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## Resolving LLC Member Disputes in North Carolina

James R. Burkhard

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## Resolving LLC Member Disputes in North Carolina

JAMES R. BURKHARD\*

### ABSTRACT

*North Carolina has a new LLC act. If LLC members assert that the managers or controlling members have in some manner breached fiduciary or contractual duties owed to the complaining members or to the LLC, how will lawyers handle such claims? This Article first considers the circumstances in which North Carolina LLC managers and members may owe fiduciary duties to other members. Assuming that there is a duty that may have been breached, what are the limits on a member bringing a direct suit either on her own behalf or on behalf of the LLC? Since direct suits will now be prohibited in many cases, the plaintiff must likely resort to bringing a derivative claim. The problems with these suits under the new law are considered in some detail. Lastly, the Article provides drafting suggestions to protect LLC members, as well as alternative methods to resolve disputes among LLC members and managers.*

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INTRODUCTION

North Carolina has a new LLC act.<sup>1</sup> The act includes significant changes to the state’s former LLC structure.<sup>2</sup> For instance, the new act provides a framework to allow for the elimination of fiduciary duties, and it allows LLC members to agree on alternative dispute remedies for resolving internal disputes.<sup>3</sup> While the act might benefit limited-liability companies in many ways, it also raises many questions. For instance, if LLC members assert that the managers, or those in control, have in some manner breached fiduciary or contractual duties owed to the complaining members or to the LLC, how will lawyers handle such claims?

This Article first notes that it may be difficult for an LLC member to demonstrate that she is owed a fiduciary duty, and even if this can be demonstrated, she may be required to pursue her claim through a derivative lawsuit. This Article considers the new derivative procedures, with a particular focus on problems that may come up in pursuing derivative claims. The Article concludes by suggesting ways to avoid these problems.

I. DO LLC MANAGERS OWE FIDUCIARY DUTIES?

There are already thousands of reported cases across the country involving disputes among members and managers of LLCs. A large number of those cases raise breach-of-fiduciary-duty claims.<sup>4</sup> Managers have been sued for breaching their duty of care,<sup>5</sup> and for various breaches of the duty of loyalty, such as self-dealing.<sup>6</sup> Assertions of “wantonness” and other claims have been made.<sup>7</sup> A common question in these disputes is

1. N.C. GEN. STAT. §§ 57D-1-01 to -11-03 (amended 2014).  
 2. *Id.* §§ 57C-1-01 to -10-07 (repealed 2013).  
 3. *See id.* §§ 57D-2-30(b)(6), (e) (amended 2014).  
 4. *See* 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES §§ 9:1 to :8, at 517–85, §§ 10:1 to :4, at 639–77 (2d ed. 2015) (listing myriad reported cases involving disputes among members and managers).  
 5. *See id.* § 9:2, at 525–31 (citing numerous cases in the notes to the section).  
 6. *See id.* § 9:3, at 531–39 (citing numerous cases in the notes to the section).  
 7. *See, e.g.,* Polk v. Polk, 70 So. 3d 363, 374 (Ala. Civ. App. 2010) (citing *Jordan v. Holt*, 608 S.E.2d 129, 131–32 (S.C. 2005)).

whether a duty is owed to the LLC, to the members, or to both.<sup>8</sup> Similar disputes have popped up in North Carolina, and it is likely that even more of these arguments will arise as more LLCs are formed in the state.

#### A. *Fiduciary Duties Created by Status*

Unlike in many states,<sup>9</sup> neither members nor managers of LLCs in North Carolina owe fiduciary duties to each other based on their status alone. Members, like shareholders, owe no fiduciary duties to one another.<sup>10</sup> Managers, like directors, also owe no fiduciary duties to the individual members.<sup>11</sup>

Other states with similar statutes have likewise concluded that since their statute mandates only manager duties to the LLC, it intentionally negates any duties to the members.<sup>12</sup> Although the wording of the North

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8. See RIBSTEIN & KEATINGE, *supra* note 4, § 10:4, at 666–69.

9. In 2013, the Delaware legislature adopted an amendment to section 18-1104 of the Delaware Code “to confirm that in some circumstances fiduciary duties not explicitly provided for in the limited liability company agreement apply. For example, a manager of a manager-managed limited liability company would ordinarily have fiduciary duties even in the absence of a provision in the limited liability company agreement establishing such duties.” H.B. 126, 147th Gen. Assemb., Reg. Sess. (Del. 2013); see also 2 F. HODGE O’NEAL & ROBERT B. THOMPSON, O’NEAL AND THOMPSON’S OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 6:18, at 6-40 (rev. 2d ed. 2014) [hereinafter O’NEAL & THOMPSON, OPPRESSION] (“Newer LLC statutes state unequivocally that members of a LLC owe each other fiduciary duties of care and loyalty. Where statutes are silent or incomplete, most courts have held duties owed to members as well as the entity.” (citations omitted)); RIBSTEIN & KEATINGE, *supra* note 4, §§ 9:1 to :8, at 517–85, §§ 10:1 to :4, at 639–77.

10. *Kaplan v. O.K. Techs., L.L.C.*, 675 S.E.2d 133, 137 (N.C. Ct. App. 2009) (citing *Freese v. Smith*, 428 S.E.2d 841, 847 (N.C. Ct. App. 1993)); see also *Selvidio v. Gillespie (In re Gillespie)*, Ch. 11 Case No. 10-30942, Adv. No. 10-3187, 2012 Bankr. LEXIS 1261, at \*11–13 (Bankr. W.D.N.C. Mar. 26, 2012) (applying *Kaplan* to reject a direct claim brought by a member against the key managing member). *But see Norman v. Nash Johnson & Sons’ Farms, Inc.*, 537 S.E.2d 248, 260 (N.C. Ct. App. 2000) (“[O]ur cases have consistently held that majority shareholders in a close corporation owe a ‘special duty’ and obligation of good faith to minority shareholders.”).

11. *Kaplan*, 675 S.E.2d at 137 (citing, as authority, a number of corporation cases, including *Governors Club, Inc. v. Governors Club Ltd. P’ship*, 567 S.E.2d 781, 786–87 (N.C. Ct. App. 2002)); see also *Lake House Acad. for Girls LLC v. Jennings*, No. 11 CVS 1666, 2011 NCBC LEXIS 41, at \*21–24 (N.C. Super. Ct. Oct. 13, 2011) (discussing the *Kaplan* principles and noting that a member–manager might not be able to limit her fiduciary duties by resigning as a manager, since the LLC agreement stated that all members were automatically managers, and defendant retained her membership interest).

12. See, e.g., *Price v. Smith*, 842 F. Supp. 2d 1111, 1115 (E.D. Wis. 2012); *Dawson v. Delisle*, No. 283195, 2009 Mich. App. LEXIS 1553, at \*9–11 (Mich. Ct. App. July 21, 2009); *Remora Invs., L.L.C. v. Orr*, 673 S.E.2d 845, 847 (Va. 2009); *WAKA, LLC v.*

Carolina statute has been slightly changed in the new 2013 act, it is clear that no substantive change is intended; the drafters continue to assume that any fiduciary duties created by being in charge of the LLC are owed only to the entity.<sup>13</sup> This is likely further confirmed by new section 57D-2-32, which implies that if fiduciary or contractual duties are not set forth in the operating agreement, they do not exist.<sup>14</sup> However, could a plaintiff convince a court “that despite the comprehensive nature of the LLC Act, LLC members retain the ability to sue for damages based on common law claims such as repudiation or breach of contract and breach of fiduciary duty”?<sup>15</sup>

It is also important to remember that historically, applying the internal-affairs doctrine, the law of the jurisdiction where the LLC is formed will determine whether a duty exists and whether that duty was breached.<sup>16</sup> However, one of the 2013 changes to the North Carolina LLC

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Humphrey, No. 2006-14305, 2007 Va. Cir. LEXIS 96, at \*7-10 (Va. Cir. Ct. May 2, 2007); *cf.* *Rivers v. Wachovia Corp.*, 665 F.3d 610, 617 (4th Cir. 2011) (noting that with respect to the parallel North Carolina corporate statute, the legislature intentionally deleted the word “shareholders” to negate any inference that there is a duty running from directors to shareholders; however, there was never a similar modification of the LLC statute); *Halebian v. Berv*, 931 N.E.2d 986, 992 (Mass. 2010) (“However, the maxim of negative implication—that the express inclusion of one thing implies the exclusion of another—‘requires great caution in its application.’” (citing 2A NORMAN J. SINGER & J.D. SHAMBIE SINGER, *SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION* § 47:25, at 429 (7th ed. 2007))). *Contra* *Internal Med. All., LLC v. Budell*, 659 S.E.2d 668, 673-74 (Ga. Ct. App. 2008) (finding that managing members owe duties to members, even though the statute only mentions duties to the LLC); *T-WOL Acquisition Co. v. ECDG S., LLC*, 725 S.E.2d 605, 617 (N.C. Ct. App. 2012) (“However, directors and officers of a corporation owe a fiduciary duty to the corporation and the shareholders.” (citing *Meiselman v. Meiselman*, 295 S.E.2d 249, 259 (N.C. Ct. App. 1982), *modified and aff’d*, 307 S.E.2d 551 (N.C. 1983))).

13. N.C. GEN. STAT. §§ 57D-3-21(b)-(c) (amended 2014).

14. *Id.* § 57D-2-32 (stating that the primary purpose of this new section is to permit the creation of remedies that might not otherwise be enforceable).

15. *OLP, L.L.C. v. Burningham*, 225 P.3d 177, 181 (Utah 2009). In addition to determining that Utah’s LLC act did not preempt the member’s common-law rights, the Utah Supreme Court also stated that the member in that case was not required to pursue his claims pursuant to the LLC act dissolution procedures, and that the member’s remedies were not limited by the provisions of the LLC act. *Id.* at 181-82; *cf.* *Willard v. Moneta Bldg. Supply, Inc.*, 515 S.E.2d 277, 284 (Va. 1999) (stating that the LLC statute, which provides that directors shall act in the best interest of the corporation, “does not abrogate the common law duties of a director”).

16. *See, e.g., Hamby v. Profile Prods., L.L.C.*, 652 S.E.2d 231, 235 (N.C. 2007) (citing former section 57C-7-01 of the North Carolina General Statutes, which provided that the liability of an LLC’s members or managers is governed by the laws of the state of formation).

statute conceivably could bring that into question.<sup>17</sup>

### B. *Fiduciary Duties Created in “Fact”*

The North Carolina Supreme Court has defined a fiduciary relationship as one in which “there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence.”<sup>18</sup> Such a duty “extends to any possible case in which a fiduciary relationship exists in fact, and in which there is confidence reposed on one side, and *resulting domination and influence on the other*.”<sup>19</sup> This is consistent with similar statements found in other jurisdictions.<sup>20</sup>

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17. *Nelson v. All. Hosp. Mgmt., LLC*, No. 11 CVS 3217, 2013 NCBC LEXIS 39, at \*26 (N.C. Super. Ct. Aug. 20, 2013) (relying on language in former section 57C-7-01 of the North Carolina General Statutes to conclude that the law of the state of formation controls), *appeal dismissed*, 761 S.E.2d 755 (N.C. Ct. App. 2014). The section of the General Statutes on which Nelson relied has since been repealed. See Act of June 19, 2013, ch. 157, sec. 1, 2013 N.C. Sess. Laws 387, 387 (repealing chapter 57C of the North Carolina General Statutes). New section 57D-7-05(c) of the North Carolina General Statutes, effective as of January 1, 2014, retains language that a foreign LLC “has the same but no greater rights and has the same but no greater privileges as, and is subject to the same duties, restrictions, penalties, and liabilities now or later imposed on [a North Carolina] LLC of like character.” N.C. GEN. STAT. § 57D-7-05(c). Does this language, coupled with the repeal of the language that one might look to the state of formation to determine the liabilities of a manager, suggest that courts should now apply the principle that “[f]or actions sounding in tort, the state where the injury occurred is considered the situs of the claim”? *Nelson*, 2013 NCBC LEXIS 39, at \*25 (alteration in original) (quoting *Boudreau v. Baughman*, 368 S.E.2d 849, 854 (N.C. 1988)); cf. *Associated Packaging, Inc. v. Jackson Paper Mfg. Co.*, No. 10 CVS 745, 2012 NCBC LEXIS 13, at \*10–24 (N.C. Super. Ct. Mar. 1, 2012) (stating that the choice-of-law provision in an LLC operating agreement did not govern the alleged tort and securities violations—both claims were controlled by the *lex loci* doctrine, with the court providing extensive analysis as to how to determine the situs of each of the two claims).

18. *Dalton v. Camp*, 548 S.E.2d 704, 707 (N.C. 2001) (quoting *Abbitt v. Gregory*, 160 S.E. 896, 906 (N.C. 1931)).

19. *Id.* at 707–08 (quoting *Abbitt*, 160 S.E. at 906).

20. See, e.g., *Berman v. Sugo LLC*, 580 F. Supp. 2d 191, 204 (S.D.N.Y. 2008) (noting that in order to determine if a fiduciary relationship exists, “New York courts typically focus on whether one person has reposed trust or confidence in another who thereby gains a resulting superiority or influence over the first”); *Tully v. McLean*, 948 N.E.2d 714, 739–40 (Ill. App. Ct. 2011) (“A fiduciary relationship exists where, by reason of friendship, agency, or business association and experience, trust and confidence are reposed by one party in another and the latter party gains an influence and superiority over the first as a result. . . . The essence of a fiduciary relationship is that one party is dominated by another; the presence of a significant degree of dominance and superiority.” (first citing *Maercker Point Villas Condo. Ass’n v. Szymski*, 655 N.E.2d 1192, 1194 (1995); then citing *Lagen v. Balcor Co.*, 653 N.E.2d 968, 975 (1995))); cf. *McKee v. James*, No. 09 CVS 3031, 2013

One court noted this in the LLC context,<sup>21</sup> but also stated that “[o]nly when one party figuratively holds all the cards—all the financial power or technical information, for example—have North Carolina courts found that the special circumstance of a fiduciary relationship has arisen.”<sup>22</sup>

The operating agreement could obviously impose fiduciary duties on the managers to the members.<sup>23</sup> A party may also create a “special duty” to an LLC member that the member can enforce by behavior<sup>24</sup> or by contract.<sup>25</sup>

Although the drafters of the new LLC act have attempted to limit the imposition of non-bargained-for fiduciary duties, given that most LLCs are closely held,<sup>26</sup> it will not be surprising if North Carolina courts find that the relationships among those in these entities, often operating similar to a partnership, mandate the finding of fiduciary duties among the managers and members.<sup>27</sup> Likewise, the courts may ultimately conclude that, similar

NCBC LEXIS 33, at \*20–21 (N.C. Super. Ct. July 24, 2013) (stating that the plaintiff could not show a long-standing, personal relationship that might create a fiduciary duty, but finding that the plaintiff sufficiently pleaded a special duty from majority shareholder to minority shareholder to allow the claim of breach of fiduciary duty to withstand dismissal); *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 177 (Tex. 1997) (holding that, at least in Texas, in order to impose an informal fiduciary duty in a business transaction, the special relationship of trust and confidence must exist “prior to, and apart from, the agreement made the basis of the suit” (citing *Transp. Ins. Co. v. Faircloth*, 898 S.W.2d 269, 280 (Tex. 1995))).

21. *Morris v. Hennon & Brown Props., LLC*, No. 1:07CV780, 2008 U.S. Dist. LEXIS 55963, at \*11–12 (M.D.N.C. July 3, 2008) (quoting *S.N.R. Mgmt. Corp. v. Danube Partners 141, LLC*, 659 S.E.2d 442, 451 (N.C. Ct. App. 2008)).

22. *Id.* at \*12 (quoting *Broussard v. Meineke Disc. Muffler Shops, Inc.*, 155 F.3d 331, 348 (4th Cir. 1998)).

23. *See, e.g., Strebel v. Wimberly*, 371 S.W.3d 267, 277 (Tex. App. 2012) (noting that where fiduciary duties are contractually owed to the “members” (plural), this should not be interpreted to mean that the duties run only collectively rather than individually).

24. *See BOGNC, LLC v. Cornelius NC Self-Storage, LLC*, Nos. 10 CVS 19072, 10 CVS 12371, 11 CVS 21122, 2013 NCBC LEXIS 22, at \*1 (N.C. Super. Ct. May 1, 2013) (noting that a member’s assertion of fraud against his co-manager survived a motion for summary judgment because factual questions existed as to whether the co-manager had a duty to disclose and whether statements were affirmative misrepresentations).

25. *Dawson v. Atlanta Design Assocs., Inc.*, 551 S.E.2d 877, 880 (N.C. Ct. App. 2001) (stating that the defendant entered into a contract specifically with a member of the LLC to design the LLC’s facility and thus owed a “special duty” directly to the plaintiff—one of four members of the LLC).

26. *See* 2 CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES ¶ 10.09[1], at 10-54 to -58 (2006) (explaining that federal taxation issues and illiquidity make LLCs attractive to small groups of owners rather than large groups).

27. In *Kaplan*, the court was willing to consider whether to apply partnership principles, but found that such principles should not apply in that case because the operating

to duties owed by majority shareholders,<sup>28</sup> majority LLC members owe fiduciary duties to the minority members.<sup>29</sup> The corporate opinions have been consistent in stating that even if the defendant is able to exercise

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agreement had explicitly negated any duties. *Kaplan v. O.K. Techs., L.L.C.*, 675 S.E.2d 133, 140 (N.C. Ct. App. 2009). However, the court also stated that even if a duty had been breached, the liability would only extend to the LLC and not to the members. *See id.*; *cf.* *Meiselman v. Meiselman*, 307 S.E.2d 551, 557–58 (N.C. 1983) (recognizing that the relationship of those in a close corporation should be treated the same as a relationship between partners); *LeCann v. Cobham*, No. 10 CVS 11169, 2011 NCBC LEXIS 28, at \*13–14 (N.C. Super. Ct. Aug. 2, 2011).

Prior to trial, the *LeCann* court observed “that the parties, as fifty percent shareholders in the Entities, acted more as partners than shareholders.” *Id.* Further, “[g]iven the nature of the professional relationship between the parties, the organization of the Entities and the fact that both parties contend they owed the other a fiduciary duty of care,” the court concluded “that there exist[ed] one or more genuine issues of material fact as to whether Defendant Cobham owed Plaintiff a special duty under the first exception to the *Barger* rule.” *Id.* Accordingly, the court denied the defendant’s motion to dismiss. *See id.* However, after hearing the case, the court determined that the plaintiff had failed to bring her individual claims within either of the two exceptions to the *Barger* rule discussed *infra* notes 58–66 and accompanying text. *See LeCann v. Cobham*, No. 10 CVS 11169, 2012 NCBC LEXIS 58, at \*26–28 (N.C. Super. Ct. Nov. 7, 2012); *see also* BISHOP & KLEINBERGER, *supra* note 26, ¶ 10.09[3][b], at 10-65 to -70 (discussing cases and supporting policies that have recognized (in some circumstances) that managers and members owe fiduciary duties, often based on comparison to partnership and close-corporation principles).

28. *See Farndale Co. v. Gibellini*, 628 S.E.2d 15, 19–21 (N.C. Ct. App. 2006) (“In North Carolina, it is well established that a controlling shareholder owes a fiduciary duty to minority shareholders.” (quoting *Freese v. Smith*, 428 S.E.2d 841, 847 (N.C. Ct. App. 1993))); *Oakeson v. TBM Consulting Grp., Inc.*, No. 08 CVS 3884, 2009 NCBC LEXIS 34, at \*17–20 (N.C. Super. Ct. Aug. 21, 2009) (applying North Carolina law and noting that since 1908, courts have applied the principle that majority shareholders owe fiduciary duties to minority shareholders that will be enforced by the courts).

29. *Bolier & Co. v. Decca Furniture (USA) Inc.*, No. 5:12-cv-00160-RLV-DSC, 2013 U.S. Dist. LEXIS 26791, at \*3 (W.D.N.C. Feb. 27, 2013) (stating that a majority LLC member owes fiduciary duties to both the LLC and the minority members, and may not deprive them of their “reasonable expectations” in the LLC); *Morris v. Hennon & Brown Props., LLC*, No. 1:07CV780, 2008 U.S. Dist. LEXIS 55963, at \*14–16 (M.D.N.C. July 3, 2008) (citing *Aubin v. Susi*, 560 S.E.2d 875, 879 (N.C. Ct. App. 2002) (observing that minority shareholders in a close corporation may bring a direct action when wrongdoers are controlling directors or shareholders who have converted, appropriated, or wasted corporate assets, so that corporate recovery would not protect minority shareholders, and stating that this principle should be applied in the LLC context)); *cf.* *Allentown Ambassadors, Inc. v. Ne. Am. Baseball, LLC* (*In re Allentown Ambassadors, Inc.*), 361 B.R. 422, 462 (Bankr. E.D. Pa. 2007) (concluding that although an LLC manager does not owe a fiduciary duty to the members simply by his position as manager, “[s]ince the majority members of an LLC have a duty to its minority members and Defendant Wolff’s authority as manager . . . is derived entirely from the exercise of powers delegated by the [majority] ‘member-managers’ of the LLC, it follows . . . that Defendant . . . owed a duty to the LLC’s individual members.” (citation omitted)).

control of the closely held corporation, no fiduciary duties will be imposed if the plaintiff actually owns 50% of the stock.<sup>30</sup>

One North Carolina Business Court judge noted that a minority shareholder should not be presumed to have the right to directly sue a controlling majority shareholder in a dispute regarding what best serves the corporation “because of the freedom of contract granted to LLC members to obtain minority protections not available to shareholders of the closely-held corporation and because the procedural hurdles which might defeat a derivative claim on behalf of a closely-held corporation might not defeat a derivative claim on behalf of the LLC.”<sup>31</sup> The court went on to note that an LLC member does not face the corporate procedural hurdle of the inflexible pre-litigation demand requirement, and thus, forcing the LLC member to utilize a derivative suit is justified.<sup>32</sup> However, pursuant to the 2013 act, the procedural rules for both LLC and corporate derivative actions are essentially the same today.<sup>33</sup> The Supreme Court of North Carolina’s warning that the minority owner often does not negotiate for protections either because of a lack of awareness of the risks, weakness of bargaining position, assumption that disagreements will not arise, or total inability to negotiate for protections, such as when memberships are obtained through inheritance or by gift, is as applicable to the LLC member as it is to a closely held shareholder.<sup>34</sup>

North Carolina courts have applied rigorous tests to determine if a defendant “holds all the cards.” In *Kaplan*, the fact that the alleged wrongdoer provided all of the financing for the LLC was not sufficient to establish a fiduciary duty.<sup>35</sup> In a business court decision, the judge

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30. *Maurer v. Maurer*, No. 13 CVS 4421, 2013 NCBC LEXIS 41, at \*11–12 (N.C. Super. Ct. Aug. 23, 2013) (citing a number of opinions where the 50% ownership eliminated the plaintiff’s claim that she was owed a special duty that would give her standing to bring a direct suit).

31. *Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 17, at \*13–14 (N.C. Super. Ct. Apr. 8, 2013). The court concluded that the LLC member’s individual claims could be resolved derivatively, but that he still retained the right “to pursue his *Meiselman* claims individually.” *Id.* at \*18; *see also* *Island Beyond, LLC v. Prime Capital Grp., LLC*, No. 12 CVS 7351, 2013 NCBC LEXIS 48, at \*15 (N.C. Super. Ct. Oct. 30, 2013) (noting that precedents allowing individual corporate shareholders to pursue actions do not necessarily apply to LLC members since members, but not shareholders, can alter the statutory default rules).

32. *Blythe*, 2013 NCBC LEXIS 17, at \*16.

33. *Compare* N.C. GEN. STAT. § 57D-8-01(a)(2) (amended 2014), *with id.* §§ 55-7-40 to -42.

34. *See Meiselman v. Meiselman*, 307 S.E.2d 551, 558–59 (N.C. 1983).

35. *Kaplan v. O.K. Techs., L.L.C.*, 675 S.E.2d 133, 139 (N.C. Ct. App. 2009) (noting that the complaining members were experienced businessmen who had accepted the funding

acknowledged that a single majority member might owe fiduciary duties to a minority member, but was unwilling to combine the two defendants' ownership shares (16% and 50%) to find that collectively, they would owe a fiduciary duty to the plaintiffs.<sup>36</sup> Similarly, in another case, the business court was unwilling to find a fiduciary duty where the defendant did not own a majority of the "shares," even though the plaintiff asserted that the defendant exercised control over a majority of the LLC's "shares" and was able to squeeze the plaintiff out of the LLC's management.<sup>37</sup> Another recent opinion stated that "it does not automatically follow that a manager is accountable to an LLC's members for management decisions solely because he holds a majority interest."<sup>38</sup>

In comparison, a North Carolina Business Court judge recently resolved a dispute among LLC members by reiterating that, in some cases, a group of minority shareholders in a closely held corporation "may be considered a majority . . . and that when their power of control is abused in those instances, a minority shareholder may need to be allowed to pursue claims individually despite the general rule that claims for harm to the corporation must be brought derivatively."<sup>39</sup>

An admission by a manager that he owed fiduciary duties to the members was ignored in one opinion as an incorrect legal conclusion.<sup>40</sup> Nonetheless, the argument can be made that this is what most managers probably believe, and thus, the courts might recognize this as reality.

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provided by Kaplan, owned controlling memberships, exercised their control, and had asserted that they controlled Kaplan).

36. *BOGNC, LLC v. Cornelius NC Self-Storage, LLC*, Nos. 10 CVS 19072, 10 CVS 12371, 11 CVS 21122, 2013 NCBC LEXIS 22, at \*1 (N.C. Super. Ct. May 1, 2013) (stating that "neither own[ed] a majority interest").

37. *Yates v. Brown*, No. 11 CVS 14997, 2012 NCBC LEXIS 22, at \*7–8 (N.C. Super. Ct. Apr. 13, 2012); *see also Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 7, at \*33–35 (N.C. Super. Ct. Feb. 4, 2013). In *Blythe*, the court found that no de facto control existed where the defendant controlled a 30% member who, in turn, had control over the LLC's accounting. *See id.* The court found that the plaintiff was a sophisticated business person who was an LLC manager and had access to the LLC's financial information, and thus was not owed a fiduciary duty. *Id.*

38. *Island Beyond, LLC v. Prime Capital Grp., LLC*, No. 12 CVS 7351, 2013 NCBC LEXIS 48, at \*15–16 (N.C. Super. Ct. Oct. 30, 2013) (noting that the member's claim for relief was not different from that which might be recoverable by the LLC in its derivative action).

39. *Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 17, at \*13–14 (N.C. Super. Ct. Apr. 8, 2013).

40. *BOGNC*, 2013 NCBC LEXIS 22, at \*1 n.2.

This “reality” was confirmed in *RSN Properties, Inc. v. Jones*.<sup>41</sup> *RSN Properties* involved a dispute among four members of an LLC, with two members on each side of the dispute.<sup>42</sup> The court noted that one side admitted that each member owed fiduciary duties to the other members.<sup>43</sup> The parties agreed that their duties ran to each other, not just to the LLC. One member also admitted that “a confidential relationship existed with fiduciary duties owed to one another.”<sup>44</sup>

Although a plaintiff may have real problems in convincing a court that an LLC manager (or controlling member) owes a fiduciary duty to one or more of the LLC members, a few of the cases noted in this Part provide some hope to a complaining member.

## II. MAY A MEMBER SUE ON BEHALF OF THE LLC FOR AN INJURY TO THE LLC?

What if a member of a five-member LLC misappropriates LLC funds? How should this dispute be resolved?<sup>45</sup>

Most likely, in North Carolina, even if there are only a few members in the LLC, courts will refuse to allow one member to pursue an action on behalf of the LLC against a manager (or against another party running the LLC). The North Carolina courts, based in part on former section

41. *RSN Props., Inc. v. Jones*, No. COA04-100, 2005 N.C. App. LEXIS 457, at \*8–10 (N.C. Ct. App. Mar. 1, 2005).

42. *Id.* at \*2–5. One “side” actually owned their membership through a corporation, but the opinion continually refers to the actual owners of this corporation in discussing the fiduciary duties that might have been owed. *Id.*

43. *Id.* at \*9 (“[E]ach [member] owed fiduciary duties to the other [members] to act with the utmost good faith in all matters and things affecting River Run [(the LLC)] and its management and operations, which included the duty to disclose all material facts relating to expenditures made by River Run and the assets of River Run.”).

44. *Id.* at \*18. However, in a more recent case, one 50% shareholder (and president) admitted in her answer that she owed fiduciary duties to the other 50% shareholder, but the court concluded that the plaintiff had not shown that the defendant owed her a special duty or that her injuries were separate from that of the corporation, and thus denied her individual claims. See *LeCann v. Cobham*, No. 10 CVS 11169, 2012 NCBC LEXIS 58, at \*27–28 (N.C. Super. Ct. Nov. 7, 2012); *LeCann v. Cobham*, No. 10 CVS 11169, 2011 NCBC LEXIS 28, at \*13–14 (N.C. Super. Ct. Aug. 2, 2011).

45. Unless somehow modified by the operating agreement, such behavior would be a violation of section 57D-3-21(b) of the North Carolina General Statutes. N.C. GEN. STAT. § 57D-3-21(b) (amended 2014). Note that the former LLC statute had additional provisions that arguably imposed more duties on the members and managers. For a discussion of these now-repealed provisions, see *Mooring Capital Fund, LLC v. Comstock N.C., LLC*, No. 07 CVS 20852, 2009 NCBC LEXIS 32, at \*10–15 (N.C. Super. Ct. Nov. 13, 2009).

57C-3-23 of the North Carolina General Statutes,<sup>46</sup> have routinely stated that one member cannot bring an action on behalf of the LLC unless a majority of the members (or the number required by the LLC's operating agreement) approve the filing of the lawsuit.<sup>47</sup> In the typical dispute, the defendants likely will own a majority of the interests and would obviously not agree to sue themselves. But if the persons whom the plaintiff member wants the LLC to sue are the managers or co-members, it makes sense to disregard their votes in determining whose vote should be required to bring the suit.<sup>48</sup>

Courts have now consistently stated, in response to a plaintiff member's claim that she has the right, based on inherent agency principles, to cause the LLC to sue another member,<sup>49</sup> that "filing a lawsuit is a management decision not related to the company's usual course of business."<sup>50</sup> Therefore, the vote of those members or managers required by

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46. N.C. GEN. STAT. § 57C-3-23 (repealed 2013) ("An act of a manager that is not apparently for carrying on the usual course of the business of the limited liability company does not bind the [LLC] unless authorized in fact or ratified by the [LLC]."). The purpose of that section was to determine when a third party could bind an LLC by the acts of a member. *See, e.g.,* United States v. Jorick Mgmt., LLC, No 3:09CV275, 2011 U.S. Dist. LEXIS 63201, at \*2-3 (W.D.N.C. June 14, 2011) (discussing whether a manager of a North Carolina LLC was authorized to borrow money and whether a third party knew of any limitation on the manager's authority).

47. Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer, 705 S.E.2d 757, 765-66 (N.C. Ct. App. 2011) (citing *Crouse v. Mineo*, 658 S.E.2d 33, 37-38 (N.C. Ct. App. 2008)); *Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 7, at \*30 (N.C. Super. Ct. Feb. 4, 2013) ("Blythe appears to agree that bringing a direct action in Drymax's name would require the approval, consent, agreement, or ratification of a majority of the managers . . ."); *see also* *Stoker v. Bellemeade, LLC*, 615 S.E.2d 1, 12 (Ga. Ct. App. 2005) (noting that one of two members could not cause the LLC to sue the other, because a majority vote to sue did not exist); *Godwin v. Vinson*, 111 S.E.2d 180, 180-81 (N.C. 1959) (stating that a partner cannot sue "in his own name, and for his benefit, upon a cause of action in favor of a partnership").

48. *See, e.g.,* 418 Meadow St. Assocs., LLC v. Clean Air Partners, LLC, 43 A.3d 607, 616-17 (Conn. 2012) (applying a Connecticut statute that specifically requires a majority vote to sue, but likewise specifically excludes the vote of any member who has an adverse interest, finding that in a suit by an LLC (50% owned by Barbara Levine) against another LLC partly owned by Barbara's husband, Barbara had an adverse interest and her vote not to sue her husband's LLC should be disregarded); *LeCann*, 2011 NCBC LEXIS 28, at \*8 n.8 ("Plaintiff argues in the alternative, that even without demands, Plaintiff has standing to proceed directly as the only disinterested shareholder since Defendant Cobham is disqualified from acting with regard to such claims by virtue of her conflict of interest.").

49. *See, e.g., Crouse*, 658 S.E.2d at 37 ("Plaintiffs rely upon agency principles to argue that an LLC manager has 'the inherent authority to authorize lawsuits to protect the LLC's interests.' Plaintiffs [also] cite N.C. Gen. Stat. § 57C-3-23 . . .").

50. *Peak Coastal Ventures, L.L.C. v. SunTrust Bank*, No. 10 CVS 6676, 2011 NCBC LEXIS 13, at \*17 (N.C. Super. Ct. May 5, 2011) (citing *Crouse*, 658 S.E.2d at 37).

the operating agreement to file suit must be obtained.<sup>51</sup> If the LLC has no operating agreement, only the “majority” members can bring such an action.<sup>52</sup> As such, if the defendants constitute a majority of those in control, the LLC is barred from bringing a direct action against the defendants, no matter how egregious the behavior of the defendants might have been. One opinion has also noted that if one member is allowed to bring an action on behalf of the LLC, what is to stop the defendant as a member from filing a motion to dismiss the action?<sup>53</sup> However, this seems a much simpler way to quickly get to the merits of the dispute, rather than wandering through the complexities of a derivative suit discussed in Part IV. The operating agreement could give the minority the right to bring such an action. But even though this may be a very positive provision, it seems highly unlikely that operating agreements will be drafted to include this power.

Former section 57C-3-23 has been deleted from the new Act, but no substantive change is apparently intended.<sup>54</sup> Similar wording also exists in

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51. See *Crouse*, 658 S.E.2d at 37–38 (holding that because “the filing of an action by one manager of an LLC against a co-manager to recover purported assets of the LLC allegedly misappropriated by that co-manager [was] a management decision and [was] not ‘carrying on in the usual way the business of the limited liability company,’” the suit could not be brought since it was not authorized.); cf. *Stoker*, 615 S.E.2d at 12–13 (noting that a 50% member could not bring counterclaims in the name of the LLC against the other 50% member because a 51% vote would be required; the action could, however, be filed as a derivative claim or an individual direct action (citing *Glisson Coker, Inc. v. Coker*, 581 S.E.2d 303 (Ga. Ct. App. 2003))).

52. See *Brewer*, 705 S.E.2d at 765–66. The court held that because a suit to recover allegedly misappropriated assets of the LLC is a management decision that requires approval by a majority of the LLC members, the plaintiffs, who did not constitute a majority, did not have authority to authorize the claims brought by the LLC. *Id.* (quoting N.C. GEN. STAT. § 57C-3-23 (repealed 2013)). Further, the court held that the majority-member defendants had standing to bring counterclaims against the defendants. *Id.*

53. *Peak Coastal Ventures*, 2011 NCBC LEXIS 13, at \*20 n.6. The court was actually commenting on language in the LLC’s operating agreement, but the point is equally applicable to whether section 57C-3-23 should be interpreted as limiting the right of a member to sue another member on behalf of the LLC. The business court also noted that in order for the LLC to sue at the request of one member, the LLC would be required to obtain counsel, since a “corporation[] cannot represent [itself] in a lawsuit.” *Id.* at \*20. The decision to hire counsel would also not be an act in the “usual course of business,” thus additionally requiring a majority vote (or whatever the operating agreement required) to hire counsel in order to pursue the action. *Id.* at \*17, \*20.

54. In deleting this provision, the drafters of the revised North Carolina LLC Act note: “This section stated applicable principles of agency law. As such it was duplicative of G.S. 57C-10-03(c), which incorporates agency law by reference into the Act.” Proposed Draft to Amend Chapter 57C of the North Carolina General Statutes at 35 n.99 (July 3, 2012) (on file with author).

the statutes of many other states<sup>55</sup> and judges may continue to deny a member the right to cause the LLC to sue on the basis that a member does not have the implied authority nor the inherent power to sue.<sup>56</sup> Courts may continue to assert that such a claim requires “express” authority—the appropriate approval of a majority of those in control or of those individuals who are specified in the operating agreement.<sup>57</sup> The bottom line seems to be that if a minority member feels that those in control have injured the LLC, she will be unable to pursue a direct claim on behalf of the LLC.

### III. WHAT IF A MANAGER BREACHES A DUTY OWED DIRECTLY TO A MEMBER?

As noted above, even though one’s status as a manager does not create duties to the members, a manager (or member) may owe fiduciary duties to members based on the behavior and relationship between the manager and members. If the manager (or, for example, a controlling member) does breach a duty owed specifically to the member, can the injured member directly sue and recover for her injuries?

#### A. *Barger Rule*

The first restriction on the member’s ability to bring a direct suit to recover for injuries suffered as a member is the *Barger* rule, which provides that shareholders and limited partners may not bring an individual action against a third party for an injury directly affecting the individual, if the entity has a cause of action arising out of the same wrong.<sup>58</sup> This common-law limitation has been carried over into the world of LLCs.<sup>59</sup>

Under the *Barger* rule, the individual may bring a direct action only if she can show either (1) that the wrongdoer owed her a special duty,<sup>60</sup> or (2)

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55. UNIF. LTD. LIAB. CO. ACT § 301(a)(2), 6B U.L.A. 585 (2014). The 1996 act has been adopted in eight states and in the Virgin Islands. See UNIF. LTD. LIAB. CO. ACT, 6B U.L.A. 93 (West Supp. 2014).

56. Cf. RIBSTEIN & KEATINGE, *supra* note 4, § 10:2, at 646–47.

57. *Id.*

58. *Barger v. McCoy Hillard & Parks*, 488 S.E.2d 215, 220 (N.C. 1997); see also *Energy Inv’ts Fund, L.P. v. Metric Constructors, Inc.*, 525 S.E.2d 441, 444–45 (N.C. 2000); *BDM Invs. v. Lenhil, Inc.*, No. 11 CVS 449, 2012 NCBC LEXIS 7, at \*27–28 (N.C. Super. Ct. Jan. 18, 2012) (noting that the *Barger* rule applies to general partnerships).

59. See *Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 17, at \*15–17 (N.C. Super. Ct. Apr. 8, 2013).

60. See *Morris v. Hennon & Brown Props., LLC*, No. 1:07CV780, 2008 U.S. Dist. LEXIS 55963, at \*17–18 (M.D.N.C. July 3, 2008) (finding that a member failed to make

that the injury suffered by the individual is separate and distinct from the injury sustained by the other shareholders or partners, or by the entity itself.<sup>61</sup> A few cases have found this special duty (entitling an individual member to a direct suit) where the defendant is the controlling owner.<sup>62</sup> The exception is unlikely to extend to a plaintiff who is a 50% owner being controlled by the other 50% owner.<sup>63</sup> A 50% “minority” owner does not face insurmountable hurdles posed by suing derivatively, since she can automatically create a deadlock, which will afford her greater opportunity to bring a direct suit for dissolution.<sup>64</sup>

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any allegations of a special duty owed only to the member and refusing to assume that former section 57C-3-22(b) created a duty); *McKee v. James*, No. 09 CVS 3031, 2013 NCBC LEXIS 33, at \*19–20 (N.C. Super. Ct. July 24, 2013) (finding a special duty by virtue of longstanding personal relationship could not be asserted because the plaintiffs only knew the defendants for four months).

61. *McKee*, 2013 NCBC LEXIS 33, at \*21 n.8 (“[T]he allegations also reveal a separate and distinct injury. Specifically, Plaintiffs allege that, in addition to the injuries they sustained as shareholders, they also lost their positions as managers and officers of the company.”); *LeCann v. Cobham*, No. 10 CVS 11169, 2012 NCBC LEXIS 58, at \*27–28 (N.C. Super. Ct. Nov. 7, 2012) (discussing that the plaintiff suffered a fiscal injury, but that it was the proximate result of her status as a shareholder, and thus, she failed to meet the requirement of either exception); *Regions Bank v. Reg’l Prop. Dev. Corp.*, No. 07 CVS 12469, 2008 NCBC LEXIS 8, at \*13 (N.C. Super. Ct. Apr. 21, 2008). In *Regions Bank*, a member failed to plead a separate and distinct injury by asserting that alleged wrongful acts forced the member to agree to a modification of the LLC operating agreement and to an improper payment of \$600,000 to other members, thus reducing its equity in the LLC. *Id.* at \*14. The claim was, in reality, a claim that members wrongfully diverted LLC assets—an entity claim. *Id.* at \*14–15. Treating this as an individual claim could impair the rights of creditors. *Id.* at \*15.

62. *See, e.g.*, *Norman v. Nash Johnson & Sons’ Farms, Inc.*, 537 S.E.2d 248, 258–59 (N.C. Ct. App. 2000); *McKee*, 2013 NCBC LEXIS 33, at \*19 (holding that a special duty runs to those who are powerless because of the legal impediments to their dissolving the company or because a derivative recovery will be in the hands of the wrongdoers, but also that the court must consider both the impact of an individual owner’s recovery on the business creditors and the danger of multiple lawsuits). *But see Blythe*, 2013 NCBC LEXIS 17, at \*15–20 (finding that the black-letter rule was not established, and noting that cases turn on particular facts).

63. *See Mauer v. Mauer*, No. 13 CVS 4421, 2013 NCBC LEXIS 41, at \*11–12 (N.C. Super. Ct. Aug. 23 2013) (first citing *Allen v. Ferrera*, 540 S.E.2d 761, 766 (N.C. Ct. App. 2000); then citing *Outen v. Mical*, 454 S.E.2d 883, 885–86 (N.C. Ct. App. 1995)). *Contra LeCann v. Cobham*, No. 10 CVS 11169, 2011 NCBC LEXIS 28, at \*13–14 (N.C. Super. Ct. Aug. 2, 2011) (finding in *LeCann* the exception based more on the fact that 50/50 shareholders operated as partners).

64. *Mauer*, 2013 NCBC LEXIS 41, at \*11–12; *see also supra* note 29 and accompanying text.

Questions have been raised regarding when the defendant is a “third party” that triggers these two limitations.<sup>65</sup> Delaware, the Revised Uniform LLC Act of 2006, and the ABA’s Revised Prototype LLC Act have all recently rejected the requirement that the plaintiff’s injury must be distinct from those of the other shareholders for the plaintiff to bring a direct suit.<sup>66</sup>

### B. *Second Restriction*

In addition to the limitations imposed by the *Barger* rule, former section 57C-3-30(b) of the North Carolina General Statutes, as applied by the North Carolina courts, imposed another restriction on the ability of a member to bring a direct suit to recover for her individual injuries.<sup>67</sup> The purpose of this statute is reasonably self-evident—a member is not liable for the wrongs of the LLC merely by being a member, and thus should not be joined in any action unless the member is suing or being sued by the LLC.<sup>68</sup> However, the North Carolina Court of Appeals greatly expanded the reach of former section 57C-3-30(b) as authority to limit an LLC member’s right to bring an individual direct claim for breach of fiduciary duty against another member or manager. Because the language of this

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65. *Norman*, 537 S.E.2d at 253; *cf.* *Gaskin v. J.S. Procter Co.*, 675 S.E.2d 115, 119–21 (N.C. Ct. App. 2009) (noting that *Norman* did not create a new special exception as to when a minority shareholder or member might be entitled to bring an individual direct action).

66. *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1036, 1038–39 (Del. 2004); REVISED UNIF. LTD. LIAB. CO. ACT § 901 (amended 2013), 6B U.L.A. 522 (2014) (this is the model that the North Carolina drafters used and intentionally omitted this provision); REVISED PROTOTYPE LTD. LIAB. CO. ACT § 909(b) (AM. BAR ASS’N 2011); *see also* *Marcoux v. Prim*, No. 04 CVS 920, 2004 NCBC LEXIS 4, at \*35 (N.C. Super. Ct. Apr. 16, 2004) (cautiously concluding that the plaintiff’s class action challenge to a merger was a direct claim, since the injury was the shareholders receiving less than they should; “[t]he treasury of the shareholder is depleted, not the treasury of the corporation”).

67. N.C. GEN. STAT. § 57C-3-30(b) (repealed 2013) (providing that “[a] member of a limited liability company is not a proper party to proceedings by or against a limited liability company, except where the object of the proceeding is to enforce a member’s right against or liability to the limited liability company”).

68. *Page v. Roscoe, LLC*, 497 S.E.2d 422, 428 (N.C. Ct. App. 1998) (finding that a claim against the LLC was proper, but disallowing a suit against a member of the LLC who did not engage in any improper acts); *see also* *Selvidio v. Gillespie (In re Gillespie)*, Ch. 11 Case No. 10-30942, Adv. No. 10-3187, 2012 Bankr. LEXIS 1261, at \*12–13 (Bankr. W.D.N.C. Mar. 26, 2012). The court in *Selvidio* held that a suit “against an individual member of an LLC in an attempt to collect money owed [to] the LLC [by] another member [was] a violation of North Carolina law.” *Id.* (citing N.C. GEN. STAT. § 57C-3-30(b) (repealed 2013)). The plaintiff lacked standing to sue because she had not “asserted the existence of a special duty owed by [the defendant manager] that [was] personal, separate, and distinct from the duty that [the defendant] owed the company,” and her claim should have been brought as a derivative suit. *Id.*

statute has been adopted in at least seventeen other states,<sup>69</sup> the implication of the following North Carolina decisions may still have substantial impact in these other states, which, in some instances, similarly applied their statute as a limitation.<sup>70</sup>

In *Crouse v. Mineo*,<sup>71</sup> one member of a two-member LLC law firm attempted to directly assert that the other LLC member breached fiduciary duties that amounted to unfair or deceptive acts, since the defendant had a special relationship of trust and confidence with the plaintiff that constituted a fiduciary relationship by virtue of their membership in the LLC.<sup>72</sup> The court agreed with the defendant's argument that former section 57C-3-30(b) barred the plaintiff's claims because "[a]ll of the allegations alleging breach of fiduciary duty . . . relate[d] to the parties' relationship through [the law firm]."<sup>73</sup> Because the claims were *through* the LLC, they had to be brought on behalf of the LLC; the plaintiff, as only one member, was not authorized to sue on behalf of the LLC. Interestingly, the court allowed the plaintiff's quantum meruit claim against the defendant,

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69. See, e.g., ARK. CODE ANN. § 4-32-305 (2001); GA. CODE ANN. § 14-11-1107(j) (2003 & Supp. 2014); IND. CODE § 23-18-3-5 (2007); LA. REV. STAT. ANN. § 12:1320(C) (2013); MD. CODE ANN., CORPS. & ASS'NS § 4A-302 (West 2007); MISS. CODE ANN. § 79-29-311(2) (2013); MO. REV. STAT. § 347.069(1) (2000 & Supp. 2014); NEV. REV. STAT. § 86.381 (2013); N.M. STAT. ANN. § 53-19-14 (2014); N.Y. LTD. LIAB. CO. LAW § 610 (McKinney 2007); N.D. CENT. CODE § 10-32-133 (2012); 15 PA. CONS. STAT. § 8991(b) (2001 & Supp. 2014); R.I. GEN. LAWS § 7-16-70 (1992); S.D. CODIFIED LAWS § 47-34A-201 (2013); TENN. CODE ANN. § 48-249-114(c) (2012); VA. CODE ANN. § 13.1-1020 (2011); WIS. STAT. § 183.0305 (2014).

70. *United States v. All Funds in the Account of Prop. Futures, Inc.*, 820 F. Supp. 2d 1305, 1327 (S.D. Fla. 2011) (citing FLA. STAT. § 608.462 (2014)). The court explained that the minority members of an LLC could not challenge a government civil forfeiture of property owned by the LLC. The members had no standing, since they had no direct ownership interest in the forfeited LLC property, and thus, they were "not a proper party to proceedings by an LLC." *Id.*; see also *Baron v. Rocketboom, LLC*, Nos. 4777N, 601066/07, 2008 N.Y. App. Div. LEXIS 9352, at \*1-2 (N.Y. App. Div. Dec. 9, 2008) (noting that a similar statute prohibited LLC member from intervening); *Katz v. Katz*, No. 2007-06043, 2008 N.Y. App. Div. LEXIS, at \*7 (N.Y. App. Div. Oct. 14, 2008) (applying a similar statute to hold that a husband could not individually bring an action against his former wife asserting that she was wrongly occupying a home owned by the husband's LLC), *rev'd in part on other grounds*, *El-Dehdan v. El-Dehdan*, No. 2011-09178, 2013 N.Y. App. Div. LEXIS 8347, at \*23-24 (N.Y. App. Div. Dec. 18, 2013); 450 W. 14th St. Corp. v. 40-56 Tenth Ave. L.L.C., No. 602527/00, 2001 N.Y. Misc. LEXIS 98, at \*11 (N.Y. Sup. Ct. Mar. 28, 2001) (holding that "a member of a company . . . is not a proper party to an action against the company").

71. *Crouse v. Mineo*, 658 S.E.2d 33 (N.C. Ct. App. 2008).

72. *Id.* at 42.

73. *Id.* at 41-42.

essentially finding that it was not based on rights derived through the parties' membership in the LLC.<sup>74</sup>

In 2011, the North Carolina Court of Appeals again confirmed that former section 57C-3-30(b) effectively prevented members from bringing individual direct claims against another member or manager where the claims were based on the duties that arose as part of the LLC—as certainly most all breach-of-fiduciary-duty claims will be.<sup>75</sup>

### C. *New Law—Same Result?*

The limitations of the *Barger* rule continue to apply after the adoption of the revised LLC act. However, since former section 57C-3-30(b) has been deleted from the new LLC act, will this mean that, assuming there is an individual duty created through the LLC relationship and that the duty was breached, the injured member can now bring a claim directly? There is no comparable provision in the 2013 LLC act, and the only provision that may be remotely related is section 57D-2-32, which permits duties and expands remedies to be provided in the operating agreement.<sup>76</sup> Will courts look to new section 57D-2-32 not only as a possible limitation on the creation of common-law fiduciary duties, but also as a limitation in the

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74. *Id.* It should be noted that the defendant asserted that the LLC only existed as a marketing tool, and that only cases obtained through it would be shared. See Brief of Defendant-Appellee at 4–7, *Crouse*, 658 S.E.2d 33 (No. COA07-344). The defendant asserted that no cases were obtained by the LLC and that the cases in question were never handled by the LLC. *Id.* As such, the plaintiff would have no rights to any fees under any theory asserted by him.

75. *Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer*, 705 S.E.2d 757, 766 (N.C. Ct. App. 2011). The court of appeals also concluded that the plaintiffs' accounting claim should likewise be dismissed: “[a]s this duty is also ‘relate[d] to the parties’ relationship’ as part of the PLLC, it is not a proper individual claim pursuant to *Crouse*.” *Id.* at 767 (second alteration in original) (quoting *Crouse*, 658 S.E.2d at 42).

76. N.C. GEN. STAT. § 57D-2-32 (amended 2014). The statute provides:

(a) An operating agreement may subject interest owners and other persons who are parties to or otherwise bound by the operating agreement to specified remedies for breach of the operating agreement or the occurrence of a specified event. Such remedies may include the recovery of reasonable attorneys' fees, the assessment of interest without the assessment being subject to the laws of usury, and the imposition of penalties that would otherwise be unenforceable as stipulated or liquidated damages.

(b) Unless otherwise provided in the operating agreement, an interest owner or other person who is a party to or bound by the operating agreement will not be liable to the LLC or an interest owner or other person who is a party to the operating agreement for that person's reliance on the provisions of the operating agreement.

*Id.*

manner that any such duties may be enforced? Nothing in this new section specifically provides such a limitation, but only time will tell how it may be applied. The failure of the legislature to adopt section 9.01 of the Uniform Limited Liability Company Act, which specifically permits a member to bring a direct action, is certainly a signal that such actions continue to be disfavored, absent specific authorization in the LLC operating agreement.<sup>77</sup>

#### IV. DERIVATIVE SUITS AS THE SOLUTION?

##### A. *When Is a Derivative Suit Permitted?*

The LLC member who believes that she has been injured, but cannot bring a direct suit, may almost always bring a derivative action, no matter how cumbersome,<sup>78</sup> even though the North Carolina Court of Appeals has pointed out that this is an inappropriate method for resolving disputes among members of a closely held business.<sup>79</sup>

New section 57D-3-21(b) continues to require each manager to discharge her duties “(i) in good faith, (ii) with the care an ordinary prudent person in a like position would exercise under similar circumstances, and (iii) subject to the operating agreement, in a manner the manager believes to be in the best interests of the LLC.”<sup>80</sup> If she fails in these duties, the LLC has standing to complain.<sup>81</sup> However, these duties can be modified or possibly eliminated by a contrary provision in the operating agreement.<sup>82</sup> New sections 57D-8-01 through 57D-8-07 of the North Carolina General

77. REVISED UNIF. LTD. LIAB. CO. ACT § 901 (amended 2013), 6B U.L.A. 522 (2014). The North Carolina drafters initially considered this revised uniform act as a model or guide, and omitted this provision. *See supra* note 54.

78. *See, e.g.,* Peak Coastal Ventures, L.L.C. v. SunTrust Bank, No. 10 CVS 6676, 2011 NCBC LEXIS 13, at \*21–22 (N.C. Super. Ct. May 5, 2011).

79. *See* Norman v. Nash Johnson & Sons’ Farms, Inc., 537 S.E.2d 248, 258–60 (N.C. Ct. App. 2000).

80. N.C. GEN. STAT. § 57D-3-21(b). Unlike the leading State of Delaware, and many other states that impose liability only if the director acted in a grossly negligent manner, North Carolina corporate directors and presumably North Carolina managers operating under identical statutory language may be liable if they merely act negligently. *See* FDIC v. Willetts, 882 F. Supp. 2d 859, 868 (E.D.N.C. 2012) (“[T]he Court finds that its holding that the corporation may bring suit against its directors and officers for ordinary negligence is not clearly erroneous.”).

81. N.C. GEN. STAT. §§ 57D-8-01 to -07.

82. *See id.* § 57D-2-30(b). This section lists those provisions that the operating agreement may not “supplant, vary, disclaim, or nullify.” *Id.* Section 57D-3-21(b) is not included in this list of mandatory provisions. *Id.*

Statutes authorize LLC members to bring derivative suits if all the required conditions discussed in Section C of this Part are met.<sup>83</sup>

*B. Whose Law Controls?*

It is well established that whether a plaintiff's claim for breach of a fiduciary duty may be brought directly or must be brought derivatively is clearly governed by the law of the jurisdiction where the LLC is organized.<sup>84</sup> Likewise, the LLC's state of organization governs whether the managers are liable to the members.<sup>85</sup> It is less clear which aspects of the derivative requirements of the foreign state should be applied in pursuing the derivative claim in North Carolina.<sup>86</sup>

In *Scott v. Lackey*,<sup>87</sup> the business court applied Delaware law in determining whether the plaintiff was an "adequate" party.<sup>88</sup> Should the court have applied Delaware law, since there was no adequacy requirement for a plaintiff to pursue a derivative action under North Carolina law?<sup>89</sup>

Prior to the 2013 amendments, North Carolina Business Court judges stated that they would follow the Delaware "procedural prerequisites" if the LLC was a Delaware LLC.<sup>90</sup> The new North Carolina LLC statute, similar

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83. *Id.* §§ 57D-8-01 to -07; *see also infra* notes 93–111 and accompanying text.

84. *Maurer v. SlickEdit, Inc.*, No. 04 CVS 10527, 2005 NCBC LEXIS 2, at \*12 (N.C. Super. Ct. May 16, 2005) ("Under North Carolina law, if a derivative claim is asserted against a foreign corporation the courts of this state look to the laws of the state in which the company is incorporated to determine the procedural prerequisites and whether the claim is derivative or individual."); *see also* Daniel S. Kleinberger, *Direct Versus Derivative and the Law of Limited Liability Companies*, 58 BAYLOR L. REV. 63, 70 n.20 (2006) (listing cases that have applied the rule).

85. *Hamby v. Profile Prods., L.L.C.*, 652 S.E.2d 231, 235 (N.C. 2007).

86. *See* DEBORAH A. DEMOTT, *SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE* § 2:13, at 235–58, § 4:2, at 354–84 (2014) (discussing choice-of-law issues that arise in shareholder derivative actions).

87. *Scott v. Lackey*, No. 11 CVS 19560, 2012 NCBC LEXIS 60 (N.C. Super. Ct. Dec. 3, 2012).

88. *Id.* at \*2.

89. *Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 7, at \*31 (N.C. Super. Ct. Feb. 4, 2013); 2013 NCBC LEXIS 17, at \*17–18 (N.C. Super. Ct. Apr. 8, 2013). The court noted that although in a North Carolina corporate dispute the derivative plaintiff must be an adequate representative, nothing in the former LLC statute included this requirement. N.C. GEN. STAT. § 57C-8-01 (repealed 2013). The same is true under the new LLC statute, N.C. GEN. STAT. § 57D-8-01 (amended 2014). The business court in *Blythe* also noted that the member "is not barred from bring[ing] such an action by his individual conflict of interest." *Blythe*, 2013 NCBC LEXIS 7, at \*32.

90. *See, e.g., Maurer v. SlickEdit, Inc.*, No. 04 CVS 10527, 2005 NCBC LEXIS 2, at \*12 (N.C. Super. Ct. May 16, 2005); *see also supra* note 84.

to the existing corporate statute,<sup>91</sup> now provides reasonably clear guidance on this:

In any derivative proceeding in the right of a foreign LLC, the matters covered by this Article will be governed by the law of the jurisdiction of the foreign LLC's organization except for the matters governed by G.S. 57D-8-02 [(court may stay proceedings)], 57D-8-04 [(discontinuance or settlement requires court approval)], and 57D-8-05 [(payment of expenses)].<sup>92</sup>

Thus, in any member dispute, the first question will be, "Where is the LLC organized?"

### C. *What Are the New Required Procedures?*

The 2013 LLC act has modified the requirements for bringing an LLC derivative action.<sup>93</sup> In an attempt to mirror the provisions governing corporate derivative actions, the following procedures are now required for an LLC member to bring a derivative action on behalf of the LLC:

- (1) The plaintiff must first make a written demand on the LLC to take action.<sup>94</sup> There is no "futility" exception. The plaintiff

91. N.C. GEN. STAT. § 55-7-47 (2013); *see* *Aubin v. Susi*, 560 S.E.2d 875, 880–81 (N.C. Ct. App. 2002) (applying the North Carolina statute rather than New York law to determine that a derivative plaintiff could recover attorney's fees, even though the plaintiff was not a successful litigant).

92. N.C. GEN. STAT. § 57D-8-06 (amended 2014); *see id.* §§ 57D-8-02, -04, -05.

93. *Id.* §§ 57D-8-01 to -07; *see* *Peak Coastal Ventures, L.L.C. v. SunTrust Bank*, No. 10 CVS 6676, 2011 NCBC LEXIS 13, at \*21–22 (N.C. Super. Ct. May 5, 2011) (describing the former procedures).

94. *Green v. Condra*, No. 08 CVS 6575, 2009 NCBC LEXIS 20, at \*16 (N.C. Super. Ct. Aug. 14, 2009) ("A plaintiff's failure to satisfy this demand requirement constitutes an 'insurmountable bar' to recovery." (quoting *Allen v. Ferrera*, 540 S.E.2d 761, 764 (N.C. Ct. App. 2000))); *see also* *Ray v. Deloitte & Touche, L.L.P.*, No. 05 CVS 15862, 2006 NCBC LEXIS 7, at \*20–24 (N.C. Super. Ct. Apr. 21, 2006) (stating that if there is no existing body upon which demand can be made, the plaintiff may first be required to cause an appropriate body to be selected); *Garlock v. Hilliard*, No. 00-CVS-1018, 2000 NCBC LEXIS 6, at \*12–13 (N.C. Super. Ct. Aug. 22, 2000) (noting that where the plaintiffs and defendant had conflicting interests, a demand was still required so that an independent advisory committee could be appointed to decide what claims the corporation should pursue and against which parties); *Greene v. Shoemaker*, No. 97 CVS 2118, 1998 NCBC LEXIS 4, at \*12–16 (N.C. Super. Ct. Sept. 24, 1998) (discussing the purposes of the demand requirement); *cf.* *Chrystall v. Serden Techs.*, 913 F. Supp. 2d 1341, 1351 (S.D. Fla. 2012) (citations omitted) (concluding that "demand 'must be made upon the board of directors or comparable authority' and 'making a demand on a president and corporate legal counsel is not sufficient'").

must also plead that a demand was made.<sup>95</sup> The business court has recently explained what is required of the demand.<sup>96</sup>

- (2) The subsequent action must be brought by a member.<sup>97</sup> However, unlike the corporate procedures, an LLC member is not required to demonstrate that she fairly represents the interests of the LLC.<sup>98</sup>
- (3) The plaintiff must have been a member at the time of the act on which the complaint is based (or her membership interest must have devolved on her from a member who meets this requirement).<sup>99</sup>

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95. *Norman v. Nash Johnson & Sons' Farms, Inc.*, 537 S.E.2d 248, 263 (N.C. Ct. App. 2000) (stating that a description of the demand is still required in pleading, but that it may be sufficient for the plaintiff to plead that all conditions precedent to filing an action have been performed or have occurred).

96. The court in *LeCann v. Cobham* explained what is required of the demand as follows: "The form of the demand is not specified, except to require that it be in writing; but to serve its purpose it should set forth the facts of share ownership and describe the redress demanded with enough particularity to allow the corporation either to correct the problem, if any, without a lawsuit or to bring its own direct action." *LeCann v. Cobham*, No. 10 CVS 11169, 2011 NCBC LEXIS 28, at \*9–10 (N.C. Super. Ct. Aug. 2, 2011) (quoting RUSSELL M. ROBINSON, ROBINSON ON NORTH CAROLINA CORPORATION LAW § 17.03[1], at 17-13 (7th ed. 2009)). Further, "[i]n determining whether the demand requirement has been met the Court must compare the derivative claims asserted in a complaint against the specific demands a plaintiff has made prior to filing suit." *Id.* at \*10 (quoting *Garlock*, 2000 NCBC LEXIS 6, at \*9). "The demand must be made with sufficient clarity and particularity to permit the corporation to assess its rights and obligations and determine what action is in the best interest of the company." *Id.* (citing *Garlock*, 2000 NCBC LEXIS 6, at \*9); see also *Greene*, 1998 NCBC LEXIS 4, at \*9 ("The demand must be made with sufficient clarity and particularity to permit the corporation, through independent directors or an outside advisory committee, to assess its rights and obligations and determine what action is in the best interest of the company.").

97. N.C. GEN. STAT. § 57D-8-01(a); see also *Mooring Capital Fund, LLC v. Comstock N.C., LLC*, No. 07 CVS 20852, 2009 NCBC LEXIS 32, at \*19–20 (N.C. Super. Ct. Nov. 13, 2009) (stating that under prior law, the plaintiff had to assert that she did not have standing to cause the LLC to sue, and thus, a member's minority status at least gave her standing to bring the derivative claim).

98. See *Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 17, at \*17 (N.C. Super. Ct. Apr. 8, 2013). The court notes that, different from a corporate derivative suit, under the former LLC statute, the member did not have to demonstrate that she fairly represented the interests of the LLC. This remains true under section 57D-8-01. See N.C. GEN. STAT. § 57D-8-01.

99. N.C. GEN. STAT. § 57D-8-01(a); see *infra* notes 126–51 and accompanying text (noting that a beneficiary of a deceased member will rarely have standing to bring the

- (4) The plaintiff must wait either ninety days or until the LLC has notified her that it is rejecting the demand before she can file suit.<sup>100</sup> The complaint must be verified by oath.<sup>101</sup>
- (5) Unless the defendants never reject the demand and do not move to dismiss, the plaintiff at some point will be required to plead “particular facts” that would demonstrate either (i) that an inappropriate group<sup>102</sup> moved to dismiss (or rejected the demand), or (ii) that there was a failure to make an appropriate and adequate inquiry into whether the action is not in the best interests of the LLC.<sup>103</sup>
- (6) Prior to a court ruling, the plaintiff may engage in discovery only to the extent it is germane and necessary to develop facts

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action; since the membership does not “devolve” on the beneficiary, only the deceased member’s economic interest is transferred).

100. The statute also permits the member to bring the action earlier if irreparable injury to the LLC would result by waiting. N.C. GEN. STAT. § 57D-8-01(a)(2)(iii). However, it is highly unlikely that these grounds will be asserted. The court of appeals has stated that the action must be commenced *within* ninety days after the demand is made. *See Allen v. Ferrera*, 540 S.E.2d 761, 765 (N.C. Ct. App. 2000).

101. N.C. GEN. STAT. § 1A-1, Rule 23(b) (2013); *see Alford v. Shaw*, 398 S.E.2d 445, 448 (N.C. 1990) (citations omitted) (“Because the rule containing the verification requirement is not jurisdictional in nature, where the purposes behind the rule have been fulfilled by the time the objection to a defective or absent verification is lodged, dismissal or summary judgment in favor of defendants is not appropriate.”).

102. The motion to dismiss must be made by either: (1) a majority vote of independent persons who have authority to cause the LLC to bring the recovery requested in the derivative suit, (2) a majority vote of independent committee members, or (3) an independent panel appointed by the court. N.C. GEN. STAT. §§ 57D-8-03(b), (f) (amended 2014).

103. *Id.* at § 57D-8-03(d). Section 57D-8-03 states, in relevant part:

If a derivative proceeding is commenced after a determination has been made rejecting a demand by a member, the complaint must allege particular facts that if proved would preclude the court from dismissing the derivative proceeding under subsection (a) of this section [automatic dismissal if an independent body moves to dismiss after conducting an inquiry]. Defendants may make a motion to dismiss a complaint under subsection (a) of this section for failure to comply with this subsection.

*Id.* The statute at this point is confusing as to when the plaintiff must plead “particular facts,” as well as who has the burden of proof as to subsections (i) and (ii). These are discussed more fully below. *See infra* notes 179–97 and accompanying text.

that establish that the dismissal of the derivative proceeding is unwarranted.<sup>104</sup>

- (7) If the LLC commences an inquiry into the allegations set forth in the demand or complaint, the court may stay the proceedings.
- (8) In determining whether to dismiss, apparently the court only needs to evaluate whether those acting were independent and that appropriate procedures were followed.<sup>105</sup> The court does not evaluate the substance of the decision. “The court shall dismiss a derivative proceeding on motion of the LLC if one of the groups [designated in the statute] . . . determines after conducting an inquiry<sup>106</sup> upon which its conclusions are based<sup>107</sup> that the maintenance of the derivative proceeding is not

104. See ROBINSON, *supra* note 96, § 17.08[5], at 17-35 (7th ed. 2014) (discussing problems created by this provision, which severely limit the plaintiff’s ability to obtain likely needed information).

105. *Cf. Madvig v. Gaither*, 461 F. Supp. 2d 398, 404 (W.D.N.C. 2006) (“The inquiry of a court reviewing the corporation’s decision not to pursue the proposed litigation is limited to determining whether: (1) the decision was made by ‘a committee consisting of two or more independent directors’; (2) a reasonable inquiry was conducted; and (3) the decision was made in good faith.” (quoting N.C. GEN. STAT. § 55-7-44(b)(2) (2013))). The LLC statute does not require “good faith.” See N.C. GEN. STAT. § 57D-8-08(a) (amended 2014); see also MODEL BUS. CORP. ACT § 7.44 cmt. 2 (AM. BAR ASS’N, amended 2013) (“[S]ection 7.44 does not authorize the court to review the reasonableness of the determination to reject a demand or seek dismissal.”).

106. The official comment to the Model Business Corporation Act states:

The word “inquiry”—rather than “investigation”—has been used to make it clear that the scope of the inquiry will depend upon the issues raised and the knowledge of the group making the determination with respect to those issues. In some cases, the issues may be so simple or the knowledge of the group so extensive that little additional inquiry is required. In other cases, the group may need to engage counsel and possibly other professionals to make an investigation and assist the group in its evaluation of the issues.

MODEL BUS. CORP. ACT § 7.44 cmt. 2.

107. The ABA goes on to say:

The phrase “upon which its conclusions are based” requires that the inquiry and the conclusions follow logically. This standard authorizes the court to examine the determination to ensure that it has some support in the findings of the inquiry. . . . This phrase does not require the persons making the determination to prepare a written report that sets forth their determination and the bases therefor, since circumstances will vary as to the need for such a report. There will be, in all likelihood, many instances where good corporate practice will commend such a procedure.

*Id.*

in the best interest of the LLC.”<sup>108</sup>

- (9) Unlike the comparable North Carolina corporate derivative statute, the LLC derivative statute does not require those acting to dismiss to act in “good faith.”<sup>109</sup> One might wonder what the significance of this deletion will be.<sup>110</sup>

The clear thrust of the new LLC act is to force all disputes among members and managers to be resolved through derivative suits. For instance, section 57D-2-30(b)(5) states that the operating agreement may not eliminate a member’s right “to bring a derivative action under Article 8 of [chapter 57] unless the operating agreement provides an alternative remedy, which may include the right to bring a direct action in lieu of a derivative action or modifying the procedures provided in Article 8 of [chapter 57] governing derivative actions.”<sup>111</sup>

Other than an action to dissolve the LLC, discussed in Part V.B of this Article,<sup>112</sup> nowhere else in the new act is there any provision for other methods of resolving disputes among members and managers.

*D. What Problems Are Created by the Requirement that Disputes Among LLC Members and Managers Must Be Resolved Through a Derivative Suit?*

The leading state treatise on corporation law, *Robinson on North Carolina Corporation Law*, provides a checklist of corporate steps, easily modified to fit the LLC context, that can be taken to defeat the derivative claim.<sup>113</sup> But there is much more to consider.

1. *The statute is procedurally confusing as to how a demand is rejected and how a motion to dismiss is to be filed and evaluated*

The statute first states in section 57D-8-01(a)(1) that the LLC shall notify the plaintiff that her demand has been rejected, but does not say how or who makes this decision. However, section 57D-08-03(d) implies that any rejection must be made by independent members (or managers)

108. N.C. GEN. STAT. § 57D-8-03(a).

109. Compare *id.* § 55-7-44, with *id.* § 57D-8-03.

110. See ROBINSON, *supra* note 96, § 17.08[3], at 17-33 (7th ed. 2014) (“The concept of ‘good faith’ is a subjective one that modifies both the inquiry and the conclusion . . .”).

111. N.C. GEN. STAT. § 57D-2-30(b)(5).

112. See *infra* note 217 and accompanying text.

113. ROBINSON, *supra* note 96, § 17.08[6], at 17-35 to -37.

concluding, after conducting an inquiry, that the derivative proceeding is not in the best interests of the LLC.<sup>114</sup>

Unless some sort of report is furnished to the plaintiff, she likely will have no information as to whether the two requirements have been met. How will the plaintiff know whether she must plead facts to contest either issue? Luckily, limited discovery may be permitted,<sup>115</sup> but again, in a confusing way, the statute states that the discovery could only be in regard to a motion to dismiss.<sup>116</sup> At this stage of the litigation, there is not even a complaint. Note that none of this will apply if the demand is not rejected and the ninety-day clock has run.<sup>117</sup>

At the pleading stage, the ultimate questions will be (1) whether the rejection was made by an independent body, and (2) whether there was an

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114. See N.C. GEN. STAT. § 57D-8-03(d), which requires the complaint to plead particular facts that “if proved would preclude the court from dismissing the derivative proceeding under subsection (a)” — that either those moving were not independent or that they failed to make an adequate inquiry. Further, if the complaint does not so plead, this can be grounds for a motion to dismiss. *Id.*

115. See ROBINSON, *supra* note 96, § 17.08[5], at 17-35. Robinson explains:

The [very similar corporate] North Carolina statute contains an unusual provision stating that, prior to the court’s ruling on the motion to dismiss, the plaintiff shall be limited to preliminary discovery only with respect to the issues presented by the motion and only if and to the extent that the plaintiff has alleged the required facts with particularity. . . . This extraordinarily tight limitation on discovery was obviously intended to control expenses and deter strike suits. It places on a party who may have limited or no personal knowledge of some essential facts, and virtually no source of information other than a request for record inspection, the burden of pleading those facts with particularity, and perhaps also the burden of proving them, for purposes of the dismissal motion. If a court concludes that this combination of discovery limitation and burden of pleading/proof unreasonably blocks a plaintiff whose case may have merit, the court might respond by relaxing either the discovery limitation or the “particularity” requirement.

*Id.*; see also N.C. GEN. STAT. § 57D-3-04 (specifying an LLC member’s inspection rights). *Contra* Halebian v. Berv, 869 F. Supp. 2d 420, 440 (S.D.N.Y. 2012) (describing why the court rejects the plaintiff’s request for discovery regarding independence and reasonable inquiry).

116. N.C. GEN. STAT. § 57D-8-03(d).

117. See *supra* note 100 and accompanying text. However, it may be possible to read the statute to also permit the LLC to reject a demand in any manner that would be consistent with the operating agreement, e.g., majority vote, regardless of whether those rejecting the demand are independent. It is likely that this will commonly happen. The statute then might suggest that the plaintiff is free to file the complaint without worrying about whether there was a disinterested rejection or whether a proper inquiry was made. However, after the complaint is filed, presumably the defendants could then file the motion to dismiss, and then the plaintiff is required to plead (possibly through an amended complaint) particular facts attacking either the lack of independence or failure to conduct an appropriate inquiry. If the defendants fail to reject the demand, this second procedure would seem to apply.

adequate inquiry. The burden of proof on these two questions depends on whether a majority of the persons who have the authority to cause the LLC to sue for the wrongs asserted in the complaint are independent. If independent, the burden is on the plaintiff; if not, it is on the defendants.<sup>118</sup>

This raises several questions: How does the court determine who has the burden? What is the procedure?<sup>119</sup> Should the plaintiff assert that she does not have the burden, since the majority of the LLC are not independent, or should the defendants in a motion assert that they are? This certainly adds a degree of complexity to the whole process. Note that this is borrowed from the corporate statute, where it may often be a lot clearer whether the board is generally independent, assuming that the board may consist of many members who had nothing to do with an alleged wrongdoing by an officer or co-director. With the typical closely held LLC, this is simply not the case—this will not be the structure of the organization.

The statute also gives the LLC the right to ask the court to appoint an independent panel.<sup>120</sup> The immediate problem is determining who votes to request this independent panel. Does the plaintiff have a vote? The Robinson treatise then raises a second problem—at this early stage, there is no court to make the appointment.<sup>121</sup>

These provisions have been adopted from the corporate derivative statutes. Unfortunately, there is little clarification in the corporate derivative world for how all of this should play out.<sup>122</sup>

118. N.C. GEN. STAT. § 57D-8-03(e).

119. See *Sojitz Am. Capital Corp. v. Kaufman*, 61 A.3d 566, 574–75 (Conn. App. Ct. 2013) (applying a nearly identical Connecticut statute, noting that the decision whether the majority are “qualified” is the threshold issue, but giving no description as to how the court is to proceed in making this determination); *Halebian*, 869 F. Supp. 2d at 444 (applying the nearly identical Massachusetts statute, but again omitting any discussion of how to determine who has the burden).

120. N.C. GEN. STAT. § 57D-8-03(f).

121. See ROBINSON, *supra* note 96, § 17.08[6], at 17-37. Robinson points out:

[T]he use of a court-appointed panel before actual commencement of the action would be problematic because there would at that time be no lawsuit or designated court in which to file the motion for appointment of the panel, thus leaving a corporation that wishes to use such a panel with a choice of either trying to get the appointment in a declaratory judgment action filed by it or doing only preliminary work during the 90-day waiting period and filing the motion for appointment after commencement of the action.

*Id.*

122. In *Madvig v. Gaither*, 461 F. Supp. 2d 398 (W.D.N.C. 2006), following the essentially identical corporate derivative statutory required procedures, the plaintiff made a demand on a corporation, the corporation then immediately put a special litigation committee in place, the complaint was filed, the committee report was then subsequently filed requesting dismissal, and the court ultimately dismissed the complaint, finding that the

2. *Inadvertent failure to carefully follow the rules—particularly when the plaintiffs assume that they may proceed directly*

There are plenty of instances where a member has directly asserted a claim against a manager, not realizing that it should have been a derivative claim. When this occurs, a court is likely to simply dismiss the claim.<sup>123</sup> On occasion, however, courts have taken a more liberal approach and essentially converted the direct suit into a derivative action.<sup>124</sup> In one case, the court of appeals noted that although the lawsuit was essentially a derivative suit and neither the plaintiffs nor the defendants had recognized it as such, the court was willing to proceed without addressing the issues that might be posed by the fact that it was a derivative suit.<sup>125</sup> Despite these plaintiff “victories,” it seems likely that we will continue to see cases brought directly that ultimately are deemed derivative, resulting in early dismissals.

3. *Plaintiff is not a member at the time the action is filed or the LLC is no longer in existence*

In order to sue, the plaintiff must be a member.<sup>126</sup> The issue of whether the plaintiff was still a member when he sued was improperly

committee met the requirements of the statute. *Id.* at 402–04, 410–11. There is no discussion in the opinion as to how the plaintiff challenged the committee’s independence or inquiry procedurally. In *Norman v. Nash Johnson & Sons’ Farms, Inc.*, 537 S.E.2d 248 (N.C. Ct. App. 2000), again applying the identical corporate derivative statute, the court noted that the plaintiff may not commence an action until the statutory period has elapsed following demand, and at that point, the corporation’s independent directors may then determine that the suit is not in the best interests of the corporation. *Id.* at 253.

123. *Peak Coastal Ventures, L.L.C. v. SunTrust Bank*, No. 10 CVS 6676, 2011 NCBC LEXIS 13, at \*23–24 (N.C. Super. Ct. May 5, 2011). The plaintiffs failed to properly plead a derivative claim, since nothing in the complaint stated that the plaintiffs asked the defendant member to explain his actions, rectify the wrong, or authorize suit. *See id.* The plaintiffs also failed to verify the complaint. *Id.*

124. *Crouse v. Mineo*, 658 S.E.2d 33, 38 (N.C. Ct. App. 2008) (concluding that the complaint could support a derivative action even though a plaintiff did not intend to proceed derivatively, since it factually asserted all of the then-required elements for a derivative claim); *see also Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 17, at \*17 (N.C. Super. Ct. Apr. 8, 2013) (“A court may employ a liberal standard to find a derivative action on behalf of a LLC has been stated even though the plaintiff made no effort to label it as such.” (citing *Crouse*, 658 S.E.2d at 40)).

125. *T-WOL Acquisition Co. v. ECDG S., LLC*, 725 S.E.2d 605, 609–10 (N.C. Ct. App. 2012).

126. N.C. GEN. STAT. § 57D-8-01(a)(1) (amended 2014). *See generally* BISHOP & KLEINBERGER, *supra* note 26, ¶ 10.07[1][a], at 10-49 n.224 (discussing situations where persons were and were not deemed members, and thus, did or did not have standing to bring a derivative action).

raised in *Crouse v. Mineo*,<sup>127</sup> but more serious allegations were raised in *Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer*.<sup>128</sup> The defendants in *Brewer* argued that the plaintiffs, in leaving their law firm, had withdrawn from the firm and could not subsequently bring a derivative suit.<sup>129</sup> The plaintiffs countered that although they had started their own new firm (among other indicia of withdrawal), they had not technically “withdrawn” within the meaning of the former North Carolina LLC statute.<sup>130</sup> Rather, their actions caused the law firm to dissolve.<sup>131</sup> Thus, as the firm was in wind-up, the plaintiffs would still be deemed members.<sup>132</sup>

The court noted that under the former statute, “[a] member [could] withdraw *only* at the time or upon the happening of the events specified in the articles of organization or a written operating agreement.”<sup>133</sup> Because the LLC articles apparently did not address the right to withdraw and there was no written operating agreement,<sup>134</sup> the three plaintiffs had not technically withdrawn, despite having clearly “left” their old firm and started a new one.<sup>135</sup> Thus, they still had standing to bring a derivative action.<sup>136</sup> The

127. *Crouse*, 658 S.E.2d 33. The defendant in *Crouse* argued that since the plaintiff filed a petition with the Secretary of State’s Office to dissolve the LLC prior to filing his lawsuit, he was automatically no longer a member pursuant to the North Carolina Limited Liability Act, asserting that section 57C-3-02(3)(d) of the North Carolina General Statutes controlled. *Id.* at 38. The court of appeals concluded that the defendant had misinterpreted the then-applicable statute, and that a member only ceased to be a member under former section 57C-3-02(3)(d) if the member itself filed for its own dissolution. *Id.* at 39–40. Nothing in the 2013 act would seem to change this outcome. Further, there may be some question under the 2013 act whether an entity that is a member of an LLC will cease to be a member by starting dissolution proceedings.

128. *Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer*, 705 S.E.2d 757 (N.C. Ct. App. 2011).

129. *Id.* at 760.

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.* at 768 (emphasis added) (quoting N.C. GEN. STAT. § 57C-5-06 (repealed 2013)).

134. *Id.* The court also rejected the defendants’ argument that certain documents and behavior should have been construed collectively as an operating agreement. *Id.* The trial court had accepted the argument that the plaintiffs were estopped from denying that they had withdrawn, but the court of appeals rejected application of equitable principles. *Id.* at 770–71.

135. *Id.* at 772.

136. *Id.* at 771–72. One reason that the plaintiff should be a member at the time she brings suit is that only one with an ongoing proprietary interest in the entity will adequately represent the entity’s interest—remembering that the entity is deemed the real party in interest, entitled to any recovery. *Schupack v. Covelli*, 498 F. Supp. 704, 705 (W.D. Pa. 1980). The *Brewer* result is inconsistent with this principle, because the *Brewer* plaintiffs

court also allowed both sides' claims that the other had breached fiduciary duties to proceed, some directly and some derivatively.<sup>137</sup>

The result in *Brewer* might be very different under the new LLC act. New section 57D-3-02(a)(4) provides that a person ceases to be a member when the person abandons all of the rights of his ownership interest except for his economic interest.<sup>138</sup>

If a plaintiff is deemed to no longer be a member when she leaves her law firm and sets up a new firm, under the new statute, she will be unable to pursue even a derivative action, since only a "member" may bring a derivative action.<sup>139</sup> Further, if the defendant's asserted wrongful "act or omission" technically occurred after the plaintiff "abandoned" her interest, the plaintiff will not have standing.<sup>140</sup>

It seems highly likely that when lawyers practicing together in LLCs have a falling out, as described in *Crouse* and *Brewer*,<sup>141</sup> that one or more will simply walk out the door and immediately set up a new practice without considering the possible ramifications that this may have on any rights they might have to sue their former "partners." It should be noted that it is much more likely that if a member engages in the types of activities that these plaintiffs carried on, such as walking out of meetings, stating that they were quitting, forming a new firm, and writing letters stating that they were withdrawing, the court will have no trouble finding

merely wanted their money from the LLC and had no interest in continuing with their old firm. *Brewer*, 705 S.E.2d at 769.

137. *Brewer*, 705 S.E.2d at 773–74.

138. N.C. GEN. STAT. § 57D-3-02(a)(4) (amended 2014). This provision can apparently be modified in the operating agreement per section 57D-2-30(b), and counsel should consider with the clients whether it should be modified when drafting the operating agreement. A person's ownership interest is defined as:

All of an interest owner's rights and obligations as an interest owner in an LLC, including (i) any economic interest, (ii) any right to participate in the management or approve actions proposed by persons responsible for the management of the LLC, (iii) any right to bring a derivative action, and (iv) any right to inspect the books and records of or receive information from the LLC.

*Id.* § 57D-1-03(25). An "interest owner" is "[a] member or an economic interest owner."  
*Id.* § 57D-1-03(15).

139. *Id.* § 57D-8-01(a).

140. *Id.* § 57D-8-01(a)(1)(i). For example, as in the *Brewer* case, is the failure to pay the plaintiff her share of LLC funds determined when the remaining members make initial statements of refusal to pay, or is it at some later point after the plaintiff has abandoned the firm and the defendants then definitely refuse to pay? If the operative event is deemed to occur after she abandons, she has no right to pursue a derivative claim. *See Brewer*, 705 S.E.2d at 771–72.

141. *See Brewer*, 705 S.E.2d at 760; *Crouse v. Mineo*, 658 S.E.2d 33, 35 (N.C. Ct. App. 2008).

that the member has “abandoned,” either because the operating agreement will state that such behavior constitutes withdrawal, or the court will conclude that her actions constitute an abandonment under the statute.<sup>142</sup> One can anticipate that in many, if not most, instances, the court will find that their behavior is a withdrawal or dissociation, thus preventing them from suing. There is no right to a direct suit because there are no duties owed to them, and no right to a derivative suit because they are no longer members. If this happens with law firms, as *Crouse* and *Brewer* demonstrate, it will certainly occur in a non-law-firm setting, wherein the “dissociating” members will surely have “no clue” that their behavior in leaving has cut off any rights they may have had as former members.<sup>143</sup> In North Carolina and in many other states, the withdrawn member will no longer have a right to bring even a derivative suit to try and rectify any wrongful behavior that triggered her leaving.<sup>144</sup>

If the LLC is no longer in existence, a derivative suit will almost never be permitted.<sup>145</sup> Note that the fact that the LLC has dissolved does not

142. N.C. GEN. STAT. § 57D-3-02(a)(4).

143. In fact, this situation has already arisen outside of the law-firm context. *See, e.g., Hosp. Consultants, LLC v. Angeron*, 41 So. 3d 1236, 1241 (La. Ct. App. 2010) (holding that an individual who would automatically become a member of the LLC if the controlling party had not allegedly improperly failed to pay debenture owed by the LLC (and instead misappropriated the needed funds), was not a member and thus had no standing to bring a derivative suit claiming misuse of funds); *Gowin v. Granite Depot, LLC*, 634 S.E.2d 714, 717–18, 722 (Va. 2006) (reversing the trial court’s determination that an 80% member had amended the articles of organization and then properly used the amended articles as a method to terminate the 20% member, and as such, the former 20% member had no standing to bring a derivative suit complaining about his removal); *see also James R. Burkhard, Resolving LLC Member Disputes in Connecticut, Massachusetts, Pennsylvania, Wisconsin, and the Other States That Enacted the Prototype LLC Act*, 67 BUS. LAW. 405, 422–23 (2012) (asserting that a Massachusetts opinion wrongly concluded that a member no longer had standing to bring a derivative suit because the LLC was dissolved).

144. *See RIBSTEIN & KEATINGE, supra* note 4, § 10:3, at 651 n.15 (listing cases where standing by a former member was contested); *cf. Cameron v. Rohn*, No. 10-126, 2012 U.S. Dist. LEXIS 18986, at \*9–13 (D.V.I. Feb. 14, 2012). In a law firm break-up that occurred in the Virgin Islands, the defendant argued that the plaintiff, who had clearly withdrawn from the LLC, lacked standing to bring direct claims. *Id.* Although the court concluded, based on its interpretation of the Uniform Limited Liability Company Act, that the plaintiff, as a withdrawn member, still could pursue her direct claims, *id.* at \*12–13, it undoubtedly could have concluded that she would have been barred from bringing a derivative claim.

145. *See, e.g., Price v. Upper Chesapeake Health Ventures*, 995 A.2d 1054, 1062 (Md. Ct. Spec. App. 2010) (“[A]n LLC whose rights have been forfeited for tax failures still exists as an entity, but may only defend an action in court, not prosecute one.”). However, if the LLC managers deliberately failed to file tax returns in order to defeat the plaintiffs’ standing, it would be inequitable to prohibit the plaintiff from pursuing a derivative suit. *Id.* at 1066–68.

mean that it is no longer in existence.<sup>146</sup> In fact, the statute provides that “[t]he dissolution of the LLC does not prevent commencement of a proceeding by or against the LLC in its own name.”<sup>147</sup>

Another problem that is not cured by the new LLC act is that if a member who would have standing to bring a derivative suit dies and her membership interest is left by will to her husband or child, that person will not have standing to bring the action. The statute provides that if a membership “devolves” on a person, he will have standing to bring the action.<sup>148</sup> However, unless specifically provided for in the operating agreement or agreed to by the members,<sup>149</sup> the beneficiary will not be a “member,” but a mere “economic interest” owner.<sup>150</sup> Thus, the beneficiary will not be entitled to bring the derivative suit. A number of states have cured this problem and permit the beneficiary, standing in the shoes of the decedent, to bring the action.<sup>151</sup>

4. *A plus for the plaintiffs, the new statute may make it much more difficult for the defendants to have the suit dismissed*

In the typical derivative squabble, the defendants may attempt to have the action dismissed, likely by a motion to dismiss on the grounds that the maintenance of the proceeding is not in the best interests of the LLC. Adopting the corporate procedures, such a motion must be made by an independent body, and if it is not, the motion must be dismissed.<sup>152</sup> In the context of LLC disputes, it seems likely, as described below, that it will be difficult to assemble an independent body, and one wonders whether the defendants will have the forethought to utilize the option of a court-appointed independent panel.<sup>153</sup>

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146. N.C. GEN. STAT. § 57D-6-07 (stating that the dissolved LLC goes into “wind up” mode).

147. *Id.* § 57D-6-07(f).

148. *Id.* § 57D-8-01(a)(1).

149. *Id.* § 57D-5-04.

150. *Id.* §§ 57D-3-01(b), -5-02.

151. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-1001 (2013) (stating that an assignee is entitled to bring a derivative action).

152. N.C. GEN. STAT. § 57D-8-03(b); *see* MODEL BUS. CORP. ACT § 7.44 introductory cmt. (AM. BAR ASS’N, amended 2013) (noting that a motion to dismiss must be made by eligible decision makers); *see also* Blake v. Friendly Ice Cream Corp., No. 03-0003, 2006 Mass. Super. LEXIS 241, at \*36 (Mass. Super. Ct. May 24, 2006) (“A motion to dismiss premised upon the determination of an improperly constituted [Special Litigation Committee] is statutorily insufficient.”).

153. N.C. GEN. STAT. § 57D-8-03(f).

The *Brewer* case is a typical example.<sup>154</sup> In *Brewer*, there were seven lawyers in the LLC.<sup>155</sup> Three lawyers complained that the other four had acted improperly to deny them LLC profits to which they were entitled.<sup>156</sup> Apparently, all four of the remaining members were in agreement not to pay the plaintiffs.<sup>157</sup> Although the statute states that merely naming the four as defendants does not automatically disqualify them,<sup>158</sup> as to the defendants who actually made the decision not to pay, it would be hard for a court to conclude that they are “independent.”<sup>159</sup> They would personally gain by not paying the profits that the plaintiffs claimed that they were properly entitled to, and as such, they could hardly be deemed disinterested or independent.

In *LeCann v. Cobham*,<sup>160</sup> the plaintiff and defendant were each 50% shareholders.<sup>161</sup> The plaintiff established that the defendant had wrongfully withdrawn hundreds of thousands of dollars from their four equally owned corporations.<sup>162</sup> The defendant herself obviously would be conflicted and could not be an “independent” party entitled to move to dismiss the complaint, and would not even have the requisite voting power to ask the court to appoint a disinterested panel.

In *Scott v. Lackey*,<sup>163</sup> the plaintiff alleged that the defendant managers improperly diverted funds from the LLC for their own personal use, and improperly covered up the diversion.<sup>164</sup> Under the circumstances, it was

154. Mitchell, *Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer*, 705 S.E.2d 757 (N.C. Ct. App. 2011).

155. *Id.* at 760.

156. *Id.* at 761.

157. *Id.*

158. N.C. GEN. STAT. § 57D-8-03(c)(2) (providing that “[t]he naming of [a] person as a defendant in [a] derivative proceeding or as a person against whom action is demanded,” by itself, will not “necessarily preclude [that] person from being considered to be independent”).

159. This conclusion is supported in part by section 57D-8-03(c)(3) of the North Carolina General Statutes, which also provides that a person’s approval of the act challenged in the derivative proceeding or demand will not, by itself, preclude that person from being considered independent so long as “the act resulted in no personal benefit to the person.” *Id.* § 57D-8-03(c)(3). In the *Brewer* case, the decision not to pay the plaintiffs resulted in personal benefits to the defendants. See *Brewer*, 705 S.E.2d at 761.

160. *LeCann v. Cobham*, No. 10 CVS 11169, 2012 NCBC LEXIS 58 (N.C. Super. Ct. Nov. 7, 2012).

161. *Id.* at \*1–2.

162. *Id.* at \*10.

163. *Scott v. Lackey*, No. 11 CVS 19560, 2012 NCBC LEXIS 60, at \*3–4 (N.C. Super. Ct. Dec. 3, 2012).

164. *Id.* at \*6–10.

essentially impossible for the defendants to plausibly assert their independence, thus negating their ability to move to dismiss.<sup>165</sup>

Most courts will likely determine that a manager or member is independent if she has neither (1) a material interest in the outcome of the proceeding (that would not devolve on the LLC or members generally), nor (2) a material relationship with a person who has such an interest (including a familial, financial, professional, or employment relationship that would reasonably be expected to impair the director's objectivity).<sup>166</sup> The Robinson treatise defines the term "independent" as "both disinterested by reason of not having an interest in the challenged act and objective in the sense of not being influenced in favor of the defendants by reason of personal or other relationships (the so-called 'structural bias')." <sup>167</sup>

However, both Massachusetts and Wisconsin have adopted a much broader seven-factor "totality of the circumstances" test.<sup>168</sup> Wisconsin has

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165. *Id.*

166. *See, e.g.,* Sojitz Am. Capital Corp. v. Kaufman, 61 A.3d 566, 573 (Conn. App. Ct. 2013) (applying the model act term "qualified," which presumably means the same (quoting CONN. GEN. STAT. §§ 33-605(a)(1), (b)(1) (2013))); *see also* Halebian v. Berv, 869 F. Supp. 2d 420, 444-45 (S.D.N.Y. 2012). The *Halebian* court stated:

[W]hile § 7.44 [of the parallel Massachusetts Business Corporation Act] does not define "independent," the comments to the section do illuminate the intent of its drafters as to the term's meaning. . . . In the first of these comments, the drafters observed that "[o]ther jurisdictions examin[ing] the qualifications of directors making the determination have required that they be both "disinterested" . . . and "independent." The drafters explicate "disinterested" in this sense to mean "not having a personal interest in the transaction being challenged as opposed to a benefit which devolves upon the corporation or all shareholders generally" and "independent" to mean "not being influenced in favor of the defendants by reason of personal or other relationships."

*Id.* (citations omitted); *see* MODEL BUS. CORP. ACT § 1.43 (AM. BAR ASS'N, amended 2013) (defining "qualified director").

167. ROBINSON, *supra* note 96, § 17.08[3], at 17-33 (7th ed. 2014).

168. *Blake v. Friendly Ice Cream Corp.*, No. 03-0003, 2006 Mass. Super. LEXIS 241, at \*46-47 (Mass. Super. Ct. May 24, 2006). The court stated:

The totality of the circumstances test considers the following nonexclusive list of factors: (1) an SLC member's status as a defendant and whether this potential liability is small or substantial, direct or indirect; (2) whether the SLC member's participation in or approval of the alleged wrongdoing was substantial or the result of innocent or pro forma involvement or affiliations; (3) an SLC member's past or present business dealings with the corporation; (4) an SLC member's past or present business or social dealings with individual defendants; (5) the number of directors on the SLC, such that with the greater number of directors, less weight may be accorded to any disabling interest affecting only one director; and (6) the structural bias of the SLC, such as whether the manner in which the SLC was appointed and proceeded was inevitably bound to be empathetic to the defendants

admonished that this test should be applied with “care and rigor”<sup>169</sup> and that the trial court must “*examine carefully* whether members of a special litigation committee are independent.”<sup>170</sup> The Wisconsin Supreme Court noted that its test, along with the provisions of the model act adopted in Wisconsin (and now also in North Carolina), are designed to overcome the effects of any structural bias inherent in having members of the board pass judgment on their peers.<sup>171</sup>

The three model act factors (adopted in North Carolina) that do not automatically preclude a person from being independent have been held to “not support the conclusion that the Legislature intended to set a low threshold for the standard of independence.”<sup>172</sup>

North Carolina court opinions determining whether directors of a Delaware corporation or LLC doing business in North Carolina are sufficiently independent to “excuse demand” may also be helpful in determining when a manager is deemed independent.<sup>173</sup> Similar “demand excused” cases in other jurisdictions suggest that it may be quite common for the court to easily find that the defendants in LLC disputes are not “independent.”<sup>174</sup> For example, demand has been excused, essentially acknowledging that the defendants are not independent, when the managing party had an interest in both sides of a transaction, each director received individual annual consulting fees being questioned, or when a

and therefore biased in favor of terminating the litigation. Some courts add as a seventh factor the roles of corporate counsel and independent counsel, such that an SLC is more likely to be found independent if it retains counsel who has not represented individual defendants or the corporation in the past.

*Id.* (citations omitted); *see also* *Einhorn v. Culea*, 612 N.W.2d 78, 89–90 (Wis. 2000). *See* generally Jay M. Zitter, Annotation, *Propriety of Termination of Properly Initiated Derivative Action by “Independent Committee” Appointed by Board of Directors Whose Actions (Or Inaction) Are Under Attack*, 22 A.L.R.4th 1206 (1983).

169. *Einhorn*, 612 N.W.2d at 91.

170. *Id.* at 87 (emphasis added).

171. *Id.* at 90.

172. *Blake*, 2006 Mass. Super. LEXIS 241, at \*41–42 (citing *Einhorn*, 612 N.W.2d at 86–87); *Einhorn*, 612 N.W.2d at 81 (“[T]he circuit court and the court of appeals erred in declaring that the threshold established by the legislature in § 180.0744 in determining whether a member of a special litigation committee is independent is ‘extremely low.’”).

173. *See, e.g., In re Pozen S’holders Litig.*, Nos. 04 CVS 1540, 04 CVS 1542, 2005 NCBC LEXIS 7, at \*16–43 (N.C. Super. Ct. Nov. 10, 2005); *Marcoux v. Prim*, No. 04 CVS 920, 2004 NCBC LEXIS 4, at \*43–47 (N.C. Super. Ct. Apr. 16, 2004) (discussing tests to determine if directors were independent in approving a proposed merger).

174. *See, e.g., Sacher v. Beacon Assocs. Mgmt. Corp.*, No. 005424/09, 2010 N.Y. Misc. LEXIS 992, at \*22–23 (N.Y. Sup. Ct. Apr. 26, 2010) (excusing demand against the manager of an LLC who had self-interest in not being sued for breach of duty); *see also* RIBSTEIN & KEATINGE, *supra* note 4, § 10:3, at 653 n.20.

controlling member used the business's assets to divert value to himself and away from the controlled business and its minority owners.<sup>175</sup>

When a derivative claim is brought against the managers or controlling members, it is certainly possible that the defendants, anticipating that a court might not accept their motion to dismiss, might ask the court to appoint a panel composed of one or more independent persons to determine whether the maintenance of the derivative proceeding is in the best interest of the LLC, in hopes that the panel will determine that the lawsuit should not continue.<sup>176</sup> If the panel moves to dismiss, apparently the court must grant the motion unless the panel failed to conduct an appropriate inquiry, with the burden placed on the plaintiff to demonstrate the inadequacy.<sup>177</sup> How often will the defendants resort to this procedure in the context of a five- or ten-person LLC with squabbles as to whether one or more members engaged in inappropriate behavior? One would assume that this will not be a commonly used procedure. Will counsel even consider this as a possibility?

However, for the plaintiff to effectively challenge the defendant's "independence," the plaintiff often will likely have to assert essentially the same facts that would prove the merits of her case.<sup>178</sup>

In considering these various steps, one wonders whether there is that much difference between North Carolina's requirement that a demand must always be made, and those states which permit the plaintiff to assert that demand is not required. Will the arguments as to whether the case should proceed be at all different in the two types of jurisdictions?

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175. See DEMOTT, *supra* note 86, § 5:13, at 703–53 (listing numerous examples of the criteria for excuse regarding demand on directors); see also RIBSTEIN & KEATINGE, *supra* note 4, § 10:3, at 654 n.22 (listing LLC decisions where demand has and has not been excused in LLC litigation, noting factors that likely will be similarly applied to determine if LLC managers or those moving to dismiss are independent); 7C CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 1831, at 123–26 (3d ed. 2007). Wright explains that a plaintiff should not be forced to “undertake a purely ritualistic act,” such as when “the basis of [the] plaintiff’s complaint is mismanagement or fraud on the part of a majority of the directors themselves.” *Id.* at 123. “Thus, a demand may be excused when plaintiff alleges, with supporting facts, that the individual directors are the alleged wrongdoers or are under the control of the real defendants.” *Id.* at 123–24 (footnote omitted).

176. N.C. GEN. STAT. § 57D-8-03(f) (amended 2014).

177. *Id.*

178. *Cf.* DEMOTT, *supra* note 86, § 5:13, at 744–45 (noting that the Delaware approach “requires the court to resolve dispositive substantive questions about the merits of the litigation in the context of determining whether the demand ‘prerequisites’ for suit have been met” before the “[f]actual issues have . . . been developed . . . through trial,” and that the plaintiff at that point is not “entitled to take discovery to supplement his allegation that making a demand would be futile”).

5. *The plaintiff may have difficulty pleading “particularized facts”*

The North Carolina statutory requirement that a petitioning member must plead “particularized facts” is a requirement that has caused plaintiffs substantial headaches in regard to other derivative issues.<sup>179</sup> Even if the evidence admitted by the court demonstrates that a defendant’s motion to dismiss should be denied, if the plaintiff’s pleadings do not meet the requisite factual particularity-pleading requirement, the court can grant the motion to dismiss.<sup>180</sup>

The Wright and Miller treatise explains that in the analogous pleading of “demand futility,” which also requires “particularized factual pleading,” “it is a good practice to provide as detailed an explanation in the complaint concerning the lack of a demand as is possible.”<sup>181</sup> As the Supreme Court of Delaware stated, “[a] prolix complaint larded with conclusory language . . . does not comply with these fundamental pleading mandates.”<sup>182</sup> Apparently, the plaintiff is not required to plead “evidence.”<sup>183</sup> The Wright and Miller treatise lists numerous cases in which the plaintiff has attempted to adequately plead facts necessary to justify a finding that demand should be excused. Not surprisingly, in a significant number of the cited cases, the plaintiff failed to adequately plead sufficient facts.<sup>184</sup> This frequent failure suggests that it may be equally difficult for a North Carolina plaintiff to challenge, on the pleadings, either the independence of the alleged wrongdoing managers or members or the sufficiency of their inquiry.<sup>185</sup>

179. See generally Alan J. Jacobs, *Derivative Actions by Shareholders*, in 10 FEDERAL PROCEDURE, LAWYERS EDITION §§ 25:111 to :144, at 270–98 (Francis M. Dougherty & Julie R. Cataldo eds., 2007) (discussing the similar requirements for pleading particularized facts that will demonstrate that demand is not required as a prerequisite to a derivative suit). *But cf.* *McKee v. James*, No. 09 CVS 3031, 2013 NCBC LEXIS 33, at \*24–25 (N.C. Super. Ct. July 24, 2013) (noting that the plaintiffs failed to plead with particularity the information that was withheld).

180. See *Sojitz Am. Capital Corp. v. Kaufman*, 61 A.3d 566, 576 n.16 (Conn. App. Ct. 2013).

181. WRIGHT ET AL., *supra* note 175, § 1831, at 118.

182. *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

183. See, e.g., *La. Mun. Police Emps.’ Ret. Sys. v. Pyott*, 46 A.3d 313, 351 (Del. Ch. 2012) (noting that the requirement of pleading particular facts does not require the plaintiff to plead evidence (quoting *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004))), *rev’d on other grounds*, 74 A.3d 612 (Del. 2013).

184. WRIGHT ET AL., *supra* note 175, § 1831, at 114 n.24, 131 n.42.

185. On the other hand, in *Scott v. Lackey*, a 2012 business court case, the plaintiff had little difficulty in adequately pleading numerous causes of action against his co-managers. See *Scott v. Lackey*, No. 11 CVS 19560, 2012 NCBC LEXIS 60, at \*61 (N.C. Super. Ct. Dec. 3, 2012).

A Missouri opinion suggests that the critical determination as to whether one has sufficiently pleaded particularized facts is simply whether the defendant knows what the action involves.<sup>186</sup>

6. *It is likely unclear how a court will determine if a proper evaluation has been made by those seeking to dismiss*

Courts may be very critical of the evaluation. In the analogous context, when courts have been asked to review the work of a special litigation committee, they sometimes have been very critical,<sup>187</sup> especially where the committee has failed to cite to specific sources to verify its assertions.<sup>188</sup> The Tennessee Court of Appeals suggested that the court should examine “(1) the length and scope of the investigation, (2) the committee’s use of independent counsel or experts, (3) the corporation’s or the defendants’ involvement, if any, in the investigation, and (4) the adequacy and reliability of the information supplied to the committee.”<sup>189</sup>

However, the plaintiff’s burden “is not just to show that the [special litigation committee’s (SLC)] inquiry and report were flawed, or that someone else might have reached a different conclusion, but that the SLC’s ‘inquiry and . . . conclusions [do not] follow logically.’”<sup>190</sup> As the United States District Court for the District of Connecticut explained, “[t]he shareholder demand process does not require an SLC to do litigation-type discovery before arriving at its conclusions.”<sup>191</sup> The defendants’ failure to interview possible critical witnesses and obtain an independent financial analysis may not be grounds to reject their report.<sup>192</sup> The fact that the defendant committee had infrequent and brief meetings, the investigation lasted only one month, counsel reviewed documents on their own, and limited fees were spent for the investigation may not be a basis for

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186. *New England Carpenters Pension Fund v. Haffner*, 391 S.W.3d 453, 461 (Mo. Ct. App. 2012) (quoting *Bennett v. Mallinckrodt, Inc.*, 698 S.W.2d 854, 865 (Mo. Ct. App. 1985)).

187. *Blake v. Friendly Ice Cream Corp.*, No. 03-0003, 2006 Mass. Super. LEXIS 241, at \*79 (Mass. Super. Ct. May 24, 2006) (“[T]he SLC’s investigation was so lacking in substance, scope and support as to raise serious questions about the good faith and reasonableness of the SLC’s inquiry.”).

188. *Id.*

189. *Lewis v. Boyd*, 838 S.W.2d 215, 224 (Tenn. Ct. App. 1992).

190. *Frank v. LoVetere*, 363 F. Supp. 2d 327, 335 (D. Conn. 2005) (quoting MODEL BUS. CORP. ACT § 7.44 cmt. 2 (AM. BAR ASS’N, amended 2013)); *see also* *Sojitz Am. Capital Corp. v. Kaufman*, 61 A.3d 566, 580 (Conn. Ct. App. 2013) (“Accordingly, the court may conduct a limited review into the board’s conclusions to determine that they follow logically from the inquiry, but may not scrutinize the reasonableness of its determination.”).

191. *See Frank*, 363 F. Supp. 2d at 338.

192. *Id.* at 335–38.

challenging the report.<sup>193</sup> However, in another action, a former general counsel and his firm spent one thousand hours gathering relevant facts, including collecting and reviewing over twenty thousand pages of documents, in advising a special litigation committee.<sup>194</sup>

In an older corporate derivative suit, the North Carolina Supreme Court noted that, in evaluating the procedures of a special litigation committee, the plaintiffs must be permitted to develop and present evidence that (1) the committee may have been unqualified to assess the “intricate and allegedly false tax and accounting information supplied to it by those within the corporate structure who would benefit from decisions not to proceed with litigation,” (2) that the committee received false or incomplete information for evaluation, and (3) that, because of those problems, “the committee’s decision with respect to the litigation eviscerates plaintiffs’ opportunities as minority shareholders to vindicate their rights under North Carolina law.”<sup>195</sup>

In a comparable situation that dealt with whether the defendants properly rejected a demand, the court concluded that it could consider allegations of self-interest in determining if the decision was reached in good faith and with reasonableness.<sup>196</sup> The defendants’ refusal to meet with the plaintiff and their assertion that they retained a stake in a claimed improper distribution from the LLC drew into question their good faith and reasonable investigation into the demand.<sup>197</sup>

7. *The role of the court in ruling on a defendant’s motion to dismiss may be confusing*

If the plaintiff files a derivative action and the defendants move to dismiss, it may be unclear how the parties should proceed and which standards should be applied. The North Carolina Business Court Rules note that if “allegations of facts not appearing of record are relied upon to support a motion, affidavits, parts of depositions, and other pertinent documents then available shall accompany the motion.”<sup>198</sup> In evaluating whether to dismiss, the North Carolina court apparently should not treat this as a simple Rule 12(b)(6) motion, and not even merely as a motion for summary judgment, since the court must make findings of fact regarding

193. *Id.* at 335 n.6.

194. *Halebian v. Berv*, 869 F. Supp. 2d 420, 432 (S.D.N.Y. 2012).

195. *Alford v. Shaw*, 358 S.E.2d 323, 328 (N.C. 1987).

196. *Scott v. Lackey*, No. 11 CVS 19560, 2012 NCBC LEXIS 60, at \*28–29 (N.C. Super. Ct. Dec. 3, 2012).

197. *Id.* at \*30–31.

198. N.C. BUS. CT. R. 15.5.

the independence of the moving body and whether proper procedures were used.<sup>199</sup>

Federal courts attempting to resolve similar derivative claims have found this difficult, requiring the court to convert what would normally be a Rule 12(b)(6) motion into one for summary judgment (still a “step below” the apparent North Carolina procedures).<sup>200</sup> Both Connecticut and Massachusetts have also adopted section 7.44 of the model act, and like North Carolina, have noted that such a motion is not treated simply as a Rule 12(b)(6) motion to dismiss.<sup>201</sup>

Georgia courts have noted that when a defendant moves to dismiss a derivative action, the motion “is perhaps best considered as a hybrid summary judgment motion for dismissal because the stockholder plaintiff’s standing to maintain the suit has been lost.”<sup>202</sup> A federal opinion noted that the Connecticut statute contemplates “that the court will review the plaintiff’s complaint on its face, using a heightened review standard akin to that required in fraud cases,” since discovery is only available to the plaintiff after she has first successfully stated a cause of action.<sup>203</sup> However, the court will consider the plaintiff’s proffered *evidence* as to whether the determination to dismiss was made independently, in good faith, and, after reasonable inquiry, if the parties have agreed to discovery,

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199. See *Alford v. Shaw*, 398 S.E.2d 445, 457 (N.C. 1990) (applying essentially the identical corporate derivative statute and concluding that the trial judge, not the jury, must hold an evidentiary hearing); cf. *Thompson v. Sci. Atlanta, Inc.*, 621 S.E.2d 796, 798–99 (Ga. Ct. App. 2005) (stating that the company’s motion was supported by a voluminous and detailed report for which the plaintiff failed to come forward with “evidence” challenging the lack of independence of those requesting dismissal).

200. See *Halebian v. Berv*, 644 F.3d 122, 130–31 (2d Cir. 2011).

201. See *Sojitz Am. Capital Corp. v. Kaufman*, 61 A.3d 566, 572 (Conn. Ct. App. 2013). The *Sojitz* court explains:

Section 33-724 is distinguishable from other motions to dismiss, as it sets forth a unique, heightened pleading standard and elements that must be either proven or disproven. In light of these substantive requirements, other jurisdictions have similarly concluded that dismissals pursuant to § 7.44 of the model act are unique. . . . [T]hese jurisdictions have concluded that trial courts, in their discretion, may issue discovery orders. In rendering judgments on these motions to dismiss, trial courts and appellate courts have thus reviewed the entire record, consisting of the complaint and documents submitted in support of and opposition to the motion to dismiss—in some instances the courts have even considered and resolved disputed factual issues.

*Id.* (citing numerous cases, including *Halebian*, 644 F.3d at 130–31).

202. *Thompson*, 621 S.E.2d at 799 (quoting *Millsap v. Am. Family Corp.*, 430 S.E.2d 385, 388 (Ga. Ct. App. 1993)).

203. *Frank v. LoVetere*, 363 F. Supp. 2d 327, 333 (D. Conn. 2005).

but the plaintiff must still show “with particularity” facts supporting his allegations.<sup>204</sup>

At least two states have determined that an appeal from a trial court’s determination to dismiss will be reviewed by an appellate court as a mixed question of fact and law, and thus will be subject to plenary review by the appellate court.<sup>205</sup>

Whatever procedures are followed, it is likely that this will not be a simple matter for the court to resolve. A six-day hearing occurred in the *Alford* litigation,<sup>206</sup> and a seven-day trial was required in Wisconsin to determine whether members of a litigation committee were independent.<sup>207</sup>

## V. RECOMMENDATIONS FOR AVOIDING THE PITFALLS OF DERIVATIVE LITIGATION

The problems that will likely be created by the default rules in the new LLC act suggest that counsel need to advise their clients on the possibility of drafting around these problems or pursuing a different type of remedy.

### A. *Alternative: Include an Arbitration Clause or Pursue Mediation*

#### 1. *Arbitration*

One obvious possibility is that the operating agreement could contain a clause that requires all disputes among members and managers to be resolved through arbitration. Bishop and Kleinberger point out in their treatise that such provisions should be enforceable, but they raise some question as to whether the operating agreement could displace or place barriers on the use of derivative suits.<sup>208</sup> The North Carolina statute says that you can,<sup>209</sup> but Bishop and Kleinberger question whether private agreements can restrain a court’s power to do equity.<sup>210</sup> O’Neal and

204. *Id.*

205. *Sojitz*, 61 A.3d at 572–73.

206. *Alford v. Shaw*, 398 S.E.2d 445, 458 (N.C. 1990).

207. *See Einhorn v. Culea*, 612 N.W.2d 78, 83 (Wis. 2000).

208. *See* BISHOP & KLEINBERGER, *supra* note 26, § 10.07[3], at S10-54 to -55 (Cum. Supp. No. 1 2009); *see also* RIBSTEIN & KEATINGE, *supra* note 4, § 10:3, at 663 (“There is significant authority enforcing arbitration as an alternative to derivative suits in LLCs. However, the courts may interpret the arbitration clause so as to limit its application. In general, there is a growing body of law interpreting arbitration clauses in LLC operating agreements.”).

209. N.C. GEN. STAT. § 57D-2-30(b)(5) (amended 2014).

210. BISHOP & KLEINBERGER, *supra* note 26, § 10.07[3], at S10-54 to -55 (Cum. Supp. No. 1 2009).

Thompson point out that attempts to arbitrate matters of dissolution have been prohibited.<sup>211</sup>

As a word of caution, arbitration can be a lengthy process. A recent two-member LLC arbitration took eight years to be resolved.<sup>212</sup> Maybe we should all heed the comments of Judge Joseph F. Anderson, a well-respected federal judge, that today's courts can provide a much quicker forum than arbitration.<sup>213</sup>

## 2. Mediation

North Carolina LLC disputes will almost always be resolved in the North Carolina Business Court.<sup>214</sup> "As such, all cases . . . shall be subject to the Rules Implementing Statewide Mediated Settlement Conferences in Superior Court Civil Actions and such other rules or orders consistent therewith as may be established or entered by the Business Court."<sup>215</sup> Although the court does not keep statistics regarding how many actions are resolved through mediation, former Chief Judge Jolly of the North Carolina Business Court has advised that even when the mediation process does not resolve the matter, the process often provides both sides with important information leading to a settlement.<sup>216</sup>

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211. See 2 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLCs § 9:46, at 9-303 (rev. 3d ed. 2014) [hereinafter O'NEAL & THOMPSON, CLOSE CORPORATIONS AND LLCs].

212. Kriti Ripley, LLC v. Emerald Invs., LLC, 746 S.E.2d 26, 27–29 (S.C. 2013) (describing a series of arbitrations and suits starting in 2005 and lasting through the South Carolina Supreme Court's decision in 2013).

213. Cox v. Time Warner Cable, Inc., Nos. 3:12-cv-03333-JFA, 4:12-cv-03407-JFA, 2013 U.S. Dist. LEXIS 140602, at \*3 n.1 (D.S.C. Sept. 30, 2013).

214. See N.C. GEN. STAT. § 7A-45.4(a)(1).

215. N.C. BUS. CT. R. 19.1. To implement the mediation, Business Court Rule 17.1(h) requires the parties in the case-management meeting to cover "[t]he timing of any mediated settlement conference . . . and the selection of a mediator or group of mediators." *Id.* R. 17.1(h). In implementing this, the case-management order (Business Court Form 2) specifically requires the parties to file the name of the mediator that they have selected and to designate that mediation shall be completed by a specified date. See Form 2, at 50, [http://www.ncbusinesslitigationreport.com/Hyperlinked%20Rules\(1\).pdf](http://www.ncbusinesslitigationreport.com/Hyperlinked%20Rules(1).pdf) (last visited May 2, 2015).

216. Telephone Interview with Hon. John R. Jolly, Jr., former Chief Special Superior Court Judge for Complex Business Cases, N.C. Business Court (Oct. 3, 2013). Former Chief Judge Jolly also pointed out that most litigation is usually settled and does not go to trial. *Id.*

### B. Provide for Dispute Resolution in the LLC Buy–Sell Agreement

Every well-drafted LLC operating agreement should include some sort of buy–sell agreement.<sup>217</sup> It may be possible to draft an equitable buy–sell agreement that would be triggered by a dispute among the members.

### C. Bring an Action for Oppression

An alternative that may be particularly attractive in North Carolina for an unhappy LLC member is to bring an action for oppression under section 57D-6-02 of the North Carolina General Statutes.<sup>218</sup> The North Carolina cases where this claim has been raised in the context of a close corporation are particularly favorable to an unhappy member, including the widely noted *Meiselman*<sup>219</sup> opinion, which established a four-step requirement for relief when the plaintiff asserts that the wrongful actions have frustrated her reasonable expectations.<sup>220</sup> Counsel for the plaintiff should particularly

217. O’Neal and Thompson outline the basic considerations of buy–sell agreements. See O’NEAL & THOMPSON, OPPRESSION, *supra* note 9, § 6:16, at 6-32.

218. N.C. GEN. STAT. § 57D-6-02 (“The superior court may dissolve an LLC in a proceeding brought by . . . [a] member, if it is established that (i) it is not practicable to conduct the LLC’s business in conformance with the operating agreement and [Chapter 57] or (ii) liquidation of the LLC is necessary to protect the rights and interests of the member.”); see also *Battles v. Bywater, LLC*, No. 14 CVS 1853, 2014 NCBC LEXIS 54, at \*24–25 (N.C. Super. Ct. Oct. 31, 2014) (appointing a receiver and noting that “deadlock” is still a ground for dissolution); *Mooring Capital Fund, LLC v. Comstock N.C., LLC*, No. 07 CVS 20852, 2009 NCBC LEXIS 32, at \*23–24 (N.C. Super. Ct. Nov. 13, 2009) (noting that the plaintiff under the former law effectively pleaded facts that suggested dissolution was reasonably necessary to protect the minority’s rights and that assets of the LLC were misapplied or wasted); *Reid Pointe, LLC v. Stevens*, No. 08 CVS 4304, 2008 NCBC LEXIS 16, at \*18–20 (N.C. Super. Ct. Aug. 18, 2008) (reluctantly concluding that a member adequately alleged facts suggesting that liquidation of the LLC was necessary to protect a member’s rights). *Contra Bolier & Co. v. Decca Furniture (USA) Inc.*, No. 5:12-cv-00160-RLV-DSC, 2013 U.S. Dist. LEXIS 26791, at \*12 (W.D.N.C. Feb. 27, 2013) (finding a minority member initially unsuccessful in asserting oppression claims); *High Point Bank & Tr. Co. v. Sapona Mfg. Co.*, 713 S.E.2d 12, 17–18 (N.C. Ct. App. 2011) (finding a shareholder unable to demonstrate that it had a substantial reasonable expectation).

219. *Meiselman v. Meiselman*, 307 S.E.2d 551 (N.C. 1983).

220. *Id.* at 564 (“For plaintiff to obtain relief under the expectations analysis, he must prove that (1) he had one or more substantial reasonable expectations known or assumed by the other participants; (2) the expectation has been frustrated; (3) the frustration was without fault of plaintiff and was in large part beyond his control; and (4) under all of the circumstances of the case plaintiff is entitled to some form of equitable relief.”); see also *Royals v. Piedmont Elec. Repair Co.*, 529 S.E.2d 515, 519–21 (N.C. Ct. App. 2000) (illustrating how the four requirements are applied and affirming decision to order dissolution of a closely held corporation); *Foster v. Foster Farms, Inc.*, 436 S.E.2d 843, 849–50 (N.C. Ct. App. 1993) (applying the analogous prior statute, the trial court failed to make the findings required by *Meiselman*).

note that by statute, an “oppression” claim is automatically a direct cause of action, which avoids the numerous traps in any derivative suit.<sup>221</sup> Further, pursuant to the new LLC statute, all members have a nonwaivable statutory right to bring an action to protect their “rights and interests.”<sup>222</sup> It will also be unlikely that the operating agreement will have waived the other basis for bringing such a suit—that “it is not practicable to conduct the LLC’s business in conformance with the operating agreement and [Chapter 57-D].”<sup>223</sup>

It should be noted that because of amendments to the North Carolina General Statutes, North Carolina courts no longer have the broad, equitable powers to fashion remedies other than liquidation that they had when *Meiselman* was decided.<sup>224</sup> One wonders if courts will be less inclined to determine that an LLC member has been oppressed, knowing that they cannot simply order that the member’s interest be purchased or that the member be provided a stream of income or some other less dramatic remedy other than dissolution of the business. However, in one dissolution action involving a closely held corporation, even though the court concluded that all of the shareholders would be injured if the company was liquidated, the court still ordered liquidation after carefully considering what value the plaintiffs were entitled to, since the defendant, pursuant to the corporate statute, had the statutory option to buy out the complaining minority shareholders at the court-approved value.<sup>225</sup> This statutory option is available to LLCs.<sup>226</sup> Counsel must be careful in precisely pleading the

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221. N.C. GEN. STAT. § 57D-6-02(2) (stating that an action to dissolve is brought by a member); see *Blythe v. Bell*, No. 11 CVS 933, 2013 NCBC LEXIS 17, at \*23 (N.C. Super. Ct. Apr. 8, 2013) (“As the court explained during oral argument, it believes that the *Meiselman* claim is an individual claim separate and apart from the breach of fiduciary duty claims brought derivatively by Drymax [a limited-liability company], even though they arise from a similar evidentiary record.”). See generally *Miller v. Ruth’s of N.C., Inc.*, 313 S.E.2d 849 (N.C. Ct. App. 1984); Kleinberger, *supra* note 84, at 120 (“Will Claims Asserting Oppression Provide an End-Run Around the Direct/Derivative Distinction?”).

222. N.C. GEN. STAT. § 57D-6-02(2)(ii); see also *id.* § 57D-2-30(b)(7) (stating that an operating agreement may not supplant, vary, disclaim, or nullify clause (ii) of section 57D-6-02(2)).

223. *Id.* § 57D-6-02(2)(i).

224. See *High Point Bank & Tr. Co. v. Sapona Mfg. Co.*, No. 08 CVS 1065, 2010 NCBC LEXIS 14, at \*16–18 (N.C. Super. Ct. June 22, 2010) (“Former section 55-125.1 gave the trial court the power to order alternative forms of relief. . . . After *Meiselman*, the Legislature eliminated the alternative remedies to dissolution set forth in section 55-125.1. Courts do not enjoy such broad powers under the current statute.”), *aff’d*, 713 S.E.2d 12 (N.C. Ct. App. 2011); see also *Blythe*, 2013 NCBC LEXIS 17, at \*23.

225. *Garlock v. Se. Gas & Power, Inc.*, No. 00-CVS-01018, 2001 NCBC LEXIS 9, at \*45–50 (N.C. Super. Ct. Nov. 14, 2001).

226. N.C. GEN. STAT. § 57D-6-03(d).

member's right to relief.<sup>227</sup>

O'Neal and Thompson's treatises provide extensive guidance for pursuing an oppression action.<sup>228</sup> The authors note that the most common claim is that it is not reasonably practical to carry on the LLC's business.<sup>229</sup> However, in cases like *Brewer* and *Crouse*, an oppression claim could be equally utilized.<sup>230</sup>

#### D. *Bring a Direct Claim for Declaratory Judgment*

In *Mooring Capital Fund, LLC v. Comstock North Carolina, LLC*,<sup>231</sup> the plaintiff member successfully pleaded a cause of action seeking a declaratory judgment as to the value of its membership interest and the interpretation of the LLC operating agreement.<sup>232</sup> Presumably, clever plaintiffs' attorneys could use this technique even more expansively. In this action, the plaintiff also made a motion for the appointment of a receiver.<sup>233</sup> Although the court denied the request, the court provides guidance as to when this might be appropriate.<sup>234</sup>

#### E. *Provide for an Accounting Remedy*

The North Carolina Court of Appeals, in an unpublished opinion, noted that under the former LLC act, unless modified by the operating agreement, members of a North Carolina LLC had a statutory duty to account for certain improper profits.<sup>235</sup> The court of appeals specifically implied that this statutory duty ran to both the LLC and to its members.<sup>236</sup> In *Brewer*, the court of appeals, in granting the dissolution and winding up

227. *Brady v. Van Vlaanderen*, No. 12 CVS 7552, 2013 NCBC LEXIS 34, at \*10–11 (N.C. Super. Ct. July 24, 2013) (granting the plaintiff leave to amend his complaint to provide more specificity).

228. See O'NEAL & THOMPSON, *CLOSE CORPORATIONS AND LLCs*, *supra* note 211, §§ 9:30 to :52, at 9-188 to -329; see also O'NEAL & THOMPSON, *OPPRESSION*, *supra* note 9, §§ 6:23 to :27, at 6-50 to -66.

229. See O'NEAL & THOMPSON, *CLOSE CORPORATIONS AND LLCs*, *supra* note 211, § 9:51, at 9-323 (discussing LLC cases applying this principle); O'NEAL & THOMPSON, *OPPRESSION*, *supra* note 9, § 6:24, at 6-57 to -61 (same).

230. See *supra* notes 71–75 and accompanying text.

231. *Mooring Capital Fund, LLC v. Comstock N.C., LLC*, No. 07 CVS 20852, 2009 NCBC LEXIS 32 (N.C. Super. Ct. Nov. 13, 2009).

232. *Id.* at \*15–17.

233. *Id.* at \*29.

234. *Id.* at \*30–34.

235. *RSN Props., Inc. v. Jones*, No. COA04-100, 2005 N.C. App. LEXIS 457, at \*8–10 (N.C. Ct. App. Mar. 1, 2005) (citing N.C. GEN. STAT. § 57C-3-22(e) (repealed 2013)).

236. *Id.* at \*8–9.

of the LLC, directed the business court to address both the plaintiffs' individual and derivative claims for an accounting.<sup>237</sup> The business court then appointed a special master to conduct an accounting.<sup>238</sup> Another LLC member was successful in pleading a claim that she was entitled access to all LLC records and to "an accurate accounting of revenues, income, debts, obligations, liabilities, distributions and assets."<sup>239</sup> Further, it seems that often in disputes among LLC members as to the handling of the funds, an accountant will need to sort out the LLC's finances.<sup>240</sup>

Although former section 57C-3-22(e),<sup>241</sup> which required managers to "account" for any improper benefit or profit, has been dropped from the new LLC act, this is an essential agency principle that continues to govern LLCs pursuant to new section 57D-2-30(c).<sup>242</sup> The new LLC act thus essentially incorporates sections 8.11 and 8.12 of the *Restatement (Third) of Agency*, both of which require an agent to account to her principal (presumably only the LLC and not the other members), but both of these duties may be modified.<sup>243</sup>

If one acknowledges that many LLCs actually function as partnerships, then it may be appropriate to include in LLC operating agreements a provision that grants the members the right to bring an

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237. Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer, 705 S.E.2d 757, 773 (N.C. Ct. App. 2011).

238. Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer, No. 06 CVS 6091, 2013 NCBC LEXIS 13, at \*25–26 (N.C. Super. Ct. Feb. 26, 2013).

239. Mooring Capital Fund, LLC v. Comstock N.C., LLC, No. 07 CVS 20852, 2009 NCBC LEXIS 32, at \*18 (N.C. Super. Ct. Nov. 13, 2009); see also Brady v. Van Vlaanderen, No. 12 CVS 7552, 2013 NCBC LEXIS 34, at \*8–9 (N.C. Super. Ct. July 24, 2013) (finding that a member successfully pleaded her right to inspect and copy LLC records and that defendant's 12(b)(6) motion was insufficient to challenge the breadth of that inspection).

240. See LeCann v. Cobham, No. 10 CVS 11169, 2012 NCBC LEXIS 58, at \*7 (N.C. Super. Ct. Nov. 7, 2012). In *LeCann*, the court appointed a CPA to determine the amount of funds that were wrongfully transferred from four closely held entities. *Id.* Even though the accountant was unable to complete the task since the transfers were so numerous and improperly documented, the partial information was sufficient for the court to conclude that the defendant had wrongfully diverted nearly \$600,000. *Id.* at \*7–10.

241. N.C. GEN. STAT. § 57C-3-22(e) (repealed 2013) ("Except as otherwise provided in the articles of organization or a written operating agreement, every manager must account to the limited liability company and hold as trustee for it any profit or benefit derived without the informed consent of the members by the manager from any transaction connected with the formation, conduct, or liquidation of the limited liability company or from any personal use by the manager of its property.").

242. *Id.* § 57D-2-30(c) (amended 2014).

243. RESTATEMENT (THIRD) AGENCY §§ 8.11–.12 (AM. LAW INST. 2006).

accounting action in appropriate circumstances.<sup>244</sup> This Article leaves for another day how such a provision should be drafted.<sup>245</sup> This is left to the creativity of counsel.

#### F. *Action for Breach of Contract?*

The revised North Carolina LLC act is completely based on the notion that an LLC is a creature of contract.<sup>246</sup> The revised act specifically provides that both the law of agency and the law of contracts govern the administration and enforcement of the LLC operating agreement.<sup>247</sup> Even though the prior statute did not include a provision that the law of contracts was to be applied in the enforcement of operating agreements,<sup>248</sup> at least one opinion, *Crouse v. Mineo*,<sup>249</sup> granted a member the right to directly sue his co-member on a quantum meruit claim.<sup>250</sup> In another case, a member's individual claim, asserting that the managers breached their contractual

244. See, e.g., *Six Corners Same Day Surgery, LLC v. Macchione*, No. 11 CH 18215, 2013 WL 2145005, at \*11–12 (Cook County, Ill. Cir. Ct. Apr. 11, 2013) (recognizing an accounting as a way to resolve aspects of disputes between LLC members). *Contra* RIBSTEIN & KEATINGE, *supra* note 4, § 10:4, at 664–65 (arguing that accounting actions have no place in resolving LLC disputes).

245. See JAMES R. BURKHARD, *PARTNERSHIP AND LLC LITIGATION MANUAL: ACTIONS FOR ACCOUNTING AND OTHER REMEDIES* §§ 7.01–.05, at 145–84 (1995).

246. See N.C. GEN. STAT. § 57D-10-01. Section 57D-10-01 states that the purpose of the chapter “is to provide a flexible framework under which one or more persons may organize or manage one or more business as they determine to be appropriate with minimum, prescribed formalities or constraints.” *Id.* § 57D-10-01(b). The policy of the chapter is “to give the maximum effect to the principle of freedom of contract and the enforceability of operating agreements.” *Id.* § 57D-10-01(c); see also *id.* § 57D-2-30(a). Section 57D-2-30(a) provides:

The operating agreement governs the internal affairs of an LLC and the rights, duties, and obligations of (i) the interest owners, . . . in relation to each other, the LLC, and their ownership interests or rights to acquire ownership interests and (ii) the company officials in relation to each other, the LLC, and the interest owners. Subject to the limitations set forth in subsections (b), (c), (d), and (e) of this section, the provisions of this Chapter and common law will apply only to the extent contrary or inconsistent provisions are not made in, or are not otherwise supplanted, varied, disclaimed, or nullified by, the operating agreement. The provisions of the operating agreement are severable and each will apply to the extent it is valid and enforceable.

*Id.*

247. *Id.* § 57D-2-30(e).

248. *Id.* § 57C-10-03(e) (repealed 2013) (providing that the statute was to give the maximum effect to the principle of freedom of contract and to the enforceability of operating agreements).

249. *Crouse v. Mineo*, 658 S.E.2d 33 (N.C. Ct. App. 2008).

250. *Id.* at 41–42.

obligation to manage the LLC in a prudent and businesslike manner, survived, on a limited basis, a motion for summary judgment.<sup>251</sup> With the new act now specifically stating that the law of contracts governs the enforcement of the LLC operating agreement, is it more probable that an unhappy member may be able to successfully bring a direct claim, rather than a derivative claim, to enforce her contract rights as established in the operating agreement?<sup>252</sup>

*G. Best Solution: Permit Direct Suits if All Members Are Joined*

The leading treatise is exceptionally critical of the use of derivative suits to resolve disputes among members and managers of LLCs.<sup>253</sup> Ribstein and Keatinge suggest that if there are disputes among the members and managers of the LLC, the better solution is to simply allow a direct suit requiring all members to be joined in the action.<sup>254</sup> O'Neal and Thompson also have identified a growing trend to allow disputes in closely held businesses to be brought directly.<sup>255</sup> Although there may be no evidence confirming the same (and such might be a topic of empirical research), when one reads the many reported LLC member-dispute cases, most of the cases do not seem to be "strike suits," and thus have no need for protections provided by the derivative procedures. However, the derivative-demand requirement that permits the company to resolve its own problems may prevent members from being able to bring mere power-struggle squabbles into court, which judges suggest do not belong in court.<sup>256</sup>

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251. See *BOGNC, LLC v. Cornelius NC Self-Storage, LLC*, Nos. 10 CVS 19072, 10 CVS 12371, 11 CVS 21122, 2013 NCBC LEXIS 22, at \*1 (N.C. Super. Ct. May 1, 2013); cf. *Island Beyond, LLC v. Prime Capital Grp., LLC*, No. 12 CVS 7351, 2013 NCBC LEXIS 48, at \*8 (N.C. Super. Ct. Oct. 30, 2013) (showing that a member dropped his claim for breach of the operating agreement).

252. See, e.g., *Schultheis v. Hatteras Capital Inv. Mgmt., LLC*, No. 14 CVS 469, 2014 NCBC LEXIS 23, at \*8–14 (N.C. Super. Ct. June 9, 2014) (concluding that minority members' derivative and individual claims that a manager breached the operating agreement should be dismissed).

253. See RIBSTEIN & KEATINGE, *supra* note 4, § 10:3, at 650–51, § 10:4, at 674–75 (listing four significant policy arguments why derivative suits should not be used to resolve member disputes).

254. *Id.* § 10.4, at 677.

255. O'NEAL & THOMPSON, *OPPRESSION*, *supra* note 9, § 7:8, at 7-73; see also O'NEAL & THOMPSON, *CLOSE CORPORATIONS AND LLCs*, *supra* note 211, § 9:26, at 9-147 (discussing reasons why fiduciary-duty claims increasingly can be brought as direct suits in disputes among members of a closely held business).

256. See, e.g., *Fisk Ventures, LLC v. Segal*, No. 3017-CC, 2008 Del. Ch. LEXIS 158, at \*31 (Del. Ch. May 7, 2008) (“[T]o find that the Court must decide whose business judgment

In some jurisdictions, courts have applied section 7.01(d) of the American Law Institute's (ALI) Principles of Corporate Governance to allow one or a few members to bring a direct suit to rectify a wrong committed against the LLC and its members.<sup>257</sup> Courts have been willing to allow a direct suit if all the members are joined in the litigation (either as defendants or plaintiffs) and if resolution of the suit will not be injurious to creditors not made a party to the action.<sup>258</sup> Because most LLCs have few members, in many states, it is easy to bring an action pursuant to the teaching of section 7.01(d) of the ALI's Principles of Corporate Governance.<sup>259</sup> At least one North Carolina judge has considered this option, but ultimately found that it should not apply in that particular case because it was unclear who the members were, and because there were outstanding creditors.<sup>260</sup> Another opinion effectively applied this option in the context of a closely held corporation.<sup>261</sup>

Following the ALI's lead, the most practical solution may be simply to provide in standard operating agreements a clause that provides that disputes among members (or members and managers) that cannot be settled by mediation or negotiation are to be resolved in a direct suit wherein each member or manager is named either as a plaintiff or defendant. This not only simplifies matters, but it may also reduce overall costs in resolving

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was more in keeping with the LLC's best interests . . . would cripple the policy underlying the LLC Act promoting freedom of contract.").

257. See RIBSTEIN & KEATINGE, *supra* note 4, § 10:4, at 675–76; see also James R. Burkhard, *LLC Member and Limited Partner Breach of Fiduciary Duty Claims: Direct or Derivative Actions?*, 7 J. SMALL & EMERGING BUS. L. 19, 52–60 (2003).

258. See, e.g., *Moses v. Pennebaker*, 719 S.E.2d 521, 529 (Ga. Ct. App. 2011) (concluding that in a two-member LLC, one member may bring a direct suit for usurpation of LLC opportunities); *accord Stoker v. Bellemeade, LLC*, 615 S.E.2d 1, 7 (Ga. Ct. App. 2005) (citing *Thomas v. Dickson*, 301 S.E.2d 49, 50–51 (Ga. 1983)). See generally O'NEAL & THOMPSON, *OPPRESSION*, *supra* note 9, § 6:20, at 6–44 to –45 ("One of the most notable movements in close corporations law in recent decades has been the increased willingness of courts to permit minority shareholders to bring direct claims for breach of fiduciary duties. That trend can also be seen in the LLC setting and for similar reasons.").

259. RIBSTEIN & KEATINGE, *supra* note 4, § 10:4, at 675–76.

260. *Nelson v. All. Hosp. Mgmt., LLC*, No. 11 CVS 3217, 2013 NCBC LEXIS 39, at \*38 (N.C. Super. Ct. Aug. 20, 2013), *appeal dismissed*, 761 S.E.2d 755 (N.C. Ct. App. 2014).

261. *Norman v. Nash Johnson & Sons' Farms, Inc.*, 537 S.E.2d 248, 259 (N.C. Ct. App. 2000); cf. *Gaskin v. J.S. Procter Co.*, 675 S.E.2d 115, 119–21 (N.C. Ct. App. 2009) (noting that the *Norman* opinion did not create a new special exception as to when a minority shareholder or member might be entitled to bring an individual direct action, and also considering the 7.01(d) factors, but noting that they were not present in this case).

disputes.<sup>262</sup>

The Business Law Section of the American Bar Association has recently released a Revised Prototype Limited Liability Company Act, which provides as a recommended statutory provision that “[a] member may maintain a direct action to enforce a right of a limited liability company if all members at the time of suit are parties to the action.”<sup>263</sup>

This simple provision could easily be adopted in any North Carolina operating agreement. It accomplishes all of the objectives that the ALI has underscored as the most important,<sup>264</sup> and it certainly seems to be in compliance with the new North Carolina LLC act.<sup>265</sup>

### CLOSING COMMENTS

The North Carolina Court of Appeals has stated that “[s]ince 1955, North Carolina has served as a pioneer and ‘shining light’ in the protection of minority shareholder rights.”<sup>266</sup> As this Article suggests, that may no longer be true. Whether this is a good or bad change probably depends on whether the reader is a plaintiff or defense lawyer. Even from the

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262. Cf. ROBINSON, *supra* note 96, § 17.08[2], at 17-31 (7th ed. 2014) (noting that the advantage of permitting the LLC to request a court-appointed independent body with authority to determine if a derivative complaint should be pursued is to reduce costs).

263. REVISED PROTOTYPE LTD. LIAB. CO. ACT § 909(c)(1) (AM. BAR ASS’N 2011). The Revised Prototype Act also includes two other optional provisions, providing first for a direct suit by one member against another. See *id.* §§ 909(a)–(b). Section 909(a) provides:

[A] member may maintain a direct action against another member or members or the limited liability company, or a series thereof, to enforce the member’s rights and otherwise protect the member’s interests, including rights and interests under the limited liability company agreement or this Act or arising independently of the membership relationship.

*Id.* § 909(a). Further, section 909(b) provides:

A member maintaining a direct action under subsection (a) must plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company, or series thereof.

*Id.* § 909(b). Second, the Revised Prototype Act, acknowledging that plaintiffs might want to resolve disputes through a derivative suit, includes sections 901 through 908, specifying how an LLC derivative suit should be pursued. *Id.* §§ 901–908.

264. All members are protected, since all are joined, and can assert whatever position they deem appropriate; there will be only one action. Presumably, the resolution of a suit brought pursuant to this provision would bar subsequent actions, and creditors of the LLC are protected, since any recovery goes to the LLC, as the real party in interest.

265. N.C. GEN. STAT. §§ 57D-2-30(b)(5), -32(a) (amended 2014).

266. *Royals v. Piedmont Elec. Repair Co.*, 529 S.E.2d 515, 517 (N.C. Ct. App. 2000) (quoting Robert Savage McLean, Note, *Minority Shareholders’ Rights in the Close Corporation Under the New North Carolina Business Corporation Act*, 68 N.C. L. REV. 1109, 1125–26 (1990)).

plaintiff's perspective, though, it is certainly not all "gloom and doom." Despite the expected problems caused by forcing most LLC member disputes into the derivative mold, in analogous close-corporation squabbles, applying essentially the identical corporate procedures that now control LLC actions, sample cases clearly show that the plaintiff can be very successful.<sup>267</sup> The business court recently determined that one of the two dentists in *LeCann* had wrongfully diverted \$559,888 from their practices and was thus liable to reimburse his corporations for that amount plus an additional \$1,679,664 in punitive damages.<sup>268</sup> Cases in other jurisdictions likewise demonstrate that LLC member wrongdoing can be successfully rectified through the derivative suit.<sup>269</sup>

Maybe all that is really important is whether a putative plaintiff is offered some method of bringing a claim—be it direct or derivative. Once the action is filed, as pointed out by former Chief Business Court Judge John Jolly, most of these cases ultimately settle.<sup>270</sup> As long as the unhappy member can file some sort of action, regardless of its form, maybe this is all that is really necessary. It will be interesting to see how this new LLC act impacts the resolution of the expected increasing number of squabbles that LLC owners will encounter.

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267. See, e.g., *LeCann v. Cobham*, No. 10 CVS 11169, 2012 NCBC LEXIS 58, at \*32 (N.C. Super. Ct. Nov. 7, 2012).

268. *Id.* at \*13–14 (noting that the defendant, as a 50% owner, would be entitled to one-half of the award).

269. See, e.g., *Tully v. McLean*, 948 N.E.2d 714, 729 (Ill. App. Ct. 2011) (demonstrating that the court may remove the breaching manager from his position, which in turn might trigger the automatic dissolution of the LLC); *Haut v. Green Café Mgmt., Inc.*, 376 S.W.3d 171 (Tex. App. 2012). In *Haut*, the court ordered forfeiture of a membership, possibly valued at \$600,000, because of the many breaches of fiduciary duties to the LLC. *Id.* at 176–77. Peculiarly, the losing member in that case argued that he owed fiduciary duties directly to only the members, and thus, the LLC had no standing to pursue breach-of-fiduciary-duty claims against him—an argument that the court rejected. *Id.* at 180; see also RIBSTEIN & KEATINGE, *supra* note 4, § 9:10, at 516–19 (listing remedies available in derivative LLC suits); cf. *Risk Mgmt. Servs., L.L.C. v. Moss*, 40 So. 3d 176, 179 (La. Ct. App. 2010) (finding the former manager liable in a direct suit for breach of fiduciary duty and awarding over \$7.5 million in damages to the LLC).

270. See *supra* note 216 and accompanying text.

