Third District Court of Appeal

State of Florida

Opinion filed July 22, 2020.
Not final until disposition of timely filed motion for rehearing.

No. 3D19-797
Lower Tribunal No. 18-4061

The Arbitrage Fund,
Appellant,

vs.

William Petty, et al.,
Appellees.

An Appeal from the Circuit Court for Miami-Dade County, William Thomas, Judge.

GrayRobinson, P.A., and David S. Oliver (Orlando); Entwistle & Cappucci LLP and Brendan J. Brodeur and Rebecca H. Arnall (New York, NY) and Andrew J. Entwistle (Austin, TX); Labaton Sucharow LLP and Ira A. Schochet (New York, NY) and Thomas Curry (Wilmington, DE), for appellant.

Greenberg Traurig, P.A., and Joseph C. Coates, III and Gina Shlaferman (West Palm Beach); Baker & Hostetler LLP and Jerry R. Linscott and Julie Singer Brady and Maureen B. Soles (Orlando), for appellees.

Before SALTER, HENDON and LOBREE, JJ.

LOBREE, J.

The Arbitrage Fund (the "Unaffiliated Shareholder") appeals from an order denying class certification in its suit for breach of fiduciary duties against William Petty, Betty Petty, David Petty, Prima Investments, Inc., Prima Investments, L.P., James G. Binch, Andrew Krusen, Jr., William B. Locander, Richard C. Smith, and Fern S. Watts (the "Affiliated Shareholders" and "Officers"). The Unaffiliated Shareholder charges error to the lower court's conclusion that it lacked standing to bring direct—as opposed to derivative—suit, arguing that the injury alleged satisfied this court's two-prong test set forth in Dinuro Investments, LLC v. Camacho, 141 So. 3d 731 (Fla. 3d DCA 2014). We agree and reverse.

Facts and Procedural Background

The Unaffiliated Shareholder, the Pettys, and the two corporate defendants below (owned or controlled by the Pettys) were shareholders of Exatech ("the Corporation"), a publicly traded corporation, when a majority of shareholders approved a merger plan to go private in 2018. Binch, Krusen, Locander, Smith, and Watts worked as the Corporation's outside directors during the merger. The complaint asserted five counts for breach of fiduciary duty, variously alleging that they colluded during the 2017 negotiations leading to the merger vote in 2018 to present shareholders only with the prevailing bidder's plan in exchange for certain personal benefits promised to them by the bidder.

In 2017, the Corporation received competing bids. At the time, the Corporation's board was composed of seven individuals, including two of the Pettys. Between March and May, the Pettys received bids from the ultimately prevailing bidder and from a different entity. In June, the Pettys informed the other entity that the Corporation would not pursue further negotiations, preferring instead the prevailing bidder. They failed, however, to inform the rest of the board of any bid other than the prevailing one. Because the Pettys had a preexisting business relationship with the prevailing bidder, and upon the advice of inhouse counsel, further negotiations with the bidder were to be conducted by the other five members of the board from that point on. However, the complaint alleged that the Pettys continued to negotiate with the bidder for more personally favorable terms under the future merger in exchange for their vote at the 2018 approval. The Pettys were the largest stockholding block, owning or controlling 26% of all common stock—the only kind issued.

In October, the Corporation entered a provisional merger agreement with the prevailing bidder, encompassing a $42 per share valuation, the Corporation's duty to pay a termination fee, and the Affiliated Shareholders' optional retention of equity in—and employment with—the new entity. In 2018, the bidder previously turned down offered $49 per share and a reduced termination fee, the prevailing bidder countering with $49.25 per share and a higher termination fee. The bidder previously turned down countered with $54 per share and the reimbursement of the Corporation for any termination fee paid, requesting only that the Pettys commit in writing to support the plan at the shareholders' vote. The Pettys refused to support that merger plan and the rest of the board rejected the offer on that basis.

The prevailing bidder's plan for $49.25 per share was ultimately approved. The day before the ratifying vote, however, Unaffiliated Shareholder filed the suit below. Upon reviewing the motion for class certification, the trial court addressed whether the Unaffiliated Shareholder "ha[d] standing to bring these claims in its consideration as to whether class certification is appropriate." The court ruled that it "lacked standing to represent the purported members of the class and therefore, the motion for class certification is denied." Applying Dinuro, the court found:

> Here, Plaintiff argues that its claims are direct, not derivative, because there is a "special injury, one group of shareholders being treated differently than another." Plaintiffs are contending that because the "insiders" or "Rollover Investors" were able to roll some of their shares into, and continue their employment with, the post-Merger entity, this constitutes a "special injury" to the Unaffiliated Shareholders. The Court finds that this fact – even if it could be considered a benefit to the Rollover Investors, a determination the Court need not make at this juncture – does not constitute a "direct injury" and "special harm" which would allow Plaintiff to bring this action as a direct action.
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> The Unaffiliated Shareholders' claim is that it received less per share for its stock because Defendants breached their fiduciary duties. In other words, Exatech could have been sold for a higher price but for Defendants' actions. The Arbitrage Fund has not articulated any "special injury" it or any other "non-Insider" suffered other than \$4.75 per share – the difference between the final price per share paid by TPG (\$49.25) and the per share price offered by Party A ("54.00"). Shareholders holding 10,786,013 shares in Exatech were given the same consideration as Plaintiff – \$49.25 per share.

Analysis

"We review the trial court's order denying class certification for an abuse of discretion." Biza, Corp. v. Galway Bay Mobile Homeowners Ass'n, Inc., 44 Fla. L. Weekly D3010 (Fla. 3d DCA Dec. 18, 2019). "That is because 'the determination that a case meets the requirements of a class action is a factual finding,' which falls within a trial court's discretion." Sosa v. Safeway Premium Fin., Co., 73 So. 3d 91, 103 (Fla. 2011) (quoting Bouchard Transp. Co. v. Updegraff, 807 So. 2d 768, 771 (Fla. 2d DCA 2002)). However, we review de novo the trial court's determination of whether the putative class representative has standing to represent the members of the class. See Baptist Hosp., Inc. v. Baker, 84 So. 3d 1200, 1204 (Fla. 1st DCA 2012); see also Griffith v. Quality Distrib., Inc., 43 Fla. L. Weekly D1599 (Fla. 2d DCA July 13, 2018) ("Where the trial court applies the wrong law or the issue involves a pure question of law, the ruling is reviewed de novo."). Because the trial court's sole finding precluding certification was the Unaffiliated Shareholder's purported lack of standing to bring direct suit under Dinuro, we review only that question, not considering any of the requirements of rule 1.220, Florida Rules of Civil Procedure.[1]

In Dinuro, after comprehensively reviewing Florida law, we adopted a two-prong test for ascertaining a shareholder's standing to bring direct suit. 141 So. 3d at 739-40. We observed:

> Confounding this already complicated issue is the lack of clarity in Florida case law regarding what standard to apply when determining whether a suit for damage to a member or company can be brought directly. Our review of the scholarly literature and case law from around the country evidences three specific approaches relied upon to determine whether an action may be brought directly or derivatively: (1) the "direct harm" test; (2) the "special injury" test; and (3) the "duty owed" test.
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> In our view, the only way to reconcile nearly fifty years of apparently divergent case law on this point is by holding that an action may be brought directly only if (1) there is a direct harm to the shareholder or member such that the alleged injury does not flow subsequently from an initial

[1] The Unaffiliated Shareholder sought to prove standing below alternatively under Dinuro and section 607.0750, Florida Statutes (2019). The lower court did not reach the retroactivity of the 2019 amendment of this section. The parties concede that the amended statute did nothing but codify Dinuro, although they disagree on how to interpret it. Because we conclude that the Unaffiliated Shareholder had standing under Dinuro, we do not reach the retroactivity of amended section 607.0750. See Interest of T.C., 290 So. 3d 580, 583-84 (Fla. 2d DCA 2020) (noting "'settled principle of constitutional law' that courts should avoid constitutional issues unnecessary to a decision of a case") (quoting State v. Mozo, 655 So. 2d 1115, 1117 (Fla. 1995)).

> harm to the company and (2) there is a special injury to the shareholder or member that is separate and distinct from those sustained by the other shareholders or members.

Id. at 735, 739-40.

Here, the complaint asserted five counts of breach of fiduciary duties predicated, in one way or another, on the same alleged harm or set of harms. Counts I, III, IV, and V relevantly alleged that some of the Affiliated Shareholders: (1) "condition[ed] their votes as Board members on undisclosed future employment and other agreements with TPG rather than the shareholders' best interests, and thereby derived an improper personal benefit, at the expense of . . . Unaffiliated Shareholders;" (2) withheld information about Party A's interest from the rest of the board; (3) "exploit[ed] their positions of control and influence . . . in order to secure improper personal benefits for themselves not shared with . . . Unaffiliated Shareholders;" (4) "attempt[ed] to wrongfully coerce" the Corporation's shareholders into approving the TPG merger agreement; and (5) "assisted or encouraged [the Pettys] to breach [their] duties by refusing to vote its shares for any offer from Party A, depriving the Unaffiliated Shareholders of value."

Count II alleged that other Affiliated Shareholders "acquiesce[ed] in the Petty Defendants' efforts" and "fail[ed] to engage a non-conflicted financial advisor, by failing to implement procedural safeguards . . . and failing to consider alternatives to the TPG [offer]." All counts incorporated the allegation that, although the

Unaffiliated Shareholders would only receive cash for their shares under either merger plan, the Pettys "will not receive only cash," but "will be able to participate in the continued growth of the business through an ownership interest in the post-transaction entity" under the prevailing plan, as well as continue as "executive officers and management," which they "were able to arrange for . . . through a series of private negotiations with TPG that were never disclosed to the Board."

On appeal, the Unaffiliated Shareholder describes the harms it and others similarly situated suffered as encompassing: (1) the lost opportunity to sell its stock for a higher price under the losing bid; and (2) failing to receive additional benefits under the prevailing merger plan received only by the Affiliated Shareholders and Officers, including the option to retain equity in the new entity and the opportunity to retain office and employment with the Corporation.

The Unaffiliated Shareholder's Direct Harm

An injury is not direct if it flows first to the company and only secondarily to the aggrieved shareholder, such that it "only damages the shareholders or members due to the loss in value of their respective ownership interest." Dinuro, 141 So. 3d at 735. The test "must compare the individual's harm to the company's harm . . . [such that] a shareholder can only bring a direct suit if the damages are unrelated to the damages sustained by the company and the company would have no right to recover in its own action." Id. at 736. We "need only look to whether the alleged wrongful conduct devalued the company as a whole or was directed specifically towards the individual plaintiff." Id.

Here, it is clear that the Unaffiliated Shareholder's inability to obtain a higher price for its shares, if harmful at all,[2] first flowed to—and actually devalued—the Corporation, there existing only one type of stock, all of which suffered from the price difference. This only secondarily affected the Unaffiliated and Affiliated Shareholders alike. See id. at 736 (approvingly citing to the proposition that shareholder cannot sue directly for devaluation of stock, since this primarily "reduc[es] corporate assets and net worth").

As to the Affiliated Shareholders and Officers' personally favorable concessions obtained from the prevailing bidder, such as continued office or paid employment in the new entity, their harm also flowed first to the corporation, devaluing or dilapidating its net worth and assets, and only secondarily to all shareholders alike. As a variety of mismanagement, such concessions first affected the assets of the Corporation, which could sue to recover the loss. See, e.g., Fritz v. Fritz, 219 So. 3d 234, 238 (Fla. 3d DCA 2017) (finding no direct harm in alleged self-dealing securing personal bonuses and management fees). To this extent, therefore, the trial court was correct.

[2] The Unaffiliated Shareholder concedes the price difference did not devalue or harm the corporation at all.

However, the Unaffiliated Shareholder's inability to retain any stock in the new entity, whereas the Affiliate Shareholders and Officers did retain some—preserving their investment, was clearly a harm that flowed first and only to the Unaffiliated Shareholder (and others similarly situated), and not to the Corporation, its stock value, or other assets. The Corporation could not sue to recover anything from this loss. In so far as all counts directly or indirectly alleged this particular harm, they sufficiently pleaded a direct harm for which the Unaffiliated Shareholder has standing to sue directly under Dinuro.

The Unaffiliated Shareholder's Special Injury

Because we find only one alleged injury to be direct, we apply the second prong of Dinuro solely to that injury. To find special injury, we must also "compare the individual plaintiff's alleged injury to those injuries suffered by the other members or shareholders . . . and then determine whether the plaintiff's injury is separate and distinct from [theirs]." Dinuro, 141 So. 3d at 736. The Unaffiliated Shareholder's loss must be "substantially different from those losses sustained by other shareholders." Id. at 737. It is also relevant whether the purported wrongdoer profited from the wrongdoing, "or at least suffered an injury less substantial" than the complaining shareholders. Id. at 740.

It is apparent that the Affiliated Shareholders and Officers profited from retaining equity—an option negotiated solely for themselves, and that any injury they might have suffered on account of that was less substantial than that suffered by the Unaffiliated Shareholder. In fact, the Pettys alone owned more than 93% of all the stock that would (or did) roll over under the prevailing merger plan.

Nevertheless, the Affiliated Shareholders and Officers argue that the Unaffiliated Shareholder's inability to retain stock is not separate and distinct from the identical inability imposed on others similarly situated, and whom the Unaffiliated Shareholder intended to represent through class certification. The question posed is whether, in satisfying the special injury prong of Dinuro, the Unaffiliated Shareholder's allegations must demonstrate that the injury was not suffered by any other shareholder, or only that it was not suffered by some other shareholder. Dinuro did not directly address whether the requirement that the Unaffiliated Shareholder complain of an injury "distinct from that suffered by other shareholders," Dinuro, 141 So. 3d at 736, meant "*all* other" or "*some* other" shareholders. Admittedly, one interpretation is more restrictive than the other.

Dinuro, however, provides guidance. In reviewing the scholarly literature on the known interpretations of the special injury test, we were fully appraised of the divide between its narrow and broader conceptions:

> Under the special injury test, a claim is direct only if the shareholder has suffered an injury that is separate and distinct from any injury suffered by the corporation. This rule requires a specific analysis of the alleged injury to the shareholder. Some jurisdictions require that the special injury be unique from any injury to the corporation. Other

> jurisdictions apply a stricter standard requiring that the special injury not only be distinct from an injury suffered by the corporation, but also from any injury suffered by all other shareholders of the corporation. For example, under the more strict special injury test, harm to a shareholder caused by diminution in share price does not constitute a direct cause of action because the harm affects all shareholders alike. The most common examples of distinct and separate injuries that truly affect only one shareholder are injuries to a shareholder under a separate contract with the corporation, or claims that a corporation singled out a shareholder specifically for mistreatment.
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> The Delaware Supreme Court combined both special injury approaches by defining a special injury as an injury that is "not suffered by all stockholders generally or where the wrong involves a contractual right of the stockholders, such as the right to vote." The Delaware Supreme Court has held that claims of stock dilution and reduction in voting power are both causes of action that fall within the special injury category. The ALI states that a shareholder's loss of wages or other income from the corporation is also an example of a special injury suffered by a shareholder that warrants direct action.

Elizabeth Thompson, Direct Harm, Special Injury, or Duty Owed: Which Test Allows for the Most Shareholder Success in Direct Shareholder Litigation?, 35 J. Corp. L. 215, 221-22 (2009) (cited in Dinuro, 141 So. 3d at 735). We deliberately relied on scholarly work and precedent from other jurisdictions in order to better assess the "merits and difficulties" of conflicting interpretations about the standards and clarify which one prevailed in Florida. Dinuro, 141 So. 3d at 735.

The Affiliated Shareholders and Officers argue that Dinuro adopted the stricter standard described above, "requiring that the special injury not only be distinct from an injury suffered by the corporation, but also from any injury suffered by all other shareholders of the corporation." Only one court seems to have interpreted Dinuro to stand for this stricter test. See Triton II, LLC v. Randazzo, No. 18-cv-61469, 2019 WL 1777726, at *7 (S.D. Fla. Apr. 23, 2019) (affirming dismissal because alleged harm was indirect and failed to be special and distinct from that of "all other shareholders," being indistinguishable from claim of self-dealing). However, while Triton II claimed to apply Dinuro, it actually relied on Medsker v. Feingold, 307 F. App'x 262, 264 (11th Cir. 2008)—predating Dinuro—for the stricter standard language. To the contrary, Dinuro did not adopt the stricter standard advanced here by the Affiliated Shareholders and Officers.

While this case does not involve a closely held corporation, we noted in Dinuro that the test for special injury we were considering was one that "allow[ed] greater flexibility for plaintiff-members to bring a direct suit in small closely held corporations or limited liability companies." The stricter test advanced here would be anything but flexible, not just in the context of closely held corporations, but especially in the case of larger corporations not so held. It would render direct class actions impossible, since, to obtain certification, the test would require members of a sub-class of shareholders singled out for mistreatment by another not to share a similar or identical injury among themselves, which is nevertheless the entire point of seeking class certification in this context.

Further, in Dinuro, 141 So. 3d at 737, we relied on Ayres v. AG Processing, Inc., 345 F. Supp. 2d 1200 (D. Kan. 2004), to inform our understanding of the special injury test. Ayres held allegations that the defendants' actions resulted both in a loss to the plaintiffs' equity ownership and a decrease in financial benefits to them to be sufficient to plead a special injury separate and distinct from "that suffered by other members." 345 F. Supp. 2d at 1209. The court found that "[p]laintiffs may therefore assert their breach of fiduciary duty and minority oppression claims as a direct action." Id. Ayres was not daunted by the fact that there was more than one plaintiff asserting the same injury. Id. at 1208-09.

This and other Florida courts have found direct claims supported by allegations of a separate and distinct injury where more than one shareholder suffered the same harm, jointly suing another group of shareholders or fiduciaries. See, e.g., Wolfe v. Am. Sav. & Loan Ass'n of Fla., 539 So. 2d 606, 608 (Fla. 3d DCA 1989) (holding that, "[f]rom the plaintiffs' point of view, the claims involve allegations of injury to their separate, individualized interests as preferred shareholders alone," and that corporation that stood to pay minority shareholders if claims were successful, could "in no sense . . . [argue] that the corporation qua corporation has been harmed by [the] allegedly wrongful actions"); Medsker, 307 F. App'x at 265 ("The fact that some other investors may also have been similarly injured does not transform these direct claims into derivative ones. The corporate entity could not bring suit to recover the investment that these plaintiffs made relying on the fraudulent actions of the defendants; thus, these claims may be maintained in this direct action."); Strazzulla v. Riverside Banking Co., 175 So. 3d 879, 886 (Fla. 4th DCA 2015) (finding special injury where more than one shareholder-plaintiff suffered from same fraudulent inducement, but others did not).

Contrary to the Affiliated Shareholders and Officers' suggestion, Dinuro did not overrule Wolfe, since Wolfe squarely rested on Citizens National Bank of St. Peterburg v. Peters, 175 So. 2d 54 (Fla. 2d DCA 1965), which Dinuro described as the controlling test in Florida. Dinuro, 141 So. 3d at 738. Moreover, the Affiliated Shareholders and Officers seek to distinguish these cases simply because they involved allegations of fraud, arguing that the stricter special injury test is met in such instances because the suffered loss flowed from an actual misrepresentation addressed to each aggrieved shareholder. This is unpersuasive. On the one hand, it incorrectly treats the misrepresentation made—as opposed to its injurious consequences—as the harm to which the special injury test must be applied. On the other, such emphasis on the actions of tortfeasors arbitrarily suggests that negligent or fraudulent misrepresentation by way of *omission* would not satisfy the stricter test, and that this is a contemplated and desirable legal result under Dinuro.

The fact that there are other shareholders similarly situated to the Unaffiliated Shareholder and equally unable to retain equity under the prevailing merger plan—

an injury they share solely because of the alleged collusion of the Affiliated Shareholders and Officers—does not render the injury any less special. A special injury under Dinuro need not be one that is unique or exclusive to an aggrieved party in the sense that it must have only been suffered by them. Ostensibly, the Corporation here cannot recover for the injury complained of. Necessarily, the claim must be direct, if it is not derivative, and this is so despite its seeking redress for a harm equally inflicted on some other shareholders, though not all. The Unaffiliated Shareholder, therefore, had standing to bring direct suit.

While we recognize that most corporate self-dealing and mismanagement claims do not meet the special injury test announced in Dinuro, under the facts of this case, the inability of aggrieved shareholders to retain equity in the new entity as a result of the fraudulent or disloyal collusions of another subset of shareholders or fiduciaries does satisfy its exacting requirements. Holding otherwise would not only run counter to Dinuro, but also render rule 1.220 virtually inapplicable to direct actions by shareholders even in fraud-based causes of action.

Conclusion

Because the Unaffiliated Shareholder had standing to bring direct suit under Dinuro, the trial court erred as a matter of law in concluding otherwise and denying its motion for class certification on such grounds.

Reversed and remanded for further proceedings consistent herewith.