DIRECTOR AND OFFICER AND CONTROLLING SHAREHOLDER DUTIES AND LIABILITIES UNDER TEXAS LAW—FIDUCIARY DUTIES AND SHAREHOLDER OPPRESSION

CHARLES HENRY STILL*
Fulbright & Jaworski L.L.P.

State Bar of Texas
CHOICE AND ACQUISITION OF ENTITIES IN TEXAS
May 25, 2012
San Antonio

CHAPTER 8.1

*The views expressed herein are the author's and not those of his firm or any of its attorneys.

TABLE OF CONTENTS

I. FIDUCIARY DUTIES OF LOYALTY AND CARE AND THE BUSINESS JUDGMENT RULE.................... 1
A. Relevant Texas Statutory Law. 1
B. Texas Common Law 1
1. Loyalty and Fairness........ 1
2. Care and Business Judgment Rule........ 2
3. Derivative vs. Direct Actions 8

II. SHAREHOLDER OPPRESSION DOCTRINE 10
A. Relevant Statutory Considerations........ 12
B. Texas Cases on Actions Alleging Shareholder Oppression........ 13
1. Patton v. Nicholas, 279 S.W. 2d 848 (Tex. 1955) and Progeny. 13
2. Davis v. Sheerin, 754 S.W. 2d 375 (Tex. Civ. App.—Houston [1st Dist.] 1988, *pet. denied*). 14
3. Hoggett v. Brown, 971 S.W. 2d 472 (Tex. Civ. App.—Houston [14th Dist.] 1997, *pet denied*)........ 17
4. Willis v. Bydalek, 997 S.W. 2d 798 (Tex. Civ. App.—Houston[1st Dist.] 1999, *pet. denied*)........ 17
5. Pinnacle Data Services, Inc. v. Gillen, 104 S.W. 3d 188(Tex. Civ. App.—Texarkana 2003, *no pet*.). 18
6. Redmon v. Griffith, 202 S.W.3d 225 (Tex. Civ. App.—Tyler 2006, *pet. denied*). 18
7. Other Cases........ 19
8. Fiduciary Duty Breach vs. Shareholder Oppression........ 20
C. A Note on Delaware Law 22
D. Richie v. Rupe........ 23

DIRECTOR AND OFFICER AND CONTROLLING SHAREHOLDER DUTIES AND LIABILITIES UNDER TEXAS LAW—FIDUCIARY DUTIES AND SHAREHOLDER OPPRESSION

I. FIDUCIARY DUTIES OF LOYALTY AND CARE AND THE BUSINESS JUDGMENT RULE.

A. Relevant Texas Statutory Law.

1. The prior corporation laws and other entity statutes were codified in the Texas Business Organizations Code, which became effective for all Texas corporations on January 1, 2010. The Texas Business Corporation Act ("TBCA") provisions referred to herein have been carried forward substantially in the Texas Business Organizations Code, which is referred to throughout as the "BOC" or the "Texas BOC".

Texas BOC § 21.401, provides as follows:

a. Except as provided by Section 21.101 [shareholder agreements] or Subchapter O [close corporations], the board of directors of a corporation shall:

(i) exercise or authorize the exercise of the powers of the corporation; and
(ii) direct the management of the business and affairs of the corporation.

b. in discharging the duties of director under this code or otherwise and in considering the best interests of the corporation, a director may consider the long-term and short-term interests of the corporation and the shareholders of the corporation, including the possibility that those interests may be best served by the continued independence of the corporation.

§ 3.101 of the BOC provides as follows with respect to general provisions relating to the governing authority of all domestic entities:

> Subject to the title of this code that governs the domestic entity and the governing documents of the domestic entity, the governing authority [board of directors in the case of a corporation] of a domestic entity manages and directs the business and affairs of the domestic entity.

With respect to the management and direction of the business and affairs of a domestic entity, §3.102 of the BOC provides as follows:

(a) In discharging a duty or exercising a power, a governing person, including a governing person who is a member of a committee, may, in good faith and with ordinary care, rely on information, opinions, reports, or statements, including financial statements and other financial data, concerning a domestic entity or another person and prepared or presented by:

(1) an officer or employee of the entity;
(2) legal counsel;
(3) a certified public accountant;
(4) an investment banker;
(5) a person who the governing person reasonably believes posses professional expertise in the matter; or
(6) a committee of the governing authority of which the governing person is not a member.

(b) A governing person may not in good faith rely on the information described by Subsection (a) if the governing person has knowledge of a matter that makes the reliance unwarranted.

B. Texas Common Law

In general, except for certain prohibited "distributions" (*see* BOC § 21.306), the BOC does not set up standards for director, officer or controlling shareholder duties or related liabilities for breach of duties. Therefore, generally, the duties and liabilities of corporate directors and officers and controlling shareholders are governed by Texas common law. Fiduciary duties of officers are often identical to those of directors. *See*, Paddock v. Siemoneit, 218 S.W. 2d 428, 431-432 (Tex. 1949); Gearhart Industries, Inc. v. Smith International, Inc., 741 F.2d 707, 719 (5th Cir. 1984); Miller and Ragazzo, TEXAS PRACTICE—BUSINESS ORGANIZATIONS, § 36.1 (West 2011) [hereinafter "MILLER"]. Under Texas common law directors and officers of a Texas corporation owe fiduciary duties of loyalty, care and obedience to the corporation. *Id*.

1. Loyalty and Fairness

Directors and Officers. The duty of loyalty of a director or officer of a Texas corporation dictates that a

director or officer must act in good faith and must not allow personal interests to prevail over the interests of the corporation. Gearhart, *supra*, at 719-720; International Bankers Life Insurance Company v. Holloway, 368 S.W.2d 567, 576-78 (Tex. 1963). So a director or officer of a Texas corporation is not permitted to derive a personal benefit or advantage at the expense of the corporation and must carry out his obligation solely with an eye to the best interest of the corporation, unhampered by any pecuniary interest of his own. *Id.*; *see*, *e.g.*, A. Copeland Enterprises, Inc. v. Guste, 706 F. Supp. 1283, 1290-91 (W.D. Tex. 1989); Milam v. Cooper Company, 258 S.W.2d 953 (Tex. Civ. App.—Waco 1953, *writ refused n.r.e.*).

Controlling Shareholders. Akin to loyalty breach or conflict of interest claims against directors and officers, some Texas cases have also embraced the notion in some limited contexts that a dominant or controlling shareholder of a Texas corporation is, like a director, a "fiduciary" with respect to minority shareholders, generally meaning that the possible duty owed by such a shareholder to minority shareholders is really one of fairness as distinguished from the "trustee notion" of total selflessness. *See*, *e.g.*, Riebe v. National Loan Investors, L.P., 828 F. Supp. 453 (N.D. Tex. 1993) ("narrow" duty to deal fairly with minority but not a duty to act in minority shareholder's best interest); Hoggett v. Brown, 971 S.W. 2d 472 (Tex. Civ. App.—Houston [14th Dist.], 1997, *writ denied*) (dicta: in certain limited circumstances majority shareholder who dominates control over the business may owe fiduciary duty to minority shareholder, citing cases discussed hereinafter under "Shareholder Oppression" topic—Section II). In Willis v. Donnelly, 118 S.W. 3rd 10 (Tex. Civ. App.—Houston [14th Dist.], 2003, *rev'd on other grounds*, 199 S.W. 3d 262 (Tex. 2006), the court said in the context of a closely held corporation that fiduciary relationships could be created where a majority shareholder dominated control over the business or where shareholders operated more as partners than in strict compliance with the corporate form. But it said that a co-shareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder. *Id.* at 31-34, citing Hoggett v. Brown, *supra*. The topic of such possible duties of controlling shareholders and cases relating thereto are treated in MILLER, § 36.14 and footnotes thereto and, with respect to closely held corporations, § 30.32 and footnotes thereto. It is noted that the cases applying Texas law are not as "definitive" in finding fiduciary duties of controlling shareholders to minority shareholders as, say, Delaware law cases and that the Texas Supreme Court has not clearly found such duty to exist.

2. Care and Business Judgment Rule

While a clear current of Texas law seems to indicate "fraud" or ultra vires to be necessary for a finding of liability for the breach of duty by directors absent an "interested director" or "breach of duty of loyalty" situation (*see* Uberlaker, "Director Liabilities Under the Business Judgment Rule: Fact or Fiction?", 35 S.W.L.J. 775 (1981-82)—an article that the court relied on in Gearhart), it is also true that it is somewhat difficult to reconcile all the language of all the old (and very old in some instances) Texas cases. Against that background, important clarification came when the Fifth Circuit rendered a decision in these regards in Gearhart, *supra*. After a comprehensive review of the full body of Texas case law on the issues and faced with the somewhat difficult task of reconciling all the Texas authorities cited, the court concluded in the last analysis in respect of liability for breach of the "duty of care" of a director—as distinguished from the duty of loyalty—that

> Texas courts to this day will not impose liability upon a noninterested corporate director unless the challenged action is ultra vires or is tainted by fraud. Such is the business judgment rule in Texas.

Id. at 721 (citations omitted). The court also said

> The district court held that a Texas court will not question the business judgment of directors without a showing of bad faith. This is not precisely the business judgment rule in Texas. The good faith requirement enunciated in *International Bankers Life Ins. Co. v. Holloway* [*supra* (directors and officers improperly profiting from fiduciary relationship)] . . . goes to inquire into both the duties of care and loyalty. . . . The business judgment rule is a defense to the duty of care. As such, the Texas business judgment rule precludes judicial interference with the business judgment of directors absent a showing of fraud or an ultra vires act. If such a showing is not made, then the good or bad faith of the directors is irrelevant.

741 F.2d at 723 n. 9. The Gearhart case arose in a takeover context in which the board of directors of Gearhart Industries became threatened by a possible takeover by Smith International. In response the Gearhart board caused to be sold subordinated debentures of Gearhart accompanied by warrants that had a so-called "springing" feature, operating to some extent similarly to "poison pills" as they developed in

years subsequent, *i.e.*, the exercise price of the warrants decreased under certain circumstances. In effect the warrants would result in a significant and expensive dilution of any interest Smith acquired in Gearhart pursuant to Smith's tender offer. Smith alleged that creating the springing feature was a breach of the Gearhart directors' duty since the warrants were issued primarily to retain their control—*i.e.,* an "entrenchment" purpose was alleged. Criticizing Smith's counsel for failing to discuss the Texas authorities and instead citing primarily authorities from other jurisdictions (mainly Delaware), the court stated that there was no Texas case that condemned the kind of defensive conduct engaged in by the Gearhart board. Furthermore, nothing condemned the Gearhart board's reliance on the business judgment rule on the grounds that the springing feature worked in such a manner as to disable the directors from exercising their business judgment, *i.e.*, the argument was rejected that the automatic operation of the warrants was an abdication of director responsibility. It was in this context that the above-quoted principle was established. (Compare this holding to the alternative holding of the Delaware Supreme Court in Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (2003), where a merger was enjoined where directors had contractually tied their own hands or disabled themselves, at the end of an auction, from acting by entering into a merger agreement with no "outs". In Omnicare there was held to have been a *per se* breach of fiduciary duty by reason of such contractual restriction on board consideration of other possible deals.)

The interpretations of business judgment principles and the standard of director liability for breach of the duty of care in Texas have not been wholly consistent with Gearhart in subsequent cases, particularly in federal district courts in cases involving failed financial institutions after the savings and loan crisis of the late 1980's and early 1990's. (In this regard it should be noted that much of the old and new Texas case law suggests the application of more rigorous duty standards for, and scrutiny of, directors of banks and savings and loan entities.)

In one failed bank case, RTC v. Norris, 830 F. Supp. 351, 356 (S.D. Tex. 1993) (quoting an old but leading Texas case: Cates v. Sparkman, 11 S.W. 846, 849 (Tex. 1889)) the court said that

> the negligence of a director, no matter how unwise or imprudent, does not constitute a breach of duty if the acts of the directors were "within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved . . . ."

But the court in Norris went on to say that gross negligence of directors, like fraud and complete abdication of duty was outside the protection of the Texas business judgment rule. Other recent federal court cases interpreting Texas law have interpreted the Gearhart holding as permitting the imposition of liability for (and, therefore, exempted from the protection of the business judgment rule) acts of gross negligence. *See* FDIC v. Harrington, 844 F. Supp. 300 (N.D. Tex. 1994); FDIC v. Brown, 812 F. Supp. 722 (S.D. Tex. 1992). In the Harrington case the court stated that the Texas definition of gross negligence is

> that entire want of care which would raise the belief that the act or omission complained of was the result of a conscious indifference to the right or the welfare of the person or persons to be affected by it. . . . The Court believes that a director's total abdication of duties falls within this definition.

844 F. Supp. at 306 n. 7 (quoting Burk Royalty Co. v. Walls, 616 S.W.2d 911, 920 (Tex. 1981), which was a case dealing with the definition of gross negligence in the context of a claim as to a worker's death where exemplary damages were sought and in which the doctrine of gross negligence in Texas was traced). (Also on the Texas definition of gross negligence, *see* Lee Lewis Construction, Inc. v. Harrison, 70 S.W.3rd 778, 785 (Tex. 2001) (gross negligence involves (i) an extreme degree of risk, considering probability and magnitude and (ii) actor must have subjective awareness of the risk but still be consciously indifferent to it—he must have known about the "peril"); and Jewell v. Sal-O-Dent Laboratories, Inc., 69 S.W.2d 544, 546 (Tex. Civ. App—Eastland 1934, *writ ref'd*) (seems to equate gross negligence and "reckless mismanagement"—also indicating that absent "usurpation, fraud, or gross negligence" a court of equity will not interfere at the suit of minority stockholders merely to overrule and control the discretion of directors on management, policy or business).)

Other failed savings and loan/bank cases have also applied a gross negligence standard to establish a director breach of the duty of care. FDIC v. Schreiner, 892 F. Supp. 869, 881-82 (W.D. Tex. 1995); FDIC v. Daniel, 158 F.R.D. 101, 103 (E.D. Tex. 1994); FDIC v. Benson, 867 F. Supp. 512, 523 (S.D. Tex. 1994); RTC v. Acton, 844 F. Supp. 307, 314 (N.D. Tex. 1994), aff'd, 49 F.3d 1086 (5th Cir. 1995); RTC v. Bonner, 1993 WL 414679, at *3 (S.D. Tex. 1993). The principles laid out in these federal district court cases as to a standard of gross negligence are generally untested by the Fifth Circuit and unaddressed by the

Texas Supreme Court and are difficult to square with Gearhart and Cates v. Sparkman, *supra*.

Adding to the confusion are a couple of additional Fifth Circuit cases—one before and one after Gearhart. In Meyers v. Moody, 693 F.2d 1196 (5th Cir. 1982)—a strange case for the application of Texas law—the Fifth Circuit applied Texas law to duties of directors and officers of an Alabama insurance company doing business in Texas under the Texas Insurance Code. (The Texas Business Corporation Act, which was a basis for the BOC, in effect at the time arguably directed the court to apply Texas law at that time, but Section 8.02 of the TBCA then in effect has been subsequently amended, and also codified in BOC §§ 1.101-102, to make it clear that the law of the state of incorporation would apply to a review of director duties as to a foreign corporation authorized to do business in Texas. This is a statutory embracement of the so-called "internal affairs" doctrine under which the laws of the state of organization of an entity, including a corporation, apply to the internal affairs of an entity. "Internal affairs of an entity" is a term defined in BOC §1.105. [Note that case law establishes the internal affairs doctrine under Delaware law, but reflects the same general principle of the Texas statutory law that the laws of the state of incorporation apply to the internal affairs of a corporation.]) Certain questionable acquisition related transactions undertaken by a single individual (Moody—who was the sole shareholder, a director, board chairman and president of the insurance company) ultimately led to an insurance company's collapse. The case was brought by a receiver for the insurance company who was looking out for the interests of policy holders—seemingly a class of creditors and not shareholders. There were jury findings in the trial court that the shareholder/director defendant had acted "negligently" and even that he had engaged in "intentional misconduct or gross negligence". The court also said that the jury accepted the "contention that Moody was at least grossly negligent" in taking on the acquisition program with an artificial surplus. *Id.* at 1209. The court held that the defendant shareholder/director was not protected from liability to insurance policy holders on account of the "business judgment rule" where he had caused the use of corporate assets without regard to the interests of insurance policy holders. It is not possible to tell with certainty whether the court distinguished between negligence and gross negligence for purposes of analyzing director liability, but one assessment of the language of the opinion is that the court was most moved by the jury findings of gross negligence. The court said that Texas law imposed on corporate officers and directors a duty to exercise due care in the management of the corporation's affairs. It said that if they breached that duty, they are liable to the corporation for any loss it may suffer as a result of their neglect. It said that "due care" was that degree of care that a person of ordinary prudence would exercise under the same or similar circumstances. For these propositions the court cited dicta in two cases that had dealt with director liability directly to creditors of two troubled corporations for allegedly wrongful acts, which, in the view of this author, are of questionable legal authority as precedents for director liability for breach of the duty of care to a corporation and its shareholders. The cases cited do, however, in dicta seem to state a negligence standard of liability as to a director's responsibility to his corporation or one acting for such corporation (*e.g.*, a shareholder in a derivative suit or a receiver or trustee) in an alleged mismanagement case where the corporation is harmed. On the other hand, the court at one key point emphasized that the jury's finding that Moody was grossly negligent in his management of the insurance company was supported by numerous witnesses. One possibly helpful aspect of Meyers v. Moody is that the court, in rejecting defendant Moody's argument that the trial court had failed to instruct the jury regarding the applicability of the business judgment rule, noted favorably that the jury had been instructed that directors "are not held responsible for ordinary mistakes of business judgment", adding

> if Moody exercised reasonable business judgment in the acquisition program and perpetrated no fraud he is not liable to the receiver in this case however mistaken his actions might appear to be in hindsight.

Id. at 1211. Another oddity as to Meyers v. Moody is that it was not even cited in the Fifth Circuit's business judgment/director duty discussions in the Gearhart case.

In the second Fifth Circuit case referred to above, FDIC v. Wheat, 970 F.2d 124, 130-31, fn 13 (1992), the court, purporting to apply Texas law, approved a jury instruction as follows:

> A director or officer of a bank shall not be held liable for honest mistake of judgment if he acted with due care, in good faith, and in furtherance of a rational business purpose.

This instruction could be argued to suggest a standard of simple negligence for establishing a due care breach under Texas law.

In FDIC v. Brown, *supra,* however, Judge Simeon T. Lake tried with careful analysis to make sense of Meyers v. Moody and FDIC v. Wheat in the light of Gearhart, but, notwithstanding his careful

consideration, may not have resolved all confusion. The Brown case is, however, the most complete exposition of Texas law in the area since Gearhart. In Brown, Mrs. Brown and other defendants sought judgment on the pleadings arguing that the Texas business judgment rule precluded the FDIC from suing defendants for acts or omissions as directors of RepublicBank-Houston unless the FDIC alleged that the defendants' conduct was fraudulent or *ultra vires,* relying on the Gearhart articulation of the standard of liability for "noninterested" directors. Judge Lake noted that the business judgment rule remained a viable part of Texas jurisprudence and that it had been applied in the context of modern publicly held corporations, citing Gearhart. He also noted that the business judgment rule

> furthers the public policy of encouraging citizens to serve as corporate directors by immunizing them from acts and omissions that in hindsight proved to be wrong, as long as the directors were not personally interested in the transaction or did not act fraudulently or contrary to their lawful authority.

812 F. Supp. at 723. He also noted that the FDIC or a disgruntled shareholder could almost always allege one or more acts of negligence by bank directors in approving a loan that went bad. Judge Lake stated that he had thoroughly reviewed the cases dealing with the Texas business judgment rule and reiterated what he had said in an earlier case (RTC v. Holmes, Civ. Act. No. H-92-075, 1992 (memorandum opinion)) that the genesis of the business judgment rule in Texas was Cates v. Sparkman, *supra.* He said that the Texas Supreme Court's opinion in Cates was not as precise as it could have been, but that it was clear that the Supreme Court, after deciding to treat the case as a shareholders' derivative action, concluded that the negligence of the director, no matter how unwise or imprudent, did not constitute a breach of duty if the acts of the director were within the exercise of the director's discretion and judgment in the development or prosecution of the enterprise. He quoted with approval from Cates as follows:

> The breach of duty or conduct of officers and directors which would authorize, in a proper case, the court's interference in suits of this character is that which is characterized by *ultra vires,* fraudulent, and injurious practices, abuse of power, and oppression on the part of the company or its controlling agency clearly subversive of the rights of the minority, or of a shareholder, and which, without such interference, would leave the latter remediless.

Id. at 724 (quoting 11 S.W. at 849). He repeated the famous statement on the circumstances for director liability from the Gearhart case quoted above, *i.e.*, for fraud or *ultra vires.* Judge Lake said that while there was language from other Texas cases that discussed the duty of a corporate director in terms of ordinary care, he had located only one case in which liability was [arguably] imposed upon a director for negligence, citing Meyers v. Moody, *supra,* but he noted that the judgment against Moody was affirmed on a number of alternative theories, including negligence, gross negligence, intentional misconduct and breach of fiduciary duty of care in the management of the corporation. He distinguished Meyers v. Moody because Moody was not a disinterested director and there was no indication in either the district court's memorandum opinion or in the Fifth Circuit's opinion that Moody ever raised the business judgment rule before the jury was charged. (While there may have been no clear indication in the opinion, the author's review of the briefs before the Fifth Circuit indicate that Moody had made arguments about the jury charge on business judgment, the court gave instruction on business judgment to the jury and Moody's counsel argued business judgment as a defense to the jury. In fact the Fifth Circuit mentions the jury instruction on business judgment in its opinion.) But Judge Lake said that the Fifth Circuit had no occasion to address whether, upon a timely motion by Moody, the district court should have required the insurance company's receiver in that case to overcome the business judgment rule by amending its complaint. He then said that he found

> that the business judgment rule as adopted and applied by Texas courts is not merely a defense to a claim of negligence or breach of fiduciary duty against a corporate director. It is a rule of substantive law that requires a plaintiff seeking damages on behalf of a corporation against its disinterested directors to plead and prove (1) that the conduct of the directors complained of was either *ultra vires* or fraudulent or (2) that the directors had a personal interest in the transactions complained of. . . .

812 F. Supp. at 724. Contrast this statement that the business judgment rule is "not merely a defense to a claim" with the Fifth Circuit's statement in Gearhart quoted above. 741 F.2d 723, fn 9 ("defense to duty of care"). The author would have preferred that Judge Lake distinguish Meyers v. Moody on the basis of the

apparently patent misconduct of Moody that led to findings of his liability. (The author has retained a copy of the briefs in the Meyers case, which he was able to borrow from the Fifth Circuit. There is much of interest in these briefs that helps one understand the case and the egregious conduct under review.)

Judge Lake then addressed FDIC v. Wheat. He said that in Wheat the Fifth Circuit affirmed a jury verdict in favor of the FDIC against a director of a state chartered bank for breach of fiduciary duty in connection with his approval of an inadequately secured loan. The trial court had approved a jury instruction that characterized the business judgment rule as a defense to negligence and breach of fiduciary duty claims. In Wheat, as noted above, the Fifth Circuit approved a jury instruction that could possibly be read as establishing simple negligence as the standard of liability.

In Brown, the FDIC argued that Wheat established that the business judgment rule does not preclude an action for negligence against disinterested directors. Judge Lake, however, distinguished Wheat from the case at hand in several respects. First, he said that the director found liable in Wheat had a personal interest in the transaction for which he was found liable, thus distinguishing his situation from the various breaches of duty alleged against the outside director defendants in the Brown case. This statement appears to be based on inference from the fact that the director in Wheat was the majority shareholder of the bank involved and was selling the bank to a person to whom the ultimately bad loan was made for another purpose at around the same time. Secondly, Judge Lake said the director in Wheat did not argue on appeal that he did not breach his duty of care or good faith on the ground that the business judgment rule precluded liability for negligence under Texas law. According to Judge Lake the director in Wheat had argued before the Fifth Circuit only that he owed no duty because (1) there was no evidence of his knowledge of the loan in question and (2) he was no longer a director of the bank when the loan closed. The Wheat director certainly made those arguments, but he also argued that, while special jury issues on duty should have been excluded, a special issue on his business judgment defense should have been given instead. On this point the Wheat court had made the conclusory statement that "[v]iewed in its entirety, the jury charge accurately and completely stated the law". 970 F.2d at 130-31. Thirdly, Judge Lake said that in Wheat the business judgment rule was discussed only in terms of whether the jury charge was correct, not whether the FDIC's allegations of negligence stated a claim. He said, as discussed above, that, as in Meyers v. Moody, it does not appear that the director raised the business judgment rule before the case was submitted to the jury. Judge Lake also stated that it was doubtful that the Fifth Circuit would have intended the departure from its prior precedent in Gearhart that the FDIC had attributed to Wheat without discussing the reasons for changing that precedent. He said that the only citation of Gearhart in Wheat occurred in a footnote in support for a very general statement that a director had duties of obedience, loyalty and due care. If he accepted the FDIC's argument that Gearhart had been overruled by Wheat, it would mean that the Fifth Circuit had violated its long-standing rule that one panel cannot overrule the decision of a prior panel—only an en banc panel can do that—and he was not willing to conclude that the Fifth Circuit "intended Wheat to overrule Gearhart *sub silentio".* 812 F. Supp. at 725. (An examination by the author of the briefs in Wheat (which the author's librarian obtained electronically) shows Gearhart was briefed, and the court's failure in Wheat to analyze Gearhart more closely is puzzling.) Perhaps quite importantly, Judge Lake did go on to say, however, that he could not find any case in which a Texas court had held that claims of gross negligence against a disinterested corporate director were barred by the Texas business judgment rule, concluding that his earlier opinion in RTC v. Holmes, *supra,* was erroneous to the extent it held that the business judgment rule barred claims for gross negligence against a disinterested director. (Contrast this statement with the fact that nowhere in Gearhart is the concept of gross negligence mentioned as an exception, like fraud and *ultra vires,* to the business judgment rule.) Judge Lake said that, although Cates did not expressly use the term "gross negligence", the Texas Supreme Court's statements in Cates (that "injurious practices, abuse of power, and oppression on the part of the company or its controlling agency clearly subversive to the rights of the minority, or [of] a shareholder" are not protected by the business judgment rule) could be fairly interpreted as exempting from the protection of the business judgment rule grossly negligent conduct of a director, which by definition in Texas, he said, meant an "entire want of care", citing Burk Royalty Co. v. Walls, *supra.* Judge Lake also said that Jewell v. Sal-O-Dent Laboratories, Inc., *supra,* had aligned *ultra vires* and fraudulent conduct with what the court characterized as "reckless mismanagement", which encompassed gross negligence. (The Jewell case dealt with what director conduct would justify appointment of a receiver.) Judge Lake said that the court in Jewell contrasted three types of corporate malfeasance, *i.e. ultra vires,* fraud and reckless mismanagement/ gross negligence, with mistakes of misjudgment, which would not authorize appointment of a receiver, and which were protected by the business judgment rule. In effect then, Judge Lake held that gross negligence was the basic

standard of liability for directors for their actions and that the business judgment rule would not protect directors from liability for gross negligence in cases where a director judgment, *i.e.*, a decision, had been made.

Perhaps importantly, in Brown Judge Lake also concluded that the Texas business judgment rule would not protect a director if he abdicated his responsibility and failed to exercise any judgment at all, quoting Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982), as follows:

> Whatever its merit, however, the business judgment rule extends only as far as the reasons which justify its existence. Thus it does not apply in cases, *e.g.,* in which the corporate decision lacks a business purpose, is tainted by a conflict of interest, is so egregious as to amount to a no-win decision, or results from an obvious and prolonged failure to exercise oversight or supervision.

Judge Lake said that if the defendants in the case before him abdicated their responsibilities as directors of the bank, he saw no reason why the business judgment rule should protect them. (He cited a highly questionable Delaware case in this regard: Rabkin v. Philip A. Hunt Chemical Corp., 1987 WL 28436 (Del. Ch.), which has always been suspect by knowledgeable practitioners as to the notion of alleged director oversight culpability being tested by a simple negligence standard and which the Delaware courts have now thoroughly rejected. In Stone v. Ritter, 911 A. 2d 362 (Del. 2006)—a leading example—the Delaware Supreme Court clearly established the legal principle that nothing short of gross negligence can be the standard for director liability, whether in the context of a specific decision or in the context of director general duties of care in overall supervision of the activities of the corporation. Indeed, Stone, requires an even higher standard than gross negligence as to oversight culpability, *i.e.*, an utter failure to implement controls, a conscious failure to monitor controls, a conscious disregard of director responsibilities. *Id*. at 369-70.) In conclusion on these points Judge Lake said that he had determined that the Texas business judgment rule may preclude the FDIC from pursuing its negligence allegations other than to the extent the FDIC alleged that the defendants had abandoned their duties as directors of the bank. It is certainly fair to conclude that the business judgment rule in Texas, as elsewhere, has no relevance to a claim against directors who had made no "judgment" on a matter, *i.e.*, who were simply passive or who had not paid any attention to a matter.

But Judge Lake's own observation in the case that "almost any loan could have been made more secure, or at least the bank could have suffered a smaller loss on it" (812 F. Supp. 723) is quite telling when we think about a hindsight judgment (which is always the case) based on a simple negligence claim that someone failed in oversight and when we focus on how easy it is to make such a claim when something has gone dreadfully wrong. At least gross negligence for such a claim seems much more appropriate in the world of 20/20 hindsight when judging alleged director oversight culpability. It would have been helpful if Judge Lake had held to the obvious point that the business judgment rule was inapplicable to an alleged director oversight culpability situation, while at the same time saying that at least gross negligence—not simple negligence—was the standard for liability for oversight failure. Intellectually, one can understand an exhortatory notion that ordinary care, that care of a prudent man in similar circumstances, is the standard for directors in their oversight and supervisory functions—articulation of an exhortatory standard of "don't be consciously indifferent to the rights or welfare of others" would be bad form and genuinely uninspirational at the least. But it can also be understood that personal liability, as a matter of good policy, should not attend a director absent a failure of supervision greater than being found simply negligent—probably by a jury. If simple negligence is the standard and jury trial is the venue for risk, what sensible person would be willing to serve as an outside director—always a part-time position where dependence on managers and experts is the customary course and sanctioned by statute (TBOC § 3.102) and the margins of director supervision are often hazy to say the least? (Compare the following observation by the Supreme Court of Delaware en banc in Stone v. Ritter, *supra:*

> [A] demanding test of liability in the oversight context is probably beneficial to corporate shareholders as a class, as it is in the board decision context, since it makes board service by qualified persons more likely, while continuing to act as a stimulus to *good faith performances of duty* by such directors.

911 A.2d at 971.)

In any event, Judge Lake granted the defendants' summary judgment motion on the FDIC's claims as to actual decisions that alleged simple negligence and denied summary judgment on those claims that alleged gross negligence. He also denied the summary judgment motion as to those claims that urged a simple negligence standard in the context of abdication of defendants' duties as directors or their failure of supervision. Maybe, the author notes, a distinction can

be made between "total abdication" or "total inaction" as a standard for liability versus conduct not that extreme. This is a subpoint of Stone v. Ritter, *supra.* In any event, if Judge Lake had had available the powerful reasoning of the subsequent Delaware decisions, especially, Stone v. Ritter, it seems possible he would have reached a conclusion making it clear that simple negligence should not be the standard of liability for a board "abdication" or "failure of oversight" or "failure of supervision" claim.

Notwithstanding the federal district courts' decisions involving failed financial institutions, which appear to set gross negligence as the standard for the liability of a disinterested director of a financial institution at least in a circumstance where a judgment was made (*i.e.*, action was taken), some confusion still seems to exist on that point. In Texas First National Bank v. Ng, 167 S.W.3d 842 (Tex. App.—Houston [14th Dist.] 2005, *judgments below vacated* at 2005 Tex. LEXIS 724 (Tex. 2005)), for example, the court upheld a jury finding that a bank chairman breached his duty of care by permitting an officer to engage in reckless conduct that resulted in substantial losses on a customer account. The court said that the chairman was aware of problems with the account, prevented the president of the bank from properly supervising the subordinate officer and did nothing himself to rein in the officer. The trial court had given an instruction, unchallenged on appeal, that specified ordinary care, rather than gross negligence, as the standard of liability for directors in Texas. The apparently egregious facts of Texas First National Bank could have easily been judged, with the same result, under a gross negligence standard or under the standard expressed by Judge Lake in the Brown case discussed above that the business judgment rule does not protect a director if he totally abdicated his responsibility and failed to exercise any judgment, which standard led to Judge Lake's denial of the defendants' summary judgment motion in Brown as to claims that alleged a total abdication of duty on the part of the directors. In the Texas First National Bank case the court did not set up the distinction between "inaction" or "oversight" cases and "judgment" cases.

One other post-Gearhart Texas case is worth mentioning on duty of care/business judgment issues. Pace v. Jordan, 999 S.W.2d 615 (Tex. Civ. App.—Houston [1st Dist.] 1999, *pet. den.*) (board rejection of demand in a derivative suit context). In Pace the court said that under the business judgment rule a shareholder cannot institute a derivative suit on a corporation's behalf by "merely showing that the board's refusal to act was unwise, inexpedient, negligent, or imprudent". *Id.* at 623. The court said the plaintiffs had to show something other than business judgment, *i.e.*, that the board's refusal to act was characterized by an *ultra vires,* fraudulent and injurious practice, an abuse of power and an oppression on the part of the board that was subversive to a shareholder. However, the court said that a board could invoke the business judgment rule's protection for its decision only if the directors were informed of all material information reasonably available to them. *Id.* at 624.

In another federal district court case discussing in detail the possible duties of directors to creditors of an insolvent company under Texas law, the court rejected the proposition that directors can be held liable for gross negligence in carrying out fiduciary duties, citing Gearhart as the controlling law. Floyd, Chapter 11 Trustee of the Estate of Seven Seas Petroleum, Inc. v. Hefner, 2006 WL 2844245 (S.D. Tex.) (Memorandum and Order).

In summary, there continues to be room for a cohesive high level court decision that attempts to pull together and reconcile Texas precedent in the due care/business judgment area.

3. Derivative vs. Direct Actions

It should be noted that generally claims against a Texas corporation's directors and officers for breaches of their fiduciary duties may be advanced only in a shareholders' derivative suit brought on behalf of their corporation. Gearhart Industries, Inc. v. Smith International, Inc., *supra;* A. Copeland Enterprises, Inc. v. Guste, *supra*, (citing Gearhart); Redmon v. Griffith, *infra*; Hoggett v. Brown, *supra*; Faour v. Faour, 789 S.W.2d 620 (Tex. Civ. App.—Texarkana 1990, *writ denied*); Bounds v. Stephenson, 187 S.W. 1031 (Tex. Civ. App.—Dallas 1916, *writ ref'd*) and other cases collected in Gearhart, 741 F.2d at 721. *See*, *also*, Somers v. Crane, *infra*. They may not be brought as direct or class action claims in contrast to Delaware law which permits direct or class action claims in some director fiduciary breach contexts. In Gearhart the court said that directors' duties of loyalty and care run to the corporation, not to individual shareholders or even to a majority of the shareholders: A cause of action for breach of director fiduciary duties belongs to the corporation and cannot be brought by a shareholder in his own right—this principle also interdicts a shareholder class action—nor can the shareholder directly prosecute the suit in the name of the corporation, that is, he can only do so derivatively. On these points s*ee, also*, Wingate v. Hajdik, 795 S.W. 2d 717 (Tex. 1990); Guerra v. Guerra, 2011 WL 3715051 (Tex. Civ. App.—San Antonio, 2011, *no writ*) (memorandum opinion). Since a claim for breach of fiduciary duty under Texas law can only be brought in a derivative suit format, subject to an exception for closely held corporations discussed hereinafter in Section II, the plaintiff is required to comply with the

strict procedures for bringing derivative actions under §§ 21.551-562 of the BOC. *See*, Marron v. Ream, 2006 WL 2734267 (S.D. Tex.), in which the strict procedures of the Texas derivative suit statute and other procedural rules in connection with derivative suits were carefully traced. In that case, the plaintiff's derivative action was dismissed for failure to follow the rules.

Accordingly, in this discussion it seems appropriate to focus briefly on certain requirements for derivative claims against directors for breach of fiduciary duties. In 1997 the Texas Legislature revised the TBCA to make Texas a more attractive place for companies to incorporate. Under Article 5.14(C) of the TBCA (now § 21.553 of the BOC), a shareholder cannot file a derivative suit until the 91st day after the date a written demand is filed with the corporation stating with particularity the act, omission or other matter that is the subject of the claim or challenge and requesting that the corporation take suitable action. Unlike Delaware where it is possible to demonstrate the futility of a demand and thus excuse it, Texas mandates demand in every instance. In In re Harold R. Schmitz, 285 S.W.3d 451 (Tex. 2009)—a case of first impression and in a unanimous opinion (8 to 0)—the Texas Supreme Court rejected a two sentence demand letter that a corporation's board of directors received three days before a shareholder filed a derivative suit to halt a pending merger. The Supreme Court refused to set a bright line for what demand entitles a shareholder to bring a derivative suit, but ruled that the two-sentence demand was not sufficient to allow a derivative lawsuit to proceed against the former directors of a large manufacturing company. Noting that the demand requirement in Texas was somewhat unclear in part because shareholder derivative actions had been relatively rare, the Court said

> Whether a demand is specific enough will depend on the circumstances of the corporation, the board, and the transaction involved in the complaint. But given the size of this corporation and the nature of this transaction, this demand was clearly inadequate.

Id. at 458.

In Schmitz the Texas Supreme Court was faced with a Revlon -type argument, *i.e.*, under the Revlon line of cases under Delaware law, which hold that where a corporation is for sale or is to be broken up, the duty of directors is to achieve the maximum price for shareholders. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A. 2d 173 (Del. 1986). In Schmitz Lancer Corp., a Texas corporation, had agreed to be bought out by another company for $22 per share—an aggregate purchase price of approximately $200 million dollars—in October 2005. Two months later and about one month before the merger was to close, a California law firm faxed a letter—without identifying the shareholder for which it acted—to Lancer's board insisting that the board cancel the merger within 24 hours "in light of a superior offer" of $23 per share. Three days later the firm filed the derivative suit in district court in San Antonio, seeking an injunction to stop the merger and declaratory relief against the board members, but the plaintiff did not seek an injunction hearing. In January, 2006, Lancer's shareholders approved the merger, and on February 2, 2006, Lancer was merged into the acquiring company. After the merger the petition in the purported derivative suit was amended to seek cancellation of the merger and damages on behalf of Lancer—the corporation itself—and attorneys' fees. The eight former directors of Lancer filed a motion to dismiss the suit. Both the trial court and the court of appeals denied the directors' motion to dismiss, and the directors sought a writ of mandamus from the Texas Supreme Court. While TBCA Article 5.14, in effect at the time, did not expressly state that the pre-suit demand must include the name of the shareholder making the demand, the Supreme Court held in the case that a demand cannot be made anonymously. Noting that a demand from Warren Buffett may be different from one from Jimmy Buffett, the Court said

> A corporation could not be expected to incur the time and expense in fully investigating a demand without verifying that it comes from a valid source.

Id. at 456. The demand does not have to come from the shareholder, but the shareholder must be identified. As to the particularity requirement in the statute—the requirement that the demand state with particularity the act, omission or other matter that is the subject of the claim—the Supreme Court noted in the opinion that the demand given by the plaintiff's law firm gave no reason why the $23 per share offer was superior to the offer that was accepted other than what one could imply from the $1 difference. The Court said

> A large number of variables may affect the inherent value of competing offers for corporate stock. A cash offer may prove more or less valuable than an offer of stock currently valued at the same amount. Competing bidders may be more or less capable of funding the offers they tender, or completing the transaction without antitrust or other obstacles. Competitors may attach

> conditions that make an offer more or less attractive in the short or long run.
>
> In a merger like this involving several hundred million dollars, one cannot say whether the $23 offer was superior to the $22 offer without knowing a lot more. A rule requiring that a corporation always accept nominally higher offers, in addition to sometimes harming shareholders, would replace the business judgment that Texas law requires a board of directors to exercise.

Id. at 457, citing Cates v. Sparkman, *supra*, and Pace v. Jordan, *supra*. As to the mandamus writ grant, the Court noted that Lancer Corp. no longer existed. Therefore, it was too late for the Lancer board to conduct a new analysis of competing merger offers. The Court said

> Allowing this case to proceed to trial would effectively allow a shareholder to sue [on behalf of the corporation itself] for damages connected with a merger without giving the corporation's board an opportunity to make such a decision for itself. As that would defeat the substantive right the Legislature sought to protect [that a corporation should be run by its board and not by a disgruntled shareholder or by the courts], we hold mandamus relief is warranted.

Id. at 459.

While the Court did not discuss Delaware law or the Revlon rule as to the duty of directors to obtain the maximum value reasonably attainable when a corporation is being sold, it did not embrace Revlon as the law in Texas or discuss Delaware case law exceptions to Revlon that acknowledge that boards under Revlon may consider factors other than price, such as financing contingencies and regulatory issues. Moreover, the case would seem to be a clear reaffirmation of the strong business judgment protection that directors of Texas corporations have under Gearhart Industries, Inc. v. Smith International, Inc., *infra*, but, curiously, the Court did not cite Gearhart when referring to director business judgment protection. There is another curious aspect of Schmitz. The transaction appears to have been a cash-out merger, and, therefore, upon consummation of the merger the purported derivative plaintiff should have lost his standing to prosecute a derivative suit for breach of fiduciary duty. Somers v. Crane, 295 S.W.3d 5 (Tex. Civ. App.—Houston [1st Dist.], 2009) (*no writ*) (holding squarely under Texas law (and citing several cases) that (i) a breach of fiduciary duty claim belongs to the corporation involved and cannot be brought as a direct action by a shareholder and (ii) that only a shareholder can bring a derivative action and a shareholder cashed out in a merger is no longer a shareholder and is no longer entitled to bring a derivative action on behalf of the corporation.) *See also*, Zauber v. Murray Savings Association, 591 S.W.2d 932 (Tex. Civ. App.—Dallas 1979), *writ ref'd per curiam*, 601 S.W.2d 940 (Tex. 1980). It is not apparent how the Schmitz plaintiff maintained standing to prosecute a derivative action and be heard by the Texas Supreme Court on the derivative claim for damages against directors.

II. SHAREHOLDER OPPRESSION DOCTRINE

While a large body of Texas law exists as to fiduciary duty breach claims in the context of corporations, it seems important—even though some Texas cases have confused the claims—to distinguish claims for breach of fiduciary duty by directors and officers and controlling shareholders from claims for shareholder oppression for at least one important reason: As noted above, claims against a Texas corporation's directors and officers for breaches of their fiduciary duties generally may be advanced only in a shareholder's derivative suit. Such claims may not be brought by a shareholder as a direct or class action claim under Texas law. Also as noted above, since such a claim for breach of fiduciary duty under Texas law can generally only be brought in a derivative format, a shareholder plaintiff, subject to an exception applying to closely held corporations discussed hereinafter, is required to comply with the strict procedures for bringing derivative actions under §§ 21.551-562 of the TBOC. *See*, *e.g*., Marron v. Ream, *supra*; In re Harold R. Schmitz, *supra*. Other cases dealing with claims for breach of fiduciary duty and their relationship to derivative actions include Somers v. Crane, *supra* (only corporation has cause of action for breach of fiduciary duty and claim must be brought derivatively); and Zuber v. Murray Savings Association, *supra*.

Notwithstanding the foregoing general rules necessitating that fiduciary duty breach claims against directors be brought derivatively, mention is made of the special statutory treatment of derivative actions involving so-called "closely held corporations". TBOC § 21.563, as did its predecessor in the TBCA, provides as follows:

> (a) In this section, "closely held corporation" means a corporation that has:
>
> (1) fewer than 35 shareholders; and
> (2) no shares listed on a national securities exchange or regularly quoted in an over-

the-counter market by one or more members of a national securities association.

(b) Sections 21.552-21.559 [derivative suit procedural requirements] do not apply to a closely held corporation.

(c) If justice requires:

(1) 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 the shareholder's own benefit; and

(2) a recovery in a direct or derivative proceeding by a shareholder may be paid directly to the plaintiff or to the corporation if necessary to protect the interests of creditors or other shareholders of the corporation.

The sections of the basic statutory provision on derivative suits that do not apply in derivative suits as to closely held corporations relate to procedural matters, including (i) requirements as to shareholder standing, (ii) necessity of demand, (iii) determinations by independent directors, etc., (iv) stay of prosecution, (v) discovery, (vi) tolling of limitations, (vii) dismissal of derivative proceedings and (viii) pleading requirements after a demand is rejected. There is scant case law on how the closely-held corporation provision quoted above fits with traditional notions of fiduciary duty litigation and derivative suits in Texas, but in any event one case has said that the discretion to treat an action as direct so as to allow recovery to be paid to a shareholder plaintiff did not mean that the action was no longer a derivative proceeding. Swank v. Cunningham, 258 S.W.3d 647, 664 (Tex. App—Eastland 2008, *pet. denied*). *Accord*, Guerra v. Guerra, *supra*; 2055 Incorporated v. McTague, 2009 WL 2506342 (Tex. Civ. App.—Dallas 2009, *no writ* (memorandum opinion).

While breach of director fiduciary duty claims belong to the corporation and generally must be prosecuted by it directly or derivatively, as noted above in Section I.B. cases applying Texas law appear to allow a minority shareholder in some limited circumstances to prosecute a claim directly against a controlling shareholder for breach of duty, typically referred to as a "fiduciary duty". *See* MILLER § 36.14 and, with respect to closely held corporations, § 30.32 and cases collected in footnotes thereto. It is said that in circumstances where a controlling shareholder enjoys a disproportionate benefit from a transaction at the expense of the minority, the controlling shareholder must satisfy the entire fairness test to have its conduct upheld. *Id*. Note, then, that minority shareholders have two possible good "bites at the apple" when controlling persons act disloyally or self-deal: They can sue directors and officers derivatively on behalf of the corporation for breach of the fiduciary duty of loyalty, and possibly enjoy the benefits of the above-referenced closely-held corporation provisions, or sue controlling shareholders directly for breach of fiduciary duty where the minority shareholders have been dealt with unfairly by the controlling shareholders, *i.e.*, where the "injury" is directly to minority shareholders and not to the corporation.

Before leaving the topic of actions for breaches of fiduciary duty by officers and directors and controlling shareholders in Texas, it should be noted that some Texas cases hold that a "co-shareholder" in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder. Willis v. Donnelly, *supra*; Hogget v. Brown, *supra*. The case law holds that the existence of such a duty depends on the circumstances. *Id*.

It is noteworthy, then, that one of the key aspects of a shareholder oppression claim is that, if such a claim can be maintained, courts have allowed it to be brought by an individual shareholder in his own right—and not in the right of the corporation as a derivative suit—without allegation of a fiduciary duty breach. In effect, then, a shareholder oppression claim "trumps" or "end runs"—by using undefined and largely undefinable terms such as "defeating minority expectations", "burdensome, harsh or wrongful conduct", "a lack of probity and fair dealing" and "a visible departure from standards of fair dealing and a violation of fair play"—a more established body of Texas law that has been widely used to redress shareholder grievances against directors and officers and controlling shareholders who violated duties of care and loyalty and fair dealing ("fiduciary duties"), to their corporations and/or minority shareholders. These terms used in oppression cases seem legally imprecise and value laden and thus facilitate the labeling of results by courts that find shareholder oppression.[1] They do not have the predictability that more well-defined concepts addressed in fiduciary duty breach cases—*e.g.*, self-dealing, corporate opportunity appropriation and competition—have as they have been established in over a hundred years of common

[1] "I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description [hard-core pornography]; and perhaps I could never succeed in intelligibly doing so. *But I know it when I see it*, and the motion picture involved in this case is not that". Justice Potter Stewart, concurring opinion in Jacobellis v. Ohio, 378 U.S. 184 (1964), regarding possible obscenity in *The Lovers* (emphasis added).

law in Texas and elsewhere. Charging a person with conduct said to fall into one of the categories covered by terms used in "oppression" cases often appears *ad hominem* and often appears to obviate logic and analysis and the normally well-appreciated values of legal stability and predictability for business people, values that form the basis for *stare decisis*. Indeed, as will be seen, some courts have even said there are no set standards for oppression. But the shareholder oppression cases are obviously an important topic to attempt to deal with as business people try to order their affairs with legal advice. So the principal Texas cases addressing this doctrine are discussed in this paper. It is noted, however, that an appeal is now being sought in the Texas Supreme Court in an important new case finding shareholder oppression. Richie v. Rupe, 339 S.W. 3d 275 (Tex. Civ. App.—Dallas 2011, *pet. denied*), but rehearing on the denial was sought and the initial order of denial was withdrawn on March 2, 2012. The Richie case will be discussed at length in this paper following a discussion of the historic development—a rather recent history starting as such in 1988—of the shareholder oppression doctrine in Texas. If it is ultimately considered by the Supreme Court, the Richie case could be a defining event for the shareholder oppression doctrine in Texas since that doctrine has not been previously considered or embraced by the Supreme Court as such, and since the Richie case extends the doctrine as it was understood from lower court cases into new waters.

A. Relevant Statutory Considerations

It seems logical to start consideration of the topic with the only statutory mention of an action for shareholder oppression under Texas corporate law. Section 11.404 of the TBOC provides in part as follows with emphasis added:

(a) Subject to Subsection (b), a court that has jurisdiction over the property and business of a domestic entity under Section 11.402(b) **may appoint a receiver for the entity's property and business if**:

(1) in an action by an owner or member of the domestic entity, it is established that:

(A) the entity is insolvent or in imminent danger of insolvency;

(B) the governing persons of the entity are deadlocked in the management of the entity's affairs, the owners or members of the entity are unable to break the deadlock, and irreparable injury to the entity is being suffered or is threatened because of the deadlock;

(C) **the actions of the governing persons of the entity are illegal, oppressive, or fraudulent;**

(D) the property of the entity is being misapplied or wasted; or

(E) with respect to a for-profit corporation, the shareholders of the entity are deadlocked in voting power and have failed, for a period of at least two years, to elect successors to the governing persons of the entity whose terms have expired or would have expired on the election and qualification of their successors;

* * *

(b) **A court may appoint a receiver under Subsection (a) only if**:

(1) circumstances exist that are considered by the court to necessitate the appointment of a receiver to conserve the property and business of the domestic entity and avoid damage to interested parties;

(2) all other requirements of law are complied with; and

(3) **the court determines that all other available legal and equitable remedies, including the appointment of a receiver for specific property of the domestic entity under Section 11.402, are inadequate.**

Note that the above-quoted provision applies to all "domestic entities" under the TBOC and not just to corporations. Also note that the statute does not by its terms negate other remedies besides receivership to deal with an oppression situation and requires a court to determine that all other "available" remedies are inadequate before establishing a receivership. A review of annotations in VERNON'S under TBCA Section 7.05—the predecessor to the TBOC provision quoted above—and under the above TBOC provision failed to turn up any case where a statutory receivership was sanctioned by an appellate court in a shareholder oppression case. *Cf.*, Texarkana College Bowl, Inc. v. Phillips, 408 S.W. 2d 577 (Tex. Civ. App.—Texarkana 1966, *no pet.*) (trial court ordered receivership but exact grounds not clear; Court of Appeals reversed).

B. Texas Cases on Actions Alleging Shareholder Oppression

The following cases constitute the main body of law in Texas on shareholder oppression claims. As will be seen, the cases are not consistent with each other and some confuse actions for fiduciary duty breaches, which are well-addressed under Texas law, with the relatively new and broadly defined concept under Texas law of a shareholder oppression cause of action. That cause of action as such was unknown under Texas law until 1988 after the Davis case, *infra*, was decided.

1. Patton v. Nicholas, 279 S.W. 2d 848 (Tex. 1955) and Progeny.

The Patton case involved an action by minority shareholders for an accounting and liquidation of a solvent corporation whose president and majority shareholder was charged with mismanagement and with maliciously suppressing the payment of dividends by the corporation. The case did not mention the shareholder oppression doctrine by name in its consideration of the claims. The Supreme Court held that where a majority shareholder/president was guilty of maliciously suppressing payment of dividends, minority shareholders were not entitled to liquidation of the corporation, but the corporation and the majority shareholder were required to declare and pay at the earliest practical date a reasonable dividend and to pay reasonable dividends annually thereafter from future profits of the corporation and from accumulated surplus. The case involved two 20% shareholders in a controversy with the 60% shareholder over several years, including the time while the two plaintiffs were officer/employees of the corporation or a predecessor. There was no agreement assuring them permanent employment or official representation with respect to the corporation beyond the first year of its operations. The corporation was reasonably successful as a business enterprise, but no dividend was paid to shareholders. The individual defendant, on the other hand, regularly received a salary. The plaintiffs were paid modest salaries until they resigned and began a competing business. Evidence in the case indicated a great deal of ill will from the individual defendant toward the plaintiffs and indicated that he was adamant about dividends not being paid so long as they were shareholders and that he would not buy their stock at even a small fraction of its value or sell his own stock at any price. Apparently, the individual defendant dominated and controlled the board of directors of the corporation. The jury found that the defendant took actions for the sole purpose of depreciating the value of the shares held by the two plaintiffs and that he was guilty of mismanagement of the corporation and that he acted with malice toward the two plaintiffs. Consistent with what might be regarded as the normal circumstance and expectation, the Supreme Court noted that general domination and control of the board of directors by the individual defendant did not connote damage to the corporation or even extreme irregularity in corporate management since he was the founder of the business, its president and owner of a majority of the stock. He could hardly have avoided imposing his personal views on the affairs of the corporation, the Court said. On the other hand, the Court said that the trial court's finding of the defendant's control of the board for the malicious purpose of, and with the actual result of, preventing dividends and otherwise lowering the value of the stock of the plaintiffs was something else and that the evidence as to the "wrongful state" of his mind was quite adequate as to that point, noting that, while the "proof of connection between this state of mind and actual conduct is both small in volume and inferential in character", it was enough. *Id.* at 853. It said that the ability of the plaintiffs to hold their stock or to sell it to third parties for a fair value would be lessened by the absence of dividends. Moreover, the defendant's statements about not purchasing the plaintiffs' stock could be interpreted as indicating a purpose to acquire that stock eventually for much less than its value. Accordingly, the Court said that—coupling all the circumstances indicating the defendant's intent to eliminate the plaintiffs from every connection with the business, and at an unfair sacrifice on their part, with the fact that no dividends were paid in the face of an accumulation of surplus—the findings of malicious suppression of dividends at the trial court "must be sustained". *Id.* at 854. The Court said that the malicious suppression of dividends was "a wrong akin to breach of trust, for which the courts will afford a remedy" and a minority stock interest in a corporation was far from "change left on the counter", quoting from a statement attributed to the defendant during the acrimonious struggle. *Id.* So the court said a remedy would be found, but it declined to find that liquidation of a solvent corporation at the suit of a minority shareholder was proper in this instance. Texas did not at the time have a statutory scheme as now exists for a receiver in the context of a dispute as to fraud or oppressive conduct. The Court said some existing law in Texas seemed to recognize the right to a receivership in the case of gross or fraudulent mismanagement, but that some of the cases indicated that even in circumstances of extreme mismanagement threatening insolvency, courts would not decree a receivership and dissolution at the suit of a private party interested in the corporation. The Supreme Court's conclusion at the end of consideration of liquidation/receivership was that Texas courts, under their general equity powers, may, in the "more extreme

cases of the general type" of the one before it, decree liquidation and accordingly appoint a receiver for liquidation or for the less drastic purpose of "rehabilitation". *Id.* at 857. But the Court went on to say that wisdom would counsel tailoring a remedy to fit a particular case. So the court eliminated the liquidation and receivership decreed in the lower court in the case and substituted a new decree which it said would give adequate protection to the plaintiffs and at the same time afford the parties "a chance to normalize their relationships". *Id.* The Supreme Court's decree required the corporation and its controlling stockholder to declare and pay at the earliest date practical a reasonable dividend on the stock of the corporation. The Court said that meant that the amount of the dividend should be substantial and take into consideration the amount of accumulated surplus of the corporation, the fact that the plaintiffs had been previously wrongfully deprived of their dividend and other factors. The decree as to reasonable dividends had a prospective feature to it with respect to future profits of the corporation so long as the dividends were not "inconsistent with good business practice", clearly acknowledging the right of those in control of a corporation to make judgments on how it spent its money. *Id.* It should be noted that the Patton case did not use the term "shareholder oppression" in its analysis of the facts, but it did use the term "malicious purpose" and "wrongful state of mind" and the phrase "unfair sacrifice" on the part of the plaintiffs. Perhaps the case can be summed up as providing a cause of action and remedy for a wrong labeled "malicious suppression of dividends". *Id.* at 854. On this cause of action, *see also*, Morrison v. St. Anthony Hotel, San Antonio, 295 S.W. 2d 246 (Tex. App.—San Antonio 1956, writ refused n.r.e.). Another case touched on the subject of suppression of dividends in a husband/wife dispute over separate vs. community property that implicated a family related corporation. Cleaver v. Cleaver, 935 S.W. 2d 491 (Tex. Civ. App.—Tyler 1996, no writ). Somewhat surprisingly, the court said in that case that a claim that corporate dividends have been suppressed implied a breach of duty by management *to the corporation* and not to shareholders, citing Faour v. Faour, *supra*, at 621-622, and saying, with additional cites, that management may invest corporate earnings in corporate assets rather than distributing them, that shareholders are not empowered to manage a corporation—just the board—and that under the business judgment rule alleged unwise, inexpedient, negligent or imprudent decisions or misconduct would not sustain a suit by shareholders against management of a corporation. The court further said that to assert a breach of management fiduciary duty the proper action was by derivative suit on behalf of the corporation. In Faour, the court said as follows on these points:

> We agree with Magnolia's contention that there is no evidence that Kenneth Faour breached any fiduciary duty to Anthony Faour. The only basis in the jury answers for liability for breach of fiduciary duty was Special Question No. 5, which found that Kenneth Faour (a) failed to hold corporate shareholders and directors meetings, (b) suppressed payment of dividends to the shareholders, (c) failed to prevent the dissipation of the corporation's assets, (d) failed to supply written financial records of the corporation as requested, (e) made improper loans by the corporation, and (f) caused stock in the corporation to lose value. These are all duties which an officer owes to the corporation rather than to an individual shareholder. A corporate officer owes a fiduciary duty to the shareholders collectively, i.e. the corporation, but he does not occupy a fiduciary relationship with an *individual* shareholder, unless some contract or special relationship exists between them in addition to the corporate relationship.

Id.

2. Davis v. Sheerin, 754 S.W. 2d 375 (Tex. Civ. App.—Houston [1st Dist.] 1988, *pet. denied*).

The Davis case (which appears to be the first Texas case addressing a claim specifically identified to be one for "shareholder oppression") involved an action by a minority shareholder against a majority shareholder and another officer in a closely held corporation to recover for breach of fiduciary duties and to obtain a buy-out of his ownership interest. The dispute was essentially between a 55% stockholder and a shareholder who, after the trial, was determined—contrary to defendants' position—to own a 45% interest in the corporation and a related partnership. The trial court ordered a buy-out of the plaintiff's stock, the appointment of a receiver, the payment of dividends in the future and other remedies. The defendants' basic argument on appeal was that the remedy of a buy-out was not available to a minority shareholder under Texas law and that, even if such a remedy were available, the facts of the instant case were not appropriate for the application of a buy-out remedy based on a determination of oppressive conduct. The court noted the predecessor of the current TBOC provision quoted above (Article 7.05 of the TBCA) and that it provided for the appointment of a receiver for aggrieved shareholders who could

establish the existence of one of five situations, including "illegal, oppressive or fraudulent conduct" by those in control. The court said that it found no Texas cases where the particular remedy of a buy-out had been ordered unless it had been provided for in a contract between the parties to a closely held corporation, but it noted that courts in other jurisdictions had recognized a buy-out as an appropriate remedy even in the absence of express statutory or contractual authority and cited cases in that regard from other jurisdictions—one case relied on extensively was a 1985 New York case decided by an intermediate court of appeals and not by New York's highest court. The court analyzed the Patton case, *supra*. The defendants argued that Patton was authority for the proposition that Texas "follows the general rule across the United States in not allowing a 'buy-out' as a remedy for a minority shareholder". *Id*. at 379. Citing other cases, the court said that the essence of equity jurisdiction was the power of a court of equity to do equity and to mold each decree to the necessities of the particular case and that whenever a situation existed which was contrary to the principles of equity and which could be redressed within the scope of judicial action, a court of equity will devise a remedy to meet the situation even though no similar relief has been granted before. So the court concluded that Texas courts, under their general equity power, may decree a buy-out in a appropriate case where less harsh remedies are inadequate to protect the rights of the parties. Having decided that a buy-out was an available remedy under the court's general equity powers, the court then turned to the question whether it was appropriate in the case before it. Importantly, the court said that it was incorrect to say that the determination of whether the defendants' acts were oppressive was a question of fact for the jury. The court said that whether certain acts were performed was a question of fact, but that the determination of whether those acts constituted oppressive conduct was usually a question of law for the court, citing cases from non-Texas jurisdictions. The court said that oppressive conduct was the most common violation for which a buy-out was found to be an appropriate remedy in other jurisdictions, again citing cases. It said that an ordered buy-out of stock at its fair value was an especially appropriate remedy in a closely held corporation where the oppressive acts of the majority were an attempt to squeeze out the minority who did not have a ready market for the corporation's shares and who was at the mercy of the majority. (Note, however, that the facts of the case did not indicate a squeeze-out effort, although the defendants did contest whether plaintiff actually was a shareholder.) The court said that the Texas statute in effect at the time did not define oppressive conduct, again citing TBCA Article 7.05. Moreover, it said no Texas court had provided a definition of oppressive conduct. So it turned to decisions in other jurisdictions to consider what constitutes oppressive conduct, noting that oppressive conduct had been described as an expansive term that was used to cover a multitude of situations dealing with "improper conduct" and that a narrow definition would be inappropriate.[2] Focusing on cases from other jurisdictions, the court said that courts may determine according to the facts of a particular case whether the acts complained of served to frustrate the legitimate expectations of minority shareholders and whether the acts were of such a severity as to warrant the requested relief. It cited the New York case mentioned above that held that oppression should be deemed to arise only when the majority's conduct substantially defeats the expectations that objectively viewed were both reasonable under the circumstances and were central to the minority shareholder's decision to join the venture.

Among the jury findings that the court considered in examining the defendant's conduct were the following:

- The defendants conspired to deprive the plaintiff of his stock ownership in the corporation

---

[2] It seems a fair question to pose as to why, after 100 years of fiduciary duty jurisprudence in the State of Texas, it was necessary to refer to laws of other states to consider the establishment of a new cause of action—for "shareholder oppression"—in Texas. The absence of prior Texas cases on the subject—even the Patton case did not establish such a cause of action—and a large body of law dealing with fiduciary duty breaches by directors and controlling shareholders of Texas corporations suggests that this new cause of action in Texas was an example of unnecessary result oriented judicial activism. In the leading case on Texas corporate fiduciary duty law, the U.S. Court of Appeals for the Fifth Circuit—in an unusual criticism of counsel—addressed its frustration with trying to decide a Texas law case based on state law from other jurisdictions: "We are both surprised and inconvenienced by the circumstance that, despite their multitudinous and voluminous brief and exhibits, neither plaintiffs nor defendants seriously attempt to analyze officers' and directors' fiduciary duties or the business judgment rule under *Texas* law. This is particularly so in view of the authorities cited in their discussions of the business judgment rule: Smith and Gearhart argue back and forth over the applicability of the plethora of out-of-state cases they cite, yet they ignore the fact that we are obligated to decide these aspects of this case under Texas law. We note that two cases cited to us as purported Texas authority were both decided under Delaware law…." Gearhart, *supra*, at 719, fn 4.

- The defendants received informal dividends by making profit sharing contributions for their benefit to the exclusion of the plaintiff and that act was a willful breach of fiduciary duty
- Defendants wasted corporate funds by using them for their legal fees and that was also a willful breach of fiduciary duty
- But defendants did not convert plaintiff's stock
- And defendants were not paid excessive compensation
- And there was no malicious suppression of dividends
- And the defendants did not conspire to breach their fiduciary duties.

The court also said that there was other undisputed evidence in the record that the trial court could have also considered in its conclusion of oppressive conduct, including the following:

- The defendants had claimed that the plaintiff had gifted them his stock
- There was evidence that the defendants wished to avoid declaring dividends and instead dispersed the surplus in the form of bonuses to officers of the corporation which could be characterized as a direct effort to deny a shareholder his dividends—a possible additional finding that appears inconsistent with the finding of no malicious suppression of dividends and no excessive compensation and redundant with the findings of informal dividends to defendants in the form of profit sharing contributions, which was found to be a willful breach of fiduciary duty.

It is interesting that each of the adverse findings or possible adverse findings against defendants was explicitly identified as a breach of fiduciary duty or, with the possible exception of the finding that defendants conspired to deprive plaintiff of his stock ownership, could have been so identified in each instance as a breach of the duty of loyalty by reason of self-dealing. The court said, even though there were findings of the absence of some of the "typical 'squeeze out' techniques used in closely held corporations, e.g., no malicious suppression of dividends or excessive salaries", that it found that "conspiring to deprive one of his ownership of stock in a corporation, especially when the corporate records clearly indicated such ownership, is more oppressive than either of those [squeeze-out] techniques". *Id.* at 382. The court said that that action by defendants would not only substantially defeat any reasonable expectation the plaintiff may have had, but also would have totally extinguished any such expectations, again citing the same New York case. The court said that the plaintiff's complaints as to the defendants' conduct went far beyond dissatisfaction with corporate management and that the defendants' conduct did not fall within the protection of the business judgment rule—the latter two circumstances having been found in the Texarkana College Bowl case, *supra*, to be inappropriate bases for causes of action under TBCA Article 7.05 as to a receivership for oppressive actions.

In conclusion the court said

> We therefore hold that the jury's finding of conspiracy to deprive appellee of his interest in the corporation, together with the acts of willful breach of a fiduciary duty as found by the jury, and the undisputed evidence indicating that appellee would be denied any future voice in the corporation, are sufficient to support the trial court's conclusion of oppressive conduct and the likelihood that it would continue in the future.

Id. at 383. Note the citing of fiduciary duty breaches as a component of a new cause of action for oppression even though causes of action already existed for fiduciary duty breaches.

After that conclusion the court said it had to determine whether lesser remedies than a buy-out would adequately protect the plaintiff's interest. In this context the court said that the buy-out order was an appropriate remedy and that the trial court did not abuse its discretion in granting such remedy. The court also said that the trial court's appointing a receiver was within its discretion, noting that the defendants can avoid the necessity of the appointment of a receiver by immediate compliance with the court's buy-out order and payment of the damages awarded. The court did hold that the trial court abused its discretion in ordering the payment of future dividends. But in these regards it said, without authority, that it disagreed with the defendants' contention that existing Texas authorities cited in the opinion stood for the proposition that an injunction to pay dividends was only proper upon a finding of malicious suppression of dividends. Still, it found that the facts of this case did not support a mandatory injunction ordering the payment of future dividends. In conclusion as to the Davis case, it seems that the facts could have been fitted into the traditional Texas law dealing with classic fiduciary duty breaches and within existing causes of action to pursue them, *e.g.*, a derivative suit availing the provisions noted above as to closely held corporations. The issue of stock ownership raised in the case, of course, could

have—or would have—been resolved in any shareholder-brought cause of action—derivative or otherwise—as a threshold matter or in a direct action for declaratory relief to establish stock ownership. With that perspective it seems unnecessary for the Davis court to have created a new cause of action in Texas for shareholder oppression to give appropriate relief in the case before it.

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

The Hoggett case is not directly in point on the topic of shareholder oppression, but it possibly gives dicta support to the notion of the existence of a cause of action for shareholder oppression. The court said that a co-shareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder. *Id*. at 488. A footnote at that point in the text stated that a majority shareholder's fiduciary duty ordinarily runs to the corporation, but that in certain limited circumstances, a majority shareholder who dominates control over the business may owe such a duty to the minority shareholder, citing the Patton case, *supra*, and Davis v. Sheerin, *supra*, and a few other cases which it said stood for the proposition that in certain limited circumstances a majority shareholder who dominates control over the business may owe a fiduciary duty directly to the minority shareholder. *Id*. at 488, n 13. Still, it is noteworthy that the court talked mainly about fiduciary duties and not about the notion of shareholder oppression.

4. Willis v. Bydalek, 997 S.W. 2d 798 (Tex. Civ. App.—Houston[1st Dist.] 1999, *pet. denied*).

In the Willis case shareholders who owned 49% of a corporation that was formed to run a nightclub brought an action against the majority shareholder for conversion, fiduciary duty breach, shareholder oppression and other theories. The trial court entered a judgment against the majority shareholder and awarded damages. The court of appeals held that minority stockholders could not recover for shareholder oppression based on a jury's finding that they were wrongfully locked out of the nightclub and that they were entitled to remain managers of the nightclub—those allegations did not support recovery for shareholder oppression. The venture was a losing one that never generated a profit or paid dividends and was ultimately closed by the successor to the original majority stockholder. In the first instance, the defendant argued that the Davis case, *supra*, was incorrectly decided, but the court in the Willis case said that for purposes of its discussion it would assume that equitable remedies besides receivership existed for shareholder oppression and that it did not need to rule on the question whether Davis correctly stated the law. Under his second issue on appeal the defendant argued that, even if equitable remedies besides receivership existed for shareholder oppression, the jury verdict in this instance did not support a finding of shareholder oppression, and on this point the appeals court agreed. The court said that what acts were performed was a question of fact, but that the determination of whether those facts constituted oppressive conduct toward a minority shareholder was a question of law for the judge. The court noted that Davis had defined oppressive conduct as follows:

- majority shareholder conduct that substantially defeated 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 (based on New York law) or
- burdensome, harsh or 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 (based on Oregon law).

In Willis the court said courts must exercise caution in determining what shows oppressive conduct and that a minority shareholder's reasonable expectations had to be balanced against the corporation's need to exercise its business judgment and run its business efficiently. In these regards, despite the existence of a majority-minority fiduciary duty, a corporation's officers and directors are, it said, afforded a rather broad latitude in conducting corporate affairs. The court said that in the facts before it locking the plaintiffs out of the nightclub plainly was just a firing of at-will employees, and the firing of an at-will employee minority shareholder was not oppressive. The court distinguished the Davis case on the grounds that in Davis a majority shareholder conspired to deprive the minority shareholder of his stock and breached fiduciary duties by wrongfully withholding dividends and by other acts. (Note that actually the Davis court found *no* malicious suppression of dividends.) The court also distinguished Duncan v. Lichtenberger, 671 S.W. 2d 948 (Tex. Civ. App.—Ft. Worth 1984, *writ refused n.r.e.*), where minority shareholders were fired and where the majority shareholder also stopped informing the minority of corporate actions and withheld corporate dividends while receiving compensation for himself. (Note that the Duncan case did not specifically find shareholder oppression and is a strange case to fit into any category since it essentially ordered rescission of a stock purchase on fiduciary

duty breach grounds said to arise by reason of not allowing plaintiffs to participate in corporate decisions and by refusing to declare dividends, neither of which has a precedented base in Texas law as a fiduciary duty breach.) The court went on to say that it was not holding that firing an at-will employee who is a minority shareholder could never, under any circumstances, constitute shareholder oppression, but that it was holding that in the particular facts before it, it did not. It said that the TBCA in effect at the time empowered a board of directors to manage a corporation and that that power obviously included the power to discharge employees. It said that, given the broad range of business judgment allowed by law to directors and the fact that Texas was an employment at-will state, the firing alone was simply not the sort of "burdensome, harsh or wrongful conduct" or "visible departure from the standards of fair dealing" that may constitute shareholder oppression. 997 S.W.2d at 803. The court said that Texas law did not recognize a minority shareholder's right to continued employment without an employment contract. Thus the court of appeals reversed the trial court's decision and rendered the case for the defendants.

5. Pinnacle Data Services, Inc. v. Gillen, 104 S.W. 3d 188(Tex. Civ. App.—Texarkana 2003, *no pet*.).

While addressing an LLC member oppression claim, the court in the Pinnacle Data case did not add any analysis to the nature and requirements of a shareholder oppression action. The claim was based on contentions that the defendant members wrongfully withheld profit distributions, fired the plaintiff's (Pinnacle's) owners from the entity, failed to inform Pinnacle of company actions and paid for legal fees in the case with company funds. The court quoted from Willis and Davis in setting out the definition of shareholder oppression, but simply said that the plaintiff had failed to set forth any evidence in support of its claim and, therefore, the trial court had properly granted a no-evidence motion for summary judgment with respect to member oppression. Note that oppression was asserted as "member oppression" in the LLC context and the court did not say that the oppression doctrine did not apply in the LLC context, which would have been another possible ground if argued, to sustain the summary judgment against plaintiff. Presumably, then, the shareholder oppression doctrine may apply in the LLC context, but note that an LLC is a creature of contract in Texas and the company agreement may, among other things, restrict duties, including fiduciary duties and related liabilities, that a member, manager or officer may have to the LLC or to another member or manager. TBOC §§ 101.401 and 101.402.

6. Redmon v. Griffith, 202 S.W.3d 225 (Tex. Civ. App.—Tyler 2006, *pet. denied*).

The Redmon case essentially involved a dispute between a 25% shareholder of a company and a 75% shareholder of the company. The 25% shareholder's employment was terminated and the minority shareholder brought an action against the majority shareholder seeking an accounting and inspection of the corporation's books and records and asserting claims of fraud, breach of fiduciary duty, breach of contract and shareholder oppression. It was, at the first level, a dispute about the standing of the plaintiff to bring the action, particularly with respect to a claim of breach of fiduciary duty. The court said that under Texas law a fiduciary duty existed to shareholders collectively, *i.e.*, to the corporation, but that there was no fiduciary relationship flowing from a corporate officer to an individual shareholder absent a contract or special relationship existing between them in addition to the corporate relationship. A corporate shareholder has no individual cause of action, the court said, for personal damages caused by a wrong done to the corporation. Such a cause of action for injury to a corporation is vested in the corporation and therefore the action had to be brought derivatively in the name of the corporation so that every shareholder would be made whole if the corporation obtained compensation from a wrongdoer. The court said that a corporate shareholder may have an individual action for wrongs done to him where the wrongdoer violated a duty arising from a contract or otherwise and owing directly by the wrongdoer to the shareholder. This principle was not an exception to the general rule requiring an action to be brought on behalf of the corporation, but rather was a recognition that a shareholder may sue for a violation of his individual rights regardless of whether the corporation also has a cause of action. The court said it was the nature of the wrong, whether directed against the corporation only or against the shareholder personally, not the existence of injury, which determined who could sue, *i.e.*, who had standing to sue. In these regards, the court said that Texas appellate courts had recognized an individual cause of action for "shareholder oppression" or "oppressive conduct". *Id*. at 234. Citing Willis v. Bydalek, *supra*, Hoggett, *supra*, Davis v. Sheerin, *supra*, and several other cases, the court noted that oppressive conduct was more easily found in the context of a close corporation, but was not expressly limited to such a context. It said that a claim of oppressive conduct could be independently supported by evidence of a variety of conduct. The court concluded that the plaintiff did have standing to bring the shareholder oppression action since it had been alleged that the majority shareholders had engaged in wrongful conduct, had not dealt with the company's

affairs fairly to the prejudice of the minority shareholder and had not observed the standards of fair dealing on which a shareholder was entitled to rely. The plaintiff had alleged that the majority shareholder had maliciously suppressed the payment of dividends and made improper personal loans to himself from the corporation in addition to paying personal expenses from corporate funds. (Note that the personal loan and personal expense allegations would be regarded by most U.S. and Texas courts as classic allegations of breach of the fiduciary duty of loyalty, *i.e.*, self-dealing, as to which the corporation itself, directly or derivatively, would have an action for recovery.) The plaintiff alleged that the majority shareholder employed "squeeze-out" techniques such as diverting corporate opportunities—again a classic loyalty/fiduciary duty breach—excessive payment of dividends to themselves and attempts to deprive the plaintiffs of the fair value of their shares and of the benefits thereof. The court said that the plaintiff had made sufficient allegations, which taken as true, would demonstrate a claim for shareholder oppression and that the trial court's grant of a summary judgment on the ground that the plaintiff lacked standing to proceed on the claim for shareholder oppression was improper. The court then turned to the question whether the plaintiff had presented sufficient evidence in the summary judgment proceeding to create a genuine issue of material fact with respect to the shareholder oppression claim. The court said that the record indicated that there was some evidence that the majority shareholder had paid personal expenses from corporate funds and that the plaintiffs had been denied efforts to have access to certain financial information with respect to the corporation. So the court concluded that the plaintiff had presented sufficient evidence to overcome a motion for summary judgment concerning the claim of shareholder oppression. It said that evidence concerning the use of corporate funds to pay personal expenses combined with evidence of denial of access to information concerning the financial condition of the corporation sufficiently created a material fact issue concerning whether there was a lack of probity and fair dealing in the company's affairs to the prejudice of the plaintiff, a visible departure from the standards of fair dealing and a violation of fair play on which minority shareholders like the plaintiff were entitled to rely. It overruled the trial court's granting of a summary judgment motion on the plaintiff's claim for shareholder oppression. Note (i) that the claim as to use of corporate funds to pay personal expenses presented a classic breach of fiduciary duty claim that could have been brought derivatively and (ii) that the denial of access to information claim could have been brought under the right to examine and copy records statutorily afforded to a shareholder under the TBCA (now BOC § 21.218), which has been regularly enforced by the courts. *E.g.*, Cotton v. Weatherford Bancshares, Inc., *infra*.

7. Other Cases

Another very recent case, which is interesting on a number of other points, briefly addressed a claim of shareholder oppression. Allen v. Devon Energy Holdings, L.L.C. F/K/A Chief Holdings, L.L.C. and Trevor Rees-Jones (Tex. Civ. App.—Houston [1st Dist.], No. 01-09-00643-CV, March 9, 2012, *no pet. history as of this writing*) (opinion replaced an earlier opinion in the case issued July 28, 2011). The Allen case involved a claim that Chief Holdings and Rees-Jones, Chief's manager and majority owner, fraudulently induced Allen to redeem his LLC membership interest in Chief two years before the company sold for almost 20 times the redemption sales price—several billion dollars. In the context of defendants' motions for summary judgment, the court upheld the fraudulent inducement claim and the common law fraud claim as well as a fiduciary duty breach claim, denying the summary judgment motion on these claims because there were fact issues. The plaintiff, however, lost on his member oppression issue. By implication, the court appears to have recognized an action for member oppression in the LLC context and said whether conduct rose to the level of member oppression was a question of law for the court, citing Willis v. Bydalek, *supra*. But the court said that the conduct alleged in the case before it was not the typical wrongdoing in shareholder oppression cases: The plaintiff was not a terminated employee; the plaintiff was not denied access to company books or records; and there was no allegation that Rees-Jones wrongfully withheld dividends, wasted corporate funds, paid himself excessive compensation or locked the plaintiff out of the corporate offices. Further, the plaintiff presented no evidence that he was squeezed-out of the company. The court said that the plaintiff had successfully raised a fact issue as to his fraud and fiduciary duty claims, but that he had cited no case, nor could the court find one, that extended the shareholder oppression doctrine to include the plaintiff's allegations of the wrongful conduct of fraud by misrepresentations and omissions and breach of fiduciary duty within that doctrine. The court said that the complained-of actions of Chief and Rees-Jones were not similar to the previously recognized examples of shareholder oppression and that the plaintiff had cited no case allowing conduct that is fraudulent or, seemingly importantly and inconsistent with Davis, *supra*, in breach of a fiduciary duty to be the basis of a shareholder oppression claim. The court said that the trial court had properly granted the defendants' summary judgment motion on that issue. Considering

the staggering amount of money involved in the Allen case, it seems likely that there is more to come on that dispute.

It is noted that other cases in addition to those cited above seem to recognize the existence of an individual cause of action for shareholder oppression or oppressive conduct, but they are not wholly consistent with prior cases. Cotton v. Weatherford Bancshares, Inc., 187 S.W.3d 687 (Tex. Civ. App.—Fort Worth 2006, *pet. denied*) (some evidence and therefore fact issue as to whether common shareholder directors oppressed preferred shareholder by improper redemption of preferred shares); Gonzalez v. Greyhound Lines, Inc., 181 S.W.3d 386 (Tex. Civ. App.—El Paso 2005, *pet. denied*) (recitation of definitions but no substantive analysis of oppression claim—plaintiffs had no standing to sue). Bulacher v. Enowa, L.L.C., 2010 WL 1135958 (N.D. Tex.) (memorandum opinion and order) (facts alleged stated a claim for shareholder oppression: dilution of value of minority interest by lowering income, excessive bonuses to defendants, efforts to deny access to information and attempts to repurchase plaintiff's interest at fraction of value); Feldman v. Kim, 2012 WL 50623 (Tex. Civ. App.—Houston [14th Dist.], *no writ*) (memorandum opinion) (Texas recognizes cause of action for shareholder oppression; defendants not entitled to summary judgment because did not conclusively prove that conduct attempting to freeze-out plaintiff from business was not within either definition of shareholder oppression; recognized need to balance minority shareholder's expectations against corporation's need to exercise business judgment); Gibney v. Culver, 2008 WL 1822767 (Tex. Civ. App.—Corpus Christi, *no writ*) (memorandum opinion) (claim for shareholder oppression as typically defined was not supported by evidence of (i) unreasonable compensation to overcome presumption of board decisions on compensation being reasonable and proper, (ii) dividend suppression or (iii) denial of inspection rights as to books and records); In re Rosenbaum, Gage v. Rosenbaum, 2010 WL 1856344 (Bkrpcy. E.D. Tex.) (citing Davis, *supra*, the court said there was no set standard for finding shareholder oppression and that courts took a broad view of the doctrine's application to a closely-held corporation and that here actions by controlling shareholders to induce investment in business and to "raid" assets leaving minority shareholders with worthless stock were oppressive).

8. Fiduciary Duty Breach vs. Shareholder Oppression

Before leaving the "historic" precedent in the area of the shareholder oppression doctrine, it should be noted that there is another confusing group of Texas cases that, like Davis and other cases considered above, seems to mix fiduciary duty breach theories with oppression theories. In Willis v. Donnelly, 118 S.W.3d 10 (Tex. Civ. App.—Houston [14th Dist.], 2003), *rev'd on other grounds*, 199 S.W.3d 262 (Tex. 2006), the court said in the context of a closely held corporation that fiduciary relationships could be created where a majority shareholder dominated control over the business or where shareholders operated more as partners than in strict compliance with the corporate form. *Id*. at 31-32. In that case the court said that there was evidence tending to show that Willis "engaged in oppressive conduct and dominated control over the business". *Id*. at 32. The court cited Willis v. Bydalek, *supra*, for the two definitions of oppressive conduct. The court said there were two actions by defendant which could be construed as purposeful ones "to dilute the value of shares while employing the business and assets solely for his own benefit". 118 S.W.3d at 42. While using "shareholder oppression" language the court affirmed a judgment against the defendant for breach of fiduciary duty.

In Joseph v. Koshy, 2000 WL 124685 (Tex. Civ. App.—Houston [1st Dist.], *no writ*), the plaintiffs asserted causes of action for oppressive conduct, breach of fiduciary duty, fraud and breach of contract against controlling shareholders who were the only officers and directors of a corporation in which plaintiffs were minority shareholders. In keeping with the notion that suits for fiduciary duty had to be brought in a derivative format, the defendants argued that the plaintiffs had brought the suits as individuals and that they did not have standing to do that and that they had failed to comply with the requirements for derivative suits in Texas under Article 5.14 of the TBCA, which was the predecessor to the current provision in the TBOC. The plaintiffs, one of whom had been removed as a corporate officer and director, were complaining about the operation of the corporation and the issuance of new shares of stock in the corporation by defendants' actions. The plaintiffs sought various relief, including an equitable buy-out of their shares. The court said that for pleading purposes it was clear that the plaintiffs had stated causes of action for oppressive conduct, breach of fiduciary duty, etc. The defendants had argued that the plaintiffs had been injured in their capacity as shareholders and that their complaint was for breach of fiduciary duty and that those causes of action belong to the corporation and not to the plaintiffs. Without analysis the court said the plaintiffs had alleged a breach of a fiduciary duty owed to them and oppressive conduct committed against them and that they did not assert any claims on behalf of the corporation, passing over the defense that one of those causes of action—at least the one for fiduciary duty breach—was arguably required to have

been brought on behalf of the corporation. The court went on to say that other courts had recognized minority shareholders' individual causes of action for oppressive conduct and breach of fiduciary duty, citing Davis v. Sheerin, *supra*, and Duncan v. Lichtenberger, *supra*. So the court said that because the causes of action were individual and did not belong to the corporation, the derivative suit scheme in the statute did not apply. The court reversed the trial court's granting of a summary judgment motion for the defendants.

Duncan v. Lichtenberger, *supra*, involved an action by minority shareholders against a majority shareholder seeking reimbursement for their monetary contributions to the corporation on the basis of the majority shareholder's alleged breach of fiduciary duty and fraud. The action was not based on shareholder oppression as such. The facts involved the firing and lockout of two shareholders and an exclusion of their participation in the business. The corporation was a Subchapter S corporation with taxable income that was attributed to all the shareholders, but no dividends were paid to allow shareholders to fund tax obligations. The majority shareholder, on the other hand, received compensation. The court said that after the firing of the two minority shareholders, the defendant Duncan had assumed total control of the corporation and management of it, that no shareholder votes had been taken concerning corporate matters and that no opinions or suggestions from the minority shareholders concerning management of the business were accepted. The court focused on the relationship of *officers and directors* to a corporation as being a fiduciary one, thus imposing upon officers and directors the duty to exercise their powers solely for the benefit of the corporation and its shareholders. The court believed that the only question before it was whether its equitable power could be used in aid of plaintiffs seeking redress for a breach of fiduciary duty. The court cited Patton v. Nicholas, *supra*, and a very old Texas case that appeared marginal on its facts, Kingsbury v. Phillips, 142 S.W. 73 (Tex. Civ. App.—Fort Worth 1911, *no writ*), which said that a *corporate* action existed as to the allegations made, or, alternatively, if the corporation no longer existed, there was an individual action for conversion of plaintiff's interest in the assets of the corporation. The court said that the only distinguishing characteristic between Kingsbury and Patton and the present case was the form of relief prayed for. In this case the plaintiffs had requested judgment against the defendants for restoration of the consideration conveyed by them to the defendant for shares of stock in the corporation. The court said the jury had found that the actions of the defendant had resulted in a breach of fiduciary duty owed to the plaintiffs and that a breach of fiduciary duty was the type of wrong for which the courts of Texas would afford a remedy. So the court said that the evidence at the trial court along with the jury's finding of a breach of fiduciary duty was sufficient to support an award of damages based on the minority shareholders' monetary contributions to the corporation. The court did not discuss the shareholder oppression doctrine, but apparently blessed an individual action for damages relating to a breach of fiduciary duty, even though it said the defendant's conduct was susceptible to a *corporate* action.

In Cotton v. Weatherford Bancshares, Inc., *supra*, a minority shareholder who owned preferred stock in a corporation brought an action for inspection, fraud, breach of fiduciary duty, oppression and civil conspiracy against a corporation and its controlling shareholders. The case is confusing in several regards. In its holdings the court said that the controlling shareholders did not owe minority shareholders a fiduciary duty. Citing several cases, the court said that while corporate officers owed fiduciary duties to the corporation they served, they did not generally owe fiduciary duties to individual shareholders unless a contract or confidential relationship existed between them in addition to the corporate relationship. 187 S.W.3d at 703-04 and citing cases in footnotes 12, 13 and 14. The court said that fiduciary duties may arise from formal and informal relationships and could be created by contract. It said that an informal fiduciary duty could arise from a moral, social, domestic or purely personal relationship of trust and confidence, generally called a confidential relationship. It said that a confidential relationship existed where influence had been acquired and abused and confidence had been extended and betrayed. But it said a person is justified in placing confidence in the belief that another party will act in his own best interest only where he is accustomed to being guided by the judgment or advice of the other party and there exists a long association in a business relationship as well as personal friendship. It said that the relationship had to exist prior to and apart from the matter that was the basis of the suit. The court said that the plaintiff Cotton had presented no evidence of a confidential relationship with the defendants. The court went on to say that fiduciary duties may be owed by those in control of a corporation to preferred shareholders, but those fiduciary duties were found by courts to be based on the articles of incorporation of a corporation as a contract between the corporation and its shareholders. So the court said at the end of its discussion of fiduciary duty liability that the trial court did not err when it granted the defendants' motion for directed verdict on the breach of fiduciary duty claim. The court then addressed the plaintiff's oppression claim. The court noted that the trial court had held as a matter

of law that there could be no oppression between common shareholders and preferred shareholders, but said that the plaintiff's claim was not defeated on the ground of shareholder oppression because the plaintiff was a minority preferred shareholder suing the defendants as directors of a corporation and not as mere shareholders of the corporation. So, citing the traditional definitions of oppression, the court appeared to find the shareholder oppression action available in a suit against *directors* as such, as distinguished from the more typical shareholder oppression case against controlling shareholders. The court said that because the potential existed for oppressive conduct between directors and preferred shareholders, the plaintiff had a cause of action as a preferred shareholder against the directors without identifying the specific form of cause of action as a shareholder oppression case. Confusingly, then, in these regards the court added that there was some evidence to support the plaintiff's oppression cause of action, seemingly distinguishing between an action for oppressive conduct between directors and preferred shareholders and a more traditional pure oppression cause of action against controlling shareholders although what the court meant is not clear. On the latter, the court said the defendants had damaged the interest of the plaintiff, preferred shareholder, by furthering exclusively their own interest as common shareholders. The two individual defendants were also the controlling shareholders of the ultimate parent bank holding company in which plaintiff owned preferred shares. The jury had found that the defendants had improperly redeemed the plaintiff's preferred shares, creating a financial benefit for themselves by decreasing the preferred share dividends that had to be paid out of corporate capital they controlled. The court said that this action raised a fact issue regarding whether the conduct of defendants fitted the second category of oppression—burdensome, harsh or 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—citing Pinnacle, *supra*, and Willis v. Bydalek, *supra*. The court said that it could not hold as a matter of law that there could be no oppression between directors and preferred shareholders and that a directed verdict on that claim was improper.

C. A Note on Delaware Law

The Delaware Court of Chancery has noted that directors may be liable, under certain circumstances, for oppression of minority stockholders. The court first discussed the concept of oppression of the minority in Litle v. Waters, C.A. No. 12155, 18 DEL. J. CORP. L. 315 (Del. Ch. Feb. 10, 1992), noting that one court in New York had defined the term as conduct that is either a "violation of the 'reasonable expectations' of the minority" or " 'burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members; or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely' ". *Id*. (quoting Gimple v. Bolstein, 477 N.Y.S. 2d 1014, 1018 (N.Y. 1984)). The language is familiar because it has been explicitly used in Texas shareholder oppression cases noted above. Litle involved failure to pay dividends to fund tax payments in a Subchapter S corporation context. In Litle the court noted that "few if any cases have involved a set of facts egregious enough to meet…the fraudulent, oppressive or gross abuse of discretion…standard", but it was unable to conclude that plaintiff would not be able to demonstrate at trial oppressive conduct. It denied a motion to dismiss on the oppression claim. The Litle case was referred to in another Delaware case as the only Delaware case that had squarely addressed the issue of oppression. Orloff v. Shulman, 2005 WL 3272355, n. 52 (Del. Ch.). *Id*. at 329-30.

Subsequent to Litle, in Gagliardi v. TriFoods International, 683 A.2d 1049 (Del. Ch. 1996), the Chancery Court noted that, while oppression of minority stockholders may be a valid cause of action in certain circumstances, a plaintiff did not state such a claim where a complaint centered around the board's failure to provide him with information and to enter into certain arrangements with him. Specifically the court found that

> [t]he board has no duty in law or in equity to furnish shareholder information as requested; Section 220 of the Delaware corporation law describes the statutory obligations and it provides a remedy for its violation. The board has no legal or other duty "to enter into arrangements with [a minority shareholder]"; nor does the board have any obligation not to enter into or authorize transactions that will have an effect of diluting his proportionate shareholding; nor does it have a duty not to threaten him with litigation so long as it acts in furtherance of its good faith view of the corporate interest.

Id at 1049. Note that in a provision similar to Delaware General Corporation Law Section 220, § 21.218 of the TBOC grants shareholders broad rights to examine and copy a Texas corporation's relevant books and records, records of account, minutes, etc.

An action can be maintained to enforce such rights without alleging shareholder oppression.

D. Richie v. Rupe

In an attempted summary of rules that may be distilled from the cases prior to Richie v. Rupe, *supra*, the following conduct has been said by Texas courts to raise issues of shareholder oppression—often in some combinations with other listed conduct:

— Conspiracy to deprive a person of his stock ownership in a company
— Receipt of informal dividends by profit sharing to exclusion of a minority shareholder
— Wasting corporate assets by controlling shareholders by using them for their legal fees or otherwise improperly paying controlling holders' legal fees
— Failure to declare dividends or profit distributions to members in LLC and instead paying bonuses or other compensation to corporate officers
— Firing minority shareholders and/or locking them out, coupled with denying shareholders corporate information and withholding dividends while compensating majority shareholders
— Failing to inform minority shareholders of company actions
— Payment of personal expenses of "controllers" with corporate funds coupled with denial of access to corporate financial information
— Wrongful withholding of dividends or dividend suppression
— Payment of excessive compensation to majority shareholder
— Improper redemption of preferred stock
— Attempts to repurchase minority shares at fraction of value and/or dilution of value by lowering income by excessive bonuses coupled with attempts to deny access to corporate information
— Inducing investment followed by "raiding" corporate assets
— Dilution of minority values accompanied by using business assets for personal benefit
— Minority share dilution by issuance of new shares
— Firing and locking out of minority shareholders accompanied by failure to pay dividends in a profitable Subchapter S corporation while compensating majority shareholder, coupled with failure to take shareholder votes and failure to take suggestions from minority shareholders about the business
— Attempting to "freeze-out" minority shareholders

As one considers Richie, it should be noteworthy that none of the conduct previously identified as oppressive was present in the case—at least it was not called out as a basis for the appellate court's ruling. In these regards, then, even if we were to accept the shareholder oppression doctrine as sound for application in some instances, what we knew about it before could not predict the Richie holding. So it is not surprising that from many quarters of knowledgeable Texas lawyers the Richie case appeared to be an extreme departure from precedent and an invitation for open season to unhappy minority shareholders of closely held corporations with grievances against their corporations and their controlling persons as to their minority status. In this regard and in light of the expansion of the cause of action as well as its debatable origins in Texas, the Richie case seems like a good opportunity for the Texas Supreme Court to address the doctrine of shareholder oppression and, if it upholds such a cause of action, at least an opportunity is presented to put more definitive and predictable parameters on that cause of action and, perhaps, to clarify the relationship of fiduciary duty breach claims and shareholder oppression claims. While the Texas Supreme Court initially denied a petition for review of the Dallas Court of Appeals' decision in Richie (Tex. Sup. Ct. J. 1544 (August 12, 2011)), as of this writing, the appellants are continuing the process of asking for a rehearing on the denial of the petition, and the order denying petition for review was withdrawn after appellants' arguments for reconsideration; the motion for rehearing was granted while the petition for review still remains pending before the Supreme Court (55 Sup. Ct. J. (March 2, 2012)).

The Richie case involved claims for shareholder oppression filed by a minority shareholder in a closely held corporation, Rupe Investment Corporation ("RIC"). The trial court determined that the plaintiff minority shareholder, Ann Rupe acting as trustee for a family trust, had been subjected to shareholder oppression by RIC and some of its shareholders and directors. The trial court ordered RIC to redeem the trust's stock in RIC for $7.3 million, which a jury had found to be that stock's fair value. The trial court also awarded the trust attorney's fees. The appellate court reversed trial court holdings with respect to attorney's fees and also with respect to the amount to be paid by RIC—*i.e.*, the "fair value"—for the trust's stock, but it affirmed the rest of the trial court's judgment, including the findings of shareholder oppression and the ordered buy-out of the trust's shares.

Family members of the Rupe and Richie families were the principal shareholders of RIC at the time of the dispute at which time the plaintiff trust owned approximately 18% of the stock of RIC. The other family members and trusts for family members owned approximately 74% of the stock, with the 8% balance being said by the court not to be relevant to the dispute.

The overriding dispute centered around the plaintiff trust's efforts to sell its stock in RIC to third parties. There was no shareholders' agreement or buy-sell agreement, right of first offer or other restriction on the sale of the trust's stock to third parties. After unsuccessful efforts by the plaintiff trust to get RIC to buy the stock at an acceptable price, the plaintiff trust sought to market the stock to third parties with the help of a financial advisor. The trustee was informed, however, that the members of RIC's management would not meet with any prospective purchasers of the stock—the author understands that the management was, with the benefit of specific legal advice, concerned about potential securities law claims or other similar claims should the management or RIC itself participate in the plaintiff trustee's sales efforts and should a third-party purchaser become unhappy with the investment. The plaintiff's financial expert testified at trial that management's refusal to meet with prospective investors made the stock impossible to sell. Based on jury findings with respect to the conduct of the defendants, the trial court concluded as a matter of law that the defendants had acted oppressively towards the plaintiff trust in several respects, including their refusal to cooperate with the trust's attempts to sell the stock to a third party. The trial court also concluded that the defendants had acted oppressively in several other respects, but these actions noted below were not developed in the appellate court's opinion and it is, therefore, not possible to analyze them:

- Causing RIC to withhold corporate books and records from the trustee
- Making redemption offers to the trustee that were not in accordance with RIC's policy
- Making the trustee a conditional offer to be placed on the board of directors in exchange for her not pursuing legal action against another RIC shareholder
- Causing RIC to pay some personal expenses of one of the defendants.

As is so often the case in the Texas appellate process, the defendants were largely unsuccessful in getting the appellate court to disregard the trial court's findings of fact that were certainly in part based on the jury verdict. Still, the defendants contended that the trial court's judgment should be reversed and rendered for the defendants because the court-ordered buy-back of the stock was not an available remedy for shareholder oppression under Texas law, the actions of the defendants did not constitute shareholder oppression as a matter of law and the buy-out remedy was inappropriate because it was unduly harsh under the circumstances. The court of appeals agreed that whether specific conduct constituted shareholder oppression was a question of law, citing Willis v. Bydalek, *supra*. It further said that the buy-back order was an exercise of its equitable authority by the trial court, that courts exercise broad discretion in ordering equitable relief and that the applicable standard of review as to equitable relief granted by a trial court was "abuse of discretion". The defendants argued in the appeal that the only relief available for shareholder oppression under Texas law was the appointment of a receiver—see TBCA Article 7.05 noted above as now contained in the TBOC—and that if the Texas legislature had intended to create an oppression cause of action for relief other than receivership, it would have done so clearly and directly. But the appeals court stated that the statute itself said that the receivership remedy was available only if all other remedies available at law or in equity were determined to be inadequate and, thus, that receivership was a remedy for shareholder oppression only as a last resort in the event that other less drastic remedies were inadequate. So the appeals court said that Article 7.05 envisioned that other remedies were available and, if adequate, were preferable to the remedy of appointing a receiver. The court cited the Patton case in support of this conclusion, but note that (i) the Patton case was dealing with the "malicious suppression of dividends", (ii) it was not addressing conduct specifically addressed in a subsequently adopted statute, *i.e.* "oppressive" actions of governing persons and (iii) there was no statute at all in effect at the time of Patton that provided for a receivership for "oppressive" actions or for anything else as to "oppressive" acts. Also note that RIC actually had a history of paying dividends to its shareholders. 339 S.W. 3d at 296, n. 38. In any event, the court in Richie, as might be expected, turned to the Davis case as authority for the power of courts of equity to fashion an appropriate remedy for oppressive conduct, including a buy-out order. The appeals court in Richie seemed impressed by the fact that the Davis court (339 S.W.3d at 286, n. 15) had recited that the legislatures of six other states had expressly authorized the buy-out of an aggrieved minority shareholder—a proposition that seems to cut exactly the opposite way since there is no Texas statutory authority for such a remedy and other states must have thought statutory authority was necessary for such a remedy or they would not have bothered to include it in their statutes. So the court rejected the defendants' argument that a buy-out order was inappropriate because it departed from the only equitable remedies permitted by the TBCA, saying that the text of Article 7.05 and the underlying holdings in Patton and Davis carried the day. The court attempted to distinguish a Massachusetts case which had held that there was nothing in the background law, the

governing documents of the particular close corporation before it (such as shareholder agreements or charter provisions) or any other circumstance that could have given the plaintiff in that case a reasonable expectation of having her shares bought out by the company. In conclusion on the issue of the remedy, the court of appeals said that Texas law authorized the trial court, in an appropriate case, to order a buy-out of an oppressed minority shareholder as an equitable remedy.

The court then turned to the question whether the defendants' conduct concerning the trust's efforts to sell its stock was oppressive, calling this the "heart of the case". 339 S.W.3d at 289. Citing Texas cases discussed above, the court repeated the "two non-exclusive definitions for shareholder oppression". *Id.* The court said that the jury determines what acts occurred (assuming facts were in dispute), but whether those acts constituted shareholder oppression was a question of law for the court, again citing cases discussed above. The court acknowledged that in deciding whether conduct rises to the level of oppression, courts must exercise caution, balancing the minority shareholder's reasonable expectations against the corporation's need to exercise its business judgment and run its business efficiently, citing Willis v. Bydalek, *supra*. But it said, citing Davis, that courts took an especially "broad view of the application of oppressive conduct to a closely held corporation, where oppression maybe more easily found". *Id.* at 289. The court also rejected the defendants' argument that shareholder oppression could not exist absent a majority shareholder—which is a stipulated element in one of the two definitions of shareholder oppression—lumping all the defendants together as directors and shareholders and saying they were in control of the corporation. Again, then, it rejected the defendants' argument that there can be no shareholder oppression absent a single majority shareholder who commits it even though one of the two definitions cited referred specifically to "majority shareholder" conduct.

The court then gave attention to that definition of shareholder oppression, *i.e.*, *majority* shareholder conduct that substantially defeated 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. (Note that in this case there had been no "decision to join the venture": The plaintiff trust had acquired its interest by gift, devise or descent not by an investment or other decision.) In this discussion, the court turned wholly to secondary writings by academics to support its conclusions about the defeat of minority expectations, distinguishing "specific expectations" from "general expectations"—academically created terms. But it cited numerous cases with respect to the expectation of any property owner—including the owner of stock in a corporation—being the right of free alienation of that property, a bed-rock proposition of American law that all would agree with. In this case, however, there had been no attempt by the defendants to restrain the plaintiff trust's efforts to sell its stock: There had been no interference with free alienation. Curiously, in a footnote that seems oxymoronic with its holding ordering a buy-out the court said with respect to stock in a closely held corporation

> Often the parties most interested in acquiring the minority shareholder's interest in a closely held corporation are the corporation itself or its other shareholders. However, generally—as is the case here—they have no obligation to offer to purchase, purchase, or market the minority shareholder's stock absent a valid restriction on transfer.

Id. at 293, n.33. The court said—as is usually the case and as would actually, in the author's experience, be the normal expectation of a stockholder in a closely held corporation absent a shareholder agreement—that there was often no ready market to sell stock in a closely held corporation to third parties and that, assuming there were no restrictions on transfer, the seller would have to identify third-party buyers through various means and then provide those potential buyers with information about the corporation and its businesses, assets "and management" so as to allow them to conduct a reasonable investigation as to the proposed transaction. The court said that corporate policies that constructively prohibit a shareholder from performing these activities would substantially defeat the shareholder's general reasonable expectation of being able to market the unrestricted stock. It is noted that the consideration of the case by the Court of Appeals is devoid of any indication that the plaintiff shareholder was denied the opportunity to have access to the corporation's books and records and financial statements, etc. and to make extracts (copies) thereof, as the stockholder would clearly be entitled to do under applicable Texas statutory law, as noted above in this paper. Nor did the court note the silence of such Texas shareholder inspection rights statute (now TBOC § 21.218), or even any mention therein, as to any right of access to management for any purpose, much less a right to require management availability for discussions with a third-party prospective buyer.

The court then turned to the second definition of shareholder oppression, *i.e.*, burdensome, harsh or 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. This definition, the court said, focused on the conduct of those in control of the corporation more than on the expectations of the minority shareholder. Citing a case that had nothing to do with shareholder oppression—Sandor Petroleum Corp. v. Williams, 321 S.W.2d 614 (Tex. Civ. App.—Eastland 1959, *writ ref'd n.r.e.*) (wrongful cancelation of unrestricted stock certificate)—the court said that standards of fair dealing with respect to the owner of unrestricted stock would include a requirement that the controlling persons act fairly and reasonably in connection with a shareholder's efforts to sell that stock to a third party and not adopt policies that unreasonably restrain or prohibit the sale or transfer of the stock or that deprive the owner of its fair market value. In a giant leap at odds with the long understood notion of what it means to be a minority shareholder in a close corporation, and without citing any authority, the court said that a holder of unrestricted stock in a closely held corporation has a general reasonable expectation of being able market her stock to third parties and that it was also reasonable to expect that the corporation and its management (as part of the standards of fair dealing on which all shareholders are entitled to rely) would consent to a shareholder's reasonable request for cooperation with respect to her efforts to sell the stock. In reaching that conclusion, the court noted the business judgment rule as articulated in Gearhart, but said this was not a derivative suit for breach of the duty of care owed to the corporation. In this regard it said that the directors of RIC were not held personally liable for shareholder oppression and the directors and those controlling the corporation were not directed to buy the stock back themselves. Instead, the trial court's judgment ordered them as directors of the corporation and as trustees of a majority in interest of the shareholders to cause RIC to redeem the stock, failing to note that such order was a direct interference with director business judgment under circumstances where there was no cited evidence that previous decisions of the board were not disinterested and independent and thus not eligible for business judgment protection. Thus it said that the business judgment rule had no application to the case. In this regard, the court appeared to reject the possibility of a good faith judgment that the corporation and its directors and controlling shareholders should not, based on legal considerations, enter into the process of selling stock of the corporation as to which securities and common law responsibilities would attach. The court also rejected the applicability of the point established by Willis v. Bydalek, *supra*, that minority shareholders had to balance their expectations against a corporation's need to exercise business judgment. Moreover, there was no mention of the TBCA provision (now TBOC § 21.401 quoted in Section I.A. hereof), which gives strong emphasis to directors' consideration of the best interests of a corporation on a long-term or short-term basis. The court said the corporation's interest in managing its affairs—or to minimize the possibility of litigation, presumably securities litigation—did not include the right to substantially defeat the reasonable expectation of the minority shareholder to effectively market its unrestricted stock in the corporation. On this point the court seemed to be saying that, by their failure to help the plaintiff market the stock, those in control had taken from the holder of unrestricted stock the value of the stock. Incidentally, it appears that those in control were advised by counsel that they were inviting potential claims by a possible unhappy third-party purchaser, presumably securities law or fraud claims, by assisting the plaintiff in marketing the stock. On this point the court said that there was no authority that reliance on the advice of counsel was an absolute defense to claims of shareholder oppression, ignoring without mention the right of directors in making decisions to rely on legal counsel as provided by the TBCA predecessor to TBOC § 3.102 quoted in Section I.A. It should also be observed that a majority of the shares of RIC were held by other trusts for Rupe and Richie family members. Those trusts were represented by their trustees who served on RIC's board, and those trustees might well have felt that it was their fiduciary duty to their trusts not to deplete the corporate assets of the principal trust asset, *i.e.*, ownership of RIC, by buying out one shareholder's substantial interest in RIC for cash. Finally, no mention was made of the reasonable and normal expectation of family members in a closely-held family corporation not to have to actively participate in inviting a stranger into their family owned and run business.

In summary, the court concluded that the defendants acted oppressively toward the plaintiff trust by refusing to meet, or allowing any officer or director of RIC to meet, with prospective purchasers of the stock because that conduct substantially defeated the trust's general reasonable expectation of marketing the stock. The court said it also concluded that the refusal to meet with potential purchasers of the stock was oppressive because it was a visible departure from the standards of fair dealing and a violation of fair play on which each shareholder was entitled to rely, citing Willis v. Bydalek for a proposition not covered thereby. The court, giving "lip service" but no substantive effect to the notions embodied in Willis v. Bydalek as well as in the Patton case, said that in reaching those conclusions it recognized that the rights of a minority shareholder and the concomitant obligation of the directors or those in control were not unlimited and that those in control of the corporation were not required to seek potential purchasers for the

minority shareholder's stock or otherwise market the stock on the minority shareholder's behalf, ignoring the fact that assistance in marketing was exactly what the plaintiff sought. Further, the court said, those in control need not agree to a request that would unduly disrupt or affect the operation of the business or intrude into issues reserved for the corporation's officers and directors. Additionally, it said a shareholder could not request the corporation's management to speak or act in a manner that would tend to inflate the value of the stock in the corporation, and the shareholder may not request that management mislead potential investors. Finally, it said that reasonable restrictions on the access to and use of business information or property, depending on the nature of the business, would normally be acceptable. In this regard the corporation's management could place reasonable limitations on the corporation's cooperation, including limiting the time spent with potential investors and requiring them to sign confidentiality agreements that protect the company's interests while permitting reasonable due diligence. These very articulations on the limits of director and management obligations to a minority shareholder offer powerful reasons for the court to have concluded exactly opposite to its holding in the case and surely point up the result labeling engaged in by the court—to paraphrase Justice Potter Stewart, "it knew shareholder oppression when it saw it".

After concluding that the defendants had engaged in oppressive conduct, the court went on to consider whether the buy-out remedy was an abuse of discretion because it was unduly harsh. In this regard, the court said that it could not say that the trial court's order as to the buy-out as an equitable remedy was so harsh as to constitute an abuse of discretion.

As they are ancillary issues to the heart of the case, this paper will not address the court's discussion of stock valuation and the attorneys fees issues.

As of this writing, reconsideration of the extraordinary holding and reasoning of Richie v. Rupe by the Texas Supreme Court is still possible.