THE BENEFIT OF REQUIRING AN UNHAPPY SHAREHOLDER OR UNHAPPY MEMBER IN A CLOSELY HELD BUSINESS TO SUE DERIVATIVELY

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So, the aggrieved shareholder or member of a closely held company has brought an action against your clients, the directors or managing members of a closely-held company, claiming, among other things, that your clients breached their fiduciary duty to the company and the aggrieved shareholder or member. The courts have made it clear that this type of claim should have been brought as a derivative claim, not a direct claim. Should you let it go?

In addition to the psychological benefit of having a plaintiff's case dismissed, the additional obstacles a derivative claim must face provide significant strategic benefits. You should not let it go.

1. Demand. Before a derivative claim can be brought, the aggrieved shareholder/member must make demand upon those in control of the company take action to rectify the alleged wrong. This, then, has the benefit of forcing a plaintiff to tell those in control of the business (your clients) what to look into. Anything not included in the demand need not be looked into, and whatever else is or could be uncovered in the investigation need not be considered in deciding whether or not to bring a claim (and the plaintiff need not be apprised of whatever is so discovered). Thus, those new matters which a plaintiff would likely find through discovery do not necessarily get added to the dispute. This alone is a significant advantage.
2. Time. Both the corporate derivative statute (F.S. 607.07401(2)) and the limited liability company derivative statute (F.S. 605.0802(1)) in Florida provide a 90 day time after demand where those in control (your clients) can investigate whether to pursue the claim (unless a reparable injury is threatened to the company). This allows some cooling off period – a minor benefit –and, importantly, it allows those in control of the company to decide how best to proceed — whether to have the company pursue the claim, allow the plaintiff to pursue the claim for the company, or wait for the claim to be brought and ask the court to appoint an independent panel or special litigation committee to investigate the claim and advise the court whether it should proceed. It also allows those in control to assess the viability of the business judgement rule defense and marshal all evidence supporting that defense.
3. The Panel/Special Litigation Committee. Both the corporate derivative statute (F.S. 607.0740(3)(c)) and the limited liability statute (F.S. 605.0804) in Florida permit the company to ask the court to appoint a panel or special litigation committee to investigate the matter and to stay the action pending that investigation. Such a panel/committee necessarily is made up of disinterested people with no axe to grind against your clients and, presumably, an understanding of the impact the business judgment rule has on the wisdom of expending the time, energy and expense of pursuing claims against directors or managing members. This provides a real opportunity to have dispassionate decision

makers assess the cost/benefit of pursuing a breach of fiduciary claim against your clients, a circumstance far more favorable to your clients than simply defending those claims in the hands of the aggrieved shareholder/member.

It does matter! You should definitely force the plaintiff to pursue the claims derivatively.

For more information on this topic, please contact the author, Ben Zuckerman, on the firm's Dispute Resolution Team.

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