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Zachary D. Cohen

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ZACHARY D. COHEN*

Timko v. Triarsi: How to Prevent Predatory Strike Suits while Avoiding Inequitable Results

IN *TIMKO V. TRIARISI*,[1] THE DISTRICT COURT OF APPEALS OF Florida's Fifth District considered whether a plaintiff in a derivative action must maintain share ownership throughout the pendency of the suit. The court dismissed the derivative suit and held that a plaintiff who fails to maintain ownership through the duration of the suit violates the continuous ownership requirement and therefore lacks standing. The language of Florida's statutory contemporaneous ownership rule does not require ownership throughout the suit. Courts, however, have construed it to, and this judicial application of the rule has lead to inequitable results. By adhering to such an expansive interpretation of the contemporaneous ownership requirement, the *Timko* court has failed to account for the different methods by which shareholders are divested of their ownership interest. To ameliorate the inequity of the application of the contemporaneous ownership requirement, this note proposes three exceptions to the contemporaneous ownership rule: (i) where the plaintiff seeks to challenge a merger that has divested his ownership; (ii) where there is an involuntary divestment of ownership through a bad act of management; and (iii) situations where no one else can vindicate the rights of the company.

I. THE CASE

In August 1998, Appellant Mark Timko formed Ferrari of Central Florida ("Ferrari"), with Appellee Onoforio Triarsi.[2] The purpose of this entity was to operate a franchised car dealership under the Ferrari name in the Orlando area.[3] Per their agreement, both Mr. Timko and Mr. Triarsi were individually assigned fifty percent of the shares in the enterprise.[4]

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* B.A, University of Virginia; J.D., *cum laude*, University of Maryland School of Law.

1. Timko v. Triarsi, 898 So. 2d 89 (Fla. Dist. Ct. App. 2005).

2. *Id.* at 92. Interestingly, the online records of the corporate register for the Florida Secretary of State list the incorporation date of Ferrari of Central Florida as June 19, 1998. http://www.sunbiz.org/COR/1998/0625/80566968.TIF. This alternate date is confirmed on Ferrari's 1999 Annual Report. http://www.sunbiz.org/COR/1999/0629/14000215.TIF. It is unclear why the Court reported that the company was formed in August of 1998.

3. *Id.*

4. *Id.* Despite, their equal ownership, Mr. Timko and Mr. Triarsi had different levels of involvement with the management of the dealership. Mr. Timko, as President and General Manager of the dealership, was intimately involved with the day-to-day operations of the company. As a result of his active role in the company, Mr. Timko would receive both salary and benefits, in addition to any dividends due to his stock ownership in

To finance Ferrari, the company borrowed $400,000 from an individual named Oscar Davis in exchange for a promissory note.[5] The loan documents used to secure this financing contained a "conversion right" that allowed anyone who purchased the remainder of Ferrari's debt to convert the unpaid balance of the loan into one-hundred percent of the equity in Ferrari.[6] At some point after the dealership's opening in November 1998, Mr. Triarsi used his recently formed company, Triarsi Enterprises, Ltd., to purchase Ferrari's residual debt from Mr. Davis and subsequently exercised the conversion right to obtain one-hundred percent equity in the dealership.[7] Through this right, Mr. Triarisi was able to increase his interest in the dealership while divesting Mr. Timko of his fifty percent stake in Ferrari.[8]

After he was ousted from the company, Mr. Timko filed a complaint in the Circuit Court for Orange County seeking "declaratory relief, an accounting, damages for breach of fiduciary duty, and dissolution of the corporation" under section 607.1430 of the Florida Statutes.[9] The court noted that Florida law gave Mr. Triarsi the right to purchase Mr. Timko's shares at fair market value.[10] Although the court determined that the fair market value of Mr. Timko's shares was $138,000, it did not, at that time, order payment to Mr. Timko.[11]

Prior to the entry of a final judgment ordering payment, Mr. Timko filed a separate shareholder derivative action on behalf of Ferrari.[12] Mr. Timko was still a shareholder when he filed this derivative action because the final judgment ordering payment for the divestment of his shares was not yet entered.[13] After Mr. Timko filed his derivative suit on behalf of the corporation, the final judgment was entered on November 13, 2003 in his action for individual damages.[14] Per the final order, Mr. Triarsi was obligated to pay Mr. Timko $138,000 within ten days of the date of

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Ferrari. *Id.* In contrast, Mr. Triarsi appears to not have been actively involved in the management of the dealership because he stayed in New Jersey. *Id.*

5. *Id.*

6. *Id.* at 92–93.

7. It is implicit from the facts of the case that Mr. Triarsi was aware of this provision in the loan documents and likely purchased the debt with the intention to remove Mr. Timko from the company. It is unclear, however, whether Mr. Timko was aware of the conversion right.

8. *Timko*, 898 So. 2d at 93.

9. *Id.* Section 607.1430 provides various grounds for judicial dissolution including deadlock, fraud, and waste of corporate assets. FLA. STAT. § 607.1430 (2000).

10. *Id.* Specifically, the court cited to Mr. Triarsi's rights under Section 607.1436 which provides that in a shareholder initiated proceeding to dissolve a corporation, "the corporation . . . may elect to purchase all shares owned by the petitioning shareholder at the fair value of the shares. An election pursuant to this section shall be irrevocable unless the court determines that it is equitable to set aside or modify this election." *Id.*

11. *Id.*

12. *Id.* In his derivative suit, Mr. Timko alleged "breach of fiduciary duty . . . as well as self-dealing and conversion." *Id.* Specifically, Mr. Timko alleged as a result of his fifty percent ownership in Ferrari he was entitled to $733,000—an amount which was supported by Ferrari's own income tax document and one that he had never received. *Id.*

13. *Id.*

14. *Id.*

the order.[15] Additionally, the court order declared: "Effective the date of this order, Mr. Timko shall no longer have any rights or status as a shareholder of Ferrari of Central Florida, except the right to receive amounts awarded by this order, which, subject to all provisions of this order and section 607.1436, shall be enforceable in the same manner as any other judgment."[16]

After the entry of the November order, Mr. Triarsi and Triari Enterprises, Ltd. filed a motion to dismiss the shareholder derivative suit.[17] The Defendants asserted that, as a result of the November 13, 2003 order, Mr. Timko had lost standing to continue the derivative action.[18] The Circuit Court for Orange County agreed and granted Mr. Trairsi's motion to dismiss.[19] Mr. Timko filed a timely appeal in the District Court of Appeal of Florida for the Fifth District.[20]

II. LEGAL BACKGROUND

Courts have been asked to address the misuse of shareholder derivative suits since 1881 when the Supreme Court decided *Hawes v. City of Oakland*.[21] In that case, the Court set forth numerous principles to ensure that derivative suits comported with their purpose—the redress of wrongs on behalf of the corporation in a manner consistent with the interests of the corporation and its shareholders.[22] One of the longstanding principles propounded in *Hawes* pertained to a shareholder's standing to maintain a derivative action.[23] For a shareholder to have standing, the Court decreed that a plaintiff must allege he was a shareholder at the time of the transaction complained of or he obtained his shares since the transaction by the operation of law.[24] One year later, in 1882, the Court codified its decision in *Hawes* by adopting Equity Rule 94, the original predecessor to Federal Rule of Civil Procedure 23.1 and the first of many in a series of federal rules relating to derivative suits.[25]

In 1966, Congress adopted Federal Rule of Civil Procedure 23.1 with the accompanying Advisory Committee Notes stating that derivative actions contain "distinctive aspects which require [the] special provisions."[26] The language of the section

15. *Id.*
16. *Id.* Mr. Timko appealed this order.
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. 104 U.S. 450 (1881).
22. 12B W. FLETCHER CYCLOPEIDA OF THE LAW OF PRIVATE CORPORATIONS § 5911 (2005).
23. *Hawes*, 104 U.S. at 460–61.
24. *Id.* at 460.
25. Lisa M Milani, *The Continuous Ownership Requirement: A Bar to Meritorious Shareholder Derivative Actions?*, 43 WASH. & LEE L. REV. 1013, 1013 n.1 (1986). There was a sequence of federal shareholder standing rules that followed the adoption of Equity Rule 94. The progression went as follows: Equity Rule 27 replaced Equity Rule 94 in 1912; Equity Rule 27 became Rule 23(b) of the Federal Rules of Civil Procedure in 1938; Rule 23(b) became Rule 23.1 of the Federal Rules of Civil Procedure in 1966.
26. FED. R. CIV. P. 23.1. Further indicating the seriousness with which Congress viewed the problem of strike suits and meritless claims, the special provisions of Rule 23.1 contained not only a shareholder standing

regarding standing codified the requirement that a plaintiff be "a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law."[27] Although the Rule clearly states the requirement that a plaintiff have ownership at the time of the transaction complained, another ownership requirement is implied under Rule 23.1—the plaintiff must have ownership at the commencement of the suit.[28] Courts have construed the language in Rule 23.1 asserting a derivative action may be "brought by one or more shareholders . . . to enforce a right of a corporation" to require a plaintiff to own shares of the corporation when he files a derivative action on its behalf to ensure that the plaintiff adequately represents the corporation he claims to be vindicating.[29] Seizing on the notion that a corporation's fate is in the hands of a shareholder who must be trusted to represent the corporation to the fullest throughout, most courts have extended the ownership requirement to necessitate a plaintiff to maintain continuous ownership of his shares for the duration of the action.[30]

Many state legislatures, including Florida's, have adopted laws reflecting the same concerns that compelled the codification of Federal Rule of Civil Procedure 23.1.[31] In 2002, the Florida legislature passed a statute entitled "Shareholders' Derivative Actions."[32] It provides that:

> *(1) A person may not commence a proceeding in the right of a domestic or foreign corporation unless the person was a shareholder of the corporation when the transaction complained of occurred or unless the person became a shareholder through transfer by operation of law from one who was a shareholder at that time.*[33]

The Florida statute, like those in many other states, seeks to curb predatory strike suits by making it more difficult for plaintiffs to utilize shareholder derivative actions for purely personal reasons which may be contrary to the interests of the

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requirement, but also the well-known demand requirement. While the demand requirement is commonly viewed as an exhaustion requirement, one designed to encourage internal resolution of corporate disputes, it functions essentially as another bar to prevent a plaintiff from achieving standing. *See* Daniel R. Fischel, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CHI. L. REV. 168, 169 (1977). The Delaware Supreme Court described the effect of the demand requirement as one that "deter[s] costly, baseless suits by creating a screening mechanism to eliminate claims where there is only a suspicion expressed solely in conclusory terms." *Brehm v. Eisner*, 746 A. 2d 244, 255 (Del. 2000).

27. FED. R. CIV. P. 23.1.

28. Schilling v. Blecher, 582 F.2d 995, 999 (5th Cir. 1978).

29. *Id.*

30. *Id.* (citing Tryforos v. Icarian Dev. Co., 518 F.2d 1258 (7th Cir. 1975), *cert. denied*, 423 U.S. 1091 (1976); Niesz v. Gorsuch, 295 F.2d 909 (9th Cir. 1961)).

31. 13 W. FLETCHER CYCLOPEIDA OF THE LAW OF PRIVATE CORPORATIONS § 5981 (2005).

32. FL. STAT. ANN. § 607.07401 (2005).

33. *Id.*

corporation.[34] Prior to the enactment of this statute, Florida courts had expressed a similar desire to prevent these predatory strike suits.[35] In *Karplus v. First Cont'l Corp.*,[36] the Florida District Court of Appeals cited one of its 1992 decisions for the proposition of "ensur[ing] that derivative actions are brought only by those individuals who have a legitimate stake in the corporation so that its interests are adequately represented."[37] In accordance with the jurisprudence of many other states, Florida courts have adopted the contemporaneous shareholder provision as a prerequisite to a derivative action.[38]

While many states have similar provisions, not all are identical in scope or application to Florida's standing requirement. For example, the California legislature has not drawn such a hard line in its adoption of a contemporaneous ownership rule.[39] Indeed, in a 1975 Legislative Committee Comment, the California Assembly acknowledged it was relaxing its contemporaneous ownership requirement, likely because of the harsh consequence of the rule.[40] On its face, the current California statute only requires a plaintiff to have stock ownership at the time of the transaction complained.[41] However, this is not dispositive. In what is presumably a quest for equity, the statute also provides California judges with a substantial amount of discretion to allow a shareholder who does not meet the ownership requirement to maintain an action upon a preliminary showing to the court.[42]

Although the contemporaneous ownership rule has been adopted in some form by the vast majority of the country's state legislatures, many courts have questioned the harshness of such a rule.[43] Specifically, several decisions have raised the issue of

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34. Timko v. Triarsi, 898 So. 2d 89 (Fla. Dist. Ct. App. 2005).

35. Karplus v. First Cont'l Corp., 711 So. 2d 108, 110 (Fla. Dist. Ct. App. 1998) (citing South End Improvement Group, Inc. v. Mulliken, 602 So. 2d 1327, 1330 (Fla. Dist. Ct. App. 1992)).

36. *Id.*

37. *Id.* This statement by the Florida court echoed the stated goal of many legislatures, including Congress, to ensure alignment of corporate and plaintiff interests and thereby prevent strike suits. Paul P. Harbrecht, *The Contemporaneous Ownership Rule in Shareholders' Derivative Suits*, 25 UCLA L. REV. 1041, 1043 (1978). One wonders if this goal has been taken to its extreme in the "protection of the corporation and its officials from the scoundrel shareholder." *Id.* at 1048.

38. *See* 13 W. FLETCHER, *supra* note 31.

39. While California is more lenient in its application of a contemporaneous ownership requirement, most states, Florida among them, follow the guidelines endorsed by Fed. R. Civ. P. 23.1.

40. CAL. CORP. CODE § 800.

41. *Id.*

42. As part of its preliminary hearing requirement, California requires a motion and hearing where the plaintiff seeking standing demonstrates the following:

> (i) there is a strong prima-facie case in favor of the claim asserted on behalf of the corporation, (ii) no other similar action has been or is likely to be instituted, (iii) the plaintiff acquired the shares before there was disclosure to the public or to the plaintiff of the wrongdoing of which plaintiff complains, (iv) unless the action can be maintained the defendant may retain a gain derived from defendant's willful breach of a fiduciary duty, and (v) the requested relief will not result in unjust enrichment of the corporation or any shareholder of the corporation.

CAL. CORP. CODE § 800. Additionally, in California, a plaintiff must satisfy the demand requirement which, like in many other courts around the country, can necessitate a separate inquiry.

43. Milani, *supra* note 25, at 1020.

whether the same standing requirement should apply when a shareholder has been divested of his ownership involuntarily.[44] In *Galliard v. Natomas Co.*,[45] a California court held that a plaintiff who was divested of her shares through a provision in a merger agreement did not lose standing to pursue a derivative action.[46] The court found it significant that the plaintiff had lost her ownership involuntarily through a forced exchange during a merger.[47] Paramount to the court's decision was its belief that requiring continuous ownership would allow a merger to prevent a lawsuit that challenged the validity of that very merger.[48] The court noted that its decision would maintain the purpose of the California legislature's contemporaneous ownership rule because its holding would continue to prevent predatory strike suits.[49] However, twenty years after the *Galliard* decision, in *Grosset v. Wenass*,[50] the California Court of Appeal, Fourth District, indicated its disagreement with the *Galliard* court's interpretation of California's contemporaneous ownership requirement.[51] Although the *Grosset* court was applying Delaware law, its dicta indicated that the California standing requirement in derivative suits should be similarly interpreted to align it with the majority of other jurisdictions.[52] Thus, it appears the breadth of the contemporaneous ownership requirement in California is currently unsettled.

Outside of California, two New York decisions conform with the notion put forth in *Galliard*—namely, that a plaintiff should be allowed to continue his derivative action where his standing is terminated by the very acts that the plaintiff contends were wrongful.[53] In *Albert v. Salzman*,[54] the court expressed reluctance to dismiss a worthy derivative action even where plaintiff lost standing after commencing the action as a result of the plaintiff's own sale of his ownership interest.[55] The court allowed another shareholder to continue in the original plaintiff's place

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44. *See* Galliard v. Natomas Co., 219 Cal. Rptr. 74, 79 (Cal. Ct. App. 1985); Albert v. Salzman, 41 A.D. 2d 501 (1973); Abrams v. Occidental Petroleum Co., 20 Fed. Serv. 2d 170 (S.D.N.Y. 1975); Zauber v. Murray Sav. Ass'n, 591 S.W.2d 932 (Tex. Civ. App. 1979).

45. 219 Cal. Rptr. 74 (Cal. Ct. App. 1985).

46. *Id.*

47. *Id.* at 413.

48. *Id.* at 420. This consequence was described as an "incongruous result." *Id.*

49. *Id.* at 415. The court stated that under its holding, "suits by individuals who had acquired stock for the sole purpose of bringing a derivative lawsuit" would not be allowed. *Id.*

50. 35 Cal. Rptr. 3d 58 (Cal. Cal. Ct. App. 2005).

51. *Id.* at 70–73 (finding the holding in *Galliard* contrary to other jurisdictions' interpretation of the continuous ownership requirement).

52. *Id.* at 70–72. The *Grosset* court actually cited *Timko* as an example of a case where the court required ownership throughout the suit despite the statutory language only mandating the plaintiff possess shares at the time of the transaction at issue.

53. Milani, *supra* note 25, at 1029.

54. Albert v. Salzman, 41 A.D. 2d 501 (1973).

55. *Id.* at 505. The plaintiff in *Albert*, claimed a breach of fiduciary duty by the directors of Papercraft Corp. in negotiating a merger agreement with the company in which he owned shares, Odell Corp. *Id.* Plaintiff specifically alleged that the directors of Papercraft had profited illegally from the merger. *Id.* The standing issue arose when the plaintiff sold his stock after filing the derivative action. *Id.*

based upon the principle that where an alternative means to continue a derivative action exists, a valid action should be allowed to go forward.[56]

Another New York court expanded on the concept from the *Albert* decision by proposing that, in addition to considering whether an alternative means to continue the derivative action exists, a court should also take into account whether the alternative means would be barred by the statute of limitations.[57] In both decisions, the New York courts were concerned with the inequity that would result from terminating the derivative action due to the conduct of the alleged wrongdoers.

Finally, another court has recognized the distinction between the voluntary and involuntary divestment of a shareholder's interest in a corporation.[58] In *Zauber v. Murray Sav. Ass'n*,[59] a Texas court refused to declare that a plaintiff lacked standing to proceed with a derivative action where he had been divested of his interest involuntarily.[60] The court recognized the contemporaneous ownership requirement but went on to review the underlying reason for the dispossession of the plaintiff's shares.[61] The opinion asserted that if a plaintiff had been deprived of ownership by an act of the corporation having no legitimate business purpose, the plaintiff should be allowed to maintain his action.[62] The *Galliard, Abrams, Albert* and *Zauber* decisions indicate that while courts recognize the contemporaneous ownership requirement in derivative suits to prevent strike suits, not all are in agreement as to the extent of its application. While preventing strike suits is still central to the debate over standing requirements in derivative suits, some courts have expressed concern over perceived inequities on shareholders from the application of such a harsh rule.

III. SUMMARY OF THE COURT'S REASONING

In affirming the Circuit Court's order granting Triarsi's motion to dismiss, the District Court of Appeals of Florida, Fifth District, first looked at the history of shareholder derivative proceedings.[63] The court cited *Larsen v. Island Developers, Ltd.*[64] for the proposition that "shareholder derivative suits were originally created by the

56. *Id.* at 506.

57. Abrams v. Occidental Petroleum Co., 20 Fed. Serv. 2d 170 (S.D.N.Y. 1975). The *Abrams* case presented the familiar situation where a shareholder is compelled to exchange his shares of a corporation per a merger agreement. In applying section 261 of title 8 of the Delaware Corporation Code, the *Abrams* court held that when a shareholder was deprived of his interest in a corporation as a result of the merger and the shareholder was proceeding in an action against a corporation that was a party to the merger, a court should proceed as if the merger had not occurred. *Id.* at 173.

58. Milani, *supra* note 25, at 1029.

59. 591 S.W. 2d 932 (Tex. Civ. App. 1979).

60. *Id.* In *Zauber*, a plaintiff was divested of his interest in the company when the board of directors voted to approve a reverse stock split.

61. *Id.* 936–37.

62. *Id.*

63. Timko v. Triarsi, 898 So. 2d 89 (Fla. Dist. Ct. App. 2005).

64. 769 So. 2d 1071 (Fla. Dist. Ct. App. 2000).

common law as a means to police 'faithless directors and managers.'"[65] While the court recognized the function derivative suits serve in allowing shareholders to redress injuries caused by improper acts of directors or officers, it also noted the frequent abuse of the derivative suit mechanism.[66] The filing of predatory strike suits—where a shareholder obtains a stake in the company after a transaction has occurred solely for the purpose of filing a derivative action—was of prevailing concern.[67]

The court noted that the Florida legislature, as many others around the country, had enacted the contemporaneous ownership rule to prevent these predatory strike suits by providing express standing requirements for shareholders wishing to institute a derivative proceeding.[68] In examining legislative intent, the court stated that the purpose of the shareholder standing requirement was to "ensure that derivative actions are brought only by those individuals who have a legitimate stake in the corporation so that its interests are adequately represented."[69]

The court then examined the language of the contemporaneous ownership rule in section 607.07401, Florida Statutes (2002).[70] Recognizing the objective of this provision "to impose additional restrictions on a shareholder's common law right to maintain a derivative suit," the court viewed the use of the words "may not" and "unless" in the language of section 607.07401 as placing additional limits on this common law right.[71] These limitations, the court said, were aimed to prevent predatory strike suits by ensuring that shareholders have a legitimate interest when pursuing a derivative action.[72] Relying on these words, the court held that the common law right of derivative action required continuous ownership throughout the pendency of the suit for the reason that the language of the contemporaneous ownership rule had not nullified it.[73] The court then cited to numerous opinions from other jurisdictions that also upheld the common law continuous ownership requirement.[74]

Judge Monaco, the lone dissenter, believed the statutory language, on its face, required a different result. Judge Monaco pointed out two distinctions between his

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65. *Timko*, 898 So. 2d at 90 (citing Larsan v. Island Developers, Limited, 769 So. 2d 1071, 1072 (Fla. Dist. Ct. App. 2000)).

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.* (quoting Kaplus v. First Cont'l Corp., 711 So. 2d 108, 110 (Fla. Dist. Ct. App. 1998)).

70. *Id.* at 91.

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.* at 91–92. One of the cases the court cites is Schilling v. Belcher, 582 F.2d 995 (5th Cir. 1978). Although, the court in *Schilling* was applying Federal Rule of Civil Procedure 23.1, the *Timko* court viewed the federal rule as a "precursor to section 607.07401." The court believed that the *Schilling* case stood for the proposition that the "sale of stock during pendency of appeal from judgment in derivative suit defeats standing to continue." *Tinko*, 898 So. 2d at 92.

reading of the contemporaneous ownership rule and the majority's reading. First, he read the statute to require an individual bringing a derivative action to be a shareholder only when the transaction complained of occurred, not at all times the suit was pending.[75] He noted that the statutory language did not require ownership throughout the derivative action.[76] Second, he believed it was significant that the statute referred to a "person" bringing a derivative action because earlier versions of the statute had contained the word "shareholder."[77] Judge Monaco viewed this as a significant change in language because the Florida legislature, an entity with tremendous experience in drafting legislation, had decided to expand the bounds of individuals who could commence a derivative action.[78] From the language of Florida's contemporaneous ownership rule, there was no indication that the legislature was "building on the pre-existing common law requirement" of continuous ownership throughout the derivative action.[79] The language of the statute only supported a derivative action standing requirement that necessitated share ownership when the transaction at issue occurred.[80]

Judge Monaco then reviewed *Schilling v. Belcher*,[81] a case the majority cited as supporting its position, and explained why he believed the case compelled the court to reach an opposite conclusion.[82] This case, decided prior to the enactment of Florida Statute § 607.07401, but when a preceding Florida ownership requirement was in effect, held that "a shareholder who sells his or her stock pending the appeal loses standing to further prosecute or defend the case, except to the extent that the judgment runs personally in favor of that person."[83] Although *Schilling* involved a derivative action governed by Florida law, the U.S. Court of Appeals, Fifth Circuit, applied the federal standing requirement codified in Federal Rule of Civil Procedure 23.1.[84] Judge Monaco noted that the *Schilling* court looked to the language of the statute and decided that the use of the word "stockholder" in the preamble required an individual commencing a derivative proceeding to own shares at the commencement of the action. Judge Monaco observed that although the *Schilling* court was within its prerogative to apply federal law to that case, Florida courts are not bound by the *Schilling* holding in interpreting Florida law.[85]

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75. *Id.* at 94.
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. From his dissent, it appears that Judge Monaco would not require stock ownership when the derivative action was initiated, but only when the transaction complained of occurred.
81. 582 F. 2d 995 (5th Cir. 1978).
82. *Timko*, 898 So. 2d at 94–95.
83. *Id.* at 94.
84. *See id.* The *Schilling* court applied the standing requirement codified in Federal Rule of Civil Procedure 23.1 because it believed the federal statute was in accordance with Florida law. *Schilling*, 582 F.2d at 999–1000. As Judge Monaco points out, this ignores the plain language of the respective statutes.
85. *Id.*

The dissenter opined that under Florida Statute § 608.131, the statute at issue in *Schilling* and a predecessor to Florida Statute § 607.1436, one only had to prove that he was a "stockholder of such corporation at the time of bringing the action and that he was a stockholder of such corporation at the time of the transaction of which he complain[ed]."[86] He then reviewed the changes the Florida legislature made in the statute succeeding 608.131, another predecessor to the current contemporaneous ownership rule. Judge Monaco noted the legislature removed language that required an individual to be a shareholder at the commencement of the suit.[87] He concluded that the actions of the Florida legislature indicated that the continuous ownership requirement had been abolished under state law.[88]

In regards to this case, Judge Monaco observed that Timko was a shareholder at both the time of the transaction complained of and the commencement of the derivative suit.[89] Furthermore, Timko was divested of his stake in the company involuntarily through the actions of Triarsi.[90] According to the dissenting judge, Florida Statute § 607.07401 was written to account for "this and similar scenarios in which the shareholder loses that status by an operation of law."[91] Judge Monaco then cited *Galliard v. Natomas Co.*,[92] an aforementioned California decision holding "where a person lost her status as shareholder by virtue of a merger . . . it would be inequitable to require continuing ownership in order to maintain a derivative suit."[93] According to both Judge Monaco and the *Galliard* court, applying a continuous ownership requirement through a derivative action would be inequitable when the plaintiff involuntarily lost his shares because it would "lead to the incongruous result of barring a lawsuit which challenges the wrongful acts of management in bringing about the merger, because of the merger itself."[94]

IV. ANALYSIS

Legitimate concerns about derivative suits warrant application of the contemporaneous ownership rule to prevent strike suits. To fulfill this goal, courts have adopted a liberal interpretation of the rule requiring continuous ownership throughout the suit. As *Timko v. Triarsi* indicates, however, not all derivative suits in which the plaintiff shareholder is divested of his interest present a situation involving a predatory suit. Focusing on statutory language, the dissent in *Timko* presents a strong case as to why the plaintiff likely met the requirements to garner shareholder standing. In this vein, there also exist situations that require additional

86. *Id.* at 95.
87. *Id.*
88. *Id.*
89. *Id.*
90. *Id.*
91. *Id.*
92. 173 Cal. App. 3d 410 (Cal. Ct. App. 1985).
93. *Id.*
94. *Id.* (citing Galliard v. Natomas Co., 173 Cal. App. 410 (Cal. Ct. App. 1985)).

considerations to be factored into the standing analyis. These situations include mergers or bad acts of management which divest share ownership, as well as situations where no one else can vindicate the rights of the company.

A. *Statutory Interpretation Alone Supports Judge Monaco's Dissent*

Reviewing the statutory language and legislative history, the dissenting judge in *Timko* makes a compelling case for allowing the plaintiff to proceed with his derivative action.[95] The codified language of Florida's contemporaneous ownership rule only requires a plaintiff in a derivative action to have owned his shares "when the transaction complained of occurred."[96] This language is of particular importance in light of the development of the contemporaneous ownership rule that the Florida legislature endorsed in the 1970s when it enacted Florida Statute 607.147 to replace 608.131.[97]

It is possible that the Florida legislature was merely mimicking the language and intent of Congress, but this does not mean that Florida's courts, in interpreting a Florida statute, are restricted by a federal court's interpretation of a similar federal statute. *Schilling*,[98] the case where a Federal court applied Federal Rule of Civil Procedure 23.1 upon its determination that Florida's contemporaneous ownership rule was identical to the Federal Rule, represents an anomalous decision that is not binding on Florida courts. It is the domain of state courts to interpret state law, and Florida courts should make an independent determination in deciding the parameters of Florida statutory enactments.

Additionally, the fact that numerous jurisdictions have construed their contemporaneous ownership requirement to necessitate continuous ownership throughout the duration of the suit, while a consideration, should not be the determinate factor in *Timko*.[99] It is of equal significance that other courts have questioned this stringent requirement and have then taken a more pragmatic approach the issue of standing.[100] In interpreting state law for derivative suits, Florida's courts should seek to ensure that neither management nor shareholders are able to profit from inappropriate acts by shaping rules that do not lead to inherent inequalities in the treatment of divested owners and those in control of the corporation.

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95. *Tinko*, 898 So. 2d at 92–96.

96. FLA. STAT. ANN. § 607.07401 (2002).

97. *Timko*, 898 So. 2d at 95.

98. 582 F.2d 995.

99. *Id.* at 91–92 (citing Schilling v. Belcher, 582 F.2d 995 (5th Cir. 1978); Lewis v. Ward, 852 A.2d 896 (Del. 2004); Lewis v. Turner Broad. Sys., Inc., 503 S.E. 2d 81 (Ga. Ct. App. 1998); A-Plus Janitorial & Carpet Cleaning v. Employers' Workers' Comp. Ass'n, 936 P. 2d 916 (Okla. 1997); Christopher v. Liberty Oil & Gas Corp., 665 So. 2d 410 (La. Ct. App. 1995); U.S. Fid. & Guar. Co. v. Griffin, 541 N.E. 2d 172 (Ind. Ct. App. 1989); Weil v. Nw. Indus., Inc., 522 N.E.2d 172 (Ill. App. Ct. 1988); Yanow v. Teal Indus., Inc., 422 A.2d 311 (Conn. 1979)).

100. *See* Galliard v. Natomas Co., 173 Cal. App. 3d 410 (Cal. Ct. App. 1985); Albert v. Salzman, 41 A.D.2d 501 (N.Y. App. Div. 1973); Abrams v. Occidental Petroleum, 20 Fed. R. Serv.2d 170 (S.D.N.Y. 1975); Zauber v. Murray Sav. Ass'n, 591 S.W.2d 932 (Tex. Civ. App. 1979).

B. Additional Considerations Dictate Exceptions to the Contemporaneous Ownership Rule

It is of paramount importance that courts keep in mind the true purpose of derivative actions when formulating ownership rules dictating an individual plaintiff's standing. At their core, derivative suits are equitable actions.[101] Many courts perceive the standing requirement to be focused primarily on preventing predatory strike suits, but they must not let this goal remove reason from their analysis. While there is no doubt that the prevention of strike suits is one aim of the standing requirement, courts should be more concerned with a principle that subsumes the prevention of strike suits—ensuring that the individual plaintiff is representing the interests of the corporation and, in turn, the totality of interests of the corporation's shareholders. In doing so, the question arises—at what point in time should we be concerned with the representation of the corporation? A plaintiff in a derivative action will always be suing for a past action and, in certain situations, should be allowed to represent the interests of the corporation if he can demonstrate his interests were aligned with the corporation's at the point in time when the action occurred.

The contemporaneous ownership requirement stated in *Hawes* reflects this concern and many courts have expanded the ownership requirement to require continuous ownership throughout the pendency of a suit.[102] However, blindly extending the contemporaneous ownership requirement fails to take into account the reality of a plaintiff's predicament where often he is challenging the legitimacy of an action that divested his interest in a corporation. Courts can adequately protect against predatory strike suits on a case-by-case basis by ensuring that the plaintiff's interest are aligned with the corporations.[103]

Traditionally, courts have been reluctant to interfere with the internal workings of a corporation. This hands-off approach is generally the proper role for the judiciary in corporate matters, but passivity should not be taken to such an extreme that it prevents intervention where the courts have the tools to perform a thorough well-reasoned evaluation of the merits of a derivative suit, and such an evaluation reveals a strong likelihood of oppression of the minority interests.[104] This is particularly true where a plaintiff had ownership at the time of the transaction complained of. Courts should not abandon their duty to prevent oppression at any level, including at the corporate level, where they have the opportunity to undertake a

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101. Rosenfeld v. Zimmer, 254 P.2d 137, 116 C.A. 2d 719 (Cal. Dist. Ct. App. 1953).

102. *See Timko*, 898 So. 2d at 92 (listing the various courts that have required ownership throughout the pendency of a derivative suit).

103. Milani, *supra* note 25, at 1035. Ms. Milani writes "equitable considerations may outweigh a per se requirement of continuous stock ownership in every instance. The absence of a present proprietary interest in a corporation does not necessarily mean that a plaintiff has no stake in the outcome of the litigation such that a plaintiff cannot adequately prosecute the corporation's right of action and represent the interest of similarly situated shareholders."

104. *See supra* note 42 (detailing the procedure used in California courts).

thorough examination of a shareholder interest. Because the opportunity for more intricate assessment exists, courts should maintain the continuous ownership requirement with three exceptions.

i. Merger situations that have terminated a shareholder's ownership

A merger can be a tool of the majority shareholders to squeeze minority shareholders out of the corporation.[105] Even if the merger requires approval of a majority of shareholders, absent an agreement with other shareholders or a supermajority voting structure, a minority interest is powerless to prevent effectuation of the merger.[106] This was not always the case—at common law, unanimous consent of shareholders was required to effectuate a merger.[107] Furthermore, some courts have permitted directors to use a merger to terminate a minority shareholder's derivative suit where a third party was acquiring the corporation.[108]

In a closely-held corporation, a merger that results in shareholder divestment can be an impenetrable devise to prevent shareholder derivative actions.[109] This is apparent because applying the contemporaneous ownership rule, it is not feasible for a plaintiff to challenge an action where he lacks an ownership interest. Delaware has recognized the potential misuse of a merger situation to manipulate ownership and recognizes two instances in the merger context where the contemporaneous ownership rule is not absolute: (i) where the merger is the subject of the claim of fraud and (ii) where a merger is in reality a re-organization of the corporation that does not divest the shareholder of his shares.[110] Beyond the instances recognized in Delaware, if a merger divests the shareholder of his interest, it also automatically prevents any challenge. This is, very arguably, an "incongruous result."[111] A shareholder who contends that the result was improper should be allowed to pursue a challenge on the merger. Without this rule, the validity of such a merger would never be challenged because any action doing so would be precluded by the very thing it seeks to question.

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105. F. HODGE O'NEAL & ROBERT B. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS, ROBERT B. THOMPSON § 5:1 (2005).

106. Some states, including Delaware, go as far as to allow a controlling shareholder to effectuate a merger without a formal vote of the shareholders, thus preventing any campaign by the minority to prevent such action. In such a transaction, it could be argued that a formal vote is wasted efforts and, regardless of a failure to object, shareholders of the subsidiary are protected by their appraisal rights. This right affords some protection, but a minority shareholder's rights are still limited in the respect that they are powerless to prevent the merger. *Id.* at 5:4, 5-54. Additionally, many states allow "short form mergers" that permit a parent and subsidiary to merge without a vote of the shareholders.

107. 12B W. FLETCHER CYCLOPEIDA OF THE LAW OF PRIVATE CORPORATIONS § 5906.10 (2005).

108. *See* Scattergood v. Perelman, 945 F. 2d 618, 626 (3d Cir. 1991) (plaintiff's standing in a derivative suit was terminated by a cash out merger).

109. This would be particularly pertinent in a closely held corporation where only two stockholders exist as in *Timko*.

110. Lewis v. Anderson, 477 A.2d 1040, 1047 n.10 (Del. 1984).

111. *See* Galliard v. Natomas Co., 173 Cal. App. 3d 410 (Cal. Ct. App. 1985).

A valid counterargument is that the minority shareholders are protected by appraisal rights. Indeed, appraisal rights are one method employed to protect dissenting shareholders, where they seek to obtain an independent determination of the fair value of their shares. The purpose of statutes affording this reevaluation on the behalf of disgruntled shareholders is "to protect the property rights of dissenting shareholders from actions by majority shareholders which alter the character of their investment."[112] In an appraisal proceeding, however, the issue is limited to the amount which was paid for the dissenter's shares.[113] This remedy fails to provide any outlet should a dissenter seek to invalidate a merger for impropriety. Indeed, in most mergers, the majority's will should rule the day, but where the majority breached a fiduciary duty to the minority in negotiating the merger, that aggrieved minority should have the greater recourse. Applying the contemporaneous ownership rule here would prevent dissenters from challenging a merger negotiated on their behalf without the requisite fiduciary obligations necessary when shareholder interest is represented. Accordingly, the contemporaneous ownership rule should be relaxed in merger situations.

ii. Involuntary termination of ownership through a bad act of management

When shareholders are deprived of standing through a bad act of management, courts should allow them to continue their derivative action. In creating exceptions to the continuous ownership requirement, Delaware has acknowledged the potential for abuse of mergers by management. When one considers this exception in conjunction with the widespread recognition of the different nature of voluntary and involuntary divestment of a shareholders ownership stake,[114] it is evident that the exception should apply more broadly. Similar to the situation involving divestment of ownership interest through a merger, in a closely held corporation when a shareholder losses his shares through the bad acts of management, preventing a shareholder from challenging the divestment effectively insulates the wrongdoers from liability. Allowing such a result creates an inequitable situation of preventing a challenge to a bad act because of the bad act itself. This is essentially the situation in the *Timko* case where a fifty percent shareholder was unable to assert the company's interest because a contract had compelled him to relinquish his shares to his co-owner. In accordance, when a bad act of management deprives a shareholders of their shares, even outside the mergers context, shareholders should be allowed to challenge the act that divested their interest.

Although a shareholder is able to bring a direct suit against management to challenge the bad act, there is a strong argument to allow the shareholder to pursue a derivative suit. When a shareholder's interest is deprived through some bad act of

112. FLETCHER, *supra* note 107, § 5906.10.
113. *Id.*
114. *See Galliard*, 173 Cal. App. 3d at 420.

management, it is likely she is not the only individual harmed. Despite management's prerogative which may or may not be to maximize shareholder return, ultimately a corporation's purpose must reflect shareholder interest and management must act accordingly. Allowing a shareholder to bring a derivative suit where he or she has been divested of ownership through management wrongdoing is more equitable because it allows an independent determination regarding the divestment of ownership. Without such an exception, the alternative results in management's alleged bad act preventing such a challenge. Tolerating a derivative suit in such situations also increases efficiency because allowing one shareholder to represent the entirety of shareholder interest prevents many separate direct suits. Therefore, another exception to the contemporaneous ownership rule should be permitted where a shareholder is divested of ownership through a bad act of management.

iii. Situations in which no one else can vindicate the rights of the company

All the attention given to preventing strike suits can create an inequitable smoke screen to corporate pilfering by management. One method to combat a lack of corporate accountability would be to allow a shareholder lacking ownership at the commencement of the suit because of an involuntary divestment, but retaining ownership at the time of the transaction in question, to pursue a derivative action when no one else can vindicate the rights of the company. Allowing a plaintiff to proceed with such an action, despite a lack of ownership, provides an equitable solution to the failure of a company to regulate the improprieties of its management. Indeed, situations do arise where no other shareholders can bring an equitable claim because of management's wrongdoing. A court must be careful not to substitute its business judgment for that of the corporation's directors, but instead should limit its focus to the likelihood of redress by the corporation. In acknowledging standing in these cases, courts would apply a rigorous examination of the shareholder's interest when evaluating whether he will actually act in such a manner to vindicate the company's rights. A court should pay particular attention to the timing of the acquisition of the plaintiff's shares as well as whether other potential plaintiffs exist as current shareholders.[115] This solution would be employed rarely, but would contribute to a more equitable solution for the treatment of plaintiffs in derivative actions.

V. CONCLUSION

Timko v. Triarisi demonstrates that courts should take a more flexible approach in determining when a shareholder has standing to maintain a derivative action. In particular, the focus of a court's analysis should remain on whether a shareholder

115. This requirement echoes the holding in *Albert v. Salzmen*, where the court suggested that a factor in the standing analysis in derivative actions should be whether an alternative means to continue the derivative action exists. 41 A.D.2d at 505.

or former shareholder can adequately represent the interests of the corporation. The contemporaneous ownership rule is intended to remove cases where a shareholder may not have the corporation's interests in mind. However, this rule, when applied too stringently, can lead to inequitable results. When determining standing, if shareholders fail to retain continuous ownership throughout their suit, courts should consider whether divestment of their shares occurred as a result of a merger or a bad act of management or whether the situation is one where no one else can vindicate the rights of the company. The *Timko* court missed an excellent opportunity to clarify and apply this doctrine in a more equitable fashion.