Chapter 607

607.07401. Shareholders' derivative actions

(1) 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.

(2) 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. If the corporation commences an investigation of the charges made in the demand or complaint, the court may stay any proceeding until the investigation is completed.

(3) The court may dismiss a derivative proceeding if, on motion by the corporation, the court finds that one of the groups specified below has made a determination in good faith after conducting a reasonable investigation upon which its conclusions are based that the maintenance of the derivative suit is not in the best interests of the corporation. The corporation shall have the burden of proving the independence and good faith of the group making the determination and the reasonableness of the investigation. The determination shall be made by:

(a) A majority vote of independent directors present at a meeting of the board of directors, if the independent directors constitute a quorum;

(b) A majority vote of a committee consisting of two or more independent directors appointed by a majority vote of independent directors present at a meeting of the board of directors, whether or not such independent directors constitute a quorum; or

(c) A panel of one or more independent persons appointed by the court upon motion by the corporation.

(4) A proceeding commenced under this section may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interest of the corporation's shareholders or a class, series, or voting group of shareholders, the court shall direct that notice be given to the shareholders affected. The court may determine which party or parties to the proceeding shall bear the expense of giving the notice.

(5) On termination of the proceeding, the court may require the plaintiff to pay any defendant's reasonable expenses, including reasonable attorney's fees, incurred in defending the proceeding if it finds that the proceeding was commenced without reasonable cause.

(6) The court may award reasonable expenses for maintaining the proceeding, including reasonable attorney's fees, to a successful plaintiff or to the person commencing the proceeding who receives any relief, whether by judgment, compromise, or settlement, and require that the person account for the remainder of any proceeds to the corporation; however, this subsection does not apply to any relief rendered for the benefit of injured shareholders only and limited to a recovery of the loss or damage of the injured shareholders.

(7) For purposes of this section, "shareholder" includes a beneficial owner whose shares are held in a voting trust or held by a nominee on his or her behalf. *Laws 1989, c. 89–154, § 67; Fla.St.1989, § 607.0740; Laws 1990, c. 90–179, § 148. Amended by Laws 1997, c. 97–102, § 19, eff. July 1, 1997; Laws 2003, c. 2003–283, § 11, eff. Oct. 1, 2003.*

Historical and Statutory Notes

Amendment Notes:

Laws 1990, c. 90–179, § 148, eff. July 1, 1990, renumbered the section.

Laws 1997, c. 97–102, eff. July 1, 1997, removed gender-specific references without substantive changes in legal effect.

Laws 2003, c. 2003–283, § 11, rewrote subsec. (2), which formerly read:

"(2) 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. If the corporation commences an investigation of the charges made in the demand or complaint, the court may stay any proceeding until the investigation is completed."

Revised Model Business Corporation Act

§ 7.40. SUBCHAPTER DEFINITIONS

In this subchapter:

(1) "Derivative proceeding" means a civil suit in the right of a domestic corporation or, to the extent provided in section 7.47, in the right of a foreign corporation.

(2) "Shareholder" includes a beneficial owner whose shares are held in a voting trust or held by a nominee on the beneficial owner's behalf.

CROSS-REFERENCES

Shares held by nominees, see § 7.23.
Voting trusts, see § 7.30.

OFFICIAL COMMENT

The definition of "derivative proceeding" makes it clear that the subchapter applies to foreign corporations only to the extent provided in section 7.47. Section 7.47 provides that the law of the jurisdiction of incorporation governs except for sections 7.43 (stay of proceedings), 7.45 (discontinuance or settlement) and 7.46 (payment of expenses). See the Official Comment to section 7.47.

The definition of "shareholder," which applies only to subchapter D, includes all beneficial owners and therefore goes beyond the definition in section 1.40(22) which includes only record holders and beneficial owners who are certified by a nominee pursuant to the procedure specified in section 7.23. Similar definitions are found in section 13.01 (appraisal rights) and section 16.02(g) (inspection of records by a shareholder). In the context of subchapter D, beneficial owner means a person having a direct economic interest in the shares. The definition is not intended to adopt the broad definition of beneficial ownership in SEC Rule 13d-2 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.13d-2, which includes persons with the right to vote or dispose of the shares even though they have no economic interest

Author Commentary

A derivative action is a suit brought by a shareholder, on behalf of the corporation, for corporate recovery of damages or equitable relief stemming from allegedly unlawful or improper conduct by directors, officers, control persons or others against whom the corporation may have a claim. The corporation is an indispensable party and is nominally served as the defendant to assure its appearance.

Demand

Prior to filing the complaint, the shareholder must make a demand upon the corporation to pursue corrective action. The demand requirement assures that the board of directors becomes cognizant of the claim and can determine whether to pursue corrective action itself or to oppose the claim. In 2003, subs. (2) was amended to provide a 90-day time frame for the corporation's response to the demand (prior to the amendment there was no time frame regarding the corporation's response). The plaintiff can act sooner than 90 days if the corporation rejects the demand prior to that time or if irreparable injury to the corporation would result by waiting for the expiration of the 90-day period. Once the complaint is filed, the corporation may request a stay of the proceedings until it has completed its investigation, thus preserving the rights of the corporation in circumstances where an investigation might reasonably exceed 90 days.

A literal reading of this section suggests that the demand requirement appears to be absolute, as the drafters in 1990 deliberately excised from the Model Act the words "if any" following "demand made" and the phrase "or why he did not make the demand" in subs. (2). Historically, courts have excused the demand requirement on grounds of futility, e.g. *Orlando Orange Groves Co. v. Hale* (cited below). It is interesting to note that the most recent version of the Revised Model Business Corporation Act also provides for an absolute demand requirement, and this may reflect a trend that will be judicially accepted.

The statutory demand requirement does not specify the particulars to be set forth to constitute a valid demand. It would appear that at a minimum the demand should (i) identify the shareholder(s) making the demand, (ii) state the alleged wrongful conduct, (iii) designate the persons charged with the wrongful conduct, (iv) allege the specific harm to the corporation and (v) request specific remedial relief

Corporate Action

If a derivative action is filed following demand, it may be stayed until a corporate investigation is completed. The corporation, through its board or a delegated committee, is entitled to use its judgment to determine whether the action is in the corporation's best interests. A corporation is not required to pursue every possible claim it might have. The nature of the claim, amount involved, potential litigation expenses, and likelihood of success are all factors appropriately considered. Subsection (3) sets forth several alternative modes for making the decision by independent directors or other appointees.

The term "independent" is not defined by statute. In *Klein v. FPL Group, Inc.*, 2004 WL 302292 (S.D. Fl. 2004), a case discussed in detail below, the court noted that, although s. 607.07401 is based on the Model Act, Florida specifically did not adopt the Model Act provision shielding any one of the following factors from *ipso facto* causing a director to be considered not independent:

(1) the nomination or election of the director by defendants;

(2) the naming of the director as a defendant; or

(3) the approval by the director of the act being challenged if the act resulted in no personal benefit to the director.

The fact that Florida did not include the Model Act's "safe harbor" provisions regarding independence appears to give Florida courts greater leeway in determining the independence of a litigation committee where one or more of the three factors are present. In *McDonough v. American International Corp.*, 905 F. Supp. 1016 (M.D. Fla. 1995), the court held that the corporation had failed to meet its burden of proof that the litigation committee was independent because the members had been elected to the board by the defendant majority shareholder. In *Kloha v. Duda et al.*, 226 F. Supp. 2d 1342 (M.D. Fla. 2002), litigation committee members were held to not be independent where they were also defendant-directors and had received substantial compensation from the corporation for a number of years. In *Klein v. FPL Group, Inc.*, the fact that a majority of the special Board committee formed to evaluate the action consisted of directors who had approved the challenged act, even though they received no personal benefit therefrom, was a major factor militating against independence. The fact that the committee directors were also named defendants was also problematic, the court noting that "It cannot be said, given the allegations, that the Board members are only nominal defendants. The inherent problem is that each director stood in a dual relation which, on its face, precludes an unprejudiced exercise of judgment." 2004 WL 302292 at 22.

The *Klein* case involved an in-depth analysis by the court of the independence issue and the factors that affect a court's decision. Plaintiffs had challenged the independence of the corporation's Evaluation Committee formed to analyze and recommend to the Board whether it was in the best interests of the corporation for the action to proceed. The Board had accepted the Evaluation Committee's recommendation that the action be dismissed and a motion to dismiss was filed on behalf of the corporation. The court began its analysis by examining the meaning of "independence", as there was neither any statutory definition nor definitive Florida case law. The court concluded that, in the absence of authority, Florida courts would look for guidance to Delaware and New York laws, citing instances in which Florida courts had done exactly that. The court considered that "dominance and control" and "financial interest" were certainly factors to be considered, but it concluded that:

in them.

§ 7.41. STANDING

A shareholder may not commence or maintain a derivative proceeding unless the shareholder:

(1) was a shareholder of the corporation at the time of the act or omission complained of or became a shareholder through transfer by operation of law from one who was a shareholder at that time; and

(2) fairly and adequately represents the interests of the corporation in enforcing the right of the corporation.

CROSS-REFERENCES

"Derivative proceeding" defined, see § 7.40.

"Shareholder" defined, see § 7.40.

OFFICIAL COMMENT

The Model Act and the statutes of many states have long imposed a "contemporaneous ownership" rule, i.e., the plaintiff must have been an owner of shares at the time of the transaction in question. This rule has been criticized as being unduly narrow and technical and unnecessary to prevent the transfer or purchase of lawsuits. A few states, particularly California, Cal. Corp. Code section 800(B), have relaxed this rule in order to grant standing to some subsequent purchasers of shares in limiting circumstances.

The decision to retain the contemporaneous ownership rule in section 7.41(1) was based primarily on the view that it was simple, clear, and easy to apply. In contrast, the California approach might encourage the acquisition of shares in order to bring a lawsuit, resulting in litigation on peripheral issues such as the extent of the plaintiff's knowledge of the transaction in question when the plaintiff acquired the shares. Further, there has been no persuasive showing that the contemporaneous

> "a broader test is required under the Florida statute which is ultimately a determination, based on the totality of the circumstances, as to whether 'a director is, for any substantial reason, incapable of making a decision with only the best interests of the corporation in mind.'" 2004 WL 302292 at 20, citing *Parfi Holding AB v. Mirror Image Internet, Inc.*, 794 A. 2d 1211, 1232 (Del. Ch. 2001).

In determining the totality of the circumstances, the *Klein* court noted the following factors that Delaware (and other) courts have adopted in considering the independence question: (1) a committee member's status as a defendant, and potential liability; (2) a committee member's participation in or approval of the alleged wrongdoing; (3) a committee member's past or present business dealings with the corporation; (4) a committee member's past or present business or social dealings with the individual defendants; (5) the number of directors on the committee; and (6) the "structural bias" of the committee, meaning the manner in which the committee was selected and proceeded in its investigation.

The *Klein* court then examined the specific circumstances regarding the Evaluation Committee and its procedures. The case is extraordinary because of the breadth and number of factors cited by the court in concluding that the Committee, and the Board that adopted the Committee's recommendation, lacked independence. Those factors were: (a) the CEO, who was the principal defendant, was instrumental in selecting the committee members, (b) the Board approved the selection of the Committee members without considering any of the alternatives presented within the statute, such as appointment of independent persons not affiliated with the company, (c) two of the three Committee members previously had approved the challenged acts, (d) all of the Committee members were named defendants, (e) if the Committee had agreed that the challenged acts were wrongful, the directors' insurers had already indicated that there might not be coverage for the damages to the corporation, (f) the Committee's outside counsel was a law firm that had previously advised the company regarding the challenged transactions, (g) a switch to another law firm eight months later did not cleanse the taint from the hiring and services provided to the Committee by the first law firm, (h) the definition of "independence" used by both law firms in advising the Committee was too narrow, focusing only on the existence of a personal benefit from the challenged acts and whether a committee member was dominated by other interested parties, (i) while the Committee was in its evaluation process, the corporation issued public statements supporting the challenged acts, with the knowledge of the Committee members, (j) when the Committee made its recommendation to the Board, the Committee's counsel acted in an advisory capacity to the Board, which necessarily resulted in an advocacy rather than neutral situation, and (k) the Board's acceptance of the Committee recommendation was made without any independent investigation, substantially relying on the Committee's report, and thus was a product of the Evaluation Committee's lack of independence.

Given the numerous problems found by the *Klein court*, it is difficult to isolate one or several of the factors as being the most dominant. The court was clearly very concerned that the Committee consisted of members who had previously approved the challenged acts, that those members had been selected by the principal defendant, and that the members were themselves defendants. It was highly critical of the hiring of a law firm that had given legal advice regarding the challenged actions. And it was very critical of the company making public statements supporting the actions during the pendency of the Committee's review. It is very possible that any one of these factors, or perhaps others noted by the court, would have caused the court to find that the Evaluation Committee and Board did not meet the test of independence.

It is clear from *Klein* and other cases that courts regard the corporation's burden of proof as to "independence" to be a high one. In a highly-publicized Delaware case, *In re Oracle Corp. Derivative Litigation*, 824 A. 2d 917 (Del. Ch. 2003), two prominent Stanford professors (one a law professor and former SEC Commissioner) who were clearly outsiders to the challenged transactions were held to not satisfy Delaware's independence standards because some of the defendant directors had substantial financial and other ties to Stanford University. In the post-*Enron* era, we may expect to see much greater scrutiny of independence claims than existed in prior years.

Judicial Review

If the corporation, through one of the authorized review processes, determines that the litigation is not in its best interests, it may move to dismiss the action. The court's role at this point is not altogether clear under the statute. The issue of whether a court should conduct an evidentiary hearing to determine the good faith and disinterested nature of the report and whether the recommendation to dismiss the action was objectively reasonable arose in the *Klein* case, discussed above. Here too the court noted that there was no Florida case directly on point. The court concluded that:

> "A full evidentiary hearing is costly and time consuming. It is unnecessary if the parties agree, or if the court independently finds, that there are no material issues of fact as to any of the criteria to be applied, and the matter may be decided as a matter of law on the evidentiary record. If, however, the court finds that there are material issues of fact, or there is a need for credibility determinations, the court...should hold an evidentiary hearing on the material issues of fact in dispute, and determine matters of credibility, in order to decide whether to exercise its discretion under the Florida Statute to dismiss the derivative proceeding." 2004 WL 302292 at 18.

If the conclusions in *Klein* are adopted by Florida courts, courts will need to examine whether material factual and credibility issues are contained within the litigation committee's report and whether, if so, an evidentiary hearing is necessary to resolve those issues before the court rules on the motion to dismiss. This kind of judicial review appears to give a broader scope to Florida courts than exists in many other jurisdictions that limit judicial review to the independence and decision-making process of the litigation committee. Many courts may not wish to open the door to full evidentiary hearings, as that will involve the very trial time and effort that the litigation committee's

ownership rule has prevented the litigation of substantial suits, at least with respect to publicly held corporations where there are many persons who might qualify as plaintiffs to bring suit even if subsequent purchasers are disqualified.

Section 7.41 requires the plaintiff to be a shareholder and therefore does not permit creditors or holders of options, warrants, or conversion rights to commence a derivative proceeding.

Section 7.41(2) follows the requirement of Federal Rule of Civil Procedure 23.1 with the exception that the plaintiff must fairly and adequately represent the interests of *the corporation* rather than *shareholders similarly situated* as provided in the rule. The clarity of the rule's language in this regard has been questioned by the courts. See *Nolen v. Shaw-Walker Company*, 449 F.2d 506, 508 n.4 (6th Cir. 1972). Furthermore, it is believed that the reference to the corporation in section 7.41(2) more properly reflects the nature of the derivative suit.

The introductory language of section 7.41 refers both to the commencement and maintenance of the proceeding to make it clear that the proceeding should be dismissed if, after commencement, the plaintiff ceases to be a shareholder or a fair and adequate representative. The latter would occur, for example, if the plaintiff were using the proceeding for personal advantage. If a plaintiff no longer has standing, courts have in a number of instances provided an opportunity for one or more other shareholders to intervene.

§ 7.42. DEMAND

No shareholder may commence a derivative proceeding until:

(1) a written demand has been made upon the corporation to take suitable action; and

(2) 90 days have expired from the date delivery of the demand was made unless the shareholder has earlier been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result by waiting for the

report was supposed to obviate. Much may depend on the quality of the committee's report. If the corporation meets its burden of proof that the litigation committee was independent, acted in good faith, and conducted a reasonable investigation, a court is likely to grant the motion to dismiss without an evidentiary hearing unless plaintiff is able to show that the report's conclusions are unreasonable in light of the results of its investigation. This appears to have heen the result in *Atkins v. Topp Telecom, Inc.*, 874 So. 2d 626 (4th DCA 2004), where the court held that Florida law permitted it to adopt the independent investigator's finding to dismiss the action without engaging in further analysis beyond the fact that the investigator acted reasonably and with good faith in conducting the investigation.

If the corporation meets its burden of proof regarding the litigation committee's report, is the court mandated to dismiss the action? Here again the statute leaves room for interpretation. Section 607.07401(3) provides that the court "may" dismiss the proceeding if the corporation meets its burden of proof. That language is a departure from the Model Act which states that the court "shall" dismiss the action. This suggests that a court is not bound to dismiss an action, even if the corporation's motion is supported by an appropriate investigation and report. On the other hand, there does not appear to be statutory support for the two-step process used in Delaware under *Zapata v. Maldonado*, 430 A. 2d 779 (Del. 1981), in which the court first examines the independence of the litigation committee and, if that test is met, the court then considers on its own the merits of the case in light of the motion for dismissal. The Florida statute, adopted after *Zapata*, could have provided for such judicial review, but it does not. One Florida court, *Atkins v. Topp Telecom, Inc.*, cited below, specifically noted that s. 607.07401(3) does not mandate that "a trial court must exercise its own business judgment pursuant to Zapata." It appears that use of the word "may" leaves the door open for courts to deny a motion to dismiss, regardless of the quality of the report, but it is likely that such denials will only come in circumstances where the court has substantial concerns that the report's conclusions lack rational bases. The distinction between "may" and "shall" was noted by the court in *Batur v. Signature Properties of Northwest Florida, Incorporated*, cited below, in which the court found deficiencies in the investigator's report recommending dismissal of the suit.

Security for Expenses

The FBCA eliminated the security for expenses requirement of prior Florida law. Plaintiffs are not required to post bond or other security to cover potential litigation costs. The statute, however, does not appear to preclude protective orders where appropriate.

Standing

Standing to bring a derivative action is based upon status as a shareholder (or transferee of such shareholder) at the time the transaction complained of occurred. The statute's reference to "shareholder" appears to accord standing to preferred as well as common shareholders. The statute does not indicate whether plaintiff must remain a shareholder during the litigation. This appears an open question, although the judicial trend appears to require a continuous proprietary interest in the corporation in order to pursue a derivative action. One federal court opined, based on similar language in the prior Florida statute, that the action would abate if plaintiff were no longer a shareholder (*Schilling v. Belcher*, cited below). A similar conclusion was reached by a divided court in *Timko v. Triarsi* (cited below), which based its result on the common law principle that plaintiff must have a continuing legitimate interest in the outcome of the lawsuit. The plaintiff in that case brought both a derivative action and an action to dissolve the corporation pursuant to s. 607.1430. Under the latter lawsuit, the opposing shareholder exercised his right to purchase plaintiff's shares under s. 607.1436, thus raising the issue whether plaintiff's derivative action could proceed. The court held that plaintiff now lacked standing to continue the derivative action, noting that its decision was consistent with the majority of case law elsewhere. The *Timko* decision may carry the day in Florida, although there is dictum to the contrary in *DiGiovanni v. All-Pro Golf, Inc.* (cited below). In *Hantz v. Belyew*, cited below under **Leading Cases**, the 11th Circuit Court of Appeals cited *Timko* as authority in denying standing to former shareholders who had involuntarily lost their shares as a result of a bankruptcy reorganization. If *Timko* becomes the accepted doctrine, there will also be ramifications for shareholders who desire to assert appraisal rights. It would appear that under *Timko* shareholders who are cashed out by reason of appraisal rights would no longer have standing to pursue a derivative action. Similarly, a shareholder may lose standing to continue a derivative action if, as a result of a reverse merger, the shareholder's holding is reduced to fractional shares which are purchased by the corporation. This was the result reached in *Quinn v. Anvil Corp.*, 620 F.3d 1005 (9th Cir. 2010) applying the Fed. Rules Civ. Proc. Rule 23.1 standing requirement for derivative actions.

The standing issue is distinct from the question of whether the shareholder's action is personal or derivative. A derivative action is properly bought when it is the corporation that has been injured, and the recovery is being sought for and on behalf of the corporation. A personal action generally involves a more direct, personal injury to the shareholder, such as a failure to pay a dividend that has been declared, or a refusal to permit the shareholder to exercise certain rights. The distinction between personal and derivative actions is sometimes difficult to determine, especially when alleged wrongful conduct affects all shareholders equally. Florida courts have held that personal actions may he brought even when all shareholders have been affected by the alleged wrongdoing.

In some states, shareholders of close corporations have been allowed, subject to the court's discretion, to bring personal, rather than derivative, actions against another shareholder. This exception "is premised on the proposition that in a closely-held corporation, the relatively few shareholders are also the parties to the suit, and thus the attendant remedies and policy concerns are distinct from those arising in derivative suits for publicly-held corporations." *Simon v. Mann*, 373 F. Supp. 2d 1196, 1198–1199 (D. Nev. 2005), citing *Orsi v. Sunshine Art Studios, Inc.*, 874 F. Supp. 471 (D. Mass. 1995). There are no Florida cases addressing this so-called closely-held corporation exception. Where the action has been brought as a derivative action, Florida courts have not permitted

expiration of the 90-day period.

CROSS-REFERENCES

"Derivative proceeding" defined, see § 7.40.
"Shareholder" defined, see § 7.40.

OFFICIAL COMMENT

Section 7.42 requires a written demand on the corporation in all cases. The demand must be delivered at least 90 days before commencement of suit unless irreparable injury to the corporation would result. This approach has been adopted for two reasons. First, even though no director may be "qualified" (see section 1.43), the demand will give the board of directors the opportunity to re-examine the act complained of in the light of a potential lawsuit and take corrective action. Secondly, the provision eliminates the time and expense of the litigants and the court involved in litigating the question whether demand is required. It is believed that requiring a demand in all cases does not impose an onerous burden since a relatively short waiting period of 90 days is provided and this period may be shortened if irreparable injury to the corporation would result by waiting for the expiration of the 90-day period. Moreover, the cases in which demand is excused are relatively rare. Many plaintiffs' counsel as a matter of practice make a demand in all cases rather than litigate the issue whether demand is excused.

1. Form of Demand

Section 7.42 specifies only that the demand shall be in writing. The demand should, however, set forth the facts concerning share ownership and be sufficiently specific to apprise the corporation of the action sought to be taken and the grounds for that action so that the demand can be evaluated. See *Allison v. General Motors Corp.*, 604 F. Supp. 1106, 1117 (D. Del. 1985). Detailed pleading is not required since the corporation can contact the shareholder for clarification if there are any questions. In keeping with the spirit of this section, the specificity of the demand should not become a new source of dilatory motions.

direct awards to the shareholder plaintiff, even in a two-shareholder situation. *Sinibaldi v. Sinibaldi*, 2011 WL 5253030 (Fla. 2d DCA 2011).

Some courts have also accorded standing to shareholders of parent corporations to bring a "double derivative action" on behalf of the parent's subsidiary. In a "double derivative action," the shareholder is effectively maintaining the derivative action on behalf of the subsidiary, based upon the fact that the parent has derivative rights to the subsidiary's cause of action. Although a strict reading of the statute might suggest that a shareholder must own shares in the corporation for which the derivative action is brought, courts have nevertheless permitted "double derivative actions" even though stock ownership is indirect (e.g. *Sternberg v. O'Neil*, 550 A. 2d 1105 (Del. 1988)). Indeed, such actions have been allowed even where the shareholder owns a minority interest in one corporation that in turn owns only a minority interest in the other corporation in circumstances where the defendant exercises control of both companies (e.g. *West v. West*, 825 F. Supp. 1033 (N.D. Ga. 1992)). Such actions are generally supported by the policy that multiple and fractionalized levels of corporations should not immunize directors and officers from meritorious derivative actions directly or indirectly affecting a shareholder's investment. Plaintiff shareholder in a "double derivative action" must make two demands in accordance with statutory requirements, one on the subsidiary and one on the parent (Fletcher, Cyclopedia of the Law of Private Corporations, 1993 Cumulative Supplement, section 5977 at 43). The right to bring and procedures regarding "double derivative actions" have not been widely litigated. There are only two cases from Florida, one recognizing the action (*Gadd v. Pearson*, cited below), the other also recognizing the possibility of a "double derivative action" but denying it in the particular circumstances (*Crow v. Context Industries, Inc.*, cited below).

Creditors' Rights

Although the statutory provision confers standing only on shareholders, creditors of an insolvent corporation may arguably be able to assert derivative claims on behalf of the corporation. This is the clear understanding in Delaware, e.g. *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 . 2d 1031, 1036 (Del. 2004) ("When a corporation is insolvent, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value....Consequently, the creditors...have standing to maintain derivative claims...."). In *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 2006 WL 2588971 (Del. Ch. May 18, 2007), the Delaware Supreme Court ruled that directors of a corporation "in the zone of insolvency" do not owe fiduciary duties to creditors and that, even as to insolvent corporations, a creditor may not assert direct claims for breach of fiduciary duty against the directors but must proceed on a derivative basis. Whether Florida courts would adopt a similar interpretation under s. 607.07401 is uncertain. Trustees in bankruptcy commonly assert claims on behalf of the corporation, but those actions are not derivative but rather direct actions in the name of the corporation.

Role of Corporate Counsel

Corporate counsel's role in a derivative action is a sensitive one. Defendant directors and officers often will want corporate counsel to represent them. However, because the action is brought in favor of the corporation, counsel may have a conflict of interest in representing such defendants. Unless both the corporate and individual defendant interests are clearly aligned against the action, courts will generally not permit corporate counsel to represent both the corporation and individual defendants. There appear to be no Florida cases on point, but decisions in other jurisdictions include *Dukas v. Davis Aircraft Products Co., Inc.*, 129 Misc. 2d 846, 494 N.Y.S. 2d 632 (NY Sup. Ct. 1985), later proceeding 131 App. Div. 2d 720, 516 N.Y.S. 2d 781, *Rowen v. Le Mars Mutual Insurance Co. of Iowa*, 230 N.W. 2d 905 (Iowa 1975), and *Cannon v. U.S. Acoustics Corp.*, 398 F. Supp. 209 (N.D. Ill. 1975), affd in part and revd in part 532 F. 2d 1118.

Limitation on Remedies

The impetus for derivative actions is substantially undercut by s. 607.0831 provisions eliminating director liability for monetary damages in most cases of ordinary negligence. Because plaintiff's attorney fees are often contingently based on the amount of recovery gained for the corporation, and s. 607.0831 significantly reduces the opportunities for such recoveries, shareholders may have trouble finding counsel willing to pursue derivative actions in the absence of clearly egregious conduct.

Subs. 607.07401(6) allows for the court to award reasonable expenses, including reasonable attorney's fees, to a "successful plaintiff." Success is not defined other than a reference to receiving "any relief." An interpretive question is whether "relief" may be non-monetary, e.g. some change in corporate governance, even if the litigation sought monetary damages. Litigation in other states suggests that a non-monetary form of relief may be sufficient to allow expenses and fees, e.g. *In re Johnson & Johnson Derivative Litigation*, 900 F.Supp.2d 467 (D. N.J. 2012) (corporate governance reforms, unaccompanied by monetary damages, may form the basis for an attorney fee award if the reforms confer a substantial benefit on the corporation).

2. *Upon Whom Demand Should Be Made*

Section 7.42 states that demand shall be made upon the corporation. Reference is not made specifically to the board of directors as in previous section 7.40(b) since there may be instances such as a decision to sue a third party for an injury to the corporation, in which the taking of, or refusal to take, action would fall within the authority of an officer of the corporation. Nevertheless, it is expected that in most cases the board of directors will be the appropriate body to review the demand.

To ensure that the demand reaches the appropriate person for review, it should be addressed to the board of directors, chief executive officer, or corporate secretary of the corporation at its principal office.

2. *The 90-Day Period*

Section 7.42(2) provides that the derivative proceeding may not be commenced until 90 days after demand has been made. Ninety days has been chosen as a reasonable minimum time within which the board of directors can meet, direct the necessary inquiry into the charges, receive the results of the inquiry and make its decision. In many instances a longer period may be required. See, e.g., *Mozes v. Welch*, 638 F. Supp. 215 (D. Conn. 1986) (eight month delay in responding to demand not unreasonable). However, a fixed time period eliminates further litigation over what is or is not a reasonable time. The corporation may request counsel for the shareholder to delay filing suit until the inquiry is completed or, if suit is commenced, the corporation can apply to the court for a stay under section 7.43.

Two exceptions are provided to the 90-day waiting period. The first exception is the situation where the shareholder has been notified of the rejection of the demand prior to the end of the 90 days. The second exception is where irreparable injury to the corporation would otherwise result if the commencement of the proceeding is delayed for the 90-day period. The standard to be applied is intended to be the same as that governing the entry of a preliminary injunction. Compare *Gimbel v. Signal Cos.*, 316 A.2d 599 (Del. Ch. 1974) with *Gelco Corp. v. Coniston Partners*, 811 F.2d 414 (8th Cir. 1987). Other factors may also be

considered, such as the possible expiration of the statute of limitations, although this would depend on the period of time during which the shareholder was aware of the grounds for the proceeding.

It should be noted that the shareholder bringing suit does not necessarily have to be the person making the demand. Only one demand need be made in order for the corporation to consider whether to take corrective action.

4. Response by the Corporation

There is no obligation on the part of the corporation to respond to the demand. However, if the corporation, after receiving the demand, decides to institute litigation or, after a derivative proceeding has commenced, decides to assume control of the litigation, the shareholder's right to commence or control the proceeding ends unless it can be shown that the corporation will not adequately pursue the matter. As stated in *Lewis v. Graves*, 701 F.2d 245, 247-48 (2d Cir. 1983):

The [demand] rule is intended "to give the derivative corporation itself the opportunity to take over a suit which was brought on its behalf in the first place, and thus to allow the directors the chance to occupy their normal status as conductors of the corporation's affairs." Permitting corporations to assume control over shareholder derivative suits also has numerous practical advantages. Corporate management may be in a better position to pursue alternative remedies, resolving grievances without burdensome and expensive litigation. Deference to directors' judgments may also result in the termination of meritless actions brought solely for their settlement or harassment value. Moreover, where litigation is appropriate, the derivative corporation will often be in a better position to bring or assume the suit because of superior financial resources and knowledge of the challenged transactions. [Citations omitted.]

§ 7.43. STAY OF PROCEEDINGS

If the corporation commences an inquiry into the allegations made in the demand or complaint, the court may stay any derivative

proceeding for such period as the court deems appropriate.

CROSS-REFERENCES

Demand, see § 7.41.
"Derivative proceeding" defined, see § 7.40.

OFFICIAL COMMENT

Section 7.43 provides that if the corporation undertakes an inquiry, the court may in its discretion stay the proceeding for such period as the court deems appropriate. This might occur where the complaint is filed 90 days after demand but the inquiry into matters raised by the demand has not been completed or where a demand has not been investigated but the corporation commences the inquiry after the complaint has been filed. In either case, it is expected that the court will monitor the course of the inquiry to ensure that it is proceeding expeditiously and in good faith.

§ 7.44. DISMISSAL

(a) A derivative proceeding shall be dismissed by the court on motion by the corporation if one of the groups specified in subsection (b) or subsection (e) has determined in good faith, after conducting a reasonable inquiry upon which its conclusions are based, that the maintenance of the derivative proceeding is not in the best interests of the corporation.

(b) Unless a panel is appointed pursuant to subsection (e), the determination in subsection (a) shall be made by:

(1) a majority vote of qualified directors present at a meeting of the board of directors if the qualified directors constitute a quorum; or

(2) a majority vote of a committee consisting of two or more qualified directors appointed by majority vote of qualified directors present at a meeting of the board of directors,

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	regardless of whether such qualified directors constitute a quorum.
	(c) If a derivative proceeding is commenced after a determination has been made rejecting a demand by a shareholder, the complaint shall allege with particularity facts establishing either (1) that a majority of the board of directors did not consist of qualified directors at the time the determination was made or (2) that the requirements of subsection (a) have not been met.
	(d) If a majority of the board of directors consisted of qualified directors at the time the determination was made, the plaintiff shall have the burden of proving that the requirements of subsection (a) have not been met; if not, the corporation shall have the burden of proving that the requirements of subsection (a) have been met.
	(e) Upon motion by the corporation, the court may appoint a panel of one or more individuals to make a determination whether the maintenance of the derivative proceeding is in the best interests of the corporation. In such case, the plaintiff shall have the burden of proving that the requirements of subsection (a) have not been met.
	CROSS-REFERENCES Board of directors: committees, see § 8.25. meetings, see § 8.20. quorum and voting, see § 8.24. Demand, see § 7.41. "Derivative proceeding" defined, see § 7.40. "Qualified director" defined, see § 1.43. "Shareholder" defined, see § 7.40.
	OFFICIAL COMMENT At one time, the Model Act did not expressly provide what

happens when a board of directors properly rejects a demand to bring an action. In such event, judicial decisions indicate that the rejection should be honored and any ensuing derivative action should be dismissed. See *Aronson v. Lewis*, 473 A.2d 805, 813 (Del. 1984). The Model Act was also silent on the effect of a determination by a special litigation committee of qualified directors that a previously commenced derivative action should be dismissed. Section 7.44(a) specifically provides that the proceeding shall be dismissed if there is a proper determination that the maintenance of the proceeding is not in the best interests of the corporation. That determination can be made prior to commencement of the derivative action in response to a demand or after commencement of the action upon examination of the allegations of the complaint.

The procedures set forth in section 7.44 are not intended to be exclusive. As noted in the comment to section 7.42, there may be instances where a decision to commence an action falls within the authority of an officer of the corporation, depending upon the amount of the claim and the identity of the potential defendants.

1. The Persons Making the Determination

Section 7.44(b) prescribes the persons by whom the determination in subsection (a) may be made. Subsection (b) provides that the determination may be made (1) at a board meeting by a majority vote of qualified directors if the qualified directors constitute a quorum, or (2) by a majority vote of a committee consisting of two or more qualified directors appointed at a board meeting by a vote of the qualified directors in attendance, regardless of whether they constitute a quorum. (For the definition of "qualified director," see section 1.43 and the related official comment.) These provisions parallel the mechanics for determining entitlement to indemnification (section 8.55), for authorizing directors' conflicting interest transactions (section 8.62), and for renunciation of the corporation's interests in a business opportunity (section 8.70). Subsection (b)(2) is an exception to section 8.25 of the Model Act, which requires the approval of at least a majority of all the directors in office to create a committee and appoint members. This approach has been taken to respond to the criticism expressed in a few cases that special litigation committees suffer from a structural bias because of their appointment by

vote of directors who at that time are not qualified directors. See *Hasan v. Trust Realty Investors*, 729 F.2d 372, 376-77 (6th Cir. 1984).

Subsection (e) provides, as an alternative, for a determination by a panel of one or more individuals appointed by the court. The subsection provides for the appointment only upon motion by the corporation. This would not, however, prevent the court on its own initiative from appointing a special master pursuant to applicable state rules of procedure. (Although subsection (b)(2) requires a committee of at least two qualified directors, subsection (e) permits the appointment by the court of only one person in recognition of the potentially increased costs to the corporation for the fees and expenses of an outside person.)

This panel procedure may be desirable in a number of circumstances. If there are no qualified directors available, the corporation may not wish to enlarge the board to add qualified directors or may be unable to find persons willing to serve as qualified directors. In addition, even if there are directors who are qualified, they may not be in a position to conduct the inquiry in an expeditious manner.

Appointment by the court should also eliminate any question about the qualifications of the individual or individuals constituting the panel making the determination. Although the corporation may wish to suggest to the court possible appointees, the court will not be bound by those suggestions and, in any case, will want to satisfy itself with respect to each candidate's impartiality. When the court appoints a panel, subsection (e) places the burden on the plaintiff to prove that the requirements of subsection (a) have not been met.

2. Standards to Be Applied

Section 7.44(a) requires that the determination, by the appropriate person or persons, be made "in good faith, after conducting a reasonable inquiry upon which their conclusions are based." The phrase "in good faith" modifies both the determination and the inquiry. This standard, which is also found in sections 8.30 (general standards of conduct for directors) and 8.51 (authority to indemnify) of the Model Act, is a subjective one, meaning "honestly or in an honest manner." See also

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	Corporate Director's Guidebook (Fifth Edition), 59 BUS. LAW. 1057, 1068 (2007). As stated in *Abella v. Universal Leaf Tobacco Co.*, 546 F. Supp. 795, 800 (E.D. Va. 1982), "the inquiry intended by this phrase goes to the spirit and sincerity with which the investigation was conducted, rather than the reasonableness of its procedures or basis for conclusions." The word "inquiry"—rather than "investigation"—has been used to make it clear that the scope of the inquiry will depend upon the issues raised and the knowledge of the group making the determination with respect to those issues. In some cases, the issues may be so simple or the knowledge of the group so extensive that little additional inquiry is required. In other cases, the group may need to engage counsel and possibly other professionals to make an investigation and assist the group in its evaluation of the issues. The phrase "upon which its conclusions are based" requires that the inquiry and the conclusions follow logically. This standard authorizes the court to examine the determination to ensure that it has some support in the findings of the inquiry. The burden of convincing the court about this issue lies with whichever party has the burden under subsection (d). This phrase does not require the persons making the determination to prepare a written report that sets forth their determination and the bases therefor, since circumstances will vary as to the need for such a report. There will be, in all likelihood, many instances where good corporate practice will commend such a procedure. Section 7.44 is not intended to modify the general standards of conduct for directors set forth in section 8.30 of the Model Act, but rather to make those standards somewhat more explicit in the derivative proceeding context. In this regard, the qualified directors making the determination would be entitled to rely on information and reports from other persons in accordance with section 8.30(d). Section 7.44 is similar in several respects and differs in certain other respects from the law as it has developed in Delaware and been followed in a number of other states. Under the Delaware cases, the role of the court in reviewing the directors' determination varies depending

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	upon whether the plaintiff is in a demand-required or demand-excused situation. Since section 7.42 requires demand in all cases, the distinction between demand-excused and demand-required cases does not apply. Subsections (c) and (d) carry forward that distinction, however, by establishing pleading rules and allocating the burden of proof depending on whether there is a majority of qualified directors on the board. Subsection (c), like Delaware law, assigns to the plaintiff the threshold burden of alleging facts establishing that the majority of the directors on the board are not qualified. If there is a majority, then the burden remains with the plaintiff to plead and establish that the requirements of subsection (a) section 7.44(a) have not been met. If there is not a majority of qualified directors on the board, then the burden is on the corporation to prove that the issues delineated in subsection (a) have been satisfied; that is, the corporation must prove both the eligibility of the decision makers to act on the matter and the propriety of their inquiry and determination. Thus, the burden of proving that the requirements of subsection (a) have not been met will remain with the plaintiff in several situations. First, where the determination to dismiss the derivative proceeding is made in accordance with subsection (b)(1), the burden of proof will generally remain with the plaintiff since the subsection requires a quorum of qualified directors and a quorum is normally a majority. See section 8.24. The burden will also remain with the plaintiff if a majority of qualified directors has appointed a committee under subsection (b)(2), and the qualified directors constitute a majority of the board. Under subsection (e), the burden of proof also remains with the plaintiff in the case of a determination by a panel appointed by the court. The burden of proof will shift to the corporation, however, where a majority of the board members are not qualified and the determination is made by a committee under subsection (b) (2). It can be argued that, if the directors making the determination under subsection (b)(2) are qualified and have been delegated full responsibility for making the decision, the composition of the entire board is irrelevant. This argument is buttressed by the section's method of appointing the group specified in

subsection (b)(2), since it departs from the general method of appointing committees and allows only qualified directors, rather than a majority of the entire board, to appoint the committee that will make the determination. Subsection (d)'s response to objections suggesting structural bias is to place the burden of proof on the corporation (despite the fact that the committee making the determination is composed exclusively of qualified directors).

Finally, section 7.44 does not authorize the court to review the reasonableness of the determination to reject a demand or seek dismissal. This contrasts with the approach in some states that permits a court, at least in some circumstances, to review the merits of the determination (see *Zapata Corp. v. Maldonado*, 430 A.2d 779, 789 (Del. 1981)) and is similar to the approach taken in other states (see *Auerbach v. Bennett*, 393 N.E.2d 994, 1002-03 (N.Y. 1979)).

3. Pleading

The Model Act previously provided that the complaint in a derivative proceeding must allege with particularity either that demand had been made on the board of directors, together with the board's response, or why demand was excused. This requirement is similar to rule 23.1 of the Federal Rules of Civil Procedure. Since demand is now required in all cases, this provision is no longer necessary.

Subsection (c) sets forth a modified pleading rule to cover the typical situation where the plaintiff makes demand on the board, the board rejects that demand, and the plaintiff commences an action. In that scenario, in order to state a cause of action, subsection (c) requires the complaint to allege with particularity facts demonstrating either (1) that no majority of qualified directors exists or (2) why the determination made by qualified directors does not meet the standards in subsection (a). Discovery should be available to the plaintiff only after the plaintiff has successfully stated a cause of action by making either of these two showings.

§ 7.45. DISCONTINUANCE OR SETTLEMENT

A derivative proceeding may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interests of the corporation's shareholders or a class of shareholders, the court shall direct that notice be given to the shareholders affected.

CROSS-REFERENCES

"Derivative proceeding" defined, see § 7.40.
"Shareholder" defined, see § 7.40.

OFFICIAL COMMENT

Section 7.45 follows the Federal Rules of Civil Procedure and the statutes of a number of states, and requires that all proposed settlements and discontinuances must receive judicial approval. This requirement seems a natural consequence of the proposition that a derivative suit is brought for the benefit of all shareholders and avoids many of the evils of the strike suit by preventing the individual shareholder-plaintiff from settling privately with the defendants.

Section 7.45 also requires notice to all affected shareholders if the court determines that the proposed settlement may substantially affect their interests. This provision permits the court to decide that no notice need be given if, in the court's judgment, the proceeding is frivolous or has become moot. The section also makes a distinction between classes of shareholders, an approach which is not in Federal Rule of Civil Procedure 23.1, but is adapted from the New York and Michigan statutes. This procedure could be used, for example, to eliminate the costs of notice to preferred shareholders where the settlement does not have a substantial effect on their rights as a class, such as their rights to dividends or a liquidation preference.

Unlike the statutes of some states, section 7.45 does not address the issue of which party should bear the cost of giving this notice. That is a matter left to the discretion of the court reviewing the proposed settlement.

§ 7.46. PAYMENT OF EXPENSES

On termination of the derivative proceeding the court may:

(1) order the corporation to pay the plaintiff's expenses incurred in the proceeding if it finds that the proceeding has resulted in a substantial benefit to the corporation;

(2) order the plaintiff to pay any defendant's expenses incurred in defending the proceeding if it finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose; or

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

CROSS-REFERENCES

"Derivative proceeding" defined, see § 7.40.

"Expenses" defined, see § 1.40.

OFFICIAL COMMENT

Section 7.46(1) is intended to be a codification of existing case law. See, e.g., *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970). It provides that the court may order the corporation to pay the plaintiff's expenses (as defined in section 1.40(9AA) if it finds that the proceeding has resulted in a substantial benefit to the corporation. The subsection requires that there be a "substantial" benefit to the corporation to prevent the plaintiff from proposing inconsequential changes in order to justify the payment of counsel fees. The subsection does not specify the method

for calculating attorneys' fees since there is a substantial body of court decisions delineating this issue, which usually includes taking into account the amount or character of the benefit to the corporation.

Section 7.46(2) provides that on termination of a proceeding the court may require the plaintiff to pay the defendants' expenses if it finds that the proceeding "was commenced or maintained without reasonable cause or for an improper purpose." The phrase "for an improper purpose" has been added to parallel Federal Rule of Civil Procedure 11 in order to prevent proceedings which may be brought to harass the corporation or its officers. The test in this section is similar to but not identical with the test utilized in section 13.31, relating to dissenters' rights, where the standard for award of expenses is that dissenters "acted arbitrarily, vexatiously or not in good faith" in demanding a judicial appraisal of their shares. The derivative action situation is sufficiently different from the dissenters' rights situation to justify a different and less onerous test for imposing costs on the plaintiff. The test of section 7.46 that the action was brought without reasonable cause or for an improper purpose is appropriate to deter strike suits, on the one hand, and on the other hand to protect plaintiffs whose suits have a reasonable foundation.

Section 7.46(3) has been added to deal with other abuses in the conduct of derivative litigation which may occur on the part of the defendants and their counsel as well as by the plaintiffs and their counsel. The section follows generally the provisions of rule 11 of the Federal Rules of Civil Procedure. Section 7.46(3) will not be necessary in states which already have a counterpart to rule 11.

§ 7.47. APPLICABILITY TO FOREIGN CORPORATIONS

In any derivative proceeding in the right of a foreign corporation, the matters covered by this subchapter shall be governed by the laws of the jurisdiction of incorporation of the foreign corporation except for sections 7.43, 7.45, and 7.46.

CROSS-REFERENCES

"Derivative proceeding" defined, see § 7.40.

Foreign corporations, generally, see §§ 15.01–15.32.

OFFICIAL COMMENT

Section 7.47 clarifies the application of the provisions of subchapter D to foreign corporations. Previous section 7.40 referred to proceedings in the right of both domestic and foreign corporations, but neither the section nor the comment discussed the interaction between section 7.40 as it applied to a foreign corporation and the law of its state of incorporation. Under generally prevailing practice, a court will look to the choice-of-law rules of the forum state to determine which law shall apply. If the issue is "procedural,' the law of the forum state will apply; if the issue is "substantive," relating to the internal affairs of the corporation, the law of the state of incorporation will apply. See, e.g., *Hausman v. Buckley*, 299 F.2d 696, 700–06 (2d Cir. 1962); *Galef v. Alexander*, 615 F.2d 51 (2d Cir. 1980). Compare RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 302, 303, 304, 306, 309 (1988) (the local law of the state of incorporation will be applied except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship under the principles stated in section 6 of the Restatement to the parties and the corporation or the transaction).

However, the distinction between what is procedural and what is substantive is not clear. See, e.g., *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 555–57 (1949). For example, in *Susman v. Lincoln American Corp.*, 550 F. Supp. 442, 446 n.6 (N.D. Ill. 1982), the court suggested that the standing requirement might be considered a federal procedural question under Federal Rule of Civil Procedure 23.1 and a matter of substantive law under the Delaware statute.

In view of the uncertainties created by these decisions, section 7.47 sets forth a choice of law provision for foreign corporations. It provides, subject to three exceptions, that the matters covered by the subchapter shall be governed by the laws of the jurisdiction of incorporation of the foreign corporation. In this respect, the section is similar to section 901 of the Revised Uniform Limited Partnership Act which provides that the laws of the state under which a foreign limited

partnership is organized govern its organization and internal affairs.

The three exceptions to the general rule are areas which are traditionally part of the forum's oversight of the litigation process: section 7.43, dealing with the ability of the court to stay proceedings; section 7.45, setting forth the procedure for settling a proceeding; and section 7.46, providing for the assessment of reasonable expenses (including counsel fees) in certain situations.

HISTORY

Model Act Derivation

1950 Act	No provision
1960 Act	§ 43A (optional), amended in 1962
1969 Act	§ 49, amendment proposed, 37 BUS. LAW. 261 (1981)
1984 Act	§§ 7.40–7.47, added by amendment, proposed 44 BUS. LAW. 543 (1989), adopted 45 BUS. LAW. 1241 (1990)

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	§ 7.48. SHAREHOLDER ACTION TO APPOINT CUSTODIAN OR RECEIVER (a) The [name or describe court or courts] 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 where it is established that: (1) the 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 being suffered; or (2) the directors or those in control of the corporation are acting fraudulently and irreparable injury to the corporation is threatened or being suffered. (b) The court (1) may issue injunctions, appoint a temporary custodian or temporary receiver with all the powers and duties the court directs, take other action to preserve the corporate assets wherever located, and carry on the business of the corporation until a full hearing is held; (2) shall hold a full hearing, after notifying all parties to the proceeding and any interested persons designated by the court, before appointing a custodian or receiver; and (3) has jurisdiction over the corporation and all of its property, wherever located. (c) The court may appoint an individual or domestic or foreign corporation (authorized to transact business in this state) as a custodian or receiver and may require the custodian or receiver to post bond, with or without sureties, in an amount the court directs.

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	(d) The court shall describe the powers and duties of the custodian or receiver in its appointing order, which may be amended from time to time. Among other powers, (1) a custodian may exercise all of the powers of the corporation, through or in place of its board of directors, to the extent necessary to manage the business and affairs of the corporation; and (2) a receiver (i) may dispose of all or any part of the assets of the corporation wherever located, at a public or private sale, if authorized by the court; and (ii) may sue and defend in the receiver's own name as receiver in all courts of this state. (e) The court during a custodianship may redesignate the custodian a receiver, and during a receivership may redesignate the receiver a custodian, if doing so is in the best interests of the corporation. (f) The court from time to time during the custodianship or receivership may order compensation paid and expense disbursements or reimbursements made to the custodian or receiver from the assets of the corporation or proceeds from the sale of its assets. **CROSS REFERENCE** "Expenses defined, see § 1.40. **OFFICIAL COMMENT** Previously, the Model Act's procedures for the appointment of a receiver or custodian were ancillary to an action for judicial dissolution under section 14.30. Section 7.48 has been added to provide a basis for relief for shareholders of any corporation, regardless of whether it is or is not a public corporation, in the two situations, both requiring a showing of actual or threatened irreparable injury, specified in (1) and (2) of section 7.48(a). These two grounds are narrower than those found in an

shareholder's action for judicial dissolution of a nonpublic corporation under section 14.30(a)(2). See the Official Comment to Section 14.30(a)(2). Section 7.48 is in addition to other shareholder remedies provided by the Act and could, for example, be sought by a shareholder of a nonpublic corporation in lieu of involuntary dissolution under section 14.30(a)(2).

HISTORY

Model Act Derivation

1984 Act — § 7.48 added by amendment proposed 60 BUS. LAW. 1577 (2005), adopted 61 BUS. LAW. 1183 (2006)

Historical Background

Section 7.48 is based on section 226 of the Delaware statute and is generally comparable to that statute, except that a third ground included in the Delaware statute, failure to dissolve, liquidate or distribute the corporate assets within a reasonable time after the corporation has abandoned its business is not a ground for appointment of a receiver or custodian under section 7.48. Instead, such a failure is a ground for judicial dissolution of the corporation under section 14.30.