suggesting contexts in which the efficient default rule will not be based on majoritarian preferences). Note also that a majoritarian default may run counter to the preferences of a large subgroup within the contracting majority. *Cf.* Ayres & Gertner, *supra* note 158, at 116-17. At times, courts select interpretations of contracts designed to force information from a more knowledgeable party, or protect parties with less power in the contractual relationship. *See id.* at 107.

237. *See* Charny, *supra* note 236, at 1823-24.

fiduciary duties have been eliminated.²³⁸

In many long term relational contracts, a fully contingent contract is prohibitively expensive.²³⁹ Parties hope a court will fill any gaps for them, but never think through which terms would be desirable.²⁴⁰ The structure of the agreement could reflect a compromise from which no clear theme can be discerned, or a contractual gap may be a strategic effort by one or more parties to shift costs to the courts and their fellow investors.²⁴¹ The desires of the individual parties might simply be in conflict, and the gap exists because it was easier to leave that conflict unresolved.²⁴²

What does the decision to eliminate fiduciary duties indicate about party preferences? Should the court ask how the parties would likely expect particular language to be interpreted as a semantic matter? Or should it ask whether the outcome of particular interpretations would be deemed desirable by the parties? Which parties among the various investors should the court focus on? Would the parties think their contract was complete? What if the parties never reached a majority understanding of the language at issue?²⁴³

238. Arguably, ex post adjustment of the contract to comport with fairness would be an alternative that does not focus on the more difficult efficiency and intent issues. However, this approach is inconsistent with the maximum freedom of contract, for reasons developed *infra* notes 220-21. It also suffers from a great deal of indeterminacy. For authorities critiquing the subjective nature of ex post fairness analyses, see *supra* note 188; see also Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 284 (1986) [hereinafter Barnett, *A Consent Theory*] (“A substantive fairness theory assumes that a standard of value can be found by which the substance of any agreement can be objectively evaluated. Such a criterion has yet to be articulated and defended.”). Barnett notes that fairness standards provide neither meaningful criteria nor predictable results. *Id.* at 285.

239. See Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1090 (1981) (“[A] complete contingent contract may not be a feasible contracting mechanism. Where the future contingencies are peculiarly intricate or uncertain, practical difficulties arise that impede the contracting parties’ efforts to allocate optimally all risks at the time of contracting.”).

240. For a helpful analysis of potential causes for incompleteness, see Clayton P. Gillette, *Cooperation and Convention in Contractual Defaults*, 3 S. CAL. INTERDISC. L.J. 167, 170 n.8 (1993) (citing Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 278-81 (1992)).

241. See Ayres & Gertner, *supra* note 158, at 93-94.

242. Cf. Frank H. Easterbrook, *Statutes’ Domains*, 50 U. CHI. L. REV. 533, 540 (1983) (“The cornerstone of many a compromise is the decision, usually unexpressed, to leave certain issues unresolved.”).

243. An in-depth analysis of the many questions which might be asked when trying to determine hypothetical bargains is set forth in Charny, *supra* note

Whichever interpretive option is chosen, hard questions arise, in part because there are often more than two parties to a limited partnership or LLC. The incentives will differ among the parties within the agreement, including the incentives to compromise, be informed, or litigate. In a limited partnership or LLC that represents the interests of a variety of different players, it will be difficult to discern what they would have expected as a group (or as subgroups).²⁴⁴ The existence of compromises between individual parties is hard to determine, and the ultimate agreement may not reflect the preferences of any one party.

Further, these problems are exacerbated if the contract was created by parties with a range of sophistication. Cognitive bias—both *ex ante* and *ex post*—could affect the interpretation of the agreement.²⁴⁵ The potential for differing levels of risk aversion also adds to the confusion.²⁴⁶ An identical set of contract terms, if drafted by different authors, might produce a distinct set of hypothetical bargains.²⁴⁷

226. See also DeMott, *Beyond Metaphor*, *supra* note 5, at 889-90 (“If [the hypothetical bargain] is an approximation of something that particular parties would have agreed to, the content of the bargain will, like actual bargains, reflect many factors, including the scarcity of the subject matter of the bargain, the parties’ relative skills in negotiation, and their relative degrees of aversion to risks of varied sorts.”).

244. For a useful example of how there may be no majority preference within a group, see Einer Elhauge, *Preference-Estimating Statutory Default Rules*, 102 COLUM. L. REV. 2027, 2076-78 (2002).

245. Cf. Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211 (1995); Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608 (1998). On hindsight bias in judging, see Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571 (1998) (analyzing the tendency when judging to conclude that events are predictable, when they were not foreseeable *ex ante*). Rachlinski notes that the business judgment rule is one method of limiting hindsight bias. *Id.* at 619. Eliminating fiduciary duties is another way of addressing hindsight bias.

246. Cf. Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. LEGAL STUD. 535, 574 (1990) (“[O]nce we relax assumptions about risk-neutral decision makers who seek to maximize expected utility, we cannot readily discern a majoritarian default rule of cooperation or egoism from a general investigation into risk attitudes. Transactional structures provide some hints but also suffer from sufficient ambiguity to preclude an authoritative default rule based on the parties’ intent.”).

247. Cf. Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 3, at 445 (“Creating hypothetical contracts is difficult. Judges have less information than the parties. Although judges can examine the contracts people have reached when the stakes were high enough to overcome the transaction costs, big-stakes negotiations may be special cases rather than

These quandaries do not mean that courts are unable to ascertain any intentions: the intention to adopt a particular contractual text is typically clear. For some agreements, that textual choice will be the one intent known to be shared by all contracting parties. In such cases, a textualist approach will decrease the risk of rewriting the parties' agreement after the fact, and may actually approximate the parties' ex ante preferences.²⁴⁸

Statutory interpretation provides a useful analogue for this analysis.²⁴⁹ Like an LLC or limited partnership, Congress is a "they," not an "it."²⁵⁰ Though legislatures function as single entities, the group that enacts a law is comprised of individual personalities, with individual preferences and understandings. Complexities of the legislative process mean that the text of a statute may not reflect any individual's preferences, and the inherent difficulty of defining group intent makes legislative intent an obscure concept.²⁵¹

Textualists are appropriately skeptical of the verifiability of an

models on which to base presumptive rules for other parties. Real transactions, at real prices, are accordingly preferable.").

248. See Scott, *supra* note 184, at 861-62 ("[W]hile a modest legal role may appear to be the admission of defeat in resolving the dilemma of relational contracts, in fact, it may be precisely what contracting parties would prefer courts to do.").

249. Arguably, contract interpretation and statutory interpretation are sufficiently different that it is questionable to borrow methods from one field for use in the other. As one commentator has noted:

Textualism in statutory interpretation is often supported on the theory that the collective intent of a legislature is simply unknowable. The only intent which can be deduced with certainty is that the legislators intended to vote on a text which would have the force of law. Contracts, in theory, are different.

Mark L. Movsesian, *Are Statutes Really "Legislative Bargains"? The Failure of the Contract Analogy in Statutory Interpretation*, 76 N.C. L. REV. 1145, 1184-85 (1998). An examination of limited partnership and LLC contracts, however, turns up a number of similarities to legislation. As described above, the group intent within these business entities is often inscrutable. In addition, LLC and limited partnership agreements are more directly relevant to third parties, and consequently filed with the state. It is not uncommon for new investors to join the business in reliance on these terms. These new members cannot be expected to gather all of the evidence of prior negotiations when making their investment decision. This formality suggests that the formative agreement is what the parties actually intend as their agreement.

250. This coinage is from Kenneth A. Shepsle, *Congress Is a "They," Not an "It": Legislative Intent as Oxymoron*, 12 INT'L REV. L. & ECON. 239 (1992).

251. On the philosophical difficulties in determining group intent for legislation, see Heidi M. Hurd, *Sovereignty in Silence*, 99 YALE L.J. 945 (1990). *But cf.* JOHN R. SEARLE, CONSCIOUSNESS AND LANGUAGE 90-105 (2002) (describing a theory of collective intent).

overarching legislative intent.²⁵² Their approach is to focus on semantic meaning:

[T]extualists deny that a legislature has any shared intention that lies behind but differs from the reasonable import of the words adopted; that is, they think it impossible to tell how the body as a whole actually intended (or, more accurately, would have intended) to resolve a policy question not clearly or satisfactorily settled by the text.²⁵³

Due to the impossibility of determining legislative intent beyond the chosen words, textualists look to the statutory language itself. In context, this meaning is verifiable.²⁵⁴

Textualists interpret the objective meaning of the text as equivalent to the intent of the legislature.²⁵⁵ As John Manning has explained:

[T]extualism might be understood as a judgment about the most reliable (or perhaps the least unreliable) way of discerning legislative instructions. If one cannot accurately ascertain what the body as a whole would have done with matters unspecified or even misspecified by the text, then perhaps the best one can do is to approximate the way a reasonable person in the legislator's position would have read the words actually adopted.²⁵⁶

252. Much of the modern skepticism comes from public choice theory, which has described how statutes may reflect compromises among the textual goals of competing interest groups. See, e.g., Frank H. Easterbrook, *The State of Madison's Vision of the State: A Public Choice Perspective*, 107 HARV. L. REV. 1328, 1346-47 (1994). Based on Arrow's Theorem, proponents also contend that the preferences of individual legislators cannot be collected into a coherent choice. For a detailed discussion of the different bases of textualists' intent skepticism, see Manning, *supra* note 183, at 2408-19. In addition to the procedural complexities, historicist concerns also arise. See William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. REV. 621, 644-46 (1990) (questioning whether legislative intent can ever be reconstructed after the fact).

253. John F. Manning, *Textualism and Legislative Intent*, 91 VA. L. REV. 419, 430 (2005).

254. See Manning, *supra* note 183, at 2396-97 ("[C]ontemporary theories of textual interpretation more plausibly build on Wittgenstein's premise that language is intelligible by virtue of a community's shared conventions for understanding words in context. Starting from that assumption, one can deem particular interpretations of words in context correct or incorrect as measured by the relevant interpretive community's practices.")

255. See, e.g., *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 254 (1992) ("[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there.")

256. See Manning, *supra* note 253, at 433.

Limited partnership and LLC agreements pose similar problems of inscrutability. In many cases, the best that courts can do in interpreting an agreement that eliminates fiduciary duties may be to approximate the way that a reasonable person in the position of the parties would read the words they adopted.²⁵⁷ The primary intent that textualists are concerned with is the intent to adopt the language before the court.

Treating contract terms as complete—i.e., assuming an objective reading of the text of the contract indicates completeness, as in the case of an absolute discretion term—does not eliminate the duty of good faith.²⁵⁸ The duty of good faith is relevant to an otherwise “complete” contract when a literal reading of the contract’s terms would not make sense. Textualists are not literalists.²⁵⁹ Context often rules out absurd understandings of language.²⁶⁰

Just as the absurdity doctrine is a limitation on the literal meaning of statutory language, contractual absurdities should also

257. Cf. Barnett, *Sound of Silence*, *supra* note 87, at 882 (“Given that a default rule reflecting the commonsense expectations within the relevant community of discourse is likely to satisfy the parties’ intentions as well (in the case of a true gap) or better (in the case where shared tacit subjective assumptions are present) than any rival default rule, there is a strong reason to prefer it.”). Here, too, the legislative analysis is instructive. See Manning, *supra* note 183, at 2397-98 (“Even without knowing the speaker’s actual intent or purpose in making a statement, one can charge the speaker with the minimum intention ‘to say what one would ordinarily be understood as saying, given the circumstances in which one said it.’”) (citing Joseph Raz, *Intention in Interpretation*, in *THE AUTONOMY OF LAW: ESSAYS ON LEGAL POSITIVISM* 249, 268 (Robert George ed., 1996)). See also Jeremy Waldron, *Legislators’ Intentions and Unintentional Legislation*, in *LAW AND INTERPRETATION* 329, 339 (Andrei Marmor ed., 1995) (“A legislator who votes for (or against) a provision like ‘No vehicle shall be permitted to enter any state or municipal park’ does so on the assumption that—to put it crudely—what the words mean to him is identical to what they will mean to those to whom they are addressed. . . .”).

258. Cf. Van Alstine, *supra* note 79, at 1224 (“[M]odern celebration of the authority of text threatens to consign the doctrine of good faith to an inconsequential marginal note in the law of contracts.”). Van Alstine’s concern, however, is aimed at the view that “every expressly conferred contractual power is presumptively absolute and unrestricted.” *Id.* The subject of the present Article is a contract term that expressly states that it is absolute.

259. See, e.g., Manning, *supra* note 253, at 434-35; see also SCALIA, *supra* note 183, at 24 (“The good textualist is not a literalist. . . .”).

260. Cf. Manning, *supra* note 183, at 2461 (“This aspect of modern textualism will not, of course, eliminate all circumstances that existing doctrine might label as absurdities. But because people typically try to choose words to effect their desired ends, textual interpretation that accounts for contextual social usage, including colloquial usage, should eliminate the most egregious cases of absurdity.”).

be avoided.²⁶¹ This comports with the ordinary use of language, which excludes highly improbable meanings from the typical reader's understanding.²⁶² The duty of good faith functions in this fashion even where a discretion-granting term does not otherwise have a "gap."²⁶³

Recall that courts applying good faith doctrine look for what must have been contemplated by the parties, in light of their agreement.²⁶⁴ A broad grant of discretion is confined by a reasonable understanding of the text as a whole. If the parties adopted contract terms that indicate that what appears to be an absurd result was nevertheless contemplated, courts should follow the literal meaning of the text.²⁶⁵ Otherwise, the duty of good faith is relevant to

261. See, e.g., *Beanstalk Group, Inc. v. AM Gen. Corp.*, 283 F.3d 856, 860 (7th Cir. 2002) ("[A] contract will not be interpreted literally if doing so would produce absurd results, in the sense of results that the parties, presumed to be rational persons pursuing rational ends, are very unlikely to have agreed to seek."); *FutureSource LLC v. Reuters Ltd.*, 312 F.3d 281, 284-85 (7th Cir. 2002) ("Nonsensical interpretations of contracts, as of statutes, are disfavored. Not because of a judicial aversion to nonsense as such, but because people are unlikely to make contracts, or legislators statutes, that they believe will have absurd consequences.") (citations omitted).

262. See *Beanstalk Group, Inc.*, 283 F.3d at 860 (explaining that avoidance of absurdities in contractual interpretation is an interpretive principle based upon linguistic and cultural context). Arguably, Judge Posner's readiness to look to practical context as an additional source of meaning is mistaken, see *id.* at 864 (Rovner, J., dissenting in part), but the linguistic point is correct. Language is used in context, and that context may render particular applications of discretion absurd.

263. For example, people do not generally enter into limited partnership or LLC agreements with donative intent. See DeMott, *Fiduciary Preludes*, *supra* note 6, at 1061 ("[I]t strains credulity excessively to characterize membership in an LLC or a limited partnership, once formed, as indicative of intention to execute a gift transaction."). Thus, it would be an unreasonable interpretation of an LLC agreement to find that absolute discretion permitted an LLC manager to misappropriate the assets of other members of the firm.

264. See *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d at 1351, 1357 (7th Cir. 1990).

265. See *Beanstalk Group, Inc.*, 283 F.3d at 860 (noting permissibility of absurd contract terms where it is clear that the absurdity was intended). See also *R.I. Charities Trust v. Engelhard Corp.*, 267 F.3d 3, 7 (1st Cir. 2001) ("True, parties can contract for preposterous terms. If contract language is crystal clear or there is independent extrinsic evidence that something silly was actually intended, a party may be held to its bargain, absent some specialized defense."). There are some limits to this principle. If the contractual text were read to permit misappropriation of assets, it could raise concerns under the doctrine of consideration (not to mention public policy). Cf. DeMott, *Fiduciary Preludes*, *supra* note 6, at 1060-61 (questioning the enforceability of an LLC contract that does not contemplate mutuality of obligation).

interpreting the scope of a manager's discretion.²⁶⁶

As an example, consider a manager of an LLC who is granted absolute discretion to make certain categories of decisions under an agreement that waives fiduciary duties. This absolute discretion clause would permit self-dealing transactions if the transactions fall within the clause's coverage, despite the risks they pose, as interested transactions are not beyond contemplation when the duty of loyalty is expressly replaced by absolute discretion.²⁶⁷ A provision to engage in self-dealing transactions is not irrational or absurd; such transactions could readily be contemplated. In effect, the business judgment rule would expand to protect discretionary choices even where the manager had a conflict of interest.

However, if the manager exercises her powers to misappropriate the assets of the minority or engages in fraud, it is hard to imagine that the parties could have contemplated such an exercise of discretion, even by a nonfiduciary. An implied term precluding misappropriation or fraud would follow from the parties' agreement, despite the fact that no such term is expressly stated.²⁶⁸ The prohibition on fraud or misappropriation reflects the presumed meaning of the text, based on context; it would be irrational to enter an agreement where someone can steal your assets or defraud you.

Similarly, waste of assets, narrowly defined, also raises the specter of absurd results.²⁶⁹ In the corporate context, Delaware law

266. *Cf.* *Chamison v. HealthTrust, Inc.*, 735 A.2d 912, 920 (Del. Ch. 1999) (“[A] party to a contract has made an implied covenant to interpret and to act reasonably upon contractual language that is on its face reasonable.”).

267. *Cf.* *Sonet v. Timber Co.*, 722 A.2d 319, 320 (Del. Ch. 1998) (rejecting claim that amounted to self-dealing in light of partnership agreement's modification of fiduciary duties).

268. *Cf.* *Walker v. Resource Dev. Co.*, 791 A.2d 799, 817 (Del. Ch. 2000) (“[T]he legislature never intended a statutory provision [permitting good faith reliance on the terms of an operating agreement] to allow the members of an LLC to misappropriate property from another member and avoid returning that property or otherwise compensating the wronged member.”). This reasoning should not be confused with the idea that poor business judgments, even irrational ones, are therefore examples of bad faith. *Cf. In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996). Rather, implied terms would not be appropriate as limitations on absolute discretion unless those terms are necessary to avoid an absurd or irrational scope of the discretion term.

269. As the Delaware Supreme Court has noted, courts applying the business judgment rule do not inquire into substantive due care. *See Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) (noting that the concept “is foreign to the business judgment rule”). Corporate waste typically applies in situations where there is a transfer of assets for no corporate purpose, or which amounts to a gift. *Id.* at 263. As the Court explained, “[i]rrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made

limits actions for waste to unconscionable cases, where “directors irrationally squander or give away corporate assets.”²⁷⁰ The business judgment rule does not apply where acts of discretion go “so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.”²⁷¹ Irrational acts of this sort are just as inexplicable for nonfiduciary managers of a firm as they are for fiduciaries.

B. Textualism Increases the Clarity of Obligations for Non-Fiduciary Firms

Textualism in this context also permits an expansion of the menu of standardized terms available to the business community. For example, an absolute discretion term carves out broad categories of predictably unreviewable conduct.²⁷² Likewise, a term that expressly permits a specific type of nonfiduciary conduct, such as a term that permits transactions in competition with the firm, provides foreseeable results. The meaning of these provisions is clear, if courts follow the objective meaning of their language.

Predictability is more attainable as categories of acceptable (and unacceptable) conduct for non-fiduciaries develop established judicial interpretations.²⁷³ Standardized meanings enable the firm’s owners to retain fiduciary duties in various contexts, while safely carving out other areas free of litigation risk.²⁷⁴ In contrast, these

in good faith, which is a key ingredient of the business judgment rule.” *Id.* at 264.

270. See *Brehm*, 746 A.2d at 263.

271. See *Parnes v. Bally Entm’t Corp.*, 722 A.2d 1243, 1246 (Del. 1999) (citing *In re J.P. Stevens & Co.*, 542 A.2d 770, 780-81 (Del. Ch. 1988)).

272. For an argument that the good faith doctrine may not be defined under a unified theory, see Summers, *supra* note 62, at 201.

273. Cf. Scott, *supra* note 184, at 866 (“[I]nsofar as courts pursuing this [plain meaning and parol evidence rule] strategy authoritatively interpret commonly used express terms, a formalist approach to interpretation would advance the standardization norm by expanding the established menu of legally blessed standard-form terms and clauses.”).

274. The use of fiduciary restrictions that are limited to specific areas of discretion is already well established. This is typical in the case of venture capital firms. See Rosenberg, *supra* note 10, at 392 (discussing the evolution of partnership agreements that focused on areas which experience had shown presented opportunities for selfish behavior). Contracts that combine specific and vague terms (in this case, including absolute discretion), enable parties to manage litigation risks in specifically tailored ways. Cf. Scott & Triantis, *supra* note 20, at 35 (“Parties adopt standards with superior knowledge of the context of their contractual relationship, and, as we have seen, generally in combination with specific contractual rules. Moreover, when standards are appropriate, the parties can always include them in their contract at relatively low cost. The courts, therefore, are wise to interpret the absence of vague standards in

meanings would be slower to develop if the terms of agreements are routinely modified by a hypothetical bargain analysis or a judicial fairness inquiry.²⁷⁵

Standardized terms make it easier to draft agreements, to predict judicial interpretation, and develop familiarity with the terms within the legal community.²⁷⁶ Established terms also provide ongoing benefits while a contract is performed.²⁷⁷ A widely-used term will provide efficiencies during the course of the agreement as the term is put to continued use, allowing for reliance on a predictable meaning.²⁷⁸ Objective interpretation of opt-out language thus has advantages over an ad hoc application of good faith standards to the extent it allows parties to determine areas in which implied good faith standards will be inapplicable.²⁷⁹

The interests of third parties also support a textualist interpretation of discretion-granting terms. Other limited partnerships and LLCs benefit from standardized terms already in use, as do creditors and third party entrants to the business

particular cases as instructions from the parties to abstain from proxy choice and to limit their construction to the specific terms of the contract.”).

275. See Scott, *supra* note 184, at 868 (noting with respect to contextualized interpretations that “the fact-specific nature of the contract dispute leaves, in virtually every case, little opportunity for subsequent incorporation of interpretations as default terms suitable for other contracting parties”).

276. See generally Goetz & Scott, *supra* note 213; see also Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713, 719-20 (1997).

277. See Kahan & Klausner, *supra* note 276, at 725-27 (describing advantages to use of a term that is contemporaneously used by many firms for a significant period of time).

278. See *id.* (distinguishing learning benefits, which exist “when a particular firm adopts a term,” from network benefits, “developed during the time the firm has the term in its contract”). Standardized terms may also limit “switching costs,” with potential benefits to a firm based on internal practices, when it can reuse the same terms. See *id.* at 727-29. Admittedly, it might be more efficient for parties to stick with a suboptimal term than to change to a novel term in some cases. See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995) (describing network effects and the potential for suboptimal contracts). However, the argument that standardized terms will be suboptimal arguably supports retaining the interpretive differences that exist between corporations and limited partnerships or LLCs. In a broad sense, these different forms provide parties with a menu of potential standardized terms. Cf. *id.* at 839-41 (proposing menus of standardized terms as a means of providing optimal terms).

279. Cf. DeMott, *Fiduciary Obligation*, *supra* note 169, at 491 (“Even if fiduciary norms are distinctive, what justifies the *mandatory* imposition of any fiduciary rule? First, mandatory rules supply standardized content for the legal consequences of relationships.”).

relationship.²⁸⁰ Third party rights are substantially affected by the predictability of judicial interpretations of intra-firm obligations, but as with courts, third parties are not in a position to readily access the background negotiations that produced the express terms.

The value of an investment to third parties will change depending upon the clarity and content of a firm's internal governance provisions; different levels of intra-firm obligations alter the investment. In addition, the enforcement of fiduciary duties sometimes invalidates agreements with third parties when such duties are grounded on a violation of the firm management's responsibilities.²⁸¹ The enforcement of good faith duties could have a similar effect on settled contractual expectations. An ability to discern the scope of intra-firm obligations from the text of an agreement serves to protect these third party interests.

Furthermore, textualism creates an incentive to draft contracts with clarity.²⁸² As Ian Ayres and Robert Gertner note: "When parties fail to contract because they want to shift the *ex ante* transaction cost to a subsidized *ex post* court determination, a penalty default of non-enforcement may be appropriate."²⁸³ A penalty default is a default interpretation that discourages parties from an inefficient creation of contractual gaps.²⁸⁴ The default interpretation is not designed to reflect a hypothetical bargain of the parties, but rather to create contracting incentives to avoid the default.

In this context, the cost of contractually avoiding an unwanted

280. Cf. Kahan & Klausner, *supra* note 276, at 723-24 (describing benefits of terms that have been used in the past for assessment by various third parties, including lawyers, accountants, and investors).

281. See, e.g., Stephen M. Bainbridge, *Precommitment Strategies in Corporate Law: The Case of Dead Hand and No Hand Pills*, 29 J. CORP. LAW. 1, 23-26 (2003) (describing the impact of recent Delaware case law limiting the power of boards to enter agreements that lock up an acquisition without a fiduciary opt-out); cf. *Omnicare, Inc. v. NCS HealthCare, Inc.*, 818 A.2d 914 (Del. 2003); see also Paul L. Regan, *Great Expectations? A Contract Law Analysis for Preclusive Corporate Lock-Ups*, 21 CARDOZO L. REV. 1 (1999); cf. John Armour & Michael J. Whincop, *An Economic Analysis of Shared Property in Partnership and Close Corporations Law*, 26 J. CORP. L. 983, 997 (2001).

282. Cf. Scott, *The Case for Formalism*, *supra* note 184, at 866 ("A rigorous application of the common-law plain meaning and parol evidence rules would preserve the value of predictable interpretation and encourage parties to take precautions in selecting terms with well-defined meanings.")

283. Ayres & Gertner, *supra* note 158, at 127-28 (emphasis added).

284. See *id.* at 97 ("Penalty defaults, by definition, give at least one party to the contract an incentive to contract around the default. From an efficiency perspective, penalty default rules can be justified as a way to encourage the production of information. The very process of 'contracting around' can reveal information to parties inside or outside the contract.").

textualist interpretation of an agreement is limited. Investors that wish for the standard fiduciary limits on discretion can choose to leave the standard default terms in place. In that case, the fiduciary duties of loyalty, care, and good faith will be inserted by the courts. Alternatively, some might wish for judicial intervention, but less stringent intervention than the common law of fiduciary duties provides. It is comparatively simple for such parties to draft a contract that substitutes a rigorous standard of behavior, or simply modifies preexisting fiduciary obligations where needed.

Judicial resources are conserved to the extent interpretation does not require a complex (and potentially obscure) hypothetical bargain analysis.²⁸⁵ Textualist interpretation in the fiduciary opt-out context should provide incentives for clarity in the drafting of contractual text.

VI. MANDATORY DUTIES ARE UNNECESSARY TO PROTECT MEMBERS OF LLCs AND LIMITED PARTNERSHIPS

Despite the benefits, fiduciary waivers raise concerns that unsophisticated investors will fail to realize what they are getting into.²⁸⁶ In light of the potential for opportunism, commentators have expressed fears that fiduciary waivers will harm unwitting parties.²⁸⁷ People are presumed not to put themselves (or their assets) entirely at the mercy of others, and allowing a complete elimination of the fiduciary relationship looks suspect from this perspective.²⁸⁸ Not all investors are sophisticated.

285. *See id.* at 93 (“If it is costly for the courts to determine what the parties would have wanted, it may be efficient to choose a default rule that induces the parties to contract explicitly. In other words, penalty defaults are appropriate when it is cheaper for the parties to negotiate a term *ex ante* than for the courts to estimate *ex post* what the parties would have wanted. Courts, which are publicly subsidized, should give parties incentives to negotiate *ex ante* by penalizing them for inefficient gaps.”).

286. *See, e.g.,* Miller, *supra* note 2, at 1620 (“Depending on the extent to which it [the contractarian vision] fails to consider the interests of the less sophisticated and less financially privileged small entrepreneurs who may not be well represented by legal counsel, the contractarian model may be positioning certain LLC members at an initial disadvantage that is impossible to surmount.”); *see also* Dickerson, *supra* note 5; Frankel, *supra* note 5.

287. *See, e.g.,* Miller, *supra* note 2, at 1619-20; *see also* DeMott, *Fiduciary Preludes*, *supra* note 6, at 1044-45 (“[I]n closely held firms, participants may not fully explore in contractual negotiations the downside risks of their future association; the participants may be unable to identify all of the contingencies that would enable opportunistic conduct or, having identified such possibilities, may be reluctant to articulate them because they fear destroying the deal underway.”).

288. *Cf.* DeMott, *Fiduciary Preludes*, *supra* note 6, at 1061 (“It strains

Several aspects of limited partnership and LLC agreements should ameliorate these concerns. The nature of a limited partnership should encourage parties to seek legal advice.²⁸⁹ In addition, closely held firms are different from public corporations—they are often the subject of real negotiation for investors.²⁹⁰ Moreover, when members of limited partnerships and LLCs choose to restrict fiduciary default terms, they have an incentive to detail the rights and obligations that affect their relationship.²⁹¹ These customized agreements allow the parties to limit the risk of managerial abuses.

The process of opting out of fiduciary duties involves several decisions. Before adopting language that eliminates fiduciary duties, the contracting parties must adopt a particular jurisdiction and business form as a starting point.²⁹² The decision to form a limited partnership or LLC is a choice to adopt a business structure known for its freedom of contract, in comparison to a corporation or a general partnership.²⁹³ In effect, by choosing these business forms, with their demonstrated contractual implications, the parties have

credulity excessively to characterize membership in an LLC or a limited partnership, once formed, as indicative of intention to execute a gift transaction.”).

289. See Ribstein, *Limited Partnership Agreements*, *supra* note 6, at 942 (explaining, in light of the typical uses of limited partnerships, and the fact that limited partnerships are not likely to be publicly traded, that “the limited partnership form itself serves as a caution flag that should induce users to get legal advice, and that reduces the justification for protecting those who do not do so”).

290. See Ribstein, *Unincorporated Firms*, *supra* note 6, at 550 (“The antiwaiver argument is a harder sell in most closely held unincorporated firms in which terms are often negotiated or voted on face-to-face and approved unanimously.”).

291. *Cf.* Rosenberg, *supra* note 10, at 382 (describing how venture capital limited partnerships waive default fiduciary duties, but replace them with detailed provisions intended to address specific types of opportunistic behavior).

292. *Cf.* Eggleston, et al., *supra* note 175, at 131 (“If parties think their contract (whether simple or complex) would be best interpreted by a strict court, then they can opt for a strict court by placing an appropriate term in the contract; alternatively, they can opt for a liberal court.”). A choice of Delaware, or a similar jurisdiction, and of contract-based business entities, is also a choice of interpretive mode.

293. *Cf.* Ribstein, *Limited Partnership Agreements*, *supra* note 6, at 942 (“[T]he limited partnership form itself serves as a caution flag that should induce users to get legal advice, and that reduces the justification for protecting those who do not do so.”). Although Ribstein distinguishes LLCs from limited partnerships, based on the passivity of limited partners, the contractual freedom of the LLC form still provides a signal when combined with a fiduciary waiver.

opted into a textualist mode of interpretation.²⁹⁴

The language that eliminates fiduciary duties is also a cautionary signal.²⁹⁵ When a party negotiates a contract and announces he would like to completely eliminate fiduciary duties from the relationship, it is a wake up call to his partners. Investors may choose to ignore these signals, but they don't enter into fiduciary waivers without warning.²⁹⁶ Indeed, even if fiduciary waivers were commonplace, replacement of fiduciary duties with distinctly different obligations, such as a grant of absolute discretion or the right to compete with the firm, should wave a red flag.

Finally, the common law includes substantial interpretive safeguards against an unknowing waiver of fiduciary duties.²⁹⁷ An established interpretive rule prevents opting out of fiduciary duties unless the parties have done so unambiguously.²⁹⁸ In effect, Delaware courts apply a clear statement rule to prevent inadvertent

294. Contracting parties may have preferences not only as to the terms contained within their agreement, but also respecting the interpretive methodology a court adopts. *Cf.* Schwartz & Scott, *supra* note 87, at 569 (“[T]he issue is not what interpretive style is best calculated to yield the correct answer. Rather the issue is what interpretive style would typical parties want courts to use when attempting to find the correct answer.”).

295. *See* Hynes, *supra* note 5, at 45 (“The very suggestion by the fiduciary that the customary protections be drafted away would serve as a warning that something is wrong. At that point, an investigation into character would indeed be triggered, but under such circumstances it would be cost effective because it would redound to the benefit of the party who is about to place trust in someone who has sent a signal that all may not be well.”).

296. For a particularly blunt statement to this effect, see *Miller v. American Real Estate Partners, L.P.*, No. Civ. A. 16788, 2001 WL 1045643, *8 (Del. Ch. Sept. 6, 2001) (“[T]he court will not be tempted by the piteous pleas of limited partners who are seeking to escape the consequences of their own decisions to become investors in a partnership whose general partner has clearly exempted itself from traditional fiduciary duties.”).

297. *See* Ribstein, *Limited Partnership Agreements*, *supra* note 6, at 948 (“Even clear fiduciary duty waivers do not necessarily cover all potential fiduciary breaches. Courts understandably hold that conduct outside the waiver is covered by default fiduciary duties.”).

298. As one Delaware court recently noted in the limited partnership context:

[J]ust as investors must use due care, so must the drafter of a partnership agreement who wishes to supplant the operation of traditional fiduciary duties. In view of the great freedom afforded to such drafters and the reality that most publicly traded limited partnerships are governed by agreements drafted exclusively by the original general partner, it is fair to expect that restrictions on fiduciary duties be set forth clearly and unambiguously. A topic as important as this should not be addressed coyly.

Miller, 2001 WL 1045643 at *8.

waivers, creating a presumption that fiduciary duties have been retained unless there is clear text to the contrary.

In those cases where it is clear that fiduciary duties have been eliminated, courts read the waiver narrowly. The agreement must not only unambiguously eliminate fiduciary duties, but eliminate them with respect to the exercise of discretion at issue. Courts readily find that fiduciary duties are retained in one area even though they are removed in another.²⁹⁹ The doctrine of *contra proferentum*, which states that agreements are interpreted against the drafter, adds further protection.³⁰⁰

In some cases, a more sophisticated party will take advantage of a less sophisticated one, but traditional contract doctrines offer remedies in this circumstance. The unconscionability doctrine could be applied in the limited partnership or LLC context.³⁰¹ Where a sophisticated party has improperly taken advantage of another party at the formation stage, producing an unfair contract, courts may find the agreement to be unconscionable.³⁰²

299. See Ribstein, *Limited Partnership Agreements*, *supra* note 6, at 948 (“Even clear fiduciary duty waivers do not necessarily cover all potential fiduciary breaches. Courts understandably hold that conduct outside the waiver is covered by default fiduciary duties.”).

300. See, e.g., *SI Mgmt., L.P. v. Winninger*, 707 A.2d 37, 43 (Del. 1998); see also Paul M. Altman & Srinivas M. Raju, *Fiduciary Duties in Delaware Alternative Entities*, 1486 PLI/Corp 383, 412 n.4 (2005).

301. As Robert E. Scott notes, unconscionability doctrine is available to address firms that seek “to use literal language as a vehicle to exploit consumers or other ‘occasional’ contractors.” Scott, *supra* note 184, at 874. For a development of this theory in the partnership context, see Hynes, *supra* note 6, at 45 (“In the extraordinary case, relief is available under the doctrine of unconscionability.”), Hynes, *supra* note 188, at 458-60. See also Ribstein, *Unincorporated Firms*, *supra* note 6, at 566-67. *But cf.* Vestal, *supra* note 32, at 74 (suggesting that it is “inconsistent with the evolution of partnership law . . . to move to an unconscionability standard that would look into the negotiation phase”).

302. Arguably, the unconscionability doctrine will not protect against bounded rationality and biases when a contract is formed. *Cf.* Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 252 (1995) (“As in the types of contracts previously considered [fiduciary waivers], the problem raised by contracts to govern thick relationships is not a problem of unconscionability. Usually, neither party to such a relationship will have exploited the other at the time the contract was made. Quite the contrary, both parties will have probably been subject to exactly the same cognitive limits.”); see also DeMott, *Fiduciary Preludes*, *supra* note 6, at 1044-45 (suggesting LLC participants may be unable to identify all the contingencies that would enable opportunistic conduct). However, the mere existence of cognitive bias does not mean that paternalism is the appropriate response. The costs of paternalism must be a factor. As Jeffrey Rachlinski has explained, the case for paternalism depends upon “demonstrating that the costs of either

VII. CONTRACTUAL CONSENT AND THE OBJECTIVE
INTERPRETATION OF CONTRACTS

Finally, a textualist approach in this context is desirable based on considerations of individual autonomy. Contractual freedom has two significant aspects: the freedom to contract; and the freedom from contract.³⁰³ Both aspects are implicated by the interpretive concerns described above. Once it is clear that fiduciary duties are waived, contractual grants of discretion should be taken literally in order to increase the likelihood that firm members receive the bargain they actually intended, and to ensure they may craft an agreement consistent with their preferred allocation of risks.

One function of a sole discretion term, for example, is to restrict the role for implied contract terms. An interpretive method that reads implied obligations into a sole discretion term, even where fiduciary duties have been eliminated, makes it extremely difficult to avoid these implied obligations *ex ante*. And, to the extent the parties' contract was intended to avoid these very obligations, a subsequent judicial decision to add them effectively rewrites the parties' bargain *ex post*.

In general, autonomy principles do not address the legitimacy of particular default terms for a contract.³⁰⁴ Assuming that it is feasible to avoid default terms when an agreement is drafted, the parties still possess freedom to contract for obligations of their choice.³⁰⁵ In many cases, the contracting parties may be deemed to have given their tacit consent to default terms by drafting an

learning to adopt a superior approach to a choice or relying on others to make a choice exceeds the cost of paternalistic intervention." See Jeffrey J. Rachlinski, *The Uncertain Psychological Case for Paternalism*, 97 NW. U. L. REV. 1165, 1219 (2003). It is far from obvious that the costs of mandatory substantive limits on fiduciary waivers are not greater than the costs of opportunism.

303. See Barnett, *Sound of Silence*, *supra* note 87, at 871 (describing a "conflict between the two aspects of the liberal conception of contractual freedom: freedom to contract and freedom from contract" (citing Richard E. Speidel, *The New Spirit of Contract*, 2 J.L. & COM. 193, 194 (1982)).)

304. See generally Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489 (1989).

305. See Barnett, *Sound of Silence*, *supra* note 87, at 866 ("[W]hen the transaction costs of discovering and contracting around the default rules are sufficiently low, a party's consent to be legally bound coupled with silence on the issue in question may well constitute consent to the imposition of the particular default rule that is in existence in the relevant legal system."); see also Goetz & Scott, *supra* note 213, at 262 (noting that the alleged expansion of contractual choice that results from standardized implied terms "implicitly presumes a neutral policy toward individualized agreements: atypical parties lose nothing, since they remain unrestrained from designing customized provisions to replace the state-supplied terms").

agreement against an established interpretive background.³⁰⁶ Consent to enter into a contract, however, is not the same thing as consent to every term that a court infers pursuant to that contract.³⁰⁷

Randy Barnett has identified two concerns which are significant for a court's choice of contractual defaults:

First, we cannot infer from the parties' silence an indirect consent to a particular default rule from the overall manifestation of assent to be bound if the parties had no reason to know of the rule. Second, we cannot infer such consent if contracting around the rule is so costly that there is little point in raising the issue in negotiation. I include in the latter category the cost of uncertain enforcement.³⁰⁸

The freedom to contract is an issue to the extent that a non-textualist rule imposes insurmountable hurdles for parties that seek expansive managerial discretion—i.e., default terms that are too costly to avoid. Implied terms raise few concerns for individual freedom because of their default nature—a fundamental premise of judicially implied contract terms is the ability of parties to contract around them.³⁰⁹ In contrast, mandatory substantive duties are inconsistent with the idea that the parties should be permitted to enter into whatever contracts they see fit.³¹⁰

306. See Barnett, *Sound of Silence*, *supra* note 87, at 865-66 (stating that many default rules “are legitimated by the silent consent of the parties in much the same way as evidence law recognizes the possibility that silence in the face of an accusation can constitute an admission”).

307. *Id.* at 826-27 (“[T]he concept of default rules reveals consent to be operating at two distinct levels of contract theory. First, the presence of consent to be legally bound is essential to justify the legal enforcement of any default rules. Second, nested within this overall consent to be legally bound, consent also operates to justify the selection of particular default rules.”).

308. *Id.* at 866.

309. This point is noted by default term theorists. See, e.g., Goetz & Scott, *supra* note 213, at 262 (“The Expanded Choice thesis [of implied terms] implicitly presumes a neutral policy toward individualized agreements: atypical parties lose nothing, since they remain unrestrained from designing customized provisions to replace the state-supplied terms.”).

310. On the importance of consent for the legitimacy of rights transfers, see Barnett, *A Consent Theory*, *supra* note 238, at 291-300; Barnett, *Sound of Silence*, *supra* note 87, at 829-59. There are arguably some circumstances that justify exceptions. See Schwartz & Scott, *supra* note 87, at 609-10 (“Mandatory contract law rules ban terms that parties choose; hence, these rules are inconsistent with the commitment to party sovereignty that we have defended. The rules nevertheless are justifiable on two grounds. The first is to prevent externalities, the classic example of which is price fixing. The second ground is to ameliorate a market failure that disclosure cannot cure.”). Neither of Schwartz and Scott's exceptions is applicable here.

The members of a limited partnership or LLC are in no position to inform each other, or the court, of every future contingency that is to be free from judicial oversight. Thus, an interpretive rule that mandates transaction-specificity for fiduciary opt-outs also mandates certain substantive results. Permitting parties to announce specific exceptions to implied good faith duties while simultaneously barring broad grants of discretion effectively precludes some contract terms that respond to risks of judicial error or moral hazard.³¹¹

If a contract's text specifies that the precise activity under dispute is permitted, it follows that this very conduct was contemplated by the parties, and is accordingly not in violation of good faith duties. A similar result should be reached by clearly describing a broad category of absolute discretion (given an objective interpretation of "absolute" and "discretion"). The contractual freedom to carve out broad swaths of non-reviewable conduct distinguishes a purely contractual regime from one based in mandatory fiduciary obligation.

A commonsense, textualist understanding of contractual language also limits the potential for judicially implied terms that the parties did not agree to, or even anticipate.³¹² A consent-based understanding of contract doctrine calls for an objective interpretation of contractual text.³¹³ Objective manifestations are

311. The *Sonet* court apparently recognized this issue. In rejecting the plaintiffs' efforts to limit the effect of a sole discretion term based on the contract's failure to expressly expand or limit the General Partner's discretion in the event of a merger, the court noted that "[t]he problem with Plaintiff's argument is that it ignores the remainder of the Agreement. It also fails to recognize the rather practical problem of the impossibility of writing contract provisions that incorporate every bell and whistle all at once." *Sonet v. Timber Co.*, 722 A.2d 319, 324 (Del. Ch. 1998).

312. *Cf.* Schwartz & Scott, *supra* note 87, at 601 (noting, with respect to default standards, that "firms often need specific guidance regarding the performance obligation").

313. *See generally* Barnett, *Sound of Silence*, *supra* note 87, at 874-94. Others have recognized a link between autonomy and objective interpretations of contract language. Lon Fuller, for example, connected it to the promotion of security of transactions. Lon Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 808 (1941) ("The principle of private autonomy, properly understood, is in no way inconsistent with an 'objective' interpretation of contracts. Indeed, we may go farther and say that the so-called objective theory of interpretation in its more extreme applications becomes understandable only in terms of the principle of private autonomy."). *Cf.* Oliver Wendell Holmes, Jr., *The Theory of Legal Interpretation*, 12 HARV. L. REV. 417, 419 (1899) ("[E]ach party to a contract has notice that the other will understand his words according to the usage of the normal speaker of English under the circumstances, and therefore cannot complain if his words are taken in that sense.").

crucial to the successful enforceability of contracts, despite the potential that parties possess an idiosyncratic understanding of contractual language.³¹⁴ Although the actual intentions of the parties matter,³¹⁵ each party must be able to rely on external evidence of their business partners' consent.³¹⁶

Default standards that add implied terms to an agreement (including good faith duties) may comport with concepts of fairness or efficiency, but they can also redistribute the obligations that exist within the agreement.³¹⁷ This redistribution implicates the freedom from contract. When an *ex post* judicial rewriting of the parties' agreement occurs, the parties are forced into a relationship not of their own choosing, with the result that entitlements are transferred from one party to another without their consent.³¹⁸ A chronic indeterminacy as to when a contract will be found complete, or what its implied terms will mean, challenges the legitimacy of the default concept.

The presumption that parties use language in the same way as a reasonable reader decreases the likelihood that a court will interpret the contract in an unanticipated way, thus redistributing the entitlements set by contract. It also enables parties to easily avoid the court's interpretation since they can predict how their

314. See Barnett, *A Consent Theory of Contract*, *supra* note 238, at 308 ("A promisee is not 'justified' in relying on the ordinary meaning of a promisor's words or deeds where a special meaning can be proved to have been actually understood by both parties.").

315. See *id.* at 305 ("A consent analysis is genuinely interested in the actual intentions of the parties, but we never have direct access to another individual's subjective mental state.").

316. See *id.* at 305-07.

317. Cf. Coffee, *supra* note 5, at 1682 ("If a court later changes the meaning of [a contractual] term through the use of the hypothetical bargaining approach, there is a redistributive impact."). The parties to an agreement may have understood the meaning of a vague contract term even where a court finds it inefficient. This is an argument against adding an implied term on efficiency grounds. As Coffee notes, "[o]ne side loses something for which it may have bargained; another side may receive a windfall gain." *Id.*; see also Butler & Ribstein, *supra* note 3, at 17 ("The problem is that it is one thing to propound a default rule to cover situations not covered in the parties' contract, and another thing to state a general rule applicable irrespective of contract.").

318. Cf. Steven J. Burton, *Default Principles, Legitimacy, and the Authority of a Contract*, 3 S. CAL. INTERDISC. L.J. 115, 138-39 (1993) ("[I]ndividuals have no general obligation to do the efficient thing, and it is mysterious why parties to result-indeterminate contracts might have such obligations when people generally do not. Even if efficiency justified enforcing deals the parties made, the justification for enforcing a deal made by the parties is not a justification for enforcing a deal they did not make.").

agreement will be interpreted.³¹⁹ By accepting conventional meanings of words, courts enable sophisticated and unsophisticated parties alike to assess the scope of their duties.³²⁰

VIII. CONCLUSION

The creation of nonfiduciary obligations for would-be fiduciaries places courts in a seemingly unfamiliar position, and courts may experience a pull toward familiar fiduciary concepts.³²¹ Good faith is the natural instrument for this tendency. A better model is the business judgment rule, with its tradition of judicial abstention. Without fiduciary duties, parties are effectively permitted to expand the effects of the business judgment rule, thus managing the scope of judicial oversight.

Delaware's contractual duty of good faith is an interpretive measure, and it is applied cautiously. It is not a means to introduce mandatory norms of business conduct into limited partnerships and LLCs that waive fiduciary duties. Instead, good faith duties are a means to enforce the implicit intentions of the contracting parties, as found in their agreement. As a result, explicit text can dramatically change the content of good faith duties, with a marked divergence from traditional fiduciary relations.

Contract law enables extensive discretion over business decisions, up to and including absolute discretion. Accordingly, if a limited partnership or LLC agreement so indicates, courts should abstain from reviewing a nonfiduciary's exercise of discretion, even in cases of gross negligence or self-dealing. There are valid reasons for investors to desire this level of abstention. Judicial error, moral

319. Cf. Scott, *supra* note 184, at 860 n.34 ("To be sure, this method of interpretation will also generate error, in that courts will not complete contracts in ways that maximize the joint value of the contract to the parties. But this error is predictable, and thus the parties can anticipate it and use the predicted and predictable legal outcome as the basis for renegotiating the contract once conditions change."). Scott notes the availability of renegotiation—the predictability of judicial interpretations may also impact negotiations at the start of the parties' relationship.

320. See Barnett, *Sound of Silence*, *supra* note 87, at 887 (supporting a conventionalist default on the following basis: "When one party is rationally ignorant of the background rules of contract and the other party is not—that is, the other party is either knowledgeable or irrationally ignorant—default rules can reduce the instances of subjective disagreements arising between parties who otherwise are manifesting mutual consent.").

321. Cf. DeMott, *Fiduciary Preludes*, *supra* note 5, at 1062 ("Many brave new worlds, as they age, strongly resemble prior institutions. My prediction is that doctrines to control opportunistic conduct in LLCs will evolve toward results that resemble present doctrine developed prior to the LLC phenomenon.").

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hazard, and the fear of overcautious business decisions all support broad fiduciary opt-outs.

Boundaries still exist for nonfiduciary relations, even in cases where an agreement vests management with absolute discretion over business decisions. Claims of fraud, misappropriation of assets, or waste should still be viable in most cases where firms have stripped away fiduciary duties, as these actions would not be contemplated by members of a limited partnership or LLC. In comparison to fiduciary obligation, however, the restrictions are minimal.

The recent statutory amendments in Delaware are historic for expressly allowing the creation of business relationships governed entirely by traditional contract law: firms may exist without any residual fiduciary duty. Any remaining obligations are therefore found in contract doctrine, with its emphasis on individual freedom. Pursuant to fiduciary duties, courts are responsible for enforcing broad standards of business conduct, but contract law does not mandate these standards; the proper concern when interpreting a contract is to enforce the agreement as written.