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Cotter v. Kane, 136 Nev. Adv. Op. 63 (Oct. 1, 2020)

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CORPORATE LAW: SCOPE AND ABILITIES OF CORPORATE NOMINAL
DEFENDANTS AND SHAREHOLDER PLAINTIFFS IN A DERIVATIVE ACTION

Summary

After the death of former CEO and majority shareholder, James Cotter Sr., the Board of Directors for Reading International Inc. (“RDI”) terminated the status of then CEO and president, James Cotter Jr. Tensions rose, and James Cotter Jr. brought a derivative action against RDI and the Board. Eventually, summary judgment was rendered against James Cotter Jr., with costs.

On appeal, the Supreme Court of Nevada first determined a nominal defendant corporation, like RDI, may not challenge the underlying claims in a derivative action, but may challenge the shareholder plaintiff’s standing to bring such an action. Second, the Court adopted the Ninth Circuit’s eight-factor test to determine whether a plaintiff adequately represents shareholders and thus has standing. Third, the Court sorted out appeals over costs and fees.

Ultimately, the Court determined that Cotter Jr. lacked standing to bring the derivative action, because he did not adequately represent shareholders. The Court did not consider the merits of the claim, but rather vacated the order denying RDI’s motion to dismiss for lack of standing. Consequently, they reversed the order of summary judgment and remanded.

Factual and Procedural Background

RDI is a public corporation that deals in multi-complex cinemas and other real estate globally. Before James Cotter Sr. (“James Sr.”), the controlling stockholder, passed away, he resigned and appointed his son, James Cotter Jr. (“Cotter Jr.”), as CEO. When James Sr. passed away, his three children—Cotter Jr., Ellen, and Margaret, all of which served on the Board of Directors—began contending over James Sr.’s trust and estate. The Board terminated Cotter Jr. as CEO and president, and replaced him with his sister, Ellen.

Cotter Jr. sued. RDI and the Board filed a motion to dismiss, arguing Cotter Jr. (1) failed to plead demand futility, (2) lacked standing under Rule 23.1 of the Nevada Rules of Civil Procedure (“NRCP”), and (3) failed to plead damages. The district court granted the motion as to the third ground and did not address grounds one and two.

Cotter Jr. amended his complaint to seek reinstatement as CEO and president, asserted the directors were interested and lacked independence, and challenged the Board’s conduct on five grounds. Ultimately, the district court granted summary judgment in favor of RDI and the Board. The district court also awarded RDI and the Board \$1,554,319.74 in costs, which included \$853,000 in expert witness fees. The district court did not award RDI and the Board attorney’s fees.

Cotter Jr. appealed the grant of partial summary judgment (Docket No. 75053), full summary judgment (Docket No. 76981), and expert witness fees (Docket No. 77648). RDI appealed the ruling to deny attorney’s fees (Docket No. 77733).

¹ By Connor Bodin.

Analysis

Docket Nos. 75053 and 76981

Before considering the merits, the Court addressed two gatekeeping issues: (1) whether RDI, as a nominal defendant, could oppose the action or present arguments on appeal, and (2) whether Cotter Jr. represented the shareholders adequately enough to have standing.

Nominal defendant RDI cannot challenge the merits of the underlying derivative action but can challenge Cotter Jr.'s standing in bringing this suit

On appeal, Cotter Jr. argued that RDI lacked standing to present appellate arguments, because of its status as a nominal defendant in a derivative action. The Court noted that a corporation's standing as a nominal defendant in a derivative action is an issue of first impression. Rather succinctly, the Court adopted California's doctrine that such a nominal defendant corporation in a derivative action cannot challenge the merits of a case but may challenge a shareholder's standing.

A nominal defendant corporation is to remain neutral in a derivative action, because its interest are not adverse to the plaintiff's. Any recovery a court awards to the plaintiff shareholder goes back to the corporation, since a derivative action is brought on behalf of the corporation. It is then the corporation that stands to benefit from the plaintiff's success. Because of this structure, most jurisdictions require a nominal defendant corporation to remain neutral. The Court adopted this position for the State of Nevada.

However, California permits a nominal defendant corporation to challenge the shareholder plaintiff's standing. According to California, the only claim a shareholder plaintiff can actually bring against a corporation in a derivative action is the claim that the corporation failed to pursue litigation where it otherwise should have. Thus, if the corporation, though its directors, had a valid reason for not pursuing litigation, that corporation should be allowed to challenge the standing of the shareholder plaintiff who decided to pursue litigation on the corporation's behalf. The Court was persuaded by this reasoning and concluded that a nominal defendant may challenge a shareholder plaintiff's standing to defend against erroneous derivative actions.

Cotter Jr. lacks standing to bring the derivative suit because he does not adequately represent shareholders

Before reviewing the order of summary judgment, the Court addressed whether Cotter Jr. had standing to bring a derivative action. The Court thus reconsidered the Board's initial motion to dismiss, which contended that Cotter Jr. did not adequately represent the shareholders. According to statute, if the shareholder plaintiff "does not fairly and adequately represent the interests of the shareholders," the derivative action cannot be maintained.² Because Nevada lacked any standards to determine adequate representation, the Court took the opportunity to adopt a factors test. In short, the Court adopted the Ninth Circuit's eight-factor test:

- (1) indications that the plaintiff is not the true party in interest;
- (2) the plaintiff's unfamiliarity with the litigation and unwillingness to

² NRCPC 23.1.

learn about the suit; (3) the degree of control exercised by the attorneys over the litigation; (4) the degree of support received by the plaintiff from other shareholders; . . . (5) the lack of personal commitment to the action on the part of the representative plaintiff; (6) the remedy sought by plaintiff in the derivative action; (7) the relative magnitude of plaintiff's personal interests as compared to his interest in the derivative action itself; and (8) plaintiff's vindictiveness toward the defendants.³

Applying these factors, the Court concluded that Cotter Jr. did not adequately represent shareholders and lacked standing. While Cotter Jr. did not seem to be controlled by an attorney and demonstrated commitment and familiarity to the action, his personal interests far outweighed shareholder's interests. He (selfishly) sought reinstatement as a remedy and showed vindictiveness toward his siblings. Cotter Jr. argued that if his father appointed him as CEO and president, then the appointment must be in the shareholder's best interests. The Court was unpersuaded by this argument, finding that the board of directors determined that plan was unworkable and not in the best interest of the corporation.

Accordingly, the Court reversed the district court's summary judgment orders without considering the merits, vacated the order denying defendant's motion to dismiss for lack of standing, and remanded for further proceedings.

Docket No. 77648

The district court abused its discretion by awarding expert witness fees in excess of the statutory maximum

The Court then turned to the issue of costs and fees. Cotter Jr. appealed the \$853,000 awarded in expert witness fees, arguing the district court abused its discretion. The Court agreed and reversed the award.

According to statute, a district court may award up to \$1,500 in expert witness fees, unless the court finds the circumstance necessitates a larger amount.⁴ The Nevada Supreme Court has held that an "expert must testify to recover more than \$1,500 in expert fees."⁵ Only in limited circumstances, not present here, may a district court award a higher amount without testimony. Therefore, the Court reversed the awarded amount over \$1,500.

The district court did not abuse its discretion by awarding RDI costs

Cotter Jr. also appealed the award for the remaining \$581,718.69 in costs. However, the Court concluded that nothing in the record demonstrated that the district court abused its discretion in regard to this award. RDI, even as a nominal defendant, was not precluded from recovering expenses, including those incurred by an indemnity agreement with its directors. Therefore, the Court affirmed the award.

³ Larson v. Dumke, 900 F.2d 1363, 1367 (9th Cir. 1990).

⁴ NEV. REV. STAT. § 18.005(5) (2020).

⁵ Pub. Emps. Ret. Sys. of Nev. v. Gitter, 133 Nev. 126, 134, 393 P.3d 673, 681 (2017) (citing Khoury v. Seastrand, 132 Nev. 520, 540, 377 P.3d 81, 95 (2016)).

Docket No. 77733

RDI appealed the district court's denial of its motion for attorney fees. The Court found that the district court did not abuse its discretion, because the record indicated that Cotter Jr.'s claims were not vexatious. Therefore, the Court affirmed the district court's order denying the motion.

Conclusion

In this case, the Court resolved two matters of first impression. First, the Court determined that a nominal corporate defendant may not challenge the merits of an underlying derivative action but may challenge the standing of the shareholder plaintiff to bring a such an action. Second, the Court adopted an eight-factor test used to determine whether a shareholder plaintiff adequately represents shareholders in a derivative action. Applying these findings, the Court reversed the district court's grants of summary judgment, because the merits were never to be considered. The Court determined that Cotter Jr. lacked standing to bring the derivative action and, accordingly, reversed the district court's order denying RDI's motion to dismiss for lack of standing. The Court also reversed the award as to expert fees, affirmed the award as to costs, and affirmed the denial of RDI's request for attorney's fees. The Court remanded.