Limited Liability Companies Are off and Running: Historic Charleston Holdings, LLC v. Mallon, Accountings, and Derivative Actions in LLC Litigation

Carmen Harper Thomas

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I. INTRODUCTION

Since the General Assembly enacted the South Carolina Uniform Limited Liability Company Act (SC ULLCA) in 1996, no reported cases have interpreted any of the Act’s substantive provisions. Fortunately, or unfortunately, the time has come for courts to interpret the SC ULLCA. The South Carolina business community has embraced the limited liability company (LLC) form, and its increasing application has finally brought a case that applies the statute. In Historic Charleston Holdings, LLC v. Mallon, the LLC’s members disputed how assets would be distributed, and one member claimed he was due reimbursements for services provided to the LLC. The case was brought both directly and derivatively on behalf of Dixie Holdings, and the court of appeals upheld the master-in-equity’s award of attorney’s fees under the derivative statute. In its decision, the court of appeals held the LLC’s operating agreement and the SC ULLCA required an accounting prior to distributing the company’s assets. The court did not address the SC ULLCA’s derivative suit requirements in the closely held LLC context, but allowed one member in a two-member LLC to sue derivatively on the company’s behalf.

This Note discusses two primary issues. First, whether the accounting remedy is appropriate under these facts, and second, whether the plaintiff met the requirements for a derivative action and if a derivative action is appropriate for a closely held LLC. Part I, Section A describes the popularity of LLCs in South Carolina. Part I, Section B stresses the importance of careful interpretation of the SC ULLCA required by the popularity of LLCs. Part II presents the facts of Historic Charleston Holdings and outlines the court of appeals’ opinion. Part III, Sections A and B conclude the court’s order of an accounting action is not the appropriate remedy because: (1) the amount in dispute is small and results from a single

2. While no South Carolina cases have addressed substantive issues related to the LLC statute, a recent case addressed punitive damages in an LLC breach of fiduciary duty action and made reference to financial records issues similar to those analyzed here. See Jordan v. Holt, 362 S.C. 201, 206, 608 S.E.2d 129, 131 (2005). Interestingly, the LLC statute has been analyzed concerning the status of an affiliate company in a Michigan bankruptcy case where the defendant was involved in a related South Carolina proceeding. In re Barman, 237 B.R. 342, 348–49 (Bankr. E.D. Mich. 1999).
4. Id. at 531, 617 S.E.2d at 391.
5. Id. at 541, 617 S.E.2d at 394.
6. Id. at 535–36, 617 S.E.2d at 394.
transaction; (2) the LLC has only two members disputing the amount; and (3) the court supported the master’s decision disallowing the member’s requested reimbursements, therefore the court only needed to divide the assets in half. Part III, Section C argues an accounting was not required because the operating agreement and the SC ULLCA do not require that procedure. Part IV concludes that awarding attorney’s fees under the derivative statute is not appropriate. Specifically, Part IV, Section A explains that derivative actions are generally not effective for closely held LLCs and Part IV, Section B shows the case did not meet the requirements for a derivative action. Part V provides a conclusion.

A. Popularity of LLCs in South Carolina

The LLC form is extremely popular in South Carolina, with over 21,260 organizational filings in 2004. The number of LLCs filed with the Secretary of State since 1994 has increased by an average of thirty-two percent annually. The Secretary of State has reacted to the form’s popularity by working with attorneys and the General Assembly to eliminate bureaucratic hurdles to managing an LLC. The LLC’s popularity results from its favorable tax treatment, flexible managerial control, and offer of limited liability for LLC members.

While the state’s economy has lagged in recent years, the General Assembly has attempted to improve the business climate by increasing financing opportunities and providing easier ways to do business in South Carolina. The LLC form’s lure

7. E-mail from Jody Steigerwalt, South Carolina Secretary of State’s Office, to Carmen Harper Thomas (Oct. 6, 2005, 16:05:19 EST) (on file with author).
8. Id. Exact figures, based on a June to May fiscal year and including both domestic and foreign LLCs: 4 LLCs filed in 1993-94; 958 LLCs filed in 1994-95; 1,804 filed in 1995-96; 3,121 filed in 1996-97; 3,960 filed in 1997-98; 6,036 filed in 1998-99; 6,974 filed in 1999-2000; 8,231 filed in 2000-01; 9,526 filed in 2001-02; 12,343 filed in 2002-03; 16,464 filed in 2003-04; and 21,260 filed in 2004-05. Id.
10. See Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 287 (Del. 1999). The Delaware Supreme Court stated:

The limited liability company (“LLC”) is a relatively new entity that has emerged in recent years as an attractive vehicle to facilitate business relationships and transactions. . . . [It is designed to achieve what is seemingly a simple concept—to permit persons or entities (“members”) to join together in an environment of private ordering to form and operate the enterprise under an LLC agreement with tax benefits akin to a partnership and limited liability akin to the corporate form.

Id.
as a tax efficient, limited liability entity may be included in the list of business environment enhancements. Beginning with Wyoming in 1977, all fifty states had enacted LLC statutes by mid-1996.12 States generally see the LLC form as a necessary component of a competitive business environment, and businesses support that view by increasingly employing the LLC form.

B. Importance of LLC Statute Interpretation

Because many businesses presently use or plan to use the LLC form and because South Carolina’s economic competitiveness depends on the form, courts must consistently and clearly interpret the SC ULLCA. Attorneys who rely on unclear and inconsistent judicial opinions may draft inefficient or incorrect operating agreements. Parties may bring unnecessary legal actions based on a cause of action that is not viable. For example, in Jordan v. Holt, the LLC did business without an operating agreement, relying on the statute for governance.13 If the LLC members had interacted with each other without violating their fiduciary duties, they might have avoided their problems by executing a detailed operating agreement.14

Another problem in not having a definitive interpretation of the SC ULLCA is the possibility for LLC members to abuse weaknesses in the statute. Several states face the dangers accompanying online LLC incorporation by non-United States members, opening the door for fraud and secret dealings.15 Foreign LLCs can then launder suspicious funds through the United States banking system, attracting Justice Department investigations.16 Wrongdoers might exploit potential weaknesses in the SC ULLCA for similar criminal purposes.17 For these reasons, South Carolina courts’ initial interpretations of the SC ULLCA must be clear and

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1743 (expanding eligibility for Jobs Tax Credits and creating a Capital Access Program to support financial institution loans to small businesses); Act of May 11, 2004, 2004 S.C. Acts 2078 (mandating state agency review of actions that could impact small businesses).


14. In Jordan, the South Carolina Supreme Court agreed with the trial judge’s assessment of punitive damages against two LLC members for committing “egregious conduct.” Id. at 203, 608 S.E.2d at 131. However, an operating agreement might have addressed the management issues that led to the lawsuit because only two of the five members actively participated in operating the business. See id. at 203, 608 S.E.2d at 130.


16. Id.

17. In South Carolina, LLC filing requires the name and address of managers and organizers, but does not require the names of all members. S.C. CODE ANN. § 33-44-203 (2006).
consistent. Courts may have to go out of their way to achieve sufficient clarity, but the resulting stability will be worthwhile for the companies, their members, the courts, and the citizens of South Carolina.

II. HISTORIC CHARLESTON HOLDINGS, LLC V. MALLON

The case discussed in this Note raises issues specific to LLCs, which may help shape the way courts and attorneys deal with the popular business form. In Historic Charleston Holdings, Dixie Holdings, LLC (Dixie Holdings) had two members at the time of the action, Historic Charleston Holdings, LLC (HCH) and Gerard Mallon. Priestly Coker and his wife were the only members of HCH. The parties entered into an operating agreement in June 1998. Mallon and HCH each held fifty-percent interests in Dixie Holdings after buying a one-percent interest from a third member who dissociated. The members organized Dixie Holdings to buy, renovate, and sell historic properties in Charleston, with Mallon performing construction services for the properties and Coker performing financial services.

After Dixie Holdings sold two of the four properties it owned, Mallon disputed the amount he received from the sales because "he believed he had not separately been compensated for work performed in renovating those properties." Mallon requested financial information from Coker. Coker kept Dixie Holdings' funds in a bank account with funds from another co-venture, Dixie Developers. Both Coker and Mallon had signatory authority on the account. In December 1999, the parties executed an amendment to their operating agreement which stated, "The sales proceeds can be held in an escrow account. OR [other [sic] written accepted offer]." The agreement also "provided for an audit of Dixie Holdings" and for arbitration "if the members could not resolve their differences." Coker gave

18. Cf. Larry E. Ribstein, A Critique of the Uniform Limited Liability Company Act, 25 STETSON L. REV. 311, 323–24 (1995) (arguing that interstate consistency of LLC statutes is undesirable for many reasons, including reducing innovation, and that "the best rule will emerge from the collective wisdom and experience of lawyers and legislatures in fifty states as lawyers and their clients learn from the actual operation of LLCs").


20. Id. at 529, 617 S.E.2d at 390.

21. Id. at 529, 617 S.E.2d at 390.

22. Id. at 529–30 n.1, 617 S.E.2d at 390–91 n.1.

23. Id. at 529, 617 S.E.2d at 391.

24. Id. at 530, 617 S.E.2d at 391.


27. Id. at 529–30 nn.3 & 4, 617 S.E.2d at 391, nn.3 & 4.

28. Id. at 530, 617 S.E.2d at 391 (brackets in original).

29. Id. at 530, 617 S.E.2d at 391.
Mallon a “computer printout for 1999 but it did not include any details of checks disbursed.”\(^{30}\) In April 2000, Coker gave Mallon a box of financial records in addition to the computer printout,\(^{31}\) but neither the printout nor the box of records satisfied Mallon’s desire for a “proper accounting.”\(^{32}\)

Also in April 2000, Dixie Holdings sold a third property, 15 Felix Street, with net proceeds of $41,845.30.\(^{33}\) Mallon placed the net proceeds into a separate bank account under the name Dixie Developers, “of which he had sole signatory authority.”\(^{34}\) Coker repeatedly requested “that Mallon place the funds in a proper escrow account,” but Mallon ignored Coker’s request.\(^{35}\) “Dixie Holdings’ fourth and final property was sold in December 2001 and the proceeds were split equally. Thus, Dixie Holdings no longer own[ed] any property.”\(^{36}\) HCH brought suit “individually and in a derivative capacity as a member of Dixie Holdings . . . against Mallon, Dixie Holdings, and Dixie Developers on October 11, 2002.”\(^{37}\)

HCH alleged five causes of action in its complaint:

(1) a judicial decree winding up and dissolving Dixie Holdings; (2) a full and complete accounting of Dixie Holdings including transfers between it and Dixie Developers and Mallon; (3) injunctive relief reversing Mallon’s diversion of funds and restraining Mallon from taking any action that would damage either HCH or Dixie Holdings’ interests; (4) a declaratory judgment regarding each member’s rights pursuant to section 15-53-10 of the South Carolina Code; and (5) attorney’s fees pursuant to section 33-44-1104 of the South Carolina Code.\(^{38}\)

Mallon answered by asserting a right to an accounting and claiming “entitlement to reimbursement for services he performed on various properties of Dixie Holdings that exceeded the proceeds Dixie Holdings received from the sale of 15 Felix Street.”\(^{39}\)

At trial before the master-in-equity, to support his request for reimbursement, “Mallon presented a statement of charges in which he claimed he was owed $9,280 for work performed on four Felix Street properties, including $1,900 for work

\(^{30}\) Final Brief of Appellant, \textit{supra} note 25, at 7.
\(^{31}\) \textit{Id.}
\(^{32}\) \textit{Historic Charleston Holdings}, 365 S.C. at 531, 617 S.E.2d at 392.
\(^{33}\) \textit{Id.} at 530, 617 S.E.2d at 391.
\(^{35}\) \textit{Id.} at 530–31, 617 S.E.2d at 391.
\(^{36}\) \textit{Id.} at 531 n.6, 617 S.E.2d at 391 n.6.
\(^{37}\) \textit{Id.} at 531, 617 S.E.2d at 391.
\(^{38}\) \textit{Id.} at 531, 617 S.E.2d at 391–92.
\(^{39}\) \textit{Id.} at 531, 617 S.E.2d at 392.
performed on 15 Felix Street. In his order, the master denied Mallon’s request for an accounting” and his request for the $9,280 for reimbursed expenses.40 “The master found HCH was entitled to receive one-half of the proceeds from the sale of 15 Felix Street, plus prejudgment interest on its half of the proceeds at the rate of 8.75% from the closing date of 15 Felix Street until the entry of judgment,” and “awarded HCH attorney’s fees and costs” based on the derivative action statutory requirements, which Mallon appealed.41 “The master also authorized HCH to deliver articles of termination” to the Secretary of State.42

The court of appeals reversed the master’s decision to deny an accounting and remanded to have “a formal accounting” conducted.43 The court held both the operating agreement and the SC ULLCA required an accounting prior to dissolution.44 The court also ordered the proceeds from 15 Felix Street be held in escrow and distributed after the accounting, reversing the master’s order giving half the proceeds to HCH.45 The court upheld the master’s award of attorney’s fees to HCH, determining the master did not abuse his discretion in awarding fees.46 The court also held most of Mallon’s arguments against the attorney fees were not preserved for review, including Mallon’s argument that the suit was not a derivative action.47

III. WAS AN ACCOUNTING NECESSARY AND APPROPRIATE TO RESOLVE THE DISPUTE?

While the court of appeals decided “an accounting was necessary for the dissolution and winding up of Dixie Holdings’ business,”48 several factors, including the operating agreement’s requirements and the size and financial status of Dixie Holdings, indicate an accounting may not have been necessary or appropriate. The equitable accounting remedy is “[a]n equitable proceeding for a complete settlement of all partnership affairs, usually in connection with partner misconduct or with a winding up.”49 An accounting is the “primary method through which partners resolve disputes among themselves.”50 In Historic Charleston

41. Id. at 532, 617 S.E.2d at 392.
42. Id. at 531, 617 S.E.2d at 392.
43. Id. at 537, 617 S.E.2d at 395.
44. Id. at 536, 617 S.E.2d at 394.
45. Id. at 538, 617 S.E.2d at 395.
47. Id. at 540, 617 S.E.2d at 396.
48. Id. at 536, 617 S.E.2d at 394.
49. BLACK’S LAW DICTIONARY 21 (8th ed. 2004).
Holdings, both parties requested an accounting at trial. Coker argued against the accounting on appeal because he received half of the disputed sum plus significant fees and interest under the master’s ruling. Mallon wanted an accounting because the procedure could determine the LLC should have reimbursed him for his work on Dixie Holdings’ properties, although the court of appeals stated “[t]he master’s findings that Mallon was not entitled to set off” would make the accounting on remand easier.

The parties required assistance to settle their dispute because they were at an impasse over how to distribute Dixie Holdings’ funds. For reasons related to the business’s size and the amount in dispute, an accounting is a disproportionate remedy compared to the court simply resolving the case on appeal by entering a decision allocating the disputed amount. While not undertaking an accounting to settle internal business disputes may be the exception, when the assets are uncomplicated and there are few members, an accounting may be inappropriate. First, meeting the statute’s minimum record-keeping requirement would have adequately allowed Coker and Mallon to determine Dixie Holdings’ profits, losses, and their individual shares on dissociation. Second, the amount in dispute was small and determinable, as evidenced by the master’s ruling on Mallon’s claim for reimbursement. Third, with only two members, an accounting procedure to determine rights between two people is inefficient when the dispute could have been resolved either by the audit agreed to by the parties prior to the action or through an entry of judgment by the court of appeals. Finally, discrepancies between the operating agreement and the statutory requirements show an accounting was not the required remedy.

A. Effect of LLC Recordkeeping on Financial Issues

First, the SC ULLCA requires the LLC to furnish records “concerning the company’s business or affairs.” The comment to this section elaborates that although the statute does not require records, “a company should maintain records necessary to enable members to determine their share of profits and losses and their rights on dissociation.” Presumably, if the LLC maintains proper records,

52. Id. at 532, 617 S.E.2d at 392.
53. Id. at 532, 617 S.E.2d at 392.
55. Burkhard, supra note 50, ¶ 1.02, at 3 (citing Dunn v. Zimmerman, 631 N.E.2d 1040, 1044 (Ohio 1994)).
57. Historic Charleston Holdings, 365 S.C. at 530, 617 S.E.2d at 391.
58. Id. at 536, 617 S.E.2d at 394.
60. Id. ¶ 33-44-408 cmt.
members should be able to determine what they are due upon dissolution.61 Maintaining financial records is helpful to the LLC62 in avoiding the problems that occurred with Dixie Holdings. Mallon argued Coker did not properly maintain records because Coker only gave Mallon a box of incomplete records.63 Mallon and the former member requested “a full set of financial records” from Coker.64 However, if the only financial records available were bank statements that Mallon had full access to as the joint signatory on the account,65 the records available to Coker were the same records available to Mallon. The additional information necessary for Mallon to be reimbursed for his expenses were receipts likely in Mallon’s possession, not the LLC’s.66 If Mallon could not produce the receipts at the first trial with the master, he would likely not have them for the subsequent accounting unless he gave the receipts to Coker; if he gave the receipts to Coker, Coker could not argue that Mallon was not entitled to reimbursement. Additionally, the master’s denial of expenses to Mallon was not based on the incomplete records, but “because the parties had a ‘course of dealing of determining expenses prior to property sales and paying authorized expenses from the sale proceeds.’”67 Therefore, if the expense records were not at issue, the bank statements would be the only records necessary to determine the account balances. While having accurate LLC records available from the outset may have avoided the dispute, the available records should have been sufficient to determine the financial status of Dixie Holdings without requiring an accounting.

61. Although it appears the LLC members did not maintain these records, bank records could have been adequate because no evidence of complicated dealings existed. However, the bank records may also have been a problem as Mallon alleged “the bank has been sold several times and ... has not been able to provide usable records.” Final Brief of Appellant, supra note 25, at 17.

62. See Ann Maxey, West Virginia’s Limited Liability Company Act: Problems with the Act, 96 W. VA. L. REV. 905, 947 n.135 (1994). In comparing Virginia’s recordkeeping requirement to West Virginia’s, Maxey stated, “The requirement to keep information and records can be helpful to the members. Courts, however, in deciding to pierce the limited liability veil of LLCs, may use the failure to keep these records in the same way courts point to the failure of a corporation to maintain its formal records.” Id. Thus, LLCs have a strong incentive to maintain adequate records.

63. Final Brief of Appellant, supra note 25, at 7.

64. Id. The appellant’s brief also mentioned the box of records Coker gave Mallon and specified that “it did not include any cancelled checks,” which would have been no more detailed as to the account transactions than the records available directly from the bank. See id.


66. Mallon listed $9,280 in expenses at trial, including specific items for each property like “Porch removal to avoid collapse $550” and “Clean up $800.” Final Brief of Appellant, supra note 25, at 6. However, Coker claimed to have never received “invoices, cancelled checks, or other documentation” to support Mallon’s claimed expenses. Brief of Respondent at 16, Historic Charleston Holdings, LLC v. Mallon, 365 S.C. 524, 617 S.E.2d 388 (Ct. App. 2005) (No. 2002-CP-10-04149).

67. Historic Charleston Holdings, 365 S.E.2d at 532, 617 S.E.2d at 392.
B. Small Amount of Money and Few Members Should Make Unraveling Simple

The second and third reasons against an accounting remedy in the case are that the $41,845.30 in dispute was too small to warrant an accounting procedure, and that the dispute involved only two members, making an accounting unnecessary to divide money in half. An accounting is appropriate when the accounts are complicated or mutual. A mutual account is "an open account where there are items debited and credited on both sides of the account," as in a buyer-seller relationship where the parties' transactions are set off. The shared account at issue in Historic Charleston Holdings involved only the transactions for Dixie Holdings. An accounting would not be necessary even when "there are several items in the account, or because of the necessity for considering numerous transactions, or for the examination of books and records."

According to the court, only one transaction was in dispute—the distribution of proceeds from the sale of 15 Felix Street. The court made conflicting statements regarding whether Mallon was entitled to reimbursement. First, the court referenced the master's denial of expenses, which established the basis for the expense issue on appeal. Second, in describing why an accounting is necessary, the court referenced the operating agreement's requirement that "the company 'shall reimburse Members for all authorized, direct out-of-pocket expenses incurred on behalf of the Company.'" While that reference conflicts with the master's holding denying Mallon reimbursement, the reference is not conclusive of Mallon's eligibility for reimbursement on appeal. Another statement by the court of appeals that conflicts with the master's denial of expenses is its holding that the "master must first conduct an accounting to determine the balance of Dixie Holdings' assets after the payment of liabilities, which presumably under the operating agreement includes reimbursements to members."

The court alluded to the possibility that Mallon may be entitled to reimbursement for certain expenses. However, the court returned to the idea that Mallon will not be reimbursed when it stated, "[t]he master's findings that Mallon was not entitled to setoff and the fact that Dixie Holdings' only remaining asset was the disputed amount will only serve to make

68. Id. at 530, 617 S.E.2d at 391.
69. 1 A.M. JUR. 2D Accounts and Accounting § 56 (2005).
70. Id. § 6.
71. Id. § 57.
72. Historic Charleston Holdings, 365 S.C. at 533 n.7, 617 S.E.2d at 393 n.7. Although Mallon wanted reimbursement from all four properties, the master "limit[ed] the scope of the underlying action to the 15 Felix Street property," and the court of appeals decided Mallon did not present adequate support for his argument against limiting the action's scope. Id. at 533 n.7, 617 S.E.2d at 393 n.7.
73. Id. at 532, 617 S.E.2d at 392.
75. Id. at 536, 617 S.E.2d at 394 (emphasis added).
[the accounting] easier."76 Finally, the court recognized the issue of Mallon’s expenses was not preserved for appellate review, further lending support to the master’s holding that recovery for expenses was not appropriate.77 Judging by the court’s statements, how to split the remaining $41,845.30 seemed to be the only issue related to the LLC’s financial status that the court needed to resolve—not whether, or how, to account for Mallon’s expenses. By returning the case to the master for an accounting, the court of appeals must have intended the master to do something additional on remand. However, the court of appeals’ statements regarding Mallon’s expenses indicate the only remaining task on remand was to divide the $41,845.30. The court unfortunately left many questions unanswered, particularly what, if any, additional action the master should take on remand.

As to the small number of members, courts have held that “one partner cannot maintain an action against his copartner for an accounting as to particular items or transactions.”78 The 15 Felix Street transaction in Historic Charleston Holdings was the sole issue to be accounted. While a party may allege an individual transaction was improper, a court cannot account for only one transaction because an accounting “should be a complete adjustment of the partnership accounts,”79 which is impossible when only one transaction is in dispute. In addition, the operating agreement in Historic Charleston Holdings provided a simple method for dividing the LLC’s assets between two members. According to the operating agreement, the assets were to be distributed “[t]o each Member in accordance with their respective Membership Percentages.”80 HCH had only two members whose membership percentages were equal. Thus, the assets should have been divided equally among the members. Because the amount at issue was ascertainable and only needed to be split in half, an accounting was unnecessary.

76. Id. at 537, 617 S.E.2d at 395.
77. Id. at 538 & n.9, 617 S.E.2d at 395 & n.9 (“Mallon raises several other issues on appeal, including whether the circuit court erred in: (1) disallowing Mallon’s charges for the Felix Street properties; (2) disallowing the charges involved with the Dixie Developers properties . . . . The arguments in support of these issues . . . either were not raised below or were presented in Mallon’s brief in a conclusory manner without supporting authority. Thus, these issues each have procedural problems that foreclose appellate review and we decline to address them.” (citations omitted)).
79. Williams v. Henkle, 201 Ill. App. 362, 370 (Ill. App. Ct. 1916); see also Stuckey v. Douglas, 401 S.W.2d 218, 220 (Ark. 1966) (“[T]he object of the suit was to obtain a complete accounting of the partnership affairs . . . . In such a situation the complaining partner is not entitled to require the defendant to account for certain items only, without respect to the rest of the partnership business.”); Baird v. Baird’s Heirs, 21 N.C. 407, 419 (N.C. 1837) (“A partner cannot demand an account in respect of particular items, and a division of particular parts of the property; but the account must necessarily embrace everything . . . .”)
C. Differences in the Statute and the Operating Agreement Show an Accounting Was Unnecessary

1. Statute Establishes the Court’s Discretion

In addition to the apparent simplicity of the financial details involved in Historic Charleston Holdings, the SC ULLCA gives courts discretion to fashion a remedy short of an accounting. The SC ULLCA, like other LLC statutes, does not give LLC members an express right to an accounting. In contrast, the partnership statute provides a “right to a formal account as to partnership affairs.” The Uniform Partnership Act references the term “account” more often than the SC ULLCA. The SC ULLCA references “account” or “accounting” in two locations. The words “account” or “accounting” are mentioned first in section 33-44-409, stating that a member owes a duty of loyalty “to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member” from the company’s assets. The second mention is in section 33-44-410, stating that a member can bring an action against an LLC or another member “for legal or equitable relief, with or without an accounting as to the company’s business, to enforce . . . the member’s rights.” However, the “duty to ‘account’ only establishes the duty; it does not statutorily require that the enforcement of this duty will be through an equitable accounting proceeding.” Because the SC ULLCA does not provide an explicit accounting requirement but explicitly gives courts discretion to avoid accountings, the legislature likely intended to give LLCs more flexibility to resolve disputes. Flexibility is particularly important when a small amount is in dispute and there are only a few members in the LLC; a court should be able to enter judgment and resolve the dispute without drawing out the process with increased judicial and economic costs.

While a master may have the ability to perform an accounting, the circuit court’s order of reference can specifically limit the master’s powers. Without specific instructions, the master performs essentially the same function as the circuit

   Any partner shall have the right to a formal account as to partnership affairs: (1) If he is wrongfully excluded from the partnership business or possession of its property by his copartners; (2) If the right exists under the terms of any agreement; (3) As provided by § 33-41-540 [fiduciary relationship to partnership]; or (4) Whenever other circumstances render it just and reasonable.
84. Id. § 1.01, at 2 (“The word ‘account’ is found at six places in the Uniform Partnership Act.”).
87. BURKHARD, supra note 50, § 5.05, at 102.
88. Rule 53(c), SCRCP.
court. The *Historic Charleston Holdings* court relied heavily on the operating agreement to define how the LLC was to act upon dissolution. The operating agreement provided how funds were to be distributed upon dissolution and for the reimbursement of members’ expenses. The court only needed to follow the agreement to distribute the funds. The master’s involvement was not necessary on remand. Because the operating agreement sufficiently described the rules for distributing the LLC’s assets and the business’s finances were simple, the court did not need to order an accounting to resolve the dispute.

2. Reliance on the Operating Agreement and Statute

The court of appeals incorrectly held the operating agreement and SC ULLCA required an accounting. Discrepancies between the operating agreement, the statute, and the court of appeals’ holding show the dispute could have been resolved without an accounting.

a. Conflict with the Operating Agreement’s Requirements

Although the court held the operating agreement required an accounting, the agreement did not require that result. According to the SC ULLCA, the LLC’s operating agreement can “regulate the affairs of the company and the conduct of its business, and . . . govern relations among the members, managers, and company.” The statute also states the LLC’s operating agreement controls over the statute, unless the operating agreement does not address the issue. The court stated, “Operating agreements are binding contracts that are superior to statutory authority where they are in place. However, to the extent that the operating agreement is silent as to some matter, statutory law will apply.” As stated above, the SC ULLCA contains no explicit requirement for an accounting. Thus, the operating agreement’s most important provisions in the *Historic Charleston Holdings* context are those describing how the company will dissolve and the role of an accounting procedure in the dissolution.

89. *See id.*
91. *Id.* at 535, 617 S.E.2d at 393–94.
92. *Id.* at 536, 617 S.E.2d at 394.
94. *Id.* (“To the extent the operating agreement does not otherwise provide, this chapter governs relations among the members, managers, and company.”).
96. *See supra* note 82 and accompanying text.
First, the agreement in *Historic Charleston Holdings* provided for how the LLC’s assets were to be distributed upon dissolution.97 The court assumed the operating agreement required an accounting prior to distributing the LLC’s assets, concluding “the master must first conduct an accounting to determine the balance of Dixie Holdings’ assets after the payment of liabilities, which presumably under the operating agreement includes reimbursements to members.”98 The operating agreement required a determination of assets and liabilities before paying the LLC’s debts. Reimbursements to members, if necessary, should be included in the first step of determining assets and liabilities. However, the court of appeals’ conclusion that an accounting procedure was the correct method to determine assets and liabilities was an overreaching assumption. Moreover, the court of appeals addressed Mallon’s reimbursement eligibility which, though confusing, seemed to resolve the issue by not allowing the reimbursement.99 Thus, the accounting procedure was unnecessary because a court could determine the company’s assets and liabilities, as required by the operating agreement upon dissolution, without conducting an accounting.

In addition to the operating agreement’s distribution of assets, the court also mentioned the operating agreement’s requirement that “[e]ach of the Members shall be furnished with a statement setting forth the assets and liabilities of the Company as of the date of the complete liquidation.”100 The court interpreted that provision as “contemplat[ing] a final accounting upon complete liquidation.”101 The court overemphasized the operating agreement’s mandate for an accounting procedure because there was no express requirement for such a process anywhere in the operating agreement. While the operating agreement required a *statement*, the court made an unnecessary inference that an accounting procedure was required to provide the statement.

However, the timing of the statement the operating agreement required shows that an accounting procedure would be ineffective. The operating agreement provided for dissolution, followed by distributions to creditors, and then distributions to members, but never required an accounting as part of the process of

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97. The operating agreement stated:
   In the event of a Termination Event and the Members do not elect to continue the business of the Company, the assets of the Company shall be distributed in the following order and priority: (a) To the payment of debts and liabilities of the Company (other than the Capital Contributions of the Members) and expenses of liquidation; (b) To the setting up any reserves . . .; and (c) To each Member in accordance with their respective Membership Percentages.

*Historic Charleston Holdings*, 365 S.C. at 535, 617 S.E.2d at 393–94.

98. *Id.* at 536, 617 S.E.2d at 394.

99. *See supra* notes 72–77 and accompanying text.


101. *Id.* at 536, 617 S.E.2d at 394.
distributing assets. An LLC with adequate records could presumably dissolve without a judicially ordered accounting. The operating agreement required the statement of assets and liabilities to be provided at "complete liquidation," which is, confusingly, after the assets have already been distributed. "Liquidation' in its general sense means the act or operation of winding up the affairs of a firm or company, by getting in assets, settling with debtors and creditors, and appropriating the amount of profit or loss." Based on South Carolina law, the complete liquidation referred to in the operating agreement meant completing the steps for distributing assets to the LLC's creditors and members. Applying the court's interpretation requiring an accounting to the agreement's use of the "complete liquidation" language, the agreement would have required the accounting to be conducted after the assets were distributed, including distribution of members' shares. An accounting at that stage would not be helpful because all the assets would have been distributed and all liabilities settled. While such a narrow interpretation of the operating agreement's complete liquidation language may not lead to an equitable result, the court's emphasis on the agreement's significance must be balanced with the agreement's specific terms. The discrepancy caused by the operating agreement's contradictory accounting and liquidation language demonstrates the court of appeals relied too heavily on the accounting language in interpreting the agreement.

Another point to note regarding the operating agreement's implied accounting requirement is the exact meaning of how the court defined an accounting as mandated by the operating agreement. The operating agreement simply required a "statement setting forth the [LLC's] assets and liabilities." The word "statement" connotes a report or a basic iteration of the LLC's financial status. Having such a statement would be a preferable result because the agreement's distribution method was simple. The court's requirement for a "formal accounting" connotes an accounting procedure. The court remanded to the master for the accounting and the master must enter a judgment rather than simply provide a report, which requires the master to conduct a proceeding similar to a trial. The court's remand

102. Id. at 536, 617 S.E.2d at 399–94.
103. Id. at 535, 617 S.E.2d at 394.
104. Anderson v. Page, 212 S.C. 522, 529, 48 S.E.2d 500, 503 (1948) (interpreting liquidation definition to distribute funds on liquidation of testator’s business as specified in his bequest); see also Henry v. Alexander, 186 S.C. 17, 22, 194 S.E. 649, 651 (1937) ("The term 'liquidation,' applied to a partnership or a corporation, is the act or operation of winding up the affairs of such firm or company by collecting the assets, settling with its debtors and creditors, and appropriating the amount of profit or loss." (citation omitted)).
106. See supra Part III.B.
108. Rule 53(b), SCRPC ("When a reference [of an action to the master by the circuit court or clerk] is made, the master . . . shall enter final judgment as to the causes of action referred. A case shall not be referred to a master . . . for the purpose of making a report to the circuit court.").
implied that some further action was necessary—that the master has to do something. Thus, the operating agreement seems to consider an accounting to be a report while the court’s opinion indicates that the accounting should be a procedure. The difference in definitions between the operating agreement and the court’s holding provides another reason why the court overemphasized the operating agreement’s accounting language and mandated more judicial involvement than was necessary to resolve the dispute.

b. Conflict with the SC ULLCA’s Requirements

The court also relied on the SC ULLCA as a second basis for requiring the accounting, stating that “even assuming the operating agreement was silent as to some aspect of winding up Dixie Holdings, we find an accounting was warranted pursuant to statute.”\textsuperscript{109} As noted above, the statute does not require an accounting procedure upon dissolution.\textsuperscript{110} The dissolution process in the statute is comparable to the operating agreement in that the same steps are required, though not in the same order because the operating agreement placed what the court interpreted as the accounting after complete liquidation. In the statute the first step is dissolution, followed by winding up\textsuperscript{111}—including distribution to creditors and then members as required by South Carolina Code 33-44-806(a)\textsuperscript{112}—and ultimately the LLC’s termination.\textsuperscript{113} Of the two specific mentions of “account” and “accounting,” neither provides for an accounting procedure specifically upon winding up.\textsuperscript{114} The court recognized the distribution process for winding up specified in section 33-44-806(a), but then made a broad statement that “[i]n most instances, including the present case, this task can only be accomplished after an accounting.”\textsuperscript{115} The court cited no supporting authority for this broad requirement of an accounting for any dissolution. Assuming the court’s statement applies only to judicial dissolutions,\textsuperscript{116}


110. See supra Part III.C.

111. See S.C. CODE ANN. § 33-44-801 (2006) (“A limited liability company is dissolved, and its business must be wound up, upon the occurrence of any of the following events,” and a list of events that trigger dissolution follows); infra note 113.

112. See S.C. CODE ANN. § 33-44-806(a) (2006) (indicating that in winding up, subsection (a) requires the LLC to first “discharge its obligations to creditors, including members who are creditors,” and then requires “[a]ny surplus must be applied to pay in money the net amount distributable to members”).

113. See S.C. CODE ANN. § 33-44-805 (2006) (stating that “[a]t any time after dissolution and winding up, a limited liability company may terminate its existence by filing” articles of termination).

114. See supra Part III.C.


116. The court said that in winding up, “courts are required to determine” how to distribute the assets and discharge obligations, implying that the statement might be limited to judicial dissolutions ordered pursuant to S.C. CODE ANN. § 33-44-801(4) (2006). See Historic Charleston Holdings, 365 S.C. at 536, 617 S.E.2d at 394.
the variety of reasons an LLC may be judicially dissolved do not always involve circumstances when the financial records would be in disorder.\textsuperscript{117} Therefore, other than the court’s preference, no mandatory basis exists for the court to determine that an accounting was necessary in \textit{Historic Charleston Holdings}.

c. The Court of Appeals’ Holding

The court of appeals’ opinion had discrepancies related to the accounting. The court of appeals stated that an accounting must occur prior to dissolution.\textsuperscript{118} The court also stated that “under these circumstances an accounting was necessary for the dissolution and winding up of Dixie Holdings’ business.”\textsuperscript{119} As explained above, the court’s broad holding requiring an accounting is not based firmly on either the statute or the operating agreement. The court said winding up requires an accounting “in most instances,”\textsuperscript{120} but the court also “recognize[d] the master may grant relief to a member pursuant to section 33-44-410 without an accounting of the limited liability company’s business.”\textsuperscript{121} A conflict exists between those statements because the statute has explicitly established flexibility in designing a remedy. However, the court imposed the idea that an accounting will usually be required, taking away from the judge’s discretion provided by the statute.

Another discrepancy is that the sequence of the court of appeals’ process for winding up does not comporte with its analysis of the statute and operating agreement. The court would have the accounting performed first, followed by distributions to members and then to the LLC’s members.\textsuperscript{122} As explained above, the operating agreement required the statement of assets and liabilities to be provided after “complete liquidation.”\textsuperscript{123} However, the court interpreted “Dixie Holdings’ operating agreement [as] requir[ing] an accounting prior to dissolution.”\textsuperscript{124} A technical interpretation of the court’s opinion places the court of

\begin{itemize}
\item \textsuperscript{117} A court can order a judicial dissolutions pursuant to S.C. CODE ANN. § 33-44-801(4) (2006) based on: (a) unreasonable frustration of the LLC’s economic purpose; (b) another member’s conduct relating to the LLC’s business making it impracticable “to carry on the company’s business with that member;” (c) impracticability of carrying on the company’s business “in conformity with the articles of organization and the operating agreement;” (d) failure to purchase a member’s distributional interest if required; or (e) actions by the controlling managers or members that are “unlawful, oppressive, fraudulent, or unfairly prejudicial to the petitioner.” S.C. CODE ANN. § 33-44-801(4) (2006). None of these reasons necessarily relate to the financial status of the LLC. However, reason (a) might require a financial analysis by the court but not analysis by a third party through an accounting procedure.
\item \textsuperscript{118} Historic Charleston Holdings, 365 S.C. at 536, 617 S.E.2d at 394.
\item \textsuperscript{119} Id. at 535–36, 617 S.E.2d at 394.
\item \textsuperscript{120} Id. at 536, 617 S.E.2d at 394.
\item \textsuperscript{121} Id. at 535, 617 S.E.2d at 394.
\item \textsuperscript{122} Historic Charleston Holdings, LLC v. Mallon, 365 S.C. 524, 536, 617 S.E.2d 388, 394 (Ct. App. 2005) (“[T]he master must first conduct an accounting to determine the balance of Dixie Holdings’ assets after the payment of liabilities." (emphasis added)).
\item \textsuperscript{123} See supra notes 99–100 and accompanying text.
\item \textsuperscript{124} Historic Charleston Holdings, 365 S.C. at 536, 617 S.E.2d at 394.
\end{itemize}
appeals’ accounting at the opposite end of the process from the operating agreement. The statute does not explicitly order an accounting during any of the steps, but an accounting procedure ordered in a judicial dissolution is most appropriately held after the dissolution as part of winding up.

3. *The Impact of Differences in Requirements*

While the discrepancies among the operating agreement, statute, and the master’s and court of appeals’ holdings may seem minor because the financial result could be identical whether the accounting was done prior to or after dissolution, the order of the process is important for several reasons. First, an LLC member can still bind the LLC after dissolution if the party with whom the member dealt did not know the LLC was dissolved or if the member’s action was taken as part of winding up the LLC. Second, a member’s fiduciary duty continues after dissolution and during winding up. Assuming all business halts immediately upon dissolution, there is potentially less likelihood for a change in the LLC’s financial status. However, assuming business would not be conducted during the winding up is not realistic.

Instead of ordering the accounting, the court could have allocated the assets with the financial information that was already before it. The court had discretion to order relief “with or without an accounting as to the company’s business.” Because the court determined the LLC should not reimburse Mallon, and the operating agreement specified the method of distribution on dissolution, the court could have ordered the amount split between the two parties. A judge could have conducted a hearing to resolve the dispute instead of referring the matter to a master for an accounting. Once the matter has been referred to the master, he proceeds with “all power and authority which a circuit judge sitting without a jury would have in a similar matter,” collecting evidence such as “contracts, receipts, [and] profit-and-loss statements,” and potentially calling witnesses. Neither the court of appeals nor the master needed evidence other than Mallon’s receipts for his expenses. If Mallon’s receipts were unavailable, an educated estimate of the amount he should have spent would still have been possible, although the master would likely have had to appoint a third-party accountant to develop the figure, as

125. See supra notes 80–82 and accompanying text.
127. 1 RIBSTEIN & KEATINGE, supra note 82, § 11:9, at 11-25 to -26 (explaining that “[m]embers’ and managers’ fiduciary duties continue through winding up” so that “managers may not engage in gross negligence, self-dealing, or other acts that would have been regarded as fiduciary breaches prior to dissolution”).
129. BURKHARD, supra note 50, § 7.05(a), at 166 (citing Beck v. Clarkson, 300 S.C. 293, 304–05, 387 S.E.2d 681, 687–88 (Ct. App. 1989)).
130. Rule 53(c), SCRCP.
131. BURKHARD, supra note 50, § 7.05(c), at 174.
the master did in Halbersberg v. Berry, where the records did not show the necessary valuation of materials to calculate profits and losses. For the master to extend the accounting procedure to involve a third party in a case like this—where the amount is related to a single transaction affecting only two parties—would be inefficient. When information is available, the court promotes judicial efficiency by deciding a case without additional unnecessary procedure.

Because the LLC form allows certain freedoms to members and can therefore encourage entrepreneurial growth, the members must be held accountable for the terms of their agreement. If the operating agreement is to be held in such high regard by the court, the members must recognize its importance when organizing the LLC. Indeed, the preface material to the SC ULLCA notes that “sophisticated parties will negotiate their own deal.” With freedom comes responsibility. If businesses are encouraged to develop in the LLC form, they must know how to correctly maneuver the LLC form and the SC ULLCA. Both LLC members and the public that interacts with them will benefit from knowing the business is secure in its dealings and that courts will consistently interpret those dealings.

IV. DID THE ACTION MEET DERIVATIVE REQUIREMENTS?

A second component of the opinion that deserves analysis is the derivative action element. The statute provides members may maintain direct actions to enforce the member’s rights under the operating agreement, rights under the statute, and “rights that otherwise protect the interests of the member, including rights and interests arising independently of the member’s relationship to the company.” An accounting action is considered a remedy between members and is therefore normally brought directly. Like the corporation and limited partnership statutes, the SC ULLCA allows claims to be brought against an LLC derivatively.

135. 1 RIBSTEIN & KEATINGE, supra note 82, § 10:4, at 10-16 to -17 (“The accounting, which reviews and settles all financial matters in a single proceeding, is the primary mechanism for resolving claims among partners.”).
136. See S.C. CODE ANN. § 33-7-400 (2006) (“Derivative suits may be maintained on behalf of South Carolina corporations in federal and state court in accordance with the applicable rules of civil procedure.” (emphasis added)) (referencing Rule 23, SCRCP (2004)); S.C. CODE ANN. § 33-42-1810 (2006) (“A limited partner may bring an action in the right of a limited partnership to recover a judgment in its favor if general partners with authority to do so have refused to bring the action or if an effort to cause those general partners to bring the action is not likely to succeed.” (emphasis added)). The Uniform Partnership Act includes no comparable provision. See S.C. CODE ANN. §§ 33-41-10 to -1330 (2006).
137. S.C. CODE ANN. § 33-44-1101 (2006) (“A member of a limited liability company may maintain an action in the right of the company if the members or managers having authority to do so have refused to commence the action or an effort to cause those members or managers to commence the action is not likely to succeed.” (emphasis added)).
A. Propriety of Derivative Actions in Closely Held Companies

1. Trend Toward Direct Actions

Commentators agree a derivative action may be improper for closely held companies. "Because of the difficulty in determining if a suit must be brought as a direct or a derivative action, an increasing number of courts are abandoning the distinction between a derivative and a direct action because the only interested parties are the two sets of shareholders." Some courts have formulated a "close corporation exception" to allow derivative-type actions to be brought as direct actions. When appropriate, a derivative action "facilitates fiduciary breach claims against managers who otherwise would control the firm's decision to sue." Derivative actions in a closely held LLC are generally inappropriate because each member of a decentralized firm probably has some power to sue, so members do not need the extraordinary derivative remedy in order to litigate the LLC's claim.

2. Was the Action in Historic Charleston Holdings Direct or Derivative?

In Historic Charleston Holdings, HCH and Coker brought the action both directly and derivatively. The court of appeals acknowledged the claims in part were brought derivatively. Mallon contested whether the action met the derivative requirements, but the court said Mallon did not preserve the issue of meeting derivative requirements for review on appeal. Because the court did not directly address the issue, the question is left open whether the case met derivative requirements.

Because the court did not distinguish between the direct and derivative action, South Carolina could be following the close corporation exception used in other jurisdictions. On occasion, other courts have not bothered to note the distinction

139. Peter H. Donaldson, Breathing Life into Aurora Credit Services, Inc. v. Liberty West Development, Inc.: Utah's Close Corporation Exception to the Derivative Lawsuit Requirement and the Case for Strong Fiduciary Duties in Close Corporations, 2002 UTAH L. REV. 519, 519 n.3 (citing Richards v. Bryan, 879 P.2d at 647–48); see also BURKHARD, supra note 50, § 5.07, at 104–05 (stating "the growing acceptance of allowing shareholders of close corporations to freely bring direct suits . . . will likely have an impact on litigation by limited liability company members").
140. RIBSTEIN & KEATINGE, supra note 82, § 10:3, at 10-7.
141. Id. § 10:3, at 10-9.
143. Id. at 532, 617 S.E.2d at 392 ("In the underlying action, HCH sued in a derivative capacity for an accounting and injunctive relief. Actions for an accounting, for an injunction, and shareholder derivative actions are all actions in equity.").
144. Id. at 539, 617 S.E.2d at 396 ("[W]e find Mallon's argument that HCH's action did not meet the requirements for a derivative action not preserved for our review.").
when treating derivative actions as direct. 145 Courts circumvent the policy behind the derivative requirements by failing to make that distinction. South Carolina Rule of Civil Procedure 23(b)(1) contains the same language as Federal Rule of Civil Procedure 23.1 for derivative actions. 146 The language of the LLC derivative requirements is slightly different and therefore not based directly on South Carolina Rule of Civil Procedure 23(b)(1), but the policy reasons for derivative actions should still apply. Plaintiffs in derivative actions must show they made a demand and that they adequately represent the other shareholders. 147 Because litigation is costly to a business, these requirements ensure that a single shareholder or member cannot force a business into court without first giving the management a chance to address the party’s concern. As stated by the court of appeals with respect to a corporation:

[I]t is manifest that to allow a single stockholder, or one or more of them, to force a corporation or its managing agents into a litigation, which the majority of the body or its officers may think unwise or unnecessary, would place it in the power of a single stockholder who may be dissatisfied with the management of the business of the corporation to involve the corporation in expensive litigation, which might be destructive to the interests of such corporation, and would permit a single discontented stockholder to force the majority, who have the right to control, to adopt his views of policy, or incur the expense and hazards of a lawsuit. 148

The Carolina First court discussed the role of corporate management in deciding whether to sue, 149 which is a different situation from a two-member LLC. While there was no real issue in Historic Charleston Holdings because there was no separate management from the members, the impact of the litigation on the LLC’s resources was more severe because the LLC was closely held and had few assets. Therefore, addressing the derivative action requirements is important in the context of closely held companies that can scarcely afford to deal with disgruntled members’ derivative suits.

The distinction between direct and derivative actions is also important because “[t]he procedural requirements are different, as are the available remedies. In

148. Carolina First Corp., 343 S.C. at 186 n.6, 539 S.E.2d at 408 n.6 (emphasis added) (quoting Latimer v. Richmond & D.R. Co., 39 S.C. 44, 53-54, 17 S.E. 258, 261 (1893)).
149. Id. at 187, 539 S.E.2d at 408.
addition, the remedies benefit different parties." In Historic Charleston Holdings, the court did not discuss the derivative action requirements, which the plaintiffs likely could not have met. Meeting the derivative requirements is important because of the method in which the court will award a remedy. Although the case was remanded for an accounting, the court upheld the master's award of attorney's fees based on the derivative action component of the LLC statute. The court seems to have treated the action as one brought derivatively but did not analyze the derivative requirements.

B. Meeting the Statutory Derivative Action Requirements

1. Membership and Demand

The LLC statute lists three requirements a plaintiff must meet to bring a derivative action. The first requirement, which is met without discussion here, is that the plaintiff must be a member of the LLC when the action is commenced. The second requirement has two prongs. First, the "members or managers having the authority to [bring an action] have refused to commence the action," and, second, "an effort to cause those members or managers to commence the action is not likely to succeed." The second requirement is equivalent to the demand requirement for corporate derivative actions; however, the corporate requirement is broader to allow demand for any type of corrective action (i.e., include suggestion in proxy vote, adopt internal procedure, or specifically request other actions) to address the shareholder's concern, while the LLC demand requirement is limited to demanding a legal action. Dixie Holdings' operating agreement did not restrict either member's ability to bring an action, and each had "votes equal to his Membership Percentage in the Company." Because they each had only fifty

152. S.C. CODE ANN. § 33-44-1102 (2006). Coker was a member of Dixie Holdings as of the December 1999 agreement and there is no indication in the opinion that Coker's status changed with respect to Dixie Holdings. Historic Charleston Holdings, 365 S.C. at 530, 617 S.E.2d at 391.
154. The LLC statute refers to "the action" in relation to the "action in the right of the company." S.C. CODE ANN. § 33-44-1101 (2006). However, the corporations statute refers to South Carolina Rule of Civil Procedure 23(b)(1). See S.C. CODE ANN. § 33-7-400 (2006). The rule refers to "efforts, if any, made by the plaintiff to obtain the action he desires from the directors." Rule 23(b)(1), SCRCP. Therefore, derivative actions under the corporations statute brought pursuant to SCRCP 23(b)(1) require a broader type of demand by the plaintiff than the LLC statute.
155. Operating Agreement of Dixie Holdings, LLC, Section 8.4(a) (June 18, 1998) (on file with author).
percent of the membership interest,\textsuperscript{156} and the operating agreement required a majority to act.\textsuperscript{157} Both members had to consent to a proposed derivative action. Although Coker requested that Mallon relinquish the funds in the separate account, the court’s description of the situation shows Coker brought the action when Mallon did not give up the funds.\textsuperscript{158} Therefore, under the first prong, if the members with authority refused to bring an action, Mallon—who had authority—had no opportunity to give consent to bring an action.

The problem with this requirement as applied to closely held LLCs is that “the same managers and members who were involved in the questioned transaction probably would be called on to make the decision whether to sue.”\textsuperscript{159} Mallon would likely never give consent because he would effectively be giving consent to sue himself. However, the court could find that such a situation would meet the second prong when an effort to get the members with authority to bring an action is unlikely to succeed. “The purpose of pre-suit demand is to assure that the stockholder affords the corporation the opportunity to address an alleged wrong without litigation, to decide whether to invest the resources of the corporation in litigation, and to control any litigation which does occur.”\textsuperscript{160} In a two-member LLC when one of the members is a defendant, the pre-suit demand requirement is ineffectual.

Another concern related to the demand requirement is that the December 1999 operating agreement amendment required the parties to arbitrate if they could not resolve their differences related to Mallon’s payment for work on Dixie Holdings’ properties.\textsuperscript{161} The court did not mention any effort by HCH or Coker to initiate arbitration before bringing their complaint, nor did the court note any effort by Mallon to initiate arbitration. The lack of evidence of an attempt to arbitrate, the preferred remedy per the operating agreement amendment, demonstrates the plaintiffs failed to make a full effort to demand an action.

2. Particularity

The third requirement for LLC derivative actions directly relates to the second because it requires that “the complaint must set forth with particularity the effort of

\textsuperscript{156} Historic Charleston Holdings, 365 S.C. at 529–30 n.1, 617 S.E.2d at 390–91 n.1 (noting the operating agreement stated that Mallon and HCH each had 49.5% interests and Storen 1%, and that Mallon and HCH bought Storen’s share when Storen dissociated, leaving each party with a 50% interest).

\textsuperscript{157} Operating Agreement of Dixie Holdings, LLC, supra note 155.

\textsuperscript{158} Historic Charleston Holdings, 365 S.C. at 530–31, 617 S.E.2d at 391.

\textsuperscript{159} 1 Ribstein & Keatinge, supra note 82, §10:8, at 10-31.


\textsuperscript{161} Historic Charleston Holdings, 365 S.C. at 530, 617 S.E.2d at 391 (“The agreement provided for an audit of Dixie Holdings and stated if the members could not resolve their differences, then an arbitrator would be appointed by agreement of the parties.”).
the plaintiff to secure initiation of the action by a member or manager or the reasons for not making the effort.” 162 The statute thus required HCH to describe its efforts to obtain Mallon’s approval of a legal action or explain why it did not try. The court did not discuss whether HCH’s complaint pled the details with particularity. This requirement also seems difficult to meet if the plaintiff’s efforts to secure initiation of an action by the members were not sufficient. Because the court did not address whether the complaint met the requirement, the court could not have determined whether the action qualified as a derivative suit.

C. Impact of Derivative or Direct Action

Whether the action is derivative affects the method of awarding damages and fees. 163 The master ordered that HCH receive attorney’s fees and costs based on section 33-44-1104, 164 which provides the requirements for an LLC derivative action. 165 The attorney’s fees were $15,643.60. 166 The master awarded half of the funds to HCH, an award the court of appeals reversed. 167 However, if the master treated the action as derivative, the statute requires the plaintiff to turn over the remaining award to the LLC. Thus, HCH, which was suing on behalf of Dixie Holdings, would have to return its awarded half to Dixie Holdings. Dixie Holdings would receive the remaining disputed assets under the master’s order and find itself in the same position as before the action. However, because HCH must pay attorney fees of $15,643.60, Dixie Holdings would actually receive only $5,279.05 from HCH, leaving Dixie Holdings with $26,201.70. When the funds are distributed per the operating agreement, each member would get $13,100.85 because they would split the remaining assets in half. Instead of splitting $41,845.30 and receiving approximately $21,000 each, the parties now have only the $26,201.70 to split. Both HCH and Mallon would lose money. Presumably the parties would retain counsel throughout the remanded accounting process and spend additional funds to resolve the distribution in court.

By upholding the attorney’s fees awarded under section 33-44-1104 but remanding the case for an accounting, the court confused which parties should benefit from the action and also confused the potential result. A derivative action benefits the LLC because it is brought to enforce the LLC’s rights. An accounting action settles disputes among members. The operating agreement in Historic

163. See Kleinberger & Bergmanis, supra note 147, at 1204.
164. Historic Charleston Holdings. 365 S.C. at 532, 617 S.E.2d at 392.
165. S.C. CODE ANN. § 33-44-1104 states that in a successful derivation action, “the court may award the plaintiff reasonable expenses, including reasonable attorney’s fees, and shall direct the plaintiff to remit to the limited liability company the remainder of the proceeds received.” S.C. CODE
166. Historic Charleston Holdings, 365 S.C. at 540, 617 S.E.2d at 396.
Charleston Holdings allowed indemnification of a member except in derivative actions.¹⁶⁸ Neither party would be able recover indemnification from the LLC in the derivative action, but the parties could both seek indemnification for expenses under the accounting action between the members. Because the court allowed HCH’s attorney’s fees as part of the derivative claim, the fees were no longer available for indemnification. However, Mallon’s attorney’s fees were not designated as the result of a derivative claim, and he could possibly seek indemnification for those from the LLC.

V. CONCLUSION

As LLCs become more popular with South Carolina entrepreneurs and existing LLCs mature, courts will face an increasing number of legal actions to resolve disputes. At the same time, South Carolina’s economy is expanding, and even more LLCs will be created as the economy grows, giving rise to more LLC litigation. To avoid problems, the courts should resolve issues in a manner that helps parties avoid litigation while decreasing the cost of doing business. One important issue is when an accounting remedy is efficient and appropriate, given the varying size of businesses and the differing complexities of their financial arrangements. Another important issue is when suits meet the requirements for a derivative action, which can force businesses into court without giving them a chance to address the issue themselves. The derivative action, if abused, can also increase the cost of doing business. Courts can easily curb abuse by holding plaintiffs to the statutory requirements on which derivative suits are based. In Historic Charleston Holdings, the accounting remedy was unnecessary and the plaintiffs likely did not meet the derivative requirements. If South Carolina is to encourage responsible business, businesspeople must be held to the terms of the agreements they enter, which in this case would have meant an order that the funds be distributed pursuant to the operating agreement. The South Carolina Court of Appeals appears to have skirted the issues of responsibility, which sets an unfortunate example for future LLC actions.

Carmen Harper Thomas

¹⁶⁸ Operating Agreement of Dixie Holdings, LLC, supra note 155, at Section 6.3 ("In any threatened, pending, or completed action, suit or proceeding to which any Member was or is a party or is threatened to be made a party by reason of the fact that he is or was a Member of the Company (other than an action by or in the right of the Company), the Company shall indemnify the Member against expenses . . . .").