

GENERAL ASSEMBLY OF NORTH CAROLINA
1995 SESSION

CHAPTER 149
HOUSE BILL 420

AN ACT TO REVISE THE LAW GOVERNING THE PROCEDURES FOR FILING
AND MAINTAINING SHAREHOLDER DERIVATIVE SUITS.

The General Assembly of North Carolina enacts:

Section 1. Part 4 of Article 7 of Chapter 55 of the General Statutes reads as rewritten:

"Part 4. Derivative Proceedings.

"§ 55-7-40. Shareholders' derivative actions.

(a) ~~An action may be brought in the superior court of this State, which shall have exclusive original jurisdiction over actions brought hereunder, in the right of any domestic or foreign corporation by a shareholder or holder of a beneficial interest in shares of such corporation; provided that the plaintiff or plaintiffs must comply with the provisions of subsection (g) of this section, if applicable, and must allege, and it must appear, that each plaintiff was a shareholder or holder of a beneficial interest in such shares at the time of the transaction of which he complains or that his shares or beneficial interest in such shares devolved upon him by operation of law from a person who was a shareholder or holder of a beneficial interest in such shares at such time.~~

(b) ~~The complaint shall allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and the reasons for his failure to obtain the action or for not making the effort. Whether or not a demand for action was made, if the corporation commences an investigation of the charges made in the demand or complaint, the court may stay any proceeding until the investigation is completed.~~

(c) ~~Upon motion of the corporation, the court may appoint a committee composed of two or more disinterested directors or other disinterested persons, acceptable to the corporation, to determine whether it is in the best interests of the corporation to pursue a particular legal right or remedy. The committee shall report its findings to the court. After considering the report and any other relevant evidence, the court shall determine whether the proceeding should be continued or not.~~

(d) ~~Such action shall not be discontinued, dismissed, compromised or settled without the approval of the court. If the court shall determine that the interest of the shareholders or any class or classes thereof, or of the creditors of the corporation, will be substantially affected by such discontinuance, dismissal, compromise or settlement, the court, in its discretion, may direct that notice, by publication or otherwise, shall be given to such shareholders or creditors whose interests it determines will be so affected. If notice is so directed to be given, the court may determine which one or more of the~~

parties to the action shall bear the expense of giving the same, in such amount as the court shall determine and find to be reasonable in the circumstances, and the amount of such expense shall be awarded as costs of the action.

~~(e) If the action on behalf of the corporation is successful, in whole or part, whether by means of a compromise and settlement or by a judgment, the court may award the plaintiff the reasonable expenses of maintaining the action, including reasonable attorneys' fees, and shall direct the plaintiff to account to the corporation for the remainder of any proceeds of the action.~~

~~(f) In any such action the court, upon final judgement and a finding that the action was brought without reasonable cause, may require the plaintiff or plaintiffs to pay to the defendant or defendants the reasonable expenses, including attorneys' fees, incurred by them in the defense of the action.~~

~~(g) In addition to all other provisions of this section, any action brought on behalf of a corporation that is a public corporation at the time of such action against one or more of its directors for monetary damages the plaintiff or plaintiffs must (i) allege, and it must appear, that each plaintiff has been a shareholder or holder of a beneficial interest in shares of the corporation for at least one year; (ii) bring the action within two years of the date of the transaction of which he complains; and (iii) execute and deposit with the clerk a written undertaking with sufficient surety, approved by the judge, in an amount to be fixed by the judge to indemnify the corporation against any and all expenses expected to be incurred by the corporation in connection with the proceeding, including those arising by way of indemnity, if the court in its discretion so requires.~~

~~(h) In proceedings hereunder, no shareholder shall be entitled to obtain or have access to any communication within the scope of the corporation's attorney-client privilege which could not be obtained by or would not be accessible to a party in an action other than on behalf of the corporation.~~

Subject to the provisions of G.S. 55-7-41 and G.S. 55-7-42, a shareholder may bring a derivative proceeding in the superior court of this State. The superior court has exclusive original jurisdiction over shareholder derivative actions.

"§ 55-7-40.1. Definitions.

In this Part:

- (1) 'Derivative proceeding' means a civil suit in the right of a domestic corporation or, to the extent provided in G.S. 55-7-47, in the right of a foreign corporation.
- (2) 'Shareholder' has the same meaning as in G.S. 55-1-40 and includes a beneficial owner whose shares are held in a voting trust or held by a nominee on the beneficial owner's behalf.

"§ 55-7-41. Standing.

A shareholder may not commence or maintain a derivative proceeding unless the shareholder:

- (1) Was a shareholder of the corporation at the time of the act or omission complained of or became a shareholder through transfer by operation of law from one who was a shareholder at that time; and

- (2) Fairly and adequately represents the interests of the corporation in enforcing the right of the corporation.

"§ 55-7-42. Demand.

No shareholder may commence a derivative proceeding until:

- (1) A written demand has been made upon the corporation to take suitable action; and
- (2) 90 days have expired from the date the demand was made unless, prior to the expiration of the 90 days, the shareholder was notified that the corporation rejected the demand, or unless irreparable injury to the corporation would result by waiting for the expiration of the 90-day period.

"§ 55-7-43. Stay of proceedings.

If the corporation commences an inquiry into the allegations set forth in the demand or complaint, the court may stay a derivative proceeding for a period of time the court deems appropriate.

"§ 55-7-44. Dismissal.

(a) The court shall dismiss a derivative proceeding on motion of the corporation if one of the groups specified in subsection (b) or (f) of this section determines in good faith after conducting a reasonable inquiry upon which its conclusions are based that the maintenance of the derivative proceeding is not in the best interest of the corporation.

(b) Unless a panel is appointed pursuant to subsection (f) of this section, the inquiry and determination shall be made by:

- (1) A majority vote of independent directors present at a meeting of the board of directors if the independent directors constitute a quorum; or
- (2) A majority vote of a committee consisting of two or more independent directors appointed by majority vote of independent directors present at a meeting of the board of directors, whether or not the independent directors constituted a quorum.

(c) For purposes of this section, none of the following factors by itself shall cause a director to be considered not independent:

- (1) The nomination or election of the director by persons who are defendants in the derivative proceeding or against whom action is demanded;
- (2) The naming of the director as a defendant in the derivative proceeding or as a person against whom action is demanded; or
- (3) The approval by the director of the act being challenged in the derivative proceeding or demand if the act resulted in no personal benefit to the director.

(d) If a derivative proceeding is commenced after a determination has been made rejecting a demand by a shareholder, the complaint shall allege with particularity facts establishing that the requirements of subsection (a) of this section have not been met. Defendants may make a motion to dismiss a complaint for failure to comply with this subsection. Prior to the court's ruling on a motion to dismiss for failure to comply with this subsection, the plaintiff shall be entitled to discovery only with respect to the issues

presented by the motion and only if and to the extent that the plaintiff has alleged such facts with particularity. The preliminary discovery shall be limited solely to matters germane and necessary to support the facts alleged with particularity relating solely to the requirements of subsection (a) of this section.

(e) If a majority of the board of directors does not consist of independent directors at the time the determination is made, the corporation shall have the burden of proving that the requirements of subsection (a) of this section have been met. If a majority of the board of directors consists of independent directors at the time the determination is made, the plaintiff shall have the burden of proving that the requirements of subsection (a) of this section have not been met.

(f) The court may appoint a panel of one or more independent persons upon motion of the corporation to make a determination whether the maintenance of the derivative proceeding is in the best interest of the corporation. The plaintiff shall have the burden of proving that the requirements of subsection (a) of this section have not been met.

"§ 55-7-45. Discontinuance or settlement.

(a) A derivative proceeding may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interests of the corporation's shareholders or a class of shareholders, the court shall direct that notice be given to the shareholders affected.

(b) The court shall determine the manner and form of the notice and the manner in which costs of the notice shall be borne.

"§ 55-7-46. Payment of expenses.

On termination of the derivative proceeding, the court may:

- (1) Order the corporation to pay the plaintiff's reasonable expenses, including attorneys' fees, incurred in the proceeding if it finds that the proceeding has resulted in a substantial benefit to the corporation;
- (2) Order the plaintiff to pay any defendant's reasonable expenses, including attorneys' fees, incurred in defending the proceeding if it finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose; or
- (3) Order a party to pay an opposing party's reasonable expenses, including attorneys' fees, incurred as a result of the filing of a pleading, motion, or other paper, if the court, after reasonable inquiry, finds that the pleading, motion, or other paper was not well grounded in fact or was not warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it was interposed for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

"§ 55-7-47. Applicability to foreign corporations.

In any derivative proceeding in the right of a foreign corporation, the matters covered by this Part shall be governed by the laws of the jurisdiction of incorporation of the foreign corporation except for the matters governed by G.S. 55-7-43, 55-7-45, and 55-7-46.

"§ 55-7-48. Suits against directors of public corporations.

In addition to the requirements of this Part, the plaintiff in an action brought on behalf of a corporation that is a public corporation at the time of the action against one or more of its directors for monetary damages shall:

- (1) Allege, and it must appear, that each plaintiff has been a shareholder or holder of a beneficial interest in shares of the corporation for at least one year;
- (2) Bring the action within two years of the date of the transaction of which the plaintiff complains; and
- (3) If the court orders, execute and deposit with the clerk of court a written undertaking with sufficient surety, approved by the court, to indemnify the corporation against any and all expenses reasonably expected to be incurred by the corporation in connection with the proceeding, including expenses arising by way of indemnity.

"§ 55-7-49. Privileged communications.

In any derivative proceeding, no shareholder shall be entitled to obtain or have access to any communication within the scope of the corporation's attorney-client privilege that could not be obtained by or would not be accessible to a party in an action other than on behalf of the corporation."

Sec. 2. This act becomes effective October 1, 1995, and applies to actions upon which shareholder derivative suits are based occurring on or after that date.

In the General Assembly read three times and ratified this the 1st day of June, 1995.

Dennis A. Wicker
President of the Senate

Harold J. Brubaker
Speaker of the House of Representatives