Rights of LLC Members

Robert J. McGaughey[1] & Kevin P. Kress[2]

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[1] ROBERT J. McGAUGHEY is a founding partner of the Portland law firm McGaughey Erickson. He practices in the areas of securities, shareholder, partnership and LLC litigation. He is the author of the Oregon Securities Law Handbook, the Oregon Corporate Law Handbook, the Washington Corporate Law Handbook, and co-author of "Oregon Securities Law," 1 Advising Oregon Businesses. He is the past Chair of the OSB Business Litigation Section and past Chair of the OSB Securities Regulation Section. He has served on the OSB Business Law Section's Legislation Task Forces regarding changes to Corporation Act in 2001, regarding Close Corporations in 1999, and regarding the LLC statute changes in 1995. He is a member of the Oregon State Bar and the Washington State Bar.

[2] KEVIN P. KRESS is a partner at McGaughey Erickson, where he practices in the areas of shareholder/LLC member disputes, securities, and business litigation. He previously practiced with a mid-sized litigation firm in New Orleans, Louisiana in the areas of insurance coverage, tort, and local government law. He also served as a law clerk to Judge Kay Bates in the 19th Judicial District Court in Baton Rouge, Louisiana. He is a member of the Oregon State Bar and the Louisiana State Bar.

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A. LLCs IN GENERAL

Limited liability companies are hybrid business entities that have some characteristics of partnerships and some of corporations. *Hibbs v. Berger* 430 SW 3d 296, 313 (Mo App 2014); *Johnson v. Columbia Properties Anchorage, LP*, 437 F 3d 894, 899 (9th Cir 2006)*; Marsh v. Billington Farms, LLC*, 2006 WL 2555911 (RI Super); *Anderson v. Wilder,* 2003 WL 22768666 (Tenn Ct App 2003); *Great Lakes Chemical Corp. v. Monsanto Co.,* 96 F Supp 2d 376 (D Del 2000). LLCs offer the tax benefits and operating flexibility of a partnership with the limited liability protection of a corporation. *Bischoff v. Boar's Head Provisions Co., Inc.* 436 F Supp 2d 626, 630 (SDNY 2006).

Courts in Oregon and other states interpret cases involving LLCs consistent with corporate case law. *Bernards v. Summit Real Estate Management*, 229 Or App 357, 213 P3d 1 (2009); *Tzolis v. Wolff*, 10 NY3d 100, 884 NE2d 1005, (2008); *VGS, Inc. v. Castiel*, 2003 WL 723285 (Del Ch 2003).

An LLC is a creation of state law. The LLC first became available in the United States in 1977 in Wyoming, although most other states did not enact similar laws until the 1990s. Oregon enacted its LLC Act in 1993; Washington did likewise in 1994. Revisions to state LLC statutes are a common occurrence.

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The natural persons who own an LLC are its "members." The members of an LLC can manage the entity themselves, or they can appoint a manger or group of mangers to manage the LLC. *Cortez v. Nacco Material Handling Grp., Inc.,* 356 Or 254, 337 P3d 111, 112 (2014).

A benefit of the LLC entity is the liability protection afforded by statute to all members and managers from persons or entities outside of the LLC. Limited liability means that the individuals are not personally liable for the debts or obligations of the entity, unless the member is personally negligent or contracts with another to be personally liable for a debt through a personal guarantee.

> LLCs share many attributes of limited partnerships, but they differ from that form of business organization in at least one respect: in Oregon, a "member or manager [of an LLC] is not personally liable for a * * * liability of the [LLC] solely by reason of being or acting as a member or manager." ORS 63.165(1). By contrast, in Oregon, a limited partner will become personally liable for the limited partnership's obligations if the limited partner "participates in the control of the business." ORS 70.135. *Cortez v. Nacco Material Handling Grp., Inc.,* 356 Or 254, 337 P3d 111, 112-13 (2014).

B. STANDARD OF CARE & FIDUCIARY DUTY

The applicable standard of care in a LLC reflects the hybrid nature of the entity and depends on whether the LLC is organized as member-managed or manager-managed. The standard of care for members in member-managed LLCs somewhat resembles that of partners in partnerships. In manager-managed LLCs, the standard of care of members and managers in more closely resembles that of corporate shareholders, officers and directors. The relevant statute on the standard of care and fiduciary duty in an LLC, ORS 63.155, delineates the duties owed by members and managers depending on the type of LLC (member-managed versus manager-managed).

1. Standard of care in partnerships & corporations

Partners owe their partnerships and their partners a fiduciary duty. *Delaney v. Georgia-Pacific Corp*, 278 Or 305, 564 P2d 277, *supplemented*, 279

Or 653, 569 P2d 604 (1977), *appeal after remand*, 42 Or App 439, 601 P2d 475 (1979); *Meinhard v. Salmon*, 249 NY 458, 164 NE 545 (1928)(J. Cardozo). The standard of care of partners in a general partnership in Oregon is set forth in ORS 67.155.

In a corporation, shareholders stand in no particular fiduciary relationship to the corporation and may deal with the corporation in an arms'-length manner. *Hagshenas v. Gaylord*, 199 Ill App 3d 60, 557 NE 2d 316 (1990); *Robbins v. Huntley Cattle Co.*, 3 Wash 2d 203, 100 P2d 386 (1940). Likewise, a shareholder owes no duty to other shareholders when selling shares to an outside party – other than a duty not to deceive other shareholders about the sale terms. *Dunnett v. Arn*, 71 F2d 912 (10th Cir 1934).

> There being no fiduciary relationship existing between the stockholders of the bank so far as the sale of individual stock was concerned, there was no duty upon the part of Smith to apprise minority stockholders of Transamerica's offer. The fact that Smith et al. received more for their stock than the minority is no evidence of fraud, since it is generally recognized that the stock of majority stockholders is of more value than that of the minority. *Tyron v. Smith*, 191 Or 172, 180, 229 P2d 251, 254 (1951). (citations omitted)

While as a general rule shareholders owe no fiduciary duty to the corporation or the other shareholders, this general rule may not apply to shareholders who are controlling/majority shareholders or are officers or directors – each of whom can owe a fiduciary duty to the corporation and its shareholders. *Hickey v. Hickey*, 269 Or App 258, 344 P3d 512, 518 (2015); *Naito v. Naito*, 178 Or App 1, 20, 35 P3d 1068 (2001) ("Majority or other controlling shareholders owe fiduciary duties of loyalty, good faith, fair dealing and full disclosure to the minority")*; Wulf v. Mackey,* 135 Or App 655, 899 P2d 755 (1995), *rev denied,* 322 Or 168 (1995); *Noakes v. Schoenborn,* 116 Or App 464, 472, 841 P2d 682 (1992); *Merger Mines Corp. v. Grismer*, 137 F2d 335 (9th Cir), *cert denied*, 320 US 794 (1943).

Likewise, persons owning at least 50% of a corporation's stock owe a fiduciary duty when the corporation is a close corporation (a corporation with a limited number of shareholders whose stock is not publicly traded). *Locati v. Johnson,* 160 Or App 63, 980 P2d 173, *review denied*, 329 Or 287, 994 P2d 122 (1999); *Lee v. Mitchell*, 152 Or App 159, 175, 953 P2d 414 (1998).

The fiduciary duty owed by a minority shareholder in a close corporation is less clear. *Rexford Rand Corp. v. Ancel*, 58 F3d 1215, 1219 (7th Cir 1995) (there is such a duty); *Selmark Assocs., Inc. v. Ehrlich*, 5 NE3d 923 (Mass 2014) (there is such a duty); *J Bar H, Inc. v. Johnson*, 822 P2d 849 (Wyo 1991) (no such duty where minority shareholder frozen out).

Officers and directors owe a fiduciary duty to the corporation regardless of the number of shareholders. *Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682 (1992); *Chiles v. Robertson*, 94 Or App 604, 767 P2d 903, *recon allowed in part, opinion modified*, 96 Or App 658, 774 P2d 500, *review denied*, 308 Or 592, 784 P2d 1099 (1989); *Williams v. Pilgrim Turkey Packers, Inc.*, 264 Or 36, 503 P2d 710 (1972).

2. Duty of members – generally

The fiduciary duty of an LLC member is not the same as the duty of shareholders and partners. As an LLC is a creature of state law, the duties and obligations of its members are defined by statute. Members of an LLC are free to impose additional duties and obligations on themselves by agreement.

> An LLC is a creation of statute and not a creation of contract like a general partnership. Therefore, similar to shareholders in a corporation, members in an LLC do not have inherent fiduciary duties to one another. As long as members are not acting in a managerial capacity, they do not have fiduciary [duties] to one another unless such fiduciary duties are set forth in the operating agreement. *Dragt v. Dragt/Detray, LLC*, 161 P3d 473, 139 Wash App 560 (2007).

In Oregon member-managed LLCs, a member only owes a duty of loyalty and a duty of care defined in ORS 63.155(3), the breach of which requires more

than negligence. In contrast, in a manager-managed LLC, a non-managing member owes no fiduciary duty to the LLC solely by reason of being a member.

3. Member-managed LLCs

The duty of members in a member-managed LLC is akin to – but not quite the same as – the duty of partners in general partnership. *Compare:* ORS 63.155 and 67.155. Under ORS 63.155(1), members of a member-managed limited liability company owe each other a duty of loyalty, which is defined in the statute much like case law on fiduciary duty in general. ORS 63.155(1) provides:

> (1) The only fiduciary duties a member owes to a member-managed limited liability company and its other members are the duty of loyalty and the duty of care set forth in subsections (2) and (3) of this section.

The duty of loyalty of a member in a member-managed LLC is defined in ORS 63.155(2), and is similar to the fiduciary duty of partnership partners. ORS 63.155(2) provides:

> (2) A member's duty of loyalty to a member-managed limited liability company and its other members includes the following:
>
> (a) To account to the limited liability company and hold for it any property, profit or benefit derived by the member in the conduct and winding up of the limited liability company's business or derived from a use by the member of limited liability company property, including the appropriation of a limited liability company opportunity;
>
> (b) Except as provided in subsections (5) and (6) of this section, to refrain from dealing with the limited liability company in a manner adverse to the limited liability company and to refrain from representing a person with an interest adverse to the limited liability company, in the conduct or winding up of the limited liability company's business; and
>
> (c) To refrain from competing with the limited liability company in the conduct of the business of the limited liability company before the dissolution of the limited liability company.

ORS 60.357 and 60.377 impose a modified negligence standard of

conduct on ***corporate*** officers and directors. ORS 63.155(3) imposes a lower standard of care on members in member-managed LLCs, a breach of which requires more than mere negligence. ORS 63.155(3) provides:

> (3) A member's duty of care to a member-managed limited liability company and the other members in the conduct and winding up of the business of the limited liability company is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law.

In some states with differently worded statutes, members do not owe each other a fiduciary duty. *In re Garrison-Ashburn, LC*, 253 BR 700 (Bankr ED Va 2000); *Suntech Procession Systems, LLC v. Sun Communications, Inc.,* 2000 WL 1780236 (Tex App). In other states, including Washington, members do owe each other a fiduciary duty. RCW 25.15.038; *Zanker Group, LLC v. Summerville at Lirchfield Hills, LLC* 2005 WL 3047268 (Conn Super 2005); *DirecTV Latin America, LLC v. Park 610, LLC*, 691 F Supp 2d 405, 438 (SDNY 2010) ("Absent provisions in an LLC agreement 'explicitly' disclaiming the applicability of a fiduciary duty, LLC members owe each other 'the traditional fiduciary duties that directors owe a corporation.'")

Members may vote their interests to transfer LLC property to themselves as long as the transaction is fair. *Gottsacker v. Monnier,* 281 Wis2d 361, 697 NW2d 436 (2005). This is consistent with corporate law.

3.1 Members liable for own torts

When a member personally commits a tortious act against a third party – even while acting within the scope of his/her duties – the member is personally liable. *Cortez v. Nacco Material Handling Grp., Inc.*, 356 Or 254, 337 P3d 111 (2014); *Weber v. U.S. Sterling Securities, Inc.,* 282 Conn 722, 924 A2d 816 (2007); *Beri, Inc. v. Salishan Properties Inc.*, 282 Or 569, 580 P2d 173 (1978); *Pelton v. Gold Hill Canal Co.*, 72 Or 353, 142 P 769 (1914); *Johnson v. Harrigan - Peach Land Development Co.*, 79 Wash 2d 745, 489 P2d 923 (1971).

A person is liable for his/her own tortious conduct, regardless of whether

such person is acting for himself/herself or is acting for another. *Fields v. Jantec, Inc.*, 317 Or 432, 438, 857 P2d 95, 97 (1993); *Harper v. Interstate Brewery Co.*, 168 Or 26, 120 P2d 757 (1942).

3.2 Member loans

Members of member-managed LLCs may lend money and transact other business with the LLC provided that the transaction is one of the following:

(a) Fair to the limited liability company;

(b) Authorized by an operating agreement; or

© Authorized or ratified by a majority of the disinterested members or by a number or percentage of members specified in the operating agreement after full disclosure of all material facts.

ORS 63.155(6)(a).

See also Synectic Ventures, LLC v. EVI Corp., 353 Or 62, 73, 294 P3d 476, 485 (2012).

This provision is similar to that imposed on corporate directors in conflict of interest situations (ORS 60.361), except that it is more liberal on the issue of loans *from* the entity *to* directors. *See:* ORS 60.364.

4. Manager-managed LLCs

“In manager-managed LLCs, substantial differences exist between the powers and duties of a manager and the powers and duties of a member.” *Synetic Ventures*, 353 Or 62, 77. The duties imposed on members and managers of manager-managed LLCs are similar to, but not quite the same as, the respective duties imposed on shareholders, on the one hand, and officers and directors, on the other.

4.1 Duty of non-managing members

A non-managing member of a manager-managed LLC owes **no** fiduciary duty to the limited liability company arising out of their status as members. Non-managing members have essentially no control over the business, and are “(with few exceptions) little more than passive investors in the LLC.” *Synectic Ventures*,

353 Or 62, 77.

ORS 63.155(9) provides:

> In a manager-managed limited liability company:
>
> (a) A member who is not also a manager owes no duties to the limited liability company or the other members solely by reason of being a member;

In *Katris v. Carroll*, 362 Ill App 1140, 842 NE2d 221 (2005), the court held that a 25% member (who was not the manager) in a 4-member, manager-managed LLC owed no fiduciary duty to the LLC, despite holding the title of Director of Technology.

In *Kalikow v. Shalik*, 43 Misc3d 817, 986 NYS2d 762 (2014), the court held that a 50% member owed no fiduciary duty to the other member (who was the managing member) or to the LLC.

4.2 Controlling owners

Controlling corporate shareholders owe a limited fiduciary duty to the corporation and minority shareholders – a duty not to use their power to advance their own pecuniary interests. *Miller v. CC Meisel Co, Inc.,* 183 Or App 148, 167, 51 P3d 650 (2002); *Locati v. Johnson,* 160 Or App 63, 72, 980 P2d 173, *review den*, 329 Or 287, 994 P2d 122 (1999); *Zidell v. Zidell*, Inc., 277 Or 413, 418, 560 P2d 1086, 1089 (1977). Although the Oregon LLC statute does not explicitly impose such a duty on controlling members, these authors believe the Oregon courts will impose such a duty.

In *Minnesota Invco of RSA #7, Inc. v. Midwest Wireless Holdings, LLC*, 903 A2d 786 (Del Ch 2006), the court held that a controlling member could exercise its majority voting power to amend the LLC agreement to eliminate first refusal rights held by a minority member.

In a Tennessee case where the controlling LLC members expelled minority members, paying $150 per ownership interest then selling the all units for $250 per unit, the court held that majority members of an LLC owe the same

fiduciary duties to minority members as to controlling shareholders in a corporation. *Anderson v. Wilder,* 2003 WL 22768666 (Tenn Ct App 2003).

A controlling member owes a duty to the minority member not to usurp opportunities that belong to the LLC. *Zanker Group, LLC v. Summerville at Lirchfield Hills, LLC* 2005 WL 3047268 (Conn Super 2005).

On the other hand, a court held that an 80% owner of an LLC did not owe a fiduciary duty to the other members under Texas law. *Suntech Processing Systems, LLC v. Sun Communications, Inc*., 2000 WL 1780236 (Tex App 2000).

4.3 50% owners

A number of Oregon decisions have held that two 50% shareholders owe a fiduciary duty to each other. *Locati v. Johnson,* 160 Or App 63, 980 P2d 173, *review denied*, 329 Or 287, 994 P2d 122 (1999); *Lee v. Mitchell*, 152 Or App 159, 175, 953 P2d 414 (1998). However, a Michigan court has held that there is no fiduciary duty between 50% owners of an LLC. *Alliance Associates, LC v. Alliance Shippers, Inc.,* 2006 WL 1506687 (Mich Ch App 2006). *See also: In re Garrison-Ashburn, LC*, 253 BR 700 (Bankr ED Va 2000).

4.4 Closely-held LLCs

The Indiana Court of Appeals has held that common law fiduciary duties, similar to the ones imposed on partnerships and closely-held corporations, are applicable to an Indiana LLC with three members. *Purcell v. Southern Hills Investments, LLC,* 847 NE2d 991 (Ind Ct App 2006). A Rhode Island Superior Court has likewise held that members in a 4-member LLC owe the same heightened fiduciary duties to each other as do partners in a partnership. *Marsh v. Billington Farms, LLC*, 2006 WL 2555911 (RI Super).

NOTE: These authors believe that a breach of fiduciary duty requires more than simply causing the LLC/corporation to act in some manner which advances the pecuniary interest of the controlling owner – it is a good thing for all owners if the business does well since a rising tide lifts all boats. Rather, a breach of fiduciary duty occurs only when the controlling owner causes the entity to act in a manner which disproportionately favors the controlling owner's pecuniary interest over

that of the other members.

4.5 Duty of managers

Managers of manager-managed LLCs have a similar standard of care to the LLC as do directors and officers of corporations. *Metro Communication Corp. BVI v. Advanced Mobilecomm Technologies Inc.,* 854 A2d 121 (Ch Del 2004). ORS 63.155(9) provides:

In a manager-managed limited liability company:

(b) A manager is held to the same standards of conduct prescribed for members in subsections (2) to (8) of this section;

© A member who, pursuant to an operating agreement, exercises some or all of the rights of a manager in the management and conduct of the limited liability company's business is held to the standards of conduct described in subsections (2) to (8) of this section to the extent that the member exercises the managerial authority vested in a manager by this chapter; and

(d) manager is relieved of liability imposed by law for violation of the standards prescribed by this section to the extent, if any, of the managerial authority delegated to the members who are not also managers by an operating agreement.

LLC managers owe the LLC and its members the fiduciary duties of care and loyalty. RCW 25.15.038(1)(a). *Bishop of Victoria Corp. Sole v. Corporate Bus. Park, LLC*, 138 Wn App 443, 456, 158 P.3d 1183 (2007). One of these duties is the duty of loyalty, which requires a fiduciary to avoid "secret profits, self-dealing, and conflicts of interest." *Horne v. Aune*, 130 We App 183, 200, 121 P.3d 1227 (2005).

The business judgment rule applies to the managers of an Oregon LLC. *Bernards v. Summit Real Estate Mgmt., Inc*., 229 Or App 357, 213 P3d 1 (2009); *HLHZ Invs., LLC v. Plaid Pantries, Inc*., 2007 US Dist LEXIS 86863 (D Or 2007). In exercising this business judgment, managers may reasonably rely on professionals. *In re Tri-River Trading, LLC*, 329 BR 252 (BAP 8th Cir 2005); *Flippo v. CSC Associates III, LLC,* 262 Va 48, 547 SE 2d 216 (2001). But the

business judgement rule does not protect a manager who acted on both sides of LLC contract and personally benefitted. *Marsh v. Billington Farms, LLC*, 2006 WL 2555911 (RI Super).

Likewise, the business judgment rule applies to the managers of LLCs in Washington. *In re Spokane Concrete Prods., Inc.*, 126 We.2d 269, 279, 892 P.2d 98 (1995). Under the business judgment rule, "corporate management is immunized from liability in a corporate transaction where (1) the decision to undertake the transaction is within the power of the corporation and the authority of management, and (2) there is a reasonable basis to indicate that the transaction was made in good faith." *Scott v. Trans-Sys., Inc*., 148 We.2d 701, 709, 64 P.3d 1 (2003). An LLC manager does not breach his fiduciary duty when he relies in good faith upon the records of the LLC or upon opinions, reports, or statements by employees of the LLC. RCW 25.15.038(3)(b).[3]

Under Tennessee law, an LLC manager was held to have had duty of loyalty requiring him to assign patents, patent applications and inventions to the LLC, particularly in light of his use of LLC funds in developing ideas. *In re Holcomb Health Care Services, LLC*, 329 B.R. 622 (MD Tenn 2004). Under Tennessee law, a manager owes a fiduciary duty to the LLC only; not to the members individually. *ARC LifeMed, Inc. v. AMC-Tennessee, Inc.*, 183 SW3d 1 (Tenn Ct App 2005).

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[3] Washington enacted a substantial revision to its LLC statute in 2016, adding more certainty and guidance regarding the operation of an entity without an operating agreement and procedures for dissociation of a member. Washington LLC agreements may be oral, written, or implied by conduct, in any combination. The agreements may eliminate most duties of the members, but cannot waive implied contractual duties of good faith and fair dealing among members. Elimination of certain other rights, such as limits on dissenter rights, must be written. Absent waiver or a written agreement, the default duties of members under the statute include the duties of loyalty and care, and the default voting structure is "one member, one vote". Dissociation of a member can occur per the terms of the operating agreement, adjudication of member incapacity, or death of a member.

5. Exceptions

A member's duty of loyalty (fiduciary duty) may be limited by either the articles of organization or the operating agreement, provided the limitation is not unconscionable. Either the articles or operating agreement may also limit the members' obligation of good faith and fair dealing. However, the members' duty of care (which is set at a standard of gross negligence, intentional misconduct, and knowing violations of law) may not be *unreasonably* reduced.

ORS 63.155 provides:

> (10) The articles of organization or an operating agreement of a limited liability company may not:
>
> (a) Eliminate completely the duty of loyalty under subsection (2) of this section, but the articles of organization or an operating agreement may:
>
> (A) Identify specific types or categories of activities that do not violate the duty of loyalty, if not unconscionable; and
>
> (B) Specify the number or percentage of members, whether interested or disinterested, or disinterested managers that may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.
>
> (b) Unreasonably reduce the duty of care under subsection (3) of this section.
>
> (c) Eliminate completely the obligation of good faith and fair dealing under subsection (4) of this section, but the articles of organization or an operating agreement may determine the standards by which performance of the obligation of good faith and fair dealing is to be measured, if the standards are not unconscionable.
>
> **NOTE:** Similar authority to limit the standard of care and fiduciary duty of partners in a general partnership is not specifically granted in the general partnership statute. ORS 67.155.

ORS 63.155(11) sets forth several specific examples of the types of conduct excluded from the duty of loyalty required of a member by the LLC

statute:

> (11) For the purposes of subsection (10)(a) of this section, specific types or categories of activities that may be identified as not violating the duty of loyalty include, but are not limited to:
>
> (a) Competing with the limited liability company in the conduct of the business of the limited liability company before the dissolution of the limited liability company; and
>
> (b) Entering into or engaging in, for a member's own account, an investment, business, transaction or activity that is similar to the investments, businesses, transactions or activities of the limited liability company without:
>
> (A) First offering the limited liability company or the other members an opportunity to participate in the investment, business, transaction or activity; or
>
> (B) Having any obligation to account to the limited liability company or the other members for the investment, business, transaction or activity or the profits from the investment, business, transaction or activity.

In *Harbison v. Strickland*, 900 So 2d 385 (Ala. 2004), the court held that, because LLCs are "creatures of statute", the court must look beyond the four-corners of the operating agreement to incorporate the duties imposed by statute. The Alabama statute permitted the Operating Agreement to limit the fiduciary duty owed the LLC, but not to eliminate the duty of loyalty.

Some states give LLCs much broader authority to limit, or even eliminate, the fiduciary duties owed by members and managers. *See, for example: DIRECT TV Group, Inc. v. Darlene Investments, LLC,* 2006 WL 2773024 (SD NY 2006)(interpreting Delaware law); *In re Garrison-Ashburn, LC*, 253 BR 700 (Bankr ED Va 2000)(interpreting Virginia law); *Harbison v. Strickland*, 900 So 2d 385 (Ala. 2004); *Lynch Multimedia Corp. v. Carson Communications, LLC*, 102 F Supp 2d 1261 (D Kan 2000).

The Georgia LLC statute provides: "It is the policy of this state with

respect to limited liability companies to give maximum effect to the principle of freedom of contract and to the enforceability of operating agreements." In light of operating agreement provision giving members the right to engage in other businesses, the Georgia Court of Appeals held that an LLC's members did not breach their fiduciary duty by doing so. *Ledford v. Smith*, 274 Ga App 714, 618 SE2d 627 (2005).

The Ohio Court of Appeals has held that members of an LLC owe each other a fiduciary duty, but that when the Operating Agreement provides that "Members shall not in any way be prohibited from or restricted in engaging or owning an interest in any other business venture of any nature, including any venture which might be competitive with the business of the Company", members may directly compete with the LLC. *McConnell v. Hunt Sports Enterprises,* 132 Ohio App3d 657, 725 NE2d 1193 (1999).

C. DERIVATIVE LAWSUITS

1. Generally

The concept of derivative lawsuits has existed for a long time with respect to corporations, and that concept has been included in the Oregon limited liability company statute. *Compare*: ORS 60.261 and ORS 63.801.

Courts in Oregon and other states have interpreted derivative cases involving LLCs consistent with corporate derivative case law. *Bernards v. Summit Real Estate Management*, 213 P3d 1, 229 Or App 357 (2009); *Tzolis v. Wolff*, 10 NY3d 100, 884 NE2d 1005, 855 NYS2d 6 (2008); *VGS, Inc. v. Castiel*, 2003 WL 723285 (Del Ch 2003); *PacLink Communications International, Inc. v. Superior Court*, 90 Cal App4th 958, 109 Cal Rptr2d 436 (2001).

As a general rule, a corporate shareholder may not sue a third party directly to enforce a right held by the corporation.

> All authorities agree that a stockholder, as such, cannot maintain an action against a third party, either for a breach of contract between such third party and the corporation of which he is a stockholder, or for an injury to the corporation or its property. All

> such wrongs must be redressed by the corporation itself and in the corporate name. *Ninneman v. Fox,* 43 Wash 43, 45, 86 P 213, 213 (1906).

Typically, a derivative lawsuit is brought by a shareholder because the corporation or the LLC has not, and will not, bring a lawsuit against a third party on its own behalf. *Davis v. Harrison*, 25 Wash 2d 1, 167 P2d 1015 (1946). If a shareholder demands that the corporation itself bring a lawsuit – and the corporation agrees and files the demanded lawsuit against the third party in the corporation's own name – no derivative lawsuit is necessary or permitted.

> Thus, in order for a complaint to state a cause of action entitling the stockholder to relief, it must allege two distinct wrongs: The act whereby the corporation was caused to suffer damage, and a wrongful refusal by the corporation to seek redress for such act. *James Talcott, Inc. v. McDowell*, 148 So2d 36, 38 (Fla App 1962).

But when a shareholder makes demand and the corporation refuses to bring a lawsuit – and that refusal is itself improper – the shareholder is permitted to pursue a “derivative” action against the third party wrongdoer. The same is true for LLCs.

A derivative claim is a claim held by the entity - corporation or LLC - not by the individual plaintiff shareholder or member. *Mills v. Baugher*, 117 Wash App 1090, 2003 WL 21761817 (2003); *Haberman v. Public Power Supply System*, 109 Wash 2d 107, 744 P2d 1032 (1987), *amended*, 750 P2d 1032 (1988). In fact, in almost all cases, the plaintiff shareholder or member is usually not entitled to any damages awarded - any funds recovered from the “true” defendant are usually payable only to the corporation or LLC. A significant exception is that the plaintiff may awarded attorney fees out of the funds awarded out of any award made to the entity. *Hoekstre v. Golden B. Products, Inc.*, 77 Or App 104, 712 P2d 149 (1985), *review denied*, 300 Or 563, 715 P2d 94 (1986).

2. Oregon's LLC derivative statute

Oregon's LLC derivative statute is essentially the same as its corporate derivative statute. ORS 63.801 provides:

> Derivative proceedings.
>
> (1) A member may not commence a proceeding in the right of a domestic or foreign limited liability company unless the person was a member of the limited liability company when the transaction complained of occurred or unless the member became a member through transfer by operation of law from one who was a member at that time.
>
> (2) Except as otherwise provided in writing in the articles of organization or any operating agreement, a complaint in a proceeding brought in the right of a limited liability company must allege with particularity the demand made, if any, to obtain action by the managers or the members who would otherwise have the authority to cause the limited liability company to sue in its own right, and either that the demand was refused or ignored or the reason why a demand was not made. Whether or not a demand for action was made, if the limited liability company commences an investigation of the charges made in the demand or complaint, the court may stay any proceeding until the investigation is completed.
>
> (3) A proceeding commenced under this section may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interest of the members or a class of members, the court shall direct that notice be given to the members affected.

The principal difference is that, unlike the LLC statute, the corporate derivative statute explicitly states that a "'shareholder' includes a beneficial owner whose shares are held in a voting trust or held by a nominee on behalf of the beneficial owner." ORS 60.261(4).

Oregon courts and the appellate courts of other states have interpreted LLC statutes consistent with the corporate derivative case law. *See: Bernards v. Summit Real Estate Management*, 229 Or App 357, 213 P3d 1 (2009); *Mills v.*

Baugher, 117 Wash App 1090, 2003 WL 21761817 (2003); *VGS, Inc. v. Castiel*, 2003 WL 723285 (Del Ch 2003); *PacLink Communications International, Inc. v. Superior Court,* 90 Cal App4th 958, 109 Cal Rptr2d 436 (2001); *Foster-Thompson, LLC v. Thompson*, 2005 WL 3093510 (MD Fla 2005).

The law on LLC derivative lawsuits in New York has been clarified in recent years. Although New York's LLC statute is silent on the issue, the Court of Appeals has held that members of an LLC may bring derivative suits on behalf of the LLC, even though there are no provisions governing such suits in the LLC statute. *Tzolis v. Wolff*, 10 NY3d 100 (2008). The *Tzolis* court based its decision on the long-recognized importance of the derivative suit in corporate law and the absence of evidence that the state legislature intended to abolish this remedy in adopting the LLC statute in 1994. This decision abrogated several earlier rulings that held no such common law right existed.

3. Contemporaneous ownership rule

In order to bring a derivative lawsuit, the plaintiff must have been an owner at the time of the allegedly improper transaction. ORS 60.261(1); ORS 63.801(1); *Bank of Santa Fe v. Petty,* 116 NM 761, 867 P2d 431 (NM App 1993), *cert denied,* 117 NM 10, 868 P2d 655 (1994); *Davis v. Harrison*, 25 Wash 2d 1, 167 P2d 1015 (1946); *The Contemporaneous Ownership Rule in Shareholders' Derivative Suits,* 25 UCLA L Rev 1041 (1978).

One who becomes a shareholder by operation of law from one who was a shareholder at the time of the allegedly improper transaction may also sue.

> Whether the case is considered in the light of the Federal Rule or the Georgia Statute is immaterial because in each the allegation that the petitioner was a stockholder at the time of the transaction of which he complains, or that his shares have devolved upon him by operation of law, is required. *Hurt v. Cotton States Fertilizer Co.*, 145 F2d 293, 295 (5th Cir 1944), *cert denied*, 324 US 844 (1945).

In a corporation, a person need not be a shareholder of record in order to bring a derivative suit. An equitable interest may be sufficient. *Rosenfeld v.*

Schwitzer Corp., 251 F Supp 758 (SD NY 1966)(construing Indiana law). A widow's community property interest in stock has been held sufficient to enable her to bring a derivative suit. *LaHue v. Keystone Investment Co.*, 6 Wash App 765, 496 P2d 343 (1972). One with a security interest in stock may bring suit derivatively. *Gustofson v. Gustofson*, 47 Wash App 272, 734 P2d 949 (1987).

> **NOTE:** The principal difference between Oregon's LLC derivative statute and it corporate derivative statute is that the LLC statute does not include wording similar to ORS 60.261 (4), which provides:
>
> > For purposes of this section, "shareholder" includes a beneficial owner whose shares are held in a voting trust or held by a nominee on behalf of the beneficial owner.

Whether the courts will read this language into the LLC statute is unclear. Some courts hold a beneficiary of a trust which owns corporate shares may initiate a derivative lawsuit. *Edgeworth v. First National Bank of Chicago*, 677 F Supp 982 (SD Ind 1988). Other courts hold beneficiaries lack standing to bring a derivative suit. *Matties v. Seymour Manufacturing Co.*, 270 F2d 365 (2nd Cir 1959), *cert denied*, 361 US 962 (1960).

In theory, this ownership requirement exists because the person who acquires the ownership interest after the alleged wrongdoing has presumably paid a price for that interest which reflects the wrongful act. *See: Colville Valley Coal Co. v. Rogers*, 123 Wash 360, 212 P 732 (1923). In a practical sense, courts (and now the legislature) imposed this requirement to prevent a person from "buying" a derivative lawsuit. *Rosenthal v. Burry Biscuit Corp.*, 60 A2d 106, 111 (Del Ch 1948).

Not only must a person be a shareholder/member at the time that the allegedly improper transaction occurred, that person must usually be a shareholder/member at the time the derivative lawsuit is filed and continue on as a shareholder/member throughout the course of the lawsuit. *Metal Tech Corp. v. Metal Teckniques Co., Inc.*, 74 Or App 297, 703 P2d 237 (1985).

One reason for this rule is that a plaintiff who voluntarily sells his/her

ownership interest after the allegedly wrongful act is perceived to no longer adequately represent the interest of similarly situated owners. In part, this is also true because the person bringing the lawsuit must have a proprietary interest in the lawsuit. *Haberman v. Public Power Supply System*, 109 Wash 2d 107, 744 P2d 1032 (1987), *amended*, 750 P2d 1032 (1988).

There are exceptions. A former shareholder may maintain a derivative suit – at least where the rights of creditors and other shareholders are not prejudiced – when the former shareholder parts "with his shares without knowledge of prior wrongful misappropriation of corporate assets by the directors" and where "the misappropriation had reduced the value of his prior shareholdings." *Watson v. Button*, 235 F2d 235, 237 (9th Cir 1956).

The Delaware courts have recognized at least two exceptions to the contemporaneous ownership rule.

> The two recognized exceptions to the rule are: (1) where the merger itself is the subject of a claim of fraud; and (2) where the merger is in reality a reorganization which does not affect plaintiff's ownership of the business enterprise. *Lewis v. Anderson*, 477 A2d 1040, 1046 n 10 (1984).

See, also: Blasband v. Rales, 971 F2d 1034 (3rd Cir 1992); *Schreiber v. Carney*, 447 A2d 17, 22 (1982).

4. Who may bring suit: representative plaintiff

Rule 23.1 of the Federal Rule of Civil Procedure requires that a person bringing a derivative lawsuit in federal court "fairly and adequately represent the interests of the shareholders or members who are similarly situated in enforcing the right of the corporation or association." The rule also requires that the lawsuit must be filed with a complaint verified by the shareholder or member plaintiff.

The Oregon Business Corporation Act, the Oregon LLC statute, and the Oregon Rules of Civil Procedure contain no similar requirements. However, FRCP 23.1 applies to derivative lawsuits filed in federal court – even lawsuits involving Oregon corporations or LLCs. *See: Rothenberg v. Security*

Management, Inc., 667 F2d 958 (5th Cir 1982).

> **NOTE:** Oregon does impose a requirement that a party filing a *class action* lawsuit "fairly and adequately protect the interests of the class." ORCP 32(A)(4). Generally, derivative lawsuits are not filed as class actions. Some lawsuits, however, combine both a derivative claim filed by a single shareholder and collective individual shareholder claims filed as a class action. This may occur in a merger where directors allegedly breached their duty to the corporation in evaluating the value of the merger (a derivative claim) and then allegedly made false representations to the shareholders in recommended favorable action on the merger (an individual securities claim).

The rationale for the rule that a shareholder-plaintiff in a derivative lawsuit be representative of the other shareholders is set out in *Cohen v. Beneficial Industrial Loan Corp.*, 337 US 541 (1949):

> Likewise, a stockholder who brings suit on a cause of action derived from the corporation assumes a position, not technically as a trustee perhaps, but one of a fiduciary character. He sues, not for himself alone, but as representative of a class comprising all who are similarly situated. The interests of all in the redress of the wrongs are taken into his hands, dependent upon his diligence, wisdom and integrity. And while the stockholders have chosen the corporate director or manager, they have no such election as to a plaintiff who steps forward to represent them. He is a self-chosen representative and a volunteer champion. The Federal Constitution does not oblige the state to place its litigating and adjudicating processes at the disposal of such a representative, at least without imposing standards of responsibility, liability and accountability which it considers will protect the interests he elects himself to represent. *Id*, at 549-50.

The most important consideration is whether the person bringing the derivative lawsuit has an economic interest antagonistic to innocent owners. *Newell Co. v. Vermont American Corp.*, 725 F Supp 351 (ND Ill 1989). “Courts have found inadequacy of representation based on conflict of interest when the shareholder plaintiff had personal entanglements adverse to the interest of the other shareholders.” *Sonkin v. Barker*, 670 F Supp 249, 251 (SD Ind 1987). Whether a plaintiff is an adequate representative “is firmly committed to the

discretion of the trial court, reviewable only for abuse." *Smith v. Ayres*, 977 F2d 946, 948 (5th Cir 1992).

5. Demand requirement

ORS 63.801(2) imposes a demand requirement on LLC members before they can bring a derivative action on behalf of the LLC. Again, this statute has yet to be interpreted by the Oregon appellate courts, but there is considerable case law interpreting and imposing such a requirement in the corporate context.

A demand requirement has long existed in the corporate context. *North v. Union Savings & Loan Ass'n*, 59 Or 483, 117 P 822 (1911). The "demand requirement is intended to allow the corporation the opportunity to take over a suit brought on its behalf." *Haberman v. Public Power Supply System*, 109 Wash 2d 107, 744 P2d 1032, 1063 (1987), *amended*, 750 P2d 1032 (1988).

> That the plaintiff should allege and prove that application was made to the directors or managing body, and a reasonable notice, request, or demand that they institute proceedings on the part of the corporation against the wrongdoers, and their refusal to do so after such reasonable request or demand, is but a statement of a general rule. *Wills v. Nehalem Coal Co.*, 52 Or 70, 87, 96 P 528, 534 (1908).

If the corporation accedes to such demand and files a lawsuit against the alleged wrongdoer, no derivative lawsuit is necessary or permitted.

Even though it may have a valid claim against a third party, a corporation may decide not to sue. "Thus, the demand requirement implements 'the basic principle of corporate governance that the decision of a corporation - including the decision to initiate litigation - should be made by the board of directors or the majority of shareholders.'" (citations omitted) *Kamen v. Kemper Financial Services, Inc.*, 500 US 90, 102 (1991). *See also: Bernards v. Summit Real Estate Management*, 229 Or App 357, 213 P3d 1 (2009).

If the corporation's decision not to sue is supportable by the business judgment rule, many courts will not permit a shareholder to override this decision and proceed with a derivative lawsuit. *See, for example: When Should Courts*

Allow the Settlement of Duty-of-Loyalty Derivative Suits?, 109 HARV L REV 1084 (1996); Kinney, *Stockholder Derivative Suits: Demand and Futility Where the Board Fails to Stop Wrongdoers*, 78 MARQ L REV 172 (1994).

But not all states so apply the business judgment rule in this context. One commentator notes there "are at least five different standards being applied by various jurisdictions across the country." Ferrell, *A Hybrid Approach: Integrating the Delaware and the ALI Approaches to Shareholder Derivative Litigation,* 60 OHIO ST L J 241, 251 n 36 (1999).

Many courts have held that demand is not required if demand would be futile. *North v. Union Savings & Loan Ass'n*, 59 Or 483, 117 P 822 (1911). "[D]emand typically is deemed to be futile when a majority of the directors have participated in or approved the alleged wrongdoing, or are otherwise financially interested in the challenged transactions." (citations omitted) *Kamen v. Kemper Financial Services, Inc.*, 500 US 90, 102 (1991). A federal district court has held that demand would be futile in the LLC context when one member files a derivative lawsuit against the only other member. *Bhan v. Patel*, 2006 WL 1050519 (SD Miss 2006) (interpreting Delaware law). *See, also: Ishimaru v. Fung*, 2005 WL 2899680 (Del Ch 2005); *Metro Communication Corp. BVI v. Advanced Mobilecomm Technologies, Inc.,* 854 A2d 121 (Del Ch 2004).

Neither ORS 60.261(2) nor 63.801(2) specify the form of demand. Some cases hold "demand need not assume any particular form or recite any specify language." *Syracuse Television, Inc. v. Channel 9, Syracuse, Inc.*, 51 Misc2d 188, 273 NYS2d 16, 24 (1966). 1990 amendments to the Revised Model Act – not adopted in Oregon – require that demand be in writing. RMBCA § 7.40(1). *See:* 45 BUS LAW 1241 (1990). Thus, ORS 63.801 is silent on whether the demand must be in writing.

Some cases require that the demand contain sufficient information so the board can properly evaluate the claim. *Renfro v. Federal Deposit Ins Corp.*, 773 F2d 657 (5th Cir 1985). *See also:* Official Comment to RMBCA § 7.42. "At a

minimum, a demand must identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused to the corporation, and request remedial relief." *Allison on behalf of General Motors Corp. v. General Motors Corp.*, 604 F Supp 1106, 1117 (D Del 1985).

6. Settlement

At common law, a plaintiff-shareholder could continue, compromise, abandon or discontinue a derivative lawsuit at pleasure until another shareholder was joined as a party or until an interlocutory judgment was entered. *Goodwin v. Castleton*, 19 Wash 2d 748, 144 P2d 725, 733 (1944); *Albrecht v. Bauman*, 130 F2d 452 (DC Cir 1942) (interpreting Delaware law).

In *Goodwin v. Castleton*, *supra,* the court held that since the claim actually belonged to the corporation, the corporation retained the right to compromise or abandon the lawsuit at any time, subject to court approval.

Today by statute, once a derivative lawsuit is filed, any compromise or settlement of the lawsuit by anyone requires court approval. This is true for LLCs. ORS 63.801(3). It is true for corporations. ORS60.261(3).

In determining whether to approve such settlement, the court need not try all of the issues raised in the plaintiff-owner's complaint in order to evaluate each issue's likelihood of success.

> The court may approve or it may disapprove the settlement. In either event, it is the action of the court and is binding on the parties concerned. Nor is the court under such circumstances required first to try out all the issues presented by the plaintiffs in the derivative action; on the contrary, the court may confine itself to the question as to whether the matters involved in such suit have, in good faith and for adequate consideration, been settled and compromised. This, in our opinion, constitutes the orderly manner of procedure, for, otherwise, the fruits of an advantageous settlement might be lost, the corporation exposed to the expense and embarrassment of protracted litigation, and the rights and property of the majority stockholders seriously jeopardized. *Goodwin v. Castleton*, 19 Wash 2d 748, 764, 144 P2d 725, 733

(1944).

In approving a settlement, the court need only determine whether the parties acted in good faith and whether the payment is adequate.

7. Recovery belongs to LLC – not plaintiff-member

Although the LLC statute does not specifically address this issue, it is clear from over a hundred years of derivative case law that if the lawsuit is successful and damages recovered, these funds belong to the entity – not the plaintiff shareholder or member. *American Timber & Trading Co. v. Niedermeyer*, 276 Or 1135, 558 P2d 1211 (1977); *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wash App 502, 728 P2d 597 (1986), *review denied*, 107 Wash 2d 1022 (1987); *Lynch v. Patterson*, 701 P2d 1126 (Wyo 1985); *Ross v. Bernhard*, 396 US 531 (1969).

Under rare circumstances, a court may permit direct recovery by a member or individual shareholders. For example, if the majority shareholder participated in the wrongful act, recovery by the corporation may be unjust since the majority shareholder would be rewarded by a pro rata distribution of the derivative lawsuit proceeds. *American Timber & Trading Co. v. Niedermeyer*, 276 Or 1135, 558 P2d 1211 (1977).

> The general rule is that in a shareholder derivative action to enforce a corporate cause of action, the judgment belongs to the corporation rather than the individual stockholders. Nevertheless, a direct recovery to the stockholders may be permitted under exceptional circumstances, notwithstanding that such recovery amounts to a forced distribution of corporate assets to the stockholders.
>
> If awarding a recovery to a corporation would result in a stockholder's receiving a portion thereof to which he was not entitled, then a court of equity will look beyond the corporation and award the recovery to the individual stockholders entitled thereto. However, when third-party rights of higher priority, such as those of corporate creditors or claimants, are involved, then a judgment in favor of the stockholders, which would prejudice such rights, would be improper. (citations omitted). *Interlake Porsche & Audi, Inc. v.*

Bucholz, 45 Wash App 502, 519-520, 728 P2d 597, 608-9 (1986), *review denied*, 107 Wash 2d 1022 (1987).

See also: LaHue v. Keystone Investment Co., 6 Wash App 765, 496 P2d 343 (1972).

8. Right to attorney fees

Although neither the corporate nor the LLC derivative statutes mention the award of attorney fees in connection with a derivative lawsuit, Oregon case law in the corporate context holds that a successful derivative plaintiff is entitled to an award of attorney fees from the corporation. *Crandon Capital Partners v. Shelk,* 342 Or 555, 157 P3d 176 (2007); *Hoekstre v. Golden B. Products, Inc.*, 77 Or App 104, 712 P2d 149 (1985), *review denied*, 300 Or 563, 715 P2d 94 (1986).

The LLC statutes in some states, including Washington, do explicitly provide for attorney fee awards in connection with derivative claims. RCW 23.15.401.

D. DIRECT ACTIONS BETWEEN MEMBERS

1. Generally

As a general rule, suits to address wrongs against an LLC should be brought as derivative actions with any funds recovered going to the LLC itself.

In recent years, the courts in Oregon and some other states have permitted individual actions between members in closely held corporations when the controlling shareholders have breached their fiduciary duty to the minority.

> When the majority shareholders of a closely held corporation use their control over the corporation to their own advantage and exclude the minority from the benefits of participating in the corporation, absent a legitimate business purpose, the actions constitute a breach of their fiduciary duties of loyalty, good faith and fair dealing. Because actions such as those alleged in this case result in both derivative and individual harm, an action brought by minority shareholders may proceed as a derivative or a direct action. *Noakes v. Schoenborn*, 116 Or App 464, 472, 841 P2d 682, 687 (1992).

See, also: Wulf v. Mackey, 135 Or App 655, 899 P2d 755, *review denied*, 322 Or 168, 903 P2d 886 (1995); *Chiles v. Robertson*, 94 Or App 604, 767 P2d 903, *recon allowed in part, opinion modified*, 96 Or App 658, 774 P2d 500, *review denied*, 308 Or 592, 784 P2d 1099 (1989). *But, see: Wilcox v. Stiles*, 127 Or App 671, 873 P2d 1102 (1994); *Stringer v. Car Data Systems, Inc.*, 314 Or 576, 841 P2d 1183 (1992), *recon denied*, 315 Or 308, 844 P2d 905 (1993).

Although there are no Oregon cases analyzing this issue for LLCs, there is no reason to believe that the Oregon courts will apply a different rule to LLCs than to close corporations.

This liberal policy of permitting a minority shareholder in a close corporation to bring a direct action against a controlling shareholder is not true where a corporation has a large number of shareholders or is a public corporation. *Loewen v. Galligan*, 130 Or App 222, 882 P2d 104, *review denied*, 320 Or 493, 927 P2d 793 (1994); *Kahn v. Sprouse*, 842 F Supp 423 (D Or 1993); *Guenther v. Pacific Telecom, Inc.*, 123 FRD 341 (D Or 1987). It is also not true where the minority shareholder seeks to enforce some corporate right against a non-shareholder. *Lee v. Mitchell*, 152 Or App 159, 953 P2d 414 (1998); *Hampton Tree Farms, Inc. v. Jewett*, 125 Or App 178, 865 P2d 420 (1993), *affirmed*, 320 Or 599, 892 P2d 683 (1995); *Johnson v. Con-Vey/Keystone, Inc.*, 814 F Supp 931 (D Or 1993). *But, see: Far West Federal Bank, SB v. Office of Thrift Supervision-Director*, 119 F3d 1358 (9th Cir 1997)(permitting a direct action by shareholders against third party).

2. Other states

Like Oregon, many states now permit shareholders in close corporations to bring direct actions against each other, rather than derivatively.

> Where majority or controlling shareholders in a close corporation breach their heightened fiduciary duty to minority shareholders by utilizing their majority control of the corporation to their own advantage, without providing minority shareholders with an equal opportunity to benefit, such breach, absent legitimate business purpose, is actionable. Where such breach occurs, the minority

> shareholder is individually harmed.
>
> Accordingly, we hold that claims of a breach of fiduciary duty alleged by minority shareholders against shareholders who control a majority of shares in a close corporation, and use their control to deprive minority shareholders of the benefits of their investment, may be brought as individual or direct actions and are not subject to the provisions of [the court rules related to derivative lawsuits]. *Crosby v. Beam*, 47 Ohio St 3d 105, 548 NE2d 217, 221 (1989).

See also: Steelman v. Mallory, 110 Idaho 510, 716 P2d 1282 (1986).

Some courts reject attempts to apply separate rules to close corporations and require that all such lawsuits be filed derivatively, unless the minority shareholder has suffered a “special injury” or can allege a “special duty.”

> Ohio, like a few other states, has expanded the “special injury” doctrine into a general exception for closely held corporations, treating them as if they were partnerships. The American Law Institute recommends that other states do the same. *Principles of Corporate Governance* § 7.01(d) and pp. 22-25 (comment), 30-36 (reporter's note). The premise of this extension may be questioned. Corporations are *not* partnerships. Whether to incorporate entails a choice of many formalities. Commercial rules should be predictable; this objective is best served by treating corporations as what they are, allowing the investors and other participants to vary the rules by contract if they think deviations are warranted. So it is understandable that not all states have joined the parade.
>
> Delaware, for one, has not. When the controlling stockholder of a family corporation transferred its assets for independent consideration, Delaware required the minority investors to pursue derivative litigation, observing that the value of the minority shares went down only to the extent the corporation as an entity was worth less. When the owner of 95% of a closely held firm's stock proposed to liquidate the corporation at what the minority thought was an inadequate price, Delaware again required the minority to bring the objection derivatively. In neither case did the Chancellor think it important that the wrong alleged involved the controlling stockholder enriching itself at corporate expense, or that the corporation was closely held. The author of the leading treatise treats [the second Delaware case cited] as establishing the proposition that the closely held nature of the corporation is irrelevant to the distinction between direct and derivative actions.

(citations omitted) *Bragdon v. Bridgestone/Firestone, Inc.*, 916 F2d 379, 383-4 (7th Cir 1990), *cert denied*, 500 US 952 (1991).

See also: Frank v. Hadesman & Frank, Inc., 83 F3d 158 (7th Cir 1996).

3. Direct actions between LLC members

The Rhode Island Superior Court has applied these same principles to closely-held LLCs and permitted an individual action by a member of a 4-member LLC against those managing the LLC. *Marsh v. Billington Farms, LLC*, 2006 WL 2555911 (RI Super). *See, also: Ayres v. AG Processing Inc.*, 345 F Supp2d 1200 (D Kan 2004). Other states permit individual claims if there is a "special injury" to the members beyond that to the LLC itself. *Argentum International, LLC v. Woods*, 289 Ga App 440, 634 SE2d 195 (2006); *Dawson v. Atlanta Design Associates, Inc*.,14 NC App 716, 551 SE2d 877 (2001); *Excimer Associates, Inc. v. LCA Vision, Inc*. 292 F3d 134 (2d Cir 2002).

Under Tennessee law, a manager owes a fiduciary duty to the LLC, not to individual members. Thus, individual members may only assert breach of fiduciary duty claims against the manager derivatively. *ARC LifeMed, Inc. v. AMC-Tennessee, Inc.*, 183 SW3d 1 (Tenn Ct App 2005). *See, also: Clockwork Home Services, Inc. v. Robinson*, 423 F Supp2d 984 (ED Mo 2006) (Mo law); *Suntech Procession Systems, LLC v. Sun Communications, Inc.,* 2000 WL 1780236 (Tex App); *Pawnee Petroleum Products, LLC v. Crawford*, 2003 WL 21659665 (D Kan 2003).

A federal district court has held that a lawsuit for rescission of the formation agreement could be brought directly because, if successful, plaintiff would no longer be an owner of the LLC and therefore not subject to requirements for derivative lawsuits. *Ismart Intern, Ltd v. I-Docsecure, LLC,* 2005 WL 588607 (ND Cal 2005).

A New York court has held that a member may bring a direct action for an accounting. *Lio v. Zhong*, 10 Misc3d 1068, 814 NYS2d 562 (2006). *But see:*

Thorpe v. Levenfeld, 2005 WL 2420373 (ND Ill 2005) (Ill law).

E. EXPULSION OF A MEMBER

While there may be roundabout methods of accomplishing this end, a corporation cannot expel a shareholder and a partnership cannot expel a partner. An Oregon LLC, however, can expel a member unless the operating agreement provides otherwise (which is often the case). ORS 63.209 provides:

> 63.209 Expulsion of member.
>
> (1) A member may be expelled from a limited liability company:
>
> (a) In accordance with a written provision in the articles of organization or any operating agreement; or
>
> (b) Except as otherwise provided in writing in the articles of organization or any operating agreement, by a court, upon application of any member, if the court determines that:
>
> (A) The member has been guilty of wrongful conduct that adversely and materially affects the business or affairs of the limited liability company; or
>
> (B) The member has willfully or persistently committed a material breach of the articles of organization or any operating agreement or otherwise breached a duty owed to the limited liability company or the other members to the extent that it is not reasonably practicable to carry on the business or affairs of the limited liability company with that member.
>
> (2) The power of a limited liability company to expel a member pursuant to this section does not limit or adversely affect any right or power of the limited liability company to recover any damages or to pursue any other remedies provided for in the articles of organization or any operating agreement or permitted under applicable law or at equity. The limited liability company, in addition to any of its other remedies, may offset any such damages against any amounts otherwise distributable or payable to the expelled member.

Although an LLC may expel a member, fiduciary duty considerations may apply. For example, in a Tennessee case where the controlling LLC members

expelled minority members – paying $150 per ownership interest and then selling all the units for $250 per unit – the Tennessee Court of Appeals held that the LLC's majority members owed the same fiduciary duties to minority members as do controlling shareholders in a corporation. *Anderson v. Wilder,* 2003 WL 22768666, 2003 Tenn App LEXIS 819 (2003), *aff'd after trial*, 2007 Tenn App LEXIS 582 (2007). *See also Brazil v. Rickerson*, 268 F Supp2d 1091 (WD Mo 2003). On the other hand, a Texas court held that an 80% owner of an LLC did not owe a fiduciary duty to the other members under Texas law. *Suntech Processing Systems, LLC v. Sun Communications, Inc*., 2000 WL 1780236 (Tex App 2000).

Under Virginia law, managers and members owe a fiduciary duty to the LLC, but not to the members themselves. *Remora Investments, LLC v. Orr,* 673 SE2d 845 (Va 2009); *WAKA, LLC v. Humphrey,* 2007 Va Cir LEXIS 96 (Cir Ct 2007). In *Gowin v. Granite Depo*, *LLC*, 634 SE2d 714 (Va 2006), the court upheld a trial court's finding that a majority LLC member did not breach his fiduciary duty by amending the articles of organization to permit eliminating a member's interest for nonpayment of a capital contribution and then seeking to eliminate the member. The court found that the amendment did not adversely affect the company and had a proper purpose ensuring that the LLC received the member's capital contribution.

In *Bell v. Walton,* 861 A2d 687 (Me 2004), the court held that in order for a member to withdraw from an LLC, the member must strictly comply with the notice requirements in the statute. The Court was unwilling to judicially impose a doctrine of constructive notice of withdrawal upon the statutory scheme.

In *Love v. Fleetway Air Freight & Delivery Service, LLC,* 875 So2d 285 (Ala 2003), the court held that the members' vote to remove the LLC's manager did not also constitute his removal as a member under the wording of that LLC's operating agreement.

Although the Louisiana LLC statutes do not set out the procedure for

terminating a member, the expulsion of a member made in accordance with the operating agreement has been upheld. *See e.g., Weinmann v. Duhon,* 818 So. 2d 206 (La App 5 Cir 2002); *Mixon v. Iberia Surgical, LLC*, 956 So. 2d 76, 82 (La App 3 Cir 2007); *Rudney v. Int'l Offshore Servs., LLC,* 2007 US Dist LEXIS 75441 (ED La 2007).

In the corporate context, a shareholder in a closely held corporation has statutory authority to seek to force the corporation to cash out his/her shares if the corporation acts in a manner that is "illegal, oppressive or fraudulent." ORS 60.952(1)(b). No similar statutory right exists for members of an LLC. ORS 63.661. Instead, the LLC statute gives the LLC the right to expel a member who is acting wrongfully. Clearly the balance of power is different in the corporate and LLC contexts.

F. RIGHTS TO INSPECTION

In Oregon, a limited liability company is required to keep in its business or registered office copies of the following documents, specified in ORS 63.771(1):

> (1) Each limited liability company shall keep at an office specified in the manner provided in any operating agreement or, if none, at the registered office, the following:
>
> (a) A current list of the full name and last-known business, residence or mailing address of each member and manager, both past and present.
>
> (b) A copy of the articles of organization and all amendments thereto, together with executed copies of any powers of attorney pursuant to which any amendment has been executed.
>
> © Copies of the limited liability company's federal, state and local income tax returns and reports, if any, for the three most recent years.
>
> (d) Copies of any currently effective written operating agreements and all amendments thereto, copies of any writings permitted or required under this chapter, and copies of any financial statements of the limited liability company for the three most recent years.
>
> (e) Unless contained in a written operating agreement or in a writing permitted or required under this chapter, a statement

prepared and certified as accurate by a manager of the limited liability company which describes:

> (A) The amount of cash and a description and statement of the agreed value of other property or services contributed by each member and which each member has agreed to contribute in the future;
>
> (B) The times at which or events on the occurrence of which any additional contributions agreed to be made by each member are to be made; and
>
> © If agreed upon, the time at which or the events on the occurrence of which the limited liability company is dissolved and its affairs wound up.

A member can inspect and copy these records, as well as "any limited liability company records" upon the member's "reasonable request." ORS 63.771(2). A member may have an agent or attorney inspect and copy these records on the member's behalf. ORS 63.777.

If the LLC does not comply with the member's request to inspect and copy, the member can apply to the circuit court for an order permitting inspection. ORS 63.781. If the court orders such inspection, it is required to order the LLC to pay the member's reasonable attorney fees incurred in bringing the action. *Id.* The court may impose reasonable restrictions on the use or distribution of the records by the demanding member. *Id.*

A shareholder's right to inspect corporate records exists independent of statute and a shareholder's common law right to inspect records may be greater than the right granted by statute. *Bernert v. Multnomah Lumber & Box Co.*, 119 Or 44, 247 P 155, 248 P 156 (1926). Presumably, a member of an LLC also has a common law right to inspection, but given the broadness of the LLC inspection statute, it is hard to imagine what records would be inspectible under common law, but not under the statute.

Under the Oregon corporate statute, shareholder access to a corporate

records can be denied where the shareholder's purpose for inspection is improper. *Babbitt v. Pacco Investors Corp.*, 246 Or 261, 425 P2d 489 (1967); *Rosentool v. Bonanza Oil and Mine Corp.*, 221 Or 520, 352 P2d 138 (1960); *Bernert v. Multnomah Lumber & Box Co.*, 119 Or 44, 247 P 155, 248 P 156 (1926). The LLC's inspection provisions make no mention of proper purpose as grounds for denying inspection, but does include a "reasonable request" requirement. ORS 63.771(2).

In *Kasten v. Doral Dental USA, LLC,* 2007 WI 76, 733 NW2d 300 (2007), the Wisconsin Supreme Court analyzed in depth its state's LLC inspection statute (which is similar to Oregon's inspection statute) and concluded that LLC members are granted broader inspection rights than are corporate shareholders. Wisconsin, like Oregon, omits a "proper purpose" requirement but includes a "reasonable request" requirement. On this requirement, the court stated:

> We read the absence of "proper purpose" language in Wis. Stat. § 183.0405(2) to indicate the drafters of the WLLCL chose not to require LLC members to demonstrate, as a threshold matter, that their inspection request is not made for an improper motive. Moreover, this interpretation is in harmony with the intent of the WLLCL drafters to favor simple default rules suitable for "mom and pop" operations. However, this does not mean that the statute is blind to a member's motive for making an inspection request.
>
> We conclude that a number of factors may be relevant to whether a request to inspect LLC records (or, here, "Company documents") was submitted "upon reasonable request." The scope of items subject to inspection under Wis. Stat. § 183.0405(2) "any ... record[s]," unless the operating agreement provides otherwise-is so broad that to permit any inspection request, no matter its breadth, could impose unreasonable burdens upon the operation of the company. Because we do not believe that the drafters intended the inspection statute to threaten the financial well being of the company, we read "upon reasonable request" to pertain to the breadth of an inspection request, as well as the timing and form of the inspection.
>
> We therefore conclude that one purpose of the language "upon reasonable request" is to protect the company from member

> inspection requests that impose undue financial burdens on the company. Whether an inspection request is so burdensome as to be unreasonable requires balancing the statute's bias in favor of member access to records against the costs of the inspection to the company. When applying this balancing test, a number of factors may be relevant, including, but not limited to: (1) whether the request is restricted by date or subject matter; (2) the reason given (if any) for the request, and whether the request is related to that reason; (3) the importance of the information to the member's interest in the company; and (4) whether the information may be obtained from another source. *Id* at 319-320.

If at least 25% of an LLC's owners live in California, those members have the inspection rights afforded by California law, even if the LLC was formed under the laws of another state. *Burkle v. Burkle*, 141 Cal App 4th 1029, 46 Cal Rptr 3d 562 (2006).

In *Fogarty v. Parker, Poe, Adams and Bernstein, LLP*, 2006 WL 2383376 (Ala 2006), the court held that allegations that an agent of the LLC who refused to allow a member to inspect the LLC's records without reasonable cause could support a claim for relief under statute.

Interpreting the Operating Agreement and Delaware LLC statute which both gave members a right to inspect the "books and records" of the LLC, the Court granted a member the right to inspect the tax records, member list, and other records pertaining to the monthly valuation of the LLC's asset (an investment in a investment Fund), while denying the LLC member the right to inspect the Fund's records. *Arbor LP v. Encore Opportunity Fund, LLC,* 2002 WL 205681 (Del Ch). The Fund was a separate entity with its own board and with owners other than the LLC.

In *Kinkle v. RDC, LLC,* 889 So2d 405 (La App 3 Cir 2004), the court held that the Estate of a deceased member is entitled to a proportionate share of profits, losses and distributions associated with that membership interest, but is not entitled to other rights of membership unless admitted as a substitute member. Thus, the Estate had no right to inspect the books and records of the

LLC nor did the Estate have a right to an accounting.

See, also: Merovich v. Huzenman, 911 So 2d 125 (Fl Ct App 2005).

G. RIGHT TO DISTRIBUTIONS

Distributions to members are required to be allocated among members in a manner provided by the articles of organization or the operating agreement, or absent such a provision, then allocated in the same proportion as the members' rights to share in profits. ORS 63.195.

During operations, a member is entitled to interim distributions "to the extent and at the times or upon the occurrence of the events specified in the articles of organization or any operating agreement." ORS 63.200.

ORS 63.229 provides that a distribution may only be made "only if, after giving effect to the distribution, in the judgment of the members, for a member-managed limited liability company, or the managers, in a manager-managed" LLC, that the distribution will not render the LLC insolvent.

A member of a member-managed LLC or the manager of a manager-managed LLC may have personal liability for an improper distribution (one that renders an LLC insolvent). ORS 63.235.

Once a member becomes entitled to receive a distribution, the member has the status of and remedies of a creditor of the LLC with respect to a distribution. ORS 63.225. These rights may be limited by the preference rules under the Bankruptcy Code.

Much like corporate officers and directors, an LLC manager who performs accounting or other professional services for the LLC is not entitled to payment under an *quantum meruit* theory. *Jandrain v. Lovald*, 351 BR 679 (D SD 2006).

H. RIGHTS TO DEFENSE & INDEMNITY

In general terms, indemnity in the corporate context refers to the right of officers or members to be reimbursed for losses incurred by them in legal proceedings related to their responsibilities as officers or members. As recognized by courts in the corporate context, the right to reimbursement is not

ripe until the underlying litigation has been resolved. *Kaung v. Cole Nat. Corp*., 884 A2d 500, 509 (Del 2005) ("Whether a corporate officer has a right to indemnification is a decision that must necessarily await the outcome of the investigation or litigation."); *Homestore, Inc. v. Tafeen*, 888 A2d 204, 211(Del 2005) ("The right to indemnification cannot be established, however, until after the defense to legal proceedings has been successful on the merits or otherwise.").

In contrast to the permissive advancement of litigation expenses during a proceeding, indemnity is a right that can only be determined upon conclusion of the underlying action.

A claim for indemnity during an ongoing legal proceeding is premature, as indemnity is not triggered until a judgment has been entered and all appeals have concluded. No obligation exists that may be indemnified unless and until a judgment has been entered on claims for which indemnity is available.

Oregon law permits the members of an LLC to provide for indemnity following entry of a final judgment in certain situations and subject to certain limitations. ORS 63.160 provides:

> 63.160 Limitation of liability and indemnification. The articles of organization or any operating agreement may provide for indemnification of any person for acts or omissions as a member, manager, employee or agent and may eliminate or limit the liability of a member, manager, employee or agent to the limited liability company or its members for damages from such acts or omissions. However, no such provision shall eliminate or limit the liability or provide for indemnification of a member of a member-managed limited liability company or a manager of a manager-managed limited liability company for any act or omission occurring prior to the date when such provision became effective, and no such provision shall eliminate or limit the liability or provide for indemnification of a member or manager for:
>
> (1) Any breach of the member's or manager's duty of loyalty to the limited liability company or its members;
>
> (2) Acts or omissions not in good faith which involve intentional misconduct or a knowing violation of law;

> (3) Any unlawful distribution under ORS 63.235; or
>
> (4) Any transaction from which the member or manager derives an improper personal benefit.

Unless otherwise prohibited by Oregon law or an LLC's operating agreement, an LLC does have the discretion to advance litigation expenses to a member or manager. In the absence of a requirement to do so in the LLC's operating agreement, such advances are discretionary, not mandatory.

ORS 60.397 provides that a corporation may advance the legal fees of a director prior to judgment if the director provides written affirmation that he believes he will be entitled to indemnity following the conclusion of the action and also agrees to repay the advance to the corporation if the final judgment disqualifies him from indemnity.

I. RIGHT TO WITHDRAW

ORS 63.205 permits a member to withdraw from the LLC. There is no similar provision in the Oregon Business Corporation Act. The withdrawal may subject the withdrawing member to liability. ORS 63.205 provides:

> (1) A member may voluntarily withdraw from a limited liability company:
>
> (a) At the time or upon the occurrence of events specified in the articles of organization or any operating agreement; or
>
> (b) Upon not less than six months' prior written notice to the limited liability company, unless the articles of organization or any operating agreement expressly provide that a member has no power to withdraw voluntarily from the limited liability company or otherwise expressly limit or condition such power.
>
> (2) If a member with the power to withdraw voluntarily from a limited liability company exercises that power, but the withdrawal is in breach of any provision of the articles of organization or any operating agreement, then, unless otherwise provided in the articles of organization or any operating agreement, the limited liability company, in addition to any other remedy available at law or

> in equity, may recover from the withdrawing member damages incurred by the limited liability company as a result of the breach and may offset the damages against any amounts otherwise distributable or payable to the withdrawing member.
>
> (3) Unless otherwise provided in the articles of organization or any operating agreement, in the case of a limited liability company for a definite term or particular undertaking, a voluntary withdrawal by a member before the expiration of that term or completion of that undertaking is a breach of the applicable articles of organization or any operating agreement.

Even though a member may "withdraw" as a member, this does not mean that the LLC is obligated to cash out the withdrawing member's interest. ORS 63.365 provides that "following the cessation of the member's interest, the holder of the former member's interest shall be considered an assignee of such interest and shall have all the rights, duties and obligations of an assignee under this chapter."

This is also true in Wyoming. Absent provisions in the operating agreement addressing this issue, the withdrawing member loses the right to participate in management, but retains his/her economic interest (much like an assignee). *Lieberman v. Wyoming.com, LLC,* 2004 WY 1, 82 P3d 274 (Wyo 2004). This is also true under Delaware law when it is the bankruptcy of a member that causes an implied withdrawal. *Milford Power Co., LLC v. PDC Milford Power,* 866 A2d 738 (Del Ch 2004).

In *Lamprecht v. Jordan, LLC,* 139 Idaho 182, 75 P3d 743 (2003), an LLC's operating agreement provided that the termination of a member's employment constituted the withdrawal of that member, entitling the member only to payment of an amount equal to the balance in his capital account, not the fair market value of his interest in the LLC. The court upheld this provision.

New York's LLC statute does not allow a member to withdraw. In New York, "a member may withdraw from a limited liability company only as provided in its operating agreement. If the operating agreement is silent, a member may

not withdraw prior to the dissolution of the company." *Matter of Horning v. Horning Constr., LLC,* 12 Misc3d 402, 408, 816 NYS2d 877 [Sup Ct, Monroe County 2006], *Klein v. 599 Eleventh Ave. Co. LLC,* 14 Misc3d 1211, 836 NYS2d 486; 2006 NY Misc LEXIS 3937 (2006).

Some state LLC statutes not only allow a member to withdraw, but also require the LLC to buy out the withdrawing member's interest at its fair value. *See Cox v. Southern Garrett, LLC, 245* SW3d 574 (Tex App Houston [1st Dist] 2007); *Sage v. Radiology and Diagnostic Services, LLC,* 831 So2d 1053 (La App 1 Cir 2002).

J. ACTIONS FOR DISSOLUTION; OPPRESSION

A limited liability company can be dissolved upon the occurrence of the events specified in the articles of organization or by vote of the members. ORS 63.621. An LLC may also be dissolved by action of the circuit court. ORS 63.647 sets forth grounds for judicial dissolution:

> The circuit courts may dissolve a limited liability company:
>
> (1) In a proceeding by the Attorney General if it is established that:
>
> (a) The limited liability company obtained its articles of organization through fraud; or
>
> (b) The limited liability company has continued to exceed or abuse the authority conferred upon it by law.
>
> (2) In a proceeding by or for a member if it is established that it is not reasonably practicable to carry on the business of the limited liability company in conformance with its articles of organization or any operating agreement.
>
> (3) In a proceeding by the limited liability company to have its voluntary dissolution continued under court supervision.

The judicial dissolution statutes in the corporate statutes contain similar provisions. ORS 60.661 & 60.952. However, grounds for judicial dissolution of corporations additionally include deadlock and instances where a corporation

acts in a manner that is “illegal, oppressive or fraudulent”, provisions absent from the LLC statute.

Despite the absence of a statutory basis for judicial intervention in the case of “oppressive” conduct, courts have long held that they have traditional equitable powers to protect minority owners and to fashion appropriate remedies when necessary. *GI Joe’s, Inc. v. Nitzam*, 183 Or App 116, 123, 50 P3d 1282 (2002); *Naito v. Naito*, 178 Or App 1, 4, 35 P3d 1068 (2001); *Browning v. C & C Plywood Corp*, 248 Or 574, 434 P2d 339 (1968); *Baker v. Commercial Body Builders, Inc.*, 264 Or 614, 507 P2d 387 (1973); *Delaney v. Georgia-Pacific Corp.*, 278 Or 305, 564 P2d 277, *supplemented*, 279 Or 653, 569 P2d 604 (1977), *appeal after remand*, 42 Or App 439, 601 P2d 475 (1979). Presumably, this equitable relief will also apply in the case of LLCs.

There are no Oregon cases interpreting this language and no consistent interpretation by other courts interpreting this “reasonably practicable to carry on the business” language. However, there may be a common law oppression law claim in limited liability companies, although this has yet to be clarified by the courts. *Rowlett v. Fagan*, 262 Or App 667, 327 P3d 1 (2014), *rev on other grounds*, 358 Or 639 (2016).

A good review of various judicial interpretations of the LLC judicial dissolution provisions is set forth in *Kirksey v. Grohmann*, 2008 SD 76, 754 NW2d 825 (2008), which begins:

> A consistent view in other jurisdictions is that a limited liability company is governed by its articles of organization and operating agreement. *See Horning v. Horning Const., LLC*, 12 Misc3d 402, 816 NYS2d 877, 881 (NY Sup Ct 2006); *Historic Charleston Holdings, LLC v. Mallon*, 365 SC 524, 617 SE2d 388, 393 (SC Ct App 2005); *Dunbar Group, LLC v. Tignor*, 267 Va 361, 593 SE2d 216, 219 (2004). Beyond this, however, there is no prevailing interpretation of the terms "not reasonably practicable" and "economic purpose . . . unreasonably frustrated" in relation to dissolution of limited liability companies. *See* SDCL 47-34A-801.
>
> Nevertheless, the cases interpreting language similar to our

> statutory terminology, whether involving a partnership or a limited liability company, are instructive. In defining what it means for it to "not be reasonably practicable" for a company to continue, one court consulted a dictionary to apply a plain and ordinary meaning. *Taki v. Hami*, 2001 WL 672399 (Mich Ct App.) (unpublished) (dissolution of a partnership). The *Taki* court held that "'reasonably practicable' may properly be defined as capable of being done logically and in a reasonable, feasible manner." *Id* at 3. Another court emphasized that "[t]he standard set forth by the Legislature is one of reasonable practicability, not impossibility." *PC Tower Ctr., Inc. v. Tower Ctr. Dev. Assoc., LP,* 1989 WL 63901, 6 (Del Ch) (unpublished) (dissolution of a partnership). Under this view, the standard does not require that the purpose of the company, as set out in the operating agreement, be completely frustrated to warrant judicial dissolution. Rather, the term "reasonably practicable" signifies a company's ability to continue the purpose identified in the operating agreement. (footnotes omitted) *Kirksey, supra,*, 754 NW2d at 828.
>
> *See also In re Hefel* Case No. 10-02787(Bankr ND Iowa, Sept 19, 2011).

One New York court has said that it is inappropriate to import dissolution standards from corporate or partnership law; the courts must look only to the New York LLC statute:

> Phrased differently, since the Legislature in determining the criteria for dissolution of various business entities in this state did not cross reference such grounds from one type of entity to another, it would be inappropriate for this Court to import dissolution grounds from the Business Corporation Law or Partnership Law to the LLCL.
>
> * * *
>
> After careful examination of the various factors considered in applying the "not reasonably practicable" standard, we hold that for dissolution of a limited liability company pursuant to LLCL 702, the petitioning member must establish, in the context of the terms of the operating agreement or articles of incorporation, that (1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible. *In the Matter of 1545 Ocean Ave., LLC v. Crown Royal Ventures, LLC*, 2010 NY Slip Op 00688 (NY App Div 1/26/2010), 2010 NY Slip Op 688 (NY App Div 2010)

In *Dunbar Group, LLC v. Tignor,* 267 Va 361, 593 SE2d 216 (2004), one of two LLC owners sought expulsion of the other owner based on alleged acts of misconduct. The trial court ordered the expulsion and the LLC's dissolution. The Virginia Supreme Court found that expulsion of the member was proper, but dissolution was not proper because the evidence failed to demonstrate that it was not reasonably practicable to carry on the LLC's business.

Interpreting language similar to that in the Oregon LLC statute ("it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement"), a New York court held that judicial dissolution of an LLC will be ordered "only where the complaining member can show that the business sought to be dissolved is unable to function as intended, or else that it is failing financially." The court stated the only grounds for judicial dissolution where those set out in the LLC statute, implying the court had no inherent equitable power to protect minority owners. *Schindler v. Niche Media Holdings, LLC,* 1 Misc3d 713, 772 NYS2d 781 (2003).

The Delaware LLC statute does not provide for judicial dissolution of an LLC in the event of deadlock, only where "it is not reasonably practicable to carry on the business in conformity with a limited liability agreement." The members were deadlocked. In the case of *In re Silver Leaf, LLC,* 2005 WL 2045641 (Del Ch), the court judicially dissolved the LLC, reasoning under the facts of this case that this business was unable to go forward since the LLC had no assets other than a choose in action against another company which it defrauded it.

In *Haley v. Talcott,* 864 A2d 86 (Del Ch 2004), the two 50% owners of an LLC were deadlocked over how to manage the LLC's property. The Delaware LLC statute did not provide for judicial dissolution of LLC in the event of deadlock, but rather only where the conflict between owners made it not practicable to carry on LLC business. The court found that it was not practicable and ordered dissolution and sale of the property. The court considered other "equitable" remedy based on provisions of the Operating Agreement at issue, but

did not find them “equitable” under the facts of the case.

In *Investcorp, LP v. Simpson Investment Co.,* LC, 267 Kan 840, 267 Kan 875, 983 P2d 265 (1999), members of an LLC owning a single property deadlocked over decisions about property. There was no right under Kansas LLC statute to sue for dissolution based upon deadlock, but the operating agreement provided that withdrawal of members triggers dissolution. Half of members withdraw, but LLC refused to dissolve. Withdrawing members sued to force dissolution and appointment of receiver. The court ruled that the LLC must dissolve, but refused to appoint a receiver, holding that LLC controlled the dissolution process.

In *Venture Sales, LLC v. Perkins,* 86 So3d 910 (Miss 2012), the court affirmed the trial court’s decision to dissolve and LLC which “is not fulfilling the purpose stated in its operating agreement” when the LLC “was formed for the purpose of developing and selling its property, and no development has taken place during the more than ten years since the company's formation.” *Id* at 916.

Another court has held that the Kansas LLC statute allows members to assert a oppression claim. *Ayres v. AG Processing Inc.*, 345 F Supp2d 1200 (D Kan 2004).

K. ARBITRATION AGREEMENTS

It is very common for operating agreements to contain the requirement that any disputes between the members, or between the LLC and the members, are subject to arbitration, rather than a lawsuit in court.

Courts give broad application to arbitration clauses in operating agreements. *CAPROC Manager, Inc. v. Policemen’s & Firemen’s Retirement System of City of Pontiac,* 2005 WL 937613 (Del Ch 2005) (a broadly worded arbitration agreement required arbitration of a dispute over the removal of the manager by the members); *Douzinas v. American Bureau of Shipping, Inc.,* 888 A2d 1146 (Del Ch 2006) (broad arbitration provision in an LLC agreement could encompass breach of fiduciary duty claims by a member.)

Even though it is customary for only LLC's members to sign the operating agreement (not for the LLC itself to sign), most courts hold that the LLC is also bound by the arbitration provisions of the operating agreement. *Elf Atochem North America, Inc. v. Jaffari,* 727 A2d 286 (Del 1999). *But see Trover v. 419 OCR, Inc.*, 337 Ill Dec 111, 921 NE2d 1249 (Ill App 2010).

L. FEDERAL DIVERSITY

For purposes of federal diversity litigation, an LLC is a citizen of each of the states in which any LLC member is a citizen. *Johnson v. Columbia Properties Anchorage, LP*, 437 F.3d 894, 899 (9th Cir 2006); *International Flavors and Textures, LLC v. Gardner,* 966 F Supp 552 (WD Mich 1997); *Shulman v. Voyou,* 305 F Supp2d 36 (DDC 2004); *Carden v. Arkoma Associates*, 494 US 185 (1990)(same rule for limited partnerships); *Great S. Fire Proof Hotel Co. v. Jones*, 177 U.S. 449, 456-57 (1900) (refusing to extend the corporate citizenship rule to a "limited partnership association" although it possessed "some of the characteristics of a corporation")).

This differs from the rule applied to corporations by 28 USCA §1332© (a corporation is a citizen of its state of incorporation plus the state of its principal place of business). The Supreme Court and lower federal courts have consistently refused to extend this corporate citizenship analysis to non-corporate business entities for purposes of diversity jurisdiction. *Hertz Corp. v. Friend*, 559 US 77 (2010); *Carden v. Arkoma Associates*, 494 US 185 (1990); *Johnson v. SmithKline Beecham Corp.* 724 F3d 337 (3rd Cir. 2013); *Harvey v. Grey Wolf Drilling Co.*, 542 F3d 1077 (5th Cir. 2008); *Johnson-Brown v. 2200 M Street LLC*, 257 F Supp 2d 175 (DDC 2003); *Trowbridge v. Dimitri's 50's Diner LLC*, 208 F Supp 2d 908 (ND Ill 2002). Only the citizenship of the members of an LLC is relevant for diversity purposes. If the members are not natural persons, the determination of citizenship may become a fact-intensive process requiring investigation.

M. RIGHTS OF ASSIGNEE OF LLC INTEREST

One who acquires an LLC membership interest through an assignment has more limited statutory rights than those that a creditor or limited partner hold. Oregon's LLC statute provides as follows:

> 63.255 Rights of assignee who becomes member.
>
> (1) An assignee who becomes a member as to the assigned interest has the rights and powers, and is subject to the restrictions and liabilities, of a member under this chapter, the articles of organization and any operating agreement. An assignee who becomes a member also is liable for any obligations of the assignee's assignor to make contributions under ORS 63.180. However, the assignee is not obligated merely by becoming a member for any other liabilities for which the assignor was liable that were unknown to the assignee at the time the assignee became a member and that could not be ascertained from the articles of organization.
>
> (2) Whether or not an assignee of a membership interest becomes a member, the assignor is not released from the assignor's liability to the limited liability company to make contributions under ORS 63.180.

The Oregon Supreme Court has recently reversed the decision by the Court of Appeals interpreting this statute in the context of charging orders in *Law ex rel. Robert M. Law Profit Sharing Plan v. Zemp*, 276 OR App 652, 368 P 3d 821 (2016) and remanded the matter to the circuit court for further proceedings. *Law ex rel. Robert M. Law Profit Sharing Plan v. Zemp*, 362 Or 302, 408 P3d 1045 (2018). The Supreme Court provided a framework for the scope of authority that may lawfully be granted to an assignee through a charging order and concluded that such authority must allow a judgment creditor to reach a general partner's financial interest without unduly interfering with management of the entity.