

By: Martinez Fischer

H.B. No. 3603

A BILL TO BE ENTITLED

1 AN ACT
2 relating to derivative proceedings on behalf of for-profit
3 corporations, limited liability companies, and limited
4 partnerships.

5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

6 SECTION 1. Section 21.551(2), Business Organizations Code,
7 is amended to read as follows:

8 (2) "Shareholder" means a shareholder as defined by
9 Section 1.002 or [~~includes~~] a beneficial owner whose shares are
10 held in a voting trust or by a nominee on the beneficial owner's
11 behalf.

12 SECTION 2. Section 21.552, Business Organizations Code, is
13 amended to read as follows:

14 Sec. 21.552. STANDING TO BRING PROCEEDING. (a) Subject
15 to Subsection (b), a [A] shareholder may not institute or maintain a
16 derivative proceeding unless:

17 (1) the shareholder:
18 (A) was a shareholder of the corporation at the
19 time of the act or omission complained of; or
20 (B) became a shareholder by operation of law
21 originating from a person that was a shareholder at the time of the
22 act or omission complained of; and

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

1 corporation.

2 (b) If the converted entity in a conversion is a
3 corporation, a shareholder of that corporation may not institute or
4 maintain a derivative proceeding based on an act or omission that
5 occurred with respect to the converting entity before the date of
6 the conversion unless:

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

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

12 SECTION 3. Section 21.553(b), Business Organizations Code,
13 is amended to read as follows:

14 (b) The waiting period required by Subsection (a) before a
15 derivative proceeding may be instituted is not required or, if
16 applicable, shall terminate if:

17 (1) the shareholder has been [~~previously~~] notified
18 that the demand has been rejected by the corporation;

19 (2) the corporation is suffering irreparable injury;
20 or

21 (3) irreparable injury to the corporation would result
22 by waiting for the expiration of the 90-day period.

23 SECTION 4. Section 21.554, Business Organizations Code, is
24 amended to read as follows:

25 Sec. 21.554. DETERMINATION BY DIRECTORS OR INDEPENDENT
26 PERSONS. (a) A determination of how to proceed on allegations made
27 in a demand or petition relating to a derivative proceeding must be

1 made by an affirmative vote of the majority of:

2 (1) all [~~the~~] independent and disinterested directors
3 of the corporation, regardless of whether [~~present at a meeting of~~
4 ~~the board of directors of the corporation at which interested~~
5 ~~directors are not present at the time of the vote if~~] the
6 independent and disinterested directors constitute a quorum of the
7 board of directors;

8 (2) a committee consisting of one [~~two~~] or more
9 independent and disinterested directors appointed by an
10 affirmative vote of the majority of one or more independent and
11 disinterested directors [~~present at a meeting of the board of~~
12 ~~directors~~], regardless of whether the independent and
13 disinterested directors constitute a quorum of the board of
14 directors; or

15 (3) a panel of one or more independent and
16 disinterested individuals [~~persons~~] appointed by the court on a
17 motion by the corporation listing the names of the individuals
18 [~~persons~~] to be appointed and stating that, to the best of the
19 corporation's knowledge, the individuals [~~persons~~] to be appointed
20 are disinterested and qualified to make the determinations
21 contemplated by Section 21.558.

22 (b) The court shall appoint a panel under Subsection (a)(3)
23 if the court finds that the individuals [~~persons~~] recommended by
24 the corporation are independent and disinterested and are otherwise
25 qualified with respect to expertise, experience, independent
26 judgment, and other factors considered appropriate by the court
27 under the circumstances to make the determinations. An individual

1 ~~[A person]~~ appointed by the court to a panel under this section may
2 not be held liable to the corporation or the corporation's
3 shareholders for an action taken or omission made by the individual
4 ~~[person]~~ in that capacity, except for an act or omission
5 constituting fraud or wilful misconduct.

6 SECTION 5. Section [21.555](#), Business Organizations Code, is
7 amended to read as follows:

8 Sec. 21.555. STAY OF PROCEEDING. (a) If the ~~[domestic or~~
9 ~~foreign]~~ corporation that is the subject of a derivative proceeding
10 commences an inquiry into the allegations made in a demand or
11 petition and the person or group of persons described by Section
12 [21.554](#) is conducting an active review of the allegations in good
13 faith, the court shall stay a derivative proceeding for not more
14 than 60 days until the review is completed and a determination is
15 made by the person or group regarding what further action, if any,
16 should be taken.

17 (b) To obtain a stay, the ~~[domestic or foreign]~~ corporation
18 must ~~[shall]~~ provide the court with a written statement agreeing to
19 advise the court and the shareholder making the demand of the
20 determination promptly on the completion of the review of the
21 matter.

22 (c) A stay, on motion ~~[application]~~, may be reviewed every
23 60 days for continuation ~~[the continued necessity]~~ of the stay if
24 the corporation provides the court and the shareholder with a
25 written statement of the status of the review and the reasons why an
26 extension for a period not to exceed 60 additional days is
27 appropriate. An extension shall be granted for a period not to

1 exceed 60 days if the court determines that the continuation is
2 appropriate in the interests of the corporation.

3 ~~[(c) If the review and determination made by the person or~~
4 ~~group is not completed before the 61st day after the stay is ordered~~
5 ~~by the court, the stay may be renewed for one or more additional~~
6 ~~60-day periods if the domestic or foreign corporation provides the~~
7 ~~court and the shareholder with a written statement of the status of~~
8 ~~the review and the reasons why a continued extension of the stay is~~
9 ~~necessary.]~~

10 SECTION 6. Section 21.556, Business Organizations Code, is
11 amended to read as follows:

12 Sec. 21.556. DISCOVERY. (a) If a ~~[domestic or foreign]~~
13 corporation proposes to dismiss a derivative proceeding under
14 Section 21.558, discovery by a shareholder after the filing of the
15 derivative proceeding in accordance with this subchapter shall be
16 limited to:

17 (1) facts relating to whether the person or ~~[group of]~~
18 persons described by Section 21.554 are ~~[21.558 is]~~ independent and
19 disinterested;

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

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

24 (b) Discovery described by Subsection (a) may not be
25 expanded to include a fact or substantive matter regarding the act,
26 omission, or other matter that is the subject matter of the
27 derivative proceeding but the scope of discovery shall not be so

1 limited [~~. The scope of discovery may be expanded~~] if the court
2 determines after notice and hearing that a good faith review of the
3 allegations [~~for purposes of Section 21.558~~] has not been made by an
4 independent and disinterested person or group in accordance with
5 Sections 21.554 and 21.558 [~~that section~~].

6 SECTION 7. Section 21.557, Business Organizations Code, is
7 amended to read as follows:

8 Sec. 21.557. TOLLING OF STATUTE OF LIMITATIONS. A written
9 demand filed with the corporation under Section 21.553 tolls the
10 statute of limitations on the claim on which demand is made until
11 the later [~~earlier~~] of:

12 (1) the 31st [~~91st~~] day after the expiration of any
13 waiting period under Section 21.553 [~~date of the demand~~]; or

14 (2) the 31st day after the expiration of any stay
15 granted under Section 21.555, including all continuations of the
16 stay [~~date the corporation advises the shareholder that the demand~~
17 ~~has been rejected or the review has been completed~~].

18 SECTION 8. Section 21.558, Business Organizations Code, is
19 amended to read as follows:

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

1 (b) In determining whether the requirements of Subsection
2 (a) have been met, the burden of proof shall be on:

3 (1) the plaintiff shareholder if:

4 (A) the majority of the board of directors
5 consists of independent and disinterested directors at the time the
6 determination is made;

7 (B) the determination is made by a panel of one or
8 more independent and disinterested persons appointed under Section
9 [21.554\(a\)\(3\)](#); or

10 (C) the corporation presents prima facie
11 evidence that demonstrates that the applicable person or persons
12 making the determination [~~directors appointed~~] under Section
13 [21.554\(a\)](#) [~~[21.554\(a\)\(2\)](#)~~] are independent and disinterested; or

14 (2) the corporation in any other circumstance.

15 SECTION 9. Section [21.559](#), Business Organizations Code, is
16 amended to read as follows:

17 Sec. 21.559. ALLEGATIONS [~~PROCEEDING INSTITUTED~~] AFTER
18 DEMAND REJECTED. If a derivative proceeding is instituted after a
19 demand is rejected, the petition must allege with particularity
20 facts that establish that the rejection was not made in accordance
21 with the requirements and standards under [~~of~~] Sections [21.554](#) and
22 [21.558](#).

23 SECTION 10. Section [21.561](#), Business Organizations Code, is
24 amended to read as follows:

25 Sec. 21.561. PAYMENT OF EXPENSES. (a) In this section,
26 "expenses" means reasonable expenses incurred by a party in a
27 derivative proceeding, including:

- 1 (1) attorney's fees;
- 2 (2) costs in pursuing an investigation of the matter
- 3 that was the subject of the derivative proceeding; or
- 4 (3) expenses for which the [~~domestic or foreign~~]
- 5 corporation [~~or a corporate defendant~~] may be required to indemnify
- 6 another person.

7 (b) On termination of a derivative proceeding, the court may

8 order:

9 (1) the [~~domestic or foreign~~] corporation to pay [~~the~~]

10 expenses the plaintiff incurred in the proceeding if the court

11 finds the proceeding has resulted in a substantial benefit to the

12 [~~domestic or foreign~~] corporation;

13 (2) the plaintiff to pay [~~the~~] expenses the [~~domestic~~

14 ~~or foreign~~] corporation or other defendant incurred in

15 investigating and defending the proceeding if the court finds the

16 proceeding has been instituted or maintained without reasonable

17 cause or for an improper purpose; or

18 (3) a party to pay [~~the~~] expenses incurred by another

19 party relating to the filing of a pleading, motion, or other paper

20 if the court finds the pleading, motion, or other paper:

21 (A) was not well grounded in fact after

22 reasonable inquiry;

23 (B) was not warranted by existing law or a good

24 faith argument for the application, extension, modification, or

25 reversal of existing law; or

26 (C) was interposed for an improper purpose, such

27 as to harass, cause unnecessary delay, or cause a needless increase

1 in the cost of litigation.

2 SECTION 11. Section 21.562, Business Organizations Code, is
3 amended to read as follows:

4 Sec. 21.562. APPLICATION TO FOREIGN CORPORATIONS. (a) In a
5 derivative proceeding brought in the right of a foreign
6 corporation, the matters covered by this subchapter are governed by
7 the laws of the jurisdiction of formation [~~incorporation~~] of the
8 foreign corporation, except for Sections 21.555, 21.560, and
9 21.561, which are procedural provisions and do not relate to the
10 internal affairs of the foreign corporation, unless applying the
11 laws of the jurisdiction of formation of the foreign corporation
12 requires otherwise with respect to Section 21.555.

13 (b) In the case of matters relating to a foreign corporation
14 under Section 21.555 [~~21.554~~], a reference to a person or group of
15 persons described by Section 21.554 [~~that section~~] refers to a
16 person or group entitled under the laws of the jurisdiction of
17 formation [~~incorporation~~] of the foreign corporation to make the
18 determination described by Section 21.554(a) [~~review and dispose of~~
19 ~~a derivative proceeding~~]. The standard of review of a
20 determination [~~decision~~] made by the person or group [~~to dismiss~~
21 ~~the derivative proceeding~~] shall be governed by the laws of the
22 jurisdiction of formation [~~incorporation~~] of the foreign
23 corporation.

24 SECTION 12. Section 21.563, Business Organizations Code, is
25 amended to read as follows:

26 Sec. 21.563. CLOSELY HELD CORPORATION. (a) In this
27 section, "closely held corporation" means a corporation that has:

1 (1) fewer than 35 shareholders; and

2 (2) no shares listed on a national securities exchange
3 or regularly quoted in an over-the-counter market by one or more
4 members of a national securities association.

5 (b) Sections 21.552-21.560 [~~21.552-21.559~~] do not apply to
6 a claim or a derivative proceeding by a shareholder of a closely
7 held corporation against a director, officer, or shareholder of the
8 corporation. In the event the claim or derivative proceeding is
9 also made against a person who is not that director, officer, or
10 shareholder, this subsection applies only to the claim or
11 derivative proceeding against the director, officer, or
12 shareholder.

13 (c) If Sections 21.552-21.560 do not apply because of
14 Subsection (b) and if justice requires:

15 (1) a derivative proceeding brought by a shareholder
16 of a closely held corporation may be treated by a court as a direct
17 action brought by the shareholder for the shareholder's own
18 benefit; and

19 (2) a recovery in a direct or derivative proceeding by
20 a shareholder may be paid directly to the plaintiff or to the
21 corporation if necessary to protect the interests of creditors or
22 other shareholders of the corporation.

23 (d) Other provisions of state law govern whether a
24 shareholder has a direct cause of action or right to sue a director,
25 officer, or shareholder, and this section may not be construed to
26 create that direct cause of action or right to sue.

27 SECTION 13. Section [101.451](#), Business Organizations Code,

1 is amended by amending Subdivision (2) and adding Subdivision (3)
2 to read as follows:

- 3 (2) "Managing entity" means an entity that is either:
4 (A) a manager of a limited liability company that
5 is managed by managers; or
6 (B) a member of a limited liability company that
7 is managed by members who are entitled to manage the company.

8 (3) "Member" means [includes] a person who is a member
9 or is an assignee of a membership interest or a person who
10 beneficially owns a membership interest through a voting trust or a
11 nominee on the person's behalf.

12 SECTION 14. Section 101.452, Business Organizations Code,
13 is amended to read as follows:

14 Sec. 101.452. STANDING TO BRING PROCEEDING. (a) Subject
15 to Subsection (b), a [A] member may not institute or maintain a
16 derivative proceeding unless:

- 17 (1) the member:
18 (A) was a member of the limited liability company
19 at the time of the act or omission complained of; or
20 (B) became a member by operation of law
21 originating from a person that was a member at the time of the act or
22 omission complained of; and

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

26 (b) If the converted entity in a conversion is a limited
27 liability company, a member of that limited liability company may

1 not institute or maintain a derivative proceeding based on an act or
2 omission that occurred with respect to the converting entity before
3 the date of the conversion unless:

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

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

9 SECTION 15. Section 101.453(b), Business Organizations
10 Code, is amended to read as follows:

11 (b) The waiting period required by Subsection (a) before a
12 derivative proceeding may be instituted is not required or, if
13 applicable, shall terminate if:

14 (1) the member has been [~~previously~~] notified that the
15 demand has been rejected by the limited liability company;

16 (2) the limited liability company is suffering
17 irreparable injury; or

18 (3) irreparable injury to the limited liability
19 company would result by waiting for the expiration of the 90-day
20 period.

21 SECTION 16. Section 101.454, Business Organizations Code,
22 is amended to read as follows:

23 Sec. 101.454. DETERMINATION BY GOVERNING OR INDEPENDENT
24 PERSONS. (a) The determination of how to proceed on allegations
25 made in a demand or petition relating to a derivative proceeding
26 must be made by an affirmative vote of the majority of:

27 (1) the independent and disinterested governing

1 persons of the limited liability company, whether one or more, even
2 if the independent and disinterested governing persons are not a
3 majority of the governing persons of the limited liability company
4 ~~[present at a meeting of the governing authority at which~~
5 ~~interested governing persons are not present at the time of the vote~~
6 ~~if the independent and disinterested governing persons constitute a~~
7 ~~quorum of the governing authority];~~

8 (2) a committee consisting of one ~~[two]~~ or more
9 independent and disinterested governing persons appointed by the
10 majority of one or more independent and disinterested governing
11 persons of the limited liability company, even if the appointing
12 independent and disinterested governing persons are not a majority
13 of the governing persons of the limited liability company ~~[present~~
14 ~~at a meeting of the governing authority, regardless of whether the~~
15 ~~independent and disinterested governing persons constitute a~~
16 ~~quorum of the governing authority]; or~~

17 (3) a panel of one or more independent and
18 disinterested individuals ~~[persons]~~ appointed by the court on a
19 motion by the limited liability company listing the names of the
20 individuals ~~[persons]~~ to be appointed and stating that, to the best
21 of the limited liability company's knowledge, the individuals
22 ~~[persons]~~ to be appointed are disinterested and qualified to make
23 the determinations contemplated by Section [101.458](#).

24 (b) An entity to which this subsection applies is
25 independent and disinterested under this section only if its
26 decision with respect to the limited liability company's derivative
27 proceeding is made by a majority of its governing persons who are

1 independent and disinterested with respect to that derivative
2 proceeding, even if those governing persons are not a majority of
3 its governing persons. This subsection applies to an entity that
4 is:

5 (1) a managing entity of the limited liability
6 company; or

7 (2) directly, or indirectly through one or more other
8 entities, a governing person of that managing entity.

9 (c) The court shall appoint a panel under Subsection (a)(3)
10 if the court finds that the individuals [~~persons~~] recommended by
11 the limited liability company are independent and disinterested and
12 are otherwise qualified with respect to expertise, experience,
13 independent judgment, and other factors considered appropriate by
14 the court under the circumstances to make the determinations. An
15 individual [~~A person~~] appointed by the court to a panel under this
16 section may not be held liable to the limited liability company or
17 the limited liability company's members for an action taken or
18 omission made by the individual [~~person~~] in that capacity, except
19 for acts or omissions constituting fraud or wilful misconduct.

20 SECTION 17. Section 101.455, Business Organizations Code,
21 is amended to read as follows:

22 Sec. 101.455. STAY OF PROCEEDING. (a) If the [~~domestic or~~
23 ~~foreign~~] limited liability company that is the subject of a
24 derivative proceeding commences an inquiry into the allegations
25 made in a demand or petition and the person or group of persons
26 described by Section 101.454 is conducting an active review of the
27 allegations in good faith, the court shall stay a derivative

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

4 (b) To obtain a stay, the [~~domestic or foreign~~] limited
5 liability company must [~~shall~~] provide the court with a written
6 statement agreeing to advise the court and the member making the
7 demand of the determination promptly on the completion of the
8 review of the matter.

9 (c) A stay, on motion, may be reviewed every 60 days for
10 continuation [~~the continued necessity~~] of the stay if the limited
11 liability company provides the court and the member with a written
12 statement of the status of the review and the reasons why an
13 extension for a period not to exceed 60 additional days is
14 appropriate. An extension shall be granted for a period not to
15 exceed 60 days if the court determines that the continuation is
16 appropriate in the interests of the limited liability company.

17 [~~(c) If the review and determination made by the person or~~
18 ~~group is not completed before the 61st day after the date on which~~
19 ~~the court orders the stay, the stay may be renewed for one or more~~
20 ~~additional 60-day periods if the domestic or foreign limited~~
21 ~~liability company provides the court and the member with a written~~
22 ~~statement of the status of the review and the reasons why a~~
23 ~~continued extension of the stay is necessary.]~~

24 SECTION 18. Section 101.456, Business Organizations Code,
25 is amended to read as follows:

26 Sec. 101.456. DISCOVERY. (a) If a [~~domestic or foreign~~]
27 limited liability company proposes to dismiss a derivative

1 proceeding under Section 101.458, discovery by a member after the
2 filing of the derivative proceeding in accordance with this
3 subchapter shall be limited to:

4 (1) facts relating to whether the person or ~~[group of]~~
5 persons described by Section 101.454 are ~~[101.458 is]~~ independent
6 and disinterested;

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

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

11 (b) Discovery described by Subsection (a) may not be
12 expanded to include a fact or substantive matter regarding the act,
13 omission, or other matter that is the subject matter of the
14 derivative proceeding but the scope of discovery shall not be so
15 limited [~~. The scope of discovery may be expanded~~] if the court
16 determines after notice and hearing that a good faith review of the
17 allegations [~~for purposes of Section 101.458~~] has not been made by
18 an independent and disinterested person or group in accordance with
19 Sections 101.454 and 101.458 [~~that section~~].

20 SECTION 19. Section 101.457, Business Organizations Code,
21 is amended to read as follows:

22 Sec. 101.457. TOLLING OF STATUTE OF LIMITATIONS. A written
23 demand filed with the limited liability company under Section
24 101.453 tolls the statute of limitations on the claim on which
25 demand is made until the later [~~earlier~~] of:

26 (1) the 31st [~~91st~~] day after the expiration of any
27 waiting period under Section 153.403 [~~date of the demand~~]; or

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

5 SECTION 20. Section 101.458, Business Organizations Code,
6 is amended to read as follows:

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

15 (b) In determining whether the requirements of Subsection
16 (a) have been met, the burden of proof shall be on:

17 (1) the plaintiff member if:

18 (A) the applicable person or persons making the
19 determination under Section 101.454(a)(1) or (2) are [~~majority of~~
20 ~~the governing authority consists of~~] independent and disinterested
21 [~~persons~~] at the time the determination is made;

22 (B) the determination is made by a panel of one or
23 more independent and disinterested persons appointed under Section
24 101.454(a)(3); or

25 (C) the limited liability company presents prima
26 facie evidence that demonstrates that the applicable person or
27 persons making the determination [~~appointed~~] under Section

1 101.454(a) [~~101.454(a)(2)~~] are independent and disinterested; or
2 (2) the limited liability company in any other
3 circumstance.

4 SECTION 21. Section 101.459, Business Organizations Code,
5 is amended to read as follows:

6 Sec. 101.459. ALLEGATIONS AFTER [~~IF~~] DEMAND REJECTED. If a
7 derivative proceeding is instituted after a demand is rejected, the
8 petition must allege with particularity facts that establish that
9 the rejection was not made in accordance with the requirements and
10 standards under [~~of~~] Sections 101.454 and 101.458.

11 SECTION 22. Section 101.461, Business Organizations Code,
12 is amended to read as follows:

13 Sec. 101.461. PAYMENT OF EXPENSES. (a) In this section,
14 "expenses" means reasonable expenses incurred by a party in a
15 derivative proceeding, including:

- 16 (1) attorney's fees;
17 (2) costs in [~~of~~] pursuing an investigation of the
18 matter that was the subject of the derivative proceeding; or
19 (3) expenses for which the [~~domestic or foreign~~]
20 limited liability company may be required to indemnify another
21 person.

22 (b) On termination of a derivative proceeding, the court may
23 order:

- 24 (1) the [~~domestic or foreign~~] limited liability
25 company to pay [~~the~~] expenses the plaintiff incurred in the
26 proceeding if the court finds the proceeding has resulted in a
27 substantial benefit to the [~~domestic or foreign~~] limited liability

1 company;

2 (2) the plaintiff to pay [~~the~~] expenses the [~~domestic~~
3 ~~or foreign~~] limited liability company or other defendant incurred
4 in investigating and defending the proceeding if the court finds
5 the proceeding has been instituted or maintained without reasonable
6 cause or for an improper purpose; or

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

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

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

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

18 SECTION 23. Section 101.462, Business Organizations Code,
19 is amended to read as follows:

20 Sec. 101.462. APPLICATION TO FOREIGN LIMITED LIABILITY
21 COMPANIES. (a) In a derivative proceeding brought in the right of
22 a foreign limited liability company, the matters covered by this
23 subchapter are governed by the laws of the jurisdiction of
24 formation [~~organization~~] of the foreign limited liability company,
25 except for Sections 101.455, 101.460, and 101.461, which are
26 procedural provisions and do not relate to the internal affairs of
27 the foreign limited liability company, unless applying the laws of

1 the jurisdiction of formation of the foreign limited liability
2 company requires otherwise with respect to Section 101.455.

3 (b) In the case of matters relating to a foreign limited
4 liability company under Section 101.455 [~~101.454~~], a reference to a
5 person or group of persons described by Section 101.454 [~~that~~
6 ~~section~~] refers to a person or group entitled under the laws of the
7 jurisdiction of formation [~~organization~~] of the foreign limited
8 liability company to make the determination described by Section
9 101.454(a) [~~review and dispose of a derivative proceeding~~]. The
10 standard of review of a determination [~~decision~~] made by the person
11 or group [~~to dismiss the derivative proceeding~~] shall be governed
12 by the laws of the jurisdiction of formation [~~organization~~] of the
13 foreign limited liability company.

14 SECTION 24. Section 101.463, Business Organizations Code,
15 is amended to read as follows:

16 Sec. 101.463. CLOSELY HELD LIMITED LIABILITY COMPANY. (a)
17 In this section, "closely held limited liability company" means a
18 limited liability company that has:

- 19 (1) fewer than 35 members; and
20 (2) no membership interests listed on a national
21 securities exchange or regularly quoted in an over-the-counter
22 market by one or more members of a national securities association.

23 (b) Sections 101.452-101.460 [~~101.452-101.459~~] do not apply
24 to a claim or a derivative proceeding by a member of a closely held
25 limited liability company against a governing person, member, or
26 officer of the limited liability company. In the event the claim or
27 derivative proceeding is also made against a person who is not that

1 governing person, member, or officer, this subsection applies only
2 to the claim or derivative proceeding against the governing person,
3 member, or officer.

4 (c) If Sections 101.452-101.460 do not apply because of
5 Subsection (b) and if justice requires:

6 (1) a derivative proceeding brought by a member of a
7 closely held limited liability company may be treated by a court as
8 a direct action brought by the member for the member's own benefit;
9 and

10 (2) a recovery in a direct or derivative proceeding by
11 a member may be paid directly to the plaintiff or to the limited
12 liability company if necessary to protect the interests of
13 creditors or other members of the limited liability company.

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

18 SECTION 25. Section 153.401, Business Organizations Code,
19 is amended to read as follows:

20 Sec. 153.401. DEFINITIONS [~~RIGHT TO BRING ACTION~~]. In this
21 subchapter:

22 (1) "Derivative proceeding" means a civil suit in the
23 right of a domestic limited partnership or, to the extent provided
24 by Section 153.412, in the right of a foreign limited partnership.

25 (2) "Limited partner" means a person who is a limited
26 partner or is an assignee of a partnership interest, including the
27 partnership interest of a general partner [~~A limited partner may~~

1 ~~bring an action in a court on behalf of the limited partnership to~~
2 ~~recover a judgment in the limited partnership's favor if:~~

3 ~~(1) all general partners with authority to bring the~~
4 ~~action have refused to bring the action; or~~

5 ~~(2) an effort to cause those general partners to~~
6 ~~bring the action is not likely to succeed].~~

7 SECTION 26. Section 153.402, Business Organizations Code,
8 is amended to read as follows:

9 Sec. 153.402. STANDING TO BRING PROCEEDING [~~PROPER~~
10 ~~PLAINTIFF~~]. (a) Subject to Subsection (b), a limited partner may
11 not institute or maintain a derivative proceeding unless:

12 (1) the limited partner:

13 (A) was a limited partner of the limited
14 partnership at the time of the act or omission complained of; or

15 (B) became a limited partner by operation of law
16 originating from a person that was a limited partner or general
17 partner at the time of the act or omission complained of; and

18 (2) the limited partner fairly and adequately
19 represents the interests of the limited partnership in enforcing
20 the right of the limited partnership.

21 (b) If the converted entity in a conversion is a limited
22 partnership, a limited partner of that limited partnership may not
23 institute or maintain a derivative proceeding based on an act or
24 omission that occurred with respect to the converting entity before
25 the date of the conversion unless:

26 (1) the limited partner was an equity owner of the
27 converting entity at the time of the act or omission; and

1 (2) the limited partner fairly and adequately
2 represents the interests of the limited partnership in enforcing
3 the right of the limited partnership [~~In a derivative action, the~~
4 ~~plaintiff must be a limited partner when the action is brought and:~~

5 ~~[(1) the person must have been a limited partner at the~~
6 ~~time of the transaction that is the subject of the action; or~~

7 ~~[(2) the person's status as a limited partner must have~~
8 ~~arisen by operation of law or under the terms of the partnership~~
9 ~~agreement from a person who was a limited partner at the time of the~~
10 ~~transaction].~~

11 SECTION 27. Section 153.403, Business Organizations Code,
12 is amended to read as follows:

13 Sec. 153.403. DEMAND [PLEADING]. (a) A limited partner may
14 not institute a derivative proceeding until the 91st day after the
15 date a written demand is filed with the limited partnership stating
16 with particularity the act, omission, or other matter that is the
17 subject of the claim or challenge and requesting that the limited
18 partnership take suitable action.

19 (b) The waiting period required by Subsection (a) before a
20 derivative proceeding may be instituted is not required or, if
21 applicable, shall terminate if:

22 (1) the limited partner has been notified that the
23 demand has been rejected by the limited partnership;

24 (2) the limited partnership is suffering irreparable
25 injury; or

26 (3) irreparable injury to the limited partnership
27 would result by waiting for the expiration of the 90-day period [~~In~~

1 ~~a derivative action, the complaint must contain with particularity:~~

2 ~~(1) the effort, if any, of the plaintiff to secure~~
3 ~~initiation of the action by a general partner; or~~

4 ~~(2) the reasons for not making the effort].~~

5 SECTION 28. Section 153.404, Business Organizations Code,
6 is amended to read as follows:

7 Sec. 153.404. DETERMINATION BY INDEPENDENT PERSONS
8 ~~[SECURITY FOR EXPENSES OF DEFENDANTS]~~. (a) A determination of how
9 to proceed on allegations made in a demand or petition relating to a
10 derivative proceeding must be made by an affirmative vote of the
11 majority of:

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

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

22 (3) a panel of one or more independent and
23 disinterested individuals appointed by the court on a motion by the
24 limited partnership listing the names of the individuals to be
25 appointed and stating that, to the best of the limited
26 partnership's knowledge, the individuals to be appointed are
27 disinterested and qualified to make the determinations

1 contemplated by Section 153.408 [~~In a derivative action, the court~~
2 ~~may require the plaintiff to give security for the reasonable~~
3 ~~expenses incurred or expected to be incurred by a defendant in the~~
4 ~~action, including reasonable attorney's fees].~~

5 (b) An entity to which this subsection applies is
6 independent and disinterested under this section only if its
7 decision with respect to the limited partnership's derivative
8 proceeding is made by a majority of its governing persons who are
9 independent and disinterested with respect to that derivative
10 proceeding, even if those governing persons are not a majority of
11 its governing persons. This subsection applies to an entity that
12 is:

13 (1) a general partner of the limited partnership; or
14 (2) directly, or indirectly through one or more other
15 entities, a governing person of that general partner [~~The court may~~
16 ~~increase or decrease at any time the amount of the security on a~~
17 ~~showing that the security provided is inadequate or excessive].~~

18 (c) The court shall appoint a panel under Subsection (a)(3)
19 if the court finds that the individuals recommended by the limited
20 partnership are independent and disinterested and are otherwise
21 qualified with respect to expertise, experience, independent
22 judgment, and other factors considered appropriate by the court
23 under the circumstances to make the determinations. An individual
24 appointed by the court to a panel under this section may not be held
25 liable to the limited partnership or the limited partnership's
26 partners for an action taken or omission made by the individual in
27 that capacity, except for an act or omission constituting fraud or

1 wilful misconduct [~~If a plaintiff is unable to give security, the~~
2 ~~plaintiff may file an affidavit in accordance with the Texas Rules~~
3 ~~of Civil Procedure~~].

4 [~~(d) Except as provided by Subsection (c), if a plaintiff~~
5 ~~fails to give the security within a reasonable time set by the~~
6 ~~court, the court shall dismiss the suit without prejudice.~~

7 [~~(e) The court, on final judgment for a defendant and on a~~
8 ~~finding that suit was brought without reasonable cause against the~~
9 ~~defendant, may require the plaintiff to pay reasonable expenses,~~
10 ~~including reasonable attorney's fees, to the defendant, regardless~~
11 ~~of whether security has been required.]~~

12 SECTION 29. Section 153.405, Business Organizations Code,
13 is amended to read as follows:

14 Sec. 153.405. STAY OF PROCEEDING [~~EXPENSES OF PLAINTIFF~~].

15 (a) If the limited partnership that is the subject of a derivative
16 proceeding commences an inquiry into the allegations made in a
17 demand or petition and the person or group of persons described by
18 Section 153.404 is conducting an active review of the allegations
19 in good faith, the court shall stay a derivative proceeding for not
20 more than 60 days until the review is completed and a determination
21 is made by the person or group regarding what further action, if
22 any, should be taken.

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

27 (c) A stay, on motion, may be reviewed every 60 days for

1 continuation of the stay if the limited partnership provides the
2 court and the limited partner with a written statement of the status
3 of the review and the reasons why an extension for a period not to
4 exceed 60 additional days is appropriate. An extension shall be
5 granted for a period not to exceed 60 days if the court determines
6 that the continuation is appropriate in the interests of the
7 partnership [~~If a derivative action is successful, wholly or~~
8 ~~partly, or if anything is received by the plaintiff because of a~~
9 ~~judgment, compromise, or settlement of the action or claim~~
10 ~~constituting a part of the action, the court may award the plaintiff~~
11 ~~reasonable expenses, including reasonable attorney's fees, and~~
12 ~~shall direct the plaintiff to remit to a party identified by the~~
13 ~~court the remainder of the proceeds received by the plaintiff].~~

14 SECTION 30. Subchapter I, Chapter 153, Business
15 Organizations Code, is amended by adding Sections 153.406, 153.407,
16 153.408, 153.409, 153.410, 153.411, 153.412, and 153.413 to read as
17 follows:

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

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

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

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

1 (b) Discovery described by Subsection (a) may not be
2 expanded to include a fact or substantive matter regarding the act,
3 omission, or other matter that is the subject matter of the
4 derivative proceeding, but the scope of discovery shall not be so
5 limited if the court determines after notice and hearing that a good
6 faith review of the allegations has not been made by an independent
7 and disinterested person or group in accordance with Sections
8 153.404 and 153.408.

9 Sec. 153.407. TOLLING OF STATUTE OF LIMITATIONS. A written
10 demand filed with the limited partnership under Section 153.403
11 tolls the statute of limitations on the claim on which demand is
12 made until the later of:

13 (1) the 31st day after the expiration of any waiting
14 period under Section 153.403; or

15 (2) the 31st day after the expiration of any stay
16 granted under Section 153.405, including all continuations of the
17 stay.

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

26 (b) In determining whether the requirements of Subsection
27 (a) have been met, the burden of proof shall be on:

1 (1) the plaintiff limited partner if:

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

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

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

12 (2) the limited partnership in any other circumstance.

13 Sec. 153.409. ALLEGATIONS AFTER DEMAND REJECTED. If a
14 derivative proceeding is instituted after a demand is rejected, the
15 petition must allege with particularity facts that establish that
16 the rejection was not made in accordance with the requirements and
17 standards under Sections 153.404 and 153.408.

18 Sec. 153.410. DISCONTINUANCE OR SETTLEMENT. (a) A
19 derivative proceeding may not be discontinued or settled without
20 court approval.

21 (b) The court shall direct that notice be given to the
22 affected partners if the court determines that a proposed
23 discontinuance or settlement may substantially affect the
24 interests of other partners.

25 Sec. 153.411. PAYMENT OF EXPENSES. (a) In this section,
26 "expenses" means reasonable expenses incurred by a party in a
27 derivative proceeding, including:

1 (1) attorney's fees;

2 (2) costs in pursuing an investigation of the matter
3 that was the subject of the derivative proceeding; or

4 (3) expenses for which the limited partnership may be
5 required to indemnify another person.

6 (b) On termination of a derivative proceeding, the court may
7 order:

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

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

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

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

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

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

1 Sec. 153.412. APPLICATION TO FOREIGN LIMITED
2 PARTNERSHIPS. (a) In a derivative proceeding brought in the right
3 of a foreign limited partnership, the matters covered by this
4 subchapter are governed by the laws of the jurisdiction of
5 formation of the foreign limited partnership, except for Sections
6 153.405, 153.410, and 153.411, which are procedural provisions and
7 do not relate to the internal affairs of the foreign limited
8 partnership, unless applying the laws of the jurisdiction of
9 formation of the foreign limited partnership requires otherwise
10 with respect to Section 153.405.

11 (b) In the case of matters relating to a foreign limited
12 partnership under Section 153.405, a reference to a person or group
13 of persons described by Section 153.404 refers to a person or group
14 entitled under the laws of the jurisdiction of formation of the
15 foreign limited partnership to make the determination described by
16 Section 153.404(a). The standard of review of a determination made
17 by the person or group shall be governed by the laws of the
18 jurisdiction of formation of the foreign limited partnership.

19 Sec. 153.413. CLOSELY HELD LIMITED PARTNERSHIP. (a) In
20 this section, "closely held limited partnership" means a limited
21 partnership that has:

- 22 (1) fewer than 35 limited partners; and
23 (2) no partnership interests listed on a national
24 securities exchange or regularly quoted in an over-the-counter
25 market by one or more members of a national securities association.

26 (b) Sections 153.402-153.410 do not apply to a claim or a
27 derivative proceeding by a limited partner of a closely held

1 limited partnership against a general partner, limited partner, or
2 officer of the limited partnership. In the event the claim or
3 derivative proceeding is also made against a person who is not that
4 general partner, limited partner, or officer, this subsection shall
5 apply only to the claim or derivative proceeding against the
6 general partner, limited partner, or officer.

7 (c) If Sections 153.402-153.410 do not apply because of
8 Subsection (b) and if justice requires:

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

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

17 (d) Other provisions of state law govern whether a limited
18 partner has a direct cause of action or right to sue a general
19 partner, limited partner, or officer, and this section may not be
20 construed to create that direct cause of action or right to sue.

21 SECTION 31. The changes in law made by this Act apply only
22 to a derivative proceeding instituted on or after the effective
23 date of this Act. A derivative proceeding instituted before the
24 effective date of this Act is governed by the law in effect on the
25 date the proceeding was instituted, and the former law is continued
26 in effect for that purpose.

27 SECTION 32. This Act takes effect September 1, 2019.