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Insolvency at Its Limits: What Management and Creditors of Insolvent LLCs and LPs Should Know About Fiduciary Duties Waivers and Standing, Inside and Outside of Bankruptcy

JUNE 8, 2017

Delaware law allows members and partners of limited liability companies (LLCs) and limited partnerships (LPs) to waive the fiduciary duties of their management in their LLC or LP agreements. When an LLC or LP is insolvent, however, the residual claimants of the entity are its creditors, who, unlike members and partners, are generally not parties to the LLC or LP agreement and therefore have not agreed to waive any otherwise applicable duties. That raises the question: Are there insolvency "limits" to the effectiveness of waivers of fiduciary duties? When the LLC or LP is insolvent, are fiduciary duty waivers still operative, or may creditors of the entities assert (either directly or derivatively) breach of fiduciary claims to the extent management fails to exercise reasonable diligence in looking out for the interests of creditors or the enterprise more broadly?

The answers to these questions may depend on whether the insolvent LLC or LP is in bankruptcy. Accordingly, the filing of a bankruptcy case for an LLC or LP may alter the fiduciary duties owed by management.

Outside of bankruptcy, management of an insolvent Delaware LLC or LP that has waived all fiduciary duties in its operating agreement owes no fiduciary duties, even though the entity's residual beneficiaries (creditors) never agreed to the fiduciary duty waivers in the first place. And even if the entity has not waived all fiduciary duties, creditors of an LLC or an LP (unlike creditors of an insolvent corporation) do not have derivative standing to bring breach claims in that context. In other words, the shift from solvency to insolvency of a Delaware LLC or LP is not enough either to overcome the express fiduciary duty waiver or to provide creditor standing to sue.

Were the entity in bankruptcy, by contrast, even if the LLC or LP agreement disclaimed all fiduciary duties, management (whether a chapter 11 trustee or directors and officers of a debtor in possession) would nevertheless owe fiduciary duties to the estate, which includes creditors, during the bankruptcy. And creditors of the entity (or, at least, an official committee representing their interests) could most likely obtain derivative standing to assert claims for breaches of those duties (where the debtor itself unreasonably declined to assert the claims), at least when those alleged

breaches occurred post-petition.

Authors

Isley M. Gostin

SPECIAL COUNSEL

isley.gostin@wilmerhale.com

+1 202 663 6551

George W. Shuster Jr.

PARTNER

george.shuster@wilmerhale.com

+1 212 937 7232