

Clarified Individual Member Rights and Duties in Limited Liability Companies

Article
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In a highly-anticipated opinion, released in April 2019, the Wisconsin Supreme Court clarified the liability of individual members of Limited Liability Companies (“LLCs”) to the LLC and the other members. In the case of *Marx v. Morris*, the Wisconsin Supreme Court held that individual members of an LLC may sue other members for injuries caused to the LLC. Additionally, the Court held that individual members owed common law duties to other members, which arise outside of Wisconsin’s LLC statute.

In *Marx*, six individuals, through their single-member LLCs, formed a new LLC—North Star, which was created to own and mine land containing sand used in fracking. Three of those individuals included Daniel Marx, Michael Murray, and Richard Morris. Marx and Murray sued Morris, alleging that Morris sold valuable North Star assets to another company owned by Morris. Marx and Murray alleged this was in violation of Morris’ common-law duty of loyalty to North Star, the LLC.

The first issue the Wisconsin Supreme Court addressed is whether Marx and Murray, as members of the LLC, could sue Morris, another member, for harm caused to the LLC. As the Court noted, Limited Liability Companies were created as a hybrid of two other business forms: partnerships and corporations. Under Wisconsin corporate law, an individual shareholder may not sue for harm done to the corporation. Instead, the shareholder brings a “derivative action” on behalf of the corporation. This means the shareholder steps into the shoes of the corporation, versus directly acting. Wisconsin Statutes Chapter 180 governing corporations dictates a series of notice requirements a shareholder must follow to bring a derivative action. Morris argued that because an LLC was similar to a corporation, it should similarly require a derivative action to be brought for harm caused to the LLC. Consequently, Morris argued the requirements for bringing a corporate derivative action should apply to Marx and Murray’s lawsuit. Since, they did not follow the notice requirements, the lawsuit should be dismissed.

In rejecting Morris’ argument, the Wisconsin Supreme Court held that individual members of an LLC were entitled to sue other members for harm to the LLC and a derivative action was not required. The Court explained that because LLCs passed along their profits and losses directly to their members, the individual

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members were more directly impacted by harm to the LLC. As such, they were allowed to sue in their individual capacity.

The second question the Wisconsin Supreme Court addressed was whether common law duties, imposed by the formation of an LLC, were still recognized. Common law duties are duties that courts—rather than contracts or statute—have historically imposed on individuals based on the relationship between the parties. Courts historically recognized common law duties between members of an LLC, including: a duty of good faith and fair dealing and a fiduciary duty of loyalty. Morris argued that the Wisconsin Limited Liability Company Law, Wisconsin Statute Chapter 183, eliminated an LLC member's common law duties. Morris therefore argued he only owed the duties defined in the statute.

In rejecting Morris' second argument, the Wisconsin Supreme Court held that LLC members may still bring a claim based on common law duties arising from the relationship between the members. The Court explained that the Wisconsin LLC Law does not explicitly state or imply that it is the only measurement of obligations owed by members and managers to the fellow owners. Therefore, the Court held that LLC members and managers do have duties arising under common law and can be sued for a breach of such duty.

While this decision brought clarity to Wisconsin LLCs, it also broadened the potential liability of the individual LLC members in two ways. First, individual members may now be sued by other members, in addition to suits brought by the LLC. Second, it confirmed that individual members and managers owe common law fiduciary duties to other members and the LLC.

However, under Wisconsin law, an LLC may limit the duties a member or manager owes the LLC and the other members by expressly stating these limits in the Operating Agreement. As such, it is more important than ever to ensure that your LLC Agreement clearly establishes these duties and responsibilities. A well-planned LLC Agreement can address not only these issues, but others, including: indemnification, alternative dispute resolution, and establish processes for bringing suit under the LLC Agreement.

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