

Dallas CPA Society's Member Appreciation CPE Series

December 10, 2013
Dallas, TX

**AM I MY BROTHER'S KEEPER: UNDERSTANDING
THE RIGHTS/DUTIES OF MAJORITY OWNERS AND
MINORITY INVESTORS IN PRIVATE COMPANIES**

**Ladd A. Hirsch
Jason Fulton**

Ladd A. Hirsch
Jason P. Fulton
Diamond McCarthy LLP
1201 Elm Street, 34th Floor
Dallas, TX 75270

LHirsch@diamondmccarthy.com
214-389-5323
JFulton@diamondmccarthy.com
214-389-5325

TABLE OF CONTENTS

- A. INTRODUCTION 1
- B. THE CLOSELY HELD (PRIVATE) CORPORATION 2
- C. REVIEW OF THE CLAIM FOR MINORITY SHAREHOLDER OPPRESSION UNDER TEXAS STATUTES AND CASE AUTHORITIES..... 3
 - 1. The Oppression Statute and Equitable Remedies in Texas 3
 - 2. Shareholder Oppression Defined by Texas Courts 4
 - 3. The Origins of Oppression Claims in Texas..... 5
 - 4. Minority Shareholder Oppression Returns to the Texas Supreme Court—More Than 55 Years Later 6
 - 5. Other Recent Shareholder Oppression Cases in Texas Courts 7
 - a. Recent Cases from the Dallas Court of Appeals..... 7
 - b. Recent Cases from the Houston Court of Appeals 8
- D. MINORITY SHAREHOLDER OPPRESSION CLAIMS AGAINST MAJORITY SHAREHOLDERS UNDER DELAWARE LAW 9
 - 1. Introduction..... 9
 - 2. Fiduciary Duties of Minority Shareholders in Delaware 9
 - 3. Delaware Courts Might Recognize a Shareholder Oppression Claim..... 10
 - 4. Fractured Foundation Of Minority Shareholder Claims in Delaware 11
 - a. *Litle v. Waters*: Minority Shareholder Prevails On Claims For Breach Of Fiduciary Duty and Shareholder Oppression 11
 - b. *Nixon v. Blackwell*: Delaware Supreme Court’s Limited Holding Related to Breach of Fiduciary Duty 12
 - c. *Riblet Products v. Nagy*: Delaware Supreme Court Narrowly Decides Certified Question from Seventh Circuit..... 15
 - 5. Litigation of Minority Shareholder Claims In Delaware 16

E.	EXAMPLES OF OPPRESSIVE CONDUCT	17
F.	APPLICATION OF TEXAS BUSINESS ORGANIZATIONS CODE TO LIMITED PARTNERSHIP AND LIMITED LIABILITY COMPANY OPPRESSION CLAIMS..	18
G.	DEPARTURE FROM THE BUSINESS JUDGMENT RULE	19
H.	CLAIM FOR BREACH OF FIDUCIARY DUTIES.....	20
I.	REVIEW OF SHAREHOLDER DERIVATIVE CLAIMS	21
J.	REMEDIES FOR MINORITY SHAREHOLDER OPPRESSION	23
K.	ISSUES REGARDING THE BUYOUT REMEDY	23
L.	OTHER NON-BUYOUT REMEDIES THAT MAY BE AVAILABLE TO MINORITY SHAREHOLDERS.....	25
M.	A LOOK AT THE FUTURE: UNCHARTED WATERS.....	26

TABLE OF AUTHORITIES

Advanced Commc'n Design, Inc. v. Follett,
615 N.W.2d 285 (Minn. 2000).....24

Allen v. Devon Energy Holdings, LLC,
367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] pet. granted, judgm't vacated w.r.m.)8

Americas Mining Corp. v. Theriault,
51 A.3d 1213 (Del. 2012)10

Argo Data Resource Corp. v. Shagrithaya,
380 S.W.3d 249 (Tex. App.—Dallas 2012, pet. filed)7

Aronson v. Lewis,
473 A.2d 805 (Del. 1984)9, 14

Baker v. Comm. Body Builders, Inc.,
507 P.2d 387 (Or. 1973)26

Balsamides v. Protameen Chemicals, Inc.,
734 A.2d 721 (N.J. 1999).....23, 24

Balvik v. Sylvester,
411 N.W.2d 383 (N.D. 1987)26

Basralian v. Hatfield,
No. 07-96-0326-CV, 1998 WL 40415 (Tex. App.— Amarillo 1998, no pet.).....22

Bayoud v. Bayoud,
797 S.W.2d 304 (Tex. App.—Dallas 1990, writ denied)22

Blaustein v. Lord Baltimore Capital Corp.,
213 WL 1810956 (Del. Ch. Apr. 30, 2013).....10

Brenner v. Berkowitz,
634 A.2d 1019 (N.J. 1993).....26

Brodie v. Jordan,
857 N.E.2d 1076 (Mass. 2006).....26

Bulacher v. Enowa, LLC,
No. 3:10-CV-156-M, 2010 WL 1135958 (N.D. Tex. Mar. 23, 2010).....5

Cardiac Perfusion Servs., Inc. v. Hughes,
380 S.W.3d 198 (Tex. App.—Dallas 2012, pet. filed)7

<i>Carsanaro v. Bloodhound Technologies, Inc.</i> , 213 WL 1104901 (Del. Ch. Mar. 15, 2013).....	9
<i>Carstarphen v. Milsner</i> , 693 F.Supp.2d 1247 (D. Nev. 2010).....	16
<i>Cates v. Sparkman</i> , 11 S.W. 846 (Tex. 1889).....	19
<i>Cinerama, Inc. v. Technicolor, Inc.</i> , 663 A.2d 1156 (Del. 1995)	14
<i>Cleaver v. Cleaver</i> , 935 S.W.2d 491 (Tex. App.—Tyler 1996, no writ).....	21
<i>Clemmer v. Cullinane</i> , 815 N.E.2d 651 (Mass. 2004)	16
<i>Davis v. Sheerin</i> , 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, writ denied)	3, 4, 5, 6, 17, 19, 23
<i>Duncan v. Lichtenberger</i> , 671 S.W.2d 948 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.).....	21, 23
<i>Ebay DomesticHoldings, Inc. v. Newmark</i> , 16 A.3d 1 (Del. Ch. 2010).....	14
<i>FDIC v. Wheat</i> , 970 F.2d 124 (5th Cir. 1992)	19
<i>Faour v. Faour</i> , 789 S.W.2d 620 (Tex. App.—Texarkana 1990, writ denied).....	20
<i>In re Friedman</i> , 661 N.E.2d 972 (N.Y. 1995).....	24
<i>Gagliardi v. TriFoods Int’l, Inc.</i> , 683 A.2d 1049 (Del. Ch. 1996).....	16
<i>Gibney v. Culver</i> , No. 13-06-112-CV, 2008 WL 1822767 (Tex. App.—Corpus Christi Apr. 24, 2008, pet. denied).....	23
<i>Gimpel v. Bolstein</i> , 477 N.Y.S.2d 1014 (N.Y. Sup. 1984).....	4, 10, 12

<i>Hirsch v. Cahn Elec. Co.</i> , 694 So. 2d 636 (La. Ct. App. 1997).....	26
<i>Hoggett v. Brown</i> , 971 S.W.2d 472 (Tex. App.—Houston [14th Dist.] 1997, pet. denied).....	5, 20
<i>Hollis v. Hill</i> , 232 F.3d 460 (5th Cir. 2000)	16, 20
<i>In re John Q. Hammons Hotels Inc. Shareholder Litig.</i> , No. 785-CC, 2009 WL 3165613 (Del. Ch. Oct. 2, 2009).....	13
<i>Joseph v. Koshy</i> , No. 01-98-01432-CV, 2000 WL 124685 (Tex. App.—Houston [1st Dist.] Feb. 3, 2000, no pet)	21
<i>Litman v. Prudential-Bache Properties, Inc.</i> , 611 A.2d 12 (Del. Ch. 1992).....	22
<i>Litle v. Waters</i> , CA No. 12155, 1992 WL 25758 (Del. Ch. Feb. 1, 1992).....	11, 12, 13
<i>Lund v. Krass Snow & Schmutter, P.C.</i> , 879 N.Y.S.2d 127 (N.Y.A.D. 1 Dept. 2009).....	23
<i>In re Mandel</i> , No. 10-40219, 2011 WL 4599969 (Bankr. E.D. Tex. Sept. 30, 2011).....	5
<i>In re Marriott Hotel Props. II Ltd. P’ship</i> , No. Civ. 14961, 2000 WL 128875 (Del. Ch. Jan. 24, 2000)	11, 13, 16
<i>Masinter v. Webco Co.</i> , 262 S.E.2d 433 (W. Va. 1980).....	26
<i>McCauley v. Tom McCauley & Son, Inc.</i> , 724 P.2d 232 (N.M. 1986)	18
<i>Minor v. Albright</i> , No. 01-C-4493, 2001 WL 1516729 (N.D. Ill. Nov. 28, 2001)	11, 16
<i>Mroz v Hoaloha Na Eha, Inc.</i> , 410 F.Supp.2d 919 (D. Hi. 2005).....	16
<i>Nagy v. Riblet Prods. Corp.</i> , 79 F.3d 572 (7th Cir. 1996)	15

<i>Nixon v Blackwell</i> , 626 A.2d 1366 (Del. 1993)	10, 11, 12, 13, 14, 15, 16
<i>O'Neill v. Church's Fried Chicken, Inc.</i> , 910 F.2d 263 (5th Cir. 1990)	22
<i>Orloff v Shulman</i> , No. Civ. 852-N, 2005 WL 3272355 (Del. Nov. 23, 2005)	11, 12, 16
<i>Patton v. Nicholas</i> , 279 S.W.2d 848 (Tex. 1955).....	5, 6, 21
<i>Pueblo Bancorporation v. Lindoe, Inc.</i> , 63 P.3d 353 (Colo. 2003).....	24
<i>Redmon v. Griffith</i> , 202 S.W.3d 225 (Tex. App.—Tyler 2006, pet. denied).....	5, 23
<i>Reserve Solutions Inc. v Vernaglia</i> , 438 F.Supp.2d 280 (S.D.N.Y. 2006).....	11, 16
<i>Reis v. Hazelett Strip-Casting Corp.</i> , 28 A.3d 442 (Del. Ch. 2011).....	10, 14
<i>Riblet Products v. Nagy</i> , 683 A.2d 37 (Del. 1993)	15
<i>Ritchie v. Rupe</i> , 339 S.W.3d 275 (Tex. App.—Dallas 2011, pet. denied)	2, 3, 6, 24, 25
<i>In re Rosenbaum</i> , No. 09-4023, 2010 WL 1856344 (Bankr. E.D. Tex . May 7, 2010).....	5
<i>In re Skyport Global Commc'ns, Inc.</i> , No. 10-03150, 2011 WL 111427 (Bankr. S.D. Tex. Jan. 13, 2011).....	11
<i>Susman v. Venture</i> , 114 Ill. App. 3d 668 (Ill. App. Ct. 1982)	19
<i>In re Synthes, Inc. Shareholder Litig.</i> , 50 A.3d 1022 (Del. Ch. 2012).....	10
<i>Ueltzhoffer v. Fox Fire Development Co.</i> , No. 9871, 1991 WL 271584 (Del. Ch. Dec. 19, 1991).....	15

<i>Weinberger v. Uop</i> , 457 A.2d 701 (Del. 1983)	10, 12, 13
<i>Willis v. Bydalek</i> , 997 S.W.2d 798 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).....	5, 18
<i>Willis v. Donnelly</i> , 118 S.W.3d 10 (Tex. App.—Houston [14th Dist.] 2003), <i>rev'd on other grounds</i> , 199 S.W.3d 262 (Tex. 2006).....	20

A. INTRODUCTION

In the book of Genesis, Cain gives a well-known response when God inquires about the status of his brother, Abel. Cain responds: “Am I my brother’s keeper?” Cain’s question is not directly answered in the Old Testament, however, which has left biblical commentators to debate the import of this exchange for more than 2,000 years. In the business context, courts dealing with claims by minority investors in private companies have faced a similar question: what duties do majority owners in these companies have, if any, to minority investors in the business?

Although a statistical analysis has not been conducted for this paper, anecdotal evidence indicates that the number of lawsuits filed by minority owners against majority owners in private companies has grown significantly over the last decade. Factors such as Sarbanes Oxley, the troubled economy and the access to capital outside the public markets have played a role in this perceived trend. This spate of claims has begun reaching the appellate courts giving rise to a growing body of legal decisions. As courts in Texas and Delaware are grappling with claims by minority owners, they are reexamining the rights and duties that majority owners of private companies owe to their fellow, minority investors in the business.¹

As a brief preview, Texas law offers some protection to minority investors in private companies who claim to have been oppressed by the majority owners, but only in limited circumstances and as discussed in this paper, the legal standards may be changing. The law is less favorable for minority shareholders in Delaware, which does not have the Texas statute providing relief when majority owners engage in oppressive conduct. *See* Section 11.404, of the Texas Business Organizations Code. In both states, an investor who buys a minority ownership stake in a private company without an exit strategy in place is likely to be “locked in” to (and unable to dispose of) this investment long after the investor desires to sell. In most cases, there is no market for a minority owner’s stock in a private company. Absent a redemption agreement with the company or with the other owners, the minority owner cannot dispose of his ownership interest and is left hoping for a liquidity event such as a sale of the business, a merger, or an Initial Public Offering (IPO).

The common sense explanation for the perceived increase in litigation filed by minority investors against majority owners is that a down economy eliminates, or sharply reduces, the minority owners’ ability to cash out. As a result, many minority investors in private businesses have become frustrated by their inability to monetize their investment. In the wake of this frustration, and in the belief that their rights have been violated by majority owners, these minority investors are turning to the courts.² Minority owners are asserting claims alleging that the majority owners abused their control to operate the company in an oppressive manner.

¹ Courts in other states have also addressed this question, and the law does vary considerably from state to state. Given that this program is held in Texas, however, the audience will be dealing most often with business entities formed in Texas or Delaware, and this paper therefore focuses on the applicable law in those states.

² For the purposes of this article, the assumption is made that the minority owner does not have a shareholder’s agreement or any other contractual right that would force a buyout of his or its interest by the majority owners for the fair value of that interest.

This overview paints a grim picture for minority investors in private companies, but private company investors in Texas do have a legal avenue available that may provide them with a way out even when they failed to obtain a redemption agreement. Under Section 11.404, of the Texas Business Organizations Code, Texas courts are authorized to dissolve private companies or appoint receivers when majority owners –“those in control” -- engage in oppressive conduct. Based on this statute, courts have provided equitable remedies to minority shareholders, including forced buyouts of their stock if they can establish that they were “oppressed” by the majority shareholder(s). In these limited circumstances, Texas courts have recognized a cause of action for shareholder oppression, and minority shareholders have secured court-ordered remedies, which provide them with value for their ownership interest in the company.³

The law in Delaware is less favorable for minority shareholders. No similar Delaware statute exists that supports the award of equitable remedies to minority shareholders who claim to have been oppressed by the company’s majority owners. As a result, whether a claim for shareholder oppression exists under Delaware law is a matter of debate and many, if not most, legal commentators are dubious about the existence or validity of claims alleging shareholder oppression under Delaware law.

B. THE CLOSELY HELD (PRIVATE) CORPORATION

The “minority shareholder oppression” scenario arises uniquely in the context of the private company, including the close corporation. An investor in a large, public corporation can feel oppressed, *i.e.*, that his investment goals are being thwarted by the management’s operation of the company or that management engaged in “bad acts.” The public company investor has a ready exit available, however, because his/her shares may be sold in the open market.⁴ As previously noted, a shareholder in a closely held company lacks this option, because there is no market typically for the shares of a private company. Moreover, in many close corporations, a shareholder’s agreement includes restrictions on the stock’s sale or transfer by the minority shareholder. The non-marketable nature of an investment in a private company makes it possible for controlling shareholders to “squeeze out” the minority shareholder from the company’s management and daily operations, while also “freezing out” the minority owner’s ability to cash out on or realize other monetary benefits from his or its investment.

By definition, a minority shareholder, minority member of an LLC and limited partner lacks control over the business. In the corporate context, shareholders elect the board of directors, which gives the majority shareholder the right through control of the board to, among other things: (i) select the officers, (ii) set officer compensation, (iii) determine whether the company will issue any dividends and, if so, (iv) how much of a dividend to issue to the minority owners. In the LLC context, the majority members have the power to appoint the managers and

³ As discussed more fully below, a shareholder oppression case is the subject of an appeal currently pending before the Texas Supreme Court, which was argued in February 2013. *See Ritchie v. Rupe*, 339 S.W.3d 275 (Tex. App.—Dallas 2011, pet. granted). The *Rupe* case is being closely observed as lawyers and businesspeople are eager to learn whether the Court will uphold the claim for minority shareholder oppression under Texas law and, if so, how the Court will define (or alter) the elements of this claim.

⁴ The minority shareholder in a public company may also have a variety of state and federal securities claims to pursue, but these claims are beyond the scope of this article.

achieve the same results described above. The majority shareholder(s) or LLC member(s) can deny the minority owner the right to participate in the management of the business, and the right to share in the financial success of the business on a current basis (*i.e.*, the denial of dividends).

In a limited partnership, the operational control belongs to the general partner, and the limited partners are not generally active in the business, although the limited partnership act does allow limited partners some leeway, including the ability to consult with (and advise) general partners and to also call, attend and participate in meetings with both the limited and the general partners. TEX. BUS. ORG. CODE § 153.103.

In most cases, the successful functioning of a closely held corporation, LLC or limited partnership depends on the relationship of trust that exists among the owners of the business and the way in which they run the company and share in its financial success. When the majority owners abuse their power and exploit their control over the company to provide themselves with a disproportionate share of the financial success of the business, claims and lawsuits by the minority investors generally follow.

C. REVIEW OF THE CLAIM FOR MINORITY SHAREHOLDER OPPRESSION UNDER TEXAS STATUTES AND CASE AUTHORITIES

Minority shareholders in a Texas private company may prevail on a claim for oppression if they can establish that the majority owners exploited their power to deny the minority owners the right to share in the company's financial returns. The claim for minority shareholder oppression and resulting equitable remedies was judicially recognized by Texas courts more than 20 years ago (and also exists in other jurisdictions), but the contours of the claim continue to develop in case law.⁵ The origins of the oppression claim (and statute) date all the way back to the 1950's, but more recently, the Texas Supreme Court heard oral argument in a shareholder oppression case in February. *See Ritchie v. Rupe*, 339 S.W.3d 275 (Tex. App.—Dallas 2011, pet. granted). The Supreme Court in *Rupe* is considering an oppression claim in which the trial court awarded a mandatory buyout of the minority shareholder's interest (which was upheld by the Dallas appellate court) based on findings that the majority owners had acted oppressively.

The Oppression Statute and Equitable Remedies in Texas

The starting point for a shareholder oppression claim is found in Texas statutes. The Texas Legislature enacted several statutes in 1955 to address "illegal, oppressive, or fraudulent" actions by controlling shareholders in closely-held corporations.⁶ The oppression statute is set forth in Section 11.404 of the Texas Business Organizations Code. Notably, Section 11.404 provides, in certain circumstances, that an oppressed minority shareholder has a statutory right to obtain relief from the majority shareholder's oppressive conduct. *See* TEX. BUS. ORG. CODE § 11.404. This statute also authorizes a Texas trial court to appoint a receiver, or to order the

⁵ *Davis v. Sheerin*, 754 S.W.2d 375, 377-80 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

⁶ The original oppression statute was codified in Articles 7.05 and 7.06 of the Texas Business Corporations Act and as discussed above, it is currently found in section 11.404 of the Texas Business Organizations Code.

company to be liquidated when there is a showing of “illegal, oppressive or fraudulent” conduct by the “governing persons” of the business entity. *Id.* § 11.404(a)(1)(C).

The remedies of court-ordered receiverships and liquidation authorized by this Texas statute, however, are often viewed as unduly harsh to the parties by trial judges. As a result, these draconian remedies are largely disfavored and rarely applied. When a private company is able to continue functioning – and particularly when the company is profitable – it is rarely viewed as a business that is ripe for the appointment of a receiver, or appropriate to be subject to a court-ordered liquidation that puts the company out of business. Before appointing a receiver, the Texas statute requires a trial court to consider where “all other available legal and equitable remedies . . . are inadequate.” *Id.* at § 11.404(b)(3). For that reason, trial courts will often craft an “equitable” remedy that includes a mandatory dividend to the minority shareholder or to issue a preliminary injunction that will preserve the status quo (and the company’s existing management) until a trial can be held on the merits of the minority shareholder’s claims.

Shareholder Oppression Defined by Texas Courts

Due to the limited relief available to oppressed minority shareholders in Texas statutes, case law has developed in Texas to provide additional remedies to minority shareholders who can prove that the majority shareholder engaged in oppressive conduct. A claim for oppression is based on tort, but there is no single set of definitive actions that constitute oppression. A minority shareholder in Texas can the basis for an oppression claim when the minority owner can establish facts that meet one of the definitions of oppression below:

- (1) majority shareholder’s conduct that substantially defeats the minority’s expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder’s decision to join the venture; or
- (2) burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the company’s affairs to the prejudice of some members; or a visible departure from the standards of fair dealing and a violation of fair play on which each shareholder is entitled to rely.⁷

This two-part test for oppression comes from a key Texas case, *Davis v. Sheerin*,⁸ which relies on language from Articles 7.05 and 7.06 of the Texas Business Corporations Act (now Section 11.404 of the Texas Business Organizations Code). *Davis* adopted the doctrine of minority shareholder oppression and held that the Texas statute authorizes court-ordered equitable remedies. In *Davis*, the appellate court upheld a jury verdict of oppressive conduct, based on: (i) findings of a conspiracy by the majority shareholders to deprive the plaintiff of his ownership interest in the corporation, (ii) findings that the majority shareholders wasted

⁷ *Davis*, 754 S.W.2d at 381-82; see also *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1017-18 (N.Y. Sup. 1984).

⁸ 754 S.W.2d at 382-83. The *Davis* court crafted a court-ordered buy-out of the plaintiff’s stock at fair value, as an acceptable “less harsh” remedy to the statutorily authorized liquidation, available to the court under its “general equity powers” when “oppressive conduct” had occurred. *Id.* at 378, 380, 382-83.

corporate funds and received dividends that were withheld from the plaintiff, and (iii) undisputed evidence that the plaintiff would be denied any future voice in the corporation's management.

For more than two decades, Texas appellate courts have consistently looked to and upheld the holding of *Davis* in defining shareholder oppression and considering the equitable remedies that are available to the trial court under Section 11.404, of the Texas Business Organizations Code. A review of Texas law since the opinion in *Davis* was issued reflects that more than 25 reported decisions in 11 of the 14 Texas appellate districts that have upheld minority shareholder oppression as a viable cause of action.⁹ Federal courts also recognize this claim under Texas law.¹⁰

The Origins of Oppression Claims in Texas

In developing the two-part test, the *Davis* court also cited to and relied on the Texas Supreme Court's holding in *Patton v. Nicholas*, which first examined the shareholder oppression claim (and related statutes) in 1955.¹¹ When the Texas Supreme Court issued *Patton*, the Texas Legislature was enacting Articles 7.05 and 7.06 of the Texas Business Corporations Act (now Section 11.404 of the Texas Business Organizations Code) to address oppressive or fraudulent actions by controlling shareholders in closely-held corporations.

The *Patton* case involved the Machinery Sales & Supply Company in Dallas. The company's owner hired two employees in 1940 and later gave them both a 20% ownership interest. From 1940 to 1945, the company generated revenues of more than \$1 million with annual net profits of more than \$100,000. The minority shareholders also received "relatively frequent and substantial" dividends until disputes arose among the owners—and the two minority shareholders left the company in December 1945. In the following five years (1946-

⁹ See, e.g., *Redmon v. Griffith*, 202 S.W.3d 225, 234-35 (Tex. App.—Tyler 2006, pet. denied) (holding that individual minority shareholders had standing to sue majority shareholders for shareholder oppression); *Hoggett v. Brown*, 971 S.W.2d 472, 488 n.13 (Tex. App.—Houston [14th Dist.] 1997, pet. denied) (recognizing various theories of shareholder oppression as claims by individual shareholders against the oppressive majority shareholder); *Davis*, 754 S.W.2d at 382-83 (noting oppression demonstrated by acts of the oppressive majority shareholder, against whom the individual shareholder plaintiff's claims were proper); *Willis v. Bydalek*, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (permitting shareholder oppression claim by 49% minority shareholder against majority shareholder, but finding that minority shareholder failed to demonstrate oppressive conduct).

¹⁰ See *Bulacher v. Enowa, LLC*, No. 3:10-CV-156, 2010 WL 1135958, at *2 (N.D. Tex., Mar. 23, 2010) (Lynn, J.) (citing *Davis* and holding: "Texas courts take a broad view of the application of oppressive conduct to a closely-held corporation . . . [and] the facts alleged by [the minority shareholder] are sufficient to state a claim for shareholder oppression under Texas law"); *In re Rosenbaum*, No. 09-4023, 2010 WL 1856344, at *7 (Bankr. E.D. Tex. May 7, 2010) (citing *Davis* and holding that "[w]ith respect to [plaintiff's] claim for minority shareholder oppression, there is no set standard for determining whether shareholder oppression has occurred. Rather, the Court must examine the facts as a whole and determine whether the corporation's conduct has deprived a minority shareholder of the shareholder's reasonable expectations as an equity holder of the corporation"); see also *In re Mandel*, No. 10-40219, 2011 WL 4599969, at *23-24 (Bankr. E.D. Tex. Sept. 30, 2011).

¹¹ *Patton v. Nicholas*, 279 S.W.2d 848, 855-57 (Tex. 1955). The *Patton* Court highlighted the "new and elaborate" statute that oppression by majority shareholders and commented "that its approach to this type of [oppression] case is one of 'rehabilitation' in preference to dissolution and liquidation." *Id.* at 854 (citing Articles 7.05-09 of the Texas Business Corporations Act).

1950), the company generated similar revenues (more than \$1 million), but after the minority shareholders left the company the company's books showed a sharp drop in profits and no further dividends were paid to the minority owners.

The minority shareholders in *Patton* therefore brought suit for an accounting and seeking liquidation of the company. At trial, multiple witnesses testified that the majority shareholders withheld dividends so the minority shareholders “don't make a penny out of this business.” The trial court ordered liquidation and the court of appeals agreed the company should be liquidated. The *Patton* Court viewed liquidation as an “extreme” remedy, but concluded that the majority shareholder's “malicious suppression of dividends is a wrong akin to a breach of trust, for which the courts will afford a remedy.” Rather than liquidating a profitable company, however, the *Patton* Court ordered the corporation (and its controlling majority shareholder) to pay a reasonable dividend “at the earliest practicable date,” and in future years.

Minority Shareholder Oppression Returns to the Texas Supreme Court—More Than 55 Years Later

Almost six decades after *Patton* in 1955 and more than twenty years after *Davis v. Sheerin* was decided in 1988, the Texas Supreme Court granted review for the first time of a shareholder oppression case. In February 2013, the Texas Supreme Court heard oral argument in *Ritchie v. Rupe*, 339 S.W.3d 275 (Tex. App.—Dallas 2011, pet. granted). In *Ritchie*, the minority shareholder, Ms. Rupe, wanted to sell her shares to a third party, who asked to meet with the majority owners of the business before purchasing Ms. Rupe's minority interest, which is typical in a due diligence process. The majority shareholders refused to meet with—or provide information to—the potential buyers of Ms. Rupe's stock. Left with no ability to sell her shares to a third party, Ms. Rupe filed suit claiming oppression.

At trial, the jury made findings supporting an oppression determination by the trial court, which ordered the majority owners to buy Ms. Rupe's stock at a “fair value” of more than \$7 million. The Dallas Court of Appeals then determined that the majority shareholders' conduct was oppressive under *both tests* set forth in *Davis* because: (1) the company's policies constructively prohibited the minority shareholder from selling her shares “would substantially defeat the shareholder's general reasonable expectation of being able to market her unrestricted stock;” and (2) the majority shareholders (and directors) departed from the “standards of fair dealing” by refusing to meet with prospective purchasers of the minority shareholder's stock.

The Supreme Court's oral argument in *Rupe* was notably active as all Justices asked questions of counsel. The Court did not provide signs, however, that would allow its holding to predicted with confidence. Nevertheless, we do not expect the Court to abandon the shareholder oppression doctrine. A holding that overturns *Davis v. Sheerin* would upend more than 25 years of case law that has consistently followed and adopted the *Davis* holding. To the extent that the Court concludes, however, that the legal standards governing oppression are murky, the Court may address and refine the standards that apply to oppression claims.

Other Recent Shareholder Oppression Cases in Texas Courts

The *Rupe* case is hardly an isolated instance as a number of Texas courts have issued opinions relating to minority shareholder disputes. Two recent cases from the Dallas Court of Appeals (reviewing trial court and jury findings); one case from the Houston Court of Appeals (legal questions on summary judgment) are reviewed below.

Recent Cases from the Dallas Court of Appeals

In the last two years, two different panels from the Dallas Court of Appeals have issued conflicting opinions regarding the standards that apply to shareholder oppression claims.

Cardiac Perfusion. In July 2012, the Dallas Court of Appeals affirmed the jury's verdict and concluded that the majority shareholder engaged in oppression. The Court upheld the equitable remedy awarding a redemption of the minority's shares at fair value (*i.e.* excluding discounts for lack of control). See *Cardiac Perfusion Servs., Inc. v. Hughes*, 380 S.W.3d 198 (Tex. App.---Dallas 2012, pet. filed). The minority shareholder in *Cardiac Perfusion* owned 10% of the business (where he had worked for over 20 years) and was later fired by the majority shareholder. Both the trial and appellate courts concluded that the majority shareholder engaged in oppression in which he (1) "suppressed payment of profit distributions;" (2) "paid himself excessive compensation;" (3) "improperly paid his family members;" (4) "used [corporate] funds to pay personal expenses;" and (5) "refused to let [the minority] examine [the company's] books and records." The court also used the "enterprise value" method to value the 10% interest (as opposed to discounts under "fair value) because the minority shareholder had been "forced to relinquish his ownership position by the oppressive conduct of the majority [shareholder]." In February 2013, the majority shareholder filed a petition for review with the Texas Supreme Court in Case No. 13-0014 and the Court has since requested and received briefing from the parties.

Argo Data. In late August 2012, the Dallas Court of Appeals reversed a trial court (and extensive jury findings) supporting a one-time, court-ordered dividend award of \$85 million from the company's large cash horde of retained earnings. The trial court had awarded the dividend to be split between the majority owner (53%) and the minority owner (47%) consistently with their ownership interest in the company. See *Argo Data Resource Corp. v. Shagrithaya*, 380 S.W.3d 249 (Tex. App.---Dallas 2012, pet. filed). In *Argo Data*, the trial court's judgment was based on the results of a six-week trial where the jury found the majority shareholder (1) refused to pay dividends from a stockpile of \$140 million of retained earnings as part of a "freeze out" scheme; (2) committed fraud by giving false information to the minority shareholder; and (3) unilaterally cut the salary of the minority shareholder by 70% without board approval and in a year of record profits; (4) obstructed potential opportunities for the minority shareholder to sell his shares to third parties; and (5) used corporate funds for personal use (*i.e.*, travel expenses; family expenses; condominium purchase). On appeal, the *Argo Data* panel held despite the jury findings, there was no oppression because either: (1) there was no harm to the minority shareholder because the company's value increased during the scheme; or (2) the majority shareholder remedied other oppressive acts "before trial." In late 2012, the minority

shareholder filed a petition for review with the Texas Supreme Court and the Court has requested and received briefing from the parties in this case, as well.

Recent Case from Houston Court of Appeals

Another significant minority owner case from the Houston Court of Appeals did not involve a review of lengthy jury trials like in *Cardiac Perfusion* and *Argo Data*, but it presented similar factual claims with slightly different legal issues.

Devon Energy. In March 2012, the Houston Court of Appeals recognized and imposed a formal fiduciary duty on a sole majority member (and sole manager) of a closely-held oil and gas company in the context of a redemption of shares owned by a minority member. See *Allen v. Devon Energy Holdings, LLC*, 367 S.W.3d 355, (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgment vacated w.r.m.). The decision in *Devon Energy* provides important guidance for majority (or controlling) owners when providing information to minority members as part of a “buyout” or purchase of their ownership interest. The crux of the *Devon Energy* case concerned fiduciary duties in a Texas LLC, however, both the trial and appeals court dismissed the oppression claim by noting: “[the] conduct alleged . . . is not the typical wrongdoing in shareholder oppression cases: [the plaintiff] was not a terminated employee; [the minority member] was not denied access to company books or records; and there was no allegation that [the controlling member] wrongfully withheld dividends, wasted corporate funds, paid himself excessive compensation, or locked [the minority member] out of the corporate offices.” Given the absence of those facts (similar to *Cardiac Perfusion* and *Argo Data* above), the court in *Devon Energy* focused on whether a majority member owed fiduciary duties to the minority member in the context of a redemption of the minority's interest.

The dispute in *Devon Energy* arose when the majority member offered to purchase the minority shareholders’ stock at \$1.13 million per 1% ownership interest. This offer came in November 2003 and the majority member provided a valuation and certain representations to the minority members (*i.e.* future projects for the oil company would be “non-economic” and that he would spend less time with the company). The deal did not close until eight months later in June 2004 where the minority member received \$8 million for the entirety of his ownership interest. But two years later, the company sold for over \$1 billion dollars and the minority member’s stock would have been worth \$160 million.

The LLC’s minority member filed suit alleging, among other things, that representations made in the November 2003 letter were fraudulent and that the majority had a fiduciary duty to disclose material changes (*i.e.* significant technological advances and lease purchases) that occurred in the eight months between the “offer” and the ultimate “redemption.” The *Devon Energy* court addressed other issues, but agreed with the minority member that the November 2003 representations could support a fraudulent inducement claim **and** that the majority shareholder owed a specific fiduciary duty to the minority shareholder (in the context of the redemption). In late 2012, with a petition for review pending in the Texas Supreme Court, the parties settled the lawsuit and the Houston Court of Appeals’ opinion continues to provide guidance on fiduciary duties in a closely-held company in Texas.

D. MINORITY SHAREHOLDER OPPRESSION CLAIMS AGAINST MAJORITY SHAREHOLDERS UNDER DELAWARE LAW

Introduction

Delaware is often portrayed as a “safe haven” by defense counsel representing majority owners of private companies. Indeed, it is common for Texas transactional attorneys to urge their majority shareholder clients to form private companies in Delaware based on the view that, under Delaware law, the majority owners are immune from oppression claims.¹² This view is based on the fact that Delaware has not enacted a “receivership” or “oppression” statute that addresses oppression (or remedies for such actions) in a closely-held corporation.

It should be noted, however, that while the case law is not extensive, Delaware courts have recognized a claim for shareholder oppression (starting in 1991), and no Delaware court has overtly rejected oppression as a valid cause of action since that time. Nevertheless, it is more common for Delaware courts to evaluate oppression claims under a standard similar to a “breach of fiduciary duty” when the minority shareholder alleges oppressive conduct.

Fiduciary Duties of Majority Shareholders in Delaware

In Delaware, minority shareholders confront two issues in bringing claims against a majority shareholder: (1) the Delaware courts’ resistance—under certain circumstances—to accept the cause of action for shareholder oppression; and (2) differing standards of review (and shifting burdens of proof) for a breach of fiduciary duty claim against the controlling shareholder(s). Most minority shareholder plaintiffs bring claims for breach of fiduciary duties in efforts to secure a review of their claims under the “entire fairness” doctrine which requires the majority shareholders to demonstrate the fairness—in terms of price and dealing—of their conduct rather than under the “business judgment rule” that gives the majority shareholders far more latitude in their decision-making.

Under Delaware law, the business judgment rule is a “presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interest of the company.”¹³ This standard is intended to prevent trial courts from substituting their judicial assessment for the business judgment of the majority shareholder (or the board of directors) as long as the challenged decision can be “attributed to any rational business purpose.”¹⁴

In turn, a minority shareholder plaintiff must “rebut” the business judgment presumption by showing that the majority shareholder either: (i) had a personal interest in the subject matter of the action; (ii) was not fully informed in approving the action; or (iii) did not act in good faith

¹² Under the law of the forum doctrine, oppression claims by minority shareholders against majority shareholders will be governed by the state of incorporation.

¹³ See *Carsanaro v. Bloodhound Technologies, Inc.*, 2013 WL 1104901, at *10 (Del. Ch. Mar. 15, 2013) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

¹⁴ See, e.g., *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

in approving the action.¹⁵ If the minority shareholder can rebut the business judgment presumption, then Delaware courts apply the “entire fairness” standard which places the burden on the majority shareholders (defendants) to prove that the complained of actions or transaction was entirely fair to the business as a whole. This standard is similar to the “entire fairness” prong followed by Texas courts in evaluating shareholder oppression claim.

In Delaware, the majority shareholder defendant must prove two elements: (i) “fair dealing” and (ii) “fair price” to defeat the plaintiff’s claim.¹⁶ With the first element of “fair dealing,” Delaware courts consider when the transaction occurred; how it was structured and negotiated; the nature of disclosures to other shareholders; and how the approvals of the directors and stockholders was obtained.¹⁷ The second element of “fair price” considers the economic and financial components of the transaction or decision including the market price; the company’s assets; future prospects for the company; and other elements that might impact the value of the shareholder’s stock.¹⁸ Both elements are considered together to determine the “entire fairness” and these same rule apply to minority stockholders of closely-held corporations in Delaware

In late April 2013, a Delaware court explained again that it considers “[t]he protections afforded to minority stockholders in closely-held corporations under Delaware common law are no different than those in publicly-held corporations.”¹⁹ The *Blaustein* court continued that although other jurisdictions have recognized special fiduciary duties among stockholders in closely-held corporations, the Delaware courts have not adopted a similar approach.²⁰ Instead, utilizing general corporate law principles, Delaware courts have mostly relied on entire fairness as a means of protecting minority stockholders. A close review of Delaware law reveals that a claim for shareholder oppression might still exist, however, even if few Delaware courts have squarely addressed the issue.

Delaware Courts Might Recognize a Shareholder Oppression Claim

While a fair reading of Delaware law indicates that courts in that state are less receptive—compared to Texas courts—to minority shareholder oppression claims, the contention by some defense counsel that minority shareholder oppression is not a valid claim under Delaware law likely overstates the case. This argument relies on dicta from just one Delaware case, *Nixon v. Blackwell*,²¹ that approved a “liquidity disparity” between controlling and minority shareholders, but did not consider—nor expressly reject—the “reasonable expectations” standard

¹⁵ See *In re Synthes, Inc. Shareholder Litig.*, 50 A.3d 1022 & n. 57 (Del. Ch. 2012).

¹⁶ See *Reis v. Hazelett Strip-Casting, Corp.*, 28 A.3d 442, 462 (Del. Ch. 2011) (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

¹⁷ See *Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1238 (Del. 2012) (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

¹⁸ *Id.* at 1243-44.

¹⁹ *Blaustein v. Lord Baltimore Capital Corp.*, 2013 WL 1810956, at *14 (Del. Ch. Apr. 30, 2013).

²⁰ *Id.* at *14 (noting that Delaware courts do not follow New York or Massachusetts in recognizing a claim for shareholder oppression)

²¹ *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993).

announced just one year earlier in *Little v. Waters*.²² Indeed, since the *Nixon* Court issued its decision in 1993, Delaware courts (and federal courts applying Delaware law) have continued to recognize *Little* as the defining legal standard when analyzing a minority shareholder’s claim for oppressive conduct.²³

In light of *Nixon* and its progeny, however, minority shareholders who invest in Delaware companies are well-advised to secure a shareholders agreement at the time of their investment. A shareholders agreement will provide minority shareholders with, among other things, a critical right of redemption for the fair (undiscounted) value of their stock in the event they experience oppressive conduct by the majority shareholders.

4. Fractured Foundation Of Minority Shareholder Claims in Delaware

Starting in the early 1990’s, Delaware courts adopted a varied stance toward the existence of a cause of action for minority shareholder oppression. A 1992 decision held that this cause of action existed; but a 1993 court hinted it might not, and the law has remained unsettled two decades later. The three Delaware cases reviewed below demonstrate the split view that now exists in Delaware regarding law applicable to claims by minority shareholders against the controlling shareholders arising from oppressive conduct.

a. *Little v. Waters*: Minority Shareholder Prevails On Claims For Breach Of Fiduciary Duty and Shareholder Oppression.

Initially, in *Little v. Waters*, the Delaware Court of Chancery considered a minority shareholder plaintiff’s two claims for breach of fiduciary duty and shareholder oppression, both arising from the majority shareholders’ refusal to declare dividends despite the company’s profitable status—which created a significant tax burden on the plaintiff.²⁴ For the breach of fiduciary duty claim, the *Little* court noted “an important issue” was that both controlling directors were “interested directors” which triggered a judicial review under the more stringent “entire fairness” standard. Under this standard, “the burden shifts to the defendants to demonstrate that

²² See CA No. 12155, 1992 WL 25758, at *6 (Del. Ch. Feb. 11, 1992) (citing *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1018-19 (N.Y. Sup. 1984)).

²³ See, e.g., *Orloff v. Shulman*, No. Civ. 852-N, 2005 WL 3272355, at *8 n.52 (explaining that *Little* is “[t]he only Delaware case that squarely addressed the issue of [shareholder] oppression”); *In re Marriott Hotel Props. II Ltd. P’ship*, No. Civ. 14961, 2000 WL 128875, at *13 (Del. Ch. Jan. 24, 2000) (recognizing application of *Little* to minority shareholder’s claim that “defendant had frozen dividends in order to effectuate an oppressive squeeze-out”); *In re Skyport Global Commc’ns, Inc.*, No. 10-03150, 2011 WL 111427, at *35 (Bankr. S.D. Tex. Jan. 13, 2011) (applying Delaware law) (citing *Little* and stating that “Delaware courts *have* recognized oppression as a cause of action”) (emphasis in original); *Reserve Solutions Inc. v. Vernaglia*, 438 F.Supp.2d 280, 290 (S.D.N.Y. 2006) (applying Delaware law) (approving *Little* and denying motion to dismiss shareholder oppression claim); *Minor v. Albright*, No. 01-C-4493, 2001 WL 1516729, at *2-3 (N.D. Ill. Nov. 28, 2001) (applying Delaware law) (recognizing definition of oppressive shareholder conduct from *Little* and denying motion to dismiss plaintiff’s claims that majority shareholder “attempted to freeze them out”).

²⁴ See 1992 WL 25758, at *3, *6.

the decision to not declare dividends and to repay the company's debt to [a majority shareholder] was intrinsically fair."²⁵ By contrast, the majority shareholders sought review under the business judgment rule that defers to the business decisions of the controlling shareholders.²⁶ The *Little* court refused to apply the deferential business judgment rule, and declined to accept the defendants' argument that the declaration of a dividend was solely within the majority shareholders' business discretion.²⁷

The second claim in *Little* was for shareholder oppression where the plaintiff alleged that the director defendants' refusal to declare dividends (causing the minority shareholder to bear a high tax burden) constituted "a gross and oppressive abuse of discretion."²⁸ The *Little* court held that the minority shareholder's claim "includes allegations sufficient to state a claim for oppression,"²⁹ and also reasoned that the failure to pay dividends "can be especially devastating [to the minority shareholder]."³⁰ After noting that few Delaware cases had addressed oppressive shareholder conduct, the *Little* Court applied standards from a New York case defining oppression as: (1) "a violation of the 'reasonable expectations' of the minority;" and (2) "burdensome, harsh and wrongful conduct."³¹ The *Little* court then explained that neither shareholder expected their stock to become "a liability" (caused by a tax burden when no dividends were paid) and the plaintiff's claims set forth "a classic squeeze out situation" that constituted shareholder oppression.³²

b. *Nixon v. Blackwell*: Delaware Supreme Court's Limited Holding Related to Breach of Fiduciary Duty

Just 16 months after *Little*, the Delaware Supreme Court pivoted toward a contract-focused approach to the rights of minority shareholder in *Nixon v. Blackwell*.³³ In *Nixon*, the Supreme Court considered the narrow issue of a minority shareholder's claim for breach of fiduciary duty where, importantly, the plaintiff did not plead a separate claim for shareholder oppression.³⁴ The Delaware Supreme Court took a less protective stance toward the minority shareholders in discussing the fiduciary duties of majority shareholders, and suggested that all

²⁵ *Id.* at *5 (citing *Weinberger v. Uop*, 457 A.2d 701, 703 (Del. 1983)).

²⁶ *Id.* at *4 (noting that defendants "imply that the business judgment standard applies").

²⁷ *Id.* at *3.

²⁸ *Id.* at *6.

²⁹ *Id.* at *7 (noting that minority shareholder plaintiff alleged in complaint that "the company was rich with cash and that the only reason that the company did not make dividends was to aid [the majority shareholder] to buy [the minority shareholder] out for less than fair value").

³⁰ *Id.* at *9.

³¹ *Id.* at * 7-8 (citing *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1018-19 (N.Y. Sup. 1984); see also *Orloff v. Shulman*, No. Civ. 852-N, 2005 WL 3272355, at *8 n.52 (Del. Nov. 23, 2005) (explaining that *Little* is "[t]he only Delaware case that squarely addressed the issue of [shareholder] oppression").

³² *Id.* at *8.

³³ 626 A.2d 1366 (Del. 1993)

³⁴ *Id.* at 1374 ("The only issue before this Court is the ruling by the trial court . . . that the defendants breached their fiduciary duties by failing to provide a parity of liquidity.").

protections or rights of shareholders should be defined by contract, not through judicial remedies.³⁵

In *Nixon*, the minority shareholders alleged that the majority shareholder directors had breached their fiduciary duties by creating a “liquidity disparity” in two different ways by: (1) creating an Employee Stock Ownership Plan (“ESOP”) that allowed only certain employees the ability to liquidate their stock; and (2) funding a “Key Man” insurance plan in which proceeds of the policy would be used to pay off corporate debts, but also trigger the purchase of a certain percentage of stock from the deceased (and remaining controlling) stockholders.³⁶ Simply put, the controlling shareholders enabled employees (through retirement) and directors (through the insurance policy) the ability to liquidate their shares, but did not provide minority shareholder plaintiffs with a similar right.

One similarity to *Little* was the initial determination—for purpose of fiduciary duty analysis—that the majority shareholders in *Nixon* were “on both sides of the transaction” which caused the burden to shift to the majority shareholder defendants to show the “entire fairness” of the challenged transactions.³⁷ While the entire fairness standard generally requires a two-pronged inquiry into both the “fair price” and “fair dealing” of the challenged transaction,³⁸ the *Nixon* Court admitted that its analysis was limited “only [to] the issue of fair dealing.”³⁹

Initially, the Delaware trial court sided with the minority shareholders but, on appeal, the Delaware Supreme Court framed the issue as whether the majority shareholders “breached their fiduciary duties by failing to provide a parity of liquidity.”⁴⁰ According to *Nixon*, under the entire fairness standard, the minority shareholders did not have “a right to ‘liquidity’ equal to [the

³⁵ *Id.* at 1379 (discussing, in dicta, question “raised at oral argument” and casting doubt that “there should be any special, judicially-created rules to ‘protect’ minority shareholders of closely-held Delaware corporations”) (citations omitted).

³⁶ *Id.* at 1371-73.

³⁷ *Id.* at 1375-76 (affirming trial court’s application of “entire fairness” standard after noting that majority shareholders benefited from the challenged transactions “beyond that which benefitted other stockholders generally”). But where the majority shareholders implement certain procedural protections (through involvement of an independent committee or a majority vote of minority stockholders), the burden of proof under the “entire fairness” standard could shift back to the plaintiff. *See, e.g., In re John Q. Hammons Hotels Inc. Shareholder Litig.*, No. 785-CC, 2009 WL 3165613, at *14 n.48 (Del. Ch. Oct. 2, 2009) (“Although the procedural protections in this case were not sufficient to invoke business judgment protection, they could have been sufficient to shift the burden of demonstrating entire fairness to the plaintiffs.”).

³⁸ *See Weinberger v. Uop*, 457 A.2d 701, 711 (Del. 1983) (explaining the concept of “fair dealing” as concerning how “the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained,” and the “fair price” prong “relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company’s stock”); *see also In re Marriott Hotel Props*, 2000 WL 128875, at *14 (“[T]he entire fairness test properly applies to protect minority shareholders from the tyranny of the controlling entity.”).

³⁹ *Nixon*, 626 A.2d at 1376

⁴⁰ *Id.* at 1374.

majority shareholders],” and the Supreme Court said—in dicta—that it would not “fashion a special judicially-created rule for minority investors” because minority shareholders should negotiate for better rights:

The tools of good corporate governance are designed to give a purchasing *minority stockholder the opportunity to bargain for protection before parting with consideration*. It would do violence to normal corporate practice . . . to fashion an ad hoc ruling which would result in a court-imposed stockholder buy-out for which the parties had not contracted.⁴¹

The *Nixon* Court did recognize that minority shareholders often lack the ability to sell their shares (without a market or market valuation), and are thus bound by the majority’s consent.⁴² After approving of a series of actions that benefited the majority shareholders (and disproportionately increased their ability to liquidate shares of stock), the *Nixon* Court explained that the minority shareholders were “entitled to be treated fairly, but not necessarily to be treated equally.”⁴³ The solution, according to *Nixon*, for minority shareholders in Delaware is to “enter into definitive stockholder agreements . . . [that] provide for elaborate earnings tests, buy-out provisions, voting trusts, or other voting agreements.”⁴⁴ For those reasons, the *Nixon* Court dismissed the minority shareholder’s breach of fiduciary duty claims, but never explicitly considered—and never rejected—any cause of action for shareholder oppression, which was not plead as a cause of action in the plaintiff’s complaint.

While the “entire fairness” standard is more exacting than the deferential business judgment rule,⁴⁵ the court’s application of this higher standard does not necessarily assure victory for a minority shareholder plaintiff. In most instances, the plaintiff’s path to the entire fairness standard involves either: (1) rebutting the “business judgment” rule; or (2) demonstrating that a controlling shareholder is engaging in self-dealing or other acts of bad faith.⁴⁶ Despite application of the more stringent standard of review, however, the *Nixon* Court approved the benefit plans adopted by the majority shareholders—relying exclusively on the

⁴¹ *Id.* at 1379-80.

⁴² *Id.* at 1379 (noting that “there is no market and no market valuation” and stating that “[i]t is not difficult to be sympathetic, in the abstract, to a stockholder who finds himself or herself in that position”).

⁴³ *Id.*

⁴⁴ *Id.* at 1380.

⁴⁵ See *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (noting that business judgment rule is the default standard of review and presumes that “in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company”); see also *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 457 (Del. Ch. 2011) (noting that, under business judgment rule, the decisions of controlling shareholders decisions will be upheld unless it cannot be attributed to “any rational purpose”).

⁴⁶ See *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1162 (Del. 1995); see also *Ebay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 36-37 (Del. Ch. 2010) (“There are a number of ways that plaintiff can rebut the business judgment, including by showing that the majority of directors who approved the action (1) had a personal interest in the subject matter of the action; (2) were not fully informed in approving the action, and (3) did not act in good faith in approving the action.”).

“fair dealing” prong—even though the controlling shareholders were positioned to benefit personally from the actions that the minority shareholder claimed constituted a freeze out.⁴⁷ In sum, the *Nixon* Court did not reject a cause of action for shareholder oppression (which was never pled), but the Delaware Supreme Court confirmed that majority shareholder defendants can meet their burden under the “entire fairness” standard to defeat a claim for breach of fiduciary duty.

c. ***Riblet Products v. Nagy: Delaware Supreme Court Narrowly Decides Certified Question from Seventh Circuit***

Three years later, in *Riblet Products v. Nagy*, the Delaware Supreme Court considered a similar fiduciary duty issue in a case filed in federal court in Indiana (but governed by Delaware law).⁴⁸ On appeal, the Seventh Circuit certified a question to the Delaware Supreme Court asking “whether corporate law requires controlling shareholders to act as fiduciaries toward minority shareholder-employees.”⁴⁹ The Seventh Circuit Court of Appeals confronted this issue of minority shareholder rights, but did not rely on – or even reference – the *Nixon* decision, and instead cited to another case, *Ueltzhoffer v. Fox Fire Development Co.*, as the “closest approach” to the topic.⁵⁰

In answering the certified question in *Riblet*, the Delaware Supreme Court did not confront the fiduciary duty issue, because the dispositive question turned on rights arising under an employment contract.⁵¹ The Supreme Court therefore reformulated the certified question (focusing on the contract issue, not fiduciary duties),⁵² and determined that the minority shareholder’s “contractual rights are separate from his rights as a stockholder.”⁵³ Still, the *Riblet* Court leaned closer to the decision issued in *Litle*—rather than its own opinion in *Nixon*—when it noted that “[t]o be sure,” the majority stockholders “may well owe fiduciary duties” to the minority stockholder.⁵⁴

In closing, three Delaware decisions — *Litle*, *Nixon*, and *Riblet* — have caused a number of commentators to conclude that the existence of a cause of action for shareholder oppression

⁴⁷ *Nixon*, 626 A.2d at 1381.

⁴⁸ See *Nagy v. Riblet Prods. Corp.*, 79 F.3d 572 (7th Cir. 1996).

⁴⁹ See *Nagy*, 79 F.3d at 573-74.

⁵⁰ *Id.* at 577 (citing *Ueltzhoffer*, No. 9871, 1991 WL 271584, at *8 (Del. Ch. Dec. 19, 1991) (concluding that majority stockholder did not terminate employment contract of minority shareholder “for the sole and improper purpose of freezing him out of the corporate entities”)).

⁵¹ 683 A.2d 37 (Del. 1993).

⁵² *Id.* at 39 (narrowing the Seventh Circuit’s certified question as “[w]hether majority stockholders of a Delaware corporation may be held liable for violation of a fiduciary duty to a minority stockholder who is an employee of the corporation under an employment contract with respect to issues involving that employment”).

⁵³ *Id.* at 40

⁵⁴ *Id.*

remains an unsettled question.⁵⁵ But, Delaware courts have expressly noted that “under some circumstances,” fiduciary duty law in Delaware recognizes a claim for oppression by minority shareholders.⁵⁶

The Fifth Circuit also confirmed the uncertainty of Delaware law regarding minority shareholder claims when it stated that: “the Delaware Supreme Court has yet to consider the precise issue . . . whether a controlling shareholder is liable for actions taken with the purpose and effect of freezing out another shareholder.”⁵⁷ Moreover, a sizable number of courts have explained that Delaware courts have not foreclosed a cause of action for all minority shareholder claims, including a freeze out in close corporations.⁵⁸

Litigation of Minority Shareholder Claims In Delaware

Three basic points flow from the limited number of Delaware cases regarding claims for minority shareholder oppression: (1) minority shareholders should contract at the outset, if possible, to have the right to redeem—or secure a buyout of—their interest when on reasonable terms; (2) the standards for a shareholder oppression claim in *Little* continue to be recognized by both Delaware and federal courts (applying Delaware law) and the “very strong dicta”⁵⁹ in *Nixon* has not foreclosed the assertion of oppression claims;⁶⁰ and (3) where a claim involves a breach

⁵⁵ See Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 Wash. U.L.Q. 1099, 1150-51 (1999) (arguing that notwithstanding *Nixon*, “the death of special shareholder duties in Delaware corporations has been greatly exaggerated”); see also Jeffrey M. Leavitt, *Burned Angels: The Coming Wave of Minority Shareholder Oppression Claims In Venture Capital Start-Up Companies*, 6 N.C. J. L. & Tech. 223, 252-55 (2005) (endorsing the view that “Delaware’s law has not yet weighed in on the question of shareholder oppression in close corporations”).

⁵⁶ See *Gagliardi v. TriFoods Int’l, Inc.*, 683 A.2d 1049, 1051 (Del. Ch. 1996) (“I need not address the general question whether Delaware fiduciary duty law recognizes a cause of action for oppression of minority shareholders; I assume for purposes of this motion, that under some circumstances it may.”); see also *Orloff v. Shulman*, 2005 WL 3272355, at *8 n.52 (explaining that *Little* is “[t]he only Delaware case that squarely addressed the issue of [shareholder] oppression”); see also *In re Marriott Hotel Props. II Ltd. P’ship*, No. Civ. 14961, 2000 WL 128875, at *13 (Del. Ch. Jan. 24, 2000) (recognizing application of *Little* to minority shareholder’s claim that “defendant had frozen dividends in order to effectuate an oppressive squeeze-out”).

⁵⁷ See *Hollis v. Hill*, 232 F.3d 460, 469 & n.28 (5th Cir. 2000).

⁵⁸ See, e.g., *Carstarphen v. Milsner*, 693 F.Supp.2d 1247, 1250 (D. Nev. 2010) (“But the holding of *Nixon* did not entirely preclude the possibility of a direct cause of action for minority shareholders in at least some circumstances.”); *Clemmer v. Cullinane*, 815 N.E.2d 651, 652-63 (Mass. 2004) (applying Delaware law) (holding that minority shareholder stated a claim for freezeout and “[d]espite the sweeping dicta, the *Nixon* decision did not preclude a cause of action for minority shareholder freezeout in close corporations.”); *Mroz v. Hoaloha Na Eha, Inc.*, 410 F.Supp.2d 919, 934-35 (D. Hi. 2005) (citing *Clemmer* with approval regarding limits of *Nixon* decision).

⁵⁹ See *Hollis v. Hill*, 232 F.3d 460, 469 n.28 (5th Cir. 2000) (“[T]he Delaware Supreme Court has yet to consider the precise issue . . . whether a controlling shareholder is liable for actions taken with the purpose and effect of freezing out another shareholder.”).

⁶⁰ See *supra* at nn. 17, 25 & 50; see also *Reserve Solutions Inc. v. Vernaglia*, 438 F.Supp.2d 280, 290 (S.D.N.Y. 2006) (applying Delaware law) (approving *Little* and denying motion to dismiss shareholder oppression claim); *Minor v. Albright*, No. 01-C-4493, 2001 WL 1516729, at *2-3 (N.D. Ill. Nov. 28, 2001) (applying Delaware law) (recognizing definition of oppressive shareholder conduct from *Little* and denying motion to dismiss plaintiff’s claims that majority shareholder “attempted to freeze them out”).

of fiduciary duty, a plaintiff's allegation concerning the majority stockholder being "on both sides" of a deal will warrant the application of the more subjective "entire fairness" standard which requires courts to review and consider the majority shareholder's "fair dealing" and whether a "fair price" was offered.

Thus, while most minority shareholder plaintiffs in Delaware will opt to bring a claim for breach of fiduciary duty, the potential for a separate cause of action for shareholder oppression continues to be viable despite the sweeping dicta in *Nixon*.

E. EXAMPLES OF OPPRESSIVE CONDUCT

One classic example of an oppression claim by the majority shareholder is the "freeze-out" or "squeeze out" scheme. A freeze out describes a pattern of behavior by the majority shareholder that is characterized by terminating the minority shareholder's employment without cause, removing the minority shareholder from the board or from all aspects of management, refusing to provide financial information to the minority, and refusing to declare dividends – all of which culminates in an offer from the majority shareholder to buy out the minority shareholder at an unfairly low price. Under this scheme, the majority shareholder freezes the minority owner out of the business and leaves no tangible financial benefit for his/her ownership interest.

To establish a claim for oppression, the minority shareholder typically will prove that the majority shareholder engaged in actions of the types listed below, which is not an exhaustive list:

- Terminating the minority shareholder's employment without cause;
- Removing the minority shareholder from the board of directors;
- Removing the minority shareholder from management;
- Refusing to declare dividends when the company is profitable;
- Denying the minority shareholder access to information,
- Siphoning off earnings to the majority shareholder through *de facto* dividends or excessive compensation;
- Entering into favorable contracts with affiliates of the majority shareholder;
- Engaging in recapitalizations or mergers designed to dilute or eliminate the minority shareholder's interest;
- Usurping corporate opportunities;
- Using corporate assets for personal benefit; and/or
- Making loans to family members.

Not every example of the conduct listed above rises to the level of minority shareholder oppression. For example, terminating the employment of a minority shareholder who is also an employee at-will is not alone sufficient to establish a valid oppression claim. The threshold question of whether minority shareholder oppression has taken place is generally decided by the court after the jury determines that all or some of these acts, or related oppressive conduct, took place. The *Davis* court held that "[a]lthough whether certain acts were performed is a question

of fact, the determination of whether these acts constitute oppressive conduct is usually a question of law for the court.”⁶¹

Similarly, the First District Court of Appeals in Houston – one decade after its decision in *Davis* – placed limitations on shareholder oppression claims in *Willis v. Bydalek*.⁶² In *Willis*, the corporation operated a nightclub that had never earned a profit. Even though the majority shareholder removed the plaintiff from management, the court in *Willis* concluded the evidence was insufficient evidence to support a finding of oppression—despite the jury’s finding of a wrongful lock-out and that majority had not misused corporate funds. Further, the jury did not find that the majority had suppressed dividends because the company was never profitable and dividends were never distributed to any shareholders – either minority or majority.⁶³

The court declined to view these acts as oppressive, and determined that the firing of the minority investor was not oppression, because he was an at-will employee without an employment contract.⁶⁴ The *Willis* decision set some boundaries on the shareholder oppression claim recognized in *Davis*, and stressed that “[c]ourts must exercise caution in determining what shows oppressive conduct.”⁶⁵

F. APPLICATION OF TEXAS BUSINESS ORGANIZATIONS CODE TO LIMITED PARTNERSHIP AND LIMITED LIABILITY COMPANY OPPRESSION CLAIMS

Before the effective date of the Texas Business Organizations Code,⁶⁶ limited partners facing oppression had to look to Section 8.02 of the Texas Revised Limited Partnership Act, and LLC members in a similar situation had to look to Article 2.02 of the Texas Limited Liability Act. Now both can look to the same statute – Section 11.314 of the Texas Business Organizations Code.

Section 11.314 is titled “Involuntary Winding Up and Termination of Partnership or Limited Liability Company” and provides a remedy similar to those in the former TBCA, upon which *Davis* was, in part, based. Section 11.314 allows for the judicial winding up and termination of a limited partnership upon application by a partner or member if the following standards are met:

a partner in the partnership if the court determines that: (A) the economic purpose of the partnership is likely to be unreasonably frustrated or (B) another partner has engaged in conduct relating to the partnership’s

⁶¹ 754 S.W.2d at 380.

⁶² 997 S.W.2d 798 (Tex. App.—Houston [1st Dist.] 1999, pet. denied).

⁶³ *Id.* at 802.

⁶⁴ *Id.*

⁶⁵ *Id.* at 801 (citing *McCauley v. Tom McCauley & Son, Inc.*, 724 P.2d 232, 237 (N.M. 1986)).

⁶⁶ The effective date of the Business Organizations Code is September 1, 2009.

business that makes it not reasonably practicable to carry on the business in partnership with that partner; or

- (2) an owner of the partnership or limited liability company if the court determines that it is not reasonably practicable to carry on the entity's business in conformity with its governing documents.

The theory behind the limited partnership portion of this provision – that a court can dissolve a partnership when relations between the partners renders it impractical for the partnership to conduct business – was applied by an Illinois Appellate Court to compel dissolution of a partnership.⁶⁷ In *Susman v. Venture*, the general partners had a dispute with Susman, a limited partner, over the sale of the partnership assets. The general partners later removed Susman's name from the tax records and refused to provide him with any information. These acts were considered sufficient to justify judicial dissolution as a remedy for the aggrieved minority.

While the LLC portion of Section 11.314 has yet to be tested in Texas, the statute does authorize a court upon sufficient proof to order liquidation. The members of an LLC, therefore, would likely be entitled to the same remedies as a minority shareholder upon a showing that the majority, controlling members engaged in oppressive conduct.

G. DEPARTURE FROM THE BUSINESS JUDGMENT RULE

In light of the general nature of Texas statutes that empower shareholders in dire situations to dissolve private companies, it is not surprising that Texas courts have fashioned less severe remedies for minority shareholders contending they have been oppressed by the majority owners. The “less harsh” non-dissolution remedies set forth in *Davis* are judicial in nature, and are not prescribed by statute. Nevertheless, these remedies continue to provide relief to minority shareholders who allege claims for minority shareholder oppression.

Before *Davis*, Texas courts had been reluctant to issue rulings that impacted the relationships among shareholders or partners and the entities in which they had invested. Courts would give great deference to company officers and directors under the “business judgment rule.”⁶⁸ The long-standing existence of the business judgment rule led courts to adopt a hands-off approach to the business conduct of officers and directors under the common law rule that they “shall not be held liable for an honest mistake of judgment if he [they] acted with due care, in good faith, and in furtherance of a rational business purpose.”⁶⁹

While *Davis* did not overturn the business judgment rule, the minority shareholder oppression doctrine does contain elements that conflict with the rule to some extent. In considering claims by minority shareholders alleging oppression, Texas courts have begun to scrutinize with less deference the actions of majority owners to determine whether they engaged

⁶⁷ *Susman v. Venture*, 114 Ill. App. 3d 668, 675 (Ill. App. Ct. 1982).

⁶⁸ *Cates v. Sparkman*, 11 S.W. 846, 849 (Tex. 1889).

⁶⁹ *FDIC v. Wheat*, 970 F.2d 124, 130-31 (5th Cir. 1992).

in “burdensome, harsh, and wrongful conduct”⁷⁰ and to assess whether the majority owners’ actions have thwarted the “reasonable expectations”⁷¹ of the minority shareholders. The Fifth Circuit Court of Appeals, in *Hollis v. Hill*,⁷² closely examined the application of the business judgment rule in a case where a controlling shareholder was clearly oppressing a frozen-out minority. The court stated that:

[i]n the context of a closely held corporation, many classic business judgment decisions can also have a substantial and adverse affect on the ‘minority’s’ interest as shareholder. Close corporations present unique opportunities for abuse because the expectations of shareholders in closely held corporations are usually different from those of shareholders in public corporations.⁷³

The *Hollis* court affirmed the lower court’s decision that required a buy-out of the minority’s shares, based upon a finding of breach of fiduciary duty and oppressive conduct by the majority.

H. CLAIM FOR BREACH OF FIDUCIARY DUTIES

Minority investors in closely held companies have another avenue available to challenge the actions of majority/controlling owners. To the extent the majority shareholder or the general partner breaches his fiduciary duties, those acts give rise to a separate tort claim. At issue is whether a claim for breach of fiduciary duty can be brought as a direct action by the minority shareholder or limited partner, or whether this claim must be brought as a derivative action by the investor on behalf of (and in the name of) the entity.

The longstanding general rule in Texas is that corporate officers and directors owe fiduciary duties solely to the entity itself, not to its individual shareholders.⁷⁴ Shareholders were therefore without standing to enforce those duties, except through a derivative lawsuit filed on behalf of the corporation.⁷⁵

Closely held companies present a different scenario, however, as borne out by cases that focus on this corporate setting. Although the cases repeatedly affirm that a majority shareholder does not owe a fiduciary duty to other shareholders as a matter of law, several Texas cases have bucked this trend and held that a fiduciary duty may arise in the closely held company context in which the “shareholders operate more as partners than in strict compliance with the corporate form.”⁷⁶ When courts hold this duty runs directly from the majority shareholder to the minority

⁷⁰ *Davis v. Sheerin*, 754 S.W.2d 375, 377-80 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

⁷¹ *Id.*

⁷² *Hollis v. Hill*, 232 F.3d 460 (5th Cir. 2000).

⁷³ *Id.* at 467.

⁷⁴ *See Hoggett v. Brown*, 971 S.W.2d 472, 488 (Tex. App.—Houston [14th Dist.] 1997, pet. denied).

⁷⁵ *Faour v. Faour*, 789 S.W.2d 620, 621-22 (Tex. App.—Texarkana 1990, writ denied).

⁷⁶ *Willis v. Donnelly*, 118 S.W.3d 10, 31-32 (Tex. App.—Houston [14th Dist.] 2003), *rev’d on other grounds*, 199 S.W.3d 262 (Tex. 2006).

shareholders, they allow the breach of fiduciary duty claim to be asserted by the minority shareholder in a direct action.⁷⁷

Private, closely held companies can constitute an exception to the general rule, and when courts hold that majority owners owe fiduciary duties directly to the minority shareholders, the breach of those duties give rise to a judicial finding of oppression. In *Duncan v. Lichtenberger*,⁷⁸ the Fort Worth Court of Appeals awarded damages to two minority shareholders who had never received compensation as officers or dividends as shareholders. The court noted that “[t]he breach of a fiduciary duty is the type of wrong for which the courts of this State will afford a remedy.”⁷⁹ To this point, however, *Duncan* and similar cases seem to be outliers.

Dating back over 50 years, the Texas Supreme Court held that the failure of a majority shareholder to declare dividends constituted fraud and an abuse of his controlling position.⁸⁰ In *Patton v. Nicholas*, the Court affirmed the jury’s verdict, observing that “the malicious suppression of dividends is a wrong akin to a breach of trust, for which the courts will afford a remedy.”⁸¹ The *Patton* court issued an injunction requiring the corporation to pay a reasonable dividend “at the earliest practical date,” as well as in future years.⁸²

In the partnership context, the Tyler Court of Appeals upheld a claim of oppression based upon a breach of fiduciary duties, even though the plaintiff was not a partner (and therefore lacked standing to assert a claim for breach of fiduciary duties).⁸³ The *Cleaver* court noted, however, that fiduciary duties would have to be weighed for a court to properly assess the policy of the managing partner that was subject to challenge, *i.e.*, retaining earnings rather than declaring distributions.⁸⁴

I. REVIEW OF SHAREHOLDER DERIVATIVE CLAIMS

In light of the frequent holdings by Texas cases that majority shareholders owe fiduciary duties to the company rather than to other shareholders, claims for breach of fiduciary duty have often been filed as derivative actions for the benefit of the company. Shareholder derivative actions are governed by statute.⁸⁵

⁷⁷ *Id.* at 34-35; *Joseph v. Koshy*, No. 01-98-01432-CV, 2000 WL 124685, at *4 (Tex. App.—Houston [1st Dist.] Feb. 3, 2000, no pet).

⁷⁸ 671 S.W.2d 948 (Tex. App.—Fort Worth 1984, writ ref’d n.r.e.).

⁷⁹ *Id.* at 950.

⁸⁰ *Patton v. Nicholas*, 279 S.W.2d 848 (Tex. 1955).

⁸¹ *Id.* at 854.

⁸² *Id.* at 849.

⁸³ *Cleaver v. Cleaver*, 935 S.W.2d 491 (Tex. App.—Tyler 1996, no writ).

⁸⁴ *Id.* at 495-96.

⁸⁵ See TEX. BUS. ORG. CODE § 21.551, et seq.

The problem for majority shareholders in pursuing derivative actions is that they may require adherence to multiple procedural hurdles, including: (1) the shareholder must have had an ownership interest in the company at the time of the alleged wrong and at the time the suit was filed, (2) the shareholder must be able to show that he can fairly and adequately represent the company in the derivative action, and (3) the shareholder must make a demand on the company to take action on the claim and have the company refuse to do so before the shareholder files a lawsuit.⁸⁶ The shareholder's failure to comply with these procedural hurdles can result in a dismissal of the derivative lawsuit.

Importantly, under the Texas Business Organizations Code, the majority of the procedural requirements that exist for shareholders in a derivative action are eliminated for a closely held company.⁸⁷ Further, the statute also provides that “[i]f justice requires . . . a derivative proceeding brought by a shareholder of a closely held corporation may be treated by a court as a direct action brought by the shareholder for his own benefit.”⁸⁸

Based on this statute, a minority shareholder in a closely held company can file the lawsuit on his own behalf directly against the majority shareholder for breaches of fiduciary duty without having to comply with the procedural requirements that accompany derivative actions. In these derivative actions, however, the minority shareholder still needs to name the company as a nominal defendant and the action must still proceed in the name of the company, but the court has the authority to permit the recovery in the action to go directly to the minority shareholder.

Whether or not a limited partner in Texas has a direct action against the general partner for breaches of fiduciary duties when the company has been harmed rather than the limited partner directly remains an open question. Some states, such as Florida, apply a “separate and distinct” injury test to corporations and partnerships. Under this test, to pursue a direct action, the minority owner must establish that he suffered an injury separate and distinct from the other owners. Limited partners are not directly injured when they are damaged only to the extent of their proportionate interest in the partnership.⁸⁹ Therefore, a limited partner faces a risk of dismissal in bringing a claim against the general partner for breach of fiduciary duties if the injuries were sustained by the limited partnership itself rather than by the limited partner individually.

One key advantage that does exist for a shareholder who files a derivative action under Texas law is the plaintiff's right under the statute to recover his legal fees and litigation costs “if the court finds that the proceeding brought by the shareholder has resulted in a substantial benefit to the domestic or foreign corporation.”⁹⁰

⁸⁶ See TEX. BUS. ORG. CODE § 21.552-553 .

⁸⁷ *Id.* § 21.563.

⁸⁸ *Id.*

⁸⁹ See *Litman v. Prudential-Bache Properties, Inc.*, 611 A.2d 12, 16 (Del. Ch. 1992).

⁹⁰ See TEX. BUS. ORG. CODE § 21.561; see also *O'Neill v. Church's Fried Chicken, Inc.*, 910 F.2d 263, 267 (5th Cir. 1990); *Basralian v. Hatfield*, No. 07-96-0326-CV, 1998 WL 40415, at *1 (Tex. App.—Amarillo Feb. 2, 1998, no pet.); *Bayoud v. Bayoud*, 797 S.W.2d 304, 307 (Tex. App.—Dallas 1990, writ denied).

J. REMEDIES FOR MINORITY SHAREHOLDER OPPRESSION

The harshest remedy for shareholder oppression is liquidation of the corporation, which is authorized by Texas statute. *See* TEX. BUS. ORG. CODE § 11.404 (Vernon’s 2011). Texas courts, however, have interpreted their equitable powers broadly to permit them to narrowly tailor remedies for oppression. Specifically, courts have reasoned that if they are empowered to dissolve the corporation—the harshest equitable remedy—they are also empowered to impose other equitable remedies that provide a less drastic outcome than dissolution.⁹¹ Using their equitable powers, courts have discretion to tailor the remedy to the fit the specific facts.⁹²

Given the harshness of the dissolution remedy and the reluctance of courts to apply it, a more common remedy for shareholder oppression is a court-ordered buyout of the minority shareholder’s interest by the majority shareholder(s).⁹³ Texas courts order buyouts under their general equitable powers as a remedy that is less harsh than dissolution, but courts also have the power to impose equitable remedies that include reinstatement of the minority shareholder to the board or require the mandatory issuance of dividends.

K. ISSUES REGARDING THE BUYOUT REMEDY

One of the most critical issues that arises in a case presenting a claim for minority shareholder oppression is in which a court-ordered buyout is requested is the standard of value to be applied to the minority ownership interest, *i.e.*, should the shares be valued at “fair value” or “fair market value.”⁹⁴ The decision on valuation standards is ultimately one for the trial court, because the issue of whether the majority shareholders actually oppressed the minority owner is a question of law, which the trial court will decide based on factual disputes resolved by the jury. Further, once the trial court concludes that the majority has engaged in oppressive conduct, the trial court has considerable discretion to apply an appropriate equitable remedy. The equitable relief the trial court decides to award to the minority shareholder may then be overturned on appeal only for an abuse of discretion.

After oppression has been found, the valuation battle between the parties is the extent to which the court will apply discounts to the valuation of the minority shareholder’s stock. These discounts are based on the lack of marketability of the stock in a private company and that lack of control that the minority is able to exert in the operations of the business. The fundamental distinction is between “Fair Value” or “Enterprise Value” where no discounts apply to the

⁹¹ *Davis*, 754 S.W.2d at 380; *Duncan*, 671 S.W.2d at 953; *Redmon*, 202 S.W.3d at 235; *Gibney v. Culver*, No. 13-06-112-CV, 2008 WL 1822767, at *17 (Tex. App.—Corpus Christi Apr. 24, 2008, pet. denied.).

⁹² *Davis*, 754 S.W.2d at 380.

⁹³ *Lund v. Krass Snow & Schmutter, P.C.*, 879 N.Y.S.2d 127, 128 (N.Y.A.D. 1 Dept. 2009) (affirming trial court judgment ordering buyout of minority shareholder Court of appeals affirmed judgment awarding plaintiff a buyout plus post-judgment interest).

⁹⁴ *See generally* Douglas K. Moll, *Shareholder Oppression and “Fair Value”: Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L.J. 293 (Nov. 2004); *Balsamides v. Protameen Chems., Inc.*, 734 A.2d 721, 734-35 (N.J. 1999).

minority interest or “Fair Market Value” where these discounts apply in full force. The fair market value of the minority interest is “the price at which property would change hands between a willing buyer and a willing seller when neither party is under an obligation to act.”⁹⁵ A fair market value will usually substantially discount the minority interest in a close corporation for lack of marketability and lack of control.⁹⁶

Before the Dallas Court of Appeals’ *Rupe* opinion in March 2011, many courts declined to include a lack of control discount in the context of a court-ordered buyout, because it would “deprive minority shareholders of their proportionate interest in a going concern,”⁹⁷ and would undermine the remedial goal of protecting “minority shareholders from being forced to sell at unfair values imposed by those dominating the corporation while allowing the majority to proceed with its desired corporate action.”⁹⁸ The lack of marketability discount, however, has been viewed as more debatable and courts would consider adjusting the valuation to reflect the fact that shares in a close corporation lack liquidity.⁹⁹ Thus, majority shareholders will argue strenuously to apply discounts and use the fair market value standard to determine the value of the minority shareholder’s interest. By contrast, minority shareholders seek buyouts of their interest at fair value, a valuation with no discounts in which the minority shareholder receives a full share of the entire enterprise value based on the percentage of ownership.¹⁰⁰

The *Rupe* decision was the first reported Texas case to require fair market discounts to be applied to the valuation of the minority shareholder’s stock interest. While *Rupe* upheld the trial court’s finding that the minority shareholder had been oppressed by the majority shareholders, the court overturned an award of more than \$7 million – as determined by the jury – as the value to be paid to Ms. Rupe for her minority stock interest. *Rupe* required the jury, on retrial, to consider discounts for lack of control and lack of marketability in valuing the minority shareholder’s stock interest in the company. As noted earlier, *Rupe* has now been argued to the Texas Supreme Court with a decision expected later this year or in the first part of 2014.

In *Rupe*, the appellate court held that minority (or fair market value) discounts must be applied by the jury when the minority stockholder complains that the majority shareholders blocked the sales of the minority’s stock to a third party. The *Rupe* court held as follows:

We conclude that a buyout is an available remedy for shareholder oppression under Texas law and that, under the circumstances, appellants’ conduct in refusing to meet—or allow RIC management to meet—with prospective purchasers constituted

⁹⁵ *Pueblo Bancorporation v. Lindoe, Inc.*, 63 P.3d 353, 362 (Colo. 2003).

⁹⁶ See DOUGLAS K. MOLL & ROBERT A. RAGAZZO, *THE LAW OF CLOSELY HELD CORPORATIONS* § 8.02[B][3] (2009).

⁹⁷ *In re Friedman*, 661 N.E.2d 972, 976-77 (N.Y. 1995).

⁹⁸ *Id.*; see also *Balsamides*, 734 A.2d at 734-35.

⁹⁹ *Pueblo Bancorporation*, 63 P.3d at 357 n.2; *Advanced Comm’n Design, Inc. v. Follett*, 615 N.W.2d 285, 291 (Minn. 2000).

¹⁰⁰ See generally Douglas K. Moll, *Shareholder Oppression and “Fair Value”: Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L.J. 293 (Nov. 2004).

oppressive conduct as to Ann. We also conclude that the trial court did not abuse its discretion in ordering appellants to cause RIC to buy the Stock as an equitable remedy for this oppressive conduct. To this extent, we overrule appellants' first issue. As a result, we need not consider whether the trial court erred in concluding that appellants' other conduct—standing alone or in conjunction with their conduct as a whole—was oppressive.¹⁰¹

The appellate court in *Rupe* also favorably cited commentary by Professor Doug Moll, who has written extensively regarding minority shareholder oppression claims.¹⁰² Prof. Moll, in turn, has expressed the view that trial courts should adopt a flexible approach in construing minority shareholder oppression claims and fashioning remedies for oppressed minority shareholders.¹⁰³

As an alternative to a court-imposed equitable buyout award, some states offer the majority shareholder the option to buy the minority owner's shares. For example, California permits the corporation or the shareholder with more than 50% to avoid dissolution by buying the dissenter's stock for "fair value."¹⁰⁴ If the parties cannot agree on fair value, the court can order evidence submitted to a panel of three disinterested appraisers selected by the Court. The Court then enters a decree based on its review of and affirmation of the valuation of the appraisers. The decree gives the corporation, or, if it declines, the majority shareholder, the right to avoid dissolution by purchasing the minority's shares for the price stated in the decree.¹⁰⁵

L. OTHER NON-BUYOUT REMEDIES THAT MAY BE AVAILABLE TO MINORITY SHAREHOLDERS

There are many potential remedies other than dissolution and buyouts, although they are the ones that are most commonly discussed. Some states seek to encourage creative judicial resolution of shareholder oppression claims by codifying equitable options. For example, South Carolina's statute includes nine separate equitable options other than a buyout or dissolution.¹⁰⁶ Illinois's statutes identify eleven alternatives.¹⁰⁷ California simply instructs its courts to do equity.¹⁰⁸ In states lacking specific statutory authority, courts have nonetheless picked up the mantle of equitable creativity in addressing shareholder oppression.

¹⁰¹ 339 S.W.3d at 299.

¹⁰² *Id.* at 291 nn. 24-25, 27-29, 299 n. 42 (citing Moll publications).

¹⁰³ See, e.g., Douglas Moll, *Majority Rule Isn't What It Used To Be: Shareholder Oppression In Texas Close Corporations*, 63 TEX. B.J. 434 (2000).

¹⁰⁴ CAL. CORP. CODE § 2000 (West 2010).

¹⁰⁵ *Id.*

¹⁰⁶ S.C. CODE 33-18-410 (West 2010).

¹⁰⁷ 805 ILL. COMP. STAT. 5/12.56 (West 2010).

¹⁰⁸ CAL. CORP. CODE § 1804 (West 2010) ("After hearing the court may decree a winding up and dissolution of the corporation if cause therefore is shown or, with or without winding up and dissolution, may make such orders and decrees and issue such injunctions in the case as justice and equity require.").

The list of potential other remedies for shareholder oppression include at least the following:

- Altering or setting aside an action of the corporation, its shareholders or directors;
- Cancelling a provision in the articles of incorporation or by-laws;
- Ordering payment of dividends;
- Appointing a custodian to manage the business;
- Appointing an individual to be an officer or director, or a provisional officer/director;
- Removing a director or officer from office;
- Ordering an accounting;
- Awarding damages;
- Reinstating the minority as an employee;
- Requiring repayment of sums wrongly siphoned from the corporation;
- Limiting the salary of the majority or defining certain amounts of compensation as a constructive dividend;
- Ordering issued stock to be cancelled or redeemed; and/or
- Permitting the minority to purchase additional share.¹⁰⁹

M. A LOOK AT THE FUTURE: UNCHARTED WATERS

The ball is now in the Supreme Court's hands with respect to the claim for minority shareholder oppression. Lawyers, business owners and investors are poised for the Court's significant decision in the *Rupe* case, which is expected soon. Defense counsel and majority owners may be hopeful that the Court will invalidate the claim for shareholder oppression or eliminate the buyout remedy, but this result is unlikely. First, as discussed, Section 11.404 of the Texas Business Organizations Code authorizes a Texas trial court to appoint a receiver, or to order that the company be liquidated when there is a showing of "illegal, oppressive or fraudulent" conduct by the "governing persons" of the business entity. *Id.* § 11.404(a)(1)(C).

Second, an additional reason to express caution about a decision that would give unfettered discretion to majority owners is the strong public perception that corporate leaders of public and private companies have run amok in recent years. This is particularly so in Texas where claims regarding the Stanford *Ponzi* scheme continue to be litigated and the corruption of Enron's senior management has not been forgotten. The distress over misconduct by corporate officers, and the devastating results caused to their companies and shareholders, led to the passage of Sarbanes-Oxley (SOX) in 2003. SOX has been in place for most of this past decade, but as the Stanford case shows, the corruption factor remains. The Supreme Court may be reluctant to abandon a claim that has served Texas reasonably well in the private company

¹⁰⁹ See, e.g., *Brodie v. Jordan*, 857 N.E.2d 1076, 1082 (Mass. 2006) (discussing prospective injunctive relief to allow minority to participate in the business, including reinstatement of employment and/or back pay); *Hirsch v. Cahn Elec. Co.*, 694 So. 2d 636, 643 (La. Ct. App. 1997) (ordering return of \$200,000 in excessive compensation and payment of a dividend); *Brenner v. Berkowitz*, 634 A.2d 1019, 1033 (N.J. 1993) (discussing alternatives to dissolution); *Balvik v. Sylvester*, 411 N.W.2d 383, 388-89 (N.D. 1987) (same); *Masinter v. Webco Co.*, 262 S.E.2d 433, 441 & n.12 (W. Va. 1980) (same); *Baker v. Comm. Body Builders, Inc.*, 507 P.2d 387, 395-96 (Or. 1973) (same); see also 805 ILL. COMP. STAT. 5/12.56 (West 2010); S.C. CODE 33-18-410 (West 2010); the Model Statutory Close Corporation Supplement (1993).

context. Moreover, the oppression claim is based on a statute that has not been amended in 50 years and it is based on fiduciary duties that reflect bedrock common law principles.

Finally, a rejection of the oppression doctrine would jettison more than 25 years of case law consistently upholding the validity of the claim set forth in *Davis v. Sheerin*. The Supreme Court may be unwilling to overturn (and abandon) the precedential value of this extensive appellate case law. Many astute appellate judges have studied this claim and concluded that shareholder oppression is a cause of action well-placed in Texas law. As a result, if the Court concludes the oppression doctrine has become unwieldy in its present form, the Court may devote its efforts to refining the standards that apply to govern the rights of minority investors and the corresponding duties of majority owners.

Stated another way, majority owners of private Texas companies may not be burdened with serving as their brother's keeper, but unless things change at the Supreme Court, they cannot oppress the minority owners in the business with impunity under Texas law.