

IN THE CHANCERY COURT FOR THE STATE OF TENNESSEE
TWENTIETH JUDICIAL DISTRICT, DAVIDSON COUNTY

TERRELL K. RALEY and 4 POINTS
HOSPITALITY, LLC,)

Plaintiffs,)

vs.)

CEES BRINKMAN and BRINKMAN
HOLDINGS, LLC,)

Defendants,)

And)

CEES BRINKMAN, individually and
Derivatively on behalf of 4 POINTS
HOSPITALITY, LLC,)

Counterclaimant,)

vs.)

TERRELL K. RALEY, AMARANTH
HOSPITALITY GROUP, LLC,)

Counterdefendants.)

NF
No: 16-0196-BC

2016 JUN -2 PM 3:55
DAVIDSON COUNTY CHANCERY COURT
902M

FILED

**MEMORANDUM AND ORDER DENYING DEFENDANT BRINKMAN'S
MOTION TO DISMISS CLAIMS OF
4 POINTS HOSPITALITY, LLC**

This lawsuit is a dispute between two 50% members of an LLC about its operation, management, and whether the two members have committed breaches of their

duties to the LLC and breaches of LLC agreements. The LLC¹ in issue is 4 Points Hospitality. It is the owner and operator of a very successful Nashville restaurant.

Claims and counterclaims have been filed by each LLC member asserting wrongful conduct by the other related to the operation of 4 Points. The Plaintiff asserts in its *Verified Complaint*: breach of contract and fiduciary duties, promissory fraud, fraudulent and negligent misrepresentation, unjust enrichment and conversion, and seeks remedies of the Court ordering Defendant Brinkman to specifically perform the parties' contracts, judicial intervention pursuant to Tennessee Code Annotated section 48-249-616, and recovery of compensatory and punitive damages and attorneys' fees. Defendant Brinkman in his *Counterclaim* asserts breach of fiduciary duty and two of the parties' agreements, conversion and an aiding and abetting claim by another LLC formed by Plaintiff Raley, and seeks the remedies of termination of Plaintiff Raley's membership, or, alternatively, judicial dissolution of 4 Points, and a declaratory judgment as to the ownership of certain intellectual property.

Important to the ruling made herein is that both the *Verified Complaint* and *Counterclaim* seek recovery and remedies not just for the individual members, Raley and Brinkman, but also for the LLC, 4 Points. Counts II, III, IV, V and VII of the *Verified Complaint*—five out of the seven counts—seek recovery or remedies not only for Plaintiff Raley but also for the LLC. The *Counterclaim* states at the outset it is both brought for Defendant Brinkman and derivatively for the LLC, "Cees Brinkman,

¹ The other LLCs who are parties: Brinkman Holdings, LLC and Amaranth Hospitality Group, LLC are not co-owned by Raley and Brinkman and are not relevant to the motion decided herein. Accordingly references in this Memorandum and Order to "the LLC" are to 4 Points Hospitality, LLC.

individually and derivatively on behalf of 4 Points Hospitality, LLC (“4 Points”), now assuming the role of counterclaimant” Counts I, II, IV, V, VI, VII and Count VIII of the *Counterclaim*—seven out of eight Counts—seek recovery or remedies not only for Defendant Brinkman but also for the LLC

That the Verified Complaint was filed not only for Plaintiff Raley, individually, but also asserting claims for 4 Points against Defendant Brinkman, is the issue ruled upon herein.

Before the Court is Defendant Brinkman’s *Motion* for partial dismissal of the *Verified Complaint*. The *Motion* seeks dismissal of claims of 4 Points. The authority cited by Defendant Brinkman is Tennessee Code Annotated section 48-249-105(b) & (c). That statute authorizes a court to enjoin and set aside *ultra vires* acts of an LLC. Additional authority for dismissal asserted by Defendant Brinkman is Tennessee Civil Procedure Rule 12.02(6) for lack of standing.

The alleged unauthorized, *ultra vires* actions committed by the LCC, Defendant Brinkman asserts, are engaging legal counsel and filing this lawsuit against one of the members. These actions do not constitute a day-to-day decision or acting in the ordinary course of business which is the extent of Plaintiff Raley’s authority to act unilaterally under the 4 Points Operating Agreement. Because retaining counsel and filing this

lawsuit fall outside of Plaintiff Raley's contractual authority, Defendant Brinkman asserts those actions are *ultra vires* or without standing.²

The dismissal and accompanying relief Defendant Brinkman seeks in his *Motion* is as follows:

12. Based on the foregoing, Brinkman respectfully submits that the claims asserted by 4 Points in this action are *ultra vires* and, thus, that those claims should either be set aside under Tenn. Code Ann. § 48-249-105 or dismissed pursuant to Tenn. R. Civ. P. 12.02(6) for lack of standing to assert them.
13. In conjunction with the dismissal of 4 Points' claims, the Court should also order Raley to reimburse 4 Points immediately for all legal fees and expenses paid by 4 Points to date in connection with this lawsuit.
14. Also, in the interest of judicial economy, to prevent further injury to 4 Points and Brinkman, and to preserve the assets of 4 Points, the Court should temporarily enjoin Raley from using any funds of 4 Points to pay legal fees and expenses incurred by the plaintiff in this action.

Motion To Dismiss Claims Asserted By Plaintiff 4 Points Hospitality, LLC and Memorandum In Support Thereof, p. 4, ¶¶ 12-14 (Apr. 22, 2016).

After researching the law, studying the briefs of Counsel and conducting oral argument, the Court denies the *Motion*. The Court concludes that under Tennessee law the claims asserted by 4 Points Hospitality LLC in the *Verified Complaint* are authorized and are not *ultra vires*, and that there is standing to assert these claims. In so concluding,

² Defendant Brinkman volunteers in his briefing that he believes that the motivation for Plaintiff Raley asserting claims by 4 Points, as well as his individual claims, is "so that [Plaintiff Raley] could use the funds of 4 Points, half of which belong to Brinkman, to pay the legal fees and expenses of the litigation." *Motion To Dismiss Claims Asserted By Plaintiff 4 Points Hospitality, LLC and Memorandum In Support Thereof*, p. 4, ¶ 11 (Apr. 22, 2016).

the Court has determined that the powers and duties assigned to Plaintiff Raley to manage the day-to-day affairs of the LLC are not the only source of authority for the LLC to exercise the power of retaining counsel and filing a lawsuit against a member.

In addition to the operating agreement, there are overriding powers vested in an LLC by case law and statute, detailed below, to redress and recover for alleged wrongful conduct of a member injurious to an LLC. Moreover, the Court concludes as a matter of law that the operating provisions of an LLC agreement can not abrogate this statutory and case law authority of an LLC to redress such wrongs.

So, while it is correct that Plaintiff Raley filing this lawsuit for the LLC does not fall within the day-to-day decisions and ordinary course of actions assigned to him under the LLC operating agreement, the lawsuit filing is authorized by sources of authority outside the parties' agreement: statute and case law.

For these reasons it is ORDERED that Defendant Brinkman's *Motion* is denied.

The analysis on which the foregoing ruling is based derives from the Tennessee LLC statute and case law.

Statutory LLC Derivative Claim

With respect to the statute, the Legislature, in Tennessee Code Annotated section 48-249-801, *et. al.*, provides to an LLC the remedy of a derivative claim to redress and recover damages for the wrongful conduct of a member:

- TENN. CODE ANN. § 48-249-801 (West 2016)

(a) Manager-managed or director-managed LLC. A member or holder of

financial rights of a director-managed LLC, or of a manager-managed LLC, may bring a proceeding in the right of an LLC to recover a judgment in its favor, if:

(1) The member or holder of financial rights, as applicable, was a member or holder of financial rights of the LLC when the transaction complained of occurred; or

(2) The member or holder of financial rights, as applicable, became a member or holder of financial rights through transfer by operation of law, from a person who was a member or holder of financial rights, as applicable, when the transaction complained of occurred.

(b) Member-managed LLC. A member or holder of financial rights of a member-managed LLC may bring a proceeding in the right of an LLC to recover a judgment in its favor, if members or other persons with authority to do so have refused to bring the proceeding, or if an effort to cause those members or other persons to bring the proceeding is not likely to succeed.

• **TENN. CODE ANN. § 48-249-805 (West 2016)**

If an LLC, or any officer, manager, director or member, as applicable, of the LLC, or other person with the authority to act for the LLC, violates a provision of this chapter, a court in this state may, in a proceeding brought by a member or holder of financial rights of the LLC, grant any equitable relief it considers just and reasonable in the circumstances, and, award expenses, including attorneys' fees and disbursements, to the member or holder of financial rights, as applicable.

This Court further determines as a matter of law that the statutory derivative claim rights of an LLC can not be waived in the operating agreement. This is so, the Court concludes, even though bringing a derivative claim is not listed as a nonwaivable defense in Tennessee Code Annotated section 48-249-205. In reaching this conclusion, the Court relies on the plain language of the LLC Act taken as a whole and the significance of a derivative claim as a judicial remedy. In addition it appears the issue of waiving a

derivative remedy is at least ambiguous giving the complexity of duties owed by each member in an LLC:

It is not clear the extent to which the parties may contract out of the derivative remedy in the operating agreement. ULLCA (1996) apparently permits contracts that waive the derivative remedy, since those provisions are not among those listed as nonwaivable. However, ULLCA (1996)'s provision that the operating agreement may not "eliminate" the duty of loyalty or "unreasonably reduce" the duty of care may restrict agreements eliminating remedies for fiduciary breach.

ULLCA (2013) provides that the operating agreement may not "unreasonably restrict the right of a member to maintain an action under [Article] 8" (providing for derivative suits). This provision is ambiguous, among other reasons because it is not clear how "unreasonably" relates to the "manifestly unreasonable" qualification on operating agreements elsewhere in ULLCA (2013). In particular, a court may decide that a judicial remedy is so important a part of the parties' duties that any significant restriction is unreasonable.

1 RIBSTEIN AND KEATINGE ON LTD. LIAB. COS., *Derivative Suits* § 10:3 (West 2016) (footnotes omitted).

Thus, by statute, one way an LLC in Tennessee can assert claims against a member is by a derivative action.

Applying this statute to the *Verified Complaint*, the Court sees that the derivative action statute, Tennessee Code Annotated sections 48-249-801 *et seq.*, has not been explicitly pled. This lack of explication leaves the impression that the claims of the LLC are not being brought derivatively by Plaintiff Brinkman but directly. If the pleader's intent is to bring a direct action against Defendant Brinkman to redress and recover for the LLC, the analysis the Court must undertake is whether a direct cause of action is allowed under Tennessee law and, therefore, is sufficient to state a claim to withstand a

motion to dismiss. If a direct cause of action is not permitted under Tennessee law, the Court must allow the Plaintiff the opportunity to amend to assert a derivative claim before ruling on dismissal.³

LLC Direct Claim

In determining whether Tennessee law authorizes an LLC direct action, the Court finds supportive text in the LLC Act. As explained in *Riverside Surgery Ctr., LLC v. Methodist Health Sys., Inc.*, 182 S.W.3d 805, 814-15 (Tenn. Ct. App. 2005):

Under Tennessee's Limited Liability Company Act, the LLC itself is granted certain general powers 'to do all things necessary or convenient to carry out its business and affairs.' Tenn. Code Ann. § 48-212-101 (2002). The first power granted to the LLC under section 48-212-101 is the power to '[s]ue and be sued, complain and defend in its LLC name.' *Id.* § 48-212-101(1). As the LLC and its member are bound by the LLC operating agreement under section 48-206-101(c), we believe any breach of the operating agreement would constitute the LLC's 'business and affairs.' *See id.* § 48-212-101. Thus, the LLC has the authority to sue in its name to enforce its operating agreement.

Additionally, drawing upon the analysis of courts in other states, this Court sees that sometimes the remedy of a derivative claim is not feasible or effective. Where there are circumstances of a closely-held LLC, as in this case with only two members, case law from other states instructs that a direct claim can be asserted, analogous to general

³ For example, in the case of *Crouse v. Mineo*, cited in support of Defendant Brinkman's *Motion To Dismiss*, the court held "that the filing of an action by one manager of an LLC against a co-manager to recover purported assets of the LLC allegedly misappropriated by that co-manager is a management decision and is not 'carrying on in the usual way the business of the limited liability company[.]'" 189 N.C. App. 232, 239, 658 S.E.2d 33, 37-38 (2008). Despite this holding, however, the court went on to conclude that the member did have standing under the North Carolina LLC Act to proceed with a derivative lawsuit even though the member had intended to cause the LLC to sue in its own right and did not intend to file a derivative action. This flexibility in construing the plaintiff's complaint in *Crouse* as a derivative cause of action is consistent with Tennessee's notice pleading standard outlined in *Webb v. Nashville Area Habitat for Humanity, Inc.*, 346 S.W.3d 422, 426-27, 437 (Tenn. 2011).

partnership and closely-held corporation law,⁴ against a member to redress and recover damages for the LLC for the wrongful conduct of the member in lieu of a derivative action. The reasons for filing a derivative suit in a closely-held entity are (1) to prevent multiple lawsuits, (2) protect corporate creditors, (3) protect multiple shareholders and (4) adequately compensate injured shareholders. If these reasons are not present, a direct action is a proper cause of action:

The general rule in the corporate context is that a shareholder suit seeking to recover damages for breach of fiduciary duties owed to the corporation must be brought as a derivative suit on behalf of the corporation. *Phoenix Airline Svcs. v. Metro Airlines*, 260 Ga. 584, 585, 397 S.E.2d 699 (1990). A shareholder has standing to bring a direct action, seeking recovery on behalf of the shareholder individually, only if the suit alleges a special injury separate and distinct from that suffered by other shareholders, or alleges a wrong involving a shareholder contractual right existing apart from any right of the corporation. *Grace Bros., Ltd. v. Farley Indus.*, 264 Ga. 817, 818–820, 450 S.E.2d 814 (1994). Applying the general corporate

⁴ Because the formation and operation of an LLC involves aspects of both corporate and partnership law, courts in Tennessee have analogized and borrowed corporate and partnership principles to LLCs when issues arise that are not addressed specifically in the LLC Act. *See, generally ARC LifeMed, Inc. v. AMC-Tennessee, Inc.*, 183 S.W.3d 1, 27 (Tenn. Ct. App. 2005) (“Borrowing from partnership law and under the terms of the Management Contract, LifeMed, LLC was entitled to a proper accounting by its managing partner.”); *Anderson v. Wilder*, No. E200300460COAR3CV, 2003 WL 22768666, at *4 (Tenn. Ct. App. Nov. 21, 2003) (citations omitted) (“The typical LLC act is usually a hybrid of provisions culled from the individual state’s partnership statutes and business corporation law....[W]hen a court is interpreting an LLC act or agreement, the court will focus on the particular aspect of the LLC that gives rise to the problem, with emphasis on the foundational business form from which that characteristic originated. Usually, the particular aspect can be traced to either the corporate components or the partnership components of the LLC act or agreement. In such cases where the characteristic originated from the partnership aspects of the LLC, the court will use the established princip[le]s and precedent of the partnership law to resolve the issue ... In such cases where the characteristic originated from the corporate aspects of the LLC, the court will utilize the established princip[le]s and precedent of corporate law to resolve the issue.”). In addition to general corporate and partnership principles, courts have also analogized certain situations arising in LLCs to principles that apply to closely-held corporations. *See, generally Ogles v. Ogles*, No. M201302215COAR3CV, 2015 WL 113336, at *4, n. 3 (Tenn. Ct. App. Jan. 7, 2015) (“Where the owners of the LLC are a small group of family members, principles used in valuing closely held corporations are ‘instructive’ and ‘equally applicable.’ *Powell*, 124 S.W.3d at 104; *see also Inzer v. Inzer*, No. M2008–00222–COA–R3–CV, 2009 WL 2263818, at *4 (Tenn. Ct. App. July 28, 2009) (explaining that an LLC is ‘a type of entity that is akin to a closely held corporation for purposes of valuing it as a marital asset’)).

rule in the present case, the Stoker LLC members did not allege that they suffered a special injury distinct from that suffered by other LLC members, nor did they allege a wrong involving a member contractual right apart from a right of the LLC. Accordingly, they did not show standing to assert a direct action, and the general rule requiring a derivative action on behalf of the LLC would ordinarily apply.

However, even where the allegations of the complaint do not show standing to assert a direct action, a direct action may nevertheless be proper in the context of a closely held corporation where the circumstances show that the reasons for the general rule requiring a derivative suit do not apply. *Thomas v. Dickson*, 250 Ga. 772, 774–775, 301 S.E.2d 49 (1983); *Grace Bros.*, 264 Ga. at 819, 450 S.E.2d 814. As set forth in *Thomas*, supra, the reasons for requiring derivative suits in the ordinary corporate context are (1) to prevent multiple suits by shareholders; (2) to protect corporate creditors by ensuring that the recovery goes to the corporation; (3) to protect the interest of all the shareholders by ensuring that the recovery goes to the corporation, rather than allowing recovery by one or a few shareholders to the prejudice of others; and (4) to adequately compensate injured shareholders by increasing their share values. *Id.* at 774, 301 S.E.2d 49. Because none of these reasons applied in the context of the closely held corporation in *Thomas*, supra, the court found that a direct action by the shareholder for misappropriation of corporate funds was proper. *Id.* at 774–775, 301 S.E.2d 49. On similar grounds, we find no reason to require the Stokers to derivatively assert the breach of fiduciary duty claims in the context of the closely held LLCs in the present case.

With respect to the two-member LLCs at issue, the Stoker member of the LLC asserted that the other LLC member breached fiduciary duties by (1) usurping LLC opportunities by engaging in competing land developments; (2) converting LLC assets by improperly transferring funds held by the LLC; and (3) improperly excluding the Stoker member from LLC affairs. Since both members of the LLC in each claim are parties to the suit, we find no danger of multiple suits and no concern that a recovery would prejudice the rights of the other member. Moreover, a direct suit with all the members joined may prevent a defendant member from inappropriately sharing in the recovery, while providing an appropriate recovery to a plaintiff member who would gain no benefit from a derivative recovery on behalf of the LLC given the lack of a ready market for closely held LLC interests. Finally, as to protection of LLC creditors, the record does not reflect any evidence of existing creditors, and none of the members have offered evidence of existing creditors. Accordingly, we find the trial court properly recognized that the Stokers had standing to assert these claims in a

direct action. *Thomas*, 250 Ga. at 774–775, 301 S.E.2d 49; LLC Member and Limited Partner Breach of Fiduciary Duty Claims: Direct or Derivative Actions? 7 J. Small and Emerging Bus. L. 19, 52–61 (2003).

272 Ga. App. 817, 822-23, 615 S.E.2d 1, 7-8 (2005), *rev'd in part sub nom. Bellemead, LLC v. Stoker*, 280 Ga. 635, 631 S.E.2d 693 (2006).⁵

⁵ Other cases applying the derivative lawsuit exception to closely-held entities include: *Johnson v. Gilbert*, 127 Ariz. 410, 412, 621 P.2d 916, 918 (Ct. App. 1980) *overruled by Turley v. Ethington*, 213 Ariz. 640, 146 P.3d 1282 (Ct. App. 2006) (“Initially, we address some preliminary issues not raised by either party on appeal. First, this action was brought individually by the Johnsons, 50% shareholders in the corporation, rather than derivatively on behalf of the corporation. Because the corporation was closely held by only the plaintiffs and defendants, they operated more as partners than in strict compliance with the corporate form. In such circumstances, the plaintiffs had standing, both derivatively and directly, to sue on the alleged contract and for an accounting.”); *Barth v. Barth*, 659 N.E.2d 559, 561-62 (Ind. 1995) (“While we affirm the general rule requiring a shareholder to bring a derivative rather than direct action when seeking redress for injury to the corporation, we nevertheless observe two reasons why this rule will not always apply in the case of closely-held corporations. First, shareholders in a close corporation stand in a fiduciary relationship to each other, and as such, must deal fairly, honestly, and openly with the corporation and with their fellow shareholders. Second, shareholder litigation in the closely-held corporation context will often not implicate the policies that mandate requiring derivative litigation when more widely-held corporations are involved...Because shareholders of closely-held corporations have very direct obligations to one another and because shareholder litigation in the closely-held corporation context will often not implicate the principles which gave rise to the rule requiring derivative litigation, courts in many cases are permitting direct suits by shareholders of closely-held corporations where the complaint is one that in a public corporation would have to be brought as a derivative action.”); *Richards v. Bryan*, 19 Kan. App. 2d 950, 965, 879 P.2d 638, 648 (1994), *as modified on denial of reh'g* (Sept. 27, 1994) (“Therefore, we conclude that if a corporation is closely held, a court, in its discretion, may treat an action raising derivative claims as a direct action if it finds to do so will not (1) unfairly expose the corporation to a multiplicity of actions; (2) materially prejudice the interests of creditors in the corporation; or (3) interfere with a fair distribution of the recovery among all interested persons.”); *Schumacher v. Schumacher*, 469 N.W.2d 793, 798 (N.D. 1991) (“A well-recognized exception to the rule that a shareholder must bring a derivative action for claims alleging injury to the corporation is that in a closely held corporation a minority shareholder may bring a direct action, rather than a derivative action, if the shareholder alleges harm to himself distinct from that suffered by other shareholders of the corporation or breach of a special duty owed by the defendant to the shareholder.”); *Crosby v. Beam*, 47 Ohio St. 3d 105, 109, 548 N.E.2d 217, 221 (1989) (citations omitted) (“Given the foregoing, if we require a minority shareholder in a close corporation, who alleges that the majority shareholders breached their fiduciary duty to him, to institute an action pursuant to Civ.R. 23.1, then any recovery would accrue to the corporation and remain under the control of the very parties who are defendants in the litigation. Thus, a derivative remedy is not an effective remedy because the wrongdoers would be the principal beneficiaries of the recovery.”).

In addition to this case law, allowing a direct claim against a member for injury to or remedies for the LLC, where the reasons for a derivative claim are not present, is also recognized as a viable claim in corporate treatises:

- 2 CLOSE CORP AND LLCs: LAW AND PRACTICE, *Direct suits for fiduciary duty claims* § 9:26 (Rev. 3d ed.) (West 2016):

The reasoning common to explaining the difference between derivative and direct suits in the context of publicly held corporation, discussed in a prior section, understate and do not capture the differing policies for derivative suits and limitations on derivative suits that have developed in a non-public setting. For example, in deciding on whether to permit a direct suit, courts do not ignore the reality that the litigation is often a dispute among shareholders. The derivative/direct distinction makes little sense when the only interested parties are two individuals or sets of shareholders, one who is in control and the other who is not. In this context, the debate over derivative status can become “purely technical.” There is no practical need to insist on derivative suits when there is little likelihood of a multiplicity of suits or harm to creditors. Any recovery in a derivative suit would return funds to the control of the defendant, rather than to the injured party.

- 2 CLOSE CORP AND LLCs: LAW AND PRACTICE, *Direct Suits in LLCs* § 9:49 (Rev. 3d ed.) (West 2016) (footnotes omitted):

One of the most notable movements in close corporations law in recent decades has been the increased willingness of courts to permit minority shareholders to bring direct claims for breach of fiduciary duties. That trend can also be seen in the LLC setting and for similar reasons. In a closely held entity where there is one party in control of the entity and another party who is the only party disadvantaged by the act the controlling group has directed the entity to take (such as cutting the return to the minority or increasing the salary or other return to the controlling party) the distinction between individual harm and collective harm blurs and courts have not required the plaintiffs to comply with the derivative requirements. An Indiana court permitted a direct claim versus a manager. A Georgia court permitted direct claim citing the close corporation exception, as did a Utah court, noting it would be illogical to limit the exception to corporations and referring the Utah Supreme Court’s prior recognition of the similar vulnerability of investors in LLCs and closely held corporations.

- 12B FLETCHER CYC. CORP. § 5911.50 (West 2016) (footnotes omitted):
Courts sometimes recognize the right of a close corporation shareholder to sue directly, as an individual, on a cause of action that would normally have to be brought derivatively. This is because of the special treatment sometimes accorded close corporations and their similarity to partnerships. Additionally, allowing a direct action may allay concerns that derivative claims inure to the benefit of all shareholders, including those who have engaged in wrongdoing. A court has discretion whether to allow a minority shareholder to proceed directly against a corporation. The availability of a direct action frees the minority shareholder from satisfying the many requirements of a derivative action, such as making a demand on the corporation or obtaining court approval to dismiss or settle an action.

A court may acknowledge an exception to the general rule precluding a direct action for corporate injury when a minority shareholder is frozen out of the management of a close corporation through oppressive majority conduct, or in the case of officer or director misconduct—including allegations of self-dealing or breach of fiduciary duty, and in its discretion, may treat an action raising derivative claims as a direct action if it finds to do so will not: (1) unfairly expose the corporation to a multiplicity of actions; (2) materially prejudice the interests of creditors in the corporation; or (3) interfere with a fair distribution of the recovery among all interested persons.

Also, courts may allow shareholders who own all of the stock of the company to proceed against each other directly under the principle that there are no persons not before the court who can be affected by the litigation and that there is no danger of a multiplicity of lawsuits—two reasons used to justify the requirement of a derivative action. Courts may, however, require derivative actions even where the only shareholders are parties to the individual action. Moreover, a court may not recognize any exception for close corporations to the general rule that wrongs against the corporation may be asserted by shareholders only as derivative actions,^{7.25} even for sole shareholder corporations.

Reasons underlying the traditional rule include: (1) it prevents a multiplicity of lawsuits by shareholders; (2) it protects corporate creditors by putting the proceeds of the recovery back in the corporation; (3) it protects the interests of all shareholders by increasing the value of their shares, instead of allowing a recovery by one shareholder to prejudice the rights of others not a party to the suit; and (4) it adequately compensates the injured shareholder by increasing the value of his shares. Another rationale

for the traditional rule is to promote commercial predicatability. A middle approach requires the court to examine the particular facts of each case to determine whether imposing derivative rules is reasonable. At the opposite end of the spectrum is the blanket exception for suits involving close corporations.

The American Law Institute's Principals of Corporate Governance adopts a middle road. Section 7.01(d) provides that a court may treat a shareholder's action as direct if the court finds that to do so will not expose the defendants to multiple actions, will not harm corporate creditors, and will not interfere with a fair recovery among all interested persons. A number of courts have adopted this approach.

- Allan B. Cooper et. al., *Too Close for Comfort: Application of Shareholder's Derivative Actions to Disputes Involving Closely Held Corporations*, 9 U.C. Davis Bus. L.J. 171, 174-75; 177-79; 181 (2009) (footnotes omitted):

Court have long required shareholders to pursue corporate governance disputes through derivative actions. There are four primary reasons for this requirement. First, the rule protects creditors by insuring that recovery for misdeeds committed against the corporation redound to the benefit of the entity. Second, the rule benefits all shareholders in a manner proportionate to their ownership interests. Third, the rule discourages crippling strike suits. Lastly, the rule permits the corporation to manage the suit and its resolution under court supervision.

Historically, the sole exceptions to the derivate action requirements were for special injury cases, i.e. instances where a shareholder had suffered some harm not shared with the corporation. Such special injury cases included, for example, employment-based breaches, wrongful refusals to issue or exchange stock, failure to pay declared dividends, fraud in the transfer of stock, etc. However, for the most common source of shareholder dispute - alleged breaches of fiduciary duty resulting from fraud, misrepresentation, waste and the like - the sole remedy for a disgruntled shareholder was to sue in a derivative action.

This requirement leads to odd and sometimes unwieldy results in disputes regarding close corporations. Closely held corporations are corporations with few shareholders, where management and ownership are often united, and where a lack of ready market for the shares exists. Closely held corporations are frequently managed more as partnerships than as corporations. Indeed, such businesses are often referred to as "incorporated

partnerships” in recognition of their management and profit-sharing structures. Imposing the procedural and substantive constraints of derivative actions, therefore, sometimes inhibits, rather than promotes, a fair and efficient resolution of disputes between or among the “partners.” This is especially so because partnership law is free of such constraints and therefore enables straightforward, direct litigation of the merits of the disputes.

Recognizing this problem, in 1992 the American Law Institute (ALI) instituted standards giving courts the discretion to allow direct actions by shareholders of close corporations if the policy reasons otherwise requiring derivative actions (i.e., avoiding a multiplicity of actions, protecting creditors and benefiting all shareholders proportionately) were absent. The ALI's recommendations created a flurry of activity among jurisdictions and legal commentators. A clear split exists among those jurisdictions that have considered the issue. Some courts argued to adopt the ALI approach. Others rejected it.

In the context of a traditional corporation, those complex, often publicly-traded companies where management and ownership roles are segregated, the shareholder's derivative requirement promotes fairness and efficiency while discouraging strike suits.

While this model works well with larger corporations, it runs into difficulty when applied to small businesses. Following the traditional shareholder's derivative approach for disputes arising from close corporations grafts an unwieldy framework onto what often are really partnership disputes.

The rationale behind the shareholder's derivative requirement is nonsensical in this context. Why not, in these circumstances, simply recognize that a shareholder in a close corporation, where ownership and management are united, may sue directly for harms to his investment interest in the corporation?

While many of the decisions focus on the right of minority shareholders to pursue claims against controlling shareholders, the concept has been extended to circumstances like *Watson v. Button*, where the dispute involved equal, deadlocked shareholders. For example, courts in various jurisdictions have held that a 50% shareholder in a close corporation can bring an individual action against the other 50% shareholder(s) “if it can demonstrate either a loss peculiarly to itself and different than that suffered by the corporation, or where the remaining 50% shareholder committed the

actionable activities in his or her capacity as a director or officer of the corporation.”

The issue is significant. It promises to expand from corporate law to the law of business organizations generally. The rise of LLCs and limited partnerships, with their hybrid characteristics of corporations and partnerships, have made them attractive alternatives to corporations. As with closely-held corporations, LLCs and limited partnerships are generally owned by few members who are often involved in management, often with no ready market for membership interests. Whether to permit LLC members or limited partners to sue directly instead of derivatively is an issue that has already been encountered, with some jurisdictions debating whether to permit direct suits by LLC members or by limited partners.

- 1 RIBSTEIN AND KEATINGE ON LTD. LIAB. COS., *Suits by members individually* § 10:4 (West 2016):

Moreover, for several reasons providing for derivative suits and requiring that some actions be brought derivatively is an inappropriate rule for the closely held firms for which LLCs statutes are primarily designed.

First, in a closely held firm, it is feasible to determine the damages of each member and, therefore, to structure a direct recovery. There is no reason to be concerned that this will bypass creditors since the suit is not intended for the benefit of creditors, and since the reality in a closely held firm is that a derivative recovery will be controlled by the members themselves rather than by non-member directors as in a corporation.

Second, derivative recovery may prejudice members of a closely held firm because they cannot cash in on the award by selling their shares, so that derivative recovery may be locked in the control of wrongdoing insiders.

Third, because each member of a closely held firm is likely to have a significant interest, the possibility of strike suits by nominal holders is diminished.

Fourth, in a closely held firm, it is feasible to have a suit on behalf of the firm approved by a vote of the disinterested, non-defendant, members. For all these reasons, the costs of having a single volunteer member sue on behalf of the firm may exceed the benefits in the typical closely held LLC.

These considerations have led some courts to be lenient in characterizing direct actions in close corporations.

In sum, then, from the foregoing authorities the Court concludes as a matter of law that:

1. In Tennessee an LLC has the right by statute and case law to redress and recover for conduct of the member injurious to the LLC or in breach of duties owed to the LLC.

2. This LLC right is nonwaivable and can not be abrogated by the operating or other agreement.

3. Under Tennessee law, a closely-held, 50%, two-member LLC has the alternative of asserting its rights against a member by a derivative claim or direct cause of action, depending upon whether reasons, such as creditors rights, require use of a derivative claim.

Motion to Dismiss Standard

Applying these rulings of law to the *Verified Complaint* in this case, the Court is unable to make the further ruling on whether the LLC's claim must proceed as a derivative claim, and, therefore, that the *Verified Complaint* be amended to plead more particularly, or proceed as a direct cause of action. That is because not apparent from the pleadings is whether there are creditors' claims in this case which warrant the derivative claim process instead of a direct claim. Nevertheless, this additional ruling by the Court is

not necessary at this juncture to decide the pending motion of dismissal. That is because of the liberal pleading standard in Tennessee.

It is not necessary at this juncture for the Plaintiff to specify whether the LLC's claim is derivative or direct. The requirement is that the pleading "must contain direct allegations on every material point necessary to sustain a recovery on any legal theory, even though it may not be the theory suggested by the pleader [emphasis added]"

Webb v. Nashville Area Habitat for Humanity, Inc., 346 S.W.3d 422, 427 (Tenn. 2011) (citations omitted). That Tennessee law provides causes of action for an LLC to redress and recover for the alleged wrongful conduct of a member is sufficient under Tennessee's standards for motions to dismiss and standing to sustain the claims of 4 Points in the Verified Complaint and to deny Defendant Brinkman's *Motion To Dismiss Claims Asserted By Plaintiff 4 Points Hospitality, LLC and Memorandum In Support Thereof*.

Taking the factual allegations of the February 25, 2016 *Verified Complaint* of Defendant Brinkman's wrongful conduct as true, as the Court must do under Tennessee law upon deciding a motion to dismiss, Plaintiff 4 Points, LLC has stated a valid claim under either a derivative cause of action or direct cause of action to withstand dismissal.

Payment of Attorneys Fees

Lastly, there is the relief requested in the Defendant's motion to dismiss for instructions by the Court on payment of legal fees. Since the Court has denied dismissal and the LLC's claims in the *Verified Complaint* are pending, the issue of payment of fees does not have to be determined herein but in the near future.

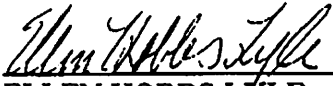
Considerations are that under Tennessee law, a single shareholder may bring both a derivative cause of action and an individual cause of action at the same time. *Hall v. Tennessee Dressed Beef Co.*, 957 S.W.2d 536, 540 (Tenn. 1997) (“This Court agrees with the Court of Appeals that the class of shareholders contemplated by Tenn. R. Civ. P. 23.06 may consist of one shareholder. Otherwise, as the court below noted, a shareholder of a closely held corporation might be deprived of the ability to bring a derivative action Shareholders may bring derivative and individual actions simultaneously.”).

In conducting preliminary research on the issues of this case, however, the Court was able to locate only one case where competing/countervailing claims were asserted on behalf of the LLC, and the case located is factually distinguishable from this case. *See, generally Sec. Professionals, Inc. By & Through Paikin v. Segall*, 685 So. 2d 1381, 1384 (Fla. Dist. Ct. App. 1997) (“Although there is only one corporation, there can be more than one shareholders’ derivative action based on different causes of actions and claims of damages pending at any one time.”).

In the event that both parties assert a derivative action on behalf of 4 Points, LLC, a possible procedure is that the attorneys on each side will bill/invoice the LLC separately from the individual parties.

Counsel shall be prepared to discuss this procedure and other possibilities for segregating out the billing/payment of counsel fees for work done solely for the LLC and work done solely for the individual parties on June 10, 2016, when Counsel will be

present in court for oral argument on Defendant's *Motion For Appointment of a Custodian.*



ELLEN HOBBS LYLE
CHANCELLOR
TENNESSEE BUSINESS COURT
PILOT PROJECT

cc: Robert G. McDowell
James A. DeLanis
TaCara D. Harris
Cees Brinkman
Brinkman Holdings, LLC
Mary Neil Price
W.Scott Sims

COPIES TO ATTORNEYS AND PRO SE LITIGANTS
AT THE ABOVE ADDRESSES

DATE 2-10-10 CLERK CS