

BILL ANALYSIS

C.S.H.B. 3603
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Judiciary & Civil Jurisprudence
Committee Report (Substituted)

BACKGROUND AND PURPOSE

It has been noted that the Business Organizations Code provisions governing derivative proceedings for limited partnerships, limited liability companies, and for-profit corporations were developed from diverse sources of law, causing the current statute to be less consistent than is desirable. In particular, provisions governing these proceedings for limited partnerships differ significantly from those applicable to the other two organizational types. C.S.H.B. 3603 seeks to remedy such inconsistencies by revising the applicable statutes.

CRIMINAL JUSTICE IMPACT

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

C.S.H.B. 3603 amends the Business Organizations Code to revise and harmonize provisions relating to derivative proceedings involving a for-profit corporation, a limited liability company, and a limited partnership.

C.S.H.B. 3603, with regard to a for-profit corporation, revises provisions relating to the following:

- the applicable definition of "shareholder";
- a shareholder's standing to institute or maintain a derivative proceeding if a corporation is the converted entity in a conversion and the proceeding is based on an act or omission that occurred with respect to the converting entity before the date of the conversion;
- the termination under certain circumstances of a required waiting period between the filing of a written demand with the corporation and the institution of a derivative proceeding;
- a determination made by independent and disinterested directors, by a committee of such directors, or by a court-appointed panel of independent and disinterested individuals of how to proceed on applicable allegations;
- a court's stay of a proceeding while the specified person or group of persons conducts in good faith on behalf of the corporation an active review of the allegations, and procedures for continuing the stay;
- the scope of discovery by a shareholder after the corporation moves to dismiss the proceeding based on the outcome of such an active review;

- conditions under which a court is required to grant such a motion to dismiss by the corporation;
- the period for which the filing of the initial written demand tolls the statute of limitations;
- an award of reasonable expenses incurred by a party;
- the extent to which statutory provisions relating to derivative proceedings apply to a foreign corporation; and
- an exemption from the bill's provisions relating to the conduct of derivative proceedings for a claim or a derivative proceeding by a shareholder of a closely held corporation against a director, officer, or shareholder of that corporation, and the extent to which such a claim or proceeding may be treated as a direct action by the shareholder against the applicable person.

C.S.H.B. 3603, with regard to a limited liability company, revises provisions relating to the following:

- the applicable definitions of "managing entity" and "member";
- the standing of a member to institute or maintain a derivative proceeding, defined by reference as a civil suit in the right of the company, if a limited liability company is the converted entity in a conversion and the proceeding is based on an act or omission that occurred with respect to the converting entity before the date of the conversion;
- the termination under certain circumstances of a required waiting period between the filing of a written demand with the limited liability company and the institution of a derivative proceeding;
- a determination made by the independent and disinterested governing persons of the limited liability company, by a committee of such governing persons, or by a court-appointed panel of independent and disinterested individuals of how to proceed on applicable allegations, including conditions determining whether a managing entity of the company or an entity that is directly or indirectly a governing person of that managing entity is an independent and disinterested entity for this purpose;
- a court's stay of a proceeding while the specified person or group of persons conducts in good faith on behalf of the limited liability company an active review of the allegations, and procedures for continuing the stay;
- the scope of discovery by a member after the limited liability company moves to dismiss the proceeding based on the outcome of such an active review;
- conditions under which a court is required to grant such a motion to dismiss by the limited liability company;
- the period for which the filing of the initial written demand tolls the statute of limitations;
- an award of reasonable expenses incurred by a party;
- the extent to which statutory provisions relating to derivative proceedings apply to a foreign limited liability company; and
- an exemption from the bill's provisions relating to the conduct of derivative proceedings for a claim or a derivative proceeding by a member of a closely held limited liability company against a governing person, member, or officer of that company, and the extent to which such a claim or proceeding may be treated as a direct action by the member against the applicable person.

C.S.H.B. 3603, with regard to a limited partnership, revises and replaces applicable provisions as follows:

- establishes applicable definitions of "derivative proceeding" and "limited partner";

- removes provisions relating to a limited partner's right to bring a derivative action and sets out provisions relating instead to a limited partner's standing to institute or maintain a derivative proceeding;
- removes a provision prescribing the content of a complaint; and
- sets out provisions relating to a required waiting period between the filing of a written demand with the limited partnership and the institution of a derivative proceeding.

The bill removes provisions relating to a court's authority to require the plaintiff to give security for the reasonable expenses of a defendant and to the award of such expenses. The bill sets out provisions relating to the following:

- a determination made by the independent and disinterested general partners, by a committee of such general partners, or by a court-appointed panel of independent and disinterested individuals of how to proceed on applicable allegations, including conditions determining whether an entity that is a general partner or is directly or indirectly a governing person of that general partner is an independent and disinterested entity for this purpose;
- a court's stay of a proceeding while the specified person or group of persons conducts in good faith on behalf of the limited partnership an active review of the allegations, and procedures for continuing the stay;
- the scope of discovery by a limited partner after the limited partnership moves to dismiss the proceeding based on the outcome of such an active review;
- conditions under which a court is required to grant such a motion to dismiss by the limited partnership;
- the period for which the filing of the initial written demand for action tolls the statute of limitations;
- requirements for the nature of allegations in a petition to institute a proceeding after a written demand is rejected;
- dismissal, discontinuance, or settlement of the proceeding;
- awards of expenses incurred by a party;
- the extent to which statutory provisions relating to derivative proceedings apply to a foreign limited partnership; and
- an exemption from the bill's provisions relating to the conduct of derivative proceedings for a claim or a derivative proceeding by a limited partner of a closely held limited partnership against a general partner, limited partner, or officer of that limited partnership, and the extent to which such a claim or proceeding may be treated as a direct action by the limited partner against the applicable person.

EFFECTIVE DATE

September 1, 2019.

COMPARISON OF ORIGINAL AND SUBSTITUTE

While C.S.H.B. 3603 may differ from the original in minor or nonsubstantive ways, the following summarizes the substantial differences between the introduced and committee substitute versions of the bill.

The substitute makes certain clarifying changes, including replacing references to the surviving entity in a conversion with references to the converted entity.