The Direct-Derivative Distinction, the Special Litigation Committee, and the Uniform Act: A Response to Professor Weidner

*By Daniel S. Kleinberger**

The Unfortunate Role of Special Litigation Committees in LLCs *has a deeply pejorative view of the Uniform Law Commission "second generation" limited liability company act, and that view extends far deeper than the target suggested by the article's title. The article's fundamental attack is on the distinction between direct and derivative claims; the criticisms of ULLCA's provisions on special litigation committees depend on that attack. In support of its wide-ranging attack,* The Unfortune Role *seeks to marshal history, policy, logic, and a research study pertaining to the outcome of derivative claims. Unfortunately, however, the article (i) misapprehends the drafting history of uniform acts and the case law origins of the direct-derivative distinction; (ii) asserts and relies on a policy with destructive practical consequences for closely held businesses; (iii) misunderstands the logical ramifications of an LLC being a legal person separate from its members; and (iv) relies heavily on a study based on inapposite data–i.e., a data set comprising mostly cases involving public corporations, with an additional focus on cases decided by Delaware courts. Thus, in this author's opinion,* The Unfortunate Role *fails on every front the article seeks to attack.*

"All knowledge of cultural reality . . . is always knowledge from particular points of view."[1]

I. Introduction

I appreciate the opportunity to respond to Professor Weidner's article, *The Unfortunate Role of Special Litigation Committees in LLCs* ("*The Unfortunate*

* Emeritus Professor of Law, Mitchell Hamline School of Law, Reporter for Uniform Limited Partnership Act (2001), co-reporter for ULLCA (2006), co-reporter for UPA (2013), ULPA (2013), and ULLCA (2013). For an explanation of citations to various uniform acts, see Part I.C. I thank Harry Haynsworth and Carolyn C.S. Kleinberger for their respective suggestions on an earlier draft of this article; those suggestions improved this response. Of course, I remain solely responsible for any errors. The views stated here are solely mine and, in particular are not the views or responsibility of, and should not be attributed to, the Uniform Law Commission. As always, my work and everything else meaningful in my life depend on the love, support, and wisdom from Carolyn C.S. Kleinberger.

1. Max Weber, The Methodology of the Social Sciences 81 (Edward A. Shils & Henry A. Finch eds. & trans., 1949) (emphasis omitted).

Role").[2] As augured by the quotation above from Max Weber, Professor Weidner and I approach this subject from very different perspectives. In the following pages, I will critique Professor Weidner's perspective substantially and, I hope, persuasively.

A. Organization of this Response

I differ with Professor Weidner in several ways. Some of my demurrers relate to two major premises of *The Unfortunate Role*. Other demurrers pertain to particular assertions *The Unfortunate* Role makes in support of its critiques.

My response is organized into six parts (including this introduction). Part II explains the context and focal points of the controversy and takes the reader, step-by-step, from the basic notion of "business judgment," through fundamental norms on business entity decision-making, to the specific mechanism of a special litigation committee.

Part III describes the "deep structure" of *The Unfortunate Role*. This Part

- identifies *The Unfortunate Role*'s two most important premises, which appear repeatedly in the article and are necessary to support each of the article's four most important arguments;
- explains how the article's most fundamental objection is not to the Special Litigation Committee ("SLC"), but rather to what the SLC presupposes—i.e., the distinction between direct and derivative claims ("the direct-derivative distinction"); and
- configures the article's four most important arguments into a logical sequence that:
  - begins with the most fundamental (and therefore broadest) criticism; and then
  - addresses the three other major criticisms in order of decreasing generality.

Part IV of this article critiques the two fundamental premises of *The Unfortunate Role*, and Part V controverts each of the article's four most important points. Part V states a conclusion.

B. A Note on Nomenclature

The Unfortunate Role aims its attacks principally at the 2006 version of the Uniform Limited Liability Company ("ULLCA (2006)"),[3] which *The Unfortunate Role* refers to as "RULLCA."[4] However, the most recent version of the uniform act is

2. Donald J. Weidner, *The Unfortunate Role of Special Litigation Committees in LLCs*, 77 Bus. Law. 381 (2022) [hereinafter *The Unfortunate Role*].

3. Rev. Unif. Ltd. Liab. Co. Act (Unif. Law Comm'n 2006)[hereinafter ULLCA (2006)].

4. *The Unfortunate Role*, *supra* note 2, at 381.

from 2013.[5] On matters relevant to the present discussion, the 2013 version made no material changes to the 2006 version, neither in statutory text nor comments. Therefore, this response most often refers generically to ULLCA (2006/2013). Where this response concerns the 2006 version in particular, the reference is to ULLCA (2006). When contemplating the first uniform limited liability company act, this response refers to ULLCA (1996).

II. From Business Judgment to Special Litigation Committee

Although the SLC first appeared in 1976 as a governance mechanism in United States corporate law,[6] the SLC reflects and results from basic governance principles applicable to any business entity that the law delineates as a legal person separate from its owners.[7] Whatever the type of entity:

i. The most important business decisions are to be decided by the entity's topmost governance level (e.g., managers of a manager-managed limited liability company ("LLC"); board of directors of a corporation; general partners of a limited partnership).

ii. A decision by a business entity to initiate litigation of major consequence is an important business decision, especially when the potential defendants are, or have been, part of the entity's topmost governance level.[8]

iii. The business judgment rule is a keystone of the law of entity governance and applies to protect business decisions made at an entity's topmost governance level—except as to decision-makers with a conflict of interest or otherwise undeserving of the rule's protection.

5. Rev. Unif. Ltd. Liab. Co. Act (Unif. Law Comm'n 2006) (amended 2013) [hereinafter ULLCA (2013)].

6. Douglas M. Branson, *Recent Changes to the Model Business Corporation Act: Death Knells for Main Street Corporation Law*, 72 Neb. L. Rev. 258, 272 n.56 (1993) ("The first case of the modern era was Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976).").

7. It was of course impossible for the SLC to appear simultaneously as a governance mechanism in the law of limited liability companies. Wyoming did invent the modern U.S. limited liability company only one year later in 1977. Carter G. Bishop & Daniel S. Kleinberger, Limited Liability Companies: Tax & Business Law ¶ 1.01[3][a] (Supp. 2020) [hereinafter Bishop & Kleinberger, Limited Liability Companies]. But LLCs became mainstream only in 1997. *Id.* ¶ 1.01[3][e].

8. In the words of Justice Brandeis, "whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management, and is left to the discretion of the directors." United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263 (1917); *see also* John Matheson, *Restoring the Promise of the Shareholder Derivative Suit*, 50 Ga. L. Rev. 327, 371 (2016) ("[T]he issue morphs from whether there is a valid claim to whether a lawsuit is a desirable action for the corporation to pursue. Many of us have at one time or another thought that we might have a valid legal claim but decided not to pursue that claim based on the time, expense, disruption and other factors that might be involved in pursuing the claim through litigation. The SLC makes a similar multi-faceted determination."). For reasons discussed at *infra* notes 9 & 28, these assertions about corporations and boards of directors apply as well to limited liability companies and the topmost rank of LLC decision-makers.

iv. Most derivative claims name as defendants at least some, and often all, of the persons at the topmost governance level, creating at least the appearance (and often the reality) of conflict of interest.

v. Either:

- the typical derivative claim will oust an entire category of important business decisions from the application of the business judgment rule; or
- a surrogate decision-maker is necessary—i.e., a mechanism must exist to replace "conflicted out" persons with disinterested persons equipped to make the necessary business judgment.[9]

vi. The SLC is that surrogate mechanism, although subject to much more skepticism than the decision-making structure being replaced.

- while in the ordinary situation, the business judgment rule presumes the decision-makers to be acting in good faith, without conflict of interest, and with adequately careful process,
- an SLC's decision obtains business judgment protection only if the SLC first establishes these bone fides (i.e., proves that its members are independent and disinterested and that its process of inquiry, assessment, and decision meet a reasonableness standard).

9. *See* Douglas M. Branson, *The Rule that Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 648 (2002) ("The manner in which the potential conflict of interest came to be reconciled was through the use of the special litigation committee, or SLC."). In the words of the seminal case of *Auerbach v. Bennett*:

> That a duty of investigation rested on the Board of Directors with respect to the transactions [at issue] is . . . plain. The board undertook to discharge its duty by recognizing that the respondent directors could not participate in that investigation because of their obvious conflict of interest, and by appointing a separate committee the Special Litigation Committee composed of directors who were presumably independent of the remainder of the board and not charged with any responsibility for the management of the corporation during the period in which the payments were made.

408 N.Y.S.2d 83, 87 (App. Div. 1978), *modified*, 47 N.Y.2d 619 (1979). And, from a New York decision also in 1979,

> We think that, assuming disinterestedness and honest judgment of the non-management majority of the Board of Directors, the procedure followed by the Board, consisting of appointing a special litigation committee of non-management directors, advised by independent counsel who made a thorough investigation, is an appropriate way for the corporation to exercise its power to determine whether a lawsuit such as this nominally on behalf of the corporation, should be pursued. *Otherwise, the principle that the Board of Directors and not individual stockholders shall decide in the exercise of their disinterested judgment whether to prosecute a lawsuit on behalf of the corporation becomes meaningless.*

Byers v. Baxter, 419 N.Y.S.2d 497, 500 (App. Div. 1979) (emphasis added). *Auerbach* and *Byers* refer solely to corporations; however (i) at that time, the LLC was a decade away from hitting the radar of even expert practitioners; and (ii) on the "separate entity" characteristic, corporations and limited liability companies are alike.

III. The Deep Structure of Professor Weidner's Critique[10]

A. The Two Key Premises

Two important, related premises appear recurrently in *The Unfortunate Role*; they support the article's four most important arguments in various ways.[11] One premise critiques the drafting methodology of the ULLCA (2006) drafters and proffers instead a UPA (1997)[12]–based frame of reference. The proffered frame of reference gives rise to the second premise—the *desideratum* of giving LLC members "easy access" to judicial remedies ("easy access to judicial remedies" or "easy access").[13]

According to *The Unfortunate Role*, the methodological error is fundamental—the ULLCA (2006) drafters lost sight of the act's appropriate target group. UPA (1997) had identified the group correctly, and ULLCA (1996) followed suit.[14] Then, however, ULLCA (2006) not only abandoned the proper frame of reference but did so without even a word of explanation.

Having in mind that the proper target group leads (almost ipso facto) to the article's second principal premise, for the purposes of *The Unfortunate Role*, "easy access" means no direct/derivative distinction. Because the SLC presupposes that distinction,[15] from *The Unfortunate Role*'s perspective, the SLC is unfortunate (and wrong) from the "git go."

B. *The Unfortunate Role*'s Fundamental Objection

Thus, the SLC is actually not *The Unfortunate Role*'s fundamental concern, despite the article's engaging title. The article's most basic complaint is against the direct/derivative distinction itself. It is this distinction that (i) identifies a myriad of claims as belonging to the company rather than to any of its owners; and (ii) thereby precludes easy access to judicial remedies.

The SLC is merely an add-on problem, since an SLC can exist only with regard to a derivative claim. Eliminate the direct/derivative distinction and you eliminate SLCs (along with whatever failings and virtues an SLC may provide).[16]

From this perspective, *The Unfortunate Role* makes four allied complaints, which might be summarized into four major points, using the expression "and

10. I borrow "deep structure" from linguistics to mean "fundamental patterns underlying the surface features." *Deep Structure*, Oxford Ref., https://www.oxfordreference.com/view/10.1093/oi/authority.20110803095706567 (last visited Nov. 5, 2021) (internal quotation marks omitted).

11. For a description of those four arguments, see *infra* Part II. For the author's critique of those arguments, see *infra* Part III.

12. Unif. P'ship Act (Unif. Law Comm'n 1994) (amended 1997) [hereinafter UPA (1997)].

13. The phrase "easy access" appears twelve times, and the article gives the phrase a particular meaning. *The Unfortunate Role*, *supra* note 2, at 409–14, 421, 430. *The Unfortunate Role* also has an overarching theme—that ULLCA (2006) is too corporate. For the response to this criticism, see *infra* Part IV.A.3.

14. UPA (1997); Unif. Ltd. Liab. Co. Act (Unif. Law Comm'n 1996) [hereinafter ULLCA (1996)].

15. *In re* Nine W. LBO Sec. Litig., 505 F. Supp. 3d 292, 309 (S.D.N.Y. 2020) ("Pennsylvania law is clear that an SLC's determination bears only on whether shareholders can maintain a derivative action."); Cutshall v. Barker, 733 N.E.2d 973, 983 (Ind. Ct. App. 2000) (stating that "a direct action is not subject to review by an SLC").

16. For a discussion of the direct/derivative distinctions, *The Unfortunate Role*'s criticisms of the distinction, and this author's response, see *infra* Part IV.A.

if that weren't bad enough."[17] Thus, in the view of *The Unfortunate Role*, and to the unwarranted prejudice of "easy access":

- ULLCA (2006/2013) imposes the direct-derivative distinction where the distinction ought not be.
- And, if that weren't bad enough, ULLCA (2006/2013) exalts the special litigation committee, which is an inherently corporate mechanism and thus alien to the limited liability company.
- And, if that weren't bad enough, through its statutory text and official comments ULLCA (2006/2013) adopts the *Auerbach* test rather than the *Zapata* test. Although, per *The Unfortunate Role*, the latter is demonstrably better for plaintiffs than the former.
- And, if that weren't bad enough, ULLCA (2006/2013) does not sufficiently emphasize the importance of SLC members being independent and disinterested and, in some circumstances, even permits the SLC to be appointed by one or more of the derivative defendants.[18]

III. Critiquing *The Unfortunate Role*'s Two Fundamental Premises

As noted above,[19] two fundamental premises recur throughout *The Unfortunate Role*: ULLCA (2006/2013) has deserted its appropriate target group and moreover destroyed a member's easy access to judicial remedies.

A. In Its "Abandoning the Target Group" Premise, *The Unfortunate Role* Misapprehends the Evolution of the Uniform Limited Liability Company Acts.

In the view of some academics, when a statute delineates and facilitates business transactions, the statute's default rules should reflect the assumed desires of one particular subset of expected users: legally unsophisticated members of the

17. *See, e.g.*, *If that Weren't Bad Enough*, Ludwig.guru, https://ludwig.guru/s/if+that+weren't+bad+enough (last visited Oct. 17, 2021) (citing the phrase's usage by the *New York Times*, the *New Yorker*, and the *Guardian*, among others).

18. *The Unfortunate Role* also criticizes ULLCA (2006/2013) for permitting the operating agreement to eliminate the SLC entirely but not to modify the prescribed standards and procedures. *The Unfortunate Role*, *supra* note 2, at 417–18. In view of the 2006 drafting committee, (i) without detailed, well-crafted protections, allowing modifications to the SLC rules and procedures risked having SLC structures unfairly antagonistic to derivative plaintiffs; (ii) drafting adequate protections would have been a complex task, with the resulting statutory language likely to be quite complicated; and (iii) given the general consensus among jurisdictions as to appropriate procedures, see *infra* Part IV.C.1, the complexity and complications far outweighed any benefits from permitting modifications. 6 Terence W. Thompson et al., Arizona Corporate Practice § 12:87(b) (Supp. 2021) (addressing "[t]he rationale for preventing the operating agreement from altering the rules regarding the special litigation committee").

19. *See supra* Part III.A.

population.[20] Professor Weidner subscribes to this view, and in *The Unfortunate Role* he praises ULLCA (1996) for its "vision that the target group for the 1996 Act was small groups of entrepreneurs operating informally without the benefit of sophisticated counsel."[21] In this respect, apparently, ULLCA (1996) followed UPA (1997), whose "primary focus . . . is the small, often informal, partnership."[22]

According to *The Unfortunate Role*, ULLCA (2006/2013) abandons this focus, deserts the target group, and substantially impairs a key desideratum of the target group—i.e., easy access to judicial remedies. Worse, this repudiation of ULLCA (1996)'s core values took place *sub silentio*—i.e., with "no indication that the statute's target group had shifted away from small groups of entrepreneurs operating informally and without the benefit of sophisticated counsel."[23]

If indeed ULLCA (1996)'s lodestar was "The Target Group of the 1996 Act and Easy Access to Member Remedies," then ULLCA (2006) did indeed make a change. The drafting committee for the 2006 act focused not on a hypothetical set of users with a hypothetical set of attitudes, but rather on the state of the law across the United States—as benefits a *uniform* act. The Prefatory Note to make this point up front:

> Eighteen years have passed since the IRS issued its gate-opening Revenue Ruling 88-76, declaring that a Wyoming LLC would be taxed as a partnership despite the entity's corporate-like liability shield. More than eight years have passed since the IRS opened the gate still further with the "check the box" regulations. *It is an opportune moment to identify the best elements of the myriad "first generation" LLC statutes and to infuse those elements into a new, "second generation" uniform act.*[24]

20. *See, e.g.*, David A. Hoffman & Tess Wilkinson-Ryan, *The Psychology of Contract Precautions*, 80 U. Chi. L. Rev. 395, 443 (2013) ("The theory of default rules rests on assumptions about the behavior of legally unsophisticated members of the population."); *cf*. Albert O. "Chip" Saulsbury, IV, *Catch You on the Flip Side: A Comparative Analysis of the Default Rules on Withdrawal from a Louisiana Limited Liability Company*, 71 La. L. Rev. 675, 687 (2011) (stating that "the rapid increase in the popularity of the limited liability company creates a correlative increase in the amount of unsophisticated businessmen that choose this business form"). Conflicting viewpoints do exist. For example, in the view of two leading scholars, Easterbrook and Fischel, "[C]orporate law should contain the defaults people would have negotiated, were the costs of negotiating at arms'-length for every contingency sufficiently low." Robert Gertner & Ian Ayres, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87, 89–90 (1989) (quoting a then forthcoming article by Easterbrook & Fischel, *The Economic Structure of Corporate Law*, 89 Colum. L. Rev. (forthcoming 1989) (at 14–15)). From this perspective, the unsophisticated are irrelevant, as the low costs of negotiating presumably put the unsophisticated and the "fully lawyered up" into the same category ("people").

21. *The Unfortunate Role*, *supra* note 2, at 409.

22. UPA (1997), Prefatory Note, at 2; *see also The Unfortunate Role*, *supra* note 2, at 409 ("Consistent with the vision that the target group for the 1996 Act was small groups of entrepreneurs operating informally without the benefit of sophisticated counsel, the default rule was that members would have the same easy access to judicial remedies as partners.").

23. *The Unfortunate Role*, *supra* note 2, at 413; *see also id*. at 421 ("It is not completely clear why RULLCA took away a member's easy access to judicial remedies. There was no indication that the target group had changed from small groups of entrepreneurs who presumptively intend to operate as partners but with a liability shield.").

24. ULLCA (2006), Prefatory Note, at 2 (emphasis added). The statutory landscape changed in the following seven years. ULLCA (2013) did not affect the decisions reflected in the above quoted passage. *See* ULLCA (2013), Prefatory Note to 2011 and 2013 Amendments, at 5–7.

The drafting committee to ULLCA (2006) had ongoing input from a myriad of advisors from the American Bar Association. The chair of the drafting committee, Dean David Walker of Drake Law School, gave as much credence and air time (if not more) to the advisors as to the ULC commissioners. His goal was consensus. When a vote was to be taken, the initial (and often the only) vote counted commissioners and advisors "per capita." Dean Walker made separate counts only on the rare occasions, when, after lengthy discussion, consensus seemed impossible. Even in these limited circumstances, the decision made by vote of the commissioners never differed from the opinion expressed by the majority of advisors.

The advisors to the ULLCA (2006) drafting committee included some of the nation's leading practitioners in the field of business enterprises, as well as most of the academics who at the time interested themselves in limited liability companies. Committee meetings often involved detailed discussions contrasting proposed statutory language with the practice "on the ground," as well as frequent discussions to the effect of "you have to understand how our clients see this and how they understand and operate their businesses."[25] Discussion with state bar committees pushed the drafting committee's perspective even deeper into the weeds of actual practice.

So, undoubtably, the ULLCA (2006)'s focus differs from the focus *The Unfortunate Role* ascribes to ULLCA (1996). However, for matters relevant to this

25. A law review article by the co-reporters for ULLCA (2006) provides more details:

> The Drafting Committee for Re-ULLCA was chaired by David Walker, Dean of the Drake Law School, included eight other commissioners, and benefited from the active participation of advisors appointed by the ABA. In addition to the ABA Advisor, the Committee had eight advisors from the Business Law Section, three from the Real Property, Probate and Trust Law Section, and one from the Section on Taxation. The current chair of the PUBO Committee [now the LLC, Partnership and Unincorporated Entities Committee] was one of the Business Law Section's Advisors, and the immediate past chair of that Committee was the ABA Advisor.
>
> As explained in the March 2006 newsletter of the ABA Committee on Partnerships and Unincorporated Business Organizations:
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> > ABA advisors actually outnumbered NCCUSL commissioners on the committee, and on most votes the committee's chair counted commissioners and ABA advisors together as one group. On the rare occasions when the committee seemed significantly divided, the chair took a formal vote of commissioners (as NCCUSL procedures require) but then also made note of a vote of the ABA advisors.
> >
> > The Drafting Committee also benefited from a scholarly perspective. As is usual, the co-reporters are law professors. In addition, the chair of the Committee is a law school dean, one of the members is a dean emeritus, and another is a law professor. One of the ABA advisors is a business school professor, and two others are law professors. Several of the ABA Advisors who are full-time practitioners have also published several articles on LLC law. All and all, authors from the three leading LLC treatises were part of this working group.
> >
> > The drafting process spanned three years and included ten drafting committee meetings, six drafts, and consideration by the entire Conference at four consecutive annual meetings. Each committee meeting lasted two and a half days, and many key issues were debated, re-debated and re-debated. The Act was on the annual meeting agenda in 2003 (concept discussion, based on drafting committee's briefing memo), 2004 (partial first reading), 2005 (first reading), and 2006 (final reading).

Daniel S. Kleinberger & Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act*, 62 BUS. LAW. 515, 517–18 (2007) (footnotes omitted).

article, *The Unfortunate Role* misapprehends ULLCA (1996). That is, key parts of ULLCA (1996) bely the article's "abandonment" and "easy access" assertions.

For starters, the sole relevant statement in the act's Prefatory Note pertains to "draft[ing] a flexible act with a comprehensive set of default rules designed to substitute as the essence of the bargain for small entrepreneurs and others."[26] There is no mention of the entrepreneurs being unsophisticated or necessarily bereft of counsel.

Even more problematic for *The Unfortunate Role* are key statutory provisions of ULLCA (1996). *The Unfortunate Role* praises Section 410 of ULLCA (1996) for granting "members . . . the same easy access to judicial remedies as partners . . . [including being] able to sue one another, or the firm, *for* any breach of the operating agreement or the LLC act."[27] However, nothing in the language of Section 410 addresses, let alone eliminates, the notion of standing.[28] Moreover, the official comment to Section 410 expressly recognizes the direct/derivative distinction and states categorically: "[U]nder this section . . . [a] member pursues only that member's claim against the company or another member under this section. Article 11 governs a member's derivative pursuit of a claim on behalf of the company."[29]

The Unfortunate Role attempts to dismiss Article 11 as merely supplemental—i.e., as an additional tool available to a complaining member at the member's discretion. Citing no authority or other support, and ignoring the above-quoted comment to ULLCA (1996), Section 410, *The Unfortunate Role* states that "the 1996 Act . . . provide[s] members *the option* to bring a derivative action."[30]

I categorically disagree. The option interpretation renders Article 11 a nullity. Even the strongest advocates of the direct-derivative distinction recognize it as constraining the power of would-be plaintiffs.[31] Opponents, for their part, denigrate "the derivative proceeding [as] involv[ing] burdensome, and often futile, procedural requirements,"[32] and decry "the tribulations of the derivative pathway [which are used] to deter, or at least delay, [a] minority[] [owner's] quest for justice."[33] Why would any sane plaintiff opt in to such *tsuris*?[34]

26. ULLCA (1996), Prefatory Note.

27. *The Unfortunate Role*, *supra* note 2, at 409 n.209 (citing ULLCA (1996) § 410).

28. At its core the direct/derivative distinction is about standing. Daniel S. Kleinberger, *Direct Versus Derivative and the Law of Limited Liability Companies*, 58 BAYLOR L. REV. 63, 91 (2006) [hereinafter Kleinberger, *Direct Versus Derivative*] ("The direct/derivative distinction is a question of standing, and standing is a matter of injury. The role of injury in standing is doctrinally fundamental, whether the context is the loftiest constitutional matters or prosaic questions of 'good fences make good neighbors.'" (footnotes omitted)); *see also* CML V, LLC v. Bax, 6 A.3d 238, 245 (Del. Ch. 2010) (noting that issues of standing viz-a-viz direct and derivative claims are comparable regardless of whether the entity is a limited partnership, a limited liability company, or a corporation), *aff'd*, 28 A.3d 1037 (Del. 2011).

29. ULLCA (1996) § 410, cmt.

30. *The Unfortunate Role*, *supra* note 2, at 410 (emphasis added).

31. Kleinberger, *Direct Versus Derivative*, *supra* note 28, at 70–87.

32. Durham v. Durham, 871 A.2d 41, 46 (N.H. 2005).

33. Kleinberger, *Direct Versus Derivative*, *supra* note 28, at 75.

34. *Tsuris* is a Yiddish word meaning "troubles" or "problems" with the connotation of great frustration. *What Does Tsuris Mean?*, CHABAD.ORG, https://www.chabad.org/library/article_cdo/aid/4171638/jewish/What-Does-Tsuris-Mean.htm (last visited Dec. 26, 2021).

Put another way, if the drafters of ULLCA (1996) intended Article 11 to apply solely at the plaintiff's discretion, those drafters were wasting their time; they were merely creating "surplusage or a nullity."[35] Put more formally, to suggest that under ULLCA (1996) derivative claims are optional is to contravene one of the most fundamental rules of statutory construction—"the interpretive canon against surplusage—the idea that 'every word and every provision is to be given effect [and that n]one should needlessly be given an interpretation that causes it to duplicate another provision or to have no consequence.'"[36]

Thus, if, as *The Unfortunate Role* asserts,[37] derivative claims and the direct/derivative distinction destroy "easy access," then *The Unfortunate Role* must abandon ULLCA (1996) as a basis for decrying ULLCA (2006/2013). Put another way, the section of *The Unfortunate* Role captioned "The Target Group of the 1996 Act and Easy Access to Member Remedies" is infelicitous, and stating that it was "*RULLCA that took away* a member's easy access to . . . remedies"[38] is straight out wrong.

B. The Unfortunate Role Never Explains Why "Easy Access" Is the Correct Approach for an LLC Statute and Seems Almost to Take the Premise as a Given. The Article's Limited Efforts to Support the Premise Are Flawed.

1. *The Unfortunate Role* invokes both ULLCA (1996) and UPA (1997) to support the easy access premise. *The Unfortunate Role* is just flat out wrong about the former, and the latter is at best a frail reed.

In exalting "easy access," *The Unfortunate Role* relies principally using ULLCA (1996) to attack ULLCA (2006). The argument seems to be the following: with ULLCA (1996), the ULC actually got this point right. With ULLCA (2006), the ULC ignored its previous wisdom and messed up.

This argument is unworkable as a matter of both history and logic. "Derivative suits . . . have been recognized for most of two centuries."[39] And as shown above, contrary to *The Unfortunate Role*'s understanding, it was ULLCA (1996) that adopted the reprehensible direct-derivative distinction.[40] In addition,

35. United States v. W.R. Grace, 455 F. Supp. 2d 1133, 1136 (D. Mont. 2006) (stating that "[c]ourts should . . . reject any interpretation that would render [a] statutory provision surplusage or a nullity" (citation omitted)).

36. Nielsen v. Preap, 139 S. Ct. 954, 969 (2019) (quoting Antonin Scalia & Bryan Garner, Reading Law: The Interpretation of Legal Texts 74 (2012)). Moreover, if Article 11 of ULLCA (1996) is merely optional at a plaintiff's discretion, the same must be true for the Article 10 of the Revised Uniform Limited Partnership Act (Derivative Actions). Comparing the words of the two Articles shows that the former derives almost verbatim from the latter.

37. *See supra* Part III.A.

38. *The Unfortunate Role*, *supra* note 2, at 410.

39. Tzolis v. Wolff, 884 N.E.2d 1005, 1007 (N.Y. 2008) ("To hold that there is no remedy when corporate fiduciaries use corporate assets to enrich themselves was unacceptable in 1742 and 1832, and it is still unacceptable today.").

40. *See supra* Part III.A.

stating that a particular statute "got it right" on an important policy issue does nothing to explain why the particular statute's approach actually was the right decision.

The Unfortunate Role also attempts to justify "easy access" by relying on UPA (1997)'s approach as *the* standard, faulting ULLCA (2006/2013) accordingly.[41] To explain this latter line of support, *The Unfortunate Role* quotes an earlier article authored by Professor Weidner, which in turn quotes a UPA (1997) comment:

> RUPA (1997) section 405 went "far beyond" the UPA rule and provided that a partner may sue the partnership or another partner at any time, for legal or equitable relief, to enforce the partner's rights under the partnership agreement or under RUPA (1997). Section 405 "reflects a new policy choice that partners should have broad judicial discretion to fashion appropriate remedies."[42]

However, although UPA (1997) does not provide for derivative claims, the just quoted language is not really on point to that issue. In the comment, the lead-in sentences to the quoted passage are as follows:

> Section 405(b) is the successor to UPA Section 22, but with significant changes. At common law, an accounting was generally not available before dissolution. That was modified by UPA Section 22 which specifies certain circumstances in which an accounting action is available without requiring a partner to dissolve the partnership. Section 405(b) goes far beyond the UPA rule. It provides that, *during the term of the partnership*, partners may maintain a variety of legal or equitable actions, including an action for an accounting, as well as a final action for an accounting upon dissolution and winding up.[43]

Thus, taking the comment as a whole, UPA (1997)'s key reform *in this area* is expanding owner access to courts *before dissolution*, not eschewing the direct/derivative distinction.

As to that distinction, the UPA (1997) comments contain only one sentence: "Since general partners are not passive investors like limited partners, [UPA (1997)] does not authorize derivative actions."[44] The logic of the asserted connection is not apparent. Shareholders in closely held corporations are typically active in the business, and yet the direct/derivative distinction prevails in that context (and beyond) in the overwhelming majority of jurisdictions.[45] The

41. *The Unfortunate Role*, *supra* note 2, at 410 ("Although the ULC considered easy access to judicial remedies a major step forward in the partnership area, it withdrew that approach from its LLC act in just ten years.").

42. *The Unfortunate Role*, *supra* note 2, at 410 n.213 (quoting Donald J. Weidner, *LLC Default Rules Are Hazardous to Member Liquidity*, 76 BUS. LAW. 151, 169 (2020) (citations omitted)).

43. UPA (1997) § 405, cmt. 2 (emphasis added).

44. *Id.*

45. *See* Saunders v. Briner, 221 A.3d 1, 33, 37–39 (Conn. 2019) (Robinson, C.J., concurring in part and dissenting in part) (stating that "courts in other jurisdictions, with near uniformity" have rejected the ALI approach and have thereby maintained the direct-derivative distinction (citing cases)). *The Unfortunate Role* praises the approach suggested by the ALI's Principles of Corporate Governance, *The Unfortunate Role*, *supra* note 2, at 414–15, which permits a court to ignore the direct-derivative distinction in closely held corporations. However, the ALI approach is law in only a handful of states. *Saunders*,

one sentence comment states a weak rationale (at best) for the UPA (1997) rule, and no basis whatsoever for exporting that rule to limited liability companies, where one of the two basic governance structures is manager-management with non-managing members essentially passive.[46]

2. For *The Unfortunate Role*, the virtues of "easy access" seem almost a given. In fact, however, those virtues rest on two other assumptions:

- "more is better" as to lawsuits inter se owners in a closely held business; and
- majority owners tend to be oppressive and minority owners are long suffering.

For example, *The Unfortunate Role* makes much of a law review article, *How Do Legal Standards Matter? An Empirical Study of Special Litigation Committees* ("*Em-Empirical Study*"), published formally in 2020.[47] The article concludes *inter alia* that a rule of law announced in *Zapata Corp. v. Maldonado*[48] tends to favor plaintiffs in derivative litigation more than a comparable rule announced in *Auerbach v. Bennett*.[49] From this conclusion, *The Unfortunate Role* criticizes

221 A.2d at 37–39. In this author's opinion, in this matter the majority rule is correct. In addition to its other defects, the ALI approach is defective conceptually:

> The ALI override devolves an entity into an aggregate of its owners, in effect replacing the entity-respecting derivative claim with something approaching an action for an accounting in a partnership. As explained by the ALI, the concept of a corporate injury that is distinct from any injury to the shareholders approaches the fictional in the case of a firm with only a handful of shareholders.
>
> The problem with this approach is that it does not adequately understand (let alone take into account) the consequences of shifting from the entity construct to the aggregate. The ALI assumed that the procedural consequences of the direct-derivative distinction had no place in a close corporation, and was content to let the courts decide—without any additional guideposts—when to order the shift. But the procedural consequences of the distinction are not inevitably bulwarks for the oppressor. They may instead be an important part of the balance of power between majority and minority owners. In particular, those consequences help prevent a simple dispute over business judgment from becoming full-fledged litigation at the whim of a disgruntled holder of a minority interest. In this context, the notion that the entity might be a fiction caused the ALI to ignore the subtleties inherent in the aggregate.

Daniel S. Kleinberger, *The Closely Held Business Through the Entity-Aggregate Prism*, 40 WAKE FOREST L. REV. 827, 854–55 (2005) (quotations and footnotes omitted) [hereinafter Kleinberger, *Entity-Aggregate Prism*].

46. BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES, *supra* note 7, ¶ 7.02; *see also, e.g.*, ULLCA (2006/2013) § 407(c)(1) (stating as the default rule in a manager-managed limited liability company, "[e]xcept [for a few, limited exceptions] . . . expressly provided in this [act], any matter relating to the activities and affairs of the company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers").

47. C. N. V. Krishnan, Stephen Davidoff Solomon & Randall S. Thomas, *How Do Legal Standards Matter? An Empirical Study of Special Litigation Committees*, 60 J. CORP. FIN. 1 (2020).

48. Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981); The *Unfortunate Role*, *supra* note 2, at 390–91 (citing Krishnan et al., *supra* note 47).

49. Auerbach v. Bennett, 393 N.E.2d 994 (N.Y. 1979).

ULLCA (2006/2013) for following *Auerbach* rather than *Zapata* and for thereby derogating "easy access."[50]

Leaving aside for the moment serious limitations on and caveats to the research,[51] *Zapata* is the better rule only if we assume that plaintiffs should win. And *Empirical Study* supports *Zapata* over *Auerbach* only upon the same assumption. Academics have debated this point for years, particularly in reference to public corporations, but there is no statistical study available suggesting (let alone concluding) whether:

- in public corporations, strike suits (and the harm they cause) outnumber and outweigh legitimate derivative claims (and the value they provide), or vice versa; or
- in closely held businesses, plaintiffs claiming oppression are more often justified than unreasonably disgruntled, or vice versa.

In my experience, some plaintiffs should win, and others definitely should not.

3. *The Unfortunate Role* ignores a major, pro-plaintiff rule instituted by ULLCA (2006), in contradistinction from both ULLCA (1996) and UPA (1997).

UPA (1997) "cabined-in" fiduciary duty, and ULLCA (1996) dutifully followed suit. That is, both statutes purported to provide an exhaustive list of fiduciary duties, and the list excluded any duties owed by one owner (partner/member) to another owner. The exclusion is highly ironic for present purposes; recognizing owner-to-owner fiduciary duties was seminal as the law developed protections for minority owners in closely held corporations[52] and, more recently, in closely held LLCs.[53]

50. Professor Weidner's preference for "easy access" is consistent with his criticism of ULLCA (2006/2013) for abandoning two UPA (1997) rules which ULLCA (1996) did follow—a limited liability company must be either at will or for a term, ULLCA (1996), Prefatory Note (stating that "unless the articles reflect that a limited liability company is a term company and the duration of that term, the company will be an at-will company"); a dissociated member has a put right—even if the dissociation is wrongful. *Id.* § 701. Professor Weidner has an explanation for this dual abandonment. "In short, from the very beginning, the RULLCA drafters assumed a conception of the business entity that characterized the public corporation." *The Unfortunate* Role, *supra* note 2, at 413. Part IV.A.3 of this response refutes that characterization in detail. What in fact propelled the 2006 drafting committee to jettison the rules was (i) the conviction that the two rules had helped cripple efforts to enact ULLCA (1996); and (ii) the knowledge that the two rules were completely out of step with LLC statutes generally.

51. For a discussion of some of these failings, see *infra* Part IV.C.3.

52. *See, e.g.*, Donahue v. Rodd Electrotype Co. of N. Eng., Inc., 328 N.E.2d 505, 515 (Mass. 1975) ("Because of the fundamental resemblance of the close corporation to the partnership, the trust and confidence which are essential to this scale and manner of enterprise, and the inherent danger to minority interests in the close corporation, we hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.").

53. Daniel S. Kleinberger, *Minority Oppression and the LLC:* Manere v. Collins*, the Uniform Act, and Comment 701*, BUS. L. TODAY (Apr. 8, 2021), https://businesslawtoday.org/2021/04/minority-oppression-llc-manere-v-collins-uniform-act-comment-701/ [hereinafter Kleinberger, *Minority Oppression*].

The drafting committee to ULLCA (2006) saw cabining-in as imprudently restrictive on a member's legitimate claims of member-to-member abuse. As explained in the Prefatory Note:

> RUPA . . . pioneered the idea of codifying partners' fiduciary duties in order to protect the partnership agreement from judicial second-guessing. This approach—to "cabin in" (or corral) fiduciary duty—was followed in ULLCA and ULPA (2001). In contrast, the new Act recognizes that, at least in the realm of limited liability companies:
>
> - the "cabin in" approach creates more problems than it solves (e.g., by putting inordinate pressure on the concept of "good faith and fair dealing" [and thereby constraining member-to-member claims of misconduct]); and
> - . . . better way[s] [exist] to protect the operating agreement from judicial second-guessing . . . . Accordingly, the [ULLCA (2006)] codifies major fiduciary duties but does not purport to do so exhaustively.[54]

4. Despite repeatedly invoking the "easy access" mantra, *The Unfortunate Role* pays scant attention to ULLCA (2006/2013)'s primary recourse for LLC members claiming mistreatment—i.e., the oppression remedy.

The article does include a section captioned "RULLCA's Offsetting Cause of Action for Oppression," but the section is inaccurately dismissive and comprises only 313 words (exclusive of footnotes). The section begins with the following premise, which is inaccurate in two ways: "RULLCA gave LLCs additional corporate features to take advantage of liberalized tax classification rules [the check the box regulations][55] and facilitate lower estate tax valuations."[56]

The first part of the premise—the addition of "corporate features" after check-the-box—omits crucial context. ULLCA (2006) was no innovator here. The check-the-box regulations produced an avalanche of legislative changes across every jurisdiction in the country. Long before the ULLCA (2006) committee began its work, LLC statutes across the country:

- eliminated or greatly attenuated the connection between the dissociation as an LLC member and the dissolution of the LLC;
- established perpetual duration as the norm; and
- provided for single member LLCs.[57]

54. ULLCA (2006), Prefatory Note.

55. *See* Bishop & Kleinberger, Limited Liability Companies, *supra* note 7, ¶ 1.01[3] (describing the "[t]he [revolution in [t]ax [c]lassification [r]egulations) (alterations added).

56. *The Unfortunate Role*, *supra* note 2, at 412.

57. Bishop & Kleinberger, Limited Liability Companies, *supra* note 7, ¶ 1.01[3][e].

Taking any other approach would have ignored the ULC's central mission—"to promote uniformity in the law among the several States on subjects as to which uniformity is desirable and practicable"[58]—and would have precluded widespread, uniform enactment.[59]

The second part of the premise—that "corporate features" were added to "facilitate lower estate tax valuations"[60]—is simply wrong. Nowhere in its statutory text or official comments does ULLCA (2006) refer even implicitly to estate valuations.[61] The ULC has in fact designed a uniform act to facilitate estate planning, but that act is not ULLCA (2006). That act is ULPA (2001):

> The [2001 Uniform Limited Partnership] Act has been drafted for a world in which limited liability partnerships and limited liability companies can meet many of the needs formerly met by limited partnerships. This Act therefore targets two types of enterprises that seem largely beyond the scope of LLPs and LLCs: (i) sophisticated, manager-entrenched commercial deals whose participants commit for the long term, and (ii) *estate planning arrangements (family limited partnerships)*.[62]

Beyond its flawed premise, the "Offsetting Cause of Action" section says very little.[63] The section does note that ULLCA (2006) "leaves it to the courts to decide when [the oppression remedy] will be available."[64] but does not consider in any depth how the oppression remedy is functioning in the context of limited liability companies.[65]

This omission is very significant. In the related realm of closely held corporations, the oppression remedy has become the principal litigation recourse for

58. UNIF. L. COMM'N CONST. art. 1, § 1.02.

59. ULLCA (1996) had serious enactment problems due to this point; *see supra* note 50 (stating why the 2006 drafting committee flatly rejected ULLCA (1996)'s approach on two major issues).

60. *The Unfortunate Role*, *supra* note 2, at 412.

61. ULLCA (2006), Section 504 is the act's only provision stating the rights of decedent's estate: "If a member dies, the deceased member's personal representative or other legal representative may exercise the rights of a transferee provided in Section 502(c), and for the purposes of settling the estate, the rights of a current member under Section 410." ULLCA (2006) § 504.

62. UNIF. LTD. P'SHIP ACT (2001), Prefatory Note [hereinafter ULPA (2001)] (emphasis added).

63. *The Unfortunate Role* seeks also to explain that ULLCA (2006) provided the oppression remedy because the 2006 act had opted for perpetual duration and eliminated the put right that ULLCA (1996) granted to dissociated members. *The Unfortunate Role*, *supra* note 2, at 412–13. The problem for this explanation is that it was ULLCA (1996) that inaugurated the oppression remedy and the 2006 act essentially copied the 1996 version. ULLCA (2006) § 701(a)(5), cmt. (stating that "ULLCA [(1996)] § 801(4)(v) contains a comparable provision, although that provision also gives standing to dissociated members"). The decision in 2006 to deny standing to dissociated members comported with the law of virtually every jurisdiction. The Delaware LLC statute was and is out of step, albeit tangentially, allowing a mere assignee to bring a derivative action. DEL. CODE ANN. tit. 6, § 18-1001 (2021) (stating that "[a] member or an assignee of a limited liability company interest may bring an action in the Court of Chancery in the right of a limited liability"). The Delaware Court of Chancery has gone even farther, recognizing that the assignee of a member, who "lack[s] standing to seek statutory dissolution under Section 18-802 [of the Delaware LLC statute,] . . . [n]everthless . . . has standing to seek dissolution in equity." *In re* Carlisle Etcetera LLC, 114 A.3d 592, 607 (Del. Ch. 2015).

64. ULLCA (2006).

65. A footnote in *The Unfortunate Role* does note the impact of the uniform act's official comments, as now showing up in the case law. *The Unfortunate Role*, *supra* note 2, at 413 n.227.

minority shareholders,[66] and LLC case law is following suit. "As with corporations, the overwhelming majority of limited liability companies are closely held. As a result, disputes about power abuses within closely-held businesses increasingly occur in the context of LLCs rather than corporations; and the terms 'oppression' and 'reasonable expectations' increasingly appear in cases involving limited liability companies."[67]

5. *The Unfortunate Role* pays no attention to the overarching practical threats inherent in installing a pro-litigation stance into a business entity statute—especially for an entity used most often to house a closely held business.

The threat is well known by litigators and transactional lawyers alike: litigation among members of a closely held business is distracting, expensive, and—depending on the finances of the business—potentially ruinous for all concerned.

In addition to auguring expense, "easy access" undermines business continuity, although Professor Weidner would apparently disagree. *The Unfortunate Role* praises "the policy choice that was made in UPA (1997) and in the 1966 Act, which was that modern business acts result in business entities that are legally and contractually stable enough to withstand internal litigation."[68] This author's experience is entirely contrary. Most often, a claim of oppression invokes a statute providing for not continuity but rather for dissolution, with a buy-out of the plaintiff as a less drastic alternative.[69] Internecine warfare rarely, if ever, results in renewed harmony.[70]

66. *See, e.g.*, Douglas K. Moll & Robert A. Ragazzo, Closely Held Corporations §§ 7.01[D][1][b][i], at 7-78 to 7-81 & n.192, 8.02[B][1], at 8-20 (2020).

67. Kleinberger, *Minority Oppression*, *supra* note 53; *see also* Glenn G. Morris & Wendell H. Holms, 8 La. Civ. L. Treatise, Bus. Orgs. § 34:2 (Supp. 2021) ("The drafting committee that prepared the LBCA [Louisiana Business Corporations Act] for legislative consideration considered the adoption of an A.L.I.-like direct-action rule for shareholders of closely-held corporations. The issue was considered briefly, and then delayed for further consideration until it was determined whether and what kind of oppression remedy would be recommended for shareholders of closely-held corporations. After the oppression remedy was approved, the committee decided against the recommendation of a direct-action provision." (footnote omitted)).

68. *The Unfortunate Role*, *supra* note 2, at 416. For why Professor Weidner's reliance on ULLCA (1996) is misplaced, see *supra* Part III.A.

69. *See, e.g.*, Moll et al., *supra* note 66, §§ 7.01[D][1][b][i], at 7-78 to 7-81 & n.192, 8.02[B][1], at 8-20; ULLCA (2006/2013) § 701(a)(5) (providing for dissolution as the remedy for oppression); ULLCA (2006/2013) § 701(b) (authorizing a court considering an oppression claim to "a remedy other than dissolution"); Minn. Stat. § 302A.751 (2021) (providing an alternative to liquidation); *cf.* N.Y. Bus. Corp. Law § 1118 (McKinney 2021) (providing an "early out" from oppression litigation by authorizing a non-plaintiff shareholder of the corporation to buy out the plaintiff's ownership interest); Tim O'Sullivan, *Resting in Pieces: Why Family Harmony Is a Frequent Casualty of Most Estate Plans*, J. Kan. B. Ass'n, Mar. 2020, at 20, 22 (referring to the "substantial risk of disagreements that will arise between active and non-active children . . . regarding business decisions if both classes succeed to the ownership of a closely held business enterprise" and the resulting "extremely high incidence of family disharmony, often leading to resentment, arguments, and not all that infrequently, costly litigation").

70. Am. Anglian Env't Techs., L.P. v. Env't Mgmt. Corp., 412 F.3d 956, 957, 962 (8th Cir. 2005) (enforcing "a buy/sell provision allowing either [member of a two-member limited liability company] to make an unconditional offer/acceptance at a price it chose—forcing the offeree to choose *either* to

Of course, disharmony is a justified product of actual oppression. The question is whether to tip the scales categorically to plaintiffs in the name of easy access.[71]

IV. Controverting *The Unfortunate Role*'s Four Principal Arguments

A. The Direct-Derivative Distinction

According to *The Unfortunate Role*, "RULLCA's implementation of the derivative model is . . . outdated and flawed,"[72] and, in its attack of the direct-derivative distinction, *The Unfortunate Role* asserts at least six different flaws. ULLCA (2006/2013)'s direct/derivative distinction:

- creates, without justification, a major barrier to member access to judicial remedies;
- precludes parties to a contract from having automatic standing to sue for breach of the contract;
- is inherently corporate and therefore does not belong in the realm of limited liability companies which—like partnerships—are unincorporated;
- occasions excess litigation;
- is not justified theoretically by the LLC being a legal person distinct from its owners; and
- reverses ULLCA (1996)'s wise decision to eschew the direct-derivative distinction.

The rest of this Part IV.A addresses these points in turn.

1. Easy Access

This part of *The Unfortunate Role*'s critique of the direct-derivative distinction is simply the assertion of one of the article's two overarching premises—i.e., the overarching importance of members having easy access to judicial remedies. Accordingly, Part III.B.2, which identifies multiple defects with the easy access premise, is "incorporated here by reference." In addition, as noted in Part III.B.5, eschewing the direct-derivative distinction in the name of easy access results

buy the offeror's entire interest, *or* to sell the offeree's entire interest" and noting that "[t]he buy/sell provision in the Operating Agreement is intended to achieve finality, expeditiousness, fairness and continuity").

71. In addition to the general concerns addressed here, numerous fact-specific practical problems result from "easy access." These problems are best understood in the context of the direct-derivative distinction and, accordingly, are addressed in *infra* Part IV.A.1.

72. *Unfortunate Role*, *supra* note 2, at 384.

in numerous, fact-specific practical problems.[73] The following examples illustrate some of these problems:

Example 1: One, LLC is a five-member limited liability company, with one member serving as manager. One of the other four members believes vehemently that the manager is taking the LLC "in the wrong direction," while the manager (of course) and the other three members support the manager's decisions. Under *The Unfortunate Role*'s "easy access" approach, the one dissatisfied member could allege breach of the duty of care and force the LLC into potentially expensive and protracted litigation. Absent the direct-derivative distinction, the dissatisfied member would have this power regardless of how small the member's interest might be.

Example 2: Two, LLC is a member-managed limited liability company with three members, with no express operating agreement.[74] The three members are in agreement that D. Merit ("Merit), one of Two's employees, has brought Two into ill repute through unethical and possibly illegal sales tactics. Two members want to terminate Merit's employment, "move on," and avoid negative publicity as much as possible. However, the third member, A. Gressive ("Gressive") wants also to sue Merit. Without the direct-derivative distinction, Gressive might well have the right to sue Merit directly.[75]

Example 3: Three, LLC is a two-member, manager-managed limited liability company. Alpha contributes 90 percent of the start-up capital and is the manager. Beta contributes 10 percent. To the greatest extent allowed by the law of Three's jurisdiction of formation, the operating agreement:

- grants Alpha full discretion in running the company; and
- exonerates and indemnifies Alpha for Alpha's conduct as manager except to the extent that Alpha does not act "in good faith."

Three has a fifteen-year term of existence, and neither Alpha nor Beta has any right to exit the company. However, Beta becomes disenchanted with Beta's investment in Three and seeks a way to force Alpha to buy Beta out (either directly or through the company). Alpha has done nothing to cause Beta any direct injury. However, due to a major drafting error, the operating agreement does

73. Tzolis v. Wolff, 884 N.E.2d 1005, 1007–08 (N.Y. 2008) (holding that derivative claims exist in the context of limited liability companies; stating that "to abolish [derivative suits] in the LLC context would . . . raise[] unanswered questions").

74. Under the commonly used definitions of *operating agreement*, "once an LLC comes into existence and has a member, the LLC necessarily has an operating agreement." ULLCA (2013) § 105, cmt.

75. Example 3 derives from *Giuliano v. Pastina*, 793 A.2d 1035, 1036 (R.I. 2002), *discussed in* Kleinberger, *Direct Versus Derivative*, *supra* note 28, at 71.

not define "good faith,"[76] which gives Beta an opening to claim some misconduct by Alpha.

> Without the direct-derivative distinction (under the "easy access" approach), Beta can become a significant nuisance, at minimum forcing Alpha to litigate at least through summary judgment. Depending on the value of Beta's interest, "easy access" may give Beta substantial bargaining power.[77]

As acknowledged in Part III.B.5, the direct-derivative distinction does not eliminate disharmony. Indeed, as the above Examples illustrate, the direct-derivative distinction (i) matters precisely when disharmony exists; and (ii) in those circumstances prevents a disgruntled member from weaponizing a claim that, even if valid, offers the member no recovery.[78] In some circumstances, the distinction prevents a disgruntled member from using an alleged injury to a fellow member to promote the disgruntled member's own, differing agenda ("intermeddling"). In other circumstances, the distinction prevents a disgruntled member from arrogating to itself the ability to delineate the best interests of the company ("arrogation").[79]

2. Precluding Contract Parties from Suing for Breach

The Unfortunate Role takes great issue with how the direct-derivative distinction channels claims for breach of the operating agreement. The direct harm requirement of ULLCA (2006/2013) Section 801 makes no exception for such claims.[80] An official comment distinguishes the operating agreement from an ordinary commercial contract for which "it is axiomatic that each party to [the] contract has standing to sue for breach of that contract."[81] Further, the

76. For the problems such an omission might cause, see Daniel S. Kleinberger, *Delineating the Implied Covenant and Providing for "Good Faith,"* Bus. L. Today (May 30, 2017), https://businesslawtoday.org/2017/05/delineating-the-implied-covenant-and-providing-for-good-faith/.

77. *Cf.* Peter J. Sluka, *Look Before You Leap: Buy-Sell Agreements Triggered by a Petition for Dissolution*, N.Y. Bus. Divorce (Dec. 20, 2021), https://www.nybusinessdivorce.com/2021/12/articles/compulsory-buyout-2/look-before-you-leap-buy-sell-agreements-triggered-by-a-petition-for-dissolution/ ("New York courts have long-enforced buy-sell agreements triggered by dissolution . . . [a]nd these provisions often make good business sense: they ensure that a corporation has a mechanism to prevent a shareholder from using the specter of a deadlock or oppression-based dissolution proceeding to compel a high buyout price.").

78. Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1038 (Del. 2004); *see* Kleinberger, *Direct Versus Derivative*, *supra* note 28, at 104 (stating that Tooley "adopted the direct harm approach . . . [,] went on to add a second prong . . . that is, whether the relief would properly go to the entity or directly to the owners, . . . [and] acknowledged that the second prong is logically implicit in the first" (footnotes omitted)).

79. Thus, when *The Unfortunate Role* rejects the notion that "procedural obstacles of derivative litigation will reduce or minimize internal disharmony," *The Unfortunate Role*, *supra* note 2, at 416, the article aims at the wrong target.

80. ULLCA (2006/2013) § 801(b) ("A member maintaining a direct action under this section must plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company.").

81. ULLCA (2006/2013) § 801, cmt.

comment asserts that the direct harm requirement protects the operating agreement.[82]

The Unfortunate Role criticizes the official comment for not stating how or why an operating agreement differs from an ordinary commercial contract for standing purposes. Further, the article asserts that, "[i]t is unclear how an agreement is 'protected' by raising procedural barriers to its enforcement."[83]

The official comment's rationale is at best implicit,[84] and *The Unfortunate Role* could fairly argue that the two points quoted above are merely bald conclusions. However, the comment's deficiency does not impair the rule, which rests on both (i) significant practical concerns; and (ii) the conceptual distinction between an ordinary commercial contract and what the Delaware Supreme Court has termed "the constitutive contract" of an unincorporated business organization.[85]

The Examples above illustrate the mischief that can arise if, given a claim for breach of the operating agreement, party status replaces the direct harm requirement. On the conceptual point, the Delaware Supreme Court has stated categorically that "the source of the duty owed—the entity's constitutive agreement [e.g., a limited partnership agreement, an operating agreement]—does not alone answer the question as to whether [a] . . . claim [is] derivative, direct, or both."[86]

That statement appears in *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, a case involving alleged breaches of limited partnership agreements.[87] In determining claims to be direct, the Court of Chancery had relied on *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.*[88] in which the Delaware Supreme Court held that an contract promisee's claim for breach of contract was direct, even though the promisee's harm derived from harm to a third-party beneficiary.[89] The Chancery Court has seen *NAF Holdings* as limiting the scope of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*,[90] Delaware's seminal case announcing the "direct harm" rule.

82. *See id.* ("The distinction between direct and derivative claims protects the operating agreement. If any member can sue directly over any management issue, the mere threat of suit can interfere with the members' agreed-upon arrangements.").

83. *The Unfortunate Role*, *supra* note 2, at 416.

84. It appears that the comment presupposes that the "ordinary commercial contract" has only two parties. In such circumstances, one party's breach perforce harms the other party and thus, axiomatically, the other party has standing. However, when a contract has three or more parties, standing is not automatic for each party, regardless of whether the contract is an operating or partnership agreement. For a discussion of this and other problematic issues in operating agreements among three or more members, see BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES, *supra* note 7, ¶ 5.06[3][f][i][B].

85. El Paso Pipeline GP Co. v. Brinckerhoff, 152 A.3d 1248, 1259 (Del. 2016).

86. *Id.*

87. *Id.*

88. 118 A.3d 175 (Del. 2015).

89. *Id.* at 176. The court provided the following summary of its holding: "[A] party to a commercial contract who sues to enforce its contractual rights can bring a direct contract action under Delaware law. Although the relationship of that party to the third-party beneficiary might well have relevance in determining whether the contract claim is viable as a matter of contract law, nothing in Delaware law requires the promisee-plaintiff's contract claim to be prosecuted as a derivative action." *Id.*

90. 845 A.2d 1031 (Del. 2004).

In reversing the Chancery Court, the Delaware Supreme Court rejected the Chancery Court's reliance on *NAF Holdings* and explained:

> *NAF Holdings* does not support the proposition that any claim sounding in contract is direct by default, irrespective of *Tooley*. Nor does it mean that [a person]'s status as a limited partner and party to the LPA enable him to litigate directly every claim arising from the LPA. Such a rule would essentially abrogate *Tooley* with respect to alternative entities merely because they are creatures of contract. Limited partnerships are governed by their partnership agreements and by the Delaware Revised Uniform Limited Partnership Act (the "DRULPA"). The partnership agreement sets forth the rights and duties owed by the partners. The trial court treated the governing instrument of the Partnership as if it were a separate commercial contract, rather than it being the constitutive contract of the Partnership under the DRULPA itself. The reality that limited partnership agreements often govern the territory that in corporate law is covered by equitable principles of fiduciary duties does not make all provisions of a limited partnership agreement enforceable by a direct claim.[91]

The Delaware Supreme Court decided *El Paso* in 2016—ten years after the promulgation of ULLCA (2006) and fifteen years after the ULPA (2001) originated the "axiomatic" statement. Had this sequence occurred in reverse, the ULC's official comment would likely have invoked *El Paso*.

3. Inherently Corporate

The ULLCA (2006) drafting process featured recurrent debates about "corpufuscation," a word coined to "reflect[] the disdain expressed by some leading partnership law practitioners for what they see as the creeping corporatization of the limited liability company."[92] To such practitioners:

> the limited liability company is essentially and fundamentally an *unincorporated organization*, i.e., like a partnership and therefore *not* like a corporation. [Such practitioners] "view the LLC entity mostly as a necessary evil for maintaining the liability shield," and perhaps also for obtaining perpetual duration. Adding other "corporate like" characteristics smacks of heresy or at least of "conceptual miscegenation."[93]

The Unfortunate Role frequently raises concerns that fit the corpufuscation label, especially with regard to the "easy access" issue and the direct-derivative distinction. For example, in one of its numerous laments that LLC law has become increasingly corporate, the article states: "Nowhere has the shift to the corporate

91. *El Paso Pipeline*, 152 A.3d at 1259–60 (footnotes omitted); *see also* Kleinberger, *Direct Versus Derivative*, *supra* note 28, at 117 ("Case law involving limited partnerships expresses the correct approach for relating the direct/derivative distinction to contracts comprising organic rules. The approach is simple and should apply as well to LLCs: an agreement among an entity's owners as to the structure, manner or conduct of entity governance does not eliminate the direct/derivative issue.").

92. DANIEL S. KLEINBERGER, AGENCY, PARTNERSHIPS, AND LLCS 654–55 (5th ed. 2017). The author began using this neologism during the ULLCA (2006) drafting process, as a play on the title of a then popular television series, Californication.

93. *Id.* at 654 (quoting Kleinberger, *Entity-Aggregate Prism*, *supra* note 45, at 872 (footnotes omitted)).

model been more dramatic, or more unfortunate, than in access to judicial remedies."[94] The principal villain in this unfortunate drama is the direct-derivative distinction.[95] Worse, the direct-derivative distinction is not merely corporate in nature but rather *uber* corporate. That is: the derivative action is a "creature[] of *public* corporation law with roots that can be traced back to the nineteenth century."[96]

Unfortunately for *The Unfortunate Role*, history does not support this argument. For one thing, the assertion ignores the fact that the direct-derivative distinction has been part of the law of uniform limited partnerships since 1976.[97] In the New York limited partnership statute, the distinction dates back to 1968.[98]

As to the corporate realm, the rise of public corporations may have influenced derivative claim jurisprudence after the 1930s,[99] but the direct-derivative distinction entered U.S. corporate law through an 1832 decision. The case involved a joint stock company and (ironically for present purposes) the decision characterized such corporations as "mere partnerships, except in form."[100]

Even when the public corporation began to dominate the U.S. economy, derivative claims were at least as likely outside the public corporation world as within it. For example:

> A 1944 study of shareholder derivative litigation commissioned by business leaders in New York . . . examined 1,266 lawsuits filed by shareholders in two New York counties and one federal district court in New York from 1932 to 1942 . . . [and found that] . . . 693 of the cases involved closely held corporations.[101]

94. *The Unfortunate Role*, *supra* note 2, at 381. The late Professor Larry Ribstein opined similarly, criticizing ULLCA (2006) for, *inter alia*, "not only preserv[ing] the corporate-type derivative remedy, but [also] march[ing] briskly in the direction of further 'corporatizing' it by providing in section 905 for a special litigation committee." Larry E. Ribstein, *An Analysis of the Revised Uniform Limited Liability Company Act*, 3 VA. L. & BUS. REV. 35, 78 (2008). The facts and analyses adduced here in response to Professor Weidner apply as well to Professor Ribstein.

95. *See infra* Part IV.A (explaining how *The Unfortunate Role*'s most fundamental complaint is with the direct-derivative distinction).

96. *Unfortunate Role*, *supra* note 2, at 381 (emphasis added).

97. ULPA (1976/1985), Article 10. Comments to each section indicate that the provision was part of the 1976 act. *See id. See also* Bartfield v. Murphy, 578 F. Supp. 2d 638, 645 n.8 (S.D.N.Y. 2008) ("A shareholder's standing to bring a derivative action under New York law was first recognized in 1832. Similarly, the right of a limited partner to bring a derivative suit on behalf of the partnership was recognized under the common law before its enactment in a statute." (citations omitted)); Arndt v. First Interstate Bank of Utah, N.A., 991 P.2d 584, 588–89 (Utah 1999) (citing R.S. Ellsworth, Inc. v. AMFAC Fin. Corp., 652 P.2d 1114, 1116–17 (Haw. 1982) (discussing history of limited partnership derivative actions under the uniform acts)).

98. *See* N.Y. P'SHIP LAW § 115-a (McKinney 2021) (enacted in 1968).

99. Ann M. Scarlett, *Shareholder Derivative Litigation's Historical and Normative Foundations*, 61 BUFF. L. REV. 837, 904 (2013) (referring to the impact of "[s]cholarly writing on the issue of corporate purpose . . . during the 1930s and 1940s").

100. Robinson v. Smith, 3 Paige Ch. 222, 232 (N.Y. Ch. 1832); *see* Donna I. Dennis, *Contrivance and Collusion: The Corporate Origins of Shareholder Derivative Litigation in the United States*, 67 RUTGERS U. L. REV. 1479, 1481 (2015) ("Commentators have generally identified *Robinson v. Smith*, decided by the Chancery Court of New York in 1832, as the first case to clearly recognize a right by minority shareholders to pursue a derivative suit against miscreant corporate officers and directors.").

101. Scarlett, *supra* note 99, at 905 (referring to *The Wood Report*) (emphasis added).

The Unfortunate Role's corpufuscation argument fares even worse if one takes into account the law of closely held corporations. That law routinely recognizes the direct-derivative distinction.[102] Given the origins of close corporation doctrine, this recognition augurs poorly for the corpufuscation label. In the words of *Donahue v. Rodd Electrotype Co.*: "[T]he close corporation bears striking resemblance to a partnership. Commentators and courts have noted that the close corporation is often little more than an 'incorporated' or 'chartered' partnership."[103]

Put another way: "The stockholders [in a closely held corporation] clothe their partnership with the benefits peculiar to a corporation, limited liability, perpetuity and the like."[104] Or, as stated by Warren Burger, before he became Chief Justice of the United States: "[S]tockholders of a close corporation occupy a position similar to that of joint adventurers and partners . . . . Indeed, 'chartered partnership' or 'incorporated partnership' is a more descriptive and accurate designation of the relationship than 'close corporation.'"[105]

In sum, to criticize the direct-derivative distinction as excessively corporate is to be exceedingly wrong.

4. Excessive Litigation

According to *The Unfortunate Role*, "[O]ne of the most frequently litigated areas of LLC law is whether a member's claim is direct as opposed to derivative."[106] The article cites no authority for this bald proposition and gives no attention to whether litigation over the direct-derivative distinction may reflect the distinction functioning properly—i.e., to limit direct claims to situations in which the plaintiff member seeks a recovery that directly benefits the member.

The Unfortunate Role tries to use Florida jurisprudence as at least one example of the "excessive litigation" problem. The article directs the reader to *Dissatisfied Members in Florida LLCs: Remedies* ("*Dissatisfied Members*"), an earlier article by Professor Weidner, in which he describes the tribulations of making the distinction under Florida law.[107] *Dissatisfied Members* does indeed recount complexity and identifies *Dinuro Investments, LLC v. Camacho*[108] as Florida's leading case.[109] *Dinuro* in turns states that "[w]hether a particular action may be brought as a direct suit or must be maintained as a derivative suit can be a confusing inquiry."[110]

102. *See* Saunders v. Briner, 221 A.3d 1, 33, 37–39 (Conn. 2019) (Robinson, C.J., concurring in part and dissenting in part) (citing multiple cases where courts have maintained the direct-derivative distinction).

103. 328 N.E.2d 505, 512 (Mass. 1975).

104. *Id.* (internal quotations omitted).

105. Helms v. Duckworth, 249 F.2d 482, 486 & n.6 (D.C. Cir. 1957).

106. *The Unfortunate Role*, *supra* note 2, at 421.

107. *Id.* at 421 n.273 (citing Donald J. Weidner, *Dissatisfied Members in Florida LLCs: Remedies*, 18 Fla. St. Bus. Rev. 1 (2019) [hereinafter Weidner, *Dissatisfied Members*]).

108. 141 So. 3d 731 (Fla. Dist. Ct. App. 2014).

109. Weidner, *Dissatisfied Members*, *supra* note 107, at 7.

110. *Dinuro Invs.*, 141 So. 3d at 735.

However, *Dinuro* itself clarified Florida law, as the opinion "reconcile[s] nearly fifty years of apparently divergent case law."[111] The case's key holding has been cited twenty-seven times.[112] Thus, *The Unfortunate Role*'s sole example works against the article, even without taking into account the likely clarifying impact of ULLCA (2006/2013)'s bright-line rule.[113]

5. The Connection of the Direct-Derivative Distinction to Entity Status

The Unfortunate Role asserts that a business organization's status as an entity separate from its owners is irrelevant to the existence *vel non* of the direct-derivative distinction: "[T]he important question is what characteristics a particular entity should have as a matter of pragmatic policy, not what is logically compelled by abstract notion that the business is an entity."[114] Moreover, according to *The Unfortunate Role* "UPA (1997) [has] by statute declared partnerships as entities distinct from their partners," and UPA (1997) eschews the direct-derivative distinction.[115]

As *The Unfortunate Role* acknowledges, ULLCA itself does not assert the conceptual connection between entity status and the direct-derivative distinction. *The Unfortunate Role* correctly assigns that error to the author of this response:

111. *Id.* at 739.

112. Per a Westlaw search on December 12, 2021.

113. *Compare* Silver Crown Invs., LLC v. Team Real Est. Mgmt., LLC, 349 F. Supp. 3d 1316, 1326 (S.D. Fla. 2018) ("Although some portions of the Florida Revised Limited Liability Company Act had already been enacted, the *Dinuro* court did not address the Act."), *with* Diekan v. HyperDaptive, LLC, No. CV165006850S, 2018 WL 717196, at *3 (Conn. Super. Ct. Jan. 8, 2018) ("The act [Connecticut ULLCA] does not apply retroactively, and is not applicable to the present case because the events giving rise to this action arose prior to its effective date. The Act, however, provides insight into the way that Connecticut courts view derivative actions in the context of LLCs."). *See also* Saunders v. Briner, 221 A.3d 1, 40 (Conn. 2019) (Robinson, C.J., concurring in part and dissenting in part) ("Because the legislature is active in this area, given its recent passage of the comprehensive Connecticut Uniform Limited Liability Company Act, and because there are natural constituencies that are well situated to advocate for legislative action in this area, I believe it best to stay our hand rather than make a public policy judgment expanding standing in civil cases involving LLCs."). The Connecticut legislature in fact adopted its version of ULLCA (2006/2013) in 2016 and the act includes ULLCA (2006/2013) § 801 almost verbatim. CONN. GEN. STAT. ANN. § 34-271 (2021) (effective July 1, 2017). Cases from other jurisdictions likewise reflect the uniform act's clarifying effect. *See* United States v. Rogan, 639 F.3d 1106, 1109 (7th Cir. 2011) (stating that, under Georgia law, it appears that "direct actions are proper only with respect to an investor's own rights against the LLC or its other members" and citing ULLCA (2006) § 901 in support); Halley v. Barnabe, 24 P.3d 140, 146 (Kan. 2001) (holding the uniform act's provisions on derivate claims are procedural and therefore applicable retroactively).

114. *The Unfortunate Role*, *supra* note 2, at 415, 416. *But see, e.g.*, Brett Larson, *A Question of Identity Direct v. Derivative Claims in Shareholder/Member Litigation*, MESSERLI KRAMER (Feb. 19, 2014), https://messerlikramer.com/direct-derivative-claims-shareholder-litigation/ ("Courts understand that the direct/derivative distinction is rooted in the concept that the entity has an identity that is separate from the identity of its owners." (citing cases)).

115. Professor Weidner in candor acknowledges that UPA (1997)'s "adoption of the entity theory was qualified by recognizing the direct rights of partners." *Unfortunate Role*, *supra* note 2, at 414.

> The Official Comment declares that "a limited liability company is emphatically an entity, and the members lack the power to alter that characteristic." RULLCA Co-Reporter Daniel Kleinberger separately stated his belief that "the distinction between direct and derivative claims follows necessarily from the concept of a legal person being separate and distinct from its owners."[116]

It might be tempting to moot this dispute by quoting William Shakespeare's Juliet ("What's in a name?")[117] or Lewis Carroll's Humpty Dumpty ("Which is to the master—[us or the words]?").[118] However, having recently spent five years studying, debating, and delineating the concept of separate legal personhood,[119] I prefer to address this issue on the merits.

I begin with words from Justice Felix Frankfurter: "All our work . . . is a matter of semantics, because words are the tools with which we work, the material of which laws are made . . . . Everything depends on our understanding of them."[120] To reach a proper understanding of the connection between entity status and the direct-derivative distinction requires (i) placing the direct-derivative distinction within a broader contextual context; and (ii) controverting *The Unfortunate Role*'s use of UPA (1997) as evidence that entity status and the direct-derivative distinction are not connected.

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116. *Id.* at 60–61 (quoting ULLCA (2006) § 105(c)(2), cmt.; Daniel S. Kleinberger, *How Can I Be a Party to a Contract and Yet Lack Standing to Sue Another Party for Breach?*, Bus. L. Today, July 2018, at 1, 4.

117. William Shakespeare, Romeo and Juliet act 2, sc. 2.

118. Lewis Carroll, Through the Looking Glass 124 (1875) ("'When I use a word,' Humpty Dumpty said in rather a scornful tone, 'it means just what I choose it to mean—neither more nor less.' 'The question is,' said Alice, 'whether you can make words mean so many different things.' 'The question is,' said Humpty Dumpty, 'which is to be master—that's all.'").

119. From 2012 through 2017, the author served as the reporter for the Drafting Committee on Uniform Limited Liability Company Protected Series Act ("UPSA"). "The protected series . . . pushe[d] the conceptual envelope of entity law by providing for a quasi-distinct legal person existing *within* an overarching entity" with the former unable to exist except within the latter. Unif. Protected Series Act (Unif. Law Comm'n 2017), Prefatory Note [hereinafter UPSA]. And for historical reasons, the committee insisted on using "person" rather than "entity" as the term of art. *Id.* As an inevitable result, the drafting committee spent considerable time discussing and determining what makes a legal person separate from its members and other affiliates. For the determination pertinent to this article, see UPSA Section 103(a)(1), stating that "[a] protected series of a series limited liability company is a person distinct from[] the company, *subject to Sections 104(c), 501(1), and 502(d)*" (emphasis added). The comment to Section 103 explains the care the drafting committee took to make the act's construct of a legal person logically consistent with the rest of the act:

> Section 104(c) provides that a protected series cannot exist on its own; therefore, a protected series is not entirely distinct from the series limited liability company on whose existence the protected series depends. Section 501(1) reflects this reality by stating that the dissolution of a series limited liability company causes the dissolution of each of the company's protected series. Section 502(d) reflects this reality by providing that a series limited liability company has not completed its own winding up until the company has completed the winding up of each of the protected series of the company.

UPSA § 103, cmt.

120. James Cleith Phillips & Sara White, *The Meaning of the Three Emoluments Clauses in the U.S. Constitution: A Corpus Linguistic Analysis of American English from 1760–1799*, 59 S. Tex. L. Rev. 181, 181 n.1 (2017) (quoting Garson Kanin, *Conversations with Felix*, Reader's Digest, June 1964, at 116, 117 (replying to a question from counsel about whether the bench was just a matter of semantics)).

As to the broader context, the direct-derivative distinction is not the only legal construct resulting from a limited liability company's existence as an entity separate from its members. To the contrary, there are myriad consequences:

> [A limited liability company's] separate legal status has numerous consequences. It "allows [LLCs] to shield their members from personal liability," can render irrelevant a person's misrepresentation of the identity of an LLC's members, and can serve as a vehicle for economic integration, and thereby avoid the "combination in restraint of trade" strictures of the Sherman Antitrust Act. The entity characteristic "prevents an LLC from binding its members or subjecting them to liability or obligations through contracts between the LLC and third parties," precludes an LLC and its members from filing a joint petition in bankruptcy, and means that a payment made personally to an LLC member does not discharge the payor's obligation to the LLC unless the member had the power to bind the LLC.
>
> The entity characteristic also means that even a one-member LLC must collect and pay sales taxes on retail sales, that payments made by a single-member LLC to the [Internal Revenue] Service on behalf of the LLC's sole member are recoverable by the estate of the LLC in a bankruptcy proceeding, and that a taxing authority may not aggregate the value of personal property owned by several LLCs even though each LLC was owned by the same individual. Likewise, "[f]or the purposes of unjust enrichment, the owners of a limited liability company do not receive a benefit when a third party pledges collateral to secure a debt. incurred by the company. In such cases, the benefit flows to the limited liability company itself, not to the owners of the company."[121]

The above quoted examples are not exhaustive. The same source identifies numerous areas of law in which separate entity status produces specific legal consequences.[122]

With regard to UPA (1997)'s "separate entity" declaration, "[s]aying so don't make it so."[123] UPA (1997) retains several constructs that are classic aggregate characteristics and, as such, are antithetical to separate entity status.[124]

The United States Treasury's once famous "Kintner Regulations" provide a good frame of reference to discussing this point. From 1960 through 1997, the Kintner Regulations "enshrined the aggregate aspects of partnership law as part of the regulatory method for determining whether unincorporated business

121. Bishop & Kleinberger, Limited Liability Companies, *supra* note 7, ¶ 5.05[1][e][i] (footnotes omitted).

122. *Id.*

123. Mark Twain, Tom Sawyer 17 (Bernhard Tauchnitz, 1876) ("*Your* saying so don't make it so.") (Tom speaking).

124. In the words of Professor Weidner: "RUPA contains a number of changes that move the law of partnership *closer* to an entity theory." Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 Bus. Law. 427, 429 (1991) (emphasis added); *see also id.* at 433 ("Not only must partners be concerned about the effect of their conduct on the partnership as an entity, but also they must avoid oppressive behavior toward individual partners. *It is true that this result can be reached under an entity theory, but it may be more readily understood if it is stated also in aggregate terms*." (emphasis added)).

organizations were to be taxed as partnerships or corporations."[125] The regulations identified four classic characteristics of a corporation—limited liability, continuity of life, free transferability of ownership interests, and centralized management—and classified an organization as a partnership if the organization lacked two or more of the corporate characteristics.[126] A general partnership under UPA (1914) lacked all four corporate characteristics,[127] and in each instance the relevant UPA (1914) provision reflected the lack of separation between a partnership and its partners.

The following chart lists Kintner's four factors and applies them to both UPA (1914) and UPA (1997). For each factor, the chart: (i) identifies the corporate characteristic; (ii) identifies the opposite, partnership law characteristics as posited by Kintner; (iii) cites the UPA (1914) provision that served as the model for the Kintner Regulations; and (iv) states whether the characteristic persists in UPA (1997).

Corporate Characteristic	**Opposite, Partnership Characteristic**	**Relevant Provision of UPA (1914)** (owner and organization connected conceptually and legally)	**Parallel Provision of UPA (1997)**
unlimited liability	at least one owner must be automatically liable—i.e., merely by being an owner, for the organization's obligations	UPA § 15 every partner is liable for the partnership's obligations, solely on account of being a partner	UPA (1997) § 306(a) in a non-LLP general partnership, every partner is liable for the partnership's obligations, solely on account of being a partner (although first promulgated in 1992, the revised uniform general partnership act began providing for LLPs only in 1997)

Continued

125. Kleinberger, *Entity-Aggregate Prism*, *supra* note 45, at 834. In 1997, "check the box" replaced Kintner, as the Treasury Department gave up distinguishing corporations from partnerships except by name. BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES, *supra* note 7, ¶ 1.01[3][e].

126. *See* Classification of Certain Business Entities, 61 Fed. Reg. 66584, 66584 (1996) (stating that "[t]he existing regulations [i.e., *Kinter*] for classifying business organizations as associations (which are taxable as corporations . . . or as partnerships . . . are based on the historical differences under local law between partnerships and corporations"). *See also* BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES, *supra* note 7, ¶ 1.01[3].

127. The Treasury Department adopted the Kintner Regulations in 1960, United States v. Empey, 406 F.2d 157, 168 (10th Cir. 1969). At that time, UPA (1914) was the relevant uniform act.

Continued

Corporate Characteristic	**Opposite, Partnership Characteristic**	**Relevant Provision of UPA (1914)** (owner and organization connected conceptually and legally)	**Parallel Provision of UPA (1997)**
continuity of life	dissociation of an owner causes or at least threatens dissolution of the entity	UPA § 29 dissociation of any partner dissolves partnership, whether rightfully or wrongfully	UPA (1997) § 801(1)(2) connection diminished substantially from the UPA but still present (in a partnership at will and in limited circumstances in a partnership for a term or undertaking)
free transferability of ownership interest	owners lack the power to transfer the entire ownership interest without consent	UPA § 27 only economic rights transferable	UPA (1997) §§ 502, 503 revised UPA (1914) language but not the rule.
centralized management	owner merely by owner status has apparent authority to bind the organization to third parties	UPA § 9 statutory apparent authority for "the act of every partner, . . . for apparently carrying on in the usual way the business of the partnership"	UPA (1997) § 301 modernized UPA § 9 but retained the core concept of statutory apparent authority

Thus, as to each characteristic identified by the Kintner Regulations, UPA (1997) contains provisions problematic to the assertion that a UPA (1997) partnership is an entity separate from its partners. For two of the characteristics (no free transferability, statutory apparent authority), UPA (1997) retains the essence of the UPA (1914) rule. For the other two characteristics, UPA (1997) has diminished the inherent connection between partner and partnership but has not severed the connection entirely.

Therefore, if we follow Justice Frankfurter's view that words are tools of the law, we should accord little weight to UPA (1997)'s self-description. Instead, we should recognize that characterizing an entity or legal person as "separate from its owners" has myriad legal ramifications—including the distinction between direct and derivative claims.[128]

128. Melvin v. Harkey, No. G049674, 2018 WL 3617855, at *4 (Cal. Ct. App. July 30, 2018) ("Because a corporation has a separate legal existence from its shareholders, the shareholders have

6. ULLCA (1996) Got It Right When It Eschewed the Direct-Derivative Distinction.

As noted above, *The Unfortunate Role* praises ULLCA (1996) as following RUPA's "easy access" approach and faults the ULC for abandoning this wisdom only ten years later:

> [ULLCA (1996)] embodied a blend of features taken from partnership law and from corporate law. It included the partnership rule that members could sue one another or the firm at any time. Ten years later, RULLCA made LLCs more closely resemble corporations, and in particular imposed the machinery of derivative litigation on all LLCs as a default rule.[129]

However, as also noted above, *The Unfortunate Role* has simply misunderstood ULLCA (1996) on this issue.[130]

B. The Next Step into the Abyss—The Special Litigation Committee Simpliciter

The Unfortunate Role begins its attack on the SLCs by tying the SLC to ULC's calamitous recognition of the direct-derivative distinction.[131] "Once the ULC decided to impose the direct/derivative distinction from public corporate law, it seemed like a natural next step to provide the SLC as the default dispute resolution mechanism for resolving the derivative claims."[132] As shown above, the ULC first recognized the distinction in ULLCA (1996), not in the 2006 or 2013 version,[133] and ascribing the distinction to *public* corporation law is specious.[134] As explained

no direct cause of action or right of recovery against anyone who has harmed the corporation. Instead, the shareholders must bring a derivative action to enforce the corporation's rights and redress its injuries if the corporation's board of directors fails or refuses to do so. Limited liability companies similarly have a legal existence separate from their members, and therefore the principles governing shareholder derivative actions apply equally to actions brought by members on behalf of their limited liability companies." (citation omitted)); Baeyens v. Westside Nutrition, LLC, No. G049323, 2015 WL 872047, at *3 (Cal. Ct. App. Feb. 27, 2015) (stating that, because "limited liability companies [like corporations] have legal existences separate from their partners and members, and therefore the principles governing shareholder derivative actions apply equally to actions brought by . . . members on behalf of their . . . limited liability companies").

129. *The Unfortunate Role*, *supra* note 2, at 409.

130. *See supra* Part III.A.

131. Outside academia, a lawyer's view of the SLC (a splendid tool for ADR or an instrument of the devil) tends to depend on whether the lawyer is a transactional lawyer or a litigator). Kleinberger, *Direct Versus Derivative*, *supra* note 28, at 81. Consider for example, the remarks of attorney Daniel Dwyer, in a bar association periodical: "Derivative actions continue to be a viable method for addressing and litigating corporate governance disputes, i.e., attempts by members of collective enterprises such as corporations (closely-held or publicly-traded), limited liability companies ("LLCs") or limited partnerships to challenge the acts or omissions of management." Daniel P. Dwyer, *The Rights of Shareholders, Limited Partners and Non-Managing Limited Liability Company Members in Corporate Governance Disputes: Derivative Actions in Pennsylvania*, 84 Pa. Bar Ass'n Q. 47, 47 (2013). Not surprisingly, Mr. Dwyer does transactional and regulatory work. *Dan Dwyer*, LinkedIn, https://www.linkedin.com/in/dp1dwyer/ (last visited Dec. 16, 2021).

132. *The Unfortunate Role*, *supra* note 2, at 416.

133. *See supra* Part III.A.

134. *See supra* Part IV.A.3.

in Part II, the SLC reflects and results from basic governance principles applicable to any business entity that is delineated as a legal person separate from its owners.

Although *The Unfortunate Role* cites academic literature objecting to the SLC construct,[135] the article offers no serious alternative to the SLC.[136] Instead, the article makes two arguments related to SLC process: (i) what is the proper standard for a court to use in reviewing an SLC's determination and (ii) how should a court assess the independence and disinterestedness of the SLC members. The next two parts discuss these arguments in turn.

C. Worse Yet—The Wrong Standard of Review

1. *Auerbach*, *Zapata*, and the Asserted Superiority of Zapata

Regardless of jurisdiction or type of entity, the SLC process typically includes:

- the SLC's investigation into the allegations of the derivative complaint and other relevant facts;
- the SLC's determination of whether, in the best interests of the company, the derivative claims should proceed; and
- a report by the SLC to be submitted to the court in which the derivative litigation is pending:
  - stating the SLC's determination;
  - recounting the SLC's inquiry; and
  - explaining the reasoning that led to and supports the determination;
- the submitting of the report to the court and the plaintiffs; and
- review by the court of:
  - the report;
  - the composition of the SLC;
  - and the SLC 's conduct in inquiring into the matter and making the determination; and

135. *The Unfortunate Role*, *supra* note 2, at 421 n.273.

136. *The Unfortunate Role* does briefly contemplate arbitration, referring to arbitration as the most "analogous dispute resolution mechanism" and stating that "RULLCA does not offer plaintiffs the independent tribunal they would have in arbitration." *Id.* at 384. Leaving aside the substantial criticisms often made about arbitration in general, arbitration is a form of adjudication, not a process of business decision-making. Moreover, in contrast to an SLC determination, an arbiter's decision is essentially unreviewable. *The Unfortunate Role* also asserts that "arbitrators, like SLC members, must be 'independent and impartial.'" *Id.* at 432–33. This assertion overlooks the fact that, as a matter in the ordinary course, an SLC must prove its independence and disinterestedness, *see infra* Part IV.D, while a party claiming bias to invalidate an arbitral award must carry the burden of proof. *See* Woods v. Saturn Distrib. Corp., 78 F.3d 424, 427 (9th Cir. 1996) ("The party challenging the arbitration decision has the burden of showing partiality.").

- the court decision as to whether to accept the SLC's determination and, if the court rejects the determination, orders from the court delineating the future course of the litigation.

While these basic steps are well accepted, debate exists as to the standard of review a court should apply.[137] ULLCA (2006/2013) § 805(e) provides the following standard:

> The court shall determine whether the members of the committee were disinterested and independent and whether the committee conducted its investigation and made its recommendation in good faith, independently, and with reasonable care, with the committee having the burden of proof. If the court finds that the members of the committee were disinterested and independent and that the committee acted in good faith, independently, and with reasonable care, the court shall enforce the determination of the committee.[138]

An official comment links this standard to the seminal case of *Auerbach v. Bennett*[139] and states:

> The standard stated for judicial review of the SLC determination follows *Auerbach v. Bennett*, 393 N.E.2d 994 (N.Y. 1979) rather than *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), because the latter's reference to a court's business judgment has generally not been followed in other states. In essence, an SLC is intended to function as a surrogate decision-maker, allowing the limited liability company to make what is fundamentally a business decision. If a court determines that "the members of the committee were disinterested and independent and whether the committee conducted its investigation and made its recommendation in good faith, independently, and with reasonable care, with the committee having the burden of proof," it makes no sense to substitute the court's legal judgment for the business judgment of the SLC.[140]

The Unfortunate Role emphatically disagrees and spends substantial time asserting the superiority of the standard announced in *Zapata* over the standard established by *Auerbach*. Per *The Unfortunate Role*, *Zapata*'s superiority rests on four pillars:

i. Delaware case law, which accurately praises *Zapata*'s approach for its ability to root out abuse by insiders, including abuse apparently hidden even from (or by?) an SLC that has demonstrated the propriety of its composition, approach, and process:

137. Douglas M. Branson, *The Rule that Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 648 (2002) ("The SLC device is accepted everywhere courts have encountered it. Instead, the frontier is what sort of deference, and what sort of review, courts should give to SLC reports and recommendations. No less than five positions have been adumbrated.").

138. ULLCA (2006/2013) § 805(e).

139. 393 N.E.2d 994 (N.Y. 1979).

140. ULLCA (2006/2013) § 805, cmt. The comment's assertion that *Zapata*'s "reference to a court's business judgment has generally not been followed in other states," *id.*, is indirectly supported by *The Unfortunate Role*, which refers to *Zapata*'s "now-famous and oft-criticized two-step review of motions to dismiss in demand excused situations," *The Unfortunate Role*, *supra* note 2, at 395.

> [T]he Delaware case of *Zapata v. Maldonado* is the archetype of a stricter standard of review, which offers the possibility of closer scrutiny of the SLC if the claims concern the wrongdoing of insiders.[141]

> [Under *Zapata*,] even if the corporation meets its burden and "establishes that the committee was independent and showed reasonable bases for good faith findings and recommendations, the Court may proceed, in its discretion, to the next step [the exercise of the court's business judgment which] . . . provides . . . the *essential key* in striking the balance between legitimate corporate claims as expressed in a derivative stockholder suit and a corporation's best interests as expressed by an independent investigating committee.[142]

> [E]ven in the context of a publicly held corporation, [Zapata] applied the broader principle that equity may disregard something even if it is technically legal.[143]

ii. The law review law article, *Empirical Study*, analyzes case law outcomes and concludes that the *Zapata* standard is more favorable to plaintiffs than the *Auerbach* standard.[144] *The Unfortunate Role* devotes substantial attention to the study and its conclusion, pointing out that:

> A recent large empirical study found that . . . under the closer review of Delaware law [rather than the *Auerbach* standard], SLCs "are less likely to move to dismiss derivative suits and courts overall are less deferential to committee determinations and recommendations."[145]

iii. *Obeid v. Hogan*,[146] a 2016 decision by Vice Chancellor Laster, which *The Unfortunate Role* credits with providing a new, improved version of *Zapata*:

> *Obeid v. Hogan* gave a retrospective on *Zapata* and explained how it applies to the appointment and review of SLCs in LLCs with different structures.[147]

141. *Id.* at 383 (footnote omitted).

142. *Id.* at 396 (quoting Zapata v. Maldonado, 430 A.2d 779, 788–89 (Del. 1981)); *see also* Abella v. Universal Leaf Tobacco Co., 546 F. Supp. 795, 799 (E.D. Va. 1982) ("[T]he Court finds the reasoning in the Zapata opinion persuasive. The Delaware Supreme Court showed its sensitivity to the danger of giving minority shareholders the power to embroil the corporation in ill-founded litigation pursuant to the minority rule, as well as the danger of allowing the board of directors to appoint a few 'good ol' boys' as a special litigation committee and to be accordingly whitewashed pursuant to the majority rule."). Judge Robert R. Merhige wrote the *Abella* decision. Ironically, according to the website of the University of Richmond School of Law, Judge Merhige appears to have had no significant experience in business. "The Honorable Judge Robert R. Merhige, Jr. graduated from the University of Richmond School of Law in 1942 and went on to lead a distinguished career in the bar and on the bench." *About Judge Merhige*, U. RICH. SCH. L., https://law.richmond.edu/academics/centers/environmental/merhige.html (last visited Dec. 11, 2021).

143. *The Unfortunate Role*, *supra* note 2, at 397.

144. Krishnan et al., *supra* note 47.

145. *The Unfortunate Role*, *supra* note 2, at 422 (quoting Krishnan et al., *supra* note 47).

146. No. 11900-VCL, 2016 WL 3356851, at *6 (Del. Ch. June 10, 2016).

147. *The Unfortunate Role*, *supra* note 2, at 422. The *Unfortunate Role* also devotes substantial attention to *Oracle*, which I see no need to controvert. Nothing precludes a ULLCA (2006/2013) jurisdiction taking guidance from *Oracle*, although the official comments happen to cite a different case as

2. The Superior Analysis of Delaware Case Law?

For several reasons, Delaware case law provides little support for choosing *Zapata* over *Auerbach*. First, as *The Unfortunate Role* candidly acknowledges, *Zapata*'s second step has been "oft[]criticized."[148] For example, Vice Chancellor (later Chief Justice) Strine referred to *Zapata*'s second step as calling for the application of a court's "oxymoronic *judicial* 'business judgment.'"[149] "Oxymoronic" is apt, because "[o]ne of the key rationales underlying the business judgment rule is that it keeps courts from becoming enmeshed in complex [business] decision-making, a task which courts admittedly are ill-equipped, ill-fitted and neither trained nor competent to perform."[150] If, due to "the institutional incompetence of courts to pass upon the wisdom of business decisions,"[151] the business judgment rule applies in ordinary situations, what justifies *Zapata*'s second step when by hypothesis the court has already approved an SLC's composition, approach, and investigative process?[152]

Moreover, *Zapata* is a minority view;[153] if the Uniform Law Commission had taken the minority position on such an important issue, the decision would have been quite controversial within the ULC and most likely would have proved an obstacle to widespread enactment. In addition, adopting *Zapata* would have posed significant costs on lawyers throughout the country, except those already *aficionados* of Delaware's LLC/limited partnership jurisprudence.

That jurisprudence is notoriously unstable and requires continual study;[154] If ULLCA (2006/2013) had adopted *Zapata*, LLC practitioners in every enacting

an example. ULLCA (2006/2013) § 805(e), cmt. ("For an extensive discussion of how a court should approach the question of independence, see *Einhorn v. Culea*, 612 N.W.2d 78, 91 (Wis. 2000).).

148. *The Unfortunate Role*, *supra* note 2, at 395.

149. *In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 928 (Del. Ch. 2003) (emphasis added) (footnote omitted); *cf.* Abella v. Universal Leaf Tobacco Co., 546 F. Supp. 795, 799 (E.D. Va. 1982) (stating that "the Court recognizes the limitations of its own expertise in applying its business judgment to the decision as to dismissal," but adopting the *Zapata* approach nonetheless).

150. Freedman v. Adams, No. 4199-VCN, 2012 WL 1345638, at *12 n.117 (Del. Ch. Mar. 30, 2012) (quoting 1 STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE 35 (6th ed. 2009) (internal quotations and citations omitted)).

151. Freedman v. Rest. Assocs. Indus., Inc., Civ. A. 9212, 1987 WL 14323, at *8 (Del. Ch. Oct. 16, 1987).

152. *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 746 (Del. Ch. 2005) (explaining the rationale for the business judgment rule and stating that "courts are ill equipped to engage in post hoc substantive review of business decisions"), *aff'd*, 906 A.2d 27 (Del. 2006); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) (explaining that "[t]his deference—the business judgment rule—is, of course, . . . a recognition . . . of the limited institutional competence of courts to assess business decisions").

153. *See, e.g.*, *Abella*, 546 F. Supp. at 799 (criticizing the "majority rule" and adopting the Zapata approach); *cf.* Douglas M. Branson, *The Rule that Isn't a Rule—the Business Judgment Rule*, 36 VAL. U. L. REV. 631, 648 (2002) (stating that, as to "what sort of deference, and what sort of review, courts should give to SLC reports and recommendations[] [n]o less than five positions have been adumbrated").

154. *See* Daniel S. Kleinberger, *From the Uniform Law Commission: Don't Dabble in Delaware*, BUS. L. TODAY (July 7, 2017), https://www.americanbar.org/groups/business_law/publications/blt/2017/07/ulc/ ("Delaware case law has its disadvantages . . . . [K]eeping pace is almost a full-time job. As a court of equity, the Court of Chancery often ladens its decisions with voluminous statements of facts. Fifty-page decisions are not unusual, and some decisions can be understood only in the context

jurisdiction would have had to invest substantial time and effort to follow Delaware developments.

A prudent lawyer does not "dabble in Delaware."[155] For example, in 2002, in *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*,[156] the Delaware Supreme Court surprised and distressed Delaware's "unincorporated entity" bar by opining that, under the Delaware limited partnership statute, a partnership agreement could limit fiduciary duty but not eliminate it. Because the Delaware limited partnership and LLC statutes are reciprocally precedential,[157] the decision applied to operating agreements as well. Two years later, the Delaware legislature amended both the LLC and limited partnership statutes to overrule *Gotham*.[158]

Similarly, in 2012, Chief Justice Steele questioned whether those who govern limited partnerships and limited liability companies have any fiduciary duties at all.[159] The very next year, the Delaware legislature rejected the Chief Justice's approach.[160] In 2016, Vice Chancellor Laster decided *Obeid v. Hogan*,[161] a decision *The Unfortunate Role* praises and adduces in support of *Zapata's* superiority over *Auerbach*.[162] However, one year later, the Delaware legislature overturned *Obeid*.[163]

In 2021, in a matter "close to home"—i.e., *pertaining directly to the direct-derivative distinction*—the Delaware Supreme Court overturned 15 years of precedent, overruled *Gentile v. Rossette*,[164] and held that a shareholder's claim for economic and voting dilution is derivative rather than direct.[165] Also in 2021, in a matter almost as close to home, the Delaware Supreme Court "clarified" fifteen years of precedent and announced a new three-part standard for determining when a derivative plaintiff must make demand on the board before bringing suit and when demand is excused.[166]

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of previous decisions in the same case."). *See, e.g.*, Bandera Master Fund LP v. Boardwalk Pipeline Partners, LP, No. CV 2018-0372-JTL, 2021 WL 5267734, at *2–3 (Del. Ch. Nov. 12, 2021), *judgement entered*, 2021 WL 5756146 (Del. Ch. Dec. 2, 2021) (issuing a 194-page memorandum opinion following a four-day trial about a general partner's exercise of its call rights).

155. *Id.*

156. 817 A.2d 160 (Del. 2002).

157. BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES, *supra* note 7, ¶ 14.01[2] n.30 (citing Elf Atochem N. Am., Inc. v. Jafaris, 727 A.2d 286, 291 (Del. 1999)).

158. *Id.* ¶ 14.05.

159. Gatz Props., LLC v. Auriga Cap. Corp., 59 A.3d 1206, 1212–13 (Del. 2012).

160. 79 DEL. LAWS ch. 74, § 8 (2013). For a detailed analysis of *Auriga*, see BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES, *supra* note 7, ¶ 14.05[1][c].

161. No. CV 11900-VCL, 2016 WL 3356851, at *6 (Del. Ch. June 10, 2016).

162. *The Unfortunate Role*, *supra* note 2, at 422.

163. 81 DEL. LAWS ch. 89, § 11 (2017). *The Unfortunate Role* acknowledges this legislative response but argues that *Obeid*'s analysis nonetheless remains useful. *The Unfortunate Role*, *supra* note 2, at 422. I view the merits (or demerits) of the case quite differently. BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES, *supra* note 7, ¶ 5.06[3][f][iv]. However, whatever *Obeid*'s merit, I use the case here as yet another example of the shifting sands of Delaware LLC and limited partnership law.

164. 906 A.2d 91 (Del. 2006).

165. Brookfield Asset Mgmt., Inc. v. Rosson, 261 A.3d 1251, 1267–76 (Del. 2021).

166. United Food & Commercial Workers Union & Participating Food Ind. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1057–59 (Del. 2021).

In sum, far from supporting *Zapata* as the proper standard for a uniform act, Delaware case law does just the opposite.

3. How Relevant Is the Empirical Study?

The answer to this question is "very little, if any," because (i) those conclusions support *The Unfortunate Role*'s support of *Zapata* only if one assumes that outcomes should be pro plaintiff; and (ii) *The Unfortunate* Role ignores the type of data *Empirical Study* collects and analyzes.

Part III.B.2 discusses in detail the assumption/outcomes issue. As to the type of data, *The Unfortunate Role* acknowledges that "LLC law has developed primarily in the context of closely held firms rather than in the context of publicly held firms,"[167] but *Empirical Study* rests primarily on the public corporation data. As the authors of *Empirical Study* state:

> Our data collection begins with the corporate disclosure data from EDGAR filings with the [U.S. Securities and Exchange] Commission . . . . We searched the entire EDGAR database which includes all registered companies' federal securities law filings, such as their Form 10-K, Form 10-Q, Form 8-K, tender offer fillings, proxy statements, merger filings and a host of other required disclosure documents.[168]

In general, "[a]round 45% of the defendant firms are incorporated in Delaware, while roughly 75% of the firms are publicly traded firms; the remaining cases involve privately held corporations, LLCs and other alternative entities."[169] The data is thus skewed toward public corporations and Delaware cases.

In fact, some of the article's conclusions are based solely on public corporation data; others are based solely on Delaware data. For example, "[w]e compare SLC recommendations with case outcomes using all of the Delaware court cases in our sample because Delaware has an electronic filing system which enables us to see all of the case filings and outcomes."[170]

According a major role to Delaware-based data may have been inevitable, because, as noted above, *Zapata* is very much the minority rule. Outside of Delaware, state court decisions applying *Zapata* are probably rare. In any event, the Delaware-based data may be biased, for reasons the *Empirical Study* does not consider. Those reasons relate to the unusual nature of the Delaware Court of Chancery.[171]

Delaware's limited partnership and limited liability company statutes allocate all claims pertaining to internal affairs to that court.[172] As a result, unlike judges in other jurisdictions, the chancellor and vice chancellors deal almost daily with

167. *The Unfortunate Role*, *supra* note 2, at 398.
168. Krishnan et al., *supra* note 47, at 9.
169. *Id.* at 10–11.
170. *Id.* at 15.
171. For a detailed and engaging account of the history of the court of chancery from its beginnings through 1992, see William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery*, Del. Cts. (1993), https://courts.delaware.gov/chancery/history.aspx.
172. Bishop & Kleinberger, Limited Liability Companies, *supra* note 7, ¶ 14.01[2].

complex issues of entity law. In fact, appointees to the court are selected in part with reference to expertise in entity law, and the court's reputation is a major reason for establishing a limited liability company or limited partnership under Delaware law.[173] The Delaware Supreme Court has the same reputation; many of its justices were formally on the bench in the Court of Chancery.[174]

In addition to their respective and collective expertise, the chancellor and vice chancellors have a penchant for delving in detail and at length into complex issues of entity law. Moreover, the court often takes an activist approach toward such issues.[175] Few state court judges outside Delaware have either comparable expertise or penchant for activism. Thus, it is quite possible that some of the pro-plaintiff tilt in Delaware cases applying *Zapata* results from the distinctive qualifications and attitudes of the Court of Chancery rather than any superiority of *Zapata* on the merits.

Finally, although, as *The Unfortunate Role* acknowledges, the typical limited liability company is a closely held business, *Empirical Study* has nothing to say about closely held businesses. Neither "close corporation" nor "closely held corporation" appears anywhere in the article.[176]

The article's silence is understandable, given the study's reliance on public corporation and Delaware–sourced data. Obviously, one cannot extrapolate public corporation conclusions to the close corporation context. As for Delaware, with regard to closely held corporations, the state's jurisdiction is almost unique. Delaware has no case law recognizing the closely held corporation as a distinct type of entity to which apply special rules pertaining to fiduciary duty.[177]

173. *Id.* The same is true for corporate formation.

174. For example, from 2004 to the present, two of four of the Delaware Supreme Court's chief justices had previously served in the Court of Chancery: Myron T. Steele from 2004–2014 and Leo E. Strine, Jr., from 2014–2019. *Historical List of Delaware Supreme Court Justices*, DEL. CTS., https://courts.delaware.gov/supreme/history/justicespast.aspx (last visited Dec. 17, 2021).

175. Obeid v. Hogan, No. CV 11900-VCL, 2016 WL 3356851, at *6 (Del. Ch. June 10, 2016), is a good example, as is the complex evolution of Delaware's approach to the implied covenant of good faith and fair dealing in the context of entity law. *See* Daniel S. Kleinberger, *From the Uniform Law Commission: In the World of Alternative Entities What Does 'Good Faith' Mean?*, BUS. L. TODAY (Mar. 2017), https://www.americanbar.org/groups/business_law/publications/blt/2017/03/ulc/.

176. *See* Krishnan et al., *supra* note 47. As to the latter phrase, the search sought both the hyphenated and unhyphenated spellings. The phrase "limited liability company" also does not appear. *See id.* The abbreviation "LLCs" does appear once but without any connection to the concept of closely held businesses. *See id.* at 10.

177. Nixon v. Blackwell, 626 A.2d 1366, 1380–81 (Del. 1993) ("One cannot read into the situation presented in the case at bar any special relief for the minority stockholders in this closely-held, but not statutory 'close corporation' because the provisions of Subchapter XIV relating to close corporations and other statutory schemes preempt the field in their respective areas. It would run counter to the spirit of the doctrine of independent legal significance."). *See generally* Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1767 (2004) ("To summarize our findings, private company derivative litigation in Delaware plays little role in the governance of these firms. Close corporation investors have a very limited set of litigation options in Delaware compared to that available elsewhere. Few suits are filed, and relief appears to be obtained in less than half of the cases. While this may reflect a superior private ordering system that makes litigation unnecessary to the resolution of internal corporate disputes, it could also demonstrate such incredible weakness of minority shareholder rights in Delaware that such suits simply are not filed.").

For all these reasons, *Empirical Study* provides no support for *The Unfortunate Role's* claims for *Zapata* superiority.

4. Does *Obeid v. Hogan* Buttress the Claim of Zapata Superiority?

Obeid v. Hogan involved SLCs in the context of limited liability companies,[178] and *The Unfortunate Role* praises the case for refining *Zapata*—even though the Delaware legislature quickly repudiated *Obeid*. Moreover, *Obeid* imposes a corporate requirement on a limited liability company, hardly a pleasing result for an article that repeatedly laments the reliance of ULLCA (2006/2013) on corporate constructs.

Obeid is also objectionable for imposing a judicial preconception on an entity that is "as much a creature of contract as of statute."[179] In an exercise of judicial overreaching, the case asserts an entity resemblance test for interpreting operating agreements. The overreaching can be best understood through a comparison of the *Obeid* rule with the contractual notion of usage of trade:

> Determining the meaning of disputed language is typically a matter of fact—initially by the court to determine whether the language is susceptible to more than one reasonable interpretation, and, if so, by the finder of fact under the objective standard. The latter factual inquiry focuses on the reasonable expectations of the parties, and may include references to generally applicable facts—for example (and notably for present purposes) a usage of trade . . . .
>
> [W]hile a factual inquiry into a usage of trade is an inquiry into whether there exists "a usage having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to a particular agreement," *Obeid* imposes upon all drafters of all operating agreements the *court's invariable expectation* about what drafters mean when they create an entity resemblance.[180]

In short, as an exercise in judicial overreaching, with its holdings promptly reversed by the legislature, *Obeid* offers little comfort to the claim of *Zapata* superiority.

D. Worse Yet—The Inadequacy of ULLCA (2006/2013)'s Approach to the Composition and Appointment of an SLC

The Unfortunate Role levels two attacks on ULLCA (2006/2013)'s approach to the composition and appointment of the SLC.[181] One concerns the concepts of

178. *Obeid*, 2016 WL 3356851, at *1.

179. ULLCA (2006/2013) § 105, cmt. (citing Travel Ctrs. of Am., LLC v. Brog, Civ. A. No. 3516-CC, 2008 WL 1746987, at *1 (Del. Ch. Apr. 3, 2008); Gottsacker v. Monnier, 697 N.W.2d 436, 440 (Wis. 2005)).

180. Bishop & Kleinberger, Limited Liability Companies, *supra* note 7, ¶ 5.06[3][f][iv][B] (quoting Restatement (Second) of Contracts § 222(1) (Am. L. Inst. 1981) (emphasis added)). For a detailed analysis of *Obeid*, see *id.* ¶ 5.06[3][f][iv].

181. *The Unfortunate Role*, *supra* note 2, at 432. *The Unfortunate Role* fails to cite any case reaching an objectionable result, under the ULLCA (2006/2013) standard—even though the ULC adopted that standard fifteen years ago. On December 17, 2021, a Westlaw search for "special litigation

independence and disinterestedness. The other concerns the rule for appointing an SLC when all individuals at the topmost level of governance are conflicted out (i.e., named as defendants).

Although *The Unfortunate Role* recognizes "the statutory requirement [under ULLCA (2006/2013)] that members of the SLC be 'disinterested and independent,'" the article warns that "as we have seen, the level of protection depends upon the jurisdiction."[182] The article then suggests that, by adopting *Auerbach* rather than *Zapata*, ULLCA (2006/2013) implies a lax approach to disinterestedness and independence.

There is simply nothing in either Section 805 or its comments to support this suggested conflation. To the contrary, the comment to Section 805(e) recommends *Einhorn v. Culea*,[183] a decision by the Wisconsin Supreme Court "[f]or an extensive discussion of how a court should approach the question of independence."[184] *Einhorn*, stating that "[i]t is vital for a circuit court to review whether each member of a special litigation committee is independent,"[185] provides a non-exhaustive list of seven factors to be considered in determining independence.[186] In addition, *Einhorn* rejects the trial court's holding that "the threshold . . . for determining whether the members of the committee were independent is 'extremely low,'"[187] reverses the trial court's determination that the SLC was independent, and remands the case for a "do over" under the proper, rigorous standard.[188]

The Unfortunate Role's second attack concerns how Section 805's rule for who has the power to appoint the SLC, especially when everyone at the LLC's topmost level of governance is named as a defendant.

committee" /100 "limited liability company" in all federal and state cases found only four cases, none of which contained any criticism of ULLCA (2006/2013) relevant to *The Unfortunate Role* or this response. *See, e.g.*, Taneja v. Saraiya, 290 So. 3d 602 (Fla. Dist. Ct. App. 2020); Young v. Bush, 277 P.3d 916 (Colo. App. 2012); LNYC Loft, LLC v. Hudson Opportunity Fund I, LLC 57 N.Y.S.3d 479 (App. Div. 2017); *Obeid*, 2016 WL 3356851.

182. *The Unfortunate Role*, *supra* note 2, at 418.

183. 612 N.W.2d 78, 91 (Wis. 2000).

184. UPA § 5-805 (citing *Einhorn*, 612 N.W.2d at 91).

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

186. *Id.* at 89–90.

187. *Id.* at 91; *see also* Boland v. Boland, 31 A.3d 529, 556 (Md. 2011) ("We disagree . . . that Auerbach's inquiry must necessarily be a 'rubber stamp' review. Although *Auerbach* held that an SLC's *substantive decisions* are presumed reasonable, it did not presume that the SLC was independent, acted in good faith, or followed reasonable procedures."); Hasan v. CleveTrust Realty Invs., 729 F.2d 372, 378 (6th Cir. 1984) (stating that "[w]hile [Auerbach and Zapata] diverge on the issue of the judicial deference appropriate to the substantive business judgments of a special committee, they are convergent in their approach to the issues of good faith and thoroughness").

188. *Einhorn*, 612 N.W.2d at 94. There is no dearth of such guidance. *See, e.g.*, Drilling v. Berman, 589 N.W.2d 503, 509–10 (Minn. Ct. App. 1999); Lewis on Behalf of Citizens Sav. Bank & Tr. Co. v. Boyd, 838 S.W.2d 215, 224 (Tenn. Ct. App. 1992) ("The court's review of the adequacy of the committee's investigation should examine (1) the length and scope of the investigation, (2) the committee's use of independent counsel or experts, (3) the corporation's or the defendants' involvement, if any, in the investigation, and (4) the adequacy and reliability of the information supplied to the committee.").

> Neither the text nor the Official Comment makes any mention of a requirement that those appointing the SLC be disinterested and independent. Indeed, they state the opposite by providing that, in certain situations likely to arise quite often, the SLC can be appointed by a majority of those named as defendants.[189]

As to the first point, Section 805(c) requires that, unless impossible, the persons appointing the SLC not be defendants in the derivative litigation.[190] A court can certainly consider the disinterestedness and independence of non-defendants who do the appointing, but such consideration is an indirect way of reaching the actual question at issue—i.e., the independence and disinterestedness of the SLC members.

As to the second point, Section 805(c) does provide that, when all the members in a member-managed LLC or all the managers in a manager-managed LLC are defendants, a majority of the defendants may appoint the SLC. *The Unfortunate Role* scoffs at this approach, suggesting instead appointment by the court. Iowa adopted that approach for corporations in 1983,[191] and Iowa's approach played a role during the ALI's contentious project on Principles of Corporate Governance.[192] However, in actual jurisprudence, Iowa has been pretty much a lone wolf.[193]

In effect, *The Unfortunate Role*:

- advocates a rule akin to "the fruit of the poisonous tree" doctrine,[194] but
- does not explain why conflicted decisionmakers should be irrefutably presumed incapable of appointing independent and disinterested surrogates, especially when the conflicted decisionmakers know that

189. *The Unfortunate Role*, *supra* note 2, at 418.

190. ULLCA (2006/2013) § 805(c).

191. Miller v. Reg. & Trib. Syndicate, Inc., 336 N.W.2d 709, 715–18 (Iowa 1983).

192. Rosengarten v. Buckley, 613 F. Supp. 1493, 1498–99 (D. Md. 1985).

193. *See* Peter Saparoff & Geri L. Haight, *Special Litigation Committees: Not Universally Effective Tools*, SE82 ALI-ABA 723, 725 n.2 ("Only one jurisdiction [Iowa] has refused to recognize the SLC procedure in a case where all directors were named as defendants in a derivative action."); James F. Hogg & Kyle R. Triggs, *Finessing Well-Plead Derivative Lawsuits: The Implications of the Minnesota Supreme Court's Selection of* Auerbach *over* Zapata, 36 Wm. Mitchell L. Rev. 70, 82–83 (2009) (recognizing that "directors can appoint an independent SLC even though that suit is based on a well-pleaded conflict of interest with respect to the board"); William J. Carney, *The ALI's Corporate Governance Project: The Death of Property Rights?*, 61 Geo. Wash. L. Rev. 898, 946 n.281(1993) (recognizing that "special litigation committees are selected by boards that are disqualified from controlling the derivative action by virtue of their own conflicts of interest" (citation omitted)); F. Hodge O'Neal & Robert B Thompson, O'Neal and Thompson's Oppression of Minority Shareholders and LLC Members § 7:7 (Supp. 2021) (recognizing "substantial room for a corporation with conflicted directors to name alternative decision-makers to whom a court will defer as to derivative litigation"); *see also* Lynn M. LoPucki, *Corporate Charter Competition*, 102 Minn. L. Rev. 2101, 2105 n.15 (2018) (recognizing that "if there are no independent directors, the conflicted directors can appoint some" to then appoint the SLC). In many jurisdictions, the corporate law requires this intermediate step, because only those appointing the SLC must be members of the board of directors.

194. *See* United States v. Hernandez, 670 F.3d 616, 620 (5th Cir. 2012) (referring to "the exclusionary rule prohibit[ing] the introduction at trial of all evidence that is derivative of an illegal search, or evidence known as the 'fruit of the poisonous tree'" (citing United States v. Singh, 261 F.3d 530, 535 (5th Cir. 2001))).

a court will closely scrutinize the appointees for independence and disinterestedness.[195]

V. Conclusion

As stated at the beginning of this article, Professor Weidner and I disagree on myriad issues. However, I have enjoyed the task of expressing and explaining my disagreement; the work re-immersed me into the breadth, depth, and details of a topic I have been studying and writing about for more than thirty years.

I hope this article brings clarity to the topic. In any event, I am grateful to Professor Weidner (and *The Business Lawyer*) for an experience that is distressingly rare these days—a substantial dispute about ideas, where the disputants can remain friends and maintain mutual respect.

195. *Auerbach* requires such scrutiny in all instances; arguably, perhaps, when the appointers are conflicted, a court's scrutiny should err on the side of excess.