The Florida Bar Business Law Section
Presents

# A Primer on Florida Business Organization Disputes


Presented by: John P. Kelly, Esq.

The Kelly Law Firm

Fort Lauderdale, FL

Organized by: Peter F. Valori, Esq.

Chair, Communications Committee

Florida Bar Business Law Section

Mark D. Nichols, Esq.

Business Litigation Committee

Florida Bar Business Law Section

## A. **Overview.**

1. Business organization litigation presents complex issues and challenges for the commercial litigator. This lecture examines some of the basic litigation issues in typical disputes involving one or more business entities. An exhaustive treatment of the subject is beyond the scope of this presentation. I will try to focus on a: "hit list" of likely topics on an examination question involving business entities disputes.

2. This lecture focuses on disputes unique to and arising out of the choice of the business entity itself. Changes in the law and the exigencies of commerce have given rise to partnerships, corporations, and other business organizations, such as the relatively new concept of the limited liability company. The need for organizations of multiple interests, unified to accomplish a particular business goal, but cloaked with the protection of a limited liability for its members, has led to the creation of various types of business entities. Business planning and tax considerations often initially dictate the choice of entity. Yet litigation counsel for each entity must be prepared to deal with ensuing conflicts within the entity and protection for the members from the consequences of often unforeseen future developments. The litigation common to each entity often revolves around internal disputes among its members with multiple, and frequently differing, interests. The immediate focus of this lecture is on the unique internal disputes arising in litigation involving a business organization composed of multiple interests.

## B. **Identifying the Business Entity.**

1. *Common Entities:* In the past, partnerships, joint ventures, and corporations have been the most often chosen business entities. Limited liability companies have emerged in the past decade as a "preferred" business entity, given their tax advantages in certain situations and in view of the perception that they are more flexible than corporations. However, the law on these organizations has not yet fully matured, so there is still some uncertainty about their true efficacy.

2. *Other Entities:* Less common and in varying degree hybrids of the basic forms, are such entities as agricultural cooperative marketing associations, banks, business trusts, common-law trusts, condominiums, cooperatives, credit unions, fraternal benefit societies, insurance companies, limited partner-ships, nonprofit cooperative associations, not-for-profit corporations, private schools, professional service corporations, public fairs and expositions, public utilities, real estate corporations, real estate investment trusts, religious societies, savings and loan associations, social clubs, and unincorporated associations. Litigation involving these various business organizations may raise substantive issues that have been treated in other publications. The primary discussion in this chapter relates to litigation issues within business organizations of the most common but protean forms — the partnership, joint venture, and corporation, as well as the more recent forms of limited liability company and professional limited liability company.

3. *Statutory Scheme*: For Profit Corporations—Chapter 607 Non-Profit Corporations—Chapter 617; Partnerships—Chapter 620; Limited Liability Partnerships-Chapter 620 ; Limited Liability Companies—Chapter 608.

## C. **Ethical Issues.**

1. *Introduction:* Business entity disputes obviously an area involving numerous ethical considerations involving multiple interests. Typically, in small entities, parties' contributions to the entity at formation and afterwards may vary: "money men", "sweat equity participant", and " silent partners" are common players.

2. *Inherent Conflict*: representation of entity versus representation of members.

3. *Representation of Organization:* Chapter 4 of the Rules Regulating The Florida Bar, titled "Rules of Professional Conduct," provides rules and comment on many potential conflict situations relevant to business organization litigation. Rule 4-1.13 specifically deals with the "organization as client" and provides that a "lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." Rule 4-1.13(a). Any communication between the organization's lawyer and a constituent in an organizational capacity is a confidential communication, even if the constituent is not a client of the lawyer. A lawyer may represent both the organization and its constituents, subject to the conflict of interest rule stated in Rule 4-1.7. In *Gonzalez ex rel. Colonial Bank v. Chillura*, 892 So.2d 1075, 1077 (Fla. 2d DCA 2004), the court, for instance, held that there was no conflict of interest in an attorney concurrently representing the plaintiff in a shareholder derivative action while at the same time representing the same plaintiff in litigation he or she is pursuing individually against the corporation, because otherwise there would be "no way for the derivative plaintiff to ever have conflict free counsel."

4. *Whistle-blowing:* Rule 4-1.13(b) places an affirmative duty on a lawyer to "proceed as is reasonably necessary in the best interest of the organization" if a constituent of an organization intends to act in violation of a legal obligation to the organization or in violation of the law, in a manner likely to result in substantial injury to the organization. The measures taken by the lawyer must be minimally disruptive to the organization and should take into consideration the organization's policies. However, the lawyer ultimately may be required to refer the violation to the highest authority that can act on behalf of the organization. If that authority insists on action that clearly violates the law and is likely to result in substantial injury to the organization, the lawyer may resign his or her representation in accordance with Rule 4 1.16.

5. *Entity Formation.* Scenario: multiple people come to a lawyer to form a business entity. Who does the lawyer represent? Case law indicates that the lawyer represents the entity (corporation) in forming the entity, but that safe harbor does not exist with respect to representation of differing interests in negotiation of shareholder agreements. Typically provisions are included in such agreements relating to waiver of

any conflicts and that the members of the entity have had opportunity to consult independent counsel.

6. *Pro Se Entity Formations:* The State of Florida has chosen to open its doors for anyone to form and register a business entity online—result is a lot of "half baked" entities with no shareholder agreements or operating agreements. Pro se entity formers rarely follow "entity formalities"—complying with the minimum statutory requirements—maintaining books and records, holding themselves out to the public as a separate entity, commingling of funds, using the entity as their alter ego, or even filing the annual UBR, often leading to an administrative dissolution the following September. Ethical considerations abound as to how the lawyer can right the ship particularly when third-party rights are affected.

## D. <u>Partnership Litigation.</u>

1. *Decline:* Partnerships as the favored means of conducting business has dwindled enormously due to the preference for corporations and limited liability companies as "liability shielders."

2. *General Partnership*: Under Florida law (Revised Uniform Partnership Act—RUPA), "the association of two or more persons to carry on as co-owners a business for profit forms a partnership." F.S. 620.8202. "Business" is defined in F.S. 620.8101(2) as "any trade, occupation, profession, or investment activity." The three essential elements of a partnership are (1) an "association" by contract or operation of law; (2) "co-ownership" in specific assets, management, and net-profit sharing; and (3) a "business for profit." The rights and remedies of partners among themselves and with others are governed by the Revised Uniform Partnership Act (RUPA), F.S. 620.81001, et seq.

3. *Intent of the Parties*: Under prior Florida law, the intent of the parties was the primary test for the existence of a partnership. Under current F.S. 620.8202, except for those associations noted in F.S. 620.8202(2), a partnership is formed by "the association of two or more persons to carry on as co-owners a business for profit . . . whether or not the persons intend to form a partnership." A person who receives a share of the profits of a business is, with limited exceptions, presumed to be a partner under F.S. 620.8202(3)(c). An "inadvertent" partnership may arise in a transaction involving co-profit sharing and co-management. The existence vel non of a partnership is for the trier of fact to determine, usually a judge in an equitable action. See, e.g., *Perez v. Hernandez*, 323 So.2d 4 (Fla. 3d DCA 1975).

4. *Supremacy of Partnership Agreement*. Under the RUPA, the intent is that the partnership agreement will govern all issues arising out of the partnership, and if there is no partnership agreement, the Act will control. The RUPA, like its predecessor, specifically provides that it "shall be applied and construed to effectuate its general purpose to make uniform the law." F.S. 620.81001. In a more simplified enactment than Florida's version of the UPA, the Florida RUPA also provides in F.S. 620.8104 that "[u]nless displaced by particular provisions of this act, the principles of law and equity

supplement this act." See former F.S. 620.58. See also *Krauth v. First Continental Dev-Con, Inc.*, 351 So.2d 1106 (Fla. 4th DCA 1977); *Myrick v. Second National Bank of Clearwater*, 335 So.2d 343 (Fla. 2d DCA 1976).

5. *Mutual Liability of Partners*: The hallmark of the general partnership is that "[e]ach partner is an agent of the partnership for the purpose of its business," F.S. 620.8301(1), and each partner is liable for the debts and the wrongful acts of the partnership, F.S. 620.8305, 620.8306, 620.8308. A partner, however, is not liable for the preexisting debt of a copartner, *Arthus Bertrand, S.A. v. Davis*, 633 So.2d 62 (Fla. 3d DCA 1994), nor is a newly admitted partner liable for any partnership obligation incurred before his or her admission, F.S. 620.8306(2). See also F.S. 620.8306(3), added by Ch. 99-285, §9, effective June 8, 1999 ("An obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership").

6. *Distinction from Agency*: A partnership is similar to an agency relationship, but an agent is subject to the principal's control at all times, while one partner does not necessarily control any other partner. RESTATEMENT (SECOND) OF AGENCY §§14A, B (ALI-ABA 1957). Under the RUPA, nonetheless, "[e]ach partner is an agent of the partnership for the purpose of its business," and an act of a partner generally binds the partnership. F.S. 620.8301(1).

7. *Imputed knowledge*: Moreover, notice to or knowledge by one partner acting in a par-ticular matter may serve as notice to the partnership. F.S. 620.8102(6); see also *In re Wildflower Landholding Associates, Ltd*., 49 B.R. 246 (Bankr. M.D. Fla. 1985). A partner's knowledge of the underlying facts of a trans-action, however, cannot be imputed to the partnership when the transaction involves fraud on the partnership. F.S. 620.8102(6); *Grossman v. Greenberg*, 619 So.2d 406 (Fla. 3d DCA 1993).

## E. Joint Venture Litigation.

1. *Separate Legal Relationship*: Although a partnership most closely resembles a joint venture, and both are governed by the same general rules of law, they are separate legal relationships. The joint venture concept was unknown at common law, and its status as a legal entity is unique to American jurisprudence. 46 AM.JUR.2d *Joint Ventures* §2. A joint venture under Florida law is a voluntary relationship arising out of the law of both express and implied contracts. *Russell v. Thielen*, 82 So.2d 143 (Fla. 1955); *McKissick v. Bilger*, 480 So.2d 211 (Fla. 1st DCA 1985); *Hyman v. Regenstein*, 222 F.2d 545 (5th Cir. 1955). The Florida Supreme Court has held that, in addition to the essentials of an ordinary contract, joint venture contracts must display "(1) a community of interest in the performance of the common purpose, (2) joint control or right of control, (3) a joint proprietary interest in the subject matter, (4) a right to share in the profits and (5) a duty to share in any losses which may be sustained." *Kislak v. Kreedian*, 95 So.2d 510, 515 (Fla. 1957); see Sutton v. Smith, 603 So.2d 693 (Fla. 1st DCA 1992). Proof that one venturer has exclusive control of the venture's business affairs and finances is inconsistent with a determination of a joint venture. *Green v. Putnam*, 93 So.2d 378 (Fla. 1957). The joint venture agreement must include a provision for the

sharing of both profits and losses. *Kislak*; *Sutton*; 8B FLA.JUR.2d Business Relationships §§749, 756.

2. *Mutual Agency*. A joint venturer's authority may be limited, however, to the particular business-venture transaction, but a partner's authority can extend to the apparent business of the partnership. As stated by the court in *Deal Farms, Inc. v. Farm & Ranch Supply, Inc.*, 382 So.2d 888, 891 (Fla. 1st DCA 1980), quoting 8 FLA.JUR.2d Business Relationships §691 (now 8B FLA.JUR.2d Business Relationships §762):

> A contract of joint adventure is in effect one of mutual agency, each adventurer acting as a principal in his own behalf and as agent for his co-adventurer. Each one of several joint adventurers has the power to bind the others in matters that are strictly within the scope of the joint enterprise.

3. *Less formality*. Traditionally, a joint venture has a limited, specific objective and is less formal than a partnership. *Russell v. Thielen*, 82 So.2d 143 (Fla. 1955). A joint venture does not arise merely by indicia of joint ownership in the absence of an express or implied agreement suggesting the feature of an actual venture. 46 AM.JUR.2d Joint Ventures §§9, 11, 12, 16. See also *Duvall v. Walton*, 107 Fla. 60, 144 So. 318 (1932). The fact that an agreement does not expressly provide for sharing of losses is not fatal to the finding of a joint venture. *Florida Trading & Investment Co. v. River Construction Services, Inc.*, 537 So.2d 600 (Fla. 2d DCA 1989). However, if a joint venture meets the definition of a statutory partnership, it may fall within the scope of the UPA or RUPA. A joint venture is governed by the principles which constitute and control the law of partnership. *Kislak v. Kreedian*, 95 So.2d 510, 515 (Fla. 1957), quoting *Proctor v. Hearne*, 131 So. 173, 176 (Fla. 1930); *Proctor v. Hearne*, 100 Fla. 1180, 131 So. 173 (1930); *Rafkind v. Simon*, 402 So.2d 22 (Fla. 3d DCA 1981); *Century Bank of Lee County v. Gillespy*, 399 So.2d 1109 (Fla. 5th DCA 1981).

4. *Does Not Arise by Operation of Law*: On the other hand, a joint venture cannot arise by operation of law because it is a voluntary relationship arising by contract.

5. *Liabilities and Rights*: The liabilities, rights, duties, and remedies of joint venturers among themselves and to others are essentially the same as those of general partners. See *Hayes v. H.J.S.B.B. Joint Venture*, 595 So.2d 1000 (Fla. 4th DCA 1992); *Campbell v. A.B. Taff & Sons, Inc.*, 519 So.2d 1039, 1041 (Fla. 1st DCA 1988) ("the rights of the parties to the joint venture are governed by partnership law"). In fact, from a litigation perspective, the distinctions between a joint venture and a partnership often are blurred. A joint venture terminates when the objects of its creation have been accomplished. *Kislak*, 95 So.2d at 514. However, the fact that a joint venture may determine to carry out the purpose of the venture through the medium of a corporation does not alter the effect of the joint venture. *Donahue v. Davis*, 68 So.2d 163, 171 (Fla. 1953).

## F. **Limited Liability Partnership Litigation.**

1. *Revised Limited Liability Partnership Act*. A revised limited partnership statute, *F.S.* 620.1101–620.2205 (the Florida Revised Uniform Limited Partnership Act of 2005 or RULPA), became effective on January 1, 2006. A Florida “limited partnership” or “domestic limited partnership” is a partnership formed “by two or more persons” under the laws of Florida, having as members “one or more general partners and one or more limited partners[, and the] term includes a limited liability limited partnership.” *F.S.* 620.1102(12). A limited partnership may “do all things necessary or convenient to carry on its activities.” *F.S.* 620.1105. As with the RUPA and other model or uniform statutes, the RULPA provides for uniform interpretation with other states that have the same enactment. *F.S.* 620.2201(1). See also *Mason v. Avdoyan*, 299 So.2d 603, 606 (Fla. 4th DCA 1974) (“In construing Uniform Laws, it is pertinent to review holdings in other jurisdictions where the particular act is in force, in the interest of attempting to achieve a uniform interpretation”).

2. *Contribution by Limited Partner*. The RULPA provides that the contribution of a general or limited partner may be “any benefit provided by a person to a limited partnership in order to become a partner or in the person’s capacity as a partner.” F.S. 620.1102(3). Unlike the predecessor statute, F.S. 620.1303 provides that a limited partner is not liable for any limited partnership obligations, “whether arising in contract, tort, or otherwise . . . even if the limited partner participates in the management and control of the limited partnership.”

3. *Fiduciary Duty*. In *Wulsin v. Palmetto Federal Savings & Loan Ass’n*, 507 So.2d 1149, 1151 (Fla. 3d DCA 1987), approved 530 So.2d 291, the court recognized that a “limited partner is like a corporate shareholder or a trust beneficiary to whom a fiduciary duty is owed.”

4. *Derivative Claims*: F.S. 620.2002 expressly provides a partner in a limited partnership the right to “maintain a derivative action to enforce a right of a limited partnership.” A pre-suit demand is required to allow the general partners to “cause the limited partnership to bring an action to enforce the right.” *Id*. If “the general partners do not bring the action within a reasonable time” or if such a “demand would be futile,” then the partner may bring the lawsuit. *Id*.

## G. **Corporation Litigation**

1. *Shareholder Derivative Claims*: To prevent abuses by corporate management, the courts have recognized the shareholders’ derivative action. As early as 1882, the United States Supreme Court exercised its equity jurisdiction to determine the rules for a derivative action. *Hawes v. City of Oakland*, 104 U.S. 450, 26 L.Ed. 827 (1882). A shareholder who initiates a shareholder’s derivative action is a fiduciary to the corporation. *Head v. Lane*, 495 So.2d 821 (Fla. 4th DCA 1986). The Florida Supreme Court recognized the fiduciary duties of directors as early as 1907 in *Jacksonville Cigar*

*Co. v. Dozier*, 53 Fla. 1059, 43 So. 523 (1907). In *Tampa Waterworks Co. v. Wood*, 97 Fla. 493, 121 So. 789 (1929), the court first recognized the standing of stockholders in equity to seek relief against corporate management by the appointment of a receiver on a proper showing of fraud, spoliation, immediate danger of loss of property, or waste of assets by corporate management, coupled with self-dealing. In more recent cases, directors have been held liable "for corporate losses resulting from practices primarily designed to maintain the directors in control." *Schilling v. Belcher*, 582 F.2d 995, 1005 (5th Cir. 1978). Shareholder derivative actions arise in equity and are the only means for a shareholder to vindicate a corporate claim and seek redress against unfair and illegal management policies. The claim belongs to the corporation so any recovery is for the benefit of the corporation; hence, the corporation is an indispensable party that must be joined as an original defendant. *Alario v. Miller*, 354 So.2d 925 (Fla. 2d DCA 1978); *Liddy v. Urbanek*, 707 F.2d 1222 (11th Cir. 1983). The trial court may allow a re-alignment of the parties to satisfy this jurisdictional requirement. *Francini v. International Marble Trades, Inc.*, 546 So.2d 777 (Fla. 3d DCA 1989).

2. *Characteristics*:

(a) Demand on Board of Directors: A shareholder's derivative action must be prefaced by a demand on the board of directors to institute the action that the shareholder desires to bring in a derivative capacity. The derivative lawsuit is premised on the wrongful refusal of the directors to assert a corporate claim. F.S. 607.07401(2) requires:

> A complaint in a proceeding brought in the right of a corporation must be verified and allege with particularity the demand made to obtain action by the board of directors and that the demand was refused or ignored by the board of directors for a period of at least 90 days from the first demand unless, prior to the expiration of the 90 days, the person was notified in writing that the corporation rejected the demand, or unless irreparable injury to the corporation would result by waiting for the expiration of the 90-day period.

(b) *Contemporaneous Ownership*: F.S. 607.07401(1) provides: "A person may not commence a proceeding in the right of a domestic or foreign corporation unless the person was a shareholder of the corporation when the transaction complained of occurred or unless the person became a shareholder through transfer by operation of law from one who was a shareholder at that time." The term "shareholder" now includes a beneficial owner whose shares are held in a voting trust or by a nominee. F.S. 607.07401(7). For a discussion of standing in a derivative action, see South End Improvement Group, Inc. by & through *Bank of New York v. Mulliken*, 602 So.2d 1327 (Fla. 4th DCA 1992).

(c) *Jury Trial Right*: In *Ross v. Bernhard*, 396 U.S. 531, 90 S.Ct. 733, 24 L.Ed.2d 729 (1970), the Supreme Court held that a shareholder was entitled to a jury trial in federal court on the corporation's derivative claim if the claim on the merits presents legal issues to which the Seventh Amendment guarantee of the right to trial by jury attaches. A claim for money damages clearly would be covered by the right to a jury trial, while a request for an injunction would be an equitable claim. However, the plaintiff's capacity and right to bring the claim is not a jury issue; therefore, these issues should be determined before the jury issues. In contrast, Florida state courts which have considered the issue have held that the right to a jury trial is not guaranteed in a derivative action because it is fundamentally an equitable action. See, e.g., *Lanman Lithotech, Inc. v. Gurwitz*, 478 So.2d 425 (Fla. 5th DCA 1985). In a footnote, however, the *Gurwitz* court noted that its decision "would not prevent the trial judge from granting a jury trial as a matter of discretion." *Id*. at 427 n.4. Consequently, the forum selected, whether initially by the plaintiff or subsequently by the defendant, is critical to the preservation of the right to jury trial. Although a shareholder's derivative action is an equity action, a jury trial may be proper in certain circumstances, such as when the legal and equitable claims are closely intertwined. *Hiles v. Auto Bahn Federalization, Inc.*, 555 So.2d 1218 (Fla. 4th DCA 1989).

(d) *Remedies:* The available remedies to a plaintiff shareholder instituting a derivative claim are essentially the same as in any other type of civil litigation, with two notable exceptions. First, any financial recovery must be for the benefit of the corporation. Moreover, some courts in other jurisdictions have used their equitable powers to ensure that those shareholders who participated in the wrongs do not benefit. Second, at least with regard to state actions, the Florida courts do not recognize a right to recover punitive damages in a shareholder derivative action. See *Chemplex Florida v. Novello*, 790 So.2d 547 (Fla. 4th DCA 2001); *McGuire, Woods, Battle & Boothe, L.L.P. v. Hollfelder*, 771 So.2d 585 (Fla. 1st DCA 2000); *Lanman Lithotech, Inc. v. Gurwitz*, 478 So.2d 425 (Fla. 5th DCA 1985). With respect to nonpecuniary remedies, because the action is fundamentally equitable, courts should not hesitate to fashion creative, just remedies nor should practitioners be hesitant to suggest them.

(e) *Settlement*: F.S. 607.07401(4) provides that a shareholder's derivative action "may not be discontinued or settled without the court's approval."

(f) *Recent Cases*. In *Chaul v. Abu-Ghazaleh*, 3rd District. Case No. 3D07-217, November 5, 2008. The Third District held that shareholders in a corporation had no standing to bring a direct action alleging that their shares in corporation were depressed when the corporation was sold at a price below its true value as result of bribery because the claims were derivative in nature and, as shareholders, plaintiffs cannot pierce their own corporate veil to gain standing. In *Lynn v. Martin County Marine Corp*, 980 So.2d 536, 33 Fla. L. Weekly D920, Fla.App. 4th Dist., April 02, 2008 (NO. 4D07-4108), the Fourth District held that where shareholders commenced a derivative action, and then sold their shares and assigned their rights in derivative action to a third party, the third party had standing to pursue the derivative action .The court distinguished a prior decision in which the court held that the shareholder who had originally filed the derivative action had no standing to pursue the action for himself after he sold his shares during the pendency of the action because it is the purchaser of the shares who wishes to maintain the derivative action, finding perfect consistency with section 607.07401(1), Florida Statutes (2005):

A person may not commence a proceeding in the right of a domestic or foreign corporation unless the person was a shareholder of the corporation when the transaction complained of occurred or unless the person became a shareholder through transfer by operation of law from one who was a shareholder at that time.

3. *Officer and Director Duties*: In general, Florida cases have recognized that a corporate officer or director owes both a duty of loyalty and a duty of care, which arise in a quasi-fiduciary relationship. See *Cohen v. Hattaway*, 595 So.2d 105 (Fla. 5th DCA 1992); *B & J Holding Corp. v. Weiss*, 353 So.2d 141 (Fla. 3d DCA 1978). A corporate officer or director breaches the duty of loyalty if that person “depart[s] from his corporate responsibility and start[s] serving himself.” *Intercarga Internacional De Carga, S.A. v. Harper Group, Inc.*, 659 So.2d 1208, 1210 (Fla. 3d DCA 1995).

4 *Statutory Scheme*: F.S. 607.0830(1), part of the Florida Business Corporation Act (the Act) adopted in 1989, provides that “[a] director shall discharge his or her duties as a director, including his or her duties as a member of a committee: (a) In good faith; (b) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (c) In a manner he or she reasonably believes to be in the best interests of the corporation.” There is no definition of the term “duties.” The “trustee” language of the early Florida decisions and some post-Act decisions has not been used in the Act’s only reference to the general exercise of corporate powers by the board of directors. The Act does not have a similar provision for officers, but F.S. 607.0841 provides that each officer “has the authority and shall perform the duties set forth in the bylaws or, to the extent consistent with the bylaws, the duties prescribed by the board of directors or by direction of any officer authorized by the bylaws or the board of directors to prescribe the duties of other officers.” Accordingly, an officer is answerable to the corporation and its board of directors for the violation of bylaws or authority conferred by the directors. Officers normally do not have any authority to manage the corporation independent of the board of directors. Minority shareholder lawsuits to challenge the management of a corporation, therefore, are brought against the board of directors, although officers may be incidental defendants. However, F.S. 607.0801(2) does allow a delegation of corporate powers and the management of the business and affairs of a corporation “subject to any limitation set forth in the articles of incorporation or in an agreement authorized under [F.S.] 607.0732.”

In Rehabilitation Advisors, Inc. v. Floyd, 601 So.2d 1286 (Fla. 5th DCA 1992), it was held that the fact that an officer and director entered into an agreement to sell her interest in the corporation did not relieve her of her fiduciary obligations to the corporation.

F.S. 607.0830(2) insulates from liability a director who, in performing his or her duties, relies on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

> (a) One or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;
>
> (b) Legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the persons' professional or expert competence; or
>
> (c) A committee of the board of directors of which he or she is not a member if the director reasonably believes the committee merits confidence.

Nevertheless, to be relieved of responsibility for misfeasance or malfeasance attributable to others, the director must otherwise perform his or her duties in compliance with F.S. 607.0830(1) and not have "knowledge concerning the matter in question" that would cause such reliance to be unwarranted. F.S. 607.0830(4). Finally, to avoid a "see no evil — hear no evil" defense, F.S. 607.0824(4) provides that

A director of a corporation who is present at a meeting of the board of directors or a committee of the board of directors when corporate action is taken is deemed to have assented to the action taken unless the director:

> (a) Objects at the beginning of the meeting (or promptly upon his or her arrival) to holding it or transacting specified business at the meeting; or
>
> (b) Votes against or abstains from the action taken.

F.S. 607.0834 provides for liability of directors for unlawful distributions. A director "who votes for or assents to" the declaration of any dividend or distribution of assets to shareholders contrary to F.S. 607.06401 or the articles of incorporation is "personally liable" with all other assenting or voting directors to the corporation "for the amount of the distribution that exceeds what could have been [properly] distributed." F.S. 607.0834(1). A director liable to the corporation under subsection (1) has a contribution claim from each shareholder for the amount of such dividends or assets the shareholder accepted, knowing the dividend or distribution was made in violation of F.S. 607.06401 or the articles of incorporation, and a contribution claim against any other director who voted for or assented to the action on which the claim is asserted. F.S. 607.0834(2). Any action under these sections must be brought within two years "after the date on which the effect of the distribution was measured under s. 607.06401(6) or (8)." F.S. 607.0834(3).

F.S. 607.0832 governs the analysis of director conflicts of interest and self-dealing. A contract or transaction between a corporation and a director or a related party is not ipso facto void by virtue of the director's participation in the corporate action approving the contract or transaction, provided that (1) the director's interest in the contract or transaction is "disclosed or known to the board of directors or committee which authorizes, approves, or ratifies the contract or transaction by a vote or consent sufficient for the purpose without counting the votes or consents of such interested directors"; (2) the interest is "disclosed or known to the shareholders entitled to vote and they authorize, approve, or ratify [the] contract or transaction"; or (3) the "contract or transaction is fair and reasonable as to the corporation at the time it is authorized by the board, a committee, or the shareholders." F.S. 607.0832(1). In no circumstances may a transaction governed by F.S. 607.0832(1) be authorized, approved, or ratified by a single director. F.S. 607.0832(2).

F.S. 607.0833 allows corporate loans and guarantees with or without interest and with or without security to officers, directors, and employees whenever, in the judgment of the board of directors, the loan, guarantee, or assistance may reasonably be expected to benefit the corporation. Although the decision is within the judgment of the board, the board should be able to document that there was a reasonable expectation of benefit to the corporation and that the directors otherwise performed their duties under F.S. 607.0830(1).

5. *Director Civil Immunity:* F.S. 607.0831(1) provides limited immunity for corporate directors:

> (1) A director is not personally liable for monetary damages to the corporation or any other person for any statement, vote, decision, or failure to act, regarding corporate management or policy, by a director, unless:
>
> (a) The director breached or failed to perform his or her duties as a director; and
>
> (b) The director's breach of, or failure to perform, those duties constitutes:
>
> 1. A violation of the criminal law, unless the director had reasonable cause to believe his or her conduct was lawful or had no reasonable cause to believe his or her conduct was unlawful. . . .
> 2. A transaction from which the director derived an improper personal benefit, either directly or indirectly;
> 3. A circumstance under which the liability provisions of s. 607.0834 are applicable;
> 4. In a proceeding by or in the right of the corporation to procure a judgment in its favor or by or in the right of a shareholder, conscious disregard for the best interest of the corporation, or willful misconduct; or
> 5. In a proceeding by or in the right of someone other than the corporation or a shareholder, recklessness or an act or omission which was committed in bad faith or with malicious purpose or in a manner exhibiting wanton and willful disregard of human rights, safety, or property.

F.S. 607.0831(2) provides a definition of "recklessness": "For the purposes of this section, the term 'recklessness' means the action, or omission to act, in conscious disregard of a risk: (a) known, or so obvious that it should have been known, to the director; and (b) known to the director, or so obvious that it should have been known, to be so great as to make it highly probable that harm would follow from such action or omission."

A director is "deemed not to have derived an improper personal benefit from any transaction if [among other things] the transaction and the nature of any personal benefit derived by the director are not prohibited by state or federal law or regulation." F.S. 607.0831(3). F.S. 607.0831(3) provides rules for determining whether a director is deemed to have derived an improper personal benefit in an action other than a derivative lawsuit, and F.S. 607.0831(4) recognizes that these rules are nonexclusive.

In *Adoro Marketing, Inc. v. Da Silva*, 623 So.2d 542 (Fla. 3d DCA 1993), the court held that the president of a company that manufactured an allegedly defective product could be held personally liable to an injured user based on evidence that the president personally derived profit from the machine. In *State Dept. of Environmental Protection v. Harbor Utilities Co.*, 684 So.2d 301 (Fla. 2d DCA 1996), the court held that corporate officers, directors, and managers may be subject to personal liability under the Air and Water Pollution Control Act.

6. *Corporate Opportunity*: One area of director self-dealing and conflict of interest not explicitly treated in the Florida Business Corporation Act is the "corporate opportunity" doctrine. In *Uvanile v. Denoff*, 495 So.2d 1177, 1179 (Fla. 4th DCA 1986), the district court adopted the following definition of "corporate opportunity" enunciated in *Farber v. Servan Land Co.*, 662 F.2d 371, 377 (5th Cir. 1981):

If there is presented to a corporate officer or director a business opportunity that the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest, or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself.

Because a director or officer occupies a fiduciary position toward the corporation, he or she may not "make a private profit from his position or, while acting in that capacity, acquire an interest adverse to that of the corporation." *Pruyser v. Johnson*, 185 So.2d 516, 521 (Fla. 2d DCA 1966). See *Orlando Orange Groves Co. v. Hale*, 107 Fla. 304, 144 So. 674 (1932); *Cohen v. Hattaway*, 595 So.2d 105 (Fla. 5th DCA 1992). As a corollary to the duty of loyalty, a director or officer may not acquire "in opposition to the corporation, property in which the corporation has an interest or tangible expectancy or which is essential to its existence." *Farber*, 662 F.2d at 377. See also *Pan American Trading & Trapping, Inc. v. Crown Paint, Inc.*, 99 So.2d 705 (Fla. 1958); *News-Journal Corp. v. Gore*, 147 Fla. 217, 2 So.2d 741 (1941); *Independent Optical Co. of Winter Haven v. Elmore*, 289 So.2d 24 (Fla. 2d DCA 1974).

The analysis of whether a corporate opportunity exists depends on whether (1) the corporation is financially able to undertake the business opportunity; (2) the corporation has a valid and significant corporate purpose in the potential business opportunity; and

(3) the business opportunity fits into the present activities of the corporation or fits into an established corporate policy that the acquisition of the opportunity would further. *Hattaway*; *Uvanile*. If a corporate opportunity is found to exist, the director or officer who acquired the business opportunity holds the property and any profits as constructive trustee for the corporation. *News-Journal Corp.; Wilkins v. Wilkins*, 144 Fla. 590, 198 So. 335 (1940); see generally Annot., What Business Opportunities Are in "Line of Business" of Corporation for Purposes of Determining Whether a Corporate Opportunity Was Presented, 77 A.L.R.3d 961 (1977). The corporate opportunity doctrine does not apply, however, to a director or officer who resigned and then later competed with the corporation. *Renpak, Inc. v. Oppenheimer*, 104 So.2d 642 (Fla. 2d DCA 1958). One case has held that officers and directors have no right to purchase corporate property at a judicial or public sale. *Etheredge v. Barrow*, 102 So.2d 660 (Fla. 2d DCA 1958).

7. *Duties of Majority Shareholders*: Some cases seem to impose similar fiduciary duties on majority shareholders toward minority shareholders, particularly in the context of the close corporation. *News-Journal Corp. v. Gore*, 147 Fla. 217, 2 So.2d 741 (1941); *Mortellite v. American Tower, L.P.*, 819 So.2d 928 (Fla. 2d DCA 2002); *Alliegro v. Pan American Bank of Miami*, 136 So.2d 656 (Fla. 3d DCA 1962). The Florida Business Corporation Act is silent on this issue, except to recognize the right of shareholders to dissent to action by majority shareholders. F.S. 607.1301–607.1320. See §18.49. (Of course, typically the majority shareholders are management and therefore subject to the fiduciary duties of officers and directors. See *Tillis v. United Parts, Inc.*, 395 So.2d 618 (Fla. 5th DCA 1981).)

For example, in *Zold v. Zold*, 880 So.2d 779, 781 (Fla. 5th DCA 2004), the court broadly held that "[w]hen a corporation has more than one shareholder, an officer/shareholder has a fiduciary duty to all shareholders." This statement seems to imply that fiduciary duties run between shareholders. In fact, given the breadth of the definition of fiduciary duty under Florida law, the circumstances which may create fiduciary duties between shareholders may not be based solely on shareholder status. However, generally, it is one's obligations as a director or officer that trigger fiduciary duties.

Some confusion may also lie in the nature of the activities being challenged. If, for example, the corporate action is a recapitalization that dilutes the minority shareholders' stock, the majority shareholders, not necessarily directors or officers, are benefited. *Biltmore Motor Corp. v. Roque*, 291 So.2d 114 (Fla. 3d DCA 1974). Another issue that has been raised is whether a majority shareholder may sell his or her controlling stock at a premium that is not shared with minority shareholders. See, e.g., *Draper v. Hay*, 555 So.2d 1306 (Fla. 4th DCA 1990) ("general rule [is] that majority shareholders owe no fiduciary duty to minority shareholders with respect to the sale of the majority stock"). See also *Martin v. Marlin*, 529 So.2d 1174 (Fla. 3d DCA 1988) (cited in *Draper*); *Jones v. H.F. Ahmanson & Co.*, 460 P.2d 464 (Cal. 1969); 8A FLA.JUR.2d Business Relationships §165; Russo-Di Staulo & Cazeau, Does a Florida Minority Shareholder in a Closely Held Corporation Owe a Fiduciary Duty to Fellow

Shareholders? 79 Fla. Bar J. 55 (Oct. 2005); Siegel, Fiduciary Duty Myths in Close Corporate Law, 29 Del.J.Corp.L. 377 (2004).

Distribution of the economic fruits of the corporation, both dividends and assets, may also trigger obligations by the majority share-holders to the minority shareholders. See, e.g., *Tillis*, 395 So.2d at 618–620 (majority stockholders' use of retained earnings to purchase "from themselves and for the corporation shares of capital stock of the corporation at a price in excess of its market value . . . constitutes a preferential distribution of corporate assets and a relative advantage over minority stockholders[,] the turning of corporate funds to personal use inconsistent with a fiduciary duty"). In addition, employment of any "squeeze-out techniques" by majority shareholders may give rise to claims of oppression and breach of fiduciary duties. See *Tillis*; *Karnegis v. Lazzo*, 243 So.2d 642 (Fla. 3d DCA 1971). A fraudulent transfer of assets of a corporation by its majority shareholder may render the shareholder liable for the difference between the consideration paid by a transferee and its true value. *In re F & C Services, Inc.*, 44 B.R. 863 (Bankr. S.D. Fla. 1984). Although the claim is brought by the minority shareholders against majority shareholders, in reality the claim is for the benefit of the corporation and therefore is derivative.

8. *Duties owed to Creditors*: Florida law has also recognized that the directors of an insolvent corporation owe fiduciary duties of diligence and good faith to corporate creditors. *Beach v. Williamson*, 78 Fla. 611, 83 So. 860 (1920), 9 A.L.R. 1438. The basis for this duty is that the property of a corporation is deemed a trust fund for the payment of the debts of the corporation, so the creditors have a lien on that property or a right of priority out of it in preference to any shareholder of the corporation

9. *Business Judgment Rule*: The chief attack on a disgruntled shareholder's lawsuit against management is the use of the "business judgment rule." As stated by the Florida Supreme Court in *Lake Region Packing Ass'n, Inc. v. Furze*, 327 So.2d 212, 216 (Fla. 1976):

> In Florida, corporate directors generally have wide discretion in the performance of their duties and a court of equity will not attempt to pass upon questions of the mere exercise of business judgment, which is vested by law in the governing body of the corporation.

See also, *Orlando Orange Groves Co. v. Hale*, 119 Fla. 159, 161 So. 284 (1935); *Pittman v. Groveowners Cooperative of Loxhatchee, Inc.*, 534 So.2d 1207 (Fla. 4th DCA 1988); *Yarnall Warehouse & Transfer, Inc. v. Three Ivory Bros. Moving Co.*, 226 So.2d 887 (Fla. 2d DCA 1969). The courts are not authorized to interfere in a corporation's business affairs or control the corporation "except in cases wherein such interference is essential to justice." *Coleman v. Plantation Golf Club, Inc.*, 212 So.2d 806, 808 (Fla. 4th DCA 1968). See also *Lobato-Bleidt v. Lobato*, 688 So.2d 431 (Fla. 5th DCA 1997); *Beville v. Freeman*, 483 So.2d 813 (Fla. 2d DCA 1986). The United States Court of Appeals for the Eleventh Circuit has held that although the business judgment rule protects directors, the rule applies only if directors used due care in the exercise of business judgment. *Federal Deposit Insurance Corp. v. Stahl*, 89 F.3d 1510 (11th Cir. 1996) (applying Florida law).

In *Aerospace Accessory Service, Inc. v. Abiseld*, 943 So.2d 866 (Fla. 3d DCA 2006), the court held that a director's unilateral decision to disregard a corporate directive was not protected by the business judgment rule.

The rule encompasses a broad set of policies designed to avoid judging with hindsight the wisdom of corporate decisions. First, there is an unfairness in scrutinizing directors' decisions made under the pressure of past events. Second, the courts are not equipped to make particular and unique business decisions. Third, no one would serve as a voluntary director if one's competence was constantly subject to challenge. Fourth, the nature of court scrutiny with the attendant litigation risks would severely impair the directors' willingness to entertain entrepreneurial business risks.

F.S. 607.0830 ("General standards for directors") codifies, in part, the business judgment rule. The primary use of the defense is to dismiss derivative actions brought on the basis that the action, in the judgment of the board of directors, is not in the best interest of the corporation. See §18.66. This is not the case under F.S. 607.0831, which specifically deals with the circumstances under which a director may be personally liable for monetary damages to the corporation and others arising out of his or her management responsibilities. Under F.S. 607.0831(1)(b)4, a director may be personally liable if the director's breach of duty constitutes a "conscious disregard for the best interest of the corporation."

10. *Direct actions versus Derivative Actions:* A direct action by a shareholder is an action that seeks to vindicate some unique shareholder right and to redress harm unique to that shareholder. The source of the direct action is often a dispute over a particular shareholder's voting rights, dividend rights, or other rights accorded a particular shareholder by statute or the corporation's articles. Often, no bright-line distinction exists between a direct action and a derivative action. The court must examine the body of the complaint to determine whether the action is brought to redress an injury sustained directly by the shareholder that is separate and distinct from that sustained by other shareholders. If so, the action is direct. *Fort Pierce Corp. v. Ivey*, 671 So.2d 206, 207 (Fla. 4th DCA 1996) ("If . . . the injury is primarily against the corporation, or the stockholders generally, then the cause of action is in the corporation and the individual's right to bring it is derived from the corporation"); *Alario v. Miller*, 354 So.2d 925 (Fla. 2d DCA 1978). The determination that an action is direct may have enormous consequences on the course and effect of the action, including whether the shareholder has to exhaust intracorporate remedies. A stockholder has no right to sue for damage to the corporation unless the lawsuit is a derivative action. *Grandin Industries, Inc. v. Florida National Bank at Orlando*, 267 So.2d 26 (Fla. 4th DCA 1972).

Direct action frequently involves "special injury" to a shareholder who is a creditor of the corporation and is liable for a corporate obligation or otherwise has a claim separate and independent from causes of action arising out of his or her mere status as a shareholder. The analytical difficulty arises in cases in which a particular shareholder’s harm is shared by other shareholders. The court must determine at the outset of the case the primary nature of the injury and therefore must weigh the amount of injury to the corporation (and other shareholders) against the amount of injury to the plaintiff shareholder.

In Gonzalez ex rel. *Colonial Bank v. Chillura*, 892 So.2d 1075, 1077 (Fla. 2d DCA 2004), the court held that there was no conflict of interest in an attorney’s “concurrently representing the plaintiff in a shareholder derivative action while at the same time representing the same plaintiff in litigation he is pursuing individually against the corporation.”

Generally, actions alleging breach of fiduciary duties and corporate mismanagement are not direct actions but instead are derivative actions because the injuries are not distinct to a particular shareholder. Specifically, examples of direct shareholder actions that have been dismissed include claims for the following:

> Corporate mismanagement, *Leppert v. Lakebreeze Homeowners Ass’n, Inc.*, 500 So.2d 250 (Fla. 1st DCA 1987).
>
> Breach of fiduciary duty, *Alario*.
>
> Misappropriation of corporate assets, *Tillis v. United Parts, Inc.*, 395 So.2d 618 (Fla. 5th DCA 1981).
>
> Relinquishment of assets, *Citizens National Bank of St. Petersburg v. Peters*, 175 So.2d 54 (Fla. 2d DCA 1965).
>
> Depreciation in value of stock, *Kramer v. Western Pacific Industries, Inc.*, 546 A.2d 348 (Del. 1988).

There have been two situations in which courts have held that a shareholder, under Florida law, has suffered a “separate and distinct” injury that entitled the shareholder to bring a direct action. In *Citibank, N.A. v. Data Lease Financial Corp.*, 828 F.2d 686 (11th Cir. 1987), the court held that a shareholder who had pledged his controlling block of stock could bring a direct action as a pledgor. Similarly, in *Wolfe v. American Savings & Loan Ass’n of Florida*, 539 So.2d 606 (Fla. 3d DCA 1989), the court held that preferred stockholders were specially injured by a merger that deprived all preferred stockholders of the right to convert their preferred stock into common stock and decreased the value of preferred stock only. Another court held that minority shareholders were distinctly injured when the majority shareholders and corporation — as opposed to the minority shareholders, all of whom were plaintiffs — generally benefited from the breaches alleged by the stockholders. *Rabkin v. Philip A. Hunt Chemical Corp.*, 547 A.2d 963 (Del. Ch. 1986).

In *Chaul v. Abu-Ghazaleh*, 994 So.2d 465 (Fla. 3d DCA 2008), the court held that shareholders had no standing to bring a direct action claiming that their share value was depressed after the corporation was sold at a price below its true value as a result of bribery.

11. *Piercing The Corporate Veil:* In *Dania Jai-Alai Palace, Inc. v. Sykes,* 450 So.2d 1114 (Fla. 1984), the Florida Supreme Court summarized what should be shown before the burden of going forward falls on an individual stockholder or officer to show why the corporate veil should not be pierced, holding that the following preliminary showing is required:

> "[T]hat the corporation is in actuality the alter ego of the stockholders and that it was organized or after organization was employed by the stockholders for fraudulent or misleading purposes, or in some fashion that the corporate property was converted or the corporate assets depleted for the personal benefit of the individual stockholders, or that the corporate structure was not bona fidely established or, in general, that property belonging to the corporation can be traced into the hands of the stockholders."

Id. at 1120, quoting Advertects, Inc. v. Sawyer Industries, Inc., 84 So.2d 21, 24 (Fla. 1955); see also *French v. F.F.O. Financial Group, Inc.*, 651 So.2d 727 (Fla. 1st DCA 1995); *Keys Jeep Eagle, Inc. v. Chrysler Corp*., 897 F.Supp. 1437 (S.D. Fla. 1995), aff'd 102 F.3d 554.

All corporate piercing is based on equitable principles. See *Barineau v. Barineau*, 662 So.2d 1008, 1009 (Fla. 1st DCA 1995).

Under Florida law, courts are reluctant to pierce the corporate veil except in "exceptional circumstances." *Molenda v. Hoechst Celanese Corp.*, 60 F.Supp.2d 1294, 1300 (S.D. Fla. 1999). The touchstone is that one business be dominated by or be the alter ego of the other and that the relationship between the businesses have been created or used to mislead or defraud creditors. *Ally v. Naim*, 581 So.2d 961 (Fla. 3d DCA 1991); *Acquisition Corp. of America v. American Cast Iron Pipe Co.*, 543 So.2d 878 (Fla. 4th DCA 1989). An officer or shareholder cannot be held personally liable even for obvious wrongs absent a basis for piercing the corporate veil. *Munder v. Circle One Condominium, Inc.*, 596 So.2d 144 (Fla. 4th DCA 1992). An officer of a corporation who is in control of the corporation and personally uses its assets for payment of personal obligations can be held liable by piercing the corporate veil, even if the officer is not a shareholder of the company. *Walton v. Tomax Corp.*, 632 So.2d 178 (Fla. 5th DCA 1994). On the other hand, the corporate veil will not be pierced based merely on the fact that a controlling shareholder induced a third party to loan funds to a corporation. *Priskie v. Missry*, 958 So.2d 613 (Fla. 4th DCA 2007).

Under a piercing the corporate veil analysis, a parent corporation may be held liable for the contractual obligation of its subsidiary. *Southeast Capital Investment Corp. v. Albemarle Hotel, Inc.*, 550 So.2d 49 (Fla. 2d DCA 1989). However, the United States Supreme Court has affirmed the general principle of corporate law that "a parent corporation (so-called because of control through ownership of another corporation's stock) is not liable for the acts of its subsidiaries." *United States v. Bestfoods*, 524 U.S. 51, 61, 118 S.Ct. 1876, 141 L.Ed.2d 43 (1998).

Evidence that shareholders of a closely held corporation did not hold formal annual meetings is not an adequate basis to pierce the corporate veil. *Schwartz v. Spectratech Ink Co.*, 568 So.2d 544 (Fla. 5th DCA 1990).

Florida also recognizes "reverse corporate piercing," whereby liabilities of shareholders are asserted against the corporation. See *Estudios, Proyectos e Inversiones de Centro America, S.A. (EPICA) v. Swiss Bank Corp. (Overseas), S.A.*, 507 So.2d 1119, rev. denied, 518 So.2d 1274 (Fla. 1987); *Broswell v. Ryan Investments, Ltd.*, 989 So.2d 38 (Fla. 3d DCA 2008).

## H. Non-Profit Litigation.

1. May have no members and Members not required to have rights F.S. 617.0601

2. Derivative Actions: In *Fox v. Professional Wrecker Operators of Florida, Inc.*, 801 So.2d 175 (Fla. 5th DCA 2001), the court held that a derivative action could be maintained by members of a nonprofit corporation. However, there is no specific authority for such an action in F.S. Chapter 617, the Florida Not For Profit Corporation Act.

## I. Close Corporations.

The Florida Business Corporation Act does not specifically recognize the "close corporation." In contrast, the Delaware Corporation Act has special provisions dealing with the close corporation. Del. Code Ann. tit. VIII, §§341–356 (1993). However, F.S. 607.0801 recognizes that the corporation's business and affairs are under the direction of a board of directors except as otherwise provided in the articles of incorporation. Therefore, deviation from the corporate norm is permitted.

## J. Shareholder Agreements Litigation.

Under F.S. 607.0732(1),

(1) An agreement among the shareholders of a corporation with 100 or fewer shareholders at the time of the agreement, that complies with this section, is effective among the shareholders and the corporation, even though it is inconsistent with one or more other provisions of this chapter, if it:

> (a) Eliminates the board of directors or restricts the discretion or powers of the board of directors;
>
> b) Governs the authorization or making of distributions whether or not in proportion to ownership of shares, subject to the limitations in s. 607.06401;
>
> (c) Establishes who shall be directors or officers of the corporation, or their terms of office or manner of selection or removal;

(d) Governs, in general or in regard to specific matters, the exercise or division of voting power by the shareholders and directors, including use of weighted voting rights or director proxies;

(e) Establishes the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation and any shareholder, director, officer, or employee of the corporation;

(f) Transfers to any shareholder or other person any authority to exercise the corporate powers or to manage the business and affairs of the corporation, including the resolution of any issue about which there exists a deadlock among directors or shareholders; or

(g) Requires dissolution of the corporation at the request of one or more of the shareholders or upon the occurrence of a specified event or contingency.

(h) Otherwise governs the exercise of the corporate powers or the management of the business and affairs of the corporation or the relationship between the shareholders, the directors, or the corporation, and is not contrary to public policy. For purposes of this paragraph, agreements contrary to public policy include, but are not limited to, agreements that reduce the duties of care and loyalty to the corporation as required by ss. 607.0830 and 607.0832, exculpate directors from liability that may be imposed under s. 607.0831, adversely affect shareholders' rights to bring derivative actions under s. 607.07401, or abrogate dissenters' rights under ss. 607.1301-607.1320.

F.S. 607.0732(2) provides that agreements authorized by this section must be:

(a) 1. Set forth in the articles of incorporation or bylaws and approved by all persons who are shareholders at the time the agreement; or

2. Set forth in a written agreement that is signed by all persons who are shareholders at the time of the agreement and such written agreement is made known to the corporation.

(b) Subject to termination or amendment only by all persons who are shareholders at the time of the termination or amendment, unless the agreement provides otherwise with respect to termination and with respect to amendments that do not change the designation, rights, preferences, or limitations of any of the shares of a class or series.

F.S. 607.0732(3) provides that the shareholder agreement must "be noted conspicuously on the front or back of each certificate for outstanding shares." It also provides for recall of certificates subject to the agreement so that the corporation can reissue substitute certificates that comply with the subsection. The failure to note the existence of the agreement on the certificate does not affect the validity of the agreement or any action taken under it, but any purchaser of shares who, at the time of the purchase, did not have knowledge of the existence of the agreement is entitled to rescission of the purchase. A purchaser is deemed to have knowledge of the existence of the agreement if its existence is noted on the certificate. *Id*. A transferee of shares in a corporation whose shareholders have entered into a shareholder agreement is bound by the agreement if the transferee takes shares subject to the agreement with notice of it. F.S. 607.0731(3). An agreement authorized by F.S. 607.0732 ceases to be effective when the shares of the corporation are listed on a national securities exchange or regularly quoted in the market maintained by one or more members of a national or affiliated securities association. F.S. 607.0732(4).

Shareholder agreements frequently are used in close corporations and are a fertile source of litigation. Shareholder agreements typically are used to restrict the transfer of shares to others or provide for "buy-sell" agreements. See generally FLORIDA SMALL BUSINESS PRACTICE Chapter 9 (Fla. Bar CLE 5th ed. 2004). A shareholder agreement must be set forth in the articles of incorporation, the bylaws, or a written agreement; approved or signed (if a written agreement) by all persons who are shareholders at the time the agreement is made; and, if in the form of a written agreement, made known to the corporation. F.S. 607.0732(2)(a). F.S. 607.0730(2) authorizes the use of voting trusts while F.S. 607.0731 authorizes the use of shareholder agreements.

A violation of a shareholder agreement is remedied by injunction, an action for specific performance, or other equitable proceeding. The actions arise in equity, and it must be established that the shareholder agreement is clearly enforceable and that the shareholders' remedy at law is inadequate. *Weissman v. Lincoln Corp.*, 76 So.2d 478 (Fla. 1954); *McTeague v. Treibits*, 388 So.2d 309 (Fla. 4th DCA 1980).

**K. <u>Limited Liability Company Litigation.</u>**

1. *Popularity: The Limited Liability Company* ("LLC") has now become the most popular business entity in Florida. The creation of the entity largely derived from a desire to have a more flexible limited liability entity closely resembling a partnership in terms of its formation documents and internal management. As is the case with the Florida Business Corporation Act, the Florida Limited Liability Company Act provides a default scheme that may be freely modified by the LLC Operating Agreement.

2. *"LLC Cocktail":* Given that the LLC statute is a blend of partnership law concepts and corporation law concepts, it is still uncertain how the courts will deal with the "LLC cocktail." It is generally believed that the courts will attempt to apply corporate limited liability principles to the LLC. For example, in *Clement v. Lipson*, 999 So.2d 1072 (Fla. 5th DCA 2008), the court applied the "corporate shield doctrine" to an LLC, preventing the assertion of personal jurisdiction over the managers of the LLC. F.S. 608.701 explicitly provides that the "piercing the corporate veil" doctrine as interpreted by the courts with respect to corporations shall apply to LLCs.

3. F.S. Chapter 608, the Florida Limited Liability Company Act, governs the limited liability company, an entity managed by its members in proportion to their capital

contribution or by managers elected by the members. F.S. Chapter 608 was amended substantially in 1999. The hallmark of the limited liability company is the availability of limited liability within a flexible structure established with articles of organization, F.S. 608.407, and an operating agreement, F.S. 608.423. The business use of LLCs has substantially increased since 1998 when Florida eliminated the corporate income tax on LLCs. "Unless otherwise provided in its articles of organization or the operating agreement, the limited liability company shall be a member-managed company." F.S. 608.422(1). Alternatively, "[I]f the articles of organization or the operating agreement provide for the management of the limited liability company by a manager or managers, the management of the limited liability company shall be vested in a manager or managers and the limited liability company shall be a manager-managed company." F.S. 608.422(3). F.S. 608.422(2) sets out the particulars of management by members and F.S. 608.422(4) of management by a manager or managers.

F.S. 608.4227 provides that neither the members nor the managers of a limited liability company are liable except as provided in F.S. Chapter 608. Under F.S. 608.4228, neither the managers nor the managing members of a limited liability company are personally liable for monetary damages to the limited liability company, its members, or any other person for any statement, vote, decision, or failure to act regarding management or policy decisions by a manager or a managing member, unless:

> (a) The manager or managing member breached or failed to perform the duties as a manager or managing member; and
>
> (b) The manager's or managing member's breach of, or failure to perform, those duties constitutes any of the five circumstances set out in F.S. 608.4228(1)(b). The duties of managers and managing members are set out in F.S. 608.4225.

F.S. 608.4229 provides for indemnification of managing members, managers, officers, employees, and agents of limited liability companies. The indemnification standards and procedures are similar to those provided for directors and officers of corporations in F.S. 607.0850. See §§18.87–18.96.

F.S. 608.601, added in 1999, allows for a member's derivative action. The complaint in a member derivative action must be verified. F.S. 608.601(2). As in a shareholder derivative lawsuit (see §18.66), a limited liability company can seek dismissal of a derivative action after obtaining a recommendation of a special litigation committee charged with investigating the allegations of the complaint. F.S. 608.601(3). A member's derivative action cannot be settled or discontinued without court approval. F.S. 608.601(4). Moreover, if the court determines that the action was brought without reasonable cause, it can order the plaintiff to pay the limited liability company's reasonable expenses, including attorneys' fees. F.S. 608.601(5).

Circuit courts have exclusive jurisdiction to enforce the provisions of F.S. 608.461. "A member of a limited liability company is not a proper party to proceedings by or against a limited liability company, except when the object is to enforce a member's right against, or liability to, the limited liability company." F.S. 608.462. Process may be served against a limited liability company in accordance with F.S. Chapter 48 or 49 as if the company were a partnership, or on the company's registered agent. F.S. 608.463(1).

In *Alexander v. Minton*, 855 So.2d 94 (Fla. 2d DCA 2003), the court found that an arbitration clause in an LLC operating agreement was enforceable even with respect to a request for LLC records under F.S. 608.4101(2) and 608.423. In *Ruggio v. Vining*, 755 So.2d 792 (Fla. 2d DCA 2000), the court reversed a summary judgment and analyzed the issues raised by F.S. 608.4238 (formerly F.S. 608.437) relating to unauthorized assumption of powers.

In *Skylake Ins. Agency, Inc. v. NMB Plaza, L.L.C.*, 33 FLW D2215 (Fla. 3d DCA 2008), the court held that a lease need only be executed in accordance with Chapter 608 irrespective of F.S. 689.01.

The law relating to business disputes within a Florida LLC is in a state of embryological development. The courts have recognized that the LLC is "a hybrid, providing the shield from personal liability found in corporations and flow-through tax advantages found in partnerships." *Ruggio*, 755 So.2d at 795 n.2. The "looser" organizational and operating procedures for the LLC may also encourage laxity within the LLC in attempting to preserve its limited liability status. Practitioners should note that F.S. 608.701 specifically adopts the Florida law on "piercing the corporate veil." For further information on LLCs, see LIMITED LIABILITY COMPANIES IN FLORIDA (Fla. Bar CLE 2004).

## L. <u>Common Claims.</u>

1. *Breach of Fiduciary Duty:*

(a) Partnership litigation: A partner's fiduciary duty to give notice to other partners of any profit the partner derives without the consent of all other partners does not end when the partner withdraws from the partnership. *Grossman v. Greenberg*, 619 So.2d 406 (Fla. 3d DCA 1993). The fiduciary duty applies equally to the personal representative of a deceased partner engaged in the liquidation of the partnership affairs. F.S. 620.8404(7).

(b) A partner is both a fiduciary and a trustee for the partnership of any profits derived from any transaction connected with the formation, conduct, or liquidation of the partnership. However, F.S. 620.8404, as revised effective January 1, 2006, now specifically delineates the scope of a partner's duty of loyalty and duty of care.

A managing partner "cannot take in-house advantage of his copartners." *Slingerland*, 389 So.2d at 589. Because a partner's share of the profits and losses is assignable under F.S. 620.8502, when the partnership is dissolved the assignee is entitled to an accounting from the date of the last account agreed to by all the partners.

2. *Corporate Duties*: It has generally been recognized that officers and directors of corporations owe fiduciary obligations to shareholders. In *Orlinsky v. Patraka*, 3rd District. Case No. 3D05-2002. L.T. Case No. 99-26994. July 5, 2007, the court held that a majority stockholder owed a fiduciary duty to a minority stockholder. See also *Biltmore Motor Corp. v. Roque*, 291 So. 2d 114, 115 (Fla. 3d DCA 1974).

3. Fraud: must be pled with specificity with detrimental reliance based on an intentional misrepresentation. "Constructive fraud" may be based on a breach of a fiduciary relationship.

4. Negligent Misrepresentation.

5. Accounting: A partner has the right to a formal account of partnership affairs. F.S. 620.8403(2) expressly provides:

> A partnership shall provide partners and their agents and attorneys access to the books and records of the partnership. The partnership shall provide former partners and their agents and attorneys access to books and records pertaining to the period during which they were partners. The right of access provides the opportunity to inspect and copy books and records during ordinary business hours.

See also *Ponton v. Bradley*, 588 So.2d 593 (Fla. 3d DCA 1991). In addition, F.S. 620.8403(3) provides:

> Each partner and the partnership shall furnish to a partner, and to the legal representative of a deceased partner or partner under legal disability:
>
> (a) Without demand, any information concerning the partnership's business and affairs reasonably required for the proper exercise of the partner's rights and duties under the partnership agreement or this act; and
>
> (b) Upon demand, any other information concerning the partnership's business and affairs, except to the extent the demand or the information demanded is unreasonable or otherwise improper under the circumstances.

An action for an accounting is cognizable in equity, and there is no right to a jury trial or a recovery for compensatory or punitive damages. The accounting is a two-phase process: (1) the need for an accounting must be proved and (2) if the plaintiff prevails, proof for an accounting is considered. *Zebouni v. Toler*, 513 So.2d 784 (Fla. 1st DCA 1987); *Wood v. Brackett*, 266 So.2d 398 (Fla. 1st DCA 1972); *Boyd v. Walker*, 251 So.2d 332 (Fla. 3d DCA 1971). A settlement agreement among partners, not procured by fraud, concealment, overreaching, or mistake, is a proper defense to a partnership accounting. *Durham v. Edwards*, 50 Fla. 495, 38 So. 926 (1905). A laches defense may also be interposed if delay in seeking the action for an accounting has resulted in injury, embarrassment, or disadvantage to the defendant partners. See *Bethea v. Langford*, 45 So.2d 496 (Fla. 1949).

Because of the elaborate nature of a partnership accounting, the court may refer the matter to a special magistrate once the preliminary issue of the plaintiff's right to an accounting has been determined by the court. *Nahmod v. Nelson*, 147 Fla. 564, 3 So.2d 162 (1941); *Slingerland*. A court may confirm, modify, reject, set aside, or refer the special magistrate's report. *Spencer v. Young*, 63 So.2d 334 (Fla. 1953); *Nahmod*; *Nims v. Nims*, 20 Fla. 204 (1883).

5. *Securities Law violations*: Regardless of whether the regulatory scheme applies, fraud in the sale of securities, which may include sales of corporate stock or entity membership rights, may be actionable.

## M. <u>Appraisal Rights: Safety valve.</u>

In *Williams v. Stanford*, 977 So.2d 722, 33 Fla. L. Weekly D829, Fla. App. 1 Dist., March 25, 2008 (No. 1D06-3701, 1D06-4808)), the First District issued in an opinion in a case that "calls upon us to navigate the relatively uncharted terrain of a recently revised portion of Florida's statutory corporations law. We decide here whether minority shareholders who object to a total transfer of corporate assets, and who allege that the majority shareholder has engaged in a course of conduct involving improper self-dealing and malfeasance over time, are limited to the statutory remedy of offering up their shares for a fair price. We conclude that Florida law does not so constrain minority shareholders' rights in the limited cases where such shareholders raise facially sufficient and serious allegations of unfairness. In such cases, minority shareholders may seek remedies beyond appraisal.

Section 607.1302, Florida Statutes (2003) -- Florida's "appraisal rights" statute -- generally requires minority shareholders who dissent from a major transaction or disposition of assets to seek the remedy of tendering their shares for appraisal and buy-back at a fair price:

> (1) A shareholder is entitled to appraisal rights, and to obtain payment of the fair value of that shareholder's shares, in the event of any of the following corporate actions:
>
> > (a) Consummation of a disposition of assets pursuant to s. 607.1202 if the shareholder is entitled to vote on the disposition, including a sale in dissolution but not including a sale pursuant to court order or a sale for cash pursuant to a plan by which all or substantially all of the net proceeds of the sale will be distributed to the shareholders within 1 year after the date of sale;

> (b) Any other amendment to the articles of incorporation, merger, share exchange, or disposition of assets to the extent provided by the articles of incorporation, bylaws, or a resolution of the board of directors, except that no bylaw or board resolution providing for appraisal rights may be amended or otherwise altered except by shareholder approval . . . .

Section 607.1302(1), Fla. Stat. (2003). Appraisal must determine the "fair value" of the dissenting shareholder's shares. '[F]air value' means the value of the corporation's shares determined: (a) immediately before the effectuation of the corporate action to which the shareholder objects." § 607.1301(4) (a), Fla. Stat. (2003).. See § 607.1302(1) (d), Fla. Stat. (2003) (providing that appraisal rights are triggered by, inter alia, "disposition of assets"). In most cases, the statute denominates appraisal as a dissenting shareholder's exclusive remedy. The exclusivity rule does not apply, however, where the minority shareholder has alleged that the challenged transaction "[w]as procured as a result of fraud or material misrepresentation." § 607.1302(4) (b), Fla. Stat. (2003)

The *Williams* court noted, "In cases such as the present controversy, involving dissenting shareholders who seek more than appraisal of their shares in the wake of objectionable transactions, courts must balance the principle that an adequate remedy should exist for a dissenting shareholder in an unfair transaction against the consideration that courts should not become bogged down in a wide range of disputes over the fairness of cash-out prices offered to minority shareholders who object to corporate transactions."

## N. <u>Dissolution.</u>

1. *Voluntary Dissolution.* F.S. 607.1401 governs the voluntary dissolution by incorporators or directors when a corporation has not commenced business or has not issued any shares. A corporation may also be voluntarily dissolved by the written consent of a majority of the shareholders entitled to vote on the issue. F.S. 607.1402(6), 607.0704. A third form of voluntary dissolution is by act of the corporation under F.S. 607.1402, in which the board of directors initiates a resolution recommending the dissolution of the corporation and submitting its resolution to a vote of shareholders, who may adopt the resolution by a majority vote. In all three cases the corporation must file articles of dissolution. F.S. 607.1405(1) provides that

> (1) A dissolved corporation continues its corporate existence but may not carry on any business except that appropriate to wind up and liquidate its business and affairs, including:
>
> (a) Collecting its assets;
>
> (b) Disposing of its properties that will not be distributed in kind to its shareholders;
>
> (c) Discharging or making provision for discharging its liabilities;

(d) Distributing its remaining property among its shareholders according to their interests; and

(e) Doing every other act necessary to wind up and liquidate its business and affairs.

Voluntary dissolution does not prevent the initiation of proceedings by or against the corporation in its corporate name nor does it suspend proceedings by or against the corporation pending on the effective date of dissolution. F.S. 607.1405(2)(e)–(2)(f).

Because F.S. 607.144, which related to the liability of directors for unlawful distributions, has been repealed, a director failing to comply with the proper procedures for dissolution presumably would now be liable under F.S. 607.0834 for unlawful distributions in violation of F.S. 607.06401.

2. *Involuntary Dissolution:*

Statutory grounds, generally relating to illegality or fraud, exist under F.S. 607.1430(1) for the involuntary dissolution of a corporation by a circuit court order on the application of the Department of Legal Affairs. Judicial dissolution is also available under certain circumstances when a shareholder can establish that there is a deadlock in the decision-making process. F.S. 607.1430(2); see §18.84. A shareholder in a corporation having 35 or fewer shareholders can compel dissolution if "corporate assets are being misapplied or wasted, causing material injury to the corporation," or "[t]he directors or those in control of the corporation have acted, are acting, or are reasonably expected to act in a manner that is illegal or fraudulent." F.S. 607.1430(3). Judicial dissolution can also be initiated under certain circumstances by creditors of the corporation. F.S. 607.1430(4). Finally, under F.S. 607.1430(5), a corporation may elect to convert its voluntary dissolution to a judicial dissolution.

F.S. 607.1434 provides "[a]lternative remedies to judicial dissolution" brought under F.S. 607.1430, including appointment of a receiver or a provisional director. See, e.g., *County Collection Services, Inc. v. Lassiter*, 689 So.2d 1299 (Fla. 4th DCA 1997). Under the same statute, the court may order a purchase of the complaining shareholder's shares under F.S. 607.1436. F.S. 607.1435 establishes the procedure for appointing and the duties of a provisional director.

3. *Judicial Liquidation Proceedings And Receiverships:*

A shareholder may institute an action under F.S. 607.1430(2) to liquidate a corporation if there is a director deadlock coupled with irreparable injury to the corporation or if there is a shareholder deadlock and they have failed to elect successors to directors whose terms have expired.

Under F.S. 607.1430(4), a creditor may institute a liquidation action when:

(a) The creditor's claim has been reduced to judgment, the execution on the judgment returned unsatisfied, and the corporation is insolvent; or

(b) The corporation has admitted in writing that the creditor's claim is due and owing and the corporation is insolvent.

The court may also entertain a liquidation action by a corporation with an existing liquidation plan or by the Department of Legal Affairs. F.S. 607.1430(1), (5). Liquidation proceedings instituted under F.S. 607.1430 must be brought in the county where the corporation has or had its last known principal office. F.S. 607.1431(1). It is not necessary to join shareholders as parties unless relief is sought against them personally. F.S. 607.1431(2).