Control Provisions of the South Carolina Code: Corporations Versus Limited Liability Companies

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CONTROL PROVISIONS OF THE SOUTH CAROLINA CODE: CORPORATIONS VERSUS LIMITED LIABILITY COMPANIES

I. INTRODUCTION

The limited liability company (LLC) has emerged as one of the most popular forms of business organization since its introduction in 1977.¹ In 1996, South Carolina adopted the South Carolina Uniform Limited Liability Company Act (the LLC Act), becoming one of the first four states to derive legislation from the then newly approved Uniform Limited Liability Company Act.² Compared to the South Carolina Corporate Code (the Corporate Code), however, the LLC Act provides little protection to minority investors. When advising a client to organize as either a corporation or an LLC, a lawyer must consider the differing statutory protections afforded minority shareholders and minority LLC members.

The Corporate Code protects minority and nonvoting investors through statutory rights designed to prevent those owning a majority interest in a corporation from overrunning the participatory rights of minority and nonvoting shareholders. These control rights are generally well-defined by statute, and most of these Corporate Code provisions are mandatory. In comparison, the LLC Act provides relatively few statutory control rights in favor of minority and nonvoting LLC members. Further, almost every potential control right under the LLC Act is amendable or avoidable by an LLC’s operating agreement, which governs relations between and among an LLC and its members.³ The operating agreement between LLC members is really the key source of control.

Comparing the control rights afforded by the Corporate Code and the LLC Act better equips attorneys to counsel clients about forming the most suitable business entity. A comparison also serves to point out control mechanisms for which the LLC Act does not specifically provide, but which may nonetheless be available to an LLC through its operating agreement. This Comment is organized according to control rights given to minority and nonvoting corporate shareholders under the Corporate Code: dissenter’s rights, judicial dissolution, preemptive rights, transferee voting rights, statutory voting rights for nonvoting

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2. Id. § 1.08, at 7 (Supp. 1996).
shares, and shareholder voting rights. Each section will compare the respective corporate control provision with the comparable sections of the LLC Act.

II. DISCUSSION

A. Entity Control

1. The Corporate Context

A corporation generally operates under the direction of its annually elected board of directors. Shareholders elect members to the board by a majority vote, vesting power to control the board’s composition in those shareholders who control a majority of the outstanding voting shares. Because the board conducts business by a majority vote of the directors, and because directors typically vote under the influence of their constituent shareholders, majority shareholders essentially govern corporate affairs. Although in some transactions the board may not act without shareholder approval, shareholder approval requires only a majority vote, which negates the value of a shareholder vote for minority shareholders. Majority shareholders thus have the opportunity to “further their own interests to the detriment of minority shareholders.”

4. Although not a control provision per se, fiduciary duties imposed on the management of both corporations and LLCs help protect minority investors. See generally id. § 33-8-300 (Law. Co-op. 1976) (prescribing general standards for directors); id. § 33-44-409 (West Supp. 1998) (defining fiduciary duties of LLC members and managers). Fiduciary duties can be especially important in the LLC context because the operating agreement is powerless to eliminate management’s fiduciary duties. Id. § 33-44-103(b)(2)-(4).

5. Id. § 33-8-101(c), -103(d) (Law. Co-op. 1990); 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 1:02, at 3 (2d ed. 1997) (“The directors determine corporate policies, select corporate officers and sometimes key employees, and supervise the normal operation of the corporation.”). The board usually appoints officers to run the corporation’s daily operations. See generally S.C. CODE ANN. § 33-8-400(a) (allowing directors to appoint officers); id. § 33-8-410 (setting the duties of officers).


7. O'NEAL & THOMPSON, supra note 5, § 1:02, at 3. O'Neal refers to this proposition as the “principle of majority rule.” Id. In the close corporation context, majority shareholders achieve the same result by simply electing themselves to the board. Id.

8. Many transactions require a two-thirds shareholder vote, but a corporation can usually reduce this to a majority vote. See S.C. CODE ANN. § 33-10-103(f)-(g) (Law. Co-op. 1976) (governing the amendment of the articles of incorporation); id. § 33-11-103(e)-(f) (governing mergers and share exchanges); id. § 33-12-102(e)-(f) (governing sales of all, or substantially all, of a corporation’s assets not made in the ordinary course of business). If a corporation requires only a majority vote, then majority shareholders can approve the transaction despite minority disapproval. O'NEAL & THOMPSON, supra note 5, § 1:02, at 3.

9. O'NEAL & THOMPSON, supra note 5, § 1:02, at 3.
2. The LLC Context

The principle of majority rule can similarly arise in the LLC context. Under the LLC Act, LLC members can choose to be either manager-managed or member-managed. Manager-managed LLCs are similar in governance to corporations because members elect managers by a majority vote to conduct the company's business. The LLC Act apportions voting rights equally among LLC members. However, the operating agreement affords members considerable latitude to either modify or opt out of almost any provision in the LLC Act. As a result, the operating agreement could distribute voting power in proportion to capital contributions, or in any other manner, thereby allocating to certain members a controlling authority to appoint a majority of the managers and subject the LLC to the principle of majority rule.

In a member-managed LLC, each member has equal managerial voting rights. But if a group of members typically votes together, outvoting the remaining members, then the majority vote will control the LLC. Additionally, a member-managed LLC's operating agreement may modify the default voting apportionment, exposing the LLC to the principle of majority rule in the same fashion as a manager-managed LLC.

B. Dissenter's Rights

1. The Corporate Context

A corporation generally conducts business through its board of directors, to which the Corporate Code grants the authority to act in normal business affairs without shareholder consent. However, the Corporate Code does not permit the board to act unilaterally in certain major transactions. Instead, the Corporate Code requires the board to first obtain shareholder approval. The
principle of majority rule nullifies the practical value of minority shareholders participating in a shareholder vote because the Corporate Code demands only a favorable majority vote.\textsuperscript{18}

To protect a minority shareholder from forced participation in an investment that is fundamentally altered by a particular transaction, and to ensure that the majority cannot force minority shareholders to sell their interest at an unfairly low price, the Corporate Code provides dissenter’s rights, which entitle a shareholder to dissent from the approval of a transaction and demand that the corporation purchase the shareholder’s shares for a fair value.\textsuperscript{19} A shareholder may dissent from the following transactions: mergers, share exchanges, control share acquisitions, substantial dispositions of corporate assets not made in the ordinary course of business, amendments to the articles of incorporation, and any other transaction in which a corporation allows its shareholders to dissent and demand fair value.\textsuperscript{20}

\begin{itemize}
  \item[a.] \textit{Share Exchanges, Mergers, and Control Share Acquisitions}
\end{itemize}

A shareholder entitled to vote on a proposed plan of share exchange or merger may dissent and receive fair value for his or her interest upon the plan’s approval.\textsuperscript{21} To consummate a plan of share exchange, only shareholders of a corporation whose shares will be acquired in the share exchange may vote on the proposed transaction; shareholders of the acquiring corporation have no statutory right to vote on the transaction.\textsuperscript{22}

In the context of mergers, shareholders of the corporation that will

\textsuperscript{18} Id. §§ 33-10-103(f), -11-103(e), -12-102(e) (Law. co-op. 1976).

\textsuperscript{19} Id. §§ 33-10-103(g), -11-103(f), -12-102(f). Because directors usually vote under the influence of their majority constituents, a majority shareholder vote should theoretically yield the same result as a director vote. See I O’NEAL & THOMPSON, supra note 5, § 1:02, at 3.

\textsuperscript{20} S.C. CODE ANN. § 33-13-102(A) (West Supp. 1998); see MODEL BUS. CORP. ACT ANN. § 13.01, at 13-3 (3d ed. Supp. 1997) (“On one hand, the majority is given an almost unlimited power to change the nature and shape of the enterprise and the rights of its members. On the other hand, the members who dissent from these changes are given a right to withdraw their investment at fair value.”).

\textsuperscript{21} S.C. CODE ANN. § 33-13-102(A) (West Supp. 1998). Codified dissenter’s rights are unavailable for shares either listed on a national securities exchange or designated by the National Association of Securities Dealers, Inc., as a national market system security. Id. § 33-13-102(B).

\textsuperscript{22} Id. § 33-13-102(A)(1)-(2). A share exchange is a corporate combination mechanism through which a corporation can acquire all of one or more classes of another corporation’s stock in exchange for cash or other consideration. Id. § 33-11-102(a), cmt. (Law. co-op. 1976). Execution requirements for mergers and share exchanges are almost identical. See id. §§ 33-11-102(a), -103, cmt.

disappear as a result of the merger must always vote to approve the plan of
merger.\textsuperscript{23} In contrast, shareholders of the surviving corporation may not vote
on a merger proposal for the following reasons: (1) if the corporation’s articles
of incorporation will not change (except for minor “housekeeping” alterations); (2) the number of outstanding voting and participating shares of the corporation
will not increase by more than twenty percent; (3) and each shareholder “whose
shares were outstanding immediately before the effective date of the merger
will hold the same number of shares, with identical designations, preferences,
limitations, and relative rights [after the merger].”\textsuperscript{24} A merger within the above
parameters prompts no dissenter’s rights because the merger does not “alter the
investors’ prospects any more than many other management decisions.”\textsuperscript{25}

The Corporate Code also grants dissenter’s rights in connection with
parent/subsidiary mergers.\textsuperscript{26} A parent corporation does not need approval from
either parent corporation shareholders or subsidiary shareholders when merging
a subsidiary into the parent corporation.\textsuperscript{27} However, the Corporate Code entitles
nonassenting subsidiary shareholders to dissent and demand fair value from the
parent corporation.\textsuperscript{28} Likewise, if a parent merges itself into its subsidiary, the
subsidiary shareholders may not vote on the transaction, but both parent and
subsidiary shareholders may dissent.\textsuperscript{29}

Dissenter’s rights are also available in the context of control share
acquisitions. In a control share acquisition, a party acquires enough shares of
a corporation to control at least one-fifth of the outstanding voting power.\textsuperscript{30} The
Corporate Code entitles shareholders of a corporation other than a public
corporation to dissent from the approval of a control share acquisition.\textsuperscript{31}

\textsuperscript{23} S.C. CODE ANN. §§ 33-11-103(a), cmt. 1, -13-102 cmt. 1(1) (Law. co-op. 1976) (“The
right to vote on a merger under section [33-11-103] extends to corporations whose separate
eexistence disappears in the merger . . . .”). Shareholders must approve the plan by at least a
majority vote. Id. § 33-11-103(t).

\textsuperscript{24} Id. § 33-11-103(h). See also id. § 33-10-102, cmt. (allowing board to make
“housekeeping” amendments without shareholder consent). The twenty percent rule applies only
if the corporation has authorized enough shares in its articles of incorporation to complete the
merger. Id. § 33-11-103 cmt. 2. See also id. § 33-2-102(a)(2) (requiring the articles of
incorporation to authorize the number of shares to be issued). If the articles have not authorized
enough shares to perform the merger, then a shareholder vote is necessary to amend the articles.

\textsuperscript{25} Id. § 33-11-103 cmt. 2 (Law. Co-op. 1976). However, a possible twenty percent
dilution of voting and equity participation rights without corresponding dissenter’s rights is
potentially problematic for minority shareholders of the surviving corporation.

\textsuperscript{26} Id. § 33-13-102(A)(1)(ii) (West Supp. 1998).

\textsuperscript{27} Id. § 33-11-104(a) (Law. Co-op. 1976).

(providing no voting prerequisite to dissenter’s rights in parent/subsidiary mergers).
Shareholders of the parent corporation do not need dissenter’s rights if the parent is merging a
subsidiary into itself because the parent corporation survives nearly unchanged. Id. § 33-11-104


\textsuperscript{30} Id. §§ 35-2-101, -102 (West Supp. 1998).

\textsuperscript{31} Id. § 33-13-102(A)(5).
Additionally, if a corporation adopts a resolution to accord the acquired shares full voting rights, and if the acquired shares will control at least a majority of the corporation’s outstanding voting power, then all shareholders of the corporation may dissent unless the articles of incorporation otherwise provide.\textsuperscript{32}

\subsection*{b. Substantial Asset Dispositions Not Made in the Ordinary Course of Business}

A shareholder entitled to vote on a sale or exchange of all, or substantially all, of a corporation’s assets not made in the ordinary course of business may dissent from such a sale and demand fair value for their shares from the corporation.\textsuperscript{33} The Corporate Code rightfully excepts sales made in the ordinary course of business because dissenter’s rights are available to remedy unfairness in forcing a minority shareholder to accept some fundamental change to the terms under which the shareholder agreed to invest.\textsuperscript{34} Terms to which a shareholder agreed necessarily encompass submission to board discretion in ordinary business transactions. Thus no transaction made in the ordinary course of business should give rise to dissenter’s rights. However, excepting sales made in the ordinary course of business gives minority shareholders a loophole through which to circumvent dissenter’s rights.\textsuperscript{35} By characterizing a major asset disposition as within the ordinary course of a corporation’s business, majority shareholders can force the minority to either “acquiesce or initiate litigation which may be lengthy, costly and uncertain as to outcome.”\textsuperscript{36}

The Corporate Code also excepts from dissenter’s rights court ordered sales and cash sales from which a corporation will distribute the proceeds within one year.\textsuperscript{37} The Corporate Code excludes court ordered sales because judicial review of the terms and conditions of a sale theoretically provides an “independent appraisal of the fairness of the transaction.”\textsuperscript{38} Likewise, a shareholder may not dissent from a cash sale from which a corporation will distribute the proceeds within one year because such sales treat all shareholders equally; each shareholder, whether in the majority or in the minority, should receive cash within a relatively short period of time.\textsuperscript{39}

\textsuperscript{32} Id. §§ 35-2-111(a), -109(a). Fair value paid to a shareholder dissenting from a control share acquisition must be at least the highest price paid per share by the acquiring party. Id. § 35-2-111(c).

\textsuperscript{33} Id. § 33-13-102(A)(3). See id. § 33-12-102 (requiring at least a majority vote to approve a substantial asset sale not made in the ordinary course of business). This section expressly covers sales in dissolution to prevent a corporation from avoiding dissenter’s rights “by characterizing sales as made in the process of dissolution.” Id. § 33-13-102 cmt. 1(3).

\textsuperscript{34} See supra note 20.

\textsuperscript{35} 1 O’NEAL & THOMPSON, supra note 5, § 5:15, at 102.

\textsuperscript{36} Id.


\textsuperscript{38} Id. § 33-13-102 cmt. 1(3) (Law. Co-op. 1976).

\textsuperscript{39} Id. The Corporate Code allows shareholders to dissent from sales other than for cash to protect the minority from assuming the risk of an illiquid asset. Id.
c. Amendments to the Articles of Incorporation

A corporation’s board of directors generally may amend its articles of incorporation only upon a shareholder majority vote.\(^ {40}\) If an approved amendment would “materially and adversely” affect a shareholder by modifying or eliminating certain participatory rights, then a shareholder may dissent.\(^ {41}\) For example, a shareholder may dissent from an amendment that alters or deletes a shareholder’s preferential rights, rights of redemption, or preemptive rights.\(^ {42}\) A shareholder may also dissent from an amendment that either limits or excludes the shareholder’s voting rights or reduces the shareholder’s number of shares “to a fraction of a share if the fractional share so created is to be acquired for cash.”\(^ {443}\)

d. Additional Procedural Protections

A corporation must estimate the fair value of a dissenting shareholder’s interest and pay the dissenter either (1) upon receipt of a dissenter’s payment demand or (2) upon performance of the transaction that prompted dissenter’s rights.\(^ {44}\) To avoid a potential squeeze-out of minority shareholders at an undervalued price, the Corporate Code permits a dissenting shareholder who is dissatisfied with a corporation’s assessment of fair value to demand additional payment from the corporation.\(^ {45}\) If a dissenting shareholder and a

\(^{40}\) Id. § 33-10-103(b)(2), (f)-(g). The board may make certain “housekeeping” amendments without a shareholder vote. Id. § 33-10-102, cmt.

\(^{41}\) Id. § 33-13-102(A)(4) (West Supp. 1998). In addition, a shareholder may dissent from an amendment through which a corporation elects to become a close corporation, and a close corporation shareholder may dissent from an amendment terminating the corporation’s close corporation status. Id. §§ 33-18-103(b), -310(c), -102(a) (Law. Co-op. 1976). Also, a close corporation shareholder may dissent from an amendment that would modify or delete statutory provisions forcing a close corporation to purchase a shareholder’s interest at the shareholder’s death. Id. § 33-18-140(d).

\(^{42}\) Id. § 33-13-102(A)(4)(i-iii) (West Supp. 1998).

\(^{43}\) Id. § 33-13-102(A)(4)(iv)-(v).

\(^{44}\) Id. § 33-13-250(a) (Law. Co-op. 1976). A shareholder planning to dissent from a proposed transaction must first notify the corporation of the shareholder’s intent to dissent, and the shareholder must not vote in favor of the transaction. Id. § 33-13-210(b). If a corporation authorizes a transaction from which the shareholder has announced the intent to dissent, the shareholder must then demand fair value for the shareholder’s shares on a form supplied by the corporation. Id. §§ 33-13-220(b)(3), -230(a), (c). If a corporation refuses to purchase a dissenter’s shares, the dissenter may have an action for conversion of stock. See Hite v. Thomas & Howard Co., 305 S.C. 358, 362, 409 S.E.2d 340, 342 (1991), overruled on other grounds by Huntley v. Young, 319 S.C. 559, 462 S.E.2d 860 (1995).

\(^{45}\) S.C. CODE ANN. § 33-13-280(a) (Law. Co-op. 1976). If a dissenter fails to notify a corporation in writing of an additional payment demand within thirty days of receiving an inadequate payment, then the dissenter will be unable to demand additional payment. Id. § 33-13-280(b). O’Neal argues that statutory procedures for asserting dissenter’s rights are too complex and limit the remedy’s effectiveness. 1 O’NEAL & THOMPSON, supra note 5, § 5:29, at 203. A dissenter theoretically can determine whether or not a corporation’s calculation of fair
corporation cannot agree on the value of the dissenter’s shares, the corporation can petition for a judicial appraisal of the dissenter’s shares. The corporation must bear the expenses of litigation, and the court may charge a corporation with the dissenter’s attorney’s fees for acting in bad faith. If a corporation fails to commence an action for appraisal within sixty days of a dissenter’s demand for additional payment, then the corporation will be liable in full for the demanded amount. The Corporate Code thus provides an economic incentive for a corporation to quickly and fairly negotiate to purchase a dissenter’s shares.

2. The LLC Context

While the Corporate Code contains an extensive provision regarding dissenter’s rights, the LLC Act provides no such equivalent. As a default, the approval of major transactions that would give rise to dissenter’s rights in the corporate context requires the unanimous consent of an LLC’s members. Dissenter’s rights would be unnecessary if the unanimous consent provision of the LLC Act was mandatory because a change in the terms under which an LLC member agreed to invest could then only come about by that member’s express consent. However, an LLC may opt out of the unanimous consent provision through its operating agreement, leaving its minority members unprotected in major transactions.

The LLC Act does appear to provide a broad analog to dissenter’s rights by permitting an LLC member to dissociate from an LLC at will and force the company to purchase the member’s distributional interest. While some authors suggest that dissenter’s rights in addition to the right to dissociate at will would be repetitious, the LLC Act severely limits the effectiveness of

value is accurate because financial statements and an explanation of the corporation’s calculation must accompany the corporation’s payment. See S.C. CODE ANN. § 33-13-250(b) (Law. Co-op. 1976).

47. Id. § 33-13-310(a), (b)(2). The court may also assess litigation costs and attorney’s fees against a dissenter who acts in bad faith. Id.
48. Id. § 33-13-300(a).
49. Id. § 33-44-404(c)(1), (3), (11)-(12) (West Supp. 1998) (requiring unanimous consent to approve mergers, substantial asset dispositions not made in the ordinary course of business, and amendments to either the articles of organization or the operating agreement).
50. See id. § 33-44-103(a), cmt. (allowing the operating agreement to modify nearly every section of the LLC Act). Although a member has no right to dissent, a member may have a cause of action for breach of fiduciary duty or oppression. Id. § 33-44-409 (setting forth fiduciary duties of LLC management).
51. See id. § 33-44-601(1), -602(a), -603(1), (2)(b).
52. See 1 RIBSTEIN & KEATINGE, supra note 1, § 11.13, at 11-29, § 11.15, at 11-49 (suggesting the redundancy of including both provisions); WALTER C. TUTHILL ET AL., LIMITED LIABILITY COMPANIES: LEGAL ASPECTS OF ORGANIZATION, OPERATION, AND DISSOLUTION, at A-29 (BNA Corporate Practice Series No. 67, 1996) (suggesting that dissenter’s rights are unnecessary if members can withdraw at will).
voluntary dissociation. First, an LLC's operating agreement could provide for the purchase of a dissociating member's interest for less than fair market value.\(^5\) Second, the operating agreement can eliminate the power to dissociate at will.\(^4\) Third, the operating agreement may permit dissociation at will, but may also provide that such dissociation at will is "wrongful," entitling an LLC to damages against a dissociating member that will act to offset any economic interest owing to the dissociating member.\(^5\) As a result, majority LLC members potentially could either force a minority member to remain in an investment fundamentally different from that which the minority member originally contemplated, or majority members could squeeze out a minority member by redeeming the member's interest for little consideration.

The possible results vary depending on whether an LLC opts to be an at-will LLC or a term LLC.\(^5\) Under the LLC Act, a member of an at-will LLC can "wrongfully" dissociate only if such dissociation violates the company's operating agreement. If an at-will company's operating agreement neither abolishes the right to dissociate at will nor provides that dissociation at will is wrongful, then the LLC will be liable to a member dissociating at will for the unabated fair value of the member's distributional interest.\(^5\) However, if the operating agreement provides that a member's dissociation will cause the LLC to dissolve, or if either the remaining members vote to dissolve the LLC or a member's dissociation somehow renders the LLC's continued existence unlawful, then the LLC must dissolve, and the dissociating member will receive only that to which the member is entitled under the dissolution provisions.\(^5\)

In contrast, a member of a term LLC can never dissociate at will without incurring damages for wrongful dissociation unless the company's operating

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53. The operating agreement may set the amount to which a dissociating member is entitled. S.C. CODE ANN. § 33-44-103 (West Supp. 1998).

54. Id. § 33-44-602(a).

55. Id. §§ 33-44-602(b)(1), (c), -701(f). Because the LLC Act permits dissociation in violation of the operating agreement, but permits the operating agreement to forbid voluntary dissociation at will, "it may not be clear if the operating agreement should be interpreted as prohibiting withdrawal altogether or making withdrawal wrongful under certain circumstances." RIBSTEIN & KEATINGE, supra note 1, § 11.02, at 91 n.8 (Supp. 1996); see S.C. CODE ANN. § 33-44-602(a), (b)(1) (West Supp. 1998).

56. See S.C. CODE ANN. § 33-44-602(b)(1) (West Supp. 1998). An at-will company differs from a term company in that an at-will LLC is not limited to a specific duration in its articles of organization as is a term company. Id. §§ 33-44-101(2), (19), -203(a)(5).

57. See id. §§ 33-44-603(1), -701(a)(1), (f). If an LLC fails to purchase a dissociating member's interest, the dissociated member may petition for judicial dissolution of the company. Id. § 33-44-801(4)(d).

58. See id. §§ 33-44-801(1)-(3), -603(3) (requiring LLCs to treat dissociated members like transferees, who, under section 33-44-503(e)(2), have a right to distributions upon dissolution). See also id. § 33-44-806 (providing that after the LLC discharges its obligations, each member gets back the member's capital contribution plus an equal portion of remaining assets upon dissolution).
agreement provides otherwise. Consequently, withdrawal at will is not equivalent to dissenter’s rights for a term company member because a term company member will never recover the full value of the member’s distributional interest. In addition, where an at-will LLC values a dissociating member’s interest to be purchased at dissociation, a term LLC values a dissociating member’s interest at the expiration of the company’s term remaining at dissociation. The time lag between dissociation and term expiration makes dissociation from a term LLC a risky proposition. First, if an LLC decides to dissolve between a member’s dissociation and the company’s term expiration, the dissociating member will receive only that to which the member is entitled under the dissolution statute, which may or may not be equivalent to the value of the member’s interest on the date of dissociation. A term company member will receive “fair value” for the member’s interest only if the company elects to continue doing business beyond the term specified in its articles of organization. If the LLC continues beyond expiration, then the value paid to the dissociating member on what would have been the company’s expiration date arguably will be worth less to the member than if the LLC had paid the member at dissociation. Because a dissociated member has no right to participate in the management of the LLC, a dissociated member is unable to hedge the risks of possible dissolution and asset devaluation incurred between dissociation and the expiration of the company’s term.

Enforcing a member’s right to receive fair value upon voluntary dissociation is procedurally difficult for a minority LLC member. Instead of requiring an LLC to estimate the fair value of a dissociating member’s interest and pay the member immediately upon dissociation (or the company’s expiration), the LLC Act creates a negotiation process in which an LLC makes an offer to purchase a dissociating member’s interest. If the parties fail to reach a bargain within 120 days, then the dissociating member has the burden of commencing an action to determine fair value. Even though a court may assess litigation costs and attorney’s fees against an LLC for acting in bad faith,

59. Id. § 33-44-602(b)(2)(i).
60. Id. § 33-44-603(2)(a), (b).
61. See id. § 33-44-603(2)(a).
62. Id. § 33-44-603(2)(b).
63. If a dissociating member receives cash on the date of dissociation, the member can invest that principle sum and earn additional interest income. If the dissociating member is not paid until expiration, then the member forgoes interest that could have been earned between dissociation and expiration. Thus, money received at dissociation is worth more to a dissociating member than the same nominal amount paid to the member at expiration.
64. See id. § 33-44-603(3) (providing that dissociating members have no management rights). However, a dissociating member may have a cause of action against an LLC if the management violates its fiduciary duties to the dissociated member. Id. §§ 33-44-409, -410.
65. See id. § 33-44-701(b). Negotiations are unnecessary if the operating agreement provides the purchase terms. Id. § 33-44-701(c).
66. Id. § 33-44-701(d), (e).
fronting initial litigation costs is expensive and may dissuade minority LLC members from seeking judicial assistance. As a result, an LLC may pressure a dissociating member to accept lower than fair value for the member’s distributional interest.

Thus, while the Corporate Code expressly protects minority shareholders from fundamental investment changes and potential squeeze outs at an unfairly low price, the LLC Act fails to provide comparable protection for minority LLC members. A minority LLC member’s protection against fundamental changes and potential squeeze outs is dependent upon an LLC’s operating agreement and the willingness of majority members to bargain for dissenter’s rights.

C. Judicial Dissolution

I. The Corporate Context

A corporate shareholder may commence a proceeding to dissolve a corporation (1) if those in control of a corporation have behaved towards a shareholder “in a manner that is illegal, fraudulent, oppressive, or unfairly prejudicial”; or (2) if those in control are guilty of asset misappropriation or waste. A remedy in dissolution allows a minority shareholder to recoup the shareholder’s investment by forcing a corporation to liquidate and distribute its net assets proportionally among its shareholders. Because dissolution is a drastic remedy, a court may prefer to give a petitioning shareholder some form of alternative relief.

Relief from “oppressive” conduct arguably has become the broadest source of shareholder control under the dissolution provision. In determining what actions are oppressive, courts often look to the reasonable expectations of a

67. See id. § 33-44-702(d) (permitting courts to assess fees against either party for acting in bad faith).
68. Id. § 33-14-300(2)(ii), (iv) (Law. Co-op. 1976). Close corporation shareholders may seek judicial dissolution in the same circumstances. See id. § 33-18-400(a)(1), (3).
69. See id. § 33-14-105(a)(4).
70. See id. § 33-14-310(d), (e). See also Robert B. Thompson, The Shareholder’s Cause of Action for Oppression, 48 BUS. LAW. 699, 708 (1993) (“Courts are more inclined to use these alternative remedies.”); Andrew P. Campbell, Litigating Minority Shareholder Rights and the New Tort of Oppression, ALA. LAW., Mar. 1992, at 113 (calling the impact of dissolution “draconian”). The Corporate Code allows courts to order alternative relief including, but not limited to: amending or deleting any provision in or amendment to the articles of incorporation or a corporate resolution; prohibiting a corporate or shareholder action; and compelling a corporation to purchase a shareholder’s shares for fair value. S.C. CODE ANN. § 33-14-310(d)(1)-(4) (Law. Co-op. 1976). The South Carolina Close Corporation Supplement provides more specific alternatives to dissolution than does the Corporate Code. See id. § 33-18-410 (listing alternatives to dissolution, including removal of directors and the appointment of provisional directors).
minority shareholder. For example, a close corporation may frustrate a shareholder’s reasonable expectation to share in the corporation’s earnings by refusing to pay dividends. Other actions that frustrate the reasonable expectations of a shareholder include the exclusion of a minority close corporation shareholder from participating in management and the payment of inordinate salaries to majority shareholder employees siphoned from corporate earnings. Oppression generally contemplates an ongoing course of conduct, and an isolated incident may not be grounds for dissolution.

Courts may also judge oppression by the same standards used to determine whether or not a director or a majority shareholder breached a fiduciary duty owed to a minority shareholder. Those in control of a corporation owe shareholders a duty to conduct business fairly and in good faith. A transaction that would violate the duties of good faith and fair dealing to the detriment of a minority shareholder may trigger a remedy in dissolution.

The South Carolina Court of Appeals in Kiriakides v. Atlas Food Systems & Services, Inc. amalgamated numerous approaches to “oppression” and created a broad standard by which South Carolina courts can judge oppressive conduct. The court defined “oppressive” as:

(1) A visible departure from the standards of fair dealing and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely; or (2) A breach of the fiduciary duty of good faith and fair dealing; or (3) Whether the reasonable expectations of the minority shareholders have been frustrated by the actions of the majority; or (4) A lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members; or (5) A deprivation by majority shareholders of participation

71. See Thompson, supra note 70, at 712. See also Campbell, supra note 70, at 110 (discussing the role of reasonable expectations in Alabama case law); Sandra K. Miller, Should the Definition of Oppressive Conduct by Majority Shareholders Exclude a Consideration of Ethical Conduct and Business Purpose?, 97 Dick. L.Rev. 227, 232 (1993) (examining problems with the reasonable expectations test); Ferdinand S. Tinio, Annotation, What Amounts to “Oppressive” Conduct Under Statute Authorizing Dissolution of Corporation at Suit of Minority Shareholders, 56 A.L.R.3d 358, 362 (1974) (describing early use of the reasonable expectations test).

72. See Campbell, supra note 70, at 110-11; Miller, supra note 71, at 251.

73. See Campbell, supra note 70, at 111; Miller, supra note 71, at 252.

74. Thompson, supra note 70, at 711. See also Tinio, supra note 71, § 3[a], at 363-67 (citing cases of “conduct consisting of a series of acts . . . preventing the minority . . . from participating effectively in managing or operating the corporation”).

75. Thompson, supra note 70, at 712. See also Campbell, supra note 70, at 109 (citing early “oppression” case law decided on the basis of fiduciary duty).

76. See S.C. CODE ANN. § 33-8-300 (Law. Co-op. 1976) (prescribing general standards for directors); Campbell, supra note 71, at 109; Thompson, supra note 70, at 712.

77. See Thompson, supra note 70, at 712.

in management by minority shareholders.79

Kiriakides involved a family-owned close corporation in which one brother, defendant Alex Kiriakides, owned the majority of the corporation’s stock.80 The court held that Alex’s exercise of corporate control was oppressive to plaintiffs John and Louise Kiriakides, Alex’s brother and sister.81 Specifically, the court named the following as evidence of oppressive conduct: (1) the corporation’s failure to pay dividends since 1990; (2) Alex’s use of majority power to overrule board decisions; (3) Alex’s removal of John from the office of corporate president; (4) the corporation’s failure to notify John of board meetings after Alex removed John from the office of president; (5) the corporation’s offer to purchase John’s and Louise’s interest at an extremely low price relative to the corporation’s value; and (6) the corporation’s $17 million expansion plan, which was unusually large for the corporation and probably instituted “to permanently deprive John and Louise of any return on their investment by diverting Atlas’s assets to the expansion.”82

Courts have become more willing to grant relief other than dissolution for oppressive conduct.83 Indeed, oppression has now become an oft-used remedy for mere shareholder dissension as opposed to a remedy resulting in dissolution of a corporation.84 For example, in Hite v. Thomas & Howard Co.,85 the plaintiff alleged that the defendant corporation’s approval of a share exchange oppressively reduced the plaintiff’s proportional ownership in the corporation by nearly one-third.86 However, the plaintiff did not seek dissolution, but instead requested the court to compel the defendant to purchase the plaintiff’s shares for fair value.87 The South Carolina Supreme Court held that the plaintiff could bring an action on grounds of oppression without seeking dissolution.88 Thus, South Carolina recognizes an action for oppression separate from

79. Id. at *18.
80. Id. at *1-2.
81. Id. at *17. The court determined that other fraudulent actions on the part of Alex alone justified a buyout remedy for John and Louise, namely a decrease in Louise’s shareholdings resulting in an incorrectly low distribution to Louise in 1990 and the nondisclosure of information relating to a stock divestiture in 1986. Id. at *10. Nonetheless, the court addressed the issue of oppression. Id.
82. Id. at *10-18.
83. See Thompson, supra note 70, at 708.
84. Id. at 708-09.
86. Id. at 361, 409 S.E.2d at 342.
87. Id. at 364, 409 S.E.2d at 343. See also S.C. CODE ANN. § 33-14-310(d)(4) (Law. Co-op. 1976) (listing relief other than dissolution).
dissolution as a remedy for mere dissension.\textsuperscript{89}

2. The LLC Context

An LLC member may petition for judicial dissolution under a mandatory provision of the LLC Act that is almost identical to the corporate statute.\textsuperscript{90} In contrast to most other control provisions in the LLC Act, the operating agreement may not prevent the dissolution of an LLC once a court determines that the LLC’s actions are illegal or oppressive.\textsuperscript{91}

Courts presumably will interpret “oppressive” in the LLC context in the same way that courts interpreted “oppressive” in the corporate context. The question is how far courts are willing to stretch the oppression cause of action for LLC members. The LLC Act does not expressly permit a court to order relief other than dissolution, in contrast to the standard and close corporation statutes. Without an express provision for alternative remedies, the LLC Act may hinder the oppression cause of action from giving LLC members anything but dissolution. Alternatively, a court may infer the authority to furnish alternative relief based either on the court’s inherent equity powers or the substantial similarity between the corporate and LLC provisions. If a court can order alternative relief, and if a court will allow an LLC member to petition directly for alternative relief, then the oppression cause of action may evolve into one of the most important control rights of an LLC minority member.\textsuperscript{92}

D. Preemptive Rights

1. The Corporate Context

A board’s decision to issue new shares of a corporation is troublesome to minority shareholders whose voting and equity participation rights will diminish in relation to the voting and equity rights conferred upon the newly issued shares.\textsuperscript{93} To guard against the diluent effect of new stock, the Corporate Code allows a shareholder to preempt the sale of new shares to third parties and

\textsuperscript{89} Hite, 305 S.C. at 364, 409 S.E.2d at 344; see also Thompson, supra note 70, at 709, 716 (suggesting that a shareholder’s individual action for breach of fiduciary duty plus courts’ increased willingness to grant relief for oppression other than dissolution “merge to become the oppression cause of action,” which has evolved into a remedy for dissension).

\textsuperscript{90} An LLC member may seek dissolution if those in control of an LLC have acted “in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner.” S.C. Code Ann. § 33-44-801(4)(e) (West Supp. 1998). The LLC Act does not expressly permit an LLC member to petition for dissolution on grounds of misappropriation, but “oppressive” may arguably encompass misappropriation. Alternatively, misappropriation may give rise to an action for a breach of fiduciary duty. See id. § 33-44-409(b)(1), (d), (h)(2).

\textsuperscript{91} See id. § 33-44-103(b)(6).


\textsuperscript{93} S.C. CODE ANN. § 33-6-300 cmt. (Law. Co-op. 1976).
purchase a proportional quantity of the new stock.94 A shareholder has preemptive rights to purchase any security that is “convertible into or [that carries] a right to acquire voting shares.”95 Contrary to other corporate control provisions, preemptive rights are fully waivable either by a corporation through its articles of incorporation or by a shareholder’s individual waiver.96 If a corporation’s articles do not waive preemptive rights, then certain limits apply. First, nonvoting shares “with preferential rights to distributions or assets,” or nonvoting preferred shares, have no preemptive rights.97 Nonvoting shares face no risk of voting dilution. However, to the extent that a corporation gives preferential rights to newly issued shares, a nonvoting preferred shareholder has no protection against reduced equity participation rights.98 Second, a voting shareholder without preferential rights may not preempt the issue of nonvoting shares with preferential rights unless the newly issued stock is convertible into voting shares.99 Further, the Corporate Code excepts from preemptive rights shares, options, and convertible securities issued to compensate directors and corporate employees.100 Excluding compensatory securities potentially leaves room for abuse because the board of directors typically determines its own compensation and that of other corporate employees.101 Although fiduciary duties owed by the board may protect the minority to an extent, the board could distribute, as wages, securities exempt from preemptive rights to squeeze out minority shareholders.102 Finally, the Corporate Code excepts “shares sold otherwise than for money,” which gives the board authority to circumvent preemptive rights based merely on the character of consideration received.103

2. The LLC Context

LLC members in South Carolina have no express preemptive rights.

94. See id. § 33-6-300(a), (b)(1). A shareholder may not preempt the sale of stock authorized by the articles of incorporation if sold within the first six months of incorporation. Id. § 33-6-300(b)(3)(ii). The price at which a corporation must offer shares preemptively must be no higher than the prices offered to third parties. Id. § 33-6-300(b)(6). “A corporation deciding to offer shares at a lower price must reoffer the shares preemptively to the shareholders before selling them to third persons.” Id. cmt.
95. Id. § 33-6-300 cmt (c).
96. Id. § 33-6-300(b)(2). A corporation may also choose to alter these statutory defaults. Id. § 33-6-300(b). As a practical matter, a corporation probably will opt-out of the preemptive rights statute. However, a corporation that avoids preemptive rights is still subject to fiduciary duties when issuing additional shares. See generally id. § 33-8-300 (prescribing general standards for directors).
97. Id. § 33-6-300(b)(4).
98. Id. § 33-6-300 cmt.
99. Id. § 33-6-300(b)(5).
100. Id. § 33-6-300(b)(3)(i)-(ii).
101. See id. §§ 33-8-101, -111.
102. See generally id. § 33-8-300 (prescribing general standards for directors).
103. Id. § 33-6-300(b)(3)(iv).
However, the default provision of the LLC Act mandates that an LLC may not admit a new member to the company without the consent of all existing members.\textsuperscript{104} Minority control over the admission of new members and the corresponding reduction in a member’s voting and equity rights is illusory, however, because the operating agreement can either modify or opt out of the unanimous vote requirement.\textsuperscript{105} Thus, in the context of preemptive rights, neither corporate shareholders nor LLC members in South Carolina enjoy any mandatory statutory protection against the diluent effects of new membership interests.

\section*{E. Transferee Voting Rights}

\subsection*{1. The Corporate Context}

Corporate stock is freely transferrable, subject only to share restrictions imposed by a shareholder agreement or by a corporation’s bylaws or articles of incorporation.\textsuperscript{106} A shareholder may wish to divest corporate shares for many reasons, including oppressive action by the board prompting neither dissenter’s rights nor the right to petition for dissolution. The ease with which a shareholder will find a willing buyer may depend, in part, upon the rights transferred with the shareholder’s interest.

The Corporate Code permits a shareholder to transfer the entire bundle of rights associated with shares of stock, including the right to vote.\textsuperscript{107} Free transferability of a shareholder’s voting rights theoretically serves to promote share liquidity, which allows a dissatisfied shareholder to cash out of a corporation more easily.\textsuperscript{108} A transferee will be more willing to purchase shares if the transferee can obtain some participatory rights in decisionmaking.

\subsection*{2. The LLC Context}

In contrast, the LLC Act does not provide for the total and free transferability of an LLC member’s interest.\textsuperscript{109} An LLC member may freely transfer only the member’s distributional interest, enabling a transferee to share

\begin{footnotesize}
105. See \textit{id.} § 33-44-103.
106. See \textit{id.} § 33-6-270 (Law. Co-op. 1976); \textbf{ROBERT CHARLES CLARK, CORPORATE LAW} § 1.2.2, at 13 (1986). However, shares of a close corporation generally are not freely transferrable. \textbf{S.C. CODE ANN.} § 33-18-110(a) (Law. Co-op. 1976). A close corporation shareholder may transfer the shareholder’s interest only if either the corporation’s articles of incorporation permit a transfer or if the transfer falls into one of a few statutory exceptions. \textit{Id.} § 33-18-110(b) (listing exceptions from the general transfer prohibition).
107. \textit{CLARK, supra note 106, § 1.2.2, at 14.}
108. \textit{Id.}
\end{footnotesize}
in the company's profits and all other distributions to which the transferor was entitled. The LLC Act does not permit a member to transfer the member's right to vote or the member's right to participate in management. The LLC Act's bifurcated approach to transferability significantly hinders the liquidity of a member's interest because buyers will refuse, "at least without a significant discount, to accept the status of outside owner with financial but not management or information rights."

A transferee may obtain voting rights only upon an LLC's approval. First, the operating agreement may provide that a member may transfer the member's voting rights. Second, if the operating agreement does not allow a member to transfer the member's voting rights, LLC members may, by unanimous vote, admit a transferee to membership in the LLC, giving the transferee full voting rights.

Therefore, an LLC member's interest is only as liquid as the company's operating agreement allows. If the operating agreement either adopts the LLC Act's statutory default or further lessens a transferee's rights, a minority LLC member will have a difficult time finding a third party who is willing to purchase the member's interest at fair value. However, if the operating agreement allows a member to transfer both the member's economic and voting rights, then the operating agreement effectively creates a market for the member's interest, allowing the member to sell the member's interest to a third party for fair value.

F. Statutory Voting Rights for Nonvoting Shares

1. The Corporate Context

Nonvoting shareholders arguably have less control rights than minority voting shareholders because nonvoting shares do not have the opportunity to participate in corporate decision making. Although a corporation may designate a class of shares as nonvoting in its articles of incorporation, the Corporate Code mandates that even nonvoting shareholders may vote on certain amendments to the articles of incorporation that would adversely affect the

110. Id. §§ 33-44-501(b), -502 (West Supp. 1998). See also 1 RIBSTEIN & KEATINGE, supra note 1, § 7.03, at 7-4 (stating that members may transfer only their rights to profits and distributions). However, operating agreements commonly restrict the transfer of a member's economic rights as well. TUTHILL ET AL., supra note 52, § IV.C.1.a., at A-16.


112. 1 RIBSTEIN & KEATINGE, supra note 1, § 7.04, at 7-6.


114. Id. §§ 33-44-103, -501(c), -503(a)-(b) (allowing the operating agreement to provide a transferee with voting rights upon admission as a member).

115. Id. §§ 33-44-503, -404(c)(7). The operating agreement may prescribe a lower vote to admit a new member. See id. § 33-44-103(a).
class of shares to which a nonvoting shareholder belongs.  

Amendments that are potentially burdensome enough to occasion statutory voting rights for a class of nonvoting shares are those that (1) alter the size, rights, or preferences of a nonvoting class; (2) grant to another class rights or preferences superior to those of a nonvoting class; or (3) reclassify shares either into or out of the nonvoting class. Dissenter’s rights probably are available to a nonvoting shareholder opposing the above amendments.  

A class of nonvoting shareholders entitled to vote on a potentially adverse articles amendment may vote as a separate voting group. A voting group is comprised of an entire class of shares authorized to vote on a transaction. Instead of tabulating individual shareholder votes, the group’s vote constitutes one collective vote. Voting as a separate voting group amplifies the statutory right to vote on a matter. Where two or more voting groups are able to vote on a matter, each group must approve the transaction. The authority to prevent an action in the wake of every other groups’ approval by opposing the transaction is a powerful control right for shareholders otherwise not entitled to participate. Also, if a nonvoting group is unable to participate in a meeting for lack of a group quorum, the corporation may not approve a transaction until the nonvoting group endorses the transaction.  

Nonvoting shareholders of a close corporation have additional statutory voting rights. If a close corporation wishes to relinquish its close corporation status, the corporation must do so by an articles amendment approved by two-thirds of both voting and nonvoting shareholders. Also, nonvoting shareholders of close corporations may vote to eliminate the board of directors, to reinstate the board, and to obligate the corporation to purchase a shareholder’s interest upon the shareholder’s death.  

Nonvoting shareholders in close corporations may also participate in certain major transactions. First, a nonvoting shareholder may vote on a

116. Id. §§ 33-6-101(c)(1), -10-104(d) (Law. Co-op. 1976). A nonvoting shareholder may also vote on and dissent from an amendment that would convert a corporation into a close corporation. Id. § 33-18-103(b).  

117. Id. § 33-10-104(a)(1)-(9).  


119. Id. § 33-10-104(a) (Law. Co-op. 1976).  

120. Id. § 33-1-400(27), cmt. 9. Generally, a majority of the votes cast within a voting group determines the collective vote. Id. § 33-7-250(c).  

121. Id. § 33-7-260(b). Any time nonvoting shareholders vote on articles amendments as a separate voting group, at least two groups will vote on the matter because voting shares will also vote as a group. See id. §§ 33-7-210(a), -10-103(f).  

122. Id. § 33-7-260, cmt. A majority of group members present generally constitutes a quorum, but the articles of incorporation may alter the number of shareholders necessary for a quorum. Id. § 33-7-250(a). One voting group may have a quorum at a meeting, and thus be able to vote, while another group may not. Id. § 33-7-260(b) cmt.  

123. Id. § 33-18-310(a)-(b). A disapproving nonvoting shareholder may dissent if the close corporation adopts the amendment. Id. § 33-18-310(c).  

124. Id. §§ 33-18-210(b), (d), -18-140(c).
proposed merger if the merger would terminate the corporation's close corporation status or if the surviving corporation would be a close corporation. Additionally, nonvoting close corporation shareholders may vote on a sale of all, or substantially all, of the corporation's assets not made in the ordinary course of business. Because nonvoting shareholders in close corporations may vote on a merger or a substantial asset disposition, nonvoting shareholders of a close corporation may also dissent from the approval of these transactions.

2. The LLC Context

The LLC Act apportions voting rights equally among LLC members. However, an LLC can create various voting and preferential classes (similar to the way that a corporation creates different shareholder classes) through its operating agreement. If the operating agreement creates a class of nonvoting members, those nonvoting members have no concrete statutory voting rights.

The LLC Act appears to require the unanimous consent of an LLC's members to approve certain major transactions, such as mergers and substantial asset dispositions not made in the ordinary course of business. However, by creating a nonvoting class, the operating agreement trumps the LLC Act's unanimous consent requirement, removing any statutory voting rights nonvoting members may appear to have. A nonvoting LLC membership is consequently less protected than its corporate counterpart because, without an unwaivable statutory right to participate in fundamental transactions, a nonvoting LLC member is absolutely vulnerable to majority discretion.

G. Shareholder and Member Voting Rights

1. The Corporate Context

a. Classed Voting Shares

The Corporate Code as a default creates a straight voting scheme under

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125. Id. § 33-18-300(a)(1), (2), cmt. These provisions are consistent with the notion that nonvoting shareholders may vote on both the election and termination of close corporation status. Id. § 33-18-300 cmt.
126. Id. § 33-18-300(b).
127. Id. § 33-13-102(1), (3) (West Supp. 1998) (giving shareholders who are entitled to vote on mergers or substantial asset dispositions not made in the ordinary course of business dissenter's rights), § 33-18-102 (Law. Co-op. 1976) (providing that general corporation provisions of the Corporate Code apply to close corporations where not inconsistent with the Close Corporation Supplement).
129. See id. § 33-44-103; Tuthill et al., supra note 52, at A-17.
131. Fiduciary duties imposed on LLC management would still protect a nonvoting LLC member. See supra note 4 and accompanying text.
which each voting shareholder may cast one vote per share “on each matter voted on at a shareholders’ meeting.”\(^{132}\) Straight voting effectively denies minority shareholders the right to select directors because majority shareholders generally control the plurality of votes necessary to elect directors.\(^ {133}\) As an alternative to straight voting and as a means of distributing corporate control, a corporation may divide its shareholders into separate classes, allocating to one or more classes the right to elect one or more directors.\(^ {134}\) As a result, a corporation may authorize a class of minority shareholders to elect one or more directors, securing at least some minority representation in corporate decision-making.\(^ {135}\)

However, classed voting is neither a mandatory nor a default provision of the Corporate Code. A corporation must specifically opt to provide for classed voting shares in its articles of incorporation.\(^ {136}\) Consequently, unless the minority can convince majority shareholders to provide for classed voting shares in the initial articles of incorporation, minority shareholders need majority consent to amend the articles and enact classed voting.\(^ {137}\) Thus the protection afforded by classed voting shares is largely dependent on the majority’s willingness to effect it.

**b. Cumulative Voting for Directors**

Another voting protection of the Corporate Code designed to offset the principle of majority rule is cumulative voting for directors. Cumulative voting gives shareholders the statutory right to concentrate the total number of a shareholder’s votes in favor of one or a few candidates.\(^ {138}\)

To determine a shareholder’s cumulative voting capacity, a shareholder must “multiply the number of votes [she is] entitled to cast by the number of directors for whom [she is] entitled to vote.”\(^ {139}\) For example, in an election to

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133. See supra note 6 and accompanying text. A corporation may require more than a majority vote to elect board members (or to approve any other shareholder or board action) in its articles of incorporation. S.C. Code Ann. § 33-7-270(a) (Law. Co-op. 1976). A “supermajority” voting provision protects minority shareholders because any action calling for an approval greater than a majority necessitates some minority support. 2 Sherwood M. Cleveland et al., S.C. Corp. Prac. Manual § 6.05[2]; Larry D. Soderquist & A.A. Sommer, Jr., Understanding Corporation Law 220 (1990).
134. See S.C. Code Ann. § 33-8-104 (Law. Co-op. 1976) (“the articles may also authorize the election of all or a specified number of directors by the holders of one or more authorized classes of shares”); see also id. § 33-6-101 (allowing a corporation to create various classes of shares). A majority vote within each class determines the collective class vote. Id. §§ 33-8-104 cmt., -7-250(c).
135. See id. § 33-8-104 cmt. A corporation may similarly allocate voting rights by class for other matters as well. See id. § 33-6-101; 2 Cleveland et al., supra note 133, § 6.05[1].
137. See generally note 40 and accompanying text.
138. S.C. Code Ann. § 33-7-280(b) (Law. Co-op. 1976). A shareholder may not vote cumulatively unless either the meeting notice or the shareholder gives the requisite notice. Id. § 33-7-280(c).
139. Id. § 33-7-280(b).
fill five board openings, a shareholder with ten shares would have fifty total votes to distribute among the candidates; the shareholder may either vote fifty times for one candidate or spread the fifty votes between the candidates. The fewer candidates over which the shareholder spreads her votes, the more likely it is that the shareholder’s candidates will win.

Thus, cumulative voting enables minority shareholders to compete with the majority vote and “secure representation on the board of directors,” especially if minority shareholders agree to vote together in favor of a particular candidate. The more board positions that a corporation must fill, the more valuable cumulative voting becomes to minority shareholders. For every additional vacancy on the board, the minority vote in favor of a particular candidate becomes stronger and, especially if the majority fails to cumulate its votes, the likelihood of a minority-elected candidate increases.

Cumulative voting is a default provision of the Corporate Code. A corporation may disallow cumulative voting by so providing in its articles of incorporation, which generally requires only a majority vote. As a practical matter, most corporations probably eliminate cumulative voting. Thus, cumulative voting protects minority shareholders only where the majority allows cumulative voting to protect minority shareholders.

c. Voting Agreements and Voting Trusts

The Corporate Code expressly permits two additional mechanisms through which minority shareholders can pool a collective vote: the voting agreement and the voting trust. In a voting agreement, minority shareholders agree to vote their shares together in order to “maximize the group’s voting power.” By contractually concentrating the minority vote, minority shareholders theoretically could approve a transaction or elect a candidate to the board of directors despite the majority shareholders’ disapproval.

Parties to the contract determine how to enforce the agreement. For example, the parties could appoint a proxy to vote all shares subject to the
contract. A party to a voting agreement enforced through proxies statutorily cannot revoke the party’s proxy. Additionally, even if parties do not use proxies to enforce the contract, voting agreements are specifically enforceable, and a court can compel either party to vote in accordance with the agreement.

Minority shareholders may alternatively create a voting trust in order to pool the minority vote. To create a voting trust, shareholders convey their shares to a trustee, who then has the authority to vote the shares in any way the trustee sees fit. Centralizing the minority votes in trust helps ensure that the votes will be cast together in much the same way as the voting agreement. However, unlike the potentially perpetual voting agreement, the Corporate Code limits the duration of a voting trust to ten years. Parties to the trust may extend the trust for additional ten year periods. Further, parties to a voting trust must file with the corporation the trust agreement and a list detailing each beneficial owner’s name, address, and trust interest.

2. The LLC Context

a. Classed Voting

The default voting apportionment under the LLC Act is more protective than that of the Corporate Code. The LLC Act allotstheLLC member regardless of the member’s contribution. One vote per member results in an equality among LLC members similar to that created by voting groups in the corporate context. Theoretically, no member’s vote is more influential than another member’s vote. But if enough members commonly vote together, outvoting the remaining members, then the principle of majority rule emerges despite the heightened default voting protection.

In response, members theoretically may establish classed voting through the operating agreement, although the LLC Act does not specifically authorize its creation. A manager-managed LLC could utilize classed voting to give

150. Id. A “proxy” is both an agent authorized by a shareholder to vote for the shareholder and the agent’s authorization to vote for the shareholder. See id. § 33-7-220 cmt. 2; 2 COX ET AL., supra note 140, § 13.22, at 13.49.
152. Id. § 33-7-310(b); 2 CLEVELAND ET AL., supra note 133, § 6.06(1).
153. See S.C. CODE ANN. § 33-7-300(a), (d) (Law. Co-op. 1976); 2 COX ET AL., supra note 140, § 13.32, at 13.84. The trust agreement should outline the trustee’s voting authority. 2 CLEVELAND ET AL., supra note 133, § 6.06(1), at 6-11. The trustee is subject to fiduciary duties when voting the trust shares. 2 COX ET AL., supra note 140, § 13.32, at 13.84.
155. Id. § 33-7-300(c).
156. Id. § 33-7-300(a).
157. Id. § 33-44-404(a)(1), (b)(3)(i) (West Supp. 1998). The operating agreement may modify the LLC Act’s voting power allocation, and indeed most LLCs allocate voting authority according to member contributions. See supra notes 13-14 and accompanying text.
158. See generally supra notes 120-22 and accompanying text.
certain members or groups of members the exclusive right to elect one or more managers. In a member-managed LLC where each member would constitute a separate class, a classed voting scheme would be redundant because of the statutory default. Classed voting would serve to allocate to each member an equal vote in management—a protection already provided to each member under the LLC Act’s default voting apportionment.\(^{159}\) However, where multiple minority members create one or more classes together, especially where the operating agreement has altered the LLC Act’s voting apportionment, classed voting may be an effective mechanism through which to concentrate and channel the minority vote.

LLC members face a problem similar to that of corporate shareholders in creating a classed voting scheme—majority approval. Adding a provision to the operating agreement either in the initial organization or by amendment requires the consent of majority members.\(^{160}\) Thus, although classed voting is a potential control mechanism, minority LLC members will be able to benefit from its protection only if majority members consent.

\[b. \text{ Cumulative Voting in a Manager-Managed LLC}\]

The LLC Act contains no provisions regarding cumulative voting. Although a member of a manager-managed LLC\(^{161}\) theoretically could bargain for the inclusion of a cumulative voting provision in the operating agreement, majority members are not likely to give the consent necessary to enact cumulative voting because cumulative voting means potentially less power for the majority. Thus, despite the Corporate Code’s inclusion of cumulative voting as a default provision, both minority shareholders and minority LLC members again must depend on majority approval for cumulative voting protection.

\[c. \text{ Voting Agreements and Voting Trusts}\]

The LLC Act addresses neither voting agreements nor voting trusts. Presumably, LLC members are free to enter at least a voting agreement. Minority LLC members can use a voting agreement to pool a collective and thus more significant vote in the same manner as minority shareholders. Unlike the Corporate Code, however, the LLC Act contains no provision making voting agreements specifically enforceable. Thus, where the Corporate Code ensures minority shareholders that parties to a voting agreement cannot renege and vote outside the terms of the contract, the LLC Act by silence may permit

\(^{159}\) See supra notes 157-58 and accompanying text.

\(^{160}\) See S.C. CODE ANN. § 33-44-404(c)(1) (West Supp. 1998). The operating agreement may change the minimum votes necessary to amend the operating agreement. See id. § 33-44-103.

\(^{161}\) Cumulative voting is appropriate only for manager-managed LLCs because its corporate analog applies only to the election of directors. See id. § 33-7-280(b) (Law. Co-op. 1976).
a party to vote in violation of a voting agreement.\textsuperscript{162} However, a party who votes in violation of a voting agreement still may be liable in damages for breach of contract. A voting agreement is not effective if parties to the contract cannot force each other to vote according to the agreement. The more parties that withdraw from a voting agreement, the less concentrated and influential the remaining contractual pool becomes. Consequently, the LLC Act's failure to render voting agreements specifically enforceable makes the Corporate Code's regulation of voting agreements more protective.

Whether or not LLC members are free to form a voting trust is questionable. The LLC Act does not address voting trusts, but the LLC Act does significantly restrict the voting rights of an assignee.\textsuperscript{163} If a trustee is treated as an assignee, the trustee would be unable to vote unless the particular LLC allowed transferees to vote.\textsuperscript{164} A trustee's inability to vote would render the voting trust worthless to minority LLC members. However, if a trustee is not considered an assignee, a voting trust may be available in the LLC context.

\textbf{III. CONCLUSION}

The principle of majority rule is disadvantageous to both minority and nonvoting corporate shareholders and LLC members. The South Carolina Corporate Code attempts to mitigate the potential for oppression by those in control of a corporation by providing corporate shareholders with a number of non-waivable control rights. In the LLC context, however, the relatively few control rights found in the LLC Act are illusory. In effect, by according such an enormous amount of discretion to the operating agreement, the LLC Act provides autonomy to each LLC to either provide or fail to provide control rights to its members. Thus the control provisions of the LLC Act are unprotective and irrelevant to minority and nonvoting LLC members unless the operating agreement otherwise provides. Lawyers counseling clients to organize either as a corporation or an LLC must be wary of the gulf between the statutory protections afforded minority shareholders and minority LLC members under South Carolina law.

\textit{Thomas Alexander Brumgardt}

\textsuperscript{162} Parties may enforce the contract by executing proxies, arguably making the proxies irrevocable. \textit{See 2 COX ET AL., supra} note \textsuperscript{140}, § 13.23, at 13.52-1 ("A proxy...is revocable unless 'coupled with an interest."). \textit{See generally supra} notes \textsuperscript{150-51} and accompanying text (discussing proxies). If the proxies are irrevocable, then a party to a voting agreement will be unable to withdraw from the appointed agent the authority to vote the party's shares.

\textsuperscript{163} \textit{See supra} notes \textsuperscript{110-115} and accompanying text.

\textsuperscript{164} \textit{See supra} note \textsuperscript{113} and accompanying text.