Agency in the Alternatives: Common-Law Perspectives on Binding the Firm

By

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1. INTRODUCTION

Although agency is not itself a form of business entity, the implications of agency doctrine are inescapable in explaining how entities “get things done” with concrete or legal consequences, in particular in interactions with persons situated externally to the entity. More broadly, agency law is foundational to any entity, furnishing as it does the bases on which the law ascribes consequences to conferrals of power and authority within any organization. This Chapter focuses more narrowly on agency law’s external aspects, that is, the bases on which an actor’s conduct has legally-salient consequences for a firm that the actor represents in dealing with third parties. Principals often argue, after the fact, that an agent acted without authority and that the agent’s action should not carry legal consequences for the principal. Across legal systems, agency law addresses these arguments through doctrines that bear some similarities but also differ in significant respects. All systems, though, draw a fundamental distinction between binding the principal on the basis that the agent acted with actual authority, consistently with a

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1Ribstein et al. at 8.

2Orts at 54.

3Danny Busch & Laura J. Macgregor, Comparative Law Evaluation, in BUSCH & MACGREGOR at 386 et seq.
reasonable interpretation of the principal’s expressed or known wishes, as opposed to other bases for attribution, such as apparent authority. This chapter uses the perspective afforded by the common law of agency to assess issues about external agency in connection with alternative business entities, in particular general and limited partnerships and limited liability companies (LLCs). Although partnerships and partnership statutes are not recent phenomena, ongoing controversies and confusion surround the bases for external agency within LLCs. Focusing on common-law agency can add clarity in understanding the underlying concepts and terminology as well as in specifying the relationships between statutory provisions and the general law.

The chapter begins by examining long-established elements of general partnership law through which partners are able to take action with legal consequences for the partnership. The agency concept uniquely characteristic of partnership law—termed by the chapter the “positional power” held by partners concerning matters within the partnership’s ordinary business—is related to but distinct from the doctrinal fundamentals of common-law agency, in particular, the robust doctrine of apparent authority. The chapter next turns to the bases under LLC statutes through which an LLC member or manager may bind the LLC. LLC statutes vary markedly among jurisdictions—contrasting sharply with common-law agency and partnership law—and agency-related doctrines are unsettled in some jurisdictions, in particular, Delaware. This confusion surprises some observers, who “thought this was so simple....”\(^4\) At least some of the muddle may stem from statutory terminology, as well as from confusion about foundational common-law concepts. The chapter demonstrates that statutory confusion is not inevitable and, additionally, may be mitigated by judicial opinions as well as by expert consensus among legal

\(^{4}\)Frost at 47.
advisors.

2. GENERAL PARTNERSHIP AND A GENERAL PARTNER’S POSITIONAL POWER

General partnership

Partnership statutes define a partner’s capacity to bind the partnership, using the language of successive uniform acts. Under section 9 of the original Uniform Partnership Act (1914)(UPA), every partner “is an agent of the partnership for the purpose of its business ....” This delimits the scope of a partner’s agency position to actions that serve the partnership’s “purpose” and its “business,” and, additionally under section 9, by whether the partner’s act was “for apparently carrying on in the usual way the business of the partnership ....” If so, the partner’s act “binds the partnership ....” However, section 9 also recognizes that a partner may, as to any particular act, lack “authority” conferred by fellow partners (just as any agent may lack actual authority conferred by the principal), for example as a consequence of a restriction or limit imposed by the partnership agreement. Section 9 reconciles the possibility that a partner may deal with a third party by acting without actual authority but by also “apparently carrying on in the usual way the business of the partnership” by looking to the state of knowledge of the party with whom the partner dealt: the partnership is bound unless the third party “has knowledge of the fact that” the partner lacks authority. Thus, as to third parties who lack such knowledge, a partner’s unauthorized act binds the partnership when the act and the partner’s manner of acting satisfy the criteria prescribed in section 9. By acting without authority the partner acted wrongfully toward the partnership and, like any agent whose unauthorized conduct binds the

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5 A corollary of this limit is the implication stemming from section 18(e) that a unanimous vote of all partners is necessary to authorize a non-ordinary transaction. Ribstein et al. at 129.
principal, the partner would be subject to liability to the partnership.⁶

Eighty years on, the 1997 successor to the original Uniform Partnership Act changed little of relevance. Section 301 of the 1997 statute ("RUPA") replaces "the usual way" limitation with "in the ordinary course," and, more substantively, provides that a partnership is not bound by a partner’s unauthorized act when the third party "knew or had received a notification that" the partner lacked authority to bind the partnership through the act.⁷ More significantly, although a partnership may file in public records a statement of authority concerning some or all of the partners, persons who are not partners are deemed to know of limits on a partner’s authority only when the limits concern authority to transfer real property held in partnership name, and then only when a certified copy of the filed statement is on record "in the office for recording transfers of real property."⁸ Filed therein, the statement is likely to come to the attention of the transferee or the transferee’s lawyer. Thus, apart from transfers of real property, third parties dealing with a partner are not deemed to know of privately-imposed or otherwise unknown limits

⁶Restatement (Third) of Agency § 8.09 cmt. b. If a partner purports to have authority to bind the partnership but the partner’s act does not bind it, the partner may be subject to liability to the third party for breaching an implied warranty of authority. See id. § 6.10.

⁷As RUPA defines the term, a notification is given by “taking steps reasonably required to inform another person in ordinary course,” and is received when the notification comes to the recipient’s attention or is “duly delivered” either to the recipient’s place of business or to another place held out by that person to receive communications. RUPA § 102 (c) & (d). RUPA also drops the specification of acts that are presumptively unauthorized contained in UPA section 9(3). The list may have been helpful, although admittedly some of its items were outdated, such as the power to “[s]ubmit a partnership claim or liability to reference in arbitration.” Unif. Partnership Act § 9(3)(e). The other presumptively unauthorized acts were assigning partnership property “in trust for creditors or on the assignee’s promise to pay the debts of the partnership;” disposing of the partnership’s business good will; doing any other act “which would make it impossible to carry on the ordinary business” of the partnership; and confessing a judgment. For the proposition that the list added predictability, which was helpful, see Ribstein et al. at 130.

⁸Id. § 303(d)(e).
imposed on the partner’s authority.

**Positional power**

Although the statutory treatment of partners as agents resembles aspects of the common law of agency, the common law is not identical to partnership law. As a consequence, the terminology of “power” better captures the capacity to bind the firm conferred by statute on partners than does the terminology of “authority.” “Power,” a broader term, encompasses in this context the possibility that it may be exercised without the right to do so.9 Partnership statutes, like the common law, recognize that actual authority (and ratification, which creates actual authority after the fact) is not the sole basis for attributing the legal consequences of an agent’s act to the principal.10 When a partner acts without actual authority, by statute a third party may bind the partnership when the partner appeared to act in the ordinary course of partnership business and the third party did not know and had not received a notification that the partner lacked authority. The basis for binding the partnership, in other words, derives from the partner’s status or position as a partner, subject to stated limits, including the third party’s knowledge, and not from communications or other manifestations about authority made by the partnership, whether to the partner, a particular third party, or a broader audience, including manifestations made through a title assigned to the partner that is generally understood to encompass authority of a particular type and scope.

The analysis is not the same within common-law agency. Unless the principal has ratified

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9Bishop & Kleinberger ¶ 7.05[1] at 7-41.

10Formally defined, “[a]n agent acts with actual authority when, at the time of taking action that has legal consequences for the principal, the agent reasonably believes, in accordance with the principal’s manifestations to the agent, that the principal wishes the agent so to act.” Restatement (Third) of Agency § 2.01.
an agent’s unauthorized act, a third party seeking to hold the principal to the act’s legal consequences would turn to the doctrine of apparent authority. An agent’s apparent authority stems from a manifestation made by the principal; the principal is bound when the third party reasonably believes the agent (or other actor) has authority to act on behalf of the principal and that belief is traceable to a manifestation of the principal.\textsuperscript{11} Apparent authority looks outward, to the principal’s manifestations, their connection to the third party, and the reasonableness (or not) of the third party’s belief. Apparent authority is not an inward-focused doctrine grounded in the principal’s relationship to the agent, as is a partner’s statutory power to bind the partnership.

To be sure, it’s understandable that a partner’s statutory power to bind might be characterized as an instance of “apparent authority”\textsuperscript{12} when it diverges from actual authority. The statutory language itself refers to “apparently” carrying on partnership business in the usual way, and a third party with knowledge or on notice that a partner lacks authority may not bind the partnership (unless it ratifies the partner’s act), just as a third party on notice that an agent lacks authority may not rely on apparent authority to bind the principal. But a third party seeking to hold a partnership need show no manifestation made by the partnership that underpinned the third party’s belief that the partner had authority. More narrowly (and more theoretically), a partner may have actual authority on the basis of the partner’s status as a partner plus the absence

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\item[11] Restatement (Third) of Agency § 2.03 (“[a]pparent authority is the power held by an agent or other actor to affect a principal’s legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal’s manifestations.”).

\item[12] For this usage, see Ribstein et al. at 127 (referring to “the scope of the partners’ apparent authority, at least to the extent that third parties are not notified of any limitation on the partners’ power”). More guardedly, RULLCA’s drafters state that UPA (1914) “codified a particular form of apparent authority by position ....” RULLCA, Prefatory Note at 3 & § 301, cmt. a (UPA “codifies the common law notion of apparent authority by position ....”).
\end{footnotes}
of any relevant restriction or limitation in the partnership agreement, but with no separate or discrete manifestation conferring authority from the partnership to that partner.

Of course, a partnership may act through agents who are not its partners. Non-partner agents may be situated internally as firm employees, such as a business manager or an associate lawyer in a law firm that is organized as a partnership, or externally, such as an external investment manager or broker. Whether the acts of a non-partner agent bind the partnership is not resolved by partnership law, but by general common-law agency. However, partnership law itself, and the partnership agreement, determine whether a partner binds the partnership by engaging a particular actor as an agent. For example, if an individual partner, acting contrary to the partnership agreement, engaged the “agent,” UPA section 9 and RUPA section 301 require inquiry into whether the partner’s action constituted “apparently carrying on in the usual way” (or the ordinary course) the partnership’s business, and whether the “agent” knew or had received a notification that the partner lacked authority to engage her on behalf of the partnership.\textsuperscript{13}

**Inherent agency power**

For these reasons, the terminology of “positional power” more cleanly specifies partners’ position as agents and differentiates them from common-law agency.\textsuperscript{14} For some scholars, the closest point of comparison within general agency law is likely be the doctrine of inherent

\textsuperscript{13} Agency law is also relevant to defining supervisory authority over an entity’s employees. See RULLCA, Prefatory Note at 4.

\textsuperscript{14} Referring to the power as “positional” is clearer than “partnership power;” an agent who acts with apparent authority but not actual authority exercises a power but one stemming from manifestations made by the principal, not the agent’s status or relationship to the principal.
agency power,\textsuperscript{15} introduced as a formal proposition in Restatement (Second) of Agency but jettisoned by Restatement (Third). Intended to protect third parties from the unfairness that would result if an enterprise “could have the benefit of the work of its agents without making it responsible to some extent for their excesses and failures to act carefully,”\textsuperscript{16} inherent agency power applied when no other basis for attribution sufficed to hold the principal.\textsuperscript{17} It cut across a broad and variegated swath—encompassing the liability of principals (whether disclosed or undisclosed\textsuperscript{18}) when agents with general managerial responsibility overstep privately-imposed limits on authority, as well as an employer’s liability for torts of employees committed within the scope of employment—and was formulated at a level of generality that did not identify the normative principle that justified the principal’s liability. As one scholar summarized, inherent agency power was an ontological concept, not a normative principle.\textsuperscript{19}

Viewed more instrumentally, inherent agency power for the most part responded to the narrowness with which Restatement Second formulated other agency doctrines, in particular, apparent authority. In more historical or theoretical terms, as I’ve written elsewhere, inherent

\textsuperscript{15}See Bishop & Kleinberger ¶ 7.05[2] at 7-43.

\textsuperscript{16}Restatement (Second) of Agency §8A, cmt. a.

\textsuperscript{17}Id. § 8A (“the power of an agent which is derived not from authority, actual authority or estoppel, but solely for the agency relation and exists for the protection of persons harmed by or dealing with a servant or other agent”).

\textsuperscript{18}When a principal is undisclosed, a third party has no notice that the agent is acting for a principal. Restatement (Third) of Agency § 1.04 (2)(b). A principal is “unidentified” when the third party has notice that the agent acts for a principal but does not have notice of the principal’s identity. Id. § 1.04(2)(c). In earlier terminology, an unidentified principal was a “partially disclosed” principal. Restatement (Second) of Agency § 4(2) (criticizing term as less accurate than “unidentified principal.”).

\textsuperscript{19}For this critique, see McMeel.
agency power may have represented an interim response to early challenges to the intellectual merit of agency as a “‘proper title in the law.’” As a free-standing doctrine, inherent agency power risked outcomes in transactional contexts in which a third party on notice of limits on an agent’s authority would nevertheless be able to bind a disclosed principal. In any event, as a doctrinal formulation, inherent agency power operated only one-way, that is, to bind the principal at the behest of a third party. A partner’s statutory or positional power, in contrast, operates bilaterally, to bind both the partnership and the third party with whom the partner dealt. And neither the text of Restatement (Second), nor the available history, relies on partnership law for an instance of inherent agency power.

3. AGENCY AND THE LIMITED LIABILITY COMPANY

Within the menagerie of business forms, the limited liability company (LLC) is “a relatively new, hybrid form of business entity that combines the liability shield of a corporation with the federal tax classification of a partnership.” LLCs (like corporations) are formed under

\[\text{DeMott at } \_\_\text{(quoting doubts of Oliver Wendell Holmes).}\]

\[\text{The theoretical possibility was realized in Menard, Inc. v. Dage-MTI, Inc., 726 N.E.2d 1206, 1208 (Ind. 2000).}\]

\[\text{For an account of that history, see DeMott. The drafter of the original Uniform Partnership Act, exploring its history, did not examine specifics of the fit between partners’ agency powers and common-law agency but did discuss the impact of a partner’s death on the agency capacity of the surviving partners plus whether partners were to be viewed as agents of a legal entity or as co-principals (and agents) on an aggregate account of partnership. Lewis at 638, 639. Partnership makes a brief appearance in Restatement (Second) of Agency, in which § 8A repeats the definition in UPA § 6 (“an association of two or more persons to carry on as co-owners a business for profit”).}\]

\[\text{Bishop & Kleinberger ¶ 1.01[1] at 1-7 (footnotes omitted).}\]
state law; unlike general partnership law, LLC law is far from uniform.24 LLC statutes vary in many ways, including the circumstances under which the LLC is bound by the unauthorized act of a member or manager of the LLC. LLC statutes also vary in the clarity with which they address agency-related issues, including the statute’s relationship to the common law; at times some statutes have been explicitly disconnected from the common law in basic respects, while some statutory formulations are confused.

The confusion may stem from the history of LLC legislation and from drafters’ reliance on partnership statutes. From early days, LLCs could elect to be managed by their members (resembling in this respect a general partnership) or centrally by managers. LLCs from early days also contemplated the execution of two documents: (1) an organizational form to be submitted for filing with the secretary of state or another official designated by the state, like the document and filing requisite for a corporation or a limited partnership; and (2) an internal agreement, not filed with the state, often termed an operating agreement or limited liability company agreement (which many statutes do not require to be reduced to writing) and which resembles a partnership agreement.25 Early concerns centered on achieving tax classification for LLCs as partnerships, likely prompting some of the agency-related provisions in LLC statutes. The tax concerns were obviated in 1997 by a “check-the-box” regime for unincorporated domestic entities that do not issue publicly-traded interests, which enables each entity to choose its own tax treatment. Regardless, and returning to the metaphor of the menagerie of business


25 And the Delaware statute now excludes the applicability of the state’s general statute of frauds. See Del. Code Ann., tit. 18-101(7).
forms, viewed from the perspective of agency-related characteristics, many LLC statutes house the new entity either in close proximity to partnerships, not incorporated entities, or in a distant enclosure away from the menagerie’s other inhabitants.

**Positional powers under LLC statutes**

In some LLC statutes, provisions comparable to the language in partnership statutes specify the position of members and managers as agents. For example, under section 301 of the Uniform LLC Act (ULLCA) (1996), “each member is an agent of the limited liability company for the purpose of its business” and the member’s act “for apparently carrying on in the ordinary course the company’s business” binds the LLC, unless the member lacked authority so to act for the LLC and the third party “knew or had notice” that the member lacked authority. But—and in contrast to a default-rule general partnership—centralized management is an express and formal statutory option for LLC structures. Under ULLCA, when an LLC is manager-managed, “a member is not an agent of the company for the purpose of its business solely by reason of being a member.” Each manager is an agent for the purpose of the LLC’s business, subject to the same limitations applicable to a member’s agency power in a member-managed LLC. ULLCA requires that the articles for an LLC specify whether it is to be manager-managed, which could enable third parties to make this basic determination about any LLC with which they may deal. Along the same lines, when an entity is a limited, not a general partnership, only the general

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26 ULLCA § 301(b)(1).

27 ULLCA § 301 (b)(1).

28 ULLCA § 203 (a)(6).
partner holds the positional powers of an agent;\textsuperscript{29} a limited partner, in the terminology of the most recent uniform act, “does not have the right or power as a limited partner to act for or bind the entity.”\textsuperscript{30} Reasonable third parties, that is, who know they deal with a limited partnership or a manager-managed LLC, are assumed to be aware that other members or partners are not positioned as agents simply through their status in the firm. However, to determine whether an LLC is manager-managed may require inquiry into the public record of the firm’s filed articles of association because LLC law does not require that the firm use a name that would reveal its management structure,\textsuperscript{31} in contrast to limited partnership law.\textsuperscript{32}

**The impact of restrictions on authority in operating agreements**

Unlike ULLCA and partnership statutes, some LLC statutes may create the possibility that provisions in LLC agreements that limit the authority of members or managers could be operative as against third parties who do not know or have notice of the restrictions. If so, LLC law clashes with common-law agency doctrine. The doctrine of apparent authority protects third parties who act reasonably on the basis of principals’ manifestations about their agents; the underlying point is that “[a] principal may not choose to act through agents whom it has clothed with the trappings of authority and then determine at a later time whether the consequences of their acts offer an advantage.”\textsuperscript{33} Apparent authority enables third parties to proceed on the basis

\begin{footnotes}
\item[29] Uniform Limited Partnership Act (2001) (ULPA) § 402.
\item[30] Id. § 302.
\item[32] ULPA § 108 (c). This requirement has a counterpart in corporate law. See, e.g., Del. Code Ann., tit. 8, § 102(a)(1).
\item[33] Restatement (Third) of Agency § 2.03, cmt. c.
\end{footnotes}
of principals’ manifestations about agents’ authority unless reasonably under the circumstances the third party should inquire further. Many cases apply the elements of apparent authority to determine whether incorporated principals are bound by acts taken purportedly on their behalves by agents of all sorts, including their officers. In contrast, giving operative effect to restrictions in a document—an operating agreement—that is not a matter of public record requires third parties to seek formal confirmation of authority in circumstances well beyond the operation of common-law agency doctrines. Separately, some LLC statutes decouple the power of members or managers to bind the firm from limitations comparable to those imposed by ULLCA and partnership statutes, thereby creating the possibility that the LLC would be bound by an unauthorized act that was wrongful, or not in the ordinary course of the LLC’s business, or effected through means not typical of the LLC. These outcomes, too, are at odds with common-law agency because each scenario makes it likely that the third party did not act reasonably, as apparent authority requires.

As it happens, the Delaware LLC statute may pose both of these problems, providing as it does in section 18-402 that “[u]nless otherwise provided in a limited liability company agreement, each member and manager has the authority to bind the limited liability company.”

34 See Restatement (Third) of Agency §§ 3.03 cmts. c-e & rep. notes.

35 Moreover, if an LLC lacks an equivalent for the secretarial function customary in corporations, obtaining formal confirmation of authority may be more difficult. On the customary authority of corporate secretaries to certify the due adoption of resolutions and to certify officers’ signatures, see Restatement (Third) of Agency § 3.03, cmt. e(5). A functional solution for LLCs is filing a statement of authority. See RULLCA § 302(a)(2), discussed infra.


As many LLCs organize under Delaware law but have their principal places of business elsewhere, arguable ambiguities in statutory language affecting basic issues are significant. For starters, in what sense would a member or manager have “authority” to bind the firm if the limited liability company agreement provides otherwise? “Authority” here must mean positional power, as discussed above, to avoid inconsistency within the same sentence. But notice the power’s breadth, unrestricted as it is by partnership-like statutory limitations.39

Perhaps to mitigate the risks of a statutorily-uncabined power to bind an LLC, section 18-402 couples the conferral of power with the “unless otherwise provided” prelude, which makes the conferred powers subject to the LLC’s limited liability company agreement, a private document not filed with the state. Read literally, “unless otherwise provided” detaches Delaware LLCs from the operation of apparent authority, creating the possibility that an LLC may deal with third parties through members and managers who bear titles or are otherwise placed in positions that would lead a reasonable third party to believe that the member or manager’s actual authority matches the manifestation made by the LLC through the title or placement, subject to being confounded by restrictions in the LLC agreement of which the third party had no notice.

Experts—lawyers who attended a 2006 meeting of the ABA’s Business Section Partnership Committee—reportedly exhibited “significant confusion” about the meaning of this portion of the Delaware statute. A few read the sentence to address only actual authority, to be governed by the operating agreement, with the consequence that the statute itself confers no

38Gevurtz at 67.


40Frost at 11.
apparent authority “but regular principles of agency law apply” and make apparent authority available to third parties to bind the LLC.\textsuperscript{41} Reading further into the statute, its final provision may support this reading because it makes applicable “the rules of law and equity” to “any case not provided for in this chapter ....”\textsuperscript{42} On the other hand, Delaware’s statute does not explicitly make the common law of agency applicable,\textsuperscript{43} and arguably “the case” is “provided for” by section 18-402. Reportedly, many Delaware lawyers treat section 18-402 to mean “that third parties may not assume that a member or manager of a Delaware LLC ever has apparent authority...the statute specifically provides the operating agreement governs authority, period.”\textsuperscript{44} Scholarly authority acknowledges that section 18-402 could be read both ways.\textsuperscript{45}

Separately, policy commitments explicitly articulated in the statute weigh in favor of confining section 18-402 and the impact of an LLC’s operating agreement to actual authority. Delaware’s LLC statute expressly states that “[i]t is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”\textsuperscript{46} Basic contract law limits a contract’s legal consequences to the

\begin{footnotes}
\item[41]Frost at 47.
\item[42]Del. Code Ann., tit. 6, § 18-1104.
\item[43]As does N.C. Gen. Stat. § 57D-2-30(e), discussed infra.
\item[44]Frost at 47.
\item[45]Ribstein et al. at 161 (statute “arguably makes the operating agreement control both actual and apparent authority of members and managers, but it could also be argued that the default rule conferring on each member and manager authority to bind the LLC confers apparent authority on one who does not know of a contrary provision in the operating agreement”); Bishop & Kleinberger ¶ 14.04[3][a] at 14-115 (characterizing “authority” as ambiguous).
\item[46]Del. Code Ann., tit. 6, §18-1101(b).
\end{footnotes}
parties to the contract and to a limited cast of further characters, in particular third parties who have enforceable rights to benefit from performance of the contract. A commitment to “the principle of freedom of contract” implicitly demarcates parties to a contract from non-parties; the principle is not equivalent to deeming the world at large to know the contract’s terms.\(^{47}\) Even more startling than the confused state of Delaware LLC law, in some states statutes explicitly provided that an LLC is not bound by the act of a member or manager that contravenes the operating agreement although the third party is unaware of the restriction and acts reasonably.\(^{48}\) Less extreme language elsewhere still deems third parties to have knowledge of restrictions on a member or manager’s authority when the LLC’s articles of organization—filed with the state—state that the operating agreement contains restrictions.\(^{49}\)

More generally, it is not evident what policy objective is furthered by holding third parties who deal reasonably to the consequences of contractual terms of which they had no notice. Many dealings by LLCs, like those of businesses more generally, are “quotidian” and do not reasonably invite inquiry beyond the generally-understood manifestations about its representatives made by the entity with whom third parties deal.\(^{50}\) Proceeding on the basis that

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\(^{47}\)For an example of statutory language accepting this point, see N.C. Gen. Stat. § 57D-2-30(b)(2)(LLC’s operating agreement not applicable to persons not party to agreement or otherwise bound by it).

\(^{48}\)To this effect were Colo. Rev. Stat. Ann. § 7-80-406(4), and Iowa Code § 490A.702(3)(b), both since repealed.

\(^{49}\)La. Rev. Stat. Ann. § 12-1317(B). See also former Okla. Stat. Ann., tit. 18, § 2019C, which provided that “[p]ersons dealing with members or managers of the limited liability company shall be deemed to have knowledge of the restrictions on the authority of members or managers contained in a written operating agreement if the articles of organization of the limited liability company contain a statement that such restrictions exist.”

\(^{50}\)RULLCA, Prefatory Note at 4.
“the operating agreement governs authority, period”\textsuperscript{51} whether or not a third party has notice of its terms appears only to arm transactional parties that happen to be LLCs with an extra-contractual option to repudiate commitments made by their representatives that is unavailable to businesses otherwise organized, which is likely to surprise reasonable third parties when the LLC deploys the option at a later time to avoid the legal consequences of its representative’s actions.

4. POTENTIAL SOLUTIONS

\textbf{Formal statutory reforms}

Statutory drafters are aware of the problems identified in this Chapter, in particular the experts charged with drafting the Revised Uniform Limited Liability Company Act (RULLCA), which was completed in 2006. RULLCA’s solution is elegant and precise. It achieves clarity by jettisoning the partnership legacy of positional powers and by reattaching LLC law to common-law agency. RULLCA section 301(a)\textsuperscript{52} provides that “[a] member is not an agent of a limited liability company solely by reason of being a member.”\textsuperscript{53} This language makes it unnecessary to clarify the relationship(s) between a partner’s positional power, actual authority, and apparent authority. A reader might then wonder how an LLC might ever be bound, if the LLC lacks managers, in the absence of members’ positional power; subsection (b) answers the question by providing that “[a] member’s status as a member does not prevent or restrict law other than this [act] from imposing liability on a limited liability company because of the person’s conduct,”

\textsuperscript{51}Frost at 47.

\textsuperscript{52}Lest a superficial reader miss the point, the title of the section is: “NO AGENCY POWER OF MEMBER AS MEMBER.”

\textsuperscript{53}RULLCA § 301(a).
which acknowledges that through the application of agency law a member of an LLC may become an agent.\textsuperscript{54} Under RULLCA an LLC is member-managed unless its operating agreement provides otherwise.\textsuperscript{55} In a member-managed LLC, acts outside the ordinary course of business require the consent of all members,\textsuperscript{56} as would be true in a general partnership. Like RUPA, RULLCA permits an LLC to file a statement of authority with the secretary of state or comparable official but it may designate positions, not just persons.\textsuperscript{57} With stated exceptions (including filings concerning authority to transfer real property), a statement of authority “is not by itself evidence of knowledge of notice of the limitation by any person.”\textsuperscript{58} Nothing in RULLCA makes restrictions of authority contained in LLC operating agreements effective as against third parties who deal with the LLC, in particular third parties who lack notice of the restriction.

Under RULLCA, as for incorporated business entities, much work is assigned to the doctrine of apparent authority. For example, designating someone as a “manager” likely implicates the power to bind the LLC as to matters within the ordinary course of business.\textsuperscript{59}

\textsuperscript{54}The language might helpfully have acknowledged that an agent’s conduct may also lead to legally-enforceable rights that the principal may wish to exercise as against third parties with whom the agent dealt.

\textsuperscript{55} RULLCA §407(a).

\textsuperscript{56} RULLCA § 407(b)(4).

\textsuperscript{57} RULLCA § 302 (a)(2).

\textsuperscript{58} RULLCA § 302(d). The other exceptions concern notice of an LLC’s dissolution, termination, or merger or the like transaction, effective within 90 days after the relevant statement or articles have been filed; and the filing of a post-dissolution statement of authority. RULLCA §§ 103(d) and 302 (d).

\textsuperscript{59} Frost at 47. RULLCA itself provides in § 407(c)(3) that in a manager-managed LLC, “a difference arising among managers as to a matter in the ordinary course of the activities of the company may be decided by a majority of the managers.” This language contemplates that a
Conferring a title such as “President” on a member or a manager implicates a large body of common-law precedent focused on the meanings ordinarily associated with formal organizational titles, as would conferring a title that designates a functional area or specialty within the LLC. To be sure, RULLCA itself does not address all questions that may surface as a consequence of jettisoning members’ positional power. For example, might a newly-formed LLC be “stymied” if it has not yet filed any statement of authority, and its operating agreement does not confer titles that denote authority to interact with third parties?\(^{60}\) The new LLC seems to lack any agents at all, which may protect its members against liability to third parties until the members reach agreement, but may also come as a surprise to third parties who deal with the LLC through a member. Backdrop agency law seems likely to fill this lacuna for an LLC with a governance structure that is incomplete or a work-in-progress. Recall that the RULLCA default is member-management. All members in a default member-managed LLC have “equal rights in the management and conduct” of the LLC’s activities,\(^{61}\) and section 407(b)(3) provides that a dispute among members on a matter “within the ordinary course of the activities of the company may be decided by a majority of the members.” It’s likely that the new LLC’s members have some understanding of the point of forming it; if the member who acts takes action that the member reasonably understands to further the LLC’s objective(s), the member has acted with actual authority unless on notice that other members object or would object if they but knew of “manager” handles matters that arise in the ordinary course of an LLC’s activity.

\(^{60}\) Rutledge & Frost at 51.

\(^{61}\) RULLCA § 407(b)(2).
the action the member intends to take.\footnote{Rutledge & Frost at 52. The resolution for the new-LLC hypothetical, introduced in this article, proposes a slight variant, which is that the member in question “has actual authority to take actions the member reasonably believes are necessary or incidental to achieving the objectives of the LLC so long as the member is not aware of any differing belief among the members and the act is within the ordinary course of the activities of the LLC.” Id. My proposed analysis is narrower by a smidgen: a member who anticipates that fellow members may well object would have an incentive to act before fellow members are clued in to the action the member plans to take. Perhaps the member harboring such a suspicion would not also “reasonably believe” that what the member does is necessary or incidental to the LLC’s objectives, but the analytic focus within agency law in determining whether an agent acted with actual authority is consistency with the principal’s known manifestations, which include “circumstances of which the agent has notice and the agent’s fiduciary duty to the principal.” Restatement (Third) of Agency § 2.02(2). A reasonable person in the agent’s situation, with the new LLC as a principal, might be on notice of the “circumstance” of the agent’s own suspicions about the principal, that is, the likely objection by fellow LLC members.}

Alternatively, a statute might retain a partnership-derived conferral of positional power on LLC members but include provisions that mitigate its consequences. A recent (post-RULLCA) LLC statute, effective as of January 2014 in North Carolina, is an intriguing example.\footnote{For an overview of the statute from the chair of the bar committee that drafted the act, see Keen.} Section 3-20(a) vests management of North Carolina LLCs in managers,\footnote{N.C. Gen. Stats. ch. 57D, § 3-20(a).} followed by section 3-20(d), which provides that all members are managers “by virtue of their status as members ....” unless the operating agreement provides otherwise,\footnote{Id. § 3-20(d).} for example by designating less than all members as managers or designating non-members as the LLC’s sole managers. Thus, member-management is the default option but the operating agreement may specify otherwise. Under section 3-20 (c) “each manager may act on behalf of the LLC in the ordinary course of its business” subject to direction and control of a majority of managers. As with the
Delaware LLC statute, the first question posed by these provisions is whether a member/manager’s status-derived power to “act on behalf of the LLC in the ordinary course of its business” is subject to any further constraints, if the act is in the “ordinary course” of the LLC’s business. Would the member/manager’s power to bind encompass acts known to the third party to represent self-dealing transactions or acts effected through atypical means? Section 2-30(e) makes applicable “the laws of agency and contract” unless provided otherwise in the statute, but this section explicitly addresses only the “administration and enforcement of operating agreements.” 66 If the third party has notice of terms in the operating agreement that restrict a manager’s authority (including the authority of a member/manager), neither actual nor apparent authority would enable the third party to hold the LLC to the legal consequences of the manager’s unauthorized act. But one wonders whether apparent-authority principles limit the status-derived power of a member to bind an LLC to a transaction that would reasonably appear to a third party not to be authorized based on the nature of the transaction or the means through which the member effects it, when the third party has no notice of any limitations imposed by the operating agreement. Perhaps such a transaction is assumed not to be in “the ordinary course” of the LLC’s business, but this may require heavy lifting by “ordinary course.”

In contrast with the Delaware statute, the North Carolina statute is clear about the impact of provisions in an operating agreement that restrict authority. Under section 2-30(b)(2), an operating agreement “does not apply” to persons “who are not parties or otherwise bound by the operating agreement.” 67 A third party, neither a party to an operating agreement nor bound by it

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66 Id. § 2-30(e).

67 Id. § 2-30(b)(2).
as the statute specifies, would be a party to whom the operating agreement “does not apply ...” Admittedly, stating that an operating agreement “does not apply” to a person is not precisely the same as stating that the person is not deemed to be on notice of its contents; but notably the North Carolina statute omits any language deeming all who may deal with or otherwise encounter an LLC to have knowledge of the terms of its operating agreement. And to preserve the potential of apparent authority as a limiting constraint on unauthorized actions, it’s important that the statute does not state that non-parties are not “affected by” the agreement.

Non-statutory solutions

By this point in the Chapter, two facts may puzzle the reader. First, only a small number of cases address the problems identified in this Chapter in the LLC context. Second, statutory fixes to the problems are either in their early days or limited in number. To date, seven states and the District of Columbia have adopted RULLCA; the North Carolina statute is both new and distinctive. One explanation for the evident stickiness of problematic statutory language is that other factors suppress or mitigate the occurrence of problems, including the fact that most transactions entered into on behalf of LLCs “transpire without agency issues being recognized by the parties, let alone disputed.” Further explanations for stickiness stem from judicial decisions and interpretations of the law by expert lawyers that can mitigate problematic statutory language.

For Delaware LLCs, opinions from Delaware courts make it clear that, in one scholarly

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68 Under section 2-31 (a) & (b), non-parties bound by the operating agreement are the LLC itself and interest holders, who under section 1-03(15) are defined to include members and non-members who hold economic interests in the LLC.

69 RULLCA, Prefatory Note at 4.
assessment, “the law of agency remains alive and well in Delaware.” Indeed, it’s noticeable that neither of the two cases on point applying Delaware law refers at all to the Delaware LLC statute! In *Jack J. Morris Assocs. v. Mispillion Street Partners, LLC*, an individual co-owner of the LLC that constituted one of the defendant LLC’s two members was originally designated one of the defendant’s general managers. Two days before he executed a contract under which the plaintiff would furnish marketing services to the defendant, the defendant’s operating agreement was amended to remove the individual as a general manager. The defendant paid some invoices submitted by the plaintiff but then ceased paying. The court denied the plaintiff’s motion for summary judgment in its suit for breach of contract, entirely relying for analytic traction on common-law agency. The individual testified that the defendant LLC was aware that he entered into the agreement with the plaintiff, which might constitute an implied grant of actual authority to the individual, based on whether he reasonably believed the defendant authorized him to enter into the agreement notwithstanding the earlier revocation of his position as a general manager. Separately, and requiring “factual evaluation,” was whether the individual acted with apparent authority, an inquiry “which must consider whether Defendant made representations to Plaintiff indicating that [individual] was its agent, whether Plaintiff relied on them, and whether that reliance was reasonable.” Unremarkable as an articulation of agency doctrine, the court’s opinion nonetheless is remarkable for the absence of any reference to the LLC statute. Perhaps counsel for the defendant did not think that a defense premised on the statute’s “unless otherwise

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72 2008 WL 3906755 at *4.
provided” language would be helpful.

In the second case, the Court of Chancery likewise did not refer to the LLC statute in denying motions for summary judgment; the case stemmed from an employee’s use of funds embezzled from his employer to buy property on behalf of an LLC in which he and another individual were members. In *B.A.S.S. Group, LLC v. Coastal Supply Co.*, once the embezzlement came to light, the now-former employee settled with his former employer on terms that required transfer to the former employer of property purchased for the LLC with the embezzled funds. After the embezzler effected the transfer, the LLC’s other member sued to void it, alleging that the embezzler lacked authority under the LLC agreement to make the transfer. The court found the question complicated under the LLC agreement because the embezzler, designated therein as the “Authorized Person” to execute instruments on behalf of the LLC, may not have acted in good faith, as the agreement required. Additionally debatable on the summary judgment record was whether the embezzler acted with apparent authority in transferring the property to his former employer because it was not clear whether the employer “relied upon anything” done by the LLC “in formulating its arguably reasonable belief” that the embezzler acted with authority in transferring the LLC’s property. Again, unremarkable applications of common-law agency doctrine, but again nowhere does the opinion refer to the Delaware LLC statute.

These opinions may furnish the backdrop for the emergence of an arguable expert

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742009 WL 1743730 at *6. Not helping the plaintiff was the strength of the former employer’s counterclaim for unjust enrichment. The court held that the LLC was not a bona fide purchaser for value of the embezzled funds and denied summary judgment on the counterclaim only because the parties did not address “who should capture the upside of the Property” if any value remained net of the embezzled funds plus interest. Id. at * 7.
consensus about the relationship between Delaware’s LLC statute and the common-law doctrine of apparent authority, a consensus at odds with the reported reactions of Delaware counsel as of 2006 reported earlier in this Chapter. Such a consensus could reinforce the impact of the judicial decisions to date as well as predict the likely outcome of future litigation. In 2014, the Committee on LLCs, Partnerships, and Unincorporated Entities of the ABA’s Business Law section prepared and published a form LLC agreement for single-individual-member LLCs organized under Delaware law. Addressing management of the LLC, the form (inter alia) permits delegation by the member to other persons or entities, with such titles as the member may elect, of “the power and authority to act on behalf of the Company as the Member may delegate in writing to any such person or entity.” Recall that one literal reading of the Delaware statute is that provisions in an operating agreement (termed an LLC agreement under Delaware law) exclusively specify the power, as well as the actual authority, to bind the LLC. Inconsistent with this reading is footnote 15 to this portion of the form, which notes that “while appointed persons or entities will only have actual authority as set forth in this Agreement, they may nevertheless have apparent agency authority, including perhaps apparent authority to bind the LLC as a third party would reasonably ascribe to the titles given.” In light of the authors’ professional and institutional stature, the form’s inclusion of apparent authority as a possible

75 The same committee sponsored the meeting that generated multiple interpretations of Delaware’s statute in 2006. See Frost at 11.

76 Single-member LLCs “once suspect because novel ..., are now popular both for sole proprietorships and as corporate subsidiaries.” RULLCA, Prefatory Note at 1.

77 Id. item 5.1 (iii).

78 Id. at 780 n. 15, citing Restatement (Third) of Agency § 2.03.
basis on which an LLC may be bound by an unauthorized act may represent an informed professional consensus inclined to reject an interpretation of statutory language disconnected on this issue from the common law.

5. CONCLUSION

External agency is essential to the capacity of any business entity to engage in business dealings with other entities and with individuals. Perhaps the relatively settled nature of common-law agency makes it all the more surprising that the most basic agency question of all— the power to bind a firm—has been so muddled over the history of LLC statutes and is treated ambiguously in the Delaware LLC statute. This Chapter demonstrates that the muddle is avoidable. RULLCA achieves clarity by jettisoning the partnership-derived concept of positional powers and by affirmatively embracing the common law to resolve agency questions. Separately, a statute might retain powers of position for LLC members and managers but also specify—as do partnership statutes—the circumstances under which an unauthorized act would bind the LLC, while also specifying that restrictions on authority contained in operating agreements do not affect the legal position of a third party who lacks knowledge or notice of the restrictions.
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