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A State Of Flux For Derivative Actions In Florida

By **Andrew Polenberg** (October 18, 2018, 3:47 PM EDT)


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Behind the scenes of the Florida Business Corporation Act, or FBCA, business lawyers are debating amendments that may change how shareholders bring derivative lawsuits. At present, a rift exists between the law and the courts' ruling on the law regarding demand futility.

The demand requirement is a concept concerning shareholder derivative actions that holds that a shareholder, prior to bringing a derivative action, must first make a demand on the board of directors identifying the problematic act or issue. Proponents indicate the idea behind making a demand prior to bringing a lawsuit is that management of a corporation should have the opportunity to correct an action it has taken that may negatively impact the corporation. In Florida, the statute governing shareholders' derivative actions, Florida Statute Section 607.07401, states, with respect to demands, "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." 607.07401 then requires the shareholder to allege that either the board of directors refused the demand, ignored the demand for 90 days, or the corporation would suffer irreparable harm if made to wait 90 days to commence the action. Of note, while 607.07401 contains an alternative to waiting out the entire 90-day demand period, a demand must still be made, regardless of any alleged futility.

Comparatively, the Florida Revised Limited Liability Company Act, or FRLLCA, takes a different approach. Under Florida Statute Section 605.0802, a member of a limited liability company can maintain a derivative action if the member first makes a demand, or if the demand "would be futile." Proponents of the demand futility provision in the FRLLCA point to the fact that the majority of LLCs in Florida are closely held, with conflicts of interest among the members leading to abuses of power and bitter disagreements. Requiring that a member make a demand to take corrective action on the manager would clearly be futile in these situations. The difference in language between the FBCA and the FRLLCA, as well as the courts' interpretation of the FBCA, has led to a debate among business lawyers concerning whether an amendment to either the FBCA or the FRLLCA is required to create a more uniform rule across Florida.

An August 2018 proposal to amend the FBCA from the Chapter 607 Drafting Subcommittee of the Florida Bar's Business Law Section simplifies the existing demand provision in the FBCA, but does not change the requirement. Under the newly proposed Florida Statute Section 607.0742, a shareholder will not be permitted to bring a derivative action until he or she has made a written demand on the

corporation to take action, and "90 days have expired from the date the 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 expiration of the 90 day period."

Underlying the demand requirement in the FBCA, either as enacted or as proposed, are the ideas that the FRLLCA allows for demand futility, and Florida courts interpret the FBCA as allowing an exception to the demand requirement based on futility. Those two ideas have opened the door to questions about whether a further amendment to the FBCA is warranted to shore up the demand requirement.

Opponents of the universal demand requirement under the FBCA might suggest adding a provision allowing for demand futility, as is the case in the FRLLCA. For all the optimistic thinking that a corporation's managers should have the opportunity to examine their actions and have a chance to correct them prior to a derivative action being filed, the demand requirement is not without its drawbacks. A majority of Florida's corporations are closely held. In closely held corporations with several directors, would the board agree to a demand alleging they have misappropriated corporate assets, or breached their fiduciary duties? Not likely, and the chances approach zero where the corporation has only one director. The requirement that a shareholder make a demand on potentially interested directors may not only be futile, but dangerous. The directors, on receiving the demand, could sit on the demand for up to 90 days. During that 90-day period, the directors can continue their potentially inappropriate conduct, and could actively work to further harm the complaining shareholder. Some states, including Delaware, New York and California, already include a demand futility exception to the demand requirement.

Aside from the law as codified, Florida's courts have been adding a demand futility exception judicially. The court in Telestrata LLC v. NetTALK.com Inc.[1] examined Florida law in stating, "Historically under Florida law, a demand on directors or shareholders need not be made if it would be impractical, unreasonable or useless. ... 'Demand on the directors to bring the action, a condition precedent to suit, is excusable where demand obviously would be unavailing.'" The problem with the courts judicially inserting an exception to the universal demand requirement, as acknowledged even by proponents of demand futility, is there is no universal standard for the courts to use when ruling on demand futility, which may lead to inconsistent rulings across Florida.

The law with respect to derivative actions in Florida is in flux. While the FRLLCA allows for members of an LLC to bring a derivative action without first making a demand on the manager if it is futile to do so, the same cannot be said under the FBCA. The FBCA requires all shareholders, regardless of perceived futility, to serve a written demand on the corporation's management prior to bringing a derivative action. Yet, even this "universal demand" may be subverted by Florida's courts adding a futility provision where none exists in the law. Irrespective of one's position, the one thing most should agree on is the need for clarification, in one direction or the other.

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[1] 2015 WL 11234143, Case No. 1:14-CV-24137-JLK (S.D. Fla., Jul. 9, 2015).