

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 a corporation is the surviving form of an entity in a  
3 conversion, a shareholder of that entity 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 a limited liability company is the surviving form of  
27 an entity in a conversion, a member of that entity may not institute

1 or maintain a derivative proceeding based on an act or omission that  
2 occurred with respect to the converting entity before the date of  
3 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 is independent and disinterested only if its  
25 decision with respect to the limited liability company's derivative  
26 proceeding is made by a majority of its governing persons who are  
27 independent and disinterested with respect to that derivative

1 proceeding, even if those governing persons are not a majority of  
2 its governing persons. This section applies to an entity that is:

3 (1) a managing entity of the limited liability  
4 company; or

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

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

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

20 Sec. 101.455. STAY OF PROCEEDING. (a) If the [~~domestic or~~  
21 ~~foreign~~] limited liability company that is the subject of a  
22 derivative proceeding commences an inquiry into the allegations  
23 made in a demand or petition and the person or group of persons  
24 described by Section 101.454 is conducting an active review of the  
25 allegations in good faith, the court shall stay a derivative  
26 proceeding for not more than 60 days until the review is completed  
27 and a determination is made by the person or group regarding what

1 further action, if any, should be taken.

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

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

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

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

24 Sec. 101.456. DISCOVERY. (a) If a [~~domestic or foreign~~]  
25 limited liability company proposes to dismiss a derivative  
26 proceeding under Section 101.458, discovery by a member after the  
27 filing of the derivative proceeding in accordance with this

1 subchapter shall be limited to:

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

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

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

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

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

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

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

26 (2) the 31st day after the expiration of any stay  
27 granted under Section 153.405, including all continuations of the



1 stay [~~date the limited liability company advises the member that~~  
2 ~~the demand has been rejected or the review has been completed~~].

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

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

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

15 (1) the plaintiff member if:

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

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

23 (C) the limited liability company presents prima  
24 facie evidence that demonstrates that the applicable person or  
25 persons making the determination [~~appointed~~] under Section  
26 101.454(a) [~~101.454(a)(2)~~] are independent and disinterested; or

27 (2) the limited liability company in any other

1 circumstance.

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

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

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

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

14 (1) attorney's fees;

15 (2) costs in [~~of~~] pursuing an investigation of the  
16 matter that was the subject of the derivative proceeding; or

17 (3) expenses for which the [~~domestic or foreign~~]  
18 limited liability company may be required to indemnify another  
19 person.

20 (b) On termination of a derivative proceeding, the court may  
21 order:

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

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

1 ~~or foreign~~] limited liability company or other defendant incurred  
2 in investigating and defending the proceeding if the court finds  
3 the proceeding has been instituted or maintained without reasonable  
4 cause or for an improper purpose; or

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

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

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

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

16 SECTION 23. Section [101.462](#), Business Organizations Code,  
17 is amended to read as follows:

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

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

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

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

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

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

1 member, or officer.

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

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

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

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

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

18 Sec. 153.401. DEFINITIONS [~~RIGHT TO BRING ACTION~~]. In this  
19 subchapter:

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

23 (2) "Limited partner" means a person who is a limited  
24 partner or is an assignee of a partnership interest, including the  
25 partnership interest of a general partner [~~A limited partner may~~  
26 ~~bring an action in a court on behalf of the limited partnership to~~  
27 ~~recover a judgment in the limited partnership's favor if:~~

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

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

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

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

10           (1) the limited partner:

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

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

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

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

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

26           (2) the limited partner fairly and adequately  
27 represents the interests of the limited partnership in enforcing

1 the right of the limited partnership [~~In a derivative action, the~~  
2 ~~plaintiff must be a limited partner when the action is brought and:~~

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

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

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

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

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

20 (1) the limited partner has been notified that the  
21 demand has been rejected by the limited partnership;

22 (2) the limited partnership is suffering irreparable  
23 injury; or

24 (3) irreparable injury to the limited partnership  
25 would result by waiting for the expiration of the 90-day period [~~In~~  
26 ~~a derivative action, the complaint must contain with particularity:~~

27 ~~(1) the effort, if any, of the plaintiff to secure~~

1 ~~initiation of the action by a general partner, or~~

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

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

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

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

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

20 (3) a panel of one or more independent and  
21 disinterested individuals appointed by the court on a motion by the  
22 limited partnership listing the names of the individuals to be  
23 appointed and stating that, to the best of the limited  
24 partnership's knowledge, the individuals to be appointed are  
25 disinterested and qualified to make the determinations  
26 contemplated by Section 153.408 ~~[In a derivative action, the court~~  
27 ~~may require the plaintiff to give security for the reasonable~~



1 ~~expenses incurred or expected to be incurred by a defendant in the~~  
2 ~~action, including reasonable attorney's fees].~~

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

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

14 (c) The court shall appoint a panel under Subsection (a)(3)  
15 if the court finds that the individuals recommended by the limited  
16 partnership are independent and disinterested and are otherwise  
17 qualified with respect to expertise, experience, independent  
18 judgment, and other factors considered appropriate by the court  
19 under the circumstances to make the determinations. An individual  
20 appointed by the court to a panel under this section may not be held  
21 liable to the limited partnership or the limited partnership's  
22 partners for an action taken or omission made by the individual in  
23 that capacity, except for an act or omission constituting fraud or  
24 wilful misconduct [~~If a plaintiff is unable to give security, the~~  
25 ~~plaintiff may file an affidavit in accordance with the Texas Rules~~  
26 ~~of Civil Procedure)].~~

27 [~~(d) Except as provided by Subsection (c), if a plaintiff~~

1 ~~fails to give the security within a reasonable time set by the~~  
2 ~~court, the court shall dismiss the suit without prejudice.~~

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

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

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

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

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

23 (c) A stay, on motion, may be reviewed every 60 days for  
24 continuation of the stay if the limited partnership provides the  
25 court and the limited partner with a written statement of the status  
26 of the review and the reasons why an extension for a period not to  
27 exceed 60 additional days is appropriate. An extension shall be

1 granted for a period not to exceed 60 days if the court determines  
2 that the continuation is appropriate in the interests of the  
3 partnership [~~If a derivative action is successful, wholly or~~  
4 ~~partly, or if anything is received by the plaintiff because of a~~  
5 ~~judgment, compromise, or settlement of the action or claim~~  
6 ~~constituting a part of the action, the court may award the plaintiff~~  
7 ~~reasonable expenses, including reasonable attorney's fees, and~~  
8 ~~shall direct the plaintiff to remit to a party identified by the~~  
9 ~~court the remainder of the proceeds received by the plaintiff)].~~

10 SECTION 30. Subchapter I, Chapter 153, Business  
11 Organizations Code, is amended by adding Sections 153.406, 153.407,  
12 153.408, 153.409, 153.410, 153.411, 153.412, and 153.413 to read as  
13 follows:

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

18 (1) facts relating to whether the person or persons  
19 described by Section 153.404 are independent and 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 if the court determines after notice and hearing that a good  
2 faith review of the allegations has not been made by an independent  
3 and disinterested person or group in accordance with Sections  
4 153.404 and 153.408.

5 Sec. 153.407. TOLLING OF STATUTE OF LIMITATIONS. A written  
6 demand filed with the limited partnership under Section 153.403  
7 tolls the statute of limitations on the claim on which demand is  
8 made until the later of:

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

11 (2) the 31st day after the expiration of any stay  
12 granted under Section 153.405, including all continuations of the  
13 stay.

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

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

24 (1) the plaintiff limited partner if:

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

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

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

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

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

14           Sec. 153.410. DISCONTINUANCE OR SETTLEMENT. (a) A  
15 derivative proceeding may not be discontinued or settled without  
16 court approval.

17           (b) The court shall direct that notice be given to the  
18 affected partners if the court determines that a proposed  
19 discontinuance or settlement may substantially affect the  
20 interests of other partners.

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

24           (1) attorney's fees;

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

27           (3) expenses for which the limited partnership may be

1 required to indemnify another person.

2 (b) On termination of a derivative proceeding, the court may  
3 order:

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

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

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

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

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

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

24 Sec. 153.412. APPLICATION TO FOREIGN LIMITED  
25 PARTNERSHIPS. (a) In a derivative proceeding brought in the right  
26 of a foreign limited partnership, the matters covered by this  
27 subchapter are governed by the laws of the jurisdiction of

1 formation of the foreign limited partnership, except for Sections  
2 153.405, 153.410, and 153.411, which are procedural provisions and  
3 do not relate to the internal affairs of the foreign limited  
4 partnership, unless applying the laws of the jurisdiction of  
5 formation of the foreign limited partnership requires otherwise  
6 with respect to Section 153.405.

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

15 Sec. 153.413. CLOSELY HELD LIMITED PARTNERSHIP. (a) In  
16 this section, "closely held limited partnership" means a limited  
17 partnership that has:

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

22 (b) Sections 153.402-153.410 do not apply to a claim or a  
23 derivative proceeding by a limited partner of a closely held  
24 limited partnership against a general partner, limited partner, or  
25 officer of the limited partnership. In the event the claim or  
26 derivative proceeding is also made against a person who is not that  
27 general partner, limited partner, or officer, this subsection shall

1 apply only to the claim or derivative proceeding against the  
2 general partner, limited partner, or officer.

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

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

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

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

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

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