CORPORATIONS, SECURITIES AND FINANCIAL SERVICES COMMITTEE

MEETING TO BE HELD ON JUNE 14, 2018

Section 607.1104 (Merger between parent and subsidiary or between subsidiaries)

Section 607.1104 authorizes mergers between a parent corporation and its subsidiary or between subsidiaries with a common parent without the consent of the subsidiaries board of directors or stockholders if the parent owns a sufficiently large percentage of the stock of the subsidiary. Florida's parent-subsidiary merger statute has an 80% threshold for use of this provision. The Model Act contemplates a 90% threshold, as does the corollary provision in the DGCL. In fact, every jurisdiction in the United States except Alabama, Florida, Montana, Pennsylvania and Wyoming, which have an 80% requirement, uses a 90% requirement.

Should the FBCA continue with its 80% threshold or, following the Model Act and the DGCL, should the threshold be increased to 90%? The co-chairs are split on how to handle this issue.

Section 607.0825 (Committees)

This section authorizes a Board of Directors to create committees that can exercise the powers of the Board. However, Board committees are not permitted to be delegated those matters described in subsection (4). One of those matters is to "authorize or approve the issuance or sale or contract for the sale of shares, or determine the designation and relative rights, preferences, and limitations of a voting group, except that the board of directors may authorize a committee (or a senior executive officer of the corporation) to do so within limits specifically prescribed by the board of directors." This limitation has been in the FBCA since 1989, and was based on the 1984 version of the Model Act. However, this provision is not included in the current version of the Model Act.

Based on the information in the 2013 version of the Model Act, it appears that 23 states have a similar restriction on committee authority. However, this restriction is not in the DGCL or in the corporate statues in California, New York or Texas. Updated information on this topic will be provided at the meeting.

During its deliberations on Article 8, the Subcommittee decided to retain this limitation. However, Gary Teblum has asked that this limitation be reconsidered by the Subcommittee. The co-chairs are split on how to handle this issue.

Section 607.1401 (Dissolution by incorporators or directors)

Under this section, a majority of the incorporators or initial directors of a corporation that has not issued shares or has not commenced business may dissolve the corporation. This language has been in the FBCA since 1989 and is consistent with the current version of the Model Act.

Recently, a question has been raised with the co-chairs (in discussions between the co-chairs and a committee of members of the Business Litigation Committee who are commenting on litigation issues contained in the Master Draft (the "BusLit CH 607 Study Committee")) as to how this section should work. For example, if an incorporator appoints a board of directors in the Articles of Incorporation, but no shares have yet been issued and no business has commenced, can the incorporator dissolve the corporation or should only the appointed board of directors have the power to dissolve the corporation under those circumstances? Also, the question of what it means to “commence business” has been raised, and whether the corporation can ever be considered to have commenced business before shares have been issued? Similarly, if proposed shareholders have made payment to a corporation for shares, and the

corporation has begun using such assets, are shares considered to have been issued even though no certificates are ever issued?

While the Subcommittee previously decided to continue with the existing statutory wording, the Committee will have a discussion about whether these are issues that need to be addressed in the statute or should be left to the Courts to decide.

Section 607.0742 (Demand)

Under current s. 607.07401(2), a derivative proceeding cannot be brought unless the complainant alleges that demand was made to obtain action of the Board of Directors and the demand was refused or ignored by the Board of Directors for a period of at least 90 days from the first demand, unless irreparable injury to the corporation would result from waiting the 90 days. The Model Act continues to include a required universal demand before a derivative action may be brought, and the current draft of proposed s. 607.0742 includes the requirement that a demand be made before a derivative action can be brought.

On the other hand, FRLLCA, in Section 605.0802(2), contemplates that if making a demand on the other members (in a member-managed LLC) or on the other managers (in a manager managed LLC) would be futile or would cause irreparable injury to the company, then such demand shall not be required in order to maintain a derivative proceeding against the LLC. The FRLLCA provision follows RULLCA on this issue. Further, while not in the DGCL, the case law that has developed in Delaware dealing with derivative actions excuses the requirement of making a demand based upon futility.

When the Subcommittee previously considered this issue, consideration was given to the following items:

- the reasons why futility might or might not be an appropriate excuse to demand in the LLC context and in the corporate context;
- the reasons why futility was not adopted in the FBCA when it was originally adopted in 1989 and why it has not been added to the FBCA as the Delaware law on the subject has continued to develop; and
- whether because of acknowledged harmonization efforts to rationalize among entity statutes in Florida, either demand futility should be added to the FBCA or FRLLCA should be modified to remove demand futility.

After taking an analysis of these items into account, the Subcommittee decided to retain a demand requirement in this statute and did not add the concept of excusing demand because of futility.

Recently, in discussions between the co-chairs and the BusLit CH 607 Study Committee, the BusLit CH 607 Study Committee pointed out that Florida courts already take demand futility into account, despite it not being in the FBCA. Their position (presented by Zach Hyman, who is heading up the BusLit CH 607 Study Committee) is as follows:

> I recommend that we include a provision concerning demand futility. While there are concerns that there will be side litigation over demand futility, I don't think that those concerns are as prevalent in Florida where there is a significantly higher number of closely held corporations. Further, there is not a consistent standard as to what needs to be alleged and/or proven to establish demand futility. *See Murphy v. O'Malley*, 531 So. 2d 203 (Fla. 4th DCA 1988) ("We reverse the trial court's order of dismissal with prejudice because we believe the appellant's complaint contained sufficient allegations to excuse her failure to request the corporation's directors to proceed against appellee Dover.") "Under Florida law, the sole exception to this demand requirement is where such a demand 'would be impractical, unreasonable or useless ...' ". *In re*

Mercedes Homes, Inc., 431 B.R. 869, 877 (Bankr. S.D. Fla. 2009) (*quoting Belcher v. Schilling,* 309 So.2d 32, 35 (Fla. 3d Dist. Ct. App. 1975)). *Conlee Const. Co. v. Cay Const. Co.*, 221 So. 2d 792, 796 (Fla. Dist. Ct. App. 1969) (*citing* 13 Fletcher Cyc. Corporations § 6008 (1961 rev. ed.)) ("Demand on the directors to bring the action, a condition precedent to suit, is excusable where demand obviously would be unavailing."); *Telestrata, LLC v. NetTALK.com, Inc.*, 1:14-CV-24137-JLK, 2015 WL 11234143, at *1 (S.D. Fla. July 9, 2015).

Should we reconsider adding the concept of excusing demand because of futility to the derivative action provisions of the FBCA?

Section 607.0848 (Shareholder action to appoint custodian or receiver)

Section 607.0748 is based on Section 7.48 of the Model Act (which, in turn, is based on s. 226 of the DGCL). Section 607.0748 provides a basis for shareholders of any corporation to obtain the appointment of a receiver or custodian in two situations arising outside the context of seeking a judicial dissolution: (i) when directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock and irreparable injury to the corporation is threatened or is being suffered, or (ii) when the directors or those in control of the corporation are acting fraudulently and irreparable injury to the corporation is threatened or being suffered.

This section is also designed to provide guidance to the courts relative to the latitude of the court's authority to make such appointments in these situations. Without this section, the express statutory power and authority to appoint a receiver or custodian is only available ancillary to an action for judicial dissolution, under s. 607.1432 (although Florida courts, through common law equitable powers, may be able to fashion, and have from time to time fashioned, such a remedy under common law).

Proposed s. 607.0748(1) provides that a circuit court may appoint one or more persons to be custodians, or, **if the corporation is insolvent**, to be receivers, of and for a corporation in a proceeding by a shareholder if the grounds for appointment of a receiver are present under the statute.

The issue of whether insolvency is required to obtain a receiver is of concern to the BusLit CH 607 Study Committee. Zach Hyman, on behalf of that committee, has provided the following commentary on this topic for our consideration:

> 607.0748 provides in relevant part that: "A circuit court may appoint one or more persons to be custodians, or, if the corporation is insolvent to be receivers . . . where it is established that there is (i) deadlock that is causing irreparable injury; or (ii) fraudulent conduct that causes irreparable injury. This makes it seem as though a receiver can ONLY be appointed if the corporation is insolvent. I have not seen any Florida Court explicitly apply the "insolvency plus" standard that will likely be applied if this section is enacted as is. Ross Holding & Mgmt. Co. v. Advance Realty Group, LLC, CIV.A. 4113-VCN, 2010 WL 3448227, at *5 (Del. Ch. Sept. 2, 2010) ("Traditionally, when considering whether to appoint a receiver in the corporate context under 8 *Del. C.* § 291, courts have employed the "insolvency plus" standard, under which the moving party must prove that the company is insolvent, plus additional facts that demonstrate that the intervention of a neutral third party is necessary to protect the rights and interests of either the company or the moving parties") Siple v. S & K Plumbing & Heating, Inc, 6731, 1982 WL 8789, at *2 (Del. Ch. Apr. 13, 1982) (noting that insolvency is a threshold issue.); Hall v. John S. Isaacs & Sons Farms, Inc., 39 Del. Ch. 244, 253 (1960) (Mere dissension among corporate stockholders seldom, if ever, justifies the appointment of a receiver for a solvent corporation. The minority's remedy is withdrawal from the corporate enterprise by the sale of its stock.)

As a starting point, the BusLit CH 607 Study Committee has raised the question of whether the definition of insolvency in s. 607.01401(27) should be modified to include both a cash flow test and an insolvency test, and the co-chairs believe that such Study Committee is correct on this topic and that modifying the definition of insolvency in this manner will make it consistent with s. 607.06401 (Distributions to Shareholders) and s. 736.103 (Florida's fraudulent transfer law) and will work in all parts of Chapter 607 that use that definition.

The second issue that such Study Committee has raised is whether insolvency should be a test for appointment of a receiver outside of the judicial dissolution context. This topic is more problematic. It seems clear that courts in equity have the power to appoint a receiver whether or not the corporation is insolvent, but that in many cases, courts will look to the topic of insolvency in deciding whether to appoint a receiver (as compared to a custodian), and Zack's analysis above supports the proposition that insolvency is often considered by courts in equity as a test for whether a receiver should be appointed.

The Committee will discuss two issues on this topic.

First, the Committee will discuss whether it is appropriate, following the corollary provision in the Model Act, to only allow for appointment of a receiver outside of a judicial dissolution proceeding if the corporation is insolvent.

Second, the Committee will consider whether this statute (and, perhaps, s. 607.1432) should expressly state that these provisions are not intended to supplant or abrogate the equitable powers of a court under common law to appoint a receiver.

Section 607.08081 (Removal of directors by judicial proceedings)

This section is modeled after Model Act s. 8.09. This Model Act section was originally adopted in 2001, and the language was substantially revised in the 2016 version of the Model Act. It is intended to apply in limited circumstances where other remedies are inadequate to address serious misconduct by a director and it is impracticable for shareholders to invoke the usual remedy of removal under s. 8.08 of the Model Act (s. 607.0808). While there was a general view that courts already have this power in equity and in an injunction proceeding, expressly setting forth this power in the statute is believed to be a good policy decision, particularly when more than 30 states (including Delaware, in DGCL section 225(c)) have included some form of judicial remedy to remove directors in their corporate statutes.

This new section is not intended to restrict a court from exercising its equitable powers under particular circumstances and the Committee will discuss whether a provision should be added to this section that expressly states that this provision is not intended to supplant or abrogate the equitable powers of a court under common law to remove a director.

Section 607.1405 (Effect of dissolution)

Subsection (6) provides that a circuit court may appoint a trustee, custodian or receiver for property owned or acquired by the corporation who may engage in any act permitted under subsection (1) (Dealing with the wind up and liquidation process) if any director or officer of the dissolved corporation is unwilling or unable to serve or cannot be located. This provision is not a Model Act provision.

In its deliberations, the Subcommittee added the words "upon application of a shareholder" to subsection (6) in the following context:

> For purposes of this section, the circuit court, upon application of a shareholder, may appoint a trustee, custodian or receiver for any property owned or acquired by the corporation who may engage in any act permitted under subsection (1) if any director or officer of the dissolved corporation is unwilling or unable to serve or cannot be located.

A group studying the Master Draft on behalf of the Bankruptcy/UCC Committee has questioned why this wording was added under circumstances where a creditor might well be the party seeking appointment of a receiver for property in a liquidation situation. The Subcommittee will consider whether to remove these words from this section of the FBCA. The co-chairs are inclined to make the suggested change, but want to get input from this Committee before doing so.

Numbering Issues

A member of the Section has expressed the view to one of the co-chairs that they are bothered by the fact that some sections of the FBCA have three numbers after the "607.", some have 4 numbers and some have 5 numbers, and that as a result the numbering order is not based on the absolute value of the number after the dot. Is this a concern for others? Should we consider having all numbering of sections include 5 numbers after the dot by adding two "following" zeros to the 3 number sections (e.g., 607.193 would become 607.19300) and one "following" zero to the 4 number sections (e.g., 607.0601 would become 607.06010)? Even if we think it's a good idea, would bill drafting allow us to do this?