IN THE DISTRICT COURT OF APPEAL
FOURTH APPELLATE DIVISION

CASE NO. 4D08-4057
L.T. CASE NO. 502006CA005626XXXXMB

ALAN I. KARTEN, TRUSTEE
of the ALAN I. KARTEN TRUST
U/A DTD 1/5/85

Appellant,

vs.

ROBERT I. WOLTIN and CARL KARMIN

Appellees.

APPELLANT'S INITIAL BRIEF

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CERTIFICATE OF INTERESTED PERSONS

Counsel for Plaintiff/Appellant, ALAN I. KARTEN, Trustee, certifies that the following persons and entities have or may have an interest in the outcome of this case.

1. Alan I. Karten
   (Plaintiff/Appellant)

2. Norman Malinski, Esquire
   (Counsel for Plaintiff/Appellant)

3. James K. Pedley, Esquire
   (Counsel for Defendants/Appellees)

4. The Honorable Diana Lewis
   (Circuit Court Trial Judge)

5. Larry M. Mesches, Esquire
   (Counsel for Defendants)

6. Robert I. Woltin
   (Defendant/Appellee)

7. Carl Karmin
   (Defendant/Appellee)

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INTRODUCTION

The action below was brought by the Petitioner, ALAN I. KARTEN, Trustee of the Alan I. Karten Trust UA d/t/d 1/5/85. The Trustee, Alan I. Karten was the Petitioner in the Court below, is the Appellant herein and will be referred to throughout this Brief as KARTEN.

The Respondents in the Court below were, ROBERT I. WOLTIN and CARL KARMIN. These are the Appellees herein and will be referred to throughout the Brief as WOLTIN and KARMIN, respectively.

References to the Record (Docket) furnished to this Court will be by the designation, "R___".

STATEMENT OF THE CASE AND FACTS

KARTEN brought this action in the Palm Beach County Circuit Court, seeking relief from the only two other shareholders in a restaurant company known as 201 East Atlantic Investments, Inc.

KARTEN sought to assert a claim for damages for breach of fiduciary duty against the two other shareholders, WOLTIN and KARMIN (R41-46). WOLTIN and KARMIN answered the Second Amended Complaint (R91-93) asserted the defense that the matter was barred since the lawsuit could only be brought as a

shareholder's derivative action. The issue then proceeded to summary judgment (other issues were raised in this litigation that are not germane to this appeal).

The summary judgment motion interposed by the defendants. (R274-277) The Court granted the defendants' summary judgment motion on June 18, 2008 (R356-358), asserting that this action could not be brought as an individual claim by KARTEN against WOLTIN and KARMIN, but could only be brought as a shareholder's derivative action, in that the harm suffered was by the corporation and not by the individual shareholder, Karten.

This Order granting summary judgment was reduced to final judgment on September 25, 2008 (R397-400) and this appeal has ensued.

STANDARD OF REVIEW

This appeal concerns the question of whether the trial judge made errors of law. The general "standard of review governing a trial court's ruling on a motion

for summary judgment posing a pure question of law is de novo". *Major League Baseball v. Morsani*, 790 So.2d 1071, 1074 (Fla.2001).

POINTS INVOLVED ON APPEAL

POINT I

WHETHER THE TRIAL COURT ERRED IN A SHAREHOLDER=S DERIVATIVE ACTION DETERMINING THAT THE PLAINTIFF'S COMPLAINT COULD ONLY PROPERLY PROCEED AS A SHAREHOLDERS DERIVATIVE ACTION

SUMMARY OF ARGUMENT

This action was brought by KARTEN as a tort identified in the second amended complaint as breach of fiduciary duty. Breach of a fiduciary duty is a tort recognized in Florida. Gracey v. Ekor, 837 So.2d 348 (Fla. 2002).

Contrary to the trial court's ruling a minority shareholder can bring an action for breach of fiduciary duty against controlling shareholders and, in the appropriate circumstances, even secure an award of punitive damages. Mortellite v. American Power, LP, 819 So.2d 928 (Fla. 2nd DCA 2002).

Even under a more traditional analysis, the second amended complaint stated a cause of action because it alleged that Karten suffered injuries separate and distinct from that sustained by any other shareholders of the corporation, especially when a fiduciary duty is owed and breached by majority shareholders who control the corporation.

Policy favoring shareholder derivative actions is not inconsistent with policy to prevent shareholder oppression. In fact, under the facts of this case both policies are supportive of each other and consistent.

There cannot be a multiplicity of lawsuits by shareholders because there is only a single shareholder (the plaintiff) who was damaged. The two other shareholders are defendants and are the wrongdoers; there are no corporate creditors; all of the shareholders are a party to the suit; and the injured shareholder (Karten) cannot be adequately compensated for the breach of fiduciary duty by the wrongdoers (Karmin and Woltin), since awarding damages to the corporation would amount to returning the money to the parties who stole it to begin with.

As such there is no rational or reasonable basis or policy implicated why this tort action should not have proceeded as pled in the Complaint.

ARGUMENT

POINT I

WHETHER THE TRIAL COURT ERRED IN DETERMINING THAT THE PLAINTIFF'S COMPLAINT COULD ONLY PROPERLY PROCEED AS A SHAREHOLDERS DERIVATIVE ACTION

The trial Court entered a Final Judgment (R 397-400) after granting the Defendants' Motion for Summary Judgment (R 356-358). The Defendants' argument, in essence was based on the assertion that the allegations of the Second Amended Complaint, even if true, could only support a shareholder's derivative action.

The court agreed with the defendants' position holding that "All of the allegations of the second amended complaint are directed to allege damages which would have been incurred by 201 East Atlantic Investments, Inc. and were not

direct losses suffered by Alan I. Karten, Trustee." at 358). Therefore, the trial court concluded, the lawsuit could only have been brought as a shareholder derivative action.

The trial court employed the wrong analysis. The Plaintiff could properly bring the lawsuit as an individual or direct action.

Breach of a fiduciary duty is a tort recognized by the Florida Supreme Court. *Gracey v. Eaker,* 837 So.2d 348 (Fla. 2002). *Burke v. Windjammer Barefoot Cruises,* So.2d (Fla. 3 DCA 2008). A tortfeasor can breach his fiduciary duty owed both, intentionally or negligently. *Palafrugell Holdings, Inc. v. Cassel,* 825 So.2d 937 (Fla. 3 DCA 2001).

The elements which sustain such an action are the existence of a fiduciary duty, and the breach of that duty such that it is the proximate cause of the plaintiff's damages. *Gracey, supra.*

Florida has permitted a shareholder to bring a direct action against the majority shareholder(s) or corporate officers or directors when a fiduciary duty is breached.

The reasoning is that the breach is directed at the minority shareholder as opposed to the corporation in general.

The right of action for breach of a fiduciary duty in this instance belongs to the minority shareholder and therefore is a direct action. When the duty owed to the corporation is breach the action would be derivative. The majority shareholders, in this case, owed a fiduciary duty to Karten, as minority shareholder as well as separate fiduciary duty to the corporation.

Controlling is the case of *Mortellite v American Tower, L.P.,* 819 So.2d 928 (Fla. 2 DCA 2002) where the court permitted the award of punitive damages where the breach of fiduciary duty action was brought as a tort by an individual plaintiff. The minority shareholder, the court held, was entitled to punitive damages for majority shareholder's breach of fiduciary duty in conjunction with the sale of the corporation to a third party. 1

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1 *Mortelitte* was not a shareholder derivative action and was decided as a lawsuit for breach of a fiduciary duty. This is unequivocally evidenced by the fact that punitive damages were permitted. Punitive damages are never permitted in a shareholder derivative action lawsuit. See, Chemplex FL v. Norelli, 790 So.2d 547 (Fla.App. 4 Dist., 2001)

The *Mortelitte* decision is consistent with the reasoning of the Florida Supreme Court's opinion in *Ault v. Lohr,* 538 So.2d 451 (Fla. 1989). (Where there is a breach of fiduciary duty compensatory damages need not be awarded to award punitive damages.) It is the breach of the fiduciary duty owed that is the damage. Thus, it is immaterial whether the corporation suffered damages.

An analysis employing the traditional analysis would bear the same result even if the lawsuit alleged breach of a fiduciary duty owed to the corporation by the majority shareholders as the minority shareholder, under the facts of this case, suffered an injury separate and distinct from that suffered by the other shareholders.

Stockholders in a corporation may bring a suit in their own right to redress any injury sustained directly by them individually and which is separate and distinct from that sustained by other stockholders. *Chemplex Florida v. Norelli,* 790 So.2d 547, (Fla. 4 DCA 2001). This court, in *Braun v. Buyers Choice Mortgage Corporation,* 851 So.2d 199 (Fla. 4d DCA 2003), stated:

2001)

> "Generally, a shareholder cannot sue in the shareholder's name for injuries to a corporation unless there is a special duty between the wrongdoer and the shareholder, and the shareholder has suffered an injury separate and distinct from that suffered by the other shareholders."
> *See also, Fort Pierce Corp., v. Ivey*, 671 So2d. 206 (Fla. 4DCA 1966).

KARTEN'S complaint alleges breach of a fiduciary duty owed by the two majority shareholders to a minority shareholder generally. In this particular instance, this factual assertion satisfies that portion of the pled claim which requires that there be a special duty between the wrongdoer and the shareholder.

Florida has long recognized that majority shareholders, corporate directors and corporate officers owe a fiduciary duty to minority shareholders to operate in good faith and for the benefit of the corporation and not themselves. Additionally, the exercise of *de facto* control over a corporation carries with it a fiduciary duty to minority shareholders despite the absence of *de jure* titles. Garrer v. Perrson, 543 F. Supp. 349 (M.D. Fla. 1988), *citing* Florida courts. Majority and controlling shareholders or a group of shareholders, such as KARMIN and WOLTIN, owe a fiduciary duty to the corporation and all minority shareholders. Pepper v. Litton, 60 S.Ct. 238 (1939); *accord;* William Meade Fletcher, *Fletcher*

Cyclopedia of the Law of Private Corporations § 5911, at 458 (perm ed., rev. vol. 2000).

Having clearly alleged in the second amended complaint a fiduciary duty recognized by the Florida courts and factual allegations to support the existence of that duty, the next analysis is to determine whether the second amended complaint sufficiently alleged that the shareholder suffered an injury separate and distinct from that of the other shareholders, who in the instant case, are Karmin and Woltin.

While Florida law acknowledges that a minority shareholder may bring a direct action as opposed to a derivative action, the courts have failed to present a standard of analysis as to how the courts are to decide whether the shareholder suffered an injury separate and distinct from that of the other shareholders. None of the courts deciding this issue have presented a ready model for analysis and determination and have failed to explain the analysis used to reach their decision. The courts have simply held that the injury was either direct or not direct.

In determining whether the allegations of the second amended complaint sufficiently alleged that the shareholder, Karten, suffered an injury separate and

distinct from that suffered by the other shareholders. The court should consider the underlying policy considerations.

The rationale underlying the rule posits that the derivative requirement"

1) prevents a multiplicity of lawsuits by shareholders;

2) protects corporate creditors by putting proceeds of the recovery back in the corporation;

3) guards the interests of all shareholders by increasing the value of their shares instead of potentially prejudicing the rights of shareholders not a party to the suit; and

4) adequately compensates the injured shareholder by increasing the value of his shares when any recovery is put back into the corporation.

See Simmons v. Miller, 544 S.E.2d 666, 674 (Va. 2001), *citing Thomas v. Dickson*, 301 S.E.2d 49, 51 (Ga.1983).

While the policy is reasonable to corporations in general it is sometimes not when the corporation is a close corporation. When determining whether the shareholder has suffered an injury separate and distinct from that suffered by the other shareholders, the court should keep in mind that Florida recognizes that there

is a difference between corporations and "close" corporations. See, *Tillis v. United Auto Parts, Inc.* 395 So.2d 618 (Fla.5th DCA 1981), quoting *Donahue v. Rodd Electrotype Company of New England, Inc.* 367 Mass. 578, 328 N.E. 505 (1975) for the proposition that the stockholders in a close corporation owed each other the same fiduciary duty as that owed by one partner to another in a partnership.

In this case KARTEN clearly stated that he was suing as an individual and that his injuries were separate and distinct from the other shareholders.

The complaint clearly and unequivocally alleges that there are three shareholders to 201 and two other shareholders, the Defendants WOLTIN and KARMIN suffered no harm but were, in fact, the parties who created the damage. It would be completely self-defeating to bring the action as a derivative action, restore the money to the corporation, and then have the wrongdoers take control of the very funds they were required to disgorge.

Where, as in the instant case, the corporation is a close corporation and the tortfeasors would benefit from a derivative action the policy and the analysis are different but consistent.

Since no Florida case has discussed the underlying policy considerations permitting a direct action where there is shareholder oppression or a close corporation this court should look elsewhere for guidance, including other jurisdictions. *Dadeland v. St. Paul Fire and Marine,* 945 So.2d 1216 (Fla. 2006), *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 371 (1966)

In 2006 the Supreme Court of Rhode Island looked for guidance from the Supreme Court of Delaware and adopted a test standard identical to that of Delaware. The court in *Marsh v. Billington Farms L.L.C.*, 2006 WL 2555911 (RI Sup Ct..) discussed the opinion of the Deleaware Supreme Court.

In *Tooley v. Donaldson, Lufkin & Janrette Inc.* 845 A.2d 1031 (Del. 2004), the Delaware Supreme Court enunciated a new, simplified standard to determine if a claim is derivative or direct. In making this determination, a court should ask itself two questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)? Discussing the first prong of this standard, the court approvingly referred to the test promulgated by the American Law Institute (AALI@), which states:

> AA direct action may be brought in the name and right of a holder to redress an injury sustained by, or enforce a duty owed to, the holder an action in which the holder can prevail without showing an injury or breach of duty to the corporation should be treated as a direct action that may be maintained by the holder in an individual capacity.
>
> ***2 American Law Institute, Principles of Corporate Governance***:
>
> Analysis and Recommendations Sec. 7.01(b) (1994).

This test, however, is a broad tool fashioned for the general corporate cause of action. As a general rule, derivative suits are designed to protect shareholders of corporations from the designing schemes and wiles of insiders who are willing to betray their company=s interests in order to enrich themselves.' *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 371 (1966).

Holding that a group of preferred shareholders had stated a claim as a direct action the Court in its opinion in *Wolfe v. American Savings & Loan Assoc. of Florida*, 539 So2d. 606, 608 (3d DCA 1989) stated:

> From the plaintiffs' point of view, the claims involve allegations of injury to their separate, individualized interests as preferred shareholders alone which would necessarily inure to their own benefit, rather than-as is true of a derivative claim-that of the corporation itself.

Carrying the argument one step further, far from requiring the corporation to make its own claim by asserting that claim on its behalf, which is the essential object of a derivative action, *Koster v. Lumbermens Mut. Casualty Co.*, 330 U.S. 518, 523, 67 S.Ct. 828, 831, 91 L.Ed. 1067, 1073 (1947); *Lynam v. Livingston*, 257 F.Supp. 520, 524 (D.Del.1966); see *Talcott, Inc. v. McDowell*, 148 So.2d 36 (Fla. 3d DCA 1962); see also 12B W. Fletcher, Cyclopedia of the Law of Private Corporations ' 5908, and cases cited, ASL is, as to the breach of contract action, actually the adverse party which must *pay* it if it loses. And, with respect to the claim against the officers and directors as fiduciaries, it can in no sense be said that the corporation *qua* corporation has been harmed by those allegedly wrongful actions, so as to invoke the Aderivative@ doctrine which has as its foundation the redress of such a corporate injury. From every point of view, therefore, this cause is correctly maintained as an individual or direct action for the benefit of those purportedly harmed, the preferred shareholders, and is therefore necessarily not one which may, much less must, be brought on behalf of the corporation as a derivative case. *Eisenberg v. Flying Tiger Line, Inc.*, 451 F.2d 267 (2d Cir.1971) (action against directors for violation of alleged duty owed individually to stockholders not to merge corporation maintainable as direct action); *Jones v. H.F. Ahmanson & Co.*, 1 Cal.3d 93, 81 Cal.Rptr. 592, 460 P.2d 464 (1969) (suit against majority shareholders for decreased value of stock not derivative); *Lipton v. News Int'l, PLC*, 514 A.2d 1075 (Del.1986) (allegations against corporations and their officers and directors for deprivation of voting rights and waste of corporate assets created individual causes of action); *Witherbee v. Bowles*, 201 N.Y. 427, 95

N.E. 27 (1911) (complaint to set aside sale of corporate stock and acts of directors states causes of action for injury to stockholders individually); *Lehrman v. Godchaux Sugars, Inc.*, 207 Misc. 314, 138 N.Y.S.2d 163 (Sup.Ct.1955) (alleged wrongful recapitalization personal right belonging to stockholder); *Reifsnyder v. Pittsburgh Outdoor Advertising Co.*, 405 Pa. 142, 173 A.2d 319 (1961) (shareholder may bring direct action to protect voting rights). See generally *Karnegis v. Lazzo*, 243 So.2d 642 (Fla. 3d DCA 1971) (allegations of both individual and derivative claims sufficient to state separate causes of action).

When it comes to a closely held corporation the analysis favors a direct action. In the context of closely held corporations, the American Law Institute (ALI), as well as most courts, has promulgated a different approach.

"the court in its discretion may treat an action raising a derivative claim as a direct action, exempt it from those restrictions and defenses applicable only to derivative actions, and order an individual recovery if it finds that to do so will not (I) unfairly expose the corporation to a multiplicity of actions, (ii) materially prejudice the interests of creditors of the corporation, or (iii) interfere with a fair distribution of the recovery among all interested parties.@ A.L.I. Principles of Corporate Governance: Analysis and Recommendations Sec. 7.01(d).

The concept of an exception for close corporation is not new. The federal judiciary for this Circuit has long acknowledged the exception. In *Fidelity & Deposit Company of Maryland v. Conner*, 973 F.2d 1236 (5th Cir 1992)(now incorporated into the case law of the Eleventh Circuit) the Court stated:

> Although the general rule is that individual stockholders have no independent right of action for injuries suffered by the corporation an exception has been applied more often in cases where there was a fiduciary relationship which required the wrongdoer to protect the interest of the stockholder and full relief to the stockholder could not be had through recovery by the corporation.) *Fidelity* at 1238.

See also, *Mass v. Davis.* 140 Tex. 398, 407-408, 168 S.W.2d 216, 221-22 (1942). *Accord*, 13 Fletcher, Cyclopedia of Corporations, Perm Ed. Sec. 1956. The courts adopting the ALI standard include: *Durham v. Durham*, 871 A.2d 41, 46 (N.H.2005); *Trieweiler v. Sears*, 689 N.W.2d 807, 838 (Neb.2004); *Mynatt v.. Collis*, 57 P.3d 513 (Kan,2002); *Aurora Credit Services v. Liberty West*, 970 P.2d 1273 (Utah 1998); *Barth v. Barth*, 659 N.E. 2d 559 (Ind.1995); *Derouen v. Murray*, 604 So.2d 1086 (Miss.1992); *Schumacher v. Schumacker*, 469 N.W. 2d 793 (N.D. 1991); *Marcuccilli v. Ken Corp.*, 766 N.E. 2d 444 (Ind. Ct. App. 2002); *Richards v. Bryan*, 879 P.2d 638 (Kan. App. 1994); *Funk v. Spalding*, 246 P.2d 184 (Arizona 1952)(Shareholder direct action failure to distribute profits to minority shareholder, profits not an asset of the corporation and shareholder would not obtain relief by returning profit directly to the corporation. See also, *Gieselmann v. Stegeman*, 443 S.W.2d 127 (Mo. 1969) holding stockholders may maintain action on an individual basis where fraud perpetrated by majority shareholders, officers or directors.

This exception has been adopted by a number of courts and has, by virtue of the fact that Florida allows direct actions, been adopted by Florida.

Applying the ALI Standard to this case, there is no rational basis to treat the lawsuit as a derivative action and the result would be contrary to the underlying policy and unjust.

1) There cannot be a multiplicity of lawsuits by shareholders because there is only a single shareholder (the plaintiff) who was damaged. The two other shareholders are defendants and are the wrongdoers;

2) there are no corporate creditors;

3) All of the shareholders are a party to the suit; and

4) the injured shareholder cannot be adequately compensated for the breach of fiduciary duty by the wrongdoers, since awarding damages to the corporation would amount to returning the money to the parties who stole it to begin with.

The trial court's judgment should be reversed.

CONCLUSION

Based on the foregoing, KARTEN respectfully requests the Court to reverse the Order Granting Defendants' Motion For Partial Summary Judgment on the Second Amended Complaint for Breach of Fiduciary Duty and to reverse the Final Judgment in this cause and remand the cause for trial.

CERTIFICATE OF COMPLIANCE

I HEREBY CERTIFY that the size and style of type used in this Brief is 14-Point Times New Roman, in compliance with Florida Rules of Appellate Procedure 9.210.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing was mailed this 12thth day of February, 2009 to: James K. Pedley, Esquire, 727 N.W. 3rd Avenue, Suite 301, Fort Lauderdale, Florida 33304 and Larry M. Mesches, Esquire, KOEPPEL, GOTTLIEB MESCHES, 525 South Flagler Drive, Suite 200, West Palm Beach, Florida 33401.

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