SECURITY FOR EXPENSE STATUTES FOR LLCS AND LIMITED PARTNERSHIPS: ADDING VALUE OR SIMPLY ADDING TO THE OWNERS' HOPELESSNESS?

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I. INTRODUCTION

Shareholder derivative suits permit a shareholder to bring a lawsuit on behalf of the corporation, against a third party, when the corporation proves unwilling or unable to bring the claim on its own behalf.[1] The shareholder is merely a nominal plaintiff in the suit.[2] The third party sued is often a corporate insider.[3] Stockholders who do not also serve as directors or officers could be quite vulnerable without the mechanism of derivative litigation.[4] Their misbehaving managers are unlikely to authorize the corporation to file a lawsuit against themselves to enforce a corporate right or duty.[5] In such cases, in the absence of derivative litigation, these shareholders would be at the mercy of their managers, subject only to any state law fiduciary duties that might inspire these managers not to misbehave.[6] This derivative litigation process may be the only avenue of

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1. GARY LOCKWOOD, LAW OF CORPORATE OFFICERS & DIRECTORS: INDEMNIFICATION & INSURANCE § 1:4 (2d ed. 2020-21). According to Professor Matheson:

> The crux of the derivative suit is that a shareholder seeks to have the corporation enforce supposed rights or claims that the corporation has not yet asserted. . . . [T]he historical focus of the derivative suit has been an attempt by shareholders to hold the corporate board or officers accountable for perceived harm to the corporation caused by a violation of their fiduciary duties.

John Matheson, *Restoring the Promise of the Shareholder Derivative Suit*, 50 GA. L. REV. 327, 334 (2016). *See also* Daniel J. Dykstra, *The Revival of the Derivative Suit*, 116 U. PA. L. REV. 74, 78 (1967) (emphasizing the role of derivative litigation as a "needed policeman").

2. C. HUGH FRIEDMAN ET AL., CALIFORNIA PRACTICE GUIDE CORPORATIONS, Ch 6-G (2020).

3. *See* Miriam R. Albert, *Security For Expense Statute: Easing Shareholder Hopelessness?*, 24 FORDHAM J. CORP. & FIN. L. 33, 35 (2019) ("The quintessential derivative suit is one filed by a shareholder to force the corporation to sue a manager for fraud, which is admittedly an awkward and likely unpleasant endeavor. . . .").

4. *Id.* at 35. *See also* Larry E. Ribstein, *Litigating in LLCs*, 64 BUS. LAW. 739, 740 (2009) (describing the derivative suit remedy in the limited liability company context).

5. LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 13:3 (2020).

6. According to Professors Ribstein and Keatinge: "As such the derivative action serves an important policing function in providing a mechanism by which those charged with management and control of a venture may be called upon to demonstrate that they are in fact

relief available to those shareholders lacking concurrent management roles who allege neglect, malfeasance, or intentional misconduct on the part of their managers.[7]

Arguably, corporate shareholders are not the only group of owners who may need redress for perceived managerial neglect or malfeasance; members of limited liability companies (LLCs) and limited partners can be just as vulnerable as their shareholder brethren to managers who are not honoring their fiduciary duties.[8] In this context, the role of LLC members and limited partners is arguably comparable to that of a corporate shareholder who has no concurrent management role.[9] Without structural avenues for relief like

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discharging the obligations they have voluntarily undertaken." *Id.*

7. *See* Bryant G. Garth, Ilene H. Nagel & Sheldon J. Plager, *Empirical Research and the Shareholder Derivative Suit: Toward a Better-Informed Debate*, 48 LAW & CONTEMP. PROBS. 137 (1985) (describing the shareholder derivative suit as a check on corporate mismanagement).

> When control and investment are separated, as is so often the case in the modern business corporation, the accountability of management to the shareholders becomes a central concern. This concern is triggered by, but not limited to, the shareholders' narrow pecuniary interest: it implicates notions of mutuality of consent, of fair dealing, and of moral responsibility to those over whom or over whose interests one has power. In this context the responsibilities of the corporate manager are often cast in terms of fiduciary duties—duties which historically have arisen out of relationships of trust and confidence.

Id. at 138. Current corporate laws have not been effective in stopping this kind of director misconduct, so "stockholders, in face of gravest abuses, were singularly impotent in obtaining redress of abuses of trust." Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949). In these situations, shareholders are arguably in "need of legal [strategies] to protect them[selves] from abuses by [] management." Kenneth E. Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 927 (1983).

8. *See* Ribstein, *supra* note 4, at 747 (arguing that limited partners are more vulnerable to managerial misconduct than shareholders).

> Where ownership and control of an enterprise are vested in the same population, the need for a corrective mechanism like a derivative suit is greatly lessened because the owner/managers' self-interests will arguably guide managerial conduct. But where ownership and control are in separate hands, the incentives change and managerial conduct may not conform to the owners' views of the best course of action. This may lead to what the owners consider to be director misconduct.

Albert, *supra* note 3, at 36.

9. Some commentators oppose extending the derivative litigation mechanism to members of LLCs, arguing that the situation of LLC members differs from that of shareholders and limited partners because LLC members can, and often do take an active role in management of the entity.

> [T]he appropriateness of LLC derivative suits is debatable. LLC statutes are designed for closely held firms that do not involve the logistical problems the

the mechanism of derivative litigation, these owners could be left with only the options of exercising their potentially limited voting rights in an effort to effect change, or selling their ownership interests outright.[10]

The LLC is a hybrid form of business, combining features of corporations, general partnerships and to a lesser degree, limited partnerships.[11] LLCs provide investors with popular features of the corporate and general partnership structures, offering owners the limited liability of the corporate structure and the favorable, pass-through tax treatment of the general partnership.[12] The underlying forms of business that are blended into the LLC have some significant structural differences; thus, the hybrid entity emerges as a bit of a mixed bag, operating more like a corporation in some contexts and more like a general partnership in other contexts.[13] The LLC does not fit fully or comprehensively into the entirety of the existing doctrine from either the corporate or partnership form, but rather falls into some of each.[14] Limited partnerships are also a hybrid,

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> derivative remedy is intended to solve. It therefore makes little apparent sense to saddle closely held LLCs with the costs of derivative suits. Alternative remedies would serve the same basic functions at lower cost, at least in closely held firms.

Ribstein, *supra* note 4, at 741.

10. Limited partners' voting rights are typically not as extensive as their general partner counterparts' voting rights; to retain their limited partner status, they cannot manage the enterprise, and their voting rights are typically, for lack of a better term, limited. *See generally* Don Augustine, Peter M. Fass, Marshall N. Lester & James F. Robinson, *The Liability of Limited Partners Having Certain Statutory Rights Affecting the Basic Structure of the Partnership*, 31 BUS. LAW. 2087, 2088 (1976) (listing examples of voting rights a limited partner can exercise under state law).

11. The hybrid nature of this form of business is supported by the background comments to the Uniform Limited Liability Company Act that noted the drafters "relied substantially" on the Revised Uniform Partnership Act for provisions governing member-managed LLCs; for provisions governing manager-managed LLCs, the drafters used an "amalgam" from the Revised Uniform Partnership Act and the Model Business Corporation Act. NAT'L CONFERENCE OF COMM'RS OF UNIF. STATE L., REVISED UNIFORM LIMITED LIABILITY ACT 1 (2006), https://users.wfu.edu/palmitar/ICBCorporations-Companion/Conexus/UniformActs/ULLCA2006.pdf [https://perma.cc/CZ63-EJD4].

12. Carol Goforth, *Too Many Cooks Spoil the Cake, and Too Many Statutes Spoil the LLC: A Plea for Uniformity*, 46 SW. L. REV. 63, 67 (2016).

13. "The LLC is a hybrid form of business, combining features of both corporations and partnerships; that said, other than the corporate-like limited liability highlighted by its' very name, the LLC more closely resembles a partnership." Miriam R. Albert, *The New York LLC Act at Twenty: Is Piercing Still "Enveloped in the Midst of Metaphor?*, 31 TOURO L. REV. 411, 413 (2015); *see also* Daniel J. Morrissey, *Piercing All the Veils: Applying an Established Doctrine to a New Business Order*, 32 J. CORP. L. 529, 552 (2007) (describing the structure of the LLC).

14. For example, some LLCs fall within the definition of "security" for purposes of the federal securities laws, and some do not, depending on whether the owners have an expectation of profits predominantly from the efforts of others. *See* Miriam R. Albert, *The*

bridging between corporations and general partnerships, albeit with different roles, rights and liabilities for the general partner and for the limited partner.[15] The hybrid nature of the LLCs and limited partnership structures can raise challenging issues when considering derivative litigation: are these entities acting more like corporations or partnerships?

Every state authorizes shareholder derivative litigation, and the vast majority extend this remedy to LLCs and limited partnerships.[16] As the availability and incidence of derivative litigation has expanded over time, a number of procedural hurdles have evolved in an effort to limit nuisance or strike suits.[17] The theory is that these strike suits are brought by small shareholders, and the need to post a bond may deter these shareholders from bringing these suits.[18] As part of this effort, some states have enacted "security for expense" provisions, requiring owners to post a bond to cover the defendants' expenses before they can proceed with their suit.[19] A few states have also enacted such provisions for derivative suit by LLC members

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Howey Test Turns 64: Are the Courts Grading This Test on a Curve?, 2 WM. & MARY BUS. L. REV. 1, 19 (2011) (discussing the fourth prong of the *Howey* test which requires expectation of profits solely from the efforts of others).

> Determination of whether corporate doctrines apply, or whether corresponding (but different) doctrines in partnership law apply, is difficult because limited liability companies share some attributes of corporations and some attributes of partnerships. The problem is compounded because most states have neither codified nor, by statute, rejected these common law doctrines.

Steven C. Bahls, *Application of Corporate Common Law Doctrine to Limited Liability Companies*, 55 MONT. L. REV. 43, 45 (1994).

15. "Limited partnerships offered at least some owners protection against personal liability for enterprise-level debts, but they obtained that protection at the cost of any right to participate in management or control of the business." Goforth, *supra* note 12, at 77.

16. According to Professor Ribstein:

> The derivative remedy has been applied to limited partnerships but not to general partnerships. What about LLCs, which share features of both types of firms? So far the legislative debate seems to have been settled in favor of extension to this context. The derivative remedy has now found its way to approximately three-fourths of the LLC statutes with little discussion either in legislatures or academia as to whether the remedy is appropriate in this context. The inclusion of the derivative remedy in the recently promulgated Revised Uniform Limited Liability Company Act suggests that the derivative remedy may continue to be a staple of LLC statutes.

Ribstein, *supra* note 4, at 740.

17. *Security For Expenses Legislation—Summary, Analysis, and Critique*, 52 COLUM. L. REV. 267, 267–68 (1952) [hereinafter *Security for Expenses Legislation Summary*].

18. *Id*. at 269.

19. For a full discussion of these corporate security for expense provisions, see Albert, *supra* note 3.

and/or limited partners.[20]

In the context of whether and how to bring a derivative suit, the challenges facing shareholders, LLC members, and limited partners can be quite similar, yet the states' treatment of who and how to post a bond before filing a derivative suits is uneven and inconsistent.[21] This Article focuses on security for expense provisions applicable to LLCs and limited partnerships, providing an analysis and evaluation of the rights of and requirements facing these owners who, like their shareholder brethren, seek to hold those who manage their entities accountable for managerial neglect or malfeasance through the mechanism of derivative litigation.[22] This Article identifies the inconsistencies in states' approaches to the rights of LLC owners and limited partners seeking to sue derivatively, specifically exploring whether such owners are required to post a bond as security for the litigation expenses, what effect this might have on the utility of derivative litigation generally, and whether the mechanism of security for expense provisions is adding value to the process writ large.

Part II provides necessary background on derivative suits generally, with attention given to the procedures required when such suits are brought by owners of LLCs and limited partnerships. Part III starts with a brief examination of the existing corporate security for expense statutes requiring bond posting by shareholders and then compares this corporate statutory landscape with the security for expense statutes applicable to LLC members and to limited partners. This Part also evaluates the limited case law flowing from the LLC and limited partnership security for expense statutes as part of a broader evaluation of the usefulness of the bond posting statute as an effective gatekeeper in derivative litigation across the three forms of business generally. Part IV provides recommendations aimed at creating owner empowerment for all "helpless" owners seeking redress against their managers, whether the business is a corporation, LLC, or limited partnership, without overwhelming the system with nuisance or strike suits.

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20. See *infra* Part III for a discussion of these states' security for expenses provisions.

21. Professor Ribstein drew a distinction between vulnerable shareholders and limited partners, and LLC members, who he argued could "be expected to take a greater role than limited partners in litigation decisions." Ribstein, *supra* note 4, at 747.

22. For a discussion of the various corporate security for expenses statutes, see Albert, *supra* note 3.

II. DERIVATIVE SUITS: HISTORICAL CONTEXT AND BACKGROUND

A. Background on Shareholder Derivative Suits: the Corporate Landscape

The Supreme Court characterized derivative suits as a "remedy born of stockholder helplessness" in *Cohen v. Beneficial Industrial Loan Corporation*, a seminal shareholder derivative case.[23] The Court offered this background on the development of derivative suits:

> As business enterprise increasingly sought the advantages of incorporation, management became vested with almost uncontrolled discretion in handling other people's money. The vast aggregate of funds committed to corporate control came to be drawn to a considerable extent from numerous and scattered holders of small interests. The director was not subject to an effective accountability. That created strong temptation for managers to profit personally at expense of their trust. The business code became all too tolerant of such practices. Corporate laws were lax and were not self-enforcing, and stockholders, in face of gravest abuses, were singularly impotent in obtaining redress of abuses of trust.[24]

Derivative suits have been characterized as "the chief regulator of corporate management"[25] and "the most important procedure the law has yet developed to police the internal affairs of corporations."[26] But the remedy of shareholder derivative suits has been subject to significant criticism from

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23. Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 547–48 (1949).

24. *Id.* at 547–48.

25. *Id.* at 548.

26. Dykstra, *supra* note 1 (quoting Eugene V. Rostow, *To Whom and for What Ends is Corporate Management Responsible*?, THE CORP. IN MODERN SOCIETY 46, 48 (Edward Mason ed. 1959)).

the courts[27] and commentators[28] focusing on the potential for abuse. Efforts to curtail the potential for abuse have resulted in procedural hurdles created through statutory and case law, with the aspirational goal that somehow only meritorious derivative suits will move forward, and the nuisance or strike suits will be weeded out.[29]

The statutory hurdles facing shareholder plaintiffs seeking to bring derivative suits can include statutory requirements that plaintiffs: demonstrate contemporaneous share ownership;[30] demonstrate that they fairly and adequately represent the interests of the corporation in enforcing its rights;[31] plead their case with particularity;[32] make a formal demand on

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27. As the Supreme Court noted in *Cohen*:

> Unfortunately, the remedy itself provided opportunity for abuse which was not neglected. Suits sometimes were brought not to redress real wrongs, but to realize upon their nuisance value. They were bought off by secret settlements in which any wrongs to the general body of share owners were compounded by the suing stockholder, who was mollified by payments from corporate assets. These litigations were aptly characterized in professional slang as 'strike suits.' And it was said that these suits were more commonly brought by small and irresponsible than by large stockholders, because the former put less to risk and a small interest was more often within the capacity and readiness of management to compromise than a large one.

Cohen, 337 U.S. at 548.

28. *See* John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 261–62 (1981) ("Today, the new threat is judicial, rather than legislative, and if the prophecies of doom are again to prove false, countervailing legislation may be necessary."); Garth, et al., *supra* note 7 at 139 (criticizing the economic theories of the firm that challenge the utility of derivative suits).

29. The bond posting requirements were designed to help distinguish the strike suits from the meritorious suits. *See Security for Expenses Legislation Summary, supra* note 17, at 269–70 (explaining the goals of the New York security for expenses legislation and other similar state laws).

> The minimum ownership standards which must be met to avoid the New York security requirement were adopted as a practical method of distinguishing before trial between strike suits and suits brought for legitimate purposes. That some legitimate suits by small shareholders are also deterred must be accepted as a necessary consequence of this legislation.

Id.

30. MODEL BUS. CORP. ACT § 7.41(1)(2005).

31. *Id.* § 7.41(2).

32. Franklin S. Wood, the author of a comprehensive study of derivative suits that has come to be known as "The Wood Report" addresses this challenge: "[d]ealing now with the sufficiency of particular allegations, the mere allegation of demand and refusal to sue is insufficient, since it does not adequately establish the exhaustion of the plaintiff's remedies before resort to equity." FRANKLIN S. WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS 59 (1944) [hereinafter WOOD REPORT].

the corporation to take "suitable" action;[33] and finally, comply with any relevant security for expense statutes.[34] It is noteworthy that derivative plaintiffs, for the most part, must do all this without access to the discovery process.[35] This prompts the question whether the cumulative effect of these

33. MODEL BUS. CORP. ACT § 7.42 (2005). According to Professors Coffee and Schwartz:

> [F]or the better part of this century, corporate law has recognized the simple axiom that a shareholder seeking to file a derivative suit must first exhaust available intracorporate remedies by making a demand on the corporation's board of directors, but never adequately explained the justification underlying this rule.*7.* By itself, this demand rule is only a procedural hurdle, and in practice a fairly inconsequential one, that serves the legitimate purpose of giving the subject corporation an opportunity to take over the suit as its own or pursue internal remedies.

Coffee and Schwartz, *supra* note 28, at 262. According to Mr. Wood: "The difficulty of drawing a complaint on facts of which the plaintiffs have no first[-]hand knowledge or sources of information was originally felt to warrant considerable lenience in judging the sufficiency of a complaint. . . . This view is now believed to have been overruled." WOOD REPORT, *supra* note 32, at 58. The current approach in most statutes requiring derivative plaintiffs to make a formal demand is to require specificity of facts. "The courts have come to recognize this [unfounded claims], to appraise such general and adverbial allegations at their true value, and to apply increasing strictures upon general allegations with no specific facts in support of them." WOOD REPORT, *supra* note 32, at 59.

34. See *infra* Part III. For a discussion of one of the first examinations of the derivative suit in the WOOD REPORT, see Albert *supra* note 3.

> His ultimate conclusion and recommendation for a security for expense statute honored his goal and allowed the shareholders to determine whether to move forward in any given case, "safeguarded by the requirement that the plaintiff have a legitimate interest in the subject-matter and assume reasonable responsibility in the way of costs in the event of failure." Wood's idea was that a "legitimate interest in the subject matter" could be satisfied by some threshold of stock ownership. This idea is the cornerstone of all of the current security for expense statutes which began to be adopted following the Wood Report in an effort to discourage non-meritorious strike suits, starting with New York in 1944.

Albert, *supra* note 3, at 43 (citing WOOD REPORT, *supra* note 32, at 116–17). *See also* Garth et al., *supra* note 7, at 140; Donna I. Dennis, *Contrivance and Collusion: The Corporate Origins of Shareholder Derivative Litigation in the United States*, 67 RUTGERS L. REV. 1479, 1519 (2015) (examining the history of strike-suits).

35. The New Jersey statute is a good example:

> (c)All discovery proceedings shall be stayed upon the filing by the corporation of its motion to dismiss and the filing required by this subsection until the notice of entry of the order ruling on the motion. Notwithstanding the foregoing stay of discovery, the court, on motion and after a hearing, may order that specified and limited discovery be conducted if plaintiffs make a good cause showing of alleged facts which evidence a lack of independence by the person or group making the determination for the corporation or a lack of a good faith determination. Limited discovery shall not include the work product, privileged

hurdles may be actually undermining the utility of the entire derivative litigation remedy, leaving derivative plaintiffs as "helpless" as the Supreme Court noted, whether the defendants be shareholders, LLC members or limited partners.[36]

B. Derivative Litigation by LLC Members

An evaluation of the landscape of derivative litigation in LLCs necessitates an understanding of the hybrid nature of this entity and the resulting variety in states' approaches to regulating LLCs.[37] Since LLCs

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> communications, or testimony of attorneys who advised or assisted the person or group making the determination.

N.J. STAT. ANN. §14A:3-6.5. *See* Feur v. Merck & Co., Inc. 187 A.3d 873, 880 (N.J. Sup. Ct. 2018) ("Within a derivative action, a plaintiff-shareholder may be entitled to "discovery 'limited to the narrow issue of what steps the directors took to inform themselves of the shareholder demand and the reasonableness of its decision'" to reject it.").

36. According to Professor Matheson:

> [T]he current state of derivative litigation is encumbered by a series of primarily procedural impediments that make pursuit of the derivative claim unduly litigious and its successful prosecution practically impossible." Matheson, s*upra* note 1, at 331. Professors Coffee and Schwartz agree: "Although the policies underlying these barriers express justifiable concerns about the dangers of frivolous litigation and unjust enrichment, their legislative implementation has been overbroad, chilling meritorious and nonmeritorious actions alike and unnecessarily disqualifying truly injured plaintiffs.

Coffee & Schwartz, *supra* note 28, at 309. According to Professor Scott:

> The result of all this seems to be an absurd state of affairs. Ringing statements on the sacredness of the management's fiduciary responsibilities are accompanied by a series of impediments to their enforcement. Each obstacle has its own peculiar history and rationale, but their unifying theme purports to be fear of the 'strike suit'—an unwarranted action brought by an attorney in order to be bought off for a sum that is less than the costs of defense.

Kenneth E. Scott, *Corporation Law and the American Law Institute Corporate Governance Project,* 35 STAN. L. REV. 927, 942 (1983). Professor DeMott argues:

> [T]he statutes, by permitting defendants to demand that security be posted well in advance of a final outcome to the litigation, may impose a greater economic risk on the plaintiff than would a rule which simply shifted the successful defendant's expenses to the plaintiff after the final resolution of the litigation. It was originally believed that these statutes would deter baseless derivative suits, or suits brought solely to extract a settlement through the "annoyance value" of the suit.

DEBORAH A. DEMOTT, SHAREHOLDER DERIVATIVE ACTIONS: LAW & PRACTICE § 3.1 (2020-2021).

37. According to Professor Ribstein:

have features from both corporations and partnerships, it is unsurprising that drafters have leaned on both corporate and partnership statutory norms in crafting structures to govern this hybrid.[38] The various state LLC statutes, as a whole, reflect this hybrid nature of the LLC, with some state lawmakers borrowing more heavily from their corporate statutes[39] and others from their partnership and limited partnership laws when crafting their individual LLC statutes.[40] Some courts borrow from the case law as well, applying corporate

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> The rapid development of limited liability companies has caused numerous growing pains as courts and legislatures have searched for appropriate sources from which to draw the rules for this new business form. Not surprisingly, legislators and courts frequently apply rules from existing business entities. Unfortunately, they sometimes apply the wrong analogies.

Ribstein, *supra* note 4, at 739.

38. "There are close similarities between LLCs and limited partnerships regarding ownership and transfer of LLC interests, and indeed many LLC statutes borrowed provisions on these issues from limited partnership statutes." RIBSTEIN & KEATINGE, *supra* note 5, at § 9:9. According to Professor Ribstein:

> The derivative remedy was not traditionally recognized in partnerships, but ended up in LLC statutes via the limited partnership . . . . When legislatures throughout the United States started passing LLC statutes twenty years ago, they faced a choice of models regarding derivative suit provisions – the general partnership and early limited partnership statutes containing no derivative suit provisions, or the more recent developments of limited partnership derivative suits. The choice was not obvious since both types of business association were models for the "hybrid" LLC form, and both derivative suits and limited partnerships has been used for a long time before the courts thought to put the two together.

Ribstein, *supra* note 4, at 746.

39. In Maryland:

> A person described in § 4A-802 of this subtitle may bring a derivative action to enforce a right of a limited liability company to recover a judgment in its favor to the same extent that a stockholder may bring an action for a derivative suit under the corporation law of Maryland.

MD. CODE § 4A-801.

40. According to Professor Goforth:

> Every American jurisdiction now authorizes the formation of the LLC. Unfortunately, there is probably more variation in the provisions of state LLC acts than for any other kind of widely available form of business, even the statutory close corporation. One of the reasons for this is that by the time the Uniform Law Commission first promulgated a Uniform LLC Act in 1994, "nearly every state had adopted an LLC statute, and those statutes varied considerably in both form and substance."

Goforth, *supra* note 12, at 98.

> When we as lawyers, judges, and students of the law engage in statutory construction, there are certain things that are sacrosanct. The meaning of words is one. Our system of precedents requires that we thoughtfully build our doctrine,

law principles to LLC issues.[41] This also contributes to sometimes significant variation in the scope and content of these statutes, opening up the possibility that similarly situated parties who transact business with LLCs may have varying outcomes from state to state, depending on the provisions of states' LLC acts.[42] And some commentators strongly believe derivative suits are unnecessary for LLC members, particularly those that are closely held.[43] In the case of a closely held LLC, a suit could be authorized by

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> with careful and appropriate layering of case law to anchor the doctrine. Our courts should be thoughtful and deliberate in the further development of this doctrine, in a way that promotes fairness while honoring the legislative intent of the NYLLCL. New York LLC piercing decisions will thus be supportable as a matter of law and not just convenience.

Albert, *supra* note 13, at 438.

41. For example, in Arizona, case law explicitly applies corporate law statutory principles to LLCs:

> The Arizona statutes governing derivative actions by a member in a limited liability company ("LLC") closely mirror the statutes governing derivative actions by shareholders. However, there is no specific Arizona case law regarding derivative actions by a member of an LLC. However, since the statutes for derivative actions by shareholders are similar, case law regarding corporate derivative actions may be used to interpret the LLC derivative action statutes.

ARIZ. REV. STAT. ANN. § 34:10. *See also* ICSC Partners, L.P. v. Kenwood Plaza L.P., 116 Ohio App. 3d 278, 284 (1996) ("Although this action involves derivative claims on behalf of a limited partnership, we find the law governing the settlement of derivative corporate claims applicable. We review the approval of settlements in limited-partnership derivative actions for abuse of discretion."). According to Professor Ribstein:

> The New York Court of Appeals decision in Tzolis v. Wolff settled years of confusion in the New York cases by reading a derivative remedy into the New York statute. Although there was evidence that the legislature had deliberately omitted derivative suits from the LLC statute as part of a compromise to get the act passed, the majority reasoned that legislators might have assumed that courts would supply the missing remedy as they had for limited partnerships.

Ribstein, *supra* note 4, at 740 (citing Tzolis v. Wolf, 884 N.E.2d 1005, 1009 (N.Y. 2008)).

42. *See* Albert, *supra* note 13, at 414 ("The existing state LLC statutes, however, are far from uniform and many have been amended on a patchwork basis and have not kept up with the LLC cases and other legal developments.") quoting *See Why Your State Should Adopt RULLCA*, UNIFF. LAW COMM'N, https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=36ed703c-12ad-070f-fa01-64010b1dabb6&forceDialog=0 [https://perma.cc/P947-FZ97] (last visited May 15, 2020).

43. As per the dissent in Tzolis v. Wolff, discussed in *infra* Part II:

> The co-author of the major treatise on limited liability companies—who (unlike the majority) questions the utility of derivative suits in the LLC context—advocates the ABA's approach as "a reasonable compromise" (*see* Ribstein, *The Emergence of the Limited Liability Company*, 51 Bus. L. 1, 23 [1995-1996] ["If the (derivative suit) remedy is justified . . . , it is only because requiring plaintiffs to seek authorization from the thousands of shareholders of publicly held firms

disinterested members owning a majority of ownership interests, obviating the need for a derivative suit.[44]

One possible lens to glean how the various state lawmakers view this hybrid form of business, at least anecdotally, may be seen by examining how the states characterize their LLC statutes as more like a corporation, more like a partnership, or neither. Twenty five states group their corporate, LLC, and limited partnership statutes together in one category[45] or put each statute

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> could prevent some legitimate suits," but "(t)he same point does not apply . . . to closely held firms. Moreover, LLC members generally have other means of self-protection at their disposal that corporate shareholders may lack, including a default right to sell their interests back to the firm and substantial veto and removal powers."]).

Tzolis, 10 N.E.3d at 118 (Read, J., dissenting), referencing Ribstein, *supra* note 4.

44. According to Professors Ribstein and Keatinge:

> Opponents of derivative actions may argue that it does not follow that a single member should be authorized to decide when the substantial cost and disruption of a suit against the managers is justified. Unlike in a publicly held corporation, permitting a member vote on the suit or joining all relevant parties will often be practicable in a closely held LLC. Thus, the suit could be authorized by a majority of the owners of the firm who do not have a personal interest in the outcome of the suit. The suit also could be brought directly by joining all affected members as plaintiffs or defendants.

RIBSTEIN & KEATINGE, *supra* note 5, at § 13:3.

45. Alabama classifies its corporations, LLCs and LPs all under its Title 10A: Alabama Business and Nonprofit Entities Code. ALA. CODE §§ 10A-2-1.01 to 10A-2-17.02; §§ 10A-5A-1.01 to 10A-5A-12.05; §§ 10A-9A-1.01 to 10A-9A- 11.07. California classifies its corporations, LLCs and LPs all under its Corporations Code. CAL. CORP. CODE §§ 100-195; §§ 17701.01-17713.13; §§ 15900-15901.17. Colorado classifies its corporations, LLCs and LPS all under its Title 7. Corporations and Associations. COLO. REV. STAT. §§ 7-101-101 to 7-117-105; §§7-80-101 to 7-80-1101; §§ 7-62-101 to 7-62-1105. The District of Columbia classifies its corporations, LLCs and LPs all under its Division V. Local Business Affairs, Title 29. Business Organizations. D.C. CODE §§ 29-101.01 to 29-107.05; §§ 29-801.01 to 29-810.01; §§ 29-701.01 to 29-711.01. Florida classifies its corporations, LLCs and LPs all under its Title XXXVI. Business Organizations. FLA. STAT. §§ 607.0101 to 607.193; §§ 605.0101 to 605.1108; §§ 620.081 to 620.2205. Georgia classifies its corporations, LLCs and LPs all under its Title 14. Corporations, Partnerships and Associations. GA. CODE ANN. §§ 14-2-101 to 14-2-1703; §§ 14-11-100 to 14-11-109; §§ 14-9A-1 to 14-9A-130. Idaho classifies its corporations, LLCs and LPs all under its Title 30. Corporations. IDAHO CODE ANN. §§ 30-29-101 to 30-29-1704; §§ 30-25-101 to 30-25-806; §§ 30-24-101 to 30-24-906. Illinois classifies its corporations, LLCs and LPs all under its Chapter 805. Business Organizations. CH. 805 ILL. COMP. STAT. §§ 5/1.01 to 5/17.05; §§ 180/1-1 to 180/60-1; §§ 215/0.01 to 215/1402. Indiana classifies its corporations, LLCs and LPs all under its Title 23. Business and Other Associations. IND. CODE §§ 23-1-1-1 to 23-1-55-3; §§ 23-18-1-1 to 23-18-2; §§ 23-16-1-1 to 23-16-12-3. Maryland classifies corporations, LLCs and LPs under the heading Corporations and Associations. MD. CODE ANN., CORPS & ASS'NS §§ 2-101 to 2-612; §§ 4A-101 to 4A-1303; §§ 10-101 to 10-1105. Minnesota classifies its corporations, LLCs and LPs all under the heading Business, Social, and Charitable Organizations. MINN. STAT.

in its own category, in each case perhaps showing a legislative view that the three forms of business are separate and distinct;[46] sixteen states group their corporate and LLC statutes together, with their limited partnership statute grouped elsewhere, perhaps reflecting a view that LLCs are like corporations;[47] nine states group their LLCs and limited partnership statutes

§§ 302A.001-302A.92; §§ 322C.0101-322C.1205; §§ 321.0101-321.1208. Mississippi classifies its corporations, LLCs and LPS all under its Title 79. Corporations, Associations, and Partnerships. MISS. CODE. ANN. §§ 79-4-1.01 to 79-4-17.05; §§ 79-29-101 to 79-29-1317; 79-14-101 to 79-14-1301. Missouri classifies its corporations, LLCs and LPs all under its Title XXIII. Corporations, Associations and Partnerships. MO. REV. STAT. §§ 351.010-351.720; §§ 347.010-347.189; §§ 359.011-359.271. Montana classifies corporations, LLCs and LPs under Title 35. Corporations, Partnerships, and Associations. MONT. CODE. ANN. §§ 35-1-112 to 35-1-1315; §§ 35-8-101 to 35-8-1307; §§ 35-12-501 to 35-12-522. Nevada classifies corporations, LLCs, and LPs under Title 7. Business Associations; Securities; Commodities. NEV. REV. STAT. §§ 78.010-78.785; §§ 86.011-86.590; §§ 87A.005-87A.230. Ohio classifies it corporations, LLCs and LPs all under its Title XVII. Corporations Partnerships. OHIO REV. CODE ANN. §§ 1701.01-1701.99; §§ 1705.01-1705.61; §§ 1782.01-1782.65. Oregon classifies its corporations, LLCs and LPs all under its Title 7. Corporations and Partnerships. OR. REV. STAT. §§60.001-60.992; 63.001-63.990; 70.005-70.070. Rhode Island classifies its corporations, LLCs and LPs all under its Title 7. Corporations, Associations and Partnerships. R.I. GEN. LAWS §§ 7-1.2-101 to 7-1.2-1804; §§ 7-16-1 to 7-16-76; §§ 7-13-1 to 7-13-69. South Carolina classifies its corporations, LLCs and LPs all under its Title 33. Corporations, Partnerships and Associations. S.C. CODE ANN. §§ 33-1-101 to 33-16-220; §§ 33-44-101 to 33-44-1208; §§ 33-42-10 to 33-42-2140. Texas classifies its corporations, LLCs and LPs all under its Texas Business Organization Code. TEX. BUS. ORGS. CODE ANN. §§ 20.001-21.917; §§ 101.001-101.662; §§ 153.001-153.555. Vermont classifies its corporations, LLCs and LPs all under its Title 11. Corporations, Partnerships and Associations. VT. STAT. ANN. tit. 11 §§ 42-568; §§ 4001-4163; §§ 3401-3503. Wyoming classifies its corporations, LLCs and LPs all under its Title 17. Corporations, Partnerships and Associations. WYO. STAT. ANN. §§ 17-16-101 to 17-16-1810; §§ 17-29-101 to 17-29-1105; §§ 17-14-201 to 17-14-1104.

46. Similarly, three states list statutes governing the three forms of business in their own separate categories: New York classifies its corporations under Business Corporation Law. N.Y. BUS. CORP. § 101-2001 (2020); New York classifies its LLCs under Limited Liability Company Law. N.Y. LTD. LIAB. CO. §§ 101-1403 (2020); and New York characterizes its LPs under its Partnership Law. N.Y. P'SHIP §§ 90-119 (2020). North Carolina classifies its corporations under Chapter 55 North Carolina Business Corporation Act. N.C. GEN. STAT. ANN. §§ 55-1-01 to 55-17-05 (West 1989); North Carolina classifies its LLCs under Chapter 57D. North Carolina Limited Liability Company Act. N.C. GEN. STAT. ANN. §§ 57D-1-01 to 57D-11-03 (West 2014); and North Carolina classifies its LPs under Chapter 59. Partnership. N.C. GEN. STAT. ANN. §§ 59-101 to 59-11047 (West 1985). West Virginia classifies its corporations under its Chapter 31D. West Virginia Business Corporation Act. W. VA. CODE ANN. §§ 31D-a-101 to 31D-17-1703 (West 2002); West Virginia classifies its LLCs under its Chapter 31B. Uniform Limited Liability Company Act. W. VA. CODE ANN. §§ 31B-1-101 to 31B-13-1306 (West 2020); and West Virginia classifies its LPs under its Chapter 47. Regulation of Trade. W. VA. CODE ANN. §§ 47-9-1 to 47-9-63 (West 2020).

47. Alaska classifies both its corporations and LLCs in their own chapters under its Title 10: Corporations and Associations. ALASKA STAT. §§ 10.06.005 to 10.06.995 (West 2020);

ALASKA STAT §§ 10.50.010 to 10.50.995 (West 2020); Alaska classifies LPs under its Title 32. Partnership. ALASKA STAT. §§ 32.11.010 to 32.11.990 (West 2020). Arkansas classifies its corporations, LLCs and LPs all under its Title 4. Business and Commercial Law, but further classifies its corporations and LLCs under Subtitle 3. Corporations and Associations. ARK. CODE ANN. §§ 4-27-101 to 4-27-1908 (2007); ARK. CODE ANN. §§ 4-32-101 to 4-32-1401 (2007); Arkansas classifies its LPs under its Subtitle 4. Partnerships. ARK. CODE ANN. §§ 4-47-101 to 4-47-1302 (2001). Iowa classifies its corporations, LLCs and LPs under its Title XII. Business Entities, but further classifies its corporations and LLCs under its Subtitle 2. Business and Professional Corporations and Companies. IOWA CODE §§ 490.101 to 490.1703 (2020); IOWA CODE §§ 489.101 to 489.1304 (2020); Iowa classifies its LPs under its Subtitle 1. Partnerships. IOWA CODE §§ 488.101 to 488.1207 (2020). Kansas classifies its corporations and LLCs under its Chapter 17. Corporations. KAN. STAT. ANN. §§ 17-6001 to 17-71-514 (2020); KAN. STAT. ANN. §§ 17-7662 to 17-7617 (2020); Kansas classifies its LPs in Chapter 56. Partnerships. KAN. STAT. ANN. §§ 56-1a101 to 56-1a610 (2020). Kentucky classifies its corporations and LLCs under its Title XXIII. Private Corporations and Associations and LPs in Title XXIX. Commerce and Trade. KY. REV. STAT. ANN. §§ 271B.1-010 to 271B.18-070 (1972); KY. REV. STAT. ANN. §§ 275.001 to 275.540 (1972); Kentucky classifies its LPs in its Title XXIX. Commerce and Trade. KY. REV. STAT. ANN. §§ 362.401 to 362.546 (1988). Louisiana classifies its corporations and LLCs under its Title 12. Corporations and Associations of the Louisiana Revised Statutes. LA. STAT. ANN. §§ 1-101 to 1-1705 (2015); LA. STAT. ANN. §§ 1301-1370 (2015); Louisiana classifies its LPs [known as "partnership in commendam"] under its Title XI of Book III. Of the Different Modes of Acquiring the Ownership of Things. LA. CIV. CODE ANN. ART. 870 (2001). Massachusetts classifies its corporations and LLCs under its Title XXII. Corporations. MASS. GEN. LAWS ANN. CH. 156, §§ 1-55 (2020); MASS. GEN. LAWS ANN. CH. 156C §§ 1-72; Massachusetts classifies its LPs under Title XV. Regulation of Trade. MASS. GEN. LAWS ANN. CH 109, §§ 1-66 (2020). Michigan classifies its corporations and LLCs under its Chapter 450. Corporations. MICH. COMP. LAWS §§ 450.98-450.192 (2020); MICH. COMP. LAWS §§450.4101-450-5200 (2020); the LLC statute is classified under "Chapter 450. Corporations." Michigan classifies its LPs under Chapter 449. Partnership. MICH. COMP. LAWS §§ 449.1101-449.2108 (2020). Nebraska classifies its corporations and LLCs under its Chapter 21. Corporations and Other Companies. NEB. REV. STAT. §§ 21-201 to 21-2,232 (2021); NEB. REV. STAT. §§ 21-101 to 21-197 (2021); Nebraska classifies its LPs under Chapter 67. Partnerships. NEB. REV. STAT. §§ 67-233 to 67-2,100 (2020). New Mexico classifies its corporations and LLCs under its Chapter 53. Corporations. N.M. STAT. ANN. §§ 53-11-1 to 53-11-51; N.M. STAT. ANN. §§ 53-19-1 to 53-19-60 (2020). New Mexico classifies its LPs under its Chapter 54. Partnerships. N.M. STAT. ANN. §§ 54-sA-101 to 54-2A-1206 (2020). North Dakota classifies its corporations and LLCs under its Title 10. Corporations. N.D. CENT. CODE §§ 10-19-1-00.1 to 10-19.1-152 (2019); N.D. CENT. CODE §§ 10-32-1-01 to 10-32.1-101 (2019); North Dakota classifies its LPs under Title 45. Partnerships. N.D. CENT. CODE §§ 45-10.2-01 to 45-10.2117 (2019). Oklahoma classifies its corporations and LLCs under Title 18. Corporations. CENT. OKLA. STAT. tit. 18, §§ 1001-1144 (2014); CENT. OKLA. STAT. tit. 18, §§ 2000-2060 (2014); Oklahoma classifies its LPs in Title 54. Partnership. CENT. OKLA. STAT. tit. 54, §§ 500-101a to 500-1207a (2014). South Dakota classifies its corporations and LLCs under its Title 47. Corporations. SD CODIFIED LAWS §§ 47-1a-101 to 47-1a-1703.1 (2005); South Dakota classifies LPs under Title 48. Partnerships. SD CODIFIED LAWS §§ 48-7-101 to 48-7a-1208 (2020). Tennessee classifies corporations and LLCs under Title 48. Corporations and Associations. TENN. CODE ANN. §§ 48-11-101 TO 48-27-103 (1986); TENN. CODE ANN. §§ 48-249-101 TO 48-249-1019 (1986); Tennessee classifies its LPs under its Title 61. Partnerships. TENN. CODE ANN. §§ 61-2-101 to together, with their corporate statutes grouped elsewhere;[48] and one state groups its corporate statutes and its limited partnership statutes together, with its LLC statute grouped elsewhere.[49]

By 1996, every state had some sort of LLC legislation, but there was then, and continues to be now, significant variation in the scope, provisions,

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61-2-1209 (1988). Virginia classifies its corporation and LLCs under its Title 13.1 Corporations. VA. CODE ANN. §§ 13.1-601 TO 13.1-781 (2021); VA. CODE ANN. §§ 13.1-1000 to 13.1-1099.27 (2021); Virginia classifies its LPs under Title 50. Partnerships. VA. CODE ANN. §§ 50-73.1 to 50-73.78 (2020). Wisconsin classifies its corporations and LLCs under Corporations (Ch. 180 to 188). WIS. STAT. §§ 180.0101 to 180.1921 (2021); WIS. STAT. §§ 183.0102 to 183.1305 (2021); Wisconsin classifies its LPs under Partnerships (Ch. 178, 179). WIS. STAT. §§ 179.01 TO 179.94 (2021).

48. Arizona classifies its corporations under its Title 10. Corporations and Associations. ARIZ. REV. STAT. ANN. §§ 10-120 to 10-1701 (1996); Arizona classifies its LLCs and LPs under its Title 29. Partnership. ARIZ. REV. STAT. ANN. §§ 29-301 to 29-373 (2020); ARIZ. REV. STAT. ANN. §§ 29-601 to 29-858 (2020). Connecticut classifies its corporations under its Title 33. Corporations. CONN. GEN. STAT. §§ 33-600 to 33-998 (1997); Connecticut classifies its LLCs and LPs under its Title 34. Limited Partnerships, Partnerships, Professional Associations, Limited Liability Companies and Statutory Trusts. CONN. GEN. STAT. §§ 34-243 to 34-290 (2017). Delaware classifies its corporations under its Title 8. Corporations. DEL. CODE ANN. tit. 8, §§ 101-398 (1998); Delaware classifies its LLCs and LPs under its Title 6. Commerce and Trade. DEL. CODE ANN. tit. 6, §§ 18-101 to 18-1110 (2020); DEL. CODE ANN. tit. 6, §§ 17-101 to 17-1111 (2020). Maine classifies its corporations under Title 13. Corporations. ME. REV. STAT. ANN. tit. 13, §§ 41-337 (1987); Maine classifies its LLCs and LPs under Title 31. Partnerships and Associations. ME. REV. STAT. ANN. tit. 31, §§ 1501-1693 (2017); §§ 1301-1461 (2017). New Hampshire classifies its corporations under its Title XXVII. Corporations, Associations, and Proprietors of Common Lands. N.H. REV. STAT. ANN. §§ 293-a:1.01 to 293-a:17.04 (2014); New Hampshire classifies its LLCs and LPs under its Title XXVIII. Partnerships. N.H. REV. STAT. ANN. §§ 304-B:1 to 304-B:64 (2019); §§ 304-C:1 to 304-C:201 (2013). New Jersey classifies its corporations under Title 14A. Corporations, General. N.J. STAT. ANN. 14A §§ 1:1 to 16:4 (1988); New Jersey classifies its LLCs and LPs under its Title 42. Partnerships and Partnership Associations. N.J. STAT. ANN. 42 §§ 2C-1 to 2C-94(2012); 42 §§ 2A-1 to 2A-73(1985). Pennsylvania classifies corporations, LLCs and LPs under Title 15 Pa.C.S.A. Corporations and Unincorporated Associations, and further breaks down that title into Part II Corporations and Part III. Partnerships and Limited Liability Companies. 15 PA. CONS. STAT. §§ 501-1997 (1989); §§ 8811-8885; §§ 8611-8695 (1989). Utah classifies its corporations under its Title 16. Corporations. UTAH CODE ANN. §§ 12-10a-101 to 16-10a-1804 (1992); Utah classifies its LLCs and LPs under Title 48. Partnership – Unincorporated Business Entities. UTAH CODE ANN. §§ 48-3a-101 to 48-3a-1405; §§ 48-2e-101 to 48-2e-1205 (2014). Washington classifies corporations under Title 23B. Washington Business Corporation Act. WASH. REV. CODE ANN. §§ 23B.01.010 to 23B.900.050 (2020); Washington classifies its LLCs and LPs under Title 25. Partnerships. WASH. REV. CODE ANN. §§ 25.15.006 to 25.15.905; §§ 25.10.006 to 25.10.926 (2020).

49. Hawaii classifies its corporations and LPs in Division 2. Business under Title 23. Corporations and Partnerships. HAW. REV. STAT. §§ 414-1 to 414-484; §§ 425E-101 to 425E-1206 (2000); Hawaii classifies its LLCs under Title 23A. Other Business Entities. HAW. REV. STAT. §§ 428-101 to 428-1302 (2010).

applicability, and enforcement of these statutes.[50] For example, virtually every LLC statute deals with derivative litigation, but there are significant differences in the approach and coverage of the various state statutes.[51] Two model acts were drafted in the 1990s and served as the basis, at least to some degree, of many of these LLC statutes.[52] The first of these model acts came from the Uniform Law Commission (ULC), which describes itself as an organization providing "non-partisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law."[53] In 1994, the ULC promulgated the original Uniform Limited Liability Company Act, blending concepts from partnership and corporate law.[54] The ULC noted that by 1994, nearly every state had adopted an LLC statute, and those statutes varied considerably in both form and substance.[55] Many of those early statutes were based on the first version of the ABA Model Prototype LLC Act."[56] In 1996, the ULC promulgated the Revised Uniform Limited Liability Act (RULLCA).[57] Twenty one states have

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50. Joseph M. Dylla, *A Case for the Adoption of the Revised Uniform Limited Liability Company Act in South Dakota*, 56 S.D. L. REV. 285, 286 (2011).

51. *See* DEMOTT, *supra* note 36, at § 2.11 (discussing different states' approaches to derivative litigation).

52. "Unfortunately, the promulgation of ULLCA did not solve the problem of variability in LLC law, in large part because it was introduced after most jurisdictions had already legislatively addressed LLCs." Dylla, *supra* note 50, at 286.

53. *About Us*, UNIF. LAW COMM'N, https://www.uniformlaws.org/aboutulc/overview [https://perma.cc/VBV4-9CXL] (last visited May 15, 2020).

54. According to the ULC:

> ULLCA's drafting relied substantially on the then recently adopted Revised Uniform Partnership Act ("RUPA"), and this reliance was especially heavy with regard to member-managed LLCs. ULLCA's provisions for manager-managed LLCs comprised an amalgam fashioned from the 1985 Revised Uniform Limited Partnership Act ("RULPA") and the Model Business Corporation Act ("MBCA"). ULLCA's provisions were also significantly influenced by the then-applicable federal tax classification regulations, which classified an unincorporated organization as a corporation if the organization more nearly resembled a corporation than a partnership.

Prefatory Note to ULLCA (2006), UNIFORM LIMITED LIABILITY COMPANY ACT (2006) (Last Amended 2011).

55. *Id.*

56. *Id.* See Part II *infra* notes 66-77 and accompanying text for a discussion of the Prototype Act.

57. The RULLLCA is a revision of the 1996 ULLCA. It:

> permits the formation of limited liability companies (LLCs), which provide the owners with the dual advantages of corporate-type limited liability and partnership tax treatment. The 2011 and 2013 amendments enacted as part of the Harmonization of Business Entity Acts project, updated and harmonized the language in this act with similar provisions in other uniform and model

adopted the RULLCA,[58] and two additional states have introduced legislation to do so.[59] The RULLCA authorizes members to maintain derivative actions, but also creates hurdles for such members, for example, contemporaneous ownership.[60] The concept of contemporaneous ownership requires that the plaintiff be a member of the LLC from the time of the complained-upon act.[61] An earlier version of the RULLCA abandoned the traditional "contemporaneous ownership" rule, instead requiring only that plaintiff was a member at the time the action was commenced and remained a member while the action continues.[62] The basis for eliminating this hurdle was that "the protections of that rule are unnecessary given the closely-held nature of most limited liability companies and the built-in, statutory restrictions on persons becoming members."[63]

The RULLCA reinstated the traditional "contemporaneous ownership" rule, again requiring that a proper plaintiff must have been a member at the time of the complained-upon act.[64] The RULLCA also requires that plaintiffs make a demand on the managers, unless demand would be futile,[65] and that the complaint states with particularity the date and content of the plaintiff's demand, or the reasons such a demand would have been futile.[66] The RULLCA does not require plaintiffs to post security for expenses, which may be a reason that more states have not adopted security for expense

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> unincorporated entity acts to enable the adoption of multiple acts in a single statute.

Description: 2006 Limited Liability Company Act, Revised, UNIF. L. COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=bbea059c-6853-4f45-b69b-7ca2e49cf740 [https://perma.cc/9963-QUSS] (last visited Feb. 17, 2021).

58. Alabama (2019); Arizona (2018); Pennsylvania (2017); Illinois (2016); Connecticut (2016); North Dakota (2015); Vermont (2015); Idaho (2015); Washington (2015); Alabama (2014); Minnesota (2014); South Dakota (2013); Florida (2013); New Jersey (2012); California (2012); District of Columbia (2011); Utah (2011); Nebraska (2010); Wyoming (2010); Iowa (2008); and Idaho (2008). *Id.*

59. H. R. AB 854, 2019 Leg., (Wis. 2019); S. R. S. 265, 123rd Gen. Assemb., (S. C. 2019).

60. REVISED UNIFORM LIMITED LIABILITY COMPANY ACT (2006) (Last Amended 2013) § 803(2013).

61. *Id.* "Underlying this rule is an understandable policy: investors should not be able to "buy" law suits, and unjust enrichment may result if the shareholder seeking recovery bought his shares at a discounted price that already reflected the injury." Coffee & Schwartz, *supra* note 28, at 312.

62. NAT'L CONFERENCE OF COMM'RS OF UNIF. STATE L., *supra* note 11, at 103.

63. *Id.*

64. RULLCA § 803 (2013).

65. RULLCA § 802 (2013).

66. RULLCA § 804 (2013). This differs from the corporate rule in the MBCA, which requires "universal" demand with no futility carve out. MODEL BUS. CORP. ACT § 7.42.

provisions.

The second model act was the Prototype Limited Liability Company Act (Prototype Act). The Prototype Act was drafted by a working group from the American Bar Association in 1992.[67] The Prototype Act does not adopt any of the typical provisions from the RULLCA dealing with derivative suits, since the Act does not permit derivative suits unless provided for in the operating agreement or unless the member is authorized to bring the action by a majority of the members eligible to consent, unless a higher percentage is required by the operating agreement.[68] A number of

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67. The Prototype Act was drafted in 1992 by the Working Group on the Prototype Limited Liability Company Act, Subcommittee on Limited Liability Companies, Committee on Partnerships and Unincorporated Business Organizations of the Business Law Section of the American Bar Association. RIBSTEIN AND KEATINGE, *supra* note 5, at Appx. C, p. App C-109. *See also* Saunders v. Briner, 334 Conn 135, 157–58 (2019) (recognizing that Connecticut's limited liability company statutory provisions were modeled after the Prototype Act).

> During the LLC "explosion" of the early 1990s, to provide guidance for the analysis and resolution of issues involved in crafting LLC legislation, a working group of the American Bar Association's Committee on LLCs, Partnerships and Unincorporated Entities ("LPUE") drafted a "Prototype Limited Liability Company Act" (the "Prototype Act"), which was published in November 1992. Shortly thereafter the National Conference of Commissioners on Uniform State Laws ("NCCUSL") began work on a Uniform Limited Liability Company Act ("ULLCA"), which was adopted in 1994 and subsequently amended in 1995 and 1996. By the end of 1996 LLC Acts had been adopted in all of the states, in the District of Columbia, and in Puerto Rico and the U.S. Virgin Islands.

Revised Prototype LLC Act, 67 BUS. LAW. 117, 117 (2011).

A comment to the Prototype Act mentions that the Act replaces derivative suits, noting, "The main difference between the approach of this section and a derivative suit is that this section does not permit a single member to sue on behalf of the LLC without first being authorized to sue by the other members." RIBSTEIN AND KEATINGE, *supra* note 5, at § 1102 cmt., at C-10 to-110. *See also* James R. Burkhard, *Resolving LLC Member Disputes in Connecticut, Massachusetts, Pennsylvania, Wisconsin, and Other States That Enacted the Prototype LLC Act,* 67 BUS. LAW. 405 (2012) (analyzing the Prototype Act provisions).

68. The Prototype provision reads:

> § 1102 AUTHORITY TO SUE ON BEHALF OF LIMITED LIABILITY COMPANY
> Unless otherwise provided in an operating agreement, a suit on behalf of the limited liability company may be brought only in the name of the limited liability company by:
> One or more members of a limited liability company, whether or not an operating agreement vests management of the limited liability company in one or more managers, who are authorized to sue by the vote of more than one half by number of the members eligible to vote thereon, unless the vote of all members shall be required pursuant to § 403(B), provided that in determining the vote required under § 403, the vote of any member who has an interest in the outcome of the suit that is adverse to the interest of the limited liability company shall be

states adopted the Prototype Act, and in essence, rejected the notion of the derivative litigation as a mechanism to resolve disputes among LLC members.[69] The original LLC laws in Alaska,[70] Arkansas,[71] Connecticut,[72] Indiana,[73] Kentucky,[74] Massachusetts,[75] New Hampshire,[76] New Mexico,[77] Pennsylvania,[78] and Wisconsin[79] were all modeled after the Prototype Act. Several of these states have since backed away from this approach to varying degrees. Pennsylvania originally followed the Prototype Act but has since moved to the RULLCA.[80] Kentucky is anomalous, including both the Prototype Act language requiring the plaintiff to be authorized by a majority

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> excluded . . .

PROTOTYPE LIMITED LIABILITY COMPANY ACT §1102.

69. Burkhard, *supra* note 67, at 409.
70. ALASKA STAT. § 10.50.735.
71. ARKANSAS CODE ANN. § 4-32-1102.
72. CONN. GEN. STAT. § 34-186 (repealed by 2016, P.A. 16-97, § 110, eff. July 1, 2017.)
73. IND. CODE § 23-18-8-1.
74. KY. REV. STAT. ANN. § 275.330; § 275.335.
75. MASS. GEN. LAWS. Ch. 156C, § 56.
76. N.H. REV. STAT. ANN. § 304-C:188.
77. N.M. REV. STAT. ANN. § 53-19-58.

> There is no express provision in the New Mexico Limited Liability Company Act for member derivative suits, though the New Mexico Liability Act includes a directive that "the principles of law and equity supplement that act, Limited Liability Company Act for member derivative actions, including such principles applicable to corporations and their owners."

In re Patel, No. 7-10-12627 JA, 2012 WL 908439, at *3 (Bankr. D.N.M. Mar. 16, 2012). "The New Mexico Supreme Court has extended the scope of corporate derivative suits to partnerships, but the New Mexico Court of Appeals has declined to decide whether derivative suits can be brought in other, similar settings." *Id.*

78. 15 PA. CONS. STAT. § 8992 §§ 8991 to 8993. Repealed by 2016, Nov. 21, P.L. 1328, No. 170, § 30(2), effective in 90 days [Feb. 21, 2017].

79. WIS. STAT. ANN. § 183.1101. In Marx v. Morris, the defendant asked the court to read corporate principles of derivative standing into the case involving an LLC. The Wisconsin Supreme Court declined, noting:

> the absence of statutory procedures that limit actions against others for injuries to the LLC is significant . . . we decline to import corporate principles of derivative standing into ch. 193 to preempt claims by individual North Star members. This conclusion is not driven by who "owns" the claim, but rather by Wis. Stat § 183.0401 and the partnership-like mode of operation North Star, LLC selected in its Operating Agreement.

Marx v. Morris, 386 Wis. 2d 122, 124 (2019).

80. The original statute was 15 PA. CONS. STAT. § 8892, which was repealed by 2016, Nov. 21, P.L. 1328, No. 170, § 30(2), effective in 90 days [Feb. 21, 2017]; the current statute is 15 PA. CONS. STAT. § 8882.

of the eligible members,[81] and also the RULLCA provision authorizing derivative suits with the typical requirements that the plaintiff make a demand unless futile, contemporaneous ownership, particularity in the complaint, and that the member fairly and adequately represents the interests of the members.[82]

Connecticut enacted its original LLC statute in 1993 based on the Prototype Act (CLLCA).[83] The statute was repealed in 2017 and replaced with a version based on the RULLCA.[84] In *Saunders v. Briner*, the Supreme Court of Connecticut examined whether the original statute authorized a member or manager of a limited liability company to bring a derivative action on its behalf.[85] Paradoxically, the suit had been filed in 2012, under the original statute but was decided in 2019, after the new statute (CULLCA)[86] was in effect and would have changed the outcome for the plaintiff. The court noted that the original CLLCA was modeled after the Prototype Act and concluded that the Connecticut act did not permit members or managers to file derivative actions; the act authorized members or managers to collectively file such a suit, only as long as the requisite majority of disinterested members or managers approved.[87] The Connecticut court was of the view that the lawmakers intentionally omitted derivative suits by LLC members and was not inclined to undo that, even though the revised statute did just that. According to the court:

> We conclude, therefore, that, in adopting a functionally identical provision to § 1102 of the Prototype Act, our legislature chose to omit the derivative action under the [old] CLLCA for members and managers of limited liability companies. Consequently, the plaintiff in the present case failed to allege that he undertook the proper procedure to maintain standing under the CLLCA. Although the allegations set forth in the plaintiff's second amended complaint—namely, that he was a member or manager of both companies and that either he made demands on Briner or such demands were futile—comport with the procedural requirements for bringing a derivative action under the [new] CULLCA, they do not comply with the requirements for bringing a member initiated action under the CLLCA.[88]

81. KY. REV. STAT. ANN. § 275.335.
82. KY. REV. STAT. ANN. § 275.337.
83. CONN. GEN. STAT. § 34-186 (repealed by 2016, P.A. 16-97, § 110, eff. July 1, 2017.)
84. CONN. GEN. STAT. ANN. § 271a-271e.
85. Saunders v. Briner, 334 Conn. 135 (2019).
86. CONN. GEN. STAT. ANN. § 271a-271e.
87. *Saunders,* 334 Conn. at 159-60.
88. *Id.* at 161-2 (citations omitted).

The Prototype Act was revised in 2011, with revisions now providing "an extensive set of provisions dealing with derivative actions derived from the RMBCA and the Colorado Limited Liability Company Act."[89] Nonetheless, Alaska, Arkansas, Indiana, Massachusetts, and New Mexico have retained the original Prototype language and do not authorize derivative suits unless plaintiffs have the approval of a majority of the membership interests eligible to vote.[90]

New York is a bit of an outlier here because, like the states that followed the Prototype Act, it does not have a provision authorizing derivative suits for LLCs, but it did not model its statute after the Prototype Act. An early draft of the New York LLC statute did contain a provision authorizing derivative suit against LLCs; the final iteration, however, omitted all reference to derivative suits when it was passed in 1994.[91] The background on how, and perhaps why, derivative suits were omitted from the final statue is discussed extensively by a closely-divided New York Court of Appeals in *Tzolis v. Wolff*.[92]

The underlying question here is how much weight to give lawmakers' failure to include a given topic in the statute. Does the absence of the provision mean that the lawmakers affirmatively intended to exclude the topic from the state's laws generally?[93] This is the position taken by the

89. *Revised Prototype LLC Act, supra* note 67, at 122.

90. *See supra* notes 70, 71, 73, 75, 77.

91. According to the New York Court of Appeals:

> The Legislature clearly did decide not to enact a statute governing derivative suits on behalf of LLCs. An Assembly-passed version of the bill that became the Limited Liability Company Law included an article IX, entitled "Derivative Actions." In the Senate-passed version, and the version finally adopted, the article was deleted, leaving a conspicuous gap; in the law as enacted, the article following article VIII is article X. Nothing in the legislative history discusses the omission.

Tzolis v, Wolff, 10 N.Y.3d 100, 106–07 (2008).

92. Tzolis v, Wolff, 10 N.Y.3d 100 (2008).

93. Not to the Tzolis majority: "The dissent finds, in the legislative history of the Limited Liability Company Law, a 'legislative bargain' to the effect that derivative suits on behalf of LLCs should not exist (dissenting op at 113). We find no such thing." *Tzolis*, 10 N.Y.3d at 106. The Connecticut Supreme court certainly thought so in Saunders v. Briner:

> Our conclusion is consistent with the context surrounding our legislature's enactment of the CLLCA and its enactment of our current limited liability company statute, the Connecticut Uniform Limited Liability Company Act (CULLCA), *General Statutes § 34-243 et seq.* Not only did our legislature decline to provide for a derivative cause of action in the CLLCA but, when it enacted the CLLCA, it also did not modify our derivative action statute, *General Statutes § 52-572j*, to include limited liability companies. [citations omitted]. The fact that the legislature did not modify *§ 52-572j* after its enactment of the

dissent in *Tzolis*, arguing that the right to bring a derivative action was deleted from the final version of the bill, thus siding with the defendants and their claim that the New York lawmakers intended to exclude LLC members from the derivative litigation process.[94]

Reading the tea leaves of legislators' unspoken intent is tricky business at best. What if the absence of the provision was not dispositive? What if the lawmakers' failure to include a topic meant that while the lawmakers affirmatively intended to exclude the topic from the statute, they also intended that the courts step in to create case law that would deal with the topic they omitted?[95] That is the position the *Tzolis* majority took in holding that LLC members were permitted to bring derivative suits on behalf of the LLC, even without express authorization in the New York LLC statute.[96] The court found that "this omission [of authorization for derivative suits] does not imply such suits are prohibited."[97]

The court acknowledged that the provision authorizing derivative suits

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> CLLCA suggests that it did not intend to allow derivative actions for that type of corporate structure.

Saunders v. Briner, 334 Conn. 135, 161 n.27 (2019).

94. According to the *Tzolis* dissent:

> Presumably, those businesses electing to organize as LLCs relied on what the Limited Liability Company Law says, and counted on the New York judiciary to interpret the statute as written. Instead, the majority has effectively rewritten the law to add a right that the Legislature deliberately chose to omit. For a Court that prides itself on resisting any temptation to usurp legislative prerogative, the outcome of this appeal is curious. I respectfully dissent.

Tzolis, 10 N.Y.3d at 121 (Read, J., dissenting). A lower New York court shared Justice Read's concerns in Lio v. Zhong:

> When the Limited Liability Company Law was enacted in New York State in 1994 a conscious decision was made to eliminate the right of its individual members to bring derivative actions. Prior drafts of the bill had included such a right, but such provisions were eliminated as a means of getting the bill passed. The omission of such provision has created controversy, particularly where, as here, allegations are made that those in control are acting contrary to the interests of the other members of the LLC.

Lio v. Zhong, 10 Misc.3d 1068(A) at 3 (2006).

95. The majority in *Tzolis* did not find this omission to be meaningfully indicative of legislative intention, suggesting that legislators may have expected only that "the problem would cease to be the Legislature's and become the courts." DEMOTT, *supra* note 36, at § 2:11.

96. *Tzollis*, 10 N.Y.3d at 102. The court based its holding "on the long-recognized importance of the derivative suit in corporate law and on the absence of evidence that the Legislature decided to abolish this remedy when it passed the Limited Liability Company Law in 1994." *Id.* at 103.

97. *Id.*

had been inserted and then removed from the bill, but found that "this does not prove that any legislator, much less the Legislature as a whole, thought that the absence of article IX would render derivative suits nonexistent—an extreme result that no legislator is known to have favored."[98] The dissent relies on the removal of the provision from the final bill to support its conclusion that the lawmakers intended that derivative suits for LLC members were not authorized in New York.[99] The Court of Appeals disagreed, noting that "the dissent cites to no evidence, and we know of none, that anyone ever suggested doing away with derivative suits entirely."[100] The

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98. *Tzolis,* 10 N.Y.3d at 108. According to the majority:

> Our only source of information on the reason for it is a sentence written by the author of the Practice Commentaries on the Limited Liability Company Law: "Because some legislators had raised questions about the derivative rights provisions, to avoid jeopardizing passage of the balance of the entire law, Article IX was dropped" (Rich, Practice Commentaries, McKinney's Cons Laws of NY, Book 32/32A, Limited Liability Company Law, at 181 [2007]). Nothing tells us what the "questions" were, or why they would have jeopardized the bill's passage."

Id. at 107.

99. According to the *Tzolis* dissent:

> The enacting (not a subsequent) Legislature considered and explicitly rejected language authorizing the very result that plaintiffs have successfully sought from the judiciary in this case. Fourteen years after the fact the majority has unwound the legislative bargain. The proponents of derivative rights for LLC members—who were unable to muster a majority in the Senate—have now obtained from the courts what they were unable to achieve democratically. Thanks to judicial fiat, LLC members now enjoy the right to bring a derivative suit. And because created by the courts, this right is unfettered by the prudential safeguards against abuse that the Legislature has adopted when opting to authorize this remedy in other contexts (*see Business Corporation Law §§ 626*, *627*; *Partnership Law §§ 115-a*, *115-b*).

Id. at 121 (Read, J., dissenting).

100. *Id.* at 107.

> But this does not prove that any legislator, much less the Legislature as a whole, thought that the absence of article IX would render derivative suits nonexistent—an extreme result that no legislator is known to have favored. We simply do not know what consequences the legislators expected to follow from the omission. It is possible that some legislators did expect—though no one expressed the expectation—that there would be no derivative suits. It is possible that some legislators expected the courts to follow the established case law, and to recognize derivative suits in the absence of a "clear mandate against" doing so (*Klebanow, 344 F2d at 298);* one witness at a legislative public hearing did express that expectation (statement of Howard N. Lefkowitz, chair of Committee on Corporation Law, Association of Bar of City of NY, Transcript of Assembly Public Hearing on Limited Liability Company Legislation, June 11, 1992, at 133). It is possible that the Senate expected one thing, and the Assembly the

court points to what it considered to be the most salient feature of the legislative history, commenting that "no one, in or out of the Legislature, ever expressed a wish to *eliminate*, rather than limit or reform, derivative suits."[101]

The court looked to other forms of business for guidance and noted that derivative suits for shareholders had long been recognized in New York case law[102] and later by statute.[103] Derivative suits had only recently been considered in New York for other forms of business such as limited partners, even in the absence of statutory authorization.[104] The court cited a Second Circuit Court of Appeals case holding that "the absence of a statutory provision was not decisive because the court found no 'clear mandate *against* limited partners' capacity to bring an action like this.'"[105] As a result, the court noted that in the instant case, it would not "readily conclude that the Legislature intended to set us on this uncharted path" to "abolish[] the derivative suit as far as LLCs are concerned."[106]

The dissent raised a valid additional concern that a judicial authorization of derivative suits in blank would thereby not subject the process to any of the typical procedural hurdles, such as requiring a demand

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> other. It is even possible that neither expected anything, except that the problem would cease to be the Legislature's and become the courts'. The legislative history is, in short, far too ambiguous to permit us to infer that the Legislature intended wholly to eliminate, in the LLC context, a basic, centuries-old protection for shareholders, leaving the courts to devise some new substitute remedy.

Id. at 108.

101. *Id.* at 106.

102. According to Justice Smith:

> Chancellor Walworth recognized the remedy [of derivative suits] in *Robinson v Smith (3 Paige Ch 222 [1832]),* because he thought it essential for shareholders to have recourse when those in control of a corporation betrayed their duty. Chancellor Walworth applied to a joint stock corporation—then a fairly new kind of entity—a familiar principle of the law of trusts: that a beneficiary (or "cestui que trust") could bring suit on behalf of a trust when a faithless trustee refused to do so.

Id. at 103.

103. N.Y. BUS. CORP. § 626.

104. Query whether the lower court truly understood the nature of the LLC entity; the procedural posture of the case reflects the confusion that some courts have about LLCs in general, and specifically, with respect to derivative suits. The Supreme Court of the New York Country initially dismissed the case, finding the plaintiffs could not bring action "to redress the wrongs suffered by the corporation." Tzolis v. Wolff, 12 Misc.3d 1151(A), 2006 N.Y. Slip Op. 50851 (U). It is worth mentioning that an LLC is not a corporation.

105. *Tzolis,* 10 N.Y.3d at 104 (citing Klebanow v. N.Y. Produce Exch., 344 F.2d 294 (2d Cir. 1965)).

106. *Id.* at 106.

and contemporaneous ownership, and would leave the right to derivative suits "unfettered by the prudential safeguards against abuse that the Legislature has adopted . . . in other contexts."[107] The majority disagreed with the characterization of derivative suits as "unfettered," relying on existing restrictions in the caselaw on shareholder derivative suits which, presumably, would now be applied in the context of LLCs.[108] The court ultimately punts on this issue, saying "what limitations on the right of LLC members to sue derivatively may exist is a question not before us today. We do not, however, hold or suggest that there are none," leaving the door open for judges in future cases or lawmakers to promulgate any needed procedural hurdles.[109]

C. Derivative Litigation by Limited Partners

Limited partnerships also blend features of corporations and partnerships, so it is again unsurprising that drafters have leaned on both corporate and partnership statutory norms in crafting structures to govern this hybrid.[110] As is the case with LLC legislation, almost every state now authorizes limited partners to bring derivative suits on behalf of the limited partnership.[111] This result reflects that, in the context of derivative suits, the limited partnership is arguably acting more like a corporation than a partnership. A limited partner with no right to manage or control the entity, and no power to bind the entity, faces much the same challenges as a shareholder would when trying to hold managers accountable.[112] Both

107. *Id.* at 108 (citing Read, J., dissenting at 121).

108. *Id.*

109. *Id.* at 108–09.

110. *Standing of Limited Partners to Sue Derivatively,* 65 COL. L. REV. 1463, 1478 (1965).

111. Louisiana is the exception. Limited partnerships in Louisiana are called "Partnerships in Commendam," and there is no mention of derivative suits for this form of business. LA. CIV. CODE ANN. art. 2837–42.

112. "Limited partners, like corporate shareholders, traditionally have little or no management power. Indeed, the limited partner 'control' rule, which was ubiquitous in limited partnerships as of the adoption of the initial LLC statutes, makes non-participation in control a condition of limited liability." Ribstein, *supra* note 4, at 747.
The courts have offered protection to limited partners even without statutory rights to bring derivative suits, relying on an analogy with the law of trusts:

> There can be no question that a managing or general partner of a limited partnership is bound in a fiduciary relationship with the limited partners . . . and the latter are, therefore, *cestuis que trustent*. . . . It is fundamental to the law of trusts that *cestuis* have the right, 'upon the general principles of equity' (*Robinson v. Smith*, 3 Paige Ch. 222, 232) and 'independently of [statutory] provisions' (*Brinckerhoff v. Bostwick*, 88 N. Y. 52, 59), to sue for the benefit of the trust on a cause of action which belongs to the trust if 'the trustees refuse to

groups of owners are, for the most part, at the mercy of their managers.[113]

The liability exposure of limited partners and shareholders is also comparable; the limited partners' liability is limited to their capital contribution and, assuming proper behavior on their part, the limited partners have no personal liability for partnership debts or obligations.[114] This is true for corporate shareholders who behave properly as well. Thus, it is unsurprising that courts have explicitly relied on corporate precedents when exploring demand futility in the case of limited partnerships.[115] The arguments made against permitting derivative suits in closely-held LLCs are not as strong in the case of limited partners, since limited partners, by definition, have no right to manage.[116]

As it did with limited liability companies, the ULC promulgated a model act for limited partnerships; the Uniform Limited Partnership Act (2001) (ULPA) was promulgated in 2001 and was last revised in 2013.[117] According to the ULC, it was drafted to provide "a more flexible and stable basis for the organization of limited partnership, helping states stimulate new

> perform their duty in that respect'. (*Western R. R. Co. v. Nolan*, 48 N. Y. 513, 518 . . . .).

Tzolis, 10 N.Y.3d at 104–05.

113. According to Professor DeMott, "the limited partner's relationship to the limited partnership is sufficiently analogous to a shareholder's relationship to a corporation to justify derivative actions." DEMOTT, *supra* note 36, at § 2:11.

114. For a discussion of piercing the corporate veil and the liability of LLC members for LLC debts and obligations, see Albert, *supra* note 13.

115. "In the absence of legislation explicitly authorizing limited partners to bring derivative actions, most courts considering the question held that limited partners were able to bring such actions as beneficiaries or *cestuis que trustent* of a fiduciary relationship with the limited partnership itself." DEMOTT, *supra* note 36, § 2:11. *See also* Seaford Funding Ltd. P'ship v. M&M Assocs. II, L.P., 672 A.2d 66 (Del. Ch. 1995) (applying Delaware corporate standards and principles in analyzing whether demand had been excused in a derivative suit brought against a limited partnership and holding that "demand futility issues in the partnership context are the same as in the corporate context.); Gubitosi v. Zegeye, 28 F. Supp. 2d 298, 306–07 (E.D. Pa. 1988) (applying Pennsylvania corporate law to a limited partnership case).

116. Ribstein, *supra* note 4.

117. According to Professor Kleinberger:

> The "shelf life" on uniform entity acts seems to be decreasing. The original Uniform Partnership Act (UPA) lasted eight decades, and the original Uniform Limited Partnership Act (ULPA (1916)) lasted six. In contrast, the 1976 Revised Uniform Limited Partnership Act (RULPA (1976)) warranted major revisions after just nine years (RULPA (1985)), and only sixteen years later NCCUSL recommended to the states that they adopt ULPA (2001) to replace RULPA in toto.

Daniel S. Kleinberger, *A User's Guide to the New Uniform Limited Partnership Act*, 37 SUFFOLK U. L. REV. 583 (2004).

partnership business ventures."[118] The current ULPA includes provisions from prior versions and a number of provisions from the ULLCA, including authorizing limited partners to bring derivative suits.[119] The ULPA has been enacted in 23 states and the District of Columbia,[120] and there is a bill pending in Wisconsin to adopt the act.[121]

The UPLA has some overlaps, but also significant departures, from another model act, the Model Business Corporation Act (MBCA). The MBCA requires contemporaneous ownership[122] and so does the ULPA.[123] But there are differences between the ULPA and the MBCA in the area of derivative suits. The MBCA requires that the plaintiff must fairly and adequately represent the interests of the corporation in enforcing its rights,[124] but the ULPA does not. The MBCA requires "universal" demand with no carve out for demand futility;[125] but the ULPA provides an exception to the demand requirement where demand would be futile.[126]

The MBCA does not require derivative plaintiffs to provide security for expenses; neither does the ULPA. Nonetheless, a handful of states require

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118. *Limited Partnership Act, Revised Description*, UNIF. L. COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=d9036976-6c90-4951-ba81-1046c90da035 [https://perma.cc/7F8B-63CW] (last visited May 15, 2020). The ULPA was promulgated in 2001 and last amended in 2013. It takes the place of the Revised Uniform Limited Partnership Act, which was promulgated in 1976 and last amended in 1985.

119. UNIF. LIM. P'SHIP ACT § 902 (2001).

120. Alabama (2019); Pennsylvania (2017); Tennessee (2017); Idaho (2015); Mississippi (2015); District of Columbia (2011); Montana (2011); Utah (2011); Oklahoma (2010); Washington (2009); Alabama (2009); Arkansas (2007); New Mexico (2007); Nevada (2007); California (2006); Kentucky (2006); Maine (2006); Idaho (2006); North Dakota (2005); Florida (2005); Iowa (2004); Illinois (2004); Minnesota (2004); Hawaii (2003). UNIF. L. COMM'N, *supra* note 118.

121. The Wisconsin Bill Number is AB 854/SB 810. *Id.*

122. MODEL BUS. CORP. ACT § 7.41(1) (2016).

123. A derivative action to enforce the right of a limited partnership may be maintained only by a person that is a partner at the time the action is commenced. UNIF. LTD. P'SHIP ACT §§ 1002-03 (2001). California provides an exception to the contemporaneous ownership rule for partners who can show:

> (1) there is a strong prima facie case in favor of the claim asserted on behalf of the partnership, (2) no other similar action has been or is likely to be instituted, (3) the plaintiff acquired the shares before there was disclosure to the public and to the plaintiff of the wrongdoing of which plaintiff complains, (4) unless the action can be maintained the defendant may retain a gain derived from the defendant's willful breach of a fiduciary duty, and (5) the requested relief will not result in unjust enrichment of the partnership or any partner.

CAL. CORP. CODE § 15910.03 (West 2014).

124. MODEL BUS. CORP. ACT § 7.41 (2016).

125. MODEL BUS. CORP. ACT § 7.42 (2016).

126. UNIF. LTD. P'SHIP ACT § 1002 (2001).

derivative shareholders to post a bond before filing suit, and an even smaller number of states require this of limited partners.[127] Professor Ribstein argues that these security for expense provisions are designed "to deal with the problem of nominal shareholders whose lawyers are essentially striking for attorneys' fees."[128] As a result, statutes authorizing derivative suits for LLC members may be less necessary when the plaintiff is a significant shareholder and not just a proxy for the lawyers. Accordingly, the statutes may be significantly less necessary for LLC derivative suits because the plaintiff is likely to be a major owner rather than a nominal holder "fronting" for a lawyer.

To the extent that LLCs and limited partnerships are similar to corporations with respect to how owners can seek to hold the entity's managers accountable, derivative litigation should be, and for the most part is, appropriately available beyond just the scope of corporation to include the equally "helpless" owners of LLCs and limited partnerships.

III. SECURITY FOR EXPENSE PROVISIONS FOR SHAREHOLDERS, LLC MEMBERS, AND LIMITED PARTNERS

Security for expense statutes require unsuccessful derivative plaintiffs to pay some or all of the defendants' expenses, including in some cases, attorney's fees.[129] The statutes typically provide that substantial owners need not post a bond. Arguably, these substantial owners are more invested in the firm, both literally and figuratively, and thus less likely to bring a nuisance or strike suit that will waste corporate time, energy, and funds.

Since the first security for expense statute was enacted in New York in

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127. For a discussion of the states that do impose security for expense provisions on limited partners, see *infra* Part III.A.

128. RIBSTEIN & KEATINGE, s*upra* note 5, § 13:9.

129.

> Most security-for-expenses statutes provide that the security amount may include the expenses not only of the defendant corporation, but also of other named defendants, such as directors and officers, for which the corporation may become liable. Thus, even when the statute does not provide so expressly, it must be read in conjunction with the corporate indemnification statute that will govern whether an individual defendant's expenses will or may ultimately become expenses of the corporation.

LOCKWOOD, *supra* note 1, at § 3:3.

1944, a number of other states have followed suit.[130] Currently, nine states[131] require shareholders to provide security for the expenses of a derivative suit: Alaska,[132] Arkansas,[133] California,[134] Colorado,[135] Nevada,[136] New Jersey,[137] New York,[138] North Dakota,[139] and Pennsylvania.[140] It is noteworthy that Delaware, where significant, large multinational corporations are incorporated, does not have a security for expense provision.[141] A number of states enacted, and then repealed, security for expense provisions,[142] including Florida, Georgia, Hawaii, Maine,[143] Maryland,[144] Nebraska, New

130. For a discussion of the history of the early security for expense statutes, see Albert *supra* note 3. Professor Galanti noted the Wood Report's "clear anti-shareholder bias" and "its confidence in the security for expense device as the exclusive safeguard against abusive practices in shareholder derivative litigation." PAUL J. GALANTI, INDIANA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 38.25 (2020).

131. The nine states do not include North Carolina, which in 1995, adopted a security for expense statute applicable only to derivative suits against directors of public corporations:

> If the court orders, [plaintiffs must] execute and deposit with the clerk of court a written undertaking with sufficient surety, approved by the court, to indemnify the corporation against any and all expenses reasonably expected to be incurred by the corporation in connection with the proceeding, including expenses arising by way of indemnity.

N.C. GEN. STAT. ANN. § 55-7-48(3) (West 1995).

132. ALASKA STAT. ANN. § 10.06.435(h) (West 2017).

133. ARK. CODE ANN. § 4-26-714(c) (West 2018). The statute is superseded in part by ARK. R. CIV. P. 23.1.

134. CAL. CORP. CODE § 800(c)-(d) (West 2014).

135. COLO. REV. STAT. ANN. § 7-107-402(3) (West 1994).

136. NEV. REV. STAT. ANN. § 41.520 (LexisNexis 1997).

137. N.J. STAT. ANN. § 14A:3-6.8 (West 2013).

138. N.Y. BUS. CORP. LAW § 627 (McKinney 2018).

139. N.D. CENT. CODE § 10-19.1-86(2) (1997).

140. 15 PA. CONS. STAT. § 1782 (2016).

141. DEMOTT, *supra* note 36, at § 3:2.

142. DEMOTT, *supra* note 36, at § 3:2.

143. Maine deleted its security for expense provision in 1973. Douglas M. Branson, *The American Law Institute Principles of Corporate Governance and the Derivative Action: A View from the Other Side*, 43 WASH. & LEE L. REV. 399, 404 n.30 (citing Historical Note to ME. REV. STAT. ANN. A. CONS. STAT. tit. 13-A § 627 (1981)).

144. The Maryland statute no longer appears in its statutes but is reproduced in *Security for Expenses Legislation Summary*:

> In any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than five percentum of the outstanding shares of any class of such corporation's stock or voting trust certificates, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of twenty-five thousand dollars, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection

Hampshire, Tennessee, Texas,[145] Washington, Wisconsin,[146] and Wyoming.[147] The case law flowing from these nine corporate statutes is

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> with such action, and which may be incurred by the other parties defendant in connection therewith for which it may in anywise become legally liable, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon termination of such action. The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon a showing that the security provided has or may become inadequate or excessive.

Security for Expenses Legislation Summary, supra note 17, at 268 n.5 (citing MD. ANN. CODE GEN. LAWS art. 16, § 195 (Cum. Supp. 1947)).

145. Texas' Business Organization Code had a security for expense provision that was effective from January 1, 2006 to August 31, 2019:

> § 153.404. Security for Expenses of Defendants
> (a) In a derivative action, the court may require the plaintiff to give security for the reasonable expenses incurred or expected to be incurred by a defendant in the action, including reasonable attorney's fees.
> (b) The court may increase or decrease at any time the amount of the security on a showing that the security provided is inadequate or excessive.
> (c) If a plaintiff is unable to give security, the plaintiff may file an affidavit in accordance with the Texas Rules of Civil Procedure.
> (d) Except as provided by Subsection (c), if a plaintiff fails to give the security within a reasonable time set by the court, the court shall dismiss the suit without prejudice.
> (e) The court, on final judgment for a defendant and on a finding that suit was brought without reasonable cause against the defendant, may require the plaintiff to pay reasonable expenses, including reasonable attorney's fees, to the defendant, regardless of whether security has been required.

TEX. BUS. ORGS. CODE ANN. § 153.404. (West 2009). As of August 31, 2019, § 153.404 has been "updated" and is now titled, "Determination by Independent Persons," and focuses on how to proceed on allegations made in a demand. TEX. BUS. ORGS. CODE ANN. § 153.404 (West 2019).

146. The Wisconsin statute no longer appears in its statutes, but is reproduced in *Security for Expenses Legislation Summary*:

> [N]o stockholders' derivative action against one or more directors or officers of a corporation of this state shall be maintained by the holder or holders of less than 5 per cent of the outstanding stock of any class, unless the action be based on conduct which results, and is willfully intended to result, in a direct or indirect personal benefit or advantage to one or more directors or officers, or conduct which results in a personal benefit or advantage to one or more stockholders over the other stockholders.

Security for Expenses Legislation Summary, *supra* note 17, at 271 n.17 (citing WIS. STAT. § 180:13(3) (1949)).

147. "Georgia's General Assembly deleted the security for expense provision contained in its statute authorizing derivative actions. GA. CODE ANN. § 14-2-123 (Comment). Maine repealed its security for expense statute in 1973. ME. REV. CODE ANN tit. 13-A § 627 (Historical Note)." DEMOTT, *supra* note 36, at § 3:2.

sparse in terms of number, scope, and significance, except that early litigation in the area of security for expense provisions supported the constitutionality of these statutes.[148]

This Part will briefly explore the nine current security for expense statutes, and then explore these states' choices whether to legislate in this area for LLC members and limited partners. Ideally, this examination would lead to consistent results or plausible reasons for the differences in approaches to security for expense statutes for plaintiffs from LLCs and limited partnerships.[149]

Most of the security for expense statutes are based, to some degree, on Section 49 of the Model Business Corporation Act:

> In any action now pending or hereafter instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of record of less than five per cent of the outstanding shares of any class of such corporation or of voting trust certificates therefor, unless the shares or voting trust certificates so held have a market value in excess of twenty-five thousand dollars, the corporation in whose right such action is brought shall be entitled at any time before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including fees of attorneys, that may be incurred by it in connection with such action or may be incurred by other parties named as defendant for which it may become legally liable. Market value shall be determined as of the date that the plaintiff institutes the action or, in the case of an intervenor, as of the date that he becomes a party to the action. The amount of such security may from time to time be increased or decreased, in the discretion of the court, upon showing that the security provided has or may become inadequate or is excessive. The corporation shall have recourse to such security in such amount as the court having jurisdiction shall determine upon the termination of such action, whether or not the court finds the action was brought without

148. In Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541 (1949), the Supreme Court held that security for expense statues do not violate either the due process or equal protection clauses of the Constitution, although these statutes clearly can result in different treatment for different plaintiffs, depending on their shareholdings. At least one state case raised constitutional grounds to set aside a security for expense statute: in Moran v. Murtaugh Miller Meyer & Nelson, LLP, 152 P.3d 416 (Cal. 2007) (holding the security for expense provision constitutional, even though plaintiff argued that the requirement to post such security discriminated against the plaintiffs of "modest means").

149. For a full discussion of each of the nine states' security for expense statutes, see Albert, *supra* note 3.

reasonable cause.[150]

The Revised Model Business Corporation Act omits any provision consistent with § 49 but "provides instead that on termination of an action the court may require plaintiff to pay defendants' reasonable expenses, if the court finds the proceeding was brought 'without reasonable cause.'"[151] This may start to explain why so few states have actually enacted and retained these security for expense provisions.[152]

These nine bond posting statutes have much in common and are consistent in structure. Each statute authorizes defendants in derivative suits to seek a court order to require derivative plaintiffs to post a bond to secure the defendants' litigation expenses before the case can proceed, unless the plaintiff meets any relevant statutory carve-out based on percentage and/or market value of their ownership interest. The range of minimum share value needed to avoid the bond posting requirement runs from $25,000 for Arkansas, Colorado and North Dakota, to $250,000 for New Jersey.[153] The amount of the bond is set by the court, with California being the only state to cap the dollar amount of the bond at a maximum of $50,000, regardless of the number of defendants.[154] Most of the current security for expense statutes go beyond simply requiring the bond and also create potential liability for the full amount of a successful corporation's costs and expenses, including, in some cases, attorney's fees.[155] California and Nevada permit a court in its discretion to require any derivative plaintiff to provide security, regardless of their stock ownership.[156]

Lawmakers in these nine states likely had concerns about strike or nuisance suits brought by spurious shareholders. The presumed aim of these statutes is to filter out nuisance or strike suits, allowing only the meritorious suits to move forward.[157] These states' concerns, for the most part,

150. MODEL BUS. CORP. ACT ANN. § 49 (1971).

151. DEMOTT, *supra* note 36, at § 3:2; MODEL BUS. CORP. ACT § 7.46(2). *See also* Elliott Goldstein & Robert W. Hamilton, *The Revised Model Business Corporation Act*, 38 BUS. LAW. 1019, 1022 (1983) (stating that the provision developed by the Committee "encourages the court to assess the costs of litigation against the plaintiff if the suit was commenced without reasonable cause").

152. "The trend, then, appears to be away from security requirements and toward reliance on other safeguards against strike suits." DEMOTT, *supra* note 36, at § 3:2.

153. ARK. CODE ANN. § 4-26-714(c) (2018); COLO. REV. STAT. ANN. § 7-107-402 (West 1994); N.D. CENT. CODE § 10-19.1-86(2) (1997); N.J. STAT. ANN. § 14A:3-6.8 (West 2013).

154. CAL. CORP. CODE § 800(d) (West 2014).

155. GALANTI, *supra* note 130, at § 38.25.

156. CAL. CORP. CODE § 800(c) (West 2014); NEV. REV. STAT. ANN. § 41.520 (LexisNexis 1997).

157. *See* DEMOTT, *supra* note 36, at § 3.1 ("It was originally believed that these statutes would deter baseless derivative suits.").

seemingly were limited to primarily shareholders. Of these nine states, four states have no security for expense provision for either their LLC or limited partnership statutes;[158] none of the nine states have such a provision for just their LLC statute; three states have such a provision for just their limited partnership statute;[159] and two states have such a provision for both their LLC and their limited partnership statutes.[160] This Part reviews the legislative choices these nine states made on whether and how to extend their concern about specious derivative suits to their LLC and limited partnership statutes.

A. Security for Expense Provisions for LLC Members and Limited Partners in the Nine States Where Shareholders Must Post a Bond

1. States Adopting Security for Expense Provisions Only for Corporate Shareholders

Alaska, Arkansas, Nevada and North Dakota all have security for expense statutes for their shareholders but no such provisions for their LLC members or limited partners.[161] An evaluation of how these states organize their various business entity statutes offers no conclusive insights into why this is so. Alaska and North Dakota each classify their corporate and LLC statutes under one title, and their limited partnership statute under another.[162] This supports the notion that lawmakers in those states consider LLCs to be more like corporations than partnerships. If this is so, arguably the LLC members should also be required to post a bond before filing a derivative suit. However, Arkansas and Nevada each classify their corporate, LLC, and limited partnership statutes all under the same title, eliminating the

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158. ALASKA STAT. § 10.06.435(h) (West 1999); ARK. CODE ANN. § 4-26-714(c) (West 1965); NEV. REV. STAT. § 41.520 (West 1997); N.D. CENT. CODE § 10-19.1-86(2) (West 2007).

159. COLO. REV. STAT. § 7-107-402(3) (West 1994); N.J. REV. STAT. § 14A:3-6.8 (West 2013); N.Y. BUS. CORP. LAW § 627(e) (McKinney 2018).

160. CAL. CORP. CODE § 800(c) (West 2014); 15 PA. CONS. STAT. § 1782 (West 2016).

161. Since the Alaska and Arkansas statutes are modeled after the Prototype Act, neither has a provision authorizing derivative suits for LLC members, thus obviating the need for a bond posting statute. *See* Part II, *supra.*

162. Alaska classifies both its corporations and LLCs in their own chapters under its Title 10: Corporations and Associations. *See* ALASKA STAT. §§ 10.06.005 to 10.06.995;(2017) (classifying corporations); §§ ; 10.50.010 to 10.50.995 (classifying LLCs). Alaska classifies LPs under its Title 32: Partnership. §§ 32.11.010 to 32.11.990. North Dakota classifies its corporations and LLCs under its Title 10. Corporations. N.D. CENT. CODE §§ 10-19-1-00.1 to 10-19.1-152, 10-32-1-01 to 10-32.1-101. North Dakota classifies its LPs under Title 45. Partnerships. §§ 45-10.2-01 to 45-10.2117.

possibility of any inference about how these lawmakers view the LLC.[163] A brief examination of the four state shareholder derivative suits and a comparison to their LLC statutes also sheds no light on the reasons why these four states chose only to require security for expenses from shareholders and not limited partners.

(a) Alaska

Alaska has a security for expense statute for corporate shareholders, enacted in 1988,[164] but does not have such a provision for LLC members or limited partners.[165] The Alaska LLC statute was modeled after the Prototype Act and thus has no provision for derivative actions for members at all,[166] even though such suits are statutorily authorized for both shareholders[167] and

163. Arkansas classifies its corporations, LLCs, and LPs all under its Title 4. Business and Commercial Law, but further classifies its corporations and LLCs under Subtitle 3. Corporations and Associations. ARK. CODE ANN. §§ 4-27-101 to 4-27-1908; §§ 4-32-101 to 4-32-1401. Arkansas classifies its LPs under its Subtitle 4. Partnerships. ARK. CODE ANN. §§ 4-47-101 to 4-47-13020. Nevada classifies corporations, LLCs, and LPs under Title 7. Business Associations; Securities; Commodities. NEV. REV. STAT. CODE §§ 78.010-78.785; §§ 86.011-86.590; §§ 87A.005-87A.230.

164. ALASKA STAT. ANN. § 10.06.435(h) (2017).

165. Since there is no statutory provision authorizing derivative suits for LLC members, it follows that there is no security for expense statute for members. Rule 23.1 of Alaska's Rules of Civil Procedure contains additional guidance regarding derivative suits, but its scope is simply any "holder of shares of the corporation." It does not include members of unincorporated associations the way Arkansas' and Colorado's do. Rule 23.1(f) restates the bond posting requirements from ALASKA STAT. § 10.06.435(h):

> (f) In a case in which demand on the board is excused under (c) of this section or the decision of the board under (e) of this section is rejected by the court as inconsistent with the directors' duties of care and loyalty to the corporation, a plaintiff who has standing under (b) of this section shall have the right to commence or continue the action created by (a) of this section. Notwithstanding (c) or (e) of this section, disinterested, noninvolved directors acting as the board or a duly charged board committee may petition the court to dismiss the plaintiff's action on grounds that in their independent, informed business judgment the action is not in the best interests of the corporation. The petitioners shall have the burden of establishing to the satisfaction of the court their disinterest, independence from any direct or indirect control of defendants in the action, and the informed basis on which they have exercised their asserted business judgment. If the court is satisfied that the petitions are disinterested, independent, and informed it shall then exercise an independent appraisal of the plaintiff's action to determine whether, considering the welfare of the corporation and relevant issues of public policy, it should dismiss the action.

ALASKA R. CIV. P. 23.1.

166. See *supra* notes 67-90 and accompanying text for a discussion of the Prototype Act.

167. ALASKA STAT. ANN. § 10.06.435(a) (2017).

limited partners.[168] The legislative choice not to include a statutory provision authorizing derivative suits for LLC members obviates the need for a security for expense statute for members of LLCs.

Alaska's corporate security for expense provision applies to any derivative plaintiffs holding less than five percent of any class of the corporation's stock.[169] Alaska is unusual in that its statute focuses only on the percentage ownership and does not provide an alternate metric for stockholders owning stock in excess of some stated financial value. As is common in these statutes, the court has discretion to change the amount of the bond upon a showing that the amount of security has become inadequate or excessive.[170] Since there is no statutory provision authorizing derivative suits for LLC members, it follows that there is no security for expense statute for members. Rule 23.1 of Alaska's Rules of Civil Procedure contains additional guidance regarding derivative suits, but its scope is simply any "holder of shares of the corporation."[171]

The absence of the bond posting language in the limited partnership statute is not likely explained by differences in the structure of the two statutes; the corporate and limited partnership statutes are very similar in construction, with one exception. Both statutes require contemporaneous ownership, so the plaintiff must have been a shareholder or limited partner, as appropriate, at the time of the complained-upon act.[172] Both statutes require that the plaintiff state with particularity the efforts made to secure initiation of the action by the entity.[173] The only structural difference between the two is that the corporate statute requires a plaintiff to make a formal demand, unless grounds exist for excusing such a demand,[174] while the limited partnership statute does not require a demand. This does not explain the lack of bond posting statutes to stem the flow of spurious derivative litigation. Arguably, the lack of a demand requirement might make it more likely, not less likely, that a plaintiff would file a spurious suit.

The case law referencing the Alaska security for expense statute does not offer any explanation for the absence of a security for expense provision in the Alaska limited partnership laws. The only cases that reference the statute at all do not discuss the security for expense requirement other than

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168. ALASKA STAT. ANN. § 32.11.490 (2017). See *supra* notes 67-90 and accompanying text for a discussion of the Prototype Act.

169. ALASKA STAT. ANN. § 10.06.435(h) (2017).

170. *Id.*

171. Alaska's Rule 23.1 does not include members of unincorporated associations the way Arkansas and Colorado do. ALASKA R. CIV. P. 23.1.

172. ALASKA STAT. ANN. § 10.06.435(b); § 32.11.500 (2017).

173. *Id.* § 10.06.435(d); § 32.11.510.

174. *Id.* § 10.06.435(c).

to note that it had not been satisfied, and that thus, the suits in question should be dismissed.[175] So, certain shareholders are required to post a bond in Alaska, while LLC members and limited partners are not.

(b) Arkansas

Arkansas has a security for expense statute for corporate shareholders, enacted in 1965,[176] but does not have such a provision for LLC members or limited partners. The Arkansas LLC statute was modeled after the Prototype Act,[177] and thus has no provision for derivative actions for members at all,[178] even though such suits are statutorily authorized for both shareholders[179] and

175. In Jerue v. Millett, 66 P.3d 736 (Alaska 2003), shareholders brought a derivative action against directors after the state issued a certificate of involuntary dissolution. The lower court dismissed the case as moot following the reinstatement of the corporation and shareholders meeting, denied shareholder's request for attorney's fees and costs, and awarded attorney's fees to the directors. The shareholders did not make a pre-suit demand and did not establish demand excusal as required by the statute. The Alaska Supreme Court, however, did not use the security for expense statute in its analysis and instead focused on determining who was a "prevailing party" to be awarded attorney's fees under Civil Rule 82. Because the shareholders failed to satisfy the statutory standard for a derivative action thereunder, the defendant directors were deemed to be the prevailing parties, but the plaintiffs did not have to make a demand under the security for expense statute since the derivative suit was not going forward.

In Holmes v. Wolf, No. S–13641, 2011 WL 6046407 (Alaska Nov. 30, 2011), the court dismissed the derivative claim when the shareholders failed to file the required bond; the case proceeded with only the shareholders' claims against the three directors directly. The Alaska Supreme Court did not address the Alaska security for expense statute in its analysis.

In Ivy v. Calais Co., No. 3AN-07-08813CI, 2008 WL 9337985 (Alaska Super. May 5, 2008), the court dismissed plaintiff's derivative action for failing to meet the procedural requirements of the Civil Rule 23.1 and AS § 10.06.435. The order did not specify which procedural requirements were not met, but the court did allow the plaintiff an opportunity to refile. The second amended complaint filed by plaintiff alleged that the aggrieved shareholders owned 6.25 percent of the company's shares and 18.75 percent of the company's assets. These ownership levels make it unlikely that the security for expense statute was even part of the reasoning for dismissing the case. Second Amended Complaint at ¶ 24, Ivy v. Calais Co., No. 3AN-07-08813CI, 2008 WL 9337985 (Alaska Super. May 5, 2008).

176. ARK. CODE ANN. § 4-26-714(c) (2018). The statute is superseded in part by ARK. R. CIV. P. 23.1 Actions by Shareholders.

177. Since there is no statutory provision authorizing derivative suits for LLC members, it follows that there is no security for expense statute for members.

178. LLC members' rights to sue derivatively are picked up in Rule 23.1 of the Arkansas Rules of Civil Procedure, which sets out rules for derivative suits by shareholders and members of any unincorporated association, which by definition includes LLCs. ARK. R. CIV. P. 23.1 (providing for suit by one or more shareholders).

179. *See* ARK. CODE ANN. § 4-26-714(c)(8) (2018) (authorizing shareholder derivative suits for corporations incorporated before 1987); *see also id.* § 4-27-740 (authorizing shareholder derivative suits for corporations incorporated after 1987).

limited partners.[180] The legislative choice not to include a statutory provision authorizing derivative suits for LLC members obviates the need for a security for expense statute for members of LLCs.

Arkansas' corporate security for expense provision applies to any derivative plaintiff owning less than five percent of any class of the corporation's stock and $25,000 or less of the corporation's stock.[181] There is no fixed dollar cap for the amount of the bond, which like the bond required under the Alaska statute, can "from time to time be increased or decreased in the discretion of the court upon a showing that the security provided has or may become inadequate or is excessive."[182]

Arkansas actually has two corporate statutes, one applicable to corporations incorporated before 1987[183] and one applicable to corporations incorporated from 1987 and after.[184] The derivative suits procedures in the two statutes both require contemporaneous ownership.[185] The newer statute requires that the plaintiff state with particularity the efforts made to obtain action by the board of directors.[186] The most significant difference between the two statutes with respect to derivative suits is that the security for expense provision appears only in the older statute. This would arguably support the conclusion that security is not required for derivative plaintiffs suing a corporation incorporated in 1987 or later, and that the Arkansas lawmakers made an affirmative choice to prohibit derivative suits.[187]

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180. *See* ARK. CODE ANN § 4-47-1002 (2018) (authorizing limited partner derivative suits).

181. ARK. CODE ANN. § 4-26-714(c)(1) (West 2018).

182. *Id.* § 4-26-714(c)(7).

183. *Id.* § 4-26-714.

184. The Business Corporation Act of 1987 applies to all corporations incorporated on or after midnight, December 31, 1987. ARK. CODE ANN. § 4–27–1706 (Supp. 1987).

185. *See* ARK. CODE ANN. § 4-26-714(a) (West 2018) (requiring the plaintiff in a derivative action to have held shares or voting trust certificates contemporaneously with the events giving rise to the complaint); *see also id.* § 4-27-740(a) (requiring the same).

186. *Id.* § 4-27-740(b).

187. However, Arkansas Rule of Civil Procedure 23.1 requires contemporaneous ownership, that the plaintiff states with particularity the efforts made to secure initiation of the action by the entity, and that the plaintiff fairly and adequately represents the interests of the owners. *See* ARK. RULES CIV. P. 23.1 Actions by Shareholders. Rule 23.1 does not require security for expenses. But according to the Reporter's Notes to Rule 23.1:

> Both this [ARCP 23.1] and FRCP 23.1 are silent concerning the "security for expenses" provision of many state business corporation acts, including that found in *Ark. Stat. Ann.* 64-223(c), (d) (Repl. 1962). Since the decision in *Cohen v. Beneficial Industrial Loan Corporation*, 337 U.S. 541, 69 S. Ct. 1221 (1949), it has generally been considered that such acts were substantive in nature and should be followed in diversity actions in federal courts. Consequently, the adoption of this rule does not supersede or repeal the "security for expenses"

The case law referencing the Arkansas security for expense statute does not offer any explanation for the absence of a security for expense provision in the Arkansas limited partnership laws.[188] Thus, certain shareholders are required to post a bond in Arkansas, while LLC members and limited partners are not.

(c) Nevada

Nevada has a security for expense statute for corporate shareholders, enacted in 1965,[189] but does not have such a provision for LLC members or limited partners, even though both groups have the statutory right to bring derivative actions like their corporate counterparts.[190]

The Nevada statute requires contemporaneous ownership by a plaintiff. As in Arkansas, the Nevada Rules of Civil Procedure add additional requirements for derivative proceedings, paralleling Federal Rule of Civil Procedure 23.1, including a requirement that the plaintiff make a formal demand.[191]

Nevada gives its courts discretion to require any plaintiff to provide security.[192] There is no carve out for shareholders owning some threshold

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provision found in the Arkansas Business Corporation Act.

ARK. R. CIV. P. 23.1, *Reporter's Notes to Rule 23.1*.

188. In Sobba v. Elmen, the District Court for the Eastern District of Arkansas had occasion to weigh in on the two Arkansas corporate statutes' treatment of bond posting when discussing Benton Window and Door, Little Rock Division, Inc. v. Garrett, 290 Ark. 244, 246, 718 S.W.2d 438, 439 (1986). The court noted that:

> *Garrett* was decided under the 1965 Business Corporation Act, which allowed the corporation in a derivative action to move for a hearing on whether the court should require the shareholder plaintiff to furnish security if there was "no reasonable possibility" that the case would benefit the corporation or its security holders. *Id.* at 246, 718 S.W.2d at 439 (citing Ark. Stat. Ann. § 64–223, now codified at Ark. Code Ann. § 4–26–714). *Garrett* noted that, under the 1965 statute, the corporation and the shareholder plaintiff "may be adversaries up to [the resolution of the security hearing] at least." *Id.* at 248, 718 S.W.2d at 440. The Business Corporation Act of 1987 — to which the nominal defendants here are subject — makes no provision for the corporation to file a motion to require the plaintiff to furnish security. *See* Ark. Code Ann. § 4–27–740.

Sobba v. Elmen, 462 F. Supp. 2d 944, 948 (E.D. Ark. 2006).

189. NEV. REV. STAT § 41.520 (West 1997).

190. NEV. REV. STAT. §§ 88.601, 86.483 (West 2017).

191. NEV. R. CIV. P. 23.1; FED. R. CIV. P. 23.1(b)(3). Like the Federal Rule of Civil Procedure 23.1(b)(3), the Nevada statute also requires derivative plaintiffs to make a demand. NEV. REV. STAT. § 41.520(2) (West 1997).

192. NEV. REV. STAT § 41.520(3).

amount of stock to avoid posting security.[193] The court will establish the amount of security for reasonable expenses when it grants such a motion. Unlike most other security for expense statutes, the Nevada statute does not require court approval for a derivative suit to be settled.

The case law referencing the Nevada security for expense statute does not offer any explanation for the absence of a security for expense provision in the Nevada LLC or limited partnership laws.[194] Thus, certain shareholders are required to post a bond in Nevada, while LLC members and limited partners are not.

(d) North Dakota

North Dakota has a security for expense statute for corporate shareholders, enacted in 1985,[195] but does not have such a provision for LLC members or limited partners, even though both groups have the statutory right to bring derivative actions like their corporate counterparts.[196]

The North Dakota statute requires contemporaneous ownership by a plaintiff.[197] Derivative plaintiffs holding less than five percent of any class of the corporation's stock and $25,000 or less of the corporation's stock are required to post a bond.[198] There is no fixed dollar cap for the amount of the bond.[199]

Upon termination of the suit, the court can order the plaintiff to pay the corporation's expenses if it finds that the derivative proceeding was brought "without reasonable cause."[200] Unlike the California statute that has a ceiling

193. *Id.* § 41.520.

194. *In Re* Cook is the only case dealing with the bond posting requirement of the Nevada statute. 444 B.R. 207 (Bankr. D. N.M. 2011). A derivative plaintiff voluntarily posted a bond in advance of a court order and eventually filed a motion to dismiss the derivative claims. *Id.* at 209. The defendant objected, not necessarily to the claims being dismissed, but instead contended that the plaintiffs should be required to post bond pursuant to the Nevada statute to cover the defendant's attorney's fees. *Id*. at 208-10. The court declined to require a bond and acknowledged that, under the terms of the statute, the bond is not an automatic right and requires a court to make certain determinations before ordering such security to be posted. N.D. CENT. CODE § 10-19.1-86(2) (1997). Here, the plaintiffs moved for dismissal before any such demand for security was made, thus, before the hearing required by the statute to determine if the bond should be ordered, and if so, how much. *Id*. The court then determined that Section 41.520(2) is applicable to derivative suits only, and once such a suit is dismissed, the statute no longer applies.

195. N.D. CENT. CODE § 10-19.1-86(2) (1997).

196. *Id.* § 45-10.2-90; § 10-32.1-34.

197. *Id.* § 10-19.1-86.

198. *Id.* § 10-19.1-86(2).

199. *Id.* § 10-19.1-86(2)(b).

200. *Id.* § 10-19.1-86(1).

dollar amount, the North Dakota statute allows for the full amount of such expenses to be paid.[201]

No North Dakota cases explore the security for expense process. Thus, certain shareholders are required to post a bond in North Dakota, while LLC members and limited partners are not.

Like the lawmakers in New York, lawmakers in Alaska, Arkansas, Nevada and North Dakota made the effort to protect the derivative litigation process from nuisance or strike suits by including security for expense provisions in their corporate law. They seemingly did not see the need to put similar protection in for LLCs and limited partnerships. Here the lawmakers did not comment in the legislative history about whether they even considered including a security for expense provision, and if they did consider it, why it was ultimately left out. This likely will not stop parties from arguing about whether any omissions were intentional, as seen in the New York case of *Tzolis v. Wolff*.[202]

The inconsistencies in enacting a security for expense provision is a curious choice, since the rights and roles of the corporate shareholder and limited partner are substantially similar. The vulnerabilities they face without having an active role in management are substantially similar. The statutes authorizing derivative actions for owners of both corporations and limited partnerships are substantially similar. Yet the corporate statutes in these four states contain a security for expense provision, so certain shareholders are required to post a bond while LLC members [to the extent they are even permitted to bring derivative suits] and limited partners are not, with no stated or even implied explanation for the distinction.

2. States Adopting Security for Expense Provisions for Corporate Shareholders and for Limited Partners

Colorado, New Jersey, and New York all have security for expense provisions for their shareholders and limited partners, but no such provisions for their LLC members. An evaluation of how these states organize their various business entity statutes offers no conclusive insights into why this is so. None of these three states list corporations and limited partnerships together,[203] which would support the notion that lawmakers in those states

201. CAL. CORP. CODE § 800(d) (West 1982).

202. See Part II *supra* for a discussion of the Tzolis v. Wolff case.

203. Colorado classifies its corporations, LLCs, and LPS all under its Title 7. Corporations and Associations. COLO. REV. STAT. §§ 7-101-101 to 7-117-105; §§7-80-101 to 7-80-1101; §§ 7-62-101 to 7-62-1105. New Jersey classifies its corporations under Title 14A. Corporations, General. N.J. STAT. ANN. 14A §§ 1-1 to 16-4 (West); New Jersey classifies its

consider LLCs to be more like corporations than partnerships. Further, New York lawmakers excluded derivative suits from their initial LLC statute, while authorizing them for shareholders and limited partners, which offers at least some explanation for the lack of a security for expense provision in their LLC statute.[204]

(a) Colorado

Colorado has a security for expense provision for limited partners, effective November 1, 1981,[205] and one for shareholders, effective July 1, 1994.[206] These statutes were designed to reduce the filing of nuisance or strike suits.[207] Yet Colorado has no security for expense provision for LLC members, who could also theoretically file nuisance or strike suits; their limited partner status arguably does not make them any less likely to bring such a suit.

Colorado's LLC statute has three provisions that are not present in the corporate or limited partnership statute. The LLC statute requires a written demand with no provision for demand futility.[208] The LLC statute requires

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LLCs and LPs under its Title 42. Partnerships and Partnership Associations. N.J. STAT. ANN. 42 §§ 2C-1 to 2C-94; 42 §§ 2A-1 to 2A-73. New York classifies its corporations under Business Corporation Law. N.Y. BUS. CORP. LAW § 101-2001 (McKinney); New York classifies its LLCs under Limited Liability Company Law. N.Y. LTD. LIAB. CO. §§ 101-1403; and New York characterizes its LPs under its Partnership Law. N.Y. P'SHIP LAW §§ 90-119 (McKinney).

204. See Part II *supra* for a discussion of Tzolis v. Wolff.

205. COLO. REV. STAT. § 7-62-1003.

206. *Id.* § 7-107-402.

207. According to Sheila K. Hyatt and Stephen A. Hess:

> Most of the special features of the shareholders' derivative action are designed to reduce the filing of frivolous "strike" suits by shareholders, which otherwise would be easily brought. Due to the expense and inconvenience attendant to such suits (most involve opening the corporation's books and accounts to the plaintiff), the rule provides at least some potential screening effect for the protection of the corporation.

SHEILA K. HYATT & STEPHEN A. HESS, WEST'S COLORADO PRACTICE SERIES: CIVIL RULES ANNOTATED R 23.1 (5th ed.).

208. COLO. REV. STAT. § 7-80-714. The Editors' Notes preceding Part 4. Actions by Shareholders in the corporate code offers this "Introductory Note to Part 4:"

> While the Model Act's correlative provisions on derivative proceedings contain provisions reflecting recent statutory and judicial developments in this area in other jurisdictions—in particular, provisions governing pre-litigation demands upon the corporation and the power of independent directors to dismiss a derivative action—the Colorado Bar Association adopted a position of neutrality on these controversial matters by proposing to continue the Code's existing

that the member "fairly and adequately represent the interests of the members similarly situated in enforcing the rights of the limited liability company."[209] And the LLC statute requires court approval in order to discontinue or settle the suit.[210] All three of these requirements are picked up in the Colorado Civil Rules, under Rule 23.1 which provides:

> In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.[211]

The Colorado Practice Series notes that both the corporate statutes and the limited partnership statutes "should be read in conjunction with Rule 23.1," with no reference to the LLC statute.[212] But by its terms, Rule 23.1 includes members of an unincorporated association, which should include LLCs.[213]

The corporate, LLC, and limited partnership statutes all require contemporaneous ownership with very consistent language.[214] All three statutes provide that the court can order the plaintiff to pay the expenses of the defendant, including attorney's fees, if the action was brought "without

provisions, and that proposal was adopted by the General Assembly in the Act.

COLO. REV. STAT. ANN. § T. 7, Art. 107, Pt. 4, Refs & Annos (West).

209. COLO. REV. STAT. § 7-80-713(1)(b).

210. *Id.* § 7-80-717.

211. COLO. R. CIV. P. 23.1.

212. "Section 7-107-402, C.R.S. should be read in conjunction with this rule." HYATT & HESS, *supra* note 207.

213. COLO. R. CIV. P. 23.1.

214. COLO. REV. STAT.§ § 7-80-713(1)(a); 7-107-402(1); 7-62-1001(1(c).

reasonable cause"[215] or was "commenced or maintained without reasonable cause or for an improper purpose."[216]

Although there is no security for expense provision in Colorado's LLC statute, the statute does deal with the payment of expense on a post factum basis.[217] The statute provides that if the court finds that the derivative suit "resulted in a substantial benefit" to the LLC, the court can order the LLC to pay the plaintiff's reasonable expenses, including attorney fees.[218] This provision in the LLC act is the only provision even touching on expenses.

The corporate and limited partnership statutes do not have this provision and instead require a bond to be posted; the bond posting statutes are quite similar. Each has the same carve-out, exempting owners with 5% or more of the outstanding corporate shares[219] or total limited partnership contributions[220] as applicable.

Both statutes permit the entity to require the plaintiff to give security for the costs and reasonable expenses in defense of such action, excluding attorneys' fees.[221] There is no fixed dollar cap for the amount of the bond under either statute, which can be "from time to time . . . increased or decreased, in the discretion of the court, upon showing that the security provided has or may become inadequate or is excessive."[222] The Colorado Rules of Civil Procedure contain additional requirements for all derivative proceedings, paralleling Federal Rule of Civil Procedure 23.1, including the requirement that a plaintiff make a formal demand.[223]

The Colorado statutes provide that if the court determines that the

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215. *Id.* § 7-62-1002; 7-107-402.

216. *Id.* § 7-80-718.

217. Payment of expenses—derivative proceeding:

> On the termination of a derivative proceeding commenced pursuant to this part 7, where the court finds that the proceeding has resulted in a substantial benefit to the limited liability company, the court may order the limited liability company to pay the plaintiff's reasonable expenses, including attorney fees, incurred by the plaintiff in connection with the maintenance of such proceeding. On the termination of a derivative proceeding commenced pursuant to this part 7, where the court finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose, the court may order the plaintiff to pay any of the defendant's reasonable expenses, including attorney fees, incurred by the defendant in connection with the defense of such proceeding.

Id.

218. *Id.* § 7-80-718.

219. *Id.* § 7-107-402(3).

220. *Id.* § 7-62-1003.

221. *Id.* § 7-107-402(3); § 7-62-1003.

222. *Id.* § 7-107-402(3); § 7-62-1003.

223. FED. R. CIV. P. 23.1(b)(3); COLO. R. CIV. P. 23.1.

derivative action was commenced without reasonable cause, the entity shall have recourse to the security upon termination of the action.[224] If the "costs and expenses exceed the amount of the bond or if no bond is posted," the derivative plaintiff must "pay the costs and reasonable expenses directly attributable to the defense" of the derivative suit, excluding attorney's fees.[225]

No Colorado case law discusses the corporate or limited partner security for expense statutes or the LLC expense provision.

(b) New Jersey

New Jersey has a security for expense provision for limited partners, effective September 21, 1988, and one for shareholders, effective April 1, 2013.[226] The New Jersey Corporate and Business Law Study Commission indicated that the purpose of the corporate statute is "to allow corporations to avoid derivative lawsuits that impose excessive and unnecessary costs on New Jersey corporations."[227] Even though New Jersey has provisions in both its corporate and limited partnership laws, it has no security for expense for LLC members.

The limited partnership statute is a pared down version of the shareholder statute. Both statutes require contemporaneous ownership by a plaintiff.[228] Both statutes require the plaintiff to make a demand.[229] But the corporate statute requires that derivative plaintiffs fairly and adequately represent the interests of the corporation in the action, while the limited partnership statute does not.[230] The corporate statute requires court approval before a derivative suit can be "discontinued or settled," but the limited partnership statute does not.[231]

Upon termination of a shareholder derivative suit, the court can order

224. COLO. REV. STAT. § § 7-107-402(3); § 7-62-1003.

225. STEPHEN A. HESS, WEST'S COLORADO PRACTICE SERIES: METHODS OF PRACTICE § 2:66 (8th ed.).

226. N.J. REV. STAT. § 14A:3-6.8 (2013).

227. *New Jersey Senate Commerce Committee Statement*, N.J. LEGISLATURE (Jan. 14, 2013), https://www.njleg.state.nj.us/2012/Bills/A3500/3123_S2.HTM [https://perma.cc/L52K-VB8S]. "The bill is largely based on sections 7.40 to 7.47 of the Model Business Corporation Act, with substantial additions based on section 7.44 of Chapter 156D of the Massachusetts Business Corporation Law." *Id.*

228. N.J. REV. STAT. § 42-2A-63; §14A:3-6.2.

229. The LP statute doesn't explicitly say that demand is required; instead, it requires that that the complaint set forth with particularity the plaintiff's efforts to get the general partner to act or give the reasons for not making the demand. N.J. REV. STAT. § 42:2A-64. The corporate statute explicitly requires that plaintiff make a demand. *Id.* § 14A:3-6.3.

230. *Id.* § 14A:3-6.2 (2013).

231. *Id.* § 14A:3-6.6.

the corporation to pay the plaintiffs' expenses if it finds that the derivative proceeding resulted in a "substantial benefit" to the corporation.[232] If the court finds that the shareholder suit was commenced or maintained without the exercise of "reasonable diligence by the plaintiff or without reasonable cause or for an improper purpose," the court can order the plaintiff to pay the defendant's expenses in defending the proceeding.[233] The New Jersey shareholder statute allows for the full amount of such expenses to be paid.[234] And finally, under the shareholder statute, the court can order either party to pay the other's expenses for filing pleadings, motions, or other papers frivolously.[235] None of these provisions are included in the limited partnership statute.

Both statutes have a carve out for substantial owners. Under the corporate statute, derivative plaintiffs are not required to post a bond if they hold at least five percent of any class of the corporation's stock or $250,000 or more of the corporation's stock.[236] There is no fixed dollar cap for the amount of the bond.[237] The limited partnership statute has the same concept but with a much lower market value. Plaintiffs are carved out if they own at least "5% or more of the contributions of or allocations to partnership property of all limited partners" or unless "the contributions of or the share allocable to the plaintiff . . . ha[s] a fair value in excess of twenty-five thousand dollars."[238] Under the limited partnership statute, the amount of the security is determined by the court.[239]

The only New Jersey cases that mention the security for expense

232. N.J. REV. STAT. § 14A:3-6.7(1) (2013).

233. N.J. REV. STAT. § 14A:3-6.7(2) (2013).

234. *Compare* CAL. CORP. CODE § 800(d) (West 1982) (limiting the bond furnished by plaintiff for reasonable expenses to fifty thousand dollars), *with* N.J. REV. STAT. § 14A:3-6.7 (2013) (requiring a plaintiff to pay any expenses incurred by the defendant in defending the proceeding).

235. The statute provides that the court may:

> (3) order a party to pay an opposing party's expenses incurred because of the filing of a pleading, motion or other paper, if it finds that the pleading, motion or other paper was not well grounded in fact, after reasonable inquiry, or warranted by existing law or a good faith argument for the extension, modification or reversal of existing law and was interposed for an improper purpose, such as to harass or cause unnecessary delay or needlessly increase the cost of litigation.

N.J. REV. STAT. § 14A:3-6.7(3) (2013).

236. N.J. REV. STAT. § 14A:3-6.8 (2013). The statute was amended in 2013 to raise the dollar amount needed to avoid posting a bond from $25,000 to $250,000. N.J. LEGISLATURE, *supra* note 227.

237. N.J. REV. STAT. § 14A:3-6.8 (2013).

238. N.J. STAT. ANN. § 42:2A-65 (1985).

239. *Id.*

provision hold that the bond requirement is inapplicable.[240]

(c) New York

New York has a security for expense provision for limited partners, effective July 1, 1991,[241] and one for shareholders, originally enacted in 1944.[242] One goal of the corporate statute was to "meet the evil posed by baseless strike shareholders' suits" and to protect corporations from the "abuse of derivative actions instituted by stockholders having small or minuscule interests in a large corporation," since "stockholder[s] motivated by personal gain instead of the welfare of the corporation" would be deterred by the threshold from bringing a frivolous action.[243] Even though New York has provisions in both its corporate and limited partnership laws, it has no security for expense provision for LLC members.[244]

Unlike New Jersey, the New York version for limited partners tracks the shareholder version to a large extent. Both statutes require contemporaneous ownership by a plaintiff.[245] Both require the plaintiff to set forth with particularity the efforts made to secure the initiation of the action by the entity.[246] Both require court approval before a derivative suit can be "discontinued, compromised or settled."[247]

Both statutes exclude from the bond posting requirement any derivative plaintiff holding at least five percent of any class of the corporation's stock

240. *See* Seidman v. Spencer Savings Bank, SLA, Nos. A-2039-17T3, A-4739-17T4, 2019 WL 4891167 (N.J. Super. Ct. App. Div. Oct. 3, 2019), *cert. denied*, 241 N.J. 144, 226 A.3d 500 (2020), and *cert. denied*, 141 S. Ct. 554, 208 L. Ed. 2d 176 (2020) (holding that the bond requirement does not apply for a party that is not a New Jersey general business association); Feuer v. Merck & Co., 187 A.3d 873 (N.J. Super. Ct. App. Div. 2018) (noting that the plaintiff would need to post security under the statute); *see also* Live Face on Web, LLC v. Emerson Cleaners, Inc., No. 14-00182, 2014 WL 2805040 (D.N.J. June 20, 2014) (referencing N.J.S.A. 14A:3–6.8 and noting that it was inapplicable).

241. New York retains its prior limited partnership statute, N.Y. BUS. CORP. LAW § § 115-a for limited partnerships formed before July 1, 1991. Sections 115-a and 115-b governing derivative suits against LPS are virtually identical to the parallel sections of the new statute, N.Y. P'SHIP LAW § §§ 121-1002 and 1003.

242. For a discussion of the history of security for expense provisions in New York, starting with the WOOD REPORT, see Albert, *supra* note 3, at 40–45.

243. Roach v. Franchises Int'l, Inc., 300 N.Y.S.2d 630, 633 (N.Y. App. Div. 1969).

244. *See* Part II, *supra.*

245. N.Y. P'SHIP LAW § 121-1002(b) (McKinney 2021); N.Y. BUS. CORP. LAW § 626(b) (McKinney 2021).

246. N.Y. P'SHIP LAW § 121-1002(c) (McKinney 2021); N.Y. BUS. CORP. LAW § 626(c) (McKinney 2021).

247. N.Y. P'SHIP LAW § 121-1002(d) (McKinney 2021); N.Y. BUS. CORP. LAW § 626(d) (McKinney 2021).

or five percent of the contributions of all limited partners, or at least $50,000 ownership interests.[248] There is no fixed dollar cap for the amount of the bond, which can be increased or decreased from time to time, "in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or excessive."[249]

The New York case law regarding security for expense is primarily in the LLC area, stemming from *Tzolis v. Wolf*.[250] The two cases referencing the limited partnership statute simply cite the statute or apply it.[251]

Lawmakers in Alaska, Arkansas, Nevada and North Dakota have not revealed why they chose to enact legislation in order to protect the derivative litigation process from nuisance or strike suits by shareholders but ignored LLC members and limited partners. What is even more curious is that Colorado, New Jersey, and New York noted the risk of these suits by limited partners, but somehow did not concern themselves with the possible behavior of opportunistic LLC members. Other than the commentary surrounding *Tzolis v. Wolff*, no clear reasons are given for this omission.[252]

3. States Requiring Security for Expense for Corporate Shareholders, Limited Liability Company Members, and Limited Partners

California and Pennsylvania are the only two states that have security for expense statutes for their shareholders, LLC members, and limited partners. An evaluation of how these states organize their various business entity statutes offers some possible insights into why this is so. Both states classify their corporate, LLC, and limited partnership statutes together.[253] That said:

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248. N.Y. BUS. CORP. LAW § 627; (McKinney 2021); N.Y. P'SHIP LAW § 121-1003 (McKinney 2021).

249. N.Y. BUS. CORP. LAW § 627 (McKinney 2021). Similar language can be found in New York's partnership laws. N.Y. P'SHIP LAW § 121-1003 (McKinney 2021).

250. *See* Part II, *supra.*

251. For a full discussion of the New York case law, see Albert, *supra* note 3.

252. For a discussion of the Tzolis v. Wolff case, see Part II, *supra*.

253. California classifies its corporations, LLCs and LPs all under its Corporations Code. *See* CAL. CORP. CODE §§ 100-195 (2005) (including general provisions and definitions for general corporations); §§ 17701.01-17713.13 (2013) (defining the general provisions for limited liability companies); §§ 15900-15901.17 (2007) (providing general provisions for limited partnerships). Pennsylvania classifies corporations, LLCs, and LPs under Title 15 Pa.C.S.A. Corporations and Unincorporated Associations, and further breaks down that title into Part II Corporations and Part III Partnerships and Limited Liability Companies. *See* 15 PA. CONS. STAT. §§ 501-1997 (1988) (encompassing legislative matters related to corporations); §§ 8811-8885 (2016) (including statutes related to limited liability companies); §§ 8611-8695 (2016) (dealing with limited partnerships).

(a) California

California has a security for expense provision for shareholders,[254] LLC members,[255] and limited partners.[256] The corporate statute was effective January 1, 1977.[257] The LLC statute was effective September 30, 1994.[258] The limited partnership statute was effective January 1, 2008.[259] California courts have noted that a goal of the corporate statute is "to give the corporation security against groundless suits on the part of shareholders"[260] and to "prevent unwarranted shareholder derivative lawsuits."[261]

While the three California statutes are very similar in both concept and wording, there are a handful of differences, mostly in the limited partnership statute. All three statutes authorize the defendant to move for a court order to require the plaintiff to furnish security for the reasonable expenses that such moving party might incur.[262] These expenses explicitly include attorney's fees.[263] The grounds for such a motion are either that the plaintiff has no reasonable possibility of success or that the moving party (other than the entity itself) did not participate in the transaction complained of in any capacity.[264]

Both the corporate and the LLC statutes require contemporaneous ownership by a plaintiff, but not absolute contemporaneous owners as commonly seen in most other statutes. California's spin on this concept does not block derivative suits if the plaintiff cannot show contemporaneous

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254. CAL. CORP. CODE § 800(c), (d) (West 1982). "Few statutes in California are asked to do the kind of heavy lifting that is required of Corporations Code Section 800. Fewer than 1,000 words in length, Section 800 represents the sum total of all legislation on the subject of shareholder derivative litigation in California." Charles J. Greaves, *The Unique Issues in Shareholder Derivative Litigation,* L.A. LAW., Dec. 2002, at 16, 16. The opening language of the corporate statute is curious, defining "corporation" to include unincorporated associations. CAL. CORP. CODE § 800(a) (West 1982). This arguably could include both LLCs and limited partnerships, obviating the need entirely for the LLC and limited partnership security for expense statutes.

255. CAL. CORP. CODE § 17709.02 (2013).

256. CAL. CORP. CODE § 15910.06 (2007).

257. CAL. CORP. CODE § 2300.

258. Stats. 1994, c. 1200 (S.B.469), § 27, eff. Sept. 30, 1994.

259. 2006 Cal. Legis. Serv. Ch. 495 (A.B. 339) (West).

260. Barber v. Lewis & Kaufman, Inc., 269 P.2d 929, 931 (Cal. Dist. Ct. App. 1954).

261. Donner Mgmt. Co. v. Schaffer, 48 Cal. Rptr. 3d 534, 538 (Cal. Ct. App. 2006).

262. CAL. CORP. CODE § 800(c), (d) (West 1982); CAL. CORP. CODE § 17709.02(b) (2013); CAL. CORP. CODE §15910.06(a) (2007).

263. CAL. CORP. CODE § 800(d) (West 1982); CAL. CORP. CODE §17709.02(c)(2) (2013); CAL. CORP. CODE §15910.06(b) (2007).

264. CAL. CORP. CODE § 800(c) (West 1982); CAL. CORP. CODE §17709.02(b) (2013); CAL. CORP. CODE §15910.06(a) (2007).

ownership like the typical derivative statute. Rather, the statute gives courts a list of considerations to apply when using its discretion to permit the action to go forward even in the absence of contemporaneous ownership.[265] Oddly, the limited partnership statute doesn't require contemporaneous ownership at all.

Both the corporate and the LLC statutes require the plaintiff to state with particularity the efforts made to secure initiation of the action by the entity and to inform the managers of the claim or deliver a "true copy of the complaint that the plaintiff proposes to file."[266] Again, the limited partnership statute is silent on this issue.

It is odd that the limited partnership statute is missing these provisions, since it was clearly derived from the corporate statute.[267] According to the bill's sponsor:

> The new 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-focused commercial deals whose participants commit for the long term, and (ii) estate planning arrangements (family limited partnerships). This Act accordingly assumes that, more often than not, people utilizing it will want: strong centralized management, and passive investors.[268]

All three statutes make it clear that a ruling by the court on the motion for security "shall not be a determination of any issue in the action or of the

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265. CAL. CORP. CODE § 17709.02(a)(1) provides:

> The criteria are:
> (A) There is a strong prima facie case in favor of the claim asserted on behalf of the limited liability company.
> (B) No other similar action has been or is likely to be instituted.
> (C) The plaintiff acquired the interest before there was disclosure to the public or to the plaintiff of the wrongdoing of which plaintiff complains.
> (D) Unless the action can be maintained, the defendant may retain a gain derived from defendant's willful breach of a fiduciary duty.
> (E) The requested relief will not result in unjust enrichment of the limited liability company or any member of the limited liability company.

CAL. CORP. CODE § 17709.02(a)(1) (2013).

266. CAL. CORP. CODE § 17709.02(a)(2) (2013).

267. JAMES F. FOTENOS & EDWARD C. RYBKA, CALIFORNIA PRACTICE GUIDE PASS-THROUGH ENTITIES CH. 5-C (2020).

268. *Bill Analysis: AB-339 Limited Partnerships and Limited Liability Companies*, CAL. LEGIS. INFO. (Aug. 28, 2006), https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=200520060AB339 [https://perma.cc/SBV6-4P68].

merits thereof."[269] Despite this language, if the motion for security is granted, it likely ends the lawsuit. Why would any rational derivative plaintiff agree to post $50,000 after the court decided the suit indicated that either there is no reasonable possibility of success or that the defendant was not involved in the complained-of act in any capacity?[270]

The biggest substantive difference among these statutes is that only the LLC statute gives the court flexibility to change the amount of the security, but in no case can the amount exceed $50,000.[271] This provision allowing flexibility is absent from both the corporate and the limited partnership statutes, though it is limited on the top end to the cap of $50,000. This threshold is an aggregate, and the court cannot require a greater bond, even if there are multiple defendants or causes of action.[272]

Unlike most other security for expense statutes, the California statutes have no statutory threshold ownership amount that must be held by plaintiffs to avoid posting the bond. Rather, the court has discretion to require any plaintiff to provide security.[273] If the motion is granted, the court will establish the amount of security for reasonable expenses, including attorney's fees, again not to exceed $50,000.[274]

California courts have provided guidance with respect to the scope and meaning of this statute.[275]

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269. CAL. CORP. CODE § 800(d)(West 2020); CAL. CORP. CODE §17709.02(b)(West 2021); CAL. CORP. CODE §15910.06(c)(2)(West 2019).

270. *See* Greaves, *supra* note 254, at 16–17 (pointing out that "few disgruntled shareholders will pose a $50,000 bond in the face of a judicial determination that there is no reasonable possibility that further prosecution of the action will benefit the corporation or its shareholders").

271. The LLC statute provides:

> The amount of the security may thereafter be increased or decreased in the discretion of the court upon a showing that the security provided has or may become inadequate or is excessive, but the court shall not in any event increase the total amount of the security beyond fifty thousand dollars ($50,000) in the aggregate for all defendants.

CAL. CORP. CODE §17709.02(c)(2)(West 2021).

272. Hale v. S. Cal. IPA Med. Grp., Inc., 103 Cal. Rptr. 2d 773, 778 (Cal. Ct. App. 2001).

273. CAL. CORP. CODE § 800(d)(West 2020); CAL. CORP. CODE §17709.02(b)(West 2021); CAL. CORP. CODE §15910.06(c)(2)(West 2019).

274. *Id.*

275. "Because the statutory scheme governing shareholder derivative actions in California is skeletal, and because these actions are equitable in nature, the courts have played a prominent role in shaping the substantive law and procedure in this area." Greaves, *supra* note 254, at 18. For a full discussion of the California case law, see Albert, *supra* note 3.

(b) Pennsylvania

Pennsylvania has a security for expense statute for shareholders, LLC members, and limited partners,[276] all effective February 21, 2017. Based on their common effective date, one could surmise that the statutes would be similar. In fact, the coverage, the wording, and even the numbering of the sections is consistent, if not identical. This makes sense since the "Editors' Notes" to the LLC statute indicate that it was modeled after the corporate statute.[277]

All three statutes require derivative plaintiffs to make a formal demand "in record form and give notice with reasonable specificity of the essential facts relied upon to support each of the claims made in the demand," unless such a demand is excused.[278]

The two differences between the statutes are that only the corporate and LLC statutes require contemporaneous ownership by a plaintiff or the showing of "a strong prima facie case in favor of the claim asserted on behalf of the corporation and that without the action serious injustice will result."[279] And only the corporate statute requires court approval before a derivative suit can be "dismissed or compromised."[280]

All three require that derivative plaintiffs are subject to the security posting provision if they hold less than a five percent ownership stake and hold ownership interests with an aggregate fair market value of $200,000 or less.[281] There is no fixed dollar cap for the amount of the bond, which can be increased or decreased from time to time, "in the discretion of the court upon showing that the security provided has or is likely to become inadequate or excessive."[282]

California and Pennsylvania are the only two states that brought bond posting to shareholders, LLC members, and limited partners, presumably recognizing that all three populations have the potential to bring nuisance or strike suits. Evaluating the success of these statutes in weeding out nuisance or strike suits is complicated. There is no clear or objective mechanism to quantify the number and legitimacy of lawsuits that were not brought because the plaintiff could not post the bond. If these provisions are actually

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276. 15 PA. CONS. STAT. § 8693 (2017).

277. *See* 15 PA. STAT. AND CONS. STAT. ANN. § 8883 (West 2017) (noting in the Editors' Notes that "[t]his section is patterned after 15 Pa.C.S. §1782(c)").

278. 15 PA. CONS. STAT. §§ 1781(a)(1)-(2),(c); 8882(a)(1)-(2), (c); 8692(a)(1)-(2), (c)(2017).

279. 231 PA. CODE § 1506(d) (1991).

280. *Id.*

281. 15 PA. CONS. STAT. § 1782(c)(2017).

282. *Id.*

useful in stopping these suits, and that has not been objectively determined, the Pennsylvania approach of using share value or ownership percentage as a proxy for plaintiffs' good faith and a lack of opportunistic behavior may prove to be an absolute barrier to entry for even the most well-intentioned plaintiffs acting in good faith, with a legitimate concern, who simply lack the funds to post the required bond.[283] The California approach is even more dangerous in this regard; with no carve-out for substantial owners, any plaintiff may be subject to the bond posting requirement. The timing of these statutes can also be a barrier for plaintiffs. Plaintiffs must post the bond before filing the suit, and this may be difficult for even the most well-intentioned and honorable derivative plaintiff who is light on funds. These statutes may wind up imposing a greater economic risk on the plaintiff than just requiring plaintiffs to pay the successful defendants' expenses after the case has been resolved.[284]

IV. RECOMMENDATIONS

Security for expense provisions have their share of supporters, as evidenced by the fourteen different statutes in nine different states requiring them. Robert Wood was an early and dedicated supporter, based on his concern for the then state of derivative litigation. In the Wood Report, he noted that an "outstanding fact derived" from his research was that most of the shareholder derivative suits he studied were unsuccessful, and that the financial results were unfavorable to the plaintiffs but more favorable to their counsel.[285] The Wood Report rejected a number of other approaches to fix the problem of strike suits and ultimately concluded that a security for expense statute would allow shareholders to determine whether to move

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283. "The potential of first having to give security and then the prospect of forfeiting it must exert a chilling effect on counsel and client." Branson, *supra* note 143, at 405.

284. DEMOTT, *supra* note 36, at 3:1.

285. As per Wood:

> Because of the large recoveries had in a few instances involving nationally known corporations, the enormous fees awarded plaintiffs' attorneys in those cases and the resulting newspaper publicity, there has been a definite tendency on the part of the public and the bar to assume a ratio of success in these actions not in accord with the record. In direct consequence of this general misconception, the common attitude on the part of laymen and lawyers has been, while admitting the abuses in this field of litigation, to condone them as necessary evils or as outweighed by the assumed beneficial effects of such litigation. The record of these cases should demonstrate the fallacy of this last assumption, and without that all excuses for further indulgence of the abuses fails.

WOOD REPORT, *supra* note 32, at 112.

forward with a case "safeguarded by the requirement that the plaintiff have a legitimate interest in the subject-matter and assume reasonable responsibility in the way of costs in the event of failure."[286]

But are shareholders, or any entity owners for that matter, truly "safeguarded" by these provisions? Or are minority owners denied the one mechanism available to hold their managers accountable? These statutes' use of share value or ownership percentage as a proxy for good faith and a lack of opportunistic behavior may instead prove to be an absolute barrier to entry for even the most well-intentioned plaintiffs acting in good faith with a legitimate concern, who simply lack the funds to post the required bond.[287] The timing may be problematic as well, for even well-intentioned plaintiffs who are light on funds prior to filing their meritorious suit; these statutes may impose greater economic risk on these plaintiffs than a system that instead requires unsuccessful plaintiffs to pay the defendant's expenses at the end of the lawsuit.

Owning a substantial ownership piece should arguably inspire owners not to behave opportunistically, or against the best interest of the entity, but there are no guarantees.[288] Owners are not necessarily rational and may have issues on their minds other than the entity's financial bottom line.[289]

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286. *Id.* at 116–67

287. *See* DEMOTT, *supra* note 36 at § 3:2 (evaluating state security for expense statutes).

288. According to Professor Hamermesh:

> [T]here is nothing in the statute that assures that a holder or a group of holders with sufficient shares to avoid the bond requirement will have resources or motivations adequate to ensure an informed, deliberate, and disinterested assessment of the merits of the litigation. If only because of collective action problems, it seems eminently possible that disaggregated stockholders will underinvest in efforts to evaluate and then support meritorious litigation; and, it seems equally possible that stockholders with enough shares to avoid the bond requirement but, without the inclination to invest in evaluating derivative claims, could choose to support litigation that lacks merit. In sum, what the New York security for expense statute lacks is any assurance that the persons (other than plaintiff's counsel) whose decisions determine whether a bond is required will expend any resources to evaluate the quality of the derivative claims to be pursued.

Larry Hamermesh, *A Most Adequate Response to Excessive Shareholder Litigation,* 45 HOFSTRA L. REV. 147, 156 (2016).

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> The theory implicitly assumes that stockholders with less than the required threshold will not bring meritorious claims; the sole metric to determine if a shareholder is acting in good faith and, thus, should be permitted a day in court, is the amount of stock owned. The idea presumes that a major shareholder has a financial interest in not wasting corporate time and resources on a frivolous claim and may be deterred from posting the required bond.

Ownership amount is not a perfect standard to measure whether a particular owner is willing to waste the entity's time and money. Yet, owners whose holdings are below the relevant statutory threshold are required to provide security in order for their claims to move forward, and those at or above the threshold are exempt. As with any bright line test, some meritorious suits may not be brought, and some spurious suits may move forward.

According to Professor DeMott, "The present trend appears to be away from reposing great confidence in the ability of security requirements to deter strike suits."[290] How can we balance the desire to help and empower owners to hold their entities accountable with the need for managerial freedom and discretion to discharge their fiduciary duties without spurious and time-wasting litigation?

Lawmakers can and should use other procedural hurdles that may be more likely to limit nuisance or strike suits. Litigating demand futility, for example, brings judicial evaluation into the process to decide whether the people making the decision should be making the decision.

Owners with legitimate concerns who do not meet the required ownership thresholder could find like-minded fellow owners and together aggregate their ownership to hit the statutory threshold and avoid posting the bond.[291] But the aggregation must be done before the suit is filed, so that the filing plaintiff "holds" the requisite ownership amount.[292]

States should revisit the Prototype Act approach on this issue, which arguably has merit even for states that have not adopted the remainder of that act. Requiring that derivative plaintiffs be authorized by fellow owners who

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Albert, *supra* note 3, at 39.

290. DEMOTT, *supra* note 36 at § 3:1.

291. Courts have opined that the language, "unless the plaintiff or plaintiffs hold five percent or more," allows plaintiffs to aggregate their shares with intervenors. *See, e.g.*, Miller v. Victor, No. 14-cv-1819 (PKC), 2015 WL 892276, at *1–2 (S.D.N.Y. Mar. 2, 2015) ("New York law allows a plaintiff to aggregate his holdings with intervenors.").

292. According to Professor DeMott:

> The problems raised by aggregation stem from the interplay between the contemporaneous ownership requirement and the exemption provisions in security for expense statutes. The plaintiff, in order to satisfy the contemporaneous ownership rule, must have owned some shares in the company as of the time of the occurrence of the wrong alleged in the suit; to be exempt from the security for expense requirements, the original plaintiff and any intervenors must own shares in excess of the threshold amount or percentage set by the statute. The problem is whether the purpose of the contemporaneous ownership rule is frustrated if the plaintiff can be exempted from the security requirements by acquiring shares after the time of the wrong alleged in the suit.

DEMOTT, *supra* note 36 at § 3:9.

own more than fifty percent of the unreturned contributions will likely improve the odds that spurious suits brought by owners with individual or untenable gripes will not be filed. Rather than using some nominal ownership proxy like a 5% ownership threshold, this approach literally requires majority buy in. Unless of course the majority is voting to cover up their own misdeeds.[293]

And finally, in the absence of any meaningful way to quantify whether these security for expense provisions are helpful, legislators from every state, regardless of whether they have a security for expense provision, should focus more on dealing with repayment of expenses after adjudication. It may be more prudent to adopt an approach that allows courts to award costs to unsuccessful derivative plaintiffs *ex post*, instead of requiring security to be posted *ex ante*. These security for expense statutes put a significant risk on derivative plaintiffs if the defendant is successful. By permitting defendants to demand that plaintiffs post security well in advance of any final outcome, plaintiffs are exposed to a greater economic risk than they would be if instead the rule required payment of the successful defendant's expenses after the litigation concluded.[294]

The Colorado LLC statute does just that, although legislative guidance on what constitutes a "reasonable cause" would be helpful here:

> On the termination of a derivative proceeding commenced pursuant to this part 7, where the court finds that the proceeding has resulted in a substantial benefit to the limited liability company, the court may order the limited liability company to pay the plaintiff's reasonable expenses, including attorney fees, incurred by the plaintiff in connection with the maintenance of such proceeding. On the termination of a derivative proceeding commenced pursuant to this part 7, where the court finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose, the court may order the plaintiff to pay any of the defendant's reasonable expenses, including attorney fees, incurred by the defendant in connection with the defense of such proceeding.[295]

This provision tracks MBCA § 7.46(1).[296] The MBCA comments note that the test of this section is that "the action was brought without reasonable cause or for an improper purpose is appropriate to deter strike suits, on the one hand, and on the other hand to protect plaintiffs whose suits have a

293. WOOD REPORT, *supra* note 32, at 24.
294. DEMOTT, *supra* note 36, at § 3:1.
295. COLO. REV. STAT. § 7-80-718 (1994).
296. MODEL BUS. CORP. ACT § 7.46(1)(2007).

reasonable foundation."[297] The comments further note that the substantial benefit requirement is needed "to prevent the plaintiff from proposing inconsequential changes in order to justify the payment of counsel fees," circling back to Robert Wood's view that derivative suits were driven by plaintiffs' counsel.[298]

V. CONCLUSION:

If the goal of security for expense statutes is to act as a sieve and somehow weed out strike suits that have no merit, this goal should be as applicable to LLC owners and limited partners as it is to shareholders; LLC members and limited partners could also bring nuisance or strike suits. Part of the challenge here is that there is no objective mechanism to determine if the security for expense provisions are actually working. The absences of any reliable metric to quantify the number and legitimacy of lawsuits that were not brought because the plaintiff was unable to post the bond makes any determination of their success impracticable.

Nine states have security for expense statutes for corporate shareholders; three of those states also have such a provision for their limited partners; and only two states have such a provision for shareholders, LLC members, and limited partners. Assuming that the presence of security for expense provisions in the corporate laws that is absent in the LLC and/or limited partnership laws was actually intentional on the part of the relevant lawmakers, it is hard to imagine why the provisions were excluded. Perhaps the thought was that the number of unhappy limited partners or LLC members would somehow be lower than their corporate counterparts. Or perhaps the theory is that LLC members and/or limited partners are somehow more invested in the success of the enterprise and thus, less likely than shareholders to bring nuisance or strike suits. In the absence of any clear direction from lawmakers through legislative history, or even press releases or interviews, there can be no clear answers to these queries, leaving just the unexplained inconsistencies.

297. MODEL BUS. CORP. ACT § 7.46 cmt. (2007).

298. Wood did not have kind words for the shareholder derivative bar, referring to the "shoddy burlesque of a professional relationship to clients [that] makes the ambulance-chaser by comparison a paragon of propriety." WOOD REPORT, *supra* note 32, at 47.