

BILL ANALYSIS

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By: Hancock
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Background

A derivative proceeding is a legal action brought by a business entity owner on behalf of the business entity against a third-party. These types of actions are evolving in complexity and increasing with investor sophistication and awareness.

Currently, the Business Organizations Code (BOC) provides for derivative actions with respect to for-profit corporations, limited liability companies (LLC), and limited partnerships, but the provisions are somewhat antiquated and not consistent in application. There is also confusion as to applicability to non-Texas business entities.

A key function of the BOC is to provide uniformity for similar procedural actions by different business entities. The bill addresses this uniformity for corporations, LLCs, and limited partnerships, and updates and improves the procedures to provide better efficiency, practicality, and less confusion.

Bill Analysis

The existing provisions governing derivative proceedings in the BOC for limited partnerships, LLCs and for-profit corporations were derived from the precedent statutes that governed those types of entities. Accordingly, those derivative proceeding provisions governing limited partnerships are completely different from those provisions governing LLCs and for-profit corporations, and those provisions governing LLCs and for-profit corporations are similar to each other. As a policy matter, there is no good reason for the derivative proceeding provisions in the BOC for limited partnerships to be different from those for LLCs. Accordingly, the primary purpose of the amendments in this bill is to make similar the derivative proceedings provisions governing for-profit corporations, LLCs and limited partnerships.

- a. The amendments narrow the exception to most of the conditions to a derivative proceeding for LLCs and for-profit corporations with 35 or fewer owners. Under the existing provisions, a single minority owner of a LLC or for-profit corporation to which the exception applies may file a derivative action on behalf of the entity for any purpose, including, for example, an action against a counterparty on a contract or to collect an indebtedness. There is no good policy reason why a single owner should be permitted to force those kinds of derivative proceedings on the entity where there is no conflict involving management or other owners of the entity. Accordingly, the amendments revise the exception to limit the actions for which a member or shareholder can file a derivative proceeding on behalf of the LLC or corporation to claims or actions against managers, members, directors, officers or other owners of the entity.
- b. The demand futility exception contained in the existing provisions for limited partnerships is eliminated. If the 35-or-fewer-limited-partner exception does not apply, any derivative proceeding on behalf of the limited partnership by a limited partner must comply with the requirements to notify the limited partnership and allow a determination to be made by the disinterested and independent general partners as to whether the limited partnership should pursue the claim.

- c. A new definition of “limited partner” for derivative proceedings of limited partnerships includes assignees of limited partners. Assignees have an economic interest in protecting the limited partnership and should have rights of this nature. This change is similar to the beneficial owner concepts that are already recognized in the derivative proceeding provisions for-profit corporations and LLCs.
- d. Provisions are added that clarify how a determination of disinterested and independent governing persons to pursue a derivative claim on behalf of a limited partnership or LLC is to be accomplished where (i) any governing person is an entity, or (ii) there are one or more other entities that own a governing person entity of the limited partnership or LLC. In these situations, there needs to be clear guidance that the determination is to be made by disinterested and independent individuals acting as direct or indirect governing persons of the underlying limited partnership or LLC.
- e. The amendments clarify the application of the specified procedures and requirements to foreign LLCs and corporations. Existing BOC provisions governing derivative proceedings contain scattered references to “domestic or foreign” which create confusion as to whether those references are intended to supersede the particular section that specifies what provisions apply, and how they apply, to foreign LLCs or corporations.
- f. The definition of “member” for derivative proceedings of LLCs is expanded to include assignees of membership interests. Assignees have a legitimate economic interest that should entitle them to derivative rights. The LLC provisions already allow beneficial owners of membership interests that are held by nominees to file derivative proceedings on behalf of the LLC. The inclusion of the assignee concept is not a substantial change as a result.

As proposed, S.B. 1972 amends current law relating to derivative proceedings on behalf of for-profit corporations, limited liability companies, and limited partnerships.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 21.551(2), Business Organizations Code, to redefine "shareholder" to mean a shareholder as defined by Section 1.002 (Definitions) or a beneficial owner whose shares are held in a voting trust or by a nominee on the beneficial owner's behalf.

SECTION 2. Amends Section 21.552, Business Organizations, Code, as follows:

Sec. 21.552. STANDING TO BRING PROCEEDING. (a) Creates this subsection from existing text. Prohibits a shareholder, subject to Subsection (b), from instituting or maintaining a derivative proceeding unless:

(1) the shareholder:

(A) makes no changes to this paragraph;

(B) makes a nonsubstantive change to this paragraph; and

(2) makes no changes to this subdivision.

(b) Prohibits a shareholder of an entity, if a corporation is the surviving form of that entity in a conversion, from instituting or maintaining a derivative proceeding based on an act or omission that occurred with respect to the converting entity before the date of the conversion unless:

(1) the shareholder was an equity owner of the converting entity at the time of the act or omission; and

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

SECTION 3. Amends Section 21.553(b), Business Organizations Code, as follows:

(b) Provides that the waiting period required by Subsection (a) (relating to prohibiting a shareholder from instituting a derivative proceeding until a certain waiting period has elapsed) before a derivative proceeding may be instituted is not required or, if applicable, is required to terminate if:

(1) the shareholder has been notified, rather than previously notified, that the demand has been rejected by the corporation; or

(2)–(3) makes no changes to these subdivisions.

SECTION 4. Amends Section 21.554, Business Organizations Code, as follows:

Sec. 21.554. DETERMINATION BY DIRECTORS OR INDEPENDENT PERSONS. (a) Requires a determination of how to proceed on allegations made in a demand or petition relating to a derivative proceeding to be made by an affirmative vote of the majority of:

(1) all independent and disinterested directors of the corporation, regardless of whether the independent and disinterested directors constitute a quorum of the board of directors, rather than the independent and disinterested directors of the corporation present at a meeting of the board of directors of the corporation at which interested directors are not present at the time of the vote if the independent and disinterested directors constitute a quorum of the board of directors;

(2) a committee consisting of one or more independent and disinterested directors appointed by an affirmative vote of the majority of one or more independent and disinterested directors, rather than a committee consisting of two or more independent and disinterested directors appointed by an affirmative vote of the majority of one or more independent and disinterested directors present at a meeting of the board of directors, regardless of whether the independent and disinterested directors constitute a quorum of the board of directors; or

(3) makes nonsubstantive changes to this subdivision.

(b) Makes a nonsubstantive changes to this subsection.

SECTION 5. Amends Section 21.555, Business Organizations Code, as follows:

Sec. 21.555. STAY OF PROCEEDING. Requires the court, if the corporation, rather than the domestic or foreign corporation, that is the subject of a derivative proceeding commences an inquiry into the allegations made in a demand or petition and the person or group of persons described by Section 21.554 is conducting an active review of the allegations in good faith, to stay a derivative proceeding for not more than 60 days until the review is completed and a determination is made by the person or group regarding what further action, if any, should be taken.

(b) Makes conforming and nonsubstantive changes to this subsection.

(c) Creates this subsection from existing text. Authorizes a stay, on motion, to be reviewed every 60 days for continuation of the stay if the corporation provides the

court and the shareholder with a written statement of the status of the review and the reasons why an extension for a period not to exceed 60 additional days is appropriate, rather than authorizes a stay, on application, to be reviewed every 60 days for the continued necessity of the stay. Requires an extension to be granted for a period not to exceed 60 days if the court determines that the continuation is appropriate in the interests of the corporation.

Deletes existing Subsection (c) authorizing the stay, if the review and determination made by the person or group is not completed before the 61st day after the stay is ordered by the court, to be renewed for one or more additional 60-day periods if the domestic or foreign corporation provides the court and the shareholder with a written statement of the status of the review and the reasons why a continued extension of the stay is necessary.

SECTION 6. Amends Section 21.556, Business Organizations Code, as follows:

Sec. 21.556. DISCOVERY. (a) Requires discovery by a shareholder after the filing of the derivative proceeding in accordance with this subchapter (Derivative Proceedings), if a corporation, rather than domestic or foreign corporation, proposes to dismiss a derivative proceeding under Section 21.558 to be limited to:

(1) facts relating to whether the person or persons described by Section 21.554 are, rather than the person or group of persons described by Section 21.558 is, independent and disinterested; and

(2)–(3) makes no changes to these subdivisions.

(b) Prohibits discovery described by Subsection (a) from being expanded to include a fact or substantive matter regarding the act, omission, or other matter that is the subject matter of the derivative proceeding but requires the scope of discovery to not be so limited if the court determines after notice and hearing that a good faith review of the allegations has not been made by an independent and disinterested person or group in accordance with Sections 21.554 and 21.558. Makes a nonsubstantive change and deletes existing text authorizing the scope of discovery to be expanded under certain conditions.

SECTION 7. Amends Section 21.557, Business Organizations Code, as follows:

Sec. 21.557. TOLLING OF STATUTE OF LIMITATIONS. (a) Provides that a written demand filed with the corporation under Section 21.553 tolls the statute of limitations on the claim on which demand is made until the later, rather than the earlier, of:

(1) the 31st day after the expiration of any waiting period under Section 21.553, rather than the 91st day after the date of the demand; or

(2) the 31st day after the expiration of any stay granted under Section 21.555, including all continuations of the stay, rather than the 31st day after the date the corporation advises the shareholder that the demand has been rejected or the review has been completed.

SECTION 8. Amends Section 21.558, Business Organizations Code, as follows:

Sec. 21.558. DISMISSAL OF DERIVATIVE PROCEEDING. (a) Requires a court, sitting in equity as the finder of fact, to dismiss a derivative proceeding on a motion by the corporation if the person or group of persons described by Section 21.554 determines in good faith, after conducting a reasonable inquiry and based on factors the person or group considers appropriate under the circumstances, that continuation of the derivative proceeding is not in the best interests of the corporation.

(b) Requires the burden of proof, in determining whether the requirements of Subsection (a) have been met, to be on:

(1) the plaintiff shareholder if:

(A)-(B) makes no changes to these paragraphs; or

(C) the corporation presents prima facie evidence that demonstrates that the applicable person or persons making the determination under Section 21.554(a) are independent and disinterested, rather than prima facie evidence that demonstrates that the directors appointed under Section 21.554(a)(2) are independent and disinterested; or

(2) makes no changes to this subdivision.

SECTION 9. Amends Section 21.559, Business Organizations Code, as follows:

Sec. 21.559. New heading: ALLEGATIONS AFTER DEMAND REJECTED. Requires the petition, if a derivative proceeding is instituted after a demand is rejected, to allege with particularity facts that establish that the rejection was not made in accordance with the requirements and standards under, rather than the requirement of, Sections 21.554 and 21.558.

SECTION 10. Amends Section 21.561. Business Organizations Code, as follows:

Sec. 21.561. PAYMENT OF EXPENSES. Redefines "expenses" to mean reasonable expenses incurred by a party in a derivative proceeding, including:

(1)-(2) makes no changes to these subdivisions; or

(3) expenses for which the corporation may be required to indemnify another person, rather than expenses for which the domestic or foreign corporation or a corporate defendant may be required to indemnify another person.

(b) Makes nonsubstantive changes and authorizes the court, on termination of a derivative proceeding, to:

(1)-(2) makes conforming and nonsubstantive changes to these subdivisions; or

(3) a party to pay expenses incurred by another party relating to the filing of a pleading, motion, or other paper if the court finds the pleading, motion, or other paper:

(A) makes no changes to this paragraph;

(B) was not warranted by existing law or a good faith argument for the application, extension, modification, or reversal of existing law, rather than the extension, modification, or reversal of existing law; or

(C) makes no changes to this paragraph.

SECTION 11. Amends Section 21.562, Business Organizations Code, as follows:

Sec. 21.562. APPLICATION TO FOREIGN CORPORATIONS. (a) Provides that in a derivative proceeding brought in the right of a foreign corporation, the matters covered by this subchapter are governed by the laws of the jurisdiction of formation, rather than

incorporation, of the foreign corporation, except for Sections 21.555, 21.560 (Discontinuance of Settlement), and 21.561, which are procedural provisions and do not relate to the internal affairs of the foreign corporation, unless applying the laws of the jurisdiction of formation of the foreign corporation requires otherwise with respect to Section 21.555.

(b) Provides that in the case of matters relating to a foreign corporation under Section 21.555, a reference to a person or group of persons described by Section 21.554 refers to a person or group entitled under the laws of the jurisdiction of formation of the foreign corporation to make the determination described by Section 21.554(a), rather than providing in the case of matters relating to a foreign corporation under Section 21.554, a reference to a person or group of persons described by that section refers to a person or group entitled under the laws of the jurisdiction of incorporation of the foreign corporation to review and dispose of a derivative proceeding. Requires the standard of review of a determination made by the person or group to be governed by the laws of the jurisdiction of formation of the foreign corporation, rather than requiring the standard of review of a decision made by the person or group to dismiss the derivative proceeding to be governed by the laws of the jurisdiction of incorporation of the foreign corporation.

SECTION 12. Amends Section 21.563, Business Organizations Code, as follows:

Sec. 21.563. CLOSELY HELD CORPORATION. (a) Makes no changes to this subsection.

(b) Provides that Sections 21.552–21.560 do not apply to a claim or a derivative proceeding by a shareholder of a closely held corporation against a director, officer, or shareholder of the corporation, rather than providing that Sections 21.552–21.559 do not apply to a closely held corporation. Provides that in the event the claim or derivative proceeding is also made against a person who is not that director, officer, or shareholder, this subsection applies only to the claim or derivative proceeding against the director, officer, or shareholder.

(c) Provides that if Sections 21.552–21.560 do not apply because of Subsection (b) and if justice requires, rather than providing that if justice requires, certain actions are authorized to be taken regarding a proceeding.

(d) Provides that other provisions of state law govern whether a shareholder has a direct cause of action or right to sue a director, officer, or shareholder, and this section is prohibited from being construed to create that direct cause of action or right to sue.

SECTION 13. Amends Section 101.451, Business Organizations Code, by amending Subdivision (2) and adding Subdivision (3), as follows:

(2) Defines "managing entity."

(3) Creates this subdivision from existing text and redefines "member" to mean a person who is a member or is an assignee of a membership interest or a person who beneficially owns a membership interest through a voting trust or a nominee on the person's behalf.

SECTION 14. Amends Section 101.452, Business Organizations Code, as follows:

Sec. 101.452. STANDING TO BRING PROCEEDING. (a) Creates this subsection from existing text. Prohibits a member, subject to Subsection (b), from instituting or maintaining a derivative proceeding unless:

(1) the member:

(A) makes no changes to this paragraph; or

(B) became a member by operation of law originating from, rather than by operation of law from, a person that was a member at the time of the act or omission complained of; and

(2) makes no changes to this subdivision.

(b) Provides that if a limited liability company is the surviving form of an entity in a conversion, a member of that entity is prohibited from instituting or maintaining a derivative proceeding based on an act or omission that occurred with respect to the converting entity before the date of the conversion unless:

(1) the member was an equity owner of the converting entity at the time of the act or omission; and

(2) the member fairly and adequately represents the interests of the limited liability company in enforcing the right of the limited liability company.

SECTION 15. Amends Section 101.453(b), Business Organizations Code, as follows:

(b) Provides that the waiting period required by Subsection (a) (relating to prohibiting a member from instituting derivative proceeding until the 91st day after the date a written demand is filed) before a derivative proceeding may be instituted is not required or, if applicable, is required to terminate if, rather than is not required if:

(1) the member has been notified, rather than previously notified, that the demand has been rejected by the limited liability company; or

(2)–(3) makes no changes to these subdivisions.

SECTION 16. Amends Section 101.454, Business Organizations Code, as follows:

Sec. 101.454. DETERMINATION BY GOVERNING OR INDEPENDENT PERSONS.

(a) Requires the determination of how to proceed on allegations made in a demand or petition relating to a derivative proceeding to be made by an affirmative vote of the majority of:

(1) the independent and disinterested governing persons of the limited liability company, whether one or more, even if the independent and disinterested governing persons are not a majority of the governing persons of the limited liability company, rather than the independent and disinterested governing persons present at a meeting of the governing authority at which interested governing persons are not present at the time of the vote if the independent and disinterested governing persons constitute a quorum of the governing authority;

(2) a committee consisting of one or more independent and disinterested governing persons appointed by the majority of one or more independent and disinterested governing persons of the limited liability company, even if the appointing independent and disinterested governing persons are not a majority of the governing persons of the limited liability company, rather than a committee consisting of two or more independent and disinterested governing persons appointed by the majority of one or more independent and disinterested governing persons present at a meeting of the governing authority, regardless of whether the independent and disinterested governing persons constitute a quorum of the governing authority; or

(3) a panel of one or more independent and disinterested individuals, rather than persons, appointed by the court on a motion by the limited

liability company listing the names of the individuals, rather than persons, to be appointed and stating that, to the best of the limited liability company's knowledge, the individuals, rather than persons, to be appointed are disinterested and qualified to make the determinations contemplated by Section 101.458.

(b) Provides that an entity is independent and disinterested only if its decision with respect to the limited liability company's derivative proceeding is made by a majority of its governing persons who are independent and disinterested with respect to that derivative proceeding, even if those governing persons are not a majority of its governing persons. Provides that this section applies to an entity that meets certain criteria.

(c) Creates this subsection from existing text and makes conforming changes.

SECTION 17. Amends Section 101.455, Business Organizations Code, as follows:

Sec. 101.455. STAY OF PROCEEDING. (a) Requires the court, if the limited liability company, rather than the domestic or foreign limited liability company, that is the subject of a derivative proceeding commences an inquiry into the allegations made in a demand or petition and the person or group of persons described by Section 101.454 is conducting an active review of the allegations in good faith, to stay a derivative proceeding for not more than 60 days until the review is completed and a determination is made by the person or group regarding what further action, if any, should be taken.

(b) Makes conforming and nonsubstantive changes to this subsection.

(c) Creates this subsection from existing text. Authorizes a stay, on motion, to be reviewed every 60 days for continuation, rather than the continued necessity, of the stay if the limited liability company provides the court and the member with a written statement of the status of the review and the reasons why an extension for a period not to exceed 60 additional days is appropriate. Requires an extension to be granted for a period not to exceed 60 days if the court determines that the continuation is appropriate in the interests of the limited liability company.

Deletes existing Subsection (c) authorizing the stay, if the review and determination made by the person or group is not completed before the 61st day after the date on which the court orders the stay, to be renewed for one or more additional 60-day periods if the domestic or foreign limited liability company provides the court and the member with a written statement of the status of the review and the reasons why a continued extension of the stay is necessary.

SECTION 18. Amends Section 101.456, Business Organizations Code, as follows:

Sec. 101.456. DISCOVERY. (a) Requires discovery by a member after the filing of the derivative proceeding in accordance with this subchapter, if a domestic limited liability company, rather than a foreign or domestic limited liability company, proposes to dismiss a derivative proceeding under Section 101.458, to be limited to:

(1) facts relating to whether the person or persons described by Section 101.454 are independent and disinterested, rather than facts relating to whether the person or group of persons described by Section 101.458 is independent and disinterested; and

(2)–(3) makes no changes to these subdivisions.

(b) Prohibits discovery described by Subsection (a) from being expanded to include a fact or substantive matter regarding the act, omission, or other matter that is the subject matter of the derivative proceeding but requires the scope of discovery to not be so limited if the court determines after notice and hearing that a good faith review of the allegations has not been made by an independent and

disinterested person or group in accordance with Sections 101.454 and 101.458, rather than prohibiting discovery described by Subsection (a) from being expanded to include a fact or substantive matter regarding the act, omission, or other matter that is the subject matter of the derivative proceeding and authorizing the scope of discovery to be expanded under certain conditions.

SECTION 19. Amends Section 101.457, Business Organizations Code, as follows:

Sec. 101.457. TOLLING OF STATUTE OF LIMITATIONS. Provides that a written demand filed with the limited liability company under Section 101.453 tolls the statute of limitations on the claim on which demand is made until the later, rather than earlier, of:

(1) the 31st day after the expiration of any waiting period under Section 153.403, rather than the 91st day after the date of the demand; or

(2) the 31st day after the expiration of any stay granted under Section 153.405, including all continuations of the stay, rather than the 31st day after the date the limited liability company advises the member that the demand has been rejected or the review has been completed.

SECTION 20. Amends Section 101.458, Business Organizations Code, as follows:

Sec. 101.458. DISMISSAL OF DERIVATIVE PROCEEDING. (a) Requires a court sitting in equity as the finder of fact, rather than a court, to dismiss a derivative proceeding on a motion by the limited liability company if the person or group of persons described by Section 101.454 determines in good faith, after conducting a reasonable inquiry and based on factors the person or group considers appropriate under the circumstances, that continuation of the derivative proceeding is not in the best interests of the limited liability company.

(b) Requires the burden of proof, in determining whether the requirements of Subsection (a) have been met, to be on:

(1) the plaintiff member if:

(A) the applicable person or persons making the determination under Section 101.454(a)(1) or (2) are independent and disinterested at the time the determination is made, rather than the majority of the governing authority consists of independent and disinterested persons at the time the determination is made;

(B) makes no changes to this paragraph; or

(C) the limited liability company presents prima facie evidence that demonstrates that the applicable person or persons making the determination under Section 101.454(a) are independent and disinterested, rather than evidence that demonstrates that the persons appointed under Section 101.454(a)(2) are independent and disinterested; or

(2) makes no changes to this subdivision.

SECTION 21. Amends Section 101.459, Business Organizations Code, as follows:

Sec. 101.459. New heading: ALLEGATIONS AFTER DEMAND REJECTED. Requires the petition, if a derivative proceeding is instituted after a demand is rejected, to allege with particularity facts that establish that the rejection was not made in accordance with the requirements and standards under Sections 101.454 and 101.458, rather than with the requirements of Sections 101.454 and 101.458.

SECTION 22. Amends Section 101.461, Business Organizations Code, as follows:

Sec. 101.461. PAYMENT OF EXPENSES. (a) Makes conforming and nonsubstantive changes to this subsection.

(b) Authorizes the court, on termination of a derivative proceeding, to order:

(1)–(2) makes conforming and nonsubstantive changes to these subdivisions; or

(3) a party to pay expenses incurred by another party relating to the filing of a pleading, motion, or other paper if the court finds the pleading, motion, or other paper:

(A) makes no changes to this paragraph;

(B) was not warranted by existing law or a good faith argument for the application, extension, modification, or reversal of existing law, rather than for the extension, modification, or reversal of existing law; or

(C) makes no changes to this paragraph.

SECTION 23. Amends Section 101.462, Business Organizations Code, as follows:

Sec. 101.462. APPLICATION TO FOREIGN LIMITED LIABILITY COMPANIES. (a) Provides that in a derivative proceeding brought in the right of a foreign limited liability company, the matters covered by this subchapter are governed by the laws of the jurisdiction of formation, rather than of organization, of the foreign limited liability company, except for Sections 101.455, 101.460, and 101.461, which are procedural provisions and do not relate to the internal affairs of the foreign limited liability company, unless applying the laws of the jurisdiction of formation of the foreign limited liability company requires otherwise with respect to Section 101.455.

(b) Provides that in the case of matters relating to a foreign limited liability company under Section 101.455, a reference to a person or group of persons described by Section 101.454 refers to a person or group entitled under the laws of the jurisdiction of formation of the foreign limited liability company to make the determination described by Section 101.454(a), rather than providing that in the case of matters relating to a foreign limited liability company under Section 101.454, a reference to a person or group of persons described by that section refers to a person or group entitled under the laws of the jurisdiction of organization of the foreign limited liability company to review and dispose of a derivative proceeding. Requires the standard of review of a determination made by the person or group to be governed by the laws of the jurisdiction of formation of the foreign limited liability company, rather than requiring the standard of review of a decision made by the person or group to dismiss the derivative proceeding to be governed by the laws of the jurisdiction of organization of the foreign limited liability company.

SECTION 24. Amends Section 101.463, Business Organizations Code, as follows:

Sec. 101.463. CLOSELY HELD LIMITED LIABILITY COMPANY. (a) Makes no changes to this subsection.

(b) Provides that Sections 101.452–101.460 do not apply to a claim or a derivative proceeding by a member of a closely held limited liability company against a governing person, member, or officer of the limited liability company, rather than providing that Sections 101.452–101.459 do not apply to a closely held limited liability company. Provides that in the event the claim or derivative

proceeding is also made against a person who is not that governing person, member, or officer, this subsection applies only to the claim or derivative proceeding against the governing person, member, or officer.

(c) Provides that if Sections 101.452–101.460 do not apply because of Subsection (b) and if justice requires, rather than if justice requires, certain actions may be performed.

(d) Provides that other provisions of state law govern whether a member has a direct cause of action or right to sue a governing person, member, or officer, and that this section may not be construed to create that direct cause of action or right to sue.

SECTION 25. Amends Section 153.401, Business Organizations Code, as follows:

Sec. 153.401. New heading: DEFINITIONS. Defines "derivative proceeding" and "limited partner" for purposes of this subchapter (Derivative Actions). Deletes existing text authorizing a limited partner to bring an action in a court on behalf of the limited partnership to recover a judgment in the limited partnership's favor if certain conditions are met.

SECTION 26. Amends Sections 153.402, Business Organizations Code, as follows:

Sec. 153.402. New heading: STANDING TO BRING PROCEEDING. (a) Prohibits a limited partner, subject to Subsection (b), from instituting or maintaining a derivative proceeding unless certain conditions are met.

(b) Prohibits a limited partner, if a limited partnership is the surviving form of an entity in a conversion, from instituting or maintaining a derivative proceeding based on an act or omission that occurred with respect to the converting entity before the date of the conversion unless certain conditions are met.

Deletes existing text requiring the plaintiff, in a derivative action, to be a limited partner when the action is brought and requiring the person to have been a limited partner at the time of the transaction that is the subject of the action or the person's status as a limited partner to have arisen by operation of law or under the terms of the partnership agreement from a person who was a limited partner at the time of the transaction.

SECTION 27. Amends Section 153.403, Business Organizations Code, as follows:

Sec. 153.403. New heading: DEMAND. (a) Prohibits a limited partner from maintaining or instituting a derivative proceeding until the 91st day after the date a written demand is filed with the limited partnership stating with particularity the act, omission, or other matter that is the subject matter of the claim or challenge and requesting that the limited partnership take suitable action.

(b) Prohibits the waiting period required by Subsection (a) before a derivative proceeding is authorized to be instituted from being required or, if applicable, requires the waiting period to terminate if certain conditions are met.

Deletes existing text requiring the complaint, in a derivative action, to contain with particularity the effort, if any, of the plaintiff to secure initiation of the action by a general partner or the reasons for not making the effort.

SECTION 28. Amends Section 153.404, Business Organizations Code, as follows:

Sec. 153.404. New heading: DETERMINATION BY INDEPENDENT PERSONS. (a) Requires a determination of how to proceed on allegations made in a demand or petition relating to a derivative proceeding to be made by an affirmative vote of the majority of:

(1) the independent and disinterested general partners of the limited partnership, whether one or more, even if the independent and disinterested general partners are not a majority of the general partners of the limited partnership;

(2) a committee consisting of one or more independent and disinterested general partners appointed by a majority of one or more independent and disinterested general partners of the limited partnership, even if the appointing independent and disinterested general partners are not a majority of the general partners of the limited partnership; or

(3) a panel of one or more independent and disinterested individuals appointed by the court on a motion by the limited partnership listing the names of the individuals to be appointed and stating that, to the best of the limited partnership's knowledge, the individuals to be appointed are disinterested and qualified to make the determinations contemplated by Section 153.408.

Deletes existing text authorizing the court, in a derivative action, to require the plaintiff to give security for the reasonable expenses incurred or expected to be incurred by a defendant in the action, including reasonable attorney's fees.

(b) Provides that an entity is independent and disinterested only if its decision with respect to the limited partnership's derivative proceeding is made by a majority of its governing persons who are independent and disinterested with respect to that derivative proceeding, even if those governing persons are not a majority of its governing persons. Provides that this section applies to an entity that is a general partner of the limited partnership or that is directly, or indirectly through one or more other entities, a governing person of that general partner. Deletes existing text authorizing the court to increase or decrease at any time the amount of the security on a showing that the security provided is inadequate or excessive.

(c) Requires the court to appoint a panel under Subsection (a)(3) if the court finds that the individuals recommended by the limited partnership are independent and disinterested and are otherwise qualified with respect to expertise, experience, independent judgment, and other factors considered appropriate by the court under the circumstances to make the determinations. Prohibits an individual appointed by the court to a panel under this section from being held liable to the limited partnership or the limited partnership's partners for an action taken or omission made by the individual in that capacity, except for an act or omission constituting fraud or wilful misconduct. Deletes existing text authorizing a plaintiff, if the plaintiff is unable to give security, to file an affidavit in accordance with the Texas Rules of Civil Procedure.

Deletes existing Subsection (d) requiring the court, except as provided by Subsection (c), if a plaintiff fails to give the security within a reasonable time set by the court, to dismiss the suit without prejudice. Deletes existing Subsection (e) authorizing the court, on final judgment for a defendant and on a finding that suit was brought without reasonable cause against the defendant, to require the plaintiff to pay reasonable expenses, including reasonable attorney's fees, to the defendant, regardless of whether security has been required.

SECTION 29. Amends Section 153.405, Business Organizations Code, as follows:

Sec. 153.405. New heading: STAY OF PROCEEDING. (a) Requires the court, if the limited partnership that is the subject of a derivative proceeding commences an inquiry into the allegations made in a demand or petition and the person or group of persons described by Section 153.404 is conducting an active review of the allegations in good

faith, to stay a derivative proceeding for not more than 60 days until the review is completed and a determination is made by the person or group regarding what further action, if any, should be taken.

(b) Requires the limited partnership, to obtain a stay, to provide the court with a written statement agreeing to advise the court and the limited partner making the demand of the determination promptly on the completion of the review of the matter.

(c) Authorizes a stay, on motion, to be reviewed every 60 days for continuation of the stay if the limited partnership provides the court and the limited partner with a written statement of the status of the review and the reasons why an extension for a period not to exceed 60 additional days is appropriate. Requires an extension to be granted for a period not to exceed 60 days if the court determines that the continuation is appropriate in the interests of the partnership.

Deletes existing text authorizing the court, if a derivative action is successful, wholly or partly, or if anything is received by the plaintiff because of a judgment, compromise, or settlement of the action or claim constituting a part of the action, to award the plaintiff reasonable expenses, including reasonable attorney's fees, and requiring the court to direct the plaintiff to remit to a party identified by the court the remainder of the proceeds received by the plaintiff.

SECTION 30. Amends Subchapter I, Chapter 153, Business Organizations Code, by adding Sections 153.406, 153.407, 153.408, 153.409, 153.410, 153.411, 153.412, and 153.413, as follows:

Sec. 153.406. DISCOVERY. (a) Requires discovery by a limited partner after the filing of the derivative proceeding in accordance with this subchapter, if a limited partnership proposes to dismiss a derivative proceeding under Section 153.408, to be limited to:

(1) facts relating to whether the person or persons described by Section 153.404 are independent and disinterested;

(2) the good faith of the inquiry and review by the person or group; and

(3) the reasonableness of the procedures followed by the person or group in conducting the review.

(b) Prohibits discovery described by Subsection (a) from being expanded to include a fact or substantive matter regarding the act, omission, or other matter that is the subject matter of the derivative proceeding, but requires the scope of discovery to not be so limited if the court determines after notice and hearing that a good faith review of the allegations has not been made by an independent and disinterested person or group in accordance with Sections 153.404 and 153.408.

Sec. 153.407. TOLLING OF STATUTE OF LIMITATIONS. Provides that a written demand filed with the limited partnership under Section 153.403 tolls the statute of limitations on the claim on which demand is made until the later of the 31st day after the expiration of any waiting period under Section 153.403 or the 31st day after the expiration of any stay granted under Section 153.405, including all continuations of the stay.

Sec. 153.408. DISMISSAL OF DERIVATIVE PROCEEDING. (a) Requires a court, sitting in equity as the finder of fact, to dismiss a derivative proceeding on a motion by the limited partnership if the person or group of persons described by Section 153.404 determines in good faith, after conducting a reasonable inquiry and based on factors the person or group considers appropriate under the circumstances, that continuation of the derivative proceeding is not in the best interests of the limited partnership.

(b) Requires the burden of proof, in determining whether the requirements of Subsection (a) have been met, to be on:

(1) the plaintiff limited partner if:

(A) the applicable person or persons making the determination under Section 153.404(a)(1) or (2) are independent and disinterested at the time the determination is made;

(B) the determination is made by a panel of one or more independent and disinterested individuals appointed under Section 153.404(a)(3); or

(C) the limited partnership presents prima facie evidence that demonstrates that the applicable person or persons making the determination under Section 153.404(a) are independent and disinterested; or

(2) the limited partnership in any other circumstance.

Sec. 153.409. ALLEGATIONS AFTER DEMAND REJECTED. Requires a petition, if a derivative proceeding is instituted after a demand is rejected, to allege with particularity facts that establish that the rejection was not made in accordance with the requirements and standards under Sections 153.404 and 153.408.

Sec. 153.410. DISCONTINUANCE OR SETTLEMENT. (a) Prohibits a derivative proceeding from being discontinued or settled without court approval.

(b) Requires the court to direct that notice be given to the affected partners if the court determines that a proposed discontinuance or settlement may substantially affect the interests of other partners.

Sec. 153.411. PAYMENT OF EXPENSES. (a) Defines "expenses" for purposes of this section.

(b) Authorizes the court, on termination of a derivative proceeding, to order:

(1) the limited partnership to pay expenses the plaintiff incurred in the proceeding if the court finds the proceeding has resulted in a substantial benefit to the limited partnership;

(2) the plaintiff to pay expenses the limited partnership or other defendant incurred in investigating and defending the proceeding if the court finds the proceeding has been instituted or maintained without reasonable cause or for an improper purpose; or

(3) a party to pay expenses incurred by another party relating to the filing of a pleading, motion, or other paper if the court finds the pleading, motion, or other paper:

(A) was not well grounded in fact after reasonable inquiry;

(B) was not warranted by existing law or a good faith argument for the application, extension, modification, or reversal of existing law; or

(C) was interposed for an improper purpose, such as to harass, cause unnecessary delay, or cause a needless increase in the cost of litigation.

Sec. 153.412. APPLICATION TO FOREIGN LIMITED PARTNERSHIPS. (a) Provides that in a derivative proceeding brought in the right of a foreign limited partnership, the matters covered by this subchapter are governed by the laws of the jurisdiction of formation of the foreign limited partnership, except for Sections 153.405, 153.410, and 153.411, which are procedural provisions and do not relate to the internal affairs of the foreign limited partnership, unless applying the laws of the jurisdiction of formation of the foreign limited partnership requires otherwise with respect to Section 153.405.

(b) Provides that in the case of matters relating to a foreign limited partnership under Section 153.405, a reference to a person or group of persons described by Section 153.404 refers to a person or group entitled under the laws of the jurisdiction of formation of the foreign limited partnership to make the determination described by Section 153.404(a). Requires the standard of review of a determination made by the person or group to be governed by the laws of the jurisdiction of formation of the foreign limited partnership.

Sec. 153.413. CLOSELY HELD LIMITED PARTNERSHIP. (a) Defines "closely held limited partnership" for purposes of this section.

(b) Provides that Sections 153.402–153.410 do not apply to 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 the limited partnership. Requires this section, in the event the claim or derivative proceeding is also made against a person who is not that general partner, limited partner, or officer, to apply only to the claim or derivative proceeding against the general partner, limited partner, or officer.

(c) Provides that if Sections 153.402–153.410 do not apply because of Subsection (b) and if justice requires:

(1) a derivative proceeding brought by a limited partner of a closely held limited partnership is authorized be treated by a court as a direct action brought by the limited partner for the limited partner's own benefit; and

(2) a recovery in a direct or derivative proceeding by a limited partner is authorized to be paid directly to the plaintiff or to the limited partnership if necessary to protect the interests of creditors or other partners of the limited partnership.

(d) Provides that other provisions of state law govern whether a limited partner has a direct cause of action or right to sue a general partner, limited partner, or officer, and prohibits this section from being construed to create that direct cause of action or right to sue.

SECTION 31. Makes application of this Act prospective.

SECTION 32. Effective date: September 1, 2019.