

14A:3-6.1 to 14A:3-6.9
LEGISLATIVE HISTORY CHECKLIST
 Compiled by the NJ State Law Library

LAWS OF: 2013 **CHAPTER:** 42

NJSA: 14A:3-6.1 to 14A:3-6.9 (Revises law concerning derivative proceedings and shareholder class actions)

BILL NO: A3123 (Substituted for S2326)

SPONSOR(S) Diegnan and others

DATE INTRODUCED: June 18, 2012

COMMITTEE: **ASSEMBLY:** Commerce and Economic Development

SENATE: Commerce

AMENDED DURING PASSAGE: Yes

DATE OF PASSAGE: **ASSEMBLY:** December 17, 2012

SENATE: February 7, 2013

DATE OF APPROVAL: April 1, 2013

FOLLOWING ARE ATTACHED IF AVAILABLE:

FINAL TEXT OF BILL (First reprint enacted)

A3123

SPONSOR'S STATEMENT: (Begins on page 6 of introduced bill) Yes

COMMITTEE STATEMENT: **ASSEMBLY:** Yes

SENATE: Yes

(Audio archived recordings of the committee meetings, corresponding to the date of the committee statement, *may possibly* be found at www.njleg.state.nj.us)

FLOOR AMENDMENT STATEMENT: No

LEGISLATIVE FISCAL NOTE: No

S2326

SPONSOR'S STATEMENT: (Begins on page 6 of introduced bill) Yes

COMMITTEE STATEMENT: **ASSEMBLY:** No

SENATE: Yes

FLOOR AMENDMENT STATEMENT: No

LEGISLATIVE FISCAL ESTIMATE: No

(continued)

VETO MESSAGE: No

GOVERNOR'S PRESS RELEASE ON SIGNING: No

FOLLOWING WERE PRINTED:

To check for circulating copies, contact New Jersey State Government Publications at the State Library (609) 278-2640 ext.103 or <mailto:refdesk@njstatelib.org>

REPORTS: No

HEARINGS: No

NEWSPAPER ARTICLES: No

LAW/RWH

P.L.2013, CHAPTER 42, *approved April 1, 2013*
Assembly, No. 3123 (*First Reprint*)

1 **AN ACT** concerning derivative proceedings and shareholder class
2 actions, supplementing chapter 3 of Title 14A of the New Jersey
3 Statutes, and repealing N.J.S.14A:3-6.

4

5 **BE IT ENACTED** by the Senate and General Assembly of the State
6 of New Jersey:

7

8 1. As used in this section:

9 “Derivative proceeding” means a civil suit in the right of a
10 domestic corporation.

11 “Shareholder” includes a beneficial owner whose shares are held
12 in a voting trust or held by a nominee on the beneficial owner’s
13 behalf.

14 “Shareholder class action” means a civil suit by a shareholder
15 against a domestic corporation or its directors or officers which
16 alleges a breach of any duty by the directors or officers or the
17 corporation which is imposed in whole or in part by statutory or
18 common law of the State of New Jersey and seeks a right, remedy,
19 or damages on behalf of a class of the domestic corporation’s
20 shareholders.

21

22 2. A shareholder may not commence or maintain a derivative
23 proceeding unless the shareholder:

24 (1) was a shareholder of the corporation at the time of the act or
25 omission complained of or became a shareholder through transfer
26 by operation of law from one who was a shareholder at that time
27 and remains a shareholder throughout the derivative proceeding;
28 and

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

31

32 3. No shareholder may commence a derivative proceeding
33 until:

34 (1) a written demand has been made upon the corporation to
35 take suitable action; and

36 (2) 90 days have expired from the date the demand was made
37 unless the shareholder has earlier been notified that the demand has

EXPLANATION – Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and is intended to be omitted in the law.

Matter underlined thus is new matter.

Matter enclosed in superscript numerals has been adopted as follows:

¹Assembly ACE committee amendments adopted September 24, 2012.

1 been rejected by the corporation or unless irreparable injury to the
2 corporation would result by waiting for the expiration of the 90-day
3 period.

4

5 4. If the corporation commences an inquiry into the allegations
6 made in the demand or complaint, the court may stay any derivative
7 proceeding as the court deems appropriate.

8

9 5. (1) Subject to subsection (5) of this section, a derivative
10 proceeding shall be dismissed by the court on motion by the
11 corporation if the court finds that:

12 (a) the person or group specified in paragraphs (a) or (b) of
13 subsection (2) of this section or subsection (6) of this section has
14 determined in good faith, after conducting a reasonable inquiry
15 upon which its conclusions are based, that the maintenance of the
16 derivative proceeding is not in the best interests of the corporation;
17 or

18 (b) the shareholders specified in paragraph (c) of subsection (2)
19 of this section have voted to terminate the derivative proceeding.

20 (2) Unless a panel is appointed pursuant to subsection (6) of this
21 section, the determination in subsection (1) of this section shall be
22 made by:

23 (a) a majority vote of independent directors present at a meeting
24 of the board of directors if the independent directors constitute a
25 quorum;

26 (b) a majority vote of a committee consisting of one or more
27 independent directors appointed by majority vote of independent
28 directors, or one independent director if the board consists of only
29 one independent director, present at a meeting of the board of
30 directors, regardless of whether those independent directors
31 constitute a quorum of the board; or

32 (c) the vote of the holders of a majority of the outstanding
33 shares entitled to vote, not including shares owned by or voted
34 under the control of a shareholder or related person who has or had
35 a material beneficial financial interest in the act or omission
36 complained of or other interest therein that would reasonably be
37 expected to exert an influence on that shareholder's or related
38 person's judgment if called upon to vote in the determination.

39 (3) If a derivative proceeding is commenced after a
40 determination has been made rejecting a demand by a shareholder,
41 the complaint shall allege with particularity facts establishing '[:

42 (a) that¹ a majority of the board of directors, or all members of
43 a **['Committee] committee**¹, which in either case determined the
44 matter, did not consist of independent directors at the time the
45 determination was made **['];** or

46 (b) the requirements of subsection (1) of this section have not
47 been met; or

48 (c) **both**¹ .

1 (4) If a majority of the board of directors consisted of
2 independent directors at the time the determination in subsection (1)
3 of this section was made or if the determination is made by
4 shareholders, the plaintiff shall have the burden of proving that the
5 requirements of subsection (1) of this section have not been met. If
6 a majority of the board of directors does not consist of independent
7 directors at the time the determination by independent directors is
8 made, the corporation shall have the burden of proving that the
9 requirements of subsection (1) of this section have been met.

10 (5) (a) If the corporation moves to dismiss the derivative
11 proceeding, it shall make a written filing with the court setting
12 forth, among other things, facts to show:

13 (i) whether or not a majority of the board of directors was
14 independent at the time of the determination by the independent
15 director or directors; and

16 (ii) that the independent director or directors made the
17 determination in good faith after conducting a reasonable inquiry
18 upon which the conclusions are based.

19 (b) Following a motion filed pursuant to paragraph (a) of this
20 subsection, the court shall dismiss the derivative suit unless:

21 (i) the court finds that the requirements of subsection (1) of this
22 section have not been met, taking into account the burden of proof
23 under subsections (4) or (6) of this section; or

24 (ii) the plaintiff, in its complaint, an amended complaint, or in a
25 written filing with the court, has alleged with particularity facts
26 rebutting the facts contained in the corporation's filing.

27 (c) All discovery proceedings shall be stayed upon the filing by
28 the corporation of its motion to dismiss and the filing required by
29 this subsection until the notice of entry of the order ruling on the
30 motion. Notwithstanding the foregoing stay of discovery, the court,
31 on motion and after a hearing, may order that specified and limited
32 discovery be conducted if plaintiffs make a good cause showing of
33 alleged facts which evidence a lack of independence by the person
34 or group making the determination for the corporation or a lack of a
35 good faith determination. Limited discovery shall not include the
36 work product, privileged communications, or testimony of attorneys
37 who advised or assisted the person or group making the
38 determination.

39 (6) Upon motion by the corporation, the court may appoint a
40 panel of one or more individuals to make a determination whether
41 the maintenance of the derivative proceeding is in the best interests
42 of the corporation. The plaintiff shall have the burden of proving to
43 the panel that the requirements of subsection (1) of this section have
44 not been met.

45 (7) (a) A director shall be considered independent for the
46 purposes of this section if the director has:

47 (i) no economic interest in the challenged act or transaction
48 material to him or her, other than an economic interest that is shared
49 by all shareholders generally; and

1 (ii) no material, personal, or business relationships with the
2 defendant directors or officers who have a material interest in the
3 act or transaction challenged.

4 (b) None of the following shall by itself cause a director to be
5 considered not independent for the purposes of this section:

6 (i) the nomination or election of the director by a person who is
7 a defendant in the derivative proceeding or against whom action is
8 demanded;

9 (ii) the naming of the director as a defendant in the derivative
10 proceeding or as a person against whom action is demanded; or

11 (iii) the approval by the director of the act being challenged in
12 the derivative proceeding or demand if the act resulted in no
13 personal benefit to the director.

14

15 6. A derivative proceeding or a shareholder class action may
16 not be discontinued or settled without the court's approval. If the
17 court determines that a proposed discontinuance or settlement will
18 substantially affect the interests of the corporation's shareholders or
19 a class of shareholders, the court shall direct that notice be given to
20 the shareholders affected.

21

22 7. On termination of a derivative proceeding or a shareholder
23 class action the court may:

24 (1) order the corporation to pay the plaintiff's expenses incurred
25 in the proceeding if it finds that the proceeding has resulted in a
26 substantial benefit to the corporation;

27 (2) order the plaintiff to pay any defendant's expenses incurred
28 in defending the proceeding if it finds that the proceeding was
29 commenced or maintained without the exercise of reasonable
30 diligence by the plaintiff or without reasonable cause or for an
31 improper purpose; or

32 (3) order a party to pay an opposing party's expenses incurred
33 because of the filing of a pleading, motion or other paper, if it finds
34 that the pleading, motion or other paper was not well grounded in
35 fact, after reasonable inquiry, or warranted by existing law or a
36 good faith argument for the extension, modification or reversal of
37 existing law and was interposed for an improper purpose, such as to
38 harass or cause unnecessary delay or needlessly increase in the cost
39 of litigation.

40

41 8. In any derivative proceeding or shareholder class action
42 instituted by a shareholder or shareholders holding less than 5% of
43 the outstanding shares of any class or series of the corporation,
44 unless the shares have a market value in excess of \$250,000, the
45 corporation in whose right the action is brought shall be entitled at
46 any time before final judgment to require the plaintiff or plaintiffs
47 to give security for the reasonable expenses, including fees of
48 attorneys, that may be incurred by it in connection with the action
49 or may be incurred by other parties named as defendant for which it

1 may become legally liable. Market value shall be determined as of
2 the date that the plaintiff institutes the action or, in the case of an
3 intervener, as of the date that the intervener becomes a party to the
4 action. The corporation shall have recourse to that security in that
5 amount which the court having jurisdiction shall determine upon the
6 termination of the action in accordance with section 7 of P.L. ,
7 c. (C.)(pending before the Legislature as this bill).

8
9 9. In any derivative proceeding or shareholder class action, the
10 provisions of P.L. , c. (C.)(pending before the Legislature
11 as this bill) shall apply to actions brought in state or federal court
12 both within and outside of the State of New Jersey if the provisions
13 of P.L. , c. (C.)(pending before the Legislature as this bill)
14 are made applicable to the corporation by the certificate of
15 incorporation.

16
17 10. N.J.S.14A:3-6 is repealed.

18
19 11. This act shall take effect immediately.

20

21

22

23

24 _____
25 Revises law concerning derivative proceedings and shareholder
class actions.

ASSEMBLY, No. 3123

STATE OF NEW JERSEY 215th LEGISLATURE

INTRODUCED JUNE 18, 2012

Sponsored by:

Assemblyman PATRICK J. DIEGNAN, JR.

District 18 (Middlesex)

SYNOPSIS

Revises law concerning derivative proceedings and shareholder class actions.

CURRENT VERSION OF TEXT

As introduced.



1 AN ACT concerning derivative proceedings and shareholder class
2 actions, supplementing chapter 3 of Title 14A of the New Jersey
3 Statutes, and repealing N.J.S.14A:3-6.
4

5 **BE IT ENACTED** *by the Senate and General Assembly of the State*
6 *of New Jersey:*
7

8 1. As used in this section:

9 “Derivative proceeding” means a civil suit in the right of a
10 domestic corporation.

11 “Shareholder” includes a beneficial owner whose shares are held
12 in a voting trust or held by a nominee on the beneficial owner’s
13 behalf.

14 “Shareholder class action” means a civil suit by a shareholder
15 against a domestic corporation or its directors or officers which
16 alleges a breach of any duty by the directors or officers or the
17 corporation which is imposed in whole or in part by statutory or
18 common law of the State of New Jersey and seeks a right, remedy,
19 or damages on behalf of a class of the domestic corporation’s
20 shareholders.
21

22 2. A shareholder may not commence or maintain a derivative
23 proceeding unless the shareholder:

24 (1) was a shareholder of the corporation at the time of the act or
25 omission complained of or became a shareholder through transfer
26 by operation of law from one who was a shareholder at that time
27 and remains a shareholder throughout the derivative proceeding;
28 and

29 (2) fairly and adequately represents the interests of the
30 corporation in enforcing the right of the corporation.
31

32 3. No shareholder may commence a derivative proceeding
33 until:

34 (1) a written demand has been made upon the corporation to
35 take suitable action; and

36 (2) 90 days have expired from the date the demand was made
37 unless the shareholder has earlier been notified that the demand has
38 been rejected by the corporation or unless irreparable injury to the
39 corporation would result by waiting for the expiration of the 90-day
40 period.
41

42 4. If the corporation commences an inquiry into the allegations
43 made in the demand or complaint, the court may stay any derivative
44 proceeding as the court deems appropriate.
45

46 5. (1) Subject to subsection (5) of this section, a derivative
47 proceeding shall be dismissed by the court on motion by the
48 corporation if the court finds that:

1 (a) the person or group specified in paragraphs (a) or (b) of
2 subsection (2) of this section or subsection (6) of this section has
3 determined in good faith, after conducting a reasonable inquiry
4 upon which its conclusions are based, that the maintenance of the
5 derivative proceeding is not in the best interests of the corporation;
6 or

7 (b) the shareholders specified in paragraph (c) of subsection (2)
8 of this section have voted to terminate the derivative proceeding.

9 (2) Unless a panel is appointed pursuant to subsection (6) of this
10 section, the determination in subsection (1) of this section shall be
11 made by:

12 (a) a majority vote of independent directors present at a meeting
13 of the board of directors if the independent directors constitute a
14 quorum;

15 (b) a majority vote of a committee consisting of one or more
16 independent directors appointed by majority vote of independent
17 directors, or one independent director if the board consists of only
18 one independent director, present at a meeting of the board of
19 directors, regardless of whether those independent directors
20 constitute a quorum of the board; or

21 (c) the vote of the holders of a majority of the outstanding
22 shares entitled to vote, not including shares owned by or voted
23 under the control of a shareholder or related person who has or had
24 a material beneficial financial interest in the act or omission
25 complained of or other interest therein that would reasonably be
26 expected to exert an influence on that shareholder's or related
27 person's judgment if called upon to vote in the determination.

28 (3) If a derivative proceeding is commenced after a
29 determination has been made rejecting a demand by a shareholder,
30 the complaint shall allege with particularity facts establishing:

31 (a) a majority of the board of directors, or all members of a
32 Committee, which in either case determined the matter, did not
33 consist of independent directors at the time the determination was
34 made; or

35 (b) the requirements of subsection (1) of this section have not
36 been met; or

37 (c) both.

38 (4) If a majority of the board of directors consisted of
39 independent directors at the time the determination in subsection (1)
40 of this section was made or if the determination is made by
41 shareholders, the plaintiff shall have the burden of proving that the
42 requirements of subsection (1) of this section have not been met. If
43 a majority of the board of directors does not consist of independent
44 directors at the time the determination by independent directors is
45 made, the corporation shall have the burden of proving that the
46 requirements of subsection (1) of this section have been met.

47 (5) (a) If the corporation moves to dismiss the derivative
48 proceeding, it shall make a written filing with the court setting
49 forth, among other things, facts to show:

1 (i) whether or not a majority of the board of directors was
2 independent at the time of the determination by the independent
3 director or directors; and

4 (ii) that the independent director or directors made the
5 determination in good faith after conducting a reasonable inquiry
6 upon which the conclusions are based.

7 (b) Following a motion filed pursuant to paragraph (a) of this
8 subsection, the court shall dismiss the derivative suit unless:

9 (i) the court finds that the requirements of subsection (1) of this
10 section have not been met, taking into account the burden of proof
11 under subsections (4) or (6) of this section; or

12 (ii) the plaintiff, in its complaint, an amended complaint, or in a
13 written filing with the court, has alleged with particularity facts
14 rebutting the facts contained in the corporation's filing.

15 (c) All discovery proceedings shall be stayed upon the filing by
16 the corporation of its motion to dismiss and the filing required by
17 this subsection until the notice of entry of the order ruling on the
18 motion. Notwithstanding the foregoing stay of discovery, the court,
19 on motion and after a hearing, may order that specified and limited
20 discovery be conducted if plaintiffs make a good cause showing of
21 alleged facts which evidence a lack of independence by the person
22 or group making the determination for the corporation or a lack of a
23 good faith determination. Limited discovery shall not include the
24 work product, privileged communications, or testimony of attorneys
25 who advised or assisted the person or group making the
26 determination.

27 (6) Upon motion by the corporation, the court may appoint a
28 panel of one or more individuals to make a determination whether
29 the maintenance of the derivative proceeding is in the best interests
30 of the corporation. The plaintiff shall have the burden of proving to
31 the panel that the requirements of subsection (1) of this section have
32 not been met.

33 (7) (a) A director shall be considered independent for the
34 purposes of this section if the director has:

35 (i) no economic interest in the challenged act or transaction
36 material to him or her, other than an economic interest that is shared
37 by all shareholders generally; and

38 (ii) no material, personal, or business relationships with the
39 defendant directors or officers who have a material interest in the
40 act or transaction challenged.

41 (b) None of the following shall by itself cause a director to be
42 considered not independent for the purposes of this section:

43 (i) the nomination or election of the director by a person who is
44 a defendant in the derivative proceeding or against whom action is
45 demanded;

46 (ii) the naming of the director as a defendant in the derivative
47 proceeding or as a person against whom action is demanded; or

1 (iii) the approval by the director of the act being challenged in
2 the derivative proceeding or demand if the act resulted in no
3 personal benefit to the director.

4
5 6. A derivative proceeding or a shareholder class action may
6 not be discontinued or settled without the court's approval. If the
7 court determines that a proposed discontinuance or settlement will
8 substantially affect the interests of the corporation's shareholders or
9 a class of shareholders, the court shall direct that notice be given to
10 the shareholders affected.

11
12 7. On termination of a derivative proceeding or a shareholder
13 class action the court may:

14 (1) order the corporation to pay the plaintiff's expenses incurred
15 in the proceeding if it finds that the proceeding has resulted in a
16 substantial benefit to the corporation;

17 (2) order the plaintiff to pay any defendant's expenses incurred
18 in defending the proceeding if it finds that the proceeding was
19 commenced or maintained without the exercise of reasonable
20 diligence by the plaintiff or without reasonable cause or for an
21 improper purpose; or

22 (3) order a party to pay an opposing party's expenses incurred
23 because of the filing of a pleading, motion or other paper, if it finds
24 that the pleading, motion or other paper was not well grounded in
25 fact, after reasonable inquiry, or warranted by existing law or a
26 good faith argument for the extension, modification or reversal of
27 existing law and was interposed for an improper purpose, such as to
28 harass or cause unnecessary delay or needlessly increase in the cost
29 of litigation.

30
31 8. In any derivative proceeding or shareholder class action
32 instituted by a shareholder or shareholders holding less than 5% of
33 the outstanding shares of any class or series of the corporation,
34 unless the shares have a market value in excess of \$250,000, the
35 corporation in whose right the action is brought shall be entitled at
36 any time before final judgment to require the plaintiff or plaintiffs
37 to give security for the reasonable expenses, including fees of
38 attorneys, that may be incurred by it in connection with the action
39 or may be incurred by other parties named as defendant for which it
40 may become legally liable. Market value shall be determined as of
41 the date that the plaintiff institutes the action or, in the case of an
42 intervener, as of the date that the intervener becomes a party to the
43 action. The corporation shall have recourse to that security in that
44 amount which the court having jurisdiction shall determine upon the
45 termination of the action in accordance with section 7 of P.L. , c.
46 (C.)(pending before the Legislature as this bill).

47
48 9. In any derivative proceeding or shareholder class action, the
49 provisions of P.L. , c. (C.)(pending before the Legislature

1 as this bill) shall apply to actions brought in state or federal court
2 both within and outside of the State of New Jersey if the provisions
3 of P.L. , c. (C.)(pending before the Legislature as this bill)
4 are made applicable to the corporation by the certificate of
5 incorporation.

6

7 10. N.J.S.14A:3-6 is repealed.

8

9 11. This act shall take effect immediately.

10

11

12

STATEMENT

13

14 This bill revises the law concerning shareholder derivative
15 proceedings in New Jersey. The bill repeals the current law
16 concerning actions brought in the right of a corporation by a
17 shareholder, and supplements the "New Jersey Business
18 Corporation Act" with a new set of regulations concerning
19 derivative proceedings. The bill retains the substantive provisions
20 of the repealed section. Certain provisions of the bill are also
21 applicable to shareholder class actions against a corporation or its
22 directors arising out of breach of duty imposed by New Jersey
23 statutory or common law.

24

25 Under the bill, the regulations governing derivative proceedings
26 and shareholder class actions are applicable only if the certificate of
27 incorporation makes it applicable. The bill raises the value of
28 plaintiffs' shareholdings required to avoid the need to post security
29 for a fee award, which had not been increased since 1968, to
30 \$250,000. The bill also adds the judicially developed concept that
31 the shareholder plaintiffs must continue to hold the shares
32 throughout the derivative proceeding.

32

33 Under the bill, a New Jersey corporation may amend its
34 certificate of incorporation to supersede judicial case law
35 developments regarding demand requirements and adopt the
36 statutory standards. This allows corporations to avoid derivative
37 suits that may impose unnecessary costs on the corporation. If
38 adopted by a corporation, demand is required in every derivative
39 proceeding and disinterested directors, shareholders, or court
40 appointed professionals are authorized to make a decision, after a
41 good faith investigation, that the derivative proceeding is not in the
42 best interests of the corporation.

42

43 The bill is largely based on sections 7.40 to 7.47 of the Model
44 Business Corporation Act, with substantial additions based on
45 section 7.44 of Chapter 156D of the Massachusetts Business
46 Corporation Law. The New Jersey Corporate and Business Law
Study Commission recommends the legislative reforms in this bill.

ASSEMBLY COMMERCE AND ECONOMIC DEVELOPMENT
COMMITTEE

STATEMENT TO

ASSEMBLY, No. 3123

with committee amendments

STATE OF NEW JERSEY

DATED: SEPTEMBER 24, 2012

The Assembly Commerce and Economic Development Committee reports favorably and with committee amendments Assembly Bill No. 3123.

As amended by the committee, this bill revises the New Jersey law concerning shareholder derivative proceedings. Derivative proceedings are lawsuits brought by a shareholder on behalf of a corporation to assert a right of the corporation if the corporation has not instituted an action upon that right on its own behalf. The bill also concerns shareholder class actions against a corporation or its directors arising out of breach of duty imposed by New Jersey statutory or common law. The bill allows corporations to “opt-in” to the bill’s provisions by amending their certificates of incorporation.

Current law provides that a shareholder cannot commence a derivative proceeding unless the shareholder 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. The bill retains this requirement and adds to it the requirement that the shareholder remain a shareholder throughout the derivative proceeding. The bill also provides that a shareholder may not maintain a derivative proceeding unless the suit fairly and adequately represents the interests of the corporation in enforcing the right of the corporation.

The bill provides that a shareholder cannot file a derivative proceeding unless the shareholder has first made a written demand upon the corporation to take suitable action and has afforded the corporation time to investigate and respond to the demand. The bill details various alternative procedures for the corporation to make an independent decision as to whether the derivative proceeding is in the best interests of the corporation.

The bill repeals N.J.S.A. 14A:3-6, the provision of law that currently addresses actions brought in the right of a corporation by a shareholder, but retains most of the substantive provisions of that section. Current law allows a corporation to require a small shareholder prosecuting a derivative proceeding against the

corporation to post security for the possible award of litigation expenses, including attorneys fees, that may be incurred by the corporation and other parties named as defendant. This currently applies if the shareholder holds less than 5% of the outstanding shares of the corporation unless the shares have a market value in excess of \$25,000. The bill would raise the value of plaintiffs' shareholdings required to avoid the need to post security against the possible award of litigation fees from \$25,000 to \$250,000.

The bill is largely based on sections 7.40 to 7.47 of the Model Business Corporation Act, with substantial additions based on section 7.44 of Chapter 156D of the Massachusetts Business Corporation Law.

The New Jersey Corporate and Business Law Study Commission recommends enactment of this bill. The commission has indicated that the purpose of the bill is to allow corporations to avoid derivative lawsuits that impose excessive and unnecessary costs on New Jersey corporations.

COMMITTEE AMENDMENTS:

The amendments provide that if a shareholder commences a derivative proceeding after a determination has been made rejecting a demand by the shareholder, the complaint must allege with particularity facts establishing that a majority of the board of directors, or all members of a committee, which in either case determined the matter, did not consist of independent directors at the time the determination was made.

SENATE COMMERCE COMMITTEE

STATEMENT TO

[First Reprint]

ASSEMBLY, No. 3123

STATE OF NEW JERSEY

DATED: JANUARY 14, 2013

The Senate Commerce Committee reports favorably Assembly Bill No. 3123 (1R).

This bill revises the New Jersey law concerning shareholder derivative proceedings. Derivative proceedings are lawsuits brought by a shareholder on behalf of a corporation to assert a right of the corporation if the corporation has not instituted an action upon that right on its own behalf. The bill also concerns shareholder class actions against a corporation or its directors arising out of a breach of duty imposed by New Jersey statutory or common law. The bill allows corporations to “opt-in” to the bill’s provisions by amending their certificates of incorporation.

Current law provides that a shareholder cannot commence a derivative proceeding unless the shareholder 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. The bill retains this requirement and adds to it the requirement that the shareholder remain a shareholder throughout the derivative proceeding. The bill also provides that a shareholder may not maintain a derivative proceeding unless the suit fairly and adequately represents the interests of the corporation in enforcing the right of the corporation.

The bill provides that a shareholder cannot file a derivative proceeding unless the shareholder has first made a written demand upon the corporation to take suitable action and has afforded the corporation time to investigate and respond to the demand. The bill details various alternative procedures for the corporation to make an independent decision as to whether the derivative proceeding is in the best interests of the corporation.

The bill repeals N.J.S.A. 14A:3-6, the provision of law that currently addresses actions brought in the right of a corporation by a shareholder, but retains most of the substantive provisions of that section. Current law allows a corporation to require a small shareholder prosecuting a derivative proceeding against the corporation to post security for the possible award of litigation expenses, including attorneys fees, that may be incurred by the

corporation and other parties named as defendant. This requirement currently applies if the shareholder holds less than 5% of the outstanding shares of the corporation, unless the shares have a market value in excess of \$25,000. The bill would raise the value of plaintiffs' shareholdings required to avoid the need to post security against the possible award of litigation fees from \$25,000 to \$250,000.

The bill is largely based on sections 7.40 to 7.47 of the Model Business Corporation Act, with substantial additions based on section 7.44 of Chapter 156D of the Massachusetts Business Corporation Law.

The New Jersey Corporate and Business Law Study Commission recommends enactment of this bill. The commission has indicated that the purpose of the bill is to allow corporations to avoid derivative lawsuits that impose excessive and unnecessary costs on New Jersey corporations.

SENATE, No. 2326

STATE OF NEW JERSEY
215th LEGISLATURE

INTRODUCED NOVEMBER 19, 2012

Sponsored by:
Senator NIA H. GILL
District 34 (Essex and Passaic)

SYNOPSIS

Revises law concerning derivative proceedings and shareholder class actions.

CURRENT VERSION OF TEXT

As introduced.



1 AN ACT concerning derivative proceedings and shareholder class
2 actions, supplementing chapter 3 of Title 14A of the New Jersey
3 Statutes, and repealing N.J.S.14A:3-6.

4
5 **BE IT ENACTED** *by the Senate and General Assembly of the State*
6 *of New Jersey:*

7
8 1. As used in this section:

9 “Derivative proceeding” means a civil suit in the right of a
10 domestic corporation.

11 “Shareholder” includes a beneficial owner whose shares are held
12 in a voting trust or held by a nominee on the beneficial owner’s
13 behalf.

14 “Shareholder class action” means a civil suit by a shareholder
15 against a domestic corporation or its directors or officers which
16 alleges a breach of any duty by the directors or officers or the
17 corporation which is imposed in whole or in part by statutory or
18 common law of the State of New Jersey and seeks a right, remedy,
19 or damages on behalf of a class of the domestic corporation’s
20 shareholders.

21
22 2. A shareholder may not commence or maintain a derivative
23 proceeding unless the shareholder:

24 (1) was a shareholder of the corporation at the time of the act or
25 omission complained of or became a shareholder through transfer
26 by operation of law from one who was a shareholder at that time
27 and remains a shareholder throughout the derivative proceeding;
28 and

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

31
32 3. No shareholder may commence a derivative proceeding
33 until:

34 (1) a written demand has been made upon the corporation to
35 take suitable action; and

36 (2) 90 days have expired from the date the demand was made
37 unless the shareholder has earlier been notified that the demand has
38 been rejected by the corporation or unless irreparable injury to the
39 corporation would result by waiting for the expiration of the 90-day
40 period.

41
42 4. If the corporation commences an inquiry into the allegations
43 made in the demand or complaint, the court may stay any derivative
44 proceeding as the court deems appropriate.

45
46 5. (1) Subject to subsection (5) of this section, a derivative
47 proceeding shall be dismissed by the court on motion by the
48 corporation if the court finds that:

1 (a) the person or group specified in paragraphs (a) or (b) of
2 subsection (2) of this section or subsection (6) of this section has
3 determined in good faith, after conducting a reasonable inquiry
4 upon which its conclusions are based, that the maintenance of the
5 derivative proceeding is not in the best interests of the corporation;

6 or

7 (b) the shareholders specified in paragraph (c) of subsection (2)
8 of this section have voted to terminate the derivative proceeding.

9 (2) Unless a panel is appointed pursuant to subsection (6) of this
10 section, the determination in subsection (1) of this section shall be
11 made by:

12 (a) a majority vote of independent directors present at a meeting
13 of the board of directors if the independent directors constitute a
14 quorum;

15 (b) a majority vote of a committee consisting of one or more
16 independent directors appointed by majority vote of independent
17 directors, or one independent director if the board consists of only
18 one independent director, present at a meeting of the board of
19 directors, regardless of whether those independent directors
20 constitute a quorum of the board; or

21 (c) the vote of the holders of a majority of the outstanding
22 shares entitled to vote, not including shares owned by or voted
23 under the control of a shareholder or related person who has or had
24 a material beneficial financial interest in the act or omission
25 complained of or other interest therein that would reasonably be
26 expected to exert an influence on that shareholder's or related
27 person's judgment if called upon to vote in the determination.

28 (3) If a derivative proceeding is commenced after a
29 determination has been made rejecting a demand by a shareholder,
30 the complaint shall allege with particularity facts establishing that a
31 majority of the board of directors, or all members of a committee,
32 which in either case determined the matter, did not consist of
33 independent directors at the time the determination was made.

34 (4) If a majority of the board of directors consisted of
35 independent directors at the time the determination in subsection (1)
36 of this section was made or if the determination is made by
37 shareholders, the plaintiff shall have the burden of proving that the
38 requirements of subsection (1) of this section have not been met. If
39 a majority of the board of directors does not consist of independent
40 directors at the time the determination by independent directors is
41 made, the corporation shall have the burden of proving that the
42 requirements of subsection (1) of this section have been met.

43 (5) (a) If the corporation moves to dismiss the derivative
44 proceeding, it shall make a written filing with the court setting
45 forth, among other things, facts to show:

46 (i) whether or not a majority of the board of directors was
47 independent at the time of the determination by the independent
48 director or directors; and

1 (ii) that the independent director or directors made the
2 determination in good faith after conducting a reasonable inquiry
3 upon which the conclusions are based.

4 (b) Following a motion filed pursuant to paragraph (a) of this
5 subsection, the court shall dismiss the derivative suit unless:

6 (i) the court finds that the requirements of subsection (1) of this
7 section have not been met, taking into account the burden of proof
8 under subsections (4) or (6) of this section; or

9 (ii) the plaintiff, in its complaint, an amended complaint, or in a
10 written filing with the court, has alleged with particularity facts
11 rebutting the facts contained in the corporation's filing.

12 (c) All discovery proceedings shall be stayed upon the filing by
13 the corporation of its motion to dismiss and the filing required by
14 this subsection until the notice of entry of the order ruling on the
15 motion. Notwithstanding the foregoing stay of discovery, the court,
16 on motion and after a hearing, may order that specified and limited
17 discovery be conducted if plaintiffs make a good cause showing of
18 alleged facts which evidence a lack of independence by the person
19 or group making the determination for the corporation or a lack of a
20 good faith determination. Limited discovery shall not include the
21 work product, privileged communications, or testimony of attorneys
22 who advised or assisted the person or group making the
23 determination.

24 (6) Upon motion by the corporation, the court may appoint a
25 panel of one or more individuals to make a determination whether
26 the maintenance of the derivative proceeding is in the best interests
27 of the corporation. The plaintiff shall have the burden of proving to
28 the panel that the requirements of subsection (1) of this section have
29 not been met.

30 (7) (a) A director shall be considered independent for the
31 purposes of this section if the director has:

32 (i) no economic interest in the challenged act or transaction
33 material to him or her, other than an economic interest that is shared
34 by all shareholders generally; and

35 (ii) no material, personal, or business relationships with the
36 defendant directors or officers who have a material interest in the
37 act or transaction challenged.

38 (b) None of the following shall by itself cause a director to be
39 considered not independent for the purposes of this section:

40 (i) the nomination or election of the director by a person who is
41 a defendant in the derivative proceeding or against whom action is
42 demanded;

43 (ii) the naming of the director as a defendant in the derivative
44 proceeding or as a person against whom action is demanded; or

45 (iii) the approval by the director of the act being challenged in
46 the derivative proceeding or demand if the act resulted in no
47 personal benefit to the director.

1 6. A derivative proceeding or a shareholder class action may
2 not be discontinued or settled without the court's approval. If the
3 court determines that a proposed discontinuance or settlement will
4 substantially affect the interests of the corporation's shareholders or
5 a class of shareholders, the court shall direct that notice be given to
6 the shareholders affected.

7
8 7. On termination of a derivative proceeding or a shareholder
9 class action the court may:

10 (1) order the corporation to pay the plaintiff's expenses incurred
11 in the proceeding if it finds that the proceeding has resulted in a
12 substantial benefit to the corporation;

13 (2) order the plaintiff to pay any defendant's expenses incurred
14 in defending the proceeding if it finds that the proceeding was
15 commenced or maintained without the exercise of reasonable
16 diligence by the plaintiff or without reasonable cause or for an
17 improper purpose; or

18 (3) order a party to pay an opposing party's expenses incurred
19 because of the filing of a pleading, motion or other paper, if it finds
20 that the pleading, motion or other paper was not well grounded in
21 fact, after reasonable inquiry, or warranted by existing law or a
22 good faith argument for the extension, modification or reversal of
23 existing law and was interposed for an improper purpose, such as to
24 harass or cause unnecessary delay or needlessly increase in the cost
25 of litigation.

26
27 8. In any derivative proceeding or shareholder class action
28 instituted by a shareholder or shareholders holding less than 5% of
29 the outstanding shares of any class or series of the corporation,
30 unless the shares have a market value in excess of \$250,000, the
31 corporation in whose right the action is brought shall be entitled at
32 any time before final judgment to require the plaintiff or plaintiffs
33 to give security for the reasonable expenses, including fees of
34 attorneys, that may be incurred by it in connection with the action
35 or may be incurred by other parties named as defendant for which it
36 may become legally liable. Market value shall be determined as of
37 the date that the plaintiff institutes the action or, in the case of an
38 intervener, as of the date that the intervener becomes a party to the
39 action. The corporation shall have recourse to that security in that
40 amount which the court having jurisdiction shall determine upon the
41 termination of the action in accordance with section 7 of
42 P.L. , c. (C.) (pending before the Legislature as this bill).

43
44 9. In any derivative proceeding or shareholder class action, the
45 provisions of P.L. , c. (C.) (pending before the Legislature
46 as this bill) shall apply to actions brought in state or federal court
47 both within and outside of the State of New Jersey if the provisions
48 of P.L. , c. (C.) (pending before the Legislature as this bill)

1 are made applicable to the corporation by the certificate of
2 incorporation.

3

4 10. N.J.S.14A:3-6 is repealed.

5

6 11. This act shall take effect immediately.

7

8

9

STATEMENT

10

11 This bill revises the law concerning shareholder derivative
12 proceedings in New Jersey. The bill repeals the current law
13 concerning actions brought in the right of a corporation by a
14 shareholder, and supplements the "New Jersey Business
15 Corporation Act" with a new set of regulations concerning
16 derivative proceedings. The bill retains the substantive provisions
17 of the repealed section. Certain provisions of the bill are also
18 applicable to shareholder class actions against a corporation or its
19 directors arising out of breach of duty imposed by New Jersey
20 statutory or common law.

21

22 Under the bill, the regulations governing derivative proceedings
23 and shareholder class actions are applicable only if the certificate of
24 incorporation makes it applicable. The bill raises the value of
25 plaintiffs' shareholdings required to avoid the need to post security
26 for a fee award, which had not been increased since 1968, to
27 \$250,000. The bill also adds the judicially developed concept that
28 the shareholder plaintiffs must continue to hold the shares
throughout the derivative proceeding.

29

30 Under the bill, a New Jersey corporation may amend its
31 certificate of incorporation to supersede judicial case law
32 developments regarding demand requirements and adopt the
33 statutory standards. This allows corporations to avoid derivative
34 suits that may impose unnecessary costs on the corporation. If
35 adopted by a corporation, demand is required in every derivative
36 proceeding and disinterested directors, shareholders, or court
37 appointed professionals are authorized to make a decision, after a
38 good faith investigation, that the derivative proceeding is not in the
best interests of the corporation.

39

40 The bill is largely based on sections 7.40 to 7.47 of the Model
41 Business Corporation Act, with substantial additions based on
42 section 7.44 of Chapter 156D of the Massachusetts Business
43 Corporation Law. The New Jersey Corporate and Business Law
Study Commission recommends the legislative reforms in this bill.

SENATE COMMERCE COMMITTEE

STATEMENT TO

SENATE, No. 2326

STATE OF NEW JERSEY

DATED: JANUARY 14, 2013

The Senate Commerce Committee reports favorably Senate Bill No. 2326.

This bill revises the New Jersey law concerning shareholder derivative proceedings. Derivative proceedings are lawsuits brought by a shareholder on behalf of a corporation to assert a right of the corporation if the corporation has not instituted an action upon that right on its own behalf. The bill also concerns shareholder class actions against a corporation or its directors arising out of a breach of duty imposed by New Jersey statutory or common law. The bill allows corporations to “opt-in” to the bill’s provisions by amending their certificates of incorporation.

Current law provides that a shareholder cannot commence a derivative proceeding unless the shareholder 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. The bill retains this requirement and adds to it the requirement that the shareholder remain a shareholder throughout the derivative proceeding. The bill also provides that a shareholder may not maintain a derivative proceeding unless the suit fairly and adequately represents the interests of the corporation in enforcing the right of the corporation.

The bill provides that a shareholder cannot file a derivative proceeding unless the shareholder has first made a written demand upon the corporation to take suitable action and has afforded the corporation time to investigate and respond to the demand. The bill details various alternative procedures for the corporation to make an independent decision as to whether the derivative proceeding is in the best interests of the corporation.

The bill repeals N.J.S.A. 14A:3-6, the provision of law that currently addresses actions brought in the right of a corporation by a shareholder, but retains most of the substantive provisions of that section. Current law allows a corporation to require a small shareholder prosecuting a derivative proceeding against the corporation to post security for the possible award of litigation expenses, including attorneys fees, that may be incurred by the corporation and other parties named as defendant. This requirement currently applies if the shareholder holds less than 5% of the

outstanding shares of the corporation, unless the shares have a market value in excess of \$25,000. The bill would raise the value of plaintiffs' shareholdings required to avoid the need to post security against the possible award of litigation fees from \$25,000 to \$250,000.

The bill is largely based on sections 7.40 to 7.47 of the Model Business Corporation Act, with substantial additions based on section 7.44 of Chapter 156D of the Massachusetts Business Corporation Law.

The New Jersey Corporate and Business Law Study Commission recommends enactment of this bill. The commission has indicated that the purpose of the bill is to allow corporations to avoid derivative lawsuits that impose excessive and unnecessary costs on New Jersey corporations.