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THE COURTHOUSE PERSONNEL DEPARTMENT

FAILURE TO FOLLOW LLC OPERATING AGREEMENT

EXCUSES MEMBER-KEY EMPLOYEE FIDUCIARY DUTIES

In the early to mid-1990s, Stephen Doherty ("Doherty") wrote a software program called "Viper" for Lester Szlendak ("Szlendak"). Subsequently, Peter Katris ("Katris") and William Hamburg ("Hamburg"), both Ernst & Company ("Ernst") employees, expressed interest in Viper, and on February 14, 1997, they joined Szlendak and Doherty in forming Viper Execution Systems, L.L.C. (the "LLC") to exploit the capabilities of the software. On that date, they filed the LLC's articles of organization with the Illinois Secretary of State. In it, they indicated that management of the LLC was vested in its managers, Katris and Hamburg, and not retained by its members.

Pursuant to the LLC's operating agreement, signed by the four members, each member held a 25% interest and, as a condition of the operating agreement, Szlendak and Doherty assigned their rights to Viper to the LLC. The operating agreement provided that the "business and affairs of the [LLC] shall be managed by its [m]anagers" and that the members agreed to elect Katris and Hamburg as the "sole [m]anagers" of the LLC. The operating agreement also enumerated the powers of the managers and set forth the rights and obligations of the members. However, none of the provisions setting forth the rights and obligations of the members provided the members with any managerial authority. Pursuant to its terms, the operating agreement could "not be amended except by the affirmative vote of [m]embers holding a majority of the [p]articipating [p]ercentages."

Also on February 14, 1997, Katris and Hamburg, as managers of the LLC, prepared a written consent adopting certain resolutions in lieu of holding an initial meeting of the managers. They resolved, inter alia, to adopt the operating agreement as the operating agreement of the LLC and to elect the following: Hamburg as chief executive officer, Katris as chief financial officer, Szlendak as director of marketing, and Doherty as director of technical services. The written consent contained signature lines for Hamburg and Katris, who were identified as "all of the [m]anagers" of the LLC.

At the time of the LLC's formation, Doherty worked as an independent contractor for Patrick Carroll ("Carroll"), also an Ernst employee; however, in late 1997, Ernst hired Doherty to work for Carroll.

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As part of his duties for Carroll, Doherty worked with a programmer hired by Ernst to adapt a software program called "Worldwide Options Web (WWOW)."

Katris initiated an action on January 16, 2002, and ultimately asserted a breach of fiduciary duty claim against Doherty and a claim for collusion against Doherty, Carroll and Ernst. He alleged that WWOW was functionally similar to Viper and contended that Doherty usurped a corporate opportunity of the LLC by working in secret with Carroll and the programmer hired by Ernst to develop competing software for Ernst. He further contended that Carroll and Ernst colluded with Doherty in the breach of Doherty's fiduciary duties to the LLC.

Doherty subsequently settled with Katris, providing Katris with an affidavit setting forth his involvement in the case in exchange for his dismissal. As a result of Doherty's dismissal from the case, only Katris' claim for collusion against Carroll and Ernst remained.

Carroll and Ernst asserted that Katris' collusion claim failed because Doherty, as a nonmanager member of the manager-managed LLC, did not owe Katris or the LLC a fiduciary duty under section 15-3(g) of the Illinois Limited Liability Company Act (the "Act"), and thus they could not collude with Doherty to breach a fiduciary duty under that section.

In response, Katris asserted the February 14, 1997, written consent constituted an amendment to the operating agreement and that, pursuant to the terms of that amendment, Doherty was named "Director of Technology" and "given the sole management responsibility for developing, writing, revising and implementing the Viper software." According to Katris' affidavit, Doherty "was in charge of adapting the software to route options orders, in addition to stock orders," and the "LLC relied on him totally to develop the Viper software." Katris contended that pursuant to section 15-3(g)(3) of the Act, Doherty was subject to the standards of conduct imposed upon managers under the Act and breached those duties by usurping a corporate opportunity belonging to the LLC.

Katris acknowledged that the LLC was manager-managed and that, pursuant to the Act, a member of a manager-managed LLC "who is not also a manager owes no duties to the company or to the other members solely by reason of being a member." Katris thus conceded that Doherty did not owe any fiduciary duties solely by reason of being a member of the LLC. Katris contended, however, that Doherty owed fiduciary duties to the LLC pursuant to section 15-3(g)(3) of the Act, which provides as follows:

> [A] member who pursuant to the operating agreement exercises some or all of the authority of a manager in the management and conduct of the company's business is held to the standards of conduct in subsections (b), (c), (d), and (e) of this Section to the extent that the member exercises the managerial authority vested in a manager by this Act[.]

Katris contended that Doherty exercised some of the authority of a manager in his capacity as director of technology for the LLC and thus fell within the ambit of this section. Carroll and Ernst disagreed, contending that pursuant to the plain terms of the statute, Doherty was only subject to fiduciary duties if he exercised managerial authority pursuant to the operating agreement. They maintained that Doherty did not have any such managerial authority under the operating agreement.

The Appellate Court agreed with Carroll and Ernst. To reach this conclusion, the Court looked at the plain language of the Act. Doherty was subject to fiduciary duties if he exercised some or all of the authority of a manager pursuant to the LLC's operating agreement. The Act provides for the creation of an

operating agreement, stating that "[a]ll members of a limited liability company may enter into an operating agreement to regulate the affairs of the company and the conduct of its business and to govern relations among the members, managers, and company." The four members of the LLC entered into such an operating agreement on February 14, 1997.

The operating agreement specifically provided that the business and affairs of the LLC "shall be managed by its [m]anagers," provided for the election of Katris and Hamburg as the "sole [m]anagers" of the LLC, and set forth the powers of the managers of the LLC. Although the operating agreement also set forth the rights and obligations of the members, these provisions did not provide for any managerial authority. Accordingly, Doherty did not exercise any managerial authority pursuant to the LLC's operating agreement.

Katris contended, however, that the managers amended the operating agreement by passing the February 14, 1997, written consent wherein they elected Doherty "Director of Technology." Katris asserted that Doherty's designation as "Director of Technology" elevated him to a position beyond that of a mere member of the LLC and was sufficient to impart on him some managerial authority. The Court rejected this argument for two reasons.

First, Katris provided no authority for his contention that the written consent constituted an amendment to the operating agreement. Pursuant to its own terms, an amendment to the operating agreement required the "affirmative vote of [m]embers holding a majority of the [p]articipating [p]ercentages." Katris and Hamburg were the sole participants to the February 14, 1997, written consent and held only a combined 50% interest in the LLC. Thus, they could not amend the operating agreement without a majority vote. Accordingly, the facts did not support Katris' contention that the written consent constituted an amendment to the operating agreement.

Second, even if the written consent were to be considered as an amendment of the operating agreement, it did not change and, indeed, it reaffirmed the terms of the operating agreement. Katris and Hamburg executed the written consent in their capacities as the managers of the LLC. In the consent, they specifically resolved to adopt the operating agreement the four members had executed that day as the operating agreement of the LLC. In the signature lines to the written consent, Katris and Hamburg designated themselves as "all of the [m]anagers" of the LLC. Based on these facts, something more than the managers' designation of Doherty as "Director of Technology" was required to change the terms of the operating agreement and grant Doherty managerial authority pursuant to it.

The undisputed facts of this case evidenced that Doherty was a member of a manager-managed LLC and exercised no managerial authority pursuant to the LLC's operating agreement. Because Katris and Hamburg failed to follow the provisions of the LLC operating agreement and the Act, their claim failed.

This decision has been widely criticized as being erroneous, on the basis that all Illinois employees owe fiduciary duties to their employers. Until this decision is overruled or distinguished, the take-away from this case is that all Illinois LLC employers should strictly follow their operating agreements if they want the benefit of the Act and all employees of an Illinois LLC should not think that they do not have fiduciary obligations to their Illinois LLC employer because they are not managers or members of the LLC.

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