

MEMORANDUM
DIRECT vs. DERIVATIVE

This Memorandum outlines the progress of the Study Group in constructing a guide for navigating direct and derivative actions, aiming for a more uniform approach among judges when dealing with these types of cases.

THE STUDY GROUP

The Study Group was formed and met on a few occasions. The group received materials from Louis Conti and Donna Litman, but did not receive any representations.

The Study Group agreed that there was no issue with the language itself, but there was a concern about providing judges with sufficient materials to ensure uniformity in handling direct and derivative actions. Additionally, the group identified further issues stemming from the application of the statute.

The Group reached out to the BLS Fellows. A meeting was held where the project was presented, but no further action was taken thereafter. Also, there has been no meeting with Donna and Lou to discuss the issues and move the matter forward.

I. ANCILLARY ISSUES.

The Study Group has identified the following ancillary issues regarding direct v. derivative actions:

- (1) Does the ninety (90) day window to purchase shares in response to an action to dissolve terminate if a voluntary dismissal of the court for dissolution is filed?
- (2) Can a derivate claim be dismissed only with court approval? Is that approval needed for each derivative count, or only as to an entire action?
- (3) Under the provisions allowing for fees and costs upon dismissal based on the determination of independent board members, the court must make a finding that the claim was not brought in good faith. That determination would reopen litigation as to all of the matters which were just resolved by dismissal. So, it is not usable
- (4) In cases where direct and derivate claims are brought, the court generally orders that separate claims must be filed for the direct action by a dismissal order. The court may also sever the claims
- (5) 50/50 owners who deadlocked, dissolution/buy out. Who pays the fees? Automatic Direct?

(6) Counterclaims/set off by the company; Managing legal actions from the company in response to claims.

(7) Buy out the minority for a dissolution - should control shift during a minority-initiated dissolution?

II. APPLICABLE FLORIDA STATUTES

i. Fla Stat. §605.0801

(1) Subject to subsection (2), a member may maintain a direct action against another member, a manager, or the limited liability company to enforce the member's rights and otherwise protect the member's interests, including rights and interests under the operating agreement or this chapter or arising independently of the membership relationship.

(2) A member maintaining a direct action under this section must plead and prove either:

(a) An actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company; or

(b) An actual or threatened injury resulting from a violation of a separate statutory or contractual duty owed by the alleged wrongdoer to the member, even if the injury is in whole or in part the same as the injury suffered or threatened to be suffered by the limited liability company.

ii. Fla. Stat. §607.0750

(1) Subject to subsection (2), a shareholder may maintain a direct action against another shareholder, an officer, a director, or the company, to enforce the shareholder's rights and otherwise protect the shareholder's interests, including rights and interests under the articles of incorporation, the bylaws or this chapter or arising independently of the shareholder relationship.

(2) A shareholder maintaining a direct action under this section must plead and prove either:

(a) An actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the corporation; or

(b) An actual or threatened injury resulting from a violation of a separate statutory or contractual duty owed by the alleged wrongdoer to the shareholder, even if the injury is in whole or in part the same as the injury suffered or threatened to be suffered by the corporation.

III. CASE STUDIES¹

- **CASE A**

Three (3) members: one serves as a personal guarantor on the lease, while the other two are not. The two non-guarantor members have decided to discontinue the business, which will cause the company to default operations.

Preliminary notes: the first issue is whether this is a valid claim by the minority. Presuming it is, this seems to be a direct action, because these are special damages to the member, which are the same damages in the amount, but there are unique damages against him.

- **CASE B**

Two (2) members, one serving as the manager. The manager member has misappropriated the funds for personal use. The Operating Agreement is silent on this issue.

Preliminary notes: this case is a classic example of a derivative action, as the damages are suffered by the company in the full amount of the absconded funds. However, an argument could be made for a direct action by the sole remaining member, since they are effectively the only party harmed for their 50% share. Additionally, the company may have grounds to claim special damages if the funds were intended for a specific purpose that the individual member cannot assert.

It seems appropriate to continue treating this as a derivative action for the full amount of the misappropriated funds, with the possibility of reducing the award by 50% if it is ultimately granted to the member rather than the company.

- **CASE C**

Two (2) members, one serving as the manager. The operating agreement requires the manager to obtain the other member's approval for any financial transactions. However, the manager has misappropriated the funds without obtaining such approval.

Preliminary notes: this situation is more complex than Case A because, under §607.0750, and due to the specific language of the operating agreement, arguably gives us both “an injury that is not solely the result of an injury suffered by the corporation” and “an actual or threatened injury resulting from a violation of a separate...contractual duty.” The key question here is whether a direct action can be filed concurrently (albeit separately) with a derivative action.

¹ For the purpose of the following case studies, LLCs and corporations are treated as equivalent.

Likely the answer is yes, and the issue of recovery – specifically avoiding double recovery – requires skilled counsel to coordinate both actions effectively.

IV. DIRECT V. DERIVATIVE UNDER FLORIDA CASE LAW

(i) *In General*

Depending on the nature of the rights asserted and the resulting damages, a claim may be brought as either a direct or derivative.

Overall, when the suit aims at vindicating a unique shareholder right or to redress a unique harm to that particular shareholder, the action is direct.² See *Fox v. Prof 1 Wrecker Operators of Fla., Inc.*, 801 So. 2d 175, 179 (Fla. 5th DCA 2001). Shareholders may bring a direct suit only in their own right to redress an injury sustained directly by them individually. *Karten v. Woltin*, 23 So. 3d 839, 840 (Fla. 4th DCA 2009).

When the suit seeks to address a harm affecting the corporation as a whole or to enforce a right of the corporation, the action is derivative. *Fox*, 801 So. 2d 175, 179 (Fla. 5th DCA 2001).

(ii) Direct v. Derivative under the First District Court of Appeal

- *Iezzi Family Ltd. P' ship v. Edgewater Beach Owners Ass'n, Inc.*, 254 So. 3d 584, 586 (Fla. 1st DCA 2018)
- *Leppert v. Lakebreeze Homeowners Ass'n, Inc.*, 500 So. 2d 250, 252 (Fla. 1st DCA 1986)

(iii) Direct v. Derivative under the Second District Court of Appeal

- *Citizens National Bank of St. Petersburg v. Peters*, 175 So. 2d 54 (Fla. 2d DCA 1965)
- *Alario v. Miller*, 354 So.2d 925 (Fla. 2d DCA 1978)

(iv) Direct v. Derivative under the Third District Court of Appeal

- *Orlinsky v. Patraka*, 971 So. 2d 796 (Fla. 3d DCA 2007)
- *Dinuro Investments, LLC v. Camacho*, 141 So. 3d 731 (Fla. 3d DCA 2014)
- *Talcott, Inc. v. McDowell*, 148 So.2d 36 (Fla. 3d DCA 1962)
- *Karnegis v. Lazzo*, 243 So.2d 642 (Fla. 3d DCA 1971)
- *Wolfe v. American Sav. and Loan Ass'n*, 539 So. 2d 606 (Fla. 3d DCA 1989).
- *OPKO Health, Inc. v. Lipsius*, 279 So. 3d 787, 791 (Fla. 3d DCA 2019) (dealing with multiple derivative suits).
- *Kaplus v. First Continental Corp.*, 711 So. 2d 108, 110 (Fla. 3d DCA 1998)

² §18.3.G, Chapter 18, *Business Litigation Involving Florida Business Organizations*, D. Hibbard.

(v) Direct v. Derivative under the Fourth District Court of Appeal

- *Karten v. Woltin*, 23 So. 3d 839, 840 (Fla. 4th DCA 2009)
- *Chemplex Fla. v. Norelli*, 790 So. 2d 547 (Fla. 4th DCA 2001)
- *Braun v. Buyers Choice Mortg. Corp.*, 851 So. 2d 199, 203 (Fla. 4th DCA 2003)
- *Fort Pierce Corp. v. Ivey*, 671 So. 2d 206, 207 (Fla. 4th DCA 1996)
- *South End Improvement Group, Inc. v. Mulliken*, 602 So. 2d 1327, 1330 (Fla. 4th DCA 1992)

(vi) Direct v. Derivative under the Fifth District Court of Appeal

- *Fox v. Prof 1 Wrecker Operators of Fla., Inc.*, 801 So. 2d 175, 179 (Fla. 5th DCA 2001).
- *Timko v. Triarsi*, 898 So. 2d 89, 91 (Fla. 5th DCA 2005)
- *Strazzulla v. Riverside Banking Co.*, 175 So. 3d 879, 883 (Fla. 4th DCA 2015)

V. APPLICATION OF FLORIDA LAW TO CASE STUDIES

- (i) Case A under Florida case law
- (ii) Case B under Florida case law
- (iii) Case C under Florida case law

VI. DIRECT V. DERIVATIVE IN OTHER JURISDICTIONS: DELAWARE

VII. ADDITIONAL ISSUES TO CONSIDER

- 1. THE 2020 AMENDMENTS TO THE LLC & BUSINESS CORPORATION ACTS: A WORKABLE SOLUTION FOR FLORIDA JUDGES WHEN CONDUCTING THE DIRECT VERSUS DERIVATIVE ANALYSIS?**
- 2. DIRECT AND DERIVATIVE TOGETHER: SHOULD ONE BE DISMISSED?**