FIDUCIARY DUTIES OF PARTNERS, MEMBERS & MANAGERS

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I. INTRODUCTION

The sum and substance of the fiduciary duty is the duty to place the interests of one or more other parties before his or her own. This is the highest duty imposed in law, and it logically applies to limited categories of relationships. Where a fiduciary duty exists, the compliance burden is very high. Parties in litigation often dispute the existence of the relationship as well as its substance. Increasingly, parties seek to limit the scope of fiduciary duties by contract before litigation arises. This article will address these efforts as well as the scope of the fiduciary duty in partnerships, limited partnerships and limited liability companies. Finally, the article will address causes of action related to fiduciary duty issues in smaller companies, specifically, aiding and abetting a breach of fiduciary duty and shareholder oppression.

The classic expression of the fiduciary duty under Texas law was stated by the Supreme Court in *Kinzbach Tool Co. v. Corbett-Wallace Corp*, 160 S.W.2d 509, 512 (Tex. 1942):

> The term 'fiduciary' is derived from the civil law. It is impossible to give a definition of the term that is comprehensive enough to cover all cases. Generally speaking, it applies to any person who occupies a position of peculiar confidence towards another. It refers to integrity and fidelity. It contemplates fair dealing and good faith, rather than legal obligation, as the basis of the transaction.

II. THE EXISTENCE OF FIDUCIARY DUTIES IN PARTNERSHIPS AND LLCS

A. Partnerships

The Texas Supreme Court has recognized that certain relationships give rise to a "fiduciary" duty as a matter of law. *See, e.g.,Kinzbach Tool Co.* 160 S.W.2d at 513 (1942) (principal/agent); *Johnson v. Peckham*, 120 S.W.2d 786, 787 (1938) (partners). Partners in a general partnership owe each other a fiduciary duty. *M.R. Champion v. Mizell*, 904 S.W.2d 617, 618 (Tex.1995).

B. Limited Partnerships

In a limited partnership, the general partner has a fiduciary duty to the limited partners. *Watson v. Limited Partners of WKCT, Ltd*., 520 S.W. 179, 182 (Tex.App.—Austin 1978, no writ). The general partner has the burden of dispelling "all doubts concerning his conduct toward the partnership or the other partners, and if he is unable to carry this burden all doubts will ordinarily be resolved against him. . . . He owes the duty to keep an accurate account of his transactions with or for the partnership, and, if he fails to keep such account, all doubts respecting particular items will ordinarily be resolved against him." *Conrad v. Judson*, 465 S.W.2d 819, 828 (Tex.Civ.App—Dallas 1971, writ ref'd n.r.e.), cert. den., 405 U.S. 1041 (1972). The general partner has the duty to administer partnership affairs solely for the benefit of the partnership. *Crenshaw v. Swenson*, 611 SW 2d 886, 890 (Tex.Civ.App.— Austin 1980, writ ref'd n.r.e.).

The First Court of Appeals recently concluded that when a limited partner exercises control over the entity's operating affairs, he will also owe a fiduciary duty to the other limited partners. *Strebel v. Wimberly*, 367 S.W.3d 267, 281 (Tex.App.-Houston [1st Dist.] 2012). While a limited partner does not normally owe a fiduciary duty, such a duty "spring[s] into existence when a limited partner ... wearing a different hat, exerts operating control over the affairs of the limited partnership." *Id*.

C. Limited Liability Companies

The case law on fiduciary duties in LLCs is thin. The First Court of Appeals, in *Allen v. Devon Energy Holdings*, 367 S.W.3d 355, 391 (Tex. App.—Houston [1st Dist.] 2012), declined to recognize as a matter of law a fiduciary duty between members of an LLC. The Court's holding was based on its determination that Texas law did not impose a fiduciary duty, as a matter of law, on a majority shareholder to a minority shareholder in a closely-held corporation.

The Court cited numerous cases for this proposition. See, e.g., *Willis v. Donnelly*, 118 S.W.3d 10, 31 (Tex. App.—Houston [14th Dist.] 2003) (op. on reh'g), rev'd on other grounds, 199 S.W.3d 262 (Tex. 2006) (holding that shareholder in closely-held corporation does not owe formal fiduciary duty to co-shareholders but could owe informal fiduciary duty under certain circumstances); *Pabich v. Kellar*, 71 S.W.3d 500, 504–05 (Tex.App.-Fort Worth 2002, pet. denied) (same); *Hoggett v. Brown*, 971 S.W.2d 472, 487–88 (Tex.App.-Houston [14th Dist.] 1997, pet. denied) (same); *Kaspar v. Thorne*, 755 S.W.2d 151, 155 (Tex.App.-Dallas 1988, no writ) (reversing judgment for plaintiff because shareholder in closely-held corporation did not owe co-shareholder fiduciary duty as matter of law and jury was not asked to find an informal fiduciary duty).

The First Court then analogized LLCs to partnerships:

> "An LLC may be run by its members collectively, like a general partnership, or it may be run by one or more manager-members, like a limited partnership."

367 S.W.3d at 392. The Court then concluded that "there is a formal fiduciary duty when (1) the alleged-fiduciary has a legal right of control and exercises that control by virtue of his status as the majority owner and sole member-manager of a closely-held LLC and (2) either purchases a minority shareholder's interest or causes the LLC to do so through a redemption when the result of the redemption is an increased ownership interest for the majority owner and sole manager." *Id.* at 396. In addition, the company's governing articles expressly created a "duty of loyalty" running from the manager to the members. *Id.*

The Court's conclusion was supported by similar cases involving closely held corporations. See *Fisher v. Yates*, 953 S.W.2d 370, 379 (Tex.App.-Texarkana 1997, pet. denied) (stating that if company director had inside information that company was "about to be acquired, he stood in a fiduciary relationship" to minority shareholders with duty to disclose such information); and *Gaither v. Moody*, 528 S.W.2d 875, 876 (Tex. Civ.App.-Houston [14th Dist.] 1975, writ ref'd n.r.e.) (holding that director and majority shareholder of corporation that solicited proxies for merger had fiduciary relationship with minority shareholders).

D. Informal Relationships

Well-settled common law establishes that "informal relationships" may be a source of fiduciary duties even when the duty does not exist "as a matter of law." Certain informal relationships may give rise to a fiduciary duty. *See, e.g., MacDonald v. Follett,* 142 Tex. 616, 180 S.W.2d 334 (1944). These types of informal fiduciary relationships have also been termed "confidential relationships" and may arise "where one person trusts in and relies upon another, whether the relation is a moral, social, domestic or merely personal one." *Fitz–Gerald v. Hull,* 150 Tex. 39, 237 S.W.2d 256, 261 (1951). The law recognizes the existence of confidential relationships in those cases "in which influence has been acquired and abused, in which confidence has been reposed and betrayed." *Texas Bank & Trust Co. v. Moore,* 595 S.W.2d 502, 507 (Tex.1980).

Informal fiduciary duties are not lightly created. "A fiduciary relationship is an extraordinary one…the mere fact that one subjectively trusts another does not alone indicate that confidence is placed in another in the sense demanded by fiduciary relationships because something apart from the transaction between the parties is required." *Kline v. O'Quinn*, 874 S.W.2d 776, 786 (Tex.App.-Houston [14th Dist.] 1994, writ denied). Facts indicating greater control by one party can be the basis for an informal fiduciary. See *Redmon v. Griffith*, 202 S.W.3d 225, 237 (Tex.App.-Tyler 2006, pet. denied); and *Vejara v. Levior International, LLC,* 2012 WL 5354681 at *5 (Tex.App.—San Antonio, 2012, no pet.). In order establish such a relationship, a party must show "he or she is accustomed to being guided by the judgment or advice of the other party." *Gregan v. Kelly*, 355 S.W.3d 223, 228 (Tex.App.—Houston [1st Dist. 2011, no pet.) There must exist a long association in a business relationship, as well as personal friendship. *Id.* (citing *Hoggett v. Brown*, 971 S.W.2d 472, 488 (Tex.App.-Houston [14th Dist.] 1997, pet. denied).

III. BREACH OF FIDUCIARY DUTY CAUSE OF ACTION

A. Elements of a Cause of Action

The elements of a breach of fiduciary duty claim are:

(1) a fiduciary relationship between the plaintiff and defendant,
(2) a breach by the defendant of his fiduciary duty to the plaintiff, and
(3) an injury to the plaintiff or benefit to the defendant as a result of the defendant's breach..

Lundy v. Masson, 260 S.W.3d 482, 501 (Tex.App.-Houston [14th Dist.] 2008, pet. denied) citing *Jones v. Blume*, 196 S.W.3d 440, 447 (Tex.App.-Dallas 2006, pet. denied) and *Punts v. Wilson*, 137 S.W.3d 889, 891 (Tex.App.-Texarkana 2004, no pet.).

B. Standard of Review

The existence of a formal fiduciary relationship is a matter of law. *Crim Truck & Tractor Co. v. Navistar Intern. Transp. Corp.*, 823 S.W.2d 591, 593 (Tex. 1992). The existence of a confidential—or informal fiduciary—relationship is ordinarily a question of fact for the jury. *Lundy*, 260 S.W.3d at 502. Any jury finding of such a duty will be reviewed for factual sufficiency. *Schlumberger Technology Corp. v. Swanson*, 959 S.W.2d 171, 175 (Tex. 1997). When the issue is one of no evidence, it becomes a question of law. *Crim Truck*, 823 S.W.2d at 594.

C. Substance and Scope of Fiduciary Duties

There is a general prohibition against the fiduciary using the relationship to benefit his personal interest, except with the full knowledge and consent of the parties to whom the duty is owed. *Chien v. Chen*, 759 S.W.2d 484, 495 (Tex.App.—Austin 1988, no writ). This is often referred to as the duty to refrain from self-dealing.

A fiduciary duty encompasses at the very minimum a duty of good faith and fair dealing. *Crim Truck*, 823 S.W.2d at 594. The duty of loyalty is also a fiduciary duty. *Allen v. Devon Energy Holdings*, 367 S.W.3d at 397. See also, *Bohatch v. Butler & Binion*, 977 S.W.2d 543, 545 (Tex.1998) ("We have long recognized as a matter of common law that "[t]he relationship between ... partners ... is fiduciary in character, and imposes upon all the participants the obligation of loyalty to the joint concern and of the utmost good faith, fairness, and honesty in their dealings with each other with respect to matters pertaining to the enterprise.")

Ordinarily, a fiduciary duty of full disclosure requires disclosure of all material facts known to the fiduciary that might affect the rights of the person to whom the duty is owed. *Home Loan Corp. v. Texas American Title Co.*, 191 S.W.3d 728, 731 (Tex.App.—Houston [14th Dist.] 2006, pet. denied). A fiduciary also "owes its principal a high duty of good faith, fair dealing, honest performance, and strict accountability." *Ludlow v. DeBerry*, 959 S.W.2d 265, 279 (Tex.App.-Houston [14th Dist.] 1997, no writ).

Fiduciary duties in partnerships include the duty to account for all profits and property and to refrain from competition with the partnership. *Hawthorne v. Guenther*, 917 S.W.2d 924, 934 (Tex.App.—Beaumont 1996, writ denied). The fiduciary duty has also been described as including "a strict duty of 'good faith and candor.'" *Id.*

D. The Texas Pattern Jury Charge

The Texas Pattern Jury Charge (PJC 104.2) contains the most complete explanation of the substance of fiduciary duties:

> To prove he complied with his duty, Don Davis must show:
>
> (1) the transaction in question was fair and equitable to Paul Payne;
> (2) Don Davis made reasonable use of the confidence that Paul Payne placed in him;
> (3) Don Davis acted in the utmost good faith and exercised the most scrupulous honesty toward Paul Payne;
> (4) Don Davis placed the interests of Paul Payne before his own, did not use the advantage of his position to gain any benefit for himself at the expense of Paul Payne, and did not place himself in any position where his self-interest might conflict with his obligations as a fiduciary; and
> (5) Don Davis fully and fairly disclosed all important information to Paul Payne concerning the transaction.

PJC 104.2 is the proper instruction whether the underlying duty is formal (i.e., exists as a matter of law) or informal. A predicate question as to the existence of a fiduciary duty is necessary when the duty is disputed.

The interesting twist in the instruction is that the fiduciary—normally the defendant—initially bears the burden of persuasion. This is because a rebuttable presumption of unfairness or invalidity attaches to any transactions involving a fiduciary. *Keck, Mahin & Cate v. National Union Fire Insurance Co. of Pittsburgh*, 20 S.W.3d 692, 699 (Tex. 2000).

The fiduciary can rebut the presumption of unfairness by offering evidence, for example, that the plaintiff was fully informed of the transaction, had competent legal advice, and asked questions about the transaction. *Stephens County Museum, Inc. v. Swenson*, 517 SW 2d 257, 261 (Tex. 1974). In such a case, both the burden of persuasion and the burden of producing evidence would shift to the plaintiff. *Sorrell v. Elsey*, 748 S.W.2d 584, 586 (Tex. App.—San Antonio 1988, writ denied).

IV. LIMITING THE SCOPE OF THE FIDUCIARY DUTY

A. Limiting the Scope by Agreement

As early as 1946, the Texas Supreme Court noted that the scope of fiduciary duties could be limited by the agreement between the parties. In *Warner v. Winn*, 197 S.W.2d 338, 342 (Tex. 1942), the Court noted that the parties had drawn an agreement that strictly limited their relationship to "the development of certain specified and carefully described areas held under certain named and well identified leases and for the production and sale of gas from the several tracts of land described in those leases." *Id.* The Court noted that the parties agreed that the contract "constituted the full agreement between the parties." *Id.* As a consequence, one of the partners was not breaching any fiduciary duty to the other "when he acquired the lease of Share 4 and made a contract for the production of gas from it." *Id.* at 343. The Court affirmed the trial court's judgment even though production from the separate well would be from the same reservoir as the partnership's other wells. *Id.* A carefully drawn agreement can, therefore, limit the scope of a one fiduciary's duty to the other.

In *National Plan Administrators, Inc. v. National Health Ins. Co.*, 235 S.W.3d 695, 701 (Tex. 2007), the Court noted that "an agency relationship imposes certain fiduciary duties on the parties." In that case, the plaintiff insurance underwriter contracted with an

administrator to perform third-party administration duties for cancer insurance policies. The insurer claimed that the administrator had violated its fiduciary duty by "rolling" its cancer policies to another insurer and effectively gutting its efforts to sell its business. The Supreme Court noted that "duties owed by an agent to his or her principal may be altered by agreement." *Id*. "[F]actors which must be taken into consideration when determining the scope of an agent's fiduciary duty to his or her principal include not only the nature and purpose of the relationship, but also agreements between the agent and principal." *Id*. at 702. The Court held that the relationship between the parties was an "arms-length business transaction" that did not impose a "general fiduciary duty" on the administrator. *Id*.

In. *Home Loan Corp. v. Texas American Title Co.*, 191 S.W.3d at 732, the court stated that "fiduciary duties arise as a matter of law" and that a fiduciary's duties must be measured by a higher standard than "ordinary contractual dealings." While those standards could not be "whittled down by exceptions," (citing *Slay v. Burnett Trust*, 187 S.W.2d 377, 387-388 (Tex. 1945)), a fiduciary's duties may sometimes be expressly limited by contract. (citing *Sterling Trust Co. v. Adderley*, 168 S.W.3d 835, 847 (Tex.2005)).

In *Sterling Trust Co.*, the fiduciary defendant objected to the jury instruction on fiduciary duty because it failed to reflect Sterling's contractual limitation of its fiduciary duties. *Id* at 846-847. The court recognized that the agreement at issue provided that provided that "Sterling Trust has no responsibility to question any investment directions given by the individual regardless of the nature of the investment," and that "Sterling Trust is in no way responsible for providing investment advice." *Id*. The Court held that the failure to account for these contractual limitations rendered the jury instruction defective. *Id*.

B. Attempts to Apply the Economic Loss Rule

At least two courts have attempted to apply the notoriously imprecise "economic loss" rule to limit fiduciary duties. In *Fish v. Texas Legislative Service*, 2012 WL 254613 (Tex.App.—Austin 2012, no pet.), the plaintiff sued two majority partners in general partnership. The Court held that the plaintiff's claims were time-barred and—to the extent they were not time-barred—they are barred by the "economic loss" rule. The basis for this ruling appeared to be that "the partnership agreement governs the relationship between the parties." *Id.* at *15. The Court failed to engage in any detailed analysis of the partnership agreement to determine whether it "whittles down" or expressly limits the fiduciary duties associated with general partnerships. See also, *Thomason v. Collins & Aikman Floorcoverings, Inc.* 2004 WL 624926 (Tex.App.—San Antonio 2004, pet. denied) (finding no evidence of a fiduciary duty where the plaintiff sued to recover commissions based on a contract).

In contrast, another court of appeals held that a limited partner violated his fiduciary duty to the partnership without violating the partnership agreement. See *Daniels v. Empty Eye, Inc*., 368 S.W.3d 743 (Tex. App.—Houston [14th Dist.] 2012, pet. denied). The Court affirmed the jury's finding that a limited partner had an informal fiduciary relationship with the partnership and affirmed an award of damages based on his removal of a personal guaranty for the partnership's debts. *Id*. at 750-751. The Court then overturned the breach of contract finding because "[n]othing in the Limited Partnership Agreement required Jiles to act as the Limited Partnership's guarantor or restricted his right to rescind the guaranty." *Id*. at 752. In other words, the Court held that the existence of a partnership agreement did not, by itself, preclude a breach of fiduciary duty claim.

C. A Simple Rule

The simplest rule for analyzing contractual limitations on fiduciary duties is that "courts [will] consider all aspects of the parties' relationship when determining the nature of fiduciary duties flowing between the parties." *National Plan Admr's*, 235 S.W.3d at 700. When determining the scope of an agent's fiduciary duty to his principal, courts must examine "not only the nature and purpose of the relationship, but also agreements between the agent and principal." *Id*. While this is an imprecise formulation, "fiduciary duties are equitable in nature and generally not subject to hard and fast rules." *Id*. at 702. A reasonable general rule would seem to be that common law fiduciary standards govern except where expressly contradicted by agreement.

V. FIDUCIARY DUTIES IN PARTNERSHIPS

A. Source of Fiduciary Duties

Partners in a general partnership owe a fiduciary duty to each other as well as to the partnership. *M.R. Champion v. Mizell*, 904 S.W.2d 617, 618 (Tex. 1995); *Gregan v. Kelly, 355 S.W.3d 223, 227–28 (Tex. App.-Houston [1st Dist.] 2011, no pet.)*. See also Tex. Bus. Org. Code § 152.210 ("A partner is liable to a partnership and the other partners for: (2) a violation of a duty to the partnership…").

A partnership is a unique business entity in that it can arise informally without a written agreement. When the partners do not have a written agreement, or when the written agreement lacks material terms, the Texas Revised Partnership Act, now found at Tex. Bus. Org. Code § 152, supplies the essential missing terms. See Tex. Bus. Org Code § 152.002(a) ("To the extent that the partnership agreement does not otherwise provide, this chapter and the other partnership

provisions govern the relationship of the partners and between the partners and the partnership.")

Under the Texas Revised Partnership Act, Tex. Bus. Org. Code § 152.001, et. seq., a general partnership agreement may not eliminate the duties of care, loyalty, and good faith except by establishing standards that "are not manifestly unreasonable." See § 152.002(b)(2)-(4). See also, Tex. Bus. Org. Code § 152.204 ("General Standards of Partner's Conduct."

The duty of loyalty is defined by statute:

> A partner's duty of loyalty includes:
>
> (1) accounting to and holding for the partnership property, profit, or benefit derived by the partner:
>
> (A) in the conduct and winding up of the partnership business; or
> (B) from use by the partner of partnership property;
>
> (2) refraining from dealing with the partnership on behalf of a person who has an interest adverse to the partnership; and
> (3) refraining from competing or dealing with the partnership in a manner adverse to the partnership.

Tex. Bus. Org. Code § 152.205.

The duty of care is defined, but in a less specific manner:

> "A partner's duty of care to the partnership and the other partners is to act in the conduct and winding up of the partnership business with the care an ordinarily prudent person would exercise in similar circumstances."

Tex. Bus. Org. Code § 152.206.

The duty of good faith is similarly defined:

> "A partner shall discharge the partner's duties to the partnership and the other partners under this code or under the partnership agreement and exercise any rights and powers in the conduct or winding up of the partnership business:
>
> (1) in good faith; and
> (2) in a manner the partner reasonably believes to be in the best interest of the partnership."

Tex. Bus. Org. Code § 152.204(b).

B. Partner Agreements Govern the Parties

Both the partnership statute and the case law allow for a written agreement to govern the partners' relationships to each other as well as to the partnership. *Bailey and Williams v. Westfall*, 727 S.W.2d 86, 91 Tex. App.—Dallas 1987, writ refused n.r.e.). The partnership statute only comes into play where the partners' agreement is silent. *Dobson v. Dobson*, 594 S.W.2d 177, 180 (Tex.Civ.App.—Houston [1st Dist.] 1980, writ refused n.r.e.) citing *Park Cities Corporation v. Byrd*, 534 S.W.2d 668 (Tex.1976).

The duties of loyalty, care, and good faith are all elements of the fiduciary duty. Section 152.002(b), as noted above states that a partnership agreement cannot eliminate these duties. The partners may, however, agree on specific categories or standards of that narrow these duties if these categories or standards are not "manifestly unreasonable." No Texas court has invalidated all or part of a partnership agreement based on a finding that one party had forced "manifestly unreasonable" terms on the other partners. In *Hoagland v. Finholt*, 773 S.W.2d 740, 742 (Tex.App.—Dallas 1989, no writ), the court stated in a footnote that:

> in the absence of *some clear violation of public policy*, it is the agreement which governs the rights of the parties; the statute will be consulted only where the agreement is silent.

This standard, stated only in a footnote, suggests some limitation on partnership agreements. It is an empty standard until a court finds an agreement that is "manifestly unreasonable" and strikes down the provision or the agreement.

C. Substance of Fiduciary Duty

The fiduciary duty has several implications in a general partnership context. The general substance of the duty is consistent across different types of business entities addressed in this paper.

1. Duty of Loyalty

A partner has duty of loyalty to the concern. *Bohatch v. Butler & Binion*, 977 S.W.2d 543, 545 (Tex. 1998). The duty of loyalty dictates that "a corporate officer or director must act in good faith and must not allow his or her personal interest to prevail over the interest of the corporation." *Landon v. S & H Marketing Group, Inc.*, 82 S.W.3d 666, 675 (Tex.App.—Eastland 2002, no pet.). The duty of loyalty requires an extreme measure of candor, unselfishness, and good faith on the part of the officer or director. *Id.* A fiduciary is under obligation not to usurp business opportunities for personal gain, and equity will hold him accountable to the corporation

for his profits if he does so. *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex. 1963). "The duty of loyalty places restrictions on a governing person's ability to participate in transactions on behalf of the company when the person has a personal interest in the transaction." *Allen*, 367 S.W.3d at 397.

Whether a partner has a personal interest in a transaction is a question of fact. *Holloway*, 368 S.W.2d at 577. In *Loy v Harter*, 28 S.W.3d 397, 407 (Tex. App.—Texarkana 2004, pet. denied), the Court laid out a specific test for "personal interest":

> An officer or director is considered "interested" if he or she (1) makes a personal profit from a transaction by dealing with the corporation or usurps a corporate opportunity, (2) buys or sells assets of a corporation, (3) transacts business in his or her officer's or director's capacity with a second corporation of which he or she is also an officer or director or is significantly financially associated, or (4) transacts corporate business in his or her officer's or director's capacity with a family member.

Id. (citing *Gearhart Industries, Inc. v. Smith International, Inc.*, 741 F.2d 707, 719 (5th Cir. 1984) (addressing Texas law).

Under the duty of loyalty, a partner must exercise "an extreme measure of candor, unselfishness, and good faith" when dealing with transactions that implicate both the partnership's and her personal interests.

2. Duty of Full Disclosure

Under both the Texas Uniform Partnership Act and the common law, partners have a duty to one another to make full disclosure of all matters affecting the partnership. *Brosseau v. Ranzau*, 81 S.W.3d 381,394 (Tex.App.—Beaumont, 2002 pet denied). A fiduciary duty of full disclosure requires disclosure of all material facts known to the fiduciary that might affect the rights of the person to whom the duty is owed. *Home Loan*, 191 S.W.3d at 731.

It is the duty of a fiduciary to deal openly, and to make full disclosure to the party with whom he stands in such relationship. *Kinzbach*, 160 S.W.2d at 513. "It is the law that in such instances if the fiduciary takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure, it is a betrayal of his trust and a breach of confidence, and he must account to his principal for all he has received." *Id*. at 514. "Full disclosure" requires a fiduciary to disclose to the principal "all the facts and circumstances concerning his dealings" with a third party if those dealings affect the principal's interests. *Id*. In *Kinzbach*, one of Kinzbach's employees failed to disclose to his employer that he would receive a commission if Kinzbach purchased a "whipstock" contract from Corbett. *Id*. at 510. The fact that Kinzbach could not identify any damages from the purchase did not bar the breach of fiduciary duty claim. *Id*. at 514.

In *Johnson v. Peckham*, 120 S.W.2d 786, 788 (Tex. 1938), the Supreme Court held that a partner selling his interest to another partner has a fiduciary duty requiring full disclosure of all important information about the value of the interest. The Court declined to allow this duty to "be whittled down by exceptions." *Id*. The Court affirmed a rigorous standard for full disclosure:

> Since each is the confidential agent of the other, each has a right to know all that the others know, and each is required to make full disclosure of all material facts within his knowledge in any way relating to the partnership affairs.

Id. at 787. Peckham, in purchasing Johnson's interest in their partnership, failed to disclose to Johnson that he was negotiating with a third party to sell partnership asset at a much higher price than he was offering to Johnson. *Id*. The Court described the duty as an "absolute duty to disclose." *Id*. at 788.

Most disclosure cases involve one party having superior knowledge about the value of the partnership's assets. The common statement is that "among the duties that a partner owes its co-partners is the duty of full disclosure of all matters affecting the partnership." *Hawthorne v. Guenther*, 917 S.W.2d 924, 934 (Tex.App.—Beaumont 1996, writ denied). In *Hughes v. St. David's Support Corp.*, 944 S.W.2d 423, 426 (Tex. App.—Austin 1997, writ denied), the Court held that all partners—even one with an "infinitesimal interest"—was entitled to notice before partnership assets were sold. In *Hawthorne*, the court found that Guenther had failed to disclose that she had borrowed money from the partnership. *Id*. at 934.

3. Duty to Account for Partnership Assets

"Partners have a duty to one another to make full disclosure of all matters affecting the partnership and to account for all partnership profits and property." *Brosseau*, 381 S.W.3d at 394. The managing partner in Brosseau violated this duty by failing to forward rental income to his partner and thereby violating their agreement to share revenues and expenses equally. *Id*. at 395.

The duty to provide an accounting includes the duty to refrain from self-dealing. *Hawthorne*, 917 S.W.2d at 934. A general partner has the "duty to keep an accurate account of his transactions with or for the

partnership, and, if he fails to keep such account, all doubts respecting particular items will ordinarily be resolved against him." *Conrad v. Judson*, 465 S.W.2d 819, 828 (Tex.Civ.App—Dallas 1971, writ ref'd n.r.e.), cert. den., 405 U.S. 1041 (1972). An accounting is a necessary step in winding up the affairs of the partnership. *Ross v. Walsh*, 629 S.W.2d 823, 826 (Tex.App.—Houston [14th Dist.] 1982, no writ). On dissolution of a partnership, a partner's interest includes his or her proportionate share of the profits after an accounting of the debts and credits of the partnership. *Stone City Attractions, Inc. v. Henderson*, 571 S.W.2d 206, 210 (Tex. Civ.App.—Austin , writ ref'd n.r.e.).

4. Duty to Refrain from Competition

Under either the applicable statute or the common law, a partner's fiduciary duties include refraining from competition with the partnership. *Bohatch*, 905 S.W.2d at 602. Breaches of a partner's duty not to compete with the partnership are compensable at law by awarding to the injured partners their proportionate shares of the profits wrongfully acquired by the offending partner. *Veale v. Rose*, 657 S.W.2d 834, 837 (Tex.App.—Corpus Christi 1983, writ ref'd n.r.e.). The use of partnership assets, such as facilities and employees, to compete with the partnership is a breach of a partner's fiduciary duty. *Id*. A partner who carries on another business in competition or rivalry with his partners can be held liable in damages for any profit that accrues to him from the competing business. *Woodruff v. Bryant*, 558 S.W.2d 535, 544 (Tex.Civ.App.—Corpus Christi 1977, writ refused n.r.e.).

In *Huffington v. Upchurch*, 532 S.W.2d 576, 578 (Tex. 1976), the Supreme Court held that where the competing venture "fell within the nature of the partnership business as defined by the written contract," the burden is on the defendant to establish the fairness of the competing venture to the partnership.

5. General Fiduciary Duties

Because the fiduciary duty is derived from the common law, it is impossible to give a definition of the term that is comprehensive enough to cover all cases or all duties. *Kinzbach,* 160 S.W.2d at 512. A fiduciary has the duty of "fair, honest dealing." *Id*. It also includes the "duty of candor." *Hawthorne,* 917 S.W.2d at 934. A fiduciary has the duty "to act with integrity of the strictest kind." *Douglas v. Aztec Petroleum Corp.,* 695 S.W.2d 312, 318 (Tex.App.—Tyler 1985, no writ). It includes the "duty of utmost good faith." *Kinzbach*, 160 S.W.2d at 512.

VI. FIDUCIARY DUTIES IN LIMITED PARTNERSHIPS

A limited partnership is a statutory entity. See Tex. Bus. Org. Code § 153.001, et seq. A limited partnership is only entitled to transact business in Texas as long as it is in good standing with the Secretary of State. See Tex. Bus. Org. Code § 153.307.

A. Fiduciary Duty of General Partners

A general partner has the same rights, powers, and liabilities of a partner in a partnership without limited partners. See Tex. Bus. Org. Code § 153.152. In other words, the general partner in a limited partnership has the same fiduciary duties as a partner in a general partnership. A general partner in a limited partnership owes a fiduciary duty to the limited partners because of its control over the entity. *Johnson v. J. Hiram Moore, Ltd.,* 763 S.W.2d 496, 499 (Tex.App.-Austin 1988, writ denied).

Managing partners owe their copartners the highest fiduciary duty recognized in the law. *Huffington*, 532 S.W.2d at 579; *Crenshaw v. Swenson*, 611 S.W.2d 886, 890 (Tex.Civ.App.—Austin 1980, writ ref'd n.r.e.). In a limited partnership, the general partner stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a trust. *Hughes*, 944 S.W.2d at 425. In a limited partnership, the general partner owes the same duty of full disclosure to the limited partners. *Id*.

A general partner has the "duty to keep an accurate account of his transactions with or for the partnership, and, if he fails to keep such account, all doubts respecting particular items will ordinarily be resolved against him." *Conrad v. Judson*, 465 S.W.2d 819, 828 (Tex.Civ.App—Dallas 1971, writ ref'd n.r.e.), cert. den., 405 U.S. 1041 (1972). The general partner has the duty to administer partnership affairs solely for the benefit of the partnership. *Crenshaw*, 611 SW 2d at 890. A general partner owes a fiduciary duty to the limited partners to act in accordance with the partnership agreement and not to misapply funds. *Grierson v. Parker Energy Partners 1984-I*, 737 S.W.2d 375, 377 (Tex.App.—Houston [14th Dist.] 1987 , no writ).

Because a limited partnership is a more formal entity than a general partnership, a limited partnership is more likely to have a partnership agreement. 737 S.W.2d 375. As discussed above, a fiduciary's duties may sometimes be expressly limited by contract. *Home Loan Corp. v. Texas American Title Co.*, 191 S.W.3d at 732. There is no statutory description of a general partner's fiduciary duties other than the terms of § 153.152, which equate the general partner to a partner in a general partnership.

B. Fiduciary Duties of Limited Partners

A limited partner has no duty to third parties as long as the limited partner does not participate in the control of the business. Tex. Bus. Org. Code § 153.102. Because limited partners do not have the broad managerial powers enjoyed by general partners, a person's mere status as a limited partner is insufficient to create fiduciary duties. *Strebel v. Wimberly*, 367 S.W.3d 267, 279 (Tex.App.-Houston [1st Dist.] 2012). A limited partner does not owe a fiduciary duty unless it actively engages in control over the operation of the business so as to create duties that otherwise would not exist. *Id*.

In *Strebel*, the Court discussed several relevant cases and then distilled a general legal principle:

> We reconcile these cases by holding that status as a limited partner alone does not give rise to a fiduciary duty to other limited partners. That is not to say, however, that a party who is a limited partner does not owe fiduciary duties to other limited partners when that party, wearing a different hat, exerts operating control over the affairs of the limited partnership. For example, when a limited partner also serves as an officer of the limited partnership…that partner may owe fiduciary duties based on his agency relationship to the partnership and the other limited partners, without regard for his limited partner role. The existence and scope of that duty will be defined not by the law governing limited partners, but rather by the relevant laws and contracts governing the role under which the party is exercising the authority. *Id*. at 281.

Thus limited partners who merely act as limited partners do not serve as fiduciaries.

VII. FIDUCIARY DUTIES IN LLCS

The law on limited liability companies in Texas is thin. LLCs are governed by Tex. Bus. Org. Code § 101. The managers of the company govern it if the certificate of formation states that it will be governed by one or more managers. Tex. Bus. Org. Code § 101.251(1). The members govern the company if the certificate of formation states that the company will not have managers. *Id.* at § 101.251(2). The governing members largely act as corporate officers, who have a fiduciary duty to the corporation but not to the individual shareholders.

The more difficult issue is whether LLC members can have a fiduciary duty to each other. In *Allen v. Devon Energy Holdings, LLC*, 367 S.W.3d 355 (Tex.App.—Houston [1st Dist.] 2012), the First Court engaged in a thorough analysis of fiduciary duties in the context of limited liability companies. The issue before the Court was whether the Manager had a fiduciary duty of disclosure to the Members of the LLC. The Court declined to establish a general formal fiduciary duty. Id. at 390.

The Court first compared LLCs to partnerships:

> "LLCs have a number of characteristics similar to partnerships, and courts in many jurisdictions have recognized a fiduciary duty between members of an LLC on that basis. An LLC may be run by its members collectively, like a general partnership, or it may be run by one or more manager-members, like a limited partnership." *Id.* at 392.

The Court then noted that the "special facts" relating to the transaction at issue—the purchase of a minority member's interests in the LLC—when coupled with an insider's knowledge about corporate affairs, would give rise to a fiduciary duty of disclosure on the part of the majority member-manager. Id. at 394. The Court stated "[W]e extend that holding to a member-manager's offer to redeem a minority member's interest in an LLC when that redemption will increase the member-manager's ownership." *Id*.

The Court reviewed several Texas cases addressing the existence of a fiduciary duty in closely-held corporations "in certain circumstances in which a majority shareholder in a closely held corporation dominates control over the business." *Id*. (citing *Willis v. Donnelly,*118 S.W.3d 10, 31–32 (Tex.App.-Houston [14th Dist.] 2003)). The Court found a limited formal fiduciary duty:

> We conclude that there is a formal fiduciary duty when (1) the alleged-fiduciary has a legal right of control and exercises that control by virtue of his status as the majority owner and sole member-manager of a closely-held LLC and (2) either purchases a minority shareholder's interest or causes the LLC to do so through a redemption when the result of the redemption is an increased ownership interest for the majority owner and sole manager

Id. at 395-396. The Court further noted that the governing articles for the LLC created a duty of loyalty that may have been applicable to the transaction. *Id*. at 397-398.

The principle on which the Court based its decision appears to confirm that the issue of control is the critical fact looked to by the courts in determining whether to impose fiduciary duties.

VIII. REMEDIES FOR BREACH OF FIDUCIARY DUTY

Several important Texas Supreme Court cases deal with the remedies available in fiduciary duty action. While a broad range of remedies—both legal and equitable—are available, several opinions address equitable remedies that deprive a breaching party of its benefits from its breach.

A. Disgorgement of Consideration

In *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867, 873 (Tex. 2010), the Court asked whether "an equitable remedy may cross the line from actual damages for breach of contract or fraud (redressing specific harm) to further, equitable return of contractual consideration." Snodgrass, who owned 50% of ERI, paid Swinnea almost $500,000 to purchase his half interest. In return, Swinnea agreed to continue working for ERI and not to compete with ERI. Swinnea and his wife, however, set up a competing company, and Swinnea's revenue production at ERI decreased.

The Court noted a long line of cases in which courts fashioned equitable remedies in fiduciary actions. The Court reiterated that a plaintiff did not need to show actual damages in order to be entitled to an equitable remedy. *Id*. "A fiduciary who breaches his duty should not be insulated from forfeiture if the party whom he fraudulently induced into contract is ignorant about the fraud, or fails to suffer harm." *Id* at 874. This type of remedy was more "punitive" than compensatory. *Id*.

While a trial court has discretion to fashion equitable remedies, the remedies "must fit the circumstances presented." *Id*. Factors for a court to consider include:

> "[T]he gravity and timing of the violation, its willfulness, its effect on the value of the lawyer's work for the client, any other threatened or actual harm to the client, and the adequacy of other remedies."

Id. (quoting *Burrow v. Arce,* 997 S.W.2d 229, 243 (Tex.1999).

Part of the transaction between Snodgrass and Swinnea had been an agreement that ERI would lease a building belonging to Swinnea. The Court held that it was proper to disgorge the lease payments that ERI had made. *ERI Consulting,* 318 S.W.3d at 876.

B. Fee Disgorgement

In *Burrow v. Arce,* 997 S.W.2d 229, 243 (Tex. 1999), the Supreme Court approved fee forfeiture as a remedy for breach of fiduciary duty. The Court held that "the agent's disloyalty, not any resulting harm, that violates the fiduciary relationship and thus impairs the basis for compensation." *Id*. at 238. The *Burrow* plaintiffs alleged, among other claims, that their attorneys entered into an "aggregate settlement" of all their claims without client approval. Before deciding the forfeiture question, the Supreme Court held that plaintiffs did not have to establish actual damages (i.e., that they would have obtained a better settlement but for the fiduciary breach) in order to obtain forfeiture. *Id*. at 240.

The Court then laid out several factors to be considered in determining the extent of fee forfeiture. In addition to the factors noted above, the Court added a fifth factor "that must be given great weight in applying the remedy of fee forfeiture: the public interest in maintaining the integrity of attorney-client relationships." *Id*. at 244. The Court then concluded that, while juries could decide "necessary factual disputes," only the trial court could weigh the factors and determine the propriety and amount of fee forfeiture. *Id*. at 246.

C. Profit Disgorgement

In *International Bankers Life Insurance Co. v. Holloway*, 368 S.W.2d 567 (Tex. 1963), the corporation sought to recover profits from sales of its stock by corporate officers and directors. The defendants sold their personal stock in competition with the corporation's public offering. "A corporate fiduciary is under obligation not to usurp corporate opportunities for personal gain, and equity will hold him accountable to the corporation for his profits if he does so." *Id.* at 577. The Supreme Court held that the disgorgement of profits was excessive and remanded the case for a determination of the proper amount. *Id.* The Court then held that the burden was on the defendants to prove the fairness of their actions. *Id*. at 578. As noted above, this burden survives in the current Pattern Jury Charge.

D. Accounting

The general partner has a duty to make full disclosure of all matters affecting the partnership and to account for all partnership profits and property. *Brosseau v. Ranzau*, 81 S.W.3d 381, 397 (Tex.App.-Beaumont 2002, pet. denied); *Bohatch v. Butler & Binion*, 905 S.W.2d 597, 602 (Tex.App.-Houston [14th Dist.] 1995), aff'd, 977 S.W.2d 543 (Tex. 1998). A general partner has the "duty to keep an accurate account of his transactions with or for the partnership, and, if he fails to keep such account, all doubts respecting particular items will ordinarily be resolved against him." *Conrad v. Judson*, 465 S.W.2d 819, 828 (Tex.Civ.App—Dallas 1971, writ ref'd n.r.e.), cert. den., 405 U.S. 1041 (1972). An accounting is a necessary step in winding up the affairs of the partnership. *Ross v. Walsh*, 629 S.W.2d 823, 826 (Tex.App.—Houston [14th Dist.] 1982, no writ). The

rule should be the same, whether the entity is a general partnership, limited partnership, or an LLC.

E. Receivership

Section 11.401, et seq. of the Texas Business Organizations Code allows a court to appoint a receiver to rehabilitate an entity. A receivership is an equitable remedy within the sound discretion of the court, and the appointment of a receiver will not be disturbed on appeal unless the record reveals an abuse of discretion. *Alert Synteks, Inc. v. Jerry Spencer, L.P.*, 151 S.W.3d 246, 251 (Tex.App.-Tyler 2004, no pet.) (citing *Abella v. Knight Oil Tools*, 945 S.W.2d 847, 849 (Tex.App.-Houston [1st Dist.] 1997, no writ). The remedy of receivership is an extraordinary remedy that must be cautiously applied because of its drastic and far-reaching nature. See *Balias v. Balias, Inc.*, 748 S.W.2d 253, 257 (Tex.App.-Houston [14th Dist.] 1988, writ denied). A receiver is appropriate if all other requirements of law are complied with and there are no other legal or equitable remedies available, including the appointment of a receiver for specific assets. *Id.* See *Fite v. Emtel, Inc.*, 2008 WL 4427676 (Tex.App.—Houston [1st Dist.] 2008, n.w.h.).

F. Constructive Trust

> "A constructive trust does not, like an express trust, arise because of a manifestation of intention to create it. It is imposed by law because the person holding the title to property would profit by a wrong or would be unjustly enriched if he were permitted to keep the property. It is used, among other things, to adjust rights of partners."
> *Omohundro v. Matthews*, 341 S.W.2d 401, 405 (Tex. 1960).

The jury's finding of breach of fiduciary duty permits imposition of a constructive trust. *Willis v. Donnelly,*118 S.W.3d 10, 37 (Tex.App.-Houston [14th Dist.] 2003) citing *Carr v. Weiss*, 984 S.W.2d 753, 767 (Tex.App.-Amarillo 1999, pet. denied). The forms of constructive trusts are "practically without limit" and may be "applied wherever necessary for the obtaining of complete justice, although the law may also give the remedy of damages against the wrong-doer." *Fitz–Gerald v. Hull*, 150 Tex. 39, 237 S.W.2d 256, 263 (1951) (emphasis added); *Wheeler v. Blacklands Prod. Credit Ass'n.*, 627 S.W.2d 846, 849 (Tex.App.-Fort Worth 1982, no writ).

G. Actual and Exemplary Damages

As with other torts, a plaintiff may also recover actual damages. Actual damages can include out-of-pocket losses. *Duncan v. Lichtenberger*, 671 S.W.2d 948, 953 (Tex.App.—Fort Worth 1984, writ ref'd, n.r.e.). A plaintiff may also recover lost profits, provided that opinions or estimates of lost profits are based on objective facts, figures, or data from which the amount of lost profits can be ascertained. *Holt Atherton Indus., Inc. v. Heine*, 835 S.W.2d 80, 84 (Tex.1992).

"Mental anguish is also compensable as the foreseeable result of a breach of duty arising out of certain special relationships." *City of Tyler v. Likes*, 962 S.W.2d 489, 496 (Tex.1997). A client can recover mental anguish damages for an attorney's breach of duty of confidentiality. *Perez v. Kirk & Carrigan*, 822 S.W.2d 261, 266–67 (Tex.App.-Corpus Christi 1991, writ denied).

A defendant's intentional breach of fiduciary duty is a tort for which a plaintiff may recover punitive damage. *Hawthorne*, 917 S.W.2d at 936; *see also Lesikar v. Rappeport*, 33 S.W.3d 282, 310 (Tex.App.-Texarkana 2000, pet. denied). The issue concerning exemplary damages for breach of a fiduciary duty is not whether there is an intention to injure, but rather whether the fiduciary intended to gain an additional benefit for himself. *International Bankers Life Insurance Co. v. Holloway*, 368 S.W.2d 567 (Tex.1963). An intentional breach of a fiduciary duty justifies the award of exemplary damages. *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312 (Tex.App.–Tyler 1985, no writ).

IX. RELATED CAUSES OF ACTION

A. Aiding and Abetting

A breach of fiduciary duty is actionable against the breaching party and any third party who knowingly aids and assists in its breach. *Brewer & Pritchard v. P.C. v. Chang*, 7 S.W.3d 862, 867 (Tex. App.—Houston [1st Dist] 1999), aff'd, 73 S.W.3d 193 (Tex. 2002) (denying Rule 166a(c) motion for summary judgment by fiduciary and third party). "It is settled as the law of this State that where a third party knowingly participates in the breach of duty of a fiduciary, such third party becomes a joint tortfeasor with the fiduciary and is liable as such." *Kinzbach Tool Co. v. Corbett-Wallace Corporation*, 160 S.W.2d 509, 514 (Tex. 1942).

Kinzbach is the most-cited case involving a cause of action for aiding and abetting a breach of fiduciary duty. Turner, a Kinzbach employee, reached an agreement with Corbett to pay Turner a commission if he convinced Kinzbach to purchase a contract right from Corbett. Turner successfully closed the sale, but Kinzbach later discovered the commission agreement and fired Turner. *Id*. at 511. Turner contended that his conduct was not tortious. *Id*. at 513. Kinzbach obtained a judgment against Corbett and Turner. The Supreme Court affirmed the judgment holding that once Corbett became a party to the breach of fiduciary duty, it became a joint tortfeasor. *Id*. at 514. The Court

charged Corbett with knowledge that Turner had a fiduciary duty to Kinzbach. *Id*. Corbett's participation in the agreement and the conduct, not any knowledge of whether the agreement or conduct violated Turner's duty to Kinzbach, was sufficient to support the judgment.

In *Brewer & Pritchard v. P.C. v. Chang*, 7 S.W.3d 862, 867 (Tex. App.—Houston [1st Dist] 1999), the appeals court considered whether an associate lawyer (Chang) breached his fiduciary to his employer (Brewer & Pritchard) when referring a personal injury case to another law firm through a friend (Johnson). The appeals court reversed a summary judgment for Johnson, holding that "whether Johnson knowingly assisted Chang in any breach of his fiduciary duty to B & P is an issue of fact." *Id.* at 868. Johnson's defense was that Chang did not have a fiduciary duty to the law firm. *Id*. at 867. The appeals court effectively held that Johnson did not have to know that Chang had a fiduciary duty in order to be held liable for aiding and abetting a breach of fiduciary duty. That Johnson knowingly participated in the conduct at issue was enough to defeat a traditional motion for summary judgment.

In *Graham Mortgage Corp. v. Hall*, 307 S.W.3d 472 (Tex. App.—Dallas 2010, no pet.), a limited partner (Hall) in a land-owning partnership brought an action against the general partner (Douglas Properties) and a mortgage company (Graham) for, among other claims, breach of fiduciary duty and participating in a breach of fiduciary duty. *Id*. at 476. The trial court enjoined the mortgage company from foreclosing on the property at issue, and the mortgage company appealed the injunction. *Id*. at 478. The transactions at issue involved loans from the mortgage company to the general partner that used the limited partnership's assets as collateral. *Id*. at 480. The appeals court held that "Graham's knowledge of the terms of these transactions supports the conclusion that Graham knowingly participated in the Douglas defendants' breach of fiduciary duty." *Id*. Knowledge of the transaction was enough for the limited partners to establish "a probable right to recover on their claim against Graham for participating in breaches of fiduciary duty." *Id*. at 479.

Finally, in *Herider Farms-El Paso, Inc. v. Criswell*, 519 S.W.2d 473 (Tex. Civ. App.—El Paso 1975, writ ref'd, n.r.e.), an employer (Herider Farms) sued its employee (Criswell) and a third party (West) for working together to deprive the plaintiff of its interests in a poultry farm. The appeals court held that West's participation in the transaction, in which Criswell allegedly violated his fiduciary duty to Herider Farms, was sufficient to establish that West "knowingly participate[d] in a breach of of duty of a fiduciary, [and] such third party becomes a joint tort-feasor with the fiduciary and is liable as such." *Id*. at 477. The appeals court reversed summary judgment for Criswell and West and remanded the case for trial. *Id*. at 478-479.

B. Shareholder Oppression

Numerous cases involving closely-held businesses include allegations of both shareholder oppression and breach of fiduciary duty. In each case, the courts engage in a fact-specific analysis to determine whether a fiduciary relationship exists between the majority and minority parties. The courts uniformly note that a majority shareholder owes a fiduciary duty to the business entity. Even if the minority interest holder is not owed a fiduciary duty, evidence of the majority shareholder's breach of that duty to the business will support a shareholder oppression claim.

"The doctrine of shareholder oppression protects the close corporation minority stockholder from the improper exercise of majority control." Douglas Moll, *Majority Rule Isn't What It Used To Be: Shareholder Oppression In Texas Close Corporations*, 63 TEX. B.J. 434, 435 (2000). Shareholder oppression is defined as:

> (1) Majority shareholder's conduct that substantially defeats the minority's expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or
> (2) Burdensome, harsh, 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.

Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex.App.-Houston [1st Dist.] 1999, pet. denied); see also *Ritchie v. Rupe*, 339 S.W.3d 275, 289 (Tex.App.-Dallas 2011, pet. denied)

"Courts take an especially broad view of the application of oppressive conduct to a closely-held corporation, where oppression may more easily be found." 754 S.W.2d 375, 381 (Tex.App.-Houston [1st Dist.] 1988, writ denied). "The jury determines what acts occurred (assuming those facts are in dispute), but whether those acts constitute shareholder oppression is a question of law for the court." *Ritchie*, 339 S.W.3d at 289.

A co-shareholder in a closely held corporation does not as a matter of law owe a fiduciary duty to his co-shareholder. *Willis*, 118 S.W.3d at 31 (citing *Hoggett*, 971 S.W.2d at 488). Instead, the existence of such a duty depends on the circumstances. See *Willis*, 118 S.W.3d at 31(citing *Pabich v. Kellar*, 71

S.W.3d 500, 504–06 (Tex.App.-Fort Worth 2002, pet. denied)). (See discussion in V and VI above).

In *Redmon v. Griffith*, 202 S.W.3d 225, 237-238 (Tex.App.—Tyler 2006, pet. denied), the Court addressed whether minority shareholders in a closely held corporation could allege fiduciary duty claims against the majority shareholders. As noted, a majority-minority shareholder relationship does not necessarily create a fiduciary duty. *Id*. at 237. The evidence that the majority shareholders breached fiduciary duties owed to the corporation does, however, support "a breach of fiduciary duty by way of oppressive conduct." *Id*. at 238. In other words, a majority shareholder's breach of his duty to the entity is relevant evidence for the jury to consider in a shareholder oppression claim.

C. Derivative Actions

As noted above, numerous courts have stated that a corporate officer always owes a fiduciary duty to the shareholders collectively, but he does not occupy a fiduciary relationship with an individual shareholder in the absence of some contractual or special relationship in addition to the corporate relationship. *See Faour v. Faour*, 789 S.W.2d 620, 621–22 (Tex. App.–Texarkana 1990, writ denied) (citing *Kaspar v. Thorne*, 755 S.W.2d 151, 155 (Tex.App.-Dallas 1988, no writ); *Schoellkopf v. Pledger*, 739 S.W.2d 914, 918 (Tex.App.-Dallas 1987), *rev'd on other grounds*, 762 S.W.2d 145 (Tex.1988)). Moreover, a corporate shareholder has no individual cause of action for personal damages caused solely by a wrong done to the corporation. *See Faour*, 789 S.W.2d at 622.

Derivative actions overcome this barrier by allowing the minority partner to sue on behalf of the limited partnership or LLC. Under Tex. Bus. Org. Code § 101.451, et seq., an LLC member can proceed derivatively if she:

(1) was a member of the LLC when the wrong occurred (or became a member by operation of law from someone who was); and
(2) fairly represents the interests of the LLC in enforcing its rights. *Id*. at 101.452.

There are fairly extensive demand requirements before the claim can be pursued, although the statute allow for waiver of the demands. In a "closely held limited liability company," defined as one having fewer than 35 members, the court can treat the claim "as a direct action brought by the member for the member's own benefit. *Id*. at § 101.463. The demand requirements do not apply in a closely held LLC, and the member may recover sums directly. *Id*.

Similar provisions apply in limited partnerships. See Tex. Bus. Org. Code § 153.401, et seq. The demand requirements are minimal, and the plaintiff may recover his fees and expenses. One caveat: a derivative plaintiff may be required to post security for fees and expenses that the partnership may incur. Id. at § 153.404.

There is a "loser pays" provision in both contexts that reads more like a Rule 13 sanctions standard. A limited partnership defendant may recover fees and expenses "on a finding that suit was brought without reasonable cause against the defendant." Tex. Bus. Org. Code § 153.404(e). An LLC defendant may recover fees and expenses if the court finds "the proceeding has been instituted or maintained without reasonable cause or for an improper purpose." Tex. Bus. Org. Code § 101.461(b)(2).

X. CONCLUSION

Fiduciary duty claims continue to be a viable cause of action for small business plaintiffs in Texas. The duty to place the interests of other parties before one's own interests is the highest duty imposed in law. Where a fiduciary duty exists—either formally or informally—the compliance burden is very high. Lawyers counseling small businesses need to be aware of whether the duty is likely to exist, how it applies to in the business form chosen, and whether the duty can be limited or avoided.